

# The Role of Industrial Development in the Achievement of the Millennium Development Goals

*Proceedings of the Industrial Development  
Forum and Associated Round Tables  
Vienna, 1-3 December 2003*

**Compendium Edition**



UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION  
**economy environment employment**



**THE ROLE OF INDUSTRIAL DEVELOPMENT  
IN THE ACHIEVEMENT OF THE  
MILLENNIUM DEVELOPMENT GOALS**

*Proceedings of the  
Industrial Development Forum  
and Associated Round Tables,*

*Vienna, 1-3 December 2003*

**Compendium Edition**



UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION

Vienna, 2004

Copyright © 2004 by the United Nations Industrial Development Organization (UNIDO)  
First published June 2004

All rights reserved. Except for the quotation of short passages for the purposes of criticism and review, no part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior permission of the publisher.

The designations employed and the presentation of material in this publication do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations Industrial Development Organization concerning the legal status of any country, territory, city or area, or of its authorities, or concerning the delimitation of its frontiers or boundaries. The opinions, figures and estimates set forth are the responsibility of the authors and should not necessarily be considered as reflecting the views or carrying the endorsement of UNIDO. The designations “developed” and “developing” economies are intended for statistical convenience and do not necessarily express a judgement about the stage reached by a particular country or area in the development process. Mention of firm names or commercial products does not imply endorsement by UNIDO.

This document has not been formally edited.

## **Acknowledgement**

This publication presents the proceedings of the Industrial Development Forum and seven associated Round Tables held in connection with the Tenth General Conference of UNIDO in Vienna on 1-5 December 2003. The organization of such a complex series of events has inevitably required the exertion of considerable efforts by a large number of people within the UNIDO Secretariat. A team was established in mid-2003 under the leadership of Hiroshi Kuniyoshi and the overall guidance of Nilmadhab Mohanty. This team comprised Goeran Appelgren, Francis Bartels, Edward Clarence-Smith, Grzegorz Donocik, Renato Fornocaldo, Ayumi Fujino, Cahit Gürkök, Steffen Kaeser, Mithat Külür, Dan Liang, Ricardo Massot, Dmitri Piskounov, Francisco Sercovich and Paul Wiedemann, with additional support being provided by Ho-Seung Lee, Carole Nengue, Vesna Petakovic and Kerry Timmins. The members of this team assumed responsibility not only for the substantive and logistical organization of the Industrial Development Forum and their respective Round Tables, but also for the preliminary editing of the initial drafts of the various papers included in this proceedings document. These drafts were compiled, consolidated and formatted by Annegret Thieme. Sarwar Hobohm undertook the final editing of the document.



## Foreword by Mr. Carlos Magariños

Director-General of UNIDO

---

It has long been a particular concern of mine to add a strong substantive element to the deliberations of the Governing Bodies. I therefore initiated the holding of a Forum on Sustainable Industrial Development on 29 November – 1 December 1999 to discuss topical issues related to the mandate and activities of UNIDO as a complementary event to eighth session of the General Conference. With a similar Industrial Development Forum having been held on 5 December 2001 in conjunction with the ninth session of the General Conference, I am pleased to note that the tradition of such fora has now become well established, and that the discussions on substantive subjects of industrial development conducted within their frameworks have become an integral and much-respected component of our General Conferences.

The Industrial Development Forum held on 1-3 December 2003 in the context of the tenth session of the General Conference has been the most ambitious to date, reflecting the importance and complexity of its theme: The Role of Industrial Development in the Achievement of the Millennium Development Goals. We regard this issue as critical to ensuring that UNIDO's contributions to international development is firmly embedded in the international development agenda, and that our Organization remains at the forefront of the development debate. For that reason, this theme will also be revisited in considerable detail in our Industrial Development Report 2004.

The Industrial Development Forum held in conjunction with the tenth session of the General Conference consisted of an initial meeting within the plenary session of the Conference to set the scene and highlight the principal issues involved, and seven subsequent Round Tables to discuss these issues in greater detail. The topics covered in these Round Tables comprised:

- Round Table 1: The Role of Industrial Development in the Achievement of the Millennium Development Goals;
- Round Table 2: Industry and Environment: The Need for a New Industrial Revolution;
- Round Table 3: Making Trade Work for the Poor: Stimulating the Real Economy's Response;
- Round Table 4: Post-crisis Industrial Rehabilitation and Reconstruction;
- Round Table 5: Promoting Investment in Developing Countries (with Special Reference to Africa): Challenges, Opportunities and Experiences;
- Round Table 6: Transition in Eastern Europe: 15 Years After; and
- Special Round Table: Poverty Reduction in Latin America in the Context of Sustainable Development.

Each of these discussions highlighted various aspects of how the industrial development that our Organization is mandated to promote has a significant role to play in the achievement of the Millennium Development Goals (MDGs), which have come to form the core of the international development agenda since they were first enunciated at the Millennium Summit of the United Nations General Assembly in September 2000. UNIDO believes that it can make a critical direct contribution, through its various technical cooperation and global forum activities, to the achievement of four of the eight MDGs, viz.:

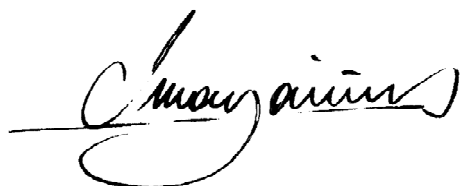
- MDG 1: Eradicate extreme poverty and hunger;
- MDG 3: Promote gender equality and empower women;
- MDG 7: Ensure environmental sustainability; and
- MDG 8: Develop a global partnership for development.

In addition, it believes that its services can also contribute effectively to the achievement of the other health- and education-based goals by supporting the development of the critical industrial capacities and infrastructure required for them.

As on previous occasions, we were privileged to be able to draw on a wide range of experts for our Forum and the associated Round Tables. These included national leaders and senior political decision-makers, as well as leading representatives of multinational organizations, national administrations, academic research institutions, and the business community. We were particularly pleased at the fact that the tenth session of the General Conference was attended by three presidents, three vice-presidents, one prime minister and 44 ministers, many of whom participated directly in the Forum and Round Tables. These participants were able to offer many valuable insights on the topics covered by the discussions, based on their wide range of specialized expertise and experience.

We were also extremely fortunate to have a very knowledgeable audience at all of these meetings, who showed a keen interest in the issues under discussion and made significant contributions to the debate. Through the lively interaction among the panellists themselves, and between them and the floor, we were able to gain many useful ideas and suggestions as to how UNIDO can enhance its effectiveness in helping our Member States to achieve the MDGs. I am particularly grateful to the contributors of the Forum and Round Tables for these suggestions.

In closing I would like to stress that arranging such an ambitious programme of discussions on such a wide range of topics, and bringing them to a successful conclusion, inevitably required considerable efforts on the part of many staff members of UNIDO, at all levels and from all of its administrative units. The names of those most directly involved are mentioned in the acknowledgements, but there were many others who made smaller but nevertheless vital contributions. To all of them I would like to express my sincere gratitude

A handwritten signature in black ink, appearing to read 'Carlos Magariños', written in a cursive style with a long horizontal line extending to the left.

Carlos Magariños  
*Director-General*



# CONTENTS

<b>Foreword by Mr. Carlos Magariños</b> <i>Director-General of UNIDO</i>	v
---	---

## Part One Summary of Proceedings

<b>Industrial Development Forum</b>	The Role of Industrial Development in the Achievement of the Millennium Development Goals	3
<b>Round Table 1</b>	The Role of Industrial Development in the Achievement of the Millennium Development Goals	6
<b>Round Table 2</b>	Industry and Environment: The Need for a New Industrial Revolution	8
<b>Round Table 3</b>	Making Trade Work for the Poor: Stimulating the Real Economy's Response	12
<b>Round Table 4</b>	Post-Crisis Industrial Rehabilitation and Reconstruction	18
<b>Round Table 5</b>	Promoting Investment in Developing Countries (with Special Reference to Africa): Challenges, Opportunities and Experiences	22
<b>Round Table 6</b>	Transition in Eastern Europe: 15 Years After	27
<b>Special Round Table</b>	Poverty Reduction in Latin America in the Context of Sustainable Development	32

## Part Two Papers and Presentations

<b>Industrial Development Forum</b>	<b>The Role of Industrial Development in the Achievement of the Millennium Development Goals</b>	
	Statement by Mr. Carlos Magariños <i>Director-General, UNIDO</i>	39
	Statement by Professor Jeffrey Sachs <i>Special Advisor to the UN Secretary-General</i>	44
	Statement by Mr. Rubens Ricupero <i>Secretary-General, UNCTAD</i>	49
	Statement by Mr. Frederick T. Sumaye <i>Prime Minister, United Republic of Tanzania</i>	52

<b>Round Table 1</b>	<b>The Role of Industrial Development in the Achievement of the Millennium Development Goals</b>	
	Issue Paper <i>UNIDO Secretariat</i>	57
	Moderator's Introduction <i>Francisco Sercovich, Special Policy Advisor to the Director-General, UNIDO</i>	65
	Industrialization in sub-Saharan Africa <i>Simon Teitel, International Development Expert, USA</i>	66
	Sub-Saharan Africa's Export Prospects in Textiles and Clothing: The Incidence of AGOA, EBA, the MFA and China in the WTO <i>Gabriel Sánchez, Director of Research, IERAL, Argentina</i>	71
	Strengthening the Contribution of the Private Sector to Poverty Reduction Strategies for the Sub-Saharan African Countries <i>Anthony Hawkins, Professor of Business Studies, University of Zimbabwe</i>	74
	The Role of Industrial Development in the Achievement of the Millennium Development Goals <i>Sanjaya Lall, Professor of Development Economics, Oxford University</i>	80
<b>Round Table 2</b>	<b>Industry and Environment: The Need for a New Industrial Revolution</b>	
	Issue Paper <i>UNIDO Secretariat</i>	87
	UNIDO Position Paper <i>UNIDO Secretariat</i>	97
	Moderator's Introduction <i>Edward Clarence-Smith, Senior Industrial Development Officer, UNIDO</i>	115
	Keynote Speech <i>Hunter Lovins, Co-Chair, Natural Capitalism Group, USA</i>	117
	Presentation <i>Michael Braungart, Managing Director, EPEA, Germany</i>	123
	Presentation <i>Fritz Balkau, Chief, Production &amp; Consumption Branch, Division of Technology, Industry and Economics, UNEP</i>	126
	Presentation <i>Suresh Prabhu, Member of Parliament, India</i>	129

	Presentation	132
	<i>Leopold Zahrer, Director-General, Federal Ministry of Agriculture, Forestry, Environment and Water Management, Austria</i>	
	Presentation	134
	<i>Hans-Peter Egler, Head, Trade-Related Technical Assistance Division, Swiss State Secretariat for Economic Affairs</i>	
<b>Round Table 3</b>	<b>Making Trade Work for the Poor: Stimulating the Real Economy's Response</b>	
	Issue Paper	139
	<i>UNIDO Secretariat</i>	
	UNIDO Position Paper	
	Trade Capacity Building: Supply-Side Development, Conformity and Integration in the Global Market	151
	<i>UNIDO Secretariat</i>	
	Moderator's Introduction	181
	<i>Otto Genee, Director, Policy Coherence Unit, Ministry of Foreign Affairs, The Netherlands</i>	
	Keynote Speech	182
	<i>Adrian Wood, Chief Economist, DFID, United Kingdom</i>	
	Presentation	186
	<i>Tadesse Haile, State Minister of Industry and Trade, Ethiopia</i>	
	Presentation	188
	<i>Silvia Cuéllar, Executive Director, FECAEXCA</i>	
	Rigged Rules and Double Standards: Trade, Globalization and the Fight against Poverty	200
	<i>Jeremy Hobbs, Executive Director, OXFAM International</i>	
	Running into the Sand: Why Failure at the Cancun Trade Talks Threatens the World's Poorest People	213
	<i>Jeremy Hobbs, Executive Director, OXFAM International</i>	
	Voluntary and Private Standards: Entry Barriers or Stepping-Stones towards Upgrading within Global Value Chains	217
	<i>Stefano Ponte, Senior Researcher, Danish Institute for International Studies</i>	
	Presentation	232
	<i>Alan Bryden, Secretary-General, ISO</i>	
	Presentation	235
	<i>Kipkorir Rana, Deputy Director-General, WTO</i>	

	Technical Assistance for Strengthening Supply-Side Capacity and Enhancing Capabilities to Meet Standards <i>Oskar Knapp, Ambassador, Delegate for Trade Agreements, State Secretariat for Economic Affairs, Ministry of Economy, Switzerland</i>	237
	Statement <i>Ibrahim Tamponé, Commissioner for Energy, Mines, Industry, Handicrafts and Tourism, UEMOA</i>	240
	Statement <i>Kandeh Yumkella, Special Advisor to the Director-General, UNIDO</i>	242
<b>Round Table 4</b>	<b>Post-Crisis Industrial Rehabilitation and Reconstruction</b>	
	Issue Paper <i>UNIDO Secretariat</i>	245
	Discussion Paper <i>UNIDO Secretariat</i>	251
	Moderator's Introduction <i>Renato Fornocaldo, Managing Director, Division of Administration, UNIDO</i>	270
	Keynote Speech <i>Kay Rala Xanana Gusmao, President of Timor Leste</i>	274
	Presentation <i>Yukio Takasu, Ambassador and Permanent Representative of Japan to UNIDO</i>	278
	Presentation <i>Ranjith Fernando, Secretary, Ministry of Enterprise Development, Sri Lanka</i>	281
	Post-Crisis Industrial Rehabilitation and Reconstruction: A Case for Sierra Leone <i>Kadi Sesay, Minister of Trade and Industry, Sierra Leone</i>	284
	Presentation <i>Erick de Mul, Former UN Coordinator in Angola and Afghanistan</i>	289
	Presentation <i>Maurizio Pieroni, Senior Liaison Officer, UN-HABITAT</i>	291

**Round Table 5****Promoting Investment in Developing Countries (with Special Reference to Africa): Challenges, Opportunities and Experiences**

Issue Paper <i>UNIDO Secretariat</i>	297
UNIDO Position Paper <i>UNIDO Secretariat</i>	310
Opening Statement <i>Yoweri Kaguta Museveni, President of Uganda</i>	322
Moderator's Introduction <i>Brian Caplen, Editor, fDi Magazine</i>	324
Keynote Speech FDI and Growth for Developing Countries: MNEs and the Challenges of the "New" Economy <i>Peter Buckley, Professor of International Business, University of Leeds</i>	325
Presentation <i>Carlos da Silva, Director of Operations, Central and Eastern Europe, Middle East and Africa Region, IBM</i>	339
Presentation <i>Bunmi Oni, Managing Director and Chief Executive, Cadbury Nigeria</i>	341
Presentation <i>Patrick Helson, Chief Operating Officer, CDC Capital Partners</i>	344
Presentation <i>Dick Kramer, Chairman, Capital Alliance Nigeria</i>	348
Presentation <i>Ms. Maggie Kigozi, Executive Director, Uganda Investment Authority</i>	350
Presentation <i>Francois de Grivel, Entrepreneur, Mauritius</i>	353

**Round Table 6****Transition in Eastern Europe: 15 Years After**

Issue Paper <i>UNIDO Secretariat</i>	357
UNIDO Position Paper <i>UNIDO Secretariat</i>	363
Opening Statement <i>Dmitri Piskounov, Director, Europe and NIS Bureau, UNIDO</i>	374

	Moderator's Introduction <i>Marianne Kager, Chief Economist, Bank Austria – Creditanstalt Group</i>	377
	Keynote Speech <i>Libor Krkoska, Principal Economist, EBRD</i>	378
	Financing Capital Formation in Central and Eastern Europe: How Important is Foreign Direct Investment? <i>Libor Krkoska, Principal Economist, EBRD</i>	382
	Keynote Speech <i>Alexander A. Dynkin, First Deputy Director, IMEMO</i>	396
	Russia's Economic Transition: Preliminary Outcome <i>Alexander A. Dynkin, First Deputy Director, IMEMO</i>	402
	Presentation <i>Attila Chikan, Rector, Budapest University of Economic Science and Public Administration</i>	419
	Presentation <i>Danuta Hübner, Minister for European Affairs, Poland</i>	421
	Presentation <i>Valeriy Khoroshkovsky, Minister for Economics and European Integration, Ukraine</i>	424
<b>Special Round Table</b>	<b>Poverty Reduction in Latin America in the Context of Sustainable Development</b>	
	Issue Paper <i>UNIDO Secretariat</i>	429
	Moderator's Introduction <i>Raimundo Gonzalez Aninat, Ambassador and Permanent Representative of Chile to UNIDO</i>	435
	Keynote Speech <i>Peter Stania, Director, International Institute for Peace, Austria</i>	437
	Presentation <i>Guillermo Oliveri, Secretary of Worship, Ministry of Foreign Affairs, International Trade and Worship, Argentina</i>	440
	Presentation <i>Mr. Carlos Zarruk Gómez, Vice-Minister for Entrepreneurship Development, Colombia</i>	442

## Abbreviations and acronyms

The following abbreviations and acronyms have been used in this publication:

AfrIPANet	Africa Investment Promotion Agency Network
AGOA	African Growth and Opportunity Act
AIDS	Acquired Immune Deficiency Syndrome
AME	Africa and Middle East
ATC	WTO Agreement on Textiles and Clothing
BAT	Best available techniques
BEP	Best environmental practices
BIPM	International Bureau of Weights and Measures
CAC	Codex Alimentarius Commission
CBI	Caribbean Basin Initiative
CDC	Commonwealth Development Corporation
CEE	Central and Eastern Europe
CEPAL	Economic Commission for Latin America and the Caribbean
CFC	Chlorofluorocarbon
CIS	Commonwealth of Independent States
COMFAR	Computer Model for Feasibility Analysis and Reporting
CSO	Civil society organization
CSR	Corporate social responsibility
CTBT	Comprehensive Nuclear Test Ban Treaty
DAC	Development Assistance Committee (of the OECD)
DC	Developing country
DDA	Doha Development Agenda
DDAGTF	Doha Development Agenda Global Trust Fund
DESA	UN Department of Economic and Social Affairs
DEVCO	Development Committee
DFID	Department for International Development (UK)
D-G	Director-General
DIIS	Danish Institute for International Studies
DMP	Disaster Management Programme
DSI	Double Standards Index
EBA	Everything but Arms
EBRD	European Bank for Reconstruction and Development
ECHA	Executive Committee on Humanitarian Affairs
ECLAC	Economic Commission for Latin America and the Caribbean
ECOSOC	Economic and Social Council
EFSA	European Food Safety Authority
EGM	Expert group meeting
EIB	European Investment Bank
EMAS	Eco-Management and Audit Scheme
EPEA	Environmental Protection Encouragement Agency
EPZ	Export processing zone
EST	Environmentally sound technologies
ETI	Ethical Trading Initiative
EWM	Early warning mechanism
EU	European Union
EUREP-GAP	Global Partnership for Safe and Sustainable Agriculture
FAO	Food and Agriculture Organization
FDA	(US) Food and Drug Administration
FDI	Foreign direct investment

FECAEXCA	Federation of Chambers and Associations of Central American and Caribbean Exporters
FSA	Food Standards Agency
FSC	Forest Stewardship Council
FTAA	Free Trade Area of the Americas
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
GHP	Good hygiene practices
GMO	Genetically modified organism
GMP	Good manufacturing practices
GRP	Gross regional product
GTAP	Global Trade Analysis Project
GVC	Global value chain
HACCP	Hazard Analysis Critical Control Points
HIPC	Highly Indebted Poor Country
HIV	Human Immuno-deficiency Virus
HLCP	High-Level Committee on Programmes
IAF	International Accreditation Forum
IBG	Integrated business group
ICAO	International Civil Aeronautics Organization
ICT	Information and communications technologies
ICTSD	International Centre for Trade and Sustainable Development
IDA	International Development Association
IDP	Internally displaced person
IDSP	Industrial Development Strategy Paper
IEC	International Electrotechnical Commission
IERAL	Instituto de Estudios sobre la Realidad Argentina y Latinoamericana
IF	Integrated Framework
IFC	International Finance Corporation
IITPP	Industrial investment and technology promotion profile
IJV	International joint venture
ILAC	International Laboratory Accreditation Council
ILO	International Labour Organization
IMEKO	International Measurement Confederation
IMEMO	Institute of the World Economy and International Relations
IMF	International Monetary Fund
IMO	International Maritime Organization
IOE	International Office of Epizootics Standards
IPA	Investment promotion agency
IPPC	International Plant Protection Convention Standards
IPRSP	Interim Poverty Reduction Strategy paper
IRR	Internal rate of return
ISIC	International Standard Industrial Classification
ISO	International Organization for Standardization
IT	Information technology
ITC	International Trade Centre
ITPO	Investment and Technology Promotion Office
ITU	International Telecommunication Union
ITU-T	International Telecommunication Union – Telecommunication Standardization Sector
JCDCMAS	Joint Committee on coordination of Developing Country Assistance in Metrology, Accreditation and Standardization
JITAP	Joint Integrated Technical Assistance Programme
LAC	Latin America and the Caribbean



LDC	Least developed country
MDG	Millennium Development Goal
MFA	Multi-Fibre Agreement
MLA	Multilateral agreement
MNC	Multinational cooperation
MNE	Multinational enterprise
MoU	Memorandum of understanding
MRA	Mutual recognition agreement
MSC	Marine Stewardship Council
MSE	Micro- and small-scale enterprise
MSTQ	Metrology, standards, testing and quality
MTS	Multilateral trading system
MVA	Manufacturing value added
NAFTA	North American Free Trade Agreement
NCPC	National Cleaner Production Centre
NEPAD	New Partnership for Africa's Development
NBER	National Bureau of Economic Research
NGO	Non-governmental organization
NIS	Newly Independent States
NORAD	Norwegian Agency for Development Cooperation
NPES	National Poverty Eradication Strategy
NSB	National standards bodies
NTB	Non-tariff barriers
OECD	Organization for Economic Cooperation and Development
OEM	Original equipment manufacturing
OHSAS	Occupational Health and Safety Assessment Series
OIE	World Organisation for Animal Health
OIML	International Organization for Legal Metrology
OSCE	Organization for Security and Cooperation in Europe
OXFAM	Oxford Committee for Famine Relief
POI	Plan of Implementation (of World Summit for Sustainable Development)
POP	Persistent organic pollutant
PGRF	Poverty Reduction and Growth Facility
PRS	Poverty Reduction Strategy
PRSP	Poverty Reduction Strategy Paper
PTS	Persistent toxic substance
QMS	Quality management systems
R&D	Research and development
RIA	Regional integration arrangement
REI	Regional economic integration
RTS	Russian trading system
SA	Social accountability
SAR	Special Administrative Region
SIDA	Swedish International Development Agency
SME	Small and medium-sized enterprise
SOE	State-owned enterprise
SPS	Sanitary and phyto-sanitary measures
SPX	Subcontracting and Partnership Exchange
SSA	Sub-Saharan Africa
STR	Standards and technical regulations
SUV	Sport-utility vehicle
TA	Technical assistance
TAS	Tanzania Assistance Strategy
TB	Tuberculosis
TBT	Technical barriers to trade

TC	Technical cooperation
TCB	Trade capacity building
TCBDB	Trade Capacity Building Database
TD	Trade development
TFP	Total factor productivity
TICAD	Tokyo International Conference on African Development
TPR	Trade policy and regulations
TNC	Transnational corporation
TRIMS	Trade-related investment measures
TRIPS	Trade-related aspects of intellectual property rights
TRTA/CB	Trade-related technical assistance and capacity building
TUV	Technischer Überwachungsverein
UEMOA	West African Economic and Monetary Union
UIA	Uganda Investment Authority
UK	United Kingdom
UN	United Nations
UNCDF	United Nations Capital Development Fund
UNCED	United Nations Conference on Environment and Development
UNCT	United Nations Country Team
UNCTAD	United Nations Conference on Trade and Development
UNDG	United Nations Development Group
UNDP	United Nations Development Programme
UNECE	United Nations Economic Commission for Europe
UNEP	United Nations Environment Programme
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNFPA	United Nations Population Fund
UN-HABITAT	United Nations Human Settlements Programme
UNHCR	United Nations High Commission for Refugees
UNICEF	United Nations Children's Fund
UNIDO	United Nations Industrial Development Organization
UNOPS	United Nations Office for Project Services
US/USA	United States of America
VIIT	Vertical intra-industry trade
WAIPA	World Association of Investment Promotion Agencies
WB	World Bank
WDI	William Davidson Institute
WFP	World Food Programme
WHO	World Health Organization
WIPO	World Intellectual Property Organization
WSSD	World Summit on Sustainable Development
WTO	World Trade Organization

## **PART ONE**

### **SUMMARY OF PROCEEDINGS**



## **Industrial Development Forum**

### **The Role of Industrial Development in the Achievement of the Millennium Development Goals**

Panellists:

*Carlos Magariños, Jeffrey Sachs, Rubens Ricupero, Frederick T. Sumaye*

#### *Introduction*

The Industrial Development Forum was held on 1 December 2003, the first day of the biennial UNIDO General Conference 2003. Under the topic “The Role of Industrial Development in the Achievement of the Millennium Development Goals (MDGs)” the panellists gave an overview of the subject matter of the General Conference, whose different issues were treated in the Round Tables following the Forum. The keynote speakers included Mr. Carlos Magariños, Director-General of UNIDO; Professor Jeffrey Sachs, Director of the Earth Institute, Columbia University, and Special Advisor to the Secretary-General of the United Nations; Mr. Rubens Ricupero, Secretary-General of UNCTAD; and Mr. Frederick Sumaye, Prime Minister of the United Republic of Tanzania.

#### *Carlos Magariños*

In his intervention, Mr. Magariños pointed out that the MDGs consist of a number of quantitative goals agreed by the international community to relieve extreme suffering and deprivation. He argued that, although the task is huge, the major obstacle for this to happen is not financial or technological but has largely to do with political will.

As a response to this challenge, he proposed three lines of action for the international community, including more development funding, UN reform and a renewed development agenda to articulate better the political dimension with the social and economic policy dimensions. He held that, for this to happen, policies designed to tackle urgent basic needs have to be integrated with policies aimed at building up the capacity to prevent recurrent emergencies through sustainable productivity growth. He regarded the work on both levels – the linking of the political and the economic reform agendas, and of the economic and social agendas – as fundamental.

Mr. Magariños highlighted the importance of UNIDO’s work on private sector development for capacity building and productivity growth. He argued that while the MDGs provide an opportunity to deal with the two-way interaction between breaking poverty traps and getting into a sustainable development track, the Poverty Reduction Strategy Papers (PRSPs) are one of the key national policy strategies to leverage the necessary resources. In this context, he argued that private sector participation in the PRSPs needs to be strengthened, stressing that it is essential for the LDCs to overcome this serious oversight if they are to succeed in stabilizing their economies, create jobs, develop exports, increase productivity and ensure social progress.

#### *Jeffrey Sachs*

In his address, Professor Sachs argued that the MDGs represent a contract between the rich and poor countries, and that the rich need to be held up to the promises they had made repeatedly, and most recently at the Millennium Development Summit, the Monterrey Conference on Financing for

Development, and the World Summit on Sustainable Development in Johannesburg. He argued that while the poor countries were often blamed by the rich for their poverty, the real reasons were far more complex and had to do with the many structural impediments facing these countries, such as unfavourable climate and geography.

Professor Sachs insisted that if the world was truly going to achieve the MDGs three critical transitions had to be advanced: Progress in human capital transition including health, education and nourishment; a transition in productive capacity enabling the least developed countries to undergo real structural change; and a transition to environmental sustainability. He held that these transitions could be achieved if a sufficient effort was made at the national policy level, but more importantly if necessary reforms were made in trade access and if the necessary large yet investments could be made in infrastructure and social services. In this context, he called upon the rich countries to live up to their promises of putting 0.7 of 1 per cent of their annual GDP into development, which he held would be more than enough to meet the Goals. He also suggested that the MDGs had to be put at the core of Country Assistance Strategies and the PRSPs.

In concluding, he challenged all in the audience to use their energy and voice to tell the world that “the promises have long been made but 2004 is the year they are going to be kept!”

### *Rubens Ricupero*

Mr. Ricupero pointed out that at a time when the net transfer of funds has been going from developing countries to the developed world for the seventh consecutive year due to debt payments, and when the developed countries have failed to show their willingness to solve the critical issues pertaining to trade liberalization, such as agricultural subsidies, at Cancun, it was difficult to talk about the industrial development prospects of the least developed countries (LDCs).

He pointed out that what was in fact being observed all over the developing world, with the exception of a few countries in East and Southeast Asia, was a premature process of de-industrialization which was threatening the very livelihood of millions as jobs in both the agricultural and industrial sectors were becoming scarce. Referring to the poverty trap in which developing countries find themselves, he argued that it was critical for international organizations such as UNCTAD and UNIDO to find imaginative ways to address these problems. One of the most promising approaches for this, he argued, was linking capacity building in trade negotiations with efforts in building the productive and supply capacities in developing countries. He concluded that in this way organizations such as UNCTAD and UNIDO could play complementary and constructive roles in helping countries to grow through enhancements of their own productive capacities and exports, and not only through the generosity of others, which is always scarce.

### *Frederick Sumaye*

Prime Minister Sumaye talked about the need to address two key issues of concern to most LDCs – development of agro-industries and HIV/AIDS – when talking about industrial development and the MDGs in Africa. He pointed out that since 70 per cent of all employment and 60 per cent of manufacturing was based on agriculture in sub-Saharan Africa, the development of agro-industries was of great importance not only for food security but also for the generation of sustainable livelihoods. He said that those agro-industries, and especially the small and medium enterprises engaged in them, played a critical role as springboards for job creation and the development of a sustainable industrial sector.

Finally, marking also the occasion of the World AIDS day, he joined the others on the panel in pointing out the important role of the fight against the HIV/AIDS pandemic in achieving sustainable

industrial development, as HIV/AIDS tends to attack the most productive groups in the population, which limited the scope of successful interventions elsewhere.

### *Conclusion*

The Forum provided the General Conference, and particularly Round Table 1 held immediately following it, a rich set of ideas and challenges to ponder from a distinguished panel of development practitioners and thinkers.

## Round Table 1

### The Role of Industrial Development in the Achievement of the Millennium Development Goals

Moderator:

*Francisco Sercovich*

Panellists:

*Simon Teitel, Gabriel Sánchez, Anthony Hawkins, Sanjaya Lall*

Round Table 1 took place on 1 December 2003 immediately following the Industrial Development Forum. The Round Table elaborated further on the topic already addressed in the Forum, which featured Mr. Carlos Magariños, Professor Jeffrey Sachs, Mr. Rubens Ricupero and Prime Minister Sumaye. The Round Table provided an advance view of the insights to be presented in the upcoming Industrial Development Report 2003-04. The presentations focused on the concerns and realities of the Least Developed Countries (LDCs) with special emphasis on sub-Saharan Africa (SSA).

Moderated by Mr. Francisco Sercovich, Special Policy Advisor to the Director-General of UNIDO, the members of the panel included Mr. Anthony Hawkins, Professor of Business Studies, University of Zimbabwe; Mr. Sanjaya Lall, Professor of Development Economics, Oxford University; Mr. Gabriel Sánchez, Research Director, Instituto de Estudios sobre la Realidad Argentina y Latinoamericana (IERAL), Argentina; and Mr. Simon Teitel, International Development Expert, USA. Following the first round of presentations from the panel a rich discussion ensued with the participation of the audience.

Mr. Sercovich pointed out in his opening remarks that the achievement of the MDGs would require the international community to live up to the pledges made in the Millennium Declaration, the Monterrey Conference and the Johannesburg Summit. For the LDCs, the MDGs involve the start of endogenous processes of structural change that can mobilize their domestic wealth creation capacity and help them connect with the international capital and technology flows. He added that, provided that a number of conditions are fulfilled, the MDGs have the potential to contribute effectively to attaining the conditions required for growth. Reciprocally, he noted that only through growth, diversification and industrialization could the sustainability of the goals be ensured. He then invited the panel to focus on the two-way relationships between industrialization and the MDGs.

Taking a historical perspective, Mr. Teitel discussed the manufacturing performance of SSA countries, highlighting both success stories and issues of concern. He contrasted high and low performance countries, with particular emphasis on the impact of population dynamics and export orientation.

Next, Mr. Sánchez assessed the medium-term prospects for the textile and garment exports of the SSA countries in light of the US African Growth and Opportunity Act (AGOA), the EU's Everything but Arms (EBA) initiative, the entry of China into the WTO, and the scrapping of the Multi-Fibre Agreement. In this context, Mr. Sánchez commented that the less developed countries in the region were likely to derive relatively greater benefits from AGOA, especially if the rising sentiment against Chinese exports of textiles in the USA leads to further curbs on these exports. He also addressed concerns over the "fallacy of composition", which holds that if too many developing countries embark on an industrialization path focusing only on textiles, for example, then the export prospects of these countries will quickly be diminished.



Referring to the challenge of initiating the process of structural change, Mr. Hawkins reminded the participants that there was no magic-bullet formula to transform low-income, agriculture-based, technologically backward economies. The attainment of the MDGs in SSA would depend primarily on the nature and robustness of the private sector response to the poverty reduction strategies. He drew attention to the glaring mismatch between the emphasis on the role of public sector agencies, including donor and multilateral financial agencies, and that of the private sector as exemplified by the rather superficial treatment of the role of private sector in the Poverty Reduction Strategy Papers (PRSPs). He held that, as various surveys suggest, some simple reforms could be expected to make a significant contribution to private sector development in these countries. He concluded that what was needed was a critical mass of measures to improve the business environment and investment climate, thereby lowering transaction costs and eliminating obstacles to doing business.

Picking up the subject of policies for structural change, Mr. Lall argued that while the implementation of macro policies for an enabling environment within which the private sector can flourish is of importance, the benefits from such policies are hardly automatic and should be supplemented with more targeted ones. As such, in a world driven by technological change, no country is exempt from the need to develop home-growth competitive capacity, technical and entrepreneurial skills and technological competence, as well as properly designed incentives to attain sustained productivity growth, export diversification and the development of manufacturing industry. He provided insights on how to address this issue in the LDCs so as to foster the achievement of the MDGs.

Following this presentation, the floor was opened for interventions from the audience. The resulting exchanges threw additional light on the issues raised during the Forum, and especially on the links between MDGs, structural change and the role of industrialization. It was argued that while the MDGs provide a sound way of overcoming critical thresholds in health, nutrition, education, infrastructure and environmental sustainability, the plight of the least developed countries will not be overcome unless more is done to achieve structural changes in such areas as technology diffusion and economy-wide productivity enhancement, which will allow countries to plug into the international economy through flows of capital and investment as well as through trade. It was hoped that a more meaningful debate on policy options and priorities for LDCs and particularly for those in SSA, could be advanced on this basis.

### **Major conclusions of Round Table 1**

- The Round Table threw light on the links between the MDGs, structural change and the role of industrialization.
- The MDGs can be achieved through economic growth brought about through structural changes in the economies of the developing countries, especially the LDCs, but this will require the international community to live up to the pledges of the Millennium Declaration,
- Industrialization, technology diffusion and economy-wide productivity growth play a crucial role in removing structural impediments to growth. They also allow countries to plug into the international economy through flows of capital and investment as well as through trade.
- In designing policies for structural change, a sound macroeconomic base on which the private sector can flourish is necessary, but this needs to be supplemented by more targeted micro policies for promoting technical or entrepreneurial skills, technological competence, home-grown competitive capacity as well as appropriate incentives designed to attain sustained productivity growth, export diversification and the development of manufacturing industry.
- The role of the private sector in bringing about economic growth is crucial, and policies and measures are needed to improve the business and investment climates, thereby lowering the transaction costs and eliminating the obstacles to doing business.
- On the basis of the above parameters, a more meaningful debate on policy options and priorities for LDCs, particularly for those in sub-Saharan Africa, can be advanced.

## Round Table 2

### Industry and Environment: The Need for a New Industrial Revolution

Moderator:

*Edward Clarence-Smith*

Keynote Speaker:

*Hunter Lovins*

Panellists:

*Michael Braungart, Fritz Balkau, Suresh Prabhu, Leopold Zahrer, Hans-Peter Egler*

This Round Table was moderated by Mr. Edward Clarence-Smith, Senior Industrial Development Officer at UNIDO. After Mr. Clarence-Smith's introduction, Ms. Hunter Lovins, Co-Chair of the Natural Capitalism Group and co-author of the book "*Natural Capitalism: Creating The Next Industrial Revolution*", gave the keynote presentation. This presentation was followed by comments from a series of panellists: Mr. Michael Braungart, Managing Director of the Environmental Protection Encouragement Agency (EPEA) and co-author of the book "*Cradle-to-Cradle: Remaking the Way We Make Things*"; Mr. Fritz Balkau, Chief of the Production and Consumption Branch in the Division of Technology, Industry and Economics at the United Nations Environment Programme (UNEP); Mr. Suresh Prabhu, Member of Parliament in India, former Minister of Industry, former Minister of Environment and former Minister of Power in the Government of India, and now Chairman of the Task Force on River Inter-Linking; Mr. Leopold Zahrer, Director General of the Waste Management and Environmental Technologies Department of the Austrian Federal Ministry of Agriculture, Forestry, Environment and Water Management; and Mr. Hans-Peter Egler, Head of the Trade-Related Technical Assistance Division in Switzerland's State Secretariat for Economic Affairs.

In his introduction, Mr. Clarence-Smith mentioned the two books that were at the starting point of the present Round Table: "*Natural Capitalism, The Next Industrial Revolution*" by L. Hunter Lovins, Amory Lovins and Paul Hawken and "*Cradle to Cradle: Remaking the Way We Make Things*" by Michael Braungart and William McDonough. A major message coming out of these two books for him was that, although cleaner production is good, it is definitely not enough: if we really want to move towards sustainable patterns of consumption and production, we have to move towards economies that use the materials over and over again in the manufacture of products, in quasi-infinite cycles. Mr. Clarence-Smith then commented that both books were written for an audience in the developed countries. He therefore posed for the following questions for the panel:

- Are the concepts covered in these two books relevant to developing countries, and if so what form should they take to be relevant?
- What happens if we overlay circular flows of materials onto globalized trade? What impacts will this have on the globalized flows of trade between developed and developing countries? Will it tend to reduce trade? Or increase trade?

In her presentation, Ms. Lovins first noted that for the last fifty years, our efforts to alleviate poverty have failed. It was thus time, she argued, to redefine our mental models and our relationship with the planet. She contended that the main defect in our current economic models is that they are built on the premise that nature is abundant and people are scarce. According to her, the sheer fact that every major ecosystem in the planet is in decline shows us the contrary: people are abundant and nature is scarce. Consequently, the challenge, she argued, is to drastically improve our use of nature's

productivity. Ms. Lovins developed this point, presenting the three basic principles that she is convinced can help answer this challenge:

- A radical increase in resource efficiency;
- Biomimicry, thanks to which the use of benign productive processes based on models derived from nature can guide industrial innovation and teach us how to eliminate waste and toxics; and
- Restoration, which aims at restoring the capacity of both the earth and society to sustain life by investing in human and natural capital.

Ms. Lovins illustrated these principles with various examples, showing that solutions already exist and can be highly profitable. She stressed that the three principles apply even better to the developing countries, since they cannot afford to develop the same way and repeat the same mistakes that the developed countries made. This was the only way, she argued, to ensure that there would be no net loss of human or natural capital.

The first contribution from the panel came from Mr. Braungart, who contended that the current focus on efficiency comes from a Western religious perspective where human beings are seen as bad, and should be controlled and made less bad through avoidance, reduction and minimization. Efficiency, he stated, is about minimizing the damage, making things less bad. The time he had spent in Africa, China and India, Mr. Braungart went on, gave him a different perspective, which is not about minimizing damage, but about supporting and celebrating natural processes, different cultures and diversity; although he warned that we should not romanticize nature. Mr. Braungart stressed that the discussion should not be about protecting nature – it can protect itself – but about human rights, about how to support human beings in the poorest parts of the world. To do this, Mr. Braungart contended, we needed to have a different agenda. Instead of trying to minimize a bad ecological footprint, we should be maximizing our footprint, but making it a supportive footprint. This, he went on, could be done with good design. Good products can bring nutrients back into technical and biological cycles, and by so doing celebrate human creativity, imagination and quality of production. He concluded by stating his full agreement with Ms. Lovins that these concepts can be applied as effectively in the developing countries as in the developed countries.

Mr. Braungart was followed by Mr. Balkau, who acknowledged that many good ideas and models were available. What was often missing, he said, was the path by which to reach the desired goals. He also noted that all the ideas and models being proposed are only part of the solution. On the supply side, there is eco-efficiency, seen as process optimization, but that needs to be complemented by the optimization of products and their use; there is recycling, although it too generates waste and consumes resources; and there is dematerialization, which in theory can allow for a drastic reduction of material flows and waste, but at the cost of a higher complexity in the recycling processes. On the demand side, Mr. Balkau went on, sustainable production needs to complement and support sustainable consumption, which implies that consumers should buy differently, if not less, than they currently do. He stressed further that social factors must be part of the solution, posing the question of how we can bring more social value into our production processes. In this context, Mr. Balkau hinted at the potential use of labour-intensive rather than capital-intensive production processes. In conclusion, Mr. Balkau proposed a few ways to operationalize these ideas and models. A first step, he argued, would be a more frequent and effective use of the variety of assessment tools available (life cycle analysis, technology assessments, risk assessment, environmental impact assessment, etc.) that are intended to help the decision-taking process. Mr. Balkau then stressed the need to develop a “model of models” that would integrate all the different ideas into one framework and thereby clarify not only the final goals to be pursued, but also the path leading to them.

Mr. Prabhu started by stating that in the end what is required of us if we want to save the planet is to change our lifestyles, which in turn will reorient the relationship between industry and environment. In the case of the developing countries, he stressed that this should not be seen as meaning that they should not industrialize. They should, but they should take a different road from that taken over the past 150 years by the developed countries, since the start of the industrial revolution. He cautioned

that the developing countries themselves must find this new road; they should not follow blindly the developed countries as they have done until now, for that will only create a new problem. He felt that the concepts embedded in “*Cradle to Cradle*” and “*Natural Capitalism*” could indeed be the signposts for the new road; certainly, they fitted with an ethos of a cooperative relationship between man and nature that still exists in the developing countries. However, the solutions should not just be technical (i.e. based just on product design) but should also consider the relevant economic, social and political aspects. He believed that it was necessary to start with some pilot projects in developing countries, to explore the implementation of these concepts, and suggested that the textile industry and the automotive components industry could be good candidates for such projects. He concluded by urging UNIDO to involve itself as a facilitator or mentor to make sure that these concepts became reality.

Mr. Zahrer stated at the outset that he wanted to use his intervention to talk about Austria’s experience, hoping that it could be of use to other countries. For a good quality of life, Mr. Zahrer continued, it was not necessary to own everything. Current patterns of consumption and production in the developed countries were neither transferable to the developing countries nor sustainable in the long-term. Mr. Zahrer noted that in Austria the consumption of energy and raw materials has already begun to be “decoupled” from the country’s economic growth. Further decoupling was a key objective of the country’s national strategy on sustainable development, with the goal of raising by a factor of four the country’s overall resource productivity. While recognizing that eco-efficiency alone was insufficient to reach this goal, Mr. Zahrer stressed that it did have an important role to play, and was one of the fundamental elements in Austria’s environmental policy. To increase circular material flows, Mr. Zahrer said that appropriate waste management policies were needed. With its Waste Management Act of 2002, Mr. Zahrer stated, Austria now has such a policy in place. Bio-wastes go to composting to close the nutrient cycle, post-consumer products go to material reuse, other wastes are used for power and energy production, with the final residuals being rendered inert and deposited in landfill sites. Turning to extended producer responsibility, a policy approach that is becoming more and more widespread, Mr. Zahrer opined that, combined with cleaner production, it also had the potential to increase circular material flows. He urged UNIDO to use its cleaner production infrastructure in developing countries and the competencies it has established to build supply chains and take-back and treatment capacities for the implementation of extended producer responsibility in developing countries.

Mr. Egler noted that the participants had heard a lot of very interesting visionary talk, backed by very valid background documents. While acknowledging that it was important to talk of visions in order to define the goals to strive for, he stated that the need of the hour was to find concrete solutions to the concrete problems of the developing countries. These countries, he stressed, all face the same fundamental problem: Their economies have to grow to generate employment, and thereby to alleviate poverty, but they cannot grow the same way the industrialized countries did. Their growth path has to be environmentally sustainable, and at the same time has to lower their cost structures, because competitiveness is crucial for them if they are to grow. Consequently, Mr. Egler continued, their productivity has to rise, new products and new services have to be developed and, at the same time, wastage has to be reduced. Such wastage, Mr. Egler pointed out, implied that the relative price structures were wrong and needed to be changed. Mr. Egler argued that the developing countries are well placed to enter global supply chains and global markets through their labour resources and their creative people who can contribute to the development of new products and services. In sum, there were partners in the developing countries that really could deliver something. What was needed, Mr. Egler declared, was to link up developing-country partners with partners in the international community such as multinationals, international donors, and international research institutions. Here, he believed, UNIDO could play a unique role, inter alia through such tools as the cleaner production centres promoted by the Organization. He concluded by agreeing with Mr. Prabhu that work should start immediately on concrete, replicable projects that can show the potential that exists.

The interventions by the panellists were followed by a short but lively debate, with questions and comments from the floor. The representative of Senegal agreed with those panellists who had urged that we continue to focus on the industrialization of the developing countries, and accept that

industrialization necessarily means some levels of pollution. He also pointed out that the developed countries have to take responsibility for the goods they manufacture and not dump them when they are no longer wanted on the developing countries. Finally, while the developing countries were of course interested to see outsourcing from the developed countries as a means to industrialization, he cautioned against this becoming a way of dumping polluting industries, which are no longer allowed in the developed countries, onto the developing countries. The representative from the United Kingdom suggested that perhaps the natural capitalism approach is too incremental and that there was not enough time left to adopt an incremental approach. Perhaps the more radical approach, such as that suggested in the cradle-to-cradle proposal, was now necessary. In response, Ms. Lovins stated that the natural capitalism approach is not incremental, although it can seem that way because it is promoting a pragmatic way to reach a revolutionary goal. Finally, the representative from Pakistan commented that one of the things the developing countries really needed was the of transfer cleaner technologies from the developed countries, and that in its technical cooperation work UNIDO should ensure that environmental feasibility was dovetailed with all the other work it did. He also made the case for promoting more strongly the use of biodegradable goods in the developing countries since they still did not have the capacities or infrastructure to properly recycle goods made of plastics and other non-degradable materials.

The moderator closed the session, saying that he took away two things from the discussions. On the one hand, there was a need for vision and for a change of mindsets. On the other hand, practical steps needed to be taken to make this happen. He thanked the panellists who had given UNIDO the opportunity to start up some practical projects in this field.

## **Major conclusions of Round Table 2**

- The achievement of more sustainable patterns of production and consumption, as has been called for at the World Summit on Sustainable Development (WSSD) held at Johannesburg in August-September 2002, necessitates a radical rethink of the way our societies produce, consume and dispose of our products.
- In this context, two recently advanced concepts – of “*Natural Capitalism*” and “*Cradle-to-Cradle*” – are particularly relevant.
- At the heart of these proposals is the idea that products must be designed to mimic nature and ensure that the materials they are made of can be used over and over again, creating circular flows of materials.
- The social aspects of these concepts are also important, because they give the promise of an inherently better quality of life.
- The Round Table discussed two main issues:
  - Are these concepts relevant for developing countries?
  - How will the circular flow of materials affect international trade, and especially the ability of developing countries to access international markets?
- The authors of the concepts and the panellists felt that the concepts were equally relevant for the developed and developing countries.
- Given the availability of these concepts, it was agreed that developing countries should adopt them to the extent possible, so as not to make the mistakes made by the industrialized countries during their industrialization process.
- It was proposed that these new concepts could be implemented on a trial basis in specific industrial sectors – textiles or automobiles – in a developing country like India, where UNIDO could design a pilot project.
- It was felt that the potential implication for international trade of the new concepts were not clear, and that UNIDO should further study this issue.

## Round Table 3

### **Making Trade Work for the Poor: Stimulating the Real Economy's Response**

Moderator:

*Otto Genee*

Keynote Speaker:

*Adrian Wood*

Panellists:

*Tadesse Haile, Silvia Cuéllar, Jeremy Hobbs, Stefano Ponte, Alan Bryden, Kipkorir Rana, Oskar Knapp*

Distinguished Speakers:

*Ibrahim Tamponé, Kandeh Yumkella*

The moderator of this Round Table was Mr. Otto Genee, Director of the Policy Coherence Unit of the Ministry of Foreign Affairs of the Netherlands. The keynote speaker was Mr. Adrian Wood, Chief Economist at the Department for International Development (DFID) of the UK, and the panelists comprised Mr. Tadesse Haile, State Minister of Industry and Trade, Ethiopia; Ms. Silvia Cuéllar, Executive Director, Federation of Chambers and Associations of Central American and Caribbean Exporters (FECAEXCA); Mr. Jeremy Hobbs, Executive Director of Oxfam International; Mr. Stefano Ponte from the Danish Institute for International Studies; Mr. Alan Bryden, Secretary General of the International Organization for Standardization (ISO); Mr. Kipkorir Rana, Deputy Director General of the World Trade Organization (WTO); and Mr. Oskar Knapp, Ambassador and trade delegate of the Swiss State Secretariat for Economic Affairs. The Round Table was also addressed by two distinguished speakers: Mr. Ibrahim Tamponé, Commissioner for Energy, Mines, Industry, Handicrafts and Tourism of the West African Economic and Monetary Union (UEMOA); and Mr. Kandeh Yumkella, Special Advisor to the Director-General of UNIDO.

The proceeding of the round table began with a short introduction by the moderator, Mr. Otto Genee. This was followed by the keynote presentation, and by short statements by the panellists. The two distinguished speakers also commented briefly on the topic of the Round Table before the floor was given to speakers from the audience.

In his introductory statement the moderator noted that the problems faced by developing countries go beyond a lack of market access to an inadequate capacity to produce exportable products that meet standards of the targeted markets. He indicated that the focus of the Round Table would therefore be to identify policy tools and technical assistance possibilities to achieve two inter-related goals: First, to strengthen the supply side capacity of developing countries, in particular of low-income countries, and second, to enhance the capacity to meet international standards and conformity assessment requirements. The moderator recalled that the issue paper had identified the main areas where institutional support capacities at national and regional level could help enterprises to participate more effectively in world trade: Technology extension, productivity enhancement, production according to international standards, proof of conformity through testing and certification, technical education and training, market intelligence and investment promotion. The moderator also indicated the key questions that could guide the discussions: What is the critical mass of support institutions and services necessary for supply side development; what is the critical mass of support infrastructure and services for standards compliance and conformity assessment; how can cooperation take place at

national, regional and international level; what is the role of technical assistance and technical cooperation; and what should be the guiding principles for such assistance?

The keynote speaker, Mr. Adrian Wood, noted that high barriers to developing country exports and a thicket of more and more dense and complex standards are one of the main reasons why developing countries are left behind in terms of poverty reduction, output growth and performance in export markets. Citing empirical evidence from two relatively impoverished regions, Mr. Wood showed that while in sub-Saharan Africa poverty levels are stagnant, growth rates are close to zero, and shares in world markets are falling, South and East Asia present a more encouraging picture with declining levels of poverty, a more rapid growth of per capita GDP than in OECD countries, and an increasing share in world markets. Mr. Wood suggested that the principal lesson to be learned from the Asian strategy to overcome barriers and meet standards was the pre-eminent role played by the local private sector and home-grown public sector interventions, with external technical assistance playing only a relatively minor part. In addition, Mr. Wood stressed that, on average, only 20 per cent of local output is sold on export markets, but 80 per cent of GDP is produced for and sold on the domestic market. Therefore, the achievement of rapid economic growth will depend on a rapid growth of production to respond to the home market demand. In this connection, he pointed out that the quality and price of products produced in developing countries would also need to take into account the needs and purchasing power of domestic buyers.

Mr. Wood then raised some hard questions that need to be borne in mind when thinking about appropriate policies, actions and technical assistance. First, do the benefits of policy measures exceed the costs? That is clearly not the case when developing countries try to catch up with standards that are used as protectionist measures, and developing countries therefore need to consider whether they want to put resources into meeting standards for high-cost exports or if they want to stay out of certain markets and use their resources to produce for the domestic market. A second issue concerns the use of public subsidies to help enterprises to meet standards. This requires a precise analysis of where the market failures are. Often the private sector, which sets higher standards than internationally agreed, assists its suppliers in developing countries to meet those standards. More broadly, the private sector should be encouraged to deliver such assistance on a for-profit basis. Public intervention should be limited to specific cases, while keeping in mind its opportunity cost. A last question raised by Mr. Wood referred to whether assistance to small and medium-sized enterprises should be directed primarily towards assisting them to export, or should rather help them to produce more effectively for the domestic market.

Mr. Tadesse Haile, the first panellist, centred his presentation around some of the main issues that he believed would contribute to making trade work for the poor. He noted that first there was a need for developing countries to provide a conducive environment for private sector development in the sense of liberalized economies, political stability, good governance, the rule of law, and better support infrastructure and services. Second, if developing countries are to be successful with private sector development, they need to be focused on sectors with good growth potentials and where they have a comparative advantage. Third, developing countries need to establish and strengthen support institutions and services for these priority sectors in order to enhance technology and product development, to provide training and research facilities, and to facilitate networking among producers. Fourth, there is a strong need for the development of private-public partnerships, since productive capacities can best be strengthened by such partnerships and consultations at sub-sectoral level between all stakeholders, including producers, researchers, academia, transporters and customs. Fifth, since foreign direct investment (FDI) is a source of technology and helps to enhance local productive capacities, there is a need to ensure a conducive environment to attract such FDI to the selected priority areas. Concluding his statement, Mr. Haile emphasized the need for technical assistance to enhance productive capacities and produce competitive products with the right quality and standards required by the markets. Particular emphasis should be given to technical support institutions for technology upgrading, the implementation of standards and technical regulations, and the implementation of national conformity assessment systems and infrastructures.

Ms. Cuéllar started her presentation by highlighting some reasons why trade in Central America has not grown as much as it could have. First, trade strategies are often not aimed at the long term but reflect the short-term imperatives of the governments. Second, there is often a lack of analysis of the needs of the private sector and a lack of private-public dialogue, which leads to a lack of coordination and a lack of the efficiency of the efforts undertaken. Third, there is a lack of knowledge on foreign markets. Fourth, there is a lack of diversification of the export base, and Central America is still remembered for the same products that it produced 10-15 years ago. Fifth, business is hampered by high interest rates and difficult access to credit, which affect small and medium-sized enterprises in particular. Finally, there is a lack of knowledge on standardization, metrology and certification. In order to improve participation in trade, Ms. Cuéllar cited a number of issues that needed to be addressed to generate a more conducive environment for investment and trade, and to establish the necessary support infrastructure and advisory capacities. In particular, she referred to the development of supply capacities for non-traditional exports, enhanced coordination between the public and private sectors, and the transfer of knowledge on standards, technical regulations and other international requirements. She argued that technical cooperation should be focused on the development of new products, assistance to produce according to market requirements, enhancement of productivity, and upgrading of laboratories for metrology and certification.

Mr. Hobbs noted that as a representative of Oxfam International, he spoke on behalf of a confederation of twelve organizations working in 108 countries. Oxfam often works directly with poor communities, mostly in rural sectors, and is involved in capacity building, strengthening the quality of products and assisting farmers to get their products to the markets. At the same time, Oxfam also plays an increasingly strong advocacy role for promoting the necessary changes at the macroeconomic level, and in particular for the adoption of a new approach by developed countries to the issue of market access for agricultural products. Noting that trade liberalization does not necessarily lead to economic growth, and that growth does not automatically lead to poverty reduction, Mr. Hobbs pointed out that technical assistance to support trade participation should be seen in a broader context of necessary political changes to unblock the trade round. He agreed with Mr. Wood on the lessons to be learnt from Asian countries on the alleviation of mass poverty, which included the protection of infant industries, heavy investment in education and health, a strategic approach to industrialization, equity measures, and only gradual trade liberalization. Oxfam's experience has shown the high importance of human resource development and of correct ethical values, which has led it to become a major actor in the fair trade movement over the past 30 years. Mr. Hobbs concluded that capacity-building in developing countries needs to take into account the absorptive capacities of communities, organizations, industries and countries. Supportive technical assistance needs to be flexible, based on an adaptable approach and aimed at a long-term mutual partnership.

Mr. Ponte centred his presentation on the question whether voluntary and private standards are entry barriers or stepping-stones for entering into global value chains and producing higher value added products. In addressing this issue, Mr. Ponte referred to two case studies: The export of fresh vegetables from Kenya to the UK, and sustainable coffee. In the first of these, private standards set by importing supermarkets were much more stringent than the prevailing mandatory regulations, and had been supplemented by new voluntary initiatives such as ethical standards. While this had made it more difficult for exporters to supply these supermarkets, it had also led to an improvement in the products, such as vegetables ready for microwave cooking, although this upgrading had also resulted in the local export-oriented producers reducing their sourcing from small local suppliers and relying increasingly on their own farms. In the second case, a number of labels and certifications have evolved to specify the conditions for farmers and the environment under which such coffee should be grown. This bears the risk that the increased certification and improvement requirements for small farmers will not necessarily be matched by commensurate increases in the price of the product. Referring to the implications for public policy and technical assistance, Mr. Ponte made a number of proposals. These included the active participation of developing countries in the development of standards, allowing them to move from being takers of standards to actively influencing their development, and the harmonization of standards between countries and at regional level to facilitate



exports. Capacity building activities would be needed to enable enterprises to meet the new standards, the cost of certification would need to be reduced through accreditation of local laboratories, and research would need to be undertaken to assist industries and governments to acquire a better understanding of the specificities of value chains and the costs and benefits of compliance with the standards required in these value chains.

Mr. Bryden saw it as a sign of the times that ISO had been invited for the first time to a UNIDO General Conference. He noted that such issues as metrology, standardization, certification and accreditation had moved from being issues for technicians to being key elements in the discussions about trade agreements. These are issues related to ISO's daily activities, and ISO hopes that within the next ten years the public perception of standards will become more positive, and that they will come to be recognized as a vehicle for social, technical and economic progress, and as a means to share knowledge and good practices, and facilitate relations between economic actors. Standards and technical regulations are more and more at the forefront of international activities and cooperation, in particular at the level of the WTO, where both the agreements on technical barriers to trade (TBT) and sanitary and phytosanitary measures (SPS) refer to international standards for products and conformity assessment practices. In this context, Mr. Bryden advocated the use of international standards rather than the adoption of regional standards within the current 220 free trade agreements existing in the world. Mr. Bryden concluded his statement by pointing out that ISO has recently adopted a five-year plan for technical assistance around five key areas: awareness raising about the importance and benefits of standardization and conformity assessment; capacity building adapted to the needs of the developing countries; encouragement of national and regional cooperation in the area of standardization and quality; promotion of the use of IT tools developed by ISO; and facilitation and encouragement of the participation of developing countries in all standards related organizations. The Memorandum of Understanding signed earlier that day with UNIDO showed that ISO was a significant partner in the area of trade capacity building.

Mr. Rana started his presentation by describing the mandate and the work of the WTO. He noted that the recent formulation of the Doha Development Agenda (DDA) had raised awareness of the importance of technical assistance, and that member states had contributed to a global trust fund for capacity building, which currently stood at 24 million Swiss francs. Explaining that the DDA is aimed at tackling the main obstacles to trade, such as tariffs, tariff escalation, tariff peaks, and non-tariff measures including those relating to standards, Mr. Rana illustrated these problems with reference to the cases of cocoa and cotton, which are subject to a variety of trade distortions. Mr. Rana then discussed his organization's contribution to trade-related technical assistance, and the planned activities for 2004. These will include trade policy courses and clinics, regional and national seminars, university programmes, and supporting developing countries in their DDA negotiations. The WTO is also engaged in two inter-agency cooperation programmes, the "Integrated Framework for Trade-related Technical Assistance to Least Developed Countries" (IF), conducted jointly with the World Bank, UNDP, IMF, UNCTAD and ITC, and the Joint Integrated Technical Assistance Programme (JITAP) focusing on least developed countries (LDCs) and medium-income countries in Africa. Mr. Rana also referred to the Memorandum of Understanding with UNIDO signed recently in Cancun, under which nine pilot countries will be assisted in the specific fields of complementary expertise of the two organizations, and noted that the WTO plans to further coordinate its technical assistance and policy support services with the Bretton Woods institutions.

Mr. Knapp began by emphasizing the need to address two main issues if trade should work for the poor: market access and the strengthening of the supply side. The issue of market access had suffered a serious setback at Cancun, and there was now an urgent need to ensure that the multilateral trading system is sustained and does not disintegrate into bilateralism or regionalism. On the subject of market access Mr. Knapp also pointed out that Switzerland had established an Agency for International Trade, Information and Cooperation some years ago as a contribution to a better understanding and use of WTO instruments, and especially to support LDCs, who cannot have permanent delegations in Geneva at the WTO. With regard to the development of the supply side to enable LDCs to be more competitive in international markets, Mr. Knapp saw a big challenge in the

coordination of technical assistance, both at the level of donors and of the developing countries, and stressed that the ownership of technical assistance should rest clearly be with the developing countries in the framework of the national Poverty Reduction Strategy Papers (PRSPs), which constitute the basis for achieving poverty reduction and the Millennium Development Goals. Mr. Knapp highlighted two areas of cooperation with UNIDO in the field of assisting developing countries in meeting international standards: the cleaner production programme that includes the support in compliance with environmental standards, and cooperation programmes in the field of quality and metrology. He also mentioned cooperation between Switzerland and agencies involved in the field of fair trade labeling, such as OXFAM and Max Havelaar, as well as the Swiss Import Promotion Programme, which assists small and medium-sized enterprises in developing countries in accessing industrial markets, mainly in Switzerland and the EU.

These presentations by the panellists were followed by short statements by the two distinguished speakers, Mr. Tamponé and Mr. Yumkella. Mr. Tamponé spoke about the experiences and challenges of the West African countries, especially with respect to the export of agro-based products including cotton. He also referred to the support provided by UNIDO within an on-going technical assistance programme in quality and standardization, financed by the EU. Mr. Yumkella underscored the importance of inter-agency cooperation in trade-related technical assistance, as seen in the two Memoranda of Understanding UNIDO had recently signed with the WTO and ISO. He also emphasized the need to transfer best practices in trade-related technical assistance, an area where research can play an important role. UNIDO has undertaken some awareness-raising on trade-related issues at the level of developing countries through joint seminars with UNCTAD financed by Austria. These activities will be pursued and complemented by an ad hoc working group of African ambassadors, which the Director-General of UNIDO has set up in Vienna.

These presentations and statements were followed by a lively discussion between the moderator, panellists and participants from the floor, including speakers from India, Sri Lanka, Senegal and UNIDO. The discussion covered the challenges faced by small and medium-sized enterprises in developing countries, and in particular the LDCs, in their efforts to enter global value chains, where the buyer is often in a dominant position and can dictate conditions; the difficulties of enterprises in their local markets when they have to face dumping practices by foreign producers, or have to discount heavily for a lack of buyer competition; the extent to which UNIDO and other development agencies can assist developing countries in strengthening their supply capacities, their negotiation skills in trade discussions, and their access to relevant market information; the need for better coordination between ministries of industry and ministries of trade; and the need for more transparency and better coordination in the area of trade-related technical assistance and its ownership through a better integration in national development and poverty reduction strategies.

### **Major conclusions of Round Table 3**

- This Round Table focused on the tools that can be used at the national level to help the real economy strengthen its productive capacity to grasp the opportunities arising from new market developments, and on identifying technical assistance needs in these areas.
- It was agreed that supply capacity development and technology upgrading are the main priorities for the better integration of the low-income countries and LDCs into global trade. Without such capacity or exportable products, they will not be able to benefit from the market access opportunities arising from the AGOA and EBA initiatives of the USA and EU.
- There is a need for national WTO-compliant policy interventions or strong incentives for investment and technology transfer to enable enterprises in developing countries to meet standards and conformity requirements of international markets.
- There is also a need for a closer alignment of trade with national poverty alleviation strategies.
- More inter-agency and donor-coordination is also needed.

- The Round Table concluded that the developing countries are being left behind in terms of poverty reduction, output growth, and participation in international markets. Clearly the supply side constraints have to be addressed as a priority so that trade can be made to work for the poor.

## Round Table 4

### Post-Crisis Industrial Rehabilitation and Reconstruction

Moderator:

*Renato Fornocaldo*

Keynote speaker:

*Kay Rala Xanana Gusmao*

Panellists:

*Yukio Takasu, Ranjith Fernando, Kadi Sesay, Erick de Mul, Maurizio Pieroni*

This Round Table was moderated by Mr. Renato Fornocaldo, Managing Director of the Division of Administration of UNIDO. Its purpose was to discuss and obtain suggestions on possible areas and modalities of UNIDO interventions in the rehabilitation and reconstruction of the countries in post-crisis situations. The panellists comprised a distinguished and prominent group of representatives of recipient countries in post crisis situations, donor countries, the private sector, and international organizations. The countries emerging from crisis situations were represented by Mr. Xanana Gusmao, President of Timor-Leste, and Ms. Kadi Sesay, Minister of Trade and Industry of Sierra Leone. Donor countries were represented by Mr. Yukio Takasu, Ambassador of Japan in Vienna, and the private sector by Mr. Ranjith Fernando, former President of the Development Bank in Sri Lanka. Representatives of international organizations included Mr. Erick de Mul, former UN Resident and Humanitarian Coordinator in Angola and Afghanistan, and Mr. Maurizio Pieroni, former Head of UN-HABITAT in the Suleymania Governorate in Iraq.

In opening the panel discussion, Mr. Fornocaldo described UNIDO's recent activities in post-crisis assistance, both in the context of broader inter-agency initiatives and within the scope of its own integrated programmes, in such countries as Bosnia and Herzegovina, Burundi, Côte d'Ivoire, Croatia, Eritrea, Guinea, Rwanda, Sudan and Sri Lanka, as well as the countries affected by Hurricane Mitch in Central America. He also referred to similar programmes currently under preparation for Afghanistan, Algeria, Sierra Leone and Timor Leste, as well as others under consideration for Angola, Democratic Republic of Congo, Iraq and Republic of Congo. He noted that UNIDO's interventions in such cases should be focused on four major areas of intervention during the phase of rehabilitation:

- a) Assistance for enterprise rehabilitation in key industrial sectors;
- b) Promotion of income generating activities;
- c) Support for institutional capacity building; and
- d) Contributions to the rehabilitation of basic infrastructure.

In conclusion, Mr. Fornocaldo encouraged the participants to assist UNIDO in formulating a more clear definition of the strategic framework for post-crisis assistance. Specifically, he called on them to provide recommendations on the precise role to be played by UNIDO in post-crisis assistance and the specific modalities and phases of UNIDO's involvement, including the strategic alliances that it might form with other actors in order to be able to respond more effectively to the needs of the post-crisis countries.

In his speech President Gusmao explained the current situation in the country, noting that after 24 years of political struggle, more than 90 per cent of infrastructure had been destroyed. The international community had been very generous with its assistance in the emergency phase, and had started with human rehabilitation and reconstruction of infrastructure. However, he argued that independence for the people of Timor would mean nothing unless the Government would be able to provide the relevant institutions to respond to the peoples' needs, particularly in the area of water

supply, electricity, justice and courts. He noted that as the programme for peace, reconciliation and rehabilitation moves ahead, the people should also be encouraged to take their own initiatives in order to achieve sustainable progress. In this connection, Mr. Gusmao pointed out that his country's economy continued to rely on imported goods, and that UNIDO could help to develop a number of potential domestic areas such as agro-industries through capacity-building for small and medium-sized enterprises (SMEs) and the improvement of knowledge and quality of products. Mr. Gusmao concluded that this would create employment opportunities in a sustainable manner, and provide the community with the perception of being a part of a business-oriented society.

Based on his understanding of the issues related to post-conflict reconstruction arising from his long association with the United Nations, Mr. Takasu argued that one of the most important elements that needed to be tackled was the concept of human security. In this connection, he pointed that Japan gives a high priority to the effective follow-up of the recently published recommendations of the International Commission on Human Security. Drawing on his own experience and these recommendations, he identified four main issues for successful post-crisis rehabilitation:

- a) Empowering individuals and communities to act on their own behalf, which Japan is supporting through a number of post-conflict projects (including one implemented by UNIDO in Sudan) financed through the UN Trust Fund for Human Security.
- b) Ensuring a seamless transition from humanitarian assistance to reconstruction assistance, as in the case of the Comprehensive Regional Development Assistance Programme known as the "Ogata Initiative" in Afghanistan, in which UNIDO could play a very important role in the rehabilitation of micro-, small and medium-sized enterprises, and in the development of rural communities through agro-industrial development;
- c) Adopting an integrated and more coordinated approach among all partners in post-conflict assistance, as exemplified by a multi-agency programme launched recently by Japan for transitional recovery in Sri Lanka, in which UNIDO also plays an important role; and
- d) The preemptive formulation of rehabilitation and reconstruction plans long before ceasefires are agreed, including the identification of implementing agencies and financial resources, as had been the case with the peace process in Sri Lanka.

Referring to the difficult situation in Iraq, Mr. Takasu emphasized the need for early assistance to the Iraqi people to reconstruct their country, and noted that Japan had recently pledged to grant humanitarian relief assistance of US\$ 1.5 billion. He concluded with the hope that UNIDO would be one of Japan's reliable partners in the reconstruction of Iraq with contributions in the rehabilitation of the water supply, the reconstruction of the non-oil sector through support for the development of SMEs, and through the provision of vocational training for returnees and internally displaced people.

Drawing on his experience in post-conflict rehabilitation in Sri Lanka, Mr. Fernando stressed that United Nations organizations, and UNIDO in particular, could play a very important role. Referring to the prevailing differences between the political parties in Sri Lanka, he noted that UNIDO could make a valuable contribution to the restoration of trust between the conflicting groups through its active involvement in Sri Lanka's economic development. He emphasized UNIDO's successful programme in Colombo and in the Northern Province, in particular through the establishment of training programmes, the transfer of technology and support for institutional strengthening, which proved the importance of the Organization's role in post-conflict rehabilitation. He also stressed that UNIDO's assistance in post-crisis rehabilitation should be undertaken in conjunction with the private sector in Sri Lanka. In this context, Mr. Fernando highlighted the results of the very successful donor conference held in Tokyo in September 2003, which raised US\$ 4.6 million for Sri Lanka's rehabilitation and recovery.

Ms. Sesay pointed out that more than two million people had been displaced and all major economic activity had been disrupted during the civil war in Sierra Leone. She noted that the national and international response to the Sierra Leone crisis has ranged from humanitarian relief to the rehabilitation and reconstruction of physical infrastructure and the productive sector of the economy. Emphasizing that the economic recovery of Sierra Leone would now depend upon how the transition from the emergency relief and rehabilitation phase to the reconstruction and development phase

would be managed, Ms. Sesay pointed out that the Government had formulated and adopted a National Recovery Strategy to coordinate this process. In this connection Ms. Sesay stressed that UNIDO, as the specialized agency of the United Nations mandated to promote industrial development, should play a key role in all the recovery stages of post-conflict countries. In particular, she suggested that UNIDO could support the strengthening of key industrial sectors and SME support institutions, the promotion of industrial competitiveness and product development, the development of income generating activities, the facilitation of market access for manufacturers from Sierra Leone, and the establishment of skills development and training programmes for women, youth and ex-combatants.

Referring to his more than thirty years of experience in humanitarian and development work, Mr. De Mul expressed his regret that the international community had made little progress in conflict prevention, let alone post-conflict recovery. At the same time, however, he expressed his optimism on our capacity to improve the way in which post-conflict situations could be managed. He noted that the principal issue that needed to be addressed was the priority given to humanitarian relief over development assistance, arguing that very few questions were asked when it came to providing humanitarian relief but that all kinds of conditions were imposed on development assistance. He stressed that this approach needed to be changed or we would never get out of the crisis. In post-crisis situations themselves, Mr. De Mul argued that the transition from relief emergency to development was a particularly important phase, and that it should take place as quickly as possible in order to bring home the people that had been displaced during the conflict, initiate physical rehabilitation measures, restore markets and facilitate mobility within the country so that people could once again move around and feel that they were free to do what they wanted in their country. Their dignity needed to be restored and they needed to be given the wherewithal to sustain themselves. Preparatory measures for such interventions needed to be taken as soon as possible, possibly even before the conflict had ended, and all stakeholders needed to be involved in these preparations – in particular the people themselves, who were always regarded as the beneficiaries of such efforts but whose opinion was never sought. He stressed that UNIDO could make an important contribution in this context and should already be actively involved when the international community discusses post-crisis issues.

Based on his experience as a former Head of UN-HABITAT in the Suleymania Governorate in Iraq, Mr. Pieroni pointed out that poverty and the lack of resources greatly increased the vulnerability of populations in post-crisis situations, and that poverty alleviation should be a central to any plan to effectively mitigate and manage such situations. Against this background, Mr. Pieroni stressed that the right to decent housing and the right to work were fundamental principles of human dignity that become dramatic in any post-crisis situation. He therefore argued that human settlements must be regarded as an integral component in post-disaster rehabilitation and reconstruction activities. He argued further that the post-disaster responses of the international community had been characterized by “rapid-rehabilitation” projects, not linked to the overall development objectives of the affected countries. However, he emphasized that humanitarian agencies could no longer operate in isolation, as they needed the active participation of development-oriented agencies for the shared realization of recovery processes for sustainable development. In this connection, Mr. Pieroni highlighted the scope for close future cooperation between UN-HABITAT and UNIDO, given the contribution that UNIDO could make to the rehabilitation of the building materials and construction industries in post-crisis environments.

The panel presentations were followed by an interactive discussion among the moderator, panellists and participants. A number of valuable comments and questions were received from the representatives from Burundi, Côte d’Ivoire, Croatia, Guinea, Iraq, Rwanda, Sierra Leone, Sri Lanka, Timor Leste and Zimbabwe, who supported UNIDO’s initiative in post-crisis assistance. They all noted UNIDO’s involvement in this area, shared their experience and encouraged possible interventions in Iraq.

This discussion covered a wide range of issues concerning countries affected by conflict, emphasizing the negative consequences such as hyperinflation and increasing poverty. The participants expressed the need to pay more attention to poverty, as a major cause of conflict, which affects the process of peace-making and economic recovery. In this context, and taking into account the Millennium Development Goals, they stressed the need for UNIDO's assistance in priority areas of poverty alleviation in all African countries. Within its mandate, they called for UNIDO to play a significant role in the area of industrial rehabilitation and reconstruction. The importance of human security and safety issues in post-conflict rehabilitation was also noted, with Sri Lanka as a very successful example of a UNIDO programme in post-crisis assistance. Finally, the participants highlighted the need for the rehabilitation/developmental phase to be sourced nationally to the extent possible, in order to support the building of domestic industrial capacities in the countries affected by crisis.

#### **Major conclusions of Round Table 4**

- Priorities need to be established for each phase of the post-crisis period, from emergency or humanitarian relief to rehabilitation and reconstruction, and finally to sustainable development.
- Too much emphasis is usually placed on humanitarian assistance, with the importance of the developmental phase not being taken fully into consideration.
- The formulation of strategies for the developmental phase should be in line with long-term sustainable development goals, and implementation should take place in close cooperation with other actors engaged in post-crisis assistance.
- All major stakeholders – government, the private sector, donors and international agencies – have a role to play.
- There is considerable scope for effective interventions by UNIDO in the field of post-crisis rehabilitation and reconstruction to enable the affected countries to restore their productive capacities, and UNIDO should intervene in all areas within the scope of its mandate and capacity.
- These interventions can include, inter alia, the strengthening of key industrial sectors, the promotion of income generating activities, support for small enterprise and entrepreneurship development, institutional strengthening for the promotion of industrial competitiveness and product development, efforts to facilitate market access, and the promotion of skill development and training programmes for women, youth and demobilized personnel.
- UNIDO shall need to find a place at the table where the various implementing agencies, donor institutions and government representatives formulate strategic frameworks and programmes for post-crisis rehabilitation.
- In particular, UNIDO should develop a close cooperation with other implementing agencies, such as UN-HABITAT and the World Health Organization, in order to meet the priority needs of the post-crisis country concerned.
- Since poverty is one of the major causes of conflict, human security and safety issues should be considered in each phase of UNIDO's assistance.

## Round Table 5

### Promoting Investment in Developing Countries (with Special Reference to Africa): Challenges, Opportunities and Experiences

Opening remarks:

*Yoweri Kaguta Museveni*

Moderator:

*Brian Caplen*

Keynote speaker:

*Peter Buckley*

Panellists:

*Carlos da Silva, Bunmi Oni, Patrick Helson, Dick Kramer, Maggie Kigozi, Francois de Grivel*

The Round Table was inaugurated with a brief statement by the Honourable Yoweri Kaguta Museveni, President of Uganda, and moderated by Mr. Brian Caplen, Editor of fDi Magazine published by the Financial Times Group. The keynote speech was given by Mr. Peter Buckley, Professor of International Business and Director of the Centre for International Business at the University of Leeds, U.K. The panellists comprised Mr. Carlos da Silva, Director of Operations for IBM, Central and Eastern Europe, Middle East and the African region; Mr. Bunmi Oni, Managing Director and Chief Executive of Cadbury Nigeria plc.; Mr. Patrick Helson, Chief Operating Officer of CDC Capital Partners Africa Region; Mr. Dick Kramer, Chairman of Capital Alliance Nigeria; Ms. Maggie Kigozi, Executive Director of Uganda Investment Authority; and Mr. Francois de Grivel, Chairman and Managing Director of several export companies in Mauritius.

In his opening statement, President Museveni noted that the main reasons for the lack of investment flows into the Third World countries in general, and Africa in particular, could be grouped into two categories:

- Endogenous reasons, which depend on the actions of the countries themselves; and
- Exogenous reasons that are external to the country.

Elaborating on this statement, Mr. Museveni suggested that the anti-private sector bias of African governments in the 1960s represented the most severe endogenous reason that continues to hinder investment flows until today. As a result, African countries missed the chance to gain investments in an era when investors faced limited investment opportunities due to the Cold War, and now face a more difficult situation as countries such as China have begun to attract foreign direct investment (FDI) at Africa's expense. In order to be able to compete with the huge Chinese market in attracting capital, African countries have to integrate their small national markets into bigger regional ones. Turning to the exogenous reasons, President Museveni referred in particular to the fact that Africa's products are locked out of European, US and Japanese markets despite such initiatives as the EU's Everything but Arms (EBA). He argued that the Western world had been hypocritical with respect to the policies it followed and the policies it imposed on other countries, e.g. with regard to agricultural subsidies. This behaviour must be corrected to allow African countries to export directly to the big markets in Europe and the USA.

In his keynote speech, Professor Buckley suggested that the strategies of multinational enterprises were changing, with serious implications for their host countries. He noted that there were three types of markets: the international capital market, which is very closely integrated, regional blocks in goods and services such as the European Union (EU) and the North American Free Trade Association



(NAFTA), and labour markets that essentially operate at national levels. He explained further that these markets are moving at different rates. This arrangement benefits multinational enterprises (MNEs), who are promoting this process. They can raise capital at the lowest possible cost, gain economies of scale in goods and services markets, and can place the labour-intensive stages of their production in low-cost and flexible labour markets. Since this arrangement leads to an immense amount of volatility in the world economy, however, MNEs build flexibility into their operations by adopting flexible location and ownership strategies. Thus, MNEs will not concentrate key resources in a single country, and will use a variety of ownership mechanism, such as sub-contracting, licensing and the use of joint ventures. This form of organization, which can be likened to an octopus with many different tentacles here and there, is facilitated by improvements in communication technology and the easy transmission of knowledge, which allows MNEs to alter operations as new opportunities present themselves. MNEs do incur costs from switching, however, and appropriate policies can help to embed the MNEs in the host countries. In particular, attention must be paid to reducing the transaction costs of setting up a business in developing countries, which can be a serious deterrent to foreign investment.

Mr. Da Silva noted that the shift of work from high-cost to lower-cost labour markets was a profound and irreversible trend that was shaping the agendas of governments, labour unions and executives throughout the world. Under increasing cost and competitive pressures, many companies are coming to regard global sourcing investments or offshoring as essential. In this context the human dimension is becoming increasingly important and people are becoming increasingly valuable as many developing nations are making quantum leaps in communications infrastructures and gaining increased access to modern e-technology. Once the increasingly cost-efficient and robust communication infrastructures allow global reach to be established, all focus and attention shifts to intellectual assets and the human dimension. To enhance human capital, two conditions must be satisfied – an adequate education platform to create a competitive workforce, and a telecommunications strategy geared to providing ample bandwidth at the most competitive rates. This is a precondition to attract any form of investments in the information technology space. Other conditions include not only the cost factor, but also the stability of the institutional framework. This involves the existence, stability and enforceability of laws and regulations; economic and fiscal discipline and robust data privacy laws. Flexibility of labour regulations, a favourable industrial relations environment, and workforce flexibility, today and in the medium term, are also decisive factors.

Mr. Oni began by stating that investment accelerates free enterprise, fosters growth and ultimately raises the quality of life of ordinary people, while also helping to improve corporate governance and link national economies into global trade. In particular, Mr. Oni suggested that countries should focus on activating domestic investment, which in turn would accelerate the growth of FDI. He identified three specific problems with the African economies:

- African economies exploit natural resources with very little value added, which leaves them with little control of revenue stream and vulnerability to world commodity and import prices;
- African markets are shallow, and cannot withstand the shocks of international markets; and
- African countries suffer from weak institutions, a large informal economy and corruption.

To overcome these problems, private investment should be promoted in prioritized sectors, and parts of the informal economy should be migrated into the formal economy, inter alia by enhancing the concept of property ownership. Mr. Oni also suggested that Africa could become more attractive for investors if regional markets were to pool together instead of operating as fragmented small markets. In addition, Mr. Oni noted the importance of ensuring the availability of trained labour to meet the requirements of investors. He also argued that more public-private sector partnerships have to be developed to smoothen the transition from public-led planned economies into private sector-led economies, and that a focused agenda for investment promotion agencies (IPAs) was essential. Mr. Oni concluded with the statement that UNIDO can help with strengthening of such IPAs to enable them to promote investment interest in developing countries.

Mr. Helson indicated that the only way to bring capital into Africa was by giving a financial incentive. Pointing to a 33 per cent return for investors in US dollar terms achieved by CDC from a Tanzanian gold mine, he argued that Africa should be promoted as a potentially very successful place to invest. Referring to CDC's future investment plans, Mr. Helson noted that the company had US\$ 350 million to invest over the coming three years and was looking for investment opportunities in African countries having the right attributes, such as:

- Expansion;
- Experienced management;
- A track record of success (at least three years of growing profitability);
- Simple projections for profit and loss, cash flow and balance sheet for five years (as given, for example, by UNIDO project profiles and COMFAR analysis); and
- Limited currency risk.

With regard to policy measures, Mr. Helson recommended African countries to be more flexible and transparent, especially with respect to taxation, land ownership and general legal issues. He also suggested that the evolution of IPAs into one-stop-shops with a high degree of empowerment and direct links to the highest decision-making authorities should be promoted. Referring to privatization, he proposed that governments should offer their best assets first, and publicize their successes accordingly.

While describing UNIDO's work with the African IPAs as extremely encouraging, Mr. Kramer pointed out that four principles drawn from experience should be borne in mind in the context of promoting foreign investment:

- If investments are not flowing into a country, it is probable that the fundamental investment environment is unfavourable through such problems as political or economic instability, the lack of sound macroeconomic fundamentals, weak infrastructure or problems with law and order, which no amount of incentives or marketing would be able to overcome. To attract investment, these problems must be corrected and the investment environment improved.
- Companies now have an opportunity to outsource non-core businesses that they originally had to do themselves because such sub-contractors were not available.
- In Nigeria in particular there is a strong emphasis on local content in the oil sector, and there are numerous oil service and other suppliers that can be developed. Moreover, the whole logistics, distribution, wholesaling and retailing area is yet to be developed and there is lot of interest in this area, inter alia from South Africa, whose investments in Nigeria are growing at high rates.
- With regard to attracting investment, emphasis should be placed on pragmatism rather than theory or ideology, and those who continue to have an anti-foreign investment bias and wish to promote the indigenous private sector should be particularly aware of this. The most important criterion in formulating investment policies is whether they ultimately attract entrepreneurs and foreign investors.

Ms. Kigozi pointed out that Africa had an opportunity to attract investors by selling "growth" because of the size of its market. She suggested that there should be increased cooperation between African countries, as supported by all African Presidents, and that Africa should take advantage not only of its natural resources but also of its well-educated people to move up the value chain by restructuring its traditional sectors and creating new knowledge-based industries that rely on information technology and biotechnology. Ms. Kigozi stressed that the speed of development could be enhanced by the use of information and communications technologies, and suggested that African IPAs should make increased use of cost-effective methods for promotion such as the Internet. She also argued that they should make use of the UNIDO ITPOs, and train their ambassadors so that they can adequately promote and help in investment negotiations. UNIDO could provide assistance with capacity building, by promoting networking among African IPAs through the African IPA Network (AfrIPANet), and helping to identify investment opportunities through such methods as the UNIDO survey. In addition, Ms. Kigozi pointed to the need for a further improvement in infrastructure and positive media reporting as a means of attracting investors. Finally, she referred to the existence of

investment funds in developed countries to support investments in developing countries, which could be used to support domestic investors setting up SMEs.

Mr. De Grivel described the situation in Mauritius, which had traditionally focused on sugar exports. He argued, however, that the country had been successful in attracting foreign direct investors from different parts of the world, as a result of which a variety of new sectors, such as tourism, financial services and cyber activities are the focus today. In Mr. De Grivel's view, Mauritius has been successful because of strong incentives, a skilled labour force and political vision. He noted that it takes only two or three weeks to establish a company in Mauritius, and that the close relationship between the public and private sectors has encouraged investors. Now investments have begun to flow from Mauritius to mainland Africa, and Mr. De Grivel felt that UNIDO would be well placed to support such ventures by domestic businessmen in other countries.

### **Major conclusions of Round Table 5**

- The Round Table looked at urgent actions that need to be taken by host governments and institutions to boost the flow of FDI to Africa, in particular sub-Saharan LDCs, which currently receive less than 1 percent of the total flows to developing countries.
- Since FDI has been a medium through which developing countries can link their economies into global production networks and value-chains, generate employment, and gain new skills, technologies and management capacities, this dearth of investment flows means that Africa has been marginalized in the globalization process and been denied these benefits.
- Investment promotion is therefore important because the free-enterprise system is based on investments, and by fostering growth investments influence the quality of life of ordinary people directly.
- In his opening speech, President Museveni of Uganda cited both endogenous and exogenous factors for the limited investment flows into Africa, with the former comprising archaic attitudes toward private investment in African countries and the smallness of the national markets, and the latter comprising protectionism in the industrialized countries.
- While incentives that target specific market failures are not irrelevant to investors, they do not constitute their top priority either – a good business environment with political stability, stable institutional structures and security, and a transparent and simple low tax regime is more important.
- The good performance of one multinational corporation (MNC) in a particular country can serve to attract others; it is therefore essential to impress chief executives not only with the opportunities that a country can offer his company, but also with success stories of other companies.
- MNCs are increasingly looking for partnerships with local businesses rather than making investments that tie down capital in risky national markets; companies in developing countries seeking to penetrate the global networks of MNCs should therefore enter into partnerships with foreign companies in the domestic market. Joint ventures are particularly suitable in this regard, since they allow MNCs to gain experience in operating in the host country and also improve the balance between global and local operations.
- The need for such partnerships heightens the need for domestic entrepreneurship, a location factor sought after by MNCs; investment promotion activities must be aimed at both domestic and foreign investors. To strengthen their local partners, MNCs should also be willing to provide them with access to intellectual assets.
- A good information infrastructure is required to promote outsourcing, sub-contracting and joint-venture arrangements – it represents the most important public good for reducing transaction costs and perceived risk premiums.
- IPAs play a crucial role by linking prospective investors and companies with national partners and other companies working successfully in the host country, and can thereby reduce transaction costs and act as facilitators within a network.

- IPAs should be granted all the authority they need to perform their tasks, which include the collection and evaluation of country, sector and company specific information, and its dissemination to investors.
- African IPAs should publicize their successes effectively, and jointly promote Africa as a brand name – once the psychological barrier of Africa’s negative image is overcome, investors will start giving more serious consideration to the location factors.
- The UNIDO-sponsored AfrIPANetwork provides a good vehicle for such cooperation, and appeals to all African investment promotion agencies to participate. They should work as a federated investment promotion system and develop a joint marketing initiative for the African continent aiming to promote larger regional markets instead of the small national ones.
- The promoters and enablers of private investment – such as the IPAs, UNIDO and other multilateral organizations, policy-makers, academics, and venture capitalists – should shift their focus from an inward concentration on their own methodology, practices, organization and structure to a more outward focus on the skills, experience and expertise that will help the entrepreneurs and foreign investors to succeed. The implication for IPAs is that they will need to introduce people with private sector skills and mindsets who know what entrepreneurs and foreign investors need, and talk their language.
- As noted above, the existing investors and their success stories are the best promoters, and the IPAs should seek their assistance and support in advertising investment opportunities to internal as well as external investors. The UNIDO survey of investors is a good starting point for this activity.

## Round Table 6

### Transition in Eastern Europe: 15 Years After

Opening remarks:

*Dmitri Piskounov*

Moderator:

*Marianne Kager*

Keynote speakers:

*Libor Krkoska, Alexander Dynkin*

Panellists:

*Attila Chikan, Danuta Hübner, Valeriy Khoroshkovsky*

This Round Table was intended to provide the UNIDO Secretariat and the Member States with an opportunity to explore industry-related issues and challenges for the future facing the countries of Eastern Europe as a result of their transition from centrally planned economies to market-oriented economies. It was opened by Mr. Dmitri Piskounov, Director of UNIDO's Europe and Newly Independent States (NIS) Bureau, and moderated by Ms. Marianne Kager, Chief Economist of the Bank Austria-Creditanstalt Group of Austria. Two keynote speeches were given by Mr. Libor Krkoska, Principal Economist at the European Bank for Reconstruction and Development (EBRD), and Professor Alexander Dynkin, First Deputy Director of the Institute of World Economy and International Relations (IMEMO) in the Russian Federation. The panelists were Professor Attila Chikan, Rector of the Budapest University of Economic Sciences and Public Administration, Ms. Danuta Hübner, Minister, Secretary of State and Secretary of the Committee for European Integration of the Republic of Poland, and Mr. Valeriy Khoroshkovsky, Minister of Economics and European Integration of the Ukraine.

Mr. Piskounov set the scene for the meeting by explaining its objective and providing a review of the different kinds of technical cooperation (TC) that UNIDO had delivered to Eastern Europe and the NIS as the transition process had proceeded over the past decade and a half. In doing so, he gave examples of how the focus and emphasis of UNIDO's TC delivery in the different parts of the region had been differentiated to reflect the different level and nature of development in different sub-regions. Looking to the future, Mr. Piskounov pointed out that UNIDO regarded small and medium-sized enterprises (SMEs) as one of the main vehicles for industrial growth, and stressed the importance of incorporating the private sector as an equal partner in the formulation and implementation of projects in the region. He also noted that there was an increasing demand by the enterprises in these countries for the incorporation of socially responsible corporate behaviour and compliance with best environmental practices as fundamental components of their business plans. In conclusion, Mr. Piskounov argued that the time had now come to think about more sophisticated policy-making mechanisms to build up the strategy and vision for the future of the transition process in the region.

Following this introductory statement, Ms. Kager posed the question to the panellists of how the international organizations and the international business community could help the economies in transition in their pursuit of sustainable development. In raising this issue, Ms. Kager emphasized the need for different kinds of cooperation models and models for development in the region. She then reminded the audience that most of the economies in the region could be very proud of what they had achieved in recent years – but that some of the countries nevertheless still required assistance.

Mr. Krkoska continued this line of thought and focused on the nexus of SMEs and foreign direct investment (FDI), and on how international organizations like UNIDO could assist this process. Noting that the transition process had led to profound structural changes in the enterprise sector, he pointed out that the SMEs that had emerged as a result of this transition were particularly important since they provided alternative employment opportunities and were an important feature of a market-oriented economy. He argued, however, that the successful development of the SME sector was hampered by a number of obstacles, including a negative investment climate, difficult access to finance, and a lack of entrepreneurial skills. He suggested that while there was a need to establish appropriate business advisory services, and that UNIDO could make an important contribution in this field, the best way for the public sector to support SME development would be through the creation of an appropriate investment climate. Based on a review of the different approaches to fostering SME development taken in the various countries of the region, Mr. Krkoska concluded that the public sector could best support the development of a vibrant SME sector through an appropriate package of rules, regulations, and practices that focus on improvements to the investment climate, a streamlining of the legislative and regulatory framework, improvements in the tax system, a well functioning social safety net, an efficient judiciary, low corruption, and transparency of public procurement. He noted that while international organizations could play a constructive role in fostering this process, they needed a vision and a strategy for their activities, and had to take care to avoid introducing any market distortions through their activities.

Commenting on Mr. Krkoska's presentation, Ms. Kager emphasized that while SMEs are important for every economy, the role and size of the SME sector varies considerably in different countries. In the transition economies this is the result not only of the developments of the past fifteen years, but is also related to the starting point of the economies themselves: in the Czech Republic, for example, the SME sector has historically been much larger than, say, in Poland.

Professor Dynkin underscored these differences by stating that big business had been the pillar of the transition process in the Russian Federation. He noted that the financial crisis of August 1998 marked the end of the first phase of the transition, following which Russia had achieved a high rate of economic growth reflecting an improved economic policy environment and growing business confidence. While acknowledging that GDP was still lower in 2003 than at the beginning of the transition period, he pointed out that the structure GDP was very different from that in 1989 as a result of a faster decline in goods production than in services. He also noted that a substantial growth in income inequality had generated serious social tensions. Looking ahead, Professor Dynkin argued that the current Russian economy had two fundamental limitations – one was that the institutional system had entered a relatively stable state of “permanent transition”, meaning that the country's institutions still did not work in an automatic mode, and the other was an over-concentration of industrial production in the hands of a small big-business sector. Russia was also characterized by a weak financial sector, which has not been modernized, and the absence of sound financial intermediation. In his conclusion, Professor Dynkin emphasized that issues such as social responsibility and corporate citizenship were in their infancy in Russia today, and that the same applied to technology foresight mechanisms. UNIDO's support in both of these areas was therefore very important.

Professor Chikan concentrated his presentation on four issues, in all of which he saw a potential role for UNIDO. These comprised:

- The lack of a commonly understood definition of the process of transition, which means different things in different fields of society – while political structures, systems and institutions developed very quickly in Hungary, the development of a political culture is still something for the next decades. Similarly, the transition can be said to have been completed in the field of business and economics, but is still in progress in the social sector.
- The fact that four different stages of competitiveness could be found parallel to one another in various sectors of his country at any given moment of time. He noted that a tool such as technology foresight could help governments in the region to have a more balanced development in this regard.

- The need for a balanced enterprise structure comprising both small enterprises to meet local demand and medium-sized enterprises to act as suppliers of multinational companies. Professor Chikan felt that here also UNIDO could help to establish supply chains linking local SMEs with large multinational companies.
- The acceptance of corporate social responsibility, and the need for the business sector itself to convey to its members the importance of organically combining such corporate responsibility with their business interests.

Ms. Hübner stressed that while we should look to the future, it was also important to assess the progress made since 1990. At that time the GDP of Poland was half of that of Hungary or the then Czechoslovakia, there was 600 per cent inflation, and the rate GDP growth in 1991 was minus 12 per cent. She agreed with Professor Chikan that while it was possible to transform an economy in a generation, social transformation took a longer time. The first lesson from Poland was that it was important to take advantage of the initial public sympathy and undertake essential market reforms quickly to increase the efficiency of local enterprises and attract FDI. Another lesson emphasized by Ms. Hübner was that the reform process was protected and accelerated by tying it to powerful international bodies. She concluded that while a comparison of the data for 2002 with those for 1990 showed very clearly that much had been achieved as a result of the reforms, the reform process would have to continue. Since there had also been losers as a result of the reforms, the government would still have to work to convince a doubting public, and to sit with the opposition and discuss the issues – often at great length!

Ms. Kager took up Ms. Hübner's comment that the last fifteen years had not been easy, but stressed that the achievements of these countries over this period had been great. There was no region in the world that had experienced as high a rate of GDP growth since 1995 as the transition economies. In introducing the next and last speaker, Mr. Valeriy Khoroshkovsky, Minister of Economics and European Integration of the Ukraine, the moderator emphasized that his presentation is a way of reminding everyone that the integration of the transition countries will not end in May 2004, and that there are other countries still in the process of transforming and restructuring their economies. She also saw this as an opportunity for the international business community and the international organizations to support this process.

Mr. Khoroshkovsky began by emphasizing that the most important development of the past 15 years in his country had been the development of a private sector. He stated that the EU accession of other transition countries was something that the Ukraine was looking forward to, even though there would be problems and challenges on the way. In this context, he saw the new, common borders with the EU as a positive development. Referring to the future prospects of the Ukraine, Mr. Khoroshkovsky argued that he saw economic growth as the principal long-term objective – both as a means to an end and as an end in itself. The country had experienced a GDP growth rate of 8 per cent in 2003 and expected 10 per cent growth in 2004. The engines for future growth will be the development of SMEs, the attraction of FDI, and the incorporation of the shadow economy into the legal economy. For the immediate future, the first and foremost goal was joining the World Trade Organization. He hoped this would take place in 2004. Finally, Mr. Khoroshkovsky confirmed that he regarded increased technical cooperation with organizations like UNIDO as very important for the Ukraine, and that he wanted to increase the efficiency of utilization of such cooperation received by his country and see fixed criteria for its evaluation.

The moderator introduced the discussion by again asking how UNIDO, the international business community, and other international organizations could help the enterprises in the region to transform themselves, improve their competitiveness, and address challenges in areas such as the environment. She noted that the development of SMEs, and of the private sector generally, was hampered in this region by financial constraints, as well as weaknesses in management, the quality of support services, corporate governance, and international cooperation. In response, Mr. Piskounov suggested that the international community needed to focus on supporting the development of the SME sector, and of the middle class in general, and to involve the business community in the transition economies as an

equal partner in the development process. He stressed that far too often technical cooperation in this region is discussed without the full involvement of the business community.

The questions raised by the audience covered the following major issues:

- Which modalities were the most effective in linking industrial development with overall development?
- What was the best approach to designing policies to support SME development in the countries of the region?
- Were there any “best” policies to upgrade the environment, particularly with respect to compliance with EU rules and regulations.

In replying to these questions Ms. Hübner emphasized that transition was a continuous process, and all economic and social challenges had to be addressed simultaneously. She stressed that the development of SMEs requires the proper environment, and that the government had to create this environment rather than simply deciding to create SMEs. She argued further that this was linked to the decentralization of the state and the social pressure that arose from this process, and suggested that this was an area where an international organization like UNIDO could offer support. Finally, she concurred that environmental issues were often neglected, and declared this to be a major sin.

Professor Chikan started his reply by emphasizing that any government policy had to have a chapter on SMEs, but that intrinsic differences between SMEs made it impossible to have a uniform policy for all types of SMEs. Specifically, he reiterated that it was also necessary to have separate policies for small and medium-sized enterprises, which could be quite distinct. He also reminded the audience that there was a special relationship between the SMEs and the transition process – many SMEs had been created because there was no other choice. Without the SMEs there would have been no jobs.

In light of his earlier comments about the special features of the Russian economy, Professor Dynkin noted that while SMEs were “a brilliant thing”, they simply did not have a major role to play in the production of goods in Russia but were more concentrated in the service sector. Mr. Krkoska replied by citing the experience of SME development in two countries in the region. In Poland SMEs had indeed been a source of growth, and had themselves often grown into large companies. In Kazakstan they had been the subject of intense support from international organizations, with the World Bank focusing on improvements in the investment climate, the EBRD on micro-financing, and UNIDO on the provision of business advisory services to SMEs.

### **Major conclusions of Round Table 6**

- The Round Table assessed the developments in the countries of Central and Eastern Europe during the transition from centrally planned to market-based economies in the past fifteen years, and sought to determine their future prospects and the possible areas for UNIDO’s assistance in the future.
- It agreed that there have been enormous turn-arounds in these countries, but noted that the transition process is not yet over and that there is still much that the international community can do for the future in these countries.
- The development paths and needs of each country in the region are different, and UNIDO’s technical cooperation should be tailor-made to meet the needs of individual countries and/or sub-regions within the region.
- One area where UNIDO can assist is in finding ways to link the SME sector with FDI flows more effectively, especially in East-Central Europe, and to integrate national SMEs into international supply chains.
- UNIDO has done successful work in establishing or strengthening business advisory services in the region (e.g in Kazakstan, Albania, Romania and Moldova). These mesh well with the activities of other international actors in the region and should be continued.



- There is a serious question in many parts of the region as to whether adherence to the principles of corporate social responsibility or compliance with best environmental practices “pays off”. UNIDO should carry out case studies in these countries to demonstrate conclusively that it does pay.
- The transition process will only succeed if it is more balanced in terms of the speed with which it proceeds in the political, economic and social spheres. UNIDO could support the efforts of these countries to reduce the prevailing imbalances in this field.
- UNIDO’s support services in technology foresight are crucial inputs for decision-makers in the region.
- For the transition to succeed, the management of enterprises must be improved. Here there are major opportunities for UNIDO service delivery.
- UNIDO should also help to ensure that the business community is a full and equal partner in discussions on technical cooperation in the countries of the region
- UNIDO can also assist the countries in transition by emphasizing quality in the delivery of its technical cooperation services.

## Special Round Table:

### Poverty Reduction in Latin America in the Context of Sustainable Development

Moderator:

*Raimundo Gonzalez Aninat*

Keynote speaker:

*Peter Stania*

Panellists:

*Guillermo Oliveri, Carlos Alberto Zarruk Gómez*

The Special Round Table for Latin America was intended to provide a forum for representatives from Latin America and the Caribbean to discuss the common challenge of poverty reduction in the region, and to give UNIDO an update on the current thinking in the region on this issue as a guide for the design of the Organization's future technical cooperation programmes. The Round Table was moderated by Mr. Raimundo Gonzalez Aninat, Ambassador of the Republic of Chile, with the keynote speech being given by Mr. Peter Stania, the Director of the International Institute for Peace in Vienna. The panellists comprised Mr. Guillermo Oliveri, the Secretary of Worship of Argentina and Chairman, Centre for Research and Studies of the City of Buenos Aires; and Mr. Pablo Alberto Zarruk Gómez, the Vice-Minister for Entrepreneurship Development and Tourism of Colombia. The diversity in background and profile of the panelists ensured that the problem was looked at from a variety of angles.

During his presentation, Mr. Stania touched on the causes and effects of poverty. He mentioned armed and social conflicts, corruption as a moral and economic issue, and security as phenomena needing attention. As a major consideration in matters of development, Dr. Stania signalled economic inequality and the urgent need to include the marginalized groups in the process. He further mentioned the need to address the issue of equal rights for women, and noted that the over-exploitation of land, which had resulted in ecological disasters, must also be addressed. As examples have shown over time, environmental degradation can end with human tragedies. As central points for the future development process, he focussed on the integration of all levels of the population, an improved institutionalism at all levels, and the non-negotiable need for a democratic process, which should be participative and not just representative.

Mr. Oliveri followed with a presentation of a different flavour. He drew attention to the fact that poverty is accompanied by unemployment, malnutrition, illiteracy, a low status of women, environmental degradation and limited access to social and health services, which contribute to high mortality rates and decrease productivity. He further noted that the Latin American countries have the primary responsibility for identifying the political, social, economic and environmental problems that they are facing. They must also take steps to ensure that the policies they formulate are sustainable by incorporating sector analysis for productive change and social dialogue in their agendas of political reform and strategies for economic development. Among the obstacles to development, Mr. Oliveri mentioned persistent imbalances in the terms of trade, the slump in the global economy, problems of debt servicing and obsolete technologies. He argued that the efforts to eliminate poverty would require investments in the provision of basic education, sanitation, drinking water, homes, security, and infrastructure for communities, and employment opportunities for the increasing number of young people joining the work force. Additional measures would also have to be taken to eliminate inequality, to remove barriers against women in the work force and against their access to productive

resources, and to strengthen social policies and agricultural programmes, so as to permit the integration of all groups in value-added chains.

In the third presentation, Mr. Zarruk Gómez presented the Colombian experience in some detail. Although Colombia had enjoyed a rather stable growth for some decades, the set-back that came in the 1990s could be attributed to structural imbalances, primarily related to the exchange rate, interest rates and export problems stemming from huge fluctuations in the price of coffee, which had been the country's prime export product at that time. Mr. Zarruk also mentioned that violence and terrorism had been an obstacle for development and one of the government's main goals now was economic recovery. He pointed out that to address the situation and get results in terms of poverty reduction, the Government has established some areas of concentration: First, to secure democracy; second, to fight corruption; and third, to work actively in pursuit of social and economic reactivation. Parallel to all of this, however, it was necessary to generate social and redistributive policies would allow all citizens to enjoy the benefits of the country's development. As part of that effort, very important work was being done to give all the small enterprises access to credit. Another important measure was a reform of the health system so that the social health care now includes the whole family of the insured and not only the worker him- or herself as it used to be in the past. Mr. Zarruk stressed that the development process had to be shared by the public and private sectors, and concluded by calling on all Latin American countries to work together to eliminate poverty from the continent.

In the discussions that followed the presentations by the panellists, education was cited as one of the most fundamental instruments in the fight against poverty is. Widespread and institutionalized corruption was identified as another major obstacle to development, which rendered many, if not all, of the measures against poverty ineffective. Many participants pointed out that institutional strengthening was a prerequisite to overcoming corruption, and stressed that strong and professional institutions were indispensable for a well functioning state and for true development. Several participants concurred that migration, both internal and external, seriously affects the countries of the region, by leading to an abandonment of the countryside and the growth of urban poverty, which breeds crime and often substance abuse, and by leading to a "brain drain". Some representatives cited militarization, which had caused prolonged civil wars in several countries as a hindrance to the development process, and it was widely acknowledged that the democratic process must be defended and upheld. Among the factors destabilizing the region, the drug trade in particular was mentioned by several participants, and it was argued that, perhaps paradoxically, the trade generates poverty and not wealth. The burden of external debt was regarded as one of the most crippling economic factors, which also led to the imposition of sanctions and conditionalities from abroad. Many speakers agreed, however, that macroeconomic stability was highly desirable in creating an enabling environment for economic growth and clearing the path for foreign investment. In that context, it was mentioned by several that the economies of the region must work hard to become more competitive. For that to happen, incentive policies would have to be put in place, especially in the rural areas.

Overall, it was concluded that any development would have to be connected to mechanisms for better income distribution so that all layers of society could benefit from the gains, especially the poor and marginalized groups. It was also generally agreed that regional cooperation and coordination would be desirable in the common fight against poverty. UNIDO was seen as an ideal partner to provide the instruments and experience, in particular in the areas of technology transfer, SME development and industrial competitiveness.

### **Major conclusions of the Special Round Table**

- This Round Table addressed the problem of poverty and inequality in Latin America and the need to deal with it as a matter of urgency. During the presentations both regional and country-specific experiences were presented and elaborated on from a variety of different perspectives: economic, political, social, moral/ethical and spiritual.

- It was agreed that a number of key measures were needed to improve the existing situation. These included:
  - Equal access to education;
  - Transparency, including a fight against corruption and lack of accountability;
  - A strengthening of the institutional and regulatory framework;
  - A clear and appropriate definition of the role of the state;
  - Inclusion of civil society and good governance;
  - The adoption of ethnically and gender sensitive policies and regulations; and
  - The coupling of economic growth and distribution as objectives of public policy.
- It was also agreed that UNIDO could play a key role in helping the countries of the region fight poverty by supporting skill development and the transfer and diffusion of science and technology. In particular, UNIDO could help these countries to design appropriate formulae for technical cooperation in these fields, and thereby help them gain access to external sources of such skills and technology.

## **PART TWO**

### **PAPERS AND PRESENTATIONS**



# **INDUSTRIAL DEVELOPMENT FORUM**

## **THE ROLE OF INDUSTRIAL DEVELOPMENT IN THE ACHIEVEMENT OF THE MILLENNIUM DEVELOPMENT GOALS**





## Statement by Mr. Carlos Magariños \*

### I. Assessing the challenge

With this intervention I intend to help set the overall scene of the deliberations of this Forum. I shall leave the treatment of more specific dimensions of the topic to the participants of the Round Tables that will follow.

Achieving the Millennium Development Goals (MDGs) entails reversing or substantially improving the least developed countries' abysmal socio-economic and environmental performance of the recent past. This is actually the whole point of the United Nations Millennium Project. It is also the reason why it is imperative that the international community succeeds in achieving them. Before looking into some key conditions for this to happen, let me give you a few examples.

*First*, estimates just released by the Food and Agriculture Organization show that the average pace of reduction in the number of malnourished people worldwide observed in the 1990s (2.1 million per year) will have to be accelerated *over twelve times* (to 26 million per year) to meet the goal of halving the total number of people with hunger by 2015. In fact, after falling steadily during the first half of the 1990s, hunger has been *on the rise* again during the second half.

*Second*, according to UNIDO estimates, the rate of annual GDP growth per capita, which would be consistent with achieving the MDGs for 30 sub-Saharan African countries, varies between 2 and 6 per cent. The weighted and unweighted means are 3.2 and 4.2 per cent, respectively.

Now, compare these figures with the reality of economic stagnation, if not retrogression, that the sub-Saharan countries have suffered over the last three decades. Contrary to other country groups, as Figure 1 illustrates, the GDP per capita of the LDCs has been stagnant for the last 30 years. This appalling performance has gone hand in hand with other indicators of deterioration in the relative position of the LDCs. Thus, for instance, the relevant evidence suggests that these countries have actually experienced a technological regression from 1970 to 1980 and an even sharper one between 1980 and 1992. This has entailed, among other things, an increasing gap with respect with best productive practices.

Figure 2 suggests that the distribution of output per worker across 57 countries turned from *unimodal* in 1965 to *bimodal* in 1990; i.e., while in 1965 there were many countries in the middle income group, in the 1990s the world had become divided, as a stylized fact, into the rich and the poor.

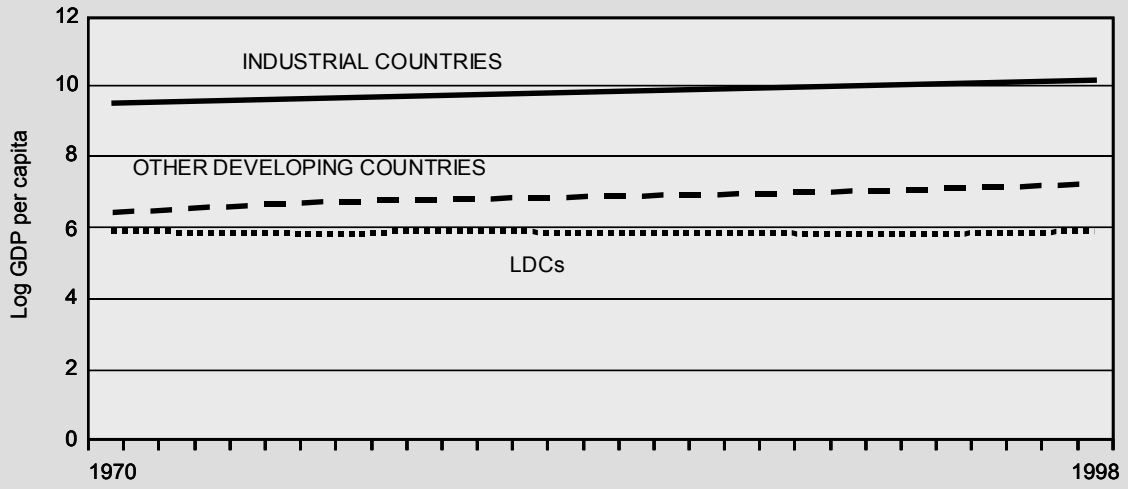
A key way to counteract these trends consists of creating the conditions for speeding up technology transfer and productivity growth. Recent empirical exercises by a number of distinguished scholars strongly suggest that the international cross-sectional variance in labour productivity cannot be plausibly explained by differences in factor intensities but implies very substantial gaps in total factor productivity (TFP).

Figure 3 conveys the results of one of these exercises. It shows that differences in TFP growth accounted for about 90 per cent of the variation in growth rates of output per worker across a sample of 96 countries over 1960-1995. I will return to the importance of this for developing countries later on.

---

\* Director-General of UNIDO.

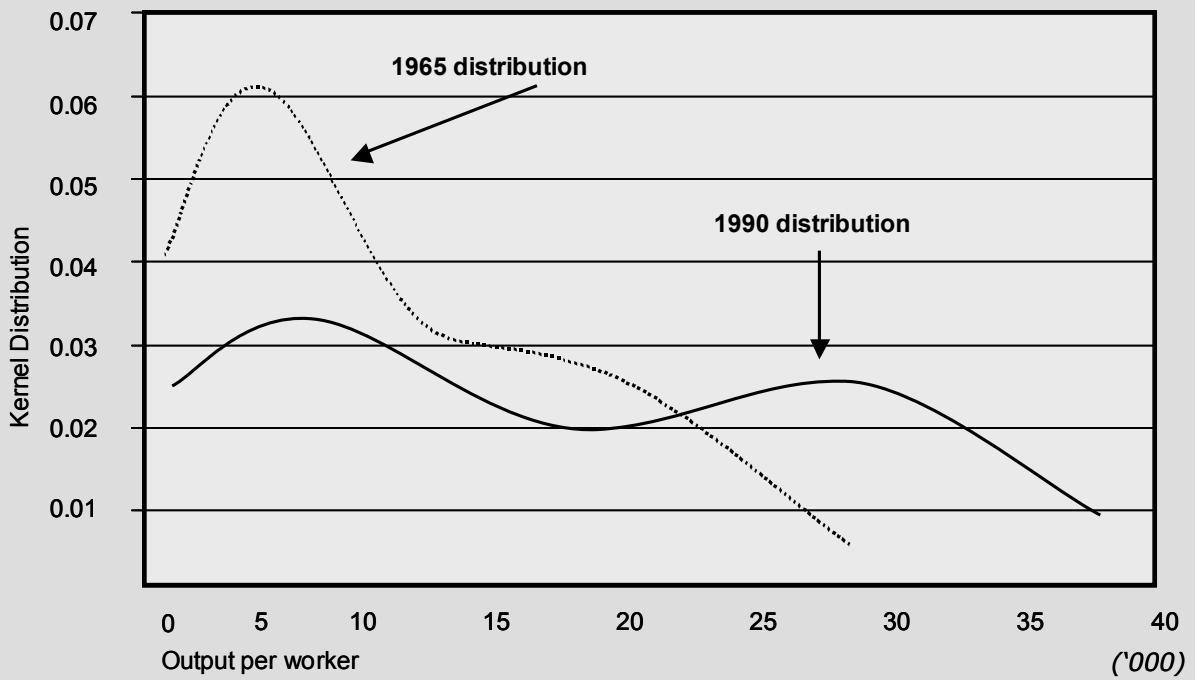
**Figure 1. Gross domestic product (GDP) per capita, by country group, 1970-1998**



Note: The figure shows weighted group averages of real levels of per capita GDP with population as the weighting variable. Values are in 1990 US dollars per person and are plotted on a natural-logarithmic scale. The data covers 41 LDCs.

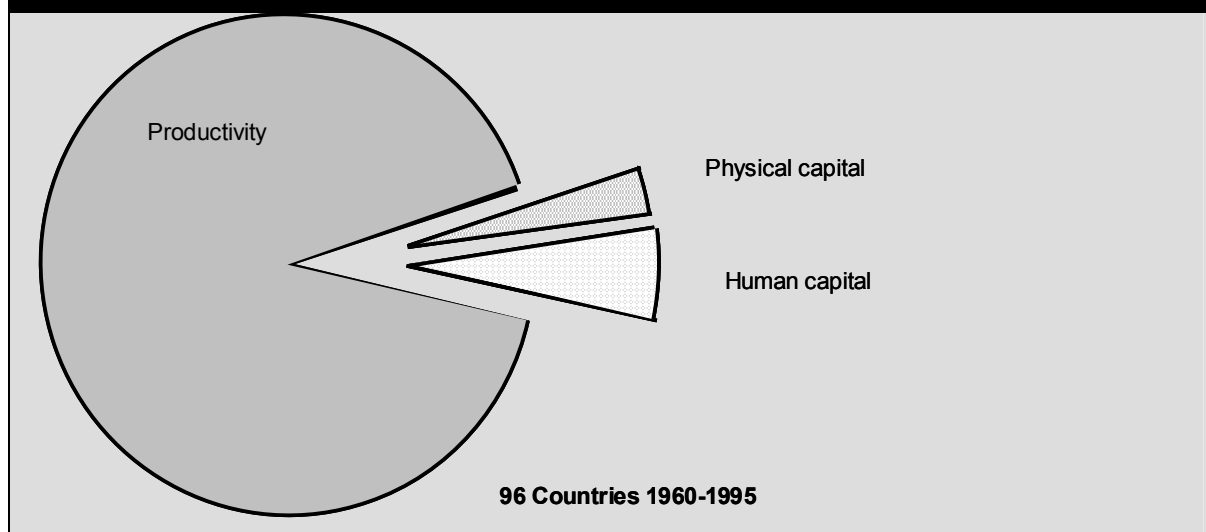
Source: UNIDO.

**Figure 2. Distribution of output per worker, 1965 & 1990**



Source: Kumar & Russel (2002).

**Figure 3. Explaining variations in the growth rates of output per worker**



Source: Klenow & Rodriguez-Clare (1997).

*Third*, as stated in the latest Human Development Report, unless things improve, sub-Saharan Africa will be unable to attain universal primary education, halve extreme poverty and cut child mortality by two-thirds before the years 2129, 2147, and 2165, respectively.

It is essential to understand that, in order for these dramatic but absolutely necessary trend reversals to materialize, major policy departures are needed along with a massive effort at addressing health, nutrition, environmental and infrastructure constraints. Unless these things happen, the appalling trends of the past will continue indefinitely, with the grave human costs and perils they entail. Installing a new growth dynamics means changing past policies and living up to current commitments. To do this it will be necessary to work on two levels: a) the linkages of the political and the economic reform agendas, and b) the economic and social agenda itself.

## **II. Towards a unified political, economic and social agenda**

We are all well aware that political hurdles of different kinds need to be overcome in order to make progress in this endeavour. Political constraints and economic reform programmes relate to one another at very different levels. There are cases such as that of political instability in Africa, which translate directly in the rise of the number of people suffering hunger. On the other hand, and at a different level, we witness cases of popular unrest in response to economic reform programmes eventually bringing about the overthrow of democratic governments in Latin America.

The Secretary General of the United Nations has said: “Without peace development is not possible; without development peace is not durable”.

I proposed this morning that, in order to relate the political agenda to the economic reform agenda, we need to address head-on the design of policies aimed at articulating both. Let me elaborate a little bit on this.

Our current development agenda comprises policies that promote market-oriented reform packages and the corresponding institutional arrangements. However, over the last decade we have seen that these reform packages have often failed to elicit the necessary popular support after not too long – eventually leading, in some cases, to political unrest and problems of governance. Because of our exposure to this reality while working with our counterparts, we have studied this problem at UNIDO

and found that only when reform programmes translate into sustainable productivity growth it is possible for them to keep momentum and succeed.

This is the reason why I believe that it is necessary to make decisive progress in the systematic assessment of national experiences of economic reform in the developing societies and their scope for success in terms of what ultimately underpins their outcome, that is, productivity growth. It is also necessary to enable these societies to do so on a permanent basis.

As I said during my speech at the inaugural session of this General Conference, I think that an important ingredient for doing so is to achieve further progress in the reform of the United Nations system. This reform should not be dealt with only by means of budget restrictions, staff cuts and the like. We need to go further, much further, than that and consider some bold steps.

It is probably now the time to think, for example, of a developing country version of the OECD. That is, a way for developing countries to articulate their own view of the development agenda and to build up the methodologies required for them to get a firm handle of productivity performance and become able to use it as a gauge to monitor the success of their economic reform programmes and as a compass to better steer their policies.

While we address these interconnections between the political and the economic reform agendas, we have to find the ways and means to articulate the economic and social agenda itself.

Here, we need to consider two kinds of interventions: a) those aimed to provide emergency relief, and b) those consisting of short- and medium-term interventions to consolidate economic performance and avoid the recurrence of critical situations. Both are required to deal with crucial problems facing the international community, such as political crises, hunger, disease and environmental degradation.

Direct emergency relief is being provided by the World Food Program, UNICEF, UNHCR, WHO and agencies working in crisis prevention and resolution. Alongside these, we also have actions aimed at more long-standing outcomes, such as those that address the development of the capacity to access the goods and services that people need. From this perspective, for example, the problem is not just how many people lack shelter today, but what is the rate at which the supply of shelter should grow in order to meet future demand.

The MDGs help us to define and focus better our contribution to linking these two avenues of action. We have already seen that, in order to reduce poverty by half by 2015, a rate of growth in per capita income of around 4 per cent is required on average. But such a rate may not be feasible if, for example, we do not successfully counteract the advance of HIV/AIDS or hunger. And the reverse is also true: if we succeed in combating HIV/AIDS or hunger, but we fail to foster technology diffusion so as to attain substantively higher rates of economic growth, such success may eventually become ephemeral since the people whose lives are thus saved will be unable to obtain gainful employment and to continue affording the treatments and nourishment that they need.

UNIDO's contributions tackle both aspects. They matter when it comes to making progress in various emergency dimensions such as creating employment and income-generating activities in agro-industry, reducing post-harvest losses or expanding food supply. At the same time, we work on more structural matters such as technology diffusion and economy-wide productivity enhancement, which are required to prevent the recurrence of new emergencies.

But there is one aspect where UNIDO's interventions are both unique and essential. That is the development of the private sector in the least developed societies. This is an aspect often neglected by the policies and instruments designed to help the LDCs out of the poverty trap. And yet, it is essential for them if they are to afford the challenge of stabilizing their economies, create jobs, develop exports, increase productivity and ensure social progress.

The lack of attention to the problem of developing a dynamic private sector is evident, for example, in the formulation of many Poverty Reduction Strategy Papers (PRSPs), which is an essential instrument for the Highly Indebted Poor Countries (HIPC) to benefit from debt reduction schemes and donor support. I recommend the international community to urgently redress this serious oversight.

We, at UNIDO, feel proud for the work of our agency in the field of private sector development, an activity placed at the heart of our programmes during the reforms implemented since my arrival; an activity in which we will try to continue to lead in the multilateral system. We believe that the private sector should lead the productivity improvements that are necessary for the LDCs to breach the poverty trap in the framework of the implementation of the MDGs.

### **III. Closing remarks**

The MDGs consist of a number of time-bound, measurable goals that the international community has agreed need to be achieved in order to relieve vast portions of the world population from extreme suffering and deprivation.

I have referred to three lines of action. In the first place, ensuring more funding for development assistance. Secondly, renewing the development agenda and articulating better the political with the social and economic policy dimensions involved in achieving the MDGs. Finally, reforming the United Nations system.

Let me insist. Today we have the financial and technological resources required to tackle successfully the problems of marginalization and poverty and, as importantly, we are improving our learning on how to use them to help the poorest countries to solve these problems by themselves. It is not a matter of choosing between direct emergency relief or substantive capability building, or between the economic and the political dimensions of reform, but of joining both agendas together. Provided that the necessary institutional innovations and strategies are in place, the pursuit of the MDGs will effectively and vitally contribute to attain the conditions required for growth; it will do so by removing stubborn structural impediments. And reciprocally, growth, diversification, structural change and industrialization are the means to ensure that the goals are sustainable over time.

### **References:**

Kumar, S., and R. Robert Russell, "Technological Change, Technological Catch-Up, and Capital Deepening: Relative Contributions to Growth and Convergence". *American Economic Review*, Vol. 92, No. 3, pp. 527-548, 2002

Klenow, P., and A. Rodriguez-Clare, "The Neoclassical Revival in Growth Economics: Has It Gone Too Far?". In *NBER Macroeconomic Annual*, No. 12, pp. 73-103. Cambridge, Mass: National Bureau of Economic Research, 1997.

## Statement by Professor Jeffrey Sachs\*

Thank you very much. It is a pleasure to be able to add some more words of amplification to Carlos's very clear and very convincing and important statement.

The Secretary-General invited me a couple of years ago, and gave me the great honour to advise him on one core question: How could we actually achieve these Millennium Development Goals? The UN Millennium Project that I direct is attempting to work together with UNIDO and UNCTAD and the rest of the UN system to get some clear answers to that. I want to bring you some of the ideas that we have been developing in recent months based on our research and the consultations.

First, what is happening with respect to the Millennium Development Goals? Remember that these are eight broad goals adopted at the Millennium Assembly that in general set quantitative targets for improving the material conditions of the poor, usually comparing conditions in a baseline year of 1990 with the target year of 2015. For example, the share of the population in any country that is living in extreme income poverty, less than a dollar a day, is to fall by half comparing 1990 and 2015. The proportion of the population in hunger is to fall by half comparing the 2015 target year with the 1990 base line. The rate of mortality of children under five is to decline by two-thirds comparing the base line of 1990 and the target year of 2015. The proportion of mothers that die in childbirth is to decline by three-quarters comparing 1990 and 2015. In addition, there are to be controls, reversals indeed, of the pandemics of aids, tuberculosis and malaria, as well as material improvements in the conditions of slum dwellers in poor urban areas and to the reversal of environmental degradation.

This is a broad agenda. It is bold. It is fitting for a world entering a new millennium. And it is important to stress that the situation is not all bleak. Not only to give us some hope but also to give us some analytical tools. I say it's not all bleak because there are many parts of the world that are achieving many or even most of these goals. There has been quite a marked reduction of extreme poverty of course in many parts of Asia. China, since the last 20 years, and India, most notably in the last decade, have made tremendous progress in industrial upgrading, faster economic growth and, yes, in reductions of extreme poverty. In fact, what is important to understand is that there isn't a simple answer that the rich are getting richer and the poor are getting poorer or what the optimists say that the richer getting richer and the poorer are also getting richer. Neither of those is true. What we have is a quite varied landscape in the world but with a very critical point to notice. It's the core of what brings us to the podium today, and that is that in the poorest countries of the world there is not significant progress as a rule.

The very poorest places in the world in Africa, sub-Saharan Africa, in parts of the Andes, in parts of Central Asia, and in other places in the world, have had a very tough go of it in the last 20 years. And while we can marvel at the tremendous progress that has been made in certain places in the world, we have to understand that the Millennium Development Goals absolutely are not being achieved on the basis of the current path in the poorest parts of the world.

Now this raises a question. If some places are successful and other places are not, why is that? That's a deep question. There is a superficial answer to that, that's been given repeatedly over the last 20 years. And that is: "Well, if you are not making it, it must be your fault." And the answer usually is to a poor country: "If you are still poor and someone else and someone else is rich, you should have done what they did." Now this is a very convenient answer, I want to stress, for rich countries to give, because it says that the problems of the poor are just the faults of the poor themselves. It's a way to assign blame but also to excuse responsibility. But it's just not so, and that's the problem. The

---

\* Director of the Earth Institute, Columbia University, and Special Advisor to the Secretary-General of the United Nations. This text is based on an edited transcript of the spoken presentation.

reasons why some places have achieved progress and other places have remained trapped in poverty are complex, they are certainly not related in any simple way to the sins of the poor and the wonders of those who have made it. They tend to reflect a number of very significant structural factors as well as policy factors.

Let me explain:

First, it is absolutely systematically the case that impoverished people living in difficult climates with difficult landscapes, in places vulnerable to malaria transmission or in places high in the mountains or far in the inland of continents, or subject to climatic variation such as repeated droughts, are far less likely to escape from poverty than countries that are luckier to not face such structural impediments. The burdens of malaria or landlockedness or a mountainous environment or soil degradation or climatic vulnerability have been huge factors in accounting for the difficulty of so many of the poorest countries of the world to get out of their current crisis. Indeed, these factors are among the most important in explaining why those countries are so poor to begin with, not only why it's been so difficult to escape from poverty.

It's very easy for a rich country like the United States to say: "Well we did it, why don't you do it?", when the United States and so many of the current rich countries were blessed with vast natural resources, fertile lands, favourable climatic conditions, large coastal access and many other structural features which enabled the early escape from poverty. What we find, in sum, is a very complex story where the problems of countries must be assessed one after the other, and where the underlying difficulties can relate to policy, indeed can relate to conflict, but can also relate to huge structural impediments that are barriers far beyond those that can be surmounted by the impoverished countries themselves.

What I want to urge in my brief remarks is that if we are going to truly see the world escape from poverty, and truly see the poorest countries achieve the Millennium Goals, we are going to have to get a lot more serious than finger pointing and a lot more serious than laying blame or giving lectures. We are going to have to analyze in a deep way the specific circumstances and the specific barriers that must be overcome in order to make progress. In order to do that let me just outline a few of the critical issues.

I believe, and again it's a gross oversimplification so let me apologize at the outset, that there really are at least three basic transitions that low-income countries need to achieve in order to break out of their poverty trap. The first transition could be called the "human capital transition". It has many parts but it basically means moving from circumstances of high mortality rates and low education and health and nutrition standards to situations of low fertility rates, low mortality rates and high investments in each child's health and nutrition and education. It includes the demographic transition from high fertility to low fertility, it includes the education revolution to guarantee universal education – and not only at the primary level by the way, because children born today need secondary education at a minimum to play a productive role in today's world economy. Primary education will not be enough. Yet we face at least 130 million, probably around 200 million, children that are not even properly completing primary education right now.

The second transition can be called the "productivity transition". That is what UNIDO specializes in. How countries can surmount very low levels of productivity in agriculture, in industry, and in services to raise living standards. Every country needs a green revolution in its agriculture. Asia has had it, Africa has not yet had it. But it can have it.

Countries need to move away from dependence on a few primary commodities and to achieve international competitiveness in manufactures. Many parts of Asia have done that, but most parts of Africa have not done that. That's why I don't believe we ever had an era of structural adjustment although we had those miserable structural adjustment programmes. We did not see adjustment in the structure of Africa's exports. If you look at the year 2000 compared to the year 1980 or 1970 or, by

the way, 1950 or 1900, you will see the same list of commodities: coffee, tea, hydrocarbons, copper, iron ore, sisal, cacao, and palm oil. You have not yet seen from Africa the manufacturing exports that are going to be the basis of the dramatic urban-based economic growth that that continent needs and is capable of achieving.

The third transition that I would stress is the “environmental transition”. This is basically a transition from destroying the environment to sustainability. It involves both a transition in rural areas to preserve eco-systems that are now being degraded as well as the transition to successful urbanization. Urbanization is proceeding, but it is not successful urbanization. Almost no cities in sub-Saharan Africa, for example, have waste-water treatment facilities. This is shocking and you know what the implications are: Disease transmission and an urban environment that is not acceptably liveable.

The achievement of these three transitions requires three different kinds of approaches. It requires policy change within the countries themselves, it requires systemic change at the international level in trade access and in other rules of the game including transfer of technology, and it requires massive investments within the poor countries in basic infrastructure and in social outlays. Those are the two massive investments that are needed: Infrastructure for paved roads, power, water and sanitation, communications, and clean and safe cooking fuels, and social outlays for health, disease control, education expenditures, nutrition, and family planning. These are expensive, but not as expensive as not making those outlays because not making them is devastatingly expensive.

As a general matter, the Millennium Development Goals are interesting to the poor countries, in my view, not just because they are useful targets but because they are part of an international promise that the rich countries have entered into. The rich countries have said: “We will help you”. The help has not been very impressive so far. So we have to make the help more impressive.

The rich countries have promised several times, not only at the Millennium Assembly, but in Monterrey, Mexico, in March 2002, at the International Conference on Financing For Development; in Johannesburg at the World Summit on Sustainable Development; and on countless other occasions including Doha, that they will be your partners in achieving these goals. Now we have to get the real mechanisms for that partnering, because if we don’t go from words to action now, we have lost. And, by the way, this world has a tremendous capacity to lose. There is no guarantee of success. Many of these goals are recycled from the 1990s, the 1980s, the 1970s. Remember, we were once going to have health for all by the year 2000? Not pandemics for all by the year 2000? We did not make it. I am determined to use every ounce of my own energy so that we don’t just set back the date to 2030 of these targets and see this endless and useless suffering continue. So we have to turn these promises into action.

How can this be done?

Very, very briefly: This has to be done overwhelmingly at the country level but in a way which prompts the international community to keep the promises of support that have not yet been fulfilled. I believe what we have to use the instruments that are around but are not yet effective to ensure that these promises are fulfilled. Let us look, for example, at the poverty reduction strategies. I am actually in favour of them, but they haven’t worked yet. Their content is not right. Their content is not ambitious enough. Their content is forced on poor countries who are told: “Do the best you can with what we help you with”, not: “What do you need to do to achieve the goals that we promised to help you achieve”.

So the first thing that I would urge on all of you is that we have to base the poverty strategies, the PRSs and the PRSPs to use the jargon, on the MDGs. Every poverty reduction strategy, every poverty reduction strategy paper that goes to the IMF and the World Bank – and I am speaking to the Heads of State over here because it is very important for them – every paper that goes to the IMF and the World Bank has to be ambitious enough to achieve the Millennium Development Goals.



I have read dozens of them. They are not ambitious enough and I know why. Because ambition to achieve the MDGs will cost money. And that's what the rich countries don't want to give you. Not in the amounts that are needed. But they promised to do so and they have plenty of money, believe me.

So we have to get on the table, into the documents, what's really needed. Not just what you should do to make do with what you have, but what you need. Let me give you a specific example that's dear to my heart. You need – and I am looking at the delegation from Mali for example, but I could look at the delegation from Kenya or Madagascar, all around the room – at least 40 dollars per capita for the health sector to be able to provide the basic life saving services that a health sector should provide: to fight malaria, to fight aids, to fight tuberculosis, to keep children from dying of diarrhoea, to keep children from dying of respiratory disease, to keep mothers from dying in childbirth, to give immunizations to children, to make sure that children aren't suffering from vitamin A deficiency, and to fight other micronutrient deficiencies.

You need money, but how much are you spending right now? Probably three or four dollars per person in Mali; probably five to ten dollars in Kenya. But that's not your fault, that's all the money you have in the budget. That's what poverty means. There is not enough money to achieve these goals. But that's where the rich countries have promised to help.

So what I would urge is that no more PRSPs go the IMF and the World Bank with public health budgets of five dollars per capita or even ten dollars per capita. They are not health programmes, they are death sentences. We need to have health programmes that really save lives and treat people. That means building clinics.

A Head of State in Africa told me recently, when I asked him why his health programme was only 1,50 dollar per capita, that that was what the IMF told him was all he could expect from the donors. That is not an acceptable answer for the 21<sup>st</sup> century and it's completely against every promise that has been made. And I said to this wonderful leader who I have admired tremendously: "You have got to put on the table a real health programme. Not what the IMF told you some donors are going to afford. You have to put on the table what you need." They have come back with a greatly expanded health agenda now and are putting it on the table. It's not funded yet; it's a challenge to the donors. But hiding the challenge to the donors accomplishes nothing except having people die.

I said to the IMF Executive Board last week, and I am sorry for the blunt language: "Your programmes are killing people. Yes, they are killing people. The people are dying with stable prices. It's not good enough having people die with price stability. We need programmes that have people live with price stability". So the PRSPs have to put on what's really needed.

Now, what does that mean? What sectors? Let me just mention a few of them. Roads – you can't have economic development without paved roads. Take my word for it, but if you are living without paved roads you know it. Your farmers can't bring goods to market, your industries can't sell competitively, the costs of doing business are too high. You need power that's reliable and you need cooking fuel that's clean. Three million children are going to die this year from inhaling manure that's being burnt for cooking fuel or fuel wood that's killing them in their houses or in their huts or in their shelters because this is poison to the lungs.

We need clean cooking fuel – liquid petroleum gas in canisters, for example – to save lives and also to save mothers eight hours a day of collecting fire wood. That costs money. The rich countries have promised to help pay for water and sanitation but they have not done so yet.

Disease control and education for all: Now that's a commitment that's been on the books for many years, and even though 35 African countries have made programmes for education for all, and even though there is a fast track initiative, the donors have not even put in the money yet to fund the fast track part of education for all.

We need family planning programmes. You cannot achieve economic growth with fertility rates of six children per impoverished mother or seven or eight children per impoverished mother. The women don't want that many children. They need access to family planning and contraception, as well as job opportunities, as well as their children surviving because they have proper nutrition and health care. And then finally, in poor countries almost everyone needs an agricultural revolution which comes from investing in rural infrastructure, improved seed varieties and soil nutrient management. This is all within our technological reach right now. But it requires investment.

And we need industrial development. Look at all those big fast growing urban areas of Africa, with hardly any of them yet exporting to world markets. This is where UNIDO can help to turn the continent into such a blooming economic success when cities like Dar-es-Salaam and Accra and Dakar and Abidjan and Maputo and Mombasa and the other great coastal cities of Africa become great engines of manufacturing export growth. This requires investments in basic infrastructure and technological upgrading, which corresponds exactly to UNIDO's agenda.

My hope is that we can make these real needs, this comprehensive agenda, sufficiently powerful to bring the MDGs into real view. Is it impossible? No, it is not impossible, ladies and gentlemen: It's just going to take your efforts and partnership with the UN System to do it. It's interesting that when the United States asked the United Nations Development Group and the World Bank to produce a needs assessment for Iraq this year, you got quite a list of needs. In fact 35 billion dollars of needs over four years.

Well, that's an honest needs assessment actually. But where is the 35 billion needs assessment for Mali or Kenya or Madagascar or Tanzania or Sierra Leone. It isn't there yet. We have to tell as much truth about what's needed in the impoverished countries as we do in countries that are high on a political radar screen because those are the real needs to meet the Millennium Development Goals. And those are the real promises that have been made repeatedly. So what I am urging, especially to the Ministers and to the Heads of States, is that 2004 is the year when we do the real assessment of what steps will be needed and how much they will cost to achieve the Millennium Development Goals. No more phony programmes, sentencing your people to death, because the money is not there. The money is there in the world. It's there in ample amounts. It's been promised to you repeatedly.

Let's put the real programmes on the table. Let's mobilize the incredible expertise of institutions like UNIDO and UNCTAD and the World Health Organization, and the Food and Agriculture Organization and UNICEF and the other specialized agencies. They can help you control malaria, fight AIDS, get TB under control, get roads paved and get your industries to a level of international competitiveness. With the partnership of the UN country teams in each country, and with your resolve not to send any more phony PRSPs back to Washington but only ones that are sufficiently bold to meet the MDGs, I think we will be able to say to the world: "You know the promises have been made, and 2004 is the year when the promises are going to be kept". Because if we keep the promises now we still have the time to do by 2015 what we said we would do at the beginning of this Millennium. Let's make this planet fit and happy and prosperous and stable and safe for all the people of the world.

Thanks very much.

## Statement by Mr. Rubens Ricupero\*

Thank you. Thank you very much. After this most eloquent presentation by Jeffrey Sachs, preceded by the wise words of our President and by Mr. Magariños, I don't have much to repeat, at least on some of the basic subjects, in relation with the Millennium Development Goals. So, I would like to ask you to keep in mind that if I do not speak about the Millennium Development Goals, it's not because I don't consider them essential to our discussion but only because I don't want to be repetitive. I would like to add a few different things to the debate and this is why I am not going to comment on those goals, except on one.

You know that the Millennium Development Goals, or at least the seven first ones, all give very specific and quantitative targets about how to reduce poverty or infant mortality by half etc., except number 8. Number 8 is the one on the global economic partnership that will be necessary for countries to attain the seven first ones, and there is where the problem lies. If I would have to sum up what Professor Sachs said, it is exactly in relation to this Millennium Development Goal number eight. What he is telling us is that it is there that we are in need of some more delivery in order to make the other seven feasible. In my own presentation I will touch on four basic subjects.

First instead of speaking on industrial development, perhaps I will surprise you speaking on de-industrialization and not on industrialization.

Secondly, I will speak about the link, the inseparable link, between trade negotiations and the supply capabilities in order to raise productivity and competitiveness, and within this subject I will speak on the third subject, the special problem of transaction costs, and I will give some concrete examples.

And finally I will make a concrete proposal about what we could do in a modest way with both of our agencies, UNIDO and UNCTAD, and perhaps with the help of others, in order to meet all those goals.

So starting with the first subject: De-industrialization. If I had to paraphrase what Karl Marx wrote in the Communist Manifesto, which opens with that famous line "A spectre is haunting Europe, the spectre of communism", I would say that the spectre, the phantom, that is haunting the developing world is the phantom of de-industrialization, not of industrialization. That is a sad tendency indeed, but it is a very real one. In reality, if you look at the world, in most of the developing world except in Asia – in China mainly, and in some of the other dynamic countries in East and in Southeast Asia – what we have now is less industrialization than we had 20 years ago, both in terms of employment creation and in terms of contribution to GDP.

There are many causes for this and unfortunately I don't have the time here to go into that. Indeed UNIDO has been making a wonderful job in terms of explaining this in its documents over the years. So it's not necessary for me to go into it. But it is true even in Latin America, where the central idea of industrialization as a tool for development was so popular in the times of Don Raul Prebisch and ECLAC, the Economic Commission for Latin America and the Caribbean. In most countries of Latin America, in almost all of them, industrialization is becoming less and less important.

Unfortunately this is not the kind of natural trend in economic development that Europe has experienced, because you know that it's true that in many European countries, in industrial countries in general, there comes a time when industrialization starts to be less important than the services sector. This is natural and healthy, but this usually happens at a very high level of income. To give you an example: In most European countries this happens when the level of per capita income reaches between 11,000 and 12,000 dollars.

---

\* Secretary-General of UNCTAD. This text is based on an edited transcript of the spoken presentation.

In Latin America this decline in the role of industry is happening now. In Argentina, in Brazil and other countries with less than half that level of per capita income, and in Africa with even less. This de-industrialization has very grievous consequences, of course. The first consequence is that many people will lose their jobs in industry, as the previous generation had already lost their jobs in agriculture.

In normal conditions they would get jobs in the service sector but this only happens when the level of income is such that people have the possibility of consuming services, because services, particularly sophisticated services, require high levels of income. In my own country, Brazil, there are now many workers who cannot afford to take a bus, which is one of the most elementary services, because they don't have the money to pay for the bus fare. So they have to walk to their jobs.

When you have this situation of a de-industrialization without a sufficient level of per capita income, you have a very serious situation because no sector in the economy is able to generate employment. Agriculture cannot generate employment because it is expelling people, and this is even more serious when you have very modern agriculture like in Brazil and Argentina, which is relying more and more on machinery or high technology. So you don't need many people to work. Those people will not find a job in industry, and neither will they find jobs in services.

De-industrialization is a danger, and we have to reflect why it's happening. One of the reasons, of course, is that previous industrialization was somewhat artificial, but it's also true that in many cases trade liberalization, or the programmes that were imposed on countries, did not take into account the fact that those countries would face an increase in unemployment. This is why, among other things, Latin America is now facing the highest rates of joblessness since the measure of unemployment was started 45 years ago. It is a record level of joblessness, and it's happening, I am sorry to say, also in Africa. So you are creating a situation of structural unemployment because of de-industrialization. A strong case must therefore be made here, and this is the right place to make it, in favour of industrialization on a good and sound basis. No one wants artificial industrialization, but we should keep in mind that there is no way that countries can really reach full development without industrialization.

My second point is based on the first one. It is that we need to take trade negotiations and trade in general together with supply capabilities. I sometimes feel that we have oversold, as Carlos said this morning regarding other matters, the value of trade negotiations. People have been fascinated by trade negotiations in WTO or regional agreements, but they often forget that the most that trade negotiations can reach, even when they are successful, is to generate export opportunities. In order to take advantage of those opportunities countries need to have goods and services of a quality and a price to offer in the market place. Unfortunately, very few countries in the developing world are in that position.

This is why, again and again, the beneficiaries of trade negotiations have been the Asian countries: The East and Southeast Asian countries, and now China. Why? Because those countries were wise to conduct trade liberalization hand in hand with the enhancement and the diversification of their productive sectors, whereas most of the other developing countries, more than 100 countries, have not done so. This is why those countries have a narrow base to supply the market.

This is the problem that in the US was called "supply side constraints". And this is why UNCTAD and UNIDO should be united to try to develop and to deepen the linkage that should unite trade negotiations on the one hand and overcoming supply side constraints on the other – not in separation, not in sequence, but together at the same time as trade negotiations move ahead. Because otherwise we will see more and more reluctance, like we saw in Cancun, on the part of developing countries to engage in trade negotiations, because they know in their hearts that they are not competitive because they only sell a few commodities.

Do you know that more than thirty developing countries rely on a single commodity for their export earnings, and do you know what all commodities share in common? They have nothing to gain in general terms from trade negotiations because they don't face tariff barriers. Coffee, for example, attracts a zero tariff. You cannot go below zero, so there is nothing that you can do for coffee in trade negotiations except in the case of a tariff escalation.

My third point is related to the need to pay attention to transaction costs, i.e. the cost of exporting. What is that? It is first the cost of services, transport, insurance, credit and banking, the delays in customs clearance, and the taxes and fees to bring goods to the consumer. Just to give you a few concrete examples of how those costs effect countries, I will tell you that on average freight and insurance alone, which is only a part of the transaction costs, represent 5.21 per cent of the total value of the exports of goods in market economies. In the case of developing countries in general these costs jump to almost nine to 8.83 per cent. In the case of the landlocked developing countries the figure is 14 per cent. In the case of the least developed countries it is 17 per cent, and in the worst case, the landlocked LDCs, it reaches up to 47 per cent in some cases. Can you imagine that 47 per cent is only freight and insurance? This is much more than the problems that are dealt with in trade negotiations.

Just let me give you some more concrete examples of the logistic cost of a trade transaction, because nothing is better than concrete cases. It costs as much to move a container from Northern Europe to Mombasa as it costs from Mombasa to Bujumbura, which is very, very, very close by in Burundi. Moving one container of electrical goods from the port of Baltimore to Nouackchott costs US\$ 6,000. From Baltimore to Hongkong, which is a much longer distance, costs only half that amount, US\$ 3,000. So for a successful trade transaction we need the right product with quality conformity to standards. This is where Carlos and his colleagues in UNIDO can give a boost to these countries. At the same time that you need all the trade negotiations, you need to concentrate on logistics, storage, warehousing, and transport. This is where UNCTAD is working more and more.

As I told you this morning, next year, starting 13 June, we are going to have UNCTAD XI in Brazil, where I am counting on Carlos to play a leading role because we want to have an alliance: We want to have a link between the trade negotiations and the supply side, including this aspect that I mentioned to you.

As a conclusion, because I have already occupied too much of your time, this is what I would like to add to what Jeffrey Sachs, Carlos and our president have already said: That we need to do something *now* among ourselves. In the case of UNIDO and UNCTAD, we have this affinity because we are both organizations whose centre of attention is development, and we do it not on an ideological basis. We don't want just to complain about how unfair the world is. Of course, all this is true, but we want to do something constructive, positive. What can we do to improve things, and what can we do in concrete terms to help those countries to have something to offer to supply to the markets? And of course, to ask countries to open up their markets to allow the developing countries to grow out of their debts through exports, and not through generosity, which is always discussed.

Thank you very much.

## Statement by Mr. Frederick T. Sumaye\*

Mr. President, Your Excellencies, Distinguished Delegates, Ladies and Gentlemen.

Since we started this conference early today, we had the opportunity and privilege of listening to statements from various leaders and experts on how we can move further through collaboration and partnership towards a prosperous world supported and built through industrial transformation. This afternoon's forum will take us further to try and identify barriers to effective industrial development and come up with policy options for the international community to work on together for the next few years.

Mr. President, in a theme paper submitted by the secretariat of UNIDO we are informed of the need for concerted efforts by the international community to trigger internal growth of the least developed countries that will enable them have sustainable development processes that will change the lives of our people. The Millennium Development Goals are about fighting poverty. Poverty can effectively be fought by increasing productivity in the core productive sectors of our economies. If we talk of better education, we talk of how our people are able to provide their children with quality education by ensuring that they do not only have access to education but that education infrastructure is improved to match the scientific and technological revolution in the world. This is why I totally agree with the paradigm that states that the Millennium Development Goals are points of departure towards sustainable development.

In talking about the role of industrial development in the achievement of the Millennium Development Goals we have to take into account the following factors:

- How to enable our countries utilize the comparative advantages available internally in order to effectively participate in the international market.
- How to utilize the technological advances worldwide to our advantage so that we can be competitive.
- How to increase world investment on education that takes into account gender equality.
- How to create market-based support institutions which will encourage and build a strong industrial base.
- How to increase investment in the extension and rehabilitation of infrastructure.

What all this amounts to, in the final analysis, is to enable our manufacturing sector to contribute more to the increase of income of both our rural and urban population and therefore contribute significantly to the war against poverty.

Mr. President, Africa is predominantly rural. In talking about development in Africa and how we can achieve the Millennium Development Goals, we inevitably have no option but to make great leaps in our agriculture and make it more agro-industrial. Over 70 per cent of total employment in Africa and 60 per cent of manufacturing value added is generated by agro-related industries. Activities such as food processing, textiles and clothing involve many of our small-scale producers. Taking the experience of my country, Tanzania, for example, we have witnessed the quality of these products improving and slowly being able to utilize, albeit in small quantities, our internal agricultural products. These value added products have raised expectations among many of our people who are engaged in their production. They have increased the incomes and therefore enabled them change their lives through, for example, being able to pay for education of their children, etc. The spillover of these changes will ultimately reach those who are in the rural areas. Such small enterprises epitomize the ingenuity of our people in working hard to enter the local and international markets.

---

\* Prime Minister, United Republic of Tanzania.

Mr. President, this is where the need arises to nurture and develop the innovations that we are witnessing in these small and medium-sized enterprises (SMEs). Why should we put more efforts in building a strong SMEs sub sector? We need to do that because SMEs are a springboard to the development of a strong industrial sector. SMEs have dynamism and flexibility that enable them adapt more readily to market conditions. SMEs also constitute an important source of employment creation. If we can have SMEs which can employ a sizeable number of our people, surely we can be able to have a large population with reliable incomes and which can be able to improve their livelihood through more small income generating activities.

Another important factor is that scientific and technological innovations available already can easily permeate our society through SMEs. The experience of the East Asian countries has shown that through a continuum of development strategies they have been able to fully utilize the technological revolution to fully enter even the most sophisticated industrial development, for example, in information technology.

Mr. President, let me briefly share with you how we in Tanzania are moving towards the achievement of our development goals. The Government of Tanzania has a sound, well-established policy framework for poverty reduction. This includes a vision which articulates the long-term development vision of the country; and medium term development strategies such as the National Poverty Eradication Strategy (NPES), the Tanzania Assistance Strategy (TAS), and the Poverty Reduction Strategy Paper (PRSP). The National Poverty Eradication Strategy was a result of a mutually felt need by the Government of Tanzania and its international development partners for a comprehensive development agenda, around which issues pertaining to ongoing activities can be regularly discussed and assessed. The PRSP is an integral part of our development processes, focusing mainly on poverty alleviation. All these strategies enshrine the objectives of the Millennium Development Goals as promulgated by the UN global development conference. Tanzania has a large rural population. The need to transform their lives becomes clear if we look at emerging performance trends in our export trade. Tanzania's exports still largely consist of traditional agricultural commodities, while manufacturing exports remain minimal and non-traditional agricultural exports and services are still to pick up. The core problem in many developing poor countries is the lack of capacity to produce for exports, including poor quality standards, barriers to trade, etc.

The country's development vision has the primary goal of the eradication of poverty in 25 years through the consolidation of gains from past reforms and addressing present and future challenges. The role of the manufacturing sector in the attainment of this vision's goal is through the structural transformation of the economy, focusing on product and market diversification, rising efficiency and productivity, and stimulation of international competitiveness as the source of achieving and sustaining rapid growth.

To bring the industrial sector on board these development efforts we have formulated an SME Development Policy, which seeks to stimulate ideas of entrepreneurship among our people, and thereby expand the growth of a strong private sector engaged in manufacturing activities.

Mr. President, the development of SMEs in Tanzania is closely associated with more equitable distribution of income, and is thus important for poverty alleviation. In the Poverty Reduction Strategy, the Government has decided to promote private participation through SMEs, which we believe is the viable base for industrial development in sub-Saharan African countries. It is through the private sector participation that our countries are able to utilize the opportunities opened by our development partners to access the markets through such initiatives such as AGOA in the US and EBA in Europe.

Mr. President, let me conclude by emphasizing the role of our governments in continuing to open up to the private sector so that the manufacturing sector can grow and take up its position in our fight against poverty.





## **ROUND TABLE 1**

### **THE ROLE OF INDUSTRIAL DEVELOPMENT IN THE ACHIEVEMENT OF THE MILLENNIUM DEVELOPMENT GOALS**



## Issue Paper

# The Role of Industrial Development in Achieving the Millennium Development Goals\*

*UNIDO Secretariat*

### Principal issues to be raised

This Round Table will provide greater focus to a number of key dimensions of the theme to be addressed by the Industrial Development Forum. In particular, the Round Table will focus on the following issues:

- i. The relevance of the international experience of structural change and industrialization from the perspective of least developed countries (LDCs);
- ii. Sub-Saharan Africa's export prospects in textiles and clothing in light of the enactment of the US African Growth and Opportunity Act (AGOA) and the EU's Everything but Arms (EBA) initiative, the phasing out of the Multi-fibre Agreement (MFA), and China's entry into the World Trade Organization;
- iii. The role of the private sector in the poverty reduction strategies for sub-Saharan African countries;
- iv. The policy dimensions of structural change with special reference to:
  - a. Pre-requisites for the development of competitive capacity;
  - b. Skills, entrepreneurship and technological competence;
  - c. Incentives;
  - d. Technological infrastructure and other public goods;
  - e. Strategies for sustained productivity growth, export diversification and manufacturing development.

The themes of this Round Table, to which renowned international experts will contribute, will be part of UNIDO's forthcoming Industrial Development Report 2003-04.

### Introduction

The key issue to be addressed at the Industrial Development Forum concerns the interface between the Millennium Development Goals (MDGs) and the initiation of sustainable industrial development processes in the LDCs. More specifically, the following questions will be posed:

- i. Why are the LDCs increasingly lagging behind the rest of the developing world and why do they, save in a few cases, find it so hard to take advantage of successful policy experiences elsewhere?
- ii. What is the role of the MDGs in enabling the LDCs to gear up for structural change and industrialization? And,
- iii. How should structural change and industrialization be factored into the MDGs and the Poverty Reduction Strategy Papers (PRSPs)?

### The predicament of the LDCs

By all relevant measures the economic and social performance of the LDCs during the past three decades, has been disappointing – save very few exceptions. Their declining shares in world trade

---

\* This will be the topic of the forthcoming Industrial Development Report.

and deterioration in productivity went hand in hand with an aggravation of the incidence of absolute poverty.

According to the United Nations Conference on LDCs, over the last three and a half decades, the number of people living on less than US\$ 1 a day went from 125.4 million to 278.8 million in 39 LDCs for which there is data. The situation has been particularly severe in the African LDCs where the percentage of people in absolute poverty went from 55.8 per cent to 64.9 per cent, while it declined in 22 other developing countries. Similarly, the trends in human development indicators have been alarming. In over 30 LDCs for which data is available, more than one quarter of children are undernourished and the chances of a child dying before its fifth birthday is 1 in 10. On average, about 50 per cent of the female population is illiterate, and in 19 LDCs the maternal mortality rate is close to 1 in every 100 live births.

The economic marginalization of the LDCs is eloquently shown by their weak growth performance and declining export shares. Although there are a few exceptions, average real GDP per capita growth was 0.9 per cent during the 1990s in all LDCs – excluding Bangladesh it was only 0.4 per cent. Other developing countries experienced on average 3.6 per cent per capita growth during the same period. It has also been estimated that LDCs' share in world commodity exports declined from 4.7 per cent in the early 1970s to one per cent in the late 1990s. In addition to the loss of market share and declining terms of trade during much of 1990s, the LDCs experienced little or no productivity gains and, as a result, a growing gap with respect to the international technological frontier. Under these circumstances, LDCs also failed to attract much needed capital investment, accounting for only 0.5 per cent of global flows in FDI, at a time when the net official development assistance was also declining in real per capita terms.

## **The response**

The MDGs are a set of quantified and time-bound goals ranging from halving extreme poverty to attaining universal primary education to halting the spread of HIV/AIDS to promoting gender equality to ensuring environmental sustainability by 2015.

The MDGs are a collective response of the international community focused in particular on the abject poverty and humanitarian crisis of the LDCs – most of which are located in sub-Saharan Africa. Stemming from the September 2000 Millennium Declaration signed by the leaders of 189 member states of the United Nations and reaffirmed in 2002 at the Monterrey International Conference on Financing for Development and the Johannesburg Summit on Sustainable Development, the MDGs address dimensions that are global in scope and significance and country-specific in application.

The whole of the multilateral system, including the United Nations Secretariat and the multilateral agencies, is involved in this unique enterprise. This response is not just a humanitarian act. It is also a way to help triggering endogenous growth processes that will enable the LDCs to stand on their own feet and take command of their own development processes.

What will it take for them to do so?

*First*, addressing structural hurdles. The MDGs are aimed at removing the most egregious barriers to the induction of sustainable development processes.

*Second*, gearing up for structural change, adapted to the LDCs' specific conditions.

*Third*, effectively mobilizing LDC societies to take advantage of scientific and technological knowledge to foster growth by strengthening the competitive capacity of the private sector and enhancing productivity so as to be able to sustain human development and social change over time.

In a significant way, the quest for the achievement of the MDGs requires us to turn back to the development fundamentals.

## **Back to the fundamentals**

Accounting for the LDCs' appalling performance over the last few decades calls for more than the conventional approaches to catching up. In particular, it entails the need to look at the case of LDCs in broad perspective, taking some distance from the usual debates on development applied to other regions. LDCs will continue to draw little or no benefit from lessons learnt about the experience of other developing countries and regions as long as their fundamental development specificities continue to be neglected.

In assessing the long-term economic performance of the LDC economies, measures such as (very low) physical and human capital accumulation and price distortions – with most of the reason attributed to ineffective policies and bad governance – are amongst the most usually resorted to. This level of explanation has captured much of the attention in the literature, including numerous papers on growth accounting, fiscal, monetary and exchange rate management, macroeconomic incentive systems and transaction costs.

These explanations relate to the *proximate* determinants of growth of per capita income, namely, physical capital deepening, human capital accumulation and productivity growth. They lead to concerns relating to the determinants of investment decisions such as the investment climate and macroeconomic stability. An important feature of this approach is that it factors in both, the resource endowments of the economy and the efficiency with which such endowments are deployed, thus leading to policy inferences that concern either static or dynamic comparative advantages or both – the latter normally receiving far less attention than the former.

Complementarily, productivity growth may also be addressed not as an accounting residual, but in terms of (at least some of) its *direct* determinants such as those relating to the microeconomic, technological and entrepreneurial behaviour. Although this approach may relate to alternative theoretical paradigms (e.g., that of evolutionary economics, as opposed to conventional theory), it can broadly be fitted within the above framework in the sense that it also accounts for *proximate* growth determinants. In particular, it focuses on the development of *man-made* comparative advantages. This strand of explanations provides a very different perspective, rich in additional insights about the role of endogenous variables. Important amongst such insights are those relating to the (in)capacity of national enterprises to compete in the domestic and international markets. These lead to policy concerns on the promotion of entrepreneurship, learning and technological diffusion.

One of the problems with the exclusive focus on *proximate* and *direct* determinants is that the conditions for policy replicability cannot be properly addressed because too much is taken for granted, for instance, by not specifying many initial conditions. This is especially critical since, while some of these conditions are exogenous, others change slowly over time and will impact the policy outcomes of the future.

Another problem is that such focus often makes *causal* implications to become blurred. This is because not only it is very hard to gauge the *relative* influence of different determinants, such as factor accumulation vis-à-vis technological change (in fact, such influences are not really independent), but also due to the influence of *other* (largely non-economic) determinants that are not captured by these approaches. This raises the possibility that causality may run, to some extent, from growth to accumulation and productivity, rather than the other way around.

The search for more *fundamental* explanations addresses questions such as: if differences across countries in per capita income growth in the long run are largely due to their ability to enlist

innovation and technical change for productivity growth, what is it that determines differences in such an ability? And, more broadly, what is it that determines cross-country differences in developing countries' ability to succeed in technological catch up?

Those relating to institutions, geography and patterns of integration into the world market are amongst the various explanations offered at this deeper level. These explanations have generated a lively debate in the literature but not enough effort has been devoted to take due stock of this debate from the LDCs' perspective so far.

An additional reason why it is important to look at the fundamentals is that they are not just about conceptual issues but they also concern the nature of the quantitative evidence required to explain success and failure in catching up. This is particularly relevant with respect to initial conditions. No analysis of LDC development problems that neglects initial conditions and structural barriers can be expected to provide either a relevant assessment of their development problems or realistic policy guidelines.

### **Removing structural impediments to attain MDG-compatible growth**

Because the LDCs are unable to pull themselves out of their predicament, for which the international system is partly accountable, reaching the minimum thresholds to get out of the poverty trap entails a shared responsibility with the donor countries.

Such thresholds relate to standards of governance, basic health care and education, agricultural productivity and core infrastructure, among others. Failing to meet these thresholds amounts to falling into a low-level equilibrium that is unable, in and of itself, to generate the necessary dynamics to break the poverty trap, thus preventing the transition to sustained growth. This may also happen in countries that have managed to achieve reasonable rates of growth, albeit at a sub-national level, giving rise to substantial localized pockets of poverty.

### **From MDG-compatible growth to structural change**

Reaching minimum thresholds and, indeed, the MDGs themselves, ought not be seen as points of arrival, but as points of departure towards sustainable development – economically, socially and environmentally.

If, while working towards building up the conditions for LDCs to reach the MDGs, due attention is not also paid to preventing the likely potential relapses that may stem, for instance, from extremely high vulnerability to external shocks because of very high commodity dependence, an important opportunity might be lost. Certainly, both steps should go hand in hand. But, can this be taken for granted? The risks involved in failing to take advantage of the major effort required to reach the minimum thresholds so that subsequent development is possible need to be explicitly addressed. Consider the role of the private sector and science and technology development.

Ensuring the success of efforts towards creating the basic pre-conditions for development rests on a wide range of ingredients needed for wealth creation. This entails, among others, establishing at least the rudiments of a technological infrastructure responsive to the needs of private enterprises, that is, the domestic provision of public goods that are required to foster technology diffusion processes that can eventually lead to catch up in productivity.

Institutions for the facilitation of domestic technology diffusion have played a key role in all developing countries that have succeeded in the path of industrialization. Among them, those relating to the quality system (including capacity in the areas of metrology, testing, standardization, traceability and quality management) are becoming indispensable even in countries at a very early

stage of manufacturing development simply because of the stringent health, safety, environmental and other technical regulations and conformity requirements imposed by advanced industrial countries.

Technical education and privately run or mixed apprentice systems complement on-the-job-training to support the development of skills required to promote learning processes in industry.

SME and gender-sensitive entrepreneurship promotion includes financial support in the form of loans with subsidized interest rates, credit and insurance-guarantees or grants aimed at stimulating particular activities, such as exports, technological learning, innovation and investment and are designed to make up for SME's regional or sector-specific disadvantages. SMEs can also be supported through "soft aid" such as consulting services, information and training and assistance aimed at facilitating the establishment of export consortia and local clusters. A further form of assistance is that aimed at developing suppliers' and subcontracting networks with large enterprises, including SMEs.

Design, project and process engineering skills and capabilities are key means of technology transfer and absorption and, as such, call for priority treatment through special fiscal and financial incentives.

If, among others, these ingredients that are required to embark upon a path of diversification, structural change and productivity growth are ignored, the MDGs may fail to start off sustained development processes even if they largely succeed in relieving the most eloquent indexes of backwardness.

No country has been able to grow steadily for a substantial period of time and, at the same time, reduce poverty significantly, without undergoing a sustained process of structural change. In most cases, such a process entails major gains in allocative efficiency through shifts in employment from low productivity to high productivity and from primary to industrial activities.

The key to structural change is not the growth of this or that sector, but increases in economy-wide productivity. Exactly how such increases are attained depends a lot on the specific constellation of countries' natural and man-made advantages and historical trajectories, the role of foreign investment and the priority given to human development, among others.

As President Olesgun Obasanjo of Nigeria recalled at the recent TICAD III meeting in Tokyo, NEPAD, with the assistance of UNIDO, is working on providing a comprehensive vision for building Africa's productive capacity. This is the kind of medium-to-long term supplement called for by the MDGs, which should not be understood as the ultimate solution to all LDCs problems. But they are a necessary step to start off the endogenous process needed to tackle these problems decisively and effectively. The political energy involved in pursuing the MDGs will only bear the expected fruits if translated into nationally-owned, nationally-driven and effectively conducted development strategies that fully address the dramatic accelerations in the pace of progress called for.

Provisional UNIDO estimates for the forthcoming Industrial Development Report indicate that the modal MDG-required rate of growth is 5-6 per cent per annum during 2003-2015 – with wide variations across countries. As a number of PRSPs explicitly suggest, sustaining this kind of economic growth calls for important transformations in the structure of the economies involved, including export diversification and a shift in the composition of manpower towards industrial activities, as a necessary supplement to the substantial increases in agricultural productivity that will be required. This will be necessary to prevent that the manpower to be released through the modernization of agriculture goes to feed growing contingents of marginalized internal migrants.

The sectoral and sub-sectoral dimensions are important in this respect. The poverty-elasticity of growth varies across sectors, so the first reaction may be to focus on those sectors that have relative higher poverty-elasticity. However, although this may make sense in the short run, it may fail to do so in the medium and long-term simply because sector elasticities have to be weighted by the

respective sector-specific growth potential as well as by its indirect impact on economic activity and job creation.

But this in turn raises questions that need to be addressed. For instance, how to avoid that the substantial internal migrations that can be expected as a result of rapid increases in agricultural productivity end up adding to the massive pockets of jobless people in the urban and suburban areas? How can the LDCs develop a comparative advantage in manufactures? What would it take for a focus on labour intensive-based industrialization to avoid falling into the fallacy of composition whereby what may be a solution for a few countries may end up being a dead-end if pursued by many countries at the same time? How far may LDCs share in the gains stemming from liberalization of trade in textiles and clothing? Does plugging into international production networks provide an alternative to the extent of export diversification otherwise entailed? Or, can natural resource industrialization offer a way out to the employment needs associated to the kind of structural change required?

The Millennium Development Compact addresses a number of these issues. In particular, it submits six policy clusters for escaping poverty traps which, in addition to those relating to human development, small farmers, investment in infrastructure, human rights and social equity, also include two of most direct relevance to the present discussion: namely, those relating to the environment and to industrial development policy. Let us quote the latter:

“Developing industrial development policies that bolster non-traditional private sector activities, with special attention to small and medium-sized enterprises. Such policies might include export processing zones, tax incentives and other initiatives to promote investment and public spending on research and development”.

Millennium Development Compact, Millennium Project (UN 2003)

These insights of the Millennium Development Compact, complemented by considerations such as those discussed further above, should help to fill gaps in the spelling out of the strategies required to achieve and sustain the MDGs.

Are the MDGs attainable? The answer is: they are, provided that the amount and quality of resources and interventions match the magnitude of the goals and, as importantly, that domestic conditions are laid down in such a way as to make progress in the standards of living and in the direction towards the goals sustainable over time.

Overall, while the recent work done by the World Bank and independently by the Zedillo Commission in preparation for the Monterrey Conference (UN 2002), show figures of over *additional* US\$ 50 billion a year needed to achieve the MDGs, more specific forecasts need to be made in light of the interdependencies between the MDGs and the structural change implications of sustaining their impact. A further exercise should also be undertaken to formulate a financial strategy to achieve these targets especially on a country basis as it is increasingly being done in some of the PRSPs but with a much shorter time horizon.

## **UNIDO, industrialization and the MDGs**

The key role for industrial development, given the extent of structural change called for by the poverty MDG, is to generate sustainable employment and higher incomes to lift people out of poverty. This also entails industry's direct and indirect contribution to the achievement of other MDGs, and non-economic measures of well-being in general.

While most studies emphasize the multidimensionality of poverty and highlight the importance of health, education and gender equality, few indicators address the two-way causality between poverty reduction and the other MDGs. It is widely accepted that, as better education and health for the poor



will improve their chances of escaping poverty, at the same time higher incomes for the poor will typically enable them to have greater access to these services and make more investment in human capital for the next generations.

For example, higher gender inequality is found to increase poverty and reduce other welfare measures, as women appear to allocate more resources to food, healthcare and education of their children than men do and female literacy has been found to be one of the most important determinants of the effects of growth on income poverty. Moreover, inequality in access to education, technology and employment opportunities for women reduces economic growth as it fails to make adequate use of female resources. Enhancing employment of women in key agro-industries and low-skilled manufacturing such as in textiles and apparel as well as through micro- and home-based enterprises and community cooperatives helps to empower women, which in turn is found to decrease childhood malnutrition and under-5 mortality.

Similarly, the dire impacts of HIV/AIDS, TB and malaria on labour productivity and human capital accumulation are imposing important challenges particularly in Africa both in terms of future growth and poverty alleviation. The policy response to minimize the impacts of these challenges has been weak, except for a few successful examples, at least partially due to the lack of resources and infrastructure. In this regard, enhancing the local pharmaceutical production capabilities and improving access to treatment and medical facilities can be important contributions from technical cooperation activities.

Finally, poverty and the state of the environment are deeply interrelated. In most LDCs where the poor are exclusively relying on the exploitation of natural resources, the sustainability of their livelihood is intrinsically dependent on the quality of their environment. Over-reliance on natural endowments and the single-tier economy exposes the already marginalized groups to volatility without adequate measures to insure against risks. Rather than being the culprit of environmental destruction, industry can provide solutions if the necessary steps are taken to insure that industrial development in LDCs, while effective in reducing poverty, is also ecologically efficient. Along these lines UNIDO works to improve the environmental performance of domestic industries by promoting the diffusion of clean technologies, better energy supply and efficiency especially in rural areas – as well as through the implementation of Montreal and Kyoto Protocols.

### **Summary of key issues to be addressed by the Industrial Development Forum**

The MDGs have become the international community's universal yardstick of success in the fight against poverty. But sustained poverty reduction entails a parallel quest to develop the endogenous structural change processes that are necessary for sustainable job creation and improvements in the standards of living. Therefore, there is a two-way interaction between the MDGs and industrialization: while the former are necessary to remove structural barriers to growth, the latter is required to sustain growth in the long-term.

The exchanges during the Industrial Development Forum will attempt to provide answers to the following key questions:

- i. Which are the fundamental reasons why the LDCs increasingly lag behind and, save a few cases, find it very hard to take advantage of successful policy experiences elsewhere?
- ii. What is the role of the MDGs in helping the LDCs to gear up for structural change and industrialization? and,
- iii. How best to factor structural change and industrialization into the MDG and PRSP processes so as to sustain human development and social change over time by strengthening the competitive capacity of the private sector and enhancing economy-wide productivity growth?

In addressing these issues, priority attention will be paid to the key role to be played by the multilateral technical cooperation system in creating domestic capacity and fostering the international

diffusion of know-how. These are indispensable preconditions to enable the LDCs to enhance productivity for social advance by developing man-made comparative advantages, diversifying exports and ensuring a more active participation in world trade and investment.

**References:**

UN, *Report of the Commission on Financing for Development (Zedillo Commission)*. International Conference on Financing for Development, Monterrey, Mexico, March 2002. New York: United Nations, 2002. [www.un.org/esa/ffd/](http://www.un.org/esa/ffd/)

UN, *Millennium Development Compact*. Millennium Project. New York: United Nations, 2003.

## Moderator's Introduction

*Francisco Sercovich\**

Distinguished members of the audience, good afternoon. I have great pleasure in welcoming you to this first Round Table.

In this Round Table, we shall examine in certain depth some specific dimensions of the topic already discussed in the Industrial Development Forum, namely the role of industrial development in the achievement of the Millennium Development Goals. We shall do so with a very distinguished panel, whose members I would like to introduce briefly. They comprise Mr. Simon Teitel, who is an International Development Expert based in the United States; Mr. Gabriel Sanchez, Director of Research at the Instituto de Estudios sobre la Realidad Argentina y Latinoamericana (IERAL) in Argentina; Mr. Anthony Hawkins, Professor of Business Studies at the University of Zimbabwe; and Mr. Sanjaya Lall, Professor of Development Economics at Oxford University.

The subject of this Round Table is the same as that of the upcoming Industrial Development Report, in which we will examine, in some detail, a number of dimensions of this issue, and for which the members of this panel are collaborating with UNIDO.

With the help of our distinguished panellists, whom I will request to make brief presentations of about 15 minutes each, this Round Table will address four specific issues. First, we shall examine certain basic elements of the industrialization experience, or de-industrialization experience in the words of Rubens Ricupero, of sub-Saharan Africa. Second, we will address the issue of the export prospects of the sub-Saharan African countries in the field of textiles and clothing, in light of the African Growth and Opportunity Act, the European Everything But Arms initiative, the phasing out of the Multi-Fibre Agreement, and the impact of the entry of China into the WTO. Third, we shall tackle one of the critical problems that was referred to during the Industrial Development Forum, which is the role of the private sector in the poverty reduction strategies, and in particular the Poverty Reduction Strategy Papers. Finally, we will have a discussion on the policies needed to create some of the preconditions for starting the industrialization processes.

Let me make a very short comment about one of our key concerns regarding the forthcoming Industrial Development Report that we shall address. There is indeed a two-way relationship between growth and industrialization on the one hand, and the achievement of the Millennium Development Goals on the other. I think that there is increasing consensus in that growth cannot automatically guarantee social advance, but indeed that growth is being blocked by a series of structural impediments that Professor Sachs referred to. The removal of these structural impediments is precisely the point of the Millennium Development Goals, and a precondition to start the process of growth and industrialization and diversification in the LDCs. But, on the other hand, without fostering growth, as the Director-General mentioned, it will be impossible to sustain whatever degree of achievement is obtained in respect of the Millennium Development Goals. Within this, of course, we are quite aware, as was also mentioned during the Industrial Development Forum, that the private sector has a leading role to play in order to create jobs, diversify exports, and promote productivity growth.

Without further introduction, I would like to invite Mr. Simon Teitel to make his presentation.

Thank you.

---

\* Special Policy Advisor to the Director-General, UNIDO. The text presented here is based on an edited transcript of the moderator's spoken introduction.

# Industrialization in Sub-Saharan Africa

*Simon Teitel\**

## Introduction

Recently I had the occasion to read a good paper, with plenty of statistical data, about the economic performance of sub-Saharan Africa (SSA) in the second half of last century. Instructive as the paper was, its title: “The Economic Tragedy of the XX<sup>th</sup> Century: Growth in Africa”,<sup>1</sup> provoked nagging doubts in me. Was it really that bad? Compared to what, and when?

The record indeed shows that the sub-region lags behind other areas that include developing countries in terms of income per capita, industrialization, agricultural productivity, and other measures of economic development. The more I search for answers to the above questions about SSA’s economic performance, the more I am reminded of the relevance of two subjects whose study I generally neglected in high-school: history and geography.

In history one should include, of course, not only important events, but also the courses of action they led to. The recent historic record in SSA is, first of all, a very short period, in terms of autonomous life for a vast majority of the countries that attained independence after World War II. We are really referring to a mere span of two generations, approximately. Second, for its economic development consequences, the nature of colonization becomes an important part of this historical record;<sup>2</sup> in particular the difference between “extractive” colonization, as practiced, for example, in the Belgian Congo, vis-à-vis British and French colonizing settlements in East and West Africa. Third, economic policies in response to particular historic episodes, such as politically motivated blockades against Ian Smith’s regime in Southern Rhodesia (today Zimbabwe), or apartheid South Africa, become critically important to understand present-day industrial development in both countries.<sup>3</sup>

Without the need to resort to prehistoric archaeological findings,<sup>4</sup> the study of geography is important because it includes the location and climate of countries, their endowment with particular natural resources, their access to waterways, or other avenues for trade and international interaction, etc. Much has been made in the African context about whether countries are coastal or land-locked, and also about the presence of specific resources such as oil. While there are of course instances in which such factors seem to play an important role, they hardly ever tell the whole story.

## Some results

To illustrate the above concepts, and to share with you preliminary results of my research, I shall now refer to two sets of data for SSA countries. In the first, about industrial performance, I examine the growth in manufacturing value added (MVA) and MVA per capita during the period 1981-2001. The data is available broken down for the sub-periods 1981-91 and 1991-2001.

---

\* International Development Expert, USA.

1 Artadi & Sala-i-Martin (2003).

2 Leaving aside for the moment the persistent heritage of tribal, religious and language fragmentation, whose presence and importance the European powers originally disregarded when dividing among themselves Africa during the latter part of the 19<sup>th</sup> century.

3 For references to the Zimbabwe story, see Wood and Jordan (2000), and Teitel (2000).

4 For a lucid, broad-brush, view of what could be called the ecological and climatic view of the history of Africa, see Cook (2003), chapter 6.

We begin in Table 1 with a summary of MVA annual growth for the world and regions that include developing countries. As can be observed, Africa holds its own during both decades, even growing faster than the world average, but being, of course, badly beaten by South and East Asia.

Next, in Table 2, we examine the performance in MVA per capita; i.e. how is this same growth of manufacturing value added affected when the growth of population is factored in? Clearly, Africa's above-average performance in growth of MVA is now gone. The region is yet to reach its demographic transition turning point, which will require a strong reduction in fertility. Recent declines in population growth have been largely due to higher morbidity rates as a result of the HIV/AIDS epidemic.

**Table 1. Annual growth of MVA, selected regions, 1981-2001**

<b>Region</b>	<b>1981-1991 %</b>	<b>1991-2001 %</b>
Africa	3.6	3.7
Latin America	1.6	2.8
S. & E. Asia	9.1	8.4
W. Asia & Europe	3.0	3.9
<b>World</b>	<b>3.1</b>	<b>3.1</b>

Source: UNIDO (2003).

**Table 2. Annual growth in MVA per capita, selected regions, 1981-2001**

<b>Region</b>	<b>1981-1991 %</b>	<b>1991-2001 %</b>
Africa	0.7	1.2
Latin America	-0.4	1.1
S. & E. Asia	7.1	6.8
W. Asia & Europe	0.4	1.7
<b>World</b>	<b>1.4</b>	<b>1.7</b>

Source: UNIDO (2003).

What can be said about the performance of individual countries? Have they all shared such mediocre industrial growth rates? Tables 3 and 4 below show the top ten SSA performers in MVA growth for both decades, while tables 5 and 6, do the same for MVA per capita.

While Tables 3 and 4 share four out of the ten countries (Lesotho, Mauritius, Cape Verde, and Seychelles), six new high-growth MVA countries appeared in the last decade.

**Table 3. SSA, Annual MVA growth, top performers, 1981-1991**

<b>Number</b>	<b>Country</b>	<b>Annual Growth %</b>
1	Swaziland	17.9
2	Lesotho	13.1
3	Mauritius	11.0
4	Cape Verde	9.6
5	Seychelles	8.9
6	Botswana	8.7
7	Gambia	7.2
8	Mali	7.1
9	Ghana	6.2
10	Burundi	5.6

Source: UNIDO (2003).

**Table 4. SSA, Annual MVA growth, top performers, 1991-2001**

Number	Country	Annual Growth %
1	Uganda	13.5
2	Ethiopia	10.0
3	Equatorial Guinea	8.3
4	Burkina Faso	7.7
5	Seychelles	6.3
6	Cape Verde	6.1
7	Mauritius	5.8
8	Lesotho	5.5
9	Rwanda	5.4
10	Benin	5.3

Source: UNIDO (2003).

We now similarly present the top SSA performers in MVA/capita.

**Table 5. SSA, Annual MVA growth per capita, top performers, 1981-1991**

Number	Country	Annual Growth %
1	Swaziland	14.1
2	Lesotho	10.8
3	Mauritius	10.1
4	Seychelles	7.8
5	Cape Verde	7.6
6	Botswana	5.4
7	Mali	4.4
8	Gambia	3.1
9	Guinea	2.7
10	Somalia	2.6

Source: UNIDO (2003).

**Table 6. SSA, Annual MVA growth per capita, top performers, 1991-2001**

Number	Country	Annual Growth %
1	Uganda	10.1
2	Ethiopia	7.1
3	Equatorial Guinea	5.4
4	Burkina Faso	5.2
5	Mauritius	4.9
6	Seychelles	4.9
7	Cape Verde	3.7
8	Lesotho	3.5
9	Botswana	2.6
10	Benin	2.3

Source: UNIDO (2003).

As can be seen by comparing Tables 3 and 5, during the period 1981-1991, the top eight countries were the same in both cases, (i.e. ranked by MVA growth and by MVA per capita growth) and in about the same order. The last two, Ghana and Burundi, did not make the top listing by MVA per capita growth because of higher population growth rates.

In comparing Tables 4 and 6 (for the period 1991-2001), only one country, Rwanda, does not keep its place when moving from ranks by MVA to ranks by MVA per capita, being replaced by Botswana, again due to its high population growth.

Let us now consider some results about SSA's pattern of industrial growth; in particular, what can be said about countries performing above and below their "expected" levels of industrialization as measured by the value of MVA.

We first look at the results for those countries that could be called "over-industrialized" because their observed MVA values are substantially higher than predicted by our econometric model.<sup>5</sup> These results are shown in Table 7, below, for the top twelve countries.

The top nine countries have MVA values that are double, or larger, than their "expected" values. As shown before, countries such as Swaziland, Mauritius, Seychelles and Lesotho, were also among the top performers in terms of growth of MVA during the last two decades, and their industrialization is strongly tilted towards export markets. The rest of the countries, larger in population, show the results of policies favouring domestically oriented industrial development.

**Table 7. SSA, top "over-industrialized" countries, 2001**

Number	Country	Observed MVA <sup>1</sup>	Predicted MVA <sup>1</sup>	Residual <sup>1</sup>	Residual percentage <sup>2</sup>
1	Swaziland	397.1	107.46	289.64	72.9
2	Burk.Faso	897.9	292.76	605.14	67.4
3	Mauritius	1,000.4	352.83	651.57	64.9
4	Ivory C.	2,930.2	1,095.08	1,835.12	62.6
5	Rwanda	445.5	170.30	275.17	61.8
6	Sudan	3,606.4	1,482.40	2,124.00	58.9
7	Cameroon	2,248.4	925.45	1,322.95	58.8
8	Senegal	1,132.8	477.16	655.64	57.9
9	S. Africa	26,418.0	12,637.70	13,780.30	52.2
10	Seychelles	80.4	42.61	37.79	47.0
11	Zimbabwe	1,779.2	947.00	832.20	46.8
12	Lesotho	104.4	63.73	40.67	38.9

Source: Author's calculations.

Notes: 1 Values in million dollars.

2 Residual percentage = (Residual/MVA) \* 100.

On the other hand, table 8, below, shows the top "under-industrialized" countries in SSA.

Promotional support via infrastructure, plus special incentives, are required for the "under-industrialized" group. Elsewhere, I have suggested the Industrial Development Strategy Papers (IDSPs),<sup>6</sup> to cover both extreme cases, as well as those in between.

5 The model used was:  $\ln MVA = \text{constant} + a \ln y + b \ln P + e$ ; where "y" is income per capita, in dollars, for 2001, and "P" is population in millions, also for 2001. It was applied to data for 45 SSA countries.

6 See Teitel (forthcoming).

**Table 8. SSA. Top "under-industrialized" countries, 2001**

Number	Country	Observed MVA <sup>1</sup>	Predicted MVA <sup>1</sup>	Residual <sup>1</sup>	Residual percentage <sup>2</sup>
1	Eq. Guinea	5.5	143.83	-138.33	-2,515.1
2	Djibouti	14.0	50.45	-36.45	-260.3
3	Tanzania	462.8	1,151.73	-688.93	-148.9
4	Nigeria	2,120.4	4,982.66	-2,862.26	-135.0
5	Sierra Leone	32.2	69.73	-37.53	-116.5
6	Comoros	10.5	22.71	-12.21	-116.3
7	Guinea	164.0	334.82	-170.82	-104.1
8	D.R. Congo	348.6	644.36	-295.76	-84.8
9	Gambia	21.0	36.88	-15.88	-75.6
10	Kenya	1,057.4	1,355.38	-297.98	-28.2
11	Botswana	334.9	426.70	-91.8	-27.4
12	Madagascar	426.4	528.37	-101.97	-23.9

Source: Author's calculations.

Notes: 1 Values in million dollars.

2 Residual percentage = (Residual/MVA) \* 100.

## References

Artadi, E. V., and X. Sala-i-Martin, *The Economic Tragedy of the XX<sup>th</sup> Century: Growth in Africa*. NBER Working Paper No. w9865. Cambridge, Mass.: National Bureau of Economic Research, July 2003.

Cook, M., *A Brief History of the Human Race*. New York & London: W.W. Norton and Co., 2003.

Teitel, S., *Technology and Skills in Zimbabwe's Manufacturing. From Autarky to Competition*. London & New York: McMillan and St Martin's Press, 2000.

Teitel, S., *Economic and Social Background to the Formulation of Economic and Industrial Development Strategies for Sub-Saharan African Countries*. Study for Industrial Development Report 2004. Vienna: United Nations Industrial Development Organization, forthcoming.

UNIDO, *International Yearbook of Industrial Statistics 2003*. Vienna: United Nations Industrial Development Organization, 2003.

Wood, A., and K. Jordan, "Why Does Zimbabwe Export Manufactures and Uganda Not? Econometrics Meets History". *Journal of Development Studies*, Vol. 37, No.2, December 2000.



## Sub-Saharan Africa's Exports Prospects in Textiles and Clothing: The Incidence of AGOA, EBA, the MFA and China in the WTO

Gabriel Sánchez\*

The attainment of the poverty-related Millennium Development Goals (MDGs) by the sub-Saharan African (SSA) countries demands, in most instances, sustained annual growth rates of around 5 per cent from today until 2015. This is a formidable goal, that has successfully been met in the recent past only by a handful of countries, such as China, Republic of Korea, India, Sri Lanka, Thailand, Indonesia, Malaysia and Mauritius. One of the common traits of these recent risers is that their initial high growth stages were accompanied by a rather fast industrialization of employment and output. The development of the textile and apparel industries, and the international specialization in these activities, often played a key role in these initial stages of growth in these countries.

This naturally leads to the question of how big the contribution of an outward-oriented development of the textile and apparel sectors to industrialization and growth in SSA can be, and what the pitfalls and opportunities that lie ahead for such a strategy are. It is important to keep in mind that the potential aggregate impact of this strategy is conditioned by the fact the apparel industry in 1997 represented relatively small shares of manufacturing employment and output, albeit representing a more important proportion of all manufacturing exports.

Such an industrial development strategy faces two big opportunities and two potentially big hazards. The opportunities are offered by the implementation in 2001 of the US African Growth and Opportunity Act (AGOA), which grants tariff and quota free access to textiles and apparel of SSA origin to the US markets under certain conditions and during a specific time horizon, and the EU's Everything But Arms (EBA) initiative, that grants free access to SSA exports of most goods into EU markets. The two potential hazards arise from the scheduled dismantling of the Multi-Fibre Agreement (MFA) by 2005 and the completion of the entry process of China into the World Trade Organization (WTO), which began in 2001. By 2005, China should also benefit from the elimination of MFA barriers to its exports of textiles and clothing.

**Table 1. Importance of textiles and apparel in SSA economies**

Per cent	Participation in manufacturing employment (%)	Participation in manufacturing exports (%)	Participation in manufacturing output (%)
Wearing apparel ISIC 3 Code 18	1.98	7.41	2.65
Textiles ISIC 3 Code 17	13.45	11.37	10.54

Source: Global Trade Analysis Project (GTAP) version 5 database.

Our research shows that AGOA and EBA offer important potential benefits for the textile and clothing industries in the SSA countries. These initiatives are estimated to have the potential to boost significantly the exports and output of textiles and apparel in the least developed SSA nations, even in the face of the phasing-out of the MFA. Indeed there are already several accounts of large investment and high employment growth in these sectors in several least developed SSA countries, like Lesotho and Madagascar, in response to these initiatives. Our estimations show that, in the counterfactual scenario of no accession of China to the WTO, these initiatives would induce a labour-intensive

\* Director of Research, Instituto de Estudios sobre la Realidad Argentina y Latinoamericana (IERAL), Buenos Aires, Argentina.

industrialization that would raise the participation of textiles and apparel in total exports much more than in total output, replicating a pattern observed in several recent industrializers, like Malaysia, Thailand and Indonesia. As the output and export shares of these industries are relatively small, the aggregate benefits of these initiatives would not be as large as the sectoral ones. These expected potential impacts would actually be to reinforce the pattern of export growth observed in the past decade: the increase in Africa exports of clothing in the 1990s was led by sales to the USA, which had a tight quota policy towards Chinese exports of these manufactures. In the EU, where the quotas are not so binding, the annual average growth rate was of 1.2 per cent.

**Table 2. SSA exports**

	1990		1999		Growth	
	US\$ billion	Share (%)	US\$ billion	Share (%)	1990-1999 (%)	Annual average (%)
Total	48.6	100.0	49.6	100.0	2.1	0.2
Textile fibres	1.328	2.7	1.413	2.8	6.4	0.6
Textile yarn, fabrics, etc.	0.228	0.5	0.206	0.4	-9.6	-1.0
Clothing and accessories	0.947	1.9	1.78	3.6	88.0	6.5
<b>Total textiles and clothing</b>	<b>2.503</b>	<b>5.2</b>	<b>3.399</b>	<b>6.9</b>	<b>35.8</b>	<b>3.1</b>

Source: Mattoo et al. (2002).

The more developed SSA economies stand to benefit less from these initiatives because they receive less generous concessions than their less developed counterparts. In particular, the application of the rule-of-origin under AGOA, by which countries only qualify for duty-free access to the US apparel markets if they use yarn of US origin, makes them very vulnerable to the enhanced competition from exports of clothing originating in the least developed SSA countries.

Except if special measures are taken to offset it, the entry of China in the WTO is expected to reduce the benefits from AGOA and to have deleterious effects on the developments of the textile and industries in the SSA countries, especially the more developed ones, which are less sheltered by AGOA from the Chinese competition in the US markets. The elimination of MFA quotas on Chinese exports will allow this country to become the world's leading exporter of apparel and textiles, especially of the former. This large gain in market share hurts the development of these industries in the SSA economies, thus partly hampering the objectives of AGOA. In particular, the expected expansion of wearing apparel exports would be much smaller than in the counterfactual scenario of no Chinese accession into the WTO, especially for the more developed SSA economies. The eventual imposition of safeguards by industrialized countries on textile and apparel imports of Chinese origin, that is already under way, would attenuate the negative impact of China's entry on the SSA textile and clothing industry but not eliminate it.

Nevertheless, China's entry in the WTO is predicted to lead to a high wage growth in this country that would reduce, and even reverse, the gap between the Chinese and SSA wages. Despite sizable labour productivity growth in China, unit labour costs in the apparel industry would still go up in this country while the opposite would occur in SSA. These factor price movements, together with AGOA and EBA, should raise the incentives to invest in the SSA textile and apparel industry to profit from the preferential access that these initiatives grant, but not enough to divest Chinese investment towards this area. Indeed, an incipient wave of foreign direct investment (FDI) from East Asia (mostly from the Republic of Korea and Taiwan, Province of China) is taking place, along with important US investment in the area that takes advantage of the "maquiladora" ingredients of AGOA. However, there remain a number of structural obstacles to massive investment and technology transfer to these industries in SSA, which include a poor institutional framework, large transaction costs, low

availability of savings, macroeconomic instability, poor infrastructure and low productive quality of labour.

Another concern arises from the fact that under AGOA after 2005 duty-free access to the US markets is granted only to exports of apparel that are made of yarn of US origin. This raises the risk that the development of this industry after 2005 may become overly dependent on the inflows of maquiladora-type FDI from the US, and that the present FDI of other origin may be in the form of footloose capital inflows that seek to take advantage of a temporary window of opportunity. This last type of FDI is very likely to leave, without any technology and knowledge transfer, as soon as the rule-of-origin becomes operative for the least developed SSA countries.

As a final reflection, initiatives like AGOA have a significant potential for promoting the development of the apparel and textile industries and to contribute to some extent to the take-off of industrialization in SSA. The entry of China to the WTO certainly poses a threat to this potential, but the already observed application of safeguards by the USA and other nations would limit this threat somewhat. The biggest pitfall actually lies in AGOA's rule-of-origin, which may discourage the undertaking of long-term FDI and technology transfers in this area, transforming this initiative into a short-term assembly-based integration into international production networks.

## References

Mattoo, A., D. Roy and A. Subramanian, *The Africa Growth and Opportunity Act and its Rules of Origin: Generosity Undermined?* Working Paper No. 02/158. Washington, D.C.: International Monetary Fund, September 2002.

# Strengthening the Contribution of the Private Sector to Poverty Reduction Strategies for the Sub-Saharan African Countries

*Anthony Hawkins\**

## **Introduction:**

### **The private sector, manufacturing industry and poverty reduction in Africa**

The attainment of Millennium Development Goals (MDGs) in sub-Saharan Africa, specifically the halving of poverty by 2015, will depend primarily on the nature and robustness of the private sector response to the poverty reduction policies being implemented across the continent. At issue is how best to achieve the desired response.

It is argued that there is no single “magic bullet” formula that will transform low-income, agriculture-based, technologically-backward economies, and it has therefore been questioned whether, for all the brave statements in Poverty Reduction Strategy Papers (PRSPs) that private sector development must spearhead the campaign against poverty, this reality is accorded the priority it deserves.

A “typical” PRSP contains at least four core policy elements:

1. Macroeconomic stabilization measures designed to create an enabling environment within which private sector initiatives can succeed and prosper.
2. Associated structural reforms – such as privatization and financial sector restructuring – and institution-building and capacity-building measures that are a sine qua non for sustained development.
3. Explicit poverty reduction strategies – specifically increased spending on education, health and social welfare, along with targeted rural development measures designed to alleviate rural poverty.
4. A variety of “enabling environment” and “investment climate” initiatives designed to facilitate a robust private sector response.

Although there is no single formula readily applicable to a very diverse range of economies in terms of geography, history, size, structure, resource-endowment and institutional capacity, it is suggested that some, often simple and straightforward, reforms can be expected to make a significant contribution to private sector development.

The necessary reforms are increasingly well-documented, both from the experience of those countries already moving down the reform road, and also in the growing number of opinion surveys and league tables on doing business and competitiveness.

The findings of such surveys are remarkably uniform and consistent, lending credence to the conclusion that, at this stage of their development, most sub-Saharan economies have more to gain from across-the-board measures of the “enabling environment” variety. The surveys suggest that such reforms will provide the critical mass necessary to attract foreign direct investment (FDI) and boost investment, output and exports, without which few countries can hope to meet their MDGs.

## **Mismatch**

There is a glaring, though unsurprising, mismatch between the emphasis and focus on the role of public sector agencies, including the donor community and the international financial institutions, and

---

\* Professor of Business Studies & Director of the MBA Programme, University of Zimbabwe.

that on the private sector. Few PRSPs discuss the role of private enterprise in anything other than the most superficial terms, though there are signs that this is changing.

The reasons for the mismatch are easily understood. The data base on the size and scope of the private sector is very poor. Private sector activity is highly concentrated in the region with a handful of countries accounting for the bulk of formal private sector activity.

Interaction between bureaucrats and donors on the one side and private entrepreneurs is limited. The enormous detail of PRSP participation, construction, implementation, financing and reporting, contrasts starkly with the superficial treatment of the driving force in the growth process – the private sector. The IMF's April 2003 report on aligning the Poverty Reduction and Growth Facility (PGRF) and PRSP approaches (IMF 2003) is a classic example, mentioning the private sector just once.

Five main explanations are suggested for this neglect of private enterprise:

1. The smallness and weakness of the private sector in most sub-Saharan economies.
2. The dominance of smallholder agriculture, in particular.
3. The scarcity of reliable data on the size, structure and potential of private enterprise in the region.
4. At least partial recognition of the difficulties experienced in ensuring that enabling environment initiatives and incentives translate into investment, output, jobs and exports. Facilitation alone is not enough.
5. The private sector's own reluctance to become involved in something which is beyond its core competence and not its core business.

### **The private sector – how large?**

Data covering the private sector's share of output, employment and exports are seldom available. In 2000, the International Finance Corporation estimated that the informal private sector accounted for 52 per cent of GDP, while the public sector's share was 26 per cent and the formal private sector share 22 per cent.

The database on the extent of private sector activity is both weak and patchy but the available data paint a picture of an African economy dominated by small-scale agriculture – approximately one third of GDP – with very high levels of informal sector employment.

### **Stylized facts**

In the absence of reliable data, there is no alternative but to fall back on stylized facts. Four groups of players comprise the private sector in sub-Saharan Africa:

1. Multinational companies, which dominate the natural resource sector, especially oil, gas and mining, often in joint ventures with state-owned enterprises, especially in the energy sector. For the most part, these firms use relatively capital-intensive – and often also high-tech – technologies and are closely monitored and managed from outside by their foreign-based headquarters. As well as energy and mining, the multinational presence is strong in finance, tourism, agro-industry, cement and chemicals and in a handful of cases, vehicle assembly. The multinationals are, for the most part, in export-oriented activities, with limited linkages with the domestic economy, except in services.
2. A rapidly-expanding category of Africa-based regionalizers rather than globalizers. This group is most prominent in South Africa, where a growing number of firms have sought to expand regionally. The most striking examples are in the mining (Anglo American, AngloVaal, Goldfields) telecommunications, banking, retail, construction, fast foods, beverages, sugar and cement industries. Public sector enterprises are also part of this regionalization process, especially in such industries as rail transport, airlines and electricity.

3. Medium-scale indigenous enterprises – fragmented businesses often with limited linkages with the local economy. Frequently the focus is trade, especially importing and regional exports, with limited manufacturing value-added. In recent years, there has been robust growth in the financial services sector – banking, insurance, stockbroking and asset management. Such businesses tend to be technologically backward relative to the multinationals and only partially integrated with the global economy, though regional links are expanding, especially in southern, west and east Africa. They are more labour-intensive than their multinational counterparts and competitors, and tend on the whole to pay lower wages, partly reflecting the lower skills levels and lower productivity.
4. Small and micro-businesses in both the formal and informal sectors of the economy. The dividing line between formal and informal is blurred. These are very low-tech, labour-intensive operations that are starved of skills, expertise, access to modern technology, working and investment capital. They are often the prime engine for job generation, largely in the agricultural and services sectors, with some spin-offs in respect of the simplest consumer goods manufactures, food processing (grain milling) and items such as building materials.

### **Constraints on private sector development**

Lessons for policymakers and PRSPs are:

1. The objective should be a system with clearly defined and well-protected property rights without the heavy-handed regulation that is associated with undesirable economic and social outcomes.
2. There are many easy-to-replicate models in best practice economies that could be implemented on a cost-effective basis within sub-Saharan Africa that would reduce transaction costs and improve the operating conditions for business.
3. Many of the needed reforms are essentially minor, implying considerable benefit for little cost.

### **Capital markets**

Three priorities for strengthening the role of the private sector in industrialization and poverty reduction can be identified:

1. The restructuring of weak, inefficient financial systems;
2. The development of domestic capital markets; and
3. The encouragement of foreign direct investment.

Significantly, neither of these priorities is accorded serious attention in PRSPs, whereas invariably financial sector restructuring is – rightly – treated as an important priority.

While there is a tendency to deride the role of capital market development in poverty reduction, the reality is very different. Stock markets constitute another string to the bow of financial development, providing greater financing flexibility for firms, improving prospects for at least some of the low-paid to protect their savings and capital via pension fund investments, offering a vehicle for financing privatisation, and imposing transparency and market discipline on domestic enterprises.

### **Foreign Direct Investment**

Although the region's share of global inward FDI inflows continues to shrink, the absolute importance of inward investment has grown rapidly over the last decade at a time when official flows have been stagnating, or declining in real terms, and trade-related and bond finance inflows have fallen steeply.

This shift has been accompanied by a sea-change in the attitudes of many African governments and policymakers who replaced their earlier antipathy, if not hostility, to inward FDI by implementing investor-friendly measures. The drive to attract FDI reflects, first and foremost, acceptance of private

enterprise as the driving force in economic development, as well as the belief that FDI brings with it many positives that are not otherwise available to Africa.

A crucial finding of recent surveys is that fiscal and financial incentives are unlikely to be as effective in attracting FDI inflows as the implementation of fundamental enabling environment reforms necessary to reduce entry barriers and transaction costs as well as operating risks. Particularly significant also is the UNIDO survey finding that private sector contacts are the most important source for potential investors in terms of creating awareness of investment opportunities in a country. Two-thirds of investors were made aware of an investment opportunity through business contacts while direct contacts with official investment promotion agencies (IPAs) accounted for only 10 per cent of all respondents.

A disturbing conclusion too is that only half of the investors who responded to the UNIDO survey are satisfied with their chosen locations. “South Africa was by far the most preferred alternative location option” – a crucially important finding in the light of the already highly concentrated and unbalanced structure of manufacturing industry in sub-Saharan Africa as a whole and Southern Africa in particular.

### **Export Processing Zones (EPZs)**

To date, with the partial exception of Mauritius, EPZs have been far less successful in sub-Saharan Africa than in other parts of the world. That, on its own, is no reason for abandoning them. Equally, it is evident that scope for success is limited in landlocked countries with high transport costs, and countries beset by weak institutions, poor governance, inappropriate macroeconomic policies, high transaction costs and deep-seated obstacles to doing business.

What do the experiences of Mauritius (by far the most successful), Madagascar and Zimbabwe, tell us in this respect?

1. While EPZs should not be regarded as a substitute for pursuing economy-wide reforms, countries like Mauritius and Zimbabwe have done just that.
2. To enhance net exports it is essential to foster backward linkages between EPZ firms and the rest of the economy. This appears not to have been achieved in Mauritius or Madagascar but fragmentary evidence suggests it is the case in Zimbabwe.
3. Where feasible, steps should be taken to encourage diversification of the EPZ sector so as to avoid a Mauritian-type situation with its focus on a relatively narrow range of simple, low-tech clothing product lines.
4. As global and regional trade liberalization proceeds so EPZs become increasingly anachronistic. Accordingly they must be seen as transitional – building blocks in the trade liberalization process.

### **Global networks and production sharing**

Manufacturing – and specifically manufactured exports – are playing a lead role in only three sub-Saharan economies:

1. Mauritius where clothing and textiles have helped drive growth;
2. South Africa, which has a broad-based manufacturing sector; and
3. Mozambique, though this is very much a special case to the extent that its growth is heavily reliant on a few mega-projects.

All three are coastal economies, sustaining the view that geographical location is important, while significantly the three have managed – to a certain extent – to tap into global networks. Mauritius stands out as the best example in textiles, but South Africa has made important breakthroughs, especially in automotive components and vehicle exports.

In 2001, Africa, along with South Asia and the Middle East, accounted for only 2 per cent of the developing world's exports of parts and components, and two-thirds of that 2 per cent came from two countries, India and South Africa. Yet participation in global production chains makes a major contribution to industrial and export growth, with manufacturing growing faster in the 20 countries with the highest shares in exports of components and parts – 5.3 per cent annually, almost double the developing country average of 2.8 per cent.

Sub-Saharan Africa is missing out also in the related activity of offshoring service tasks – data entry, call centres, tele-marketing, and transaction processing as well as R & D. In 2001, the global value of such activities amounted to more than US\$ 25 billion. About half of this business was carried out in developing countries, mostly Asia (India and to a lesser degree China and Indonesia). Only one African country, South Africa, featured in this group, with an output value of US\$ 10 million.

The prime motivation for offshoring is the reduction of labour costs. According to the McKinsey Global Institute such offshoring is a “Win-Win Game” in that every dollar of labour cost savings in the US economy translates into global value-added increases of US\$ 1.45. Over three-quarters of this gain is captured by the US economy while balance accrues to the developing country.

## Conclusions

The main conclusion is that neither the good intentions in respect of private sector development that pervade PRSPs, nor selective targeted programmes and incentives will reverse sub-Saharan Africa's ongoing marginalization in global industry.

There are substantial scale economies and externalities to be gained from across-the-board, often relatively simple and inexpensive general policies designed to improve the business climate, rather than searching for targeted, complex and often more costly specific measures. Pack (2000) demonstrates that sectors of the economies of Japanese and the Republic of Korea that were accorded special support contributed only modestly to productivity growth.

It is arguable too that specific, selective policies may pay higher dividends in terms of greater value-added, when they are implemented on a phased basis – after the basics of good governance, sound institutions, and efficient markets have been put in place.

Many – possibly most – PRSPs reflect this. Some go further to push for greater government emphasis on enterprise-level competitiveness, without which sustained poverty reduction and the MDGs will remain distant and unattainable goals.

Yet PRSPs stop short of what is necessary. That two recent PRSP reports from the “success story” economies of Ghana and Uganda bewail the absence of structural transformation – industrialization and modernization – is a reflection of the combination of disappointment and frustration felt at both the pace and nature of progress.

Operationalizing PRSPs from a private enterprise viewpoint might well mean less participatory discussion and consultation and more benchmarking and targeting. Arguably, private enterprise would view the process more positively, were PRSPs to contain specific – attainable – targets such as a ceiling for the number of procedures and time taken for starting a business and objectively measurable targets for labour market flexibility.

Donors should consider funding and assisting capacity-building in three fields crucial for private sector development:

1. Independent think tanks, charged with creating a focal point for private enterprise and ensuring that its voice is heard. This would ensure that PRSPs and consultation were more effective from a



private sector viewpoint than at present. They would also contribute to filling the knowledge gap on the size and structure of the private sector in Africa as well as constraints on its growth.

2. The funding of competitiveness councils in some countries to ensure that competitiveness is much higher on the national development agenda than at present.
3. The establishment of management and business training institutes (business schools) to provide the training necessary for private sector development. At present, while many such institutions exist, they lack adequate and appropriately qualified and experienced staff and access to the resources necessary for developing managers to be able to compete with peers in emerging market economies, let alone industrialized countries. Once again there is a serious mismatch between the funding and effort earmarked for public sector training and private sector development.

Within the context of PRSPs, there is a clash of cultures that must be resolved. It is difficult to square the overly bureaucratized culture of PRSP construction and implementation with the advice to governments to de-bureaucratize business regulation and markets.

Competitive economies are the product of competitive enterprises. Competitive enterprises thrive where the appropriate prior conditions are in place. Surveys of competitiveness, business regulation and governance, institutional quality and effectiveness are near unanimous in pointing the way ahead. Needed are critical mass measures that improve the business environment and investment climate, thereby lowering transaction costs and eliminating the obstacles to doing business.

## References

IMF, *Aligning the Poverty Reduction and Growth Facility (PRGF) and the Poverty Reduction Strategy Paper (PRSP) Approach: Issues and Options*. Washington, D.C.: International Monetary Fund, Policy Development and Review Department, 25 April 2003.

Pack, H., "Industrial Policy: Growth Elixir or Poison". *The World Bank Research Observer*, Volume 15, No. 1, January 2000.

# The Role of Industrialization in Achieving the Millennium Development Goals in Least Developed Countries

Sanjaya Lall\*

## The global setting for industrialization in LDCs

Driven by rapid technical change and policy liberalization, the *main new feature* of industrialization is the need to be competitive, facing intense and immediate competition in domestic as well as export markets. This implies:

- Access to and import of the latest technologies – old vintages become uncompetitive even at low wages.
- Ability to quickly master new technologies and use them at or near world “best practice” levels.
- Keep them constantly updated as new technologies appear and market demands change.
- Deploy modern organizational, managerial and human resource strategies (not just “hard” technologies).
- Provide a business environment that matches competitors with similar factor endowments elsewhere.

Rapid innovation is changing the *dynamics of the industrial and trade structure*. The normal shift of developing countries from resource-based into low-technology, and then a gradual evolution into medium-technology products, has become accelerated and altered. Technical change is raising the share of innovation-based activities in both production and trade – good market positioning and the need to tap the benefits of current technical change requires countries to shift rapidly into technology intensive activities. The traditional mainstays of industrial development – textiles, clothing, footwear and food processing – are among the slowest growing activities in production and trade.

Technical progress in transport and communications (the “death of distance”) has led to an unprecedented *fragmentation of economic activity across countries*. This has meant the spread of manufacturing and service activities in search of low cost, efficient locations. At the low technology end in manufacturing, it has been led largely by buyers (e.g. of garments, footwear or sports goods); at the high technology end, it has been led by transnational corporations (TNCs) setting up affiliates in desirable sites. In between, there are many different modes of fragmentation involving different ownership and contractual arrangements, like original equipment manufacturing (OEM) in Republic of Korea and Taiwan, Province of China. The organization and ownership of global value chains has changed as a consequence, becoming more tightly organized and controlled by fewer key players. Competitive production in a liberalized world increasingly requires developing countries to understand and adapt to these new forms of global value chains.

In general, the *role of TNCs* has become more important in global innovation, technology transfer, production and trade. Driven by technical change (with rising innovation costs), the “death of distance”, policy liberalization and the growing possibilities of fragmentation, industrial success increasingly requires active participation by TNCs.

However, *domestic enterprises and domestic capabilities* remain the bedrock of industrial success. TNCs invest more, and in higher quality activities, in countries that have strong suppliers, active technology institutions, capable workers and managers and well-managed infrastructure. The fact that all productive factors are more mobile does not mean that they spread across the world evenly. On

---

\* Professor of Development Economics, Oxford University.

the contrary, there is growing concentration of the FDI flows to developing countries, with the top ten countries now accounting for about 80 per cent, up from around 70 per cent about ten years ago.

In sum, it is vital to build strong domestic capabilities to industrialize in the new global setting. FDI provides additional resources and/or missing factors but cannot substitute for a weak and inefficient productive base. Because capability building is a cumulative process, countries that gain a head start can carry on pulling ahead of the laggards. This seems to be the situation today – and coherent strategic action is needed to reverse the trend.

### **Prerequisites for building industrial capabilities**

The basic prerequisite is a sound, business friendly investment environment. This has several components:

- Political and social stability;
- Sound macroeconomic management with realistic exchange rates;
- Clear, transparent and predictable policies friendly to private investment;
- Greater openness to trade, FDI, technology transfer (but not necessarily complete and rapid liberalization);
- A strong and efficient legal framework able to enforce property rights and contracts;
- Low business costs in terms of entry, exit, trade, employment and expansion (in other words, administrative and fiscal procedures in line with competitors elsewhere); and
- A government responsive to the needs of industry and labour, and, for sustainable development, the environment.

While good framework conditions are necessary for building capabilities, they are not sufficient. As policies across the world converge on a business-friendly norm, it is the extra advantages that count: strong technological capabilities, good supply clusters, efficient logistics and support institutions, and a proactive government ready to improve factors and procedures in line with investment needs and new technologies.

### **The “extra” edge: strong technological capabilities**

The base of technological capabilities lies in having adequate skills at all levels. However, skills are not provided just by formal education – though this provides the essential base of learning on which capabilities are grafted. They also arise from on-the-job learning, training (and retraining), and deliberate effort to master particular technologies. In other words, capabilities are specific to particular technologies and involve experience of those technologies. Moreover, they are not embodied in individuals but the particular collection of individuals who work together in an enterprise.

Enterprises do not build capabilities in isolation. They interact constantly with other enterprises (suppliers, buyers and competitors), equipment manufacturers, technology and R&D institutions and international sources of knowledge. Thus, capability building is a truly collective process, both within the enterprise and outside it. Increasingly the scope of interactions is becoming global as information transmission costs drop to negligible levels.

Capability development is thus not an automatic, instantaneous or costless process. While its costs and duration vary greatly by technology – there are “easy” technologies and “difficult” ones – there are certain generic features that are vital to note for industrialization strategy.

- Capability building is a cumulative learning process.
- It takes time and involves cost and uncertainty.

- It is deliberate and not an automatic by-product of production. New knowledge has to be sought and applied, new skills developed and new managerial routines built.
- Even the use of technologies that are diffused elsewhere involve learning in a new location. Countries cannot thus become efficient users of mature technologies by simply opening themselves to knowledge flows.

What determines how effectively countries build technological capabilities? Much depends on the incentive framework and on the responsiveness and efficacy of factor markets.

### *Incentives*

Competition is the ultimate determinant of the decision to invest in the costly and uncertain process of capability building. However, since by definition enterprises that arrive late on the industrial scene face greater learning costs than those that have already undergone learning, competition is a double-edged sword. Too much exposure to global competition early in the learning process can deter or damage capability building. Sweeping liberalization can destroy the legacy of past capabilities unless countries raise their capability levels as they open up.

There is thus a valid case for infant industry protection – but this is different from old-fashioned import substitution where high and perpetual protection is given. Protection has to be offset by strong incentives to build capabilities; the most effective way has been strong pressures to export as domestic capabilities develop.

The “new rules of the game” constrain many policy instruments used to promote capability development in past, not just by the newly industrializing countries but also by the presently mature industrialized economies. Some constraints are desirable, to remove the more egregious forms of government interventions in industry and to provide a conducive environment for international product and factor flows. However, given the need for capability building, a rapid and unplanned move to liberalization can damage industrialization prospects in the late-latecomers.

There is a good case for relaxing the stringent demands of the new rules on liberalization for the least developed countries.

### *Factor markets*

Enterprises do not build capabilities on their own. They need support from all the factor markets: finance, skills, technology, information, physical inputs and infrastructure. In developing countries all these markets can suffer from deficiencies. Protecting the learning process in enterprises is bound to fail if factor markets are not simultaneously improved to provide the new inputs they need to learn and compete.

Improving factor markets involves strengthening institutions and building new institutions. “Institutions” here refers not to the legal system but to the particular bodies charged with education, training, finance, technology support, quality, R&D, inter-firm linkages, infrastructure and so on. In many least developed countries (LDCs), there is also a pressing need for institutions to help the development of industrial entrepreneurship, the lifeblood of all industrial activity. Again, this needs not just a conducive environment and a level playing field (e.g. removing policies that discriminate against small and medium-sized enterprises) but also specific skill development and financial assistance.

Most LDCs have a large array of support institutions inherited from pre-independence days. However, most of these do not function well in supporting industrial enterprises. They suffer from the same skill gaps that pervade industry (indeed, it would be surprising if they did not). They tend to be bureaucratic, with few incentives to reach out to and help their clients, and lack the necessary facilities and equipment.

Strengthening industry support institutions must be at the core of building competitive capabilities. This is a difficult and slow process, at least compared to liberalizing policies and setting the right framework conditions.

### **The way forward**

- Recent trends in the developing world show growing divergence rather than convergence in industrial performance between (a few) successful and (large numbers of) unsuccessful countries.
- Given the cumulative nature of capability building, the divergence is likely to carry on growing under globalization and liberalization unless a clear strategic response is adopted
- The strategy must involve not just the LDCs but more advanced developing and developed countries, the donor community and the international institutions setting the rules of the game.
- The rules have to be adapted to the specific needs of LDCs. They should be given more “policy space” – more time and flexibility to develop their basic industrial capabilities. This flexibility should apply to rules on trade, FDI, performance requirements and intellectual property rights.
- This should not, however, mean a return to traditional strategies of highly protected import substitution. Policies that did not work in the past will not work well in the future: a completely new set of policies is needed, focusing explicitly on the process of capability development at the enterprise, industry and national level in the framework of international competitiveness.
- The launch of AGOA provides one good instance of how trade discrimination in favour of LDCs is helping them enter apparel export markets. However, trade policies per se will not ensure that industrial activities take root and persist after preferences are removed. Governments have to be helped to mount proactive policies to build genuine competitive capabilities, raising productivity and setting in place the institutions needed to ensure that future activities can flourish.
- This help can take many forms: apart from aid and investment, it can involve better information, skills and guidance on “best practice” industrial policy, tailored to the needs and capacities of each country.
- The final determinant of industrial success will be the ability of national governments to design and mount effective strategy. The first stage of the strategy must therefore focus on improving government capabilities and governance.



## **ROUND TABLE 2**

### **INDUSTRY AND ENVIRONMENT: THE NEED FOR A NEW INDUSTRIAL REVOLUTION**





## Issue Paper

# Industry and environment: The Need for a New Industrial Revolution

UNIDO Secretariat

## I. Introduction

Ever since the publication of “Our Common Future” in 1987 (commonly known as the Brundtland Report, Brundtland 1987), there have been calls to radically rethink the relationship between our societies and the environment in general, and industry and the environment in particular. Many proposals have been put forward: the Factor Ten or Factor Four proposals (where countries would commit to 90 per cent and 75 per cent reductions, respectively, in energy and materials intensity); adoption of the concepts of industrial ecology (where groups of enterprises use each other’s wastes as raw materials); dematerialization (the replacement of physical products with non-physical products or services, thereby reducing a company’s production, demand and use of physical products, and the end-user’s dependence on physical products); Zero Waste initiatives (the recycling of all materials back into nature or the marketplace in a manner that protects human health and the environment), the Natural Step (a framework of four principles promoting reduction, reuse, recycling, and composting), to name but a few. The need for such a radical realignment was underscored when the Member States of the United Nations declared in their Millennium Declaration of 2000 that “the current unsustainable patterns of production and consumption must be changed in the interest of our future welfare and that of our descendants”, and adopted as one of the Millennium Development Goals that of ensuring environmental sustainability.

In the last years of the last century and the early years of this, two books were published that took up many of these proposals and wove them together into radically new programmes for reaching environmentally and socially sustainable development: “Natural Capitalism, The Next Industrial Revolution” by Paul Hawken, Amory B. Lovins and L. Hunter Lovins, published in 1999 (Hawken et al. 1999), and “Cradle to Cradle, Remaking the Way We Make Things” by William McDonough and Michael Braungart, published in 2002 (McDonough & Braungart, 2002). This paper reviews the principal ideas proposed in these two books and explores their practicability and applicability to the situation in the developing countries.

## II. “Natural Capitalism, The Next Industrial Revolution”

The authors start with the contention that the central failure of current economic policies is to considerably undervalue natural capital used in our economic systems – the natural resources that are the inputs to our economies, but also the ecosystems that absorb, break down, detoxify and recycle our economies’ waste materials. As a result, the world’s stocks of natural capital are currently being consumed at unsustainable levels. The authors go on to propose that four central strategies need to be adopted if we wish to avert scarcity, perpetuate abundance, and provide a solid basis for social development. They see these strategies as the basis of responsible stewardship and prosperity for this century and beyond.

The first is to *radically increase resource productivity*, which the authors see as offering three significant benefits:

- It lowers resource depletion at one end of the value chain;
- It lowers pollution and waste at the other end of the value chain;

- In the specific case of energy efficiency, it reduces much of the threat to climate due to CO<sub>2</sub> emissions from fossil fuels; and
- It provides a basis to increase worldwide employment with meaningful jobs.

The result of this can be to lower costs for business and society, which no longer has to pay for the chief causes of ecosystem and social disruption.

The second central strategy that the authors propose is the strategy of *biomimicry*, in which industrial systems are redesigned along biological lines. Rather than having materials primarily used in a linear fashion by our economies (raw materials extracted from the natural environment, and the products which are made from them dumped into the environment when no longer needed or functioning), as is the case today, products and industrial processes should be changed to mimic the biological world, where materials are constantly cycled through the environment and reused. This includes the use of non-fossil-carbon fuels like biomass and renewables.

The third central strategy put forward by the authors is to bring about a fundamental change in the relationship between producers and consumers, shifting from an economy based on goods and purchase to a *service and flow economy*. Essentially, this requires manufacturers to cease thinking of themselves as sellers of products (e.g. washing machines) and become instead deliverers of services (e.g., the washing of clothes at home) provided by long-lasting, upgradeable durable goods. In the authors' words, "[t]his concept offers incentives to put into practice the first two innovations of natural capitalism by restructuring the economy to focus on relationships that better meet customers' changing value needs and to reward automatically both resource productivity and closed-loop cycles of materials use."

The final central strategy presented by the authors is to *invest in natural capital*. As the authors see it, "[t]his works towards reversing world-wide planetary destruction through reinvestments in sustaining, restoring, and expanding stocks of natural capital, so that the biosphere can produce more abundant ecosystem services and natural resources."

### **III. "Cradle to Cradle, Remaking the Way We Make Things"**

The authors start by taking aim at eco-efficiency, a term coined by the World Business Council for Sustainable Development in 1992 (it can be considered equivalent to Hawken's and the Lovins' strategy of increasing resource productivity). They contend that eco-efficiency is not the path to sustainability that it is so often claimed to be by various groups. As they put it, eco-efficiency essentially advocates doing more with less, allowing industry to grow and prosper while at the same time using fewer resources, producing less waste, and generating less pollution. In their view, increasing resource productivity (alone) does not avoid the inevitable catastrophic scarcity of natural resources that will occur; it merely makes the inevitable take longer to happen. It also is a strategy that is fundamentally incompatible with human nature; human beings find it difficult to accept a strategy that perpetually asks them to do with less.

The authors argue instead that economies should primarily follow strategies of eco-effectiveness. Fundamentally, this is equivalent to Hawken's and the Lovins' strategy of biomimicry, where the flows of materials through our economies are circular, with materials being reused over and over again. The authors of "Cradle to Cradle" refine the concept to argue that two major and distinct flows of materials must be created, one made up of biodegradable materials, which they call "biological nutrients", and one made of non-biodegradable materials (such as metals and plastics), which they call "technical nutrients". The Earth's natural cycles will ensure that the biological nutrients are recycled, while our economies will need to put in place the necessary systems to recycle the technical nutrients. For this recycling of materials to occur properly the authors argue that product design becomes vitally important. It is only by designing products that can easily be consigned to one or the other of the two nutrient flows that the material loops of technical or biological nutrients can be properly closed. The

authors also introduce the concept of maximizing the use of current solar income through the use of renewable energy sources. This too requires radical redesigns of the products we use.

To this the authors add the concept of a product as a service, at least for products made of technical nutrients. In the words of the authors, “[i]nstead of assuming that all products are to be bought, owned, and disposed of by “consumers”, products containing valuable technical nutrients ... would be reconceived as *services* people want to enjoy. In such a scenario, customers (a more apt term for the users of these products) would effectively purchase the service of such a product for a *defined user period* ... When they finish with the product, or are simply ready to upgrade to a newer version, the manufacturer replaces it, taking the old model back, breaking it down, and using its complex materials as food for new products” [all italics are the authors’].

#### **IV. Comparison of the two approaches**

The approaches advocated by Hawken and the Lovins’, on the one hand, and McDonough and Braungart, on the other, are in many ways very similar. Both stress the vital importance of creating economies where the flow of materials through them is circular rather than linear. Both stress the centrality of product design to make this happen. Both see a change from manufacturers selling products to offering services as a necessary outcome of this approach. Both argue that there are actually large cost-savings to be made if circularity rather than linearity is adopted, since companies can design out of the product many of the current, and generally hidden costs, associated with the handling, transportation and disposal of materials. Both suggest the use of renewable energy sources. Both emphasize that social equity can be significantly enhanced by this approach.

Where they appear to differ sharply is the importance they give to the strategy of improving resource productivity. In their book, McDonough and Braungart strongly reject this as a valid strategy, whereas Hawken and the Lovins’ have it as one of their four central strategies. However, in discussions Mr. Braungart has held in UNIDO, he has made it clear that what he and McDonough are actually against is adopting improvement in resource productivity, or eco-efficiency, as the only strategy towards environmental sustainability. If it is used together with eco-effectiveness (i.e. as an add-on to eco-effectiveness) eco-efficiency has its merits.

The vision, then, that both sets of authors promote is one where:

- Our societies move towards circular flows of materials through our economies on an (almost) infinite basis;
- The size of these flows can be reduced through greater efficiency in the use of the materials (Hawken and the Lovins’ stressing this more than McDonough and Braungart);
- Circular flows encourage, and are supported by, changes in the relation between manufacturer and user, where manufacturers change from selling products to supplying services;
- There is a move towards the use of non-fossil-carbon energy sources.

In both books, the role of industrial design in bringing this about is extremely important, if not paramount in the case of “Cradle-to-Cradle”. Both sets of authors stress that the quasi-infinite circulation of materials in our economies is only possible if products are designed to allow this to happen.

#### **V. UNIDO’s activities in the field of cleaner production**

The strategy promoted by both sets of authors fits well with the concept of cleaner production as defined by UNEP and adopted by UNIDO. Therefore, it is valuable to briefly review UNIDO’s activities in this field, in which it has been working since at least the early 1990s. One of UNIDO’s major cleaner production activities is the work it is undertaking under the Montreal Protocol. It also

has a strong programme to establish National Cleaner Production Centres (NCPCs) in the developing countries and countries with economies in transition. In addition, UNIDO undertakes cleaner production work through its leather and textile units, as well as through such focused programmes as that on mercury reduction in artisanal gold mining. Finally, UNIDO is working in the field of renewable energy and industrial energy efficiency.

UNEP has defined what cleaner production means for production processes, for products, and for services. For production processes, cleaner production means reducing the amount of raw material and energy inputs into processes; eliminating the use of toxic and dangerous raw materials in processes; and reducing the quantity and toxicity of all emissions and wastes released from processes, at their source in the process. This is equivalent to the radical increase in resource productivity promoted by Hawken and the Lovins', and to the eco-efficiency discussed by McDonough and Braungart. To date, this is where UNIDO has focused most of its cleaner production work.

For products, cleaner production means reducing their environmental, health and safety impacts over their entire life cycles, from their manufacturing (which is equivalent to cleaner production in production processes), through their transport and use (where cleaner production reduces the consumption of natural resources by the product during use and during its transportation), to their ultimate disposal (where cleaner production ensures that the materials of the product are re-used to the maximum extent possible). Thus, there is an element here of resource productivity increase/eco-efficiency but the definition also covers the concepts of biomimicry/eco-effectiveness. UNIDO has been involved in product design, particularly in the leather and textile units, but not necessarily from an environmental point of view. This is changing now, with the NCPCs in particular getting more involved in environmentally driven product (re)design.

For services, UNEP simply states that cleaner production implies incorporating environmental concerns into designing and delivering services. This is much weaker than the two books' concept of moving from manufacturing goods to offering services. UNIDO has not worked at all in this area.

## **VI. The applicability of the concepts to the situation in the developing countries**

By far the largest consumer markets are in the developed countries. Therefore, it is only if these countries act that there will be a significant move towards the sustainable patterns of production and consumption<sup>1</sup> that both sets of authors proclaim are necessary. Furthermore, it is in these countries that the overwhelming majority of consumer product design takes place. A measure of the latter contention can be had from data on the resources spent by the private sector on research and development – product innovation necessarily requires R&D – that is shown in Figure 1 (produced by UNIDO's Strategic Research and Economics Branch). This is a Lorenz Curve of private sector R&D spending in 87 countries, and it shows that 95 per cent or more of such spending worldwide takes place in the developed countries.

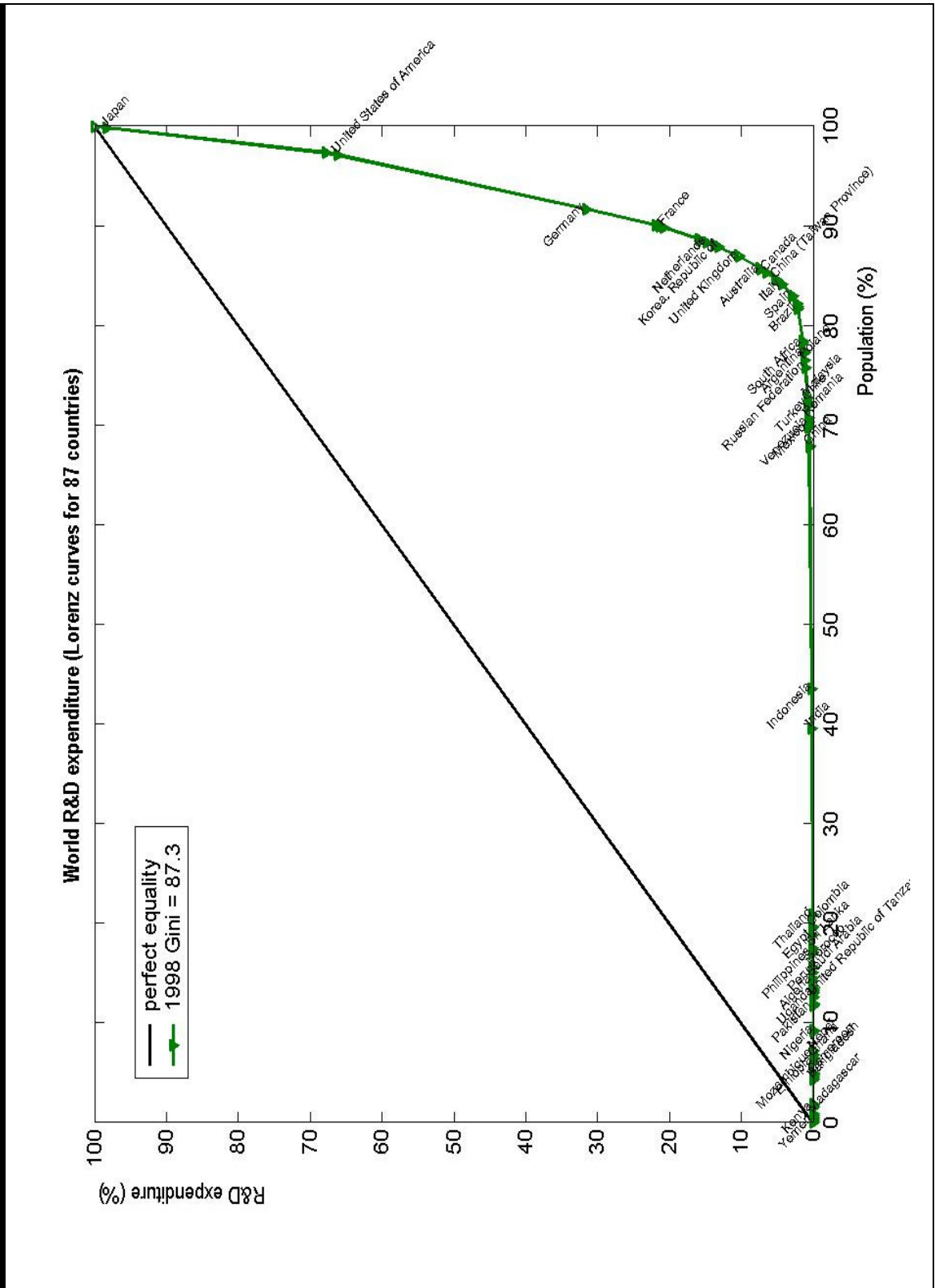
Therefore, significant worldwide progress in the implementation of the concepts advocated by both sets of authors will only come about if the industries based in the developed countries and their designers adopt them (either voluntarily, because they appreciate the important cost savings and/or increased market share they can obtain, or because public policies are passed to make it happen).

One could argue that the revolution has already started. For quite a number of years now, there have been regulatory and non-regulatory pressures in the developed countries to make companies design consumer products so that they are more efficient during use or use less toxic/hazardous compounds.

---

<sup>1</sup> A working definition of sustainable consumption has been given as “the use of goods and services that respond to basic needs and bring a better quality of life while minimizing the use of natural resources, toxic materials and emissions of waste and pollutants over the life cycle, so as not to jeopardize the needs of future generations.” Sustainable production is one that supports such patterns of consumption.

Figure 1.



For instance, fuel efficiency in cars has been a subject of concern for many years. A number of energy labelling regulations exist, and these have encouraged companies to make their consumer products more energy efficient. Various eco-labelling schemes, while still quite weak, have encouraged some companies to redesign their consumer products to make them more efficient during use in the consumption of water, detergents or other materials. This would fall into the category of

eco-efficiency or increased resource productivity. Small steps are now being taken in the direction of eco-effectiveness or biomimicry. The European Union and Japan are moving forward on directives or laws that promote so-called product take-back or extended producer responsibilities for certain categories of consumer products. These policies require the manufacturers of certain product categories to take back their products once consumers no longer want them. Generally, the driving force behind such policies are to resolve waste management and disposal problems, but the fact of forcing companies to take back their products is already leading to a growing movement in redesign of consumer products to extend their useful lives and/or to make them more easily recyclable once they are taken back. Even the concept of consumer products becoming services has already been exploited by a limited number of companies.

So where does this leave the developing countries? Would this new industrial revolution pass them by? Would they be affected by it in any way? Would they have a role to play in it? In today's globalized world, a revolution of this magnitude would assuredly not leave the developing countries unaffected. They would definitely be impacted by a series of knock-on effects; whether overall these impacts would be for better or for worse is difficult to say at this stage. In general, their role in this revolution would be modest but there would be one area where they could play an active and positive role. These points are dealt with below.

#### **A. *The knock-on effects and their impacts***

##### *1. The effect on globalized material flows*

One of the primary outcomes of globalization is that many of the products consumed in the developed countries are manufactured in the developing countries, often also using raw materials extracted in these countries. This has enormously increased the global flow of finished or semi-finished products. Given this, there appear to be three possible consequences for the developing countries from a strong trend towards circularity of material flows have in the developed countries. One could be positive for the developing countries, the other two not.

- Developed countries could adapt their economies to send the used materials back to the developing countries for reprocessing into new products. This would tend to further develop the manufacturing economies of developing countries.
- If the costs of sending the used materials back were too high, developed countries might begin to shift manufacturing back, in which case developing countries would begin to lose their export-oriented manufacturing base.
- In either case, many of the resource-based industries in the developing countries will come under pressure; in theory, economies with circular flow of materials no longer require the extraction of non-renewable resources such as metals (or only require it if there are overall increases in the circular flows due to population increase, or there are losses, or for some other reason).

*To date, there appears to have been no studies on this topic. As part of its Global Forum activities, UNIDO could explore the possible outcomes of material flow circularity on global flows of products and manufacturing in the developing countries.*

##### *2. The effect on global supply chains*

In cases where global supply chains continue after the adoption of policies for circular material flows (see above), the patterns of manufacturing in the developing countries could nevertheless be quite significantly altered, for a variety of reasons:

- Substantial modifications to manufacturing processes would be required to deal with recycled rather than virgin materials, or to substitute biodegradable materials for non- and vice versa.
- It is quite possible that it would be cheaper to disassemble products in the developing countries, and this would require developing new processes and new skills in the developing countries.

- Specifications on materials used in products and in processes will certainly become much more demanding since one of the primary design concerns will be to ensure that the main materials making up products are not contaminated with low levels of other materials that make it difficult to reuse them.

All these elements will put sub-contractors in the developing countries under yet more pressure to innovate and to assure high levels of quality. One can expect sub-contractors to lose existing contracts if they are not flexible enough or gain new contracts if they can quickly respond to the new requirements. Shifts within countries and between countries can be expected.

*UNIDO already works with enterprises in developing countries that are in supply chains, assisting them to meet technical requirements of the international market place. Its scope of activities could be expanded to cover these new challenges facing developing-country entrepreneurs. In countries where they exist, NCPCs or SPXs could be the mechanism to deliver this support. In addition, UNIDO could use its Public-Private Partnership programme to team up with multinational companies that have decided to redesign their products and work with them to bring the companies' supply chains in line with the new designs.*

### 3. *The effect of collection systems*

A vital component of any economy based on circular flows of materials is collection systems that ensure that waste products are separated and sent back to the correct place for disassembly and recycling/reuse. Where enterprises in developing countries are tied very strongly to the final manufacturer and/or retailer in their supply chains, it can be expected that the latter will do the necessary to ensure collection. However, enterprises with much looser ties with the final manufacturers or retailers could well be expected to work out their own collection mechanisms, which could become a significant technical barrier to trade (TBT) for these enterprises.

Something along these lines has already been seen in connection with the take-back policies in place in the European Union for packaging material. Enterprises in developing countries have been faced with the risk of losing their access to the EU's markets because they were made responsible for finding solutions to the collection requirements. Some concern is already surfacing in enterprises in developing countries about similar impacts on their export markets due to further take-back policies coming on line in the EU. It is possible that this kind of pressure would drive enterprises in the developing countries into much tighter contractual relationships with companies they supply than they currently have, leaving them even less room for maneuver than they have now.

*Two sets of activities by UNIDO are possible here. Should UNIDO go forward with plans to establish an early warning mechanism for TBTs in general, it could make sure that information on collection requirements are covered by the scope of the mechanism. In addition, as part of the scope of the early warning mechanism, UNIDO could support clusters of enterprises affected by the new requirements to find and implement solutions. Secondly, as part of the Global Forum activity suggested above, UNIDO could evaluate the likely outcomes on enterprises in the developing countries of different possible collection requirements.*

Depending on how moves towards circularity of material flows develop, there could be a trend towards the export of used products and equipment from the developed countries to the developing countries, for sale there at greatly reduced prices. Strictly speaking, this would not set up circularity in the flow of materials unless the products were finally dismantled and the materials recycled in the developing countries that received them. However, it might be argued by industries in the developed countries that this would be the first step towards a circular economy. If such global markets in a wide array of second-hand products were truly to take off, it could ruin the chances of enterprises in the developing countries to create local markets for these products, placing a significant barrier on their ability to expand their productive capacity. This type of phenomenon has already been in existence for some time now in the garments sector (although for different reasons), where exports of

used garments from developed to developing countries has ruined the latter's local garment markets. The rapid buildup of electronic waste products in the developed countries is leading to the same phenomenon. Similar phenomena have even occurred between developed countries, where the dumping of waste paper, for instance, by one country in another country has ruined the latter's paper recycling markets.

*The dumping of used products in developing countries seems to be outside of UNIDO's mission, this being more an issue of international trade in waste and therefore falling under the jurisdiction of the Basel Convention and UNEP. Nevertheless, as part of its Global Forum function, UNIDO could call attention of the world community to this kind of development and the effects it is having on the economies of the developing countries.*

## **B. A role in the revolution for the developing countries**

As was stated above, the role of the developing countries in this revolution would be modest, but there is one important area where they could play an active role. Until now, we have been focusing on the final product purchased by the consumer, and primarily the consumer in the developed countries at that, since as we have said this is where the biggest markets are. Yet every product requires the consumption of many other natural resources to manufacture it, as the primary raw materials that make it up are mined or otherwise harvested, as these materials are processed to make them fit for use, as they are brought together for assembly, as they are assembled, and as they are transported to the final retail space where they will be purchased by the consumer. And, in turn, all of the materials that were consumed during this process had to be themselves mined or harvested, processed and transported. Thus, behind every final product stands a substantial pile of materials that the consumer never sees but that were consumed to bring him the product. It has been estimated that the mass ratio between the product and these other materials can be as high as 1:9, i.e. for every kilogram of product some nine kilograms were consumed to make it (Von Weizsacker et al. 1997). Sustainable patterns of consumption and production require that these materials also be subjected to the concepts of circular material flows.

Because of the globalized nature of trade, much of this "ancillary consumption" takes place in the developing countries, where much of the mining/harvesting of raw materials and manufacturing of semi-finished or finished goods takes place. In theory, therefore, there is the possibility that developing countries could make significant contributions to circular material flows through industrial design (product and/or process design), as well as through cleaner production/eco-efficiency. However, with respect to product design in particular, the actual freedom of action that enterprises in the developing countries will have to do this may be not be as great as one could suppose. Some clients will give enterprises strict specifications on what processes to use and what ancillary materials to use, leaving the enterprise with little room for independent design decision-making. Others will be much more flexible. In addition, often the ancillary materials (and technology) that enterprises in the developing countries use have been designed by designers from the developed world and therefore the enterprises have little opportunity to pressure the designers to change the designs.

This last point, the lack of influence of enterprises in developing countries over designs decided upon in the developed country, points to what is perhaps the most far-reaching effect of moves towards circularity of material flows. Such moves will widen the already yawning gap between the developed and the developing countries with respect to design capacity. Even though some design and innovation takes place in the developing countries, as was noted above the vast majority of it is to be found in the developed countries. If there is now another quantum jump in design capabilities in the developed countries to meet the requirements of material flow circularity, then the developing countries will get left even further behind in the design "race". This will increase the barriers to their further development since beyond a certain level of wealth developing countries need to have their own design capacity, or more broadly their own innovation capacity, if they are to continue to develop.



In effect, if these concepts become the standard in the developed countries there is a real danger of creating a “two-tier” world, with the developed economies having the monopoly on product (and technology) design and being served by global supply chains where enterprises in the developing countries are trapped into being responsible only for manufacture. Since MVA levels are lower in the manufacturing stage, this means the bulk of the value added during a product’s cycle from design to marketing would remain in the developed countries, thus increasing the wealth divide between the developed and the developing countries. In addition, the local markets in the developing countries will be untouched, thus raising the possibility of “sustainable” products being available only in the developed countries and the local markets in developing countries being served only by unsustainable and marginalized industries.

*It will take time for the revolution described in this paper to take place so the developing countries do still have a “window of opportunity” in which to begin to catch up with the developed countries in the field of design, and more generally innovation. It is therefore of paramount importance that UNIDO starts now to assist developing countries to build up their design and innovation capabilities. They can be built up through existing UNIDO programmes such as the NCPC programme or the SPX programme, or through a specific design capacity-building programme such as is proposed in UNIDO’s Thematic Initiative on product innovation. The capacities can initially be built up around the ancillary materials consumed in the manufacture of products destined for the markets in the developed countries, as well as around products that serve local markets (and therefore where the design decision rests with enterprises in the developing country) or the few products that are designed locally for the markets of the developed world. The design capacities UNIDO builds up can already contain the elements of the coming revolution, so that they will be ready to affront it when it comes.*

## **VI. Summary**

Ever since the publication of the Bruntland Report in 1987, there have been calls to radically rethink the relationship between industry and the environment. Many proposals have been put forward; two books in particular, “Natural Capitalism” and “Cradle to Cradle”, took up many of these and wove them together into radically new programmes for reaching environmentally and socially sustainable development. The vision that both books promote, with variations, is one where:

- Our societies move towards circular flows of materials;
- The size of these flows are reduced through greater efficiency in the use of materials;
- Circular flows encourage changes in the relation between manufacturer and user, where manufacturers change from selling products to supplying services; and
- There is a move towards the use of non-fossil-carbon energy sources.

One could argue that this revolutionary programme has already started in the developed countries. For a number of years now, companies in the developed countries have been persuaded or forced to design consumer products that are more efficient or less toxic/hazardous during use. The European Union and Japan are now preparing policies that will make companies take back certain consumer products when their owners no longer want them, and this is already leading to product redesign to extend the useful lives of consumer products and/or make them more easily recyclable once they are taken back. Even the concept of consumer products becoming services has already been exploited by a limited number of companies.

Where will this new industrial revolution leave the developing countries? Will it pass them by? Will they be affected by it in any way? Will they have a role to play in it?

By far the largest consumer markets are in the developed countries, so only if these countries act will there be a significant move towards sustainable patterns of production and consumption. Furthermore, it is in these countries that the overwhelming majority of product design takes place. This suggests that the role of the developing countries in this revolution will be modest. However, in

today's globalized world, with developed and developing countries locking into supply chains for the manufacture of consumer products, a revolution of this magnitude will assuredly not leave the developing countries unaffected. They will definitely be impacted by a series of knock-on effects; whether on balance these impacts will be for better or for worse is difficult to say at this stage. And even if overall their role will be modest, there is one area – the ancillary materials used in production and process technology – where they could play an active and positive role in product/process redesign and innovation.

UNIDO believes that four primary issues can be distilled out from this, and which the panel can discuss:

1. There needs to be a more exact understanding of the knock-on effects that this revolution might have on developing countries, especially in relation to the potential for the revolution (or misdirected elements of it) to create barriers to the access by developing countries to international markets;
2. There needs to be an evaluation of the programmes that multilateral and bilateral organizations in general, and UNIDO in particular, can modify, extend, or create de novo, to assist enterprises in the developing countries that are part of global supply chains to surmount and adapt to the new demands that this revolution could put on them;
3. There needs to be a more exact understanding of the contribution, even if modest, that the developing countries can make to this new industrial revolution; and
4. There needs to be an evaluation of the programmes that multilateral and bilateral organizations in general, and UNIDO in particular, can modify, extend, or create de novo, to assist enterprises in the developing countries play their role in the new industrial revolution, in the areas of product design and more generally innovation.

## References

Brundtland, G. H. (ed.), *Our Common Future: The World Commission on Environment and Development*. Oxford: Oxford University Press, 1987.

Hawken, P., A. H. Lovins and L. H. Lovins, *Natural Capitalism: Creating the Next Industrial Revolution*. Boston: Little, Brown & Company, 2000.

McDonough, W. and M. Braungart, *Cradle to Cradle: Remaking the Way We Make Things*. New York: Farrar, Straus and Giroux, 2002.

Von Weizsacker, E., A. B. Lovins and L. H. Lovins, *Factor Four: Doubling Wealth - Halving Resource Use: A Report to the Club of Rome*. London: Earthscan Publications Ltd., 1997.

# **UNIDO Position Paper**

## **Industry and environment: The Need for a New Industrial Revolution**

*UNIDO Secretariat*

### **I. Introduction**

In the Issue Paper for the Round Table on “Industry and Environment: The Need for a New Industrial Revolution”, the source of the calls for a new paradigm for the relationship between environment and industry were briefly discussed, some of the more radical ideas on how to bring about this paradigm shift were described – especially those laid out in two books, “Natural Capitalism, The Next Industrial Revolution” (Hawken et al. 1999) and “Cradle to Cradle, Remaking The Way We Make Things” (McDonough & Braungart, 2002) – and some of the major issues that this brought up for the developing countries were illustrated.

In this paper, a more detailed description is given of the calls for such a paradigm shift emanating from major international fora held in the last few years – in particular the UN General Assembly when it adopted the Millennium Declaration in 2000 and the World Summit on Sustainable Development (WSSD) that was held in Johannesburg in 2002 – together with an analysis of how UNIDO’s Corporate Strategy dovetails with these calls for a paradigm shift. It goes on to show that the call in the Millennium Declaration for sustainable patterns of consumption and production requires the world community to go beyond the actions listed in the WSSD’s Plan of Implementation and adopt the kinds of strategies promoted in “Natural Capitalism” and “Cradle to Cradle”. It then lays out in great detail UNIDO’s position on the issues presented in the Issue Paper as well as the activities the Organization could undertake around these issues. Finally, it proposes a concrete project that UNIDO could undertake to explore in greater detail the possible impacts of such paradigm shifts on the developing countries and the role that UNIDO could play to assist them to deal with such shifts.

### **II. The Millennium Declaration**

In September 2000, the UN General Assembly adopted the United Nations Millennium Declaration, in which the Member States declared that they considered certain fundamental values to be essential to international relations in the twenty-first century. One of these was a respect for nature, wherein prudence was to be shown in the management of all living species and natural resources, in accordance with the precepts of sustainable development. Only in this way did the Member States believe that “the immeasurable riches provided to us by nature [can] be preserved and passed on to our descendants”. The Member States went on to assert that current unsustainable patterns of production and consumption had to be changed “in the interest of our future welfare and that of our descendants”.

In the chapter “Protecting our common environment”, the Member States repeated that no effort should be spared to free all of humanity, particularly future generations, from the threat of living on a planet irredeemably spoilt by human activities, and whose resources would no longer be sufficient for their needs. They therefore reaffirmed their support for the principles of sustainable development agreed upon at the United Nations Conference on Environment and Development (UNCED) held in Rio de Janeiro in 1992, and resolved to adopt in all their environmental actions a new ethic of conservation and stewardship.

The commitments made by the Member States in the Millennium Declaration were codified into the Millennium Development Goals, or MDGs (although these always have to be situated within the broader norms and standards of the Millennium Declaration).<sup>1</sup> One of these (Goal 7) is to ensure environmental sustainability, and this has been focused down on three targets:

- Integrate the principles of sustainable development into country policies and programmes, and reverse the loss of environmental resources;
- Halve, by 2015, the proportion of people without sustainable access to safe drinking water; and
- Have achieved, by 2020, a significant improvement in the lives of at least 100 million slum dwellers.

### **III. Plan of implementation, world summit on sustainable development**

In September 2002, at the conclusion of the World Summit on Sustainable Development, the delegates adopted a Plan of Implementation (POI), which laid out the concrete actions and measures to be taken to realize the development goals internationally agreed to since UNCED, and in particular the MDGs. The POI starts with poverty, declaring that its eradication is the greatest global challenge facing the world today and is an indispensable requirement for sustainable development, particularly for developing countries. In this manner, the POI firmly links sustainability (and therefore Millennium Development Goal 7, ensuring environmental sustainability) to the implementation of Millennium Development Goal 1, eradicating extreme poverty and hunger. The POI goes on to state that poverty eradication requires, among other things, a strengthening of the contribution of industrial development to poverty eradication and sustainable natural resource management. Among the several actions needed to bring this about, the POI calls for an enhancement of industrial productivity and competitiveness as well as industrial development in developing countries, including the transfer of environmentally sound technologies on preferential terms.

With respect to patterns of consumption and production, the POI underscores the Millennium Declaration's assertion that they are currently unsustainable, stating that fundamental changes in the way societies produce and consume are indispensable for achieving global sustainable development. All countries, continues the POI, should promote sustainable consumption and production patterns, with the developed countries taking the lead and with all countries benefiting from the process. It calls for integrating the issue of production and consumption patterns into sustainable development policies, programmes and strategies, including, where applicable, poverty reduction strategies.

To this end, the POI calls on all stakeholders to encourage and promote the development of a ten-year framework of programmes in support of regional and national initiatives whose objective would be to accelerate the shift towards patterns of sustainable consumption and production, which it defines as patterns that would promote social and economic development within the carrying capacity of ecosystems. According to the POI, this requires addressing and, where appropriate, delinking economic growth and environmental degradation by improving efficiency and sustainability in the use of resources and production processes, and reducing resource degradation, pollution and waste. In turn, this would require actions at all levels to:

- Identify specific activities, tools, policies, measures and monitoring and assessment mechanisms;
- Adopt and implement policies and measures aimed at promoting sustainable patterns of production and consumption, applying, inter alia, the polluter-pays principle;
- Develop production and consumption policies to improve the products and services provided, while reducing their environmental and health impacts;
- Develop awareness-raising programmes on the importance of sustainable production and consumption patterns;

---

<sup>1</sup> See the Guiding Principles in "The UN and the MDGs: A Core Strategy", made available by the United Nations Development Group (UNDG), which the UN Secretary-General has requested to coordinate the MDG campaign and country level monitoring activities (UNDG, 2002).

- Develop and adopt (where appropriate and on a voluntary basis) effective, transparent, verifiable, non-misleading and non-discriminatory consumer information tools to provide information relating to sustainable consumption and production – the POI stresses, however, that these tools should not be used as disguised trade barriers.

The POI lays particular stress on actions required to increase investment in all countries in cleaner production and eco-efficiency, as a means to reach sustainable patterns of consumption and production. It calls for the adoption of, inter alia, incentives and support schemes and policies directed at establishing appropriate regulatory, financial and legal frameworks. It also calls for support for exchange of technology between developed countries and developing countries and countries with economies in transition, in cooperation with relevant international organizations. The POI mentions specifically the following actions in this field:

- Support for more efficient production methods by providing, inter alia, incentives and capacity building to assist enterprises, especially SMEs and particularly in developing countries, to improve their productivity. This includes the establishment of, and support for, cleaner production programmes and centres.
- Provision of incentives for investment in cleaner production and eco-efficiency in all countries, such as state-financed loans, venture capital, technical assistance and training programmes for small and medium-sized companies (while avoiding trade-distorting measures inconsistent with WTO rules).
- Collection and dissemination of information on cost-effective examples in cleaner production, eco-efficiency and environmental management, and promotion of the exchange of best practices and know-how on environmentally sound technologies between public and private institutions;

The POI also sees the enhancement of corporate environmental and social responsibility and accountability as a means to attain patterns of sustainable consumption and production. Finally, the POI encourages the relevant authorities at all levels to take sustainable development considerations into account in decision-making.

#### **IV. UNIDO's Corporate Strategy**

What are the main elements in the Millennium Declaration and supporting Millennium Development Goals, on the one hand, and the WSSD's Plan of Implementation, on the other, that are most relevant to UNIDO's mission and therefore where it can contribute most effectively? They can be summed up as follows:

- Current patterns of consumption and therefore production must be changed to make them sustainable, i.e. make them patterns that would promote social and economic development within the carrying capacity of ecosystems. All countries should promote such patterns, with the developed countries taking the lead and with all countries benefiting from the process.
- The eradication of poverty, particularly for developing countries, is an indispensable requirement for ensuring sustainable development in general and sustainable patterns of consumption and production in particular.
- Poverty eradication, and the sustainable management of natural resources that comes with that, requires strengthening the contribution of industrial development to poverty eradication.
- Among other things, strengthening the contribution of industrial development requires an enhancement of industrial productivity and competitiveness.
- An industrial development that is environmentally sustainable (i.e., maintains the carrying capacity of ecosystems) will delink economic growth and environmental degradation by improving efficiency and sustainability in the use of resources and production processes, and reducing resource degradation, pollution and waste.
- An important part of this delinking process will come through increasing cleaner production and eco-efficiency.

UNIDO's Corporate Strategy dovetails well with this logical flow. The Strategy affirms that because countries are neglecting the scope for preventive, remedial and pro-active steps in their management of the environment, they are passing on the costs of today's unsustainable exploitation of natural resources, on the one hand, and of the excessive pressures on the absorptive capacity of the natural environment, on the other, to future generations, which will curtail, inter alia, their potential for future industrial development. The Strategy stresses that environmental degradation is as much a problem for the developing countries as it is for the industrialized nations; indeed, the problem may even be starker there since poverty itself is a great environmental hazard. In the words of the Strategy, "industrialization, urbanization, rapid population growth and poverty along with de facto 'grow now clean up later' environmental strategies in many developing countries are putting tremendous pressure on physical environment, natural resources, forests and biodiversity, air and water quality and freshwater and marine ecosystems".

The Strategy goes on to say that even in developing countries it has now become clear that there is no longer a trade-off between growth and measures for ensuring environmental sustainability. All developing countries now face the consequences of environmental neglect brought about by the urban-industrial model of growth. For development to be sustainable the environment needs to be protected and environmental concerns must be systematically incorporated into the conventional paradigms of economic development. In this regard, the Strategy underscores the importance of modifying economic development models to make achievement of high levels of productivity in the use of natural resources (i.e., the rate of natural resource input per unit of output) a central concern, both in the developing countries and in the advanced industrial nations; the Strategy stresses that issues of natural resource productivity and proper valuation of natural assets are just as important to the developing countries if they are to have consistent, productivity-led sustainable development over time.

The Strategy reasons that this will create important challenges for the development of cleaner technologies and improved environmental management systems, as well as for innovation and technology diffusion. As stated in the Strategy, "in the process of industrialization there has to be a shift from end-of-pipe pollution control to the use of new and advanced technologies which are more efficient in the use of energy and materials and produce less pollution and waste; and finally to the adoption of fundamental changes in both production design and technology represented by the concept of 'natural capitalism' and the 'cradle-to-cradle' approach".

In summary, UNIDO's Corporate Strategy can effectively contribute to the achievement by member States of the Millennium Development Goal on Environmental Sustainability and in so doing contribute also to their achievement of the Millennium Development Goal on poverty reduction because of the recognized close connection between poverty eradication and sustainability. Recognizing as it does the importance of cleaner production and cleaner technologies in the Organization's work in the environmental field, the Strategy allows UNIDO to contribute actively and extensively to the call in the WSSD's Plan of Implementation for continued implementation of cleaner production and eco-efficiency. However, it recognizes that this will be not enough if sustainable patterns of consumption and production are to be reached, and that *fundamental and revolutionary changes in the way we produce and consume will be necessary*.

## **V. Sustainable patterns of consumption and production: the need for a new industrial revolution**

There is no doubt that the revolutionary changes required in our patterns of consumption will demand equally wrenching changes in our patterns of production, first because the unsustainability of consumer products is often designed and manufactured into them at the production stage but also because the act of production is also an act of consumption. In the manufacture of every final product, a substantial amount of ancillary materials is consumed all along the value chain, as the materials making up the final product wend their way from mining/harvesting, through processing and

transport, to assembly into the final product (and transport of the product to the point of retail). It has been estimated that the mass ratio between the product and the ancillary materials can be as high as 1:9, i.e. for every kilogram of product some nine kilograms of ancillary materials are consumed to make it (Von Weizsacker et al. 1997). UNIDO firmly believes that the calls for sustainable patterns of consumption and production effectively translate into *the need for a new industrial revolution*.

What form should this industrial revolution take? Certainly, the concrete actions that the POI calls for are not very radical. There is a considerable focus on the promotion of cleaner production and eco-efficiency and relatively less on other possible actions or strategies. Cleaner production and eco-efficiency, or more generally strategies aimed at reducing the amount of materials and energy that are consumed and wasted during production, have been quite intensively implemented since the mid-1980s as a response to calls to reduce environmental impacts and costs.<sup>2</sup> UNIDO itself has had an active cleaner production programme since the mid-1990s. At the level of the individual production unit, there have been notable – sometimes quite spectacular – successes, and there is still much potential especially in the developing countries. The strategies are also being tried with success in individual service units such as hospitals and even at the level of individual households. However, the absolute quantities of materials extracted from, and wastes and pollution disposed into, the natural environment have continued to grow, albeit at a slower rate than might otherwise have been the case. As an example from the productive sector, globally the amount of energy used in metallurgical aluminium production per tonne of product dropped by ten per cent in the period 1991-2000. However, over the same period total global production of metallurgical aluminium has increased by over 40 per cent. Thus the total energy used for aluminium production has continued to increase, although perhaps more slowly than it might have done.

In addition, although cleaner production strategies in particular are meant to move enterprises and consumers away from the use of hazardous, toxic or eco-toxic materials, in practice the overall use of such materials is growing, although again at a slower pace than might otherwise have been the case had there been no cleaner production activities or environmental legislation. The hazards posed to human health and the environment of the twelve persistent organic pollutants (POPs) were recognized thirty years ago in the developed countries and action taken to remove them from commerce, yet now thirty years later it has still been necessary to adopt an international convention to remove them from global commerce and use – and this over a long time-frame. Behind these twelve substances lie many other persistent toxic substances (PTSs), whose use has in many cases been restricted in the developed countries but not in the developing countries. And behind these lie thousands of chemical substances and other biologically active materials that are in commerce but whose effects on human health and the environment are poorly known if at all. And for the most part, these substances are either released as pollutants into the environment, or they are landfilled, or they are incinerated or otherwise destroyed (and this not very efficiently).

It is therefore legitimate to ask if the principal actions being advocated in the POI to reach sustainable patterns of consumption and production – cleaner production and eco-efficiency – can alone bring about the revolutionary changes required in our consumption patterns and patterns of industrial production. There are many who believe it cannot. More radical strategies have been proposed, which in general revolve around the idea that sustainable patterns of consumption and production cannot come about if the current linear flows of materials through the world's economies continue.<sup>3</sup> Instead, they have to be “bent around” to become circular flows, where the materials used by our societies are used over and over again, or eliminated where they are simply too hazardous, toxic or eco-toxic to risk bringing into contact with the natural world. In effect, our societies should extract from the natural environment a certain stock of materials and sequester them indefinitely for their use. This would lead to a strong decrease in the rates of materials extraction from the environment (especially

---

2 Similar strategies have also been deployed under the names of waste minimization, source reduction and pollution prevention

3 It is pertinent to note here that about 80 per cent of products are used only once - see Von Weizsacker et al. (1997).

of the non-renewable fraction), with a concomitant reduction in the amount of wastes that have to be absorbed by the Earth's natural cycles. The strategies have been given various names and differ from one another in various details, but two in particular sum up much of the thinking: "Natural Capitalism, The Next Industrial Revolution" by Paul Hawken, Amory B. Lovins and L. Hunter Lovins, published in 1999 (Hawken et al. 1999), and "Cradle to Cradle, Remaking the Way We Make Things" by William McDonough and Michael Braungart, published in 2002 (McDonough & Braungart, 2002).

The concepts laid out in these two books are discussed in more detail in the Issue Paper. However, they can be summarized in the following four points:

- Our societies should move towards setting up circular flows of materials through our economies, to ensure that they are used on a quasi-infinite basis;
- The size of these flows should be reduced through greater efficiency in the use of the materials;
- Circular flows should encourage, and would be supported by, changes in the relation between manufacturer and user, where manufacturers would change from selling products to supplying services; and
- Our societies should move towards the use of non-fossil-carbon energy sources.

The two main results of this call for circular flows of materials is first, a focus on the reuse of the wastes of one producing or consuming unit as raw materials in another (in industrial circles, this commonly goes under the name of industrial ecology), and second, a focus on the reuse of products once consumers no longer want or need them. The latter is the more revolutionary of the two, since it requires a complete rethinking of product design for it to work, because products now have to be designed not only with their intended use in mind but also with their final recovery and reuse in mind. For this reason, both books recognize the centrality of industrial design in bringing this revolution.

## **VI. Existing attempts to modify product design for environmental purposes**

At this point, it would be useful to briefly review past and ongoing attempts to modify industrial design through public policies, to see if there are any ongoing attempts to put in place policies that operationalize some of the radical strategies being proposed, or to put it another way, to see if the new industrial revolution that is being called for is underway in any countries.

The redesign of products for environmental reasons (or for other reasons that nevertheless also improve their environmental performance) has been going on for at least thirty years. Fuel efficiency in cars has been a subject of (waxing and waning) concern and regulation in the developed countries since the first Oil Shock of 1973. At about the same period, there were concerted actions in the developed countries to substitute pesticides and other products that were bioaccumulative with others that were not (or less so). Chlorofluorocarbons (CFCs), the first family of recognized ozone-depleting substances, began to be removed from products in the late 1970s. These kinds of pressures have continued in various forms, lastly in the shape of the Stockholm Convention on Persistent Organic Pollutants. Regulations with the primary objective of protecting the consumer have also removed from the market products that impacted the environment.

Labelling has been a "softer" form of persuading manufacturers to modify the designs of their products, which has been in use for the last twenty years. A number of countries have energy labelling regulations for household products, with the objective of encouraging companies to make household products more energy efficient. Other types of labelling schemes, focusing on other forms of environmental impacts, have been created (one of the best known being the German "Blue Angel" labelling scheme). Their impact seems relatively weak, but they have encouraged some companies to redesign their products to make them more efficient during use in the consumption of water, detergents or other materials.



Economic instruments such as subsidies have also been used in certain cases, especially to encourage the development of renewable sources of energy. However, it is true to say that in the developed countries, economic instruments, especially subsidies, have been used more intensively to encourage the wasteful use of natural resources or the over-production of products. This is especially true for agricultural products, which as we have seen in the recent WTO Ministerial Meeting of Cancun are politically extremely divisive but also politically extremely difficult to eliminate.

All these developments, while laudable, can be considered to fall under the general heading of cleaner production or eco-efficiency and therefore subject to the same general criticism that alone they cannot bring about sustainable patterns of consumption and production. However, there have also been moves to “bend the material flows”, that is, promote/ensure that used products are recycled. The European Union and Japan are most active in this field; for a number of years now they have been promulgating directives or laws that promote product take-back or extended producer responsibilities. These are policies that put the responsibility of disposing of waste products on the manufacturers of the products. Generally, the driving forces behind such policies are to reduce waste management and disposal problems by decreasing the amount of waste products that need to be landfilled, incinerated or otherwise dealt with. It is expected (or hoped) that by making companies take back their products there will be a growing movement in product redesign to extend the useful lives of products (so that they become waste less quickly) and/or to make them more easily recyclable once they no longer work or consumers no longer want them.

It is not only public policies that have been driving the efforts to redesign products for environmental reasons. Many private companies, especially the multinationals, through their company policies have made public commitments to environmental principles such as the Global Compact or have adopted environmental managements systems such as ISO 14001 or the Eco-Management and Audit System (EMAS). A number of these companies are using these commitments to also begin using their purchasing power to require an equally stringent commitment to environmental performance from their suppliers. Some of these have started requiring their suppliers to modify the design of products they purchase from them to make them more recyclable and/or more environmentally friendly in other ways. In addition, currently it is only companies – and a limited number of companies – that have tested voluntarily, and as a business strategy, the concept of products becoming services. A manufacturer of wall-to-wall carpets offers a service where the carpet remains the property of his company, which will lay it, remove worn parts, or replace it entirely, for a service fee. A company offers a leasing service for cars that goes further than traditional car hires. Clients use the cars for such mundane things as a one-hour shopping trip or a trip downtown for the afternoon. Other companies are following up this kind of service-oriented approach for products, but it is still a concept very much in its infancy.

In summary, practical applications and policies (both public and private) do exist in the field of product design, and some go beyond cleaner production and eco-efficiency to adopt some of the strategies being advocated to create circular flows of materials. The continuing waste disposal crisis in the developed countries as well as international conventions such as the Kyoto Protocol will ensure that the pressure gets greater over time in these countries. Therefore, at least in the developed countries, the trend is generally towards the models being advocated in the books “Natural Capitalism” and “Cradle to Cradle”. In a word, *the new industrial revolution has begun*.

## **VII. The issues raised by these trends for the developing countries**

In assessing what are the issues that should be discussed by the panel, UNIDO starts from the position that there is no need to discuss if there should or should not be a new industrial revolution. We believe that the need for such a revolution is self-evident if we are to satisfy the calls of the international community at the highest levels for the creation of sustainable patterns of consumption and production. Indeed, we have argued above that, however imperfectly, this revolution has already started in the developed countries; new public and private policies are slowly developing whose

outcome will be to push enterprises to adopt strategies of circular materials flows and even to become service providers rather than product manufacturers, while existing policies continue to pressure enterprises into adopting resource-reducing strategies such as cleaner production and eco-efficiency. Therefore, the issues that should be discussed are those that derive from the potential effects that this slowly developing industrial revolution could have on the developing countries.

These potential effects have been discussed in some detail in the Issue Paper, but they can be summarized as follows:

- It is unlikely that the developing countries will be much involved in the product redesign that circularity of material flows requires, since the great preponderance of products are sold in the markets of the developed countries and therefore it is there that most industrial design takes place.
- However, with trends in globalization leading to increased involvement of the developing countries in the manufacture of products for the developed countries (often using raw materials also extracted in developing countries), any moves in the developed world towards materials flow circularity will inevitably have knock-on effects in the developing countries. At the moment, it is not clear whether these knock-on effects could weaken or strengthen global value chains.
- Even where global value chains are strengthened, the patterns of manufacturing in the developing countries could nevertheless be quite significantly altered, for a variety of reasons. This could impact individual enterprises in the developing countries, either negatively if they are not flexible enough to modify their manufacturing methods, or positively if they can take advantage of the new opportunities offered. There could even be significant shifts between countries if the new patterns of manufacturing harmonize better with the competitive advantages of certain countries than with those of others.
- Collection systems ensuring that waste products are separated and sent back to the correct place for disassembly and recycling/reuse are vital to any economy based on circular flows of materials. At this time, there do seem to be possible impacts on export-oriented enterprises in the developing countries from these collection systems, but the precise impacts are not clear.
- Moves towards circularity of materials flows could create a trend towards the export of used products and equipment from the developed countries to the developing countries, for sale there. If such global markets in a wide array of second-hand products were to take off, it could ruin the chances of enterprises in the developing countries to create local markets for these products, placing a significant barrier on their ability to expand their productive capacity.
- There is one area where the developing countries could in theory have an important role in making circular materials flows effective, and that is in their dealings with all the ancillary materials that are consumed on the way to the manufacture of a final product, many of which in globalized value chains will be consumed in developing countries (as noted above, it has been estimated that for every kilogram of product as much as nine kilograms of ancillary materials are consumed throughout the phases of extraction and processing of the raw materials and their assembly into the final product). However, how much actual freedom of action they have is unclear, because clients often dictate the use of ancillary materials or it is often industrial designers in the developed countries that design such materials.
- Perhaps the most far-reaching effect will be to widen the yawning gap with the developed countries in design capacity. If there is now another quantum jump in design capabilities in the developed countries to meet the requirements of material flow circularity, then the developing countries will get left even further behind in the “design race”. This will increase the barriers to their further development since developing countries need to have their own design capacity to have long-term development. The design capabilities of the developing countries need to be strengthened.

UNIDO believes that four primary issues can be distilled out from this set of effects, which could be discussed by the panel:

1. There needs to be a more exact understanding of the knock-on effects that this revolution in the developed countries might have on developing countries, especially in relation to the potential for

- the revolution (or misdirected elements of it) to create barriers to the access by developing countries to international markets;
2. There needs to be an evaluation of the programmes that multilateral and bilateral organizations in general, and UNIDO in particular, can modify, extend, or create *de novo*, to assist enterprises in the developing countries that are part of global value chains to surmount and adapt to the new demands that this revolution in the developed countries could put on them;
  3. There needs to be a more exact understanding of the contribution, even if modest, that the developing countries can make to this new industrial revolution;
  4. There needs to be an evaluation of the programmes that multilateral and bilateral organizations in general, and UNIDO in particular, can modify, extend, or create *de novo*, to assist enterprises in the developing countries play their role in the new industrial revolution.

## VIII. UNIDO's position on the issues

As is clear from the exposition above, the issues fall into two groups. There are those where the developing countries have little if any leverage and they will simply have to deal with whatever knock-on effects ensue from the eventual adoption on a large scale by the developed countries of policies promoting circular materials flows. Then there are those issues where developing countries can and should make a contribution to such policies. The outline given below of UNIDO's position on the issues will reflect this division, distinguishing in turn between what UNIDO can do in its role as a Global Forum and what it can do through its technical assistance and cooperation programmes.

### A. *Dealing with the knock-on effects*

#### 1. *Using UNIDO's Global Forum activities to analyze some unclear aspects of the knock-on effects*

To date, there appear to have been no extensive studies on the impacts that requirements for circular flow economies might have on global trade, especially between the developing countries and the developed countries. Yet it seems to UNIDO that this aspect of circular flow economies must be studied, because we must avoid at all costs that decisions taken in the developed countries for the justifiable reason of ensuring environmental sustainability create unnecessary barriers to international trade, which will be the main engine for the developing countries to get onto the path of sustainable economic growth. As part of its Global Forum activities, UNIDO should bring this element of the issue to the attention of the world community. In particular, UNIDO should undertake the studies required to better understand the relationships between national economies with circular materials flows and the globalization of trade. There seem to be at least three possible ways in which global patterns of trade could change.

One possibility is that the developed countries adapt their economies to materials circularity by sending the used products, or the materials making them up, back to the developing countries for reprocessing into new products. In other words, the material flow would become international, with the products being manufactured in the developing countries, being exported to the developed countries for use and consumption there, and then being sent back "down the value chain" for reprocessing and reuse. This would tend to further develop the manufacturing economies of developing countries. A first, rapid analysis would suggest that this could well be the outcome for durable consumer products made from non-biodegradable materials.

On the other hand, the complexity and/or the costs of sending used products, or the materials making them up, back to the developing countries may be high enough that there will be a trend to "shorten the supply lines", i.e., shift manufacturing closer to the use. If this begins to happen, then one would expect developing countries to begin to lose their export-oriented manufacturing base. A first, rapid analysis would suggest that this could be the case for products made from biodegradable materials

(where materials circularity would probably come about through composting and taking advantage of the planet's natural recycling cycles) or small, lightweight non-durable products.

In either case, one would expect that circular materials economies would put many of the resource-based industries in the developing countries under pressure. In theory, economies with efficient circular materials flows (i.e. flows where there is little "leakage" of materials) would require no, or very little, extraction of resources from the Earth's natural stocks.<sup>4</sup> As an example, about 60 per cent of the world's production of copper come from South America, Asia, Africa and Oceania, while the same regions are responsible for about 50 per cent of the world's smelting of copper ores.<sup>5</sup> Copper metal is an excellent candidate for circular economies since it quite easily recyclable. One would expect that a massive shift by the developed countries to circular materials flows would very significantly reduce the mining and smelting of copper ores. The expected economic growth in the developing countries would tend to counterbalance this trend, since their growing economies would require increases in the stocks of copper in circulation in their economies. However, the overall trend in copper mining and primary smelting would likely be downwards. At a more generalized level, a little over 50 per cent of the world's mining of mineral commodities takes place in Asia, Africa and South America.<sup>6</sup> Therefore, one could expect significant impacts in the developing countries' mining industries from moves towards economies with circular materials flows.

Another aspect of circular material flows that needs to be studied and brought to the attention of the world community is what might be termed the "dark side" or "hidden side" of circular material flows, that is, that part of the cycle that has to do with the collection of used products, their sorting, their disassembly and their recycling/reuse. Some of the technical aspects of this issue, and their impact on enterprises in the developing countries, are addressed in the next section because they involve an extension of technical assistance services that UNIDO already offers. However, there are some aspects that need further study to appreciate their true implications for enterprises in the developing countries.

The first has to do with understanding better under what conditions such enterprises might be made responsible for the collection of their used products in their export markets. Currently in Europe and Japan, there are already collection requirements for certain categories of used products, and in the main the responsibility for their collection and subsequent management has been put on the retailers and/or manufacturers. One can expect that this trend will continue. In this case, would manufacturers in the developing countries find themselves responsible for the collection of their used productions in far-off markets? A first, quick analysis suggests that where enterprises in developing countries are sub-contractors to the final manufacturers, or have strong ties with the retailers in, their value chains, they will probably not be affected by such collection requirements; the final manufacturers or retailers will take on the responsibility. However, enterprises in developing countries that make the final products themselves and sell them abroad through retailers with which they have only loose commercial ties, could find themselves being made responsible for the collection of their used products. This could become a significant technical barrier to trade for these enterprises.<sup>7</sup> It is possible that this kind of barrier would drive enterprises in the developing countries into much tighter contractual relationships than they have now with manufacturers or retailers they supply, leaving them even less room for manoeuvre than they have now.

---

4 Steady-state economies would only require "topping up" to make good for leakage; growing economies would need additional input to increase the stock that is already in circulation.

5 Data from the International Copper Study Group, <http://mmsd1.mms.nrcan.gc.ca/icsg/default.asp>.

6 Data from "World Mining Data 2002", [http://www.wmc.org.pl/wmd2002\\_3.pdf](http://www.wmc.org.pl/wmd2002_3.pdf) (cited data excludes diamonds and natural gas).

7 Something along these lines has already been seen in connection with the take-back policies in place in the European Union for packaging material. Enterprises in developing countries have been faced with the risk of losing their access to the EU's markets unless they redesign their packaging to make it more compatible with collection systems.

Another aspect of the “hidden side” of circular material flows that needs to be studied stems from the inevitable existence of a grey area between materials that are destined for recycling/reuse and materials that are essentially waste. As has been suggested above, it is quite possible that economics will dictate that the used products, or at least the materials making them up, will go back to the developing countries to be recycled and reused. In cases where this is so, the “hidden side” of the cycle will stretch globally, from the developed countries where the products were used to the developing countries where the materials making them up will be recycled/reused. The precise sharing of responsibilities for the tasks that take place along the “hidden side” is not clear. Almost certainly, institutions in the developed countries will be responsible for collecting the used products and at least some sorting of them. A more thorough sorting of products, their disassembly, and further sorting of the resulting materials could be either done in the developed countries or in the developing countries. The final recycling and reuse will be the responsibility of the developing countries.

It does not take much imagination to see that a collection, sorting, disassembly and recycling system stretched out over several different countries is ripe for the kind of abuse that the international community wanted to stop when it adopted the Convention on the Control of Transboundary Movement of Hazardous Wastes and their Disposal (the so-called Basel Convention). One could foresee situations where disassembly is undertaken in the countries where the products are used and is done so haphazardly that the result is badly sorted materials. These are then shipped to developing countries for reuse. However, strict specifications on the acceptable levels of contamination in the recycled materials to be used in products (see next section) force the developing countries to do further sorting, which produces an acceptably pure raw materials stream but also leaves them with a waste stream made up of what remains, which they now have to dispose of. *De facto*, the developed countries in cases such as these have dumped wastes on the developing countries.<sup>8</sup>

If only collection and sorting were undertaken in the countries where the products were used, there could be a trend towards the export of used products and equipment from the developed countries to the developing countries, not so much for disassembly and reuse as for sale as second-hand products. This would not actually set up circularity in the flow of materials unless the products were finally dismantled and the materials recycled in the developing countries that received them. However, it might be argued by industries in the developed countries that this would be the first step towards a circular economy. If such global markets in a wide array of second-hand products were truly to take off, without any concomitant disassembly and reuse, then again this would simply be a mechanism for the developed countries to export their wastes to the developing countries. Just as seriously, it could also ruin the chances of enterprises in the developing countries to create local markets for these products, placing a significant barrier on their ability to expand their productive capacity.<sup>9</sup>

Both these possibilities (and there could well be others) strongly suggest that any moves towards circular material flows need to be accompanied by the development of adequate monitoring mechanisms to ensure that the establishment of circular material flows is not used as an excuse to export wastes. The responsibility for ensuring such monitoring mechanisms is outside of UNIDO’s mission, this being more an issue of international trade in waste and therefore falling within the mission of the Secretariat to the Basel Convention and UNEP. Nevertheless, as part of its Global

---

8 Examples of this kind already exist. Much old newspaper is exported from the developed countries to the developing countries for reuse. However, before the paper can be reused it has to be deinked. The waste sludge that this produces is often hazardous because of the chemicals used in the printing inks, and these now have to be disposed of in the developing country.

9 This type of phenomenon has already been in existence for some time now in the garments sector, where exports of used garments from developed to developing countries has ruined the latter’s local garment markets. The rapid build-up of electronic waste products in the developed countries is leading to the same phenomenon. Similar phenomena have even occurred between developed countries, where the dumping of waste paper, for instance, by one country in another country has ruined the latter’s paper recycling markets.

Forum function, UNIDO could call attention of the world community to this kind of potential development and the effects it could have on the economies of the developing countries.

On the basis of the results of such studies as these, whether they are done by UNIDO or others, it is then necessary to study what mechanisms should be put in place to ensure that the concerns of the developing countries are taken into account in decisions by countries to move towards circular economies. One could argue that in theory the network of enquiry points already put in place by WTO should be sufficient for this, since the role of these national focal points is (a) to disseminate to all other focal points information on any upcoming legislation or regulation that could have impacts on trade, (b) to disseminate to potentially affected enterprises in their countries the same information they receive from other countries, and (c) to channel comments on these upcoming laws and regulations to the authorities preparing them. However, initial experience with the national focal points suggests that WTO's network needs to be complemented by other information dissemination networks that lead more directly to potentially affected enterprises and give these enterprises a means of making their concerns heard in the country where the laws and regulations are being elaborated. In the case of UNIDO, it would be good to explore if and how its current networks of industry support institutions – e.g., the National Cleaner Production Centres (NCPCs), the Subcontracting and Partnership Exchanges (SPXs), and the Investment and Technology Promotion Offices (ITPOs) – could be used as an early warning mechanism to disseminate information on any upcoming policies that could impact trade. This could be linked to technical assistance programmes that would help exporting enterprises to meet new requirements (see below).

2. *Delivering new/expanded technical assistance services to deal with knock-on effects whose existence can be predicted with some certainty*

Even where the global value chains remain more or less as they are now in a scenario of substantial moves towards circular materials flow economies, a number of aspects of those value chains would nevertheless change. As far as export-oriented manufacturing enterprises in the developing countries are concerned, the following major changes seem possible.

In the first place, as was stated above, circular materials flows will require substantial redesigns of products. One group of changes will surely be that the materials making up the products will be changed, to make their recovery at the end of the products' life easier. For instance, it is possible to imagine that there would be switches from biodegradable materials to non-biodegradable materials and vice versa, so that products can be either completely made up of one or other family of materials. Alternatively, or in addition, material changes could be made to reduce the range of different materials in a product, so as to simplify the recovery procedures at the end of the products' life. For instance, products made up of many different types of plastics might be redesigned to contain only one or two plastics. And of course, as a reflection of the basic concept of circular materials flows, manufacturing will primarily use recycled materials rather than virgin materials. All these things will require substantial modifications to the manufacturing processes themselves, and the responsibility for this would rest primarily with the enterprises in the developing countries, which would have to enter into a cycle of major process innovation and adaptation.

In the second place, materials flow economies would add an extra step to the overall manufacturing process, a disassembling step. Wherever products are made of different types of materials these would have to be separated to ensure that they could be properly reused and recycled. In other words, for many assembly lines there would have to be somewhere, as a mirror image, disassembly lines. This immediately raises the question of where this disassembly would take place. Economic considerations suggest that just as much as it is cheaper to assemble products in the developing countries so will it be cheaper to disassemble them there too.<sup>10</sup> In turn, this would mean that enterprises in the developing countries would have the opportunity to invent new processes, or adapt

---

<sup>10</sup> Although, as mentioned above, transportation costs could work against this. These costs might drive disassembly to take place closer to where the products were used.

existing ones, for disassembly, which would also mean that there would be a need to build up a whole new set of skills in the developing countries.

Thirdly, circular materials flow economies would almost certainly tighten specifications on materials used in products and in processes. To be truly sustainable, circular materials of flows must be quasi-infinite. This immediately means that by the time the materials come back around for reuse in new products they should be free of micro-contaminants that would make them unusable or that would seriously attenuate their properties. In other words, the materials must come back at quite high levels of purity. To some extent, issues of purity of the recycled materials will depend on the industrial designer. For instance, it will be the designer who will be responsible for ensuring that non-biodegradable or toxic and eco-toxic materials are designed out of a product destined for biodegradation. However, to a large extent materials purity will also be a function of the operational efficiency and effectiveness of the systems used to collect the used products, sort them, and send back to the correct place for disassembly and further sorting, and finally recycling/reuse. Imperfections in these systems will tend to cross-contaminate different material streams, which will then make it much more difficult to recycle and reuse the materials. Here, the responsibility will be shared between the designer (who through design can make cross-contamination less likely in the disassembly phase), the institutions in the developed country responsible for collection and sorting of used products (and possibly disassembly and further sorting), and the enterprises in the developing countries who will reuse the recycled materials (and possibly undertake the disassembly and further sorting).<sup>11</sup> Among other things, these kinds of factors will almost certainly encourage the ultimate sellers of products to create more stringent specifications on the purity of the materials used to make the products. The enterprises in developing countries will have to meet them and just as importantly show that they meet them, which in turn requires the presence of properly accredited and certified laboratories.

All these elements will put export-oriented enterprises in the developing countries under yet more pressure to innovate and to assure high levels of quality. This suggests that new opportunities will be created for multilateral/bilateral programmes to promote the diffusion of technology that responds to circular materials flow requirements, with a view to maintaining or even increasing market access for developing countries. Certainly, UNIDO will be in a good position to bring this new type of technical assistance and cooperation to the developing countries. The Organization's overall strategy to assist developing countries in market access can easily absorb these new challenges, which would be translated into:

- An expansion of the scope of existing programmes to assist in overcoming trade barriers, such as those in the Quality Unit or in the Agro-Industries Branch, so that they can cover these new challenges for developing-country entrepreneurs.
- In countries where UNIDO has established local industry support institutions like SPXs, NCPCs, or ITPOs, the building of new capabilities in these institutions to deliver the necessary support to their countries' entrepreneurs to meet these new challenges.
- An involvement of UNIDO's international technology centres and cooperating networks in the assistance to be given to entrepreneurs in the necessary technological and material transformations.
- A new element in UNIDO's Business Partnerships, where the focus would be to team up with multinational companies that have decided to redesign their products for circular materials flows and work with them to bring the companies' value chains in line with the new designs.

In addition to all this, UNIDO would need to actively promote process innovation, and build up the necessary capabilities in the developing countries to do this. As was stated above, in at least one

---

<sup>11</sup> An example of a product containing stainless steel can be used to clarify this point. It would be the responsibility of the designer to ensure that the product's design allowed for an easy and effective separation of the stainless steel from other materials in the product that would otherwise contaminate it, the responsibility of the collectors and sorters not to mistakenly mix with the products containing the stainless steel other products that are incompatible, and finally the responsibility of the disassemblers and the recyclers/reusers not to mistakenly add to the disassembled stainless steel incompatible materials.

scenario regarding knock-on effects, circular material flows would mean that disassembly and materials sorting take place in the developing countries, which would require new technologies or adaptation of existing technologies, and there would certainly need to be process changes to use recycled materials rather than virgin materials.

**B. *Dealing with the areas where developing countries can/should make a contribution***

*1. Using UNIDO's Global Forum activities to analyze some unclear aspects of the developing countries' potential contribution to circular material flows*

As was stated above, it has been estimated that in the manufacture of every final product a substantial amount of ancillary materials, perhaps as high as nine kilograms per kilogram of product, is consumed all along the value chain (Von Weizsacker et al. 1997). The concept of sustainable patterns of consumption and production requires that these materials also be subjected to the concepts of circular material flows.

Because of the globalized nature of trade, a substantial fraction of this ancillary consumption takes place in the developing countries, where much of the mining/harvesting of raw materials and manufacturing of semi-finished or finished goods takes place. In theory, therefore, there is the possibility that developing countries could make significant contributions to circular material flows through product and/or process design, as well as through cleaner production/eco-efficiency. However, with respect to product design in particular, it is not clear how much freedom of action enterprises in the developing countries really have. An enterprise's freedom of action will be a function of the tightness of the relationship between it and its clients. Some clients will give enterprises strict specifications on what processes to use and what ancillary materials to use, leaving enterprises little room for independent design decision-making. Others will be more flexible. In addition, it is often the case that the ancillary materials (and technology) that enterprises in the developing countries use have been designed by designers from the developed world and therefore the enterprises have little opportunity to pressure the designers to change the designs. More study is needed to understand with greater precision how much the developing countries could really do on the ancillary materials and what might be the barriers to their being able to do it. Through its Global Forum activity, UNIDO could undertake the necessary studies and bring the results to the attention of the world community.

*2. Delivering new/expanded technical assistance services to assist developing countries play a more significant role in circular material flow strategies*

While there are questions about how much the developing countries can actually do through redesign to render circular the flows of the ancillary materials they consume, it is true that there are some activities along these lines already underway. Earlier in the paper it was mentioned that industrial ecology is a strategy for making material flows circular, and quite a number of projects of this nature are ongoing in the developing countries. This would be an area where UNIDO could offer more programmes than it has to date.

It is also the case that enterprises in the developing countries can do much to reduce the amounts of ancillary materials that they consume in their industrial processes per unit of product manufactured, i.e. reduce the ratio cited above. This is classical cleaner production/eco-efficiency, an area where UNIDO already has a strong programme. In this case, then, the cleaner production programme can simply be intensified, which would anyway be in line with the Plan of Implementation of WSSD, and its policy work can be made to focus more sharply the attention of the policy-makers in the developing countries on upcoming moves towards circular material flows.

Here, too, UNIDO can intensify its activities to promote the transfer of Best Available Techniques (BAT) and Best Environmental Practices (BEP) between developed and developing countries. This



would also be in line with the Plan of Implementation of WSSD, which stresses the need to enhance the transfer of environmentally sound technologies. Such BATs and BEPs can assist enterprises in the developing countries mostly in their cleaner production efforts, although some could also play an important role in the creation of new industrial ecological cycles or the extension of existing ones.

As important is the need for UNIDO to take action now to lessen the yawning gap between the developed and the developing countries with respect to the latter's capacity to design and innovate products and processes, a gap which will only get wider if much of the redesign work for circular material flows takes place in the developed countries because that is where all the industrial designers are. The bulk of the value added during a product's cycle takes place in the design and marketing stages, the stages dominated by the developed countries, with relatively little being added at the manufacturing stage, which is where the developing countries are most active. Only if developing countries begin to be active in design and innovation can they hope to decrease the wealth divide between themselves and the developed countries. If they do not, and leave the bulk of the design and innovation work needed for circular material flows to the developed countries, there is a real danger of creating a "two-tier" world, with the developed economies having the monopoly on product (and technology) design and innovation, being served by global value chains where enterprises in the developing countries are trapped into being responsible only for manufacture. In addition, the local markets in the developing countries will be untouched, thus raising the possibility of "sustainable" products being available only in the developed countries and the local markets in developing countries being served only by unsustainable and marginalized industries.

It will take time for the revolution described here to take place so the developing countries do still have a "window of opportunity" in which to begin to catch up with the developed countries in the field of design and innovation. It is therefore of paramount importance that UNIDO starts now to assist developing countries to build up their design and innovation capabilities. They can be built up through existing UNIDO programmes such as the NCPC programme or the SPX programme, or through a specific design and innovation capacity-building programme such as is proposed in UNIDO's thematic initiative on product innovation. The capacities can initially be built up around the ancillary materials developing countries consume, as well as around products that serve local markets (and therefore where the design decision rests with enterprises in the developing country) or the few products that are designed locally for the markets of the developed world. The design capacities UNIDO builds up can already contain the elements of the coming revolution, so that the developing countries will be ready to affront it when it comes.

### ***C. Proposed demonstration project in India***

As is clear from the discussion so far in this paper, there are many unknowns about how the kinds of strategies being proposed to bring about truly sustainable patterns of consumption and production would work in enterprises in the developing countries, or how they impact them. A number of activities have been suggested where UNIDO could use its Global Forum function to analyze in more detail the potential impacts on the developing countries and inform the world community about the results. It has also been suggested that a number of UNIDO's current programmes could be expanded to assist enterprises in developing countries overcome probably impacts, especially where barriers to market access are concerned.

As part of this process of arriving at a better understanding of what the impacts could be, and how serious they could be, UNIDO is currently undertaking a short study in India to assess the relevance and the importance of the strategies outlined in "Cradle-to-Cradle" and "Natural Capitalism" in the context of a developing country like India. An evaluation of the types of industries, companies and products which in the Indian context could be most open to the "Cradle-to-Cradle"/"Natural Capitalism" strategies, the study use the garments sector as a case, to (a) evaluate the attitude of the relevant government and non-government bodies to the introduction of such strategies, and (b) elaborate recommendations about how such strategies could best be carried forward in the Indian context.

The study will focus in particular on the textile and garment sectors, because these sectors are such an important part of India's exports, and therefore important for India's overall economic development. They are also sectors that are of great social significance because of the employment opportunities they have created in the country; but they are also sectors that have a potential for great harm socially due to the use of unacceptable working practices by certain entrepreneurs. In addition, the textile sector, and particularly the dyeing and finishing parts of the sector, have the potential to greatly damage India's natural environment because of the large amounts of pollution generated, to which can also be added the large amounts of pollution generated in the production of dyes and other ancillary chemicals consumed in the textiles sector – most of India's textile sector relies on locally manufactured dyes and ancillary chemicals. India's textile and garments industry is really a microcosm of other countries' textile and garment sectors, where economic development is bound closely to the sectors, they create employment opportunities but also opportunities to exploit the labour force, and they generate significant amounts of pollution. As Mr. Braungart remarked in his study for UNIDO of this sector, "the power of textiles to fuel economic development is complemented by their potential to rip apart social and environmental systems" (Braungart, 2003).

Building on this study, UNIDO proposes to carry out a demonstration project in India focusing on the garment/textiles sectors, to explore the possibility of creating a "regenerative textile sector", in the words of Mr. Braungart, for India: that is, "textile and clothing industries [that] contribute positively and simultaneously to the social, economic and environmental conditions" of India.

Several export-oriented enterprises would be encouraged to take part in the demonstration project, with a view to entering into an exercise to redesign their products or their ancillary materials (or even their processes, if necessary), with the purpose of implementing one or more of the four strategies promoted in "Cradle-to-Cradle" and "Natural Capitalism", namely:

- Redesign to allow for a circular flow of the materials in the products and/or the ancillary materials that are used in the manufacture of the products;
- Redesign the products, ancillary materials, or processes to reduce the size of these flows;
- Change from selling a product to supplying a service; and
- Move towards the use of non-fossil-carbon energy sources.

"The ultimate goal is clear: products and processes associated with the textile industry must be designed, manufactured, marketed, used and disposed of or recycled to fit into cyclical biological or technical metabolisms" (Braungart, 2003)

Following the scheme laid out in UNIDO's sectoral study on the apparel sector (UNIDO, 2003), the demonstration project will include where possible participating enterprises from all the networks – where they exist in India – that make up the garment value chain: the raw material networks, the component networks, the production networks, the export networks, and marketing networks as presented in detail in Figure 1 (Annex). Ideally, enterprises that are actually linked commercially should be chosen, to examine how the relevance and importance of the various strategies varies along an actual value chain. The demonstration project should account for – if relevant in describing different behaviours – the fact that the participating enterprises belong to one of the three international production systems specified in UNIDO's sectoral study on the apparel sector, namely assembly, original equipment manufacturing (synonymous with specification contracting and full-package supply), and original brand name manufacturing.

If possible, the demonstration project in India should be complemented with evaluations of major apparel buyers in the developed countries that purchase in India, to study if these buyers are sensitive to the issues raised in "Cradle-to-Cradle" and "Natural Capitalism", seeing these as possible inhibitors to their business or on the contrary seeing them as creating new market opportunities for them.

To ensure that the results of the demonstration project can have as great a resonance as possible, an advisory board will be created to oversee the project whose membership will be made up of all the sector's key stakeholders – both in the private and public sectors. The primary roles of this board will be to ensure that the demonstration projects are implemented as planned, that the results of the demonstration projects are disseminated as widely as possible, both within and outside of India, and that where necessary the relevant public and private policies are put in place in India to ensure that the results of the demonstration project can be sustained and adopted on a wide scale.

Apart from project management, UNIDO will play several key roles in the project. It will bring in as project partners institutions such as the National Cleaner Production Centre of India and other related institutions, as well as more textile-related institutions, which can act as the industry support institutions for the enterprises that have accepted to take part in the project. It will also bring in its own expertise, primarily from the cleaner production unit but also in the textiles unit as well as in the energy efficiency unit where there are energy concerns to be dealt with. In addition, it can bring to the project a host of international experts in textiles with which it has worked over the years. Finally, it will ensure that the results of the demonstration project are disseminated globally so that other countries with important textiles sectors can benefit from the results of the project.

## References

Braungart, M., *Creating a Regenerative Textile Sector: The Importance of UNIDO* (Draft). Vienna: United Nations Industrial Development Organization, May 2003.

Brundtland, G. H. (ed.), *Our common future: The World Commission on Environment and Development*. Oxford: Oxford University Press, 1987.

Hawken, P., A. H. Lovins and L. H. Lovins, *Natural Capitalism: Creating the Next Industrial Revolution*. Boston: Little, Brown & Company, 2000.

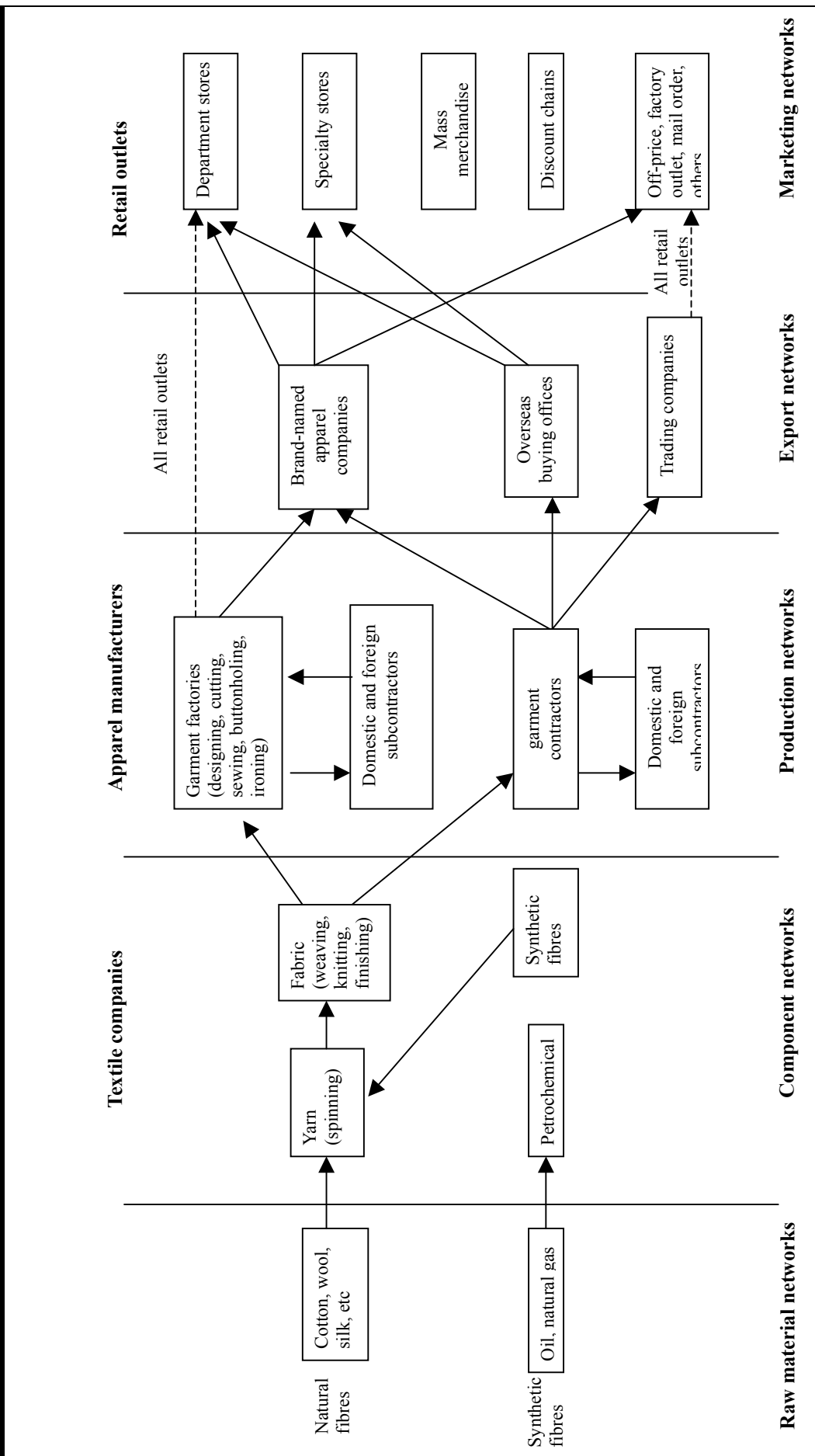
McDonough, W. and M. Braungart, *Cradle to Cradle: Remaking the Way We Make Things*. New York: Farrar, Straus and Giroux, 2002.

UNIDO, *The Global Apparel Value Chain: What Prospects for Upgrading by Developing Countries*. Sectoral Studies Series. Vienna: United Nations Industrial Development Organization, 2003.

UNDG, *The UN and the MDGs: A Core Strategy*. New York: United Nations Development Group, 2002.

Von Weizsacker, E., A. B. Lovins and L. H. Lovins, *Factor Four: Doubling Wealth - Halving Resource Use: A Report to the Club of Rome*. London: Earthscan Publications Ltd., 1997.

**Figure 1 (Annex). The apparel value chain**



## Moderator's Introduction

*Edward Clarence-Smith*\*

Good morning ladies and gentlemen.

Kindly allow me make a few introductory remarks. The first thing I should say is that I have taken over the moderation of this session. Unfortunately, Ms. Jackie McGlade, who is the Executive Director of the European Environmental Agency and who was slated to be the moderator, contacted me on Friday and said that due to a combination of emergency work and ill-health, she was forced to give up and that she very much regretted it.

Let me give you a little bit of background as to where this Round Table came from. The starting point was two books that have come out in the last three or four years. One is called "Natural Capitalism: The Next Industrial Revolution" and the other is called "Cradle-to-Cradle: Remaking the Way We Make Things". I am glad to say that we have co-authors of both those books with us today. Mrs. Hunter Lovins, to my right, co-authored the book "Natural Capitalism"; Mr. Michael Braungart, to my left, co-authored the book "Cradle-to-Cradle". I would like to take this opportunity to thank Mr. Braungart for lending us an exhibition on "Cradle-to-Cradle", which you will find in the cafeteria area.

If any of you have not read these books, I would highly recommend that you do so if you can. I think they give us a very interesting point of view of where the cutting edge of environmental thinking is at this moment. Of course, there are other books, but these two really are very good. You can download "Natural Capitalism" off the web; it's very nice of the authors to have done that for us! As for "Cradle-to-Cradle", for those of you in UNIDO there are several copies of the book in the UNIDO library.

I took from these two books a series of messages, which I would like to share with you, and which were behind the issue paper and the position paper that were prepared for this session.

The first message that I took is that cleaner production, which we know well at UNIDO, sometimes also called eco-efficiency, is definitely not enough, in and of itself, to bring about sustainable patterns of consumption and production, as was called for by the General Assembly in its Millennium Declaration and also at the World Summit for Sustainable Development in Johannesburg just recently. It is good, but it is not enough. For those of you who want to see a little bit of historical analysis of how cleaner production has worked, the latest issue of the Journal of Cleaner Production has done an assessment and an evaluation of past programmes and you can find the table of contents on the table by the door.

What we have to do if we really want to move towards sustainable patterns of consumption and production is that we have to move towards economies that take the materials that make up our products that we consume in our societies and use them over and over again in quasi-infinite cycles. Broadly speaking, we need to set up two sub-cycles. One is a cycle that uses the Earth's natural cycles, so basically for products made up of biodegradable materials. The other one is a cycle that recycles non-biodegradable materials such as metals and plastics, which have been termed technical nutrients in the book "Cradle-to-Cradle". The same concept also tells us that we must move our economies towards the use of naturally renewable energy sources and away from the fossil and radioactive fuels that we use today.

---

\* Senior Industrial Development Officer, Energy and Cleaner Production Branch, UNIDO. The text presented here is based on an edited transcript of the moderator's spoken introduction.

This kind of thinking that materials and products should go round and round begins to have some very interesting implications for the business models that we might want to use. When you begin to think in that way, it becomes possible for manufacturers to think in terms of no longer being manufacturers of products but really providers of services. That is to say, rather than selling products, they can begin to think in terms of selling services through the leasing of those products for use. This business model is already being used in several ways, by several companies, and I am sure the speakers will refer to it.

One of the concerns that I have is that both of these books were written primarily for audiences in the developed countries and focus mainly on the economies of developed countries. This leads to me to pose two major questions for our panellists, which I hope that they will respond to as we go forward. The first is the most obvious question, namely are the concepts covered in these two books relevant to developing countries, and if so, then what form should they take to be relevant? That, of course, is of extreme importance to UNIDO. If the Organization wishes to move into this area, then we must know if it is relevant and how it is relevant.

The other question which I pose is what engineers would call a materials-balance question. If we overlay a circular flow of materials, which is a natural outcome of this concept of thinking in cyclical terms, onto globalized trade, what happens? We have products that are manufactured in the developing countries and these are then coming onto the markets of the developed countries; circular flow concepts tell us that somehow after use they should go back to where they were made and start again. But is that really going to happen? Therefore, are there going to be impacts on globalized flows of trade? And if so, what? Of course, at UNIDO we are especially interested in knowing if they are going to be impacts – positive or negative – on the developing countries and their efforts to access international markets.

We will now hear from the keynote speaker, Ms. Hunter Lovins, and then I will ask the panellists one-by-one to comment on that and on anything else that is inherent to this panel. After that, I will open the floor to discussion and I hope that we will have a good and lively discussion.

## Keynote Speech

Hunter Lovins\*

The issue paper from Round Table 1 essentially said that the efforts of those of us who have been trying to alleviate poverty for over 50 years have failed. Somebody once said that continuing on with the same efforts and expecting a different outcome is the definition of insanity. So clearly, we have a problem here. One thing that is very clear is that it's time for redefining our relationship with our home, the Earth.

The problem that we are facing is not necessarily that we are doing the wrong thing; it's that our mental models of how we are going about all of this may well be wrong. We assume that government is going to solve all the problems in the world. We assume that protecting the environment is costly. We assume that industrial development is the route to prosperity. It is time to start questioning some of these assumptions, in particular those about government. The governments of the world came together a little over a year ago in Johannesburg to put in place an implementation plan for the promises that the world's governments made ten years before in Rio, and they failed to do so.

At the same time, of the world's 100 largest economic entities well over half are not countries any more; they are companies. Who rules the world really? The business community may be the only institution on the planet that is big enough, that is rich enough, that is well enough managed to take on the problems that are facing us. On the other hand, in an Internet empowered world a small group of citizens can legitimize any country or any company. So our mental model of who is in charge here may be entirely wrong, and we need to start to rethink how we go about meeting these challenges and who deserves a seat at the table. In a sense, we now live in a tripartite world in which there are at least three power nodes and yet we lack a theory of governance for how to bring these powers together.

I'll be talking about the challenges that are facing us, the approach that we call natural capitalism, how to profitably solve many of the environmental problems as well as many of the social problems in what might be called the over-developed world, and then the extent to which this can also be the basis for development in the rest of the world.

Let's start with the challenge. There's really no longer any serious scientific dispute that every major eco-system on the planet is in decline. Now you might say, "So what?" Well here's a bit of so-what. These eco-systems are not just pretty; they give us services, the eco-system services. You count up the contribution to the economy of these services and it comes to around US\$ 30 trillion worth a year, none of which is on anybody's balance sheet. The US Utility Regulator, Peter Bradford, once said that it is better to be approximately right than to be precisely wrong, and treating these things as having a value of zero is clearly not right.

So the economists say, "Fine, stick a price tag on them, let's start counting them". All right, how do you do that? The team at Biosphere II spent US\$ 200 million and could not keep eight people in clean air for two years. What's the value of clean air? Whatever it is, I would argue that we are all a bit sentimental about it. What is the value of a stable climate? We are about to find out. Of late, the insurance companies are becoming a *little* concerned because if there are a few more Category 5 hurricanes in the south of Florida they're out of business. You could calculate the economic cost of hand-pollinating all of agriculture but it would surely be tedious. Or the ability of the planet to absorb and detoxify society's wastes: what is the value of that to us? We do not know.

---

\* Co-Chair of the Natural Capitalism Group, Colorado, USA. Co-founder of the Rocky Mountain Institute, Colorado, USA. The text is based on an edited transcript of the keynote speech as delivered.

This way of doing business came out of the time in our history when it made good sense. In the first industrial revolution there were relatively few skilled people and many new machines coming in, so profit-maximizing capitalists economized on their scarce resource, people, substituted their plentiful resource, nature, and increased labour productivity 100-fold. If anybody had said at the outset that that was what they were about, everybody would have laughed. But that's what happened.

So that is the economic model, or the mental model, which gave us the first industrial revolution, and which all of our modern economies still use: People are scarce, nature is abundant; so use a lot of nature, subsidize the use of nature, penalize the use of people. Now here is the mental model for the next industrial revolution. Currently we have 10,000 more people arriving on Earth every hour. Clearly, we are not short of people while every major eco-system is in decline. We live in a time of changed relative scarcity.

Profit-maximizing capitalists will continue to employ the same logic of capitalism – that has not gone away – but the outcome will be very different. It will be based on what we call natural capitalism. First of all, it will be based on dramatically greater efficiencies with which we use everything taken from the Earth or borrowed from the future. But that's only the beginning; eco-efficiency is just good housekeeping. It's after this that it gets fun. Natural capitalism will be based on bio-mimicry, asking how nature itself does business and ultimately building an economy based on restoration. Michael Braungart's work, "Cradle-to-Cradle", taken from the phrase of the Swiss analyst Walther Stahel twenty years ago, is clearly part of this. We believe that these principles, and others that we have not found yet, are the key to prosperity in the coming decades. Continuing the way we have done business in the past is not going to work.

In the next industrial revolution, we will increase resource productivity – or total factor productivity – four-fold, ten-fold, ultimately even 100-fold, just as we increased labour productivity in the first industrial revolution. Fortunately, this is relatively easy to start on because at present we are incredibly wasteful. The amount of material that the American economy digs up, mobilizes, and puts through various resource-crunching activities, amounts to 20 times the body weight of every American every day. Globally, half a trillion tons of material each year gets dug up and put into the economy. And of all this material, less than 1 per cent ever gets put into a product and is still in use six months after sale.

In other words, we have an enormous business opportunity. Reducing this waste is profitable right now. It's easiest to see this in the energy sector, where in the United States we still waste US\$ 300 billion a year buying and burning energy that is not needed to deliver the services that we want. I'm not talking about curtailment. I'm talking about using energy more productively, through better devices, to perform the same or greater services. Just as an example, the amount of energy that the United States emits from power plants as waste heat is the same as all the energy Japan uses. And we think that the USA is going to compete with Japan? A typical community in the developed countries spends about 20 per cent of its gross income buying energy and 80 per cent of that money immediately leaves the community. And we expect to do good economic development?

But there is something that one can do about this. Wes Birdsall was the manager of the general utility company in Osage, Iowa – a tiny rural town, the United States' equivalent of a developing nation. He helped his customers use the energy they already had a bit more productively. He wound up saving a million dollars a year in this tiny community. The average homeowner saved US\$ 200 a year. He reduced the electric bills to half that of the State average and unemployment to half that of the national average because with the reduced electric bills, new factories came to town. A pretty decent start to an economic development programme.

Companies are getting in on the act as well:

- South Wire was an energy-intensive maker of cables, rods and wire. They cut in half the energy they used per pound of product. The savings from this equalled the company's profits over about



a ten-year period and kept the company in business. They wound up saving about 4,000 jobs at ten plants in six States.

- Down in Louisiana, a man named Ken Nelson had an odd idea. He asked the workers on the shop floor, “How would you save energy?” Nine hundred worker-suggested savings measures later, the company was making US\$ 110 million a year in savings, with huge returns on investment, that rose as the programme continued over twelve years because they got better at seeing the savings and implementing them. This is not a one-time belt-tightening. This is a programme that is at the core of a company’s profitability.
- Du Pont recently announced that they are going to cut their greenhouse gas emissions by 65 per cent over their 1990 levels by 2010 while increasing production 6 per cent a year with no increase in energy use, and by 2010 they will get 10 per cent of their energy and a quarter of their feedstocks from renewables. Has Du Pont joined Greenpeace? No, they did this in the name of increasing shareholder value.
- STMicroelectronics went one better, a 40-fold increase in production over the same time period, ending up with zero net CO<sub>2</sub> emissions. Implementing this took them from the number twelve chipmaker in the world to the number six, and saved them US\$ 9 billion.

My friends, protecting the climate is profitable. Anyone like my President who tells you otherwise simply has not done the sums. And Europeans know this. The EU’s Intelligent Energy Programme reckons to get 22 per cent of the EU’s electricity, and 10 per cent of all its energy, from clean sources within the next ten years while maintaining a high standard of living and European competitiveness. Governments in Europe are setting national goals of a four-fold increase in resource productivity as the basis for economic development policy. Some people are calling for a 10-20 fold increase, or a factor 10 to 20 increase, in resource productivity.

I’m talking here about technologies that are on the market now, and are being used by real companies profitably right now. I’m not even talking about some of the interesting new technologies that are coming out, but here’s one of them. It’s called a Hypercar. It’s an SUV that would haul a lot of people up a hill safely, and it has high performance – 50 kilometres per litre as an SUV, but if you make it a family sedan car you could get 100. But it would not use gasoline; it would use hydrogen. It’s a hydrogen-fuel-cell, ultra light, hybrid drive car that is in production right now. All of the major car companies around the world have programmes moving somewhat in this direction. No emissions but hot water. (What do you do with hot water in a car? Put in an espresso maker in the dashboard? Hold that thought!) There are five of these cars, made by Toyota and Honda, now being run in Los Angeles. We reckon that within ten years they will be relatively common; within 20 years they will be dominant.

Now suppose that you are driving one of these hydrogen-powered cars, and that you pull up to a building like Four Times Square in New York City where there is a hydrogen fuel cell in the basement (in the recent New York blackout that building kept working 24/7. It also has photovoltaics in what look like the glass. It is also efficient, using half the energy of a typical building costing the same to build). You plug your car into the hydrogen supply of the building and then into the electric grid, and your car is now a power plant on wheels supplying electricity back to the grid at the real time price. There go the electric utilities unless they get smart and start leasing these things. And by the way, that is what you do with the hot water. Hot water has an economic value right now in a building, which is why Four Times Square installed the fuel cell; it was cost effective to do so now.

And this is only the beginning. Here’s where it gets really fun and this is what is particularly relevant to developing countries. What is our way of making? Heat, Beat and Treat is the industrial model. Nature does it very differently. Nature uses low energy flows (with the occasional exception of volcanoes and lightning) and near-body manufacturing. How many of you want to stick your body up against most industrial machinery? In nature, there’s no waste. The output of any process is food for another.

Take the little spider. I reckon you are all sitting within three feet of one – that is what the scientists tell us their density is, on average. They eat flies and crickets at room temperature and spin a fabric stronger than Kevlar, better than steel. How do they do that? The best way we know to make Kevlar uses vats of boiling sulphuric acid and high-pressure extruders. The Japanese have started to use spiders as an architectural model.

Or take the abalone, a little sea creature that at sea water temperature excretes proteins that assemble an electrically charged framework on which seawater deposits minerals, forming a crystalline inner shell twice as tough as our best ceramics. The only way we know how to make ceramics is to use very high-temperature kilns. The scientists at Sandia Laboratories said, “If nature does it, it must be possible; whatever exists is possible”. So they took an electrically-charged silicon substrate and dipped it in alternating baths of calcium carbonate and polymer, and the material self-assembled at the molecular level, just like it does for the abalone. Sandia is now making a material that can make scratchless eyeglasses, breakless windscreens and the nose cone for the Space Shuttle.

Take as another example the sewage treatment plant called the Living Machine. If you had to have a sewage treatment plant as a neighbour, this would be a very nice one: its by-products are water and flowers. The makers of Mars bars installed one of these treatment plants in their production facility near Las Vegas in Nevada. Not only did it do a better job of dealing with the very sludgy cocoa butter, it also was a great tourist attraction.

Bio-mimicry has different principles than we have. It runs on sunlight, it uses minimal energy, it fits form to function, it recycles everything, it curbs excess from within, it rewards cooperation (much of nature is really not about competition, it’s about cooperation), it eliminates toxicity, and it’s beautiful. How many of us in our industrial practice consider that last issue? Nature does. Nature creates conditions conducive to life. In contrast, here’s what we do. These are the compounds now found in mother’s milk: Ketones, aldehydes, phenols, and on and on. What are we doing to ourselves? Well, we’re going to find out. Nature is a testing laboratory that has been around for a long time in which products that do not work get recalled by the manufacturer: A cautionary tale for a young species like ours.

Finally, our economies must come to be restorative. Here are some examples from Jamaica, where I’m currently working:

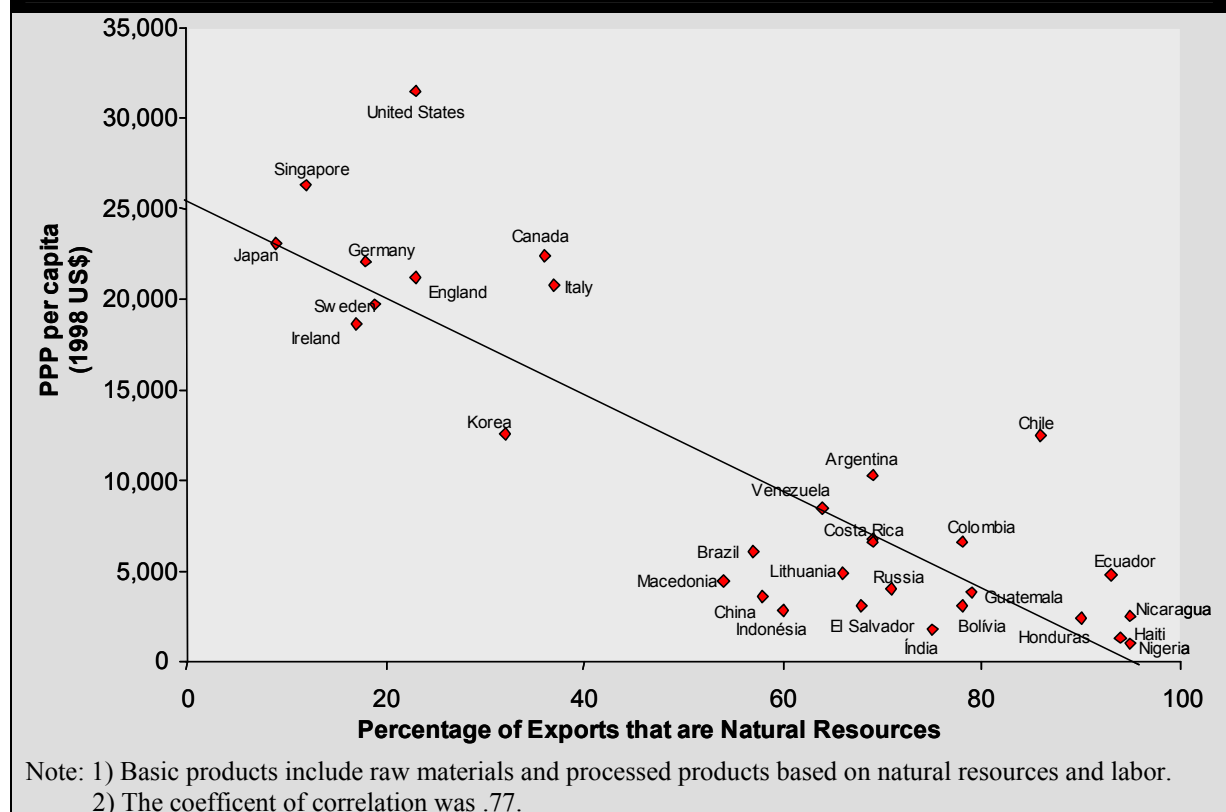
- I have a project with a little community economic development group that has put in a bamboo processing facility. Bamboo is an incredible component of manufacturing that is overlooked in most of the world. Most of the world’s people need housing. Bamboo grows fast and it can provide cheap housing incredibly well. The Colombian architect, Simon Valez, has put forth a design for a very comfortable house that grows itself in five years, and which costs US\$ 1,700.
- We’re also working with a sauces and spice company, Walkerswood, that is not just mining the soil, as used to be the case with bauxite – commodity extraction for export. It’s working with the local community, using integrated pest management, using drip irrigation, using composting and recycling, helping the local farmers. Not only is this restorative of the land, it is restorative of the culture.
- Tourism is the biggest industry in the world and the fastest growing. Practiced as it is now throughout most of the world, it is extractive. Much of the money spent on it leaves the local economy and goes back to the West. But there is an alternative. Eco-tourism is the fastest-growing form of tourism and done right it’s restorative of the local economy. Here’s an example: Stanley Selengut put in an eco-tourist resort in the Caribbean called Maho Bay. Photovoltaics and wind power it. There are tents on raised structures. When hurricanes Hugo and Marilyn swept through, his was one of the few facilities in the island that kept working. He just rolled up the tents, put away the photovoltaics and the wind generators, and did not care. He does not charge room rent, he charges tuition because what you get when you go there is an educational experience about where your food comes from, where your energy comes from, and what the

local culture is. This is authentic tourism. This is what people who have disposable income, who could go anywhere in the world, increasingly want. It's an authentic experience of a local culture.

These principles apply even better in the developing world than they do in the developed countries. I believe they are essential if the developed countries are to endure with a high quality of life, but they are even more essential if the rest of the world wants to develop. It cannot afford to develop in the way in which the developed countries have. It's no mistake that sustainability is more profitable than unsustainability. Increasingly, the Index of Domini Social Investments out-performs Standard and Poor's Index. Companies on the Dow Jones Sustainability Index do better. Regions that protect their environment out-perform those that do not. Things like using resources more productively and bio-mimicry drive innovation. Just staying with the old technologies does not drive innovation; it does not help anybody in particular. Why do the 100 largest companies in the world all now have a sustainability officer?

Here's the mental model we've been working on: Commodity-led export development. It's a race to the bottom.

**Figure 1. Percentage of exports that are basic products versus purchasing power parity, 1998**



Source: ITC - International Trade Center, CIA World Factbook (1999), OTF Group Analysis. Macedonia (2001) data from OTF Group trade statistics analysis and CIA World Factbook (2002).

The countries that are most dependent on it are at the bottom right of the graph. The countries that don't depend on commodity-led export development, towards the upper left of the graph, are the rich ones. That's where we want to be. What we need is a new form of development that we might call leapfrog development. It uses resource productivity as its cornerstone, otherwise you cannot afford to develop. Right now, a quarter or more of all development capital in the world goes to building power plants, great big things to sell power to the urban elite. They will not help the people in whose name they are being built, and the countries cannot even afford to build them.

In contrast, you can put in a factory to make compact fluorescent light bulbs or windows that insulate as well as triple glazing, called “super windows” and using a product called heat mirror. The capital cost is one thousandth that of a power plant, and it pays back much faster. I reckon that in the not too distant future, houses with no wires and no pipes will be the norm, just as cell phones are outstripping wire telecommunications in the developing world. There is no reason to repeat the mistakes that the developed countries made.

The whole-systems approach that we’re talking about here is the only real basis for development. And it has happened: There is a living example in Curitiba, Brazil. It’s not a rich city. It has a per capita budget one-fifteenth that of one of the poorest cities in the United States, and a very rapidly growing population. All the Northern experts said: “You have to do it our way, with underground transportation and concrete stormwater drains”. And they said: “We cannot afford to”. So they put in place a policy where they refused to trade off social and economic, environmental and industrial priorities. They said, “These are all priorities; the solutions we pick have to meet them all or we cannot afford them”. The centre of the city used to flood, causing a lot of misery. So they put in a park. When it rains, the ducks float a metre higher and it’s the lungs of the city. They have a botanical garden built entirely from recycled materials. When the street gangs started to vandalize it, they gave the kids jobs working in the facility. In Chapter 14 of “Natural Capitalism”, we detail how they did it and I truly suggest it to you. It is a much better model than anything in my country for how to do genuine economic development in the rest of the world. Ed Willard, when he was Chair of Du Pont, said: “Companies [and I would add countries and communities] that take such opportunities seriously will do very well. Those that do not, will not be a problem because ultimately they will not be around.”

These are the principles of prosperity in the coming decades, whether you are in the North or in the South or anywhere else in the world. Our goal ought to be to ensure no net loss per capita of natural or human capital. Can we do it? I think we can, but it’s going to be up to everyone of us to rethink our mental models, our assumptions, and our data. And for those of you who want more information, go to the website [www.natcap.org](http://www.natcap.org) from which you can download the entirety of the book “Natural Capitalism” and a lot of other papers that document what I have been saying.

I hope that this has been a good way to kick off the discussion. Thank you very much for your kind attention.

## Presentation by Mr. Michael Braungart\*

What we have just heard is a type of thinking based on a Western perspective, which is more of a religious perspective, and where we see human beings as bad and we want to make them be less bad. So it is about reducing, avoiding, and minimizing. I have just come back from Africa, from Tanzania, and I can tell you I have a different perspective. I refuse to see human beings as bad, to control them to be less bad. We do not have over-population. We have an over-abundance of cars, not of human beings. So the future is not more cars, nor is it about hyper cars, but it is about how to support human beings.

What I'm talking about is not about less bad. It is not about zero emissions. For example, I can tell you that the average citizen in Tanzania is protecting the environment 500 times more than any citizen in the United States. So forget about factor four or factor ten or factor 100. Protecting does not mean destroying a little bit less. I have three children. Would I say: "Dear children, I am protecting you because I am beating you a little bit less?" That is no protection. It only minimizes damage.

Traditional Western thinking is triple bottom line thinking, and it is there to support the economy. On the other hand, Western thinking romanticizes Nature. Nature is not romantic. Nature is not beautiful. This is just our perception. Nature is sludge, ugly, productive only when it is not clean. This cleaner production thinking is an American housewife's perspective. It is not at all productive. Nature is not productive when it is clean. We think we are protecting the environment by destroying a little bit less, by having Germany, for example, build incinerators in China and India for waste that does not burn at all. So they need to add oil just to burn the waste and they lose all the nutrients those wastes contain. This, at a time when we are losing 5,000 times more topsoil than we are regaining!

I am coming to this from a perspective of having lived in China, from having been a long time in India, from having been in other Southern countries. And this perspective is not about minimizing damage; it's about how to support. How can we support natural processes? How can we support culture? And this is totally against the efficiency way of thinking.

Efficiency is ugly. What is efficient food? I invite you for dinner; let's have an efficient dinner! It would be one tablet of Italian flavour and a glass of water. Efficiency, that's McDonalds, that's ugly, it destroys our culture, it homogenizes, it's one-size-fits-all thinking. And efficiency is a nightmare because it destroys all our cultural diversity. And if something is wrong, and if it's efficient, then it's efficiently wrong. Half of my family was murdered by the Nazis, because of some racist or other type of stupidity. I can tell you, I prefer an inefficient Nazi to an efficient one.

How can we celebrate efficiency? Nature is not efficient at all. Nature wastes energy and resources. It doesn't minimize or reduce or avoid; instead everything becomes a nutrient. How can we protect the climate? The climate doesn't need to be protected by us. The climate just works. How can we see carbon dioxide as a problem? Carbon dioxide is rare. It's a rare nutrient. If you look at the whole quantity of the Earth, you see that carbon is rare and we need it. Look at the ants of this planet. These little insects make up four times more biomass than human beings but they are not an environmental problem because they make everything a nutrient again for the other animals. So we can be far more numerous, but only if we support the other species.

When you go into the tundra, your ecological footprint needs to be minimized. You cannot throw away a banana skin in Sweden because it never degrades. So you minimize, you collect, you reduce, you avoid, and you feel bad. You say, "Human beings are bad; let's control them to make them less

---

\* Managing Director, Environmental Protection Encouragement Agency, Hamburg, Germany. Co-founder, McDonald-Braungart Design Chemistry Society, Virginia, USA. The text is based on an edited transcript of the spoken presentation.

bad". But this is a Northern way of thinking, which basically means, "Let's minimize our ecological footprint". Instead, I want a big footprint, but I want to turn it into a wetland to make it productive for the other animals – but not to romanticize, not to say, "We are the bad ones and let's be less bad".

Look at a child; when does this child start to become bad? At what age? Can you tell me? Do you hear all this terminology right now in Iraq, about the "evildoers"? That is a Western cultural way of thinking. From a perspective that you can have in the South or in other areas, I don't think evil exists, not at all. It's just the absence of good. Darkness doesn't exist. It's only the absence of light. Coldness doesn't exist. It's only the absence of heat.

And it's the same thing with design. Bad design is just the absence of quality. If we make products that accumulate in mother's milk, that's just bad design. If we have materials that cannot become nutrients, that's just bad design. Look at the European Union, which is now enacting legislation banning lead in electronics. How funny, because the replacement for lead is silver, tin, bismuth. These metals are highly toxic, very rare, and they all come geologically with lead. So whenever you are mining them, you get lead. So just use the lead again.

Or look at companies like the ones Ms. Lovins presented. In the terminology of the American President, Du Pont is the Evil Empire of chemistry. There is no doubt about this. If you want to look for weapons of mass destruction, go look there. So we just try to reduce, to avoid, to minimize, to be less bad. And that is not good enough. We must think about how to support instead of how to minimize damage.

I'm talking about a different agenda. It's not the triple bottom line, it's the triple top line. It's about how to celebrate culture, diversity, how to celebrate economy and how to celebrate environment and nature. But without any romantic notions about bio-mimicry; the lifetime expectation 100 years ago was less than 40 years. I can tell you that the most toxic substances are natural substances. They are not chemical substances. The most lethal weapons are biological weapons, natural weapons. Nature is not good. Romanticizing and protecting nature is not the way, just because we now want to compensate it after we have been destroying it for hundreds of years. Sigmund Freud could tell you exactly what happens with that.

Why can we not just think about making good products? In the Western world we have had 30 years of destructive environmental discussions all about the end of planet and so on. There will be no end of the planet. It's just a question of human rights. We say, "People in the countries of Africa do not respect human rights." Yet for a few cents a child we could save five million children who die every year because they don't have drinking water. This is a question of basic human rights for us. How can we let these children die? I'll tell you why. Because we think, "The more that die, the less of a problem we have with over-population". That is why. And as soon as we give up human rights for the children in Africa, we give up human rights for us here as well, so we have a smaller and smaller group who spend more and more money to somehow live forever.

With a positive nutrient management agenda, the issue is no longer about guilt management, it's not about reducing, avoiding, minimizing; it's about supporting. Now, I have a product that can become a nutrient, either a technical nutrient or a biological nutrient. If it's a technical nutrient, you bring it back into the technical nutrient cycle. If it's a biological nutrient, you can throw it away. But being biodegradable is not enough. We have just developed an ice cream packaging that contains seeds from rare plants. It's a liquid at room temperature. It's only a film when it's frozen. When you throw it away, you support biodiversity. So it's no longer about, "Please buy less because then you de-materialize; and actually you had better not breathe at all because the more you breathe, the more carbon dioxide you are emitting".

The opposite agenda says: "How can we support the other animals?" It is a programme of nutrient management. We have gained so much knowledge out of these 30 years of destructive environmental discussions that we can now do far better things to bring nutrients back into technical and biological

cycles. We can celebrate human creativity, fantasy, quality of production. And we can do the same in the developing countries. I totally agree with Ms. Lovins on this point, it is not a programme just for the industrialized countries.

As I said earlier, we are losing right now 5,000 times more topsoil than we regain. If we continue with that, we really can just see human beings as a problem of overpopulation. But I want to look at a child and say, "Isn't he or she nice" and not, "Damn! Overpopulation!"

Thank you very much.

## Presentation by Mr. Fritz Balkau\*

Let me start by going back to the issue paper that UNIDO prepared, just to see if we can use that as a starting point for some further discussion. Before that, I would like to thank Ms. Lovins for an interesting presentation. My comment on it is that if we could take all those elements that she presented and put them into a single model, we would be able to move ahead. I think one of the problems that UNEP has been facing for a long time has been that we have many of the elements but we are not always quite sure how they can be fitted together.

As for Mr. Braungart's comments, which were certainly thought-provoking, they remind me that it's not only the end point that we need to be clear about, it's also the path for getting there. I have enormous difficulty sometimes in trying to work out what to do next in order to get a little closer to the dream or the ideal. We live in an intensely practical world, where on any one day millions of people are making very practical decisions. Sometimes we think they are not exactly right but they are decisions, and if we are concerned with influencing those decisions so that they take a new direction, then it's not only the end point we need to be clear about, it's also how to get there. Often, it's that vision of the path or the road that is missing, while the end point is very clear.

But let me go back to the discussion paper and the notion of cradle-to-cradle. Is eco-efficiency enough? What about de-materialization? Is natural capitalism a good model for moving forward? Where exactly do we stand? For those practical decision-makers who have a daily job to do, there seems to be no shortage of models, over and above the ones I've mentioned. We've heard of the Natural Step. Some of us are involved in Industrial Ecology, then there's Ecodesign and Green Procurement.

There seem to be so many models out there. Which do we use and when? Are they all valid? Are none of them valid? Fashion also seems to play a role. Every few years a new terminology, a new term, a new concept, comes up. What happens to the old models and concepts? Are they no longer valid? For instance, who remembers the Natural Step? We don't talk about it any more; where is it now? It was very popular at one stage. Does it mean that it's no longer useful? And if we don't like the current fashion, do we just wait because in three years' time there'll be a new concept coming along that may be better?

Let's start by looking at how we can move ahead. We've been pushing eco-efficiency, or cleaner production, for ten years within the United Nations system. I think it's still a good concept but I also agree it's not enough, because we need to optimize the product as well as its manufacturing process. We understand now that many of the issues we are confronting actually arise from the product or the way we use the product, and not from the way the product is manufactured. So eco-efficiency is part of the solution, but it is not *the* solution.

We've heard a lot about what is sometimes called a recycling economy – cradle-to-cradle, cradle-to-grave, whatever we call it – and there's certainly a large constituency out there that says recycling is the answer. On this topic, UNEP carried out a survey, together with UNESCO, of young people as consumers – they will be consuming for far longer than most of us here, so maybe we should start influencing them. The survey brought out an interesting result. Young consumers are much more environmentally and socially conscious than the older generation but their idea of environment is just to recycle: you buy whatever you want, you put it in the recycle bin, and someone recycles it afterwards. We have spent ten years, maybe longer, convincing young people that to be environmental just means recycling; do whatever you want, just recycle afterwards.

---

\* Chief, Production and Consumption Branch, Division of Technology, Industry and Economics, UNEP. The text is based on an edited transcript of the spoken presentation.



But maybe this is not enough. To my way of thinking the education process has taken a side road somewhere. Anyway, recycling is a production process, but is it a cleaner production process? Recycling generates waste, it demands enormous amounts of energy, and it has some other questions it has to answer. Within UNEP, we think that recycling is part of the solution, but again it is not *the* solution.

What about de-materialization? Factor-ten, factor-four, or however you want to call it. Maybe the answer is in this because if intrinsically we use fewer resources, maybe we can sidestep many of the problems: There is less pollution, less energy involved, less resource extraction, less transport, less impacts, less of everything, right across the board. The factor-ten people certainly seem to think that de-materialization is the answer. But if we de-materialize substantially but not totally, then recycling becomes quite difficult because we have so many very small products. Just to collect these things uses more energy than the whole business is worth. So in the end we throw them away. The best way to improve recycling is actually to build more mass into the products, have a bigger materials flow, to consume more, throw more away. Then the recycling industry can truly be economically viable. In fact de-materialization, if it reduces the mass of products beyond a certain point, is actually going to result in residues being thrown away that might actually be recycled right now. So we certainly think de-materialization is part of the solution but maybe it is not *the* solution either.

Let's look at the demand side of things because so far many of the solutions that have been put about are really on the supply side: better production, better products. What about the demand side, the consumption side? If with some social engineering we can persuade people to buy fewer things in the rich countries and to buy different things in developing countries, maybe we can solve the problem that way. Certainly the Plan of Implementation of the 2002 World Summit on Sustainable Development in Johannesburg was very strong on this. Many of you may have missed it – certainly much of industry has missed it – but Section III of the Plan, particularly paragraphs 14 and 15 on sustainable consumption and production patterns, lays it out very clearly that the whole societal pattern of production and consumption must become sustainable.

This is now the mission that has been given to the United Nations family of organizations. UNEP, the UN Department of Economic and Social Affairs (DESA) in New York, UNIDO, and other UN organizations are now joining forces in this new effort to put in place a framework of programmes that achieve sustainability in consumption patterns as well as in production patterns. We do not quite know what the framework is yet but we are working hard on it and maybe success will come through that.

If consumption is to become sustainable, how to do it? We don't really know. On the production side, right across the world, we have a global consensus that sustainable production is probably quite a good idea and we know more or less how to do it, and it is not so value laden. But consumption is enormously value laden and culturally loaded, and we know that many countries are not consuming enough while some countries perhaps need to consume differently. I don't know whether Mr. Braungart would agree, maybe he thinks we should all consume more, that it doesn't matter, but I think he also said that we should consume differently, and maybe part of the answer is there.

Let's go back to the issues I've mentioned – eco-efficiency, recycling, de-materialization, consumption, and product design – and insert social aspects into them. I was quite impressed with Mr. Ricupero yesterday in the Industrial Development Forum, who pointed out that what we are seeing at the moment in most (but not all) parts of the world is significant de-industrialization. My question is that if the production processes in this world are becoming more automated and less labour-intensive, where is this going to lead us? We are going to produce more goods for people who are out of work. What sort of equation is this?

Maybe one of the directions we ought to be taking is to put the social agenda more prominently into the industrialization process so that it's not just about producing better quality products more cheaply,

but it's also about producing in a way that generates social value, in the first instance more employment, and that it's more focused on labour-intensity rather than capital intensity. I am reminded of a very large copper mine I visited in South America two weeks ago. It is a US\$ 2 billion investment that has generated 1,500 direct jobs, 5,000 jobs in total. That is US\$ 400,000 per job. In Latin America with US\$ 400,000, I think even I could create more than one job!

Perhaps this pattern of production, which is very capital-intensive and leaves most of the country just looking at the capital flows, is not enough. Certainly governments need capital and industry needs to generate a cash flow but maybe it also needs to generate something else. For those of you who are industrialists, perhaps the issue of how to maximize the social aspects of industry as well as its capital flow aspects and the product side needs to have more attention.

Let me finish up. How to operationalize these issues? I said that we need some sense of the path to the end-point, and not only the end-point itself, and that this seems to be the hardest part, even within the NGO community and sometimes within governments. There is the saying that a journey of a thousand miles starts with a single step. Sometimes we are not very sure about what the first few steps actually should be in this journey onwards. So one of the things that UNEP would like to propose is that we ensure a more widespread use of assessment tools – lifecycle assessment, technology assessment, environment impact assessment, risk assessment, chemicals assessment, social assessment – so that we can actually measure what we are trying to do instead of just working on feel-good initiatives. We do not need to use all of them in every case but perhaps we ought to use some of them a little more consistently and more deliberately, and actually base decisions on the results of some of these assessment processes rather than purely on guesswork and sometimes, unfortunately, on purely political decisions.

That's the first thing: A more widespread use of assessment tools that include all relevant criteria. Secondly, for those who are academics or theorists, I think we need to create some sort of universal model of models, to borrow a term from the physicists. Many of the ideas we've been talking about – de-materialization, recycling, eco-efficiency, sustainable consumption, the Natural Step, Industrial Ecology, the circular economy, the recycling economy, and so on and so on – do have differences between them but basically they try to do very similar things. Somehow or other, we need to integrate them all into a larger, more global model where they can all find their place. Until we get more cohesion behind these different ideas, the decision-making world will be confused, and many of the decision-makers will just wait for the next fashionable model to come along because it might actually suit them better than the current one. A model of models, or integrating these different ideas together, would do a service to us all. And we certainly need to integrate the social aspects more into all of this. The world is not only about materials flows and modelling materials flows and plotting materials flows and optimizing materials flows. There is more to it than that. The social goods and the social flows are sometimes running in the other direction.

Finally, I would encourage you, as they say, to think big, start small, or think globally, act locally, but certainly think globally. Identify some of the global movements that could include the United Nations movement. Look for the programmes within your countries and within your business sectors that are debating on what exactly sustainable consumption and production mean in practice, where they are supposed to take us, and what will be the path to take us there, and see how you can join in the debate. There are no concrete answers on all this yet, and we would certainly welcome all your inputs.

Thank you very much.

## Presentation by Mr. Suresh Prabhu \*

What needs to be done at the macro level to change our ways of thinking about how we live? Our lifestyles must change altogether because what we see as world integration really is a net result of our lifestyles. That is one plane on which we need to work. This Round Table, which is essentially addressing the issue of coexistence between industry and environment, has to be integrated within the new context encapsulated in the Millennium Development Goals. Therefore, I think we should focus on what is the coordination between industry and environment and in that context how we should think about the environment in a new way.

In the current process of so-called development, we see that we have had snatched away from our populations a very essential thing which we thought would always be there and which could be considered an inherent right of any human being to have: Clean air, clean water, in a word, a clean environment. This is especially fundamental for developing countries, which as a result of development have had taken away from them what they had in abundance. When we are discussing new ways of thinking, we should keep this very clearly in mind.

It would be very unfair if, in thinking about a better basis for industrialization we were to put into question the very need for industrialization. We must make sure that we agree that the developing countries need industrialization, so that they too can reap its benefits as some parts of the world already have done. The developing countries, which still depend primarily on family, on farming, on agriculture, need to graduate from this process, so industrialization is in any case required. But this does not mean that we have to follow the same path of industrialization that has been followed to date. I fully agree with the previous speakers that we need to make a break from the past and start thinking afresh. We must find new rules by which industrialization should take place. The way that has been described in this Round Table, a new industrial revolution that implicates all countries is a very interesting idea to which we really should give some thought.

In the developing countries, the ethos still is that human life is dependent upon living in harmony with nature. It was never considered that nature and man are totally different; rather, they are part of the same overall system. In this globalized world of ours, where we are talking of integrated economies, we cannot keep one part of the world separate from the rest and ask it to behave differently. The whole world must change. But the world's eco-systems are all integrated, so what happens in one part of the world affects the other part, adversely or otherwise. So in our thinking about the new industrial revolution, we should really find out how that part of the world, which has been adversely affected as a result of industrialization in the past, can benefit more. As a result of that, we can find out how we can now depend on each other in a much better manner and how can there be a win-win situation.

When we think about this new approach, we should consider all aspects. We should not just think about the technical aspect of product design, because product design could again become a monopoly. We already have intellectual property rights issues where someone can say, "I have designed a product, now I should benefit from the intellectual property rights and everybody should keep paying for them for a long time to come", and probably even thinking that these intellectual property rights should never be put into the public domain. In this case the new approach will become about repatriation of industries and the equity that now exists in the world, so it really should not just be technical. It should also be ecological, because any new industrial revolution necessarily has to be in harmony with eco-systems, it cannot be defined against the laws by which nature runs.

---

\* Member of Parliament for India. Ex-Minister of Power, of Industry, and of the Environment. Chairman of the Task Force on River Interlinking of India. The text is based on an edited transcript of the spoken presentation.

It also has to be essentially social, as Mr. Balkau pointed out. We have to think about how it can really bring about social justice, because the Millennium Development Goals that we are trying to implement are the concern of any form of industrial development. The first Millennium Development Goal talks about halving the poverty levels by 2015, and so any new approach to industrialization necessarily has to be social. Also, if we are thinking of a new approach, how can it happen in a political sense? Can political systems really develop it? How will it really happen? And also, it is important to think about the economic aspects, because I am sure that what is not economic is not sustainable.

Mr. Sachs yesterday posed a question: “If everybody is so convinced, why are the resources not coming; why are they being spent on the military and for other political considerations?” Anyone who thinks that a country that has the resources is going to think about considerations other than its self-interest and is going to give money away, will be living in a fool’s paradise. So any new approach ultimately has to be economically sustainable for the country that actually uses the resources. Therefore, any new approach must encompass the technical, ecological, social, political and economic aspects.

We really should think about a new meaning for globalization. How can the two worlds that we live in on this one planet live together in harmony with each other? How can they really benefit from each other? How they can live sustainably? We have to think how we can do this. And from this point of view I think the concepts of natural capitalism and cradle-to-cradle are really good. But now we should see where we can actually put cradle-to-cradle into place, how can we make it a reality, because right now it looks like riddle-to-riddle. Are these concepts that we just discuss in such fora and then go home saying, “I have done very well and I am very happy because we have talked about it; the world is in danger but my responsibilities are over and now it is somebody else’s responsibility to protect the world”? Or do we really want to put into practice something that is fully sustainable, not just environmentally sustainable? If you opt for the latter, we really need to find out how we can do it in a developing country, what are the sectors where we really need to do it.

In the developing countries we have some sectors that are the backbones of industry in those countries, like, for example, textiles. The textiles sector is one of the major industries from an employment point of view and it is agro-based. It adds value to agriculture because cotton gets processed and re-processed and climbs the value added chain, and then it is exported for the most part to the developed world. Therefore, it is an integrated system in which, if you do something in a developing country, you export that to a developed country, so then the export will become dependent on that. Therefore, can we now think about a new system in which new product design takes place in the developing world, in a sector like textiles where the product is a biological nutrient, or in a sector like the automobile industry where the product is a technical nutrient and where we are thinking about a new concept of making the whole product recyclable and make sure the producer takes products back after they are consumed.

Can it really happen? Can we actually start doing something like this in developing countries in a manner that it is socially sustainable by creating employment, that is economically sustainable because it helps the countries benefit, that is environmentally friendly because the products we use are getting into nutrient cycles and so do not damage the environment? Also, can this be a model that we really elaborate in developing countries and not be something that comes from developed countries so that we just ape the West, which is something that is not politically sustainable? We have suffered from this over the last 150 to 170 years as a result of the old industrial revolution. There, we have seen that we are forced to follow something that was developed in some other part of the world, just because we are part of a global system.

An important aspect of this is the social sustainability that will come from involving that part of the governing system that is civil society. What we are seeing now is that because no auditorium anywhere in the world can accommodate all of civil society, they normally have to wait outside where

the WTO meeting is taking place, probably under the sun that beats or the snow that falls. The challenge before us is how we can accommodate them into mainstream thinking. Therefore, if we try a new approach like this in a developing country, we must make sure that they are also involved and take part in the process.

So I think the concepts promulgated in “Natural Capitalism” and in my friend Michael Braungart’s book “Cradle-to-Cradle”, now need to be taken forward in a way that can ensure they make sense – economically, socially, politically, and ecologically – and that they are actually happening somewhere on the ground so that over a period of time we do not make the same mistakes we have made in the past, but we change, and change in a manner that is mutually beneficial. But someone might ask: “Why should it be done in the developing countries?” The issue is whether this new industrial revolution, which has been proposed in the background paper and which is a very testing and a very important issue, will by-pass the developing countries. At the moment this is an apprehension of mine. But if everything is done in the developed countries and then the developing countries have to follow, my apprehension will become a reality, and then we will have a problem rather than a solution.

If instead it is done in a developing country then the development will lead to benefits. A good example of this is a business process: Outsourcing. It helps companies in the industrialized countries to sell as profitable business entities by allowing them to outsource some of the functions that are economically more viable in a developing country. So it is a win-win situation. No jobs are being lost in a developed country; in fact, the entities in the developed country survive.

So can we not think about something like this? The resources can come in a way that allows a new industrial revolution to originate from a developing country. UNIDO should be the facilitator or the mentor, making sure it happens. I really congratulate you for doing this and I hope it becomes reality.

Thank you very much.

## Presentation by Mr. Leopold Zahrer\*

I am a person in a position where I have to act very pragmatically and where the time for discussion – What is the best solution? What could be a better solution? – is over. We are sure that we do not have the best solution or the optimum measurements. Nevertheless, we are successful some of the time; I believe this is the most important result. I cannot convince everybody in the world to do the same as we are doing in Austria, but I can share with you some of the experience we have gained on the way to a sustainable world. I would therefore like to give you some comments about the situation and the activities here in Austria on the way towards sustainability. This is from the point of view of a small country in the heart of Europe. We know we alone cannot save the world, but we can contribute to the overall need for sustainable development as a response to tendencies (like climate change or loss of biodiversity) that have an adverse effect on our future. If we do not succeed in containing and reversing these tendencies within a reasonable period of time, many of them will become irreversible. And issues have to be tackled on the regional as well as on the international level.

For a good quality of life, it is not essential to own everything. It is more important to enjoy the benefits of all these different products. The prevailing orientation towards material prosperity results in production and consumption patterns that lead to a drastic increase in the consumption of resources, energy and space as well as an increase in waste and emissions. These resource-intensive patterns are neither transferable to the entire world, nor can they be maintained in the long run if we are to respect a fair distribution of resources. In Austria, economic growth and the consumption of energy and materials has been de-coupled in some sectors in recent years, this with the thinking of a Western industrialized country and facing reality with a holistic but practical approach. Nevertheless, significant advances are still necessary in order to establish this trend in all sectors and to achieve an absolute reduction of raw material and energy consumption. Only a few per cent of the total material flows in our national economy are moving in circular flows. This means that it is necessary to ensure a further marked increase in the efficiency of resource use, a responsible closing of material cycles, and as widespread a use of renewable raw materials and energy sources as possible.

The key objective of our national policy as laid down in the Austrian Strategy on Sustainable Development is to increase resource productivity while maintaining economic growth in such a way as to achieve a further de-coupling between economic growth and resource consumption. In the short term, at least absolute resource turnover should be stabilized and in the long term the objective must be to increase on average the productivity of resources by a factor of four, as we already have heard. To reach this goal, I do not think we need an industrial revolution but rather a constant evolution on the way towards sustainability. Several different approaches have to be followed, dedicated to increasing companies' ability to continuously improve the eco-efficiency of their processes and products. Boosting eco-efficiency is an important core component of sustainable management. I know it is not enough, but it is important. In this context, priority must be given to increasing material efficiency so that we have both a product- and a production-oriented approach.

So one of the fundamentals of Austria's environmental policy is enhancing cleaner production approaches in industry. The Austrian Environment Fund is a key instrument in implementing this policy. We started with the first cleaner production pilot project in the early 1990s and since then cleaner production has been a priority in our voluntary policy measures. Today, the Austrian Environment Fund is financing a variety of cleaner production activities in the Austrian provinces, several of which have established their own cleaner production programmes over the last few years. The cleaner production approach needs the constant engagement of the Administration to get more

---

\* Director-General, Waste Management and Environmental Technologies Department, Austrian Federal Ministry of Agriculture, Forestry, Environment and Water Management. The text is based on an edited transcript of the spoken presentation.

and more companies involved and to keep them involved. The Environment Fund is also active in greenhouse gas mitigation by funding the implementation of new energy technologies with a focus on renewable energies, especially biomass.

To increase a circular-material-flow economy, regional cooperation programmes between companies have to be supported, in which the waste from one company can be used by another as a raw material within a networking programme. Proactive management of these material flows between companies can result in reductions of up to 90 per cent compared with the non-network approach. One of the most important conditions for this is the further development of a waste management framework that promotes re-use and recycling not only in companies but also between companies. Designing such a framework requires government intervention. With the Waste Management Act in 2002, Austria paved the way to sustainable waste management, which is not only based on disposal. Bio-wastes are directed towards composting so as to close the nutrients cycle, post-consumer products are directed towards material utilization, and other wastes are used for power and energy production with the final residuals being rendered inert and landfilled. The Waste Management Act ensures that our local waste disposal capacities are secured for future generations. In general, we think that even in a global economy it is of great importance for local disposal and treatment capacities to keep up with industrial development.

Extended producer responsibility is another policy approach that is becoming more and more widespread and can be applied to a variety of product groups or materials. It enhances both the eco-design of products and the change from just selling products to supplying services, and it establishes standards for recycling. To be effective, such policies have to define clear targets for the amount of material that has to be recycled, and they have to set up a framework for the collection and treatment of post-consumer goods.

Combined with a cleaner production approach that fosters innovation in clean technologies and their diffusion in industry, extended producer responsibility has the potential to increase circular material flows. UNIDO has already successfully helped to implement the cleaner production approach in several countries, and it could now use the infrastructure and competencies it has established to build supply chains, take-back, and treatment capacities for the implementation of extended producer responsibility in developing countries and countries with economies in transition.

In the overall context, some measures are of extensive importance. I think creation of the basic legislative framework conditions is one of the fundamental actions. Protecting the environment by the implementation of the state-of-the-art in landfilling, in flue gas cleaning, in the collection and treatment of hazardous waste and so on, is another very important element. Recording the amounts of waste and other specific measurements is essential to do the right things. Other essential elements are support to waste prevention and recycling, the implementation of separate waste collection so as to gain the economic and ecological advantages this gives, and separate collection of products containing hazardous materials, and the substitution of these materials. And last but not least, financial measures through the use of incentives and taxes.

Finally, I hope that UNIDO and UNEP will continue to be partners for the introduction of successful environmental policies on a regional as well as on a global level because a successful environmental policy needs a partner. I think it is time not only to discuss these matters but also to do something and I would like to say all of you: Let's do it.

Thank you very much.

## Presentation by Mr. Hans-Peter Egler\*

Today we have heard a lot of visionary talk, backed up by the documentation we received. It is very interesting to discuss our visions; it is very important and very useful so that we can see what goals can be reached in the future. I am quite sure that in this regard we all share the same views; we think, “Yes, this is the way to go”. But now, within the context of globalization, in the face of the problems confronted by our partner countries in the developing parts of the world, we must find solutions, concrete solutions. And that is very complicated.

How to take the first step, in which direction do we take it? It was very interesting to read the document we received. We saw there many technical solutions, although I personally very much missed economic guidance and economic solutions. Then today we had a very interesting speech, which had a lot of economic vision in it. We have to merge all these studies and visionary speeches so that we can build upon what exists. I do not think we have to find new ways. Instead, we should focus on co-mingling what exists and trying to deliver good tools to our partner countries in the developing world.

They are all facing the same problem. Their economies have to grow because they have to generate employment; they have to do this to alleviate poverty. No amount of visionary thinking will get around this. But how to grow? We all know that we cannot grow like we have done so far: We have to do something in the area of waste, we have to do something in the area of production, but we must not influence the cost structure too much. In fact, the cost structure should be lowered because competitiveness is crucial if developing countries are to grow, and unfortunately I do not know if we can find aspects in all these visionary concepts that lower costs. Competitiveness also means the possibility of attracting foreign direct investment; as we have rightly seen today, it is crucial to work with the transnational companies. But it is also important to work with the governments, as well as in the transportation sector, and on communication issues. And, last but not least, we must work on the demand that is crucial for the supply.

So this is where we have to find concrete solutions. Productivity has to rise, new products and new services have to be developed but, at the same time, waste has to go down. The existence of waste also means that there is something wrong with the relative price structure, so we also have to think about how to change relative price structures. Energy resource prices, transport prices are key for the competitiveness of countries. So the developing countries also have to look closely at relative price structures in order to be able to deliver efficiently and effectively produced goods and services that fully correspond with the demand, either in the countries themselves or in partner countries outside, such as the industrialized countries.

Under this perspective, I think the developing countries are not badly positioned. They have something to offer. They can play a role. They can offer equal services. For instance, we heard about eco-tourism where a bigger share is possible. There are tropical forestry products. Enterprises in the developing countries can play a more active role as good partners for outsourced parts of transnational companies’ production. These countries have labour resources and they also have creative people who can really contribute to the development of new products and services. We should always bear in mind that we have partners in the developing countries that really can deliver something that is important for global supply chains and global markets. And we also have institutional partners we can link up with, at the World Bank and the Regional Development Banks but also in the developing countries themselves.

---

\* Head, Trade-related Technical Assistance Division, Swiss State Secretariat for Economic Affairs. The text is based on an edited transcript of the spoken presentation.



This is something very crucial, and I think that UNIDO can play a unique role here. We have developed very good tools, like the cleaner production centres for instance. We can further strengthen these tools, but they have to link themselves up more effectively with other projects financed by other donors in the international community, as well as with national institutions. In addition, they have to establish links with international research institutions, in order to be really up-to-date and to be able to diffuse new technologies and new know-how so that the latter can be adopted directly in our partner countries.

In conclusion, and here I perfectly share the view of my Indian colleague, I would really invite UNIDO, other donor countries, and our partner countries in the South, to work immediately on concrete, replicable projects that can show that there are possibilities, and that we have a potential to do something. We now have a lot of information, and we can do something. We just need the right partners and we have to take the first steps.

Thank you very much.



## **ROUND TABLE 3**

### **MAKING TRADE WORK FOR THE POOR: STIMULATING THE REAL ECONOMY'S RESPONSE**



## Issue Paper

# Making Trade Work for the Poor: Stimulating the Real Economy's Response

*UNIDO Secretariat*

### Introduction

What is the global setting facing the real economies of countries today?<sup>1</sup> Perhaps it can best be described as one of intensifying globalization, driven by accelerated technological progress, by trade and investment liberalization, by enforceable international rules and regulations, and by the progressive spread of integrated global production systems or value chains (UNIDO 2003 a-c) – initiated and dominated by transnational corporations (TNCs).

This emerging global scene offers greater opportunities for income and employment generation and for welfare gains. But it also presents new challenges. The real economy of a given country faces growing competitive pressures. Resources tend to flow to relatively few economies. Leading TNCs from developed countries are increasingly able to control the production, marketing and distribution of many of the world's most important commodities and products, though they are also keen on exercising corporate responsibilities and participating in the joint initiatives that link businesses in developed countries to the achievement of Millennium Development Goals (MDGs), like the UN Global Compact (UN 2003). It is estimated that around two-thirds of visible trade worldwide is conducted by TNCs. They are particularly dominant in activities where there are economies of scale in innovation, production and marketing (UNCTAD 1999, pp. 14 & 26).

The world is also witnessing increasing inequality, ecological disruption and marginalization. According to 1999 data, approximately 1,169 million people still lived on less than US\$ 1 a day (World Bank 2003 a, p. 5). And although the proportion of people living on less than US\$ 2 a day fell from over 62 per cent in 1990 to around 56 per cent in 1999, more than half of the world's population (i.e. 2,802 million) still lives in poverty. Furthermore, the income gap between high- and low-income countries widened between 1997 and 2001. The Gross National Income per capita of high-income countries was 58 times that of low-income countries in 1997. By 2001 it had risen to 62 times (World Bank 2003 a, pp. 4-5).<sup>2</sup>

The role of an open trade regime in stimulating growth and fighting poverty has been widely researched and debated by academic economists. According to one study, an increase of one percentage point in the share of trade in Gross Domestic Product (GDP) raises income by at least one-half of one per cent (Frankel & Romer 1999, pp. 279-399). The same study suggests that trade increases income by spurring investment in human and physical capital, and by stimulating productivity. Empirical analysis of country-specific data also confirms the existence of a link between economic growth and poverty reduction (Doller & Kraay 2000). For example, the experience of India over the last two decades shows a correlation between growth and poverty reduction on the one hand and increased openness to trade on the other (Ferro et al. 2002).

The poverty-reducing effects of an open trade regime are likely to be stronger in the case of developing countries because trade in goods is a more important source of income than it is in the

---

1 The real economy refers here to enterprises utilizing the factors of production and natural resources in production processes for goods (in agriculture and manufacturing) and services for the market.  
2 See also World Bank Data Query, website <http://devdata.worldbank.org/data-query>.

developed world. But the relatively larger share of trade in developing countries' GDP also means that they are more exposed to volatility in demand. The least developed countries (LDCs) are extremely vulnerable, because their export earnings tend to depend on one or two commodities, for which world prices are at their lowest levels for 150 years (UNCTAD 2000, Table 1, pp. 18-19; OECD 1997).

There is, as noted, a vast empirical literature on how open trade boosts income growth and output and on the requirements needed to realize the beneficial effects from trade reforms in low-income countries as well as on the lives of the poor.<sup>3</sup> The rural poor are usually found in agriculture and the urban poor are found in low-skilled, labour-intensive, often informal, sectors. In general, open trade can reduce poverty in rural areas when it generates employment in small-scale agriculture, and can reduce urban poverty when it is associated with increased output and export of labour-intensive manufactures (Oyejide 2003).

Despite successive rounds of multilateral trade negotiations under the GATT and WTO, as well as unilateral and bilateral liberalization of trade and investment, and despite the potential benefits of new technologies on the lives of the poor, most developing countries have been unable to benefit from these new market opportunities and to integrate into the global economy.<sup>4</sup> Industrial activity and production capabilities are highly concentrated in a few economies, both industrialized and developing. Most developing countries remain on the bottom rung of the technology ladder (UNIDO 2002). Low-income countries in particular, are technologically weak and vulnerable. Exports of manufactures are also highly concentrated within a small group of developing countries. Only a few developing countries have experienced dynamic production growth and a change in export structure characterized by an increasing share of technology-intensive products. These have achieved sustainable income growth. But many developing countries, which have actively participated in the process of international specialization, have been unable to achieve sustainable income growth.

### **Why has trade not worked for the poor?**

There are several reasons why trade has not worked for the poor and they vary by groups of countries. In the case of the low-income countries, the core problem is related to lack of capacity to produce a surplus of exportable goods of sufficient quantity, stable quality, and required standards that can be traded internationally. Such countries have therefore not been able fully to utilize the duty- and quota-free market access offered by developed countries' preferential initiatives (Medhora & Joeques, 2002).

For other developing countries, the challenges are related to various barriers to international trade. Trade in goods continues to be impeded by trade-distorting policies on tariffs and non-tariff barriers, imposed by both developed and developing countries alike. Recent research has outlined that the low-income countries face tariffs on global markets that are more than twice the level of those faced by non-poor producers (World Bank 2002). Barriers to external market access are particularly high in agriculture and in labour-intensive manufactures – crucial sectors for the development of low-income countries and for the poor – because of the presence of tariff peaks, tariff escalation and quantitative

---

3 See, for example, Sachs & Warner (1995), Dollar (1992), Edwards (1993 & 1998), Ben-David (1993), and Frankel & Romer (1999).

4 While WTO members reconfirmed their commitment to multilateralism in Doha, regionalism is still an important challenge to the multilateral trading system. Regarding the impact of regionalism on the regional division of labour and industrial development, there is some evidence that regionalism has stimulated the creation of regional production systems with a high degree of integration (e.g. the cases of NAFTA, Mercosur and the EU), but the issue of how much it has stimulated the industrial upgrading of countries which belong to regional trade groupings, and low-income countries among them in particular, still remains.

restrictions.<sup>5</sup> Tariff barriers to external markets are complemented by non-tariff measures, like agricultural subsidies, anti-dumping duties and threats, and rules of origin (Hoekman et al. 2002; Walmsley & Winters 2002; Winters 2002).<sup>6</sup> Trade in manufactures between developing countries, which accounts for the lion's share of the external trade of developing countries, is also heavily constrained by high tariffs and by the increasing use of anti-dumping measures (Somesh 2003).

Stringent product standards and conformity requirements, as well as various forms of certification have also emerged as new barriers to participation in the global economy. According to recent enterprise surveys, which include both developed and developing countries, the highest non-tariff barriers include performance standards, product quality standards, technical measures, product requirements relating to standards and technical regulations, conformity assessment, labelling and testing, and certification requirements (World Bank 2003 b).

Standards can create trade barriers and they can also segment markets (World Bank 2003 b). They can impose costs on developing countries, as they call for upgrading skills and capabilities, mastering new technologies, and enhancing old and establishing new institutions (e.g. accreditation bodies, metrology, standardization and technical support facilities). The costs of such requirements can be very high relative to the value of exports and can thus pose a barrier to exporting. Moreover, many standards and technical regulations are applied to products that are already heavily protected by tariff and non-tariff barriers, particularly in the developed countries. These tend to be products in which developing countries enjoy comparative advantages (e.g. agricultural and agro-industrial products, textiles and clothing and footwear).

Other impediments to trade, such as slow and unclean customs administration, complex administrative requirements including certification of origin, inefficient trade logistics, bad transport links and lack of access to information and technology networks, are also important, as they contribute to the inefficient allocation of resources.

Given these constraints, developing countries, and low-income countries in particular, find it extremely difficult to earn foreign exchange by means of accessing dynamic comparative advantages. They may find some of their existing productive structures obsolete. Their productive supply capabilities may be stagnating and they may even face an increase in poverty through a loss of export earnings.

## **What has to be done?**

What has been done so far on the level of technical assistance to change this situation? Not enough. Trade-related technical assistance has been scattered and has dealt with individual impediments to trade in a rather isolated manner. In this context, it is important to note that the ability of developing countries to identify and spell out trade capacity building needs tends to increase with their respective levels of exposure to the international playing field. For LDCs, technical assistance needs are the least defined and focused and worse served (UNIDO 2003 d, p. 4). Today, trade-related technical assistance needs a more holistic approach. This has been widely accepted by the developing countries initiatives like NEPAD, as well as by the development community (WTO 2001, paragraph 42). Such trade capacity building should be based on an economic analysis of possible trade potentials in main export goods and services of a given country, on an evaluation of existing obstacles to trade, as well as on the evaluation of the role of the public sector in supporting services that are vital for businesses (UNIDO 2003 d, p. 9).

---

5 A significant number of quantitative restrictions remain in place under the WTO Agreement on Textiles and Clothing (ATC).

6 See also Figure 1, Annex 1, for an analysis of non-tariff barriers to accessing global markets.

It is therefore worth discussing developed and developing country trade-related policy issues that impede open trade at different levels, a discussion that could contribute to multilateral and bilateral trade negotiations and would guide technical assistance in this area. At the multilateral level, what is called for is “a new grand bargain”, involving both developed and developing countries, to expand external market opportunities for the exports of low-income countries and for the poor (Hoekman 2003). The recent end of the Cancun Ministerial Conference demonstrated that this is not an easy process.

At the national level, the domestic policy agenda to make trade work for the poor extends far beyond traditional trade policy reform to embrace industrial policies, and other complementary policies addressing macroeconomic stability, labour market functioning, institutional and regulatory factors, social safety nets, investment and competition. These policies must be addressed by individual country governments as well as by the donor community. They will work for the poor only if they are used in an appropriate mix and targeted effectively.

At the core of “behind-the-border” industrial policy-making is the issue of how to create the capacity-building capabilities needed to produce and trade diversified groups of products, in the context of the restrictions that international rules and disciplines now put on the use of the various policy instruments, which were deployed in the past by successful developing economies to stimulate their industrial development.<sup>7</sup> Today, industrial policy-making is based on the belief that greater reliance on the free functioning of the market mechanism is the best incentive for effective and dynamic allocation of resources. But the majority of developing countries face an array of market, government and institutional failures, which mean that market forces alone are not a sufficient condition for industrial development.

Developing countries that participate in global value chains must confront the reality that TNC global strategies do not always coincide with their development objectives. For developing countries, the real challenge is to convert foreign affiliates, joint-venture companies or sub-contractors of TNCs into developmental enterprises that actively contribute to productive national capacity building and enhance export potential in goods with higher added value.

These constraints shorten the time horizon within which developing country producers must adjust and face intensified competition. Developing countries need to adopt a wider interpretation of industrial policy in general, and of the particular instruments to be used. Those instruments should be directed at correcting the market and institutional failures that are inherent in low-income economies. There is also a growing need for strengthening technical cooperation in this area.

A “behind-the-border” industrial policy agenda would therefore include: Issues related to removing government-imposed barriers to entrepreneurship; policies geared towards the supply of public goods like knowledge, information, basic research, technology extension, and standards and metrology; policies and institutions that support the participation of national firms in international markets (investment promotion, export processing zones, industrial parks and market intelligence); and policies that promote the provision of services to support small and medium sized enterprises (SMEs) in their efforts to leverage resources for development (e.g. promoting small business export consortia and associations, and export-oriented clusters and networking).

### **The Round Table discussion focus**

The focus of this Round Table discussion is on the tools that can be used at a national level to help the real economy strengthen its productive capacity in order to grasp the opportunities arising from new market developments, and on identifying technical-assistance needs in these areas. These tools include a wide range of institutions and organizations that support the building of skills; acquisition of

---

7 For a fuller discussion of these issues see ICTSD (2003), Stern (2002) and UNDP (2003).



capital, technology and information; and compliance with international conventions and agreements, and with different types of technical, environmental, and health standards. More specifically the Round Table discussion is structured around following two areas:

- I. Strengthening supply-side capacity
- II. Enhancing capabilities to assess and prove conformity with standards, technical regulations and other market requirements

### ***I. Strengthening supply-side capacity***

A wide variety of institutions and organizations provide services that can help enterprises to meet the information, skills, knowledge and finance, and other needs that are difficult to satisfy in open markets. Industry associations; export agencies; productivity centers; technology information centers; metrology, standards, testing and quality infrastructure; R&D laboratories; and cluster development institutions can together create a business environment rich with knowledge and information on new technology, essential for enhancing productive supply capacity.

In the present global setting the role of such intermediaries becomes even more important. These intermediaries can provide support for building capabilities to use new technologies, adapt and improve processes and products, and move up the value chain into more sophisticated production activities. In other words, they can support the real economy along the “high road” to competitiveness by helping it to avoid reducing wages, devaluing national currencies, disregarding labour or environment regulations – the “low road” to competitiveness that is incompatible with sustained growth.

The functioning of many of these institutions and organizations depends on government subsidies. Market failures, the public-good character of the services provided, constraints on public policy, and multilateral trade agreements’ constraints on what policy instruments to use, are some of the factors that favour the subsidized provision of these services. In developed countries many of these services are supplied through the market, but even here it is necessary to augment what is supplied through the market.

Many developing countries have established institutions and organizations designed to support the real economy, but they often function badly, providing poor quality services with inadequate equipment. They often also employ poorly motivated and remunerated staff not responsive to demand, and suffer from unrealistic objectives, bad management and a lack of financial resources. Equally, enterprises in developing countries, and in low-income countries in particular, frequently do not have a clear idea of the services they need, and they have difficulty in assessing the suitability of both the services and those offering them. There is a clear need for technical assistance in this area, underpinned by well-defined priorities and guidelines.

There are several areas in which these intermediaries can provide support to the real economy. The first crucial area relates to supporting firms’ technological efforts and productivity enhancements. Technology extension services include extending available technology to enterprises lacking such capabilities; helping firms use cleaner production technologies; providing information on available technology; assisting firms by demonstration and implementation of new technologies; etc. Productivity enhancement services include efficiency and productivity improvements, management strategies, and training.

The second crucial area relates to meeting internationally agreed standards. Local business associations and/or various government programmes can also play a critical role in raising awareness of the need for quality systems to meet the requirements of foreign markets.

The third important area of support relates to proof of conformity through testing, measurement and certification. Entry into new industry supply chains increasingly depends upon testing and

measurement facilities and upon certification requested by the targeted markets. The relevant products have to be tested to exacting standards, and continued control over their production requires that measuring equipment needs to be calibrated. The provision of such facilities plays an important role in enabling firms to meet the requirements of foreign markets. For instance, for firms linked into supply chains for original equipment manufacturing (OEM), where the buying enterprise gives all specifications to contracting firms (supplying assemblers and certified replacement parts), quality control and certification is essential. It is to be expected that ever-greater emphasis will also be placed on enterprises meeting environmental standards, such as ISO 14000.

In well-established markets, much of the process of certification and the provision of consultancy services for enterprises preparing to meet these standards can be provided through market mechanisms. Private-sector provision of certification services tends to follow the market. When standards requirements are first developed, both governments and business associations can support their diffusion. If the certification process is to include locally based certifiers, then it is critical that the accreditation process for certifying firms is credible. There have been difficulties in some developing countries relating to the credibility of certification agencies (UNIDO 2003 b).

The fourth area of support for local firms relates to technical education and training systems. Increasingly, buyers in global industries impose exacting standards, but do not wish to be involved in helping their suppliers to meet them. Firms wishing to maintain their involvement in global value chains must invest in engineering skills, which are particularly important in the area of process engineering in order that technical and quality standards can be met. Therefore, provision of skilled labour here is vital.

The fifth area of support focuses on the provision of information, market intelligence services and investment promotion. The long-term survival of small firms in the global value chains of particular industries will depend upon access to information on new technologies, global information networks, and proactive market strategies, seeking out new customers and new markets. This is costly for small and medium-sized enterprises (SMEs), and there is a case to be made for the collective provision of market intelligence and promotion of an industry presence at trade fairs. The promotion of foreign investments serves as a vital tool for enriching the indigenous base of technological capabilities and for achieving strategic industrial development objectives through exploiting the potential complementarities between local and foreign producers (UNIDO 2002, pp. 119-120).

Issues to be discussed:

- *What is the critical mass of real economy support institutions for low-income countries, particularly with reference to their participation in the global economy?*
- *What is the role of technical assistance in this area and what are the guiding principles for this assistance?*

## **II. *Enhancing capabilities to assess and prove conformity with standards, technical regulations and other market requirements***

### *Standards compliance*

Standards, technical regulations, and the certification against them, relate to products and processes and labour conditions (e.g. HACCP – Hazard Analysis and Critical Control Point – for food safety, ISO 9000 for quality management, ISO 14000 for environmental management, and SA 8000 for labour conditions). Their principal intention is to protect public and workers' safety and health and to provide confidence to the international clients. They can also be a stimulus for technology transfer and a driver of innovation through acquisition of best international practice.

However, a challenge developing countries are facing is the growing number of international standards. With close to 100,000 standards being applied world-wide at present, and the number

increasing at a rate of 1,000 new standards a year, developing countries have great difficulty in creating awareness of new standards and disseminating information about them at national levels.<sup>8</sup>

While tariff barriers can be removed by a simple piece of legislation, standards and technical regulations present a challenge that developing countries must address. At the core of this challenge is the need to enhance institutional infrastructure. Building and maintaining a quality infrastructure should ensure that developing countries are able to produce goods of a standard that can be traded globally and thus to take advantage of free trade.

Conforming to standards is undeniably more difficult than defining the standards themselves. It is a matter of reforming and upgrading standards-setting regimes, as well as establishing efficient testing, certification and laboratory accreditation mechanisms that conform to the requirements of the Agreements on Sanitary and Phytosanitary Measures (SPS) and Technical Barriers to Trade (TBT) and enjoy international recognition.<sup>9</sup> It is also a question of the developing countries asserting themselves in standards-setting bodies.

#### *Assessment and proof of conformity*

Developing country producers thus must be able to prove the reliability of their test data and inspection procedures, as well as the conformity of their products to international standards and/or those applied in the recipient country. Testing, calibration and certification facilities are therefore of extreme importance. If such facilities are not recognized internationally, a country's trade potential is seriously hampered and the prices its products can command on global markets are correspondingly lower. Moreover, local metrological and testing capabilities reduce the associated costs for products that would otherwise either have to be tested abroad or locally by international certification companies at very high rates. Effective assessment also provides domestic companies with objective results, which are essential to improving designs and technologies and assuring quality. Although markets in both the certification process itself and the preparation of firms for certification will emerge, governments can play an important role in developing and regulating these markets.

In order to prevent technical regulations and industrial standards whose original purpose was to protect public health and safety, and which vary from country to country, from becoming barriers to trade, the WTO includes the SPS and TBT Agreements. Yet despite these agreements, many producers, from both developed and developing country alike, complain that such regulations are still used as non-tariff barriers, obstructing access to markets, and/or that they are applied in an arbitrary or discriminatory, and sometimes exaggeratedly restrictive, way (Otsuki et al. 2000).<sup>10</sup> Also, despite initial accord by the signatories to the TBT and SPS agreements to facilitate the provision of technical assistance to those signatories not yet able to adjust to and comply with the agreements, such assistance has been limited so far.<sup>11</sup>

---

8 The most recent official data supplied by ISO show that by December 2001, 510,616 ISO certificates and 36,765 ISO 14000 certificates had been recorded. Also, as of 2005, developing country food products entering the EU market should comply with EU directive 179/2002 that requires the implementation of the traceability system, which might lead to non-tariff barriers for developing countries (See FSA 2002).

9 In a survey conducted by the WTO TBT Committee to assist developing country members to identify and prioritize their specific needs in the TBT field, 62 per cent of the respondents indicated a need for assistance in infrastructure and capacity building in relation to conformity assessment bodies as against 35 per cent who indicated a need for assistance in infrastructure and capacity building in relation to standardizing bodies.

10 An added problem is that contractors in developing countries are often required to produce according to technical standards set by buyers that are neither international nor consensual.

11 At the time the TBT and SPS agreements were drawn up, the inability of developing countries to comply with the provisions was common knowledge. Despite clauses in the agreements providing for assistance to be given to the developing countries, little has been done.

Developing countries also lack awareness of such standards and regulations, and not enough has been invested in the requisite infrastructure and skills.<sup>12</sup> Constructing a scientific and technical base, as well as the productive capabilities able to meet the challenges posed by WTO agreements and the quality demands of industrialized country markets, can take decades and calls for levels of investment that most developing countries, and LDCs in particular, cannot afford.

Issues to be discussed:

- *What is the critical mass of quality-supporting infrastructure for low-income countries and the poor?*
- *How can the provision of cost-effective, sustained and internationally recognized services in testing, conformity assessment and metrology be enhanced through cooperation at the national, regional and international level?*
- *What is the role of technical assistance in this area and on what level? Foreign donor agencies sometimes play an important role in co-funding and organizing these intermediaries – what lessons does their experience offer?*

## Summary

### *The current setting*

1. Developing countries seeking to participate in the international division of labour to access the gains from trade face a world characterized by intensifying globalization under the auspices of international agreements setting the rules of the game and formal barriers to trade; heightened international competition; and increasing control of trade by TNCs, through their dominance of global value chains.
2. The past decade has witnessed increasing concentration of trade and growth in the developed world and in a few successful developing countries; many of the rest, especially LDCs, have been left behind with a declining share of world trade and stagnant growth. There has been a failure of convergence among economies that have attempted to integrate into the international division of labour. Thus the gains from trade, which should flow to the poor, have been limited.
3. This is despite evidence for linkages between increased openness of trade, export growth, economic growth and reduction in poverty. The developing countries' greater openness to trade as compared with developed countries implies that they should gain even more, but this has only happened in a few cases. Many LDCs lack the capacity to produce for the world market and are dependent for export revenues on a few commodities for which international prices are low and demand is volatile. Developing countries, which participate in international trade, confront numerous trade barriers, including increasing numbers of standards and conformity requirements.

### *A new response*

4. New opportunities and challenges for developing countries arise from the freeing of trade under international rules and a new, integrated, policy response is necessary at national and donor level – one which takes account of research into the potential, in conformity with the new international rules, for supporting the national enterprises, capable of accessing economies of scale, of raising productivity, earning foreign exchange and of raising incomes.
5. At the multilateral level, calls for a new “grand bargain” covering international trade reform, aimed at assuring that trade benefits the poor, could result in greater scope for the implementation of policies targeted towards an approach to industrialization based on capability and capacity

---

<sup>12</sup> Under the WTO notification system, details of new standards and regulations are available through the enquiry points that have been established for both TBT and SPS.

building. “Behind-the-border” industrial policies are needed, which focus on an array of macroeconomic and social policies as well as the reform of failing institutions, the creation of new ones, the correction of market failures, and the better provision of information, skills, knowledge and technology to support the efforts of enterprises.

6. At a national level, there is a clear role for the provision of technical assistance with aspects of standards conformity, market information and other support services aimed at the establishment of a supportive institutional base for national enterprises. The WTO agreements on SPS and TBT emphasize the need for the provision of such assistance. Developing countries also need to be more closely involved in the development of international standards, whether concerned with health and safety or environmental protection, and of systems for monitoring conformity.

#### *Focus of the Round Table*

7. The focus of the Round Table will be on the identification of national policy tools and technical assistance possibilities to achieve two overall goals:
  - Strengthening supply-side capacity; and
  - Enhancing capabilities to meet standards, and conformity assessment requirements.
8. An array of institutions and organizations, some market based, some government-led, can provide services that will help enterprises to meet information, skills, knowledge and finance needs in order to participate in world trade. These intermediaries should focus on providing support in the following five areas:
  - Technology extension and productivity enhancement;
  - Meeting international standards;
  - Proof of conformity through testing, measurement and certification;
  - Technical education and training systems; and
  - The provision of market intelligence and investment promotions services.
9. With reference to the areas identified under point eight, the following specific questions should be considered at the Round Table.
  - What is the critical mass of real economy support institutions for low-income countries, particularly for enhancing their supply side capacity and their participation in global economy?
  - What is the critical mass of quality-support infrastructure for low-income countries and the poor? How can cooperation at the national, regional and international levels enhance the provision of cost-effective, sustained and internationally recognized services in testing, conformity assessment and metrology?
  - What is the role of technical assistance in these areas and what principles should guide it? How can the experience of donor agencies in the co-funding and organization of support providing institutions best be drawn upon?

#### **References**

Ben-David, D., “Equalizing Exchange: Trade Liberalization and Income Convergence”. *Quarterly Journal of Economics*, Vol. 108, 1993.

Dollar, D., “Outward-oriented Developing Economies Really do Grow More Rapidly: Evidence from 95 LDCs, 1976-85”. *Economic Development and Cultural Change*, Vol. 40, No. 3, 1992.

Dollar, D., and A. Kraay, *Trade Growth and Poverty*. Policy Research Working Paper No. 2199. Washington, D.C.: World Bank, 2000.

Edwards, S., *Trade Policy, Exchange Rates and Growth*. NBER Working Paper No. 4511. Cambridge, Mass.: National Bureau of Economic Research, February 1993.

Edwards, S., "Openness, Productivity, and Growth: What Do We Really Know?". *Economic Journal*, Vol. 108, No. 1, 1998.

Ferro, M., D. Rosenblatt, and N. Stern, *Policies for Pro-Poor Growth in India*. mimeo. Washington, D.C.: World Bank, 2002.

Frankel, J., and D. Romer, "Does Trade Cause Growth?". *American Economic Review*, Vol. 89, No. 3, 1999.

FSA, *Traceability in the Food Chain – A Preliminary Study*. London: Food Standards Agency, March 2002.

Hewitt, A., and I. Gillson, *Income Distribution Impact of Trade Facilitation in Developing Countries*. Document No. TRADE/2003/21. Geneva: UN Economic Commission for Europe, 8 April 2003.

Hoekman, B., "More Favorable Treatment of Developing Countries: Towards a New Grand Bargain". *Development Outreach*. Washington, D.C.: The World Bank, July 2003.

Hoekman, B., F. Ng, and M. Olarreaga, "Tariff Peaks in the Quad and Least Developed Country Exports". *World Bank Economic Review*, Vol. 16. Washington, D.C.: World Bank, 2002.

ICTSD, *The Second Dimensions of S&DT: "Spaces for Development Policy" Revisiting Special and Differential Treatment*. Working Draft – 16 May 2003. Geneva: International Centre for Trade and Sustainable Development, 2003.  
<http://www.ictsd.org/dlogue/2003-05-06/06-05-03-prog.htm>.

Medhora R., and S. Joekes, *April 15, Presentation to the Sub-Committee on International Trade, Trade Disputes and Investment of the Standing Committee on Foreign Affairs and International Trade*. Ottawa: International Development Research Centre, 2002.

OECD, *Document No. TD/TC(97)19*. Paris: Organization for Economic Cooperation and Development, 1997.

Otsuki, T., J. Wilson and M. Sewadeh, *A Case Study to Quantify the Trade Effect of European Food Safety Standards on African Exports*. Development Research Group. Washington, D.C.: World Bank, October 2000.

Oyejide, A., "Trade Reform for Economic Growth and Poverty Reduction". *Development Outreach*. Washington, D.C.: World Bank, July 2003.

Sachs, J., and A. Warner, *Economic Reforms and the Process of Global Integration*. Brookings Institutions Papers on Economic Activity No. 1. Washington, D.C.: Brookings Institution, 1995.

Somesh, K., *Trade Liberalization and the Poor: A Framework for Poverty Reduction Policies with Special Reference to Some Asian Countries Including India*. Washington, D.C.: World Bank, 2003.

Stern, Nicholas, *Making Trade Work for Poor People*. Speech delivered at the National Council of Applied Economic Research, New Delhi. Washington, D.C.: World Bank, November 2002.

UN, *How the Global Compact Works: Missions, Actors, and Engagement Principles*. New York: United Nations, 2003

UNCTAD, *World Investment Report: Foreign Direct Investment and the Challenge of Development*. Geneva: United Nations Conference on Trade and Development, 1999.

UNCTAD, *Handbook of Statistics*. Geneva: United Nations Conference on Trade and Development 2000.

UNDP, *Making Global Trade Work for People*. London and Sterling, Virginia: Earthscan Publications Ltd., 2003.

UNIDO, *Industrial Development Report 2002/2003: Competing Thorough Innovation and Learning*. Vienna: United Nations Industrial Development Organization, 2002.

UNIDO, *The Global Wood Furniture Value Chain: What Prospects for Upgrading by Developing Countries*. Sectoral Studies Series. Vienna: United Nations Industrial Development Organization, 2003(a).

UNIDO, *The Global Automotive Industry Value Chain: What Prospects for Upgrading by Developing Countries*. Sectoral Studies Series. Vienna: United Nations Industrial Development Organization, 2003(b).

UNIDO, *The Global Apparel Value Chain: What Prospects for Upgrading by Developing Countries*. Sectoral Studies Series. Vienna: United Nations Industrial Development Organization, 2003(c).

UNIDO, *Trade Capacity Building: The Role of UNIDO and the Multilateral System*. Background paper prepared for the Informal Consultative Group on Trade Capacity Building. Vienna: United Nations Industrial Development Organization, May 2003(d).

Walmsley, T., and L. Winters, *Relaxing Restrictions on Temporary Movement of Natural Persons: A Simulation Analysis*. mimeo. Brighton: University of Sussex, 2002.

Winters, L., *Doha and the World Poverty Targets*. mimeo. Washington, D.C.: World Bank, 2002.

World Bank, *Global Economic Prospects*. Washington, D.C: World Bank, 2002.

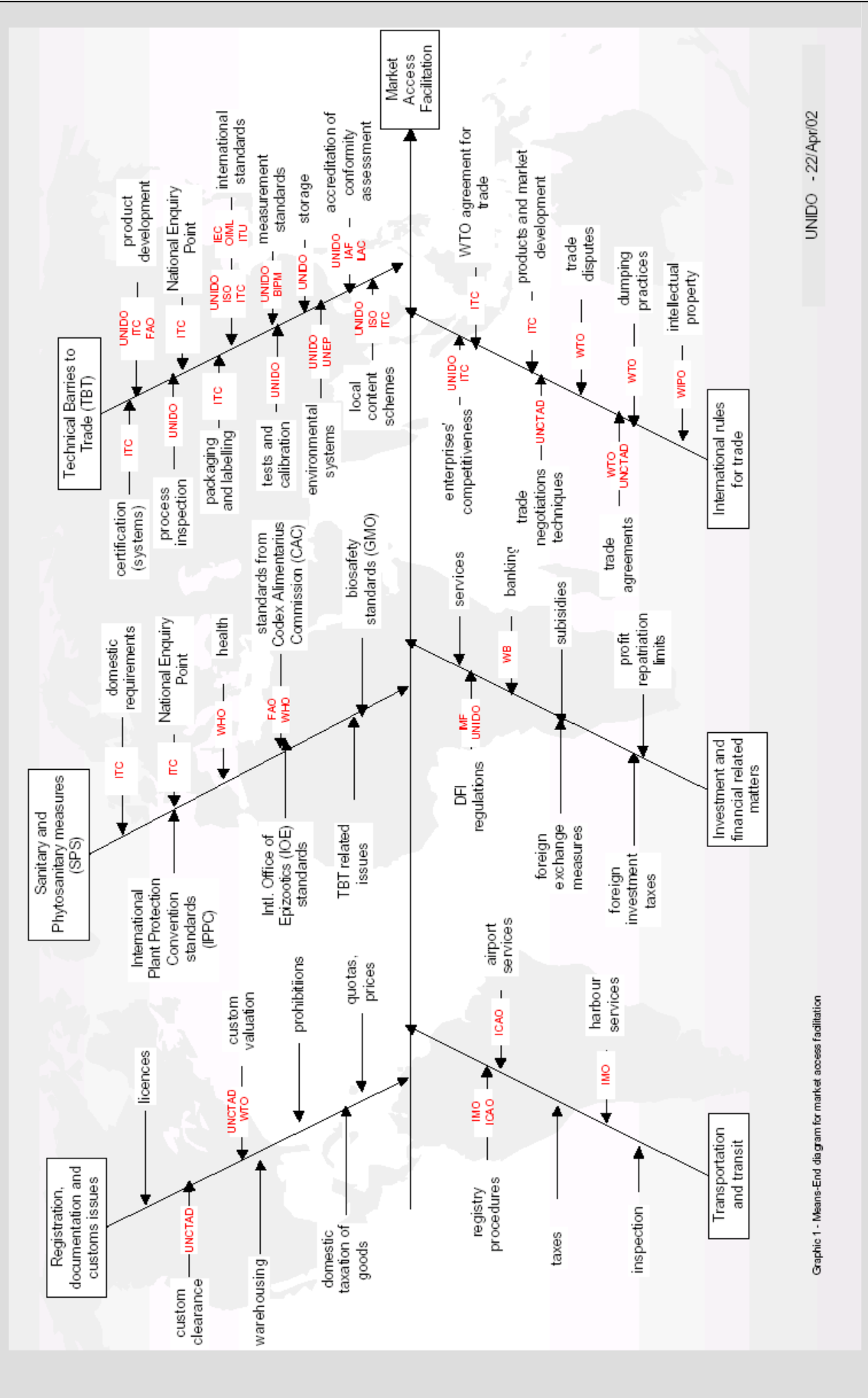
World Bank, *World Development Indicators*. Washington, D.C.: World Bank, 2003(a).

World Bank, *World Bank TBT Database, Preliminary Results Covering 17 Developing Countries*. Presentation at DFID. Washington, D.C.: World Bank, June 2003 (b).

WTO, *Declaration of the 4th Ministerial Conference in Doha, Qatar, November 2001 (Doha Declaration)*. Geneva: World Trade Organization, 2001.

Annex.

Non-tariff barriers affecting market access



Graphic 1 - Means-End diagram for market access facilitation



# UNIDO Position Paper

## Trade Capacity Building: Supply-Side Development, Conformity and Integration in the Global Market

*UNIDO Secretariat*

### Executive summary

UNIDO is committed to foster developing countries' access to and integration into global markets while assuring adequate protection of consumers and of the environment. UNIDO's position with regard to trade, poverty and sustainable development and the solutions the Organization is offering to its Member States are defined in the Organization's trade capacity building (TCB) initiative, which encompasses the improvement of supply capacity, conformity to market requirements to overcome barriers to trade, and enhanced inter-agency cooperation (UNIDO 2002). The UNIDO TCB approach has been developed on the basis of research activities carried out by UNIDO and on the Organization's 40 years of experience in strengthening developing countries' industrial capacity and their metrology, standards, testing and quality (MSTQ) infrastructure and skills.

This paper reflects the holistic approach pursued by UNIDO for enhancing the trade capacity of developing countries while improving coordination and harmonization with key development partners and technical institutions, as illustrated in the fishbone-like scheme for market access facilitation presented in the Annex,<sup>1</sup> by the Memorandum of Understanding (MoU) signed with the World Trade Organization (WTO) at the latter's Ministerial Conference in Cancun in September 2003, and the establishment of the Joint Committee on Coordination of Developing Country Assistance in Metrology, Accreditation and Standardization (JCDCMAS).<sup>2</sup> UNIDO has been pleading for an interagency coordinated response as it believes that facilitating a real participation in international trade is a complex and a manifold challenge that requires an international multi-agency response involving not only the UN agencies but also relevant technical partners. UNIDO launched a TCB initiative at the UN Conference on Financing for Development in Monterrey, which is being reinforced by the formalization of strategic partnership with selected organizations (Magariños 2002).

This paper addresses specifically the questions raised in the issue paper prepared for the Round Table on "Making Trade Work for the Poor: Stimulating the Real Economy's Response".

Chapter I reviews the relationship between trade, sustainable development and poverty in the international context. The milestones of UNIDO's involvement in trade-related technical assistance and capacity building (TRTA/CB) are presented in Chapter II. The UNIDO approach for TCB, including an overview of the three major ongoing large-scale regional projects in the West African Economic and Monetary Union (UEMOA), Central America and the Mekong region are given in Chapter III. Chapter IV outlines the major achievements of UNIDO in the field of trade capacity building. Finally, new concepts and strategies being pursued by UNIDO are presented in Chapter V.

---

1 This scheme was first presented by UNIDO at the Meeting of the UN High-Level Committee on Programmes (HLCP), Second regular session, 25-26 September 2001, ACC/2001/11, and updated by UNIDO in 2002 and 2003.

2 This Committee includes UNIDO, the International Bureau of Weights and Measures (BIPM), the International Accreditation Forum (IAF), the International Electrotechnical Commission (IEC), the International Laboratory Accreditation Cooperation (ILAC), the International Measurement Confederation (IMEKO), the International Organization for Standardization (ISO), the International Telecommunication Union's International Telecommunication Standardization Sector (ITU-T) and the International Organization of Legal Metrology (OIML).

## I. Trade, poverty and sustainable development

### *The international context*

The multilateral trading system (MTS) has experienced a severe setback at the WTO Ministerial Meeting in Cancun in September 2003. Its impact on global trade has still to be fully comprehended and the future developments remain uncertain. Nevertheless, multilateral trade negotiations and the WTO Doha Development Agenda (DDA) still represent a unique opportunity for the developing world and for the least developed countries (LDCs).<sup>3</sup> The multilateral rule-based approach to trade – that encompasses broad negotiations centred on development and supported by technical assistance and capacity-building (Doha Round) – still appears to be a valid, fair, and transparent system compared with bilateral negotiations and regional agreements alone.

*Disagreements on agricultural subsidies and the proposal to start negotiations on the “Singapore issues” – trade and investment, trade and competition policy, transparency in government procurement, and trade facilitation – were the key factors that caused the talks to break up in Cancun.*

The possibility to resume talks and move the negotiations forward will depend on the ability and willingness of WTO members to pursue fair trade rules that would effectively enable poor countries to develop, thus allowing the global economy to flourish.

It must also be stressed that the failure at Cancun followed an important agreement reached by WTO members on medicines. The agreement enables developing countries to produce essential medicines to combat HIV/AIDS and other pandemics. It is also expected to make a strong contribution to alleviate poverty and the suffering of the poor.

Thus, the opportunity offered to developing countries at Doha cannot be neglected or forgotten. The firm commitment of WTO members to “continue to make positive efforts designed to ensure that developing countries, and especially the least developed among them, secure a share in the growth of world trade commensurate with the needs of their economic development”, has definitely opened the way to increased support to integrating developing countries in the global economy.

The position of UNIDO in trade capacity building has evolved to respond to the DDA and as a result of its participation in, and the results of, major international events, not directly linked to the WTO, that took place in the last few years.

At the International Conference on Financing for Development in Monterrey, Mexico, in March 2002, consensus was reached on the need to remove supply-side constraints on trade and secure predictable financing for trade-related assistance and capacity-building (UN 2002 a, chap. I, resolution 1, annex). At the same conference, UNIDO launched its TCB initiative (Magariños 2002). In September of the same year, the World Summit on Sustainable Development held in Johannesburg, South Africa, reaffirmed the importance of trade to sustainable development. It emphasized the need for further

---

3 The Doha Development Agenda comprises several instruments: A Ministerial Declaration setting out the mandate for negotiations in a number of areas and a work programme for WTO members in other areas (WT/MIN (01)/DEC/1); a Decision on Implementation-related Issues and Concerns (WT/MIN (01)/17), which deals with some of the difficulties that developing country WTO members have encountered in implementing certain WTO agreements; and a Declaration on the Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS) and Public Health (WT/MIN/01/DEC/2), which deals with the relationship between intellectual property rights and public health issues. These instruments are available on the Internet at <http://docsonline.wto.org>.

efforts in support of sustainable trade, extending beyond the commitments entered into at Doha and Monterrey (UN 2002 b).

Other attempts have also been made to address the specific trade-related needs of the LDCs and Africa. In May 2001, the Programme of Action for the Least Developed Countries for the Decade 2001-2010 was adopted at the Third United Nations Conference on the Least Developed Countries (UN 2001) and six months later NEPAD, the New Partnership for Africa's Development, was launched (UN 2002 c). Analysis of both initiatives reveals a commonality of design.

From the Programme of Action for the LDCs and NEPAD, it emerges that the reasons for the failure of developing countries to benefit from the opportunities offered by the rapidly changing global markets are not linked merely to limited reductions in tariffs and quotas; the reasons clearly lie elsewhere. As the developing countries themselves recognize, they lack both an effective industrial productive capacity, which they need to ensure optimization of production and product diversification, and the ability to comply with international standards and practices, which they need to exploit the opportunities offered by the liberalized global trading system.

In conclusion, despite the failure in Cancun to respond to the international development agenda, it is clear that it will be necessary to continue efforts to help developing countries to increase trade and growth. Thus, facilitating access to markets and the elimination of distorting subsidies and other trade barriers must continue at an even faster pace. On the other hand, to achieve real impact through the trade negotiations will not be enough. It is clear that developing countries need to add value to their production and need to improve their productive capacities so that they are in a position to supply markets with marketable and competitive goods. It will be necessary to come back to the idea that trade is an engine for development and for this reason the Doha Round was called the development round. It will therefore be essential not only to expand the TRTA/CB but also to provide a comprehensive multilateral response showing that a collective UN action will bring about better solutions. In relation to future assistance, it will be necessary to shift from pure support to trade negotiations to enhanced technical assistance on removing supply-side constraints.

### *Trade and the poor*

Many researchers and institutions are studying the relationship between trade, sustainable development and poverty, and are involved in assessing whether trade really has a positive impact on development and clear effects on poverty reduction. It can be stated that linkages between trade and poverty issues are not as direct or immediate as the linkages between poverty alleviation and access to social economic and physical infrastructure such as education, health, water, land, finance, and effective governance. It is evident, however, that growth of the real economy due to an increase in the value and quantity of exported commodities, manufactured goods and services naturally has an impact on income and on the wealth of a nation. It is likewise clear that this increase in trade might have a positive impact on the poorer segments of the population and on the country's income distribution. The degree of the impact of trade, and the process of liberalization, varies in view of the general economic conditions of each country and of the role and strength of both its real and monetary economy.

Poor countries are generally more dependent on trade for generating income than developed countries. One-third of Africa's GDP comes from trade, while countries in the Organization for Economic Cooperation and Development (OECD) earn on average less than a fifth of their GDP through trade. Specifically, it has been reported that about 25 LDCs depend on non-fuel primary products for more than half of their exports. The poorest countries earn eight times more each year from trade than they receive in aid. A large share of trade in GDP represent a risk for developing countries as they are vulnerable to changes in demand for traded goods, in markets that they do not control nor can influence directly due to existing unbalances among rich and poor countries and enterprises.

*Half the world – nearly three billion people – lives on less than two US dollars a day. The GDP (gross domestic product) of the poorest 48 nations (i.e. a quarter of the world's countries) is less than the wealth of the world's three richest people combined. Least developed countries (LDCs) account for less than one half of 1 per cent of world trade.*

*That international trade is of major importance to LDCs is evident. For example, it has been estimated that exports and imports accounted for an average of 43 per cent of the GDP of LDCs in 1997-98.*

*The majority of LDCs are dependent on exports of one or two commodities that cover half of their foreign exchange earnings, and commodity prices are currently at their lowest level for 150 years.*

*The USA and the European Union remain the most important markets for LDCs, absorbing two thirds of total LDC exports. In the specific case of clothing they account for up to 97 per cent of total LDC exports.*

The main purpose of this paper is not to assess the overall economic impact of globalization, but rather to analyze specific issues. In this perspective, it might be useful to present schematically some of the most common pros and cons related to trade-orientation and liberalization to better understand the relationship between trade and poverty alleviation:

#### Main benefits of increasing trade-orientation and trade liberalization

- Increased export opportunities and specialization in productive activities that can exploit comparative advantages.
- Higher economic growth and real income through better access to ideas, technology, goods, services and capital.
- More efficient use of resources leading to higher productivity as a result of increased international and domestic competition.
- Long-term effect on increased inflow of foreign investment and transfer of technology.
- Increased opportunities to produce competitive goods and services in global demand and incentives to adopt new business practices develop new products and markets.
- Enlarged market for local producers, allowing them to better exploit economies of scale, which increases income levels and the efficiency of resource allocation.
- Developing countries might be more competitive in low-skill intensive sectors and these sectors might expand and increase the demand for low-skilled workers, who typically belong to the poorer segments of the population.
- Increased access to cheaper imported products.

#### Potential risks of increasing trade-orientation and trade liberalization

- Domestic firms are typically import competing companies. Often they cannot compete easily on price and quality, and therefore they can lose market share or go out of business.
- Workers in failing businesses can lose their jobs.
- Workers without skills may not find new jobs or may have to accept lower paying jobs.
- Removal of tariff barriers might lead to a reduction of government revenue, reducing its ability to provide services to the poor; although tariff rates are lower, trade volumes are higher and these two effects work in opposite directions.
- Trade liberalization is typically followed by a restructuring of economic activities and this might negatively affect the poor.

- A process towards openness to trade might cause distortions in the balance of payments if the country is not capable of competing in a global market.
- The full integration of beneficiary countries into the multilateral trading system poses many challenges, which relate to a better understanding of the rules-based system, as well as to the implementation and enforcement of rights and obligations that can be derived from membership.
- One-way trade facilitation.

To sum up, trade can foster economic and social development and be a major instrument in bringing about a convergence in incomes between rich and poor countries and within the countries themselves. Therefore, fostering developing countries' participation in trade, under fair and transparent rules, can increase and create incomes for the poor, and provide more resources to fight poverty.

*The current global agricultural subsidy regime in developed countries involves a massive total support of US\$ 250-300 billion, i.e. five to six times the amount of all aid sent to developing countries.*

*Typically 80 per cent of those transfers goes to the richest 20 per cent of producers and only a small fraction trickles down to the farmer on the land.*

To make the process fair and sustainable, governments should act to mitigate possible adverse effects on certain segments of the population (e.g. farmers in rural areas and workers of enterprises in high competition sectors). Likewise, the whole international community must provide fair opportunities for all by facilitating trade and market access and by providing developing countries with both special and differential treatment and needed TRTA/CB.

To access foreign markets effectively, developing countries need to improve their own performance, but also need constructive help to build up and diversify their supply capabilities through:

- The elimination of export subsidies and the massive transfers to producers in developed countries.
- A further opening up of markets for goods produced by developing countries, such as tropical products, beverages, foods and fibres, by slashing tariffs and expanding quotas.
- An increase in investments and technology transfer to upgrade and diversify productive activities.

WTO negotiations for access to non-agricultural markets that encompass industrial tariff reduction and the elimination of non-tariff measures are key priorities for many industrialized and developing countries within the ultimate long-term objective of total elimination of tariff barriers by all WTO members. In this context, special consideration must be given to the needs of the least developed countries, especially in terms of the level and staging of the tariff reduction in accordance with their capacity.

In overall terms, the share of the value of LDC exports, excluding arms, that enters developed country markets duty-free has increased since 1996. However, when the figure is further adjusted for oil there is a clear downward trend. This downward trend reflects the shift in LDC exports to products and export markets that are not duty-free. In fact, the trade values show that there is basically no increase in the value of duty-free imports from LDCs while at the same time there is a significant increase in the dutiable imports from LDCs.

Moreover, even when LDCs are offered special treatments, they are not necessarily able to exploit them. For example, a recent report from the WTO Secretariat to the LDC Sub-Committee emphasizes the extremely low level of utilization of market access preferences. This analysis is based on the customs data of importing countries and an analysis of imports that are eligible for preferences. It is clear that the main reason for the lack of exploitation of preferences is the weakness of productive capacities. It is not enough to achieve market access concessions but it is necessary that at the same

time tradable goods are produced. The international community is actually committed to providing trade-related assistance and the means to facilitate trade and enable greater access to their markets; however, increased efforts should be made by the developing countries themselves.

*For example, the United States Congress passed the African Growth and Opportunity Act (AGOA) in 2000, providing duty- and quota-free access to the United States market for 1,800 products from Africa. In addition to streamlining its generalized system of preferences, the European Union introduced its “Everything but Arms” (EBA) initiative for LDCs. Many countries, such as Canada, Italy, Japan, New Zealand and Norway, have launched similar duty- and quota-free access initiatives and simplified customs procedures for LDCs. Much, however, remains to be done.*

If trade liberalization is to have an impact on poverty, it is vital that it should be an integral component of comprehensive national development and poverty reduction policies and strategies in the developing countries, ensuring that world trade must be socially and environmentally sustainable. As indicated also, for example, by the OECD, putting in place an effective policy framework for trade is essential and all efforts should be guided by a vision to bring into the mainstream a comprehensive trade development strategy in a broader national development and poverty reduction strategy. Therefore, it is necessary to strengthen and harmonize trade and development policies, including those related to debt and supply-side issues. TRTA/CB should be provided based on such a perspective.<sup>4</sup>

To support that process, donor countries need to coordinate trade capacity-building efforts more effectively, foster local ownership and participation in all trade-related development cooperation activities, embrace approaches that strengthen the ability of partner countries to continue helping themselves once donors have left and even strengthen donors’ own trade-related capacities. The need to commit significant financial and personnel resources to build trade policy frameworks in developing countries – with the prospect of substantial returns – is therefore widely accepted by the donor community.

#### *Trade and debt*

Another important issue addressed by UNIDO in its analysis of linkages between trade, sustainable development and poverty is the relationship between trade and debt in developing countries (Pataconi et al. 2003).<sup>5</sup> The principal characteristics of the relationship between trade and debt are summarized in the box below.

*Debt is an important constraint on the trade capacity of developing countries. In many of them, the debt burden is extremely heavy while their trading situation is not improving. Angola, for instance, had a ratio of debt over gross domestic product (GDP) of 91.4 per cent in 2000, Cambodia a ratio of 71.8 per cent and Ethiopia a ratio of 86.7 per cent. These countries seem to be condemned to a debt trap because export revenues determine the ability of a country to finance its external debt.*

4 The need to address this issue appears clearly in the recent WTO trade policy reviews for Niger and Mali that requested the increase of technical assistance for both trade negotiations and productive capacity development.

5 A WTO Working Group on Trade, Debt and Finance has also been established in accordance with the Doha Agenda (WT/MIN (01)/DEC/1, para. 36).

Developing countries and the international community are well aware of the complementarities between initiatives to reduce indebtedness and those aimed at improving market access for poor countries. The linkage between trade and debt is not simple and it is at least less direct than that between trade and finance. The relationship between trade and debt in developing countries has many facets and the combination of international trade and foreign debt policies can be perceived as a paradoxical mix of the potential these policies offer to improve living standards. Attempts made to study this relationship by various economic research groups have not defined a stable correlation between the two factors. The main elements identified by UNIDO with regard to trade and debt are presented below.

- Trade liberalization, i.e. removing trade restrictions, may have a positive impact on external debt and debt servicing, as it is expected to enhance domestic growth, productivity and exports.
- The level of openness to trade has positive effects on the debt structure of countries, as it might attract foreign direct investment and hence foreign exchange reserves. This would enable countries to finance technology transfer and consequently improve productivity and to shift towards production with a higher income elasticity and better terms of trade (Lane & Milesi-Ferretti, 2000).
- Developing countries indebt themselves also to stimulate the growth of the real economy and as a means to increase their exports. To increase their productive capacity and their ability to market their products abroad (commodities, processed goods and services), the majority of developing countries import inputs, technology and know-how.
- Foreign debt must be financed with foreign currency that is earned through trade: As debt service payments consume a larger proportion of the earnings of developing countries, they divert foreign currency from purchases of essential imports.

*The percentage of exports of goods and services to total debt service in 2000 for three heavily indebted LDCs was 3.7 per cent in Angola, 2.6 per cent in Burundi and 2.6 per cent in Guinea-Bissau, giving a good indication of the efforts needed to increase export capacity in order to service external debt. Again, this fact reduces the ability of a country to invest in the social and productive activities needed to take advantage of trade opportunities.*

Addressing supply-side constraints (available marketable products), increasing productive capacity and value added, and diversification of the production base of developing countries is crucial. This should be matched with action to increase market access for countries affected by external indebtedness problems, including LDCs. All these measures must be taken within a global structure of non-discriminatory reduction of trade barriers. For indebted countries, trade policy reform must be supported by pro-growth policies intended to reduce poverty and increase standards of living.

In conclusion, restrictions and barriers to trade imposed on developing countries (both tariff and non-tariff) can dramatically reduce their ability to earn the foreign exchange they need to invest and service their external debt, forcing them into further unsustainable borrowing. Hence, trade facilitation and market access initiatives, as mentioned above, would directly increase the trade of developing countries and consequently improve their external debt situation.

Developing countries should make use of the multilateral trading system as the proper framework within which they might reduce their public debt burden and stimulate real economic growth. This will contribute to improving the social and economic situation of these countries and make available more resources to fight poverty.

## *Barriers to trade*

As reviewed by UNIDO, the IMF conservatively estimates that if barriers to trade were reduced by 50 per cent, the developing countries would obtain additional benefits in excess of US\$ 100 billion per year (UNIDO 2003 a). Clearly, this estimate assumes that the developing countries are actually in a position to take effective advantage of the reduction in trade barriers, which is far from granted. Just for textiles, apparel and other labour-intensive manufactures, UNCTAD estimates that developing country's export earnings would increase by US\$ 500 billion per year if they were able to take full advantage of market opening moves by the industrialized countries.

*It has been estimated that the world's poor people face tariffs that are on average more than twice as high as those that the non-poor face.*

*The World Bank also estimates that many of those barriers are imposed by other developing countries.*

*Analyses conducted by the EU showed that real income gains to developing countries from a 50 per cent cut in protection, by both developed and developing countries, would be in the order of US\$ 150 billion a year – around three times what they receive in aid. (UNIDO, 2003 a)*

The global level of protectionism is diminishing thanks to the trade liberalization process and the multilateral trading system. However, even as markets continue to open, this is not resulting in rapid increases in exports from developing countries. There are various reasons for this.

Developing countries – but rich countries alike – are still burdened by specific tariffs, export subsidies, antidumping measures, tariff quotas and numerous non-tariff barriers, which are only partly offset by the special treatments and TRTA/CB being provided to them.

Developing countries that are so dependent on exports of commodities are suffering even greater barriers to trade due to the dramatic reduction in commodity prices. These are currently at their lowest level for 150 years, and this aggravates the negative effects of tariffs on trade.

*In 2001, the average trade weighted tariff facing LDC agricultural exports into developed country markets was 3.2 per cent. The equivalent figures for textiles and clothing are, respectively 4.5 and 8.5 per cent. These figures take into account preferences granted to LDCs but they do not take into account actual preference utilization. For a variety of reasons, such as rules of origin requirements, preferential access offered to LDCs may not often be fully utilized.*

An example of the negative link between commodity price reduction and tariffs is provided by the “specific tariffs”, which are usually levied on quantity rather than on value (price). Therefore, in addition to the reduction in earnings due to lower commodity prices, earnings are also eroded by the fixed tariff to be charged for the same exported quantity.

The most common issues addressed to actually help LDCs participate in trade are related to the abolition of all form of subsidies and export credits for agro-based products granted in industrialized countries. For example, in the case of cotton, subsidies in the USA, EU and China alone amounted to US\$ 6 billion in 2001/2002, equal to the total global exports of cotton in the same period. A group of West African countries – Benin, Burkina Faso, Niger and Chad – jointly pleaded for the abolition of



trade distorting subsidies on cotton production by the USA at Cancun. Moreover, in relation to the failure of the WTO Ministerial Meeting at Cancun, export subsidies in the agricultural sector were without doubt the principal issue around which a new coalition of developing countries, the G21 led by Brazil, China, India and South Africa, was formed.<sup>6</sup>

UNIDO's is focusing its attention towards non-tariff barriers (NTBs),<sup>7</sup> and more specifically on technical barriers to trade (TBTs) and applications of sanitary and phyto-sanitary measures (SPSs),<sup>8</sup> both of which are regulated under WTO agreements.

Non-tariff barriers cover a variety of issues ranging from TBT/SPS, customs and related trade procedures, internal taxation, recognition of pre-shipment inspection, quantitative restrictions/quotas, import licensing, rules of origin, etc. It should also be noted, however, that measures that can be classified as NTBs and are covered by the multilateral trading system can include issues such as countertrade and balance of payment measures. They can also include sanctions, boycotts, buy-national campaigns, export bans, export taxes, export subsidies, investment related barriers, intellectual property related barriers, services related barriers, monopolies, cartels, arrangements, finance measures and capital movements, insurance, transportation, distribution, movement of business persons, the legal framework, lack of transparency, corruption, and problems with local and regional authorities. This list is not complete or exhaustive. In view of its mandate, technical know-how and experience, and the requests it receives for assistance, UNIDO is focusing on TBTs and SPSs.

#### *Technical barriers to trade and sanitary and phyto-sanitary measures*

Effective market access depends on the reduction of or elimination of barriers and experience shows that as tariffs are reduced, the importance of NTBs grows.<sup>9</sup>

Among non-tariff barriers, standards and technical regulations,<sup>10</sup> conformity assessment procedures and SPSs have become the main obstacles to the free flow of industrial goods and agricultural products. Two WTO agreements on TBTs and on SPSs were specifically designed to ensure that they do not create unnecessary obstacles to trade. That notwithstanding, those very same regulations and standards still act as non-tariff barriers and obstruct the access of products to markets.

These barriers negatively affect the export capacity of developing countries and their participation in international trade. They remain difficult to address and eliminate since they form part of a complex system of standards and conformity assessment schemes with varying ties to government regulations.

---

6 The G21 initially comprised the following countries: Argentina, Bolivia, Brazil, Chile, China, Colombia, Costa Rica, Cuba, Ecuador, Egypt, Guatemala, India, Mexico, Pakistan, Paraguay, Peru, the Philippines, South Africa, Thailand, Turkey and Venezuela.

7 Some NTBs could best be addressed within the context of already existing WTO agreements, others should likely be addressed by specific multilateral trade facilitation agreements. To deal with and negotiate reductions in NTBs is a complex matter. Some institutions have suggested that for some NTBs a tariff equivalency should be determined with a view towards negotiating their subsequent reduction. That could be the case notably for border measures or charges of any kind applied to imported goods (e.g. trigger prices, variable duties, minimum prices etc.).

8 SPSs are designed to make trade between countries easier and to ensure product safety and quality. These measures relate to sanitary (human and animal health) and phyto-sanitary (plant health) requirements that developing countries must meet. Governing such issues as the origin of food products, inspection and treatment processes, traces of pesticides and use of additives, compliance with these measures and other voluntary standards that are de facto mandatory, such as hazard analysis and critical control point (HACCP) procedures, requires laboratories and supporting systems.

9 For a detailed assessment of TBTs, standards and conformity assessment costs and investment required, see UNIDO 2003(a).

10 In order to simplify reading, we refer to both mandatory (e.g. technical regulations) and voluntary standards in this text.

Even for experienced internationally operating companies, the diversity of technical requirements and certification schemes is far from transparent. Under the Market Access chapter of the Doha Declaration, members are invited to identify TBTs that should be removed.

*The worldwide stock of Standards and Technical Regulations (STRs) was estimated in the order of 100,000 in 1990 (UNIDO 2003 a), affecting some 80 per cent of world trade (OECD, 1999). This is most likely to be on the low side since technical regulations at the national, provincial and local level in industrial countries also need to be taken into account; however, the respective data are not available. Furthermore, between 1990 and 1999, the annual rate of new STRs notified to the WTO under the SPS agreement has doubled (UNIDO 2003 a).*

As indicated by various government experts and enterprise representatives, many TBTs/SPSs are difficult to overcome and need to be addressed within the WTO agreements since they are non-discriminatory. It has been reported that there is little WTO case law giving guidance and clarification on the TBT/SPS agreements. There is no mechanism below the level of formal WTO dispute settlement procedures that can deal with the lack of implementation and barriers. Therefore, many are calling for the implementation of a TBT specific mechanism that can resolve technical questions swiftly and without a disproportionate bureaucratic burden.

To overcome existing, emerging and potential technical barriers, developing countries must raise substantially their level of readiness to meet the increasingly stringent requirements applied to their products with respect to quality, productivity, safety, health and the environment, and their work force. The inability to do so entails high actual and potential economic and social costs.

*For example, the growing concern over health risks associated with food products has prompted the industrialized countries to revise their SPSs. The application of the new aflatoxin standard (regarding the acceptable level of aflatoxin) in the EU will reduce health risks only by approximately 1.4 deaths per billion a year, yet will reduce exports of cereals, dried fruit and nuts from just nine African countries by 64 per cent, or US\$ 700 million (Wilson & Abiola 2003).*

Improving quality and environmental performance is not enough to succeed in the new competitive struggle. Increasingly, enterprises pursue certification in important international standards (e.g. ISO 9000 and ISO 14000), product standards, good practices and technical regulations. A growing number of buyers and potential investors are demanding standards and testing certificates as “tickets of admission” for a range of trading and partnership activities.

Until now, the testing and certification process has been very costly, with only a handful of internationally recognized firms awarding globally accepted certificates. The high fees charged by these firms prevent the vast majority of enterprises in developing countries from achieving certification. With the envisaged spread of new international standards – particularly concerning food as well as health and occupational safety – the “standards gap” will only worsen for developing countries.

Standards, certification and measurement-related issues are, therefore, surfacing as significant factors influencing trade relations. While tariffs have declined in importance as barriers to trade, standards and technical regulations are increasingly becoming significant non-tariff barriers. Despite the efforts of international organizations to harmonize international standards – the WTO TBT/SPS agreements being the strongest initiative in this direction – many countries continue to introduce differing standards and technical regulations. Thus, developing countries remain “standards-takers” in the

global marketplace. Finally, without a resolution on how to define the term “international standards”, parts of the agreement cannot be applied efficiently. The Doha Round should therefore strive at a more precise definition of the term “international standard”. The definition should be made in the light of the overall purpose of the TBT agreement – which is to facilitate trade.

To sum up, in order not to be further marginalized but to benefit from the trade liberalization process, developing countries must be able to relate to international levels of quality by meeting a wide range of standards, regulations, certification requirements and applied recognized conformity assessment procedures.

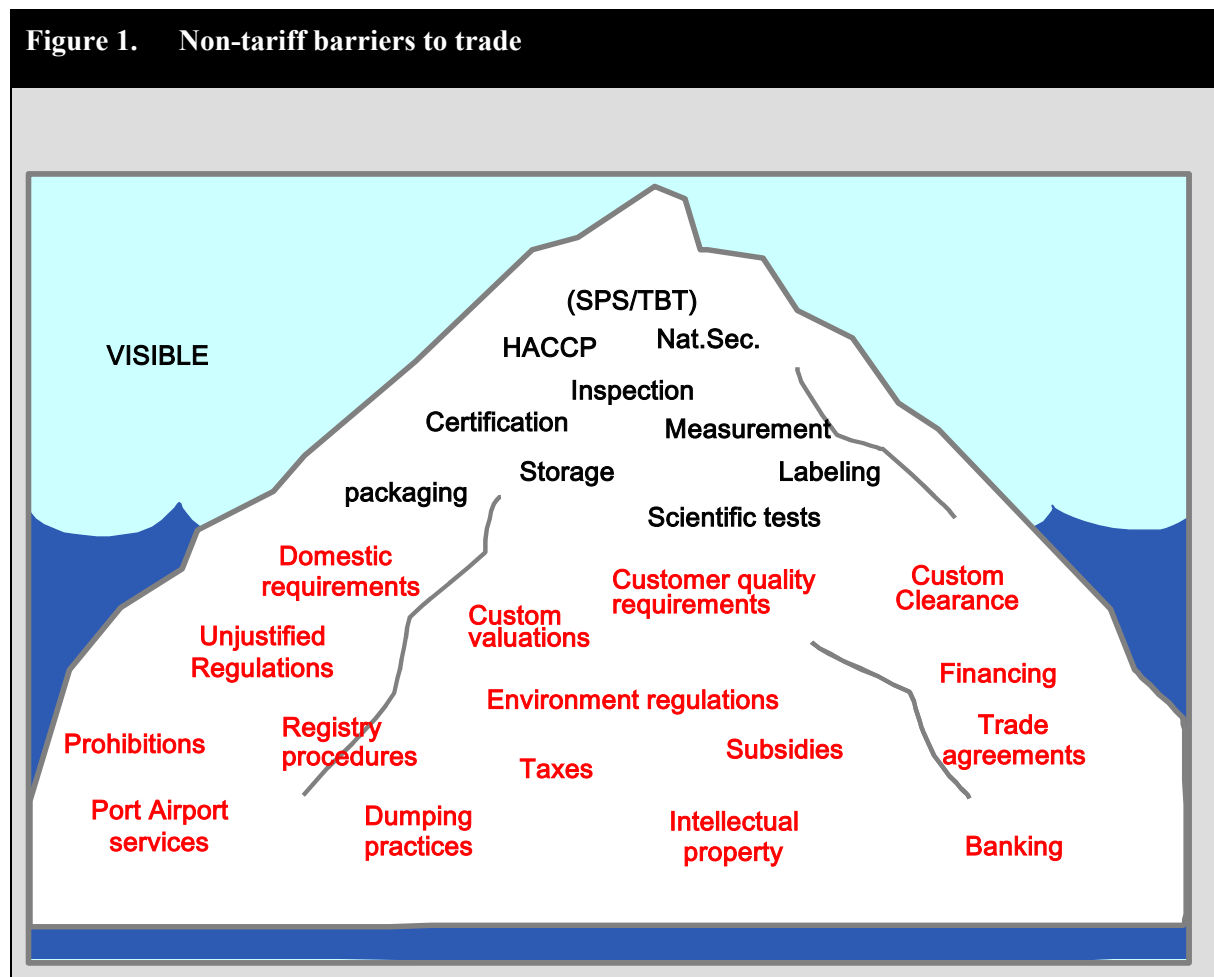
*The main TBT/SPS-related problems encountered by developing countries can be summarized as follows:*

- *Developing countries faced severe implementation problems with regard to TBT and SPS agreements as also assessed in the 2<sup>nd</sup> Triennial Review of the WTO/TBT Committee;*
- *Standards, technical regulations and conformity assessment procedures can be used as non-tariff barriers;*
- *Developing country enterprises have little knowledge and information on the standards to which they need to conform in order to enter export markets, and lack the capacity to analyze and solve TBT/SPS problems;*
- *Enquiry Points that are mandated by the WTO SPS/TBT agreements are not so effective in disseminating information to and within developing countries (government institutions, enterprises and consumers);*
- *The perception that many standards are “imposed” by industrialized countries is usually a consequence of the limited participation by developing countries in the international standard-setting process, resulting in these countries becoming mainly standard takers;*
- *Risk analysis and scientific justification of SPS measures, standards and conformity assessment procedures should not hide protectionist objectives;*
- *Buyers require enterprises from developing countries to comply with market standards and increasingly to implement good manufacturing practices (GMP) and management system standards (i.e. the ISO 9000 quality management systems and the ISO 14000 environmental management systems). Such enterprises do not have easy (or cheap) access to standardization, conformity assessment, and accreditation services and infrastructure (e.g. inspection, certification, testing, calibration, metrology, etc.);*
- *The standards and conformity assessment infrastructure of developing countries is inadequate to meet the quality demands of consumers and regulators from industrialized countries, thereby reducing the export potential of these countries;*
- *Infrastructure constraints are also preventing developing countries from participating/benefiting from trade liberalization and mutual recognition arrangement (MRAs);*
- *Exporters from developing countries often need to carry out duplicative tests as local tests and certificates are not internationally recognized due to lack of international credibility of the standards and conformity assessment organizations of these countries;*
- *Barriers to trade also exist among developing countries; and*
- *Changes in the requirements of international standards (ISO 9001/1997-2000, Guide 25 -ISO 17025, Guide 58-ISO 17011, etc.).*

Therefore, standards and conformity assessment procedures affect a large and growing number of internationally traded products, although their impact on the export prospects of developing countries varies from product to product and from one standards and conformity procedure to another. The available evidence suggests that these countries are particularly affected by their poor acquaintance with quality and standards and under-investment in this field. Unlike traditional non-tariff barriers

that can be removed by a simple piece of legislation, addressing STRs is a challenge that developing countries must deal with in several fronts, including information-dissemination activities, investments in skills and technological infrastructure and greater international cooperation to help them meet the STRs. If these and other complementary actions are not taken, the market access problems of developing countries will continue to grow, regardless of how much industrial countries liberalize their markets.

In any event, the burden of proof that standards are met lies with the exporter. The increased participation of the developing countries in global trade thus depends on their ability to satisfy these standards, testing and conformity-related requirements. This calls for technological and scientific skills and capabilities as well as adequate physical and institutional infrastructure. By ensuring that their institutions are fully equipped to meet the demands made of them and their testing complies with international standards, the developing countries can build up sorely needed client confidence, heighten the consumers' sense of security and nurture a quality culture: Ingredients essential to market access and success. In other words, the developing countries need to acquire technology and build up their supply capacities: Two key areas of comparative advantage that are the very essence of UNIDO's corporate strategy (UNIDO 2003 b).



In conclusion, the WTO SPS and TBT agreements have helped to focus attention on the substantial strengthening of multilateral technical cooperation that is required in order to enable developing countries, particularly the LDCs, to meet standards-related obligations and take advantage of the ensuing opportunities. The costs of not doing so are substantial, particularly in terms of the vitality and inclusiveness of the world trading system.

In view of the great difficulty developing countries have in applying the WTO/TBT agreement and its related standards code of good practice, the provision of technical assistance is essential to enable developing countries face a wide range of barriers they face, as recognized in article 12.7 of the Agreement on Technical Barriers to Trade that specifically states: “Members shall ... provide technical assistance to developing country Members to ensure that the preparation and application of technical regulations, standards and conformity assessment procedures do not create unnecessary obstacles to the expansion and diversification of exports from developing country Members.” (UN 1995).

A special reference to LDCs even strengthens this point. However, in spite of this commitment, so far only limited assistance has been provided, especially in terms of the technical infrastructure required, and much still needs to be done.

## **II. UNIDO’s involvement in TRTA/CB**

### *UNIDO TRTA/CB 2001-2003*

The Doha Development Agenda Trade Capacity Building Database (TCBDB) contains over 8,000 activities for 2001, 2002 and early 2003, provided by 39 bilateral donor countries and multilateral agencies. The WTO and OECD estimate that in 2001 and 2002 there was an annual average of some 1,665 commitments, equivalent to US\$ 719 million, to activities that cover all aspects of trade policy and regulations identified in the Doha declaration, and an average of a further 1,860 commitments, or US\$ 1,408 million, to activities in trade development. In addition to these TRTA/CB activities, the average of US\$ 8.1 billion committed to economic infrastructure in 2000 and 2001 (some 20 per cent of all aid) helps to build the transport, energy and communications network essential for international trade. Global commitments to TRTA/CB equate to some 4.8 per cent of total aid commitments in 2001-2002 (OECD/WTO 2003).

In the period 2001-May 2003, UNIDO’s TRTA/CB activities amounted to around US\$ 35 million and 174 activities. Seventy projects were classified as being related to trade policy and regulations (TPR), and amounted to US\$ 19.1 million, while 104 projects with a value of US\$ 15.8 million were classified under trade development (TD). Specifically, 64 activities have been carried out under trade promotion strategy and implementation (industry), amounting to US\$ 9.9 million, and 24 activities under market analysis and development (industry), for a total amount of US\$ 5.5 million. One project was related with trade promotion strategy and implementation (mining sector).

UNIDO is providing vital TRTA/CB. For some 40 years, the Organization has been promoting the industrial development of developing countries and countries in transition. From its initial focus on assistance for import substitutions, UNIDO shifted towards fostering export-orientation strategies and strengthening supply chains in the late 1980s. Moreover, while UNIDO has assisted developing countries to strengthen their capacities in standards, quality, metrology, testing and accreditation since 1967, the demand for those services has increased substantially from the late 1980s.

UNIDO enjoys a continuous dialogue with Government representatives, key trade-development support institutions, and research and academic entities, in addition to the direct and permanent contact with both multinational enterprises and thousands of small and medium-sized enterprises (SMEs) in the developing world. This enables the Organization to provide demand-driven assistance. In this perspective, the focus of UNIDO’s TRTA/CB is on strengthening both the supply side and the capacity to conform to market requirements at the level of policy and the regulatory framework, institutions and enterprises.

**Table 1. UNIDO trade-related technical assistance and capacity building (TRTA/CB)  
(Classification OECD/WTO)**

<b>TRADE DEVELOPMENT (Total sum of 2001 – June 2003)</b>		
<b>Activity</b>	<b>No. of projects</b>	<b>Total (in 1000 US\$)</b>
Business support services and institutions	30	4,210
Public-private sector networking	2	149
E-commerce	5	347
Agricultural inputs	1	103
Food crop production	2	162
Industrial policy and administrative management	8	920
Industrial development	5	2,744
SME development	17	2,497
Cottage industries and handicraft	3	427
Agro-industries	6	678
Forest industries	5	928
Textiles, leather and substitutes	5	1,194
Non-ferrous metal industries	2	69
Engineering	1	58
Transport equipment industry	3	475
Technological research and development	8	811
Industrial minerals	1	38
<b>TOTAL</b>	<b>104</b>	<b>15,810</b>
<b>TRADE POLICY AND REGULATIONS (Total sum of 2001 – June 2003)</b>		
<b>Activity</b>	<b>No. of projects</b>	<b>Total (in 1000 US\$)</b>
TBT and SPS	56	18,271
Accession	1	27
Trade and environment	5	321
Trade and Investment	8	526
<b>TOTAL</b>	<b>70</b>	<b>19,145</b>
<b>GRAND TOTAL</b>	<b>174</b>	<b>34,955</b>

UNIDO's participation in the preparation of the 3<sup>rd</sup> Triennial Review of the WTO TBT Committee, facilitated the process of raising awareness at CTBT (G/TBT/W/168) of problems faced by developing countries and of UNIDO TCB services (Loesener & Jaich, 2003).

#### *UNIDO trade-related milestones*

To better comprehend the evolution process of UNIDO's interventions that has brought to the development of its TCB initiatives, emphasis should be placed on the following milestones.

#### UNIDO Conference on the impact of standardization on developing countries (1967)

UNIDO, which belonged to UN Secretariat at that time, organized a world conference on the industrialization of developing countries that included a special session on the impact of standardization. The recommendations of that conference guided UNIDO's assistance in MSTQ.

### MSTQ assistance (1967-2003)

UNIDO was the main UN agency providing assistance to developing countries in building up national standards bodies (NSB); testing, metrology and calibration laboratories; quality improvement institutions; and inspection, certification and accreditation bodies. NSBs and other MSTQ institutions in over 80 developing countries have been established or upgraded by UNIDO through projects with a total value of more than US\$ 100 million.

### Surveys on trade implications of ISO 9000, ISO 14000 and eco-labels (1995-1997)

UNIDO carried out pioneer work in 1995 and 1997 by conducting two global surveys assessing the trade implications of ISO 9000, ISO 14000 and eco-labels on developing countries and countries with economies in transition. The two surveys implemented in cooperation with ISO and UNCTAD/ITC, were designed and carried out by UNIDO involving Governments, national, regional and international standardization bodies, and industry-related organizations. The results of the surveys were then analyzed by UNIDO and synthesized, discussed at two high-level expert group meetings (EGMs) held at the UNIDO Secretariat, and widely disseminated, inter alia through presentations at ISO and WTO meetings. As a result of the surveys, UNIDO's actions in support of developing and transition countries were re-defined.

### Pre-peer evaluation of accreditation bodies (1997)

In 1996 UNIDO developed, with the International Accreditation Forum (IAF) and the International Organization for Standardization (ISO), a pre-peer evaluation and scheme to facilitate international recognition of accreditation bodies and certification bodies of developing countries. The scheme was then enlarged to the International Laboratory Accreditation Council (ILAC) to cover laboratory accreditation. Through the services provided under this scheme to a number of developing countries, their accreditation bodies have been recognized internationally, and the certificates and laboratory tests issued by these locally accredited bodies have gained international acceptance.

### UNIDO trade capacity building initiative and the Doha Development Agenda (2001)

As a direct impact of the process of the restructuring of UNIDO, and to respond to the challenges posed by the Doha Development Agenda, UNIDO has re-aligned its trade-related services – including research activities, methodology and tools, and technical cooperation – towards the development and implementation of a new TCB strategy.

More emphasis has been placed on:

- TBTs and SPSs;
- Enhanced inter-agency cooperation (with both development partners and technical institutions); and
- Linking UNIDO's approach to remove supply-side constraints and improve conformity and market connectivity with sustainable development and poverty alleviation.

### UNIDO Trade Capacity Building Trust Fund

On the occasion of the launching of the UNIDO strategy "*Enabling Developing countries to Participate in International Trade*" (<http://www.unido.org/en/doc/5106>) during the International Conference on Financing for Development in Monterrey, Mexico, in March 2002, UNIDO also established a trust fund to support the initiative. The three main types of activities that could be financed from this trust fund comprise:

- Preparatory and programme development activities likely to lead to larger projects in the area identified in the UNIDO TCB strategy;

- Technical and economic analyses and advice facilities, under which UNIDO could, at the request of an exporter and/or the government of an exporting country, provide a technical analysis of products and production processes in cases where exports actually encounter a technical barrier. Based on this analysis, advice and, if needed, further assistance could be provided to find and implement a technical solution to the problem.
- Joint activities with international technical organizations specialized in the fields of standard-setting, accreditation and metrology, specifically to develop approaches that are more appropriate for developing countries.

This trust fund is established to cover these three activities because in all three areas a stream of urgent but relatively small activities are expected. Seeking special purpose contributions for each such case would certainly not be cost-effective. For the larger programmes under components 2 and 3, special purpose contributions will be pursued at the country and regional level.

Donors are invited to make contributions to this trust fund. These contributions can, if so desired, be limited to specific regions or purposes, for instance for technical and economic analysis and advice only. So far four countries have made contributions to the trust fund.

### **III. The UNIDO approach to Trade Capacity Building**

The issue paper identifies three issues to be discussed by the participants at the Round Table. The first is related to how to enhance the participation of developing countries in global value chains (GVCs), the second to standards and conformity assessment and the third to the technical assistance required, including the identification of guiding principles. The UNIDO approach to trade capacity building presented below specifically addresses those issues.

As indicated above, UNIDO's TCB strategy has been refocused to respond more effectively to the Doha Development Agenda and to address specifically the relationships between trade, sustainable development and poverty alleviation. In this perspective, a significant proportion of UNIDO services are linked to industrial and trade policies and regulations as well as industrial trade development.<sup>11</sup>

As mentioned in this report, paragraph 42 of the Doha declaration recognizes that the integration of the LDCs into the multilateral trading system requires support for the diversification of their production and export base. UNIDO's work goes in this direction and aims to foster the integration of poor countries in international trade as a mean to stimulate growth in the real economy and increase the availability of opportunities and resources to fight poverty.

#### *UNIDO vision*

UNIDO's mission is to contribute to the achievement of a considerable increase in the share, volume and amount of the manufacturing value added (MVA) and exports of developing countries and countries with economies in transition, with a special focus on LDCs.

Specifically, UNIDO addresses the following needs of developing countries:

- Assistance to selected productive sectors, with emphasis on those with a high export potential, to access markets, upgrade product features, product quality, productivity, safety and cost-effectiveness, and comply with applicable standards and regulations so that they can export their products successfully;
- Availability of services and physical and institutional infrastructure to promote exports and develop the national capacity to satisfy the technical requirements of the multilateral trading system;

---

<sup>11</sup> See WTO-OECD classification of TRTA/CB (OECD/WTO 2003).



- Skills to carry out technical analysis and obtain advice on technical solutions when export products encounter technical or non-tariff barriers addressing TBTs and SPSs and compliance with the two WTO agreements.

Therefore, in the context of trade of value added/processed goods, UNIDO aims at addressing the needs of developing countries to upgrade human and institutional capacities to:

- Formulate/implement industry-specific trade development strategies and support the creation of an enabling environment for: a) Increasing the volume/value added of exports; b) Diversifying into high-value export products and markets; c) Increasing foreign investment to generate jobs and trade; d) Overcoming barriers to trade; and e) Streamlining trade in development policies;
- Stimulate trade to both developing and industrialized countries by domestic firms and encourage investment in trade-oriented industries;
- Participate in and benefit from the institutions, negotiations and processes that shape national trade policy and the rules/practices of international commerce;
- Enhance the ability of enterprises to participate in international trade through increased productivity and competitiveness, the ability to comply with market requirements, and enhanced connectivity and integration in national, regional and international markets); and
- Increase national capacities to participate in the multilateral trading system.

With regards to the compliance with market requirements, UNIDO intends to focus on: (a) Standards formation, adoption and dissemination; (b) Laboratories for calibration, precision measurement and testing; (c) Conformity assessment, market surveillance and transparency; (d) Abilities to improve product quality and productivity; (e) Overcoming barriers to trade.

UNIDO's efforts are directed towards increasing the participation of developing countries' enterprises in global value chains and fostering transfers of technology and investment flows towards developing countries to create and upgrade supply capacities leading to greater trade flows.

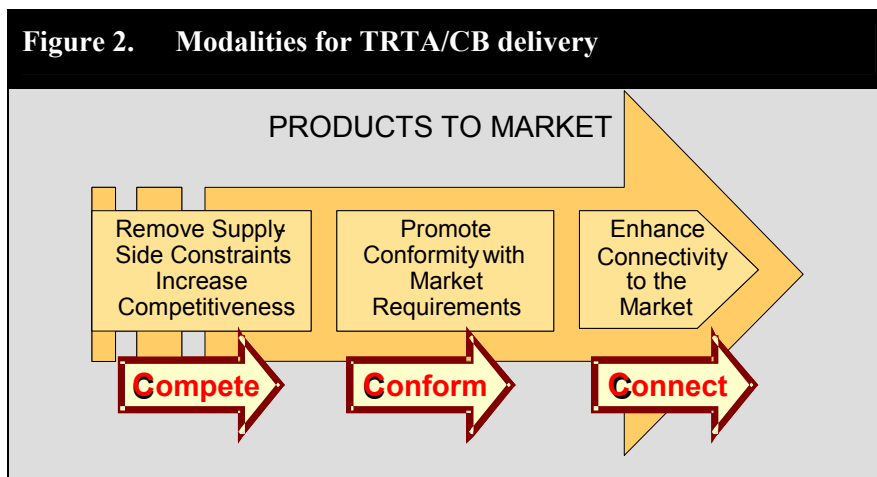
#### *Modalities for TRTA/CB delivery*

The TCB strategy adopted by UNIDO to facilitate trade, foster export capacity and increase access to markets consists of a set of three-pronged coordinated and integrated technical assistance and capacity building actions:

- *To remove supply side constraints and increase the competitiveness of the industrial sector (COMPETE);*
- *To enable products to conform with market requirements (standards, technical regulations and conformity assessment procedures) and overcome barriers to trade (CONFORM);*
- *To enable industrial firms to be connected with the market and foster integration in the multilateral trading system (CONNECT).*

#### Removing supply side constraints

In removing supply side constraints the focus is on the manufacture of products with high-export potential, especially in agro-business, and the provision of assistance related to enterprise upgrading, innovation, technology acquisition, and increasing their capacity to meet international standards, technical requirements and environmental regulations. Through the introduction of supporting legislation, policies and institutional reform, UNIDO also supports also the creation of an enabling environment for foreign direct investment, formulation of policies conducive to greater competitiveness, and increased productivity and trade and investment flows. The strengthening of supply capacity also encompasses the identification of key exported products that encounter technical barriers to trade and are facing supply-side impediments, the promotion of technology transfer and best practices related to process/product upgrading including quality management, cleaner technology and supply chain management.



The developing countries enjoy the highest competitive advantage in agro-based industries, yet only a small proportion of produce is now processed. Post-harvest losses are extensive owing to the lack of storage facilities, infrastructure and even knowledge of the most basic techniques for conversion and manufacturing. Repair and maintenance facilities are deficient. Added to that is the lack of affordable and reliable energy services, especially in rural areas. In the ultimate analysis, however, adding value to raw materials is the only sustainable way of creating wealth at the grassroots or community level – not to speak of securing a greater share in export markets.

The introduction of good, clean and safe processing technologies, new designs, and production practices that meet market requirements, would increase the value-added of agricultural produce and enhance competitiveness. At present, however, the requisite support institutions often lack the capacity for extension services; professional and sectoral trade associations are weak; and there are only a few companies able to advise on processes and machinery/equipment selection, production planning and control, waste minimization, product mix, choice of raw materials and technical inputs.

***Example of assistance in conformity with market requirement: Sri Lanka.***

*Assistance provided in laboratory development and accreditation has led to increased exports. Now, international buyers (BHS, Mothercare, Tesco, Adams Childrenware, Safeway, Home Base, Ethel Austin, Woolworths, Sainsbury Group, Boden, Liz Claiborne, NEXT) accept Sri Lankan laboratory certificates in textiles and garments, as a direct result of the accreditation. Moreover, new export possibilities have been created for organic tea, as tea can now be tested with confidence for pesticide residues in the accredited laboratories. These interventions have had an immediate market access.*

In addition to restructuring and upgrading the existing industrial base in the developing countries, the enhancement of productive capacities would encompass investment promotion, technology diffusion, human resource development, private sector development and the creation of an enabling environment in terms of policy, institutional and infrastructure support. It has been observed that a country with institutions that are functional in terms of its development tend to do well (barring major policy mishaps), whereas a country with dysfunctional institutions tend to do badly regardless of the policies pursued.

Many developing countries find themselves trapped in a technology divide and an investment gap. Foreign direct investment (FDI) and the acquisition of technology are indispensable elements for the

economic transformation that the developing countries require in order to achieve sustainable economic growth and eradicate poverty. The barriers they face include the lack of investment and technology promotion policies, inappropriate legal and regulatory frameworks, inadequate capabilities for investment promotion and technology support institutions, as well as the lack of access to potential investors and sources of new technology.

The latter constraint holds particularly true for SMEs. Customarily considered the engine of economic growth in the developing countries, they account for up to 90 per cent of manufacturing enterprises and some 40-80 per cent of the manufacturing workforce. Nonetheless, SMEs find it difficult to attract investors and access technology. Given their size and relative isolation, they are unable to achieve economies of scale or enter national and global value chains driven by large transnational organizations. At the plant level, their constraints range from limited technical and managerial skills to problems in securing funds and insufficient knowledge of laws and regulations. The complexity of the issue calls for the design and implementation of effective SME policies and the development of a coherent set of specialized support institutions to stimulate and promote SME development, such as business centres and incubators, as well as local business systems based on SME clusters, networks and private sector partnerships.

The promotion of investment and technology flows and the founding of business alliances call for a host of services to identify and promote the manufacturing capacities and capabilities of local SMEs. These include national investment promotion agencies; technology support institutions to advise on the assessment, transfer and management of new and appropriate technology; advisory services throughout the entire technology and investment promotion cycles; and subcontracting and partnership exchanges. All this has to be backed up by governments providing the appropriate policy instruments and taking steps to improve the investment climate.

#### Improved conformity with market requirements

In ensuring conformity and international recognition of local certificates and laboratory analyses and tests, UNIDO focuses on upgrading standards, metrology, testing and quality infrastructure and services. UNIDO also supports developing countries to overcome barriers to trade and to participate in international standard-setting. Furthermore, UNIDO assists in the establishment, on a national or regional basis, of accreditation/certification systems, national measurement institutions to ensure harmonization with international metrology systems, and market surveillance institutions.

#### Enhanced connectivity and integration

One important area of intervention here is to assist developing countries in upgrading the capacity to meet the requirements of the multilateral trade system and to be in a position to reach mutual recognition agreements (MRAs) with both industrialized and developing countries. This component is often implemented in cooperation with other partners such as WTO, ITC and UNCTAD.

#### Delivery features

As indicated earlier, the above UNIDO TCB strategy has been refocused to respond more effectively to the Doha Development Agenda and to address more specifically the relationship between trade, sustainable development and poverty alleviation as called for in the UN Millennium Declaration. Consequently, UNIDO services are linked to industrial and trade policies and regulations as well as industrial trade development, and aim to build human and institutional capacities to facilitate the participation of developing countries in the multilateral trading system. UNIDO's strategy paper, entitled "Enabling Developing Countries to Participate in International Trade – Strengthening the Supply Capacity" was released in March 2002 (UNIDO 2002).

UNIDO's technical assistance and capacity building addresses three different levels: Policy, institutional and enterprise.

Thus, to deliver its services, UNIDO pursues a capacity building approach encompassing policy, institutions and enterprises, combined with troubleshooting and advisory services, the development of solutions to problems encountered, and the transfer of knowledge and technology. UNIDO's actions seek cost-sharing efforts to be made by the recipient countries themselves.

***Example of successful implementation of the 3C approach: Lake Victoria – Fish safety improvement, quality assurance, HACCP, and export development.***

*The programme assisted the fish industry of lake Victoria (shared by Tanzania, Uganda and Kenya) to overcome an export ban by the EU. It worked with fish factories in the implementation of GHP, GMP, HACCP, and in upgrading inspection systems, developing services and accrediting laboratories. UNIDO brought the fish industry to an international level, permitting the resumption of exports to former markets and targeting new markets as well.*

The combination of technical analysis, advice and support for upgrading key export sectors is an innovative approach and a key element in the strategy. The availability of expertise, experience and methodologies covering both technology and management issues at industrial sector level (with a focus on agro-based industries, such as food processing, textiles, leather, and wood), enables UNIDO to be very effective in the delivery of appropriate information, advice, technical assistance and capacity building. As can be seen in several UNIDO technical assistance projects, this integrated approach also generates an increase in the demand for income generating support services (e.g. advisory services, certification, calibration, testing, etc.) from both private and governmental entities.

UNIDO's strategy is also characterized by a strong emphasis on building and strengthening *existing regional trade-related organizations and agreements* by working with the secretariats of such organizations and with their specialized structures at the regional and sub-regional levels.

A regional focus has three major advantages. Firstly it allows a more cost effective technical assistance delivery, combining expertise and training for the whole group of countries, and drawing on resources available from within the region. Secondly it allows some parts of the required support infrastructure to be shared between countries, resulting in important reductions in the cost of establishing the service, but also in the operating cost (i.e. regional accreditation schemes). Thirdly, it provides a major boost to regional integration by fostering the creation of compatible and complementary production and supply chains, standards and regulations, mutual recognition of laboratories and certification, and possibly joint participation in international standards setting activities.

Finally, the UNIDO strategy assists enterprises in developing countries to become integrated in national, regional and international supply chains. To ensure connectivity with markets, export promotion support is provided in cooperation with other specialized organizations. Specifically, UNIDO assists in value chain integration and in strengthening those institutions that bear directly on export performance, such as small business export consortia and export oriented clusters and networks. It also provides support to enable SMEs to respond to changing market conditions in increasingly open economies.

*UNIDO's holistic approach: An effective inter-agency cooperation*

To increase wealth, foster growth and fight poverty requires finding common and agreed solutions and joint efforts. UNIDO has developed an holistic approach seeking the participation of both donors and developing countries, and enhanced interaction among all development partners, including UN agencies, bilateral donors, technical institutions and civil society.

The problems addressed are complex and multi-dimensional. The approach thus has to be holistic and focused solely on identifying solutions to the exclusion of all other considerations. As with many integrated service packages, numerous activities extend beyond the bounds of one single agency. A multi-agency response is called for – joint solutions with other common-system organizations and agencies, as well as bilateral agencies and professional institutions.

It would seem that the focus by international institutions hitherto has been on improving capabilities related to trade negotiations, information dissemination, market access and trade facilitation (in the sense of reforming customs operations and simplifying import and export procedures). This also holds true for main WTO-led initiatives, such as the Integrated Framework (IF) for Trade-related Technical Assistance to the Least Developed Countries and the Joint Integrated Technical Assistance Programme (JITAP). Nonetheless, complementarities clearly exist with the supply-side concerns being addressed specifically by UNIDO.

Developing these productive capabilities, a UNIDO concern, has to be matched by effective export promotion, an ITC concern. Similarly, establishing the standards and conformity assessment infrastructure, a UNIDO concern, has to be matched by the promotion of industrial investment, in part a UNIDO concern, and the facilitation of financial flows, an UNCTAD concern. Simplifying customs procedures, transportation and documentation are the concerns of UNCTAD, WTO and IMO, while issues related to international agreements and rules for trade are concerns for WTO.

*The international community is promoting enhanced international cooperation to provide assistance to developing countries in trade-related matters. For example, in a document on trade and sustainable development and assisting developing countries to capture the benefits of open trade, the European Commission spoke of more efficient co-operation with, and the comparative advantages of, organizations possessing specialized expertise in trade and trade-related matters, such as WHO, UNCTAD, WTO, ITC, UNDP, UNEP, WB, IMF, UNIDO, WIPO and ILO (European Commission 2002).*

Furthermore, just as no activity can be carried out in isolation by any single agency, no activity can be carried out without the full and proper involvement of the developing countries. Integration and cohesion are essential. Simplification of customs procedures is a case in point. Unless the developing countries are fully involved, they may well find themselves at the thin end of the wedge. Under certain circumstances, simpler entry requirements for goods and services may serve better the interests of the developed countries as exporters to the developing countries rather than those of the developing countries as exporters to the developed countries.

Accreditation of laboratories serves as another example. The presence of fully accredited national laboratories adds to the credibility of a country's product and client confidence, thus boosting exports. It also makes a country so equipped a more attractive proposition for potential investors, thus boosting FDI.

The developing countries need to be helped to acquire a stronger voice in negotiating trade agreements. They need training in advocacy skills so as to help them mount an effective defence of their interests. In this context, the industrialized countries' commitment in the Doha Ministerial Declaration to use their "best endeavours" to assist developing countries to implement their Uruguay Round agreements, especially in relation to TBTs and SPSs, was a firm and much needed response.

As with all approaches, the key to success is assuring proper inter-agency co-operation and securing budgetary resources so that long-term commitments can be made and – more importantly – honoured.

Adequate resources must be directed towards solving the problems that the developing countries face as they seek to implement SPS and TBT agreements, strengthen their institutional infrastructure or derive the full benefits of expanding trade liberalization. In this context, the provision of insufficient funds translates into lower growth. This, in turn, perpetuates the poverty trap and weakens the dynamics of the global trading system.

This vicious circle must be broken to the benefit of all (UNIDO 2003 a). An alliance of all players is called for with a concomitant shift from trade facilitation in the narrow sense of the term to a broader concept encompassing the enhancement of productive capacities and product conformity. A broad vision must be articulated and endeavours made to narrow the widening gap in industrial capabilities between nations. Technical progress has integrated the world economy on an unprecedented scale, linking products and markets much more closely than ever before. It is an opportunity that should not be missed.

To implement this holistic approach UNIDO has recently signed an MoU with WTO. With regard to other organizations of the UN system, UNIDO has recently signed MoUs and is implementing joint trade-related programmes with UNCTAD and ITC, such as the recently launched UNIDO initiative on capacity building for market access in Central America aimed at assisting Central American countries to develop and implement a coherent joint policy to meet the ever-stringent quality, productivity, safety, health and environmental standards their enterprises face in overseas markets.<sup>12</sup> Closer cooperation with FAO and WHO in respect of the good hygiene practices (GHP), good manufacturing practices (GMP), Hazard Analysis and Critical Control Points (HACCP) applications and Codex Alimentarius food safety standards, and related national legislation, is also part of UNIDO's strategy.

#### ***TCB inter-agency cooperation (UNIDO and UNCTAD)***

*Participants from seven East African and eleven West African LDCs identified in two regional workshops obstacles for a better integration of LDCs into global trade and proposed a strategic orientation for inter-agency TCB activities. The participants represented the private sector, standards and conformity assessment bodies, WTO liaison points and customs. They emphasized the need for a holistic approach to remove supply-side constraints, foster competitiveness of local enterprises, upgrade conformity assessment services and facilitate cross-border exchanges. The two workshops were organized in 2003 by UNIDO and UNCTAD in cooperation with WTO and ITC, and were financed by the Austrian Government.*

The agencies concerned will undertake technical assistance activities in areas where they enjoy a clear comparative advantage. The basic objective is to increase efficiency and effectiveness while keeping within the bounds of agency mandates. This reduces the risk of overlap and duplication and creates synergies in the delivery of assistance across a broad spectrum, thus lending greater momentum to the common system's efforts to achieve sustainable development.

#### The UNIDO fishbone for market-access and trade capacity building

The first UN-wide attempt to clearly identify the players in multilateral co-operation efforts directed towards non-tariff measures affecting trade and market access facilitation was made by UNIDO in 2001 on the occasion of the meeting of the UN High-Level Committee on Programmes (HLCP), Second regular session, 25-26 September 2001 (ACC/2001/11). The HLCP is a body of the United Nations System's Chief Executives Board (CEB) aiming at enabling Executive Heads to focus their

---

<sup>12</sup> Other joint implementation projects will include the Mekong region, East/West Africa, Pakistan, Armenia, Yemen and Mauritania.

attention on matters of strategic importance to the UN system. HLCP is responsible for ensuring coordination in the programme areas.

The analysis carried out by UNIDO was presented at the HLCP through a simple but effective scheme attached to this report: The UNIDO fishbone for market-access and trade capacity building. It identifies the main elements that have to be considered when providing assistance to facilitate market access: International trade rules, SPS, TBT, transport, issues related to investment and finance, and international trade rules. The scheme also identifies the priority issues to be addressed within those six axes, as well as the main player/service provider within the multilateral systems. UNIDO's TCB is based on the analysis presented through this scheme.

### The UNIDO MoU with the WTO

In Cancun, UNIDO and WTO signed an MoU that defines both general principles of cooperation including a preliminary list of priority countries in which the MoU will be implemented, and specific technical cooperation activities. The MoU establishes a strategic partnership between the UNIDO and WTO for the purpose of the implementation of the Doha Development Agenda, to ensure that trade and industrial development enhance economic growth, and to assist the beneficial integration of the developing and least developed countries as well as the transition economies into the global economy and the multilateral trading system.

The primary objective of the technical assistance framework and of the UNIDO-WTO programme is to achieve a visible increase in developing country exports by removing supply side constraints, developing and proving conformity to technical requirements and integrating into the multilateral trading system. Three main programme modules will support the objective as indicated in Figure 3 below on the UNIDO-WTO Programme Modules. The initial group of countries to be covered under the MoU is expected to include Armenia, Bolivia, Cambodia, Cuba, Egypt, Ghana, Jordan, Kenya and Mauritania.

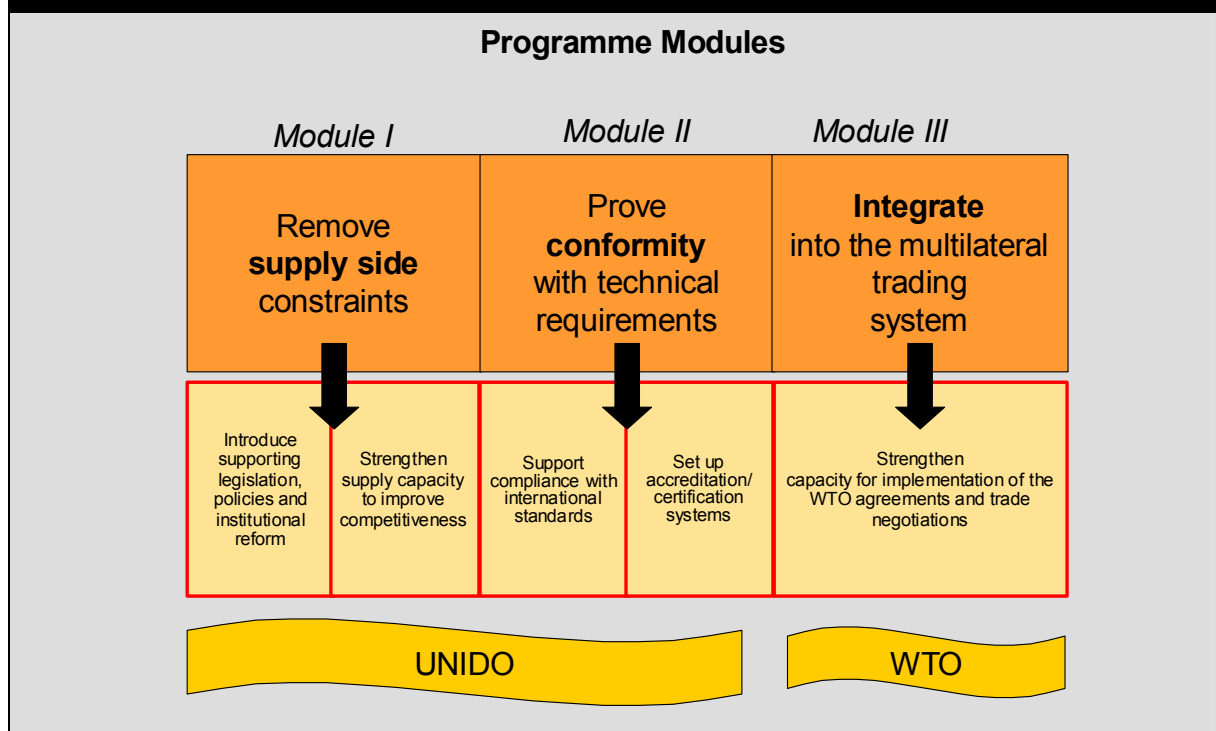
UNIDO took part in August 2003 in the First WTO Trade Clinics mission that was carried out in Sierra Leone. The mission led by WTO involved, in addition to UNIDO, ITC and the Commonwealth Secretariat, and identified concerted priority actions by the involved agencies.

### Cooperation with the international technical organizations

UNIDO has been cooperating closely with the International Organization for Standardization (ISO) in setting up and upgrading national and/or regional standardization bodies in coordination with the Developing Countries Committee (ISO/DEVCO), and participates regularly as an observer in the ISO Annual General Assemblies and related workshops. The cooperation is formalized through a Memorandum of Understanding signed in 1986. A New MoU with ISO is under negotiation to strengthen even further the cooperation with UNIDO.

Coordination with the International Accreditation Forum (IAF) resulted in the creation of a pre-peer evaluation scheme for accreditation bodies, under the leadership of UNIDO. This scheme aims at providing relevant national accreditation institutions in developing countries and countries with economies in transition with an integrated approach, in order to facilitate their participation in the IAF's Multilateral Mutual Recognition Agreement for Certifiers of Quality Management Systems (MLA QMS) ensuring mutual recognition of certificates. A Memorandum of Understanding was signed in 1997 in relation to these pre-peer evaluations, and as a result six accreditation bodies have been pre-evaluated since then.

**Figure 3. UNIDO-WTO programme modules**



The pre-peer evaluation model has been extended and in 2001 applied together with the International Laboratory Accreditation Cooperation (ILAC) to facilitate recognition of calibration and tests of laboratories in developing countries. It is planned to further enlarge the scope of the scheme to other areas of relevance to developing countries. This may include the Mutual Recognition Arrangement (MRA) for national measurement standards and for calibration and measurement certificates coordinated by the International Bureau of Weights and Measures (BIPM), as well as the Certificate System for Measuring Instruments to facilitate administrative procedures and international trade through mutual recognition of type/pattern approval of measurement instruments used for legal purposes from the International Organization for Legal Metrology (OIML).

As a result, the Joint Committee on coordination of Developing Country Assistance in Metrology, Accreditation and Standardization (JCDCMAS) has been established in 2002.

The joint committee aims at coordinating assistance to developing countries and economies in transition covering metrology, accreditation, and standardization related technical assistance.

#### **IV. UNIDO achievements in the field of trade and development**

*The three TCB regional projects: West Africa, Central America and the Mekong Region*

UNIDO's TCB approach as presented above is being applied successfully in a number of countries. Among the technical assistance projects under implementation that demonstrate how the approach is applied we shall briefly report on there major regional projects:

The three regional projects have many common features as presented in the table below. Clearly, the overall TCB approach applied by UNIDO includes different types of services intended to solve the specific problems of each of the three regions assisted. A comparison of the content of each of the three programmes is presented below.



**Table 2. UNIDO TCB projects in Central America, West Africa (UEMOA) and the Mekong Delta**

Action	Central America	UEMOA	Mekong Delta
Product, firms survey of compliance problems	X	X	X
Product evaluation and estimate of cost of foregone benefits	X		
Sector and product analysis to determine testing needs	X	X	X
Assessment of conformity assessment/standards policy, legal, regulatory framework/procedures		X	X
Standard harmonization	X	X	
Consumer protection law		X	
Regional and national document centre		X	
Metrology, chemical, microbiology lab upgrading	X	X	X
Regional accreditation body	X	X	X
Regional certification body ISO 9000/14000	X	X	
Pilot enterprises ISO 9000	X	X	
Pilot enterprises ISO 14000			X
Regional and national quality award		X	
Training on Codex, ISO 9000, ISO 17025, HACCP		X	X
Set up national enquiry point	X		
Customs valuation improved	X		
Training on trade agreements, dumping, dispute settlement...	X	X	X

***Central America Trade Capacity Building Programme***

*The programme, with a budget of US\$ 5 million, seeks to identify measures hindering trade from the region and to help implement a strategy to minimize the actual losses and unaccrued profits due to the region's inability to meet standards, technical regulations and conformity assessment procedures, with a focus on the products most heavily affected. The steps taken for this purpose include:*

- i. Identification and systematic gauging of the products, enterprises and main markets with regard to which of the most critical market access difficulties arising from conformity problems are encountered. For instance, key categories of products and enterprises with conformity problems were classified by the nature of the problem encountered (product attributes, production methods, packaging, labelling, etc.);*
- ii. Estimation of the costs and the unaccrued profits owing to conformity problems;*
- iii. Determination of the origin of the conformity problems and identification of the requirements for their traceability and, whenever possible, early detection and prevention; and*
- iv. Establishment of the necessary quality, metrology, standardization and traceability infrastructure as well as the provision of technical cooperation to the enterprise sector so that it can take effective advantage of such infrastructure and complementary public goods by mastering the required technical and managerial skills.*

***Facilitating trade and reducing poverty in Africa: EU/UEMOA/UNIDO Programme in accreditation, standardization and quality promotion***

*A major programme funded by the European Commission with a budget of € 7.6 million is under implementation with the West African Economic and Monetary Union (UEMOA). The programme identifies technical barriers to trade (TBTs) that are replacing traditional trade barriers as the main obstacle to trade. LDCs, while exposed to the increased competition that comes with lowered trade tariffs, are currently unable to meet the requirements of the TBTs due to the inadequacy of national laboratories in quality control, the lack of harmonization with regional or international standards, and the lack of local infrastructure to support improved product quality. TBTs represent an insurmountable obstacle to the trade that these countries need to foster their economic development. The programme will establish a regional accreditation and certification system; it will upgrade laboratories so that they can receive international accreditation; it will strengthen and harmonize existing standardization institutes: it will establish a regional documentation centre with a database of standards and technical regulations; and it will develop and coordinate national standardization institutions. In addition, it will promote quality in companies by helping to develop regional technical support centres to assist companies to improve the quality of their products, and encourage the development of a culture of quality, with a particular emphasis on consumer protection and on cotton.*

***Trade capacity building for Mekong Delta countries (Cambodia, Laos, Myanmar and Viet Nam)***

*Recognizing the growing importance of developing standards and conformity infrastructure, UNIDO recently launched its trade capacity building initiative. The Norwegian Development Agency NORAD – a key development partner – has also analyzed the marginalization concerns of developing countries and recently documented a new strategy to provide assistance to developing countries. The project was developed on the basis of a UNIDO/NORAD project implemented in 2001-2003 in Sri Lanka, which targeted trade capacity building and led to the development and international accreditation of five testing laboratories in the country while giving it the capacity for ISO 14000 certification. In an effort to replicate this successful experience in the Mekong Region, the joint UNIDO/NORAD project for this region was launched in 2003, with a financial contribution from NORAD amounting to US\$ 2.5 million.*

*In order to overcome technical barriers to trade for the Mekong region, the UNIDO/NORAD Mekong Delta project focuses on developing the necessary technical infrastructure for laboratories and also ensures that the laboratories are recognized globally. There are two immediate objectives:*

- *National capacity creation related to market access requirements and technical barriers to trade (TBT), and identifying manufacturing sub-sectors and export market focus for remedial action in each beneficiary country.*
- *Upgrading the technical infrastructure required for standards development and harmonization; metrology and testing laboratories required by the selected sectors; and standards for labelling and accreditation and/or certification of laboratories and quality systems.*

*In the case of Cambodia and the Lao PDR, the intervention is intended to lead to the development of a legal framework for standards, metrology and conformity, supporting the establishment of standards, metrology and testing facilities. In Viet Nam, which has a stronger base, the intervention would be to upgrade the existing facilities and support the accreditation.*

## V. New trends and concepts

### *UNIDO's new initiatives*

As mentioned earlier, since Doha UNIDO has re-focused its efforts and approaches to TRTA/CB, emphasizing the urgent need for knowledge, appropriate technical assistance and capacity building measures to assist least-developed countries to increase their trade and add value to their exports. These efforts were carefully re-evaluated and grouped together and now form the basis of the new UNIDO corporate strategy and new initiatives.

Additionally, UNIDO has paid particular attention to the effect of environmental measures on access to markets, especially in relation to developing countries, (in particular the least developed among them), and those situations in which the improvement of quality, capacity and conformity assessment would benefit trade.

### Informal consultative group on Trade Capacity Building

The Director-General of UNIDO has established an Informal Consultative Group on Trade Capacity Building, co-chaired by the representatives of the UK and Peru to UNIDO. The Committee's objective is to assess industry and trade issues and improve UNIDO's response to the emerging trade-related needs of developing countries.

### New methodologies and tools

UNIDO is studying the trade weakness of developing countries with a focus on their supply-side capacity constraints, the barriers to trade faced by them, and trade-specific market failures. As a result, the Organization is developing cost-effective solutions and tools that are applied in ongoing technical assistance and capacity building projects. Some of the recent applications are related to:

- The development of a system as part of the UNIDO regional project for Central America for the identification and systematic gauging of products, enterprises and markets with regard to the most critical market access difficulties encountered by developing countries due to conformity problems such as product attributes, production methods, packaging, labelling, etc. The methodology also includes the estimation of costs and unaccrued profits owing to conformity problems, as well as the determination of the origin of the conformity problems, the identification of the requirements for their traceability and, whenever possible, early detection and prevention. Based on this assessment, cost-benefit evaluations are provided of the investment necessary for remedying/averting the conformity problems encountered, and the establishment of the necessary quality, metrology, standardization and metrology infrastructure as well as the provision of the required technical cooperation to the enterprise sector.
- The assessment of non-tariff barriers to trade at enterprise level through ad-hoc surveys. An initial survey was conducted in Bahrain in 2002 and now enterprise-level TBT/SPS surveys are being conducted in various projects (e.g. in Central America, Sri Lanka and Lebanon).
- The establishment of a early warning mechanism (EWM) to assess the impact of new standards, technical regulations and conformity assessment procedures on the industrial sectors of developing countries, and to provide know-how and technology solutions, a clear value-added service provided by UNIDO. The EWM would work in parallel with and complement the existing network of enquiry points and other information dissemination systems. It would provide enterprises with the necessary advice and technical support to disseminate information at enterprise level; assess impact at industry level; assist in advocacy activities and the preparation of position papers; identify feasible solutions to overcome potential problems arising from new standard/TR/conformity assessment procedures, and assist in upgrading products, production procedures or conformity assessment services to meet the requirements of importing countries. A practical application of the concept led to the development of the traceability project in Egypt that

after alerting Egyptian enterprises before the corresponding EU directive enters into force in 2005. An assessment of the possible implication of this directive as a barrier to trade was carried out, and a programme providing a solution before the problem arises has been developed.

***Egypt: traceability of agro-industrial products for the European market***

*The project is funded under a debt-swap mechanism agreed between Italy and Egypt. It is meant to support Egyptian producers and exporters of agro and agro-industrial products to Europe to be ready to comply with the new European regulation on food safety and circulation (EU 178/2002). It prevents legislation meant to protect consumers from becoming a trade barrier, and so an obstacle to the development of the Egyptian export and access to foreign markets. The project includes a technical assistance component together with a funding facility for the acquisition of know-how and technology to build a traceability system.*

## **VI. Concluding remarks**

UNIDO has been pleading for an interagency response as we believe that facilitating a real participation in international trade is a complex and multidimensional challenge that requires an international multi-agency response involving not only the UN agencies but also other technical partners. UNIDO launched a trade capacity building initiative in Monterrey, which is being reinforced by the formalization of strategic partnerships with selected agencies.

Last but not least it should be recalled that UNIDO signed in Cancún a MoU to work together with WTO on trade related technical assistance. We are tightening our cooperation links also with UNCTAD, ITC, ILO and JCDCMAS. Trade related technical assistance, to be effective, has to attend the whole product to market chain. Developing countries need capacities to produce competitive exportable products that conform to international standards. A solid participation in international trade and investment flows by the developing countries can be seen as a feasible path out of the poverty trap. For this to happen it will be necessary to increase the support to a larger participation in real terms by increasing the exports and the balanced distribution of its benefits.

## **References**

European Commission, *Trade and sustainable development assisting developing countries to capture the benefits of open trade*. Brussels, European Commission, 5 September 2002.

Lane, P. R., and G. M. Milesi-Ferretti, *External Capital Structure: Theory and Evidence*. IMF Working Paper No. WP/00/152. Washington, D.C.: International Monetary Fund, 2000.

Loesener, O., and H. Jaich, *In-depth Analysis of the Responses to the WTO Questionnaire – relevance of UNIDO services*. Document No. G/TBT/W/178. Vienna: United Nations Industrial Development Organization, 2003.

Magariños, C., *UNIDO's contribution to financing for development: statement to the International Conference on Financing for Development*. Vienna: United Nations Industrial Development Organization, March 2002.

Pataconi, G., M. Cañamero Vicente and P. Beltrami, *Debt Swaps: A New Opportunity to Finance Trade Capacity Building – The Project UNIDO-Italy-Egypt*. Working Paper No. 1, Working Paper Series on Trade Capacity Building. Vienna: United Nations Industrial Development Organization, 2003.

OECD/WTO, *Second Joint OECD/WTO Report on Trade-related Technical Assistance and Capacity-building*. Paris and Geneva: Organization for Economic Cooperation and Development, and World Trade Organization, 2003.

UN, *Treaty Series*. Vol. 1868 I:31874 (continued-suite). New York: United Nations, 1995

UN, *Programme of Action for the Least Developed Countries for the Decade 2001-2010*. Document No. A/CONF.191/11. New York: United Nations, 20 May 2001.

UN, *Report of the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002*. Sales publication No. E.02.II.A.7. New York: United Nations, 2002(a).

UN, *Report of the World Summit on Sustainable Development, Johannesburg, South Africa, 26 August-4 September 2002*. Sales publication No. E.03.II.A.1 and Corrigendum. New York: United Nations, 2002(b)

UN, *New Partnership for Africa's Development*. Document No. A/57/304 Annex. New York: United Nations, 15 August 2002 (c)

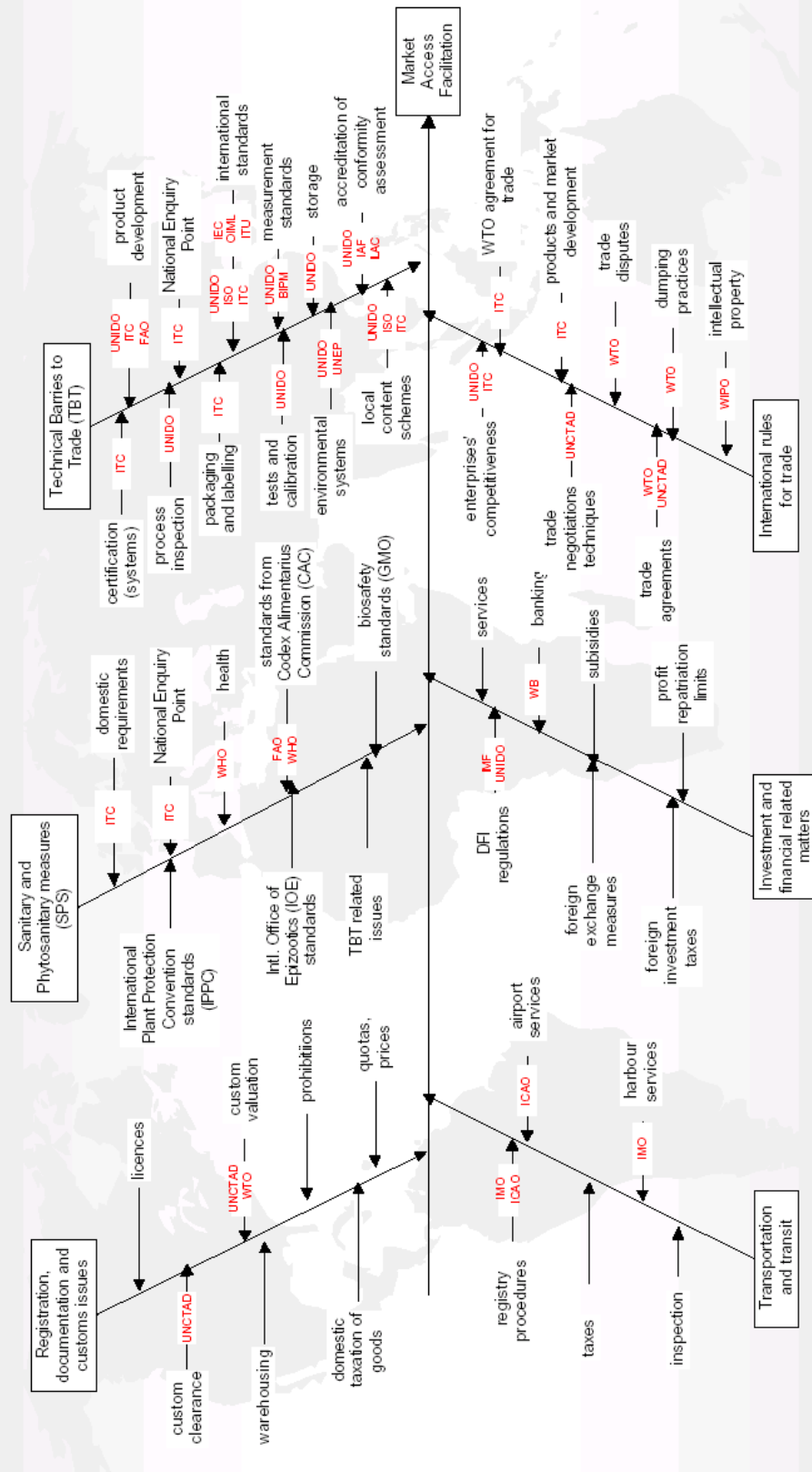
UNIDO, *Enabling Developing Countries to Participate in International Trade: Strengthening the Supply Capacity – A UNIDO Strategy for Capacity-building*. Vienna: United Nations Industrial Development Organization, March 2002.

UNIDO, *Trade Capacity Building: The Role of UNIDO and the Multilateral System*. Background paper prepared for the Informal Consultative Group on Trade Capacity Building. Vienna: United Nations Industrial Development Organization, May 2003(a).

UNIDO, *Developing Industry: Productivity Enhancement for Social Advance – UNIDO's Corporate Strategy*. Vienna: United Nations Industrial Development Organization, 2003(b).

Wilson, J. S., and V. O. Abiola (eds.), *Standards and Global Trade: A Voice for Africa*. Washington, D.C.: World Bank, 2003.

NON-TARIFF BARRIERS AFFECTING MARKET ACCESS



Graphic 1 - Means-End diagram for market access facilitation

## Moderator's Introduction

*Otto Genee* \*

Your Excellencies, may I invite you to take your seats so that we can start this third Round Table with the title "Making Trade Work for the Poor: Stimulating the Real Economy's Response". We have a very excellent issue paper written by the UNIDO Secretariat as a background for our discussion. This paper also benefited tremendously from discussions at two regional workshops that we held earlier this year with seven East African countries in a meeting in Addis Ababa, Ethiopia, and eleven West African countries in Dakar, Senegal. Representatives of the private sector, standards and conformity assessment bodies, the WTO offices, and the customs services participated in these workshops that provided inputs for the issues paper of the Secretariat. It was a joint UNIDO/UNCTAD activity, which indicates the degree of cooperation amongst the international organizations, and WTO and ITC, the International Trade Centre, also participated. A report of these workshops is available at the desk.

I would also like to thank at this stage the Government of Austria for providing financial support for these workshops, and also for today's Round Table.

Just briefly, to lay out the scene for today's workshop, we have an issue paper that provides an input for our discussion. It focuses on the problems that developing countries have, not just in gaining access to their export markets, but also their lack of capacity to produce exportable products that can be readily supplied to export markets and that can meet the standards prevailing in these markets. Therefore, the focus of this Round Table is actually to identify national policy tools, in particular also technical assistance possibilities, that can help to achieve two interrelated goals. First of all, to strengthen supply side capacity in developing countries, and the low-income countries in particular. And second, to enhance their capacity to meet the standards and conformity assessment requirements. The paper, therefore, identifies five areas where intermediary organizations and institutions at national and regional level can help enterprises to participate in world trade. Those five areas are, very briefly, technology extension and productivity enhancement; meeting international standards; proof of conformity to testing, measurement, and certification; technical education and training systems; and the provision of market intelligence and investment promotion services.

To focus our discussion, the paper has three specific questions on those five areas and I would ask also the speakers to focus on those areas as much as possible. First of all, what is the critical mass of support institutions to enhance supply side capacity in developing countries? Second, what is the critical mass of institutional infrastructure required in low-income countries to meet standards, and how can we cooperate at national, regional and international level? And thirdly, what is the role of technical assistance and technical cooperation, and can we develop guiding principles for this?

Let me just briefly conclude my opening remarks by explaining how we would like to organize this Round Table. We will have presentations from the speakers, starting with a keynote presentation by Adrian Wood of DFID, and followed by contributions from the other speakers. These contributions will be brief. Then I would like to stimulate as much as possible an interactive debate. We will not just have a Round Table of speakers behind the table here discussing amongst themselves. I would like to stimulate very much your interaction with the podium, and encourage you to come up with questions or positions.

Without further ado, I would like now to give the floor to our keynote speaker, Adrian Wood from DFID. Adrian, you have the floor.

---

\* Director, Policy Coherence Unit, Ministry of Foreign Affairs, The Netherlands. The text presented here is based on an edited transcript of the moderator's spoken introduction.

## Keynote Speech

*Adrian Wood\**

Thank you very much Mr. Chairman, and thank you very much to UNIDO for inviting me to speak in this Round Table.

The issues for the Round Table, as the Chairman has pointed out, are well laid out in the issue paper that was prepared by the UNIDO Secretariat. There is serious concern that developing countries are being left behind in terms of poverty reduction, in terms of output growth and in terms of performance in export markets. Part of the reason why they are being left behind are high barriers to developing country exports in their export markets, including a thicket of standards that is becoming ever denser and more complex, with nearly 1,000 new standards being added every year. The issue paper rightly identifies trade-related capacity-building, including technical assistance to meet some of these standards, as a key area for action.

In the next few minutes, I want to try and do two things. One is to put this set of issues into a broader, and I think somewhat more positive, perspective, and the other is to raise what I see as some rather difficult questions about what to do in this area. My purpose in both these respects is to stimulate more of a discussion about what to do in this area and how to do it better.

The first thing I want to do by way of giving some perspective on this issue is to remind us that reality is a mixed picture. As Jeff Sachs put it yesterday, it is a varied landscape. To illustrate this, I have put up some numbers that relate to the two regions in which most of the world's poor live, sub-Saharan Africa and South and East Asia, and to contrast those with the OECD, the rich countries.

**Table 1. Reality: A mixed picture**

	<b>Africa</b> (Sub-Saharan)	<b>Asia</b> (East & South)	<b>OECD</b>
Change in US\$ 1 per day poverty rate 1990-2000 (percentage points)	1.6	-12.7	..
Growth of real per capita GDP 1980-2000 (% p.a.)	-0.7	5.2	2.2
Change in share of world exports 1980-2001 (percentage points)	-1.4	11.4	0.3
Population 2000 (billions)	0.6	3.2	0.9

What you have here are weighted averages for these regions. Of course, the discouraging aspect, which is highlighted in the issue paper, relates to the first column, which is Africa. This shows poverty, an essentially stagnant or near negative growth rate, and a falling share in world export markets. The encouraging aspect of reality is what has been happening in Asia, in the second column. Poverty is coming down at a very satisfactory rate, and per capita GDP is growing substantially faster than in the OECD countries. So Asia is catching up, which is something that has not happened for a couple of hundred years, and Asia's share of world export markets has gone up, even though world export growth has been very rapid during this period. It is also important to remember, I think, as is shown in the last row, that six times as many people live in Asia as live in Africa.

So overall, the picture is not quite as discouraging as one might believe from the issue paper. But I mention the Asian experience also because I think there may be lessons that can be learned from Asia

---

\* Chief Economist, DFID, United Kingdom. The text presented here is based on an edited transcript of the keynote speech as delivered.



that are relevant to other regions, particularly Africa. These include, in particular, lessons about how Asia has managed to overcome the barriers and meet the standards that appear to be such an obstacle elsewhere. I suspect that when we look at the Asian experience, we will find that the solutions have come mainly from the private sector and from home grown public sector interventions, and that external technical assistance has probably played a rather minor role. That is an important lesson, because I think we can learn from that how best to focus technical assistance in Africa.

The second respect in which I want to put into perspective the issues raised by this Round Table, which is all about access to export markets and overcoming barriers to exporting, is by asking the question how important exports really are for growth. Growth matters a lot for poverty reduction, and exporting is certainly important for growth. The issue is really how much, and the point I want to make here, because I think it is often overlooked, is that on average across all countries, only about 20 per cent of output is sold in export markets. This is a calculation that one has to make, by netting out the import content of exports which in many cases is high. So 80 per cent of GDP in the average country is produced for and sold on the domestic market. That is very important when you are thinking about sources of growth, because on the demand side it means that four-fifths of the demand in an average country is going to come from the domestic market, and on the supply side it means that four-fifths of the output is going to be sold on the domestic market. So you can have very rapid export growth but if your production for the home market is not growing fast, you will not have a rapid rate of overall growth and it is very important to bear that in mind.

### How important are exports for growth?

- 80% of output is sold on the home market
  - relevant to growth of demand
  - relevant to growth of supply
  - relevant to standards
- Main contributions of trade to growth are
  - through imports
  - through flows of people
- Exports good because they increase these

It is also very relevant, I think, to the standards issue because the quality of most production that is sold on the domestic market in developing countries is well below the quality that is needed to compete on world export markets. That is how it should be, because people on lower incomes do not want to spend their incomes on very high-priced, very high-quality products; they want to spend their incomes on lower quality, cheaper products. There is, of course, an important issue of appropriate standards for goods and services sold on domestic markets, but it is a different sort of policy agenda than the export standards agenda, and I think it is a less daunting, a less depressing, agenda.

I now want to move on to the second thing I want to do, which is to ask some hard questions about trade-related technical assistance, particularly in the area of standards. These are particularly hard questions from the perspective of an economist, and they are questions that we need to ask if we are going to make good decisions about policies and actions in this area. Of course, the first question that an economist asks about any policy measure is, do the benefits exceed the costs? And there are two

cases in this area where clearly they do not. One is where high standards are being set in developed countries as a protectionist measure. Technical assistance will not solve that problem. You can help developing countries meet those standards but then the bar will be raised or some other protectionist measure will be introduced. This is not going to solve the problem of protectionism. But there is a more general issue about benefits and costs. This is that high-cost exports can make a country poorer, and if these standards are very high, and it is very expensive to meet them, it may not be rational to put resources into doing so. It may be more rational to stay out of certain export markets and use those resources to produce for the domestic market.

Now when I say the costs of meeting standards are very high in some cases, I am talking about social costs and not about private costs, because private costs may be high and yet, because of market failures of one kind or another, it may be worth using public interventions and public subsidies to help meet those standards. One does need to look very carefully at where exactly the market failures in this area are, and it is therefore necessary to look very closely at what the private sector is doing in this area.

In the area of standards, I believe that the private sector is both part of the problem and part of the solution, and this is something that I think Mr. Ponte will talk about more in his remarks. It is part of the problem because private firms are increasingly setting standards that are higher than those that have been internationally agreed. But the private sector is part of the solution in two senses. One is that the same multinational companies that are setting high standards are also in many cases assisting their suppliers in developing countries to meet those standards. More broadly, the private sector is also able to deliver assistance in meeting standards on a for-profit basis in response to demand from other firms in the private sector, and there is an active market of that kind.

One therefore has to think very hard about where to put public resources. For economists, the default is always no intervention. Leave it to the market, leave it to the private sector unless you can actually demonstrate, in specific cases, that public intervention is worthwhile. I think that this general principle applies in this case too. I think that one has to ask, in addition, how effective public sector intervention can be in this area. I think the track record of public intervention to assist and support private companies is very uneven, and the opportunity cost of the resources that can be used for this are very high. There are lots of other things that could be done with these funds, including other kinds of trade facilitation.

The final hard question I want to raise in this area, which Ms. Cuéllar is going to talk about as well, is how much of our effort should actually be focused on helping small and medium-sized enterprises? Because meeting standards involves a fixed cost so there are economies of scale, large firms are inherently at an advantage over smaller firms. The same is true of exporting. Exporting involves a fixed cost, so in every country you observe that exports come predominantly from larger firms, and smaller firms are not in export markets. There are good underlying economic reasons for this and I think that all of us, including UNIDO, need to think hard about the degree to which assistance to small and medium-sized enterprises, which is important, should be directed at helping them to compete in export markets, or whether it should be directed to helping them produce more effectively for the domestic market.

Let me sum up and conclude. The first thing I want to do is to clarify what I have been trying to say. To come back to where I started. Many poor countries face serious problems in the area of poverty reduction, slow growth, difficult access to export markets, and slow export growth. There are barriers to trade that should be tackled, and standards definitely pose increasing difficulties for low-income countries, which trade-related technical assistance can play a valuable role in helping to overcome. This is why DFID has, rightly, put a lot of money and a lot of staff time into trade-related technical assistance.

What I have been trying to add to this message is two things. One is that these issues should be viewed in a broader context, in a broader perspective, which makes the problems seem less daunting

and the prospects seem more positive. In addition, I am arguing that we should be very sceptical about all the proposed solutions in this area, because if we are not very sceptical about them, we will choose the wrong ones. Being sceptical is the right way to make sure that the resources used in this area are most effectively deployed.

Thank you.

## Presentation by Mr. Tadesse Haile\*

Thank you Mr. Chairman.

Much has been said by the previous speakers yesterday and today about the challenge developing countries are facing to be part of the global economy. Even the present keynote speaker has indicated through figures and statistics the challenge developing countries face in integrating their economies to the global economy. Much has been said about the Millennium Development Goals, the widespread poverty, HIV/AIDS, social and physical infrastructure, and the effect of transport and insurance costs on competitiveness, as you have heard yesterday. I do not want to repeat all this, since these issues have been well covered, but I will raise four or five points that I believe would contribute to make trade work for the poor.

First and foremost, I would like to mention that a conducive environment has to be created in less developed countries for private sector development. Conducive in the sense that least developed countries (LDCs) have to deepen further their economic reform programmes and further liberalize their economies, to maintain economic stability, increase political stability, maintain good governance and the rule of law, develop better infrastructure and services, and improve efficiency. These are the basics which need to be addressed.

Having presented this general picture, let me move to the important issues of prioritization and focus. It is very important for us to prioritize and focus our efforts on selected areas where there is good potential for growth and where we can also exploit our comparative advantages. In the case of Ethiopia, we have selected the following priority areas in our National Industrial Development Strategy: Textiles and garments, leather and leather products, agro-processing, MSEs (or micro- and small-scale enterprises), horticulture and floriculture, and construction. In light of the meagre resources that many developing countries have, it is very important for them to focus on priority areas where they believe they have competitive and comparative advantages.

The third point I would like to mention concerns the establishment and strengthening of supporting institutions. We need to establish and strengthen supporting institutions with particular emphasis and relevance to the priority sectors in order to enhance technology and product development, provide training, and support research and development. For example, we have tried to develop our leather and leather products technology with the support of the Italian Government and, of course, UNIDO. We have therefore established a modern state-of-the-art technology institute to support the leather sub-sector, with the objective of upgrading the technology employed in this selected priority area, as well as improving product development, providing training and laboratory services, and enhancing networking among producers. Thus, to summarize, it is important to establish and strengthen support institutions for the selected priority areas.

The fourth point I would like to mention is the need for private-public partnership. In our efforts to enhance our productive capacities, we need to establish and strengthen public-private partnership fora and consultations in the selected priority areas. Such sub-sectoral fora or consultations are expected to bring together all stakeholders starting from producers of raw materials, researchers, academics, transporters, and customs officials, in one place to discuss and overcome constraints. If this functions very well, it could improve the efficiency of the supply chain management, reduce the cost of doing business, and also improve competitiveness.

---

\* Minister of State for Industry and Trade, Ethiopia. This text is based on an edited transcript of the spoken presentation.

The fifth point I would like to mention is with regard to attracting foreign direct investment (FDI). FDI is a source of technology and a means of enhancing productive capacities. In order to stimulate the real economy, it is therefore crucial to attract FDI in the selected priority areas by creating an attractive and conducive environment for investment in these priority areas. As I said, FDI is a major source for technology transfer, market access, and managerial skills. All forms of foreign direct investment – joint ventures, sub-contracting, networking and other forms of non-equity collaboration – should therefore be encouraged.

Having said all this, my last point deals with technical assistance. Technical assistance is required from the developed countries to enhance our productive capacity, and to enable us to produce competitive products with the right quality and standards required by the market. This assistance is required for building the physical and social infrastructure, strengthening the technical institutions established to support the priority areas, technology upgrading, human resource development and skill development, and for capacity-building in investment promotion to attract FDI joint ventures and support networking.

It is also necessary to strengthen the public-partnership fora in order to create an effective supply chain management. Technical assistance is also required in the implementation of such standards as ISO 9000 and ISO 14000 in the selected priority areas. Technical assistance is also required in the preparation and implementation of acceptable technical regulations and national conformity assessment. Also it is required in the area of national accreditation programmes for inspection bodies, testing and calibration bodies, and certification bodies.

I thank you.

## **Paper presented by Ms. Silvia Cuéllar\***

### **Introduction**

Any thoughts regarding the role that trade and trade openness plays in developing countries must grasp the external and internal variables taking place in the region during the last few years.

First of all, we should reflect on the fact that globalization is a world-wide phenomenon that has altered the conditions and rules of the global economic environment, leading among others to decentralized production processes, new information technologies and communications, capital flows and foreign direct investment, which have given rise to a greater flow of goods and services among countries.

The adoption of economic liberalization policies by a great majority of countries with the creation of the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO) has reduced trade and investment barriers, leading to the generation of opportunities for companies, accompanied by new challenges regarding investment in human capital, competitiveness, technology, research and development in order to really take advantage of the new opportunities.

Likewise, external events, such as the severe fall of the prices of the main traditional export products of the Central American region, including coffee and bananas, during the past years, have affected the external trade volume and structure of these countries. Nevertheless, the trading difficulties for these traditional export products in international markets have proved once more the importance of the Central American market for the rest of the products in the region, providing new possibilities to increase the export platform of these countries.

The reduction in world growth rates, particularly in the USA, with which the Central American countries conduct more than half of their trade, plus a rise in unemployment rates, new migration, transport and customs regulations, and now other measures resulting from the events of September 11, 2001, are external factors that have significantly affected the trade conditions for these countries.

However, there are also internal factors which have changed the economic and trade conditions of Central America. A weak and unconsolidated economic integration system which not only hinders commercial exchange around the region but also trade negotiations with third countries or regions as well as the development of projects with regional cooperation.

Similarly, natural disasters such as Hurricane Mitch and the 2001 earthquakes which greatly affected Honduras, Nicaragua and El Salvador have caused a negative impact on the economic and social growth of the region and political instability in countries like Guatemala and Nicaragua with the resulting insecurity for its citizens. All of these are factors that have defined the economic characteristics of Central American countries, the way in which the challenges of globalization are faced, participation and tapping into the commercial openness and benefits or disadvantages of international trade flows, and its implications on the living conditions and poverty in the region.

### **Commercial openness and foreign trade in Central America**

During the early 1970s, a series of crises in the Central American countries put an end to the integration principles of the 1960s that established the basis for the Central American Common

---

\* Executive Director Federation of Chambers and Associations of Central American and Caribbean Exporters (FECAEXCA).

Market efforts, and at the same time necessitated the identification of a new policy basis for a greater openness during the following years. These were mainly economic factors, but there were also political and institutional factors present.

The global economic recession, the increased international inflation and the oil crises and debt caused in Central American countries as well as in the rest of Latin American countries to suffer a significant reduction of their terms of trade, which together with the inadequate internal policies in most of these countries, resulted in the debt crisis of the 1980s.

This situation reduced the importance of intra-regional trade and the countries adopted unilateral measures that restricted free trade. Eventually, these countries had to undertake structural adjustment processes, and by the end of the 1980s these adjustments paved the way for other reforms in the economic area. Changes were made to trade policies, from import substitution to export promotion in order to increase economic efficiency and promote a free market. A peace and unification process for the region began during this period, which included actions in the economic and trade areas.

A series of special regulations aimed at promoting exports were introduced, such as the installation of free trade zones, fiscal concessions, grace periods for new companies to pay taxes, among others.

The WTO emerged in 1994, as one of the historic agreements derived from the Uruguay Summit, and has had an important impact over trade negotiations, guaranteeing that trade between countries can be carried out without placing obstacles for the rest of the world. All of the countries in the region joined this organization almost immediately, as a right acquired through their membership of GATT.

As part of the trade openness process the countries in the region have been gradually standardizing and reducing import taxes. The average tax in Central America on imports of raw materials not produced in the region is 0.0 per cent, for intermediate goods it does not exceed 10 per cent, and for finished goods it averages 15 per cent. Generally the average customs duty does not exceed 8 per cent.

Unilateral trade agreements followed, such as the Caribbean Basin Initiative (CBI) by which the USA unilaterally grants preferential customs duties to countries in the Caribbean Basin and promotes the diversification of exports among beneficiary countries. This has helped to reduce the volatility caused by external shocks, especially in the prices of the main export products. In the case of Central America, non-traditional exports have increased significantly, but the sector that has probably benefited the most in the CBI has been the textile sector, and especially the apparel industry.

Furthermore Central American countries have signed free trade agreements with other countries. Although these negotiations were initiated jointly by the countries of the region (but dominated by the “Northern Triangle” comprising Guatemala, Honduras and El Salvador), the agreements that were eventually signed are unfortunately mainly bilateral. Agreements with Chile, the Dominican Republic, Mexico and Panama are already in effect; and others with Canada and USA are under negotiation. Nevertheless, it is worth mentioning that they provide for the same trade discipline called for by the regulations and basic principles of the WTO.

The free trade agreement with the USA, in particular, has brought high hopes to export companies in Central America, since the USA is the most important export market for the region. The process has been a very dynamic and difficult one, specially for the agricultural sector, which faces disadvantages because of the subsidies given to agriculture in USA.

This trade policy in the region proves that the regional economic integration has presented new challenges to these countries, including that of advancing with the presidential plan of the Central American Customs Federation so that all of the member countries establish the same customs duties in order to increase the state of well-being in the region.

## Benefits of trade openness and international trade in the Central American region

The level of economic activity in Central American countries during 2002 showed some improvement. The regional gross domestic product (GDP) presented a moderate increase (2.3 per cent), a pattern that reversed the trends established in 1999 and 2000. Nevertheless, this modest revival occurred in the context of a weak trend growth rate. Even when every economy recorded positive growth rates, a contraction of the GDP per capita was evidenced in more than half of them, so that this indicator recorded a decline of 0.5 per cent, as shown in Table 1.

**Table 1. Central America: Main economic indicators**

	2000	2001	2002 (est.)
	<b>Growth rates</b>		
<b>Economic activity and prices</b>			
Gross domestic product	3.0	1.7	2.1
GDP per capita	0.4	-0.8	-0.5
Consumer prices (December – December)	6.1	6.5	5.9
Exchange rate	-7.3	-2.1	-1.9
	<b>Percentages</b>		
Open urban unemployment	4.2	5.5	5.4
Fiscal Results / GDP	-2.7	-3.2	-2.8
	<b>Millions of dollars</b>		
<b>External Sector</b>			
Exports of goods and services	26,539.6	25,680.3	25,692.5
Imports of goods and services	31,930.1	32,048.5	33,699.6
Balance of goods and services	-5,390.5	-6,368.2	-8,007.1
Factor profitability balance	-2,682.9	-2,081.1	-1,416.9
Current transfer balance	4,001.4	4,891.5	5,646.6
Current account balance	-4,071.9	-3,557.8	-3,777.4
Financial and capital accounts	3,947.8	3,296.6	4,097.5
Direct foreign investment	1,964.1	2,017.2	1,333.1
Global Balance	-124.1	-261.2	320.1
Net resources transfers	1,839.2	2,298.2	2,838.8

Source: ECLAC (2003).

Also, following the drastic downturn of the previous year, the exports of the Central American countries continued to face difficulties in 2002. The main traditional products showed generalized setbacks, while non-traditional goods only experienced a mild recovery. The apparel industry in particular has experienced two years of slow growth, which contrasts with the acceleration of the second half of the 1990s (Table 2).

**Table 2. Evolution of exports of goods in Central America (growth rates in %)**

	1997	1998	1999	2000	2001	2002 (est.)
Central America*	18.3	15.4	5.3	2.3	-8.7	1.8
Costa Rica	11.8	31.2	18.7	-11.6	-15.3	7.2
El Salvador	36.3	0.9	3.0	16.9	-2.4	4.4
Guatemala	16.6	9.4	-2.3	10.8	-7.1	-8.2
Honduras	13.9	11.9	-15.0	14.5	-3.4	-0.6
Nicaragua	24.4	0.8	-3.3	16.8	2.7	-11.9

Source: ECLAC (2003).

Note: \* Not including Panama and Belize.



In contrast to exports, other sources of external income recorded a better performance and exerted a compensating effect over the trade deficit, which itself was widened by the rebound of goods imports. Tourism recorded only a modest growth, reflecting the effect of the terrorist acts in September 2001 in the USA, and family cash remittances continued to rise despite the moderate growth of the US economy, which is Central America's main trading partner and the main destination of Central Americans migrants seeking better opportunities.

In view of the weak export sector in 2002, the Central American countries continued to promote economic policies aimed primarily at maintaining the results achieved during the past years in terms of macroeconomic stability. Guatemala, Honduras and Nicaragua focused on the framework of agreements established with the International Monetary Fund (IMF), which facilitated access to new financial resources that compensated the imbalances in their public finances.

The standardization of results in the context of low growth is something that stands out in this analysis, since four of the five countries in the Central American region recorded growth rates of 2-3 per cent, accumulating a third year of adverse GDP results per capita. The reason for this was the low increase of internal demand, due mainly from the fact that the increased inflow of cash remittances was not enough to compensate for the weak performance of the export sector.

Intra-regional trade among the Central American countries also remained stagnant in 2002, despite the fact that the region is the second most important destination for exports from the majority of Central American countries (Table 3).

**Table 3. Central American Isthmus: Intra-regional exports**

	1997	1998	1999	2000	2001	2002 (est.)
	<b>Value of exports to the rest of the Central American Isthmus</b>					
Central American Isthmus	2,330.7	2,613.8	2,793.2	2,948.6	3,289.5	3,068.6
Central America	2,171.8	2,423.9	2,580.2	2,742.7	3,069.4	2,856.3
Costa Rica	497.4	573.4	637.5	663.2	675.9	633.7
El Salvador	603.5	642.2	674.1	776.0	771.3	785.0
Guatemala	725.9	815.9	854.3	870.0	1,103.0	922.9
Honduras	217.5	268.0	260.4	266.8	328.4	282.7
Nicaragua	127.5	124.4	153.9	166.6	190.8	232.0
	<b>Growth rates</b>					
Central American Isthmus	12.8	12.1	6.9	5.6	11.6	-6.7
Central America	14.6	11.6	6.5	6.3	11.9	-6.9
Costa Rica	5.7	15.3	11.2	4.0	1.9	-6.2
El Salvador	25.8	6.4	5.0	15.1	-0.2	1.8
Guatemala	16.3	12.4	4.7	1.8	26.8	-16.3
Honduras	0.1	23.3	-2.8	2.5	23.1	-1.9
Nicaragua	22.6	-2.4	23.7	8.3	14.5	21.6

Source: ECLAC (2003).

In a close correlation with the level of economic activity in the Central American region, employment presented a moderate deterioration with varying patterns in each country. The common denominator was the increased formal open unemployment and the expansion of informal activities.

The dynamics driving the patterns of employment have varied from sector to sector, but a greater incidence of unemployment was recorded in the agricultural sectors accounting for the region's traditional exports (mainly sugar, coffee, cardamom, bananas, and shrimps) as a result of the strong downturn in international prices of these products, than in the manufacturing sector and apparel industry.

In view of the insufficient creation of jobs in the formal sector, the informal sector continued to expand in practically all of the countries of the region, generating low productivity, income and employment for a large number of persons, thus contributing to a rise in the poverty indexes to an average of 48.54 per cent for the region as a whole in 2002, implying that almost half of the population in Central American countries is poor (Table 4).

**Table 4. Central American Isthmus: general indicators**

Country	Units	Year	
<b>Costa Rica</b>			
Open unemployment	Percentage of labour force	2002	6.4
Poverty	Percentage of homes	2002	20.6
Human Development Index		2001	0.832
<b>El Salvador</b>			
Open unemployment	Percentage of labour force	2002	6.2
Poverty	Percentage of homes	2002	36.8
Human Development Index		2001	0.719
<b>Guatemala</b>			
Open unemployment	Percentage of labour force	2002	3.1
Poverty	Percentage of homes	2002	56.2
Human Development Index		2001	0.652
<b>Honduras</b>			
Open unemployment	Percentage of labour force	2002	3.8
Poverty	Percentage of homes	2002	64.0
Human Development Index		2001	0.667
<b>Nicaragua</b>			
Open unemployment	Percentage of labour force	2001	10.7
Poverty	Percentage of homes	1998	65.1
Human Development Index		2001	0.643

Source: ECLAC (2003).

### **Trade openness and trade have not improved the conditions of Central American populations**

Since the late 1960s, when the Central American integration process began, a firm commitment to trade openness, increased intra-regional trade, and the promotion of exports from the region to the rest of the world has been established as the most viable strategy to generate employment, reduce and eradicate poverty, and provide growth and development opportunities for the population.

Thus, whether through bilateral or regional efforts, or by participating in hemispheric forums such as the Free Trade Area of the Americas (FTAA) or in multilateral organizations such as the WTO, Central American countries have been participating actively in the promotion of trade and trade openness. Nevertheless, when analyzing the economic and social situation of countries in this region we realize that the situation has not improved significantly in terms of the level of economic activity, the social conditions faced by their populations, or the reduction of poverty levels.

Why then has Central America not been able to derive the benefits of these policies? What are the main obstacles or barriers that prevent a greater access and penetration to foreign markets, and its subsequent benefits?

There are several reasons why trade has not benefited the Central American region. Notwithstanding the individual variations in the experience of the five countries in the region, they have common elements.

At a state or governmental policy level, we can identify a lack of foreign trade policies and coordinated export promotion efforts with the productive sectors, which should be coherent and

consistent with the long-term growth strategies. The strategies and positions taken during trade negotiations are established, in most cases, as a response or reaction to proposals from other countries or political or diplomatic interests, and are therefore seldom based on broad and deep market, sector or product analyses aimed at promoting the region's development. Central American countries depend greatly on the Central American market, and the industrial and agro-industrial plants subsist on the technological and protectionist conditions established in the 1970s and 1980s. The exporting platform is narrow and markets are highly concentrated. Thus, El Salvador depends on five markets (Guatemala, Honduras, Nicaragua, Costa Rica and the USA) for 87 per cent of its exports.

Trade agreements with the Dominican Republic, Mexico, Panama and Chile have helped to achieve greater market diversification, but there is still a need to improve and extend the range and productivity of exports.

Also, the continuity of trade policies constitutes a fundamental element to capitalize on the accumulated expertise of successive negotiation processes and the formation of negotiating teams having a long-term strategic vision.

On the other hand, government policies in Central America have not sought to develop the support infrastructure required to facilitate a greater access to new markets: Inefficiency and high fees for utilities such as electricity and communications, and extensive paperwork for customs procedures, as well as corruption and smuggling, increase the cost of goods produced in the region, which in turn reduces the competitiveness of the productive sector.

The high cost of interest rates compared to those found in developed countries with whom trade is carried out, as well as the absence of guarantees such as export insurances, fiscal incentives, etc. are elements that reflect the low levels of competitiveness with which Central American entrepreneurs produce.

We can also add that the lack of standardization, metrology and quality certification systems, together with little or no quality, metrology and packing laboratory infrastructure, are elements that reduce the capacity of companies to access other markets.

We must also mention aspects such as inadequate juridical and public security, that significantly raise the cost of products in Central America due to the increased payment of insurances or premiums. For example, in the case of Guatemala and El Salvador a high percentage of all exporting companies were robbed in the year 2002, either in their plants or while transporting their goods to the ports.

There are also factors at the company level that obstruct the access to international markets and the participation in the benefits of international trade: poor training on international trade topics, often accompanied by a limited entrepreneurial vision regarding the concrete benefits to be gained from trade with countries outside the Central American region. Moreover, many different economic sectors in these countries have been exposed to an excessive degree of protection, which has resulted in a non-aggressive culture and led to entrepreneurs missing out on market opportunities even when they are at hand or can be obtained through trade negotiation processes.

In addition, there is an increasing tendency to lose competitiveness due to a low investment in training skilled labour, and in creating conditions to improve workers' productivity. This comes on top of a labour force with low educational levels in almost every country in the region.

The scanty investment in research and development, as well as in new business production and administration technologies, and in quality control systems such as HACCP, ISO 9000 quality assurance systems or ISO 14000 environmental systems, reduce the possibilities of sustainably competing in other markets. This situation has been recently aggravated for other countries after the ruling of the Bioterrorism Law and other regulations established by the USA for products entering that market.

Another factor that is overlooked by entrepreneurs is the investment for acquiring knowledge on foreign markets, consumption patterns, consumer preferences, distribution channels, etc., as well as the investigation of requirements, regulations and norms necessary to reduce the risks in order to successfully access a market.

On the other hand, the dispersal of national support services to promote exports and improve competitiveness of the sectors is common in almost every country of Central America, as well as a lack of integral, long-term support programmes.

In contrast to the countries with whom we engage in trade, it is difficult to identify specific and permanent programmes in Central America to enhance trade intelligence, quality and productivity, entrepreneurial training, formal technical training to support export sectors, the development of export-oriented and investment attracting cultures, and the establishment of the support infrastructure needed for training, technical assistance and programmes to improve the quality of products.

Additionally, the countries in the region receive only limited support from their embassies, consulates or trade offices in obtaining trade intelligence or information on trade or investment opportunities, or for the effective promotion of the products and services offered by the region to the rest of the world.

These limitations to the ability of Central American countries to take effective advantage of the opportunities generated by international trade are even harder to overcome when we consider that 98 per cent of all Central American companies are small and medium-sized, and therefore have to invest greater efforts in terms of financial and human resources, innovation and creativity, to compete in an increasingly demanding globalized world market.

### **Support services should be more focused to facilitate the participation of Central American companies in the world trade**

The main objective is to identify the support services needed to facilitate the successful penetration of Central American companies in foreign markets and enable them to reap the benefits of trade. These services involve the implementation of instruments, measures and actions aimed at raising the competitiveness levels of the economies in the region. They may be categorized as follows:

- I. Increasing supply capacities;
- II. Improving the supply side ability to meet standards, technical regulations and other requirements; and
- III. Creation of a favourable environment for investment and trade.

#### *I. Increasing supply capacities*

It is undeniable that important efforts are being carried out in Central American countries to facilitate training and technical assistance to companies. Nevertheless, these initiatives are still insufficient and in many cases are not directly aimed at creating or improving necessary capacities or abilities to develop an efficient and competitive exporting sector.

In this sense, it is fundamental to develop and support programmes aimed at improving the productivity of these sectors and to link small and medium-sized companies to international value chains through exports.

The strengthening of productive capacities of companies must start from training programmes to improve the managerial and negotiation capacities of companies; technical assistance programmes on the design, innovation and development of products; and programmes aimed at raising the quality of export goods and the trading of products at an international level, technology transfer and production diversification.

The efficiency and operation of these programmes should be based on a joint effort between the public and private sector, in financing schedules as well as in implementation, supervision and control, in order to guarantee their effective operation in agreement with the previously defined objectives and goals allowing for a future impact evaluation.

At the same time, these mechanisms must allow the development of a market for support services operating in accordance with the supply and demand for these services, thus favouring the efficient allocation of resources, the achievement of the stated objectives, and the development of support services markets within the countries of the region, which will be more developed depending on how much more demanding the entrepreneurial sector becomes in relation to the services it starts demanding.

## *II. Improving the supply side ability to meet standards, technical regulations and other requirements*

One of the greatest limitations for Central American products in foreign markets is the lack of compliance with requirements, norms and regulations demanded by these markets. Even though it is true that customs duties for products are being reduced due to trade openness and the signing of trade agreements or preferential customs duties, technical trade barriers nowadays constitute one of the most difficult obstacles to overcome.

Their non-compliance derives from a lack of knowledge. This is why it is important to have supporting organizations and institutions to develop the required trade intelligence in agreement with the structure of productive sectors and comparative and competitive advantages of Central American countries.

On the other hand it is important to educate entrepreneurs on international production standards and regulations, required certifications, obligatory norms, good manufacturing skills such as HACCP, quality management (ISO 9000), environmental management (ISO 14000) and labour conditions, as well as the specific regulations prevailing in some countries, such as the Bioterrorism Law in the USA.

At the same time it is necessary to develop the support infrastructure needed to provide these services. Here we can mention the creation or strengthening of the standardization, weights and measures and certification infrastructure of Central American countries, as well as laboratories for quality control, weights and measures, packing, etc.

These services should be provided jointly between the public and private sector, but the creation and proper operation of these systems is the responsibility of the countries in the region.

This support must be accompanied by a definite strategy for the promotion of the prioritized productive sectors selected on the basis of serious and verifiable analyses of their advantages and opportunities in the international markets, and taking into account the productive chains within the economies of the region to achieve the participation of small businesses, an increase of domestic manufacturing value added, and the creation of employment.

Finally, it is important to have the necessary resources to build up companies, such as a financial system to enable access to credits and other necessary financial services to build up the productive and exporting activity in at least similar conditions as those of our main trading partners, in order to increase the levels of competitiveness.

Unfortunately, in the case of Central American economies, the financial systems are underdeveloped in terms of diversifying risks and pools of products and services, and they are highly protected, so the access and cost of services is a determining factor in order to improve competitiveness.

### *III. Creation of a favourable environment for investment and trade*

Just as important as training, technical assistance and the facilitation of support and infrastructure services, is the creation of a favourable investment and trade environment.

It is important to establish a favourable environment for the exporting entrepreneur to get involved in exporting. This includes a global framework of the stability, certainty, transparency and facilitation to allow economic agents to develop long-term plans and reduce costs in the production and trade process, in order to take advantage of the opportunities that the international market has to offer.

Also, it is important to increase investment and creativity to generate programmes and actions to reduce the citizens' insecurity indexes in these countries.

In the case of the majority of Central American countries, an important percentage of the final cost of products is originated by security costs, which entrepreneurs have to pay.

Additionally, juridical security is necessary to create a favourable environment to attract investments such as joint ventures or strategic alliances to inject new capital and new production technologies into the productive activities of these countries.

On the other hand, many efforts have been carried out to negotiate and sign trade agreements and investment promotion at a regional or bilateral level. Nevertheless, it is important to create relevant institutions to manage and administer them in order for them to become real foreign trade development and diversification tools.

These institutions must have the necessary budget, equipment and above all, trained personnel to effectively provide support to the exporting sector.

### **What is being done in Central America to face the challenges and increase competitiveness?**

Increasing the competitiveness of these countries certainly implies a series of policies and measures involving a joint effort between all the various players in the economy and a long-term strategy that will not yield immediate results. Nevertheless, an important starting point has been set by the Central American private sector, which includes defining the strategic economic sectors for which foreign trade represents an important development opportunity.

Additionally, efforts have been carried out to strengthen national support institutions in charge of providing facilitation services to productive sectors such as institutions and laboratories responsible for establishing standards, quality, weights and measures, and packing. Public and private institutions in charge of developing trade intelligence (trade points) have also been created or strengthened.

One of the most important efforts at the Central American level has been the plan to establish the Central American Customs Federation. This has demanded an enormous commitment from each individual country, and the corresponding changes in national legislation.

Also, Central American countries have worked to establish programmes aimed at improving the productivity of the entrepreneurial sector through training and education in international trade, norms, regulations, requirements, market investigations, and promotion and international marketing, among others. These programmes have been so successful that they have often started as pilots in one country and have later been transferred as successful experiences to the other countries in the region.

Some of the main sectors by country

Guatemala: Agricultural and agro-industrial products, crafts, manufacturing, furniture and forest resources, hydro-biological resources, textiles and maquila (clothes), etc.

Honduras: Agricultural and marine products, processed foods, wood, crafts, textiles and maquila (clothes), etc.

Nicaragua: Agricultural products, wood, leather articles, textiles and maquila (clothes), etc.

Costa Rica: Software, fruits and vegetables, plants and flowers, frozen and canned products, wood, plastics, coffee products, leather, organic products, gifts, etc.

El Salvador: Pharmaceutical products, paper and cardboard, agricultural and agro-industrial products, metal engineering, textiles and maquila (clothes), and a line of business that has recently emerged called “ethnic or nostalgic products” aimed at the market of 2.5 million Salvadorans residing in the United States (equivalent to 25 per cent of the current population of El Salvador).

Source: FECAEXCA.

It is also important to mention the efforts that have been made at the country level to fuel and promote the association or culture of entrepreneurial clusters at a horizontal and vertical level utilizing diverse methodologies adapted to the sectors being served.

Also, since the administration of free trade agreements is seen as a key factor for obtaining positive results, efforts are being made in every country to establish offices that are efficient and respond rapidly to the needs of entrepreneurs.

Finally, an important effort has been made in the majority of Central American countries to improve the international promotion of the region, including the supply of products and a greater participation in the search for business opportunities through the creation of trade offices or trade representatives in consulates or embassies in some countries that present opportunities for business development.

These efforts are oriented towards improving the competitive advantage of all productive sectors in the region with the rest of the world, and to make international trade become an internal development instrument for the economies of the region. Even though it will take some time for the results to be achieved, other initiatives and programmes will be incorporated during this period to improve the ability of the regional countries to take advantage of the benefits derived from trade.

**The role of national, regional or international cooperation...**

*...and how this cooperation should be oriented to increase the cost-effective provision of support services for productive sectors to increase participation in the global economy*

Support from cooperation institutions has been and will continue to be important to implement initiatives to promote the improvement of support services for productive sectors in Central American countries.

Several programmes have been executed in the region's countries, and many benefits were obtained from their implementation. We therefore consider that the productive capacities in the prioritized areas and the respective infrastructure for support services should continue to be strengthened.

Regarding the strengthening of the supply capacities, it is important to continue providing support through training, education and technical assistance programmes aimed at increasing productivity and efficiency. At the support infrastructure level it is necessary to provide training on international standards and norms; investment on support infrastructure; trade intelligence; and research and development of new products, production techniques, technological innovation, etc. Support also needs to be given to the promotion of exports.

It is important to keep in mind that even though resources may be channelled through governments, their direct executors must be those who are most efficient at administrating them. In the case of facilitation programmes for procedural matters, customs, financing, and regulations, these must be executed directly by governments via institutions, agencies or specialized departments working as a directive council with participation and representation of the private sector, which in the end knows best about the productive sectors.

By contrast, training programmes, trade promotion, export promotion, analysis of the export sector's potential, trade links, and advice on product development topics, are the responsibility of the private sector.

The promotion and dissemination of exports through participation in fairs, missions, round tables, and entrepreneurial meetings, should be executed by the public and private sector in a coordinated manner, in order to combine the support that can be obtained from foreign representations, national export promotion entities and private institutions. Nevertheless, the responsibility for organizing this should fall on the private sector since it is knowledgeable on the sector's performance.

It is important to keep in mind that support from international organizations should be aimed at strengthening specific programmes in each of the areas mentioned above, but ensuring that funds are channelled directly to companies and not to the organizations; in other words, the bulk of the funds allocated for such programme should be spent on the activities foreseen in the programmes, with administrative expenditures being held at a minimum.

Particular reference needs to be made in this connection to the Central America Trade Capacity Building Programme developed by UNIDO with the aim of identifying obstacles for market access caused by the inability to meet standards, technical regulations and conformity assessment procedures. It represents a good effort and if implemented in a practical manner can offer technical skills for immediate application by the enterprise sector. It has had a good start by selecting private sector organizations as counterparts in each country, since they are the ones who are directly related to the companies in a day-to-day work environment.

## **Summary**

- The benefits of trade and trade openness in Central American countries have been influenced by external variables like globalization, world economic liberalization, and the behaviour of the world economy and its main trade partner, the USA, as well as being influenced by internal factors, such as a weak and poorly consolidated integration system, natural disasters and political instability, that have characterized most of these countries.
- The trade openness process for Central America originated from the efforts to create a common market. Afterwards, with the accession of these countries to the WTO and the signing of trade agreements or customs preferences awarded by some countries or regions, this openness process was strengthened greatly in the region as a whole, with some variations between the countries.
- Even though Central American countries consider trade openness as a strategy to generate employment and reduce poverty, the analysis of the main economic and social indicators in the region reflects a marked fall in the growth rate and a deterioration of the population's living conditions.



- The main obstacles faced by Central American entrepreneurs in penetrating foreign markets effectively and taking advantage of trade opportunities can be identified at the policy level, the enterprise level, and with regard to the availability of support services. The State's role has to do with the lack of an integral long-term policy to develop foreign trade and the exporting sector; the high cost of public support services it provides; a financial system that does not respond to the needs of the economic sectors; the lack of standardization, quality control and weights and measurement systems; and the high level of juridical and public insecurity in most of these countries.
- At the enterprise level, the major constraints are the limited training on international trade topics, limited vision, and inadequate investment in training, technology and knowledge of markets.
- With regard to support services, the dispersal and lack of integral long lasting programmes constitutes the main constraint. There is little infrastructure for the training of the necessary human resources and inadequate investment in technologies allowing for the efficient provision of support to the productive sectors.
- The key factors that can be identified at a country level in Central America that would allow better advantage to be taken of trade opportunities and a greater participation in foreign trade involve raising the competitiveness of the export sectors through the provision of training and technical assistance services emphasizing increased productivity.
- It is fundamental to invest more in trade intelligence in order to know about the behaviour of markets, their requirements, norms and regulations, as well as the strengthening or creation of the necessary support infrastructure to improve the quality of the products, measurement and calibration systems, establishment of national norms and everything needed to comply with the requirements of the final markets.
- In the particular case of Central America, efforts are made to enhance national and regional competitiveness through different programmes and initiatives aimed at improving productive capacities for the supply of exports, improve the supply of public and private support services, and improve the investment and business environment. Nevertheless, these initiatives will take some time to yield results leading to a greater participation of the productive sectors in trade, which will eventually improve living conditions for the population and reduce poverty in these countries.
- Free trade agreements represent a good opportunity for increasing exports, but these special schemes require a high degree of administrative support.
- The challenges for the UNIDO programme are very important, but the most interesting aspect to consider is to gain the willingness of the companies to comply with recommendations given during the technical assistance.
- Cooperating institutions play a key role in supporting initiatives seeking to increase the competitiveness of the productive sectors in these countries. Nonetheless, its channelling must be carried out taking into consideration the roles, strengths, capabilities and skills of the public and private sectors and the players involved in supporting the productive and exporting activities. Also, it must consider the support given to specific programmes, guaranteeing that administrative expenses are held to a minimum of the resources allocated, and taking advantage of economies of scale by combining them with programmes already in execution or taking advantage of the experience gained from previous programmes.
- Technical assistance should be provided in a direct manner, being coordinated and oriented by the private organizations dedicated to provide support at a national level to such companies and with the support of the agencies in government that can offer some added value to the programme. There must also be a contribution from the beneficiaries of the technical assistance. They must be companies with a record of continuity and growth in exports.

## References

ECLAC (CEPAL), *Istmo Centroamericano: Evolución económica durante 2002 y perspectivas 2003*. Santiago: Economic Commission for Latin America and the Caribbean, 8 October 2003.

# **Rigged Rules and Double Standards: Trade, Globalization and the Fight against Poverty**

*Jeremy Hobbs\**

## **Foreword**

Global interaction, rather than insulated isolation, has been the basis of economic progress in the world. Trade, along with migration, communication, and dissemination of scientific and technical knowledge, has helped to break the dominance of rampant poverty and the pervasiveness of “nasty, brutish, and short” lives that characterized the world. And yet, despite all the progress, life is still severely nasty, brutish, and short for a large part of the world population. The great rewards of globalized trade have come to some, but not to others.

What is needed is to create conditions for a fuller and fairer sharing of the enormous benefits from trade. Can this be done without destroying the global market economy? The answer is very firmly yes. The use of the market economy is consistent with many different resource distributions, rules of operation (such as patent laws and anti-trust regulations), and enabling conditions for participating in the market economy (such as basic education and health care). Depending on these conditions, the market economy itself would generate different prices, dissimilar terms of trades, distinct income distributions, and more generally diverse overall outcomes. Institutional change and policy reform can radically alter the prevailing levels of inequality and poverty, without wrecking the global economy.

This report is concerned precisely with that task. The work involves the diagnosis of institutional features that impede a more equitable sharing of the fruits of trade and exchange. The organizational arrangements that require reform include, for example, the prevailing patent laws that effectively exclude the use of the most needed drugs by the most needy people (while giving little incentive for the development of particularly appropriate drugs, such as preventive vaccines, which are less attractive to pharmaceutical companies).

I will not try to summarize the report. There is a very useful executive summary – the excellence of which would not, I hope, deter the reading of the entire report. The authors of the report have proposed specific institutional changes which deserve serious attention. In addition, the broader object of the report is to promote discussion of the kind of institutional architecture that may best serve the interests of the poor and the deprived. The basic objective is to combine the great benefits of trade to which many defenders of globalization point, with the overarching need for fairness and equity which motivates a major part of the anti-globalization protests. The constructive agenda of the report draws on both concerns.

Amartya Sen,  
Honorary President of Oxfam,  
March 2002

## **Executive summary**

There is a paradox at the heart of international trade. In the globalized world of the early twenty-first century, trade is one of the most powerful forces linking our lives. It is also a source of unprecedented wealth. Yet millions of the world’s poorest people are being left behind. Increased prosperity has gone hand in hand with mass poverty and the widening of already obscene inequalities

---

\* Executive Director, OXFAM International.

between rich and poor. World trade has the potential to act as a powerful motor for the reduction of poverty, as well as for economic growth, but that potential is being lost. The problem is not that international trade is inherently opposed to the needs and interests of the poor, but that the rules that govern it are rigged in favour of the rich.

The human costs of unfair trade are immense. If Africa, East Asia, South Asia, and Latin America were each to increase their share of world exports by 1 per cent, the resulting gains in income could lift 128 million people out of poverty. Reduced poverty would contribute to improvements in other areas, such as child health and education.

In their rhetoric, governments of rich countries constantly stress their commitment to poverty reduction. Yet the same governments use their trade policy to conduct what amounts to robbery against the world's poor. When developing countries export to rich country markets, they face tariff barriers that are four times higher than those encountered by rich countries. Those barriers cost them US\$ 100 billion a year – twice as much as they receive in aid.

Various polite formulations can be found to describe the behaviour of rich-country governments. But the harsh reality is that their policies are inflicting enormous suffering on the world's poor. When rich countries lock poor people out of their markets, they close the door to an escape route from poverty.

Lack of market access is not an isolated example of unfair trade rules, or of the double standards of Northern governments. While rich countries keep their markets closed, poor countries have been pressurized by the International Monetary Fund (IMF) and World Bank to open their markets at breakneck speed, often with damaging consequences for poor communities. The problem of low and unstable commodity prices, which consigns millions of people to poverty, has not been seriously addressed by the international community. Meanwhile, powerful transnational companies (TNCs) have been left free to engage in investment and employment practices which contribute to poverty and insecurity, unencumbered by anything other than weak voluntary guidelines. The World Trade Organization (WTO) is another part of the problem. Many of its rules on intellectual property, investment, and services protect the interests of rich countries and powerful TNCs, while imposing huge costs on developing countries. The WTO's bias in favour of the self-interest of rich countries and big corporations raises fundamental questions about its legitimacy.

Reform of world trade is only one of the requirements for ending the deep social injustices that pervade globalization. Action is also needed to extend opportunity, and reduce inequalities in health, education, and income distribution. However, world trade rules are a key part of the poverty problem. Fundamental reforms are needed to make them part of the solution.

### **The Oxfam trade campaign**

This report sets out Oxfam's analysis of the rules that govern world trade. The campaign that it launches aims to change those rules in order to unleash the potential of trade to reduce poverty. It is motivated by a conviction that it is time to end double standards and to make trade fair. The following are among Oxfam's main policy goals:

- Improving market access for poor countries and ending the cycle of subsidized agricultural over-production and export dumping by rich countries.
- Ending the use of conditions attached to IMF-World Bank programmes which force poor countries to open their markets regardless of the impact on poor people.
- Creating a new international commodities institution to promote diversification and end over-supply, in order to raise prices to levels consistent with a reasonable standard of living for producers, and changing corporate practices so that companies pay fair prices.
- Establishing new intellectual-property rules to ensure that poor countries are able to afford new technologies and basic medicines, and that farmers are able to save, exchange, and sell seeds.

- Prohibiting rules that force governments to liberalize or privatize basic services that are vital for poverty reduction.
- Enhancing the quality of private-sector investment and employment standards.
- Democratizing the WTO to give poor countries a stronger voice.
- Changing national policies on health, education, and governance so that poor people can develop their capabilities, realize their potential, and participate in markets on more equitable terms.

Why campaign on trade, and why now? There are three answers to this question. The first is that the existing trade system is indefensible. No civilized community should be willing to tolerate the extremes of prosperity and poverty that are generated by current trade practices. And none of us should be willing to accept the abuse of power, injustice, and indifference to suffering that sustains those practices.

The second reason for action can be summarized in a simple phrase: “enlightened self-interest”. What is happening today is not just indefensible, it is also unsustainable. Large parts of the developing world are becoming enclaves of despair, increasingly marginalized and cut off from the rising wealth generated through trade. Ultimately, shared prosperity cannot be built on such foundations. Like the economic forces that drive globalization, the anger, despair, and social tensions that accompany vast inequalities in wealth and opportunity will not respect national borders. The instability that they will generate threatens us all. In today’s globalized world, our lives are more inextricably linked than ever before, and so is our prosperity. As a global community, we sink or swim together. No country, however strong or wealthy, is an island.

The third motivation for Oxfam’s trade campaign is the conviction that change is possible. The international trading system is not a force of nature. It is a system of exchange, managed by rules and institutions that reflect political choices. Those choices can prioritize the interests of the weak and vulnerable, or they can prioritize the interests of the wealthy and powerful. Trade is reinforcing global poverty and inequality because the international trading system is managed to produce these outcomes. The rules of the game reflect the power of vested interests. Concerted public campaigning can change this. As demonstrated by the international campaign to cancel the debts of poor countries, public action can force the interests of the poor on to the international agenda. And it can achieve real gains for human development.

Ultimately, there is a clear choice to be made. We can choose to allow unfair trade rules to continue causing poverty and distress, and face the consequences. Or we can change the rules. We can allow globalization to continue working for the few, rather than the many. Or we can forge a new model of inclusive globalization, based on shared values and principles of social justice. The choice is ours. And the time to choose is now.

## **Trade and globalization in the twenty-first century**

Well-managed trade has the potential to lift millions of people out of poverty. However, increased trade is not an automatic guarantee of poverty reduction. The experience of developing countries exposes the gap between the great potential benefits of trade on the one side, and the disappointing outcomes associated with growing integration through trade on the other.

Current debates about trade are dominated by ritualistic exchanges between two camps: the “globaphiles” and the “globaphobes”. “Globaphiles” argue that trade is already making globalization work for the poor. Their prescription for the future is “more of the same”. “Globaphobes” turn this world-view on its head. They argue that trade is inherently bad for the poor. Participation in trade, so the argument runs, inevitably leads to more poverty and inequality. The corollary of this view is “the less trade the better”.

The anti-globalization movement deserves credit. It has raised profoundly important questions about social justice – and it has forced the failures of globalization on to the political agenda. However, the war of words between trade optimists and trade pessimists that accompanies virtually every international meeting is counter-productive. Both world views fly in the face of the evidence – and neither offers any hope for the future. The false debate raging on trade is an unfortunate diversion, not least because of the revolutionary changes that are transforming the global trading system. Those changes have profound implications for all countries – and their future direction will determine the prospects for success in eradicating poverty.

Part of the change is quantitative. Exports have been growing much faster than global gross domestic product (GDP), so that trade now accounts for a greater share of world income than ever before. As a result, changes in trade patterns will have an increasing influence on patterns of income distribution – and on the prospects for poverty reduction. Developing countries have registered particularly rapid increases in their ratios of exports to GDP. Exports now account for more than one-quarter of their combined GDP, a proportion which is higher than for rich countries.

The composition of exports from developing countries has also been changing. While many remain dependent on primary commodities, the share of manufactured goods has been growing. Over the past decade, there has been a boom in high-technology exports, with countries such as China, India, and Mexico emerging as major suppliers of cutting-edge technologies, as well as labour-intensive goods.

The changing role of developing countries in the international division of labour reflects the powerful technological forces that are driving globalization. The marriage of computer technology and telecommunications – or digitalization – is revolutionizing international economic relations. Under the auspices of TNCs, it has facilitated the development of global production systems. Increased trade within companies has been one of the most powerful forces behind the expansion of world trade. The foreign sales of the largest 100 TNCs are equivalent in value to one-quarter of world trade; approximately two-thirds of all trade takes place within companies.

*“We are told that the American computer market is failing. They say that means there will be less production here. Without this job, my life will be very hard.”*

*Josephine Laranja,  
employed in an electronics factory  
south of Manila, The Philippines*

Through their production, investment, and marketing activities, TNCs are linking producers in developing countries ever more closely with consumers in rich countries. From women workers in Bangladesh’s garment factories, to workers in China’s special economic zones and workers in the free-trade zones of Central America, to small farmers and agricultural labourers across the developing world, globalization is generating forces which create major opportunities, along with huge threats.

### **Trade as a force for poverty reduction**

History makes a mockery of the claim that trade cannot work for the poor. Participation in world trade has figured prominently in many of the most successful cases of poverty reduction – and, compared with aid, it has far more potential to benefit the poor.

If developing countries increased their share of world exports by just 5 per cent, this would generate US\$ 350 billion – seven times as much as they receive in aid. The US\$ 70 billion that Africa would generate through a 1 per cent increase in its share of world exports is approximately five times the amount provided to the region through aid and debt relief.

Apart from the financial benefits, export growth can be a more efficient engine of poverty reduction than aid. Export production can concentrate income directly in the hands of the poor, creating new opportunities for employment and investment in the process. However, the “aid versus trade” dichotomy can be overstated: Aid can play a critical role in enabling poor people to benefit from trade, notably by supporting investments in health and education services and economic infrastructure.

Export success can play a key role in poverty reduction. Simulations conducted for this report have attempted to capture the potential impact on poverty of an increased share of world exports for developing countries. At one level, these simulations are artificial. Gains from trade are dynamic and cumulative: They cannot be captured by a static snapshot. Even so, the figures are striking. They suggest that a 1 per cent increase in world-export share for each developing region could reduce world poverty by 12 per cent. The decline would be greatest in sub-Saharan Africa and South Asia, the two regions with the highest concentrations of poverty.

This shift in distribution of world export activity implied by our simulation is very modest, especially when measured against the current imbalance between population and world-export shares. Low-income developing countries account for more than 40 per cent of world population, but less than 3 per cent of world trade. Whereas rich countries export goods and services worth approximately US\$ 6,000 per capita, the equivalent figure for developing countries is US\$ 330, and less than US\$ 100 for low-income countries.

Experience from East Asia illustrates what is possible when export growth is broad based. Since the mid-1970s, rapid growth in exports has contributed to a wider process of economic growth which has lifted more than 400 million people out of poverty. In countries such as Vietnam and Uganda, production for export markets has helped to generate unprecedented declines in the levels of rural poverty. Where export growth is based on labour-intensive manufactured goods, as in Bangladesh, it can generate large income gains for women.

There are caveats to be attached to all of these success stories. Rising inequality has slowed the rate of poverty reduction in East Asia, and export growth has been accompanied by extreme forms of exploitation, especially among female workers. Yet these outcomes are not inevitable. They are the result of governments failing to protect the interests of the poor.

*“If you ask me how our lives compare with our parents’ lives, I will tell you that things are better. We are still vulnerable. But there is less poverty today.”*

*Lam Van,  
rice farmer,  
Mekong Delta, Viet Nam*

The benefits of trade are not automatic – and rapid export growth is no guarantee of accelerated poverty reduction. Yet when the potential of trade is harnessed to effective strategies for achieving equitable growth, it can provide a powerful impetus to the achievement of human-development targets. Access to larger markets and new technologies creates incentives for investment, which in turn generates economic growth and employment. If countries are able to engage in higher-value-added trade, as in East Asia, export growth can contribute to rapid increases in living standards.

### **Left behind: poor countries and poor people in the global trading system**

Despite some notable successes, the expansion of world trade under globalization has produced disappointing outcomes for poverty reduction. Rising tides are supposed to lift all boats; but the rising tide of wealth generated by trade has lifted some boats higher than others, and some are sinking fast.

Persistent poverty and increasing inequality are standing features of globalization. In the midst of the rising wealth generated by trade, there are 1.1 billion people struggling to survive on less than US\$ 1 a day – the same number as in the mid-1980s. Inequalities between rich and poor are widening, both between and within countries. With only 14 per cent of the world's population, high-income countries account for 75 per cent of global GDP, which is approximately the same share as in 1990.

Inequalities in trade are reinforcing these wider inequalities. For every US\$ 1 generated through exports in the international trading system, low-income countries account for only three cents. Even though developing countries have been increasing their exports more rapidly than rich countries, large initial inequalities mean that the absolute gap between them is widening. In the 1990s, rich countries increased the per capita value of their exports by US\$ 1,938, compared with US\$ 51 for low-income countries and US\$ 98 for middle-income countries.

Export success in developing countries has been highly concentrated. East Asia accounts for more than three-quarters of manufactured exports, and an even larger share of high technology products. South Asia and sub-Saharan Africa together account for less than 2 per cent, and (with the exception of Mexico) Latin America's share is shrinking.

Some countries that appear to be successfully integrating through trade are trapped in low-value-added ghettos, and the growth in their exports has little impact on their levels of poverty. International trade data identify Mexico as a major exporter of high technology goods and services. However, less than 2 per cent of the value of its exports derives from local inputs. The same is true of a number of countries with high rates of export growth in the garments sector, such as Bangladesh and Honduras. In each case, export production is dominated by the simple assembly and re-export of imported components under TNC auspices, with limited transfer of technology.

Other countries have failed to escape long-standing problems. Exporters of primary commodities have seen their shares of world trade shrink, with sub-Saharan Africa bearing the brunt of problems associated with low prices. Deteriorating terms of trade since the late 1970s have cost the region the equivalent of 50 cents for every US\$ 1 that it receives in aid.

Trade theory predicts that poor people in developing countries will benefit from integration through trade, but the theory has been confounded by reality. In Latin America, rapid growth in exports has been associated with rising unemployment and stagnating incomes. Real minimum wages in the region were lower at the end of the 1990s than at the start of the decade. Evidence presented in this report shows that the rural poor in particular are losing out.

Not all of the problems associated with trade can be assessed through their effects on incomes. In many countries, export growth has been built on highly exploitative employment practices. Women employed in China's economic zones are often forced to work twelve-hour days in appalling conditions. Garment workers in Bangladesh are denied the right to join unions. Long working days for poverty-level wages make heavy demands on the time and energy of women. Meanwhile, many governments have imposed "flexible" labour practices – a euphemism, in this context, for violating basic employment rights.

### **Market access and agricultural trade: the double standards**

The full potential of trade to reduce poverty cannot be realized unless poor countries have access to markets in rich countries. Unfortunately, Northern governments reserve their most restrictive trade barriers for the world's poorest people.

Competition in the international trading system can be likened to a hurdle race with a difference: the weakest athletes face the highest hurdles. When desperately poor smallholder farmers or women garment workers enter world markets, they face import barriers four times as high as those faced by

producers in rich countries. Trade restrictions in rich countries cost developing countries around US\$ 100 billion a year – twice as much as they receive in aid. Sub-Saharan Africa, the world's poorest region, loses some US\$ 2 billion a year, India and China in excess of US\$ 3 billion. These are only the immediate costs. The longer-term costs associated with lost opportunities for investment and the loss of economic dynamism are much greater.

Trade barriers in rich countries are especially damaging to the poor, because they are targeted at the goods that they produce, such as labour-intensive agricultural and manufactured products. Because women account for a large share of employment in labour-intensive export industries, they bear a disproportionate share of the burden associated with the lower wages and restricted employment opportunities imposed by protectionism.

Who are the worst offenders in damaging the interests of developing countries through trade barriers? Oxfam has attempted to answer this question through its Double Standards Index (DSI). This measures ten important dimensions of rich-country trade policies, including average tariffs, the sizes of tariffs in textiles and agriculture, and restrictions on imports from the least developed countries (LDCs). We call it the Double Standards Index because it measures the gap between the free-trade principles espoused by rich countries and their actual protectionist practices. No industrialized country emerges with credit, but the European Union (EU) emerges as the worst offender, beating the USA by a short head.

Nowhere are the double standards of industrialized-country governments more apparent than in agriculture. Total subsidies to domestic farmers in these countries amount to more than US\$ 1 billion a day. These subsidies, the benefits of which accrue almost entirely to the wealthiest farmers, cause massive environmental damage. They also generate over-production. The resulting surpluses are dumped on world markets with the help of yet more subsidies, financed by taxpayers and consumers.

Oxfam has developed a new measure of the scale of export dumping by the EU and the USA. It suggests that both these agricultural superpowers are exporting at prices more than one-third lower than the costs of production. These subsidized exports from rich countries are driving down prices for exports from developing countries, and devastating the prospects for smallholder agriculture. In countries such as Haiti, Mexico, and Jamaica, heavily subsidized imports of cheap food are destroying local markets. Some of the world's poorest farmers are competing against its richest treasuries.

Rich countries have systematically reneged on their commitments to improve market access for poor countries. Instead of reducing their own farm subsidies, they have increased them. Having pledged to phase out the Multi-Fibre Arrangement (MFA), which restricts imports of textiles and garments, they have liberalized fewer than one-quarter of the products for which they had agreed to open their markets.

Improved market access could provide a powerful impetus to poverty-reduction efforts, especially if linked to domestic strategies for extending opportunities to the poor and overcoming gender-based barriers to market access. Among the priorities are the following:

- Duty-free and quota-free access for all low-income countries.
- A general reduction in tariff peaks, so that no tariffs applied against developing country exports exceed 5 per cent.
- Accelerated phase-out of the MFA, to allow market access for textiles and garments, which are the main labour-intensive exports of the developing world.
- A comprehensive ban on export subsidies, and a restructuring of farm subsidies to achieve social and environmental objectives, rather than increased output.
- Recognition of the right of developing countries to protect their agricultural systems for food-security purposes.



Reforms such as these would create an enabling environment for poverty reduction. They would offer new opportunities for poor countries and poor people. However, improved market access is only one of the requirements for strengthening the links between trade and poverty reduction. Many of the poorest countries lack the infrastructure to take advantage of market openings. Within countries, poor people similarly lack access to productive assets – such as land and credit – and to health care, education, and infrastructure provision.

## **Trade liberalization and the poor**

The removal of trade barriers in rich countries would produce clear benefits for poor countries. Carefully designed and properly sequenced import liberalization in developing countries can also benefit the poor, especially when the lowering of trade barriers is part of a coherent poverty-reduction strategy. However, rapid import liberalization in developing countries has often intensified poverty and inequality. Loan conditions attached to IMF and World Bank programmes are a major part of the problem.

*“Imports are killing our markets and our communities.”*

*Hector Chavez,  
smallholder farmer,  
Chiapas, Mexico*

The IMF, the World Bank, and most Northern governments are strong advocates of trade liberalization. In the case of the IMF and the World Bank, advocacy has been backed by loan conditions which require countries to reduce their trade barriers. Partly as a result of these loan conditions, poor countries have been opening up their economies much more rapidly than rich countries. Average import tariffs have been halved in sub-Saharan Africa and South Asia, and cut by two-thirds in Latin America and East Asia.

International financial institutions and governments have sought to justify their support for rapid import liberalization by reference to World Bank research which seeks to establish that trade liberalization is good for growth, and that the poor share in the benefits of growth on an equitable basis. In this report we challenge the evidence presented by the World Bank. We show that the research on which it is based is deeply flawed, and that it is producing bad policy advice.

One of the problems stems from confusion over the meaning of “openness”. The World Bank uses an economic outcome (ratio of trade-to-GDP) as an indirect measure of the impact of policy changes in favour of liberalization. Using a different indicator of openness, based on the speed and scale of import liberalization, we show that many of the countries that are integrating most successfully into world markets – such as China, Thailand, and Viet Nam – are not rapid import liberalizers. Conversely, many rapid import liberalizers have a weak record on poverty reduction, despite following the spirit and the letter of World Bank-IMF policy advice.

In many countries, rapid liberalization has been associated with rising inequality. Case studies from Peru show smallholder farmers in highland areas operating at a disadvantage, compared with commercial farms. In Mexico, the “poverty belt” states in the south are becoming poorer, in comparison with states in the north. In India, import liberalization is intensifying inequalities within rural areas, and between urban and rural areas. These inequalities matter, because they slow the rate at which economic growth is converted into poverty reduction.

Poverty Reduction Strategy Papers (PRSPs) provide the IMF and the World Bank with an opportunity to place trade at the centre of their dialogue with governments on poverty. That opportunity is being lost. In a review of twelve PRSPs we found that only four mentioned the possible impact of trade reform on poor people, of which two considered measures to protect the losers. In Cambodia, the IMF and the World Bank are supporting a strategy which will sharply reduce import tariffs on

agricultural goods, exposing millions of rice farmers to competition from Thailand. Yet no poverty assessment has been carried out.

Among the recommendations set out in this report are the following.

- IMF-World Bank programmes should not impose further loan conditions requiring trade liberalization.
- Rich countries should reciprocate past liberalization undertaken by developing countries under IMF-World Bank conditions by making equivalent reductions in their own import barriers.
- All PRSPs should include a detailed analysis of the potential impact of trade liberalization on income distribution and poverty reduction.

### **Primary commodities: trading into decline**

*“Proper economic prices should be fixed not at the lowest possible level, but at a level sufficient to provide producers with proper nutritional and other standards.”*

*John Maynard Keynes, 1944*

More than half a century has passed since Keynes argued for a new international institution to address the problems facing exporters of primary commodities. Today, low and unstable prices for commodities are among the most powerful influences that prevent trade from working for the poor. Many of the world’s poorest countries remain heavily dependent on primary commodities. More than fifty developing countries depend on three or fewer such commodities for more than half of their export earnings. The national economies of these countries and the household economies of millions of poor people have been devastated by a protracted decline in prices.

Coffee has been one of the commodities worst affected. Prices have fallen by 70 per cent since 1997, costing developing-country exporters some US\$ 8 billion in lost foreign-exchange earnings. For some countries, these losses have outweighed the benefits of aid and debt relief. Poor households have suffered particular hardship. Our research among coffee farmers in Tanzania, southern Mexico, and Haiti found families reducing their general consumption, taking children out of school, and facing extreme difficulties in meeting health costs. Family and community structures were coming under strain, as women were forced to increase their off-farm labour, and men to migrate in search of work.

The underlying causes of the crisis in commodity markets vary from product to product. However, the general problem is one of structural over-supply. Output across a wide range of products is consistently exceeding demand, which leads to excessive stocks and periodic price collapse.

Any change in world market prices generates winners and losers, and commodity markets are no exception. The losers include in their ranks millions of the world’s most vulnerable households. The winners, in this case, include the large TNCs that dominate global markets. These TNCs – such as the Nestlé corporation – have been able to take advantage of ruinously low producer prices to enjoy high profit margins.

*“The price of coffee is destroying this community.”*

*Tatu Museyni,  
coffee farmer,  
Kilimanjaro region, Tanzania*

Resolving the protracted crisis in commodity markets is a fundamental requirement for more inclusive globalization. The issues raised are complex, but the current piecemeal approach to reform is not working. This report sets out an agenda for reform, including the following recommendations:

- *A new institution to oversee global commodity markets, and a new system of commodity agreements.* This would seek to reduce price volatility. In contrast to the failed agreements of the past, the new institution would include financing mechanisms designed to bring supply back into

balance with demand, at reasonable price levels. It would also work to support diversification, and to increase the value of exports through strategies for adding value to the products of low-income countries.

- *The adoption by TNCs of socially responsible purchasing operations.* This would include an increase in the proportion of commodities purchased under long-term contract arrangements, and a fair price when world market prices fall below levels consistent with reasonable living standards in exporting countries.

## **Transnational companies: Investment, employment, and marketing**

Technological change has made globalization possible. Transnational companies have made it happen. Through their investment, production, and marketing activities, TNCs bring the world's economies and people more closely together. They have the potential to spread the benefits of globalization more widely, but they are failing to do so.

Many developing-country governments have introduced an "open door" policy for foreign investment. Encouraged by Northern governments and financial institutions, they have sought to generate rapid export growth by attracting TNCs. But this strategy is flawed.

Foreign direct investment (FDI) has many potential benefits. It can provide access to new financial resources, technologies, and markets. However, the current financial benefits have been exaggerated. High levels of profit repatriation, high-cost incentives to attract investors, and tax avoidance combine to reduce real financial transfers. For every US\$ 1 of foreign investment, around 30 cents are repatriated through profit transfers.

Not all investment is good investment. In development terms, good-quality investment transfers skills and technology, and creates dynamic linkages with local firms. Much FDI does not fit into this category. In Latin America, increased FDI has been associated with reduced capacity for research and development, and a growing dependence on technology imports. Free-trade zones appear to attract the worst-quality FDI. In many cases – as in Bangladesh and Mexico – these zones operate as enclaves, almost totally isolated from the domestic economy. FDI in the extraction of mineral resources has a particularly bad development record. It has often intensified conflicts, caused extreme environmental damage, and led to the displacement of local communities.

TNCs have a major influence on employment standards in developing countries, partly as direct employers, but mainly through their sub-contracting activities. While most TNCs have adopted codes of conduct on employment, the benefits have been limited. With their emphasis on voluntarism, these codes have failed to address the erosion of workers' rights, or to prevent the emergence of extreme inequalities based on gender.

Weak auditing of corporate codes is a serious problem, but even the best auditing practices would not resolve the deeper tensions. In many major exporting economies, governments have dismantled employment protection in order to attract FDI, often with the encouragement of TNCs. This report documents cases in which Northern-based companies, many of which have exemplary codes of conduct, are being supplied by subcontractors which violate basic employment rights on a systematic basis. Moreover, the market conditions created by TNCs, including intense price pressures on suppliers and stringent delivery deadlines, make it difficult to raise standards.

*"Work in the factory is hard. We are not well treated. Do people in your country think about our condition when they buy the shirts we make?"*

*Nawaz Hazari,  
sewing machine operator,  
Ganakbari Export Processing Zone,  
Dhaka, Bangladesh*

As the most vulnerable members of the workforce in export industries, women face special challenges. Inadequate social-insurance rights, obligatory over-time work, hazardous work conditions, and poverty-level wages are common. In many countries, export-led success is built on the exploitation of women and girls.

Through their marketing activities, some TNCs are posing grave threats to public health. Efforts to create markets for tobacco and infant-formula milk are two activities which inflict especially serious damage.

The recommendations presented in this report include the following:

- Governments should enact and enforce national employment laws consistent with the core standards of the International Labour Organization (ILO).
- The WTO's Trade Policy Reviews should report on trade-related labour standards.
- Employment rights in export-processing zones should be strengthened, with an emphasis on improving the employment status of women.
- The ILO's capacity to monitor and enforce core labour standards should be strengthened.
- Northern governments should establish (under their Guidelines for Multinational Enterprises) better mechanisms for investigation, monitoring and reporting, in order to hold TNCs accountable for their actions in developing countries.
- Governments should establish a legally binding international protocol, based on the (currently draft) UN Fundamental Human Rights Principles for Business Enterprises, to govern the production, trade, and consumption of natural resources from conflict areas.

### **International trade rules as an obstacle to development**

Good international trade rules can create an enabling environment for poverty reduction. Bad rules have the opposite effect. They can prevent governments from initiating the strategies that are needed to make trade work for the poor. Many of the provisions of the World Trade Organization are bad rules.

The agreement on the Trade-Related Aspects of Intellectual-Property Rights (TRIPS) is a prime example. Adam Smith once warned governments to guard against the instincts of private traders: "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some diversion to raise prices." He could have been writing about the TRIPS agreement. More stringent protection for patents will increase the costs of technology transfer. Developing countries will lose approximately US\$ 40 billion a year in the form of increased licence payments to Northern-based TNCs, with the USA capturing around one-half of the total. Behind the complex arguments about intellectual-property rights, the TRIPS agreement is an act of institutionalized fraud, sanctioned by WTO rules.

The application of the TRIPS agreement to medicines will have grave consequences for public health. Evidence from developing countries suggests that reinforced patent protection could double the costs of medicines. Given that poor households already spend more on drugs than on any other item of health care, this will significantly raise the cost of treating illness. Premature death and unnecessary sickness are inevitable corollaries. Because of their higher levels of vulnerability to illness and their role as primary carers, women will suffer the gravest consequences.

Current approaches to patenting directly threaten the interests of small farmers. Northern governments have effectively authorized corporate investors to undertake acts of bio-piracy, by permitting them to patent genetic materials taken from developing countries. If a royalty of 2 per cent were to be levied on these materials, it would generate some US\$ 5 billion. To add to their problems, smallholder farmers could lose the right to save, sell, and exchange seeds.

Under the General Agreement on Trade in Services (GATS), industrialized countries are seeking to open new markets for TNC investors. These include markets for financial services and basic utilities, such as water. Service-sector activities in which developing countries stand to benefit – such as labour supply – have not been prioritized. Meanwhile, by applying free-market principles to the provision of essential utilities, the GATS agreement threatens to promote forms of privatization which will damage the interests of the poor.

Many of the industrial policies that facilitated successful integration into world markets in East Asia are now either restricted or prohibited by WTO rules. These include policies that would require TNCs to source products locally, along with restrictions on foreign investment. By requiring countries at very different levels of economic development to apply the same rules, the WTO system is out of touch with the challenges that confront poor countries.

Among the reforms advocated in this report are the following:

- An end to the universal application of the WTO intellectual-property blueprint: developing countries should retain the right to maintain shorter and more flexible systems of intellectual-property protection.
- A clear commitment to put public-health priorities before the claims of patent holders, building on the commitments made at the Doha Ministerial Conference in 2001.
- A prohibition on patent protection for genetic resources for food and agriculture, and stronger rights for poor countries to develop more appropriate forms of plant variety protection, and to protect farmers' rights to save, sell, and exchange seeds. The TRIPS agreement is an act of institutionalized fraud, sanctioned by WTO rules. Developing countries will lose approximately US\$ 40 billion a year in the form of increased licence payments to Northern-based TNCs.
- A rebalancing of the services agreement in order to prioritize development objectives, to exclude essential public services from liberalization negotiations, and to strengthen national sovereignty.
- Strengthening of the WTO's provisions for the "special and differential treatment" of developing countries; and the removal of restrictions on the rights of governments to regulate foreign investment and protect their countries' infant industries.

## **Making trade work for the poor**

Trade can realize its full potential only if rich and poor countries alike take action to redistribute opportunities in favour of the poor. This requires action at the national level, new forms of international co-operation, and a new architecture of global governance at the WTO.

The challenge of extending opportunity at the national level goes beyond the narrow confines of trade policy. Inequalities in health and education services, and in the ownership of assets, are a formidable barrier to making markets work for poor people. Lacking access to land, marketing infrastructure, and financial resources, the poor are often least equipped to take advantage of market opportunities, and the most vulnerable to competition from imports. In many countries, extensive corruption and excessive bureaucracy act as a tax on trade – and the tax falls most heavily on the poor.

International co-operation must be strengthened in a range of areas. Developing countries need development assistance if they are to integrate into world markets on more favourable terms and to extend opportunities to the poor. Yet rich countries reduced their aid budgets by US\$ 13 billion between 1992 and 2000. Some of the heaviest cuts fell on the poorest countries and in areas – such as agriculture – where well-targeted aid can make a difference to levels of poverty. Failure to resolve the long-standing debt problems of low-income countries, and to respond effectively to new problems in private capital markets, poses further threats. There is a growing danger that many developing countries will be forced by unsustainable debt to transfer the wealth that is generated by exports to creditors in rich countries.

The WTO is one of the youngest international institutions, but it is old before its time. Behind the façade of a “membership-driven” organization is a governance system based on a dictatorship of wealth. Rich countries have a disproportionate influence. This is partly because of a failure of representational democracy. Each WTO country may have one vote, but eleven of its members among the least-developed countries are not even represented at the WTO base in Geneva. Informal power-relations reinforce inequalities in negotiating capacity at the WTO. Meanwhile, beyond the WTO, powerful TNCs exercise a disproportionate influence over the direction of trade policy.

Reforms to trade governance are needed in order to make trade work for the poor at all levels. They include the following:

- Redistributive reforms linked to national poverty-reduction strategies. These reforms include land redistribution, changes in public-spending priorities, infrastructural development, and measures to overcome gender-based barriers to equity in local markets.
- Action to tackle the problems of corruption. At the national level, this implies stronger auditing through bodies answerable to the legislature, along with adherence to the OECD anti-bribery convention and guidelines on corruption.
- Increased technical support for poor countries through a Financing Facility for Trade-Related Capacity Building. This would include an annual budget of approximately US\$ 250 million to enhance the negotiating capacity of developing countries at the WTO.
- Improved transparency and accountability in developing countries. All governments should submit to their respective legislative bodies an annual report on their activities at the WTO. Trade-policy reviews at the WTO should include an assessment of the quality of dialogue between governments and civil society on trade-policy reform.
- Greater transparency on informal influence. All national governments should be required to disclose contacts and submissions made by organizations that seek to influence trade-negotiating policies.
- The development of a Global Anti-Trust Mechanism. In view of the massive concentration of corporate power in the global economy, the principles of antimonopoly legislation should be extended beyond national borders to the international economy.

Just as in any national economy, economic integration in the global economy can be a source of shared prosperity and poverty reduction, or a source of increasing inequality and exclusion. Managed well, the international trading system can lift millions out of poverty. Managed badly, it will leave whole economies even more marginalized. The same is true at a national level. Good governance can make trade work in the interests of the poor. Bad governance can make it work against them.

At present, trade is badly managed, both at the global level and, in many countries, at the national level. Continuing on the current path is not an option. But a retreat into isolationism would deprive the poor of the opportunities offered by trade. It would counteract a powerful force for poverty reduction. That is why we need a new world trade order, grounded in new approaches to rights and responsibilities, and in a commitment to make globalization work for the poor.

# Running into the Sand: Why Failure at the Cancun Trade Talks Threatens the World's Poorest People

Jeremy Hobbs\*

In September 2003 world trade ministers meet in Cancun Mexico to start a new phase in the Doha “development round”. The meeting provides an opportunity to reform the unfair trade rules that systematically disadvantage the world’s poorest countries. Urgent action is needed to stop agricultural dumping, protect access to affordable medicines, improve market access, and prevent damaging new rules on foreign investment. Failure to deliver will undermine efforts to tackle global poverty and further damage the credibility of the World Trade Organization (WTO).

## Executive summary

*International trade can play a major role in the promotion of economic development and the alleviation of poverty. We recognize the need for all our peoples to benefit from the increased opportunities and welfare gains that the multilateral trading system generates.*

*Doha Ministerial Declaration, November 2001*

*Any export effort we might make will be worth nothing if rich countries continue to preach free trade and practice protectionism*

*President Lula Da Silva,*

*World Economic Forum, 26 January 2003*

Rich countries have broken an important promise to the world’s poorest people. Meeting in November 2001 in Doha, Qatar, they committed themselves to a “development round” of multilateral trade negotiations. Bold pronouncements were made on the need to work for a fairer distribution of the benefits from trade, and for measures to strengthen the links between trade and poverty reduction. *Almost two years on, none of the promises made at Doha have been honoured. The Cancun meeting of World Trade Organization (WTO) ministers in September 2003 could be the last chance for rich countries to deliver.*

Cancun is a defining moment for global poverty reduction efforts. It provides an opportunity to reform the unfair trade rules that systematically disadvantage the world’s poorest countries and its poorest people, giving them a chance to share in global prosperity. Decisive action at Cancun could set globalization on a new course, reducing the obscene inequalities that divide rich and poor countries and liberating forces that could lift millions out of poverty.

For Northern governments, Cancun provides an opportunity to respond to public demands for change. Trade justice has become a rallying call for people around the world. Already, more than three million have added their voices to the “Big Noise” – Oxfam’s global petition to make trade fair. They range from Zambian cotton farmers and Bangladeshi garment workers to Kofi Annan and Desmond Tutu. Decision makers have so far been deaf to these voices. Cancun is their chance to listen – and to act.

And success in Cancun would extend far beyond trade. At a time when multilateralism is in retreat, a reformed WTO could provide the foundations for a renewal of international cooperation. By contrast, failure in Cancun would do to the WTO what the Iraq war did to the UN: Undermine its influence and leave it marginalized.

---

\* Executive Director, OXFAM International.

Responsibility for Cancun's fate resides overwhelmingly in the national capitals of the rich world. When they signed up for a "development round" at Doha in late 2001, industrial countries promised to change policies that hurt poor countries. Acting on this promise will require radical change. Low-income countries account for over 40 per cent of the world's population, but for only three cents in every US\$ 1 generated through exports. At the other extreme, rich countries account for 15 per cent of world population and three quarters of world exports. Globalization built on such inequalities is unsustainable – and it is not worth sustaining.

Fundamental reforms are needed if the WTO is to play a constructive role in making trade work for the poor. In some areas, the institution needs to do much more. If the Doha round is to succeed, rich countries have to eliminate policies that penalize poor countries, including agricultural export dumping and tariff systems that discriminate against imports from developing countries. Such policies are flagrantly anti-poor and, coming from countries that preach free market principles, profoundly hypocritical. WTO rules should prohibit them. It is equally vital that the Doha round produces rules that place the rights of poor people to affordable medicines before the claims of big drugs companies.

In other areas, the WTO needs to do far less. Corporate-driven "mission creep" is at the heart of the institution's crisis of legitimacy. Industrialized countries are using the WTO in an effort to prise open markets for Northern-based transnational companies. The General Agreement on Trade in Services (GATS), and efforts to force new issues – investment, trade facilitation, competition, and government procurement – on to the Doha agenda are prime examples of mission creep inspired by corporate lobbying.

Reform of agricultural trade is one of the most important challenges facing the Doha round. More than three-quarters of the world's poor – some 900 million people – live in rural areas, most of them working as small-scale farmers. The EU and the USA, the world's farm-subsidy superpowers, promised in Doha to cut agricultural export subsidies. Since then, both the EU and the USA have done exactly the opposite, increasing subsidies to their biggest producers.

*Northern governments now spend US\$ 1 billion a day on agricultural subsidies. Amounting to six times their spending on aid, these subsidies generate large surpluses that are dumped on world markets at prices bearing no relation to production costs.* From cotton farmers in West Africa to corn farmers in Mexico, millions of producers in developing countries receive lower prices for their products and get pushed out of markets as a result of agricultural dumping. The livelihoods of the world's poorest farmers are being systematically destroyed by subsidies for its richest farmers.

There remains an acute danger that WTO patent rules (the TRIPS agreement) will make vital medicines unaffordable for people living in poverty. At Doha, while trade ministers agreed to change WTO patent rules to improve access to cheaper generic drugs, rich countries, led by the USA, have been using negotiations over the exact wording to block a meaningful solution. For developing countries, this broken promise is the most glaring sign that development still takes second place to the narrow commercial interests of the powerful nations. If trade ministers genuinely want to help the sick and dying, and restore some legitimacy to the WTO, they should admit that TRIPS is fatally flawed and start fixing it.

Improved market access is a vital part of making trade work for poor people. Export growth is not a guaranteed route to poverty reduction. The benefits can (and often do) bypass the poor and cause environmental damage. But linked to domestic policies that extend opportunities to poor people, trade has the potential to act as a powerful catalyst for poverty reduction. The problem is that rich countries like to preach free trade and then use protectionist policies to deny opportunities to poor countries. Taking these double standards to their logical conclusion, the same countries are using the WTO to demand rapid import liberalization in developing countries, ignoring their special needs and



circumstances. Viewed from the developing world the guiding principle for rich country behaviour can be simply summarized: “Do as we say, not as we do.”

*Developing countries exporting to rich ones face trade barriers four times higher than those faced by industrialized countries – and goods produced by the poorest people face the highest import barriers of all.* Shirts produced by Bangladeshi women enter the US market at a tax rate some 20 times higher than that imposed on goods imported from Britain. Viet Nam – a country with 23 million people in poverty – pays more in US customs duties than the Netherlands, despite accounting for a far smaller share of imports. To add insult to financial injury, rich countries impose higher taxes on processed goods than on raw materials. This hampers efforts by developing countries to add value locally and diversify out of poverty. Eliminating import restrictions on textiles and garments alone could generate as many as 27 million jobs in developing countries, many of them for women workers.

Most systems of taxation start from a simple principle of graduation: the more you earn, the more you pay. The trade taxes of rich countries turn this principle on its head. They impose the highest tax rates on the world’s poorest countries, reserving their most punitive tariffs for goods produced by the poorest people in those countries. Were rich countries to base their income-tax systems on the same principles as their trade policies, single mothers on low income would be facing the highest tax rates, while corporate executives would operate in a virtually tax-free zone. For example, trade taxes paid by Bangladesh when exporting to the USA are fourteen times higher than those paid by France, despite the fact that average French incomes are fourteen times higher than those in Bangladesh.

Some Northern governments defend protectionism in manufacturing and agriculture by reference to the interests of poor people at home. That defence is specious. High tariffs on low-cost clothing imports act as a tax on poor consumers. *And under the Common Agricultural Policy, an average European family pays more than US\$ 1,000 each year, directed not towards Europe’s many struggling farmers but towards the richest farmers and agribusinesses.*

Rolling back the corporate agenda should be a major priority in the Doha round. *The EU should abandon its reckless pursuit of the so-called “new issues” agenda, under which it is pressing poor countries to accept uncontrolled foreign investment.* WTO negotiations in this area will lead to rules that developing countries do not want, do not need and cannot afford. It will also overload an already overcrowded agenda.

This paper looks briefly at the background to the Doha round and then examines four issues that will be critical in judging success or failure in Cancun: agriculture, patents and public health, market access and investment. It suggests the following key benchmarks for success:

#### *Agricultural dumping*

- A prohibition on all forms of direct and indirect agricultural export subsidies, including export credits by 2005;
- An “early harvest” commitment to immediately phase out all subsidies that generate surpluses and finance export dumping in cotton and other products of interest to developing countries; and
- Developing countries should retain the right to restrict imports in the interests of poverty reduction and food security.

#### *Patents and public health*

- No restrictions on the export of cheap generic versions of new drugs to developing countries, in line with Doha commitments; and
- WTO patent rules should be reformed to give developing countries greater freedom to decide when to introduce high levels of patent protection for medicines, on the basis of their public health and development needs.

*Market access*

- Duty-free and quota-free access in industrialized countries for all low income countries;
- Average industrial-country tariffs on developing country imports no higher than for developed countries; and
- Immediate phasing out of textile and garment quotas and a 5 per cent ceiling on tariffs.

*Investment*

- Removed from the WTO agenda;
- Existing OECD Guidelines for Multinational Enterprises to be strengthened;
- WTO rules on investment reformed to allow the imposition of export and local content requirements on foreign investors; and
- A moratorium on the GATS negotiations until the implications of the agreement for development are properly assessed.

# Voluntary and Private Standards: Entry Barriers or Stepping-Stones towards Upgrading within Global Value Chains

Stefano Ponte\*

## Introduction

Trade liberalization is held in contemporary development circles as one of the key ways of alleviating poverty and stimulating economic growth in the South. This “vision” is based on two observations: (1) between 1983 and 2000, the value of world merchandise exports has almost quadrupled; and (2) trade is an important revenue base for developing countries – especially as aid flows decreased by almost one quarter between 1990 and 2000 (OECD/DAC 2002). Yet, trade liberalization provides better opportunities for some countries (and groups within countries) than for others. The Republic of Korea, Mexico and China, to mention a few countries, have been able to increase their export flows not only of labour-intensive goods, but also of high-technology products. Yet, most low-income countries still depend heavily on exports of primary commodities and manufactures, which have lagged behind the growth of global income (UNCTAD 2002). As a result, low-income countries still account for only 3 per cent of income generated through exports in the global economy.

International trade liberalization – through successive rounds of the General Agreement on Tariffs and Trade (GATT) and the establishment in 1995 of the World Trade Organization (WTO) – was supposed to open new trade opportunities for developing countries. The record in achieving this objective has been uneven. While tariffs and quantitative restrictions on trade have been lowered or eliminated, government subsidies to producers, processors and exporters in developed countries (especially in agriculture) have remained at high levels. Furthermore, barriers of different nature have become increasingly important in restricting trade, especially anti-dumping and safeguard measures, sanitary and phyto-sanitary requirements (SPS)<sup>1</sup> and technical standards (Henson and Loader 2001, p. 85).

The debate surrounding the protectionist effects of tariffs and quantitative restrictions to trade has produced a large literature. There is also considerable interest within the global policy community in theoretical, empirical, and policy-oriented work on the impact of standards on trade – especially in relation to developing countries. However, most of the available research focuses on *mandatory* technical standards adopted in developed countries. The role of *voluntary* and *private* standards that are used to certify products or production processes, define labels, and set codes of conduct has received less attention.

---

\* Senior Researcher, Danish Institute for International Studies.

1 Sanitary and phytosanitary measures are designed to: (1) protect human or animal life from risks arising from additives, contaminants, toxins or disease-causing organisms in food; (2) protect human life from diseases carried by plants and animals; (3) protect animal and plant life from pests, disease or disease-causing organisms; and (4) protect an importing country from the entry, establishment or spread of a pest (see Oyejide et al. 2000, p. 3).

**Table 1. Standards typology and examples in agro-food industries**

<i>Typology of standard</i>	<i>Sub-typology</i>	<i>Main aspect(s) covered</i>	<i>Selection of standard(s)</i>	<i>Brief Description</i>
Mandatory	regulation requiring conformity to SPS Agreement	food safety, labelling, quality	EU and US food safety and labelling regulation (FDA, EFSA)	Standards mandated by law; now include food safety HACCP procedures on imported foods
	regulation requiring conformity to Articles 22-24 of TRIPS Agreement	protection of geographical indications	EU and US regulation on geographical origin	Rules restricting the naming of products which characteristics are essentially attributed to conditions available in its geographical origin (i.e. wine, spirits and cheese appellations)
	regulation requiring conformity to TBT Agreement	environmental protection	EU and US regulation	Rules on packaging, recycling of materials, product and process methods
Voluntary	international standards	food safety	Standards set by Codex Alimentarius	Commission created by FAO and WHO to develop universal food standards and guidelines
		environmental protection	ISO 14000	Standard on environmental impact formulated by the International Standardization Organization
		quality management	ISO 9000	Standard on quality management systems
		socio-economic conditions	SA8000	Universal social accountability standard for companies interested in auditing and certifying labour practices in their facilities and those of their suppliers and vendors
	Model codes of conduct	food safety	EUREP-GAP	Good agricultural practice certification for fruit and vegetables; aims at reducing the risks of food safety lapses in agricultural production
		environmental protection	EU Eco-Management and Audit Scheme (EMAS)	Voluntary management tool devised by the European Commission for companies and other organizations to monitor and improve their environmental performance
		socio-economic conditions	Ethical Trade Initiative (ETI)	Code of conduct for good labour standards; includes the observance of ethics code provisions and standards for ethical sourcing
	Labels	environmental protection	Marine Stewardship Council (MSC)	Label rewarding environmentally responsible fishery management and practices
		environmental protection	Organic certification	Label awarding production management systems that promote and enhance biodiversity and soil activity
		socio-economic conditions	Fair trade	Label awarding a minimum guaranteed price to producers matching a series of socio-economic and labour standards
Private	quality conventions	protection of geographical indication, quality	Appellation systems	Schemes facilitating the enforcement of intellectual property rights related to geographic indications of origin and truth in labelling
	Private codes of conduct	product quality socio-economic conditions & environmental protection	quality requirements, sourcing systems, preferred supplier schemes	Standards developed and monitored internally in individual companies with the aim of matching quality, socio-economic and/or environmental goals

This paper focuses on how national-level public policy, cooperation efforts at the regional and international levels, and technical assistance could address the *de facto* trade barriers erected by standards, procurement systems and performance parameters that are set for the most part outside the realm of national and international regulation. Examples are mainly provided in relation to agro-food industries (see Table 1). However, these examples provide significant insights that are applicable to manufactures as well. Essentially, the analysis of private and voluntary standards provides a scenario of the market access challenges that developing country farms and firms may face when (and if) tariff and technical trade barriers are lowered through multilateral, regional and bilateral liberalization processes.

## Standards: key concepts and issues

*Standards are agreed criteria . . . by which a product or a service's performance, its technical and physical characteristics, and/or the process, and conditions, under which it has been produced or delivered, can be assessed.*

*Nadvi and Wältring 2002, p. 6*

The evolution of the role of standards in shaping access to international trade has to be understood in relation to two changing global “environments”. First, a business environment defined by spreading of global value chains, corporate financialization, the principle of “shareholder value”,<sup>2</sup> and more or less serious attempts at incorporating environmental and socio-economic concerns in codes of conduct and criteria of supply chain management. Second, in relation to agro-food industries, a consumer environment that is characterized by food safety awareness, focus on health and diet, globalization of consumer tastes, and social and environmental concerns. This, together with market saturation for goods with “commodity” traits, has led to product proliferation and differentiation. It has also been accompanied by an increased importance of issues of quality control, “field-to-fork” custodial tracking, and certification requirements in relation to the ecological and socio-economic impact of production processes.

Heightened food safety, social and environmental concerns in developed countries, together with product proliferation and specialization, has led to the increasing importance of the evaluation of credence (rather than search or experience) attributes of products, such as more complex aspects of food safety, worker conditions and authenticity of origin.<sup>3</sup> This has translated into standards that focus (sometimes exclusively) on production and process methods rather than on the product. In other words, in the world of “mass consumption” of relatively homogeneous commodities, standards created economies of scale and facilitated the creation of futures markets (Daviron 2002). In the current situation, characterized by more affluent consumers with varied tastes and by production, processing and distribution technology that allow product differentiation and market segmentation, standards are also proliferating and becoming more specific (Giovannucci & Reardon 2001; Reardon et al. 2001).

In this paper, standards are analyzed through a classification in three broad categories: mandatory, voluntary and private. Standards are *mandatory* when they are set by governments in the form of

- 
- 2 Corporate financialization refers to the rise of institutional investors, such as pension funds and investment trusts, and a broadening popular participation in corporate shareholding that has taken place from the 1980s onwards (see Froud et al. 2000). The principle of “shareholder value” refers to prescriptions promoted within the business community for corporations to best take advantage of these developments, particularly the prioritization of strictly financial objectives – such as the attainment of high levels of post-tax return on capital employed (see Gibbon and Ponte 2003).
  - 3 Quality standards communicate information about the attributes of a product. These attributes can be classified depending on the ease with which they can be measured. Search attributes are those that can be verified at the time of the transaction (the color of a coffee bean, for example). Experience attributes can be assessed only after the transaction has taken place (the taste of brewed coffee). Credence attributes cannot be objectively verified and are based on trust (whether coffee is organic) (Tirole 1988).

regulation. These may affect trade flows by placing technical requirements, testing, certification and labelling procedures on imported goods (Wilson 2001). Governments can rely on standard enforcement through *ex post* liability rules that allow punitive damages to be awarded to the buyer in case of non-compliance, or they can adopt *ex ante* measures – such as requiring information or banning a product not matching technical standards from being imported (Caswell & Henson 1997). Although mandatory standards are a key feature of agro-food trade, they are often overshadowed by even stricter, multiple, and often-changing requirements set by multinational corporations or industry associations. These can take the form of voluntary and/or private standards.

*Voluntary* standards arise from a coordinated process in which key participants in an industry or sector seek consensus. Some are set in formal international institutional settings (e.g. through the International Standardization Organization of Codex Alimentarius – see Table 1). Others, such as eco-labels, are introduced as a response to consumer requests (Grote and Kirchoff 2001, p. 6) or, as in the case of fair trade labeling, a result of initiatives by non-governmental organizations (NGOs). Sectoral or industry associations can also establish voluntary standards that apply to their members. Voluntary standards are usually verified through third-party auditing. *Private* standards are developed internally by individual enterprises. In some cases, they may be monitored externally or audited.

The distinction between mandatory, voluntary and private standards, however, is becoming increasingly blurred. Although voluntary standards are not mandatory by rule, some of them (such as the ISO 9000 standards on quality management) have become *de facto* mandatory standards, meaning that they are required for producers if they want to compete globally. The distinction between private and voluntary standards is also to some extent arbitrary, as many private enterprises borrow parts of voluntary standards when designing their own. Adherence to voluntary and/or private standards is often a pre-condition for the acceptability of products by consumers and/or distributors. Moreover, insurance companies may request compliance with standards to reduce product liability exposure. Voluntary standards may also be incorporated in regulation (Zarrilli 1999).

### **Standards and global value chains: Issues of governance and upgrading**

Global value chain (GVC) analysis seeks to outline the limits of firm-to-firm learning and upgrading within specific industries and in relation to specific export markets. At the same time, it highlights the limitations of state-centric analyses of international trade and economic restructuring (see among others, Gereffi 1994; Gereffi et al. forthcoming; Ponte 2002 a). One of the ways in which it does so is by analyzing the role of “private forms of governance” and the role of standards in shaping trade flows and the possibilities for upgrading (see Messner 2002; Ponte 2002 b).

As highlighted in Nadvi and Wältring (2002), Gibbon and Ponte (2003), and Wilson and Abiola (2003), standards are important for developing country farms and firms because they determine access to specific segments of the market (e.g. in defining forestry products that are “sustainable”), to specific countries (e.g. through regulation on food safety and technical requirements) and the terms of participation in global value chains (e.g. through matching quality standards). On the one hand, standards set entry barriers for new entrants in a value chain, and throw new challenges to existing developing country suppliers. On the other hand, the challenge of rising standards provides the opportunity for selected suppliers to add value, assimilate new functions, improve their products, and even spur new or enhanced forms of cooperation among actors in a specific industry or country (Jaffee 2003). Standards may also be seen as improving the efficiency of value chains by providing a set of common benchmarks transmitting information on product characteristics, thus lowering transaction costs (Reardon et al. 2001; Nadvi and Wältring 2002). However, the efficiency argument does not hold when suppliers have to match multiple and often-changing sets of standards – depending on the market niche, country of destination, and kind of certification.

Standards can arise as result of pressure from NGOs (in relation to working conditions, environmental impact, “fairness” of trade), or as initiatives by corporations that seek to build up consumer

confidence, differentiate their product and service offering, and/or reduce the costs of monitoring (Nadvi and Waltring 2002). If corporations are pressured by NGOs to adopt a certain set of standards, then they have all the interest in seeing their particular set of standards becoming global in its application. The engine behind the formation of these standards are private policy networks (of NGOs, unions, corporations) that tend to reach agreements on the model of collective bargaining (Messner 2002, 28). However, this does not mean that governments are not influential in the process of standard formation and acceptance, especially when food safety is concerned (and especially in the EU). Furthermore, governments are increasingly active in “private standards networks” as facilitators in the bargaining process (the UK government was active in the formulation of the Ethical Trade Initiative; the German government is facilitating the writing of a code of practice on sustainability in the coffee sector). In these cases, however, governmental action is often accompanied by NGO “mediation” with the private corporations that are most influential in a particular sector.

In a sense, these standard setting initiatives are “public-private” only to the extent that the “government seal” provides them with a certain level of legitimacy. We can then conceptualize standard setting processes as new forms of “social contract” where the state, rather than being directly involved between parties, provides a form of lax guarantee while (more or less accountable) NGOs are in charge of hammering out the bargains. Thus, if in the age national capitalism labour unions (and perhaps the church) generated normative framework in which the market was embedded, in the age of global capitalism, new actors (such NGOs) provide the normative framework that “socially-responsible” corporations use for social legitimation. On the basis of these observations, we can argue that standards are key elements of governance because they allow corporations to adopt forms of coordination that reduce their transaction costs, and, at the same time, enhance the legitimacy of their “leadership” position in a value chain (see also Messner 2002, p. 32).

Standards are also a key factor in upgrading trajectories. They keep actors out of global value chains. At the same time, they can stimulate national-level business or industry associations to cooperate to find solutions to new challenges (see the example of Kenyan horticulture in Jaffee 2003). Upgrading is then not only linked to building up competitiveness in the classic parameters of competition (time, price and quality) but also to the ability of matching products and production processes to the demands of global quality, safety, social, and environmental standards (Messner 2002; Ponte 2003).

### **Standards in sustainability and ethical trade initiatives**

Standards can be set up to specify technical characteristics of a product, specific process and production methods, quality traits, and safety. Increasingly, they also include specifications relating to environmental impact, animal welfare concerns, and labour conditions. This is most clear when one analyses certifications and labels used in so-called “sustainable” or “ethical” trade – that is forms of trade that seek to be socially, environmentally, and economically responsible (Tallontire et al. 2001). Ethical consumerism is a growing phenomenon that has motivated ethical business practice, together with the increasing vulnerability of brands to reputation problems, which may lead to stock value losses. Many businesses adopt ethical practices because they think that is what consumers want. The globalization of food sourcing and foreign travel have resulted in more adventurous consumers, and in consumers who ask more questions about the source of the products they purchase. This has led to the proliferation of ethical trade schemes and of standards that define them. Examples of these schemes are fair trade, codes of practice of enterprises, eco-labels, forest and fisheries certification, and ethical sourcing initiatives of major retailers and brand owners. Unfortunately, many sustainable and ethical trade schemes are driven by developed country consumers and business, rather than developing country producer opinions or priorities.

Sustainable and ethical trade initiatives can be usefully distinguished in two broad categories: (1) enterprise initiatives; and (2) certification and labelling procedures. Among *enterprise initiatives*, the most common instrument for showing ethical responsibility is the adoption of “codes of practice”, which define the criteria for measuring company performance against a set of ethical objectives.

These codes may be developed by individual companies or draw from model codes, such as the “Code of Labour Practices for the Apparel Industry” by the Clean Clothes Campaign, or the “The Charter of the Safe Production of Toys” by the Hong Kong Coalition. Unfortunately, as Blowfield (1999, 758) argues, “too many codes are launched with a fanfare of publicity in the West, yet are ‘unknown, unavailable or untranslated’ in the developing country sites of operation.” Compliance is rarely reported upon, and independent verification is the exception rather than the rule. Too often, these initiatives are cases of “a launch, a lunch and a logo” (ibid.). Furthermore, companies that develop their own code can pick and choose which standards to adopt without consulting the so-called beneficiaries. Finally, if enterprise initiatives do not earn a premium to suppliers or higher wages to workers, then they simply become a further requirement to access a market segment (du Toit 2002, p. 371).

*Certification and labelling procedures* are used as a means of communicating information on the social or environmental conditions surrounding the production of goods or the provision of services. Examples of these are the Fairtrade label, organic certification, and the Forest Stewardship Council initiative, which certifies landowners matching a series of criteria for sustainable forest management. Labels can help by setting common standards for certain sectors and help prevent confusion among consumers. They generally ensure better stakeholder representation in the negotiation of standards than enterprise initiatives. However, participation to the setting of criteria may not amount to much – especially when the label is controlled by an industry association or by an organization with close links to a particular company (Blowfield 1999; du Toit 2002).

While sustainable and ethical trade schemes have created new opportunities for their beneficiaries, there is evidence that there have been negative impacts among those who are unable or unwilling to participate. In some cases, consumer concerns have even had negative consequences on their “beneficiaries”.<sup>4</sup> It is also clear that these schemes have been weak in targeting certain disadvantaged groups and regions (Ponte 2002b; 2003). Finally, stakeholders have rarely been able to influence codes of practice and labels, with the result that they do not address all of the priority issues for workers and smallholders (du Toit 2002).

### **The role of public policy and technical assistance: general guidelines, institutional setups and forms of support**

Farms and firms in developing countries face at least three layers of challenges in participating in specific global value chains and therefore in gaining access to developed country markets: (1) tariff barriers; (2) non-tariff barriers – including standards and technical requirements embedded in regulation; and (3) mandatory and private standards. So far, public policy and technical assistance efforts have focused on the first two layers. The few efforts that have been carried out in the realm of standards have focused mainly on mandatory standards. The rest of this paper provides a preliminary framework indicating general guidelines, institutional setups, forms of support, and the role of research in helping developing country governments, industry associations, farms and firms to match voluntary and private standards.

Policy and technical assistance support in this realm should be directed towards two general objectives:

1. Develop capacity in developing countries to participate in standard setting and revision, to comply with existing standards, and to set up local certification and auditing systems; and
2. Minimize the discriminatory impacts of standards on different groups of farms/firms/workers, among different actors along a value chains, between countries with different levels of capacity, and among different regions.

---

4 For example, King & Marcus (2000) show how consumer concerns on child labour in East Asian clothing factories led to many children losing their jobs and ending up in more dangerous occupations on the street.



Government regulation can have only limited impact on private and voluntary standards. However, public policy and technical assistance can be instrumental in addressing some of the discriminatory effects of standards, and in helping private actors and industry associations in developing countries to gain access to global value chains. The key questions that should guide support for developing countries are the following:

1. Who defines the standards?
2. Who decides the content?
3. Who defines the measurement methods?
4. Who pays for the costs of compliance, monitoring and verification?
5. Who captures the benefits?

Or, in more macro terms:

1. Are standards eroding the comparative advantage of developing countries?
2. Are they marginalizing smallholders, small and medium-sized enterprises (SMEs) and/or poorer countries?
3. How can standards be used as a tool for stimulating learning and as a launch-pad for upgrading?

Cooperation at the national, regional and international levels on voluntary and private standards should be structured so as to:

1. Promote coordination, harmonization and/or equivalency of voluntary standards to avoid unnecessary duplications and therefore higher costs (that are eventually passed on to producers);
2. Ensure that the voices of developing country actors (especially smallholders and SMEs) are heard in relation to the appropriateness and the costs/benefits arising from such standards;
3. Coordinate efforts in raising funds for technical assistance;
4. Promote the concept that the extra efforts that are entailed in matching higher standards should yield extra incomes to producers, processors and traders – rather than being an extra demand to be matched at the same price; in other words, the “race to the top” entailed in matching higher standards needs to yield concrete results for local actors.

### *Information, transparency and participation*

Private standards are set and enforced within individual firms with minimal levels of transparency. In global value chains where these private standards are prevalent, “standard setters” tend to use them to extract concessions and better terms from their developing country suppliers. This happens even in value chains where voluntary standards are important because they are often set with limited participation from developing country governments, producers, processors and traders. In short, in most value chains, developing country actors are “standard takers” and thus have limited bargaining power. Yet, the lack of information on standards and participation in their setting can be addressed in various ways:

1. Setting up and/or coordinating “information clearinghouses” on voluntary and private standards;
  - a. This could be carried out at the national level (e.g. through the Bureau of Standards or industry associations – where applicable), at the regional level (e.g. establishing standards coordination offices linked to regional organizations), and internationally (e.g. through “honest and impartial broker” institutions such as the Consumer Choice Council in the USA).
2. Promoting developing country participation in voluntary standard setting where participation is open at least in theory (some international standards, model codes of conduct and labels); funding could be provided for:
  - a. Government officers and local industry actors to participate to meetings where standards are discussed (not only in ISO and Codex, but also in relation to initiatives such as EUREP-GAP, ETI, FSC, etc.); funding and information needs could be supported at various levels through the institutions mentioned above;
  - b. Generating research results and training personnel in view of formulating science-based positions to increase bargaining power in negotiation processes.

3. Lobbying efforts could be carried out by the same institutions to promote:
  - a. More transparency and participation in standard setting processes where they are not open to developing country actors; the same could be achieved in relation to private standards by convincing corporations to use sectoral standards or codes of conduct rather than strictly private ones;
  - b. Standard setting processes that take place in multi-stakeholder fora – where Northern and Southern actors can both participate, and where government agencies and civil society actors can provide a mediating role; and
  - c. The principle of minimizing duplications among different certification systems and push for harmonization in order to avoid multiple demands and higher costs for developing country actors.

### *Criteria for coordination*

Coordinating voluntary standards and, even more, private standards is a particularly challenging task. Each industry, NGO, and company has its own interests and goals when it establishes or uses a particular set of standards. The most viable form of coordination in the case of private standards is to promote, within specific industries, one (among the many emerging) set of standards that can be adopted by individual companies – on the basis of which modifications can be made to tailor individual situations. Another aspect that needs to be addressed in relation to private standards is the issue of accuracy of claims, especially in areas where there are no universally recognized standards. In relation to voluntary standards, coordination efforts should be undertaken to avoid duplication. This can be achieved in three steps of increasing difficulty:

1. Facilitating *multiple certifications*
  - a. In the coffee sector, for example, the most common and successful of these has been the double organic and fair trade label;
  - b. Because separate certifications can be combined in numerous ways, they can achieve more flexibility and cater for a variety of different end-markets.
2. Creating *umbrella certifications*
  - a. This could be developed on the basis of the principle of equivalency; different certification agencies would use their own criteria but agree on a set of common principles that should be respected within each individual certification. This option allows for more flexibility in matching different local criteria, and at the same time, provides a common framework of reference.
  - b. Yet, different certifications adopt standards that focus on one area more than another, and it may be difficult to find common ground. The history of certification initiatives in agro-food industries suggests that it will be difficult to bring together initiatives that have established their own individual “image” and may be suspicious of each other.
3. Promoting standards *harmonization*
  - a. Harmonization is based on the idea that one set of criteria is used for the definition of all aspects covered in the standards system. This is very difficult to achieve in voluntary standards, especially for those that are not developed under the auspices of an international organization.

### *Capacity building*

Complying with new or improved standards involves investment in upgrading products and processes to match quality and performance parameters, improve reliability, and conform to certifications. Public policy and technical assistance can have a supporting role for this to happen. Possible actions include:

1. Setting up industry- or national-level fora for the discussion of voluntary and private standards, with the participation of government agencies (national laboratories, bureaus of standards, trade and industry ministries), business and industry associations, auditing and certification firms, civil society groups working on issues of sustainable trade, and private actors.
2. Developing guidelines within these fora to help:
  - a. Government agencies to supply support services and ensure that standards conformity and national-level development strategies are not in contradiction with each other;
  - b. Government agencies and industry associations to formulate export and investment strategies that take into consideration the challenges and opportunities provided by changing standards.
3. Setting up national and regional level public-private institutions dedicated to capacity building in standard conformity. These could be the same that provide information clearinghouses as discussed above, or could be linked to them. Their tasks would be:
  - a. Providing credit facilities to help private actors in matching the costs of compliance so that they can gain access to (or improve returns in) specific value chains, end-markets, and market segments;
  - b. Providing technical training to improve understanding among government agencies, industry associations and private actors of the content of private and voluntary standards (training of trainers);
  - c. Studying ways of reducing certification costs – including facilitating the setting up of local certification systems and their accreditation to international bodies or mutual recognition;
  - d. Supporting the coordination, simplification (and possibly the harmonization) of certification procedures;
  - e. Developing national and regional standards that are not as stringent as international (or developed country-based) ones and are better matched to local situations; these standards could be used as “stepping stones” towards meeting more demanding standards;
  - f. Promoting regional harmonization to increase the economies of scale in matching “stepping stone” standards; in time, these standards should be tightened and efforts should be made to have them recognized as equal to developed country-based ones or to design them in ways that they eventually match international standards;
  - g. Supporting the establishment (or upgrading) of laboratories, metrology and testing facilities that can provide support services to local industries in matching standards – either through market mechanisms (as is often the case in the provision of certification and auditing services) or through “public-private” ventures;
  - h. Funding activities that strengthen local capacity in risk assessment and scientific and policy research;
  - i. Promoting direct contact between exporters and importers.

*Super partes, regulatory and compensatory functions*

Standards raise entry barriers, which are more pronounced for smallholders and SMEs than for larger enterprises. Technical assistance is one of the ways of ensuring compliance with new standards. Yet, the coverage of technical assistance is spotty, sometimes politically motivated, and tends to concentrate in areas that are less disadvantaged and more likely to show “success”. Technical assistance also tends to be “reactive” (filling the gaps after they arise), while developing country industries need to be “pro-active”. International, regional and national-level public institutions have an important role in promoting initiatives that address discrimination arising from standards. They can also act as guarantors against misleading claims, and in providing a regulatory and legislative framework for the enforcement of standards. Also, public regulation may have an important role in achieving recognition of the content of certification and to ensure the validity of claims made under it. Activities within this group of functions include:

1. Monitoring misleading claims in certification and labelling initiatives and setting up a public register publicizing possible breaches (name and blame).

2. Funding research assessing the impact of standards on equity and discrimination and publicizing their results; this can be done in relation of the impact of standards on:
  - a. Smallholders and SMEs vs commercial farms and larger enterprises;
  - b. Developed country vs developing country producers, processors and traders;
  - c. Richer developing countries vs low-income countries; and
  - d. Different regions (e.g. Latin America vs Africa).
3. Monitoring whether costs and benefits arising from compliance with certifications are distributed fairly along the value chain, and whether additional costs are balanced by benefits – especially where the marketers of these initiatives make claims on “sustainability”;
4. Advising businesses and industry associations in developed countries on how to draw up non-discriminatory standards;
5. Designing “standards for standards” in terms of procedures for standard setting, monitoring and revision, and researching and publicizing “best practices”;
6. Devising compensatory actions when discrimination takes place through capacity building efforts that target disadvantaged groups/regions, or by seeking redress “at source” (via lobbying efforts with standard setting/revision bodies). A few examples in this realm of activities include:
  - a. Promote linkages between SMEs and larger exporters to facilitate learning in relation to standards;
  - b. Promote certification systems that are “friendly” to smallholders and that provide a premium;
  - c. Target standard and upgrading credit facilities towards SMEs and smallholder groups or cooperatives;
  - d. Provide training and organizational assistance for cooperatives, smallholder associations and SMEs;
  - e. Facilitate direct marketing between these organizations and buyers in consuming countries or importers.
7. Strengthen the legal framework on standards, metrology, certification and labeling by:
  - a. Streamlining the roles of different agencies that monitor, certify and enforce standards; and
  - b. Updating and enforcing regulations in relation to standardization, accreditation, metrology and quality assurance.

### *Funding sources*

Developing countries, and especially low-income countries, are particularly affected by the rising importance of standards as potential trade barriers because of their institutional weaknesses. Low domestic standards make it difficult for producers to upgrade to the increasing levels of standards set by importing countries or enterprises. Yet, commitments in WTO agreements to support developing countries with technical assistance on standards are vague and not mandatory. Even less is being done in relation to matching voluntary and private standards. Also, technical assistance is usually provided after the problems of compliance arise, rather than being part of a capacity building strategy. Funding for standards-related activities (including research) aiming at benefiting developing countries’ actors should be increased and better coordinated. Increased support should be provided through a multi-pronged approach that builds upon existing initiatives.

1. UNIDO, in addition to its own initiatives, could consider participating in the Standards and Trade Development Facility (a World Bank, WHO, FAO, OIE partnership). This recently-established facility concentrates on agro-food industries and has a limited budget (US\$ 300,000 in 2003); its scope and strength could be improved by coordinating efforts between agro-food and manufacturing industries in standards activities.

2. The development of “information clearinghouses” for private and voluntary standards could be sought in connection to the Doha Development Agenda Trade Capacity Building Database that was launched in November 2002 by WTO and OECD.
3. Support for standards-related capacity building could be sought within other trade-related multilateral trust funds and programmes, such as:
  - a. The Doha Development Agenda Global Trust Fund (DDAGTF);
  - b. The Integrated Framework for Trade-Related Technical Assistance to Least-Developed Countries (IF);
  - c. The ITC South-South Trade Promotion Programme (in relation to the development of “stepping stone” regional standards); and
  - d. The Joint Integrated Technical Assistance Programme (JITAP, phase II) (for selected African countries).

### *The role of research*

Research activities should be an integral part of capacity building and standards-related activities in the realm of trade facilitation. Little research has been done in this realm so far to provide highly needed and relevant information to policy-makers in developing countries and to donor agencies. In order to do so, new research efforts should be undertaken to answer the following questions:

1. Are developing countries able to participate meaningfully in the setting of standards?
2. Which kinds of standard setting mechanisms are more transparent and participatory? What can we learn from the case studies where wider participation has been attempted and/or achieved?
3. In specific sectors and countries, how important is the impact of various kinds of standards in affecting trade flows? Under what circumstances?
4. Are standards the reason potential exporters choose not to enter some markets? Are there successful cases of capacity building where market access was actually stimulated through trying to match new standards?
5. What are the costs of inspection, testing, and certification procedures? When and how are they discriminatory? What are the compliance costs for developing country institutions, firms and producers?
6. Are voluntary or private standards easier to meet in certain importing countries rather than others (e.g. US vs EU) or for certain sustainable trade schemes than others?
7. What are the consequences of changing standards in terms of distribution of value added along a value chain, vertical integration and other contractual forms of coordination?
8. How do producers and exporters alter their business strategies to accommodate the requirements set in standards?
9. What are the effects of standards on the profitability of producers, processors and exporters in developing countries? Which countries, institutional settings, groups within countries gain and which ones lose when standards change or new standards arise?
10. What upgrading possibilities are opened (or closed) by standards? How can upgrading be facilitated?

## References

- Blowfield, M., "Ethical Trade: A Review of Developments and Issues". *Third World Quarterly*, Vol. 20, No. 4, pp. 753-770, 1999.
- Caswell, J., and S. J. Henson, "Interaction of Private and Public Food Quality Control Systems in Global Markets", in: Loader, R. J., S. J. Henson, and W. B. Traill, (eds.), *Globalization of the Food Industry: Policy Implications*. Reading: Department of Agricultural and Food Economics, University of Reading, 1997.
- Daviron, B., "Small Farm Production and the Standardization of Tropical Products". *Journal of Agrarian Change*, Vol. 2, No. 2, pp. 162-184, 2002.
- Du Toit, A., "Globalizing Ethics: Social Technologies of Private Regulation and the South African Wine Industry". *Journal of Agrarian Change*, Vol. 2, No. 3, pp. 356-380, 2002.
- Froud, J., C. Haslam, S. Johal, and K. Williams (eds.), "Shareholder Value and the Political Economy of Late Capitalism". *Economy and Society*, Vol. 29, No. 1, pp. 1-12, 2000.
- Gereffi, G., J. Humphrey and T. Sturgeon, "The Governance of Global Value Chains". *Review of International Political Economy*, forthcoming.
- Gibbon, P. and S. Ponte, *Africa in the Age of Global Capitalism: Trade Rules, Value Chains and Quality Conventions*. Book manuscript. Copenhagen: Danish Institute for International Studies, 2003.
- Giovannucci, D. and T. Reardon, *Understanding Grades and Standards and How to Apply Them*. Washington, D.C.: World Bank, 2001.
- Grote, U., and S. Kirchhoff, *Environmental and Food Safety Standards in the Context of Trade Liberalization: Issues and Options*. ZEF Discussion Papers on Development Policy No. 39. Bonn: Zentrum für Entwicklungsforschung, University of Bonn, 2001.
- Henson, S., and R. Loader, "Barriers to Agricultural Exports from Developing Countries: The Role of Sanitary and Phytosanitary Requirements". *World Development*, Vol. 29, No. 1, pp. 85-102, 2001.
- King, F., and R. Marcus, *Big Business, Small Hands: Responsible Approaches to Child Labour*. London: Save the Children, 2000.
- Jaffee, S., *From Challenge to Opportunity: Transforming Kenyan Fresh Vegetable Trade in the Context of Emerging Food Safety and Other Standards*. Agriculture and Rural Development Working Paper No. 10. Washington, D.C.: World Bank, 2003.
- Messner, D., *The Concept of the "World Economic Triangle": Global Governance Patterns and Options for Regions*. IDS Working Paper No.173. Brighton: Institute for Development Studies, University of Sussex, 2002.
- Nadvi, K., and F. Wältring, *Making Sense of Global Standards*. INEF Report No. 58/2002. Duisburg: Institut für Entwicklung und Frieden, University of Duisburg, 2002.
- OECD/DAC, statistical database available at [www.oecd.org](http://www.oecd.org), 2002.
- Oyejide, T. A., E. O. Ogunkola, and S. A. Bankole, *Quantifying the Trade Impact of Sanitary and Phytosanitary Standards: What is Known and Issues of Importance for Sub-Saharan Africa*. Paper presented at the workshop on "Quantifying the Trade Effects on Standards and Regulatory Barriers: Is It Possible?". Washington, D.C: World Bank, 27 April 2000.

Ponte, S., "The 'Latte Revolution'? Regulation, Markets and Consumption in the Global Coffee Chain". *World Development*, Vol. 30, No. 7, pp. 1099-1122, 2002(a).

Ponte, S., *Standards, Trade and Equity: Lessons from the Specialty Coffee Industry*. CDR Working Paper No. 02.13. Copenhagen: Centre for Development Research, 2002(b).

Ponte, S., *Standards and Sustainability in the Coffee Sector: A Global Value Chain Approach*. Paper prepared for the Sustainable Commodity Initiative. Winnipeg: International Institute for Sustainable Development, 2003.

Reardon, T., J. M. Codron, L. Busch, J. Bingen, and C. Harris, "Global Change in Agrifood Grades and Standards: Agribusiness Strategic Responses in Developing Countries". *International Food and Agribusiness Management*, Vol. 2, No. 3, pp. 421-435, 2001.

Tallontire, A., E. Rentsendorj, and M. Blowfield, *Ethical Consumers and Ethical Trade: A Review of Current Literature*. Policy Series No. 12. London: Natural Resources Institute, University of Greenwich, 2001.

Tirole, J., *The Theory of Industrial Organization*. Cambridge, Mass.: Massachusetts Institute of Technology Press, 1988.

UNCTAD, *Trade and Development Report, 2002*. Geneva: United Nations Conference on Trade and Development, 2002.

Wilson, J. S., *Advancing the WTO Agenda on Trade and Standards: A Developing Country Voice in the Debate*. Paper presented at the African Economic Research Consortium (AERC) – Organization of African Unity Seminar on Trade, Geneva, 8-9 March, 2001.

Wilson, J. S. and V. O. Abiola (eds.), *Standards and Global Trade: A Voice for Africa*. Washington, D.C.: World Bank, 2003.

Zarrilli, S., *WTO Sanitary and Phytosanitary Agreement: Issues of Developing Countries*. Geneva: South Centre, 1999.

## Annex.

### ***Box 1: Standards in the Kenya-UK fresh vegetables industry***

In response to consumer concerns, especially within the EU, there has been a wave of regulatory and legislative activity on food safety in the last decade, and the emergence of numerous codes of conduct (EUREP-GAP, ETI, etc.). The 1990 Food Safety Act in the UK, for example, stipulated a requirement of “due diligence” for food producers, traders and retailers. In the event that a company faced a food safety problem, it would have to prove that it had made an active effort to avoid the problem, not only when the product was in its possession, but also further upstream in the value chain. This meant, in practice, that supermarket chains needed to monitor their suppliers, keep records of the origin of the food they buy, and monitor the conditions under which it has been produced and traded. In time, supermarket chains have devised private standards and sectoral codes of conduct that go well beyond what was required by the legislation. In the process, they have also outsourced a number of functions that were previously performed “in-house”. While most horticultural products were sold in bulk to wholesale markets in the UK in the 1980s, currently supermarket chains source individual items from a small number of importers. These importers have pushed some functions further upstream (including washing, grading, packing and even bar-coding). Evidence from Kenya suggests that these functions have been picked up by exporters that source mainly from their own farms or large commercial farms – rather than groups of smallholders. At the same time, the challenge of new standards is pushing the Kenyan industry to cooperate more intensively, with the result that it has repositioned itself into more value-added segments of the UK fresh vegetable market.

*Sources:* Dolan, C., and J. Humphrey, “Governance and Trade in Fresh Vegetables: The Impact of UK Supermarkets on the African Horticulture Industry”. *Journal of Development Studies*, Vol. 37, No. 2., 2000  
Jaffee, S., *From Challenge to Opportunity: Transforming Kenyan Fresh Vegetable Trade in the Context of Emerging Food Safety and Other Standards*. Agriculture and Rural Development Working Paper No. 10. Washington, D.C.: World Bank, 2003.



**Box 2: The “sustainable coffee” industry**

Voluntary and private standards are not inherently unfriendly towards smallholders and/or SMEs. Yet, they have to be designed carefully to avoid discrimination among actors of different sizes and technological capabilities, and between countries with different qualities of infrastructure. The case study of “sustainable” coffees is illustrative of this point. The concept of sustainability in the coffee industry refers to aspects variously referred to as “economic viability for farmers”, “environmental conservation” and “social responsibility”. Some sustainable coffees are sold as certified coffee, such as “organic”, “fair trade”, “bird friendly”, “Rainforest Alliance”, and “Utz Kapeh”. Others are sold under sustainability initiatives that are designed by private enterprises (e.g. Starbucks preferred supplier system) – with or without third party monitoring. Although these initiatives have good intentions, their impact on local communities varies according to their design. Fair trade coffee, for example, caters specifically to smallholders, pays a minimum price, and stimulates the organizational capabilities of farmers. Organic coffee is “size-neutral” and pays a smaller premium to farmers who have invested in improving farming practices. Many of the other initiatives, while having some benefits (improving shade coverage, guaranteeing minimal labour standards, improving environmental practices) have not offered guaranteed premiums, have been targeted for the most part to large estates, and are active mainly in Latin America. The result is that smallholders (and especially African and Asian ones) are increasingly cut off from a market segment of the coffee industry that has registered fast growth in the last five years.

*Sources:* Ponte, S., *Standards, Trade and Equity: Lessons from the Specialty Coffee Industry*. CDR Working Paper No. 02.13. Copenhagen: Centre for Development Research, 2002.  
Ponte, S., *Standards and Sustainability in the Coffee Sector: A Global Value Chain Approach*. Paper prepared for the Sustainable Commodity Initiative. Winnipeg: International Institute for Sustainable Development, 2003.

## Presentation by Mr. Alan Bryden \*

Thank you Mr. Chairman.

I have been told that this is the first time that the Secretary-General of ISO has been invited to speak at the General Conference of UNIDO. This is a great honour, but it is also a sign of the times. In my professional life, in the past 20 years, in various positions, I have been an actor on the scene of metrology, standardization, certification, accreditation, and related issues. In this time I have seen these topics go from a subject for technicians that had nothing much to do with strategic or economic issues to a stage where they have become a key point in trade agreements and in many other discussions. I therefore think that it is a sign of the times that this subject is on the agenda of your General Conference.

I was reading the background material that UNIDO has prepared. This contained a statement based on recent enterprise surveys reported by the World Bank that the highest non-tariff barriers in both developed and developing countries included performance standards, product quality standards, technical measures, product requirements relating to standards and technical regulations, conformity assessment, labelling and testing, and certification requirements. Well, this is our daily bread in the ISO, and it is our objective that in the next ten years this perception of standards should go from the rather negative appreciation at present to a more positive approach and explanation. Standards are meant to be, and should be seen as, a vehicle for social, technical and economic progress. They should not be seen as a barrier, because they are about sharing knowledge and good practices, and about facilitating relations between economic actors. At least this is the way we perceive it in our organization, the ISO.

At the international level, this subject has come more and more to the forefront. International cooperation and harmonization has therefore, developed extensively in the course of the past decade. The subject has clearly been taken up by the World Trade Organization, and with the agreements on technical barriers to trade (TBTs) and sanitary and phyto-sanitary measures (SPSs) there is a commitment to make reference to international standards for products and to conformity assessment practices. More international cooperation has also taken place on good regulatory practices to implement these principles. In the United Nations Economic Commission for Europe, for instance, a generic model for good regulatory practices has been developed precisely to implement these principles that are advocated in the WTO.

I recently heard in a WTO meeting that there are currently 220 or so free trade agreements being implemented in the world. It is very important that we do not recreate regional fortresses through these free trade agreements by promoting specific regional harmonization, and it is our role to advocate that these free trade agreements should also be a mechanism to encourage the use of international standards and practices.

Our family of international standardization organizations – namely the three Apex organizations: ISO, which I represent; the International Electrotechnical Commission, IEC; and the International Telecommunication Union in its standardization dimension, ITU-T – has come together, and we have formed what we call a World Standardization Cooperation to contribute to the simplification, clarification and harmonization of this very complex world of standards. We are taking a number of initiatives in this regard, in particular in the area of training.

---

\* Secretary-General, International Organization for Standardization (ISO). This text is based on an edited transcript of the spoken presentation.

Metrologists, the reference standards, have also developed closer international cooperation and recognition. The International Bureau of Weights and Measures operates a multilateral agreement of mutual recognition to facilitate the traceability of measurements, which is an indication of the quality and international acceptance of measurements.

We have seen in the past 20 years the development of the concept of accreditation, the recognition through formal procedures of the competence of operators in this area, such as testing laboratories and calibration laboratories. This is the role of ILAC, the International Laboratory Accreditation Corporation, or in the area of certification, of the International Accreditation Forum, IAF. These organizations have progressively developed harmonized procedures and mutual recognition agreements.

So, a lot has happened on the world scene recently, and will certainly help to clarify and penetrate this jungle of standards and certificates.

The area of technical assistance is also gaining importance. Of the 148 national members of ISO, 112 are developing countries or economies in transition. We are therefore very sensitive to the need not only to deliver technical assistance, but also to contribute to optimizing resources in this very complex area. ISO has therefore recently adopted a five-year Action Plan, which is articulated around five key points, which I believe also apply to all the other organizations providing technical assistance at the international level.

First, there is a need to raise awareness, especially in the less developed countries. There are so many social, economic and environmental problems that need to be dealt with in these countries, that they often do not recognize the importance and urgency of making long-term investments in issues related to standardization and conformity assessment. Raising awareness is therefore extremely important to explain why such a long-range investment is necessary to enable these countries to participate in what is going on on the world scene.

The second element is developing capacity. We must be careful not just to transpose models which are used in developed countries. We must adjust what we implement at the national level to the size of the economy, the priorities in terms of development, and the characteristics of the country. Developing capacity thus implies optimizing. For instance, the first priority of a less developed country is not to build a high-tech metrology laboratory that will compete with the most developed countries. It is to have the basic traceability mechanism of whatever calibrations are done in the areas of industry, where that traceability is part of a requirement for quality. As another example, one does not need to build an extensive accreditation system if one has just a few laboratories to accredit. Maybe one would benefit from pooling one's forces and resources with those of one's neighbours or of other countries in one's region. Developing capacity is thus about having the appropriate technical expertise needed to provide the required services and develop the standards that are needed for the development of the country.

From this stems the third element of our priorities, which is to encourage national and regional cooperation. In ISO, we interact with a seven organized regional cooperation organizations in the area of standardization and quality and we consider that such regional cooperation is very important, especially for developing countries. We have our own regional liaison officers.

The fourth point is the use of IT tools. Standardization is about knowledge, and knowledge today is about accessing that knowledge in an electronic format. ISO has developed 40 programmes with countries to give them access to the IT tools that they need.

Last but not least, it is necessary to encourage the participation of developing countries in all of these organizations. We have recently initiated twinning arrangements, and we have a number of representatives of developing countries in our governing bodies.

This is just to introduce what we may expand on later on. Just before this meeting, I signed an important Memorandum of Understanding with the Director-General of UNIDO to enhance and expand the collaboration between UNIDO and ISO in this area. This underlines the fact that we are obvious development partners in this area.

Thank you for your attention.

## Presentation by Mr. Kipkorir Rana\*

Thank you very much Mr. Chairman.

Mr. Chairman, I personally have been very educated by the contributions from the podium, and please excuse me if I will be very simplistic. I want to start by saying that my colleagues on the podium have already done a very good job of explaining the problems which we face in making trade work for the poor, and stimulating the real economy's response. I want to begin by saying simply that WTO, the World Trade Organization, is a rule-based organization: We make rules; our job is to liberalize trade and also to make rules. This is a two-pronged job. We are not really a development agency. In the year 2000, when I used to be Ambassador there, the technical assistance budget was something like 800,000 Swiss francs. As a result of the Doha Development Agenda (DDA) and a push by members, the importance of trade-related technical assistance was recognized and we created a global trust fund into which members have contributed. We now have something like 24 million Swiss francs, with which to try to build capacity.

However, our real job is still making rules for international trade. WTO is an organization and also an agreement, which came about as a result of seven years of trade negotiations, known as the Uruguay Round. This led to the creation of an agreement called WTO, World Trade Organization Agreement.

On a broader level, the DDA aims to tackle obstacles to trade, including the main ones referred to in the papers prepared by the UNIDO Secretariat. I think of tariffs, tariff escalation, tariff peaks on specific sectors, non-tariff measures, including standards, etc., which my colleagues on the podium have done an excellent job at trying to explain. I will give you two examples. First cocoa: 60 per cent of the world's cocoa is produced in Côte d'Ivoire but 90 per cent of the children of Côte d'Ivoire cannot eat chocolate because of tariff escalation. They only export cocoa in raw form because they cannot produce chocolate and will not be able to export chocolates because of tariff escalation, and that way they do not get a good deal. They only export raw materials, and these are some of the problems of trade about which we are trying to negotiate during this Round, the so-called reform of trade in agriculture.

Another example is cotton. In my home town in Kenya there was only one factory, a cotton factory. It collapsed, and nobody knew why it collapsed. People thought it had to do with corruption and mismanagement, but now we are finding out that it had to do with the way international pricing and trade works. It had to do with distortions in trade, subsidies, etc. Our farmers just cannot compete with farmers in other countries where billions of dollars are being put into subsidies for cotton farmers.

These are some of the problems which need to be tackled. With that, I would like to come straight down to the issue of trade-related technical assistance, by which we are trying to make trade work more effectively for the poor and to address the related issues from our side. My department is responsible for development and technical assistance in WTO, and right now we are in the process of negotiating next year's technical assistance plan. The plan is very comprehensive, and it follows a certain logic. It is quality-oriented and is meant to support the building of sustainable human and institutional capacity. It provides a listing of all activities that the Secretariat can undertake, which we have divided into specific products like three-month trade policy courses, regional seminars, national seminars, university programmes and trade policy clinics. The special emphasis of our technical assistance plan is on the present Doha Development Agenda negotiations, and we are giving priority to least developed countries and their needs. We also have some specific programmes in which the

---

\* Deputy Director-General, World Trade Organization (WTO). This text is based on an edited transcript of the spoken presentation.

least developed countries are targeted. One is the Integrated Framework in which we work together with five other development partners – UNDP, World Bank, IMF, UNCTAD and ITC – and try to mainstream trade within the development programmes of the LDCs, and thereby to raise the profile of trade within the development agenda of the LDCs participating in this exercise.

Another programme is the Joint Integrated Technical Assistance Programme, which covers both LDCs and middle-income countries in Africa. Currently 16 such countries are included in the programme, in which we try to build inter-institutional committees within the 16 countries and also try to set up national WTO committees within them so that there is a much more effective participation of both the private and public sectors in formulating the negotiating positions of these countries.

Our technical assistance plan plans what is plannable, but there is much more flexibility in the organization of national seminars. We try to maintain geographical balance and provide coverage across all countries. In those programmes we also try to establish partnership arrangements and work with other agencies in the delivery of TA in order to be able to take advantage of the expertise or comparative advantage of our development partners in the delivery of technical assistance. Recently at Cancun we signed a Memorandum of Understanding with UNIDO, and we initially intend to work in nine countries with on this programme. We have already had a meeting yesterday to try to inform these nine countries how we are going to kick-start the programmes. UNIDO will provide their comparative advantage on issues of standardization and WTO will provide its contribution in the form of information and training on rules. The countries we have initially selected are Armenia, Bolivia, Cambodia, Cuba, Egypt, Jordan, Ghana, Kenya and Mauritania. We hope that this will build on the already good relations which exist between UNIDO and WTO. Similar arrangements also exist with other organizations, and we have had very positive relations and meetings with the Bretton Woods institutions. In this way we try to ensure a degree of coordination or coherence between the different organizations involved in the delivery of TA and policy advice, as requested by our Member States.

I think I would like to end here, and will be pleased to respond to questions.

Thank you very much.

# Technical Assistance for Strengthening Supply-Side Capacity and Enhancing Capabilities to Meet Standards

*Oskar Knapp\**

## Introduction

As you already know, the Joint WTO/OECD Report on Trade-Related Technical Assistance and Capacity Building (TRTA/CB) of July 2003 mentions that, based upon the reporting of 39 bilateral donor countries and multilateral agencies, there is an annual average of some 3,525 commitments amounting to US\$ 2,127 million for TRTA/CB. Further, there is an annual average commitment of US\$ 8,100 million for economic infrastructure that is spent upon building the transport, energy and communications networks essential for international trade. Clearly, this level of mobilization of TRTA/CB, within less than three years of the Doha declaration, reflects the importance placed by the international donor community on the role of TRTA/CB for development and poverty reduction.

Now, the challenge is to find ways in which this large international mobilization of resources for TRTA/CB is used efficiently and effectively to achieve the desired results of increased development and reduced poverty in the world. Within this context, this round-table discussion to assess how to actually implement TRTA/CB efficiently in two specific areas, improving supply side competitiveness and enabling products to conform with market requirements, is highly relevant.

Strengthening supply-side capacity and enhancing capabilities to meet standards are both important elements of a comprehensive trade development programme. The supply-side capacity provides competitive products and standards are crucial for international market access. For the purposes of this round table discussion, I would like to table a few points that, in my opinion, are important in the effective design and implementation of technical assistance projects in these areas.

## Ownership

In the last few years, certain concepts have generally been promoted when talking about technical assistance activities. These include “ownership”, “empowerment”, “multi-stake holder”, “demand-driven”, etc. I believe that these concepts are important and that we should change our approach to adopt them in our day-to-day work. Accordingly, I believe that any technical assistance provided and/or institutions created, should be done within the principle of ownership, and based upon the demand for the services offered by the proposed activity or institution. In this context, I welcome a further integration of trade related aspects into the Poverty Reduction Strategy Papers, or PRSPs. I think that we need to tailor our approach to the specific conditions, needs and demands of each country rather than to follow a “one size fits all” strategy. We also need to keep in mind the absorptive capacity of the specific country. Following this logic, the critical mass of necessary institutions for any country should depend upon the specific conditions prevailing in that country.

The implication of the above approach is that one has to spend more resources at the stage of project design, with more emphasis placed upon working with partner countries to understand their specific needs and demands and prioritizing them. Based upon this, we need to select the most critical needs and work with the partner countries to find appropriate solutions to these needs. This has to be done in active partnership with the recipient country so that effective ownership and empowerment is established right from the beginning.

---

\* Ambassador, Delegate for Trade Agreements, State Secretariat for Economic Affairs, Ministry of Economy, Switzerland.

In order to meet the needs of the beneficiary countries more pro-actively, I think that it is important for donors and implementing agencies to be closer to them. Over the past few years, Switzerland has been opening local coordination offices in our partner countries. Today, we have a network of local coordination offices in more than 40 countries and we are steadily decentralizing our work and responsibilities to these offices. I propose that implementing agencies should also consider having a more decentralized structure with strengthened field offices.

## **Institution building**

As the discussion paper points out, “Many developing countries have established institutions and organizations designed to support the real economy, but they often function badly, providing poor quality services with inadequate equipment, poorly motivated and remunerated staff, not responding to demand, with unrealistic objectives, bad management and a lack of financial resources”.

Building new institutions is often easier than working at changing existing institutions. However, I think that a lot of resources are spent on starting institutions that eventually end up as described above after the technical assistance period is over. I think that, as far as possible, we should first try involving the private sector in the provision of services and then see how to have the maximum efficiency from public-private partnerships. Further, we should work at changing or improving existing institutions before we think of creating new institutions. We should embark on creating new institutions (especially in the public sector) only when really necessary and when we are sure of the commitment of the host country and the demand for the services of such an institution over the long-term.

Accordingly, if we were to follow the demand-driven approach and also find ways to have the private sector deliver these services, then the demand will determine whether a specific country should have a specific laboratory or testing facility or whether it could be more efficient to have these facilities pooled on a regional basis (catering to several countries in a region) or whether it is most efficient to get the service delivered through partnerships with international institutions.

Another factor to take into account for institutional building is that it takes time and adequate resources. Planning for new institutions should be done with a long-term perspective and in a phased manner. In our experience, it is better to develop an institution with a critical mass and adequate support over an extended period of time so that it is able to survive and achieve sustainability.

Further, institution building should be part of a comprehensive strategy rather than an end in itself. Setting up a laboratory or testing facility should be part of a coordinated and comprehensive series of activities which include work with enterprises to promote awareness of quality and training on quality management, and work with them for penetration of international markets. It does not imply that one organization needs to implement all these activities, but with a global strategy, effective coordination and links between various projects, these activities need to be implemented in a comprehensive manner.

## **Coordination**

I started by quoting the joint WTO/OECD Doha Development Agenda Trade Capacity Building Database. As you know, this database, the Joint Integrated Technical Assistance Programme (JITAP) and also the Integrated Framework for Trade-Related Technical Assistance to Least Developed Countries (IF) were created as mechanisms to facilitate coordination amongst donors and recipient countries. We believe that effective coordination amongst donors, agencies and recipients is very important and strongly support such measures.



However, these are only the first steps. There is still a lot to be done to improve the effectiveness of technical assistance activities in general, and donor coordination in particular. The database only contains information on projects as submitted by donors and multilateral agencies. A lot of information about planned activities, ongoing programming exercises, etc. is not captured in the database. This requires donor coordination mechanisms at the level of the specific beneficiary countries. I think that such field-level coordination amongst donors is something that could greatly improve the efficiency of technical assistance. I believe that the recipient countries, along with assistance from multilateral agencies, need to be more pro-active in coordinating the activities of technical assistance directed towards their countries.

### **The “high road” to competitiveness and sustained growth**

I believe that we should keep things in perspective when we talk about trade and its benefits towards poverty alleviation. While it is true that trade can assist in the task of reducing poverty, the impact it has on the poor of any specific country depends upon how pro-poor the policies of the country are. Further, trade by itself is not the panacea for all problems. In fact, we have to be careful that our work does not lead to increased “commodification” and increased risks for fragile economies due to dependencies upon a limited number of commodity exports and/or a limited number of export markets. We know that in real terms the prices of most commodities have been falling over the years as, in many cases, the global supply has been increasing faster than global demand. I believe, that we, the international community, should bear the responsibility of not encouraging all developing countries to follow one model. In terms of exportable goods, we should not prescribe to them a standard formula – certain exportable commodities (e.g. coffee) and some labour intensive production (e.g. clothing) all competing amongst each other for market share in a relatively slow-growing, or even mature, OECD market. Part of the reason for deteriorating terms of trade for developing countries is that a lot of them depend upon exporting the same goods and services to the same markets. I believe that it is our responsibility to assist in identifying products and services for which a country may have competitive advantages or may be able to develop them over time. At the same time, we should not encourage all the countries to focus on the OECD markets. We have to encourage local and regional markets and encourage south-south trade. Further, we have to encourage a culture of constant innovation and creativity.

Switzerland has been supporting its partner countries to develop and meet the minimum standards necessary for market access. At the same time, we have been working with them to develop and meet maximum standards to access premium markets, thereby increasing value addition and also ensuring export diversification. At the same time, we have programmes in place which complement standards with policy level work and concrete export promotion measures.

### **Conclusions**

With an average of 20 commitments and US\$ 12 million of funding available for each beneficiary country every year for trade related technical assistance and capacity building, I think that it is important that we all critically assess our programme design and implementation methods and come up with more innovative, appropriate and sustainable solutions so that we can make more efficient and effective use of these resources in meeting the Millennium objectives.

It is impressive, indeed, to learn about the 40 years of accumulated experience of UNIDO in increasing industrial productivity and strengthening capacities in quality standards in developing countries. We have been working in close partnership with UNIDO to implement a number of projects in these two areas and I look forward to a reinforced partnership in the future that delivers even more successful results towards realizing our common goals.

## Statement by Mr. Ibrahim Tamponé\*

Thank you Mr. Chairman.

As this is the first time that I am taking the floor within the confines of this august chamber, allow me please at the outset to convey my gratitude, and that of the West African Economic and Monetary Union (UEMOA) to the Director-General of UNIDO for the honour that he has granted us by inviting us to participate in this present session.

I would like to share the experience of UEMOA with all the participants in this room, but before that I would like to present the Union to you. UEMOA is the youngest of the regional integration organizations of western Africa, and was established in January 1994. It nevertheless represents one of the most evolved forms of these integration experiences, as it compounds the advantages of economic union with the achievements of political union, which has existed for several decades.

Specifically, UEMOA comprises eight member states, with 74 million inhabitants, of whom 45-60 per cent are young people below the age of 25. The countries of the Union are experiencing a population growth of 3 per cent per year on average, which unfortunately surpasses the annual growth rate of their economies, which in 2002-2003 is below this level of 3 per cent. Although UEMOA makes up 33 per cent of western Africa's GDP, seven of its eight members are least developed countries (LDCs), and the majority of its eight member states are classified as highly indebted poor countries.

As you can see, we experience poverty on a daily basis. Despite our great potential in agriculture and mining, the dearth of investment in basic infrastructure and in the development of human resources hampers our ability to increase our supply capacity, and to increase trade both among the members of the Union and between the Union and the wider world.

For us this morning's topic is therefore a very important one. We recognize that to struggle against poverty and to ensure that our poor people enjoy the benefits of trade requires the strengthening of our productive capacity. The strengthening of our supply capacity is an indispensable requirement, whether for raw commodities or for manufactured goods – for we are indeed increasingly trading processed, high value-added goods. But even the raw materials which we trade amongst ourselves are unfortunately hampered by tariffs and technical barriers in the form of increasingly precise and specific norms and standards.

Against this background, I would like to inform you very briefly about two initiatives stemming from our industrial policy, and a third initiative concerning the cotton industry, which was referred to by Mr. Rana.

The first initiative that I would like to share with you was developed with the technical and financial support of UNIDO, and UNIDO is also supporting its very rapid implementation. This is a programme for the creation of a system of accreditation, standardization and quality enhancement in the UEMOA member states. We have been implementing a pilot project linked to this initiative, which is intended to last for three years, since 2002. This pilot project is fully financed by the European Union to the sum of € 12.5 million and technically implemented by UNIDO. The programme is intended to ensure that the goods and services produced in these countries are in conformity with international norms and standards. More specifically, the objectives are the following:

---

\* Commissioner for Energy, Mines, Industry, Handicrafts and Tourism, West African Economic and Monetary Union (UEMOA). This text is based on an edited transcript of the English interpretation of the speaker's original presentation in French.

- Establishment of a regional accreditation and certification system;
- Establishment of a system to harmonize the already existing institutions;
- Promotion of quality within enterprises; and
- Strengthening of human capacities through training and various other forms of education.

In the long term this programme should allow us to increase our volumes of trade at a regional and global level, and ensure that the harmonization of technical standards is a common rule for all of us. It should also contribute to integrating UEMOA's member states into the regional economy of our sub-region, as well as with the wider world. By the end of this pilot project we hope to be able to achieve a situation where all our members states will be in a position to overcome the technical barriers to trade that we currently face.

Our experience in the field of standardization is unique, for instead of having each state establish its own individual system for accreditation and standardization, we thought that it would be more useful to establish regional cooperation in this field at the level of quality enhancement, accreditation and certification, and also to raise the awareness of our enterprises about the importance of quality assurance and strengthening quality management.

The second initiative I would like to present to you is a sub-regional programme for the restructuring of UEMOA industry. We recognized that the industries of our member states face a number of major problems, including high support requirements for enterprises and related institutions, the institutional weaknesses of state organizations, and weaknesses in our human resource base. We thus believed that we had to establish a programme to restructure the industries of the Union, especially those that had great export potential. This programme has three fundamental objectives:

- At the macro level, the programme is part of a strategy for the relaunch of industrial investment, promotion of foreign investment, generation of employment, and enhancing our competitiveness at a regional and global level.
- At the intermediate level, this programme should allow us to ensure the emergence of support services, which will provide us with the experience and assistance our industries need to overcome their prevailing weaknesses.
- At the micro-level, i.e. at the level of the enterprises themselves, this programme has two objectives: The first is to allow these enterprises to become competitive as far as quality and production is concerned; and the second is for these enterprises to master technical innovation and to adapt to the requirements of regional integration and international competition.

This programme is based on experiences gained in other African states with the assistance of UNIDO. However, it was set up bearing in mind the specificities of our region, and especially the various integrated programmes which are currently underway in the member states.

Finally, I would like to mention the third initiative in the cotton sector. We all remember what happened at Cancun. I would just like to remind you that the cotton sector currently employs ten million individuals in our Union, and represents the first or second source of export earnings for several members of the Union. During 2001-2002, due to the subsidies in the Northern states, UEMOA states lost US\$ 266 million of export income. Faced with this situation, we have had no choice but to refine our strategy by introducing a capacity-building programme, which is made up of two tiers: Support and promotion of the cotton industry at an international level, and the promotion of cotton processing within the UEMOA states.

These are the activities that we are working on at the level of UEMOA, which will enable us to enhance our capacities, upstream and downstream, to participate in adding value to our products, to create jobs, and finally, to struggle against poverty.

Thank you.

## Statement by Mr. Kandeh Yumkella\*

Thank you very much Mr. Chairman.

A lot has already been said about our partnerships with various agencies. I would just like to underscore a few major points in my brief statement.

First, I would like to stress that we are indeed doing quite a bit on enhancing supply-side capacities and on strengthening the national and regional standards and conformity assessment infrastructure, as you have heard from the UEMOA representative. Our Director-General is providing even stronger leadership now for many of the reasons that have been raised by this panel. He has set up an advisory group of permanent representatives to UNIDO to make sure that the services we continue to provide in this thematic area are in line with the specific needs that have been identified in various countries and regions. This advisory group is very active, and is helping us to streamline our various activities and sharpen our interventions.

I also want to underscore the issue of partnership. You have heard of the agreement, the cooperation framework, that we have signed with WTO. We're very pleased that this morning we followed that up with another Memorandum of Understanding with ISO. These are real partnerships. We will continue to cooperate actively with WTO, UNCTAD, ITC, ISO and others in our practical work in the field. We know from our experience – I was in Nigeria for three years and have only just come back – that quite a bit of hand-holding is still needed, even in countries where there is a so-called industrial capacity. This hand-holding is needed to let people understand what these standards are, how they can conform to them, and how they can deal with the cost implications. There is also quite a bit of work to do with the national agencies and standards boards that have been established. We need to help the people understand that these are not policing agencies but that they serve a facilitatory role as the panel has been emphasizing.

We also are looking at research. Indeed, as has been mentioned by the panel, standards also relate to the transfer of knowledge and best practices. We therefore want to strengthen our practical technical cooperation work with further analytical work for some of the needs-identification and constraints-identification issues that were raised by the panel. In recent workshops that we have organized with UNCTAD, some of the very issues that you have raised here have been identified, and we will continue this awareness-creation in partnership with other agencies.

We are very pleased with the support that we are receiving from donors. The representative of Switzerland has mentioned some of the support his country is giving us on the environment side. Austria has also given us considerable support with some of the awareness and needs-identification workshops that we have organized together with UNCTAD.

In conclusion I would like to stress that we are now putting more energy behind this effort. Trade must be linked with other development activities, both conceptually and practically, in the field. In this context, we are also giving due attention to peculiar problems in Africa. The Director-General has set up an ad-hoc working group chaired by the Ambassador of South Africa to look at the specific needs within Africa itself. From our Organization's standpoint, we are firmly behind this, and we are looking at partnerships and cooperation to help the poorer countries to benefit more from trade.

Thank you very much.

---

\* Special Advisor to the Director-General, UNIDO. The text presented here is based on an edited transcript of the spoken statement.

## **ROUND TABLE 4**

### **POST-CRISIS INDUSTRIAL REHABILITATION AND RECONSTRUCTION**



## Issue Paper

# Post-Crisis Industrial Rehabilitation and Reconstruction

*UNIDO Secretariat*

### Introduction

This issue paper aims at identifying the potential UNIDO interventions in post-crisis situations resulting from military conflicts (post-conflict) as well as natural disasters or an economic collapse (post-crisis). As the term “post-crisis” has a wider application it has been used throughout the following text in both scenarios.

In all cases of natural disaster and civil conflict, there will have been widespread damage to the social and economic infrastructure in terms not only of the loss of physical establishments, but also with regard to the loss of qualified human skills and indigenous knowledge. A large proportion of the population will usually also have been displaced.

Such disasters and civil strife exacerbate the economic challenges facing the affected countries and regions by destroying physical infrastructure and distribution networks, disrupting markets and financial systems, and undermining public confidence in the country’s future. Civil life is often dominated by widespread militarization and the displacement of people, which hinders access to previous livelihoods and to basic services. In such an environment, social organization and family units break down, and gender roles are changed.

Since the early 1990s, at the end of the Cold War, internal conflicts at the country and regional level have emerged as a major new concern. Since the cases vary and each is unique, flexible priority setting is required for devising policies and strategies for recovery and reconstruction. Interventions for post-crisis rehabilitation need to tackle the root causes of the conflict based on its “specificity”. Furthermore, common to such situations is the need to bridge the gap that is created when humanitarian assistance begins to taper off and longer-term reconstruction aid is still in the planning stage. This applies in all cases, irrespective of whether the disaster is the result of a war or an industrial or natural calamity.

Countries affected by crisis/conflict are faced with social and economic dislocation which inevitably reduces the productive capacity of the economy and the ability of the affected populations to generate sustainable livelihoods. The resulting poverty, hunger and risks to health, child mortality and lack of education are in direct conflict with the Millennium Development Goals (MDGs). They call for external interventions to ameliorate their adverse impact in the short term and overcome them more comprehensively in the longer term. Given the evident inability of the crisis-affected countries to undertake these interventions on their own, they will require substantial support from the international community to help them to overcome the setbacks they have suffered.

### International response to crisis situation

The international response to disaster and conflict situations is challenged to address the whole spectrum from emergency and relief, via reconstruction and rehabilitation, to sustainable long-term development. This will typically involve a continuum of activities beginning with humanitarian relief measures intended to meet the immediate nutritional and housing needs of the affected population, leading to the rehabilitation or reconstruction of the damaged or destroyed physical infrastructure, strengthening institutional capacity, and the restoration of the human resource base as a platform for

sustainable development. In case of a post-conflict situation, there are additional dimensions to be incorporated, such as conflict resolution (e.g., peace negotiations), reconciliation and conflict prevention.

Particular attention needs to be given to the appropriate timing and sequencing of assistance. As the support activities needed in post-crisis situations are closely interlinked and the needs vary significantly from one case to another, it is usually very difficult to draw discrete lines between the evolving stages of post-crisis assistance. Many agencies involved in emergency relief extend their programmes into rehabilitation and reconstruction work. At the same time, development agencies may identify opportunities for appropriate interventions in some instances or in specific sectors even during what is normally viewed as an “emergency relief” or “conflict” phase.

Against this background, the support of the international community needs to be extended in an integrated manner incorporating multi-sectoral and multi-dimensional approaches towards the recovery efforts. All major multilateral and bilateral aid agencies work in a wide spectrum of activities for crisis and disaster reduction (prevention, preparedness and mitigation) and recovery (rehabilitation and reconstruction). These activities are, however, complemented closely by a longer-term development agenda, with issues such as capacity-building for poverty eradication and sustainable livelihoods, sound governance, environmental concerns (including the sustainable use of natural resources), and gender equality.

### **Importance of economic recovery**

The economic recovery of a post crisis-country depends heavily on the success of the transition from the emergency and relief phase to the rehabilitation and reconstruction phase and ultimately to the development phase of the recovery process, since the rebuilding of the domestic economy needs a smooth restoration of access to all relevant internal and external resources. While social infrastructure and security are the priority areas to be restored, the economic recovery, particularly in terms of reviving markets, creating opportunities for income earning, and absorbing the population in need of employment, should accompany the efforts of national conciliation or disaster relief. From this broad scope of post crisis economic recovery, UNIDO will specifically focus on its core competencies of industrial rehabilitation, reconstruction and development.

In order to achieve these objectives, an integrated package of rehabilitation and reconstruction assistance is needed. This package should comprise, *inter alia*, the following elements:

- A re-establishment of the framework of governance by strengthening government institutions, restoring law and order, and enabling the organizations of civil society to work effectively;
- A restoration of important physical infrastructure, including key transport, communication, and utility networks, and rehabilitation of key productive sectors in order to provide critically important goods and services;
- Provision of assistance to those affected by war through the reintegration of displaced populations, demobilization and reintegration of ex-combatants, revitalization of the most disrupted local communities through the provision of credit lines to subsistence agriculture and micro-enterprises, and support for vulnerable groups such as women and children as well as female-headed households;
- Rebuilding and maintenance of key social infrastructure by strengthening the education system to provide qualified and skilled human resources and rehabilitating and improving health care facilities;
- Jump-starting the economy through investment in key productive sectors and the creation of conditions for a resumption of trade, savings, and domestic and foreign investment; and promotion of macroeconomic stabilization, the rehabilitation of financial institutions, and the restoration of appropriate legal and regulatory frameworks.



## **UNIDO initiative for post-crisis industrial rehabilitation and reconstruction**

### *Basic principles*

UNIDO has launched a thematic initiative specifically addressing the need of industrial rehabilitation and reconstruction in countries affected by a crisis. This is based on the experience and lessons accumulated in various technical cooperation projects and is built on the following principles:

#### Sound diagnosis

Through its specialization on industrial development, UNIDO is able to support the efforts of host governments to analyze the needs for industrial rehabilitation and reconstruction, identify the kinds and levels of intervention required, and formulate appropriate policy advice and technical cooperation proposals. Based on a thorough assessment of the situation and clear identification of demand for industrial recovery, UNIDO can provide the appropriate mix of its existing services that would be needed to meet the specific requirements of the country concerned.

#### Tailor-made responses

UNIDO's involvement can ensure that a signal is given at the earliest stage to the government, international aid agencies and donors regarding the need for an integrated approach based on striking a balance between the humanitarian relief operations and the restoration of productive capacities, especially in the industrial sector, as a source of local inputs for the relief operations and the basis for a sustainable longer-term recovery.

The level of such interventions will vary according to the type and dimensions of the crisis/conflict, and the timing and course of actions taken by UNIDO will be determined according to UNIDO's potential and capacities.

#### Donor coordination and inter-agency collaboration

UNIDO can play an important role in linking the host government's needs with the most feasible and appropriate bilateral and multilateral activities to promote the recovery of the industrial sector as well as the related institutional and physical infrastructure. UNIDO's intervention for economic and industrial recovery would be harmonized with other implementing agencies and stakeholders.

### **Phases of interventions**

The activities undertaken in the context of UNIDO's initiative can be grouped into three phases ranging from emergency relief and humanitarian assistance needs to reconstruction/rehabilitation and sustainable development.

#### *1) Emergency relief and humanitarian assistance needs*

During this initial phase, the most feasible activity that UNIDO can contribute is to perform a needs assessment and absorptive capacity review to understand clearly the socio-economic situation of the country and identify the areas of UNIDO's interventions which could generate added value for the rehabilitation and reconstruction phase of the country.

In this endeavour, some critical elements will have to be duly looked into. They include, inter alia, understanding the level and status of destruction and damage suffered, the root causes of the conflict, the role of respective local actors, the cultural and historical background of the country, the condition

of environmental degradation and pollution, the availability of resources – physical, human and financial – required for industrial rehabilitation, and the role of local institutions and social groups in the past. These are the issues that facilitate a good understanding of the modalities for an effective interaction of actors involved in the country, which is required for successful rehabilitation and reconstruction initiatives. Through an in-depth analysis of the issues mentioned above, specific needs can be identified for rehabilitating a group of key industries selected on the basis of their relative importance to the immediate post-crisis relief efforts and their significance to other enterprises and industries which have close supply and/or procurement linkages.

UNIDO's intervention in the needs assessment and absorptive capacity review process can be based on two types of information:

- Information outside UNIDO's areas of specialization, where the Organization will have to create alliances with other groups or agencies in order to have a more holistic view and understanding of the situation (such as social, cultural, financial, educational or legal aspects).
- Information that UNIDO can contribute and assess through its experience, to the multi-stakeholder process.

## 2) *Rehabilitation and reconstruction*

The phase of rehabilitation and reconstruction is where UNIDO can provide more value added through the implementation of its services and by strengthening the industrial sector as well as public and private institutions with industrial and economic mandates.

In concrete terms, the following four major areas of intervention might be identified:

- Strengthening key industrial sectors:
  - a) Techno-analysis of productive sectors and provision of methodologies and tools for economic and industrial sector analysis;
  - b) Assistance to rehabilitate selected enterprises – UNIDO's rehabilitation assistance will focus on micro- and small scale industry in such sectors as woodworking, metalworking, blacksmithing, food processing, the production of building materials and agricultural tools and equipment, and essential medicine.
- Promoting income generating activities:
  - a) Establishment of community-based production units and related basic infrastructure;
  - b) Assistance in designing job creation programmes, inter alia through the promotion of foreign investment;
  - c) On-site training programmes for technical skill upgrading;
  - d) Development of training programmes specifically designed for rural and women entrepreneurs, including refugees, internally displaced people and especially youth (in many cases ex-combatants) by establishing links to on-going community-based activities and social services such as health, nutrition, literacy, and awareness building on human rights.
- Institutional strengthening:
  - a) Assistance to public institutions in developing a coherent industrial strategy for recovery and future growth, and the establishment of a sound policy framework for industrial development;
  - b) Assistance to rehabilitate and rebuild support institutions for small and medium-sized enterprises (SMEs) to provide advisory services to entrepreneurs in accordance with their specific rehabilitation needs;
  - c) Capacity building of public and private sector institutions;
  - d) Immediate institutional strengthening of the government organizations and staff responsible for industrial recovery and development.
- Infrastructure rehabilitation:
  - a) Identification of appropriate technology and assistance in immediate technology transfer required to rehabilitate the water supply, waste management and energy sectors.

### 3) *Sustainable development*

Once a degree of stability is observed in the country's situation and a positive transition emerges from the rehabilitation and reconstruction phase towards more long-term development, the type of assistance required for the country will evolve into assistance required to achieve sustainable development.

Based on the issues that UNIDO is proposing to address in its post-crisis initiative, emphasis would be given to the following activities.

- Promotion of industrial competitiveness;
- Connection of SMEs with regional and global markets; and
- Strengthening of the governance and institutional support systems.

### **Key issues to be addressed by the Round Table**

*Key questions for general discussion:*

- How important is the concept of human empowerment as referred to in the report *Human Security Now* (Commission on Human Security 2003)?
- What are the main political and economic challenges for post-crisis response and related strategy setting?
- What are the priority needs for each of the stages of emergency and humanitarian relief, rehabilitation and reconstruction, and development?
- What are the respective roles of the government, the private sector, donors and United Nations agencies?
- What is the key contribution of the industrial sector in post-crisis rehabilitation and reconstruction?

*Specific questions regarding UNIDO's role in post crisis assistance:*

- What should be the most tangible and feasible contribution (in terms of concrete interventions) that UNIDO can offer in support of economic recovery?
- In the continuum from relief to development, how early should a needs assessment and absorptive capacity analysis be made, taking into account the need for a long-term sustainable development strategy?
- What kind of strategic alliances should UNIDO seek with other agencies and partners?
- Does UNIDO need a specific approach and/or a mechanism/structure to address post-crisis assistance in order to respond appropriately and promptly to urgent support requirements?

### **Summary**

UNIDO's initiative for post-crisis assistance thus aims to:

- Facilitate the understanding of the need for an effective involvement in post crisis recovery;
- Emphasize the importance of economic recovery in post-crisis countries and UNIDO's potential contribution to recovery, specifically in the area of industrial rehabilitation;
- Create a common understanding that UNIDO's post-crisis initiative is based on three basic principles, i.e., sound diagnosis, tailor-made responses and close donor coordination and inter-agency collaboration; and
- Identify three phases and respective strategies for UNIDO's post-crisis intervention in emergency relief and humanitarian assistance needs, reconstruction and rehabilitation, and sustainable development.

More in-depth consideration of these issues is given in a separate discussion paper.

## **References**

Commission on Human Security, *Human Security Now*. New York: United Nations, 2003.

## Discussion Paper

# Post-Crisis Industrial Rehabilitation and Reconstruction

*UNIDO Secretariat*

## Section 1 Conceptual framework of crisis situations

### Introduction

Whenever disasters and conflicts occur, they cause widespread damage to the social and economic infrastructure, not only in terms of physical losses, but also in the loss of qualified human skills and indigenous knowledge.

Such disasters and civil strife exacerbate the economic challenges facing the affected countries and regions by destroying physical infrastructure and distribution networks, disrupting markets and financial systems, and undermining the confidence of the country in its future. Life in these countries in crisis is often dominated by widespread militarization and the displacement of people, impeding access to previous livelihoods and basic services. In such an environment, social organization and family units usually break down.

Since the end of the Cold War in the early 1990s, internal conflicts at the country and regional level have emerged as a major new concern. Since each case is unique, there is a need to set flexible priorities for devising policies and strategies for recovery and reconstruction. Furthermore, in such situations there is a need to bridge the gap created when humanitarian assistance begins to taper off and longer-term reconstruction aid is still in the planning stage. This is true whether the disaster is the result of war, natural calamity, or social and political unrest.

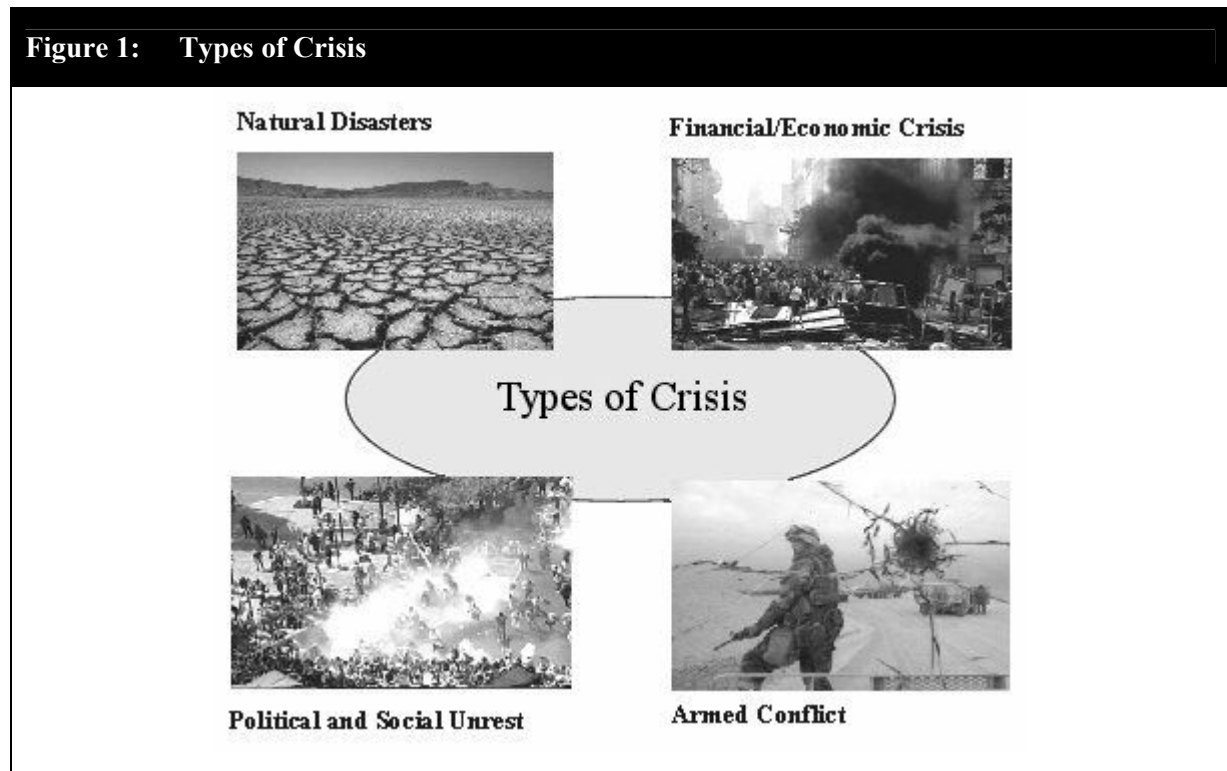
Countries affected by crises or conflicts have been faced with social and economic dislocation, which inevitably reduces the productive capacity of the economy and the ability of the affected populations to generate sustainable livelihoods. The resulting poverty, hunger and risks to health, child mortality and lack of education are in direct conflict with the aim of the Millennium Development Goals (MDGs). They call for external interventions to ameliorate their adverse impact in the short term and overcome them more comprehensively in the longer term. Given the evident inability of the crisis-affected countries to undertake these interventions on their own, they will require substantial support from the international community to help them to overcome the setbacks they have suffered.

### Different types of crisis

There are many different types of crisis situations, and every one of them is uniquely characterized by its root causes and its development. Attempts to standardize crisis and conflict situations might be misleading because solutions should be tailored to each local crisis according to its respective local circumstances. However, for a clear understanding of crises in general, commonalities can be identified and grouped into the four categories indicated in Figure 1.

In the past decade, 4,777 **natural disasters** have claimed more than 880,000 lives, affected the homes, health and livelihoods of 1.88 billion people and inflicted economic losses of about US\$ 685 billion on the world's economies (UN 2002). Natural disasters such as droughts, earthquakes, floods, geomagnetism, hurricanes, landslides, volcanic eruptions, wildfires, wildlife disease, tornados and

storms have a devastating effect on societies. It should be noted however that these disasters are often the result of human activities that are changing the balance of nature due to the control and/or interference by human beings of the atmosphere, the oceans, the polar ice caps, the forest cover and the natural pillars. Reports on natural disasters indicate that underlying the devastation was poverty, social exclusion, environmental degradation and other structural vulnerabilities that had not been addressed by development efforts. This means that the extent of their damage can be significantly reduced if there is community participation and the inclusion of preventive measures in developmental efforts. Furthermore, adequate monitoring of investments, such as in infrastructure development, and socio-economic programmes in the reconstruction process should be approached from the standpoint of prevention in order to avoid extensive damage caused by natural disasters.



**Economic and financial crises** have been observed in the last decade within the framework of globalization of all spheres of socio-economic activities. They not only disrupt the social fabric of many countries and send millions of people into poverty, but create voids in social safety nets and produce tension and turbulence between different groups. In the process of globalization, the free flow of capital that globalization offers and the increasing reliance of economies on volatile capital markets are welcome when investments are coming into a country. When investments are withdrawn, however, the loss of capital creates unrest and has a negative effect on social stability. The economic crisis that started in Asia in 1997, for example, proved that such a crisis in one region could easily go beyond it – as far afield as Latin America and Russia, in fact – and the affected countries suffered drastic declines in real GDP growth, falls in equity prices and output, very high inflation rates and a sharp drop in employment, consumption and incomes.

**Political and social unrest** often constitutes a preliminary phase which leads to situations of armed conflict. Social tensions can become a permanent source of instability and trigger deep crises. The impact of transition from centrally planned economies to market-oriented ones, for example, generated high expectations of people waiting for a swift improvement in their economic conditions parallel to their gains in democratic rights. Unfortunately economic developments tended to lag behind because of recession, inefficiency and market adaptation. The bankruptcy of the large state-

owned enterprises combined to push unemployment and underemployment to high levels, further contributing to the deterioration of individuals' livelihoods. Such trends can threaten democratic gains by generating political instability. The emerging social instability can also discourage new foreign investments from creating new employment opportunities.

**Armed conflict** can happen at either the inter-state level across borders, or the intra-state level within borders. A large proportion of armed conflict starts from the social and political unrest triggered by various causes within a country and/or a region. Regardless of the scenario, the crisis situation that escalates into armed conflict must address key issues that need immediate attention after the crisis, such as:

- Reintegrating the diverse conflict-affected groups (refugees/returnees, internally displaced people, demobilized combatants, women, children) into civil society;
- Rehabilitating the socio-economic and physical infrastructure;
- Promoting social and political negotiations, dialogue and reconciliation between the diverse groups;
- Promoting equity and social justice; and
- Supporting development and peace building, and tackling the conflict's root causes.

Common features of all types of crises are economic dislocations and recessions, leading to a sharp increase of poverty levels and unemployment in the population. This, in turn, could generate high tensions that could lead to open social and armed conflicts.

### **Development assistance and international response to crisis situations**

The international response to disaster and crisis situations has been challenged to address the full spectrum of assistance, from emergency and relief aid, via reconstruction and rehabilitation, to sustainable long-term development. Typically, this involves a continuum of activities, beginning with humanitarian relief measures intended to meet the immediate food and housing needs of the affected population. Next, there is the rehabilitation or reconstruction of the damaged or destroyed physical infrastructure, strengthening of institutional capacity, and the restoration of the human resource base as a platform for sustainable development.

The 1990s observed a major shift in international assistance in response to crisis situations as a result of the changed strategic environment following the end of the Cold War and the bi-polar geopolitical order (Woodward 2002). The rise of national sovereignty and national political agendas began to expose embedded problems that had been overshadowed by the Cold War. Soon there was an explosion in the number of humanitarian and peacekeeping operations among international and development agencies. The crises encountered dealt with complex problems from the concept of neutrality, the personal dangers of wartime conditions and the new financing challenges. Deep concerns were expressed by donors as the results of decades of development assistance were destroyed overnight by conflict.

Realizing the limitations of the international mechanisms in place to cope with emerging crisis situations, the High Level Meeting of the Development Assistance Committee (DAC) in May 1997 decided to broaden its work on conflict prevention to address these challenges. The policy guidelines, subsequently issued under the title *Conflict, Peace and Development Co-operation on the Threshold of the 21<sup>st</sup> Century* (OECD – DAC 1997) resulted in the creation of many new units and the expansion of mandates of existing bureaus dealing with conflict. The primary focus was on operational improvements in aid delivery, better coordination among donors and more targeted conditionality. However, the increased attention on post-conflict issues did not have much effect on the substance of aid programmes. In addition, since the way that the gap between relief and development was addressed did not consider its separate conditions and requirements, the de facto operation of programme implementation was not extensively changed.

While the DAC Guidelines provided a platform for effective intervention in post-crisis situations, the report of the Brahimi Panel on UN Peace Operations (UN 2000) further reflected not only much of the accumulated scholarly and operational knowledge, but also the disillusionment over the failure to prevent conflict in certain countries. It also detailed the inequitable ways cases were handled, depending on the strategic interests of the Permanent Five of the Security Council.

More recently, the international response to crises and conflict has been characterized by two tendencies:

- On the one hand, the incident of September 11, 2001, has redirected attention to the “anti-terrorist campaign”, and resulted in priority being given to military approaches to international security.
- On the other hand, international organizations have recognized that there is a “funding and strategic planning gap between relief and development activities in the context of natural disasters and complex emergencies”, and are aiming “to continue to strengthen the consolidated appeals process as a coordination and strategic planning tool for the provision of humanitarian assistance and transition from relief to development” (UN-ECOSOC 2002).

In response to these changes, the United Nations has established a working group on transition issues formed by the United Nations Development Group (UNDG) and the Executive Committee on Humanitarian Affairs (ECHA). The purpose of this group is to examine further the emergence of “hybrid” or ad hoc approaches and the appeals processes when developing the UN’s response to transition, thus providing a clear and consolidated guidance to United Nations Country Teams (UNCT). This initiative will integrate the efforts of UN agencies into framing a common needs assessment and create synergies among the different initiatives.

### **Economic recovery and political transition**

The support of the international community needs to be extended in an integrated manner, incorporating multi-sectoral and multi-dimensional approaches towards the recovery efforts. All the major multilateral and bilateral aid agencies engage in a wide range of activities for crisis and disaster reduction from prevention, preparedness and mitigation, to recovery, rehabilitation and reconstruction. These activities should be closely coordinated with a longer-term development agenda, that deals with issues such as capacity building for poverty eradication and sustainable livelihoods, sound governance, environment (including the sustainable use of natural resources), and gender equality. While much of the emergency and humanitarian assistance is usually geared to respond to the urgent and immediate needs of the affected population and basic social infrastructure, it should clearly have the vision to continue to the economic recovery of the country as a prerequisite for a long-term sustainable development.

Particular attention needs to be given to the appropriate timing and sequencing of assistance. Because the support activities needed in post-crisis situations are closely interlinked yet the needs vary significantly from one case to another, it is usually difficult to draw discrete lines between the evolving stages of post-crisis assistance. Many agencies involved in emergency relief extend their programmes into rehabilitation and reconstruction work. At the same time, development agencies may identify opportunities for appropriate interventions in some instances or in specific sectors even during what is normally viewed as an “emergency relief” or “conflict” phase.

In order to achieve these objectives, an integrated package of rehabilitation and reconstruction assistance is needed. This package should comprise, inter alia, the following elements:

- Re-establishing the framework of governance by strengthening government institutions, restoring law and order, and enabling the organizations of civil society to work effectively;



- Reconstructing and repairing important physical infrastructure, including road and transportation systems, communication networks, and utility services, and rehabilitating key productive sectors in order to provide for urgent goods and services;
- Rebuilding and maintaining key social infrastructure such as the education system to create a pool of qualified and skilled human resources, and rehabilitating hospitals and clinics to improve health care;
- Providing assistance to the population affected by the crisis, particularly the reintegration of internally displaced populations and refugees, demobilization of ex-combatants, and mobilization of community participation, particularly through women;
- Jump-starting the economy through investments in key productive sectors, and creating the conditions for a resumption of trade, savings, and domestic and foreign investment; and
- Promoting macroeconomic stabilization, the rehabilitation of financial institutions, and the restoration of appropriate legal and regulatory frameworks.

### **Strategic need for partnerships and alliances**

Services and activities in post-crisis situations can be provided to support the transition from relief and basic needs assistance to development aid and economic recovery. In order to have an effective impact on the country, partnerships should be created for cooperation with other agencies and groups.

Within the UN family, UNDP has the country-level presence that will allow it to coordinate field level interventions and provide logistical support for programme implementation. Organizations like UNHCR, FAO, WFP, HABITAT, UNICEF and WHO, among others, have broad experience assisting countries in post-crisis situations in the first phases of the intervention.

Partnerships between UN agencies pose some challenges in terms of de-facto coordination and operational modalities for implementation. It occasionally happens that activities overlap more than desired. Nevertheless, the fragility of post-crisis situations suggests that working jointly and generating synergies through partnerships will be necessary in order to deliver the services proposed.

Other strategic groups considered essential to support the implementation of activities in these situations are non-governmental organizations (NGOs) and local grass-roots associations. The flexibility and mobility of NGOs allows them to operate in places where UN agencies usually could not be present. In cases where there is a lack of cooperation from central government or where the central government does not have control over certain regions, NGOs are able to operate and thus obtain a cultural know-how and understanding. In many cases, NGOs have wide local networks and outreach through which the assistance provided by international organization could be channelled to the right clients. Some NGOs are proactively involved in bridging the gap between business initiatives and the crisis situation.

Consideration should also be given to the establishment of partnerships with associations and groups of experts engaged in the areas of crisis resolution and economic recovery. Establishing alliances with such professional experts will help promote the services offered by UNIDO and enable us to gain a better understanding of the delicate nature of the work environment.

## **Section 2 UNIDO Strategy for post-crisis industrial rehabilitation and reconstruction**

UNIDO's mandate is to assist developing countries and economies in transition to enhance their capacities for promoting sustainable industrial development that achieves economic growth and alleviates poverty.<sup>1</sup> This is achieved through:

- Formulation and implementation of technical assistance projects and programmes which enhance skills, technology and related capacities; and
- Organization of "global forum" activities involving the generation and dissemination of knowledge about industrial development processes and associated issues, and thus conducting debates and discussions on industrial development matters in order to influence the development agenda.

Furthermore, the UNIDO corporate strategy states that long-term economic growth will occur only if business investment in equipment and infrastructure results in increased productivity growth. UNIDO is therefore committed to enhancing technological progress, learning, and improvements in the quality of labour to achieve increased productivity (UNIDO 2003).

In the past, UNIDO interventions have been undertaken in some countries/regions facing post-crisis situations. However, they were not specifically geared to correspond to the needs of post-crisis situations per se. Furthermore, the role of UNIDO in emergency and humanitarian relief activities has been rather limited, and there has been little involvement in the initial stages of crisis situations. In recent years, UNIDO has accumulated some experiences in technical cooperation projects in some countries which face a big challenge of post-crisis rehabilitation and reconstruction. Based on these experiences and the lessons learned, some new modalities of intervention have been introduced.

### **UNIDO's basic principles for crisis support**

In post-crisis situations, where international interventions have traditionally been conducted within the spheres of humanitarian assistance and aimed at satisfying urgent and basic human needs, UNIDO could play an important role to alert international communities about the need to address the industrial rehabilitation and reconstruction at an early stage and to encourage concerned actors to engage proactively in economic initiatives. Working together with other agencies and organizations already active in the initial stages of crisis situations, UNIDO is fully qualified to introduce activities aimed at reconstruction and long-term development. For this purpose, there are a few principles which UNIDO would follow.

#### *Sound diagnosis*

Through its specialization on industrial development, UNIDO is able to support the efforts of host governments to analyze the needs for industrial rehabilitation and reconstruction, identify the kinds and levels of intervention required, and formulate appropriate policy advice and technical cooperation proposals. Based on a thorough assessment of the situation and clear identification of demand for industrial recovery, UNIDO would provide the appropriate mix of its existing services that would be needed to meet the specific requirements of the country concerned.

---

1 UNIDO's Mission: The United Nations Industrial Development Organization (UNIDO) helps developing countries and countries with economies in transition in their fight against marginalization in today's globalized world. It mobilizes knowledge, skills, information and technology to promote productive employment, a competitive economy and a sound environment. Carlos Magariños, the Director-General of UNIDO, describes the Organization as a specialized United Nations agency that focuses its efforts on relieving poverty by fostering productivity growth.

### *Tailor- made responses*

UNIDO's involvement can ensure that a signal is given at the earliest stage to the government, international aid agencies and donors regarding the need for an integrated approach based on striking a balance between the humanitarian relief operations and the restoration of productive capacities, especially in the industrial sector, as a source of local inputs for the relief operations and the basis for a sustainable longer-term recovery.

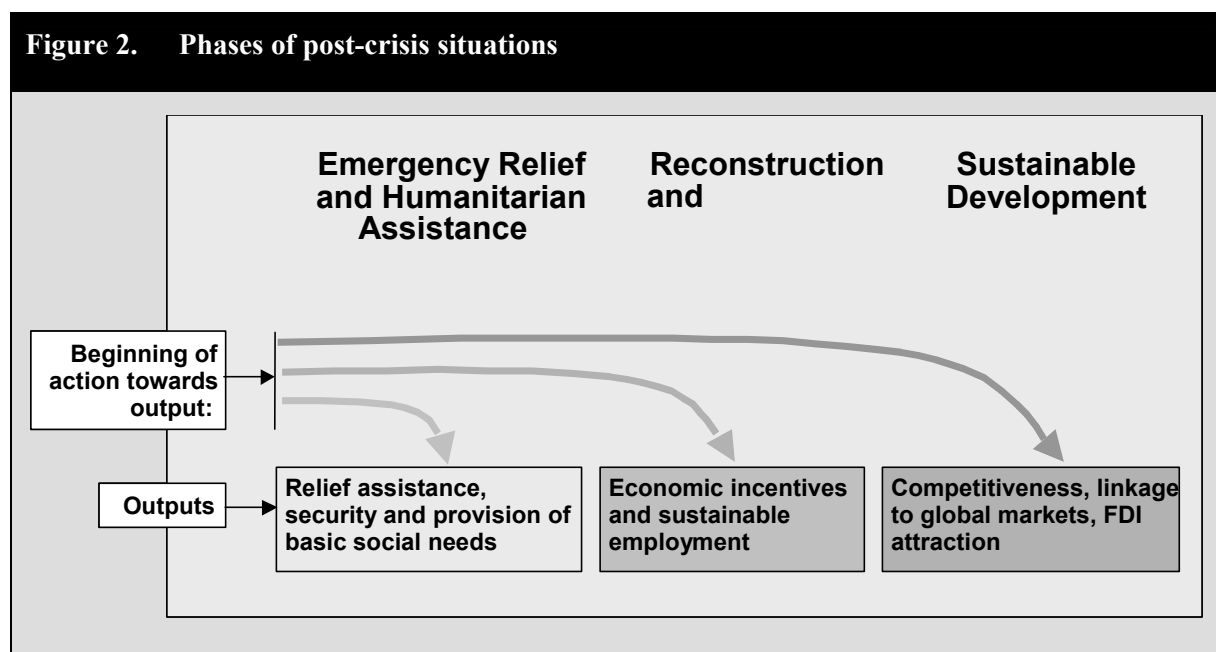
The level of interventions would vary depending on the type and dimensions of crisis/conflict, and the timing and course of actions taken by UNIDO will be determined according to UNIDO's potentials and capacities.

### *Donor coordination and inter-agency collaboration*

UNIDO can play an important role in linking the host government's needs with the most feasible and appropriate bilateral and multilateral activities to promote the recovery of the industrial sector as well as the related institutional and physical infrastructure. UNIDO's intervention for economic and industrial recovery would be harmonized with other implementing agencies and stakeholders.

## **Timing and sequencing of UNIDO's post crisis intervention**

In order to take action in post-crisis situations, their different temporal phases and time sequencing will have to be considered (Figure 2). Each of the phases has its major thrust of activities: The provision of relief assistance, security and basic social needs in the first phase; economic incentives and sustainable employment in the second; and enhanced competitiveness and linkages to global markets in the third development stage.



### *First phase: Emergency relief and humanitarian assistance*

In the first phase of a post-conflict situation, restoring the security of the area and guaranteeing basic human needs is the major priority. International organizations get involved in providing emergency

and relief assistance. At this stage, institutions are usually weak and destabilized, so strengthening them in order to provide local ownership during the subsequent reconstruction period is a strong need.

Since UNIDO is not an emergency relief agency, the involvement of UNIDO in this phase would be minimal. However, this does not mean that UNIDO should be excluded from performing a detailed needs assessment and absorptive capacity evaluation of the country concerned in order to be able to identify the most appropriate areas of intervention. This will provide the government and the international community with a broader understanding of the activities that need to be undertaken to rehabilitate the industrial structure and revitalize economic activity.

### *Second phase: Rehabilitation and reconstruction*

During the rehabilitation and reconstruction phase of post-conflict situations, institutions are more stable, internally displaced people and ex-combatants are either on their way back to, or reintegrating themselves in, their home communities, or are settled in defined camps, and the regulatory framework is being rehabilitated. This is the period in which the country is establishing the necessary platform, though incomplete, to start reviving productive activities and promoting economic recovery.

In this phase, UNIDO could introduce various activities to reinvigorate industry and economic performance:

- Concentrating on the implementation of programmes and services to assist the government, the private sector and specific industries to recover from conflict;
- Initiating income-generating activities among the affected populations as well as rural and poor communities;
- Reconstructing/rehabilitating enterprises to function properly, by addressing the urgent need to restore the productive capacities of industries as soon as possible.

These activities will be conducted in a close collaboration with other UN agencies and NGOs which have been in the field since the initial phases of the post-crisis situation.

### *Third phase: Sustainable development*

Developing countries can only achieve long-term economic growth if business investments in equipment and infrastructure are characterized by increased productivity growth. This will occur only with the creation of a business climate that promotes domestic and foreign investment, and where local actors use those investments to upgrade technological standards of industry, improve human capital and labour skills, and establish quality standards that allow production to compete in global markets.

In this sense, during the long-term phase of a post-crisis situation, the process of creating industrial capacity should be intertwined with technological change, capital accumulation, strong public institutions, and a decentralized income generating capacity, so that long-term economic growth, productivity enhancement, and poverty alleviation are guaranteed.

Once the situation is in this long-term phase, UNIDO's activities could focus on promoting competitiveness and productivity growth, and on providing services through its existing expertise. It is worth keeping in mind that a sustainable transition eventually should lead towards a stable economy with good governance and a solid, robust civil society that participates democratically in the country's decisions. If the transition from a crisis situation is conducted properly, the long-term sustainable development path of the country concerned should not be very different from that of any other country.

## UNIDO Strategy for post-crisis situations

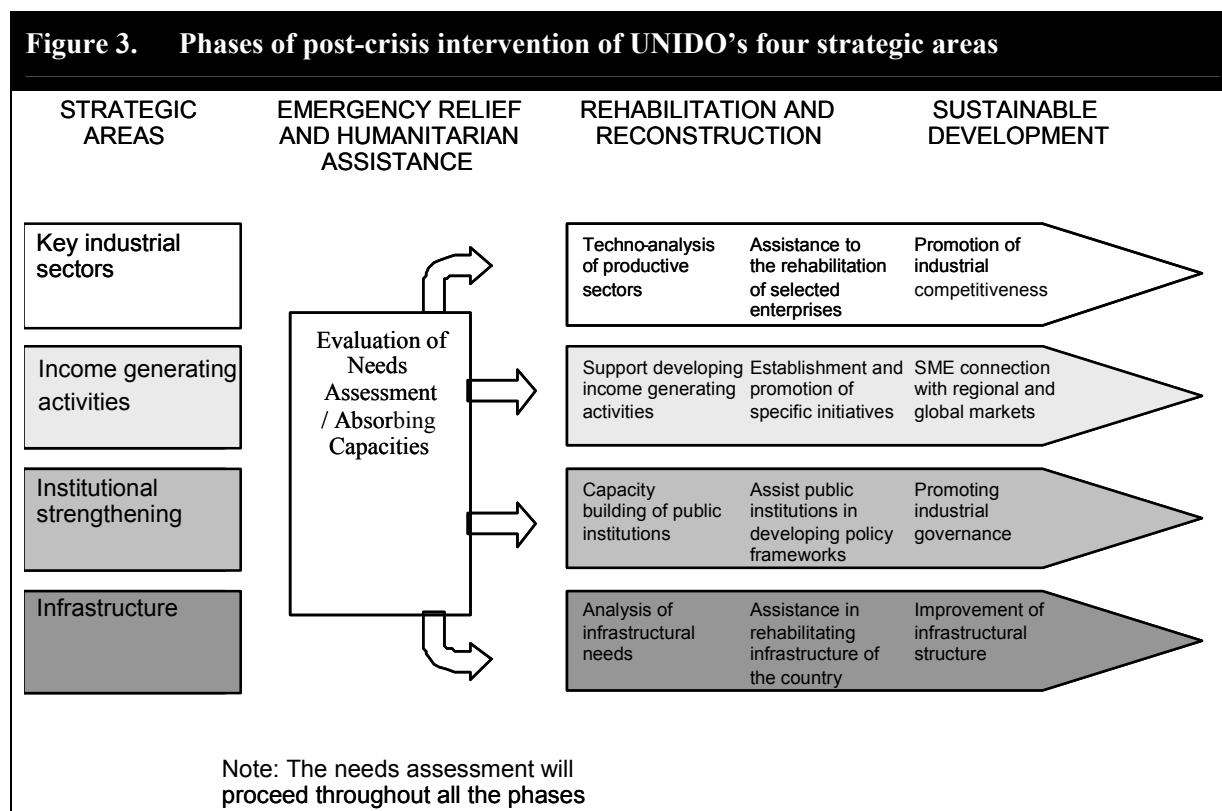
Figure 3 shows the process of potential UNIDO strategic involvement in effective post-crisis intervention, in which UNIDO could offer assistance to promote economic recovery in post-crisis situations, having in mind the time sequencing. There are four major areas of work, i.e.,

- Strengthening key industrial sectors;
- Promoting income generating activities;
- Strengthening institutions; and
- Rehabilitating basic socio-economic infrastructure.

Implementing actions in the short-term stage of a crisis without considering long-term goals or implications, or directing activities towards relief and emergency needs without taking into account long-term economic reform, will be detrimental for the country's economic recovery and will jeopardize the promotion of its comparative advantage and the corresponding specialization of its economy. In designing its interventions, UNIDO will have to pay due respect to the country's long-term sustainable development by involving itself as early as possible and giving due consideration to the country's economic recovery even at earliest stages of the post-crisis situation.

*Evaluation of needs assessment and absorption capacity at the emergency relief and humanitarian assistance phase*

During the initial phase of a post-crisis situation it is important to get involved and undertake the needs assessment and absorptive capacity evaluation in all strategic areas. This is necessary in order to understand clearly what the country situation is, and to identify areas in which UNIDO activities would be most helpful for the rehabilitation and reconstruction phase of the country. This exercise is particularly crucial to promote initiative-taking and interaction with various actors in the country.



There are several key issues that need to be addressed specifically in the case of post-crisis situations, such as the root causes of the crisis; the role played by each local actor and social groups; the cultural and historical background; the legal and political framework; the human rights situation; and the environmental effects and conditions.

While UNIDO interventions should be focused on and geared to the improvement of economic and industrial competitiveness, much of the information required for the needs assessment and absorptive capacity evaluation at this stage will also lie outside UNIDO's specialization. This holistic view of the situation is important for UNIDO's future interventions to be properly integrated and accepted in the country, society and/or communities in question, as well as for ensuring the effectiveness of the assistance to be provided by UNIDO in post-crisis situations.

Along with other agencies, UNIDO could furthermore contribute to the needs assessment and absorptive capacity evaluation by analyzing the issues most closely related to the specialized areas of the Organization, such as:

- The current status and the rehabilitation needs of the transportation infrastructure that will allow trade among local markets;
- The condition and the rehabilitation needs of the water and electricity supply and infrastructure;
- Laws and regulations that have an impact on defining industrial policy and promoting economic activities;
- The effectiveness of existing small and medium-sized enterprises (SMEs) and the identification of support services needed to promote and expand them;
- The status of the banking system and its financial mechanisms;
- The level of education of the population in order to identify the training needed to promote entrepreneurship and skills that will generate economic initiatives;
- The need for health care – including maternity and child care – in order to ensure the availability of a healthy and capable workforce

These exercises need to be repeated if and when new requirements for post-crisis assistance emerge and/or revised interventions are needed, according to the development of the post-crisis situation.

### *The rehabilitation and reconstruction phase*

#### Strengthening key industrial sectors

The objective of these activities is to promote and strengthen strategic industrial sectors by evaluating the capabilities of the country to raise productivity, as well as its resources and potential markets, and to propose a plan of action geared to improving the ability of national industries to compete. In this phase, there are two major activities; techno-analysis of productive sectors and assistance to enterprise rehabilitation.

#### a) Techno-analysis of productive sectors

After the crisis situation, many of the physical infrastructure facilities, factories and enterprises of the country concerned will have been damaged. UNIDO could perform a techno-analysis of selected key industrial sectors and industrial enterprises in order to assess both the rehabilitation needs and capacity building requirements. Through this assistance, those industries and enterprises in urgent need of capital for rehabilitation would be able to present their rehabilitation plans and thereby improve their accessibility to available financing.

When selecting potential sectors to rehabilitate, it might be relevant to consider the following criteria:

- Sectors that satisfy the local needs of the country's reconstruction process.
- Employment generating sectors which are labour intensive and can absorb a large segment of the affected population in need of jobs;

- Sectors that require lower initial investments and lower maintenance costs to promote the quick initiation of rehabilitation.

As the major driving force for post-crisis industrial rehabilitation and reconstruction, UNIDO should play a proactive role for the promotion of SMEs in critical sub-sectors such as food processing, textiles and garments, agricultural tools and machinery, construction materials, essential medicines, and agricultural tools and equipment for better productivity in agriculture.

After selecting specific sectors and evaluating their condition, UNIDO can provide assistance in formulating an industrial rehabilitation plan that could take into account the following:

- Detailed information of investments needed to make the sectors operative;
- Maintenance costs and potential profitability;
- Personnel required and type of training needed;
- Type of production outlays and resources needed, as well as access routes and viability to acquire them; and
- Available markets and how to create and satisfy potential demand.

#### b) Assistance and rehabilitation of selected enterprises

UNIDO could provide assistance to rehabilitate selected enterprises in two ways: One is to assist companies to restart their production, and another is to rehabilitate enterprises de facto.

The first mechanism would involve providing various packages of capacity building assistance required for enterprise rehabilitation. These would include:

- Assisting the government with the selection of technology to enhance productivity, keeping in mind environmentally sound technologies (ESTs);
- Increasing the quality and efficiency of production;
- Promoting and supporting local distribution;
- Helping to bridge the gap to regional and international markets;
- Assisting to locate resources;
- Assisting to establish eco-efficient production techniques;
- Creating training courses for employees to increase human capital;
- Providing entrepreneurial and leadership courses to increase managerial skills; and
- Assisting public institutions in adopting environmental regulations without jeopardizing the priorities of promoting economic recovery.

The second mechanism would involve direct interventions in enterprise rehabilitation. In the unique situation of post-conflict economies, the rehabilitation and reconstruction phase has a set of specific demands that need to be addressed with urgency. Historically, these economic activities have been imported from abroad, increasing the rehabilitation cost and losing an exceptional opportunity to generate local production that would simultaneously promote economic growth and sustainable employment.

As the sole international agency with an industrial development mandate, UNIDO could participate in the activities which put productive facilities into place in the early stages of rehabilitation and reconstruction in order to create jobs and incomes for a large proportion of the affected population. This requires rapid interventions from UNIDO, with the goal of establishing an entire industrial site with all its needs, i.e. reconstructing buildings, starting up production, training local operators and managers, supplying needed technology, providing energy and other utilities needed, such as vehicles for transportation and well-equipped areas for storage, waste treatment technology and techniques, etc. As UNIDO is not usually involved in implementing projects of such dimensions and does not have much experience in this area it might be necessary for the Organization to work with other agencies and institutions by creating partnerships. Under the supervision of UNIDO, these local

partnerships would establish these industrial sites and reinitiate the productive capacities of economic activities.

#### Promotion of income generating activities

Post-crisis situations often lead to a serious erosion of the human resource base and to a widespread loss of entrepreneurial, managerial, industrial, technical and vocational skills. In these cases, specialized assistance is needed to strengthen the capacity of affected populations to participate in productive activities and thereby enable to earn incomes for a sustainable livelihood. The assistance should be addressed to the owners and entrepreneurs of small businesses both in urban and in rural areas. However, specific programmes will be required for the groups affected by crisis situations, such as ex-combatants and returning soldiers, internally displaced people and refugees, women's groups and war widows as they need specialized assistance to be re-integrated and re-inserted into the communities.

##### a) Mobilization of communities and groups for developing income-generating activities

During the first stage, UNIDO could develop economic activities that target specific groups and encourage development in particular geographical areas that have been most affected by the crisis. When addressing these groups, it is important to understand the dynamic role that communities play in promoting, sustaining and benefiting from growth. The proposed activities include:

- Quickly organizing community assets and preparing community profiles in order to define the target groups and ensure that the proposed interventions will not create tensions among the people.
- Preparing on-site training programmes for skills relevant to micro- and small-scale industries, such as construction, the repair and maintenance of basic infrastructure – i.e. woodworking, metalworking, blacksmithing, food processing and the production of building materials and agricultural tools and equipment – as well as some basic entrepreneurial concepts.
- Promoting self-help training programmes among those micro- and small-scale enterprises in both urban and rural areas, and facilitating the sharing of information and mutual teaching/training within the various networks.

##### b) Establishment and promotion of income-generating activities

Once the situation in the country is more stable, in the rehabilitation and reconstruction phase, UNIDO could develop the activities to help modernize the economic activities of these communities and make them more efficient. These would include:

- Developing training programmes specifically designed for rural and women entrepreneurs, including refugees, displaced people and the youth, by establishing links to on-going community based activities and social services aimed at exploring their opportunities to emerge as growth-oriented micro-entrepreneurs;
- Defining the full range of income generating activities in these areas and developing upgrading strategies to improve the efficiency of the production processes, the quality and design of the products, and the functionality and added value that the production generates in the community;
- Supporting and strengthening the capacity of credit and financial institutions in establishing a self-sufficient operating structure so that the communities and small and medium-scale entrepreneurs could have easier access to funds required for their activities;
- Attract FDI into the region by initiating UNIDO business partnerships in the areas of implementation by exploring the need for partnerships, and assessing the internal capacities and needs to implement them.



### Strengthening institutional capacity building

#### a) Capacity building of public institutions

One of the first areas where UNIDO could deliver assistance in the field of institutional capacity building is by providing immediate capacity building of public institutions responsible for industrial recovery and development. This includes, inter alia, the rehabilitation of public buildings; provision of minimum equipment for office management; information and materials required for industrial recovery and rehabilitation, marketing, and investment; a set of training modules, guidelines and manuals necessary for various technical and managerial skill development programmes; and tools and support to form statistical databases of the country's key data, etc.

In addition, UNIDO could assist in providing training for public officials to help them address the basic needs of the country, strengthen their response capacity, help them define a coherent industrial policy for reconstruction, and design a plan for medium- and long-term industrial promotion.

#### b) Development of industrial policy frameworks

Especially in the case of post-conflict situations, the countries concerned face a new challenge to reconstruct their policy framework to respond to the emerging needs after the crisis has ended, and to restore their socio-economic well-being. It is also the responsibility of the governments in such countries to take an initiative to redefine their policies for national reconciliation. This applies to various aspects of industrial development. In recent years, the countries concerned have also had to adapt their policy frameworks not only to national but also to regional economic development schemes. In order to achieve healthy and sustainable growth, it is essential to establish a mix of policies that support increases in productivity, creation of employment, and enterprise and human resources development.

UNIDO can provide assistance by helping the government to prepare a strategy for industrial recovery and future growth, and establish a sound policy framework for industrial development. This would require assisting government ministries in incorporating specific policy requirements for industrial development based on the industrial sector analysis and statistical survey.

Some of the activities that could be developed are:

- Provision of methodologies and tools for economic and industrial sector analysis, when and if feasible, on a sub-sector basis, and the organization of skill training for using these methodologies and tools, including the collection and analysis of industrial data and information
- Assistance in formulating a new and/or revised industrial policy framework including the detailed preparation of a plan of action for its implementation
- Training programmes for policy makers in the assessment, formulation, implementation, and monitoring of industrial policies and strategies
- Implementation of activities to promote the dissemination of services and information.
- Assistance in framing environmental policy regulations

### Basic social infrastructure

Infrastructure is usually defined as the buildings, institutions, facilities or other essential elements necessary to sustain and enable growth and development of a community (Verhoef 2003). This would imply the underlying foundation or framework of basic services, facilities and institutions upon which the growth and development of an area, community or a system depend. Infrastructure, therefore, would include a broad spectrum of services and facilities such as roads, utilities, water, sewage, etc.

These services and facilities are considered essential for enabling productivity, as well as for providing a platform to promote economic initiatives and allow economic growth. Developing infrastructure often requires a large initial investment, which countries in post-conflict situations often lack. But the economies of scale tend to be significant, and the return on investment is thus usually compensated.

While UNIDO does not normally get involved in supporting infrastructure development per se, assistance from UNIDO could be provided to support the basic social infrastructure by improving the production capacity required for infrastructure development, providing advisory services on technology and equipment, and promoting investments in key industrial sectors which are essential for infrastructure development.

#### Water and sanitation

The sector of water and sanitation would be one of the areas where UNIDO's expertise could be used in the activities listed below.

- Promote the transfer of technology to provide drinking water to the population.
- Provide small-scale water depurators to recycle and reuse municipal wastewater in rural areas.
- Participate in the pre-treatment of industrial water and promote technology transfer to recycle or re-use industrial wastewater.
- Analyze water pollutants and help the government to identify appropriate technologies for clean-up, as well as providing support for transferring the technology and creating local know-how in applying it.

#### Waste management

Another possible area would be waste management. In post-crisis situations, issues such as waste management may not be handled with the necessary priority due to other emergency needs. However, this could eventually lead to a deterioration of hygienic standards and affect the population at large, particularly children in poor communities. Based on its broad experience in managing waste and promoting "best practices" in this field, UNIDO could provide the following assistance:

- Propose programmes to recover waste materials that could be used as industrial inputs. UNIDO has developed several of these programmes around the world, and they can be a good incentive to promote income-generating activities that achieve a better sustainable industrial production.
- Create different small-scale initiatives that would recover, clean, shred and develop all the intermediate phases that waste goes through in order to be used as a secondary raw material for industry.
- Transfer technology to enable the country to treat its toxic waste and reduce the exposure of the community to such waste.
- Develop a "manual of best practices" to minimize industrial waste and aim towards increasing productivity and resource-efficiency.

#### *Achieving sustainable development*

When there is a positive transition after a post-crisis situation, the type of activities undertaken by the country's economy should gradually return to normalcy. UNIDO's interventions would follow the same approach to development, by providing the appropriate mix of its expertise, particularly focusing on the promotion of industrial competitiveness and industrial governance as well as connecting SMEs to the global market.

### Promotion of industrial competitiveness

The long-term goal of assisting and strengthening the industrial sector is to accelerate its integration into global markets and promote industrial competitiveness. Some of the activities that can be developed are:

- Promote a positive investment climate by advising local actors on the best international practices and experiences in industrial development, investment promotion and effective industrial policies and strategies.
- Create and develop capacities for identifying technology gaps for the acquisition, adaptation and improvement of technologies by providing information on successful experiences and world-wide best practices.
- Develop national quality and standards systems in support of industrial competitiveness, market access and protection of consumer health, safety and environment.
- Establish industrial parks and support the development of SME clusters.

### SME connection with regional and global markets

The long-term goal of UNIDO in promoting SMEs and income generating activities is to create awareness of the contribution that SMEs can make to fostering growth, specialization, technological innovation and expanding national exports; and support them to become competitive on a global scale. To this end, UNIDO can promote the following activities:

- Supporting the integration of more advanced SMEs into global value chains and procurement networks;
- Promoting horizontal, vertical and regional SME networks to improve their cluster efficiency;
- Strengthening specialized public and private service providers seeking to address market failures working against SMEs; and
- Enhancing entrepreneurial and managerial skills of micro-enterprises, with emphasis on disadvantaged rural areas, and on harnessing the potential of women.

### *Global Forum and international cooperation*

#### Global Forum

Another important area for a strengthened UNIDO presence in post-crisis situations are the Organization's global forum activities. Active participation in such activities would strengthen the generation and dissemination of knowledge about industrial development; initiate and conduct debates to influence the development agenda; and create a multi-stakeholder dialogue to manage the rehabilitation and reconstruction of the country more effectively.

The objective of UNIDO's participation in such activities is to better understand and improve the role of industry in a country emerging from a crisis, and to highlight the importance of achieving the MDGs (for equitable development) and increased productivity (for sustainable economic growth).

It is acknowledged that in order to achieve robust economic growth that guarantees equitable development, it is important to promote social dialogue among different local stakeholders. This dialogue will help to promote a more integrated vision of the economic opportunities of the country, and alleviate part of the crisis that usually arises among different stakeholders during reconstruction phases.

UNIDO could organize national and regional meetings where the major stakeholders and actors for industrial rehabilitation and reconstruction would be gathered from both the public and private sectors, and discuss with them the strategies and modalities of formulating and implementing specific programmes and activities.

## International cooperation

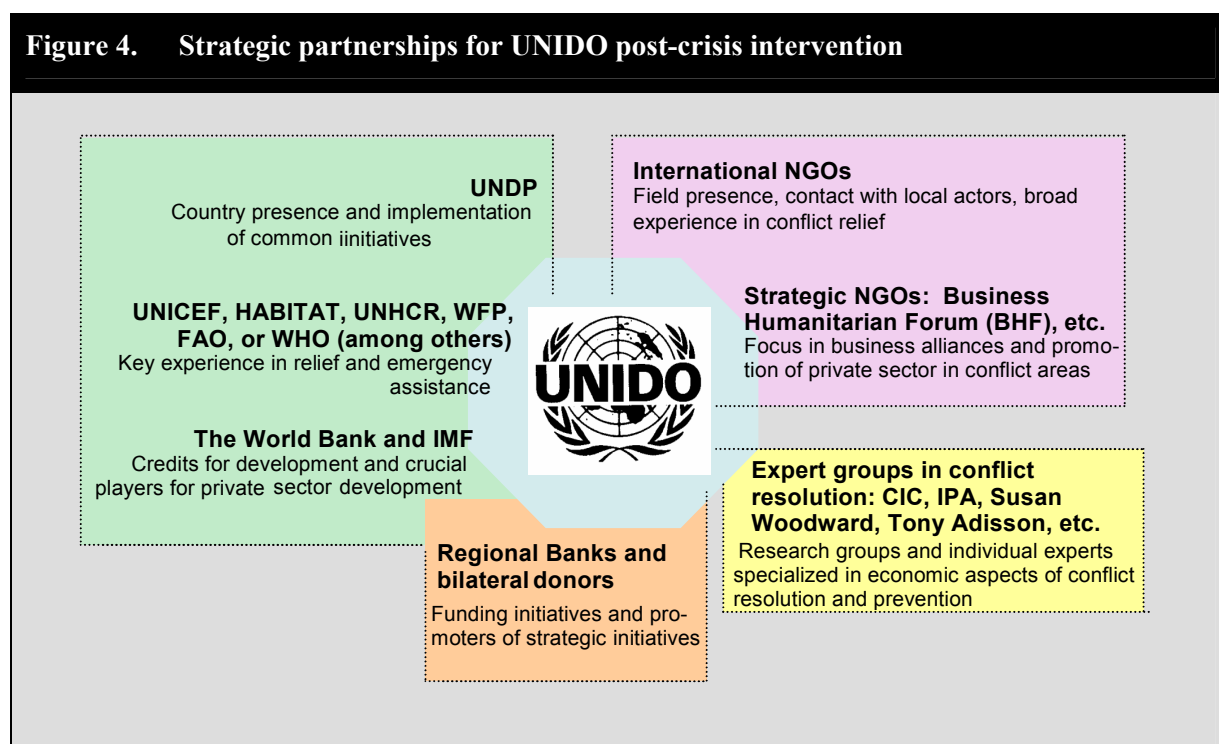
International cooperation is also an essential part of effective post-crisis involvement. In the early stages of post-crisis situations, while the needs assessment and absorptive capacity evaluation is taking place, UNIDO could work more efficiently in cooperation with other agencies in areas such as:

- Formulating laws and regulations that have an impact in defining industrial policy and promoting economic activities;
- Analysing the effectiveness of existing SMEs and identifying the requirements to promote and expand them;
- Assessing the infrastructure and rehabilitation needs of the water and electricity supply; and
- Assessing the environmental condition of rivers, seas and specific sites affected by industrial waste spills or the impact of ordnance of various kinds (such as depleted uranium, etc.).

Other crucial areas in which UNIDO should be involved but lacks the internal *capabilities* for proper assessment, and therefore needs to establish partnerships with other groups, include:

- The banking system and its financial mechanisms;
- The current infrastructure and the rehabilitation needed to re-establish transportation routes that will allow trade among local markets;
- The level of education of the population in order to identify the training needed to promote entrepreneurship and skills that will generate economic initiatives;
- Health systems involving maternity health care and AIDS;
- Food supply and distribution;
- Housing construction and development; and
- The repatriation of refugees and internally displaced people, and the re-insertion of ex-combatants into the work force.

**Figure 4. Strategic partnerships for UNIDO post-crisis intervention**



## Summary

As the Report of the Commission on Human Security (2003) states, people's security around the world is interlinked, and ensuring the concept of human security means protecting vital freedoms. Today, more than 800,000 people a year lose their lives to violence. About 2.8 billion suffer from poverty, ill health, illiteracy and other maladies. Crises and deprivation are interconnected. Deprivation has many causal links to violence, although these have to be carefully examined. Conversely, wars kill people, destroy trust among them, increase poverty and crime, and slow down the economy. Addressing such insecurities effectively demands an integrated approach.

UNIDO is not an emergency relief agency and will not play a major role in the humanitarian assistance phase of a crisis. However, considering the global mandate of the organization to assist developing countries to enhance their capacities for promoting a sustainable industrial development that achieves economic growth and poverty alleviation, UNIDO could provide its services to bridge the gap between relief assistance and a more peaceful transition that guarantees economic development and sustainable recovery. More pro-active involvement could enable UNIDO to more effectively participate in the development phase of post-crisis assistance.

It is essential that the relief and humanitarian assistance phases focus on long-term economic planning in order to achieve a sustainable economic growth and a peaceful transition of the country. Therefore, it is desirable that aspects such as economic reform, the establishment of a solid industrial policy framework, or the formulation of needed institutional changes are designed as soon as possible and integrated into the overall post-crisis strategy.

UNIDO's core competency and principles in post-crisis environments could be oriented to developing productivity enhancement and promoting business competitiveness. These objectives should be promoted by disseminating technology and capacity building for market access and development, as proposed in the UNIDO corporate strategy.

The first activity UNIDO should perform in a post-crisis situation is the needs assessment and absorptive capacity evaluation, in order to understand clearly what the situation of the country is, and to identify in which areas UNIDO's activities would be most beneficial for the rehabilitation and reconstruction phase of the country. This is one of the highest priorities and will determine the success of the activities implemented.

Once the situation is more stable, and the relevant economic actors and key players in public institutions have been identified, UNIDO can intervene by promoting and strengthening strategic industrial sectors by evaluating the productive capacity of the country as well as its resources and potential markets, and propose a plan of action oriented towards improving the competitiveness capacity of national industries.

Another important area of action for UNIDO would be to strengthen the ability of groups to participate in productive activities and thereby to earn income for a sustainable livelihood. During crises, groups that are particularly vulnerable are owners of small businesses and rural entrepreneurs; women entrepreneurs and women's groups; refugees and internally displaced people; and the youth and returning soldiers or ex-combatants.

The establishment of solid institutions capable of assuming a proactive role in promoting the economic and industrial development of the country is critical for a successful rehabilitation and reconstruction process. To succeed, it is necessary to establish a mix of policies that support productivity growth, job creation, enterprise development and the development of human resources. UNIDO can promote this through capacity building of public institutions, assisting public institutions in developing policy frameworks and promoting institutional governance.

It is important that a culture of “crisis prevention” is instilled through every stage of post-crisis intervention (emergency relief, rehabilitation and reconstruction, and sustainable development), as well as an in-depth analysis of the peace and crisis impact assessment and what donors can contribute to achieve a sustainable peace.

While UNIDO is not a relief agency, its services and activities in post-crisis situations create a competitive niche to bridge the gap and support the transition from relief and basic needs assistance to development aid and economic recovery. In order to be effective, it is essential that UNIDO creates partnerships and work jointly with other international agencies, NGOs and local communities.

Crises occur unexpectedly and frequently. The lives of millions of people depend on how quickly the international community is able to react and provide assistance. In order to provide the necessary services and implement projects, it is essential that UNIDO develops an internal mechanism for an integrated rapid response that allows it to have immediate access to funds; to deploy professionals to the area of crisis; and to interact with local as well as international actors responsible for managing the humanitarian assistance efforts and the relief strategy of the crisis.

UNIDO must work in cooperation with its different divisions. The divisions have expertise that can be used in a post-crisis situation. Building on this expertise and providing an integrated service that is flexible and able to adapt to the country’s crisis will be the key to achieving a peaceful transition and a more stable and solid economy.

## References

Commission on Human Security, *Human Security Now*. New York: United Nations, 2003.

OECD, “Helping Prevent Violent Conflict”. Policy Brief. *OECD Observer*, 2002.

OECD – DAC, *Conflict, Peace and Development Co-operation on the Threshold of the 21<sup>st</sup> Century*. DAC Guideline. Paris: Organization for Economic Cooperation and Development – Development Assistance Committee, 1997.

UN, *Report of the Panel on United Nations Peace Operations*. Document No. A/55/305 - S/2000/809, 55<sup>th</sup> Session of the General Assembly. New York: United Nations, 2000.

UN, *Living with Risk: A Global Review of Disaster Reduction Initiatives*. Inter-agency effort coordinated by the ISDR Secretariat with special support from the Government of Japan, the World Meteorological Organization and the Asian Disaster Reduction Center in Kobe, Japan. New York: United Nations, 2002.

UN-DESA, *Guidance in Preparing a National Sustainable Development Strategy: Managing Sustainable Development in the New Millennium*. Background Paper 13. New York: United Nations Department for Economic and Social Affairs / Division for Sustainable Development, 2002.

UN-ECOSOC, *Resolution E/2002/32*. New York: United Nations Economic and Social Council, July 2002.

UNIDO, *Developing Industry: Productivity Enhancement for Social Advance – UNIDO’s Corporate Strategy*. Vienna: United Nations Industrial Development Organization, 2003.

Verhoef, E., *A Short Literature Survey about Infrastructure Definitions*. Delft: Delft Interfaculty Research Center, TuDelft, 2003.

Woodward, L. S., *Balkan Tragedy: Chaos and Dissolution After the Cold War*. Washington, D.C.: The Brookings Institution Press, 1995.

Woodward, L. S., *The Political Context for Programmes of UNDP/UNCDF Assistance*. Discussion Paper for the Workshop Local Governance Approach to Social Reintegration and Economic Recovery in Post-Conflict Countries, held in New York, 8 October 2002.

## Moderator's Introduction

*Renato Fornocaldo*\*

Excellencies, distinguished guests, ladies and gentlemen.

It is my great honour and pleasure to open this Round Table with such a high calibre of panellists to represent the views and roles of governments, the private sector, donors and United Nations agencies in post-crisis rehabilitation. The purpose of this Round Table is not just to present what UNIDO would be willing to do and could do, but rather to hear from the panellists and participants the lessons learnt from previous and current UN rehabilitation operations.

Allow me, first of all, to introduce briefly the panellists here with us:

1. H.E. Mr. Kay Rala Xanana Gusmao, President of Timor Leste, who has been deeply involved in the independence & reconstruction process of his country.
2. H.E. Ms. Kadi Sesay, Minister of Commerce & Industry of Sierra Leone, who has been playing a major role in the post-conflict activities in her country.
3. H.E. Mr. Yukio Takasu, Ambassador of Japan and Permanent Representative to the International Organizations in Vienna. Japan is the backbone of the Trust Fund for Human Security.
4. Mr. Ranjith Fernando, former President of the Development Bank of Sri Lanka, who is taking a very active part in the peace talks in the north-east.
5. Mr. Erick de Mul, former UN Resident & Humanitarian Coordinator in Afghanistan & Angola.
6. Mr. Maurizio Pieroni, Senior Liaison Officer at the Geneva Office of UN-HABITAT and former Chief of the HABITAT rehabilitation programme in the Governorate of Suleymania, Iraq.

As at today, there are more than 70 countries and regions which face the challenge of recovery from political unrest and/or natural disasters. Within this group of 70 countries, 37 are at present in political conflict.

So far, UNIDO has had relatively limited experience in the field of post-crisis recovery. In the past, we participated in the inter-agency endeavours for reconstruction in Bosnia-Herzegovina and Croatia, and for the recovery from Hurricane Mitch in Central America. In addition, UNIDO has been involved in several countries with post-crisis challenges within the framework of its Integrated Programmes – including Burundi, Côte d'Ivoire, Eritrea, Guinea, Rwanda, Sudan and Sri Lanka. Programmes specifically geared to post-crisis assistance have been developed or are under preparation for Timor Leste, Sierra Leone, Afghanistan & Algeria. Furthermore, UNIDO is considering a possible involvement in Angola, Republic of Congo, Democratic Republic of Congo & Iraq.

However, the major thrust of UNIDO's activities has not been developed specifically for post-crisis recovery. Two major reasons can explain this past and current practice. The first one is that UNIDO has no role per se in the early stages of post-crisis recovery during the emergency relief and humanitarian operations. The second reason could be the lack of consensus among ourselves on what constitutes the assistance to be provided for rehabilitation. Our non-involvement in humanitarian operations and the subsequent lack of accumulated ground experience might also be the cause of this lack of consensus on what we should do to help countries in post-crisis recovery, and, more importantly, how we should do it.

It has become apparent in recent years that the support activities needed for post-crisis recovery are closely interlinked, and that the needs of the affected populations have to be addressed at various stages depending on the causes of the crisis, their locations, the communities involved, and the scale

---

\* Managing Director, UNIDO. This text is based on an edited transcript of the spoken presentation.

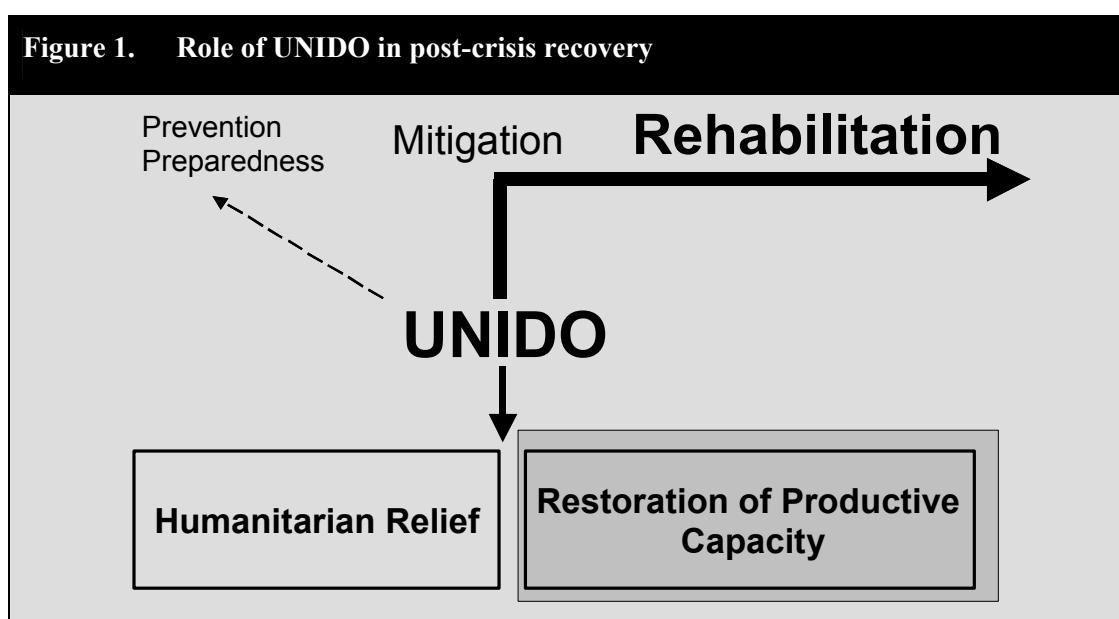


of operations, etc. This means that the evolving stages of response cannot be “linear” and that the complexity of the post-crisis recovery needs is making it more and more difficult to draw clear lines between each phase of conventional post-crisis assistance.

These days, many agencies involved in emergency relief extend their programmes into rehabilitation and reconstruction work, without losing sight of the development work ahead. At the same time, development agencies may identify opportunities for interventions during the rehabilitation phase, without losing sight of the lessons learnt in the prior phase of emergency relief. UNIDO’s involvement in post-crisis assistance could therefore be based on the work done by UN agencies in the early phases of the post-crisis period.

What does this mean to UNIDO?

The international community increasingly needs to address a wide spectrum of activities for crisis and disaster reduction such as prevention, preparedness, mitigation and rehabilitation. UNIDO must be a part of this, although with a varying intensity in the different stages. Our interventions should be focused on economic recovery and capacity building, as this will ensure the stabilization of the transition process. In particular, this will help to create opportunities for employment and income generation, and for absorbing those segments of the population in need of employment, including ex-combatants and refugees. However, striking a balance between relief operations and the restoration of productive capacities is the key area where UNIDO could play an important role for a sustainable longer-term development.

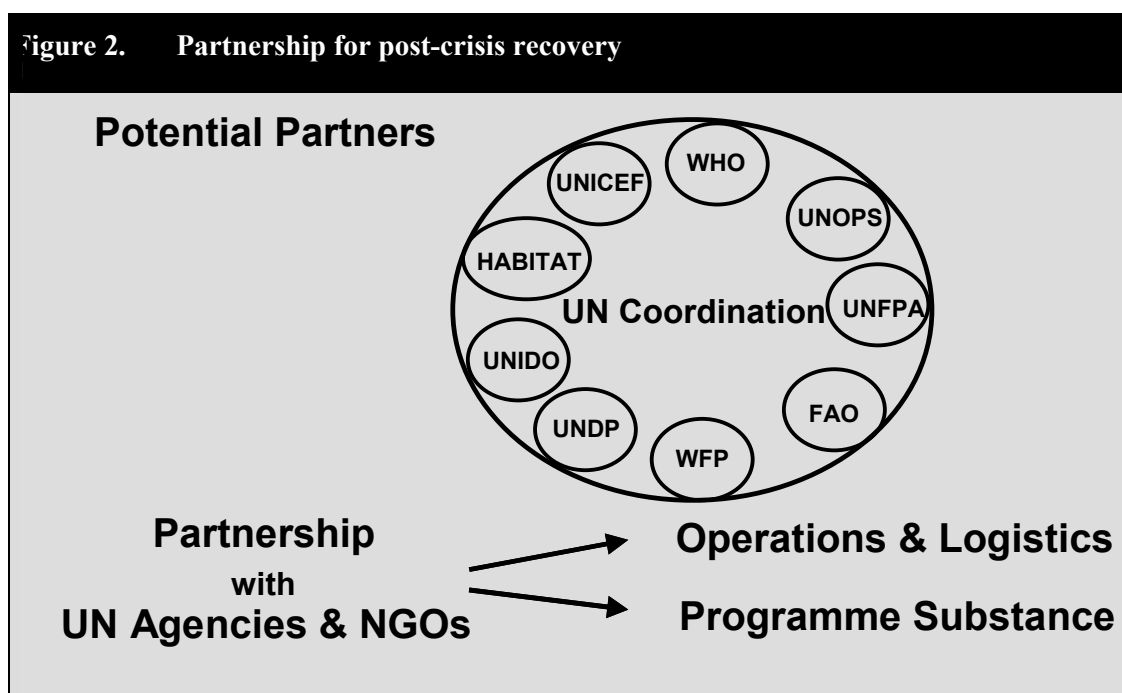


What then should be the role of UNIDO?

Our assistance needs to be based on two major principles: Sound diagnosis and tailor-made response. A sound diagnosis will enable us to identify clearly the demand for industrial recovery, and formulate and organize a response comprising an appropriate mix of our existing services. The tailor-made response is possible through UNIDO’s specialized expertise. The Organization’s strengths for formulating and implementing supporting interventions rest in its capacity to provide the hands-on knowledge, skills and information required by specific groups of affected populations in certain sectors (e.g. agro-industry), and in rural or urban areas. Macroeconomic advisory services could also be offered to assist the public and private sectors.

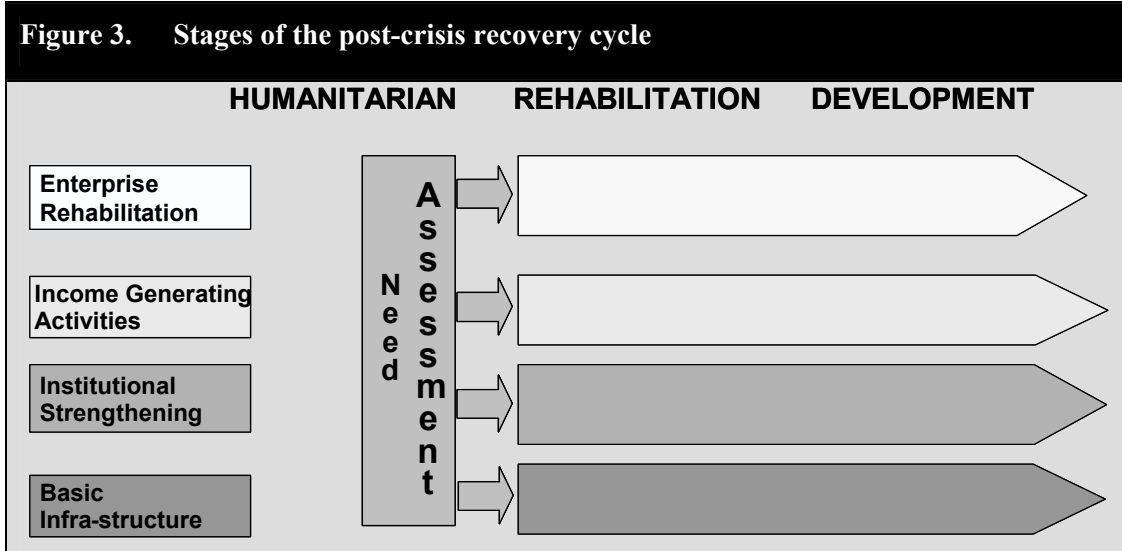
Having said that, I would like to present to you four major issues on which I would be more than happy to receive your able guidance and suggestions. First of all, despite the fact that we have accumulated some experience, we still need to define our most tangible and feasible interventions for post-crisis recovery. Based on the needs assessment and absorptive capacity analysis being made as a prerequisite, we are willing to get involved in four major areas during the phase of rehabilitation. These comprise:

- Assisting enterprise rehabilitation in key industrial areas based on a techno-analysis on productive sectors;
- Promoting income generating activities also addressing specific groups of affected population;
- Supporting institutional capacity building for providing the services required for industrial rehabilitation to the public and private sectors;
- Contributing to the rehabilitation of basic infrastructure, particularly addressing the production of goods and services related to water treatment and sanitation.



The second issue refers to the kind of strategic alliances that UNIDO should seek to establish with other agencies and partners. As mentioned previously, assistance required during a post-crisis phase has to be multi-sectoral, address cross-cutting aspects of recovery, and consist of coordinated actions by many actors. UNIDO cannot work alone in this field, and substantive and operational inter-agency collaboration is the *conditio sine qua non* on the basis of which our programmes and projects will gain in efficiency and solid outputs to respond better to the host government's needs. Who could be our partners in facilitating the endeavours for economic and industrial recovery?

The third issue concerns how UNIDO would implement the assistance for post-crisis recovery, which is normally of an urgent nature. Usually, within development programmes, resources are scarce but the implementation period is long. In post-crisis situations, however, the opposite is often the case. Rehabilitation activities often benefit from more financial resources, but with the requirement for these resources to be spent within a shorter period of time. While a thorough assessment is needed for conducting any meaningful interventions, UNIDO may need specific modalities in order to be more effective and timely. Is there any specific approach and/or mechanism needed in order to respond appropriately and promptly?



Then, the fourth issue relates to the continuum from relief to development, and raises the question as to how early UNIDO's involvement should be initiated. Let me recap my earlier concept of a "varying intensity" for UNIDO's involvement in the different stages. We could get involved in fact-finding and needs assessment as early as the first phase of crisis situations, not at the very beginning but definitely before the end of this first phase.

Distinguished participants, colleagues, ladies and gentlemen. We thus have to seek the answer to the following four questions:

1. What should UNIDO do to help countries in post-crisis situations?
2. With which partners should we do it?
3. How should we do it?
4. At which stage of the post-crisis recovery cycle should we get involved?

Today, we at UNIDO wish to get some insights on these issues from the panellists and participants of this Round Table. As mentioned in the beginning, the main purpose of this Round Table is not just to present what UNIDO would be willing to do and could do, but rather to hear the lessons learnt in order for us to receive valuable inputs and advice to guide us in deriving a more clear definition of the strategic framework for UNIDO's interventions.

With these introductory remarks, I would like to invite our first speaker, H. E., Mr. Kay Rala Xanana Gusmao, President of Timor Leste, to enlighten us on the extraordinary experience of his country.

## Keynote Speech

*Kay Rala Xanana Gusmao*\*

Thank you Mr. Chairman, Excellencies, Ladies and Gentlemen,

Thank you for this opportunity to share with you the experience of Timor Leste. I will talk about post-crisis rehabilitation and reconstruction, but first of all, I would like to give you an idea of a real post-crisis situation. Otherwise you might get the impression that the crisis we are facing is not so deep or severe.

As you know, our people gained the opportunity to decide on their own destiny after 24 years of struggle, 24 years of oppression, of violation of human rights, in August 1999. After that, we witnessed more violence and destruction, which put our country in a very, very bad situation. More than 90 per cent of our infrastructure was destroyed. With the houses burned, our people were left with only one alternative: To flee to the mountains, losing everything. In addition, more than one hundred thousand people were forced to flee to the other half of the island. It was a disaster. We were able to gain our independence, but the independence came to us with a very, very difficult beginning.

Of course, we were assisted generously by humanitarian agencies and their emergency activities. After that we started to look at the settlement of our people that had fled to the mountains, and at the repatriation of the hundreds of thousands of people that had been forced to go to West Timor, which is part of Indonesia.

We have to understand the meaning of a post-crisis situation in the context of this kind of human suffering. We started our freedom in 1974 after Portugal gave us the opportunity to choose. Our political history started with political violence. This was followed by the invasion that lasted 24 years.

I believe that everybody has heard that we had to start a new process from scratch, from zero. Our people lost almost everything, with much of our infrastructure destroyed. I can tell you in the past year we spent US\$ 14 million only to rebuild two schools that were destroyed. We had clinics destroyed. Everything was destroyed. Therefore, for us the big challenge of post-crisis rehabilitation is that of post-crisis reconstruction.

Besides the assistance of humanitarian organizations, we started to look at the future in two fields: Human rehabilitation, and physical reconstruction. When we talk about human rehabilitation, we mean human rehabilitation from the trauma caused by the violence our people experienced – both the violence committed by ourselves and by the occupying forces – and by the material losses that our people were forced to suffer. In terms of human rehabilitation we are trying to do our best to promote reconciliation so that the people of Timor-Leste can forgive each other to accept each other again.

In the process of post-crisis recovery we have to look particularly closely at the social aspects, and in this context we are facing problems arising from demands for justice. But in other respects, we are also facing demands for social justice – social justice in terms of providing services for all our people. Our people fought for their independence, but they had dreams beyond the objective of independence. They believed that after independence they could live in better conditions of life, and independence was taken as only a means, but not an end, of the struggle.

---

\* President of Timor Leste. This text is based on an edited transcript of the keynote speech as delivered.

In the beginning of the process of building our country, we had difficulties in terms of creating and consolidating the institutions of the state, government, environment, presidency, and judiciary. We faced difficulties in human resources, and we are trying to get more and more help in developing our human resources and our capacity to run the state and the government, and to make good programmes and good plans. On the other hand, we feel that we are not able to respond to the needs of the people.

From the beginning we were totally dependent on the generosity of the international donor community. Faced with so many challenges, so many things to do, we were sometimes not able to decide in the best way how to respond to the needs of our people. Let me give you an example: If we mentioned to donor countries that agriculture was our priority, they answered that education was the priority and that we should rebuild our schools and put our children in school because we have to rebuild our country. But it is difficult to make this process of education sustainable when we have to charge school fees of 50 cents per month for a child and our people come to us and say that they don't even have ten cents to buy food. Unfortunately we are still a very poor country, and in poor countries we witness big families. We don't have a good family planning programme yet, and our people have a minimum of seven children and a maximum of 17 children. When we talk about a 50 cent monthly fee for each child, it means four or five dollars a month for a family to send their children to school, and we feel that sometimes we cannot decide on our own priorities.

With a globalized world, and globalized standards, we sometimes talk about how to improve the difficult economic conditions we face.

We are committed to building a democratic society, and I can tell you that one of the most important decisions we made was to dissolve the liberation movement to give an opportunity to the political parties to run the process. We also asked the veterans not to seek jobs or compensation for their past sacrifices, but how should we recognize the new sacrifices that the political process demands from them?

We want to establish a society in which tolerance is the guideline of the democracy. We want to establish a society in which we understand human rights, and the people understand human rights. As a result of the violation of human rights they have suffered, and of the lack of democracy they have faced in the 24 years of the struggle, our people are now very committed to democracy. I can tell you, however, that to guarantee the success of this process – a process through which we want to commit ourselves to democratic values and universal principles – we need to solve the immediate needs of our people. We have established some basic activities in order to push the process, and have taken the poverty reduction required by the Millennium Development Goals as our own goal. But because we are totally dependent on donor countries, we are sometimes asked to be responsible for some of our expenses, and we are forced to increase the taxes that we take. When we increase taxation, just to satisfy the need of the budget of the government, our people feel that independence means nothing to them, and that their struggle and sacrifices now have no value.

Sometimes we face an organization talking about trauma, about justice, about the need to listen to the victims, even when we don't respond to the needs of the victims ourselves. We talk about violence, we say that it was a crime against humanity, that it was genocide, but we don't respond in real terms to the needs of the people. Now we are in a post-crisis situation and we don't know what to do! If we put more emphasis on justice we offend God. We are building more prisons, and we cannot use the money to improve the lives of the population.

We are the poorest country in Southeast Asia, one of the ten poorest in the world. This is why when I talk about the needs of the population, I really mean the needs of the population; the basic needs of the population. This is why we are thinking and talking and discussing how to respond to this problem, and to give hope to our people. To make them understand that we must go slowly, but that we are going in the right direction.

Sometimes we discuss and we feel that we need to open our doors to investment, but investment of what? To industrialization. But what kind of industry? How can we, a very small country and one of the ten poorest in the world, compete in this globalized world, and how can we respond to the needs of the people? How can we assure that people understand that we are going to give them better conditions of life?

Some financial organizations helped us to establish a micro-credit programme. It succeeded. Yes, and the agency that is running this activity is getting more and more money because people are paying in a good way. But what we saw, what we feel about this micro-credit – fifty dollars, one hundred dollars to get people running the activities of the street vendors – is that because the programme cannot reach the mountains and the remote and isolated places, people are leaving the fields and are coming to the cities and towns to be street vendors. They pay back the money, and I applaud our people for paying back the money, but we are creating a migration phenomenon which forces people to come from the countryside to the towns to be street vendors.

Sometimes, they give one hundred or two hundred dollars to somebody to open a kiosk. We are witnessing almost hundreds of kiosks opening along our roads and yes, we feel that the economy is moving, is living. These kiosks give the people a place where they can buy and sell things, but what we see is that everything they are selling is from Indonesia – clothes, sandals, noodles, everything. Everything is imported. And the micro-credit is not helping our people to live. It is not helping our economy to grow because our people can get some savings in cents and dollars. Of the dozens of hundreds of thousands, even millions, of US dollars to come into East Timor, all are going back to other countries.

We feel that we are living in a false economy. We are living in something that is unreal and we note the need to start helping our people in productive activities, not as street vendors, not as kiosk vendors, but in some way that they can produce goods from our own raw materials so that we can avoid importing these goods, and then to start distributing the income to everybody. This is the big challenge that we face now. We need to start pushing the small and medium-sized enterprises. We need to establish a system of integrated agro-business or agro-industry.

We import everything. We even import the rice that we can produce ourselves. All of you know the size of Singapore. It is a city-state. They don't produce any agricultural products, but we import rice even from Singapore. We have plenty of soil to produce rice, and we have the potential to be self-sufficient in almost all our food requirements. So why, why are we importing food? Because we produce a bad quality of rice. And we don't have good production of corn, potatoes, or vegetables, or rice, because the people are not motivated. Our people live in a subsistence agriculture.

They produce everything because at least they don't buy it from anybody else, but they produce a small amount of everything and that is why we need to motivate our people to produce more and better. I can tell you that at the end of the 1990s, we were all receiving food from the humanitarian agencies because people lost everything, but we went around and we told people we must produce.

It is not our culture to beg. Our ancestors never knew humanitarian agencies, and we are now the generation of our people that must start to produce. In 2000, I saw many fields of corn and rice, in 2001, when we visited the countryside and villages, I started to see people reducing the production. I asked why? Why did you produce on three hectares yesterday and are producing on only half of a hectare now? Why? And you are crying that when we go to the world to ask for more food, they say no – if you want to produce corn you have to produce in yourselves. I asked why? Tell me why you have reduced your production? They said: The last harvest we ate inside our house and could not sell the rest. That is why we are producing only enough to eat. We need assistance, assistance that motivates the people to produce better and more, so that we can buy the products, we can process the products, and we can distribute the products, to be self-sufficient.

We also need to give income to everybody and to respond to the demands of the veterans, because we initiated a tolerant process, a democratic process in which we told to the people that participated in the struggle not to demand to be part of the government or to demand jobs in the institutions of the state as compensation. Instead, we have other educated people that didn't even participate in the struggle governing our country. But now they are posing to us the problem: What about us, what about the sacrifices we made for the struggle? We need to encourage them to run their own life in a sustainable way, so that they can believe that independence means something for them.

Small and medium-sized enterprises should respond to the needs of the people, of the widows. We have so many widows. I just want to tell you that in 1974, when we initiated the process of war, our population was about 750,000. Now, 28 years later, we are about 800,000. This is because more than 250,000 were killed in the war. Now we have 54 per cent of our population under twenty years of age. Because of the bad system of education, people feel that their education can provide them with an opportunity to become civil servants, to go to the police, to go to the government bodies. We don't have a business-oriented mentality. We need also to give to the people a new perception of the private sector as a place of opportunity. We need to change the people's mentality so that they understand that they should not rely on the government but rely on their own capacity. We face the challenge of giving the perception of a business-oriented society. We face the problem of giving the capacity to small and medium-sized enterprises to provide the community, the society, the country, with products of sufficient quality and quantity. We need to provide jobs to the people in a sustainable manner, and that means in a manner in which they have the opportunity to run their own life.

This is what I can tell you about my experience, of my awareness and knowledge, of the lack of the capacity to deal with the problem of developing our country. I feel that you will understand that this is not experience in terms of already having solved something, but the experience of having problems and being willing to solve them. This is why I believe that UNIDO can help us to start taking good steps in the direction of solving the problems of our post-conflict situation.

Thank you very much.

## Presentation by Mr. Yukio Takasu\*

President Xanana Gusmao, Excellencies and Distinguished Panellists,

It is a distinct honour for me and also gives me great pleasure to join such a distinguished group of panellists. My long association with the United Nations has given me the opportunity to devote myself to the various aspects of issues related to conflict and reconstruction. I have also been actively involved in developing and mainstreaming human security.

I would therefore like to discuss the importance and relevance of the human security perspective in tackling post-crisis industrial rehabilitation and reconstruction.

Human security is a concept that focuses on the perspective of individuals in order to ensure their survival, livelihood and dignity. Every individual, wherever he or she lives, must be provided security free from any kind of want and fear. The International Commission on Human Security, co-chaired by Mrs. Sadako Ogata and Prof. Amartya Sen, and consisting of ten prominent commissioners, submitted a final report entitled “Human Security Now” in May this year to UN Secretary General Kofi Annan, after two years of intensive deliberations.

We attach high priority to the effective follow-up of the Commission’s recommendations. Japan is prepared to finance meritorious projects aimed at enhancing human security through the UN Trust Fund for Human Security and also through bilateral assistance programmes, including grass roots human security grant aid.

The Commission put forward a set of important recommendations to address the inter-related question of conflict and poverty, including protecting people in post-conflict situations and empowering people to overcome economic and social insecurities. The key and basic starting point to advancing human security in post-conflict situations is to provide minimum living standards everywhere. All other efforts must be built on a block of early successes providing for such conditions.

Based on my past experience, and drawing on some of the Commission’s recommendations, I would like to summarize the most essential considerations for successful post-crisis rehabilitation and reconstruction into the following four important points:

1. Empowering individuals and communities;
2. The seamless transition from humanitarian assistance to reconstruction assistance;
3. An integrated and better coordinated approach among partners; and
4. Earlier formulation of rehabilitation and reconstruction plans long before a ceasefire is agreed.

Now I would like to elaborate further on each point, particularly with UNIDO’s involvement in mind:

### *1. Empowering of individuals and communities*

Empowering or fostering people’s abilities to act on their own behalf is of primary importance, because people develop their potential and resilience as individuals and as communities.

This important point has borne fruit in many post-conflict situations. The end of conflict relieves people from fear but does not necessarily guarantee the basic human security needs of a minimum livelihood, only with which a society can proceed to the reconstruction process. Throughout the relief to reconstruction process, we should always focus on empowering the individual and community alike. In Timor-Leste, I am pleased that Japan could support a number of post-conflict projects,

---

\* Ambassador Extraordinary and Plenipotentiary, Permanent Representative of Japan to UNIDO.



through the UN Trust Fund, to reduce post-harvest losses, to enhance the economic empowerment of returnees and women and to reactivate the community.

A post-conflict community empowerment project to revitalize agricultural productive capacity in southern Sudan was approved this year as the first UNIDO project financed by the UN Trust Fund for Human Security.

## 2. *Seamless transition*

During and immediately after conflict, efforts should focus on providing key services, rebuilding basic infrastructure, reintegrating displaced people and demobilized combatants, and establishing a social safety net as well as a macroeconomic framework.

In post-conflict situations, there should therefore be a seamless transition from ceasefire, emergency relief, recovery and rehabilitation through to reconstruction. Humanitarian assistance and development assistance have been the separate responsibilities of different organizations at national and international level when in reality there should be no gap between the two activities.

Traditionally, emergency relief assistance is provided by humanitarian organizations which are not expected to stay on to provide assistance for rehabilitation and reconstruction as these are within the realm of development organizations. However, the actual situation in the field is often far from clear enough to enable the separation of the recovery stage from the rehabilitation stage even though the mandates of assisting organizations are clearly delineated. In recent years, efforts have been made by both humanitarian organizations and development organizations alike to come forward to bridge the gap between their respective programmes. Such efforts were first attempted during the early post-conflict stage in Timor-Leste. And currently in Afghanistan, a large scale Comprehensive Regional Development Assistance Programme (“Ogata Initiative”), centering around Kandahar, Jalalabad and Mazar-i-Sharif, has been launched with this concept in mind.

The programme has proceeded from Phase One (emergency assistance) to Phase Two (recovery), to Phase Three (rehabilitation) and is now at Phase Four (reconstruction and development). UNIDO could play a useful role in phase four to create jobs and industries. A UNIDO project to assist rural communities is now under consideration by the UN for financing from the Trust Fund for Human Security. Japan is working with the UNIDO Secretariat, which is involved in Phase Four of this Comprehensive Programme.

## 3. *Coordination*

Each post-conflict recovery requires an integrated human security framework developed in full partnership with the national and local authorities to ensure ownership and commitment to objectives. There should be a comprehensive and better coordinated approach among the relevant international organizations as many of them have a particular weakness when it comes to working together with other international organizations. But, as we know, the various needs in each post-conflict situation demand an integrated and well-coordinated response from a number of international organizations, utilizing their wide-ranging experience and mandates.

There is room for improvement in co-ordination and collaboration among the relevant international organizations to ensure the effective implementation of projects. As the first attempt in this respect, Japan is taking an initiative to facilitate the proactive formulation of comprehensive projects in Sri Lanka. UNIDO plays an important role in the Human Security Initiative, a multi-agency programme for transitional recovery in Sri Lanka, which was recently launched on Japan’s initiative. UNIDO was identified as one of the six United Nations agencies that address the immediate and urgent human security needs of post-conflict Sri Lanka and is to support the recovery of community-based small businesses.

#### 4. *Earlier formulation of plans*

Long term planning of rehabilitation and reconstruction at an early stage is essential for successful implementation, in terms of identifying partners, securing financing and preparing for all contingencies.

The earlier discussion of reconstruction plans sometimes works as an inducement to facilitate the political process. I recall how I tried a few years ago to promote the peace process in Sierra Leone with this consideration in mind. The Sri Lankan peace process, although it has temporarily slowed down, could be assisted by a clear appreciation of the benefits which peace will bring to reduce the plight of its affected people. The situation in Iraq is difficult and I regret very much that I lost one of my best friends in the recent attack. However, we should not be discouraged and should rededicate ourselves to assist the Iraqi people to rehabilitate and reconstruct their country. Japan recently pledged grant assistance of US\$ 1.5 billion to meet the immediate rehabilitation requirements of the Iraqi people including (i) power generation, (ii) education, (iii) water and sanitation, (iv) health and employment, and (v) the improvement of the security situation. As an initial step, grass roots human security grant aid was extended last week.

Japan hopes that UNIDO will be one of its reliable partners in the reconstruction of Iraq. The fields in which UNIDO could make a valuable contribution may include improvement in the water supply, rehabilitation and reconstruction of small and medium-sized enterprises in the non-oil sector, and vocational training of returnees and internally displaced people.

Mr. Chairman,

In conclusion, the cases I discussed demonstrate UNIDO's great potential for contributing significantly to post-crisis rehabilitation and reconstruction. The following categories of activities seem to be particularly promising, bearing in mind the mandate and experience of UNIDO:

1. Rehabilitation and reconstruction of micro-, small and medium-sized enterprises that provide the poorest segment of the population with employment opportunities.
2. Empowerment of rural communities through increased agricultural activities and vocational training of returnees and internally displaced people.

## **Presentation by Mr. Ranjith Fernando\***

Thank you Mr. Chairman, your Excellencies, distinguished Delegates, Ladies and Gentlemen,

I would like, with your permission, to spend the next five to ten minutes and try to share with you Sri Lanka's experience in the post-crisis period that we are facing now.

I thought you would appreciate it if I could briefly summarize the crisis itself, so that you will understand the kind of issue we are facing now in the post-crisis period and the role that UN organizations such as UNIDO could play during this period.

Sri Lanka is an island nation in the Indian Ocean, a small country of about 25,000 square miles with about 19 million people, multi-ethnic and multi-religious. We have a majority community of about 74 per cent of the population which is referred to as the Sinhalese nation. About 12 per cent of our population are Tamils, who have affinities to the southern part of India, speaking the same language as the southern state in India. The third community in the country comprises the Moslems.

While Sri Lanka has a recorded history of about 2,500 years, it was ruled by foreigners for the last four hundred and fifty years. We had the Portuguese ruling the country for about one hundred and fifty years – I get my name, Fernando, from them – and the Dutch who ruled after that for another one hundred and fifty years, and finally the British.

The crisis between the majority and the minority community which has been going on for these 20-25 years is very complex, so I am not going to try to explain the reasons. There are many explanations, but I will try to present the situation in a very simple way. When the last colonial government left the country and we got our independence in 1948, we found the minority community had much better positions in government because of the preferential treatment they received in the context of the policy of divide and rule that had been carried out by the colonial masters, and the majority community felt that it had to assert itself to get back its share of power and the plums of office.

This current situation started in 1948, in the post-independence period, when a government was established by the majority community. They tried to redress the existing imbalance in favour of the minority community, which had been the legacy of the colonial masters, by doing various things, such as promoting the majority community's language, its representation in government positions, and so on.

This created a conflict, which finally erupted in 1983, with armed conflict organized by the minority community who occupied the northern part of the country. They wanted to establish a separate country because they no longer had faith in the majority community, and this led to the armed conflict in which we have lost 65,000 people up to now, and which has caused enormous damage to the economy of the country.

The situation is a little bit more complicated because two years ago a new government was elected and negotiated a cease-fire agreement with the rebels. For the last 24 months we have had a situation in which that cease-fire held. We have a presidential system of government, on the French model, where the President enjoys executive power, and we have an elected uni-cameral legislature, or Parliament, with representatives of the people. The Prime Minister is elected by the Parliament.

---

\* Secretary to the Ministry of Enterprise Development, Industrial Policy, Investment Promotion and Constitutional Affairs; former President of the Development Bank of Sri Lanka. This text is based on an edited transcript of the spoken presentation.

We therefore have a peculiar situation in which we have a President who was elected by the people from one party, and the Prime Minister and Parliamentary majority elected from another party. This has led to another conflict between the President and the Prime Minister, who are from different parties both belonging to the majority community, with the Prime Minister who negotiated the peace cease-fire agreement with the rebels having power in the legislature, and the President holding the executive power of the presidency.

In this situation, a permanent solution to the crisis is far away, because we have had six rounds of negotiations. At last, the Prime Minister and the rebels have agreed to consider a federal solution within a united country rather than establishing a separate state, provided that a large degree of power is devolved to them. Thus, the real issues have recently been discussed, but the discussions are temporarily stalled because the President and the Prime Minister are in conflict on some of these issues. To simplify the description of the situation, we are in a position where negotiations will recommence on the extent of power that may be devolved to the minority community in the north, so that the country remains an integral country of one nation, but with a federal structure and a large degree of devolution of power to the minority community in the north.

What are the issues we face in the post-crisis period, if I can name it as a post-crisis period, because there is a peace now? And what kind of role can UN agencies like UNIDO play in this situation?

It has been rightly pointed out in the background paper for this Round Table that a country goes through three phases in a post-crisis situation: The first is the period requiring immediate relief measures like food security etc., that comes when the crisis is over. We have gone through this phase and now come to rehabilitation phase. This is a phase when houses and schools, as well as the social infrastructure that has been damaged during the war, have to be built again. We have identified the needs of rebuilding the housing, roads, energy power, educational system, schools, hospitals, etc. We are in the midst of that phase.

The next phase that we face is the reconstruction phase, when the development process begins and the economy of the area has to be revived. This means the building of institutions, the reviving of the market economy and entrepreneurship development, employment generation, and the demobilization of the fighting cadres that were used both by the army and the rebels, to bring them to normal life. The guerilla movement itself has to transform itself from a guerilla movement to a recognized political party willing to share power with other parties. We also have to make an effort to introduce a democratic form of government, which was not there in the area controlled by rebels because they killed their own people who did not want to be under their supremacy.

In this situation, the questions of inter-party democracy, of holding multi-party democratic elections, of establishing a government in power, of establishing the institutions that really control the economy in those areas, are very important issues today.

In that context, the Japanese government has been very supportive. They have led the international community in providing the financial assistance for the reconstruction of these areas. Recently, in September, we had a very successful donor conference in Tokyo, which raised US\$ 4.6 million for the rehabilitation of these areas, of which 25 per cent was in grant funds and around 50 per cent in very soft long term loans.

We are faced with the really difficult situation of how to reallocate these funds. Who rules the interim government and the interim structures? Especially since the rebels want control of these interim structures.

This raises the question of how the democratically elected government which rules the country can devolve that power to people who have power but have not been democratically elected. How can they transform themselves into a democratic regime? Which kind of institutions should be established

under their control with government participation. Who should run the police force in that area? Who should collect the taxes? Is it the regional body?

These are issues that have to be determined in negotiations, and these issues have been reflected in the interim administration that we have to set-up in that area. Then we are faced with the issues of trying to draw up the development agenda and how to spend the money. Who should be in charge of the expenditures, procurement and other related issues, and who should ensure that they are rightfully spent. These are all issues that concern us now.

In this context, my final question relates to the role of UNIDO and of the private sector in this kind of situation. There are a few initiatives that have been taken with regard to UNIDO and the private sector that I would like to share with you. UNIDO has been implementing a programme with the Government and the private sector in the northern province, where we have set up a branch of the Chamber of Commerce.

Training programmes have been organized under that programme in the areas emerging from crisis, where some of the participants are young people who have never known anything but war. The civil unrest have gone on for more than 20 years, and some of them have never lived in peace, never known a regular form of government in their area, and always lived with guns.

We arranged for some of these young people to come to Colombo and be trained in the factories. We have also set up some other programmes where UNIDO has already been involved in Colombo, for instance in the transfer of technology and the setting-up of calibration laboratories, which have been extended to the Northern Province.

Industrial rehabilitation and reconstruction of some large factories in the northern region, like a cement plant, will provide employment opportunities for about one thousand people in this region.

Things like this have been done in that area, and we are hoping that these initiatives will move the focus from the central issues of power and devolution so that we can enter the stage when the conflict really ends and we can start with reconstruction, supported by UN agencies, because there is a little trust between the minority and the majority communities.

The government itself does not exercise full power in those areas, some of which are still controlled by rebels. In such a situation, where the government cannot fully enforce its authority, I think that agencies like UNIDO and other UN agencies, which are unbiased in the conflict, can help to build trust in the area and play a very critical role in the rehabilitation of the industrial projects that were once active but are now defunct. They should also joint up in programmes with the private sector that could open markets for the products on those areas, as well as enabling some goods from the other part of the country to enter this market.

Mr. Chairman, distinguished Delegates,

I am quite conscious of the fact that any problem in a country that has led to this kind of strife is peculiar to that country. The solution has to be tailor-made to the needs of the country. I nevertheless hope these few remarks and the sharing of thoughts will give you some ideas for developing a generic approach to the whole role of the United Nations agencies in post-conflict areas.

Thank you very much.

## **Post-Crisis Industrial Rehabilitation and Reconstruction: A Case for Sierra Leone**

*Kadi Sesay\**

Chairman, distinguished Delegates, Ladies and Gentlemen,

I would like to thank the Director-General of UNIDO for having invited me to participate in this particular Round Table.

Sierra Leone is emerging from the end of a brutal war that began in 1991, lasted for more than a decade, and left a trail of human tragedy and extensive destruction of the country's social, economic and physical infrastructure. During this protracted war, more than two million people, nearly half of the population, were displaced. Virtually all major economic activity was disrupted leading to the collapse of agriculture, manufacturing and mining production and related services. The provision of key social services outside the capital virtually stopped owing to the large-scale destruction of education and health infrastructure. The rebel attacks on Freetown, the capital, in January 1999 and the ensuing fighting across the country put an end to the modest economic recovery that had started during the second half of 1998. Output fell and the associated reduction in the Government's revenue base led to a 56 per cent decline in Government revenue during the first half of 1999. Inflation surged from 6 per cent in December 1998 to 28 per cent by June 1999. The exchange rate depreciated by 35 per cent by June 1999 with devastating effects on the economy.

So clearly, in common with other countries that have experienced natural disaster and civil conflict, there has been widespread damage to the social and economic infrastructure in terms not only of the loss of physical establishments, but also of qualified human resources and indigenous expertise. A large proportion of the population was not only internally but externally displaced to neighbouring countries, where many doctors, teachers, engineers, lawyers, university lecturers and entrepreneurs picked up jobs. These professionals are yet to return to Sierra Leone to contribute effectively to the reconstruction and development of the country. Sierra Leone therefore has faced tremendous challenges during and after the war with schools, hospitals, roads, telecommunication systems, banks, markets, courts, industries and other enterprises having been destroyed. The productive capacity of the economy and the ability of Sierra Leone to generate sustainable livelihoods were greatly reduced. The precarious state of the economy resulted in extreme poverty, deterioration of health facilities, lack of education for many young people, and a rise in infant and maternal mortality, which were the main reasons why Sierra Leone was classified as the poorest nation and featured at the very bottom of the UNDP Human Development Index.

The national and international response to the Sierra Leone crisis ranges from humanitarian relief, including disarmament and demobilization of ex-combatants, to the rehabilitation and reconstruction of physical infrastructure and the productive sector of the economy to ensure long-term sustainable socio-economic development. In addition, major initiatives were introduced to address issues of justice, reconciliation and forgiveness.

A disarmament and demobilization programme targeting more than 72,000 ex-combatants was completed in January 2002. It is heartening to note that the Government's resettlement programme has succeeded in re-settling the entire internally displaced case load of 206,000 and over 97,000 returning refugees to their original communities. Beyond the resettlement of the displaced population and essential rehabilitation was the need for Government to extend its presence throughout the

---

\* Minister of Trade and Industry, Sierra Leone.

country more effectively by redeploying the security and law enforcement agencies, as well as providing several economic services.

I am delighted to inform you that in consultation with all the key stakeholders, the Government defined and adopted a National Recovery Strategy based on a comprehensive needs assessment that was conducted at the district and chiefdom levels. The National Recovery Strategy focuses on the immediate actions to address the essential needs of the population while laying the foundation for the transition to sustainable development. The major objectives of the National Recovery Strategy are to consolidate civil authority, improve and expedite service delivery, facilitate resettlement and re-integration, promote reconciliation and human rights, stimulate economic recovery and facilitate access to those previously inaccessible areas. As I indicated earlier, the Strategy and related programmes were put together after extensive consultation and the interactive participation of the relevant district and local government authorities and civil society. Being the main stakeholders and concerned parties, they were in a better position to establish the most critical needs and priorities in the respective districts.

Chairperson, Distinguished Delegates,

A major underlying cause of the war is poverty. The Government's post-conflict development agenda therefore reinforces its commitment to its overarching goal of poverty reduction through a participatory approach and a focus on monitorable outcomes. To address poverty, Government prepared an Interim Poverty Reduction Strategy Paper (IPRSP) with extensive participatory consultations involving civil society and other development partners. The IPRSP provides a comprehensive overview of the incidence, depth and severity of the poverty situation and outlines the Government's strategy for enhancing growth and redressing the desperate poverty situation prevailing in the country. The IPRSP was completed and approved in 2001. In December 2001 the international Development Association (IDA) of the World Bank also approved a Second Economic Rehabilitation and Recovery Credit to support the objectives of the IPRSP. The IPRSP addresses the immediate challenges of the transition from war to peace. Given the immediate post-war challenges and the longer term development goals, the Government adopted a two phased approach to poverty reduction in the IPRSP. The transitional phase covering the period 2001-2002, addressed issues of security and law and order, the immediate requirements of the most vulnerable, displaced people, and war victims, as well as fostering economic recovery. The medium term phase 2003-2005 is focusing on long term development and concrete poverty reduction measures.

Chairperson,

Let me now concentrate on the efforts of the Government to re-launch the economy.

### **Relaunching the economy**

At the very initial stage, the Government made a policy decision to stimulate economic recovery and address emerging development challenges. This policy decision was complemented with enhanced budgetary allocations to the economic sector, mainly directed towards agriculture, rural development and infrastructure, including feeder roads. In 2001, as a result of the Government's efforts, economic recovery accelerated, and GDP grew by 5.4 per cent in real terms. The positive trend of GDP growth continued throughout the year 2002, and economic growth is estimated to have recorded a 7 per cent increase in that year. Let me say that economic recovery was further nurtured by sound fiscal and monetary policies, as well as the generous support of our bilateral and international cooperating partners. The Government's expenditure policies have sought to reorient outlays towards service delivery to the poor. In 2001-2003 the largest share of public expenditure is for the social sector. In 2002 it accounted for 35.8 per cent of total non-salary, non-interest recurrent expenditure.

The Government's post-conflict development agenda reinforces:

- Renewal of economic growth and agricultural and rural development, including the rural infrastructure;
- Human resource development;
- Private sector development; and
- The three cross-cutting themes of HIV/AIDS, gender and the environment.

The development of the private sector is an essential element of the Government's forthcoming full poverty reduction strategy. Government recognizes that a vibrant private sector is the engine of growth, and is essential for employment creation, income generation and poverty reduction. The post-conflict Government of Sierra Leone therefore accords priority to macroeconomic stability and the creation of an enabling environment that is pro-business, pro-poor and promotes and encourages individual efforts and innovation. As part of this strategy, the Government of Sierra Leone seeks to promote, through the support of UNIDO and other agencies, the development of small and medium-sized enterprises (SMEs) through the provision of micro-finance, activating centres for skills training, facilitating the development of value added products for accessing international markets, formulating transparent guidelines and creating export processing zones.

Distinguished Delegates,

Within the scenario that I have just highlighted, what is the role of the international agencies and UNIDO?

### **The role of international agencies and UNIDO**

The challenge to international agencies' response to post-conflict situations depends on how and when the intervention is made. The post-conflict concerns to be addressed extend from emergency and humanitarian assistance (emergency food and temporary shelter) to the consolidation of peace, disarmament, demobilization, reintegration, reconciliation, resettlement, rehabilitation and longer term sustainable development. These phases should be continuous without a very rigid separation between humanitarian and development phases. Some of the needs of the post-conflict communities during the humanitarian relief phase may be developmental in nature.

Before my appointment as Minister of Trade and Industry, I held the portfolio of Development and Economic Planning. In that capacity I supervised the post-war assessment needs of Sierra Leone for donor assistance, and also supervised the development of an Interim Poverty Reduction Strategy Paper immediately following the end of the war. I realized that the damage done to the country was not restricted to life and property only, but also included the breakdown of economic activities and the deterioration of living standards. The attendant unemployment caused by the war made our recovery more difficult, and I was disappointed when I realized that the thrust of donor support concentrated more in the areas of health and education and other social services at the neglect of the productive sectors. Whilst I do accept that these sectors were and are essential requirements, the lack of support to the rejuvenation of economic activities at the early stages of the recovery programme has, I believe, had a negative impact on the recovery process.

The post-conflict needs of a country should be addressed in an integrated way that is multi-sectoral and multi-dimensional, with humanitarian, rehabilitation, and reconstruction efforts in some cases running side by side with medium to longer-term developmental interventions. For example, some issues of capacity building for poverty reduction and sustainable livelihood should be addressed early.

The economic recovery of a post-conflict country like Sierra Leone depends on how the transition from the emergency relief and rehabilitation phases to the reconstruction and the development phase is managed. If the humanitarian phase is rigidly compartmentalized and handled solely as such, and



all NGOs involved in that phase refuse to handle any activities outside that phase and many donors refuse to fund anything else during that phase, then the transition from humanitarian phase to the developmental phase will not be smooth. The economic recovery of a post-conflict country like Sierra Leone depends heavily on the success of the transition, as the rebuilding of the domestic economy needs a smooth restoration of access to all relevant internal and external resources. Whilst it is true that the social sectors – health and education and physical infrastructure and security – are indeed a priority for any post-conflict country, the recovery of the economy through income generating activities and employment creation should often go on side by side with humanitarian relief, reconstruction and reconciliation.

There is a need for an integrated post-conflict agenda that addresses governance and law and order; restores nationwide state authority; rehabilitates and reconstructs physical infrastructure; and provides for disarmament, demobilization, reintegration, resettlement and the rehabilitation of local communities. Local communities will not be revitalized without support to agriculture and micro- and small enterprises. The provision of micro-credit, especially to women and youths, is also important, as is the strengthening of social infrastructure, including educational and health facilities.

To kick start the post-conflict economy, there is need for investment in some key productive sectors, the creation of an enabling environment for trade and investment, promotion of macroeconomic stability hand-in-hand with reform of financial institutions and the establishment of appropriate legal and regulatory framework that will attract investors.

## **UNIDO's role**

The missing link between some of these stages and processes in some post-conflict recovery programmes has been the absence of UNIDO. As a specialized industrial development agency, UNIDO should play a key role in all the recovery stages of post-conflict countries, starting with an early needs assessment after the war, so that industrial rehabilitation and reconstruction needs assessment becomes part of the overall rehabilitation and reconstruction needs assessment of the country in order to identify the kinds and levels of intervention required, and formulate appropriate policy advice and technical cooperation proposals.

For example, in Sierra Leone, the country's recovery efforts would have benefited greatly if UNIDO had been part of the needs assessment teams immediately after the war ended, and the National Recovery Strategy would have benefited and would have been more comprehensive with inputs from UNIDO experts on industrial rehabilitation and reconstruction needs. This is why we welcome the Director-General's post-conflict initiative as a way of positioning UNIDO for work in crisis countries.

My concerns of a lack of balance between the humanitarian relief operations and the restoration of productive capacities, especially in the industrial sector, as a necessary input for relief activities and a basis for laying the foundation for a sustainable longer term recovery would be addressed by early UNIDO interventions. UNIDO therefore has a significant role to play in each of the recovery phases of post conflict countries. Understanding the level of destruction and damage caused by the war and the requirements for successful industrial rehabilitation initiatives is relevant at the early stages of the recovery. There are industries whose early rehabilitation could be pertinent and useful to the post-crisis relief efforts, and some could be relevant to the later recovery of others. UNIDO's early intervention in the needs assessment and productive capacity review could help to identify and address such needs.

At the rehabilitation and reconstruction stage and the longer development stage, UNIDO's role is even more urgent. Particularly significant areas for UNIDO interventions in these stages would include the strengthening of key industrial sectors; the promotion of income generating and job creation activities; skills development and training programmes for women, youths and ex-combatants; the development of industrial strategies and policy frameworks for industrial development; capacity building support

for SMEs; capacity building for the Ministry for Industry and private sector organizations like the Chamber of Commerce and Industry; the identification of appropriate technology, including the promotion of industrial competitiveness; and support to SMEs in the field of product development and promoting access to markets. An early needs assessment by UNIDO in a post-conflict country will assume that “made to measure” responses are developed that will be relevant to the country concerned and will meet the particular needs of that country. In any case, UNIDO has expertise in industrial issues, which none of the other agencies has, and this expertise can be utilized in collaboration with other agencies for post-conflict recovery.

Standards fall during a war. Post-conflict countries require assistance in standardization, quality, metrology and certification etc., and in upgrading post-war industries. UNIDO can provide appropriate support services in these areas.

Chairperson, distinguished Participants,

As you know, UNIDO has adopted a comprehensive programmatic approach to the delivery of its technical assistance services. Quite a good number of integrated programmes for industrial development have been formulated and are currently being implemented in various countries. Sierra Leone is in the process of finalizing one such Integrated Programme that I believe will provide significant support towards our reconstruction and development efforts, in particular with regard to the development of SMEs in Sierra Leone. Technical assistance in the above mentioned areas will greatly facilitate productivity and growth, as well as the enhancement of industrial competitiveness.

Chairperson,

Let me conclude by extending Sierra Leone’s appreciation to the Director-General of UNIDO for his support. We were delighted to receive him in March this year after he had conducted similar visits to Afghanistan and Rwanda.

Thank you.

## Presentation by Mr. Erick de Mul\*

Thank you Mr. Chairman,  
Mr. President, Madame Minister, Mr. Ambassador, colleagues,

I will keep my intervention short because I understand that time is running out. Let me start with a short story. When I started my career in the UN in 1971, I thought that I would be out of a job in about 15 years because I thought the world would be a better world. I thought there would be no need for development or humanitarian assistance anymore, and that everything would be all right.

However, when the first 15 years were over, in which I had devoted myself to development work, I discovered that I was drawn more and more into humanitarian affairs.

Starting off in Mozambique, I went to Guatemala, and then to Mongolia during the crisis after the break-up of the Soviet Union. After that I went back to Mozambique. Thank God peace came there, but after that I went to Bosnia and Herzegovina, then to Afghanistan, and finally to Angola. So I feel as if my career has been upside down. I should have started with humanitarian assistance and then made a seamless transition, without a gap, to development-related activities.

Unfortunately it went the other way. I feel sorry and unhappy about it, but this shows that we are not very good at crisis or conflict prevention. I think that until now we have not been very good at the management of post-conflict situations either, but we have become very good at providing humanitarian relief. I think there is something wrong. It cannot be accepted that the world continues to deteriorate gradually. The figures given to us at the beginning of this Round Table, that more than 70 countries are in some sort of crisis and 35 are in a post-crisis situation, are unacceptable. It is high time that we became serious and started to do something about this. This is not acceptable. This cannot continue.

While I am not optimistic with regard to the prospects for conflict prevention, I am much more optimistic with regard to post-conflict management. I do think there are better ways in which we can handle this. Even so, we have to be realistic and recognize that it will normally take more time than we hoped, because the problems faced by countries in post-conflict situations are overwhelming at times, and confusing. Moreover, the problems caused by conflict are often structural problems, which need a structural approach. In addition, problems caused by conflicts have to be dealt with in different phases, so let us be aware that solving them will take time.

As the President of Timor-Leste has indicated very strongly, the issues that have to be addressed are overwhelming, and it is very difficult for a government to set priorities and to stick to them.

There are, I think, two issues to be considered. One is that the number of humanitarian organizations has grown tremendously. This has been a kind of a growth industry, while development has lost its appeal. This has to change.

The point is that once one has a humanitarian situation, it takes a while before one can progress to the development stage. It is like the famous oil tanker that needs a couple of days before it can turn around. The same happens with this humanitarian business, and we have to be aware of that. The other thing is that donors seem to find it easier and more attractive to finance and fund humanitarian activities than development activities. This will also have to change, because if we keep focusing on humanitarian relief we will never get out of the crisis.

---

\* Former UN Resident and Humanitarian Coordinator in Angola and Afghanistan. This text is based on an edited transcript of the spoken presentation.

The point was made by Ambassador Takasu that the move from humanitarian emergency relief to development assistance is not taking place. It is also interesting to see that when it comes to humanitarian assistance, very few questions are asked, but when it comes to development assistance, all kinds of questions are asked and conditions of all kinds are imposed. This slows down the process and makes it more difficult to implement.

Similarly, the coordination of humanitarian relief seems to proceed quite smoothly and easily, but when it comes to coordinating development-related activities the whole system breaks down and everybody starts to pursue their own agendas. This holds true for both the UN agencies and the donors. The donors have the same kind of mentality: As long as it is a humanitarian crisis, yes, we will work together and solve the problems. The moment the time comes to shift one's efforts towards longer-term development issues, it becomes more difficult to coordinate donor activities. Eventually the whole system breaks down, and everybody tries to do what he or she thinks is more useful.

There may be different reasons for this. I don't know. I nevertheless think, however, that we should not think in terms of a gap between emergency relief and development assistance, but in terms of a transition. This transition should be seen as a kind of interface, which should be used effectively to tackle at least the immediate issues of bringing people that have been displaced during the conflict home. We should ensure that these people get their dignity back, and that they are brought back from the extreme conditions in which they initially find themselves to a point where they can sustain themselves, so we can wean them all as quickly as possible from the emergency type of operations.

One also has to deal with the thorny issues first, because if one tries to hide or postpone them, one risks provoking conflict later on. Thus, one must deal with the ex-combatants first, and to look after the refugees and the internally displaced persons (IDPs) as quickly as possible. One also has to try to start physical rehabilitation quickly and do the minimum as soon as possible, as there is no point in waiting two years for this. One has to try to re-establish normality all around the country as soon as possible. In this context, one must also re-establish the transport and communications infrastructure, to make market functions again and to make it possible for people to move around and feel that they are free to do in their country what they would want to do.

There are a number of things that need to be done in this connection. One point that has already been made a number of times is the need for assessments, which should be initiated as soon as possible – if possible even before the conflict has ended. Even more important is the need to involve all relevant stakeholders. The main stakeholder one always forgets are the people, whom we often refer to as the so-called “beneficiaries”: The people that are going to receive our assistance or who are going to benefit from the projects and the programmes that there are going to implement. They are not consulted in most cases, but it is important that they should be involved in any needs assessment. Then a timetable needs to be established with a realistic time frame for the implementation of the support activities on the basis of an agreed framework. Of course, this timetable can be adjusted if necessary – one shouldn't think that the economy will start growing the day after the conflict is ended. This will not happen. One needs to be realistic, and to give the process enough time. But one needs to create a solid base and then, indeed, to start working on economic and social growth in which UNIDO should play an important role.

UNIDO will only be able to assume this important role, however, if its struggles and fights to find a place at the table. At the moment it is still hard to find a place at the table where such issues are discussed and decided. UNIDO should do what it can to be accepted at this table and to establish the necessary links and coordination with the agencies.

That is all I have to say, Mr. President.

Thank you.

## **Presentation by Mr. Maurizio Pieroni\***

On behalf of UN-HABITAT, I wish to thank UNIDO and particularly the Chairman of this meeting, Mr. Fornocaldo, for having organized this Round Table on post-crisis industrial rehabilitation and reconstruction, and for having invited the UN-HABITAT Disaster Management Programme (DMP), which I represent, to take part to this important event.

On this occasion, I would like to mention that “Post-conflict, natural and human-made disasters assessment and reconstruction” is one of the two special themes included in the provisional agenda for the UN-HABITAT 20<sup>th</sup> Governing Council that will take place in May 2005. In this connection, we consider industrial rehabilitation a key element of overall human settlements development in post-disaster and post-conflict situations.

### **UN-HABITAT DMP**

Within the United Nations Programme for Human Settlements/UN-HABITAT, the DMP has been established with the aim of streamlining the transition phases in post-crisis situations. The human settlements component is integral to most post-disaster solutions. From the provision of emergency measures to development, a long and complex process needs to be put in place. Thus, in order to develop a global, integrated approach to rehabilitation of human settlements, coordination between humanitarian and development-oriented agencies is needed to achieve the maximum possible benefits from chronically limited resources.

This applies to the prevention of risk and mitigation of disasters as well as to the rehabilitation and reconstruction process in post-crisis situations at large.

### **Post-disaster management issues**

It should be noted that in the framework of the Economic and Social Council (ECOSOC) held in Geneva in July this year, the “Humanitarian Affairs Segment” addressed, inter alia, the problem “*The Transition from Relief to Development*”. In brief, it was concluded that in human-made or natural disasters, transition phases assume primary importance for a sustainable relief operation in view of reconstruction and development.

Many areas of the world are caught in a disaster/re-building cycle whereby the damage may be repaired but the causes underlying the devastation are critically overlooked. Population and economic growth are increasingly concentrated within urban areas resulting in a growing vulnerability to disasters. In the last decade, more than 200 million people were annually affected by natural disasters – seven times more than those affected by conflict. Most of these people are urban dwellers.

Factors such as inappropriate land use, poorly designed and constructed buildings and infrastructure, and an increasingly degraded environment put human settlements at risk, while reconstruction is increasingly difficult as appropriate measures to rehabilitate production sectors are systematically overlooked.

These hazards exist in both developed and developing countries, but they tend to impact more severely and repeatedly in developing countries where the institutional capacity is lowest, leaving large populations of the poorest inhabitants chronically vulnerable. Poverty and lack of resources

---

\* Senior Liaison Officer, UN-HABITAT Geneva Office.

increase vulnerability, weaken coping strategies and delay the recovery process. Demand for commercial and residential land in cities and their outskirts has led to use of unsuitable areas prone to hazards. Hazards become disasters when they impact the people, assets and production systems that are susceptible to their destructive effects.

Ironically, most of today's largest cities are in hazard-prone areas. As a result, most of the world's poor who are living in densely populated squatter settlements, on the periphery of cities, which lack the basics of life, are caught in a spiral of increasing vulnerability. Poverty alleviation is, therefore, central to any plan to effectively mitigate disasters on a proactive basis and manage post-disaster situations.

In this perspective, the aim should be to ensure the development – in line with the principles of sustainable human settlements – of a disaster-resistant environment for human settlements dwellers at large, to live, work and invest, by reducing their vulnerabilities and strengthening their capacities for managing disaster situations. Capacity building, development of vulnerability reduction programmes, technical support including the production sectors, empowerment of civil society and local governments are the essential tools for this purpose.

In addressing disasters in terms of both response and prevention, the UN-HABITAT DMP is equipped to provide support in the following emergency-related areas of expertise:

Land and property management: Security of tenure and access to land is a central issue in disaster response. It is also crucial when developing programmes to minimize vulnerability of populations to future crises.

Shelter and reconstruction planning: The right to adequate shelter is central to the mandate of UN-HABITAT and expressed through the campaigns on “Urban Governance” and “Shelter for All” and is even more important when addressing the needs of communities affected by disasters or prone to disasters. Shelter is often the primary need in the post-disaster phase, but the delivery of immediate shelter, including basic infrastructure and services, must be undertaken within a long-term strategy.

Safety and security: Crime is a serious problem in cities all over the world. Crime and violence do not happen spontaneously, but grow out of an unequal and exclusive society and upon breakdown of institutional and social control where unemployment plays a critical role.

Local governance: Managing disaster in human settlements is an issue that must be addressed in all aspects of urban governance. Creating inclusive institutions that allow for greater participation of the population as highlighted through UN-HABITAT's “Urban Governance” campaign is closely linked with reducing vulnerability to disasters. This is particularly important in post-disaster scenarios vis-à-vis nascent or custodial local governments.

Gender and disaster management: Gender issues impact all areas of disaster management, from vulnerability to relief, and rehabilitation to development. Analyzing the gender situation will help to improve impacts at all phases of post-disaster work, and will help to reduce vulnerability through improving inclusive governance promoting gender equality.

In this framework, cooperation between UN Agencies, as well as the other actors involved is essential.

### **Sustainable relief in post-disaster situations**

Post-disaster responses by national governments, the donors' community, bilateral aid, NGOs and UN agencies have been, so far, characterized by the implementation of a series of ad-hoc, palliative rapid rehabilitation projects, not linked to the overall development objectives of disaster-hit countries.

Piecemeal efforts which are not linked with the long-term development strategy can aggravate not only the precarious social conditions creating dependency on aid, but may entail a critical waste of financial and human resources invested in stand-alone emergency relief operations. Humanitarian organizations exist to meet the basic needs when the responsible players cannot, or when they fail to do so for other reasons. However, humanitarian agencies can no longer operate in isolation; they need the active participation from development-oriented agencies in shared realization of recovery process for sustainable relief and development.

The challenge is inverting the prevailing trend of competition among those dealing with post-disaster situations making a closer cooperation especially among UN partners possible, which is instrumental to defining how to bridge the gaps repeatedly materializing between emergency relief actions and sustainable development efforts. This should lead to defining how to provide practical tools (policies, strategies and technical support) for mitigating and recovering from disasters to local government, civil society and business organizations in a sound and sustainable manner. Public awareness and good governance are basic preconditions to address disaster management in human settlements. This applies to disaster mitigation as well as to disaster response<sup>1</sup>.

The right to decent housing is fundamental for all individuals, while half of humanity currently lives in towns and cities too often without being able to satisfy their basic needs. The same applies to the right to work and income. These are fundamental principles of human dignity that become dramatic in virtually any post-crisis situation.

Far too often the entity of assistance – both in quantity and quality – to people hit by disasters is limited to what we conventionally identify as “humanitarian aid” and financial efforts are provided without conditions and longer-term planning to actors dealing with emergencies. We could also define them as “first-page actors”, being financial contributions provided more on visibility basis than on actual needs assessment in the framework of longer-term perspectives. In other words, as the importance of a problem decreases in the media, the donor community’s attention is attracted by other more visible issues, thus often creating such a gap in the emergency-to-development mechanism that the efforts provided during emergency phases come to have little or no use for development.

Regrettably, while this subject has been repeatedly discussed and generally agreed upon, a restricted number of humanitarian actors still play the “star role” and virtually no donor is ready to re-consider funding policies and strategies. This attitude requires a radical and immediate change: Past emergency and development practices need to be reconsidered in order to make better use of limited financial resources vis-à-vis increasing humanitarian crises.

In post-war situations, peace cannot, easily be imposed from the outside. Solid foundations must be laid for this difficult process. Certainly, one of the most important elements to lay the foundation for peace is poverty alleviation through income generation and the reconstruction of the production systems. This concept applies very much to the construction industry in post-disaster situations as, in any destruction process, it is the reconstruction of the physical environment that plays a major role for a long time to go after the disaster has taken place.

---

1 Disaster Management Terms:

- |                     |      |  |
|---------------------|------|--|
| Disaster Migration: | i)   | <i>Risk Assessment</i> (hazard assessment and vulnerability assessment).   |
|                     | ii)  | <i>Prevention</i> (structural measures and non-structural measures).   |
|                     | iii) | <i>Preparedness</i> (emergency planning and warning/evacuation).   |
| Disaster Response:  | i)   | <i>Relief</i> (search & rescue, shelter provision, food supply, medical care, removal of debris, transport).   |
|                     | ii)  | <i>Rehabilitation</i> (restoration of basic functions of society; duration: weeks to months).  |
|                     | iii) | <i>Reconstruction</i> (full resumption of the pre-disaster state, including all preventive measures and modernization of the urban layout, industry, housing, infra-structure, etc., duration: months to years). |





## **ROUND TABLE 5**

**PROMOTING INVESTMENT IN DEVELOPING COUNTRIES (WITH  
SPECIAL REFERENCE TO AFRICA):  
CHALLENGES, OPPORTUNITIES AND EXPERIENCES**



## Issue Paper

# Promoting Investment in Developing Countries (with Special Reference to Africa): Challenges, Opportunities and Experiences

*UNIDO Secretariat*

### Abstract

This paper indicates the broad pattern of foreign direct investment (FDI) at global and regional levels. It addresses the key problem of asymmetries within this pattern, as well as the major issues pertinent to developing countries and the least developed countries (LDCs), particularly those in sub-Saharan Africa (SSA) – where the problem is greatest and the challenges of crafting policies to attract, retain and increase FDI are particularly severe. The major issues are seen to be how developing countries can exploit motivations for FDI; the ways in which developing countries can maximize positive externalities from FDI while minimizing negative spillovers; and the empirical evidence indicating that, with well-articulated policies, the benefits of FDI can be substantial for the industrial development of developing countries.

### Introduction

The pressing issues within the dynamics of international capital flows and the organizational behaviour of the principle actors in the world economy – multinational enterprises (MNEs) and the state (Stopford et al. 1991) are best examined through a lens that focuses on the international business of FDI. While a positive economics approach, in contrast to a normative perspective, is assumed in this paper, a major issue of contemporary concern is one that relates FDI to increasing industrialization and the reduction of poverty. This issue finds its most vivid expression in relation to the marginalization from FDI of Africa. Evidence suggests that not only does increasing the ratio of FDI stock to GDP correlate positively with a decreasing share of the population living below US\$ 1 per day (OECD 2002) but that increases in FDI are also correlated with industrial development (UNIDO 2002; World Bank 1993). It would appear that this correlation is not making the kind of impact in SSA that the international community would expect.

Nevertheless, it is conclusively proven by well-established empirical evidence and research that FDI flows, and resulting accumulations of FDI stock, are asymmetrically distributed between the industrialized and developing countries (DCs), in powerful favour of the former (UNIDO 2002; UNCTAD 1991-2002; OECD 2002; and Buckley & Casson 1976, 1985).<sup>1</sup> Secondly, and equally well founded, is the highly skewed distribution of FDI across the geo-economic landscape of the developing countries (UNIDO 2003), benefiting a few hosts at the expense of the majority.<sup>2</sup>

These twin asymmetries find challenging industrial expression at the macro-, meso- and microeconomic levels. First in terms of the predominance of the Triad of North America, Europe and Japan as hosts to, and sources of, FDI. Second, in terms of areas of robust regional growth.<sup>3</sup> Third, in terms of the local embedding of FDI decisions at the level of individual cities and localities that

---

1 Economies in transition are included in this category for brevity.

2 See UNIDO (2003), Table 2, p. 4, 2003, for the profile of FDI shares that accrue to developing regions.

3 For example: The growth corridor of Europe that runs in an arc from southeast Britain via the engineering heartland of Germany to the innovation parks of southern France and northern Italy; the growth triangles of Southeast Asia; and special economic zones of coastal China.

display an attractive dynamism.<sup>4</sup> The asymmetries in the growth pattern of FDI can be explained econometrically by differences not only in costs between countries but also, and perhaps more importantly, because governments and their policies differ in credibility (Janeba 2001). To give an illustration of these asymmetries, a comparison of the distribution of FDI stocks, expressed in terms of major partners, in 1985 and 2001 mentions only Egypt, Nigeria, Tunisia and Zimbabwe as partners of the European Union (EU) in 1985; and Egypt, Kenya, Morocco, Nigeria, South Africa, Swaziland, Tunisia in 2001<sup>5</sup> – an addition of only three over a 15 year period. For the USA and Japan as sources of FDI stocks, there were no African partners mentioned for either 1985 or 2001.

This paper does not take issue either with the problematics of measurement (Lehmann 2002) or the distinction between gross and net FDI, and their statistical terminology. It takes it as given that the FDI increases recorded by the International Monetary Fund (IMF) in its *International Financial Statistics* are representative. But this is far from a trivial matter because, in the co-operative and conflictual bargaining relationships between host governments and investors, firms' investment choices concern different components of FDI.

Since about 1980, two key developments have determined the industrial organization of MNEs and increases in FDI activity. The first is the extension of policy liberalization, under multilateral trade agreements and pressures for structural adjustment, as well as intensive competition between countries focused on capturing the beneficial impacts of FDI (Oman 2000). This liberalization has led to decreasing costs of both cross-border trade and FDI. The second is the spatial location and dynamic distribution of manufacturing and services (in both horizontal and vertical FDI) within industrialized and across developing countries, and especially in Southeast Asia. This spatial distribution, driven by MNEs' competitive search for efficiency gains in response to increasing production costs and the perils of exogenous shocks,<sup>6</sup> is hallmarked by the strategic integration of MNE headquarters, subsidiaries and affiliates. With respect to Southeast Asia, this distribution has distinctive trade characteristics, exemplified by vertical intra-industry trade (VIIT) and exports in a relatively narrow range of product categories.<sup>7</sup>

Notwithstanding the argument about the balance between the quantity and quality of FDI, since 1980 relatively few developing countries (or regions) have demonstrated a consistent capacity for, and capability in, attracting significant levels of FDI.<sup>8</sup> There has been a significant growth of foreign investment flows to DCs and LDCs, from below US\$ 50 billion in 1990 to about US\$ 200 billion in 2000 (UNIDO 2003). The regional distribution of this growth of FDI inflows in 1980-2001 is presented in Table 1. Global FDI flows grew from US\$ 52 billion in 1980 through US\$ 202 billion in 1990 to a peak of over US\$ 1,400 billion in 2000 before falling off to US\$ 490 billion in 2002.

---

4 For example Singapore and Bangalore on one hand and the cluster of northern 'maquiladora' cities of Mexico on the other.

5 UNCTAD (2003), Figure I.14, p. 24, "FDI stocks among the Triad and economies in which FDI from the Triad members dominate, 1985 and 2001".

6 Such as the 1973/74 and 1979/81 oil price shocks.

7 In the electrical machinery industry, the share of VIIT in total trade in East Asia grew from 31 per cent in 1996 to 43 per cent in 2000. With respect to the share of Japan's total trade with the electrical machinery industry in the five main Southeast Asian economies, the respective figures for 1988 and 2000 are as follows: Indonesia 2 per cent to 39 per cent; Malaysia 40 per cent to 34 per cent; Philippines 16 per cent to 55 per cent; Singapore 17 per cent to 43 per cent; and Thailand 16.5 per cent to 41 per cent (Fukao et al. 2003).

8 See UNIDO (2003) and UNCTAD (2002, pp. 25-26) for a view of FDI potential and performance indexes of industrialized and developing countries. It should be noted that for many developing countries, absolute levels of FDI may be less significant than the FDI to GDP, FDI to gross capital formation, and FDI per capita ratios.

**Table 1. Regional FDI inflows for 1980-2001, % of total**

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
<i>Industrialized Countries</i>	89.04	68.69	56.22	66.92	72.76	75.09	84.50	90.03	85.85	87.03	85.19
<i>North Africa</i>	0.25	0.56	0.49	0.81	1.57	2.56	1.31	0.78	0.92	0.85	0.56
<i>Central Africa</i>	0.43	0.37	0.57	0.82	0.16	1.25	0.40	0.31	0.25	0.06	-0.17
<i>Western Africa</i>	-0.97	0.99	1.15	0.88	0.53	0.85	0.16	0.63	0.30	1.08	0.44
<i>Eastern and Southern Africa</i>	0.58	0.18	0.13	0.16	0.17	0.30	0.23	0.24	0.15	0.22	0.25
<i>Latin America</i>	12.33	12.98	12.54	11.01	7.49	10.33	5.37	2.90	4.79	4.02	4.05
<i>West Asia and Europe</i>	-6.42	10.37	21.21	10.98	9.63	1.72	1.54	-0.73	0.30	0.22	1.28
<i>South and East Asia</i>	4.75	5.85	7.69	8.42	7.71	7.91	6.49	5.84	7.43	6.52	8.40
<b>TOTAL REGION</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
<i>Industrialized Countries</i>	76.00	72.82	70.06	62.43	69.98	65.96	65.20	74.51	82.26	85.75	86.62
<i>North Africa</i>	0.52	0.90	0.74	0.90	0.26	0.22	0.27	0.29	0.15	0.17	0.08
<i>Central Africa</i>	0.42	0.27	0.11	0.05	0.09	0.02	0.02	0.18	0.21	0.00	N/A
<i>Western Africa</i>	0.61	0.51	0.71	0.99	0.51	0.59	0.51	0.24	0.16	0.02	N/A
<i>Eastern and Southern Africa</i>	0.22	0.19	0.02	0.18	0.29	0.26	0.26	0.22	0.13	0.07	N/A
<i>Latin America</i>	8.37	9.00	6.36	11.91	9.39	11.84	14.37	10.71	8.15	5.21	7.80
<i>West Asia and Europe</i>	1.39	1.64	1.50	0.83	-0.06	0.83	1.22	1.07	0.31	0.12	0.83
<i>South and East Asia</i>	12.46	14.68	20.50	22.71	19.53	20.27	18.13	12.77	8.62	8.68	4.66
<b>TOTAL REGION</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: UNIDO Statistics compiled from the *International Financial Statistics* released by the International Monetary Fund, according to the UNIDO list of countries and areas included in selected groupings in the *International Yearbook of Industrial Statistics* (UNIDO, 2002).

Table 1 also shows that, in terms of share of FDI, while industrialized countries have maintained their lion's share (dropping from 89 per cent to 87 per cent) over two decades with a low point of 56 per cent in 1982 and a high point of 90 per cent in 1987, four African regions<sup>9</sup> and West Asia and Europe<sup>10</sup> have lost out heavily to the countries of South and East Asia and Latin America. Within Asia the main beneficiaries of cumulative FDI inflows over the two decades have been the countries of South and East Asia, in particular China, Hong Kong SAR, Singapore and Malaysia. In Latin America, Brazil, Mexico, Argentina and Chile have attracted large volumes of internationally mobile capital. Since 1990, the investment flows to SSA have collapsed. In 2000, FDI inflows were relatively low and extremely so for the four African regions that received only 0.26 per cent of the total FDI inflows. Cumulatively, Egypt, Nigeria, Angola and Tunisia have received the bulk of the low volumes of FDI to Africa. In West Asia and Europe the largest cumulative flows of FDI have been hosted by Saudi Arabia, Turkey, Bahrain and Croatia. Latin America, having performed relatively weakly in attracting FDI in the latter part of the 1980s, proved a stronger magnet for FDI in the 1990s. South and East Asia have consistently shown improvement in attracting FDI throughout the last 20 years (despite cyclical downturns) until the hiatus of the Asian economic crisis of 1997.

In general, among developing countries, Southeast Asia's performance appears to have surpassed that of Latin America and Africa, and sub-Saharan Africa's performance in particular appears, with few

9 North Africa, Central Africa, Western Africa, Eastern and Southern Africa.

10 According to UNIDO classification, this group comprises only countries of the former Yugoslavia as European, other European countries and that of the former Soviet Union are comprised under Industrialized Countries.

exceptions,<sup>11</sup> to have dimmed considerably. Within the constraints dictated by the Scylla and Charybdis<sup>12</sup> of government failure and market failure (Wolf 1979,1988; Le Grand 1991; Greenwald and Stiglitz 1986; Le Grand et al. 1991), and implicit in the differentiated national and regional performance, is the central issue that different government policies, in so far as they attenuate or strengthen industry structure on the one hand and moderate or amplify transaction costs on the other hand, have created different combinations of increases or decreases in market imperfections that repel or attract the attention of MNEs undertaking FDI.

The factors that animate the morphology of international FDI, its flows and industrial dynamic (Dunning 2000, 2003), such that the aforementioned asymmetries are persistent, need to be disclosed in terms that can be captured, and internalized, by the decision-making structures and policy communities of developing countries. The morphology of FDI appears to be characterized essentially by two vectors in dynamic tension. The first is constituted by the spatial, but uneven, distribution of productive assets and their inherent stages of production. This distribution, which is hallmarked by the interactions of MNEs, changes constantly as MNEs competitively configure and recalibrate their operations and relocate them in response to competitive pressures. The second vector is rooted in the capability of MNEs for governance, by managerially coordinating and controlling the functional relations of sourcing, technology, production, marketing and servicing within their organization. Whereas, the first vector is disintegrative, the second is integrative (Bartels & Pass 2000; Dicken 2003).

These fundamental features of modern industrial organization are motivations for renewed policy action and need to be more fully appreciated by a wider leadership in developing countries.

Furthermore, the efficiency of modern industrial systems, and the differentiated manufacturing stages within them, is such that there tends to be overcapacity in production.<sup>13</sup> The implication of this broad view of industrial dynamics and investment is that, in general, developing countries, and in particular the LDCs in Africa, have to work harder and smarter as potential hosts to capture the FDI attention of the approximately 65,000 MNEs and their more than 850,000 subsidiaries, that together account for about two thirds of global trade (UNCTAD 2002).

Regarding the integration of world economic activity, it is noteworthy that at the global level three major divergences have occurred in the post-World War II era, with profound implications for developing country host government FDI policies. First, in the face of falling barriers after 1960, the global rate of trade growth far exceeded that of global production, implying that trade acted as the integrating factor. Secondly, after 1985 the global rate of growth of FDI far exceeded that of global exports. This implies that FDI (notwithstanding the fall off of FDI between 2000 and 2003) and inter- and intra-firm transactions have superceded trade as the integrating factor of the global economy (Dicken 2003). Thirdly, capital and financial market performance indicators<sup>14</sup> between high-income and middle- and low-income countries have diverged, thus implying that the role of capital markets is increasingly crucial to the operationalization of FDI, which in turn is correlated positively to capital raising, stock market listing and securities trading in international financial centres (Claessens et al. 2002).

The rest of this issue paper is organized as follows: Part 2 addresses the underlying rationale to the motivations for FDI and advances the case for an improved appreciation of these motivations by the

---

11 Resource-seeking FDI into oil/gas/mineral locations on the one hand, and efficiency-seeking FDI into South Africa, for example, on the other.

12 In Greek mythology, the two immortal and irresistible monsters who beset the narrow waters traversed by the hero Odysseus in his wanderings (later localized in the Strait of Messina).

13 The present low inflationary profile in industrialized countries and the razor thin profit margins of producers of commodities, in China for example, is one manifestation of this trend.

14 Market capitalization/GDP; value traded domestically/GDP; capital raised abroad/GDP; value traded abroad/GDP.

policy communities in developing countries. The motivations are set in the context of government and market failures. Part 3 looks at the issues of the costs and benefits of FDI, in terms of positive externalities and negative spillovers that need to be evaluated for policy choices within the international regulatory framework provided, inter alia, by the WTO. Part 4 concludes with a view on the persistence of the asymmetries in FDI flows and the impact of the services economy on future directions of FDI.

## **FDI rationale, motivations and their exploitation by developing country hosts**

The basic premise herein is that governments of developing countries select policy choices to attract FDI in relation to overall economic development goals. These goals are encapsulated by the aim of wealth creation through industrialization efficiencies that are gained ultimately from increases in total factor productivity growth. There is general acceptance that government policies and their effective articulation can be important determinants of FDI. However, among the stark realities facing developing countries is one of boundedness. Local economies, and the states which exercise sovereignty over them, are location bound. However, the spatially distributed and internationally integrated sourcing, technology, production, marketing and servicing FDI of MNEs are not territorially bound. The latter operate strategically as an interlocking matrix of networks (Kim et al. 1998; Birkinshaw 1996; Lawrence & Lorsch 1967). The territorial freedom of these cross-border networks, and their organizational functions, present a major challenge to developing countries as they attempt to capture FDI.

The necessary, but insufficient, conditions in which motivations for FDI are actualized by MNEs appear as an investor's "wish list".<sup>15</sup> If and when fulfilled, they manifest themselves as an enabling host environment. The sufficient conditions are framed by the taxonomy of FDI motivations (OECD 2002; Dunning 2000; Brook and Buckley 1988).<sup>16</sup> The taxonomy reduces parsimoniously to firm-specific advantages of ownership that are matched with national location-specific advantages and overlaid by internalization advantages that allow MNEs to execute cross-border transactions within the organizational boundary of the firm rather than through external markets (which are subject to Williamsonian market failure).<sup>17</sup>

The boundedness of sovereign economies with respect to FDI by MNEs implies that, on balance, host countries would need to pay crucially more policy attention to motivations related to location-specific

---

15 This may be summarized as follows:

- 1 Political stability (because capital investments are time framed longer than the incumbency of elected governments or electoral cycle);
- 2 Economic stability (economic strength through a robust fabric of inter-transactions, intermediation, and sub-contracting);
- 3 International outlook (global in thinking/behavior with respect to best practice and policy framework);
- 4 Government regulations (clarity and consistent interpretation of rules; purpose of regulations);
- 5 Infrastructure (distribution logistics efficiencies and operabilities; data communications/infrastructure);
- 6 Labour (profile of skills);
- 7 Banking/Finance (strong intermediation capabilities and capacities);
- 8 Government attitude (service orientation);
- 9 Local business infrastructure (backward and forward linkages); and
- 10 Quality of life (personal safety/health/education lifestyle).

16 These comprise: Host market-oriented (comprising socio-demographic and socio-economic properties); cost-oriented (constituted by efficiency properties of production); vertical integration-oriented (involving the input-output relations of raw materials and intermediates); investment climate-oriented (related to "soft" and "hard" infrastructure); response to "pull" forces (from distributions or agents); and response to "push" forces (from the source country).

17 Williamson (1975) refers to market failure due to dynamic complexity, bounded rationality, information asymmetries, asset specificity, the dominance of the few in industry supply and demand factor markets, and opportunism.

advantages. The sequencing of the resultant policy measures cannot be effected in isolation from what other governments may be crafting in response to pressures to increase their share of FDI. The direct and indirect effects of one government's policy framework concerning the macroeconomic – fiscal and monetary – variables as well as capital controls, transfer pricing, mergers and monopolies, labour relations, intellectual property protection rights and privatization would need to be seen not only in terms of the relative level of cross-national differences, but also in terms of the relative rate and direction (pro- or anti-FDI) of change in those policies. For example, privatization may not necessarily lead to increased FDI if a neighbouring country has a more extensive programme coupled with a liberalized trade regime.

That said, government policy reflects the collective interests of the dominant socio-economic groups which control the apparatus of the state (Olson 1967). The national and regional articulation of a given set of government policies that produce market imperfections to foster conditions conducive to FDI may have variations that have countervailing effects on FDI. One illustration is government procurement and to what extent it is discriminatory – are all FDI subsidiaries prevented from bidding irrespective of location within the country or are foreign owned domestic firms granted the same bidding rights as domestically owned firms? The former case represents a higher level of market imperfection compared to the latter which has a positive impact on FDI since government markets can be contested through FDI with, for example, mergers and acquisitions as entry modes. Another example is given by inbound trade quotas in so far that such a policy increases FDI in the protected market. However, FDI may actually increase not in the protected market but in a third host that either faces no quotas or has unfilled quotas (Brewer 1993).

At the regional level, reflecting trade-creating and/or trade-diverting outcomes of trade arrangements, regional FDI arrangements<sup>18</sup> can decrease intra-regional market imperfections, thus increasing intra-regional FDI. When coupled with common external tariff protocols, such agreements can also increase FDI into the region.

Due to the networked nature of integrated international production, policy makers in developing country hosts need to perceive FDI by MNEs as a multifaceted organizational decision process that evolves over time with respect to entry mode, reinvestment, intra-company debt transfers and project expansion as well as industry sector competitive dynamics. This presents a major challenge for the analytical capacities of investment boards, investment promotion agencies and institutions in developing and least developed countries that must engage in policy analysis and advocacy, and feed advise into national decision-making structures.

The analytical challenges of policy formulation and dynamic reconfiguration of policy presented by Table 2, especially for resource constrained African countries, are not to be underestimated. For example, incentives such as subsidized loans can alter the ratio of the foreign to the local components in the capital structure of the FDI, and hence the relative volumes of foreign to domestic investment. The FDI motivations referred to earlier therefore need to be appreciated as being amenable to amplification by the policy prescriptions of developing country hosts. However, changes in policy need to be set in a trilateral policy framework of modal neutrality, market contestability and policy coherence.<sup>19</sup> Signalling changes in policy would need to be well-timed, transparent and consistent with overall industrial development goals.

---

18 For example ASEAN Investment Area, Andean Common Market.

19 Modal neutrality describes policies that allow foreign investors to decide for themselves how best to serve the markets they enter. Market contestability embodies the ability of both foreign and domestic investors to compete on a level of playing field for the factors of production. Policy coherence refers to the degree of internal consistency of objectives, FDI policies and interpretation of policies, in their regulatory form, across a range of issues and at different level of Government.



**Table 2. Comparative policy effects on market imperfections and inward FDI**

Effect on FDI	Effect on market imperfection	
	Increase	Decrease
Increase	<ul style="list-style-type: none"> <li>• Protectionist import policies</li> <li>• Weak IPRs</li> <li>• Subsidies on inward FDI</li> <li>• Undervalued exchange rate</li> <li>• Weak competition policy</li> <li>• Procurement discrimination vs. foreign (non-domestic) firms</li> <li>• Technical standards</li> </ul>	<ul style="list-style-type: none"> <li>• Liberalization of FDI regime</li> <li>• Privatization</li> <li>• Foreign exchange convertibility</li> <li>• Anti-dumping policies</li> <li>• Import duties on subsidized exports from other countries</li> <li>• National treatment</li> <li>• Strong competition policy</li> <li>• Tariff debates on imports for export oriented FDI</li> <li>• Liberalization of trade restrictions</li> </ul>
Decrease	<ul style="list-style-type: none"> <li>• Overvalued exchange rate</li> <li>• Restrictions on inward FDI</li> <li>• Price controls</li> <li>• Import restrictions on FDI inputs</li> <li>• Export controls on FDI outputs</li> <li>• Restrictions on capital access</li> <li>• Restrictions on capital repatriation</li> </ul>	<ul style="list-style-type: none"> <li>• Strong anti-monopoly policy enforcement</li> <li>• Strong arm's length transfer pricing policy enforcement</li> </ul>

Source: Adapted from Brewer (1993).

Host governments, specifically those in Africa, therefore have to select carefully what FDI motivations they wish to target and consequently bargain for over time with policy settings that change according to the nation's developmental stage. However, they have to make their selections with respect to state-firm and state-state relations in the context of policy competition for FDI (Oman 2000). This in turn implies not only specifying policy for inter-industry linkages and technology requirements but also implementation strategies that pay attention to the regulatory behaviour of national institutions in attracting FDI.

With respect to developing and least developed countries positioning themselves to successfully exploit the motivations for FDI, fundamental questions remain. How do DCs and LDCs configure institutionally their policy setting to capture FDI efficiently when the setting needs to address non-tariff barriers, technical barriers to trade, technical standards, TRIPS and TRIMS?<sup>20</sup> What is the configuration of obstacles that prevent the knowledge-based institutions in DCs and LDCs from contributing more significantly to FDI policy research and analysis? How may the obstacles be overcome? Given the established positive link between regional integration arrangements (RIAs) and FDI (Yeyati et al. 2002),<sup>21</sup> what mechanisms and processes are available to DCs and LDCs for overcoming fragmented regional markets (especially those in Africa)? How do DCs and LDCs "race to the top" in attracting FDI in preference to the "race to the bottom" through incentive wars?

Assuming that DCs and LDCs can exploit favourably the motivations for FDI, such that FDI is directed to strategic industrial sectors, there remain equally important issues about the comparative benefits and costs of FDI and their macroeconomic impact on host economies. Ultimately, DCs and LDCs need to maximize benefits while minimizing costs in a sequential dynamic of calibrating and recalibrating their investment regimes as a function of their evolving stage of development, and changing industrial development goals. This is particularly important for those African countries that are lagging behind in the competition to attract FDI.

20 Trade Related Intellectual Property Rights and Trade Related Investment Measures.

21 A regression analysis study of FDI stocks from 20 OECD source countries to 60 host countries between 1982 and 1998, comprising 6,768 observations, shows that on average common membership in an RIA comprising a free trade area with a FDI source country increases two-fold the bilateral stocks of FDI (Yeyati et al. 2002, p. 11).

## Balancing the externalities from FDI in favour of the positive

For our purpose, the issues concerning benefits and costs of FDI are more usefully examined in terms of externalities (or spillovers) and whether in sum they can be made positive in favour of the developing host. Whereas externalities are viewed often in macroeconomic terms, from the perspective of industrial development, positive externalities are best seen at the enterprise level, because FDI decisions are ultimately business decisions. The tentacular presence of MNEs in a large number of DCs and LDCs has focused attention on MNEs as organizational powerhouses with economic capabilities that often transcend those of individual sovereign states. As indicated previously, a country is, by definition, a fixed entity; the MNE, in contrast, constitutes a package of resources which can be deployed between countries. As the deployment takes the form of “slicing up” of industry and firm value chains and their location across borders for manufacturing goods in different stages at different locations which add value at each state, ensuring a balance in favour of positive externalities represents major challenges to DCs and LDCs.

The challenges presented by the relative costs and benefits of FDI are usually framed on the one hand by the impact on national economies in terms of relative losses and gains between industrialized sources of, and DCs/LDCs host to, FDI, and on the other hand by economic as well as socio-cultural effects. The externalities (spillovers) should not be considered in isolation from the various interest groups who are affected by FDI.<sup>22</sup> The inherent issues revolve, *inter alia*, around differences in deceleration or acceleration in output and employment; advances or declines in the balance-of-payments and trade; and decreases or increases in competitiveness. There are also considerations of capital, skills, resources and technology transfer dependence by the host on the source of FDI. Furthermore, issues of sovereignty and the possibilities for manipulative transfer pricing by foreign investors (Plasschaert 1994), the creation of FDI enclaves and the encouragement of rural-urban migration as well as cultural change resulting from FDI impose additional policy challenges on decision-makers in DCs and LDCs.

The “obvious” benefits arise in general from the well-acknowledged fact that FDI helps to fill a number of “gaps”, including those of technology, capital investment, foreign exchange, management and budget. However, these are beneficial in sum only if firstly the host can capture efficiently the associated externalities, and secondly, if the returns on FDI are not entirely absorbed by the investor. Issues that arise concern macroeconomic effects and improvements in terms of trade gained through access to, and integration with, the marketing networks of MNEs, which have to be weighed against “crowding out” problems. Of course, the ability to capture the positive externalities of FDI depends very much on the stage of development of the developing countries. Countries at different points of the development trajectory – broadly speaking commodity factor or resource-based, FDI-driven, and innovation-driven – can capture, or maximize, different aspects of the full range of positive externalities (Porter 1990). In general, the less advanced the developing country, the lower the range of positive externalities that can be captured, whereas the more advanced the developing country the more positive externalities that can be locally embedded. The implication herein is for countries to move as rapidly as possible through the stages of development from factor-driven to innovation-driven development.

At the intra-country level, the potential benefits of lower consumer prices and higher labour wages from domestic market servicing FDI would need the riders about which groups of consumers and which domestic sectors may lose out? Additionally, what is the quality of jobs being created – low capital to labour ratios capable of upgrading or not? Are labour unions emasculated or will conditions be conducive to higher rates of training? And with respect to inter-sectoral inequalities, to what extent is rural-urban drift affecting agribusiness for those DCs and LDCs whose economies are primarily commodity and resource driven?

---

22 Government, workers in labour unions, customers and consumers, suppliers and competitors.

Regarding the competition and monopoly aspects of FDI, precisely because MNEs have overwhelming firm-specific advantages – referred to as monopolistic-oligopolistic advantages by Lall & Streeten (1977) – relative to domestic firms, without robust policies FDI can lead to market failure, manifest in resource misallocation, higher local pricing (Vaitsos 1974), lack of choice and alteration of local consumption patterns.

The positive externalities manifesting themselves as benefits of FDI would need to be weighed against the cost of offering incentives. Here, the central question is to what extent do DCs and LDCs compete to offer incentives in a race to attract FDI in such a manner that environmental and other standards are raised rather than lowered? This is far from trivial as different socio-economic groups may lose or gain. Oman (2000) delineates the incentives and policy competition for FDI among countries and highlights the fact that for DCs and LDCs this competition comes not only from among themselves but also more importantly from the industrialized countries which have greater financial resources with which to influence market imperfections.

These issues are not easily tractable and require high-quality policy analysis resources on the part of the investment promotion agencies of DCs and LDCs.

The effect of FDI on national planning revolves around the issue of the fundamentally co-operative or conflictual bargaining between MNEs and hosts, because whereas investors have primary responsibility to their shareholders, governments have primary responsibility for their citizens' welfare. These two sets of responsibilities do not necessarily coincide at all times. Whereas host governments are primarily concerned with strategic economic security, socio-economic considerations and the potential loss of economic sovereignty; the main considerations of MNEs have to do with the rights to, and protection of, intellectual and physical assets, as well as the unhindered ability to decide how best to operate their business in terms of deploying and managing human, financial and technological assets. At a regional level, intra-MNE trade may negate the social function of the market when domestic firms are excluded, because of technical incapacities, from the MNEs' supply relationships. Despite incentives, without policy coherence, and faced with perceived high taxes, foreign investors with extensive production networks can indulge in international transfer pricing to reduce their global fiscal liabilities to the detriment of national balance-of-payments and developing country treasuries, and thus potentially reduce the effectiveness of national fiscal and monetary policy.

Regarding the effects of FDI on economic development, while DCs and LDCs can benefit from the exemplary cases of Southeast Asia and leading countries in Latin America and North Africa, externalities have to be well-configured for maximizing benefits. For example, the demerits of FDI can include, on the one hand, enclave creation that can stimulate uneven development. There are a number of examples of enclave creation in sub-Saharan Africa that have led to economic tensions. On the other hand, an over-concentration on resource-oriented FDI can lead to export earnings that are subject to relatively large international price fluctuations. Anecdotal evidence is available that “sweat shops” associated with FDI can lead to exploitation of workers and child labour.

Overall, notwithstanding pressures for investment rules,<sup>23</sup> the above issues present to DCs and LDCs the challenge of crafting FDI policies with the requisite system of incentives that are able to take advantage of WTO non-actionable subsidies.

## **Concluding remarks**

Notwithstanding the complexity of the issues raised above, empirical research indicates that the crucial areas of impact of FDI on host country effects are on: (a) host country wages in terms of wage comparisons between foreign and domestic investors, and wage spillovers as well as average wages;

---

23 See Noboru Hatakeyama, “The World Needs Investment Rules”, *Financial Times*, 1<sup>st</sup> August 2003, p. 13.

(b) host country productivity in terms of productivity comparisons of foreign and domestic manufacturing as well as productivity and knowledge spillovers to domestic industry; (c) the introduction of new industries and host country export performance; and (d) host country growth.

The challenge for decision-making structures in DCs and LDCs is to fully appreciate the dynamics of FDI in general, and within these the above mentioned areas in particular, so that FDI regimes that are coherent and effective may be created to attract the desired type and quality of investment. The persistent twin asymmetries of the vast majority of FDI going to industrialized countries and to a few within developing countries suggest that the bulk of developing countries continue to face serious challenges. The economic and organizational power of MNEs is such that calls for monitoring their operations<sup>24</sup> have been intermittent since the 1970s (Soros 1998; Servant-Schreiber 1980; Vernon 1971).

The DCs and LDCs, especially in Africa, face a new challenge with respect to international investment – that in service industries. Reflecting the international relocation of production throughout the 1980s and 1990s, service industries are going global in search of relatively low costs to perform functions with high quality.<sup>25</sup> In this new round of globalization, again it would appear that the Indian Ocean Rim countries are capturing the lion's share of this FDI in services and African countries, having largely missed out on the first wave of the international relocation of production, appear to be poised again to lose out on this second wave of the international relocation of services.<sup>26</sup> This is worrying as African countries have international language skills based on their relations with their former metropolitan powers.<sup>27</sup> The requirements for DCs and LDCs to set policies to amplify their location specific advantages in order to attract some of this FDI in services, so that managerial skills transfers can be captured, presents a serious issue.

Nevertheless, the empirical evidence suggests powerfully that foreign investors pay higher wages than their domestic counter parts.<sup>28</sup> Also the presence of FDI raises the average level of wages. As with wages, productivity studies show that foreign-owned firms demonstrate higher productivity levels than domestic firms. Even though indications of productivity spillovers to domestic firms are mixed, the presence of FDI leads to an overall improvement in productivity. It is also found that foreign investors contribute knowledge, particularly about demand in global markets, to the domestic economy. Finally, through these combined effects, and the introduction of new production techniques, FDI is associated with accelerated economic growth.

Of course, precisely because accelerated economic growth by definition involves punctuated equilibrium at sector level and therefore disruption to established domestic economic patterns, the issue of the preference for the stability of industrial organization (in terms of traditional skills for example) over economic progress remains to be resolved. There are winners and losers, benefits and costs, in FDI. Gains would need to accrue to broader rather than narrow interests. Costs and losses would need to be moderated by the policy decisions of DCs and LDCs to foster an efficient economy, sound environment and productive employment. The challenge to African countries in general remains serious and there is a need for well-articulated policy solutions.

---

24 Jonathan Birchall, "UN looks to Keep Check on Multinationals", *Financial Times*, 13<sup>th</sup> August 2003, pp. 1 and 4.

25 See "Outsourcing - Service Industries go Global: How High-wage Professional Jobs are Migrating to Low-cost Countries", *Financial Times*, 20<sup>th</sup> August 2003, p. 11, which argues that computing and language skills play key roles in this outsourcing.

26 "The New Global Job Shift", *Business Week*, 3<sup>rd</sup> February 2003, pp. 36-48 for a view on the kind of services being internationally relocated.

27 The problem lies in the woefully inadequate structure of information and communications infrastructure in most African countries.

28 See Lipsey (2002), for a comprehensive review of the literature.

## Summary

This issue paper presents a number of key issues that affect, to greater or lesser extent, developing countries in their attempt to capture FDI. The asymmetries in the distribution of FDI, and the lack of domestic investment in much of Africa give serious cause for concern. The key issues identified are:

1. The highly asymmetrical pattern of global inflows and stocks of FDI, and of the international location of the subsidiaries, affiliates and productive assets of MNEs.
2. The dominance of industrialized countries as hosts to, and sources of FDI.
3. The dominance of a few developing countries as hosts to FDI.
4. The almost complete marginalization of Africa in general, and sub-Saharan African in particular, from mainstream manufacturing and export-oriented FDI.
5. The challenge faced by developing countries in exploiting the motivations for FDI by MNEs.
6. The challenge faced by developing countries in crafting policy solutions that maximize the capture of positive externalities from FDI while moderating the impact of negative spillovers.

## References

- Bartels, F. L., and C. L. Pass, *International Business: A Competitiveness Approach*. Singapore: Prentice Hall, 2000.
- Birkinshaw, J., "How Multinational Subsidiary Mandates are Gained and Lost". *Journal of International Business Studies*, Vol. 27, No.3, pp. 467-495, 1996.
- Brewer, T. L., "Government Policies, Market Imperfections, and Foreign Direct Investment". *Journal of International Business Studies*, Vol. 24, No. 1, pp. 101-120, 1993.
- Brooke, M. Z., and P.J. Buckley, *Handbook of International Trade*. London: Macmillan, 1988.
- Buckley, P. J., and M. C. Casson, *The Future of the Multinational Enterprise*. London: Macmillan, 1976.
- Buckley, P. J., and M. C. Casson, *The Economic Theory of the Multinational Enterprise*. London: Macmillan, 1985.
- Claessens, S., D. Klingebiel, and Schmukler, S. L., *FDI and Stock Market Development: Compliments on Substitutes*. Paper presented at the joint conference of the World Bank and the IDB on "The FDI Race: Who Gets the Prize? Is it Worth the Effort?", Washington, D.C., 3-4/ Oct/2002. Washington, D.C.: World Bank, 2002.
- Dicken, P., *Global Shift: Reshaping the Global Economic Map in the 21st Century*. London: SAGE Publications, 2003.
- Dunning, J. H., "The Eclectic Paradigm as an Envelope for Economic and Business Theories of MNE Activity". *International Business Review*, Vol. 9, No. 2, pp. 163-190, 2000.
- Dunning, J. H., "Some Antecedents of Internalization Theory". *Journal of International Business Studies*, Vol. 34, No. 2, pp. 108-115, 2003.

Egelhoff, W., *Organizing the Multinational Enterprise: An Information-processing Perspective*. Cambridge, Mass.: Ballinger, 1988.

Fukao, K., H. Ishido, and K. Ito, *Vertical Intra-Industry Trade and Foreign Direct Investment in East Asia*. Paper presented at the 15<sup>th</sup> Annual TRIO Conference, New Development in Empirical International Trade, 10<sup>th</sup>-11<sup>th</sup> December 2002, Tokyo, Japan. (Revised Version January 2003).

Greenwald, B. C., and J.E. Stiglitz, "Externalities in Economies with Imperfect Information and Incomplete Markets". *Quarterly Journal of Economics*, Vol. 101, Vol. 2, pp. 229-264, 1986.

Janeba, E., *Attracting FDI in a Politically Risky World*. NBER Working Paper No. 8400. Cambridge, Mass.: National Bureau of Economic Research, July 2001.

Kim, K., J.-H. Park, and J.E. Prescott, "The Global Integration of Business Functions: A Study of Multinational Businesses in Integrated Global Industries". *Journal of International Business Studies*, Vol. 34, No.4, pp. 327-344, 2003.

Lall, S., and P. Streeten, *Foreign Investment, Transnationals and Developing Countries*. London: Macmillan, 1977.

Lawrence, P., and J. Lorsch, "Differentiation and Integration in Complex Organizations". *Administrative Science Quarterly*, Vol. 12, pp. 1-47, 1967.

Le Grand, J., "The Theory of Government Failure". *British Journal of Political Science*, Vol. 21, No.4, pp. 423-442, 1991.

Le Grand, J., C. Propper, and R. Robinson, *The Economics of Social Problems*. London: Macmillan, Third edition, 1991.

Lehmann, A., *Foreign Direct Investment in Emerging Markets: Income, Repatriations and Financial Vulnerabilities*, IMF Working Paper No. WP/02/47. Washington, D.C.: International Monetary Fund, March 2002.

Lipsey, R. E., *Home and Host Country Effects of FDI*. NBER Working Paper No. w9293. Cambridge, Mass: National Bureau of Economic Research, 2002.

OECD, *Foreign Direct Investment for Development: Maximizing Benefits, Minimizing Costs*. Paris: Organization for Economic Cooperation and Development, 2002.

Olson, M., *The Logic of Collective Action*. Cambridge, Mass.: Harvard University Press, 1967.

Oman, C., *Policy Competition for Foreign Direct Investment: A Study of Competition among Governments to attract FDI*. Paris: Organization for Economic Cooperation and Development, Development Center, 2000.

Plasschaert, S.R.F., "The Multiple Motivations for Transfer Pricing Modulations in Multinational Enterprises and Governmental Counter-Measures: An Attempt at Clarification". *Management International Review*, Vol. 34, No. 2, 1994.

Porter, M. E., *The Competitive Advantage of Nations*. New York: The Free Press, 1990.

Servant-Schreiber, J.J., *The American Challenge*. New York: Atheneum, 1980.

Soros, G., *The Crisis of Global Capitalism: Open Society Endangered*. New York: Public Affairs, 1998.

Stopford, J., S. Strange, and J.S. Henley, *Rival States, Rival Firms: Competition for World Market Shares*. Cambridge: Cambridge University Press, 1991.

UNCTAD, *World Investment Report*. Various issues. Geneva: United Nations Conference on Trade and Development, 1991-2002.

(<http://www.unctad.org/Templates/Page.asp?intItemID=1485&lang=1>)

UNCTAD, *World Investment Report, FDI Policies for Development: National and International Perspectives*. Geneva: United Nations Conference on Trade and Development, 2003.

UNIDO, *Industrial Development Report 2002/03*. Vienna: United Nations Industrial Development Organization, 2002.

UNIDO, *Guidelines for Investment Promotion Agencies: Foreign Direct Investment Flows to Developing Countries*. Vienna: United Nations Industrial Development Organization, 2003.

Vaitsos, C. V., *Intercountry Income Distribution and Transnational Enterprises*. Oxford: Oxford University Press, 1974.

Vernon, R., *Sovereignty at Bay: The Multinational Spread of US Enterprises*. New York: Basic Books, 1971.

Williamson, O.E., *Markets and Hierarchies*. New York: Free Press, 1975.

Wolf, C., "A Theory of Nonmarket Failure", *Journal of Law and Economics*, Vol. 22, pp. 107-139, 1979.

Wolf, C., *Markets or Governments: Choosing between Imperfect Alternatives*. Cambridge, Mass.: Massachusetts Institute of Technology Press, 1988.

World Bank, *The East Asian Miracle: Economic Growth and Public Policy*. Oxford: Oxford University Press, 1993.

Yeyati, E.L., E. Stein, and C. Daude, *Regional Integration and the Location of FDI*. Paper presented at the joint conference of the World Bank and the IDB on "The FDI Race: Who Gets the Prize? Is it Worth the Effort?", Washington, D.C., 3-4/ Oct/2002. Washington, D.C.: World Bank, 2002.

## **UNIDO Position Paper**

### **Promoting Investment in Developing Countries (with Special Reference to Africa): Challenges, Opportunities and Experiences**

*UNIDO Secretariat*

#### **Summary**

The last two decades have seen rapid economic transformations accompanied by an unprecedented pace of technological innovation, liberalization of trade and globalization of the world economy. Governments and enterprises of industrialized countries are investing massively in research and development (R&D) activities in order to bring out new processes, products and services continuously to overcome competitive pressures, and are generating ever-increasing wealth and sustaining growth.

However, apart from a few exceptions, developing countries have neither made available the financial resources nor the knowledge base to develop competitive technologies and achieve a share of the international trade to alleviate the poverty of their populations. This reality is even more striking for the countries in Africa and the least developed countries (LDCs).

International investment in general and foreign direct investment (FDI) in particular is perceived as indispensable for the growth of developing countries in view of its multiple impacts. It is expected to bring skills and know-how leading to improved efficiency in the use of resources and increased productivity. Through capital accumulation, FDI enhances growth by incorporating new inputs and technologies into production in the recipient country.

However, success in attracting FDI and its expected growth effects has eluded most developing countries. Competition between themselves has given way to “me too” incentives that have not been well calibrated. These countries have consequently become increasingly marginalized from global production networks. Government failures in terms of adequate policy frameworks and enabling environments have raised the risk premium on investments to prohibitive levels.

While economic orthodoxy provides the ingredients for sound growth policies, including the attraction of FDI, extensive research on the development trajectory of many countries has shown that the success stories are mostly derived from context-specific solutions, whether orthodox or non-orthodox, tailored to particular circumstances of the concerned country. Developing countries have to be able to frame FDI promotion into specific growth policies that ensure a positive balance between benefits and costs. It has also been observed that igniting growth and sustaining it in the medium-long term are very different in terms of institutional capacity requirements (Rodrik 2003).

These realities dispel the straightforward use of recipes based on conventional economics or the simple transplantation of successful experiences from one country into another. They highlight the role that an organization like UNIDO is called upon to fulfill. Assisting a country in charting a path for sustainable development and growth and in attracting FDI as a catalyst for that process requires a wealth of diversified operational experience and a command of related technical disciplines.

This paper is developed in three parts. The first characterizes FDI flows from industrialized countries to developing countries within the broader framework of international investment. The second elaborates the drivers and determinants of FDI and its effects on productivity and growth. The third part describes the framework of a UNIDO strategy to assist developing countries in capturing FDI and using it as an instrument for sustainable growth.



## Characterization of FDI flows

### *International investment and FDI*

According to conventional wisdom capital will flow from where it is abundant and facing diminishing returns to where it is less plentiful and thus yields higher returns. This unfettered flow of capital will make the world better off. The conclusion, in terms of orthodox policy advice, has been to completely liberalize capital flows.

However, unlike liberalized trade flows, where the direct benefits to growth are clear, the benefits of liberalized capital flows are less straightforward. There is little empirical study that attempts to estimate developing countries' gains from capital flows. There is no consensus because of opposing views about what is the determining feature of openness to capital – growth through increased investment versus increased vulnerability to economic turbulence leading to slow growth. The Latin American debt crises of the 1980s, the Mexican and Asian crises of the 1990s, and many other banking and currency crises have caused recessions and years of lost growth. Therefore, unlike trade in goods and services where the benefits to participants can be estimated and total welfare increases, capital flows have potentially severe downsides that make it less predictable.

According to one review of the literature (Dobson & Hufbauer 2001), the gains of developing countries from access to global capital markets may be approximately the same as that from access to trade in goods and services. The important distinction is made, however, that different kinds of capital (loans, portfolio investments and FDI) may have different effects, and that financial integration requires that certain conditions be met before its benefits can be reaped.

In recent years, there has been a significant shift in the composition of private capital flows to developing countries characterized by increased and accelerated inflows of FDI in relation to the other forms. Flows of short-term debt amounted to US\$ 30 billion in 1980, shrank to US\$ 15 billion in 1990 and turned negative from 1998 onwards. Over the same period, FDI has grown from US\$ 5 billion in 1980 to US\$ 24 billion in 1990 and US\$ 160 billion in 2000.<sup>1</sup>

On the one hand, this trend reflects the experiences of past financial crises and the corresponding concerns about the volatility of financial markets – FDI is comparatively safe and not so easy to withdraw in difficult times. But, on the other hand, the growing interest of developing countries in attracting FDI is also a recognition of its multiple impacts and spill-over effects. In the short run, FDI requires only basic skills at the receiving end and brings in capital, management skills, market links and technology. There is little dispute of the fact that China's consistently high growth rates in recent years have a strong link to its success in attracting FDI.

For many developing countries, FDI is the most direct way to start industrialization and enter international markets. However, if the host country does not provide minimum prerequisites that inspire interest and confidence to the business communities, foreign investors may simply not come.

### *Patterns of FDI flows*

Although international investment flows have been increasing steadily over time, they are asymmetrically distributed between the industrialized and developing countries, in favour of the former, and among developing countries themselves. The main feature of FDI flows in developing countries is its high concentration in only a few countries. As an illustration, statistics on regional FDI inflows for the period 1980-2001 compiled by UNIDO (UNIDO 2003 a) reveal the following findings:

---

1 "A Survey of Global Finance", *The Economist*, 3 May 2003.

- a) Industrialized countries captured most of the international FDI flows over the two decades, with a share of 89 per cent in 1980 and 87 per cent in 2001;
- b) Africa, West Asia and the countries of Europe that are in the category of developing countries, have lost out heavily to the countries of Southeast Asia and Latin America;
- c) Within Asia, the main beneficiaries of cumulative FDI inflows over the two decades have been the countries of South and East Asia, in particular China, Hong Kong SAR, Singapore and Malaysia;
- d) Latin America performed relatively weakly in attracting FDI in the latter part of the 1980s but its performance recorded a visible improvement in the 1990s;
- e) In 2000, the African countries as a whole received a mere 0.26 per cent of total FDI inflows, and for the sub-Saharan countries the share became negligible at 0.07 per cent.

Having in mind the mandate and responsibilities of UNIDO, the above picture calls for further analysis on what determines the motivations and options of transnational corporations (TNCs) when targeting developing countries for their operations. By the same token, it will be useful to analyze the relevant aspects of market imperfections and government failures that policy makers have to address in order to attract investors, provide the necessary public goods, and articulate the instruments that spur and sustain growth.

#### *Characterization of FDI*

Although the entrepreneurial dynamics brought about by the new economy has induced many innovative small- and medium-sized enterprises (SMEs) to enter into international business, the bulk of FDI flows has traditionally been and still is associated with TNC activities. FDI can take different forms, focus on diverse sectors and be driven by a number of investors' motivations that change over time. Competitive pressures make enterprises readjust, redefine and relocate their operations and, accordingly, there will be different impacts in the host country's development.

Different terms have been used in literature to characterize FDI, and the terminology sometimes depends on the analytical perspective. For the purpose of illustration, the following broad characterization can be used (Usata 1997; Te Velde 2001):

- a) *Market seeking FDI* – driven by location factors and the relevant dynamics and size of the market;
- b) *Natural-resource seeking FDI* – driven by the availability of natural resources;
- c) *Efficiency-seeking FDI* – driven by the search for efficiency through cost-saving and maintenance of competitiveness.

Other categories or sub-categories can be added to the above, such as: Labour-intensive FDI; capital-intensive FDI; FDI with high local manufacturing value-added; "Zone" FDI; service sector FDI; infrastructure FDI; mergers and acquisitions; joint ventures; wholly owned subsidiaries, etc. (Aron 1999)

FDI is widely accepted as an important element for the growth of developing countries. Without FDI inflows many developing countries would not expect to achieve basic development targets such as increasing growth through productivity and alleviating poverty. That is why developing countries compete strongly among themselves to catch the attention of TNCs as suitable locations for their FDI projects.

However, there are considerable challenges that developing countries and their policy makers have to face with regard to FDI promotion. Different forms of FDI have different impacts in such areas as the labour market (and specific segments of the labour market), productivity, trade, domestic investment, education, technological innovation, and so on.

For example, *labour-intensive FDI* is a generator of employment, which is important for poverty reduction but often requires unskilled workers and has few other spillover effects such as the upgrading of the country's technological level. Another example frequently cited is the potential of certain forms of FDI to "crowd out" domestic enterprise and its investment.

While developing countries in general need and compete for FDI to reap its perceived benefits, FDI has costs and effects that have to be subject to scrutiny by host governments. From the investors' perspective, there are expectations of profit that have to be balanced against the perceived risk, which means that the host country has to provide a climate of confidence for business.

## **Effects and determinants of FDI**

### *FDI and growth*

In a world of persistent disparities in the distribution of wealth, a major concern and task for the political leadership in poorer countries is to promote growth to alleviate poverty and create the conditions to achieve the Millennium Development Goals (MDGs).

UNIDO's position regarding the role of industry in the development agenda has been clearly set forth in the Organization's corporate strategy (UNIDO 2003 b).

- There are different rates of growth and a pattern of divergence between the industrialized and developing countries as well as among the developing countries themselves.
- Modern economic growth in industrialized countries, and also in developing countries, has predominantly been related to productivity increases and technological change;
- A comparison of relevant data analyzed by UNIDO in respect of 32 LDCs and 22 industrial countries shows that there is a big gap between both groups of countries in terms of the levels of technology and the related practices;
- Only a relatively small number of countries in the industrialized world has the resources to invest massively in R&D activities and in technological innovation as a way of achieving and sustaining competitive advantage and economic growth;
- Concerning developing countries, the path for growth has to involve the acquisition of technologies from abroad and their assimilation and diffusion, accompanied by a process of learning and leveraging;
- The growth success of East Asian countries is rooted in technology transfer and diffusion, which links with productivity enhancement and the development of export capabilities;
- In some cases (e.g. Republic of Korea and Taiwan, Province of China) the process started with technology acquired through licensing or sub-contracting arrangements; in other cases (e.g. China, Singapore and Malaysia) the way of accessing technology was through FDI;
- The lessons learned in both cases are that success was due not only to appropriate policies to capture foreign technology and investment but also to existing capacities and externalities that enable learning, entrepreneurship and innovation.

Clearly, FDI as a vehicle for technological progress can make a decisive contribution towards the sustained growth of developing countries and for their integration into the world economy. Despite the role of technology transfer through commercial channels, it is FDI that has mostly been resorted to as a response to the developing countries' needs.

For African countries and LDCs, the promotion of FDI inflows is a key element in response to their needs with regard to technological development and economic growth. Other forms of technology acquisition through commercial channels would require at the outset a significant technology base and absorptive capacity, which is insufficient or simply does not exist in some countries. Many forms of FDI only require basic skills in the host country and yet they bring capital, technology, management techniques and market links.

## *Effects and impacts of FDI*

### Estimating the quantitative impact

The benefits of FDI are argued in terms of its quantitative effects on growth. Of course, these depend on the particular conditions of the recipient country and its ability to direct FDI properly and capture all positive externalities that are associated to it.

A “Survey of Global Finance” published in *The Economist* on 3 May 2003 presents a literature review on the gains of developing countries from trade and from capital market integration including FDI. According to the review, the GDP of developing countries had recorded a gain of about US\$ 350 billion a year (roughly 5 per cent) by 2000 as a result of their access to international markets in goods and services.

Concerning the overall effects of financial integration, the results of the survey are not straightforward and the picture remains unclear. While some authors estimate a meaningful effect on the growth of developing countries, other authors do not find any benefit at all. Certainly, the big financial crises in various parts of the world during the 1990s and the losses they have induced in the host economies are the backdrop of these mixed perceptions.

On the positive correlation between FDI inflows and developing countries’ growth, there seems to be no dispute. This explains the shift in recent years in the composition of capital flows to the emerging market economies, with a clear preference for FDI over portfolio flows, as highlighted earlier. Research results presented in *The Economist* survey suggest that a rise of one percentage point in the ratio of the stock of FDI to GDP will raise GDP by 0.4 per cent. The report thus states that: “In the decade to 2000, the ratio of FDI to GDP in the developing countries went up from 7 per cent to 21 per cent. That rise of 14 percentage points implies an improvement in GDP of 5.6 per cent.” This is indeed very meaningful; and the more so when we think of FDI effects on trade, which itself is a powerful driver of growth.

### FDI-trade correlation

The positive correlation between FDI and trade seems obvious. As a matter of fact, in most cases the TNC strategies with regard to FDI location are based on trade-related motivations; for example, taking advantage of local endowments in natural resources, raw materials, low-cost labour or sub-contracting capabilities in order to improve the competitiveness of their manufacturing activities and successfully export to global markets. Even in cases where FDI is oriented to the host country’s market, this results in an import substituting effect with a corresponding positive effect in the country’s trade balance.

This correlation between FDI and trade is more than just the increased trade that would result from an absolute increase in the level of investment. FDI has an effect of linking national economies more into global trade streams. OECD research suggests that as countries progress towards industrialized-nation status, increased inward FDI to the host country reflects and contributes to further integration of the economy on a global scale (OECD 2002). Enhanced foreign trade flows, through greater openness to trade and investment, intensify exports as well as imports. Inward investment, as an export increasing strategy, can be positive if it allows the host country to take advantage of its resource endowments and/or geographical location, which is the case for transition economies as the research highlights (OECD 2002, p. 92). Export-processing zones have also played a role in linking host-economies into global trade streams. At the same time, however, the research suggests that it is important to keep in mind that inward investment cannot be used as an import substitution strategy for lesser-developed countries (OECD 2002, pp. 11-12 & 92).

### Technology spillover effects and knowledge accumulation

The most significant spillover effect of FDI on productivity gains is through the transfer and diffusion of technology. The evidence regarding this aspect of FDI suggests that the impact of technology introduced by a TNC is highest if it is absorbable by others and diffused in the economy. This analysis refers mostly to a study of TNCs and to technology imparted and diffused through backward linkages to local suppliers of the TNC (OECD 2002, Ch. V).

The simplest linkages involve being engaged in contractual supply of goods and services. TNCs moving into a new market usually need local firms as suppliers of maintenance services or as suppliers of materials and components. These can be upgraded to encompass more demanding tasks, involving more added value, as the incumbent builds longer-term relations, which means a learning effect in the local firms and a process of knowledge accumulation with a consequent leveraging of the technological capabilities of the host country.

As competence grows, so does the depth of inputs induced by the TNCs, creating or leading to a virtuous circle that is making some developing countries emerge as serious players in world markets. A trend of international investment in recent years has been the relocation of service industries to some developing countries, namely to countries in the Indian Ocean Rim. Even more recently, TNCs have begun to outsource innovation and to set up subsidiaries for R&D operations in developing countries, for instance in a number of East Asian countries.

However, the technology transfer element of FDI is not automatic and explicit efforts to enhance technology transfer in the FDI process are required if the desired effects are to be achieved. Because technological gaps exist between foreign investors of developed countries and domestic firms of developing countries, proper mechanisms need to be put into place, both from a structural level and business level, in order to realize such gains.

There are two more aspects that need to be taken into consideration. The first is that in order for technology transfers to generate some externalities that would assist in structural reforms, the technologies need not only to be relevant to the domestic firm that receives them, but even more importantly to the host-country business sector as a whole, as illustrated in the OECD study (OECD 2002). This would generate more country benefits. If, on the other hand, the technological capabilities of the host country are too low, it might be impossible actually to absorb the benefits of technology transfer from the TNC in the first place. Therefore, as far as LDCs are concerned, the simple promotion of FDI inflows, important as it is, may not be enough to generate sustainable growth in the host economies. It is also necessary to assist the host countries in other relevant and correlated areas, namely in upgrading their overall technological capabilities.

### FDI and poverty alleviation

As argued above, FDI is a determinant of growth and has spillover effects on various aspects of human development such as job creation, education, gender equality, improved health, etc. Observations regarding the correlation between the stock of FDI as a percentage of GDP and poverty (measured as the percentage of population living on below US\$ 1 per day) indicate that there is a direct non-linear relationship. As FDI stock increases from zero to 15 per cent there is a very large drop in the proportion of population living below the US\$1 level, following which there is a relative levelling off as the proportion of FDI increases (OECD 2002, p. 169). This cursory observation supports the notion that, looking purely at FDI stock as a portion of GDP, the effect on poverty reduction is most apparent at the lower end of the spectrum. It has also been found in one major study conducted in 1997 based on data related to 26 developing countries in different periods that “an increase in the rate of GDP growth produces an equivalent increase in the income growth rate of the poorest 40 per cent of the population – an income elasticity of one” (Aron 1999).

The above observations seem to imply that inward FDI to LDCs, even as a small percentage of GDP, could have a significant impact on poverty alleviation.

### *Determinants of FDI*

#### FDI and new global production patterns

The combined effects of a rapid pace of innovation and specialization on the one hand and the adoption of liberalization policies by developing countries on the other, have resulted in new ways of organizing manufacturing activities by TNCs. This has had several consequences on the ways of doing business and on the management of TNCs. This in turn has influenced the motivations and patterns of FDI.

TNCs themselves are subject to high competitive pressures as well as increasing R&D and production costs. As a result they tend to split up the global value chains and their locations across borders for manufacturing goods in different stages and at different locations, and dynamically change location whenever convenient. Even R&D, one of the least mobile functions, is increasingly being transferred overseas. According to the same underlying rationale, TNCs show a growing tendency to outsource functions and inputs to capable suppliers. These divisions, taking advantage of small differences in cost, logistics, skills and efficiency, are made visible by new communication and management techniques.

The fundamental features of modern industrial organization need to be appraised and understood by policy-makers in developing countries, if they are to promote and capture successfully the FDI inflows they need.

### **The UNIDO response**

#### *Review of issues*

In their attempts to promote FDI inflows, developing countries face considerable challenges which result from a multitude of factors that were touched upon throughout the preceding sections.

This complex equation requires well articulated policy solutions not only to attract FDI but also to build-up the conditions that are necessary to capture its positive externalities and achieve sustainable growth.

#### *Importance of macro-environmental structures and the need for context-specific solutions*

Observation and experience leads to the conclusion that getting the macro-environment right and liberalizing capital flows may not necessarily lead to the inflow of FDI, and that if the right interventions are not applied, the anticipated impact of FDI on productivity, growth and poverty reduction may not be fully realized.

Government failures, resulting in over-regulation, weak institutions and unpredictable policy, hinder entrepreneurial initiative and impact negatively on the flows and effects of FDI. Improving the investment climate by reducing government-imposed imperfections is always the first advice given to developing countries for improving the inflow of FDI. This is a necessary but not always sufficient condition for initiating rapid growth through investment. Countries may also need to look at market failures that require positive action on the part of government to induce investment in modern industrial sectors. This requires designing appropriate interventions of incentives and discipline (reward linked to performance) to overcome barriers imposed by market factors. To stimulate investments under conditions of stagnation, governments need to intervene and encourage markets. The incentives need to be carefully crafted to promote innovation-oriented learning, encourage the

entry, under competitive conditions, of pioneer investors into the growth sectors (and induce others to follow), and promote the forms of cooperation between domestic and foreign investors that stimulates rapid dissemination of technology (Rodrik 2003).

The evidence that successes cannot simply be transplanted from one country into another implies that capacities for high quality policy analysis are required on the part of developing country investment promotion agencies (IPAs). The multitude and complexity of issues that have to be articulated in order to put in place the policies and conditions to attract FDI and generate growth require considerable local knowledge and technical capabilities, as well as sufficient resources to experiment with new approaches.

#### UNIDO response:

UNIDO's approach to investment promotion is geared towards supporting developing countries, especially LDCs and less developed regions of non-LDCs, in developing the right combination of interventions to overcome the particular types of failures hindering investment growth as well as growth through investment.

UNIDO complements the work of other organizations in the field of investment promotion through its concentration on productivity gains in the agro-processing industries and focus on initiating rapid growth in low-income countries through investment promotion into industry. In this respect the uniqueness of UNIDO's approach is in combining the investment promotion function with industrial development functions.

Most of the advice and assistance offered by multi- and bilateral agencies to developing countries in the field of investment promotion involves two key areas of intervention: The development of best-practice promotion skills, including organizational structures for national IPAs; and the improvement of the investment climate through across-the-board removal of administrative and legislative hurdles. The issues of IPA diagnostics, advice on policy and legal framework for FDI, and best-practice skills development are appropriately dealt with by several institutions. Most capacity building initiatives are to some extent based on the models and experiences of successful agencies that have been instrumental in completely transforming their national economies through FDI (e.g. Ireland), and comprise many of the skills and strategies that have proven useful in generating FDI.

Recognizing that methodologies and strategies that were successful in one setting may not be as effective in others, especially in LDC and lower income environments, UNIDO programmes try to expand the mandate and activity range of national IPAs to cover interventions that integrate industrial development, technology diffusion and domestic investment and FDI promotion.

Promotion of investment and technology in specific sub-sectors is conducted in close cooperation with other UNIDO services. In particular, it is combined with UNIDO's areas of specialization in technical assistance. These include rural energy, appraisal of investment projects in energy saving and carbon reducing technologies; investment strategies in textiles and garments, leather and leather products, and food processing; the identification, appraisal and promotion of environmentally sound technologies coordinated with the network of national cleaner production centres (NCPCs). Issues pertinent to sub-contracting and other forms of technology alliances are coordinated with the work of the technology group and the sub-contracting exchange (SPX) network.

#### *Expanding the functions of IPAs*

In many developing countries, especially LDCs, there are shortcomings of the institutional infrastructure needed to articulate, coordinate and execute the range of interventions for supporting and stimulating private sector actions and market forces. As a result, the actions of different institutions involved in different aspects of investment are discordant and frequently at cross-purposes.

One of the conditions that are crucial to an IPA's effectiveness in investment promotion is the accord and respect of other national institutions that impinge on the investment process. Those responsible for implementing the local conditions of investment that the IPA presents to international investors must adhere to those conditions. For example, if the IPA and the revenue authority are giving investors different pictures of the tax framework, the IPA loses its credibility and its ability to influence investor decisions (independently of the attractiveness of the tax regime). This places on them a "national coordination" responsibility that requires the IPA to convince these stakeholders to rally around a common strategy. Therefore, IPAs need support in formulating arguments linking FDI to the priorities, within the national development agenda, of other national institutions.

The second condition is the availability of a minimum amount of institutional capacity for supporting domestic industry to complement IPA efforts in investment promotion, especially for supporting enterprises in both interacting with FDI and in playing a role in the attraction of FDI. This implies developing close working relationships with industrial sector associations to intertwine technical assistance with investment related services. In this case, an IPA's role in mobilizing and channelling support (if not providing some of it directly) is just as crucial as employing best-practice promotion techniques vis-à-vis foreign investors.

UNIDO's strategy in investment promotion is to provide the tools, training and information as well as networking for developing these supplementary capabilities. This involves leveraging UNIDO's expertise in specific sub-sectors. It also involves utilizing the partnerships developed with many industry related stakeholders in a country through the integrated programmes.

One of the services provided within the framework of this strategy is empirical analysis to assist IPAs in articulating country specific approaches to FDI promotion and linking FDI to the development objectives of critical stakeholders.

Another service is practical support in bridging the institutional divide between the IPA and institutions of the domestic private sector; especially support institutions for specific industrial sub-sectors.

#### *Elements of the strategy and services*

##### 1. Platform to develop focused strategies to attract FDI into productivity enhancing activities

The limited resources available to IPAs make it difficult for them to be effective in the removal of barriers to FDI. The objective of this service is to identify the highest priority barriers to target with limited resources. This involves identifying the characteristics of different categories of foreign investors, gaining an understanding of the interplay between them and elements of the domestic economy, and sharpening their focus on the most critical factors affecting the decisions of selected target groups.

UNIDO is currently surveying and analyzing the driving forces of FDI to developing countries, taking into account the specificity of different sectors and the constraints faced by foreign investors in their capabilities to compete and upgrade their operations in those countries.

In this connection UNIDO is launching in-depth surveys for African countries, in particular to assess investors' perceptions and assist national IPAs to improve their effectiveness and provide information that could benefit a wider audience of African stakeholders. The first of these surveys, which are intended to be repeated every two years, was conducted in 2001 on a pilot basis. The second one, on a full-scale basis, was conducted in 2003 and is published for release at the UNIDO General Conference on 1-5 December 2003 (UNIDO 2003 c). The survey is expected to:



- Identify sub-sectors of growing interest for foreign investors and determine the characteristics of potentially important investor sub-groups like major exporters, companies with expectations of high growth and new investments and investments with high local content operations;
- Identify trends in FDI inflows;
- Determine IPA services and government interventions most valued by foreign investors and the additional support and incentives that would facilitate new investment;
- Understand the most important determining factors influencing the decisions of foreign investors;
- Develop a forward-looking macro indicator of future investment flows to the region and identify the most attractive sub-sectors for future investments;
- Rank countries in terms of foreign investor perceptions.

The survey is the empirical input for the platform through which country, region and sector level activities could be designed. The platform is a network of IPAs and the first of these has been established for the sub-Saharan countries with the ongoing UNIDO integrated programmes.<sup>2</sup>

Based on the analysis of the survey results (at both the individual country level and the aggregate level) the network is the vehicle to develop comprehensive activity plans and promotion strategies for each member country.

UNIDO's focus and deepening specialization in specific industrial sub-sectors; operational involvement, through the integrated programmes, in micro-level issues; high profile presence and multi-faceted involvement in the integrated programme countries provide it with a natural network, which differentiates UNIDO interventions.

The network also serves as a means for continuous capacity building and the introduction of relevant products and services into the activities of the IPAs in the countries covered, and to facilitate interchanges between the IPAs and UNIDO Investment and Technology Promotion Offices (ITPOs).

## 2. Assistance to IPAs in becoming a part of the industrial development support system

In order to be more effective in inserting the country into the global industry networks, the IPA itself must integrate into the industrial development efforts of the country. It has to establish strong linkages with domestic manufacturers and to work with or facilitate the work of other institutions. IPAs need to map out the characteristics of important industrial sub-sectors, benchmark their competitiveness and develop a database of company profiles. They have to look for ways to interlink FDI promotion with the mobilization of domestic investment.

UNIDO interventions take two forms: Proprietary training packages and tools; and joint programmes with critical stakeholders like banks, private consultants, chambers, manufacturers and other professional associations as well as ministries and parastatals.

The approach is to build a core group of representatives of different organizations to assess companies and develop a picture of "state-of-enterprise" in targeted sub-sectors. Together with the review and assessment made by the relevant technical branches of UNIDO, this information is the basis for the preparation of sub-sector profiles.

The main tools used for these activities are the Computer Model for Feasibility Analysis and Reporting (COMFAR), the Industrial Investment and Technology Promotion Profile (IITPP), and training material on project formulation and appraisal. COMFAR is a widely used application tool for structuring different categories of investment projects and conducting various forms of financial and economic analyses. IITPP is a tool for the systematic profiling of enterprises and investment projects

---

<sup>2</sup> UNIDO-Africa Investment Promotion Agency Network (AfrIPANet) was launched in November 2001. Its second meeting is scheduled for 2-4 December 2003 in Vienna.

with automatic links to COMFAR for quick appraisal and comparative analysis of competitiveness with competing countries. The extensive training in the application of UNIDO tools provides the members of the core group with common appraisal standards and analysis methodologies that facilitate closer cooperation in project development and financing.

The database of company profiles and the sub-sector analyses, developed through close cooperation with the relevant national stakeholders, provide the IPAs a deeper understanding of the domestic private industry and the dynamics and relative competitiveness of key sub-sectors. Together with close links to the key umbrella and technical support institutions developed through the joint programmes, this allows the IPAs to craft much more informed promotion strategies with more analytical information with which to approach potential investors, and to be in a much stronger position to lead and coordinate the national investment promotion drive.

The company profiles can also be used by IPAs for promotion through the UNIDO ITPOs. This promotion cycle is additional IPA capacity building, presenting the opportunity to IPA staff to design and execute promotion events in targeted investor countries.

A key feature of UNIDO's strategy is to frame FDI and its promotion within the overall objective of productivity gains. Consequently, UNIDO's tools and training focus on specific forms of FDI. In particular, UNIDO fosters the skills needed to facilitate modes that are more conducive to technology spillovers, such as industrial joint ventures and technology transfer partnerships. In addition, support is provided to develop capital market financial instruments designed to both overcome some of the effects of weak financial systems and to facilitate the design of targeted incentive systems that guide investors into desirable economic activities.

## References

Aron, C., *FDI's Contribution to Poverty Alleviation: A Report From the FIAS '98 Singapore Conference*. Washington, D.C.: Foreign Investment Advisory Service, 15 July 1999.

Dobson, W., and G. C. Hufbauer, *World Capital Markets: Challenge to the G10*. Washington, D.C.: Institute for International Economics, 2001.

OECD, *Foreign Direct Investment for Development: Maximising Benefits, Minimising Costs*. Paris: Organization for Economic Cooperation and Development, 2002.

Rodrik, D., *Growth Strategies*. Working Paper prepared for publication in the *Handbook of Economic Growth* (forthcoming). Cambridge, Mass.: Harvard University, April 2003.

Te Velde, D. W., *Policies Towards Foreign Direct Investment in Developing Countries: Emerging Best-Practices and Outstanding Issues*. London: Overseas Development Institute, March 2001.

UNIDO, *Promoting Investment in Developing Countries (with special reference to Africa): Challenges, Opportunities and Experiences*. Issue Paper for Round Table 5 of the 10<sup>th</sup> UNIDO General Conference, Vienna, 1-5 December 2003. Vienna: United Nations Industrial Development Organization, 2003(a).

UNIDO, *Developing Industry: Productivity Enhancement for Social Advance – UNIDO's Corporate Strategy*. Vienna: United Nations Industrial Development Organization, 2003 (b).

UNIDO, *Africa Foreign Investor Survey 2003*. Vienna: United Nations Industrial Development Organization, 2003 (c).

Usata, S., *Foreign Direct Investment Diversion*. Discussion paper by Shujiro Usata, Professor of Economics, School of Social Science. Tokyo: Waseda University, 11 November 1997.

## Opening Statement

*Yoweri Kaguta Museveni\**

Mr. Chairperson,

I was told that you wanted me to speak about why there are no investments coming to the Third World countries, especially to Africa. Well, there are a number of reasons, but let me group them in two categories. Some of the reasons are indigenous, meaning that they originate within the less developed countries themselves. There are programmes within these countries that stop investments from coming in. The other factors are exogenous. They originate outside these countries.

Let me start with the indigenous factors. In the 1960s, the main indigenous factor that denied us investment in Africa was the anti-private sector bias of our governments. Many of our governments in Africa, in the 1960s, were against the private sector. They had not thoroughly understood the meaning of nationalism and they did not understand the role of the private sector. They thought that the private sector would lead to a net outflow of resources out of Africa to the outside world.

This was, in fact, a misunderstanding because if you study private sector flows of money, you will discover that if I earn US\$ 100 million as a private company in a country, most likely 85 per cent of my gross earnings will remain in that country and I will take out only 15 per cent. Therefore, it was wrong for our leaders in the 1960s to fear the private sector. The private sector was an ally.

I can give you the example of Uganda. In Uganda we made two mistakes. The first one was made by one of our leaders called Apollo Milton Obote in 1970, when he nationalized private companies. In 1972 the second mistake happened. One of our leaders called Idi Amin went further and expelled the Asian investors who had come to Uganda. Those were the investors from the Indian subcontinent. That is one of the indigenous factors in the 1960s.

In the meantime this issue has been resolved in many countries. Many of the African countries now believe in private sector-led growth, but there are other factors: The small size of our economies, and the low spending and low purchasing power of our populations. If you take the market of Uganda, it is worth about US\$ 30 billion. If you take the economy of the United States, it is worth US\$ 11 trillion. If you take the market of China now, it is worth US\$ 1 trillion. If an investor is choosing where to go, he is more attracted by China than by this small economy. The African leaders are not paying enough attention to integration. Africa is a huge continent, with 800 million people. It is one of the biggest continents in the world, but it is not pulled together, so the investor has to decide whether to go to Uganda, to Kenya, to Tanzania, to Burundi. That is the second big problem, small markets.

Why are people rushing to China? China is a communist country. If you fear communism, then you do not go to China. But they are going to China because China has a huge market. Once you are there, you will make money. In order to overcome the second internal weakness within Africa, the small markets, we must integrate them into big regional markets.

Now, what about the external factors? There are many of them, but the major external factor is the parasitism of the West. The western countries say that they believe in Christianity but they do not practice Christianity. In the Christian belief it is said, "you shall love your neighbour as you love yourself". The Europeans believe in loving themselves more than anybody else. Because of that, the

---

\* President of Uganda. This text is based on an edited transcript of the spoken presentation.

western countries – referring here to Europe, the United States and Japan - have locked us out of their markets for a long time.

Recently, however, there was some movement, on which I would like to comment. In the European Union, they initiated a policy known as the EBA, Everything but Arms. This is very important because now Uganda can export processed coffee to Europe without taxes, without tariffs, without quotas. We can export textiles; we can export anything we process. It is the same with the United States. I hear Japan is also doing something similar. What still remains to be done on the part of Europe and the United States are subsidies for some of the agricultural products. If they could get rid of those, that would be a very important stimulus for the small economies of Africa, which could then export directly to Europe and the United States because those are big markets.

Let me give a summary. Firstly, the biggest problem in Africa was the anti-private sector bias of our governments in the 1960s.

Secondly, the small size of the African economies is another big issue. They are too small because they were fragmented politically by the colonial powers. They need to be pulled together in order to attract investment.

These are the two big indigenous factors.

The main exogenous factor is the lack of access to markets. If there is access to markets, investors will come. In the last 15 years, our situation has got worse because what used to be the Communist Bloc of Eastern Europe, Russia and China has opened to capitalism. The Africans had missed their chance in the 1960s because in the 1960s, European capitalists were knocking at the door of Africa, they were begging to come in because at that time they could not go to China, they could not go to Russia, they could not go to Eastern Europe. But the Africans locked out the capitalists; they did not allow them in. Now, the Africans are begging the capitalists to come in, but the capitalists have got better and greener pastures to go to.

This is my summary. Thank you very much.

## Moderator's Introduction

*Brian Caplen*<sup>\*</sup>

Thank you very much Mr. President for that very interesting opening speech. Now I would like to formally open this Round Table on Promoting Investment in Developing Countries (with Special Reference to Africa) – Challenges, Opportunities and Experiences. My name is Brian Caplen. I am the editor of fDi Magazine, which is a magazine owned by the Financial Times. It is aimed at executives in multinational corporations looking to invest in overseas countries and it tells them about the opportunities that are available and the kinds of incentives and the kinds of issues they face in investing overseas.

We are very lucky today to have on the panel a range of speakers covering investors, multinationals, an entrepreneur and a representative of an IPA. We will begin with a presentation by our keynote speaker: Professor Peter Buckley, who is professor of international business and Director of the Centre for International Business at the University of Leeds in the United Kingdom. Professor Buckley is going to speak about how the new economy affects FDI flows and makes new demands on both the management of multinational enterprises and the countries that are trying to attract that investment into their countries. We will then ask the different panellists to make brief presentations to basically set the scene from their respective points of view for the following discussion.

---

\* Editor of fDi Magazine, Financial Times Group. The text presented here is based on an edited transcript of the moderator's spoken introduction.

## Keynote Speech

### FDI and Growth for Developing Countries: MNEs and the Challenges of the “New” Economy

*Peter Buckley\**

#### Introduction

In the context of the theme of Round Table 5, this paper in dealing with Foreign Direct Investment (FDI) and economic growth will acknowledge that there is a substantial body of theoretical and empirical research in the discipline. This stock of literature is considerably weighted in the perspective that addresses the international dimensions of business and corporate strategy as well as organizational behaviour. Econometric perspectives are also widely available. However, in speaking to this paper, the academic and research literature on international business that captures the essential dynamics of FDI and multinational enterprises (MNEs) will not be surveyed.<sup>1</sup> The determinants of FDI will be briefly touched upon, without going into academic detail, but the main thrust of the paper is in the direction of the inter-relation between FDI and MNEs in the new setting of the international location of production – and their implications for the investment policies of developing countries. The thorny issue of the place of incentives in FDI regulatory frameworks is not addressed directly or extensively for good reason – empirical research illustrates amply that in general incentives are not highly prioritized in the considerations or motivations when MNEs make their economic analyses for FDI. However, once an investment has been made, naturally MNEs will take advantage of whatever incentives there are in order to reduce operational or transactions costs. Having said this, the paper does make some remarks about the role of incentives.

#### Overview of FDI

There are many major issues regarding the juxtaposition of globalization, the role of FDI and MNEs in development and the reality of “failed” or “failing” states, which demonstrate an apparently endemic failure of parts of the global economy to rise above subsistence levels onto the path of robust industrialization.<sup>2</sup> Among the most pressing are the challenges and opportunities concerning FDI for developing countries. Some of these challenges and opportunities are faced by MNEs as well, and they provide points to which developing countries and economies in transition can move to minimize their disadvantages and maximize their advantages in strategizing the role of FDI and MNEs in their industrial development. MNEs and FDI are the key actors on the global economic stage, and the essential features of the international operations of MNEs are of crucial importance for the developing countries to appreciate and fully comprehend if they are not be sidelined in the race for development.

Foreign Direct Investment – production owned and operated across international borders by foreigners – evokes international business in terms of real capital flows recorded as an identity in balance of payments statements.<sup>3</sup> However, given the evolution of the modes of internationalization

---

\* Professor of International Business and Director of the Centre for International Business at the University of Leeds, U.K.

- 1 Multinational enterprises are taken to include all types of foreign investors notwithstanding differentials in size and geographical coverage.
- 2 Primarily the developing countries which are taken to include the least developed countries as well as the economies in transition.
- 3 Foreign direct investment aggregates corporate economic activity as a component of the financial account of a country recorded in the balance of payments. Its components are: (1) the net acquisition of share and loan

by MNEs since 1960, FDI operations actually may involve neither cross-border capital flows nor investment in capacity. This is because financing can be conducted through host capital markets and, in the case of mergers and acquisitions, there may not be an increase in capital expenditure to increase output. Nevertheless, from a variety of sources,<sup>4</sup> recorded FDI flows demonstrate a remarkable global growth profile, from under US\$ 60 billion in 1980 to just over US\$ 1,400 billion in 2000 before falling back to an estimated US\$ 490 billion in 2002 (OECD 2003). The distribution of FDI shows significant growth in flows to developing countries, from just below US\$ 50 billion in 1990 to just below US\$ 200 billion in 2001 (UNCTAD 2002).

An overview of the global distribution of FDI shows that developed countries have maintained the lion's share since 1980. This share has fluctuated between 70 per cent and 90 per cent with a few exceptional years (notwithstanding the relatively low performance of 56 per cent in 1982 and the high performance of 90 per cent in 1987). In general, African, West Asian and Eastern European countries have performed poorly in comparison with South and East Asia and Latin American countries. The main beneficiaries of FDI flows to Asia have been the countries of South and East Asia, particularly "greater" China, Singapore and Malaysia. In Latin America, the high performers have been Brazil, Mexico, Argentina and Chile. The flows to Africa, and particularly to sub-Saharan Africa, have been disappointingly low – almost to the point of immeasurability – with the bulk of the low volumes being captured by Nigeria and Angola in the south and by Egypt and Tunisia in the north (UNCTAD 2000). This, however, does not mean that the continent is incapable of connecting industrially with the world economy (UNIDO 2000).

### **The vectors of FDI and globalization**

Since about the early 1980s, two major trend developments have influenced profoundly the industrial organization of MNEs and the profile of increases in FDI activity. The first – state directed – is the continuing percolation and reach of policy liberalization under pressure from multilateral trade negotiations and agreements, as well as the conditionalities of structural adjustment programmes supported by the international financial institutions. These have been reinforced by the intensive competition – company induced – between countries focused on capturing the beneficial impacts of FDI from MNEs (Oman 2000). Evidence of liberalization in policy regimes and regulatory frameworks for FDI is provided by the number of recent pro-FDI changes that various countries have undertaken.<sup>5</sup> Policy liberalization has led to decreasing transaction costs in cross-border FDI and trade. The response, in terms of industrial organization of international firms, is manifest in the acceleration, and geographical spread, of spatially distributed networks for international production and servicing (UNCTAD 1993, 2001).

The second major trend development – company directed – is the spatial location and dynamic distribution of manufacturing and services, in both "horizontal" and "vertical" FDI (Dicken 2003) within industrialized, and across developing, countries and especially in the so-called emerging markets of Central and Eastern Europe, Latin America and Southeast Asia. This spatial distribution, driven in large part by MNEs' competitive search for efficiency gains and market share in response to increasing production costs and the perils of exogenous shocks,<sup>6</sup> is characterized by the strategic

---

capital through mergers and acquisitions or takeovers, joint ventures, and the establishment of new green-field subsidiary companies; (2) profits of overseas subsidiaries which are reinvested abroad and (3) parent to subsidiary capital transfers.

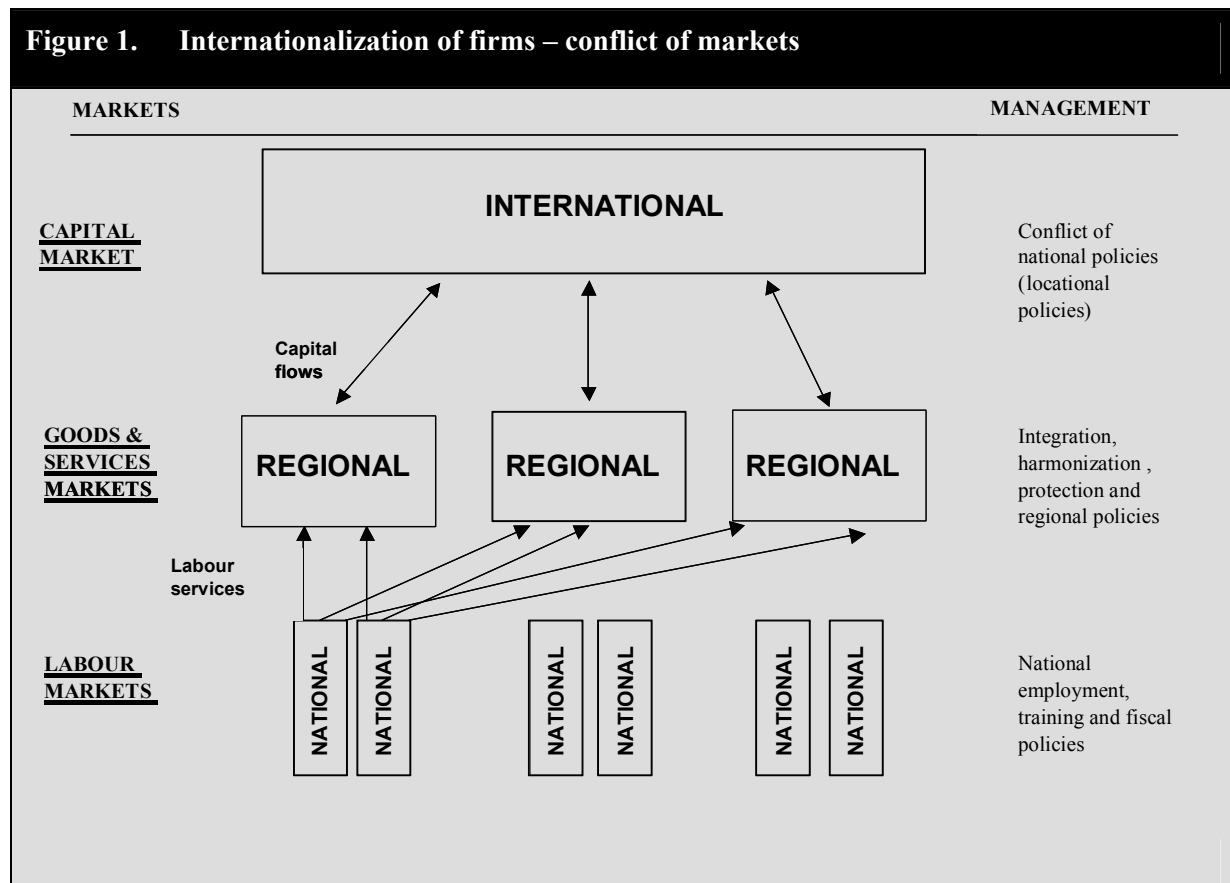
4 IMF, *International Financial Statistics*; OECD, *International Direct Investment Statistics*; UNIDO; and UNCTAD, *FDI/TNC Database*.

5 In 1991, 35 countries introduced 82 changes in their FDI regimes, compared with 71 countries making 208 changes in 2001. In 1991, 97.6 per cent of all changes made were pro-FDI, compared to 93.3 per cent in 2001; down from 98 per cent in 2000. Asia and the Pacific region introduced the highest number of pro-FDI changes.

6 Such as episodic financial crises and the oil price shocks of 1973/74 and 1979/81.



integration of MNE headquarters and affiliates and is articulated through specific operational mandates for particular subsidiaries (Birkinshaw & Hood 1998). With respect to Southeast Asia, where this strategic integration of MNE headquarters, subsidiaries and affiliates is arguably most visible and efficiently staged, the spatial distribution has quite distinctive trade features that are exemplified by vertical intra-industry trade (VIIT) and international exports in a relatively narrow range of product categories.<sup>7</sup> The regional dimension to this spatial distribution should not be overlooked (Figure 1).



Despite the nuances in the theoretical literature on FDI, growth and economic development since the 1960s, and the empirical debate over the derived net benefits of globalization (Fischer 2003; Stiglitz 2002), given the weight of evidence there is a robust argument that international business – manifest as FDI – is positively correlated with economic growth and the integration of world markets (Albuquerque et al. 2002). This growth is visible, through the positive externalities generated and captured by hosts to FDI, in terms of increased intermediation by some developing countries with the Triad-dominated international system of the FDI-intensive geographical distribution of production.<sup>8</sup> This correlation is no longer a subject of debate. However, the magnitude of the effects at firm,

7 In the electrical machinery industry, the share of VIIT in total trade in East Asia grew from 31 per cent in 1996 to 43 per cent in 2000. With respect to the share of Japan's total trade with the electrical machinery industry in the five main Southeast Asian economies, the respective figures for 1988 and 2000 are as follows: Indonesia 2 per cent to 39 per cent; Malaysia 40 per cent to 34 per cent; Philippines 16 per cent to 55 per cent; Singapore 17 per cent to 43 per cent; and Thailand 16.5 per cent to 41 per cent (Fukao et al. 2003).

8 The Triad is taken as the geo-economic spaces of North America (and its NAFTA dimension), the European Union (recently enlarged) and the Japanese sphere of economic influence in Asia.

industrial sector or sub-sector, industry, and economy-wide levels – longitudinally and cross-sectionally – is subject to continuing empirical research and discussion (Ewe-Ghee Lim 2001).

The central issue remains how to address, in a more balanced manner in favour of the developing countries (notwithstanding the, for some, disappointing outcome of the multilateral trade negotiations in Cancun, Mexico, in September 2003), the widening asymmetries in FDI flows and stocks. Since the 1960s, MNEs – the principal actors in the dynamics of FDI – have been increasing their capacity for managerial co-ordination of, and capability for control over, international production and its articulated spatial distribution. How developing countries, through anticipatory policy postures and adaptive structures of incentives, manage to insert their economies (and inherently their industrial sectors and enterprises) more solidly into the interstices of global value-chains and co-ordinated networks of MNEs remains the central conundrum. Clearly, some developing countries are doing well at this new game; others are faring poorly.

The previous separated patterns of FDI and international involvement by firms (usually sequential and, hitherto, more predictable in terms of the mode of entry) have been superseded by the multifaceted pattern of “alliance capitalism” (Dunning 1997) hallmarked by MNEs’ competitiveness. This, in turn, is characterized by FDI involving simultaneous collaboration with competitors and rivalry (in different economic spaces) with strategic and alliance partners, as well as participation in dense networks of technology suppliers (Buckley & Casson 1976, 2003). The intricacies of these internationally networked systems of industrial sourcing, technology, production, marketing and servicing place severe challenges on economic, industrial and development policy-making in developing countries. The essence of the challenges is best seen as a puzzle of what economic and industrial policies to adopt on the one hand, and how to sequence policy instruments in a manner that captures the desired components of the MNEs’ network on the other hand. The performance of Southeast Asian economies, since the 1960s but particularly over the last two decades, elucidated in part by the 1993 World Bank study *The East Asia Miracle: Economic Growth and Public Policy* (World Bank 1993), highlights the essential role of government in overcoming market failures and assisting economic development. That performance also demonstrates what is possible for other developing countries.

Among the challenges for developing countries not sufficiently well-versed in the lessons from Southeast Asia is how to emulate, and compress into a shorter time, that kind of performance while coping with the triple confrontation of: a “rules-based” world trading system; technological “componentization” (the slicing up of the stages of production and its spatial distribution); and the emergence of China as the “workshop of the world” (Roberts & Kynge 2003, p. 13).

### **The challenge of FDI in the new economy for developing countries: What lessons?**

The political-economy of cross-border transactions in FDI and trade within the “new economy”,<sup>9</sup> and its impact on the configuration of MNEs’ decision-making structures with reference to headquarters-subsidiary mandates, has resulted in crucial changes in strategic thinking within MNEs. This carries serious consequence for the world economy in general and the developing countries in particular.

The so-called “golden age of capitalism” in which MNEs were predictably structured with divisions locked into rigid linkages with other parts of the *same* firm has given way to a new international environment that is very different, and very challenging from a policy perspective. With competitive pressures increasing relentlessly, the questions asked by MNEs are twofold:

- Firstly, where to locate productive assets and manufacturing activity in a manner that efficiently differentiates between locations and maximizes the difference between manufacturing value-added and locational cost structures; and

---

9 The “new” economy is taken as the technological revolution in information and communications and electronic commerce in the context of developments in the opening years of the new millennium.

- Secondly, how should the assets and activity be controlled (and co-ordinated)?

The locational decision concerns the relative merits of the cost and market-related advantages between different locations. The control decision concerns whether or not to own or to have *an option* on ownership (Trigeorgis 1996) through collaboration (for example through outsourcing, sub-contracting, joint ventures, or strategic alliances with different firms). In the new economic environment, the MNEs' desire for flexibility militates against the rigid backward and forward vertical integration into input factors or into distribution of the "golden age". The more advantageous alternative is to sub-contract production and franchise sales (thereby distributing the associated risk profiles). The implications for developing countries are that their leaderships need to fully understand, and incorporate into their development policy and strategy, the dynamics of these two decisions by MNEs.

The outcome of these two decisions by MNEs is manifest as disintermediation and re-intermediation of the spatially distributed production networks and the internalization of external markets by MNEs. With managerial utility being emphasized ever-increasingly, especially during the 1990s, divisional managers have incentives to want to have more degrees of freedom in which they can deal with economic agents external to their own firm. The overall result of this dynamic is a very complex strategic set that confronts decision-makers and managers in MNEs (and of course, by definition, policy-makers in developing countries who aspire to capture parts of the MNEs' system of production and marketing). It is evident that, in the course of the four "development decades" (notwithstanding the "fortune" of the Vietnam War,<sup>10</sup> and the inflationary 1970s and early 1980s), policy-makers in Southeast Asia have been arguably the best at understanding how exploitation of these dynamics can be built into economic development strategies.

In examining the new economy, it needs to be noted that approximately 80 per cent of all e-commerce transactions is accounted for by B-2-B engagements over the inter- and intra-net. In other words, it is interactions between formal businesses that are driving the content in, and the media of, e-commerce. This has profound implications for developing countries that wish to connect with the integrated international production and marketing services of MNEs, their networks of subsidiaries and the supply chains that link them to other firms. Among the most serious implications is that the perennial dichotomy between focusing on "the global" or "the local" in co-ordinating networks can be better managed on the world-wide web and/or the intranets of MNEs. Clearly, the implications are simply enormous for developing countries "on the wrong side" of the digital divide.

The outcomes of this process of co-ordinating networks with reference to the MNEs' operations underway in the world economy include the fact that the internal markets of MNEs are tending to become more "open" and less "closed". Opening up the internal markets of MNEs leads to a loosening of the ties between divisions and their production capacities at adjacent stages of manufacturing. The effect is that MNEs become more like "hubs" in networks of interlocking collaborations (Buckley and Casson 1988, 1996), as shown in Figure 2. The opened up internal markets of these networks are more efficient in providing price and profit signals to which all players, including policy-makers in developing countries who proactively incentivize their industrial sectors, must respond competitively. This is why the so-called digital divide – in reality a profound difference in capacity and usage of information communications technologies (ICT) between the industrialized and the developing countries – is so crucial.<sup>11</sup> The lack of capacity and low skills in usage debilitate the developing countries from exploiting the interstitial spaces of spatially distributed networks of the MNEs.

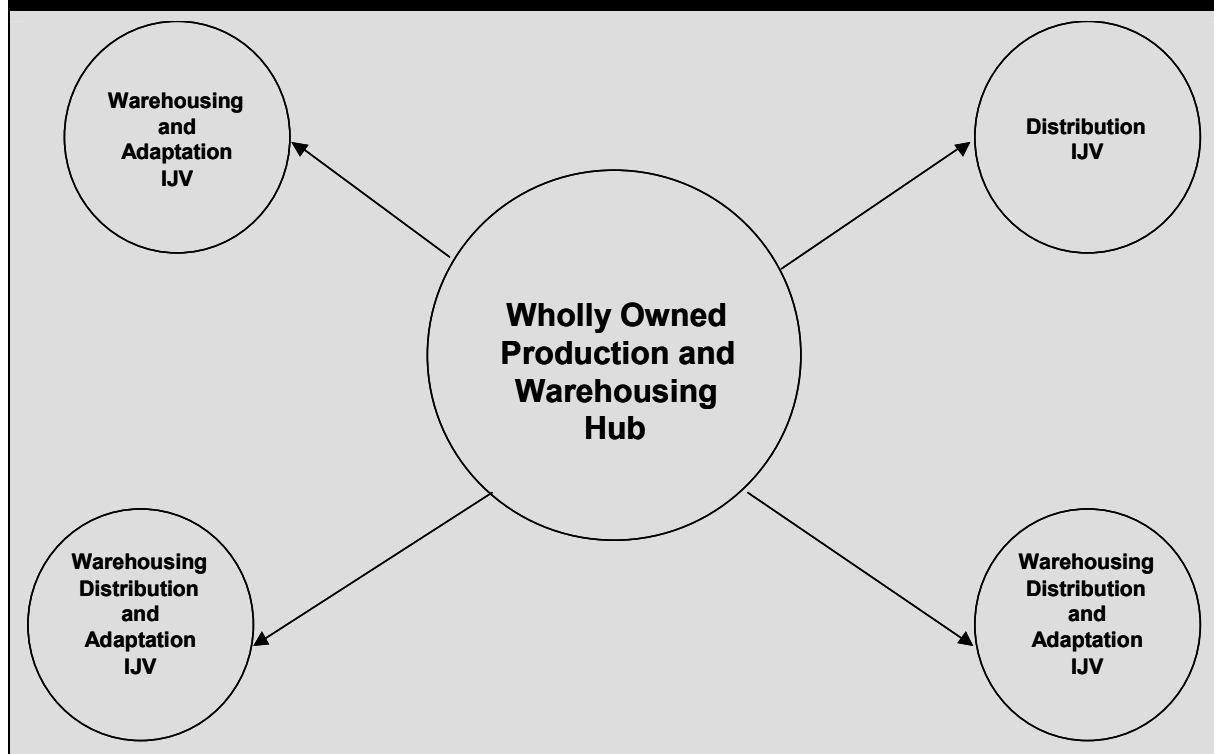
---

10 The volume of resources poured into Southeast Asia during the period for the "effort" would need to be recalled.

11 Developing countries' capacity is highly truncated. It is estimated that the total number of telephone lines in the 48 least developed countries (LDCs) is less than one per cent of the number of lines in North America, and that Africa has about 1 per cent of all the world's telephone lines (and of these South Africa has about half).

Such hub-centred networks retain torsional flexibility across a broad range of corporate functions, including industrial as well as science and technology research and development (R&D). To a certain extent, the high-performance Asian economies (the Asian “Tigers”) and the newly industrializing economies of Asia and Latin America testify to the successes of diffusion of technology since the first development decade of the 1960s. Thus the range of countries able to innovate with confidence and competence has increased significantly. However, many developing countries have failed to exploit this development adequately with the result that there is not only a digital divide but also an innovation divide.<sup>12</sup>

**Figure 2. “Hub and Spoke” strategies: An example**



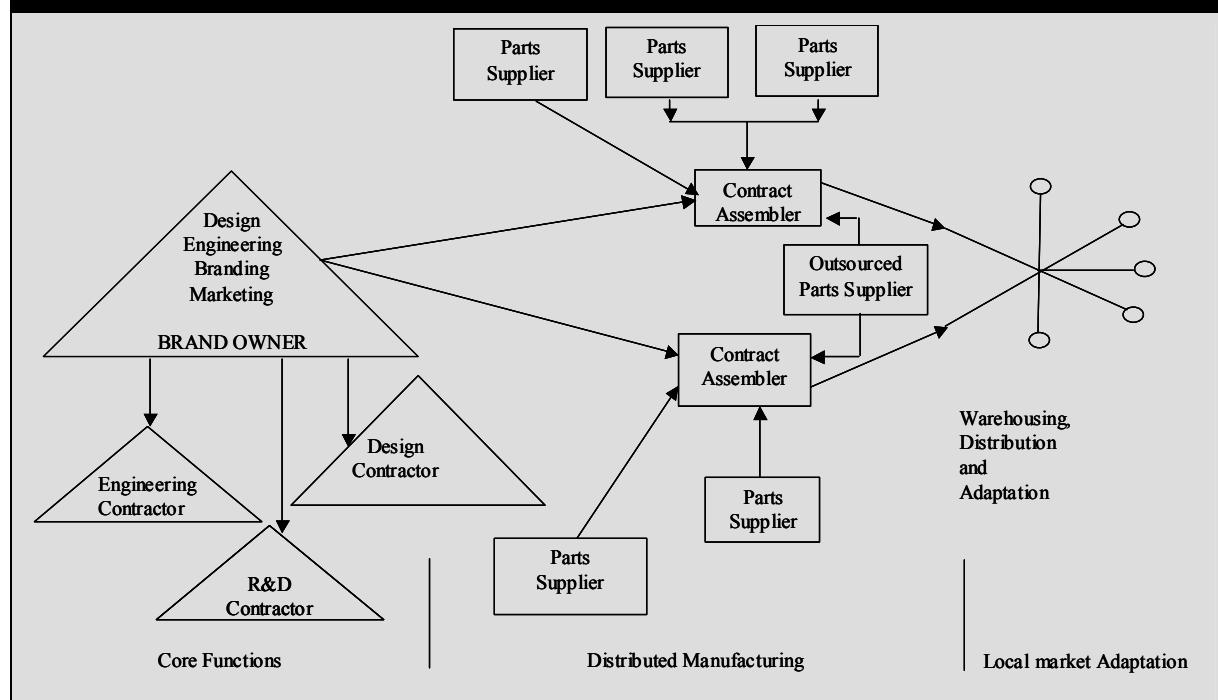
The new economic perspective for MNEs in managing the international operations of their FDI concentrates managerial attention on: The characteristics of volatility and uncertainty in markets; the value of options and flexibility in entry modes for FDI; alliances, collaborative and network forms of co-operation and competition; entrepreneurship within networks; managerial competence; and a corporate and organizational culture that is progressively more adaptable to the demands of change. This set of valuable attributes that management in organizations engaged in international business must continuously develop distills into flexibility of operations. This is the ability to orchestrate the allocation, and re-allocation, of resources efficiently, smoothly and rapidly in anticipation of, and response to, change. Implicit in this is the ability to locate (and capture) resources, that may not be within the purview of the organization, also smoothly and quickly in response to internal or customer demands. The greater the amplitude and frequency of change in the business environment, the greater this need for organizational and operational flexibility (Figure 3).<sup>13</sup>

<sup>12</sup> These of course reflect the asymmetries in FDI flows and technology flows.

<sup>13</sup> This raises questions pertinent to ‘emergence’ – the study of complex adaptive human systems and businesses from the perspective of complexity science and philosophy – and coherence in strategy and operations of MNEs of which developing countries need to be increasingly aware.

The challenge for the developing countries is that the evidently increasing pace in the liberalization of FDI, trade, and capital and financial markets as well as the agglomeration of factor markets (since the collapse of the Bretton Woods-based system of fixed exchange rates in the early 1970s) means that exogenous shocks travel through geo-economic spaces without the once-present “breaks” imposed by sovereign borders, each with differentiated set of rules and regulations at a pace that catches most policy-makers in developing countries by surprise. Developing countries need to appreciate the examples of punctuated equilibria much more intensely if they are to emerge from the marginalization that is confining them. The result of the centre-periphery quality to the structure of MNEs and that sources of innovation are no longer confined to MNEs’ headquarters (Casson et al. 1991) is an increasing aversion to internal monopoly.<sup>14</sup> The underlying common factor to this dynamic is the acceptance among international managers, as they operationalize their FDI, that the boundaries of the firm are no longer well-defined and are far more “virtual” than real. The notion of arm’s length markets is less solid and firms merge with markets and markets merge with firms.<sup>15</sup>

**Figure 3. Globally distributed operations**



The analysis indicated above raises the issue of accelerated dynamic market entry and exit as the strategic preference for MNEs. In the new volatility, FDI is revealed as a high risk strategy – in the absence of location specific compensating factors such as a transparent and coherent business climate with both the “hard” and “soft” infrastructure to do business. However, developing countries would need to realize that FDI offers much better options for capturing information in comparison with other

14 In the 1980s, the arguments for maintaining centralized R&D lost ground to those managers wanting to distribute these centers as services for internal (and in some cases of co-R&D joint ventures external) customers in competition with other providers (universities etc.) in an attempt to diversify risk. There followed the delayering of middle management ranks.

15 According to UNCTAD (1995), 60 to 70 per cent of all global trade is conducted either *within* MNEs or *between* MNEs.

entry modes.<sup>16</sup> Although exporting and licensing confer more flexibility in anticipation of market decline, FDI confers more flexibility in anticipation of market growth.

What options are there for an even more flexible approach for MNEs? Kogut (1991) posits that international joint ventures (IJVs) may be the answer as they hold the value of options.<sup>17</sup> In terms of strategic superiority, on the one hand, an IJV in which the real option is never executed is probably inferior to an FDI that takes the form of a wholly-owned subsidiary; on the other hand, an IJV in which the option is exercised at the first opportunity does not last long (by definition).<sup>18</sup> With respect to the interaction between markets that developing countries have to take into consideration when designing their FDI policies, it is worth noting that, from the MNEs' perspective,<sup>19</sup> that the cost-based competitiveness inherent in the economies of scale and rationalization in networked global operations have to be weighed against the revenue-based competitiveness of local operations due to the fact that, in the latter case, MNEs can differentiate products and services to such an extent as to extract maximum rents from their firm or ownership specific advantages (Dunning 1977, 1988, 2000). In much the same way, reflecting the flexibility inherent in spatially distributed production networks, the "hub" and "spoke" strategies employed by MNEs enable responsiveness to market decline by divesting distributional assets to local partners (exercising one of the options in joint venturing) while retaining production capacities with high appropriabilities (Lall and Streeten 1977),<sup>20</sup> the output of which can be diverted to other markets.

Globalization represents a dynamic that is geared to different speeds depending on geography. The concern over the marginalized developing countries is that their collective velocity is so retarded. They are in danger of getting left completely behind in a world of their own that is essentially cut off from the industrialized countries and characterized by extremes of high risk, the uncertainties of the "failed state", and the inability to use either the language of modern business or the tools of communication in effective engagement with the rest of the world. The electronic revolution has increased the co-ordination skills of MNEs. Thus the intensification of the process underway whereby the collation of data, which when given purpose leads to information; and which in turn when given value, through manipulations such as statistics, yields knowledge, is largely by-passing many of the developing countries. The information processing and co-ordination skills of MNEs give flexibility by improving forecasts and reducing the costs of change with respect to the location of international production. Developing countries have to begin cultivating the zeal for data and its purposeful exploitation and manipulation so that policy-makers can anticipate more accurately the moves and counter-moves of MNEs.

With respect to the co-ordinated networks in terms of outsourcing and related logistics, contract manufacturing (under various guises such as sub-contracting and original equipment manufacturing using formalities such as licensing and co-production) has been growing apace since the late 1980s and early 1990s as MNEs have sought to concentrate on value adding upstream activities while

---

16 Anecdotal evidence suggests that in many cases, MNEs prefer to maintain a presence in a market, even when there may be an economic argument for exit, for the advantage of being able to capture information and market intelligence.

17 The phenomenal growth in joint international business associations throughout the 1990s attests to this. In addition to mergers and acquisitions being responsible for most of FDI throughout the 1990s, according to *The Economist*, between 1996 and 1998 over 20,000 international strategic alliances (ISAs) were formed worldwide. The number of bio-technology ISAs for the leading pharmaceutical MNEs jumped from 152 in the period 1988-1990 to 375 in the 1997-1998 period. The number of inter-firm technology and marketing agreements rose from 280 during 1980-1993 to 650 in 1996 alone. ("Mergers and alliances: Hold my Hand", *The Economist*, 15 May 1999, pp. 75-76).

18 This explains the reluctance by managers to enter IJVs, the instability of joint ventures (Pearce 1997) as well as the pressing need for managers to enter into IJVs.

19 See London (2002, p. 15), for the management levers used by global companies.

20 Due to monopolistic-oligopolistic advantages that are sourced, *inter alia*, from technological functions.

shedding routinized downstream activities.<sup>21</sup> From the developing countries' perspective, the issue is how to go about identifying the evolution of, and capturing the directions of change in, the sub-contracting networks of MNEs as they are configured and re-configured according the relative differences in factor conditions and costs among countries, and within regions? This difficult task of the developing countries is complicated by the fact that the sub-contracting networks of MNEs are also subject to intra-industry trade and FDI vectors (Fukao et al. 2003).

## Concluding remarks

In the promotion of, and competition for, FDI, Africa stands in a field of its own where the flows are miniscule, with few exceptions (Tables 1 and 2). While the weight of evidence points to the argument that international business – manifest as FDI and its externalities – is positively correlated with economic growth, the ability to capture externalities depends very much on the absorptive and technological capacities available in the host countries, and therefore in the ability to grab “best practice”. The implicit assumption is that local firms must be able to absorb the spillovers from foreign investors – in other words the technology gap cannot be prohibitively large. These capacities do not seem to be either immediately visible or robust in developing countries, and Africa in general and the least developed countries (LDCs) in particular. When combined with the requirement of an enabling host investment climate in terms of whether the FDI reception regime is economically open with well-articulated policies that change in dynamic reflection of the changing strategies of MNEs (as is so visible from the Singaporean example), the challenges are indeed considerable. Hosts to FDI would need to move from a passive posture towards FDI to a more proactive policy stance whereby they calibrate and re-calibrate continually their investment regimes to progress to higher levels of modal neutrality, contestability for factor markets and policy coherence.<sup>22</sup>

**Table 1. FDI inflows in LDCs, 1991-2002 (US\$ million)**

		1991-1996 (Annual average)	1997	1998	1999	2000	2001	2002
1	Least developed countries	7,713	3,401	4,573	4,974	3,427	5,629	5,232
2	All developing economies excluding China	66,061	148,987	147,533	188,976	205,285	162,585	109,445
3	1 as %2	2.59	2.28	3.10	2.63	1.67	3.46	4.78

Source: UNCTAD (2003), p. 252.

21 See “Factories for Hire”, *The Economist*, 12 February 2000, p. 81; and “Incredible Shrinking Plants”, *The Economist*, 23 February 2002, pp. 75-78, for a view of contract manufacturing growing at about 20 per cent per year since the mid- to late-1990s, with Asia and Mexico playing key roles and redefining, for example, the boundaries between automotive manufacturers and their suppliers through outsourced “flexible global manufacturing”.

22 Modal neutrality ascribes to investment policies the best ways to serve the markets in terms of entry mode. Contestability refers to the legal ability of foreign as well as domestic investors to compete for the same input factors of production. Policy coherence signifies the degree to which development objectives, the FDI regime and interpretation of that regime, in its regulatory form, has internal consistency across business functions, at different levels of Government and in different places in the country.

**Table 2. FDI inward stocks in LDCs, 1980-2002 selected years (US\$ million)**

		1980	1985	1990	1995	2000	2001	2002
1	Least developed countries	3,419	5,132	8,165	16,208	35,609	40,867	46,099
2	All developing economies excluding China	301,219	396,306	526,669	783,121	1,681,222	1,778,733	1,891,896
3	1 as %2	1.14	1.29	1.55	2.07	2.12	2.30	2.44

Source: UNCTAD (2003), p. 252.

It is not possible to refer to the dynamics of FDI, its policy regime and the promotion of FDI without reference to incentives and the difference they might make. First, it needs to be recalled that the empirical research indicates that incentives are low on the list of motivations of MNEs, especially when they are provided by developing countries. This is because the authorities making the various offers lack credibility, and in most cases the incentives, however generous they may seem, are not sustainable either over the lifetime of the investment or the strategic timeframe of MNEs. Nevertheless, it appears that “incentives-based competition for FDI is a global phenomenon” (Oman 2000, p. 8). Oman illustrates the two sides of the argument over incentives by reference first to the positive-sum game hypothesis. In this hypothesis competition for FDI, based on incentives oriented towards the “fundamentals” of the investment climate – those with public goods characteristics – ratchets up the respective quality of the environments of competing countries over the long-term. The other side of the argument is the negative-sum game hypothesis. In this hypothesis competition for FDI, using fiscal and financial incentives, results in the “prisoner’s dilemma” created by the dynamics of the competition (Oman 2000, p. 14), and “bidding wars” and the race to the bottom in the short-term.

Incentives also appear to appeal more to cost-minimizing “footloose” investors who may not necessarily be bringing high levels of investment or technology that a host country may want for its socio-economic development. These types of investors may also be prone to “shopping” around to engage in “an auction of incentives”. Empirical research suggests that incentives are perceived to be more important for export-oriented FDI in comparison with market seeking FDI. As a function of their advanced economies, developed countries are prone to offer non-fiscal incentives such as grants and subsidies. In contrast, due to their “stages of development”, governments of developing countries tend to offer fiscal incentives, typically tax holidays. In the final analysis, it is the coherent design and implementation of the incentives regime that matters rather than the question of incentives *per se*. Equally importantly, just as with other aspects of the FDI policy framework, the incentives have to be seen as “windows” of opportunity that open and close in order to coerce MNEs to make the kind of investments that developing countries wish for; bearing in mind the fierce competition for FDI. This said, MNEs now expect that the real incentive for investing in a country should be the overall quality of its investment climate, *ceteris paribus*, with the efficiency-seeking, market-seeking and raw materials-seeking motives of MNEs (Table 3).

**Table 3. Time needed to establish a business**

Top Five	
Australia	2
New Zealand	3
Canada	3
Denmark	4
USA	4

Source: World Bank, as quoted in *The Times*, 8 October 2003.



An important consideration is the cost to the host developing country of providing the type of “direct” incentives (those without a public goods dimension to them). These costs are seen in terms of fiscal revenue losses. In the case of developing countries, the complexities of incentives systems and the acknowledged administrative weaknesses and institutional incapacities, especially in sub-Saharan Africa, can severely deform the design and implementation of the incentives regime. The result is the proliferation of rent-seeking points in the FDI regime, the down-side risk of distortionary effects and the discrimination between groups of investors (Table 4).

**Table 4. Time needed to establish a business**

Top Five	
Angola* <sup>+</sup>	146
Brazil	152
Mozambique* <sup>+</sup>	153
Laos PDR*	198
DR Congo* <sup>+</sup>	215

Notes: \* Least Developed Country + Africa

Source: World Bank, as quoted in The Times, 8 October 2003.

In summary then, some of the lessons of FDI in the new economy for developing countries centre around the acceptance that, while market size in terms of the growth of disposable income remains a key motivation for FDI, the “fundamentals” of the investment climate and environment (including the provision of public goods) are becoming far more important for the majority of foreign investors. This is related to the increase in volatility in the global business environment and the need for MNEs to have flexible options for dynamic market entry and exit with respect to their spatially distributed network of affiliates and subsidiaries. Developing countries have to generate the informational capacity and business intelligence to be able to track foreign investor behaviour far more effectively and efficiently than at present in order to be able to factor the implications of this dynamism of MNEs into their FDI policy frameworks. In this respect the digital and innovation divides are major obstacles preventing Africa from engaging its economy with that of the world. While the impact of regional economic integration (REI) has not been touched on for purposes of brevity, clearly there is a role for this kind of economic development as it has a direct effect, *inter alia*, on market size. Regional economic integration also has the effect of enabling MNEs to exploit the differences in locational factor cost structures, inherent at different stages of development, by linking different stages of production with different locations within the region.

Promoting investment in developing countries and Africa presents many challenges and opportunities which are reflected in the challenges facing MNEs in the new economy. With respect to the change from sequential market entry with “stand-alone” operations to dynamic market entry using co-ordinated networks, developing countries would need to craft their FDI reception regulations to enable the intensification of linkages between affiliates and local firms. Regarding ownership, the preference for uncontested rights is changing to a preference for real options allowing more flexibility in response to changing marketing conditions. Developing countries would need to move towards a better sequencing of greater modal neutrality in their FDI policy regimes. Ultimately FDI, as an international business decision, relies on the cross-border functions of business being executed with competence and entrepreneurship by organizations that demonstrate viable corporate cultures able to anticipate and respond to change. Developing countries would need to mimic the best managerial practices evident from the track-record of successful and excellent international companies with respect to the implementation of FDI regimes in legal interpretation, consistent official behaviour of the highest integrity,<sup>23</sup> and demonstrated willingness to adopt a strategic vision of the long-term

---

23 Transparency International thus states that: “Political elites and their cronies continue to take kickbacks at every opportunity. Hand in glove with corrupt business people, they are trapping whole nations in poverty and hampering sustainable development. Corruption is perceived to be dangerously high in poor parts of the world, but also in many countries whose firms invest in developing nations... Corrupt political elites in the

nature of economic development that must be built layer upon layer on the competent management of resources.

## References

- Albuquerque, R., N. Loayza, and L. Servén, *World Market Integration Through the Lens of Foreign Direct Investors*. Paper presented at the joint conference of the World Bank and the IDB on “The FDI Race: Who Gets the Prize? Is it Worth the Effort?”, Washington, D.C., 3-4/ Oct/2002. Washington, D.C.: World Bank, 2002.
- Birkinshaw, J. and N. Hood, “Multinational Subsidiary Evolution: Capability and Charter Changes in Foreign-owned Subsidiary Companies”. *Academy of Management Review*, Vol. 23, No. 4, pp. 773-795, 1998.
- Buckley, P. J., and M. Casson, “A Theory of Co-operation in International Business”. In: Contractor, F. J., and P. Lorange (eds.), *Co-operative Strategies in International Business*, Lexington, Mass.: Lexington, 1988.
- Buckley, P. J., and M. Casson, “An Economic Model of International Joint Venture Strategy”. *Journal of International Business Studies*, Vol. 25, No. 5, pp. 849-876, 1996.
- Buckley, P. J., and M. Casson, *The Future of the Multinational Enterprise*. London: Macmillan, 1976.
- Buckley, P. J., and M. Casson, *The Future of the Multinational Enterprise: 25<sup>th</sup> Anniversary Edition*. London: Palgrave Macmillan, 2003.
- Casson, M., R. D. Pearce, and S. Singh, “A Review of Recent Trends”. In Casson, M. (ed.), *Global Research Strategy and International Competitiveness*. Oxford: Blackwell, 1991.
- Dicken, P., *Global Shift: Reshaping the Global Economic Map in the 21<sup>st</sup> Century*. London: Sage, 2003.
- Dunning, J. H., “Trade, Location of Economic Activity and the Multinational Enterprise: A Search for an Eclectic Approach. In: Ohlin, B., P. O. Hesselborn, and P. J. Wiskman (eds.), *The International Allocation of Economic Activity*. London: Macmillan, 1977.
- Dunning, J. H., “The Eclectic Paradigm of International Production: A Restatement and Some Possible Extensions”. *Journal of International Business Studies*, Vol. 19, No. 1, pp. 1-31, 1988.
- Dunning, J. H., *Alliance Capitalism and Global Business*. London and New York: Brunner-Routledge, 1997.
- Dunning, J. H., “The Eclectic Paradigm as an Envelope for Economic and Business Theories of MNEs Activity”. *International Business Review*, Vol. 9, No. 2, pp. 163-190, 2000.

---

developing world, working hand-in-hand with greedy business people and unscrupulous investors, are putting private gain before the welfare of citizens and the economic development of their countries... From illegal logging to blood diamonds.” Transparency International, *Corrupt Political Elites and Unscrupulous Investors Kill Sustainable Growth in its Tracks, Highlights New Index*. Press Release, Transparency International Corruption Perceptions Index 2002, 28 August 2002.

Ewe-Ghee Lim, *Determinants of, and the Relation between, Foreign Direct Investment and Growth: A Summary of the Recent Literature*. IMF Working Paper No. WP/01/175. Washington, D.C.: International Monetary Fund, November 2001.

Fischer, S., "Globalization and Its Challenges". *American Economic Review*, Vol. 93, No. 2, May 2003.

Fukao, K., H. Ishido, and K. Ito, *Vertical Intra-Industry Trade and Foreign Direct Investment in East Asia*. Paper presented at the 15<sup>th</sup> Annual TRIO Conference, New Development in Empirical International Trade, 10<sup>th</sup>-11<sup>th</sup> December 2002, Tokyo, Japan. (Revised Version January 2003).

Kogut, B., "Joint Ventures and the Options to Expand and Acquire". *Management Science*, Vol. 37, No. 1, pp. 19-33, 1991.

Lall, S., and P. Streeten, *Foreign Investment, Transnationals and Developing Countries*. London: Macmillan, 1977.

London, S., "Corporations with Hard and Soft Centers". *Financial Times*, 20 February 2002.

OECD, *Trends and Recent Developments in Foreign Direct Investment*. Paris: Organization for Economic Cooperation and Development, June 2003.

Oman, C., *Policy Competition for Foreign Direct Investment: A Study of Competition Among Governments to Attract FDI*. Paris: Organization for Economic Cooperation and Development, 2000.

Pearce, R. J., "Toward Understanding Joint Venture Performance and Survival: A Bargaining and Influence Approach to Transaction Cost Theory". *Academy of Management Review*, Vol. 22, pp. 203-225, 1997.

Roberts, D., and J. Kyngé, "How Cheap Labour, Foreign Investment and Rapid Industrialisation are Creating a New Workshop of the World". *Financial Times*, 4 February 2003.

Stiglitz, J. E., *Globalization and its Discontents*. New York: W. W. Norton, 2002.

Trigeorgis, L., *Real Options: Managerial Flexibility and Strategy in Resource Allocation*. Cambridge, Mass.: Massachusetts Institute of Technology Press, 1996.

UNIDO, *African Industry 2000: The Challenge of Going Global*. Vienna: United Nations Industrial Development Organization, 2000.

UNCTAD, *World Investment Report 1993: Transnational Corporations and Integrated International Production*. New York and Geneva: United Nations Conference on Trade and Development, 1993.

UNCTAD, *World Investment Report 1995: Transnational Corporations and Competitiveness*. New York and Geneva: United Nations Conference on Trade and Development, 1995.

UNCTAD, *Capital Flows and Growth in Africa*. New York and Geneva: United Nations Conference on Trade and Development, 2000.

UNCTAD, *World Investment Report 2001: Promoting Linkages*. New York and Geneva: United Nations Conference on Trade and Development, 2001.

UNCTAD, *World Investment Report 2002: Transnational Corporations and Export Competitiveness*. New York and Geneva: United Nations Conference on Trade and Development, 2002.

World Bank, *The East Asian Miracle: Economic Growth and Public Policy*. New York: Oxford University Press, 1993.

## Presentation by Mr. Carlos da Silva \*

Good morning,

It is a real pleasure for me to be here and represent my company, together with a few of my colleagues who are sitting in the audience as active participants of this conference. I am the Chief Operating Officer for International Business Machines (IBM) in Central and Eastern Europe and Russia, the Middle East and Africa. At some point in time, my territory covered between Vladivostok and Cape Town. If the amount of revenue and the amount of profits that we make in this territory were proportional to the mileage that I covered, I would be a multi-billionaire. That is not, unfortunately, the case.

Although my activities today in Africa are more closely associated with North-West Africa, up until a couple of years ago, and for a long stretch, I was equally covering South and Central Africa, and I have continued to follow the great progress accomplished by many of your respective nations. I am Portuguese. My natural instinctive curiosity goes to the giant steps that the Portuguese-speaking nations are taking to provide social and economic stability and the increased wealth to their people.

Just to introduce my company, IBM is the world's largest information technology company. It is based in Armonk in the United States, and operates across 150 countries in the world. It has 320,000 employees, and its revenue in 2002 exceeded US\$ 81 billion. Unlike public institutions, IBM's commercial objective is to increase shareholder value and to bring the expected returns to those that invest in our company. IBM has been in existence since 14 February 1924. To give you an idea of its social leadership dimension and its commitment to diversification, IBM introduced equal pay for equal work on 15 August 1935. That was 28 years before it was actually legally introduced in the USA.

Shifting work from high-cost labour markets to lower-cost markets is a profound and irreversible trend. It is shaping the agendas of governments, and that is why you are here today. It is shaping the agendas of labour unions and it is shaping the agendas of executives throughout the world, and it has altered the way we think about work. Where you are does not really matter much any longer. Under increasing cost and competitive pressures, leaders in many companies, such as IBM, view global sourcing investments or offshoring as not only viable but also essential. It is amazing, as I talk to many economic development agencies in the territories that I cover, that they seem to focus almost solely on attracting plants, often neglecting the powerful multiplier of the creation of intellectual value and its replication and dissemination. That is where the human dimension becomes increasingly important and people become increasingly valuable. That is my industry's most important dimension today.

The trends in the information technology industry are shifting. Many developing nations are achieving quantum leaps in communications infrastructures and because of their increased use of it, they are gaining access to modern e-technology, often enabled by IBM. The developing nations actually by-pass waves of information technology infrastructure, moving directly from the old-aged mainframe era to the network era and into e-business without the burden of complex legacy migrations, creating rather competitive, cost-efficient and reliable environments. When you establish global reach, all focus and attention shifts to the human dimension and its capacity. This is all about the new paradigm of bringing work to people as opposed to bringing people to work. For that, you naturally need people and adequate cost-efficient and robust communication infrastructures that will allow you to be at any time, anywhere, at any place in a totally seamless manner.

---

\* Director of Operations for International Business Machines (IBM), Central and Eastern Europe, Middle East and Africa region. This text is based on an edited transcript of the spoken presentation.

This human dimension is, and will increasingly be, very attractive for us at IBM and many others, and here you have essentially two jobs to do. Firstly, you must provide the education platform to create a competitive workforce. On this count, IBM is immensely proud to have contributed, and continues to contribute, to the development and competitiveness of many nations through technology and through increases in the availability of well-trained professionals. For example, in order to support Egypt in achieving their challenging plans in human resources development, IBM and the Ministry of Communications and IT in Egypt have been collaborating in the field of IT training since 2001. Within the framework of the Egyptian graduate programmes, we are training 3,000 graduates a year on the latest e-business technologies. The objective is to create a generation of skilled software professionals, providing added value to the local businesses and allowing Egypt to compete in this challenging market place of software worldwide. This is replicated in various forms in other places in the world.

Secondly, you must gear your telecommunications strategy to provide ample bandwidth at the most competitive rates. This is a precondition to attract any form of investments in the information technology space. For example, next door, in Hungary, in Budapest, hundreds of young IBMers, at our Accounts Payable Centre, work seven days a week, three shifts a day, in 20 different languages, to execute their mission which is simply to pay the money we owe to our suppliers across the whole world. Or again, even closer in Slovakia, in Bratislava, hundreds of young IBMers manage the whole customer support chain from proposing to customers, to contracting with customers, to ordering from customers, to delivering to and collecting the money from those customers, across the whole of Europe, the Middle East and Africa.

How did we decide to invest in those places as opposed to others? You would have thought that cost was the overriding factor. Actually, not only. Common sense is really the methodology. The stability of the institutional framework is the imperative. This means the existence, stability and enforceability of laws and regulations, economic and fiscal discipline, and robust data privacy laws. American institutions such as IBM are bound abroad by the United States Foreign Corrupt Policy Act, which sets high ethical and commercial standards that constitute an overwhelming decisive factor for any place that we invest in.

Flexibility of labour regulations today and in the medium term is also an important and decisive factor. So are the industrial relations, the environment and the workforce flexibility. But this stems largely from the labour regulations.

So, you have now gone through the model. You have got yourself a place, favourable legislation, low cost, ample flexibility, lots of skills available and a very attractive site, maybe a tax-free haven, maybe on the beach, that is a dreamland. So what is this dreamland? That would be your question. Well, today it is India – I am sure that you have heard in the news that the largest insurance company in the United Kingdom has decided to export thousands of jobs to India. Similarly, Eastern Europe seems to be enjoying a large share of attraction in my company. But this could evolve as nations such as yours take action to attract and compete and make available an increased understanding of more attractive sites. The whole assessment process that you see here goes round and round, creating more happiness for a few, less happiness for many others. But if I understood it right, that is your job. The job of most attendees at this conference is to make your countries attractive enough that you will be among the lucky few.

I wish you luck at that and I wish you all the very best.

Thank you.

## Presentation by Mr. Bunmi Oni\*

Thank you very much Mr. Chairman,

My perspective will be that of an African operating in Africa who is anxious to see the continent grow to be a part of the global company.

First a few words about Cadbury. We are a global player in confectionery and beverages, with 133 factories around the world, 55,000 employees, and about US\$ 15 billion in sales. It is a company that has grown through targeted acquisitions and disposals, which really speaks for the flexibility that was mentioned a little earlier with reference to supply chains, and also for our programme of managing for value. The company has a heritage of more than 200 years, and we have a portfolio of market-leading local and regional brands. It also has a very strong history behind it in corporate governance and corporate social responsibility. The Europe, Middle East and Africa region is one of the five regions in which the company operates, and we have a matrix organization in which the supply chain is separated from commercial management.

The Africa and Middle East sub-region – if you like, this is simply the African continent, with the Middle East – accounts for 16 per cent of the world's population but only 3.5 per cent of the world's money. But in AME, as we call it, we have seen a growth of about 22 per cent compound over the last four years, and such is the opportunity we see into the future that in the next four years we are projecting a 30 per cent compound annual growth rate. We contribute 12 per cent to the sales of the Europe, Middle East and Africa region, and about 15 per cent to the profit, so our sub-region is a little more profitable than the total region as a whole. Within Africa and the Middle East we have 17 factories, just over 7,000 employees and essentially a first-mover advantage, which is supported by the fact that in many of our countries we have a very strong commonwealth heritage.

I would just like to speak about investment by going back to the basics. We must never forget that investment is not for the sake of investment. Investment is what accelerates the free enterprise that drives growth, and its ultimate goal is to raise the quality of the life of the people. This really has to be kept very firmly in view. Our view is that in the process of seeking investment, we have got to activate domestic investment and create momentum because in many of our economies the growth challenge is moving like a flywheel. Once you can get momentum from the flywheel, through domestic investment, then we can accelerate the pace of the growth through FDI, and keep an eye on attaining measurable improvements in human development indices.

Investment primarily links national economies to global trade, and we have seen some studies about how small the contribution is that Africa makes to world trade. But I think that there is one more area in which investment is important. It offers the opportunity to leverage for corporate governance standards, and that is one of the areas in which we, as a company, are seeking to get involved. When we see the movements in stock markets, we find that when you measure the market capitalization as a proportion of GDP, it tends to give an indication of how much leverage there can be. In the case of South Africa, the market capitalization is nearly 150 per cent of GDP. Let me contrast that with a selection of three other countries: Mauritius 30 per cent, Egypt and Nigeria are 25 per cent. Clearly these levels are pretty low.

Speaking as a representative of a global company that operates from within the continent of Africa, I believe that we must address a number of key issues. The first of these is related to the structure of the economy. Many of our economies are simply based on exploiting natural resources and

---

\* Managing Director and Chief Executive of Cadbury Nigeria plc. This text is based on an edited transcript of the spoken presentation.

generating very little value added. That means that we have very little control over our revenue stream. We have to sell our commodities at the price of the market. We are import-dependent and, therefore, we have to pay the price of the exporter as well. So we are trapped in-between. Most of our markets are shallow and unable to withstand the shocks of the international arena so that when there is a big problem, for example, in the oil market, the economy of Nigeria simply goes into a frenzy. We have, in many cases, weak institutions and a very large informal economy, the size of which in many of our countries, is unknown. In addition, our economies suffer from the dragon of corruption, which I have called the weapon of mass diversion – mass diversion of the nation's resources.

What needs to be done? I think it is mainly a matter of empowerment. Empowering and promoting private investment in prioritized sectors. Since many of our participants are representatives of IPAs, I would like to stress that it is very important that we privatize, and in doing so that we focus on those areas that we are going to develop. We also need to work very consistently at migrating the informal economy into the formal. In many of our economies the informal economy is very big – sometimes as big as the formal – and that does create an issue. And yet, it is not too difficult to begin the process of migration, which can often be initiated simply by granting property ownership. Property ownership, of both real estate and intellectual property, gives informal entrepreneurs a title and makes them visible, and so brings them more into the formal economy.

The issues that motivate investors most are local markets, labour availability, regional markets and, to some extent, labour costs – labour costs not just from a cost point of view but from quality as well. I would say that in each of these areas Africa can develop a significant advantage, especially if we pool our regional markets together instead of operating as fragmented little markets. Concerning labour availability, we have in many of our countries trained people but they need to be exposed more to be able to match the investors' requirements. I would say here that this potential advantage reflects a window of opportunity, which may not last very long. As you have seen, there are many other regions of the world that are competing on the same grounds and I reckon that, unless we do something very clearly in the next three years, that window may gradually begin to close and the opportunities will not be as available as before.

In managing the turbulence that we see arising from the transition from public sector-led planned economies into private sector-led economies, I think we need to develop more public-private sector partnerships to smoothen the change in that process. I think this is what President Museveni was speaking about a few minutes ago. That transition has got to be made and we have got to make the transition seamless.

Sector reforms and a focused IPA agenda are also important. Some of the survey reports also did show that only 7 per cent of investors were made aware of the opportunities within the various countries through IPA activity. Those of you who have read Jim Collins will know that the power of focus involves the merging of the issues that we feel passionately about as a country: What drives our economic engine, what are the areas in which we can really develop and grow our economies the fastest, and what are the areas in which we are better than everyone else, i.e. what are our areas of competitive advantage? Focusing on the areas of intersection of these three will be a very great advantage, and I think IPAs would find this concept very useful.

The opportunity that we find is that, almost wherever we turn, the base is very low. Most of the markets are under-supplied. In Nigeria, we have seen a 10-fold explosion of the telecom sector in the last two years, only because that is how long that sector has been completely de-regulated. Even despite this phenomenal change that has taken place in the last two years, the market is not nearly supplied completely. We have just under four million GSM telephone lines at the moment, but the market is put at something like 25 to 30 million at least.

The growth engine of the future will be given by the fact that we have fairly significant local markets, especially if we bring them together as regions, which is one of the reasons we at Cadbury now



operate on a sub-regional basis. We regard West Africa as one single block. We find that this is basic common sense because many people in the informal sector have been operating like that for decades and even centuries over borders, which only exist in the mind of the politicians because they cannot seek votes from across the borders – even though they try, sometimes. There is also an opportunity to generate value in the baseline economic sectors. Many of our baseline economic sectors – such as agriculture in many countries, mining in many others, and tourism in quite a few others – have not been developed.

Just to round up: In promoting investment a focused IPA agenda is very critical. It is also important to establish partnerships with existing investors, using them very critically as ambassadors in order to drive both domestic and foreign investment. There are many Africans living abroad who should also be engaged. India provides an excellent example. I think they set up a whole department in a ministry for non-resident Indians, and that is one of the things that we are beginning to do as well. A strong drive for FDI in priority sectors will also require managing some of the very significant image issues that our countries face. The Nigerian situation may be seen as an example in this context. But we are beginning to see democracy take hold in many countries. We are also beginning to see economic reforms, and the establishment of competition and anti-trust legislation. In addition, we are seeing steps being taken against corruption across the continent.

Where can UNIDO come in to support this? I think one major area is in capacity building among the IPAs, and a forum like this will help to build capacity by helping IPA representatives and executives to develop their own agendas and providing a platform for sharing best practice. This is very critical, and I think that sharing best practice does not need to happen only every other year when we gather together, but that it is important to maintain the network and the linkages on an ongoing basis. Finally, I think that UNIDO can help the IPAs to clarify their objectives, align their own agenda, make their agenda consistent with the economic reform agenda, involve themselves with policy advocacy because many of the things that are required and which are stumbling blocks today are still related to policy issues, serve as catalysts for public-private partnerships, and provide a window to the investing world by showcasing successes. I think UNIDO can serve that purpose to help in the issues of image management.

Thank you very much indeed.

## Presentation by Mr. Patrick Helson\*

Thank you Mr. Chairman,

Good morning everybody. I am delighted to be here to represent CDC Capital Partners. I will try to be brief.

I will tell you a bit about who we are. I am going to say something about what I think are the winning attributes of the investments that we like to make in Africa, and then I am going to give you three examples from CDC's experience, from which I think that we can draw some helpful lessons.

I wanted to share with you our mission statement, because I think that it has much in common with those of the IPAs that are represented here today. I think we share the same goal, which is to mobilize investments to benefit poorer countries by growing sustainable local businesses. That is what CDC is all about. CDC started life 50 years ago as a government institution, and has been migrating over the last six years to the private sector. I believe that the introduction of private sector disciplines and skills to our mission can only help this task of mobilizing capital because the whole game at the end of the day is about aligning the interests of everybody, all the stakeholders involved in bringing capital into Africa and the only way you can do that, I believe, is by giving everybody a financial incentive to mobilize this capital.

Table 1 presents some of our highlights in 2003: We have invested US\$ 180 million of government money in Africa directly. We have also raised US\$ 77 million of third party money.

**Table 1. 2003 highlights**

- |   |
|---|
| <ul style="list-style-type: none"><li>• US\$ 180 million of UK Government money invested directly;</li><li>• US\$ 77 million of third party funds raised;</li><li>• US\$ 43 million of equity co-investments made by third parties;</li><li>• US\$ 58 million of new capital introduced when CDC made an exit;</li><li>• US\$ 217 million of new third party loan facilities for CDC portfolio companies; and</li><li>• Successful exits made from a Tanzanian gold mine with an internal rate of return (IRR) of 33%, a Zimbabwe manufacturing company with a 21% IRR, and a Ghanaian bank with a 17% IRR.</li></ul> |
|---|

I want to point out that Africa is not short of capital. There is capital queuing up at the borders of the continent, waiting to invest, and our job and the job of many of you as well, is how do we persuade that capital to come into Africa? Let us flag that Africa can also be a very successful place to invest. CDC has made three successful exits this year, from a Tanzanian gold mine, where we made a 33 per cent return for our investors; a manufacturing company in Zimbabwe, where we made a 21 per cent return; and finally, a Ghanaian bank, where we made a 17 per cent return. Who would have thought that you can make a 21 per cent return in Zimbabwe in its current state, but we did. Moreover, these are US-dollar returns, not local currency returns.

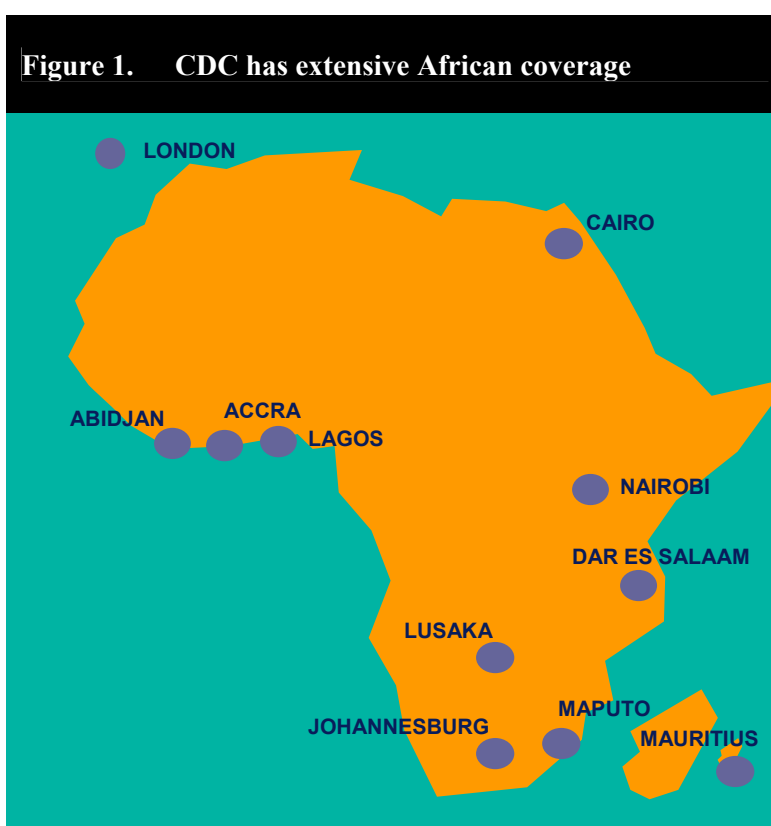
We have seven offices of our own, as well as a link with a joint venture that focuses on the SME sector called ORIOS, of which CDC owns 50 per cent. The combined offices of CDC and ORIOS are shown in Figure 1. We are all over Africa. We have been there for 50 years. We believe that it is part of our skill, part of our unique value added, that we have close, on-the-ground relationships in many African countries.

---

\* Chief Operating Officer of CDC Capital Partners Africa Region. This text is based on an edited transcript of the spoken presentation.

Our current portfolio amounts to US\$ 400 million, which includes investments of US\$ 120 million in the power sector in Africa this year.

In terms of the funds that we manage, we have US\$ 350 million to invest in the next three years. The capital is there if you can bring us investment proposals with the right kind of attributes. We receive an awful lot of investment proposals from Africa – thousands a year. Mostly they do not have the attributes that we are looking for. The things that we are interested in are expansion or change-of-control finance, rather than start-up finance. Obviously many of you will be thinking that so many of the opportunities in Africa will be in start-ups, but start-ups are extremely risky, even in the most developed markets. In England, if you put money into a start-up, you have got a 70 per cent chance that you will lose all your money. In Africa, where you have the compounded risks of political risk and government risk, you are not going to get foreign investors putting money into start-ups because it is simply too risky.



The second thing that we look for is experienced management. Again, Africa gets accused of lacking an experienced management depth. I disagree with that. We have many investments with many absolutely world class African managers who are very skilful at earning much higher returns than foreigners working in those markets. Of course, it is certainly true that you often have opportunities in Africa where the management is inexperienced. This is not necessarily a bad thing because it gives you an opportunity for a joint venture, which people have referred to already, where you can have a foreign company come in and bring you the international management skills and links to markets that can make the African company thrive.

We look for a track record of success. We usually get presented with companies that have a history of making losses. Again, if you invest in a loss-making company, you actually have a 90 per cent

chance of losing your money. But there are plenty of businesses out there with profitability that we could be backing and growing.

Out of a thousand prospects that get brought to our door, I would say that less than ten have attached simple projections of what this company could do if we put our money into it. We need a profit and loss calculation; a cash flow is crucial, and a balance sheet for, say, three years or five years rolling forward. We do not need a 50-page business plan very impressively produced at great expense that does not actually tell you if this investment will generate cash. That is what people are interested in.

And finally, limited currency risk is required because in the African environment many economies suffer from currency volatility. In the last two years, our investments have gone through a helter-skelter of evaluation because of what has happened to the round of devaluing and then appreciating and then devaluing again. I am hoping that those of you that work for IPAs will explain how we judge these things when you get business plans put across your desk: Which proposals we would take forward and which ones we would not.

Let me tell you some specifics about three CDC investments.

MSI is an investment we have made for currently US\$ 46 million outstanding across Africa. It is a Pan-African mobile telephone company. It is a fantastic business. It operates in twelve different countries and it is full of lessons for investors into Africa. The main lesson for me from MSI – which was very frustrating for MSI, but of great relevance to the kind of IPA and investor audience at this Round Table – was that they found it difficult to connect the thinking between different government departments, particularly regarding taxes. We often see short-term pressure from the tax authorities to collect tax revenues that can be at the expense of a more beneficial longer term strategy. Let me give you an example of what I mean. In MSI's case, one of the things that MSI has to do is to take phone calls from the government-owned telephone system and the government has to pay a fee for that. So when people ring from a government line onto a mobile line, there is what is called an inter-connect fee that has to be paid across to MSI. The governments in certain countries owe MSI a lot of money for these fees and do not have the cash to pay those fees. So, with a bit of lateral thinking in some countries, the government departments have agreed to apply the money owed from the government against the tax owed by MSI for the profits it has made. This is extremely helpful for MSI's investor and it means that the government has also settled that liability. That would be my main point.

MSI found it very valuable if the IPA is a one-stop shop. Otherwise, whose door do we knock on to take this issue to the government? To whom do we say that we would like to set off taxes owed against the inter-connect fees owed? In some countries, it is very difficult because the IPA is not a one-stop shop and you do not know who to talk to and there are many doors to knock on. My lesson learned from this is that you should make the investment promotion authority a true one-stop shop, which means that it has to be empowered and have the full authority of the President, and in return there should be a direct reporting line. I think that this can make your work much more effective.

Investors love transparency and clarity. MSI needs to set up lots of stations to put telecoms masts all over Africa, but if there is confusion over land registration and land ownership and tenure, it slows down the roll-out of these telephone systems.

These masts are in remote areas and can be vandalized. We all know it. So we need to provide physical security over assets like that. You will hear different views on incentives and whether it is good for you to offer incentives. In MSI's case, or in any major infrastructural investment, my argument would be that it can be very helpful to have some tax incentives to help the cash flow when you are setting up in a new country. If you have to go in and put in enormous capital investment and you are taxed fully straight away, then your cash flow is very tight indeed.

Publicize your successes. MSI featured in an article in the *Financial Times* last week. This is fantastic publicity for Africa, and we need to get across the fact that there is plenty of money to be made in Africa, and that it can be a very successful investment destination. This sort of *Financial Times* article, which was written by a journalist about the company, is very effective. What is not effective is a kind of centre spread in *The Economist* paid for by the government investment promotion authority saying why should you bring your money to this country. You want to let your success stories speak for themselves because the more you can remove the sense of government from around the investment process, the happier investors will be to bring their money.

The privatization of a road in South Africa has been very successful for us. I will only pick out one of these points, the most controversial one. When you are deciding which assets to put up for privatization first, many countries make the mistake of putting up their second tier, the lower quality assets, because the government wishes to hang on to the top quality assets. You have got to start marketing your respective countries because you are competing for all this capital. You have got to start acting like you are marketing a product that you are selling in a shop, and if you want to be a successful shopkeeper, you do not sell second-rate assets, you sell your best assets. Even if it means that you might make a bit of a loss first, you should not be worried by that because if you can have one great privatization, it will attract the attention of the world's investment community and they will say, that is a fantastic country to do business with, what else can we do there? Sell some of your top assets first; treat it as a loss leader. You will get in more business later. It will do you good.

If the tone of what I say sounds like this is what Africa should do all the time, I must apologize for that. I am also conscious that if I apply many of these rules to how Britain sells itself, we fall short as well, so these are meant to be lessons actually for everyone to learn. I am just applying them to the African context because that is what we are talking about today.

East Africa Gold Mines in Tanzania is my final example. They were a hugely successful investment for us with a return of 33 per cent in hard currency. It is a wonderful example of where you should be plugging the gap in terms of market failure and where you should be letting the private sector do its own thing. What happened around East Africa Gold Mines was that the Tanzanian Government used commercial industrial specialists to design or revise their Mining Act in 1990 and they made it extremely commercial and extremely world competitive. It guaranteed security of tenure for the mines that were operating different sites. It guaranteed that if any minerals were found the companies could exploit those minerals. This is a very strong legal environment that attracted lots of interest. Tax incentives were given, there were no duties paid on new equipment needed for these mines, foreign exchange was liberalized, foreign currency bank accounts were allowed, and people could service their foreign currency debt. The Government did not seek ownership or control. They only took a royalty, which was very important. They were happy to step to one side but they aligned their interest to the success of this business by accepting a royalty payment.

The public sector's role in this, and the role of IPA, the World Bank and the UNDP, was that they gave the market and the specialists lots of market data about the quality of Tanzania's mineral wealth, all sorts of surveys. And that was a fantastic plugging of market failure because that really interested the investors and made them come into Tanzania. If you want to know something about the results: In 1996, there was US\$ 80 million of expenditure in the mining sector in Tanzania, in 2002 it was US\$ 400 million. Tanzania now has five modern gold mines, world class, worth over US\$ 600 million. I think that it speaks for itself.

Thank you very much.

## Presentation by Mr. Dick Kramer\*

Thank you Mr. Chairman.

I must start out by saying that Capital Alliance is a miniature copy of CDC Partners in the sense that we also have proven that the best practices in venture capital and private equity work can be transferred into Africa, and can be quite successful. In fact, CDC is an investor in our Cape Funds, and our Capital Alliance Private Equity Fund, which focuses on West Africa. It is fully invested, and I believe that we will have some very good returns similar to what Patrick said earlier.

We have also been involved in the small and medium enterprises sector, which the Government in Nigeria has required the banks to go into and set aside 10 per cent of their before-tax profits for investment in companies that have capital requirements of US\$ 2 million or less. Our methodology is very similar to what you saw in CDC, so what I would like to do is to focus on how we can assist the IPAs and the policy-making processes on the basis of our practical experience. Actually, UNIDO's work with the African Investment Promotion Agencies is extremely encouraging. I see a clear focus on structure, best practices, successful techniques, and tailoring the IPA plans to the unique local situations. For me, this is a good sign that maybe Africa is finally getting its investment act together.

However, there are four relevant principles drawn from experience that I think may offer practical help for today's topics.

The first principle is, do not try to make water run uphill. If investments like water are not flowing, it is probable that the environment is not right, and no amount of incentives or marketing will overcome the problems of political or economic instability, the lack of sound macroeconomic fundamentals, weak infrastructure or problems with law and order. These environmental conditions must be fixed first if you want investment flows. Even then, water will not run uphill unless investment conditions are positive. And you have seen some of those conditions in the previous presentations.

Now I will use a case in Nigeria where policy-makers are totally obsessed with manufacturing and yet the conditions in this country and timing are not right. It is an oil-producing economy, with an over-valued currency, which favours imports and discourages exports, local raw material production and local manufacturing. But, there are numerous emerging opportunities in many service and service-related businesses, which create jobs, improve productivity and contribute directly to the GDP. For example, we are seeing significant investments in a number of areas, many of which we have targeted in our Cape Funds. Particularly in Nigeria, we have seen a 10-fold expansion in telecoms in the past two years. Not only does this create peripheral opportunities but it changes the way that many businesses do business.

Secondly, there is an opportunity for outsourcing of non-core businesses by companies that had to originally do these things because potential suppliers of such goods and services were not available.

Thirdly, Nigeria has a big emphasis on local content in the oil sector, and there are numerous oil service and other suppliers that can be developed. Interestingly enough, the whole logistics, distribution, wholesaling and retailing area is yet to be developed, and there is lot of interest in this area. I may add in this connection that capital and technology inflows from South Africa in particular are really booming. Now, I would expect the Nigerian IPA to prioritize these sectors and not try to make water run uphill towards manufacturing. As my grandkids say: "Oh granddad, you have to go with the flow!" That is what they should do.

---

\* Chairman of Capital Alliance Nigeria. This text is based on an edited transcript of the spoken presentation.

The second principle is to remember that we are enablers and not the entrepreneurs – by we I mean not only the IPAs, but also UNIDO, policy-makers, academics, multilaterals, and yes, even venture capitalists. We all tend to focus inward on our methodology, our best practices, our own organization and our structure, but the results are always outside, with the entrepreneurs and with the foreign investors. The focus must fundamentally be on their success, and our role must be to help them succeed. The recent UNIDO study of investors in Africa will help all of us to focus ourselves on helping investors succeed. As a fund manager, for example, we have found UNIDO very helpful with our invested companies and management in several areas.

We have to understand markets and understand technology. We routinely take companies to UNIDO for its kind of support of finding technical partners, improving business practices, training and capacity building. I would suggest that the IPAs keep focused on how to help investors succeed.

The third principle deals with capacity building. We cannot sell from an empty wagon. All of us need to focus on the skills; the experience and the expertise that will help the entrepreneurs and foreign investors succeed. For IPAs, this will require the introduction of private sector people and skills and mindsets, people who know what entrepreneurs and foreign investors need and talk their language. Once an IPA can demonstrate value added, then selling becomes easier to achieve.

As an example from the field of venture capital, we have found that entrepreneurs particularly appreciate our help with several different areas such as access to markets, introduction to potential customers, and access to funding, including how to structure funding and filling in those skill gaps that they do not have. I want to keep reminding us that they pilot the plane. I do not want to get on any plane because I cannot fly but I do not mind being a co-pilot. The entrepreneurs are the ones that we back.

The fourth and final principle deals with what President Museveni told us today. It deals with pragmatism, as distinct from theory. Our search should always be for what works in practice, not some erratic theory. This advice is aimed squarely at those who continue to have the anti-foreign investment bias as described today by President Museveni. They also tend to have an anti-private sector bias for indigenous entrepreneurs as well. Perhaps we can learn something from the dictum laid down by Deng Xiaoping, when he triggered China's take-off with the phrase, "I don't care whether a cat is black or white, as long as it catches mice". Perhaps we can re-phrase this for Africa. We do not care whether our investment policies are white or black, or even green, red or yellow, as long as they catch entrepreneurs and foreign investors. I think it is time for us to take the practical steps which create wealth and empower the private sector. Then we will have a larger cake to divide among us.

## Presentation by Ms. Maggie Kigozi\*

Thank you very much Mr. Chairman.

I think you heard what my President said. He means business and we need to fall in line.

I will cover two areas today: The World Association of Investment Promotion Agencies (WAIPA), which I need to tell you more about, and then address the topic as the Executive Director of the Uganda Investment Authority. I think, many of you are members of WAIPA. It is an association of IPAs worldwide, including both national and provincial IPAs in some countries where these exist. We meet every year. The offices are in UNCTAD. This year the meeting is in January in Geneva, and I hope you will all be there. You should all become members. It costs US\$ 2,000 a year to become a member. Then we have the second meeting next year, the UNCTAD XI in Brazil, and that is where elections will take place. The President right now is from Jamaica. Uganda and India are Vice-Presidents, and on the Committee we have Kenya, Ghana, Cameroon and others from Africa.

We network, and I think that is very important. We are able to share information and hear from speakers such as those at this Round Table: Multilateral agencies and donors. There is capacity building. Pro-Invest is a project that I hope you have all heard about. It is an EU initiative where there is a lot of support for various activities. They will support African Investment Promotion Agencies to go both to Geneva and to Brazil.

Concerning capacity building there are study tours. You can come to other IPAs. To the Uganda Investment Authority, or to any of the more interesting ones. There are many countries. You can send your people there for capacity building and I can send my people to you for capacity building. So that is an opportunity and training beside private sector meetings.

WAIPA is now signing an MoU with UNIDO, and we intend to work very closely together with UNIDO and with AfriPANet.

The topic of this Round Table is “Promoting investment in Africa: Challenges and Opportunities and Experience”. I am really happy that it refers to investment and not FDI. As the previous speakers have said, all investors need the same things. There is very little the foreign investor needs that the domestic investor does not. So if we make the climate right, both foreign and domestic investment will grow.

I want to say that the figures we have seen here, that Africa is getting low FDI, are history, because we know what we can do about it. We have an opportunity. What are we selling? We are selling growth. There are not many continents that can sell growth. The per capita consumption of Coca Cola in the United States is already 600 bottles a year. How many more can you drink? Per capita consumption of Coke in Africa is 13, 14, 15 bottles! We want to drink 600 bottles as well. That is growth. That is demand and need.

Secondly, we have information and communications (ICT). We had the presentation from IBM. We are jumping. We are going where we are supposed to go and we can do it very quickly. We have ICT as a tool, that the other developed countries did not have. It took them 200 years to get where they are. We shall get there.

---

\* Executive Director of the Uganda Investment Authority; Executive Director for Africa on the OECD African Investment Promotion Initiative, and Vice-Chairman of the World Association of Investment Promotion Agencies (WAIPA). This text is based on an edited transcript of the spoken presentation.



We also have the New Partnership for Africa's Development (NEPAD). I am calling that an opportunity, a tool. Africa is getting its act together. You heard my President. All presidents in Africa are saying the same thing. We now have new leaders with the educational background it takes to lead countries. You have seen one today. He understands issues. He is saying that Africa is a donor. We donate jobs because we send out our raw materials. We do not process them. The little money that comes back to us is nothing. We actually donate much more by exporting raw materials and exporting jobs.

NEPAD is a framework and it a way forward, with its focus on best national practices. But who is going to implement them? It is not NEPAD. We at the national level can do it. I do not see why not. I am very optimistic. We have the labour resources. Everybody looks at Africa as the Dark Continent. Are we? How many people working for UNIDO here are Africans? We have educated people. We have the capacity.

I get so depressed when at the WTO we allow the NGOs to lead us. We have the capacity. Come on Africa; let us get our act together. WTO is important to us. We need the global market. We are working with India and China to frustrate WTO. They have huge domestic markets. We do not. It does not mean that we accept subsidies; no, but WTO should be the organization that handles this, that prevents subsidies and dumping. I think that what Africa needs to do is to go up the value chain, restructure traditional sectors, create new knowledge-based industries using IT and biotechnologies.

How is Africa handling biotechnology? I will give examples of Uganda, which I know the best. We have scientists who are telling us what to do and they want to use new technologies, but because people think of new technologies in Uganda as terminator seeds, nobody wants to listen, not even the government. We need biotechnologies. It does not mean we need genetically modified organisms (GMOs), but let us listen to our own scientists. In my country, my scientists say this and everyone else says something else. Let us listen to our own scientists why biotechnologies are important for us.

For the IPAs, what can we do? We are so under-funded. We need to promote cost-efficiency through the use of the Internet, and to train our ambassadors. We have ambassadors who can promote investment, and we have to use the UNIDO ITPOs. I want to say thank you to UNIDO. We have been to France, to Brussels. In fact, we have an inward mission following our mission to the UNIDO ITPO in France, that took us to Brussels as well. Right now there is an inward mission from Brussels, and they are not only going to Uganda, but they are going to Kenya and Tanzania as well. One of us must be able to attract them to stay, and I hope we can do it. We have had a lot of assistance from UNIDO.

UNIDO can also help us with capacity building of our people, and that is what AfrIPANet is about. We have spoken about priority sectors. Let us identify them and let us focus and target countries. You cannot promote to the whole world. We have to focus on a few countries, so let us promote to those.

We have talked about the facilitation of host country measures, e.g. concerning infrastructure. The NEPAD has prioritized this part. If we cannot do regional business because we lack roads, because we lack trains between us, because there are no airlines, we have a problem. Prioritize infrastructure, and UNIDO again has helped us in some of this. We have to think of regionalization. The fact that there is a train between Durban in South Africa and Kampala in Uganda has enabled us to feed the south when there is a drought in South Africa. Infrastructure has been very important in enabling us to export to the region.

I think you have heard two expert speakers of the financial service sector. In Uganda I see that financial services are available, but our business people do not know about them. I also see financial services from the other countries. When I went to Norway, there was a fund for support to developing countries. I knew about the one from the Netherlands, and there are two in Sweden and one in Denmark. Did you know that they had these funds? Those are investment funds to support their own

investors in developing countries, e.g. through joint ventures. There is a lack of information in this sector. I have always been talking about the Netherlands because it has done so well. Last year, we licensed US\$ 22 million in Dutch projects because of these funds of the Dutch Government.

Joint ventures and the support of small and medium-sized enterprises (SMEs) depend heavily on domestic investors. As I said, the climate is important and we feel we have made some improvements. My President does not agree. There has been some improvement in the climate in Uganda and the domestic investors are investing. Last year, we licensed US\$ 143 million of Ugandan investors investing in Uganda. That is a major achievement and it is happening. And these were serious investors. So improve the environment and you have got them all.

Entrepreneurship – UNIDO, we need help here. Our domestic investors need more of this. A lot is happening. UNIDO has helped us work on the curriculum in primary schools. All the people coming out of primary schools have training in commerce. They can prepare a business plan. They know about commercial agriculture and things like that.

I quote surveys. Surveys are very important. We need to address the constraints and regulations. Capacity building has taken place among regulators. This is very important. If they cannot do their work, we cannot do our work. So regulators, the environment authority, the Uganda Revenue Authority, the tax collector, all these are very important bodies that we must focus on.

For home-country measures we would like to ask the developed world to invite the investment promotion agencies to meet your business community. I also want to tell my brothers and sisters from the IPAs, they are inviting us. I just came back from Sweden, I came back from Iceland, and this was an invitation from their government, or from the Swedish Industrial Development Cooperation Agency, or SIDA. So it is happening. Just find out where they are and they will help you. But we need them to help us more, e.g. the chambers of commerce and industry. It is really very difficult for me, even if I have a good climate and nice opportunities in Uganda, to get the business community to listen to me.

The media is always negative. Can we get some positive media reporting? I do not know how, but we need help there. We need support from the investors. I have already talked about home-country measures, the need for financial support and outward missions. The Dutch are brilliant. They invited us and then the Minister of Trade came with a delegation of 50 potential investors to Uganda. In fact, they actually stayed. They invested in various areas. But the Government led them. This reduces the perception of risk. Once they come to Uganda, they see that the risk is less. But how do I get them to come to Uganda? It is not easy for me. I need help. Maybe UNIDO can help us here. Can we have this next meeting in Uganda or in Kenya or in Cameroon? I have to be biased for Uganda. So we need help with feasibility studies, and with insurance and investment funds. As I have just said, such help is available.

I would like to thank you very much for listening to me. I think the future is ours. Africa, this is our turn. Let us get our act together. We can do it.

## **Presentation by Mr. Francois de Grivel\***

Thank you very much Mr. Chairman.

I am the last speaker and I will try not to repeat what has been said before. Of course, my activities are in export industries from Mauritius. For the time being, I have 14 export-based enterprises in different fields, and we employ 2,500 people in Mauritius. Mauritius is a country which earlier had a tradition in the sugar industry. Then we went into the export industry in 1972-1973. I was one of the first investors at that time. In the meantime we have also gone into the tourist industry, freeport industries, financial services, and very recently into cyber activities and cyber islands.

Mauritius is a small country, with 1.2 million people and no raw materials at all except sugar cane. We therefore have to rely on our expertise and on foreign investors from different parts of the world: The Far East, Europe, Africa (mainly South Africa), and to a small extent the USA.

Why are we succeeding in Mauritius? I think we are succeeding because of the political vision, because of strong incentives and the skilled labour force. To create a company in Mauritius we do not need 170 days or 200 days. It takes two or three weeks to create a company in Mauritius in different fields of activities. In 1993, we organized a mission in Madagascar with UNIDO and its representative. From that time, we have created 45,000 jobs, mainly in the textile industry. We have also invested in Lesotho, Mozambique, and, recently, Senegal. Why? Because we thought that Africa is part of our game, in the sense that we have to work together. For us, UNIDO is the right body to help us establish these ventures in other countries, like the ones I mentioned in East Africa and Madagascar, but also in West Africa, which is a bit far from us.

Our experience has been very fruitful. We have been successful in many fields, not only through our cooperation with UNIDO but also as a result of our own ideas and commitments. As I mentioned to you, we are involved in cyber activities. Although we are very small and are facing competition (from India, of course), we are now developing our activities very strongly. I myself have created 200 positions in cyber-activity call centres in Mauritius for the European market. Of course, Mauritius is facing competition from China, Viet Nam and India, but we are confident with our small dimension. We will succeed because we have the commitment and the political will. The correlation between the private sector and the public sector is very close in Mauritius, and we are also succeeding for this reason.

These are the main points I wanted to raise. I thank you very much.

---

\* Chairman, Managing Director or Director of several export companies in Mauritius; former President of the Mauritius Export Processing Zone Association; former President of the Mauritius Chamber of Commerce and Industry. This text is based on an edited transcript of the spoken presentation.



## **ROUND TABLE 6**

### **TRANSITION IN EASTERN EUROPE: 15 YEARS AFTER**



## Issue Paper

### Transition in Eastern Europe: 15 Years After

*UNIDO Secretariat*

#### Introduction

The present paper has been prepared as a contribution to the panel discussion in Round Table 6 on “Transition in Eastern Europe: 15 years after”, organized as part of the tenth session of the UNIDO General Conference.

The starting point for this paper, as well as for the formulation of UNIDO programmes for the Europe and Newly Independent States (NIS) region, is the commitment of the Organization to support the efforts of the countries of the region to achieve the long-term objective of the transformation process: The attainment of sustainable development. The UNIDO response to the needs and priorities of the countries focuses particularly on assisting them in meeting their policy objectives in the economic, employment, and environmental areas.

The transition process in the region has been as diverse as the countries of the region themselves, and this heterogeneity is explicitly incorporated as a fundamental element of UNIDO’s efforts to respond to the challenges posed by the economic transition process in the region. Within this context, UNIDO aims to fully incorporate in its work the concerns of the policy makers of the region concerning issues of importance (to different degrees in different countries) during the transition process. These have included, or do include, concerns such as the erosion of industrial potential, industry’s declining contribution to gross domestic product (GDP), pressing requirements for environmental protection, recovery of the industrial sector, the utilization of aging technologies, the failure of many products to meet international quality standards, the low rate of utilization of productive capacity, the high level of (hidden) unemployment, narrow markets for locally manufactured goods, and the inability to increase the inflow of foreign capital to the industrial sector.

In programming its activities, UNIDO operates within the framework of the United Nations Millennium Development Goals (MDGs) as well as the UNIDO Corporate Strategy (UNIDO 2003 c). In addressing the needs of the recipient countries, UNIDO works in partnership with all major actors – government, business, other UN agencies, non-governmental organizations (NGOs) and civil society organizations (CSOs), and the academic and scientific community.

The challenge to the Organization is to design programmes for the future that are complementary and supportive of the policy measures of the governments of the region to meet the policy challenges they have faced and/or are still facing during the transition process. Needless to say, the response to this challenge must at the same time be tailored and shaped to correspond to the resources available to the Organization for its activities in the region.

The role of private enterprises has been fundamental in the restructuring that accompanied the transition process. But the industrial enterprise in the region is very much an *enterprise in transition*. Moreover, the small and medium-sized enterprises (SMEs) that will lie at the core of these economies for the next 15 years must be a very different one from the ones which played such a fundamental role over the last 15 years. To ensure their long-term viability, the enterprises will be forced to adopt a *sustainable enterprise strategy* that gives appropriate weight to social and environmental dimensions as integral elements of their business strategy. Policy makers, for their part, will be increasingly forced to adopt a process-oriented *vision and strategy for the future* that systematically looks into the

longer-term future and emphasizes the positive interaction of the different stakeholders in the process of sustainable development.

Because of their importance in the transition process, these three themes have been singled out as road signs that may be useful during the panel's analysis of the future for the economies in transition.

### **The enterprise in transition**

The evidence on the role played by the SME sector in many of the economies in transition suggests that the sector has clearly been a contributing factor to the growth of GDP per capita of the country. But the evidence is just as clear in suggesting that the private enterprise in the region is an enterprise in transition.

In the market economy the private sector and private sector enterprises are the long-term driving force of industrial development. It is this vibrant private sector that triggers economic dynamism, enhances productivity, carries out the transfer and diffusion of new industrial technologies, and maintains competitiveness. In so doing it also shapes the economic globalization process. At the same time, it must be underscored that the ultimate objective of this process is poverty reduction.<sup>1</sup>

Since the objective of UNIDO's work in the area of private sector development is to support the formulation and implementation of overall industrial strategies conducive to strengthening private sector development and to promote SMEs, the role that UNIDO can potentially play in supporting the policy makers is critical for the future of the transition process in the region.

The strengthening and support of the SME sector is crucial for the future of the transition process, since SMEs directly foster economic cohesion – a process that has not yet found its full development in these economies – by linking up with, and supporting, large enterprises.<sup>2</sup>

Even more importantly for the region, SMEs foster social cohesion by reducing development gaps and disparities in the society, thus spreading the gains of industrial development and economic growth to the whole of the population, including women, and to less developed regions.<sup>3</sup>

While it is a principle that is valid across all economic systems, it is particularly important to stress for the economies in transition that SME development – despite its importance – must not be understood to stand on its own. It must be an integral element of a supportive and conducive policy environment, and one that incorporates the social, the environmental and other dimensions as integral elements.

With this background, the panellists in Round Table 6 may wish to address questions such as:

- How can SMEs from the region participate more fully in the global economy?
- How will the industrial sector as a whole in the region look in the future?
- How should the restructuring process continue in the future? Must there be major changes in the degree of transparency and competitiveness in the industrial sector?
- How can the countries of the region overcome the obstacles that exist to the formation and growth of new SMEs in the region – including, among others: Lack of access to finance, weakness in economic governance, corruption, and problems with the protection of property rights?

---

1 Because of its overriding importance, poverty reduction will be discussed in Round Table 1 on the role of industry in the achievement of the MDGs.

2 This often takes place in the context of foreign investment inflows and partnerships for development – and hence is also part of the discussion of Round Table 1 on the role of industry in achieving the MDGs, as well as of Round Table 3 on making trade work for the poor.

3 This topic is also discussed in Round Table 1 on industry and the MDGs. Related UNIDO programmes and projects are discussed in the Position Paper for Round Table 6. See also Service Module 4: Private Sector Development in UNIDO (2003a).



## Sustainable enterprise strategy

Following the political and economic transformation in the former planned economies, the enterprises have become more competitive and market-oriented. Many of the enterprises have yet, however, to proceed with the transformation process to the extent that they can be competitive in the global marketplace. In many cases the enterprises still face the challenge of identifying their competitive strengths and developing a strategy based on these strengths.

Such a strategy must, however, go beyond traditional elements such as improvements in quality and reductions in costs. Such a sustainable enterprise strategy must combine the essential elements of a business plan with a commitment to social action in the context of socially responsible enterprise behaviour with the integration of best environmental practices into their production process. The commitment to socially responsible enterprise behaviour will move the transition enterprises into the mainstream of corporate behaviour of Europe as a whole. Here corporate social responsibility (CSR), and demonstrably ethical, socially responsive, and environmentally sensitive business practices have become the hallmark of progressive business enterprises.<sup>4</sup>

At the same time, the adoption of best environmental practices in their enterprise behaviour would bring the enterprises in transition into compliance with the environmental norms of the European Union and of the respective international conventions.<sup>5</sup>

It is only through the incorporation of these social and environmental dimensions into their behaviour that the transition enterprises will be able to guarantee their long-term viability in the context of the European-wide (and increasingly the global) marketplace. It is also only through the pursuit of such a sustainable enterprise strategy that the enterprises will be able to integrate themselves into the long-term transition process, with its accompanying social and economic transformation of society, to which the enterprises themselves must belong.

The transition process in the East proceeded without a road map. It is therefore neither a surprise nor a secret that mistakes were made along the way. The adoption of a sustainable enterprise strategy by the transition enterprises would also provide them with a vehicle to compensate and correct in the future some of the mistakes of the transition process in the past. It would also be a vehicle to bring the interests and behaviour of transition enterprises more in line with the pattern of corporate behaviour of the more established enterprises in the rest of Europe. But the sustainable enterprise strategy would also have to be conceptualized and defined to ensure a realistic and achievable approach for the very different nature and level of enterprise development in the different parts of the region.

Compliance with best environmental practices would also be a vehicle for transforming the SMEs into a motor for introducing and diffusing future-oriented technological change into their societies. This future-oriented pattern of enterprise behaviour is one that will require the interaction of a very wide set of policy makers and shareholders to nurture this multi-dimensional process.

These considerations lead to questions such as the following:

- How can the business community in the economies in transition be transformed from a passive partner to an active and equal partner in cooperation with the international community in the development process?

---

4 See Raynard & Forstater (2002) as well as work in progress on CSR in UNIDO/PTC/SME. UNIDO programmes and projects in this area are discussed in the accompanying Position Paper.

5 This latter point is discussed in Round Table 2 on industry and the environment. Such enterprise behaviour would also contribute to the achievement of MDG 7 on ensuring environmental sustainability. Work on sustainable enterprise strategy undertaken by UNIDO in the context of the regional programme on the "Transfer of Environmentally Sound Technology" is discussed in the Position Paper for this Round Table.

- How great is the threat to social cohesion in the countries of the region from an enterprise sector that focuses exclusively on short-term enterprise profitability?

## **Vision and strategy for the future**

One process-oriented approach that emphasizes partnership among these different actors is that of “foresight”, a process of systematically attempting to look into the longer-term future of science, technology, the economy, the environment, and society, with the aim of identifying the emerging generic technologies and the underpinning areas of strategic research likely to yield the greatest economic and social benefit (Martin 2002, pp. 7-31).

Particularly because of its emphasis on partnerships among the various actors, foresight appears to be a process through which the different stakeholders – including government, industry, NGOs, the scientific and academic community, and other interest groups – can discuss the sort of world they would like to create for the future.

While the focus and application of the process is different in different countries, foresight is a methodology that has been utilized in countries such as Austria, France, Germany, Japan, the Netherlands, Sweden, the United Kingdom and the United States in their vision and strategy building. As the transition process has moved forward, it has also begun to attract attention as a policy-making tool for strategy and policy formation in the countries of the Eastern part of Europe as well.

The process is well suited to the conditions in the region because it collects locally existing knowledge and experience in a systematic manner, and creates confidence among participants in the exercise that they are part of the society through their participation in the process-oriented dialogue. Most importantly, it creates strong unity and partnerships among participants (UNIDO 2001, para. 66; UNIDO 2003 b).<sup>6</sup>

Panellists may wish to consider questions such as:

- How can countries generate the necessary commitment from all participating partners in the foresight process?
- How can frequent flaws in foresight activities, such as the abandonment of continuous monitoring, the equation of technical feasibility with market demands, or the overestimation of the speed of change, be avoided in the region?
- Is it possible to transfer the technology foresight methodology from Western countries to the countries of the region without changing the nature of the process?

## **Summary**

A thread running through the discussion above is the argument that, in a number of dimensions, the transition to a market economy in the economies of Eastern Europe is “work in progress”. The challenge of fully developing a market economy that permeates the fibre of the society and transforms the socio-economic fabric of the country is one that is still facing the policy makers in these countries. One of the paths for achieving this objective is to integrate policies on enterprises in transition designed to improve quality management with policies to improve the social and environmental impact of the operation of these enterprises. Through improved foresight, policy makers will be better able to move from separate consideration of economic, social, and environmental issues in the transition economies towards policy and strategy formulation for sustainability management.

---

<sup>6</sup> UNIDO regional and national programmes and projects in technology foresight are discussed in the Position Paper for Round Table 6.

In this context, it would follow that an analysis of the transition process in Eastern Europe would include, inter alia, the following themes and the following challenges (as well as those enumerated earlier):

1. *The enterprise in transition*, and challenges such as: What should be the nature of the policy of the government towards the SME sector in the region? What is the optimal mix of government policy towards industrial enterprises and government policy on innovation?
2. *Sustainable enterprise strategy*, and challenges such as: How can the role for civil society in the region be strengthened? How can a government policy to foster enterprise development also be a policy supportive of social and environmental development?
3. *Vision and strategy for the future*, and challenges such as: How do we best motivate both public and private stakeholders to create and act on the basis of a long-term vision of the development of society? Do the necessary instruments for participatory policy making between government, science, and the private sector exist in the region?

What appears clear is that it is not an option to consider or not to consider all the dimensions of the process of transition such as these and others discussed above. It is much more the question of their optimal integration in the overall policy and strategy of the country towards sustainable development.

As a decade and a half of transition comes to an end, it is crucial to understand that the transition process in the region compressed generations of development into less than one generation. As social development is a more complex and slower process, it did not move at the same pace as industrial and economic development. Moreover, in the West the rules of the game were developed over a long process of economic evolution. In the East, on the other hand, there was no textbook, and the development took place and the rules were often deduced from practice ex-post.

The result is that the transition economies are still facing extraordinary challenges in their drive towards sustainable development. Experience has also shown that there are no simple solutions in the market place. But the experience thus far has significantly enhanced the knowledge of policy makers of the transition process and will allow the countries of the region to move forward to a new Europe with wisdom and understanding.

## References

Martin, B., "Technology Foresight in a Rapidly Globalizing Economy". In: UNIDO, *International Practice in Technology Foresight*. Vienna: United Nations Industrial Development Organization, 2002.

Raynard, P., and M. Forstater, *Corporate Social Responsibility: Implications for Small and Medium Enterprises in Developing Countries*. Vienna: United Nations Industrial Development Organization, 2002.

UNIDO, *Medium-Term Programme Framework, 2002-2005: The Business Plan and Medium-Term Programme Development*. Note by the Director-General to the ninth session of the General Conference, Vienna, 3-7 December 2001. Document No. GC.9/11. Vienna: United Nations Industrial Development Organization, 2001.

UNIDO, *Medium-Term Programme Framework, 2004-2007: Service Modules and Areas of Emphasis*. Note by the Director-General to the tenth session of the General Conference, Vienna, 1-5

December 2003. Document No. GC.10/CRP.4. Vienna: United Nations Industrial Development Organization, 2003(a).

UNIDO, *Strategic Guidelines: Towards Improved UNIDO Programme Delivery*. Vienna: United Nations Industrial Development Organization, 2003(b).

UNIDO, *Developing Industry: Productivity Enhancement for Social Advance – UNIDO's Corporate Strategy*. Vienna: United Nations Industrial Development Organization, 2003 (c).

# UNIDO Position Paper

## Transition in Eastern Europe: 15 Years After

*UNIDO Secretariat*

### Introduction

The present paper has been prepared as a contribution to the panel discussion in Round Table 6 on “Transition in Eastern Europe: 15 years After”, organized as part of the tenth session of the UNIDO General Conference.

The purpose of the Round Table is both to explore issues that have emerged during the process of economic transition from the centrally planned economy to the market economy in Central and Eastern Europe and the Newly Independent States (hereafter CEE & NIS), as well as to address the challenges that these countries must face in the future. While transition is a process that affected all dimensions of society in the countries of the region, the focus of the deliberations at the Round Table will be on the industrial sector, and in particular on the potential role of an international organization such as UNIDO in supporting the transition process.

The social, political and economic transformation experienced in CEE & NIS in the last decade and a half have brought about dramatic changes to the landscape of Europe. While it has achieved a great deal of reform and positive changes to the lives of millions of citizens in the region, the transition process has also been difficult for many; and the transition is still ongoing. There remain many industrial development issues of concern for policy makers of countries in the region.

These challenges include, depending on the specific country in question, problems such as the erosion of industrial potential, industry’s declining contribution to gross domestic product (GDP), pressing requirements for environmental protection and recovery in the industrial sector, the utilization of aging technologies, the failure of many products to meet international quality standards, the low rate of utilization of productive capacity, the high level of (hidden) unemployment, narrowing markets for locally manufactured goods, and the inability to increase the inflow of foreign capital to the industrial sector. In addition, the market reform measures, such as liberalization, stabilization and privatization, have caused social difficulties in many parts of the CEE & NIS region. Many of these problems – including increasing poverty, deteriorating social services, and the increasing gap between the haves and have-nots – remain, despite whatever success has been achieved in the economic sphere.

It should also be noted that the countries of the CEE & NIS region have undergone quite different transformation processes during the last fifteen years. After the initial economic recession due to the collapse of the centrally planned system, some countries, like the Czech Republic, Estonia, Hungary, Poland and Slovenia, showed an upward trend in economic growth, and indeed forecasts of GDP growth for the coming year are currently being revised upwards by some researchers. Others, however, have remained stagnant. Eight of the countries of the region – the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia – will accede to the European Union in 2004. Others still struggle with fundamental reforms, such as institutional reforms, sound corporate governance and restructuring of the economy. This regional heterogeneity is one of the major challenges facing UNIDO in the design of its future programme of complementary response and support to the countries of the region.

At the onset of the 15<sup>th</sup> year of the economic transition in the CEE & NIS region, examining the results of the past market reform and looking for the best ways to move forward seems to be more than reasonable. This UNIDO Round Table offers such an opportunity. As a background document

to these discussions, the present paper proposes, after surveying the current economic state of the CEE & NIS region, to address the following three elements of the transition process for the future: The nature of the enterprise in transition, the need for incorporating socially responsible and environmentally sustainable behaviour into the business plans of the enterprises in transition, and the necessity for analyzing the environment in which the industrial enterprises will operate in the future.

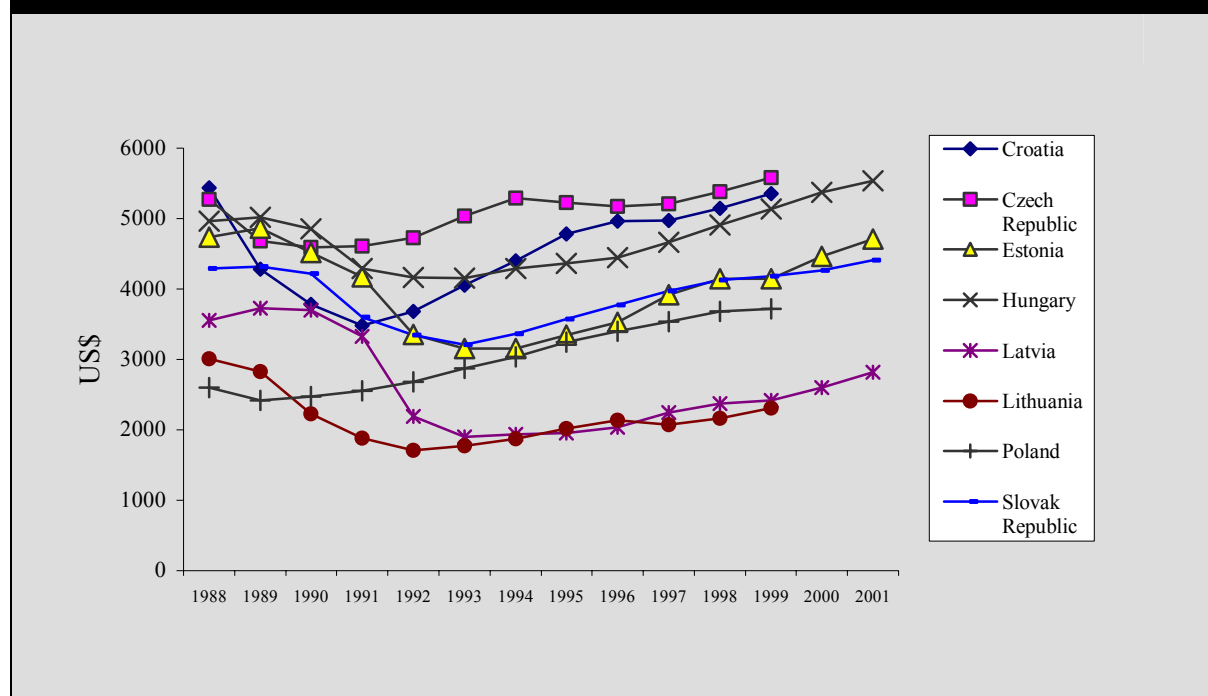
These topics are all areas in which UNIDO possesses considerable experience and knowledge, gained through numerous industrial development project activities in the field, and this paper will highlight a number of these project areas. It is very much hoped that the discussion will lead to new insights as to how an international organization such as UNIDO can support the efforts of the countries of the region to address the challenges they are now facing in these areas successfully in the future. The solutions will, of course, need to be as unique as the countries themselves.

### The transition after 15 years

What did the economic transition from the centrally planned economy to the market economy achieve for the populations of the CEE & NIS region? Figure 1 shows the GDP per capita (in constant 1995 US\$) of the upper-middle income countries in the CEE & NIS region, almost all of which are accession countries to the EU in 2004. After the initial, marked downturn, the policy makers have, in all cases, turned the countries around under the new market-oriented conditions. In four of the eight they also managed to achieve an increase in GDP per capita between 1989 and 2001. As noted above, the prospects for the immediate future are also seen by analysts as promising.

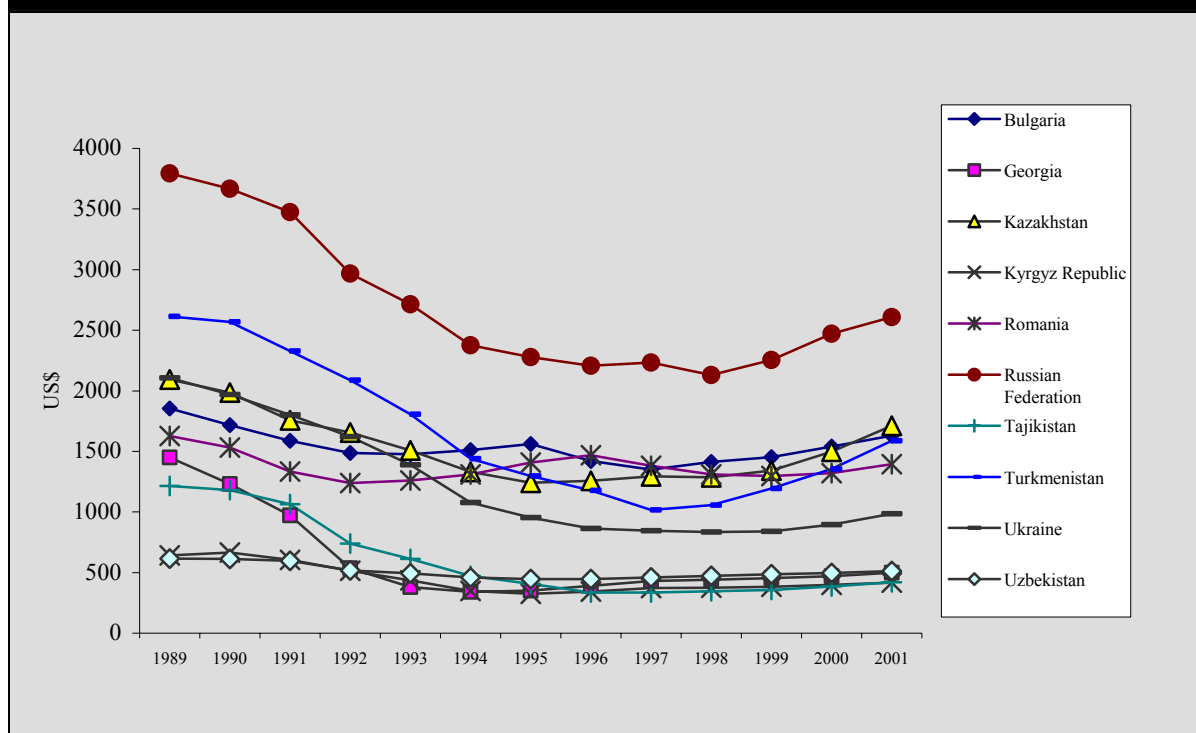
Figure 2 plots similar data for the lower to lower-middle income countries in the CEE & NIS region, and illustrates a rather different picture of the region's market reform effort. In all cases, the countries experienced a decline in GDP per capita over the period between 1989 and 2001, although there is an upward trend from the mid- to later 1990s.

**Figure 1. GDP per capita (constant 1995 US\$), upper-middle income countries**



Source: World Bank (2003).

**Figure 2. GDP per capita (constant 1995 US\$), lower to lower-middle income countries**



Source: World Bank (2003).

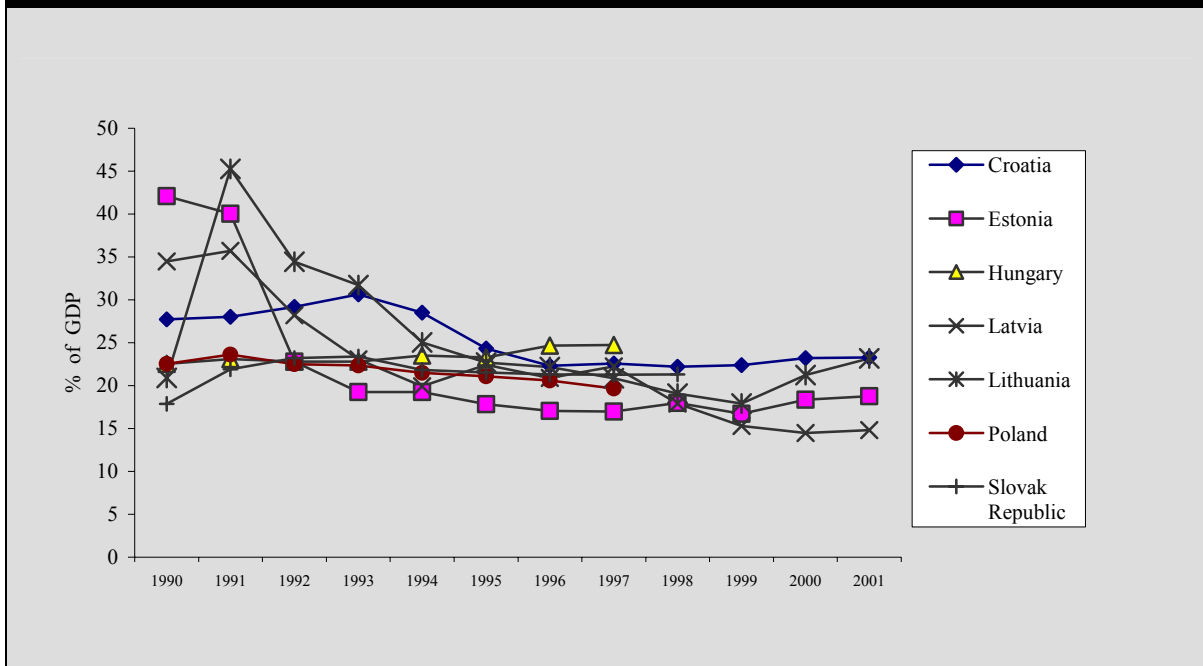
In the case of Russia, the fall in GDP per capita from 1989 to 2001 was greater than 30 per cent (in constant 1995 US\$). These clear economic disparities within the region demonstrate the need for efforts to support policy makers and other actors in the industrial sphere in these countries to be carefully tailored to the conditions of the specific country.

In the CEE & NIS region, where all the industrial assets were controlled by the government, privatization – and the subsequent restructuring of the state-owned enterprises (SOEs) – was one of the most important transformations of the economy. It also represented a transformation of society as a whole. As Figures 3 and 4 show, fifteen years later the share of manufacturing value added (MVA) in GDP in the CEE & NIS economies has failed to regain the level that prevailed at the beginning of the transition.

For countries where the manufacturing sector holds the key to the further industrial growth, this decreasing trend of the sector is alarming. Policy makers in the region are paying particular attention to industrial issues, such as technology upgrading, product quality improvement, competitive management practices and international marketing, in order to reverse the trend. Certainly, enterprise development in the region is one of the keys to addressing this challenge.

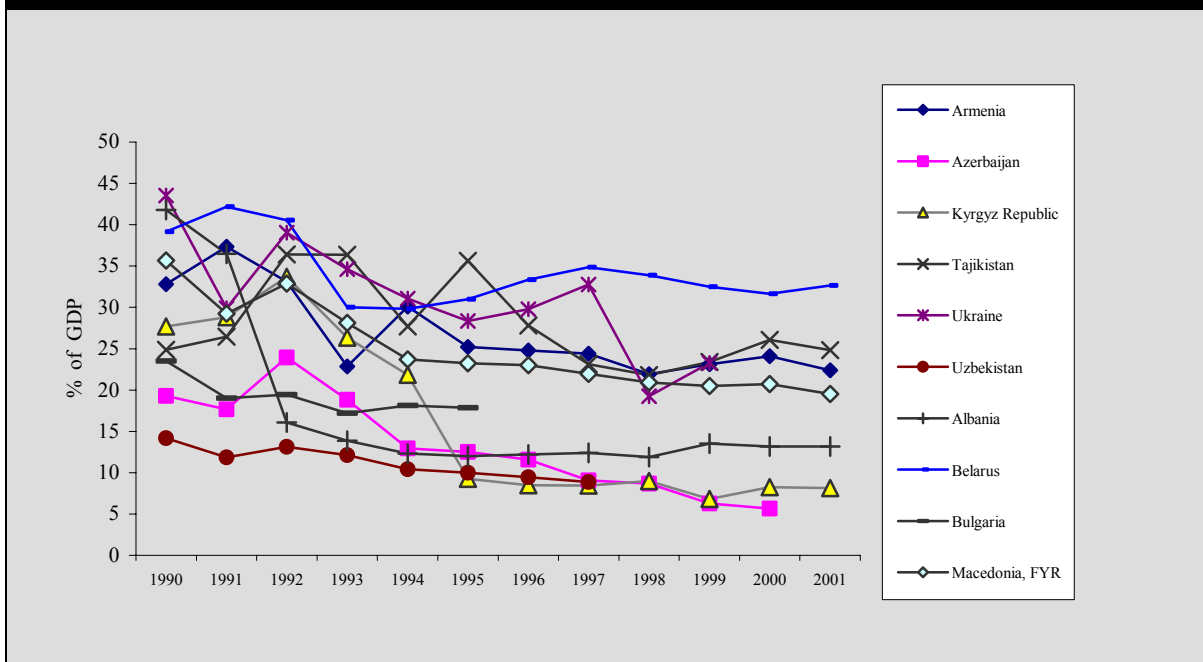
There are many possible explanations for the declining trend in the manufacturing sector in the CEE & NIS countries. First, the privatization of SOEs in the region was a measure to improve the government's fiscal position by reducing subsidies to SOEs, simultaneously increasing government revenue by the sale. Instead, as is now recognized, many SOEs (for example in Russia) were sold at less than the market price to local managers, who were neither capable of, nor interested in, making the long-term investments necessary to turn the companies around. Many of them engaged in asset stripping, selling off company properties piece by piece at discounted prices to make a quick return. In such a situation competitiveness inevitably declined.

**Figure 3. Manufacturing value added, upper-middle income countries**



Source: World Bank (2003).

**Figure 4. Manufacturing value added, lower to lower-middle income countries**



Source: World Bank (2003).

Secondly, stabilization measures, such as an increase of interest rates and tight control on the money supply, taken in response to the high inflation caused by the rapid price liberalization, made the business environment extremely difficult for enterprises and entrepreneurs interested in carrying out new or expanded business activities. The institutional framework to assist a smooth process of industrial restructuring was still weak, managerial and marketing expertise to restructure the



enterprises was scarce, and financial resources to invest in business activities were limited. Some countries, such as the Czech Republic, Hungary, Poland and Slovakia were successful in fulfilling these needs through foreign direct investment. Their geographical proximity to the EU market was one factor which helped to attract some major investments from the West.

The decreasing competitiveness of manufacturing industry in the CEE & NIS economies resulted in an increasing reliance on natural resource based industries, such as mining. The recovery of the GDP per capita observed in some countries from mid-1990s in Figures 1 and 2 was attributable in certain cases directly to the oil and oil-related industries – a sector where prices can be volatile. In addition, analysts have argued that such heavy reliance on natural resource based industry in the CEE & NIS region slowed significantly the speed of key structural and democratic reforms in the region (Esanov et al. 2001).

One of the most important features of industrial restructuring involves the reallocation of human resources to more efficient and productive uses. As the inefficient use of resources, including labour, was quite high in the previously state-owned enterprises, it was impossible to avoid generating significant unemployment as a result of the restructuring process. It was important, therefore, that the governments in the CEE & NIS region prepared for this massive unemployment by introducing policies targeted at providing social safety nets, such as unemployment insurance, proper skill training programmes, job placement services, etc. At the beginning of the transition, however, there were limited resources to be directed to services for the unemployed, making this an extremely difficult task. This, in turn, contributed to a rapid increase of unemployment as well as poverty.

The privatization and subsequent industrial restructuring in the CEE & NIS countries also brought with it a seriously adverse impact on the region's social infrastructure. The previous socialist system in the region provided citizens with a broad range of basic social services, including housing, utilities, education, health insurance and treatment, public transportation and food supply, mainly through the state-owned enterprises. The market forces, which were expected to take over such social services, did not function, and many services simply became unavailable. This can be seen in the fields of education and the environmental in particular.

### **Resolution of the outstanding challenges**

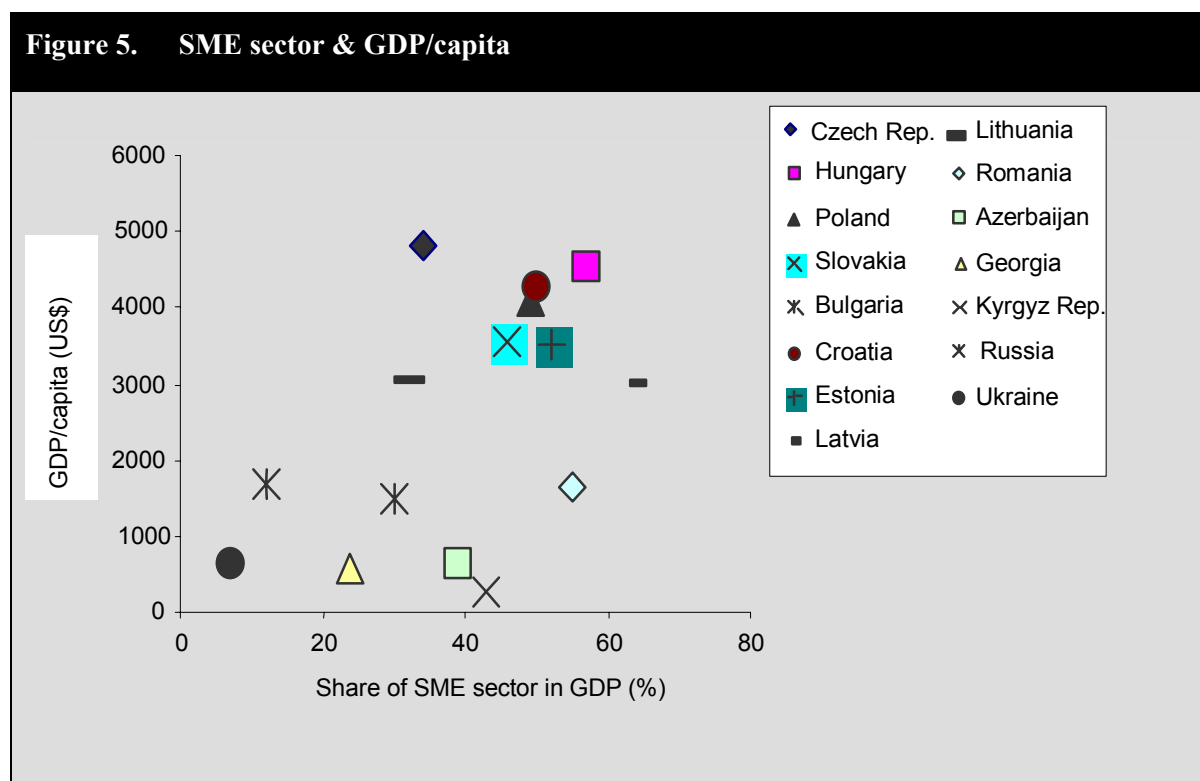
Sustainable industrial growth, accompanied by appropriate environmental and social infrastructure, is a necessary condition for the success of the transition process in the CEE & NIS region. Some countries, especially the ones scheduled to become part of the EU, have made use of FDI as an engine of growth. This forced enterprises in those countries to participate in the international supply chain and brought them in closer contact – if not yet integration – with the EU market and beyond. However, although they are quickly learning and replicating from the best practices established by this group of countries, enterprises in a number of the other CEE & NIS countries have yet to participate in such markets in such a manner as to be able to reap the benefits of the global market system.

To a greater or lesser extent, depending on the specific country, the attainment of sustainable industrial growth and the establishment of the appropriate environmental and social infrastructure still pose the most severe challenge to the countries in the region.

### **The enterprise in transition**

Figure 5, which has been constructed using data presented in Szabo (2003), illustrates the relationship between the share of the SME sector in GDP and GDP per capita in a number of the economies in transition. In general terms, the data suggest that the higher the share of the SME sector in the economy, the higher GDP per capita in the country. The figure says nothing about causation, but is

consistent with the prevailing perception of the importance of SMEs in economic development in general, and in the CEE & NIS region during the transition process in particular.



Source: Szabo (2003).

In the context of transition, the SME sector was generally expected to serve as an engine of economic growth. It has been suggested, however, that up to 80 per cent of the emerging SMEs fail within 3-5 years. This means that for SMEs to play the role of an engine of growth, an extremely high rate of new entry is required (Hare 2002). Considering the fragility of the market, the failure rate might be even higher in the CEE & NIS countries. The pressure on the remaining 20 per cent of SMEs to become competitive and grow in size is therefore extremely great. This in turn means that it is crucial for the government to create a business environment where SMEs can become competitive and grow, as they expand their business activities. Only in this way can they play the role of an engine of economic growth.

UNIDO's experience in recent years has led to the conclusion that the real cause of the weakness of SMEs in the CEE & NIS countries might be their isolation. Specific support policies, which facilitate access to crucial resources such as financing and information, both technological and industrial, are required. Correspondingly, a major obstacle affecting the good performance of SMEs in the CEE & NIS region is their introspectiveness and failure to plug into external sources. Such information deficits are often a result of the absence of national industrial and technological information infrastructures, and a consequence of the SMEs' inability to establish comprehensive data retrieval systems.

These and other problems have been the target of a major regional programme that UNIDO has launched in the Caucasus and Central Asia, covering Azerbaijan, the Kyrgyz Republic, and Uzbekistan. A group of concrete outputs has sought to address the information deficits and signs of introspectiveness in the developing SME sector in those countries. A core group of business consultants has been trained in Bishkek, capital of the Kyrgyz Republic, who now provide advisory services to local SMEs in such areas as business partnerships and joint ventures. A pilot business

advisory unit attached to the Republican Business Incubator in Tashkent, capital of Uzbekistan, has been created to provide business counselling, information and referral, and training services to potential entrepreneurs and SMEs.

Another UNIDO response to these challenges has been a major programme implemented in a number of countries in the region (including Romania, Albania, Moldova, and Kazakhstan) focusing on providing information and referral services, training, and counselling to SMEs. The mechanism for the delivery of these business development services was demand-driven, through small and decentralized business support centres. They operated on sound business principles, following the concept of good practice drawn from world competitive manufacturing where a good practice was defined as one that was internationally competitive and more successful at achieving strategic objectives than alternative practices. The programme focused on developing models and approaches for business support centres that were replicable and adaptable in the regional context. It was then possible to adapt these models and systems to the specific needs in a number of somewhat different environments at a lower cost and with less effort.

In many CEE & NIS countries, improvement of the business environment, which can promote the growth of SMEs, is still an unresolved issue. A number of major impediments to SME growth, such as limited access to working capital and long term credit, legal and regulatory restrictions, inadequate infrastructure, high transaction costs, and limited managerial and technical expertise, still require the attention of policy makers. In this context, a coherent SME policy framework constitutes an integral component of an overall industrial development strategy.

UNIDO helps to establish appropriate institutional arrangements (within government structures) for SME policy measures and support programmes, particularly in building-up national capacities to effectively perform an advocacy role for SMEs. Such services build competence not only at national level, but also within local authorities to enable them to formulate coherent sectoral and local strategies and to enhance dialogue with local representative business organizations. The full range of UNIDO support in this area includes policy-related economic analysis, policy formulation, policy implementation, and policy monitoring and impact assessment.

### **Sustainable enterprise strategy**

As industrial development progresses in the transitional economies of CEE & NIS region, the importance of the concept of corporate social responsibility (CSR) increases. Businesses that participate in global markets are increasingly required – as a condition of doing business – to comply with internationally established CSR practices in the fields of, for instance, environmental protection, labour relations, manufacturing processes and material usage, in addition to the quality standards and delivery requirement of their products. The UN Global Compact encourages corporations to employ socially responsible corporate behaviour in relation to labour rights, human rights and environmental issues. In this framework, UNIDO supports actors from all spheres in the countries of the region in their efforts to adopt business strategies that go beyond traditional elements such as improvements in quality and reductions in cost.

Particularly for those enterprises from the region that participate in global value chains through cooperation with transnational corporations and the international SME network, it is of considerable importance to adopt a sustainable enterprise strategy that combines the essential elements of a business plan with a commitment to social action in the context of socially responsible enterprise behaviour, and integrates best environmental practices into the production process. It may well be that it will require significant creativity and leadership from policy makers in the region to achieve this policy objective; but its adoption is of critical, long-term importance both for the society and for the enterprises themselves. Such corporate behaviour will increasingly become a *sine qua non* of participation in the global marketplace. Similarly, it will just as rapidly become a condition for the acceptance of the new enterprises in transition in their home countries.

The current UNIDO approach in the special conditions prevailing in the CEE & NIS region is to utilize the international supply chain as a stepping-stone towards promoting the adoption of CSR by SMEs in CEE & NIS. The basic idea is that, by integrating them into the global value chain, SMEs are forced to apply internationally recognized CSR standards in their production processes, such as environmental protection and fair labour practice (Raynard & Forstater 2002).

The development of CSR is the target of an ongoing UNIDO project in Croatia, for example. In order to achieve the overall objective of generating evidence that CSR has a positive impact on business activities, the project promotes the adoption of good CSR management practices and the development of CSR capacity by Croatian SMEs in line with their integration into global supply chains.

In a large-scale, multi-country project in the Danube River Basin, UNIDO has for several years been working to support the transfer of environmentally sound technologies to a large number of industrial enterprises in the region. The UNIDO services worked to build capacity in cleaner production in five Danube Basin countries (Bulgaria, Croatia, Hungary, Romania, and Slovakia), to bring 15 pilot enterprises in compliance with the international environmental norms of the European Union and of the respective international conventions. At the same time, importance was attached to their need to remain competitive and to deal with the social consequences of major technology upgrading in the enterprises.

Compliance with best environmental practices would be a vehicle for transforming the SME sector into a motor for introducing and diffusing future-oriented technological change into society. Moreover, it is only through the incorporation of these social and environmental dimensions into its behaviour that the transition enterprise will be able to guarantee its long-term viability in the context of the European-wide (and increasingly the global) marketplace. It is also only through the pursuit of such a sustainable enterprise strategy that the enterprise will be able to integrate itself into the long-term transition process, with its accompanying social and economic transformation of society, to which the enterprise itself must belong.

It can be suggested that policy makers in the CEE & NIS region need to consider taking the initiative to encourage locally established corporations, including both the restructured former state-owned enterprises and new, local private firms, large and small, to participate in the building (or re-building) of social infrastructure. How to persuade local firms to adopt such a sustainable enterprise strategy is not an easy question and may be one of the issues that the Round Table wishes to discuss: Despite improvements, the business environment in CEE & NIS countries is still relatively difficult. This may require a unique and creative approach, but it is possible. In this sense, it is important for a country to see such a sustainable enterprise strategy as part of a vision and strategy for the future economic and social development of the country.

### **Vision and strategy for the future**

It may be unnecessary for the current paper to emphasize the importance of the vision and strategy for a country's industrial development. When a country makes strides in the landscape of economic growth, there needs to be a map that shows destinations and directions and helps to set goals and objectives. Naturally, as they are making great strides for future industrial growth and the building of a social and environmental infrastructure, it is vital for the countries in the CEE & NIS region to have a clear vision and strategy. A specific question for the round table is how to develop the vision and strategy that best harnesses SME and enterprise development generally to industrial growth, corporate social responsibility, and best environmental practices? The present paper proposes, as one part of the answer, the use of the foresight methodology. Foresight is a process- and partnership-oriented policy-making mechanism particularly well suited to mid- to long-term vision and strategy development.

In recent years UNIDO has been promoting the foresight exercise in the CEE & NIS region, with a particular focus on the science and technology dimension (and hence it is often known as “technology foresight”). UNIDO’s technology foresight activities concentrate mainly on awareness building of the foresight concept and the related capacity building. A major UNIDO event in this area was the Technology Foresight Summit held in March 2003 in Budapest, Hungary, which was designed to respond to the need for a vision of the medium- and long-term development of the region as well as a more technology-oriented focus in the relevant national and regional knowledge-based institutions. The event brought together 310 participants, comprising policy representatives at the highest level, top business leaders, and heads of research institutions, to discuss future trends, strengths, weaknesses, opportunities, and threats facing their countries, companies and regions, which can be addressed through the early mobilization of technology and knowledge.

Another typical activity of this kind was the “International Conference on Technology Foresight for the Ukraine” which UNIDO organized jointly with national and international counterparts in 2002. These UNIDO services, like those provided elsewhere in the region as well, were designed to build awareness among Ukrainian government decision makers, R&D institutes, and industrial associations regarding the benefits and advantage of using technology foresight for strategic planning.

The basic idea of the foresight approach can be expressed as follows: “Foresight is the process involved in systematically attempting to look into the longer-term future of science, technology, the economy, the environment and society with the aim of identifying the emerging generic technologies and the underpinning areas of strategic research likely to yield the greatest economic and social benefits... Foresight is not a technique (or even a set of techniques) but a process that, if well designed, brings together key participants from different groups of stakeholders (the scientific community, government, industry, non-governmental organizations and other public interest or consumer groups) to discuss what sort of world they would like to create in coming decades” (Martin 2002).

According to the above definition, foresight is a process, and it is based on extensive partnerships. One of the conclusions of the UNIDO global fora on technology foresight is that, because of this process orientation, as well as the emphasis on partnerships among various policy makers, the foresight methodology is particularly relevant, not only to the field of science and technology, but also to the overall vision and strategy for industrial development. Experts from a number of countries, such as Austria, France, Germany, Japan, the Netherlands, Sweden, the United Kingdom and the United States, have demonstrated the benefits of utilizing the foresight methodology in their vision and strategy building, and their experience has been made available to the participants in the UNIDO global fora. But the deliberations at the various meetings have also clearly demonstrated that the focus and application of the methodology can differ quite significantly in different countries.

By the same token, the heterogeneity of the economies in transition, and the often unique issues and challenges in economic and social development in the region, means that its application requires a great deal of patience and commitment from all participating partners – including government, business and industry leaders, academic and research communities, and NGOs – to apply the foresight approach. It should not be overlooked that the foresight exercise can strengthen the democratic process of policy making, can collect locally existing knowledge and experiences in a systematic manner, and can make participants feel that they are part of the society by going through the process-oriented dialogue. And, most importantly, it creates strong unity and partnerships among participants.

## **Conclusion**

The market reforms carried out through liberalization and privatization in the CEE & NIS region involved a complete shift in people’s beliefs and behaviour, and in the social system. The market mechanism, as an alternative to central planning, was introduced almost overnight; but the market took much longer to function as it was envisaged than had been initially expected by many.

The present paper has explored industry-related issues and challenges for the future resulting from this process of transition over the past fifteen years. Through the deliberations at the Round Table UNIDO hopes to be better able to fine-tune its future services for the region.

The industrial restructuring process in the region under transition involved the reallocation of human resources to more efficient and productive uses. A number of UNIDO projects were carried out in countries of the region to support the governments in these efforts. Given the initially high level of inefficient use of resources under the former system, it was unavoidable that a significant amount of unemployment was generated by the industrial restructuring process.

The SMEs that were created therefore had, as a fundamental objective, the need to provide employment. UNIDO was active in many countries with programmes to support and strengthen the process of SME development, including work on business advisory services and on the development of a coherent SME policy framework. Foreign direct investment – another area of UNIDO concentration in the region – played an important role in fuelling the transition process, particularly in countries such as those that will accede to the EU in 2004.

The resources required to direct the necessary amount of services to the unemployed were, particularly at the beginning of the transition process, not available to the governments of the region. The market forces, which were to take over such social services, also did not function as many had expected. Nor were the policy measures sufficient to avoid often marked falls in the level of MVA and per capita GDP, particularly over the first decade of the transition.

One of the basic arguments presented in this paper was that it is therefore crucial for the future of the long-term social and economic development process in the region that enterprises increasingly integrate the concepts of corporate social responsibility and of best environmental practices into their business strategies. The UNIDO work in this area, particularly in the Balkans and in the Danube River Basin, was cited as an example of how this could proceed. The results of the Organization's services also suggest that one of the methodologies for supporting the development of a vision and strategy for achieving the sustainable development of the countries of the region is technology foresight, and the results of the deliberations at the Round Table will help shape the nature of this work in the future.

The fact remains that despite the considerable progress that has been achieved, the economies in transition are still facing major challenges to their social and economic development at the start of the 15<sup>th</sup> year of economic transition. There are no simple solutions to these challenges. The actors and decision-makers at all levels in the countries of the region have, however, learned much from the experience of the past 15 years, and the indicators suggest that progress in the transition to sustainable development will continue.

## References

Esanov, A., M. Raiser, and W. Buiter, *Nature's Blessing or Nature's Curse: The Political Economy of Transition in Resource-based Economies*. EBRD Working Paper No. 65. Paris: European Bank for Reconstruction and Development, November 2001.

Hare, P. G., *Industrial Restructuring as a Means of Enhancing National Competitiveness: Overview of the Problem*. UNECE Round Table on Industrial Restructuring in European Transition Economies:

Experience to Date and Prospects, Geneva, February 2002. Geneva: United Nations Economic Commission for Europe, 2002.

Martin, B., "Technology Foresight in a Rapidly Globalizing Economy". In: UNIDO, *International Practice in Technology Foresight*. Vienna: United Nations Industrial Development Organization, 2002.

Raynard, P., and M. Forstater, *Corporate Social Responsibility: Implications for Small and Medium Enterprises in Developing Countries*. Vienna: United Nations Industrial Development Organization, 2002.

Szabo, A., *The Development of the SME Sector in the Various Regions of the OSCE*. Paper presented at for the Third OSCE Parliamentary Assembly Conference on Sub-Regional Cooperation: Small and Medium-sized Businesses, 2003. Vienna: Organization for Security and Co-operation in Europe, 2003.

UNIDO, *International Conference on Technology Foresight for Ukraine, September 10-12, 2002, Kiev, Ukraine*. Conference Report. Vienna: United Nations Industrial Development Organization, 2002.

Whitehouse, L., "Corporate Social Responsibility as Citizenship and Compliance – Initiative on the Domestic, European and Global Level". *The Journal of Corporate Citizenship*, Issue 11, pp. 85-98, Autumn 2003.

World Bank, *World Development Indicators 2003*. Washington, D.C.: World Bank, 2003.

## Opening Statement

*Dmitri Piskounov*\*

I would like to start by explaining how we in UNIDO see our Round Table and how we selected the title of this Round Table “Transition in Eastern Europe: 15 Years After”. One of my colleagues, a French national, asked: “Why did you select ‘15 Years After’, and not ‘20 Years Later’”? We think this title is extremely relevant for our region because of the fact that next year, in May 2004, there will be a very remarkable event for Central and Eastern Europe, or CEE. It will have reached a certain stage in the development of the transition. Ten countries in our region will join the European Union and this will be some sort of indication of the success of the transition in the Central and Eastern Europe.

We therefore thought that it is now appropriate for us, during the General Conference of UNIDO, to discuss the lessons and experience, and maybe to draw some conclusions and discuss further priorities and the challenges which we still facing, in this region. We also wish to address the question of what kind of priority or direction we should select for UNIDO’s technical cooperation. This is the main purpose of our Round Table.

First of all, I would like to give you an overview of our technical cooperation. We started in 1989, and during the 15 years of technical cooperation services offered by UNIDO, we changed the priorities and nature of our interventions. We started with industrial development issues, and we paid a lot of attention in the beginning of the 1990s to microeconomic stabilization, to the question of privatization, and to industrial restructuring. We also tried to help Central and Eastern European countries to cope with the massive unemployment which was the logical and natural consequence of the privatization process in the CEE region. Then, later on, we began to focus on small and medium-sized enterprises (SMEs) and entrepreneurship development. In addition, we started working very closely with our colleagues in the area of environmental protection, and also tried to find ways to help the governments to fight the increasing income gap and poverty.

Presently, we are working together with our partners and the countries in the area to strengthen the competitiveness of the national industries. We are also thinking of how to help them increase the importance of science and technology, as well as working in the areas of environment, sustainability, and the implementation of the different international environmental protocols. Very importantly, we are trying to attract and involve the business community in the process of development, through such concepts as corporate social responsibility. The specific responses of UNIDO and the programmes we are trying to develop are summarized in Figure 1.

During the past few years we have concentrated much of our effort on regional programmes related to technology foresight, e-business and e-productivities, industrial strategies, and corporate social responsibility.

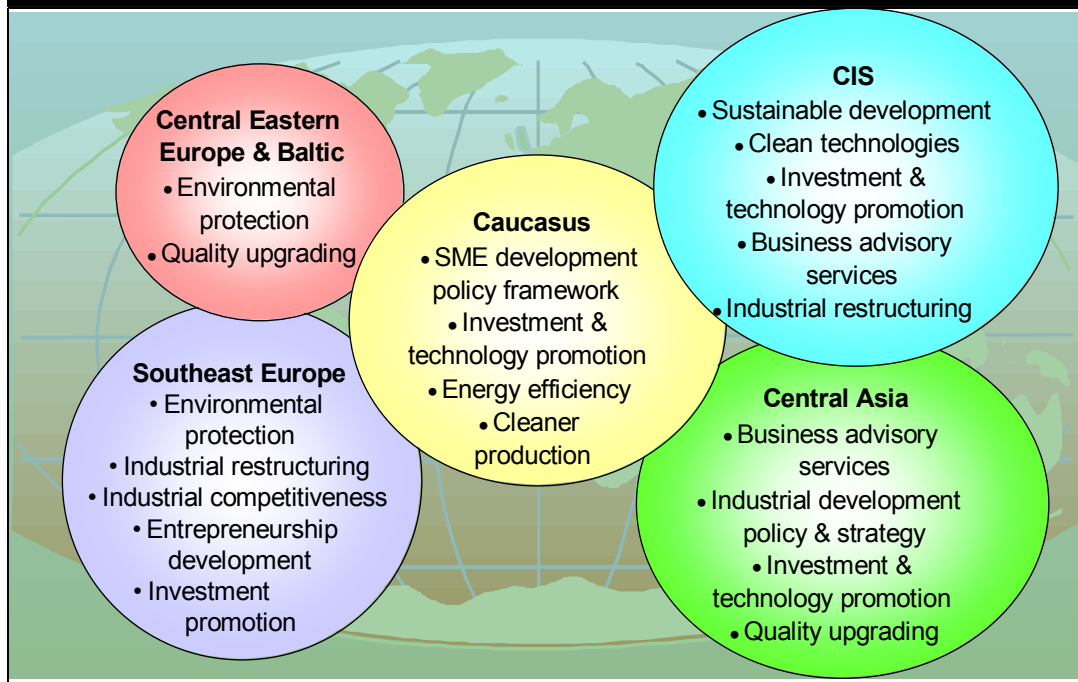
It is also certainly true that while we are talking about Central and Eastern Europe as a whole, the focus and emphasis in the different parts of region are different. Thus, in the different sub-regions we pay more (or less) attention to different topics. For example, in the Central Eastern European countries and the Baltic states we are working mainly on environmental protection and quality upgrading; in the CEE countries we are working on cleaner technology promotion, business advisory services, and industrial restructuring. In Central Asia the focus is different. In other words, we are trying to customize our services to the countries according their needs and their priorities.

---

\* Director, Regional Bureau for Europe and the Newly Independent States (NIS), UNIDO. This text is based on an edited transcript of the spoken presentation.



**Figure 1. UNIDO response by region – past and present**



I would now like to present some ideas on how we in UNIDO see the future prospects of industrial development in Eastern Europe. From our point of view, the private sector, and particularly SMEs, will be of increasing importance for industrial development in this region. This raises the question of how we can support SME development in our region? We see the SMEs as a tool to fight against unemployment, and as one of the main vehicles for industrial growth. We also see the increasing demand for socially responsible corporate behaviour of the business community as extremely important. We would like to see the private sector as an equal partner in our development projects and our technical cooperation.

Finally, I think that after 15 years of the transition period, it is now time to think about the very sophisticated policy-making mechanism needed to create the vision and build up the development strategy for the different countries. Therefore, we would like to introduce certain questions and certain topics for discussion.

First of all, we want to raise the issue of the enterprise in transition, referring in particular to SMEs and the development of new enterprises. What should be the nature of government policy towards the SME sector in the region, and how can the countries of the region overcome the existing obstacles to the formation and growth of the new SMEs?

Secondly, there is the issue of corporate social responsibility and the building of social infrastructure. How can business corporations in the region be transformed from passive to active and equal partners of the international community in the developmental process? How can governments enforce enterprise development and also pursue policies supportive of regional development? This is another of the questions that we would like to introduce.

The third point refers to the vision and strategy for future industrial development. This is technology foresight. Technology foresight is an extremely important tool and I would like to stress once again that we started the regional programme on technology foresight with the Hungarian Government and this year, in March 2003, we had the technology foresight summit in Budapest. In our view, which

was shared by many of our colleagues and by other countries, this tool can help the countries of Central and Eastern Europe to build a consensus or a common vision of their future development.

The final question that I would also like to discuss with you concerns the future role of UNIDO in this region. How can technical cooperation from UNIDO, or from other international organizations, help the future industrial development in Central and Eastern Europe? As a representative of UNIDO I want to stress that we would like to learn from this discussion and draw some lessons from this Round Table on how we can continue to work in our region.

Thank you.

## Moderator's Introduction

*Marianne Kager\**

Thank you Mr. Piskounov for your opening statement, which has set the framework for our discussions.

The question we would like to address in this Round Table is how international organizations and the international business community can help the economies in transition to achieve sustainable development. In speaking of the economies in transition, we have to keep in mind that we are referring to countries and economies which are quite different. In this region we have countries which will be members of the European Union within a few months, but we also have countries such as the Newly Independent States in Central Asia, which are far away from Europe, for which we will also need to develop cooperation models and models for development. We should also keep in mind that in the past 15 years there has been a huge turnaround in these economies. Most of these economies can be very, very proud of what they have achieved in the past years. Nevertheless, many countries of this region will still require assistance for the foreseeable future.

I would like to be brief, and will now give the floor to Mr. Krkoska.

---

\* Chief Economist, Bank Austria–Creditanstalt Group. The text presented here is based on an edited transcript of the moderator's spoken introduction.

## Keynote Speech

*Libor Krkoska*\*

The topic of my speech concerns one particular area of industrial restructuring. We all know that foreign direct investment (FDI) is probably the most important source of financing for the restructuring of enterprises in Central and Eastern Europe. Mr. Piskounov identified the real questions: “How to link foreign enterprises with local small and medium-sized enterprises (SMEs), and how the public sector – including both governments and international organizations such as EBRD or UNIDO – can support the development?” What I want to talk about briefly is the role of SMEs in industrial restructuring.

First, I will explain what I mean by industrial restructuring and how I see SMEs involved in that process. Secondly, I would like to talk about the obstacles to the development of SMEs in this particular context, and about the existing policy options and how to support them. Since the EBRD works with projects focused on individual enterprises, I will give you a few examples of how such public support can actually be given in practice. The choice of EBRD projects is explained by the fact that all of the case studies which I will present here are projects that I worked on. I therefore know them inside out, and could answer any questions you might have about them.

First, what do we understand by industrial restructuring? These are the financial, operational and managerial changes that enterprises need to make in the way they operate, in the way they manage the finances and accounts, and in the products which they produce.

Of course, restructuring does not happen by itself. There has to be some trigger, some reason why it should happen. In the case of transition countries, it was a change 15 years ago when central planning systems started moving towards the market economy and there was an ownership change through privatization or takeovers of private enterprises.

Some restructuring cases were triggered by the bankruptcy process or by outside pressure in the case of inefficient companies. Owners may not have been aware of how the enterprises were managed, or creditors may not have been happy about the prospect of being repaid.

After 15 years we know more or less what the attributes of success are, and in which cases enterprise restructuring is likely to succeed. Probably the most important of all is the willingness to change. It doesn't help very much if the state provides large amounts of state aid to enterprises where managers do not want to change the way how they operate, do not want to change the product mix, or do not want to change the way the production is financed.

What has been proven to be an important factor is the presence of “strategic investors”. This was originally understood to mean foreign strategic investors, but after 15 years such strategic investors are no longer entirely foreign. Local strategic investors already exist in some places. It is possible to see, for example in Poland, a local company taking over another Polish company which is in need of restructuring. But the further East or South we go, the more it is still usually the case that the foreign investors continue to play a quite important role for the success of restructuring.

In addition one needs a favourable investment climate, by which we mean comprehensive and transparent legislation and regulation, an effective judiciary, a transparent and as simple as possible tax system and, of course, minimal corruption.

---

\* Principal Economist, Office of the Chief Economist, European Bank for Reconstruction and Development (EBRD). This text is based on an edited transcript of the keynote speech as delivered.

The role of the government in industrial restructuring is very much related to improvements in the investment climate, because the governments are the creators of laws and regulations. In addition, the governments – or international organizations – can provide the funds required for measures to remedy the environmental damage from the past, or the employment consequences of restructuring (which is quite often accompanied by significant employment downsizing). In the case of Central and Eastern Europe, it used to be enterprises which provided housing, social, health, and other benefits to their employees. These services were moved out of the enterprise sector to the state sector when the enterprises were privatized.

How do the SMEs get into the industrial restructuring picture? Most of all, SMEs provide alternative employment opportunities for workers. But if you look at industrial restructuring, not on the enterprise level but on the sectoral level – let's say, in the case of mining industry restructuring or steel industry restructuring – SMEs create employment opportunities which are not related at all with the enterprises to be restructured. You have basically to see how SMEs can provide employment opportunities, either through non-core activities, spin-offs from enterprises being restructured, or the sector being restructured, or by replacing one sector by another. An example could be the replacing of steel production by automotive production or electronics production.

Related to that is the fact that in some cases SMEs are developed by being linked to an anchor company which is not an SME by itself, and SME service suppliers are linked to that competitive supplier by a supplier link. In other cases, let's say in agro-business, you can see networks of SMEs, cooperatives of agro-business producers, or retail chains. I will give an example of that how that can work later.

When we talk about SMEs and their role in industrial restructuring, it is quite important to identify the obstacles to their development, to their success in industrial restructuring. As I mentioned earlier, the investment climate is important not only for the restructuring of enterprises but also for the development of SMEs. With respect to SMEs, we very often talk about their lack of access to finance, or difficult access to finance. Another obstacle to the development of SMEs is the lack of skills or know-how on how actually to operate SMEs. Here I would like to highlight the work of UNIDO in setting up business development advisory services in Central Asia and in Southeastern Europe.

With regard to access to finance by SMEs, I would like to introduce that topic by telling a story which happened to us when we discussed the lack of access to finance in one of the Central European countries about half a year ago. We went to representatives of SMEs and asked them: "Do you have problems with access to finance?" The reply was: "Yes." We asked if the commercial banks did not want to lend money to SMEs, and they said: "No, there is no problem with commercial finance. It is the lack of subsidies and guarantees". Then we went to the Ministry of Industry asked the same question and the reply was the same: "There is no problem with access to finance; it is the lack of subsidies and state guarantees."

However, I think that there is still a problem with access to commercial finance. One issue is the lack of a track record of SMEs; either that they are new clients for a bank or that they are start-ups and do not have any credit history. In such a case it is quite difficult to have an external source of finance. In other cases it is just the insufficient capital of an enterprise, so that the leverage would be too high in case they would get more external financing. Or they do not have security. Or the cash flow is such that it is not commercially viable to provide finance to such enterprises, even though they would be viable businesses in the long-term. In other cases – as I already mentioned, there is this business development advisory service in Central Asia run by UNIDO – it is simply that the SMEs present an inadequate business plan to the bank or financial institution. The fact that an enterprise or SME does not have very good business plan does not necessarily mean that the entrepreneur does not know how to run a business. It can simply be that the entrepreneur does not know how to write it up in such a way that a bank would understand it.

In some cases it is also the lack of appropriate financial instruments for external financing. As I said, in some cases there is insufficient equity and an enterprise would need some equity provider to provide external finance. If the companies cannot issue shares on the stock exchange, however, either because they are too small or because the stock exchange is not developed enough, there is basically no way for them to attract external finance since there are no private equity funds.

In my view there are three different reasons why financial institutions hesitate to lend to SMEs. One issue is whether they are willing to lend to SMEs at all. It can simply be that they are focused on a different market segment. If a financial institution focuses on consumer lending, then it won't provide financing to business. The same is true if the bank focuses on large enterprises; it just simply doesn't fit that bank's strategy to work with SMEs. It is a different issue if financial institutions would like to lend to SMEs but they do not have the capabilities to do so. They simply do not know how to do it. That was the case with many banks in Central and Eastern Europe in the early transition years, and the consequence of that lack of capabilities to lend to SMEs was that the region experienced a few banking crises. A final point is the inability of financial institutions to lend, which could be linked to regulations related to the composition of the bank's resources. If the banks have only short-term resources, then they cannot provide long-term finance to enterprises because they wouldn't have matching resources.

How can the public sector support the development of SMEs and their involvement in industrial restructuring? What I would probably highlight here is that the public sector should focus on market failure. If the legislations or regulations are not correct, then it doesn't make sense to provide subsidies. In some cases tax incentives for lending or for an increase in the equity of SMEs are necessary. Governments can provide subsidies linked to employment, environment, infrastructure, research and development, or the upgrading of skills; and there are various other possible mechanisms.

I have a few case studies. Most of them are EBRD approaches, but I shall call them public sector approaches because SME credit lines to banks and leasing companies in Central Eastern Europe are provided not only by EBRD but also by the European Investment bank (EIB) and various governments and other international institutions. The major objective of these credit lines or the creation of micro-finance institutions or support for private equity funds is to help to build institutions and to upgrade skills and know-how linked to the capabilities of financial institutions to lend. International organizations provide finance and provide technical assistance to upgrade skills. Of course, when you provide finance for the expansion of SMEs, and when you transfer skills, it is for the better use of resources. One important part of all this is that this SME lending should be sustainable. It doesn't make sense to create what should be commercial institutions which are dependant on taxpayers' money.

Another example involves the recent restructuring of a bankrupt malting company in the Czech Republic. It had very strong backward linkages to farmers producing malting barley. These companies are of course SMEs by their nature, and here the point made by Mr. Piskounov about corporate social responsibility is quite important. What you want to see in such cases is that supplier SMEs have the best-practice payment terms and get also some help with the upgrading of skills, technical advice, and maybe some pre-financing of their production.

Another case refers to the international company Bosch Services, which introduced a franchising system in the Ukrainian car servicing sector, and through this project transferred skills and know-how to local SMEs. Again, this is a purely commercial project, which was supported by international institutions because of the country limits.

The last example concerns the Intermarché Pekaio Framework Financing project in Poland, which addressed the issue of a lack of finance for SMEs. The Intermarché International retail chain is actually a network of SME companies, which basically mixed together individual features of SME

companies. These individual stores take entrepreneurial risk. They are franchises in terms of concept and quality control, and they are also co-operatives.

To conclude, I think we all agree that SMEs are important for successful industrial restructuring, and that the public sector can support their involvement in various ways. But I would probably highlight the public support which can be provided by the government: That includes improvements to the investment climate, streamlined legislation and regulations, improvements in the tax system, a well functioning social safety net, an efficient judiciary, low corruption, and transparency of public procurement. We talk about desirable features of subsidies and state aid and the involvement of the international organizations. What really we need is to focus – and this refers to UNIDO and EBRD as well as the other international organizations: We have to have some vision, some strategy; and target well identified market failures. We should also try to avoid distortions, and that includes best practice environmental standards, labour market standards and public consultations. We should, of course, allow competition because in transition countries the support of the market economy is one of the key features of the process.

# Financing Capital Formation in Central and Eastern Europe: How Important is Foreign Direct Investment?

*Libor Krkoska*\*

## Abstract

This paper investigates the relationship between gross fixed capital formation and the sources of its financing in Central and Eastern Europe during the transition period. A theoretical model to study the relative importance of different financing sources of capital formation is built on the basis of enterprise cash flow analysis. Aggregate data from 25 transition countries over a ten-year period are used in the empirical analysis to show that foreign direct investment (FDI) had the largest impact on capital formation among external sources of enterprise financing, although domestic debt and capital market financing were also important. The data did not reveal any statistically significant link between capital formation and foreign debt or subsidies. The paper further shows that FDI was a substitute for domestic credit and complementary with foreign credit. The privatization process and natural resource endowment were found to be the most significant investment climate factors influencing the relationship between capital formation and FDI. The empirical results presented in this paper thus confirm the usefulness of transition reform strategies based on a strong support for foreign direct investment as well as on the development of local financial intermediation.

## Introduction

Transition countries in Central and Eastern Europe faced many challenges at the beginning of the transition reforms in the early 1990s. A particularly difficult task was the upgrading and replacement of obsolete machinery and equipment in enterprises, the modernization of roads and railways, and other investment in fixed capital. The need for massive investment in both the public and private sector was never disputed. However, both governments and enterprises faced severe constraints on their ability to finance the necessary investment projects. Governments had to focus on financing the current, mainly social, costs of the transition reforms. Long term financial planning by the mostly state-owned enterprises was restricted by their uncertain future in the reformed economies based on market principles and the underdevelopment of financial sectors, including the non-existence of many standard financial instruments and institutions, such as stock markets and purely commercial banks. Given this background, most transition countries have, perhaps surprisingly, achieved great progress in modernizing their existing capital stock over the past ten years, although this process is far from complete.

The main aim of this paper is to provide a comprehensive analysis of the financing sources for capital formation and their relative importance in Central and Eastern Europe during the first ten years of transition. The empirical assessment is partly based on a theoretical framework constructed on corporate accounting principles. Particular attention is paid to FDI, which emerged as a specific form of enterprise financing favoured by policy advisors and policy makers both within and outside the region. FDI inflows have been praised for their impact on many levels, including the achievement and maintenance of macroeconomic stability, improvements in corporate governance, transfers of new technologies, introduction of new products and processes, and financing of enterprise restructuring and fixed capital replacement. This paper is concerned primarily with the impact of FDI on the last

---

\* Principal Economist, Office of the Chief Economist, European Bank for Reconstruction and Development. The author would like to thank Alan Bevan, Elisabetta Falcetti, Rika Ishii, Nevila Konica, Vanessa Mitchell-Thomson and Peter Sanfey for many helpful comments, and Bostjan Jazbec and Tatiana Lysenko for excellent research assistance. The views presented are those of the author and not necessarily of the EBRD.



dimension, analyzing the impact of FDI on capital formation. Obviously, FDI was not the only source of enterprise financing, and its impact is thus compared with that of the other financing sources.

There are many issues related to the analysis of financing capital formation in transition countries. Initial conditions and structural reforms in formerly centrally planned economies moving towards a free market based system are of particular importance, since transition countries have had initially different economic structures compared to both developed and developing countries. The role of the public sector in shaping preferences for alternative financing sources of capital formation is also important, including the impact of budgetary subsidies and tax incentives. Finally data availability in Central and Eastern Europe puts some constraints on the choice of a form of the theoretical model that can be empirically tested.

This paper proceeds as follows. The next section looks more closely at the challenges in financing capital formation in transition countries, presents the overview of the main forms of financing sources, and discusses the differences between capital formation and FDI, including the determinants of investment capital flows. The third section introduces a theoretical model based on corporate accounting principles, which relates the uses of financial means to their sources. The impact of the external environment, including the level of interest rates, progress in privatization, and natural resource endowment, among other business climate factors, is studied as well. The empirical evidence, including descriptive macroeconomic and enterprise survey data and the results of model estimation are presented in the fourth section. The fifth section concludes the paper and provides some policy implications.

### **Capital formation, its financing, and FDI**

The existing capital stock in Central and Eastern Europe at the beginning of the transition reforms can be characterized as excessive in relation to the demand for goods and services produced by this capital stock, and at the same time inadequate in relation to the current and future requirements of consumers. Central planning had misallocated resources on a massive scale for a variety of reasons, although social engineering and military needs had played a substantial role and should be emphasized in any discussion of the structural distortions in the former communist countries. All transition economies had excess capacity in large, inefficient industrial complexes producing goods with no markets outside military and artificial requirements of central planners, while production capacity for consumer goods in short supply was lacking. Moreover, relations between enterprise costs and revenues were blurred by the focus on production targets, expressed in volume terms, extensive price and wage regulations, cross-subsidization of goods and services, and the non-existence of open unemployment.

The abrupt change in the late 1980s and early 1990s led to the collapse of investment projects driven by central planners. Public sector infrastructure projects were scaled down in many areas, including the maintenance and expansion of the road network and railways. Capital expenditures of enterprises were delayed not only because of the lack of resources, but also because the managerial focus shifted to privatization, and long term strategic decisions were mostly left to the new owners. However, it should be noted that some un-restructured enterprises engaged in large investment projects on the basis of flawed economic analyses, with short-term viability due to slow progress in transition reforms misinterpreted as long-term niche market opportunities, and further contributed to misallocation of resources in transition countries.

Budgetary subsidies became less prominent in financing the enterprise sector, but they did not cease to exist. Often, direct budgetary subsidies were replaced by soft loans provided by state owned banks and state guarantees for commercial loans. The state in some transition countries also allowed a build-up of sizeable tax and social contribution arrears, frequently in large so-called strategic enterprises with a substantial employment in depressed regions. Some governments also started providing tax incentives for investors, including both the support for a small number of large-scale

foreign investors in selected regions and wholesale tax incentives for investors in selected, mostly manufacturing, enterprises regardless of their national origin and the location of the investment.

Early assessments of the transition process highlighted the need for massive investment in capital stocks in order to replace obsolete technologies and increase the chances of enterprise survival in a free market environment. The infrastructure sector, including transport, utilities and telecommunications, also required significant investment in capital stock to facilitate private sector development and increase potential output growth. Reforms underpinning potential economic growth through investment activities included policy measures targeted at the development of the commercial financial sector, such as the creation and expansion of standard commercial banks and the emergence of stock markets and privatization of state owned enterprises.

Financial constraints on both the public and private sector played an important role in planning investment outlays. Governments had to deal with the social consequences of transition reforms which were putting great pressure on public budgets. Enterprises faced the loss of traditional markets, the imposition of hard budget constraints, difficult access to finance, and uncertain viability in a free market environment. As the transition reforms progressed, standard financial market institutions were established and companies started to build the track records necessary for access to external finance. Progress in privatization also assisted in alleviating the transitional problems related to capital formation, both by raising resources for public investment in infrastructure and allowing enterprises to act as commercial entities with private owners responsible for strategic decisions, including capital expenditure.

The literature on financing investment in transition countries highlights the gap between domestic savings and investment requirements (EBRD 2000). Indeed, in some transition countries rising investment was not matched by domestic savings, resulting in growing current account deficits and increasing macroeconomic instability, necessitating painful adjustments. This paper focuses, however, on the relationship between capital formation and its immediate financing sources, provided mainly by shareholders, financial intermediaries and governments. The relationship between the uses of financial resources and their primary origin, i.e. domestic or foreign savings, is beyond the scope of this paper.

From the point of view of enterprises, or public sector agencies in charge of implementing public infrastructure projects, capital formation can be financed by internal sources, including retained earnings and asset sales, by external commercial sources, including capital increases and borrowing, and by the public sources, i.e. budgetary subsidies and other transfers from governments. From the macroeconomic point of view it is sensible to consider also the national origin of the financial sources, i.e. whether financing external to the enterprise is of domestic or foreign origin.

In developed economies the major source of enterprise financing is internally generated cash. Debt financing and capital increases, mostly through the issuance of new shares on the stock markets, are the major sources of external financing (Borio 1990). Internally generated cash is the most important source of enterprise finance also in the transition countries (see Section 4 for more details). However, the underdevelopment of financial institutions has led to a lower importance of financial intermediaries for enterprises in transition countries compared to their counterparts in developed countries. A particularly interesting point is the importance of FDI in the transition countries during the past ten years. FDI inflows are a relatively new phenomenon in Central and Eastern Europe, attracting a lot of attention for their potential to act as substitutes for underdeveloped financial markets (see Buiter et al. 1998) and also for their impact on macroeconomic stability (Krkoska 2001; Razin et al. 1998).

The role of FDI in financing capital formation is not clear cut. Some publications present FDI as a share of capital formation, although this is a misleading presentation because of significant differences between the two concepts. FDI is defined as the category of capital flows on the balance of payments that reflects the objective of obtaining a lasting interest by a resident entity in one

economy (direct investor) in an enterprise resident in another economy (direct investment enterprise). A direct investor is defined by his ownership of 10 per cent or more of the ordinary shares or voting power in direct investment enterprise (IMF 1993). FDI includes capital increases in the concerned enterprise, inter-company loans, and retained earnings. Capital formation, on the other hand, includes investment in land improvements, plant, machinery and equipment purchases, construction of roads, railways, commercial and industrial buildings, offices, schools, hospitals, and private residential dwellings. As can be seen from the definitions, FDI focuses on the flow of funds, subject to their national origin but without regard to their use in target entity, while capital formation focuses on the uses of funds, without any regard to their origin.

FDI inflows thus can, but do not have to, be translated into capital formation. Indeed, both Graham (1995) and Lipsey (2000) note that FDI inflows in developed countries were mostly related to ownership change and did not seem to have a significant impact on investment in fixed assets. Developed countries account for a major part of FDI flows. However, these flows are mainly associated with merger and acquisition activities and only a small part is used for new capital formation.

The uncertain impact of FDI on capital formation may also hold in transition economies. The privatization process is nothing but an ownership change. However take-overs of enterprises in Central and Eastern Europe rarely ended with changes in ownership and management. The important role of FDI in enterprise restructuring was recognized by a number of scholars (e.g., Barrel & Holland 2000; and Konings 2000). As already discussed above, large investments in the modernization of equipment and machinery were required in most Central and Eastern European companies. In addition, some privatization contracts included clauses on investment commitments of the buyers, while other privatization deals took the form of a capital increase through capital expenditure by the investor. Privatization proceeds may also have had an impact on capital formation by providing finance for public capital expenditure projects with no direct link to the enterprise originally subject to the privatization-related FDI flows.

An important constraint on the ability of enterprises in transition countries to access external finance is their mostly non-existent, or at the best very short, track record. A newly established presence of a foreign investor in an acquired company may influence the access to finance for capital expenditure without the contribution of direct shareholder funds. Foreign ownership may improve the credit assessment of an enterprise by implicitly or explicitly transferring part of the risk associated with commercial lending to foreign shareholders. In addition a foreign investor may introduce the acquired enterprise to its providers of finance, who would otherwise not consider such a company to be a potential borrower. In such a case, capital expenditure would be a result of an entry of the foreign investor, most likely accompanied by a substantial flow of funds, but the financing of such capital expenditure may not need to be from these funds but could well be financed by borrowing from local credit providers.

It should be emphasized that FDI is only a potential source of funds, and the possibility of the enterprise to use such funds is dependent on the ability and willingness of an enterprise to attract the entry of foreign capital. A large body of literature has emerged analyzing the determinants of FDI, mostly from a macroeconomic point of view (Lankes & Venables 1996, Bevan & Estrin 2000, Resmini 2000, and Kinoshita & Campos 2001, among others). On a country level, FDI depends on the size of the domestic and potential export markets, the closeness to main markets, the endowment with natural resources, the skills of the local labour force, unit labour costs, and the structural background, including macroeconomic and political stability. Many of these factors are also important on an enterprise level, although in this case a potential investor would focus mainly on the viability of an enterprise, be it an existing company or a greenfield facility.

Other characteristics of transition economies also have a profound impact on the availability of different types of external finance for enterprises, including FDI. The lack of transparency, low standards of business conduct, inadequate protection of creditor and shareholder rights and other

business climate deficiencies may result in a preference of foreign investors for taking majority control of a firm, while the role of a sizeable minority equity investment by foreign investors would be relatively minor. Indeed this was the case in many transition countries (see Meyer & Pind 1999), and particularly so at the beginning of transition reforms. Buitter et al. (1998) show that internally generated cash, relatively unsophisticated commercial debt, and shareholder funds were the main sources of finance for enterprises in Central and Eastern Europe during the early transition years. In only a handful of transition countries did new share offerings to minority shareholders or equity fund investments provide a significant amount of financing for enterprises.

## A model

The theoretical framework is based on a corporate cashflow concept, formalizing the relationship between the sources and the uses of financial means. According to the International Accounting Standards a company has four main sources of cash:

- i) Internally generated cash, including cash from operations, sale of existing assets, disposal of investments and income from investments, associates and minority interests;
- ii) New issues of short or long term debt in any currency and any jurisdiction;
- iii) New issues of equity, encompassing all types of shares such as common shares, preference shares, etc; and
- iv) Exceptional items such as state subsidies.

The cash can be then used for:

- i) Operations, including the purchase of goods and services, payment of wages, accruals and creditors;
- ii) Capital expenditure, including investments in land, buildings, machinery, equipment, and other fixed assets;
- iii) Acquisitions, payment of dividends, etc.; and
- iv) Exceptional items such as redundancy costs.

This approach applies also to state agencies entrusted with implementing public sector capital formation projects, mostly in infrastructure. In the case of public sector capital formation the source of cash from the government and debt would be dominant, except in cases where cash raised from operations of existing state owned fixed assets, e.g. road tolls and railway revenues, is earmarked for a particular use and does not flow through the state budget.

This paper focuses on a particular use of cash, i.e., capital expenditure, and its relation with different sources of cash. Investment in fixed assets, referred to as gross fixed capital formation, *gfcf*, using national accounts terminology, is thus presented as a function of sources of cash, including internally generated cash, comprising reinvested earnings, *re*, new debt, *nd*, new equity, *ne*, and state subsidies, *s*.

In addition, the relationship between capital expenditure and sources of financing is subject to the economic environment in which an enterprise operates. The impact of the economic environment, *ee*, is measured in this paper by the inclusion of variables indicating the level of real interest rates, *rir*, stock market liquidity, *sml*, the size of privatization revenues, *pr*, progress in transition reforms, *ti*, inclusion in the process of accession to the European Union, *acc*, and endowment with natural resources, *nr*. The formal definitions are given in Table 1.

**Table 1. Definition of variables employed in the model**

<b>Variable</b>	<b>Variable name</b>	<b>Definition</b>
<i>gfcf</i>	<i>Gross fixed capital formation</i>	Investments in land improvements (fences, ditches, drains, and so on); plant, machinery, and equipment purchases; and the construction of roads, railways and the like, including commercial and industrial buildings, offices, schools, hospitals and private residential dwellings.
<i>re</i>	<i>Retained earnings</i>	Net profits kept to accumulate in an enterprise after dividends are paid.
<i>dc</i>	<i>Domestic credit</i>	Total loans extended by the local banking sector to the non-financial enterprises, include both loans in local currency and in foreign currency.
<i>fc</i>	<i>Foreign credit</i>	Total loans extended by a resident entity (lender) in one economy in an enterprise resident (borrower) in another economy where the lender does not have a significant (10 per cent and more) ownership stake.
<i>cmf</i>	<i>Capital market financing</i>	New equity and bond issues by enterprises, approximated by the change in the stock market capitalization, accounting for changes in equity prices.
<i>fdi</i>	<i>Foreign direct investment</i>	International investment that reflects the objective of obtaining a lasting interest by a resident entity in one economy (direct investor) in an enterprise resident in another economy (direct investment enterprise).
<i>s</i>	<i>State subsidies</i>	Non-repayable transfers from the budget to private industries and public enterprises, including public capital expenditures, and the cost of covering the cash operating deficits of departmental enterprise sales to the public.
<i>other</i>	<i>Constant term</i>	Constant term in the linear approximation, substituted for non-available retained earnings and non-public capital increases and tested for time/country independence by inclusion of appropriate dummies
<i>rir</i>	<i>Real interest rate</i>	Interest rate on short-term lending between financial institutions discounted by the inflation rate.
<i>sml</i>	<i>Stock market liquidity</i>	Stock market turnover (total value of shares traded during the year) over stock market capitalization (market value of all listed shares).
<i>pr</i>	<i>Privatization revenues</i>	State revenues from the sales of assets.
<i>ti</i>	<i>EBRD transition indicator</i>	Simple average of eight transition indicators published by the EBRD in its Transition Report and covering large-scale privatization, small-scale privatization, governance and enterprise restructuring, price liberalization, trade and foreign exchange system, competition, banking reform, and finally securities markets and non-banking financial sector.
<i>acc</i>	<i>Accession dummy</i>	Dummy variable with value 1 for an accession country (Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia) and 0 otherwise.
<i>nr</i>	<i>Natural resources dummy</i>	Dummy variable with value 1 for a natural resource endowed country (Azerbaijan, Kazakhstan, Russia, Turkmenistan).

The model linking a particular use of cash and its sources can thus be formally presented as follows:

$$gfcf = f(re, nd, ne, s | ee) \quad (1)$$

Model 1 can be empirically tested by firm-level data. Unfortunately, for most transition countries firm-level cashflow data are not available, not least since the publicly listed companies are only a small and non-representative sample of all enterprises. It is therefore necessary to adjust the model in such a way that the aggregate data available from national accounts, balance of payments, and other national sources provided by authorities in transition countries, can be used.

The issuance of new debt includes domestic credit,  $dc$ , foreign credit,  $fc$ , and shareholder loans. While the first two variables are available on an aggregate level from monetary surveys and the information on the composition of external debt, shareholder loans are part of the FDI inflows,  $fdi$ , often aggregated with equity FDI inflows and retained earnings in foreign owned companies. The data on new equity issuance is also only partly available since only equity issues in publicly listed companies are reflected in the data on capital markets,  $cmf$ , while capital increases in non-listed enterprises are not reported. However, for foreign owned enterprises these data are available at least for companies benefiting from FDI inflows. Capital increases in non-listed local enterprises are likely to be limited and are treated as a residual term,  $other$ , together with reinvested profits in companies without a significant foreign shareholder.<sup>1</sup> The data limitations thus lead to a modification of the model 1 into the following form to be empirically analyzed:

$$gfcf = f_{gfcf}(dc, fc, cmf, fdi, s, other | ee) \quad (2)$$

It is also important to look at the relation of foreign direct investment flows and the other investment sources. Given the general reluctance of shareholders in transition countries to open to external, independent shareholders, it is likely that foreign direct investment is influenced by the availability of other financing sources, as well as the economic environments. This relation is modelled as follows:

$$fdi = f_{fdi}(dc, fc, cmf, s, other, | ee) \quad (3)$$

For simplicity a linear approximation of functions  $f_{gfcf}$  and  $f_{fdi}$  is used in the empirical analysis and the final model to be empirically tested is as follows:

$$Y' = A'X' + E \quad (4)$$

Where

$$\begin{aligned} Y' &= (gfcf, fdi) \\ X' &= (dc, fc, cmf, fdi, s, other, rir, sml, pr, ti, acc, nr) \\ A' &= (a_{xy}); \quad x = 1, 2; y = 1, \dots, 12; \\ a_{24} &= 0, \end{aligned}$$

and

$E$  is a random term with the mean equal to  $(0, 0)'$  and variance equal to  $\Omega$ ,  $|\Omega| \neq 0$ .

---

1 Excluding a potential explanatory variable that influences the dependent variable leads to the bias of other coefficients. It is therefore assumed that the impact of retained earnings and non-public capital increases in companies without significant foreign investment is included in the constant term of the model. Time and country dummies were included in the model to test whether the impact of these factors is independent of time period and country.

## Empirical analysis

According to the EBRD 2002 Business Environment and Enterprise Performance Survey, enterprises in Central and Eastern Europe financed almost 70 per cent of their capital formation by internal funds (Table 2).<sup>2</sup> Bank loans were also a significant source of funds for investments in fixed assets, accounting for over a quarter of total financing. Sales of stocks and state funds were less important sources of financing capital formation, accounting for 2 to 3 per cent of the total.

**Table 2. Enterprise survey data on capital formation financing**

Region	Internal Funds	Bank loans	Sale of stocks	State funds	Residual
<i>Central Europe and the Baltics</i>	61%	31%	6%	2%	na
<i>Southeastern Europe</i>	68%	27%	3%	2%	na
<i>CIS</i>	76%	22%	1%	2%	na
<i>All transition countries</i>	69%	26%	3%	2%	na
<i>Japan</i>	53%	44%	3%	na	0%
<i>Germany</i>	72%	22%	3%	na	3%
<i>UK</i>	66%	22%	10%	na	2%

*Sources:* Business Environment and Enterprise Performance Survey (2002), for transition countries and Borio (1990) for Japan, Germany and the UK. Data for transition countries refer to 2002 while data for developed countries refer to 1983-87.

The sources of capital formation financing in Central and Eastern Europe are similar, on average, to developed market economies. While internal funds accounted for larger share for financing in transition countries than in Japan or the UK, their importance was smaller than in Germany during the 1980s. Bank loans were more important for enterprises in transition countries than in Germany or the UK, but less so than in Japan. Financing capital formation by issuing new equity in Central and Eastern European countries was similar to Japan and Germany, but lower than in the UK. Some of these differences reflect enterprise preferences for alternative financial instruments, such as the preference of UK enterprises for financing capital formation by equity issuance and strong links between the banking sector and companies in Japan. It is therefore not surprising that there are regional differences in the importance of alternative sources of financing among transition countries.

Internal funds are more important in Southeastern Europe and in the CIS than in Central Europe and the Baltics. In Southeastern Europe over two thirds of new investment is financed by internal funds, and in the CIS the share of internal funds in total financing exceeds three quarters, compared to just over 60 per cent in Central Europe and the Baltic countries. Bank lending accounts for over 30 per cent of financing fixed assets investment in Central Europe, over a quarter of the total in Southeastern Europe, and just over a fifth in the CIS. Issuance of new equity is the most important in Central Europe and the Baltics, accounting for 6 per cent of total financing, while in Southeastern Europe capital markets account for 3 per cent of capital expenditure financing and in the CIS for only 1 per cent of the total. Perhaps surprisingly, state funds are responsible for a similar share of total capital formation in all major regions in Central and Eastern Europe at 2 per cent of the total.

Significant regional differences in the importance of alternative forms of capital formation financing exist both among the developed countries and among the transition countries. However a large part of the explanation for regional differences within Central and Eastern Europe is probably linked more

2 The data are based on Business Environment and Enterprise Performance Survey conducted by the EBRD in cooperation with the World Bank. The survey asked managers in over 3,000 enterprises questions on their firm's basic characteristics as well as the quality of the business environment in which they operate.

with the development of local credit and capital markets, including the existence of the necessary institutions, the availability of various financial instruments, and the quality of legislation and regulation related to financial intermediation, rather than with the preference of enterprises regarding ownership control while deciding between issuance of new debt or equity. It should be noted that sales of stocks do not include only share issuance on the local capital markets but also cover direct equity investments, such as greenfield FDI and capital increases outside the stock markets.

Table 3 provides another useful indication of the extent of available capital formation financing from sources external to an enterprise in the transition countries. The first observation on the basis of aggregated data suggest that the availability of finance for capital formation from domestic commercial sources is, relative to the other transition countries, the best in Central Europe and the Baltics and the worst in the CIS, with Southeastern Europe somewhere in between, close to the average for all transition countries. On average, transition countries raised approximately 10 per cent of GDP from privatization revenues, with Central Europe and the Baltics reporting more than 12 per cent and the CIS less than 8 per cent. The banking sector in Central Europe and the Baltics is clearly more developed than in the other two regions, with domestic credit equivalent to over 40 per cent of GDP compared to over 30 per cent in Southeastern Europe and just over 20 per cent in the CIS. Stock market capitalization is also substantially higher in Central Europe and the Baltics, at 14 per cent, than in Southeastern Europe at less than half of that level, and less than 5 per cent in the CIS. State subsidies were the most important in Southeastern Europe, followed by the CIS and Central Europe and the Baltics, although in all sub-regions budgetary subsidies were equivalent to between 3 and 4 per cent of GDP.

**Table 3. Macroeconomic indicators on sources of finance (stock at the end of 2001, per cent of GDP)**

Region	Privatization revenues	Domestic credit	Foreign credit	Foreign direct investment	Stock market capitalization	Subsidies (annual)
<i>Central Europe and the Baltics</i>	12.4	42.4	37.4	30.9	14.1	3.2
<i>Southeastern Europe</i>	10.5	31.4	12.7	20.6	6.7	3.7
<i>CIS</i>	7.8	22.4	19.7	28.0	4.5	3.4
<i>All transition countries</i>	10.0	30.7	23.9	27.0	8.4	3.5

Source: EBRD.

The availability of finance from foreign sources is also the best in Central Europe and the Baltics, where foreign credit reached almost 40 per cent of GDP and the stock of FDI exceeded 30 per cent of GDP. However foreign investors were more active in the CIS than in Southeastern Europe, partly due to investment inflows related to projects in the natural resources sector in Russia, Kazakhstan and Azerbaijan. Foreign credit stood at almost 20 per cent of GDP in the CIS compared to just over 12 per cent in Southeastern Europe, and the stock of FDI reached almost 30 per cent of GDP in the CIS compared to just over 20 per cent in Southeastern Europe.

FDI inflows deserve closer attention. Until recently, the transition countries had not received significant amounts of FDI. However, by the end of 2002 the transition countries received a cumulative total of over US\$ 170 billion, equivalent to almost 20 per cent of the region's GDP (or over 25 per cent if reported as an average of country level ratio of FDI to GDP). Most of the FDI inflows targeted Central Europe and the Baltic countries. This sub-region received almost US\$ 120 billion, equivalent to almost a quarter of the sub-region's GDP. The good performance of advanced transition countries was often compared to the less favourable performance of the Balkan and CIS countries, with the difference being attributed in large part to the impact of the better investment



climate in Central Europe and the Baltics (Mayer & Pind 1999; Barrel & Holland 2000; Konings 2000).

The regional distribution of projects financed by FDI highlights the determinants of FDI inflows identified in the literature. Transition countries closest to the European Union markets (the Czech Republic, Hungary, Poland, and Slovakia) have received a substantial share of FDI. Market size also matters, but countries such as Poland, Romania and Russia received a lower inflow of FDI per capita than the average for their respective sub-regions. Endowment with natural resources (Azerbaijan, Kazakhstan, Russia, and Turkmenistan) has also proven to be an important factor attracting FDI (see EBRD 2003 for detailed data).

FDI in transition countries is to a certain degree associated with the privatization process. Indeed, on average cumulative privatization revenues are equivalent to almost a third of the cumulative stock of FDI. However, some transition countries have attracted a large amount of FDI without generating large privatization revenues, while in others privatization revenues are equivalent to over two thirds of FDI. This is the result of different privatization strategies, which included not only direct sales to foreign investors but also stock market flotations, voucher privatizations, debt-financed sales to managers, the distribution of sales to employees, and other privatization methods.

Following the analysis of the basic descriptive data, the linear approximation (4) of equations (2) and (3) was estimated using the generalized least squares method. The results are presented in tables 4a and 4b.

The data for 25 transition countries in Central and Eastern Europe<sup>3</sup> were used in the empirical analysis. The time period covers eleven years (1989-2000). However, due to the limited availability of the data for earlier transition years as well as for some of the less advanced transition countries, only about one third of the observations are complete and thus used in the empirical testing (82 observations out of total possible 275 observations). All variables except for the real interest rate and dummy variables are used as logarithmic transformations of a share of GDP.

**Table 4a. Empirical results for equation (2) on financing gross fixed capital formation**

Type of variable	Variable	Value	t-statistic
<i>Explanatory variables related to enterprise financing</i>	Domestic credit	0.070*	2.238
	Foreign credit	0.016	0.251
	Capital market financing	0.255*	2.125
	Foreign direct investment	0.721**	4.039
	State subsidies	0.439	1.370
<i>Constant</i>	Other factors	12.681*	2.097
<i>Explanatory variables related to economic environment</i>	Real interest rate	- 0.036	1.424
	Stock market liquidity	- 0.002*	2.294
	Privatization	- 0.024	0.317
	EBRD Transition Indicator	1.041	0.378
	Accession dummy	0.608	0.313
	Natural resources dummy	- 3.445	1.421
<i>R – squared</i>		0.46	

Note: \* Statistical significance at 5% level.

\*\* Statistical significance at 1% level.

3 The Central and Eastern Europe region includes Albania, Armenia, Azerbaijan, Belarus, Bulgaria, Croatia, Czech Republic, Estonia, FYR Macedonia, Georgia, Hungary, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Poland, Romania, Russia, Slovakia, Slovenia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan.

**Table 4b. Empirical results for equation (3) relating FDI to other financing sources and economic environment**

<i>Type of variable</i>	<i>Variable</i>	<i>Value</i>	<i>t-statistic</i>
<i>Explanatory variables related to enterprise financing</i>	Domestic credit	-0.043*	2.251
	Foreign credit	0.093**	2.659
	Capital market financing	-0.075	1.338
	State subsidies	-0.144	0.785
<i>Constant</i>	Other factors	6.101	1.746
<i>Explanatory variables related to economic environment</i>	Real interest rate	0.036	2.294
	Stock market liquidity	0.000	0.126
	Privatization	0.699*	2.358
	EBRD Transition Indicator	-1.127	0.792
	Accession dummy	0.699	0.580
	Natural resources dummy	5.206	3.858
<i>R – squared</i>		0.35	

Note: \* Statistical significance at 5% level.

\*\* Statistical significance at 1% level.

The empirical results related to the first equation in model (4) shows that gross fixed capital formation is indeed positively correlated with FDI, issuance of new shares, and increases in domestic credit. The data suggest that a 1 per cent increase in FDI results in a 0.7 per cent increase in gross fixed capital formation. As discussed above, this relation can be channelled either directly, by the use of FDI inflows for financing capital formation, or indirectly, by restructuring and modernization after the acquisition of existing shares in the company.

The impact of share issuance and borrowing from local banks is also statistically significant and positive, although it is smaller. A 1 per cent increase in stock market capitalization (adjusted for price changes) results in a 0.2 per cent increase in gross fixed capital formation and a 1 per cent increase in domestic credit results in less than 0.1 per cent increase in fixed assets investment. It should be noted that there is a close link between an increase in equity and an increase in debt. The debt-equity ratio is an important indicator for the assessment of the financial viability of an enterprise, and the implementation of some investment projects financed partly by debt require an increase in equity, not least to show the strong commitment of shareholders to the project during negotiations with lenders.

The data do not reveal a statistically significant relationship between gross fixed capital formation and state subsidies or foreign credit. With the exception of stock market liquidity, there is also no statistically significant relationship between gross fixed capital formation and the variables describing the economic environment, such as the real interest rate, privatization, the natural resources endowment, being an EU accession country, and progress in transition. Higher stock market liquidity is negatively correlated with gross fixed capital formation. This might be explained by the unsettled ownership of enterprises in transition countries, and thus the lesser importance of capital markets in raising finance for investment projects compared to the greater importance of more liquid stock markets for transfers of corporate control, i.e., allowing exits of owners/managers following the successful development of a company.

The empirical results from estimating the second equation in model (4) show that FDI inflows are positively correlated with foreign credit.<sup>4</sup> A 1 per cent increase in foreign credit is associated with a

4 It should be noted here that lending by foreign shareholders is included in the data on FDI and not in the data on foreign credit.

0.1 per cent increase in FDI inflows, which is an interesting observation given the importance of FDI for capital formation and the lack of a statistically significant relation between foreign credit and capital formation. There are several alternative explanations for this result. One option is that the main recipients of foreign credit are banks and other financial institutions which do not engage in capital formation directly, so the impact of foreign funds on capital formation is captured through the impact of domestic credit.<sup>5</sup> Another possibility is that better investment climates are conducive for both foreign direct investment and foreign credit, but only the first form of financing is used for investment purposes while the second is used for consumption, either private or public. Yet another possible explanation is an improved credit assessment of an economy benefiting from more FDI inflows, including foreign companies, and thus greater willingness of foreign owned banks to lend to domestic entities for purposes other than capital expenditure, e.g., for working capital or for re-financing of expensive domestic debt.

The impact of the variables describing the economic environment in the second equation of model (4) is consistent with results of the literature on the determinants of FDI. Progress in the privatization process has a significant impact on FDI inflows, and a 1 per cent increase in privatization revenues results in a 0.7 per cent increase in FDI. Being a country endowed with natural resources (Azerbaijan, Kazakhstan, Russia and Turkmenistan) increases FDI inflows by more than 5 per cent. However being an EU accession country, achieving greater progress in transition reforms, and having a larger ratio of state subsidies to GDP, have not been found statistically significant, and thus correlated with FDI, in this model.

## **Conclusions and policy implications**

The paper shows that FDI has been the most important source of external financing for capital formation in Central and Eastern Europe during the first ten years of transition. Domestic credit and equity issuance were also found to have had a statistically significant positive impact on capital formation, although the impact of FDI is substantially stronger. The empirical analysis also established that FDI is a substitute for domestic credit while foreign credit is positively related to FDI, controlled for the impact of the business climate. The analysis of the data also confirmed that the privatization process and the endowment with natural resources was of considerable importance for attracting inflows of FDI.

The results related to the impact of government subsidies on capital formation and FDI deserve particular attention, not least because of their policy implications. This paper shows that subsidies are not correlated either to capital formation or to FDI, although enterprises report that subsidies account for about 2 per cent of fixed asset financing. A possible explanation is that subsidies are merely crowding out private financing of capital expenditure. In addition, although some companies use subsidies for investments in fixed assets, often for environmental upgrades and infrastructure investments, their impact is probably more often related to restructuring of labour force (steel sector, coal mining, railways), commercial debt (banking sector) and liabilities to the state (tax arrears, social welfare contribution arrears), and there may be a difference between an intended use of the subsidy and its actual use. An important conclusion arising from the empirical results is that a change in government subsidies neither hinders nor increases capital formation, and that subsidies are shown to be similarly neutral with regard to FDI inflows. It should be emphasized, though, that public sector subsidies exclude the impact of tax concessions granted to large foreign investors in a number of transition countries, and this issue should be studied in more detail to reach firm conclusions about the impact of public policy measures on capital expenditures and FDI inflows.

The relationship between public sector support through investment incentives and capital formation is an important and interesting issue, which goes beyond the scope of this paper. However, the strong

---

5 It may be noted in this context that there was a statistically significant positive relationship between capital formation and domestic credit.

results related to the correlation between FDI and capital formation provide a useful argument for policy makers to implement changes in the investment climate which are supportive for FDI inflows, including improvements in the corporate code and bankruptcy legislation, the strengthening of creditor and minority shareholder rights, and improvements in the judicial system. Such changes are also likely to support the expansion of financial intermediation, including an increase in domestic credit and equity issuance, which are positively correlated with capital formation and, ultimately, with investment-led economic growth. Indeed, in this respect this paper complements the literature on the positive impact of FDI on growth (e.g. Borensztein et al. 1998).

## References

Barrel, R., and D. Holland, "Foreign Direct Investment and Enterprise Restructuring in Central Europe". *The Economics of Transition*, Vol. 8, No. 2, pp. 477-504, 2000.

Bevan, A. A., and S. Estrin, *The Determinants of Foreign Direct Investment in Transition Economies*. WDI Working paper No. 342, William Davidson Institute, University of Michigan Business School. Ann Arbor, Mich.: University of Michigan, 2000.

Borensztein, E., E. J. De Gregorio, and J.-W. Lee, "How does Foreign Direct Investment Affect Economic Growth". *Journal of International Economics*, Vol. 45, pp. 115-135, 1998.

Borio, C., *Leverage and Financing of Non-Financial Companies: An International Perspective*. Economic Paper No. 27. Basel: Bank for International Settlements, 1990.

Buiter, W. H., R. Lago, and H. Rey, *Financing Transition: Investing in Enterprises during Macroeconomic Transition*. EBRD Working Paper No. 35. London: European Bank for Reconstruction and Development, 1998.

EBRD, *EBRD Transition Report*. London: European Bank for Reconstruction and Development, 2000.

EBRD, *EBRD Transition Report Update*. London: European Bank for Reconstruction and Development, 2003.

Graham, E. M., *Foreign Direct Investment in the World Economy*. IMF Working Paper No. WP/95/59. Washington, D.C.: International Monetary Fund, 1995.

IMF, *Balance of Payments Manual*. Fifth edition. Washington, D.C.: International Monetary Fund, 1993.

Kinoshita, Y. and N. F. Campos, *Agglomeration and Determinants of Foreign Direct Investment in Transition Economies*. mimeo, 2001.

Konings, J., *Effects of Direct Foreign Investment on Domestic Firms: Evidence from Firm Level Panel Data in Emerging Economies*. WDI working paper No. 344, William Davidson Institute, University of Michigan Business School. Ann Arbor, Mich.: University of Michigan, 2000.

Krkoska, L., "Assessing Macroeconomic Vulnerability in Central Europe". *Post-Communist Economies*, Vol. 13, No. 1, pp. 41-55, 2001.

Lankes, H. P. and A. J. Venables, "Foreign Direct Investment in Economic Transition: The Changing Pattern of Investments". *Economics of Transition*, Vol. 4, No. 2, pp. 331-47, 1996.

Lipsey, R. E., *Interpreting Developed Countries' Foreign Direct Investment*. NBER Working Paper No. 7810. Cambridge, Mass.: National Bureau for Economic Research, 2000.

Meyer, K. E. and C. Pind, "The Slow Growth of Foreign Direct Investment in the Soviet Union Successor States". *The Economics of Transition*, Vol. 7, No. 1, pp. 201-214, 1999.

Razin, A., E. Sadka, and C. Yuen, *Capital Flows with Debt- and Equity-financed Investment: Equilibrium Structure and Efficiency Implications*. IMF Working Paper No. WP/98/159. Washington, D.C.: International Monetary Fund, 1998.

Resmini, L., "The Determinants of Foreign Direct Investment in the CEECs: New Evidence from Sectoral Patterns". *The Economics of Transition*, Vol. 8, No. 3, pp. 665-689, 2000.

## Keynote Speech

*Alexander A. Dynkin*\*

I would like to talk mainly about the industrial restructuring in Russia, both at the industrial branch level and at the micro-level of companies. In contrast to the previous speaker, I will concentrate mainly on big business because the development of big businesses is a very specific feature of the Russian economy at present. Basically, the transition period in Russia can be divided in two parts: From 1992 to the famous financial crisis of August 1998, and the period thereafter. Before the crisis, the policy focus was on price liberalization, privatization, and the opening of the economy. Political consensus about the necessity of financial stabilization was achieved only in the face of the financial crisis.

After the crisis, during the past five years, our economy has grown at a rather healthy pace. Since the crisis our GDP grew up by 35.7 per cent, with an annual growth rate of 6.3 per cent. Those figures clearly stand out when compared with the indicators for the big EU countries and Japan. Today it has already become a banality to explain the current economic growth only on the grounds of favourable energy prices. In my perception, this is not a sufficient explanation, because the previous jump of oil prices in the late 1970s and early 1980s did not stop the demise of the planning economy. I would argue that in addition to energy prices – which are, of course, very important – it is necessary to mention the strong fiscal policy and budgeting in Russia. Also, at the micro-level, there is a visible growth in management competence and the aggressiveness of Russia's businesses.

At present, even after the high growth rates of the past five years, our GDP is still less than it was at the beginning of the reform process. Of course, it is important to have in mind that we had a closed economy and that the structure of our GDP was not based on real demand. The economy is now structurally substantially different, and it produces goods and services which are intended to meet household, export, government and production demand. In the meantime the sectoral pattern of the Russian economy has approached that of the developed countries of Western Europe or Japan, and the percentage of industrial production has decreased 1.5 times while services has grown 1.6 times.

However, this shift took place because of a faster decline in the production of tangible goods and a less rapid decline in services. If we look at the changes in the sectoral pattern of production between 1990 and 2001 presented in Figure 1, we find that the chemical and petrochemical industry, non-ferrous and ferrous metallurgy, the coal and gas industry, and power engineering all grew, whereas the other sectors, with the exception of the medical industry, all fell. This means that our changes were connected with the growth of production of raw materials and semi-finished goods, and not with manufacturing and the production of equipment.

If we look at the employment statistics, we find that they follow the changes in the industrial structure. For example, employment in trade has doubled during the past twelve years, while employment in industry declined by 42 per cent. It increased by 160 per cent in the gas industry and 80 per cent in the oil industry. This is quite understandable because those industries have a higher labour productivity and salaries, so labour moved to this sector.

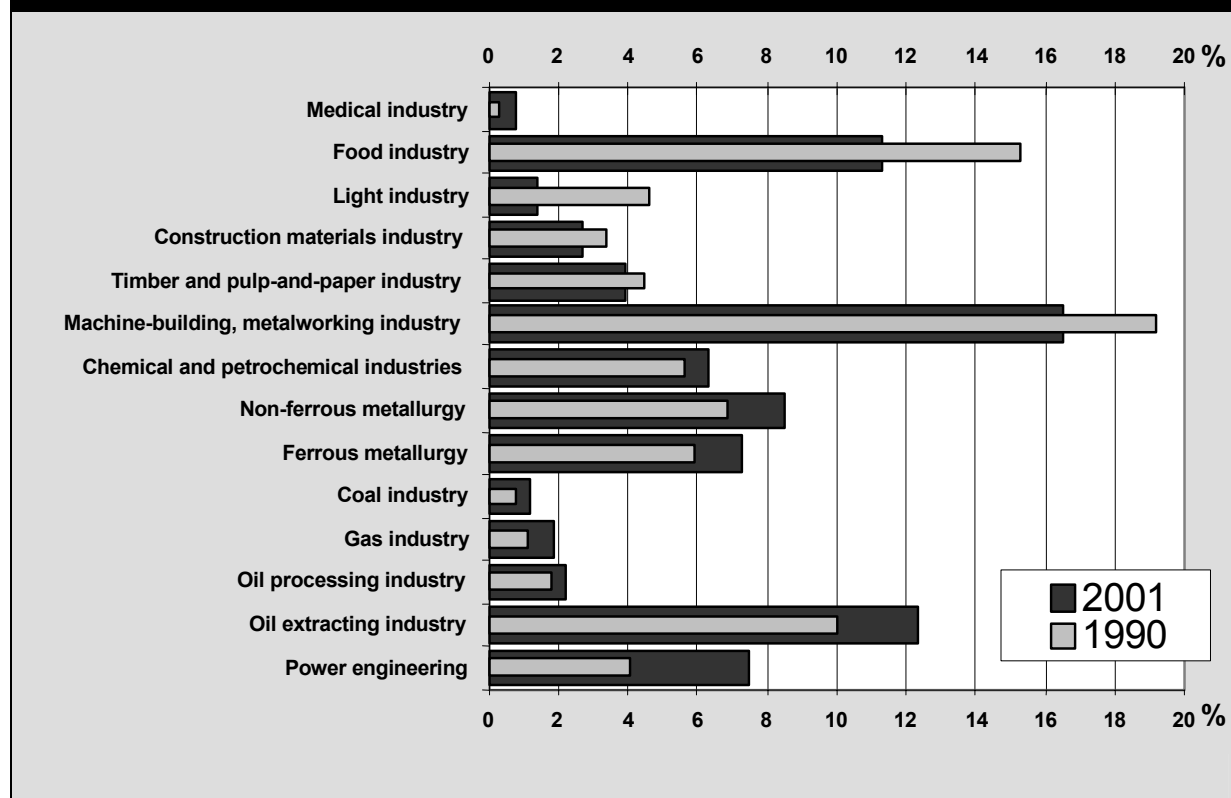
Let me say a few words about labour productivity: By 1999, when our economy really started to grow, the GDP had fallen by 40 per cent – while employment had decreased only by 15 per cent. Of course, this helped to preserve social and political stability; but it also meant that in terms of labour productivity, we are still far below the pre-reform level in all industries except the coal industry and

---

\* First Deputy Director, Institute of World Economy and International Relations (IMEMO). This text is based on an edited transcript of the keynote speech as delivered.

machine building. These are the only industries that demonstrated productivity growth during the decade of reforms.

**Figure 1. Sectoral pattern of industrial production in 2000 prices, %**



Let me also say a few words about the important subject of income differentiation in Russia. In the countries in Central and Eastern Europe, this period of transition was characterized by a simultaneous and proportionate decline in production, which corresponded to a decline of the population's aggregate income. Russia was a remarkable exception to this rule: While our GDP decreased substantially, retail trade – the main income-spending channel – went down only 2.5 per cent. Currently the Russian population's aggregate income is comparable with the pre-reform level. How can this be explained? I suppose the explanation lies in the growing income differentiation and huge "grey" zone of salary and income distribution. Taken together, these developments have, of course, given rise to a remarkable gap between the rich and the poor in Russia.

Thus, the income of the tenth decile of the Russian population grew by 50 per cent, while that of the ninth decile stayed at the same level as in the pre-reform period and the income of the remaining 80 per cent of the population decreased substantially. The difference between the first and the tenth deciles, which was 4.65 times in 1990, has increased to 15 times in the meantime. This indicator is less than in United States, but higher than in Western Europe and slightly higher than in China. What is important is that this happened during a very short historical period. It has resulted in serious social tensions in the society, which was assumed to be an egalitarian society for 75 years.

On the other hand, the period of reform did not generate such a huge divergence in terms of regional disparity. The gross regional product per capita of the tenth decile in Russia is comparable with the figures for Poland or Slovakia; but the gross regional product per capita of the poorest decile is comparable to such countries as Ecuador or Peru.

Let us turn to an analysis of the transition on the micro-level. If we look at a list of the 100 largest East European companies, we find that 36 positions are occupied by Russian companies. The Russian economic model, as it currently exists, has two fundamental limitations or traps. One is institutional. It means that our institutional system has entered a relatively stable transitional state; or, as we call it, “permanent transition”. This means that our institutions still do not work in an automatic mode. Many informal shadow-type relations, which initially were a major shock-absorber during the shock-therapy approach and helped to cushion the transitional crisis, eventually became a constant element of the socio-economic structure. This is one institutional problem.

Another problem is the structural limitations of the Russian economy. These are connected with the large non-market segment in our economy, and with our lop-sided involvement in the world economy. The share of exports in our GDP is around 40 per cent; which is one of the highest in Europe. Historically, the establishment of large diversified holding companies was connected with many factors, and large enterprises played a dominant role in the planned economy. The structural problems of the Russian economy are also connected, of course, with the peculiarities of the national privatization model. In the Russian economy the development of big corporations has therefore taken a different path from the other Central and East European countries, because in our case the old state enterprises were restructured and made into profitable ventures operating in competitive markets without heavy foreign direct investments and the establishment of large numbers of new companies. By contrast, in the other Central and Eastern European countries the main recipe was foreign direct investment, green field construction, and the development of new companies.

Our case is different. One of the characteristic figures of our big businesses is the over-concentration of industrial production. As shown in Table 1, the ten biggest integrated business groups (IBGs) produce close to 35 per cent of industrial output in our country. The corresponding figures for Western countries are 27 per cent in the United States, 15 per cent in Germany, and 30 to 32 per cent in Japan and Republic of Korea.

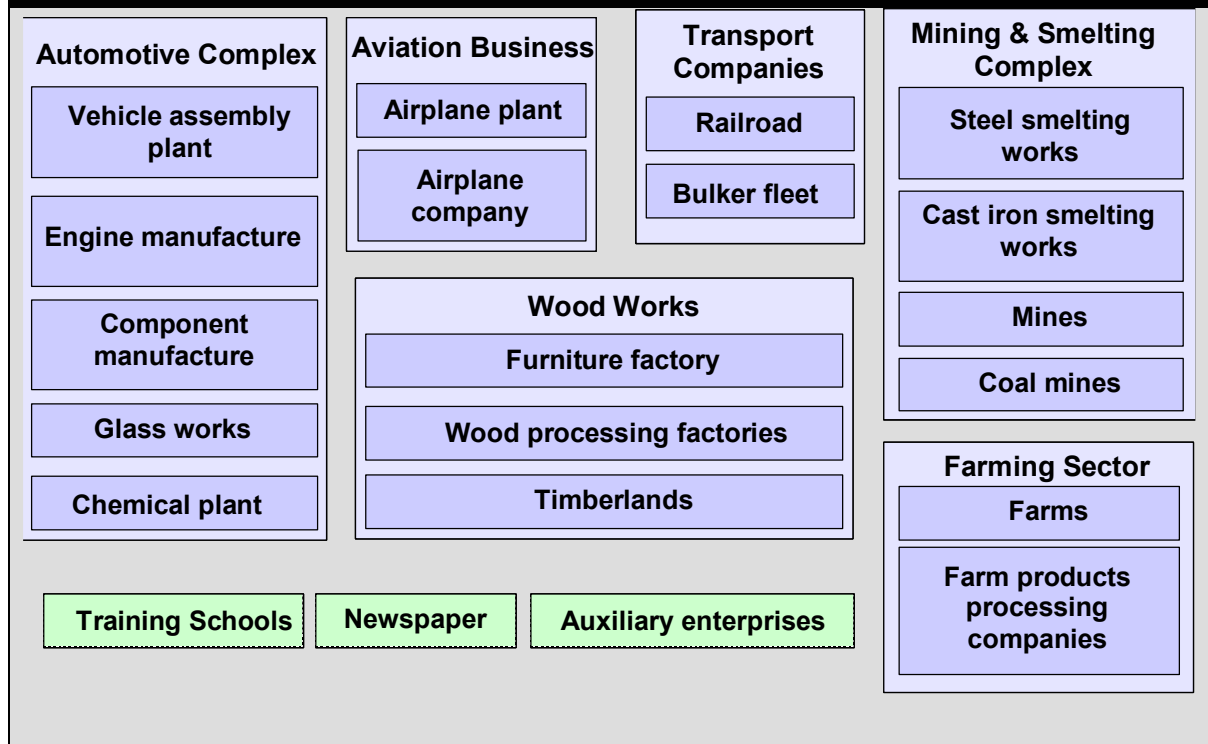
**Table 1. Industrial output**

	<b>Billion of rubles</b>	<b>%</b>
<b>Gross output</b>	<b>5,881.0</b>	<b>100.0</b>
<b>Natural monopolies</b>	<b>820</b>	<b>13.9</b>
Electricity	454	7.7
GAS	366	6.2
<b>Ten largest IBGs</b>	<b>2,432.9</b>	<b>41.4</b>
Lukoil	445.1	7.6
Menatep	314.6	5.3
Interros	223.8	3.8
Surgutneftegaz	179.3	3.0
Alfa-group – Access-Renova	393.8	6.7
Basic Element Company	274.3	4.7
SeverStal	85.0	1.4
Sistema	178.0	3.0
AvtoVAZ	231.0	3.9
MDM Group	108.0	1.8
<b>Others</b>	<b>2,628.1</b>	<b>44.7</b>

The structure of big Russian IBGs is such that the core business is protected by a ring of supporting organizations. The structure of the Ford motor company in the late 1920s, as shown in Figure 2, shows a certain similarity with the structure of current Russian companies because, beside the core-business of automotive production, it included airplane production, furniture, and even agriculture.



**Figure 2. Ford Motor Company**



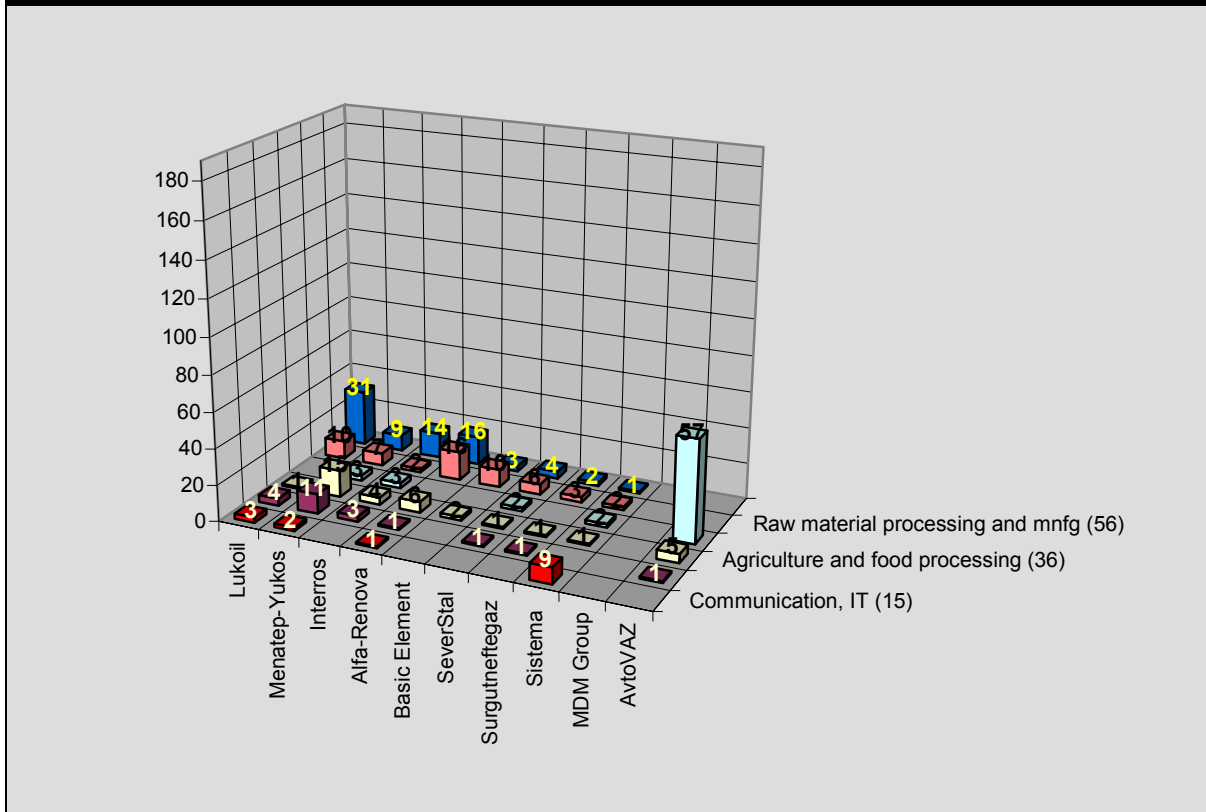
It is understandable that Mr. Krkoska very clearly demonstrated the role of small and medium enterprises in the development of Central and Eastern European companies. In this connection I would like to draw your attention to the importance of the different financial structure in the country and the low level of development of financial institutions in Russia. In our case, the problem is that we have very weak financial institutions. Our banking system did not undergo major reforms after the crises, and the capitalization of all Russian banks is close to 6 per cent of GDP. Pension funds, insurance companies, etc. are not yet able to play the role of financial intermediaries. Only 25 per cent of the shares of Russian enterprises are traded on the organized stock exchange. All mergers and acquisitions happen outside the stock exchange. In the Russian situation, the big companies work outside the financial intermediary institutions.

Let me present some statistics, in Figures 3 and 4, to demonstrate how sustainable those companies were during the financial crises. If one looks at the sectoral structure of Russian companies in 1996, one sees that they were concentrated in mining and raw materials. Six years later, those figures look very different, as those companies had switched to investment in communication, agriculture, and machine building. Their restructuring has caused them to move towards the more value-added sectors.

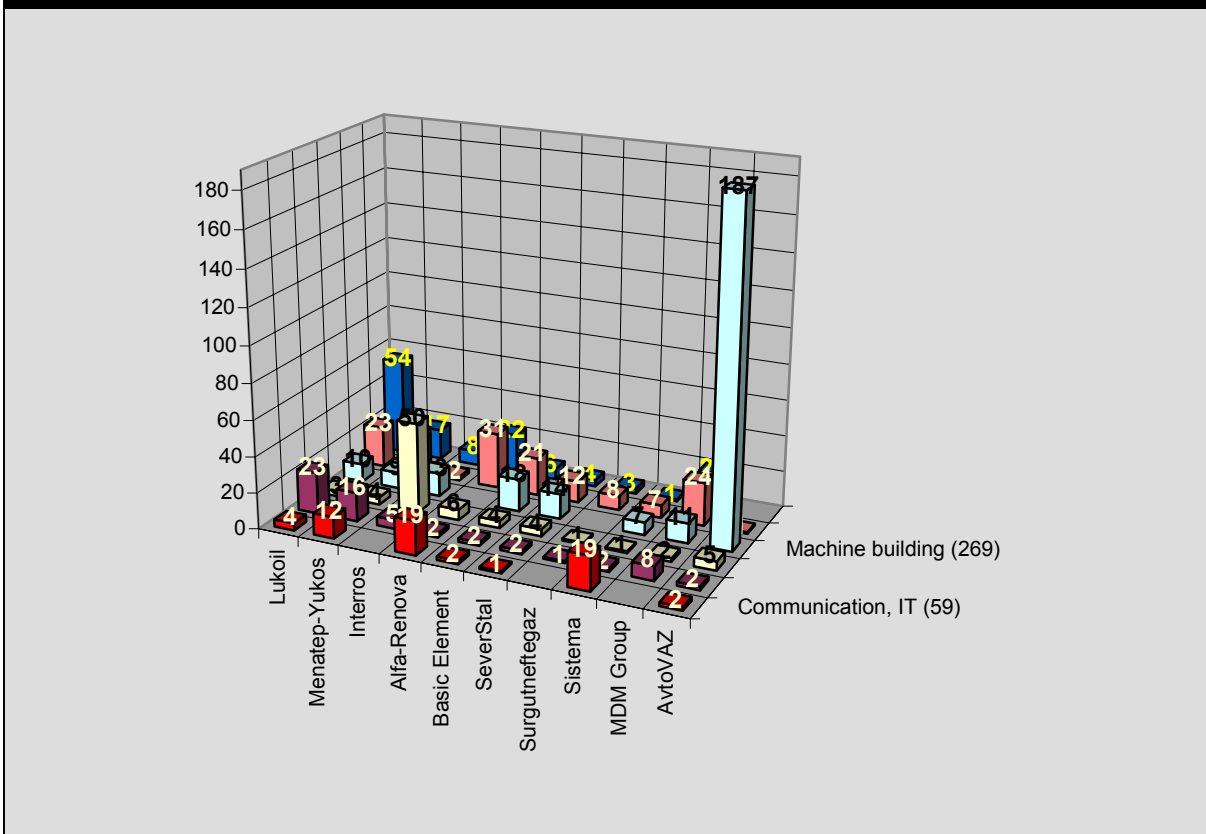
Another feature is the very strong regional expansion that took place in the past ten years, and in which the big companies played a substantial role.

I have also tried to chart the institutional impacts of the development of the big Russian companies in Table 2. This shows some positive elements and, of course, several negative ones. The most serious negative influences have been the prevention of horizontal economic diversification, the localization of economic relations within the IBG networks, and the prevention of horizontal economic ties. Some very simple scenarios of the possible future path of the development of Russian companies are the persistence of the IBGs, leveraged buyouts, and disintegration.

**Figure 3. Number of industrial IBGs by sector, 1996**



**Figure 4. Number of industrial IBC's by sector, 2002**



**Table 2. Institutional impacts of corporate restructuring in Russia**

<p>POSITIVE</p> <ul style="list-style-type: none"><li>• Adjustment of big enterprises to markets.</li><li>• Reduction in transaction costs; mediation between individual companies and imperfect markets.</li><li>• Mediation between IBGs, foreign partners and the authorities.</li><li>• Improved economic control and stability; erosion of the economic basis for separatism.</li></ul>
<p>NEGATIVE</p> <ul style="list-style-type: none"><li>• Excessive concentration of manufacturing and capital.</li><li>• Localization of economic relations inside the IBGs.</li><li>• Prevention of horizontal economic ties.</li></ul>

To conclude, I would like to say that such developments as social responsibility or corporate citizenship are very important today in the current political circumstances. In my paper you will find an annex demonstrating some programmes in the area of corporate citizenship. This instrument and the programme developed by UNIDO are very important for us today. The second point is that such processes as foresight or technological foresight are valuable since they produce a consensus between public and private stakeholders. Those approaches are important for Russia, and we greatly welcome UNIDO's initiatives in this regard in Russia.

# Russia's Economic Transition: Preliminary Outcome

*Alexander A. Dynkin\**

## Introduction

The 20<sup>th</sup> century, which proved to be dramatic for Russia in every way, has come to a close. In 1917, Russia missed a perfect opportunity for industrializing the country – a very realistic goal at the start of the last century. Today, is it possible for Russia to make up for the lost opportunity and bridge the structural, institutional, technological and cultural gap between itself and other countries? I am optimistic that this scenario can be achieved, as the turn of the century has ushered in many of the necessary prerequisites for a swift and historical modernization programme: A predictable political leadership which enjoys the strong support of a majority of the population; the formation of basic democratic and free market institutions; and the establishment of valuable partnerships with the developed part of the world, all built on the foundation of commonly shared values. Other favourable factors include the development of information technologies, which make various types of knowledge available to every person in “real time”.

There is no doubt that Russia possesses very good chances for a robust recovery. Few countries have yet made such energetic strides in initiating a programme of modernization in this global, post-industrial period of development. Nevertheless, despite the progress, Russia still has many problems that it must resolve. In the 1990s, Russia and the rest of the world changed dramatically.

Therefore, this paper will focus on the economic reforms in Russia over the past decade, as well as the future prospects of the Russian economy in the context of the international trends prevailing in the early 21<sup>st</sup> century.

## Current trends

Today, the Russian economy continues to grow at a healthy pace. Since the financial crisis of August 1998, it has surged by almost 30 per cent, with an average annual growth of 6 per cent in 1999-2003. The annual growth rate for 2000 stood at an impressive 10 per cent, a record high since World War II. Yet, despite these high growth rates, Russia's gross domestic product (GDP) amounted to only 70 per cent of its 1990 level in 2002. In order to achieve the 1990 level by the year 2010, Russia's GDP must grow by an annual average of 4.3 per cent – a seemingly realistic objective for the Russian economy. Understandably, the structure of Russia's GDP will be very different, consisting mostly of goods and services from the market segment of the economy intended to meet household, export, state and production needs. At the same time, the percentage of defence-related production within the GDP will be drastically reduced.

According to estimates by the Institute of the World Economy and International Relations (IMEMO), Russia's GDP in 2002 amounted to 2.8 per cent of the global aggregate. In the previous 40 years this share has declined continuously, both for Russia and for the former Soviet Union. In 1980, this figure stood at 11.5 per cent for the entire Soviet Union, and 7 per cent for Russia, which was a constituent republic of the Soviet Union at the time. A decade later, the figures stood at 9.1 and 5.5 per cent, respectively. Interestingly, Russia's per capita GDP has traditionally exceeded that of other countries, and the world as a whole. In 1980, it was 120 per cent higher than the rest of the world's figure. Ten years later, it was 100 per cent higher, and at the turn of the century it was higher by only 10 per cent.

---

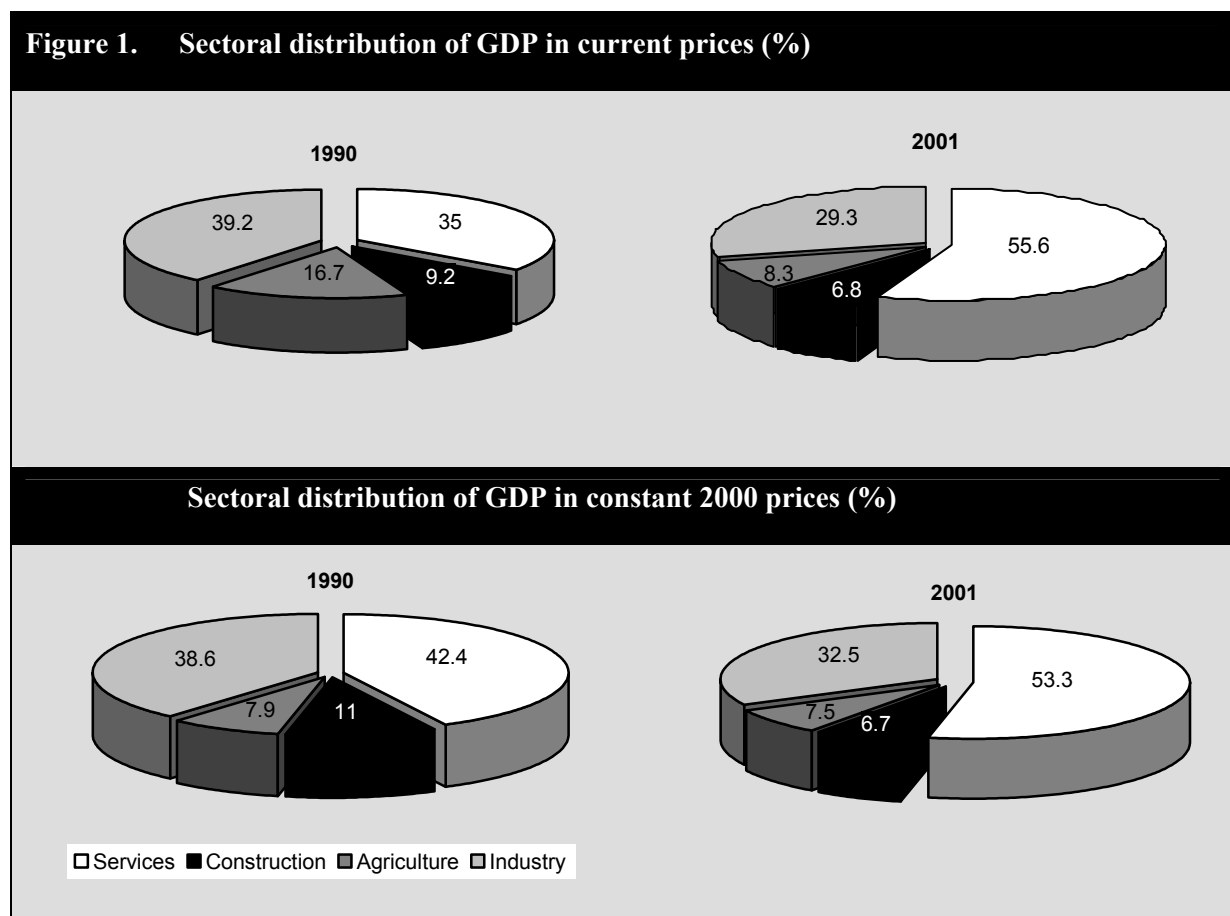
\* First Deputy Director, Institute of World Economy and International Relations (IMEMO).

By 2015, Russia's per capita GDP is expected to be 15-20 per cent higher than the 2000 figures recorded for Greece or Portugal, but is predicted to be 30-35 per cent lower than these countries' 2015 data.

Russia is highly involved in the world economy and international labour markets – its share of exports in GDP exceeds 40 per cent, based on current exchange rates. The decline in the growth rate of international trade, which plummeted to practically zero in 2001-2002, was especially painful for those countries which export mostly raw materials. The more diversified structure of Russian exports, however, made this effect less destructive for the Russian economy. In the first half of the 1990s, Russia missed an important opportunity for growth while the rest of the world economy was enjoying fantastic gains. Presently, the most rational strategy for Russia would be to restructure the sectoral distribution of its economy while raising its labour productivity, which will enable it to participate in the new cycle of economic growth around the world.

### Changes in the sectoral distribution

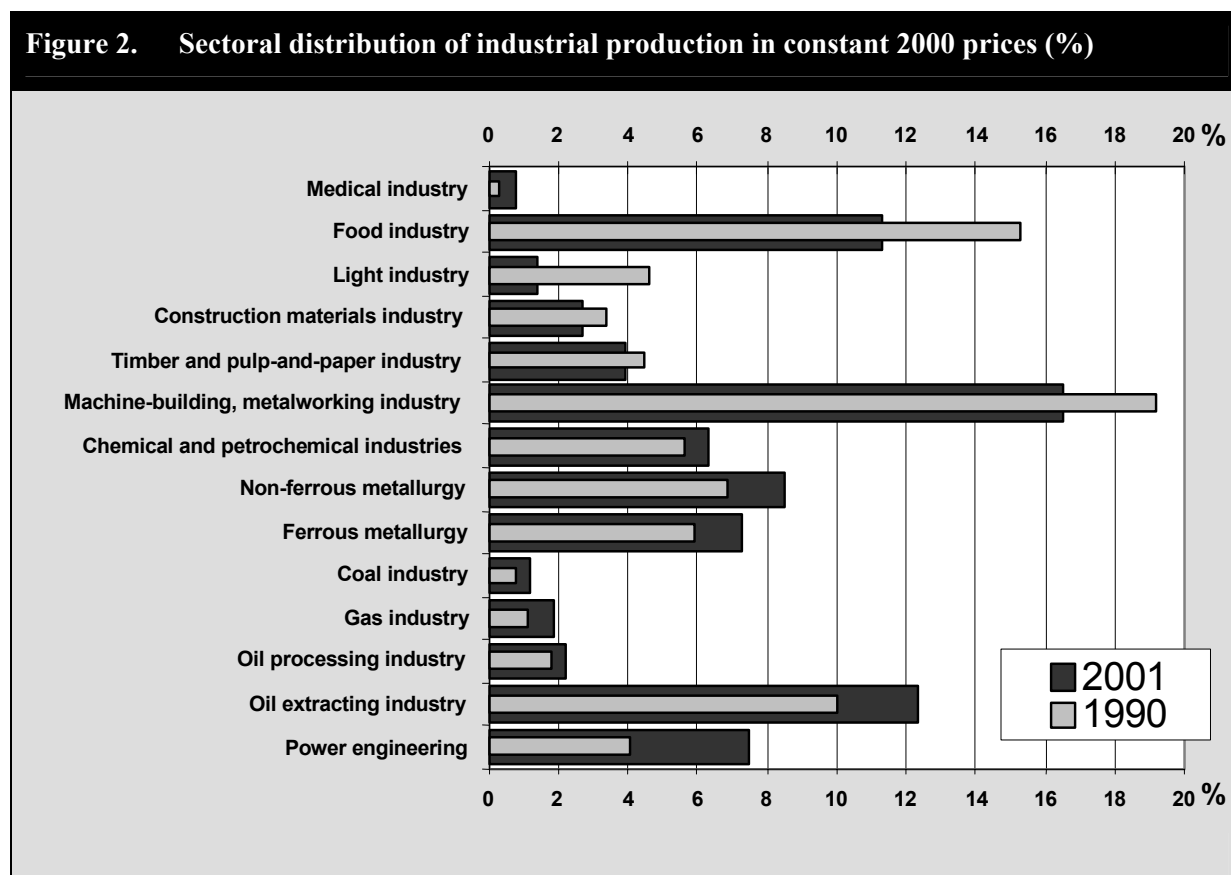
In 1990-2001, the sectoral distribution of the Russian economy changed dramatically both in terms of the GDP and industrial production, as shown in Figures 1 and 2.



Source: Socio-Economic Status of Russia in January-March (2002), p. 10; Rossiisky Statistichesky Yezhegodnik (2001), pp. 279-301.

The figures in current prices demonstrate that the sectoral distribution of the Russian economy is approaching that of the USA, Western Europe and Japan: The percentage of the industrial production sectors in the economy has decreased by 1.5 times, while the service sector's percentage has increased

1.6 times. However, this shift did not necessarily take place because of an accelerated development of the service sector, but because material production decreased more than non-material production – by 42.4 and 30 per cent, respectively. In addition, prices in the service sector have been increasing faster than consumer prices – by 28,000 and 17,000 times from 1990, respectively. Dramatic changes have also occurred in the structure of various industries, as shown in Figure 2.



Source: Rosiisky Statistichesky Yezhegodnik (2001), pp. 337-372.

As follows from Figure 2, the imbalance in the sectoral distribution in favour of industries producing capital goods, which emerged in Soviet times, has remained to this day. In 1990, capital goods industries accounted for 74 per cent of all production in the country, while consumer goods industries accounted for only 26 per cent. By 2001, the proportions had changed only slightly – to 75 and 25 per cent, respectively. The only distinction from the former times is the percentage of machinery and other equipment in the capital goods group, which had decreased to 21 per cent in 2001 from 42 per cent in 1990. At the same time, the percentage of raw materials, semi-finished goods and fuel/energy resources increased from 58 to 79 per cent in the same group (in constant prices). In current prices, considering an accelerated increase in capital goods prices, the production of capital goods represented 83 per cent of all goods, of which machinery and equipment accounted for less than 20 per cent.

According to employment statistics, the service sector (especially trade) now employs an increasing number of people who have lost their jobs in the non-competitive industrial sectors. Over the past ten years of reforms, employment in trade has doubled, bringing Russia's production and employment structures closer to those in the West.

The changes in the employment distribution in industry reflect changes in the sectoral distribution. Characteristically, whereas employment in Russia's industry as a whole has decreased by 42 per cent,

it has increased by 160 per cent in the gas industry, 80 per cent in the oil industry, and 20 per cent in the medical industry.

The fluctuation in prices, which brings about a considerable divergence between values for the sectoral distribution of industry calculated in current and constant prices has already been mentioned. Price changes have become a major way of redistributing incomes among producers in various industries.

Apart from the aforementioned differences between the rate of price increases for goods and services, there is a disparity of more than 100 per cent between the growth rates of industrial product prices (which have surged by 17,000 times) and the prices of agricultural products (which have increased by 7,800 times). This discrepancy greatly impedes Russia's ability to modernize the technical facilities of its agricultural sector.

### **Decline in labour productivity**

By 1999, when the Russian economy really started to grow, GDP had decreased by 40 per cent, while employment had decreased by only 15 per cent. The cautious policy of owners and managers in industry towards staff reduction and redundancies helped to preserve social and political stability throughout the country, and can therefore be considered a justified action.

As a result, however, labour productivity – an important index of a country's economic development – decreased markedly in many sectors of the economy, thus relegating Russia to a second-class status. Over the past decade, labour productivity has increased in only two industries: In the coal industry it has risen by 40 per cent, and in machine-building by 23 per cent (Figure 3). Obviously, this increase was caused by an accelerated staff reduction programme, as opposed to any actual growth in output.

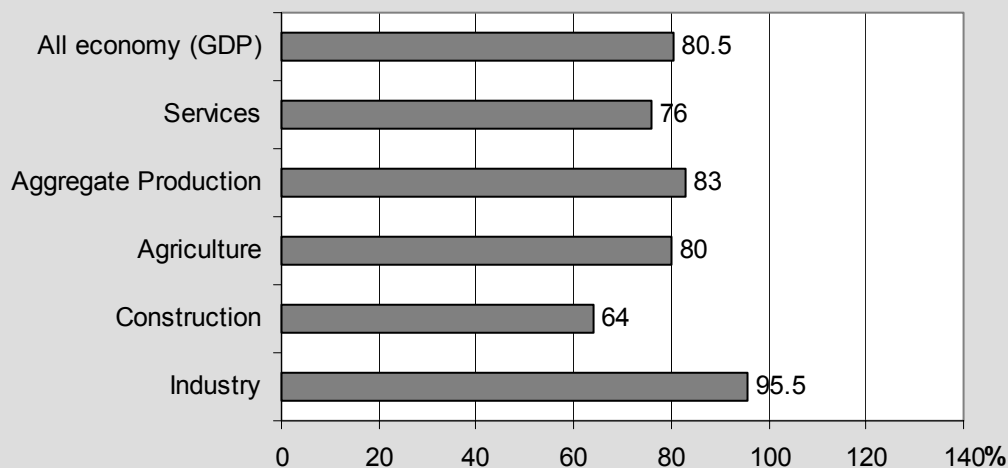
### **Income differentiation of the Russian population**

In all of the post-communist countries of Central and Eastern Europe, the period of transition to a free market economy was characterized by a simultaneous and proportionate decline in production, which corresponded with a decline in the population's aggregate income. Russia presented a remarkable exception to this rule: Between 1990 and 2001, Russia's GDP decreased by 30 per cent, whereas retail trade, the main income-spending channel, went down by only 2.5 per cent. The Russian population's aggregate income in 2001 stood at 94 per cent of the 1990 figure, a decrease of a mere 6 per cent. On the face of it, this figure contradicts other statistics. For example, the average salary in 2001 stood at 60 per cent of the 1990 figure, while the average pension was less than half the 1990 size. This paradox is explained by an increased income differentiation of the Russian population, a huge "grey" zone of income distribution, which together brings a remarkable gap between the rich and the poor. Over the years of reform, the aggregate income of the wealthiest 10 per cent of the Russian population (tenth decile) has increased by 50 per cent; the income of the next 10 per cent (ninth decile) has remained at pre-reform levels; and the income of the other 80 per cent of the population (116 million people) has decreased, on average, by 25 per cent. A more detailed breakdown of these statistics shows that the income of 30 million people decreased by 40 per cent, and that of another ten million, by half.

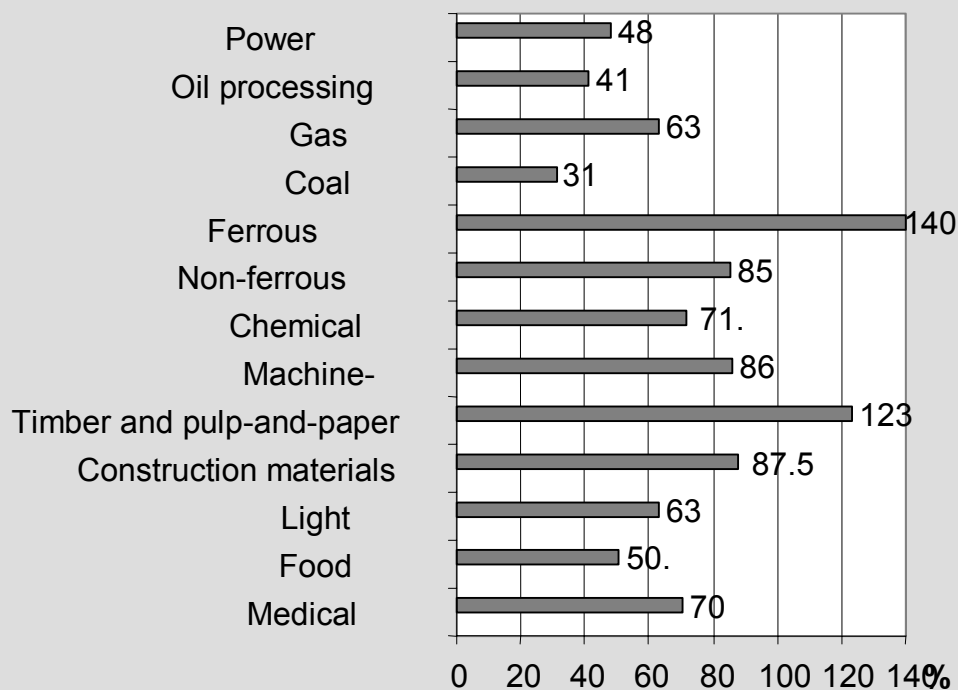
These statistics reveal an obvious trend: Until the 1998 financial crisis, the percentage of the wealthiest 10 per cent of the population enjoyed a steady and marked increase in income, while all the other groups of the population grew steadily poorer (especially deciles 1-5; i.e. the poorest 50 per cent of the population). The 1998 financial crisis caused a shift in the income redistribution pattern. The income of the tenth decile decreased markedly, as did the overall percentage of this group as a whole. Consequently, the percentage of the population who fell between the fourth to ninth deciles increased. On the whole, the income disparity between the first and the tenth deciles, which was 4.65 times in

1990, increased to 16 times by 2001. This is less than the corresponding figure for the USA, but higher than in Western Europe. The absolute per capita income level in the 1<sup>st</sup> decile (the poorest 10 per cent of the population) in Russia is about ten times lower than it is in the United States, and approximately seven times lower than in Western Europe.

**Figure 3. Labour productivity in the Russian economy in 2001 (% of 1990)**



**Labour productivity in Russian industries in 2001 (% of 1990)**



Source: IMEMO estimates based on data compiled by State Statistics Committee.



The gap between the richest and the poorest decile groups of the Russian regions in terms of per capita gross regional product (GRP), which stood at 3.1 times in 1990, had increased to 3.85 times by 2001. In per capita GRP, the regions of the richest tenth decile group have now approached the post-communist countries of Eastern Europe such as Poland or Slovakia, whereas the poorest first decile group of regions remains at the level of Ecuador, Peru or Sri Lanka.

## **Economic discussions and real opportunities**

Inside Russia's economic circles there is an ongoing discussion over the best strategies for further development.

Proponents of *dirigisme* (government control in the economy) propose giving up the liberalization programme, first enacted under Yevgeny Primakov (e.g. equal competition terms, balanced budget, low taxes, abandonment of foreign loans, the strengthening of legislation and its application). These individuals propose a substantial increase in the tax burden for export-oriented sectors of the economy, and for a redistribution of resources in a centralized way. This programme would favour manufacturing industries, machine-building, the aircraft industry, the automotive industry, and others.

By contrast, the adherents of the liberalization school argue that the quality of growth based on structural changes is no less important than the quantitative growth rate figures. They explain the present problems facing the Russian economy as being due to the current recession in the world economy, ineffective and excessive meddling in enterprises (especially at the regional level), and the presence of non-transparent sectors that are counterproductive to a free market economy, and a weak legal system, especially in terms of the protection of property and contractual rights. They propose to continue developing the institutional environment, pursuing legal, administrative and military reforms, and reducing the scale of certain sectors within the economy that do not conform to free market principles. Furthermore, they suggest reforming the natural monopolies, developing the financial system, supporting small and medium-scale businesses, enhancing the effectiveness of budget spending to reduce the load on the budget, and preventing an increase in the ratio between budget spending and the GDP. This policy can and must keep the GDP growth rate at 5-6 per cent – with natural cyclical fluctuations. After the phenomenally rapid post-crisis revival of the Russian economy, each percentage point of the rate of GDP growth is acquiring special importance.

At the same time, it must be admitted that the architects of the economic policy of the 1990s did not set themselves the vital goal of bridging the technological gap between Russia and the developed (and even some developing) countries. Nor did they rescue Russia from its dependence on oil and gas exports, which began as far back as the 1970s.

Since then, the world has made tremendous headway into new markets. Ireland and India have achieved phenomenal success in software exports, while in recent years Mexico, Thailand and Malaysia have become net exporters of information technologies. However, it seems that the business planners inside Russia is tossing about in the “Bermuda triangle” of trade in chicken, steel and second-hand foreign-made cars. It must be recognized that by 1997, world trade in information technologies and equipment already exceeded the world's trade in motor vehicles, rolled steel and food as a whole.

The difference in living standards between the rich and poor countries today stems from high technologies which are indicative of the competitiveness of socio-political systems, public institutions, national economies, businesses and industries. The start of the 21<sup>st</sup> century is witnessing the emergence of a new paradigm of technological development. It consists of the growing interdependence between capital markets and new technologies; the swift development of what is now called the “knowledge-based economy” or “new economy;” a stronger social orientation of the new

technologies; and the global nature of the creation and employment of new knowledge, technologies, products and services.

Several circumstances may help to boost innovative activity. Demographic restraints, and the need to spend more and more funds to support an aging population, have confronted the developed countries with the problem of manpower resources. This is an especially vital consideration when viewed in the context of inevitable limitations on migration. Other acute problems facing the world include improving the quality of the environment, overcoming dangerous climatic changes, developing the public health and educational systems, and ensuring safe labour and living conditions. In the face of these daunting challenges, it becomes more obvious that innovative activity is a necessary factor for developing the economic prospects of a country.

### **The corporate sector: avoiding institutional and structural traps**

An analysis of transitional changes in the economy involving various sectors will not be sufficient if it fails to cover certain peculiarities of big business development in Russia. Russian corporations now occupy 36 positions in list of the 100 largest East European companies. This development is one of the few positive results of the decade of reforms.

The Russian model of a market economy, which took shape at the turn of the 21<sup>st</sup> century, has two fundamental limitations or traps: Institutional and structural. The system of state and market-economy institutions has entered a relatively stable transitional state. Many informal, shadow-type ties, which initially were a major shock-absorber for the shock-therapy approach to economic transformation adopted by the government and helped to cushion the transitional crisis, eventually turned into a constant element of the socio-economic structure. Formal institutions, although steadily developing, are not yet able to operate in automatic mode. This has resulted in a segmentation of markets on the one hand, and in the narrowing of the time frame for economic decision-making on the other. In other words, economic ties characterized by low transaction costs are possible only between enterprises included in a network whose members trust one another. Large Russian corporations or integrated business groups (IBG) represent one such type of networks.

The structural limitation of the Russian economic model stems from the survival of a large non-market segment in the Russian economy, as well as from Russia's lop-sided involvement in the world economy. Only the energy, extractive and defence industries can compete on the world markets. In the service sector, a high level of competitiveness is demonstrated by the retail trade and the consulting and advertising companies, as distinct from banks and insurance companies. The situation may improve if the IBGs shift the focus of their business activity from fuel and other raw material commodities toward products and sectors with an increasing value added.

The author of this paper and a group of his colleagues have made an extensive study of Russia's corporate sector based on original corporate statistics compiled by the authors (Dynkin & Sokolov 2001, 2002). This ongoing survey is focused on the ten leading Russian corporations in terms of sales: LUKoil, Menatep, Alfa-Group – Renova, Bazovy Element, Interros, SeverStal-Group, Sistema, Surgutneftegaz, AvtoVAZ and MDM Group. Their sales volume are given in Table 1.

Historically, the establishment of large diversified holding companies or IBGs was a result of the combined effects of many factors. These include the domination of large enterprises in the planned economy (dependency path); peculiarities of the national models of privatization chosen in the 1990s (spontaneous and mass voucher privatization, and privatization through credits for shares auctions) and, as a result, the predominance of the governmental-private form of ownership in the economy (almost two-thirds of all assets in Russian industries belong to this form of ownership, imperfect from the viewpoint of corporate governance), and the rather unique bankruptcy procedures.

**Table 1. Sales volume of top ten IBGs, 1998-2002 (billion roubles, current prices)**

	<b>IBG</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
1	Menatep	68	103	252	315	580
2	LUKoil	154	298	406	445	488
3	Alfa-Group – Renova	55	108	174	394	436
4	Bazovy Element	30	100	155	274	226
5	Surgutneftegaz	72	155	171	179	211
6	AvtoVAZ	46	120	180	231	193
7	Interros	90	133	184	224	185
8	Sistema	30	56	147	178	178
9	SeverStal-Group	34	53	79	85	111
10	MDM Group	20	35	67	108	108

Source: IMEMO estimates based on corporate statistics.

Large Russian businesses, investing their own capital, have successfully carried out an intensive restructuring of their facilities. This process has not corresponded with the standard methods for a post-communist transformation in Central and East European Countries. Old state enterprises have been restructured and made into profitable ventures operating in competitive markets without the heavy financial support of foreign investors, and without new big construction projects.

Today, in the new Russia, the role of IBGs in adapting large enterprises to the market economy is difficult to overestimate. In former times, a large enterprise was basically an entity geared toward pure production. Economic, financial and personnel considerations, not to mention such issues as the structure of output, the cost-effectiveness ratio, and the search for new markets, were all solved “from the outside.” Today, enterprises supported by IBGs overcome their transformation shocks with fewer difficulties than other enterprises. This is due to the fact that they have investment and marketing partners, and are provided services for strategic planning, personnel recruitment, public relations, etc.

The specific nature of this institutional environment results in the establishment by IBGs of their own economic and financial structures: Banks, marketing organizations, insurance companies, and non-state pension funds. Such “self-sufficiency” was typical of large conglomerates in the U.S. in the first half of the 20<sup>th</sup> century, and of West European companies in the 1950s. It is also very reminiscent of Japanese companies in the 1950s-1960s, and present-day chaebol companies of the Republic of Korea.

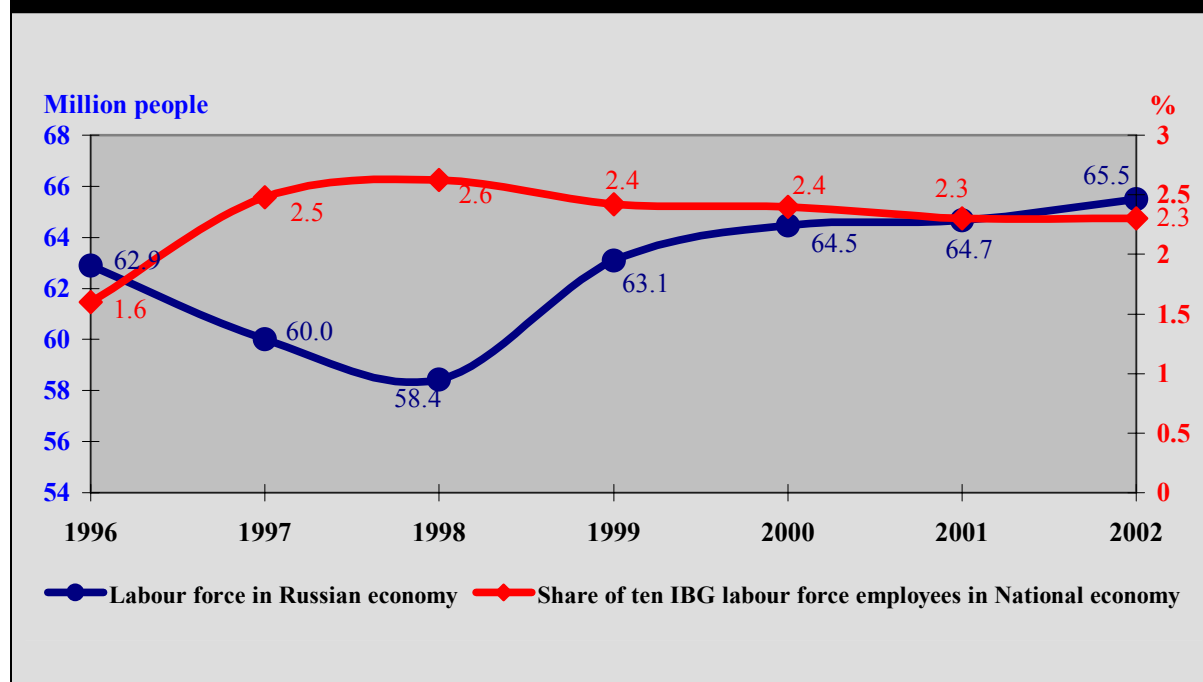
Russia’s industry is now marked by what could be termed “hyperconcentration”: In 2001, ten companies produced 41.4 per cent of all industrial output in the country. In the United States, the ten largest companies account for 27.4 per cent of industrial output, and in Germany this figure stands at 15 per cent, while in Japan and Republic of Korea it accounts for 30-32 per cent.

On the whole, the establishment of IBGs in the formation of the corporate sector in the developing economies seems to be a historically consistent pattern of development. Yet, some experts are beginning to express fear over Russia’s “chaebolization”. Their concerns stem from an obvious threat to the freedom of competition and a resultant inefficiency of inter-sectoral redistribution of resources, from state interference in the “selection” of “national champions” and, finally, from the limitations which could be unwittingly imposed on political democracy. Theoretically, such expectations have legitimate grounds, and the experience of the Republic of Korea has confirmed these fears in practice. It is also widely believed that the expansion of IBGs impedes the development of small and medium-scale businesses.

This is all true, but reality shows that in the next ten years, due to historical inertia, Russia will have no choice but to confront the situation. Among the businesses that survived the acute financial and economic crisis of August 1998, the diversified groups proved to be the only institutional structures that did not reduce their personnel during that difficult period (Figure 4). At the same time, the

banking reform has produced no marked success over the five years that have passed since the crisis. Non-state pension funds, according to numerous expert estimates, will not be able to perform the function of financial intermediaries for another seven to eight years. The role of insurance companies as potential investors will remain questionable for the foreseeable future. Organized capital markets (stock-exchanges) are responsible for no more than 25-35 per cent of the shares traded. All other merger and acquisition deals go through direct purchase. The capitalization of the entire Russian stock market now amounts to some US\$ 145 billion, or about equal to the market value of one of the top 100 corporations listed in the FT Global-500 list of the world's largest companies (Table 2).

**Figure 4. Share of IBG personnel in total number of employees**



**Table 2. Ranking of selected companies in the FT Global 500 list, 2003**

Rank	Company	Country	Market value US\$ million	Business sector	Revenue US\$ million
1	Microsoft	USA	264,003.20	Software, services	28,365.00
2	General Electric	USA	259,646.90	Diversified industrial company	130,685.00
3	Exxon Mobil	USA	241,036.50	Oil and gas	204,506.00
4	WalMart Stores	USA	234,398.60	Retail trade	244,524.00
5	Pfizer	USA	195,948.00	Pharmaceuticals, biotechnology	32,373.00
144	Yukos	Russia	22,079.10	Oil and gas	9,590.10
169	Gazprom	Russia	19,284.50	Oil and gas	18,758.40
280	Surgutneftegaz	Russia	12,293.50	Oil and gas	5,215.80
294	Lukoil	Russia	11,839.80	Oil and gas	14,831.70
375	Sibneft	Russia	9,672.30	Oil and gas	3,575.70

Source: Financial Times, FT Global 500, 2003.

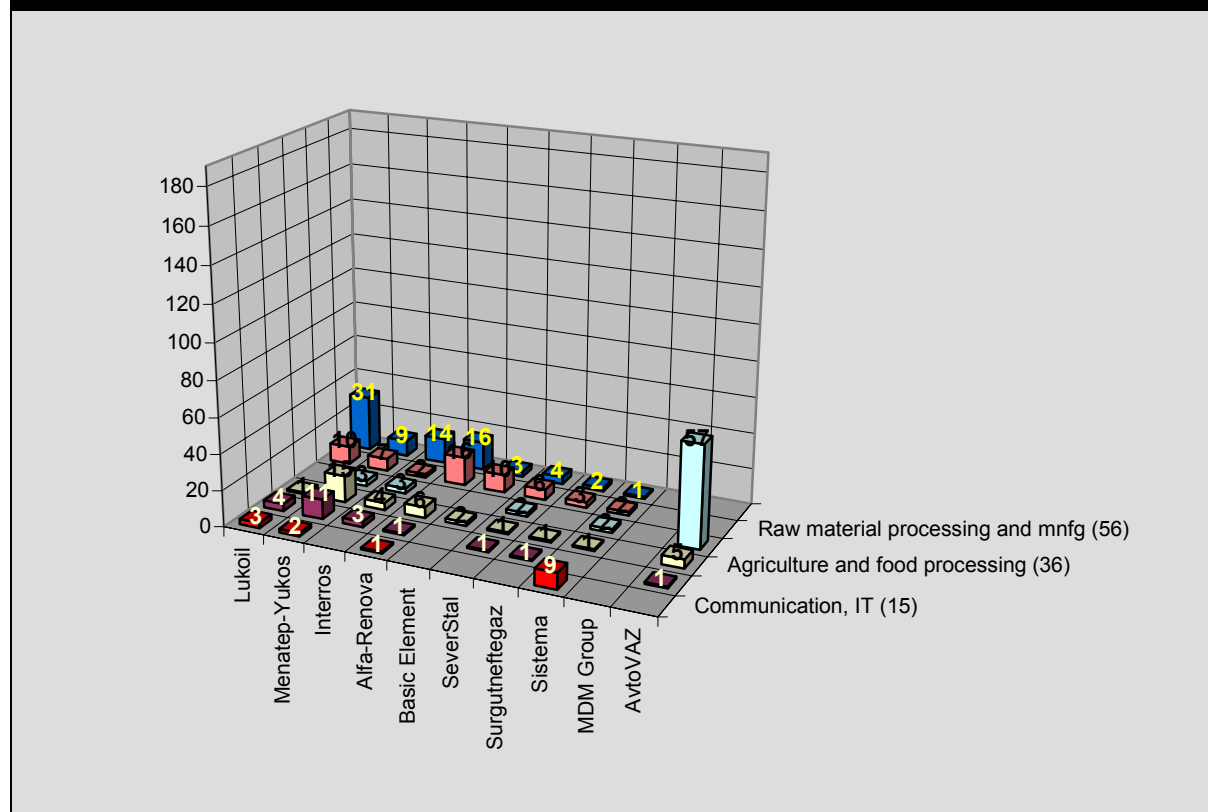
For the next few years large IBGs will therefore remain the only institution capable of making large investments. Simultaneously, these groups will replace the standard institutional and financial structures that are lacking in Russia as in other emerging markets. According to various estimates, the establishment of such structures may take another 10-15 years.

It is important and possible for Russia to borrow time-tested legislative standards from other countries. However, their application will always acquire specific national features. Improving judicial applications will also take much time, as it will require upgrading specific skills and changing many stereotypes and traditions marked by high levels of inertia. The prolonged problems associated with the introduction of international bookkeeping standards in this country go a long way towards confirming this argument.

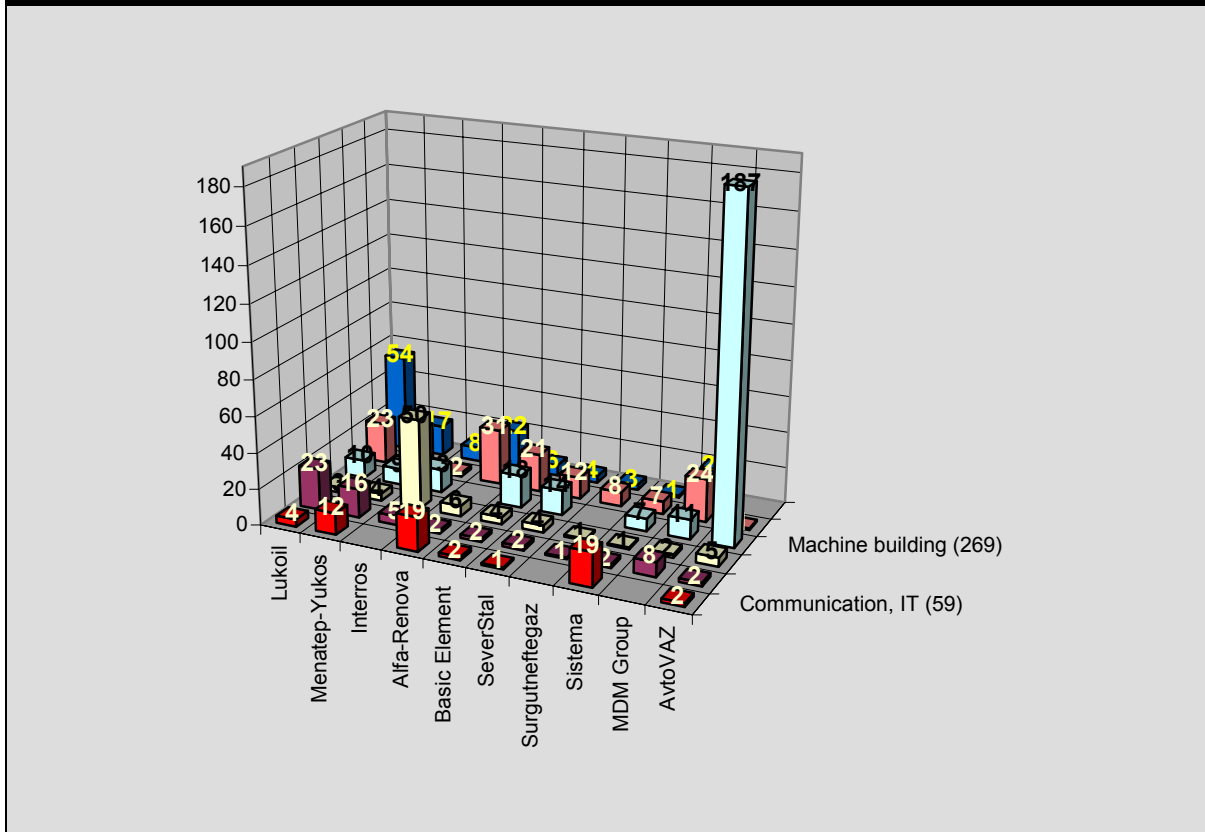
The illusions about Russia's investment attractiveness have proven to be false. At the previous stages of transformation, the government lost a chance to attract foreign investment into the country. Without elaborating on the reasons for that missed opportunity, I would like to point out that business-to-business ties will now play a decisive role in attracting foreign capital. It is only the IBGs that have a real capability for attracting foreign capital by selling them blocks of shares, inviting them to participate in joint financial or business projects, and establishing other kinds of strategic alliances with them, inter alia in the high-tech sectors of the Russian market. The deal concluded by British Petroleum and Russia's TNK Oil Company, predicted in advance by analysts, offers a practical example of such a tendency.

Many IBGs have recently been moving capital between different sectors of the economy, giving preference to industries with an increasing potential for value addition (Figures 5 and 6).

**Figure 5. Number of industrial IBG's by sector, 1996**



**Figure 6. Number of industrial IBG's by sector, 2002**



Importantly, IBGs in Russia have legal entities, branches and production facilities in various regions of the country. This process of regional expansion is continuing. Whereas in 1993 LUKoil operated in five Russian regions, this figure increased to 44 by 2003. Between 1993-2001, the corresponding figures for Interros are one and 23, and for the Alfa-Group two and 43 (Table 3).

**Table 3. Regional expansion of IBGs, 1993-2003 (number of legal entities)**

10 Top IBG	1993	1995	1997	1999	2001	2003
Lukoil	5	15	23	22	41	44
Alfa-group – Access-Renova	3	8	8	38	46	43
Menatep	10	15	22	28	38	47
Basic Element Company	-	-	-	16	26	31
Interros	1	11	15	23	25	23
Surgutneftegaz	3	4	7	9	11	11
Sistema	1	13	21	38	43	49
SeverStal	-	3	5	8	29	30
AvtoVAZ	33	34	45	55	66	66
MDM Group	1	2	11	22	25	21

Source: IMEMO estimates based on corporate statistics.

The IBGs are therefore objectively interested in consolidating the single economic space and unifying the legislative environment. These interests help to enhance the manageability and stability of the economy, and to remove the economic factors that give rise to separatist trends.

A favourable and realistic scenario for the development of large Russian corporations includes the transformation of the IBGs into highly diversified and transparent public industrial corporations, which will supply a wide range of products and services to the market. Gradually, as standard corporate control procedures are established, the owners will depart from direct participation in the management process and focus more on investment. This optimistic scenario requires that the state actively strengthen its procedures for protecting property (including intellectual property) and contracts, and guarantee the competitiveness of the country's leading companies. With the formation of the institutional environment and a system of financial intermediaries, more sophisticated businesses (related to machine-building and high technologies) will become its core, while the oil-extracting and metal-producing businesses, which began as the state's "cash cows", will develop into full-fledged independent corporations. IBGs such as Bazovy Element, Interros and Severstal-Group are already developing according to this scenario.

To overcome institutional and structural limitations, the interests of two main agents of modernization – the state and big business – must be brought into line. In my view, standard market processes and institutions typical of the European Union will not allow the Russian economy to make up for the time lost in the 20<sup>th</sup> century. Rather, a more competitive strategy based on energy exports and innovations would be more rational for the new decade. On the one hand, it would provide for a more liberal economic policy than that pursued by EU states, and on the other hand, it would provide for the formation of a simple yet rigid system of institutional signals sent by instruments of the tax, credit, customs, license, regional and sometimes administrative policies. These signals must encourage private investment in the high-tech sphere. Their borrowing and investment in human capital must also be aimed at enhancing national competitiveness and forming the structures and regional groupings of the post-industrial economy.

The redistribution capabilities of the federal and regional budgets should be concentrated on the development of education, fundamental sciences, public health, and the infrastructure of the post-industrial economy. Clearly, state policies, aimed at improving the competitive climate, corporate transparency and building financial institutions will provide the necessary preconditions for the positive development of Russia's corporate sector.

As for big business itself, some "infant" cases of charity and social responsibility recently implemented by some companies (see Annex) will have to be developed into a constant and systematic corporate citizenship approach.

## References:

Dynkin, A., and A. Sokolov, *Integrated Business Groups as a Breakthrough to the Country's Modernization*. Moscow: Center for Research and Science Statistics, 2001.

Dynkin, A., and A. Sokolov, "Integrated Business Groups in the Russian Economy". *Voprosy Ekonomiki*, Vol. 73, No. 4, pp. 78-95, 2003.

Rosiisky Statistichesky Yezhegodnik. Moscow: Goskomstat, 2001

## Annex: Corporate Social Programmes Implemented by Russian Companies

**Annex Table 1. Standards of CRS followed by the largest Russian companies**

<b>IBG</b>	<b>Standard</b>	<b>Comments</b>
Lukoil	ISO 9000	First Russian shipping company certificated by international standards
	ISO 14001	
	SA 8000	Corporate social code was developed in accordance with this standard. For the first time in Russia the company is preparing to be audited according to the standard.
	ISO 9001:2000	Foreign oil-processing companies were certificated
	OHSAS 18001	
SeverStal	ISO 9001	
	ISO 9002	
	ISO 14001	
	OHSAS 18001:1999	First Russian steel-making enterprise to receive the certificate of approval
	ISO 14001	
	ISO 9002:1994	
Surgutneftegaz	«TUV» ISO 9001	
AvtoVAZ	ISO 14001	
	ISO 9001	
Alfa-group – Access-Renova	ISO 14001:1996	
	ISO 9001	
	ISO 9002:1994	
Interros	ISO 9001:1994	
	ISO 9001:2000	
	ISO 9000	
	ISO 9002:94	
MDM Group	ISO 9001:2000	First Russian enterprise to receive a certificate of the American Oil Institute
Basic Element	ISO 14001	
	ISO 9001	
	ISO 9002	
	ISO 9001:2000	
	ISO 9001	
Sistema	ISO 9001	

*Sources:* Annual reports and press releases of the respective companies.



**Annex Table 2. Social programmes implemented by enterprises of the largest IBGs**

<b>IBG</b>	<b>Kinds of social programmes</b>	<b>Comments</b>
AvtoVAZ	Housing programme	23,9 mln roubles (2001)
	Insurance programme	
	Pension provision	
	Savings programme	
	Support for citizens of moderate means	
	Building of sports and cultural centres	
Lukoil	Help to medical institutions	
	Support for cultural institutions	
	Aid to religious organizations	
	Educational programme	
	Publishing projects	
	Help to children	
	Support for military men	
	Support for veterans	
Assistance to indigenous peoples of the Far North		
Basic Element Company	Educational programme	
	Assistance to science organizations	
	Help to medical institutions	30 mln roubles (2001)
	Support for military men	
	Support for cultural institutions	
	Ecological programme	
	Human resource development	
	Support for sports organizations	100 mln roubles (2002)
	Help to children	
	Assistance to invalids	
	Support for citizens of moderate means	
	Support for cultural institutions	
SeverStal	Health protection	30 mln roubles
	Housing programme	100 mln roubles
	Pension provision	
	Support for citizens of moderate means	1 mln roubles
	Support for sports organizations	
	Support for cultural institutions	
	Ecological programme	
Interros	Educational programme	
	Support for cultural institutions	
	Publishing projects	
	Support for veterans	
	Assistance to invalids	
	Support for sports organizations	
	Human resource development	
	Pension provision	
	Housing programme	
	Rest and recreation for the workforce	
	Mainland resettlement programme	

**Annex Table 2. Contd.**

<b>IBG</b>	<b>Kinds of social programmes</b>	<b>Comments</b>
Surgutneftegaz	Support for cultural institutions	
	Educational programme	
	Pension provision	
	Help to medical institutions	
Alfa-group	Support for cultural institutions	
	Pension provision	18,8 mln roubles (2001), 9,27 mln roubles (first half 2002)
	Aid to religious organizations	
	Support for military men and veterans	
	Assistance for female workers	0,074 mln roubles (2001), 0,061 mln roubles (2000 )
	Support for young people	
	Rest and recreation for the workforce	
	Support for sports organizations	
	Help to children	
	Educational programme	
	Help to medical institutions	
	Ecological programme	
	Housing programme	
	Medical insurance	
MDM Group	Rest and recreation for the workforce	10 mln roubles (2001-2002)
	Help to children	
	Support for young people	
	Health protection	2001 – 22 mln roubles
	Housing programme	3 mln rubles
	Support for military men and veterans	2001 r – 6 mln roubles 2002 – 6,15 mln roubles
	Support for cultural institutions	2001 — 1,5 mln roubles
	Support for sports organizations	8,6 mln roubles 1,7 mln roubles
Menatep	Ecological programme	2000 – 57 mln roubles
	Rest and recreation for the workforce	
	Support for veterans	
	Support for young people	
	Educational programme	\$ 100 mln during ten years
	Assistance to indigenous peoples	
	Support for cultural institutions	
Sistema	Building of sports and cultural centres	2001 r – 30 mln roubles 2002 r – 120 mln roubles
	Business programme	
	Help to children	
	Insurance programme	
	Educational programme	

Sources: Annual reports and press releases of the respective companies.

## **Definitions of social programmes listed in Annex Table 2**

<b>Educational programme:</b>	Grants for schoolchildren and students, financing of educational institutions, buying of equipment, holding of competitions.
<b>Support for cultural institutions:</b>	Financing of artistic ensembles, museums, libraries, organizing of cultural events.
<b>Assistance to science organizations:</b>	Research grants, financial aid, buying of equipment.
<b>Help to medical institutions:</b>	Financial aid, buying of equipment.
<b>Support for sports organizations:</b>	Financing of sports centres, help to sport teams, holding of competitions.
<b>Support for citizens of moderate means:</b>	Companionate allowance, companionate shops, canteens etc.
<b>Housing programme:</b>	House-building for employees, housing credits.
<b>Insurance programme:</b>	Medical insurance, housing insurance.
<b>Pension provision:</b>	Additional pensions and other types of assistance to pensioners.
<b>Savings programme:</b>	Unit funds for employees.
<b>Building of sports and cultural centres:</b>	Building and reconstruction of sport clubs, stadiums, libraries, museums, theatres etc.
<b>Aid to religious organizations:</b>	Financial aid to religious organizations.
<b>Publishing projects:</b>	Publication of books.
<b>Help to children:</b>	Support for nursery schools, orphan schools, children's hospitals.
<b>Support for military men:</b>	Financial aid to military men and their families.
<b>Support for veterans:</b>	Financial aid to veterans.
<b>Assistance to invalids:</b>	Support for organizations of invalids.
<b>Assistance to indigenous peoples of the Far North:</b>	Social support for indigenous peoples.
<b>Ecological programme:</b>	Financing of environmental protection.
<b>Health protection:</b>	Measures for health improvement of employees.

<b>Human resource development:</b>	Additional educational programmes, professional development.
<b>Rest and recreation for the workforce:</b>	Financing of health centres, recreation departments.
<b>Mainland resettlement programme:</b>	Assistance for people moving from the Far North to other regions.
<b>Assistance for female workers:</b>	Protection of women's rights, solving of family problems.
<b>Support for young people:</b>	Solving of employment problems, solving of housing problems, organization of recreation.
<b>Business programme:</b>	Holding of business conferences.

## Presentation by Mr. Attila Chikan\*

Thank you.

What I would like to do is to give a few very brief remarks on the four issues that have been given to us by UNIDO in the position paper. All of the four issues contain some reference to areas where UNIDO can have a role. It is these four independent issues that I would like to talk about.

First of all, we probably all agree that transition means different things in our various societies. The experience of most countries, and certainly of Hungary, is that we have seen a very rapid development of our political structures, systems, institutions and operations since the early 1990s. This has not been true for the political culture, however, the development of which will come, I hope, in the next decades.

I believe that it was right when we announced in 1997 that the transition in the business sphere of the economy has been completed. In 1997, we said that the behaviour and the pattern of activity of business enterprises in Hungary were basically the same as in any other market economy, so that the transition in this field had been completed. When we look at the social sector, however, we see that the transition here is very far from being completed. We believe that it will still take several decades for the social transition to be fully completed. I personally believe that it may be a question of a generation or more until it will be completed.

The conflicts and imbalances in any society in transition are to a great extent the consequence of this different speed of development of the various spheres of society. I believe that UNIDO could help by presenting the big picture and showing us – based on the experience of other countries and other societies – how we can proceed to have a more balanced development and how we can put in place the various elements of society so that they will be synergetic. I think that in many cases policy makers actually concentrate too much on business and they don't think enough about the surrounding issues.

The second topic that I would like to talk about is competitiveness. Of course, to be successful in the global economy every country has to be competitive. In fact, there are four stages of competitiveness in any country: The first is resource-based competitiveness, when a country is competitive because it has some natural or other resources which cannot be utilized in any other country. The second is investment-based competitiveness, when the climate in a country and the environment is appropriate for foreign and local investment, which makes faster development possible. The third is innovation-based competitiveness, when the country is good enough to come up with new products and processes in the global economy, which allows it to make extra profits in some areas. The fourth is welfare-based competitiveness, where the general status of the economy is such that it can actually afford to develop faster and more intensively. In any country you will find those four different stages of competitiveness operating in parallel to one another, and various sectors of the economy will be at different levels of competitiveness at any moment of time. Of course there is also some characteristic status of the country itself.

I share the view about the usefulness of technology foresight expressed by UNIDO. I think it can greatly help all governments of the transition economies in the region to achieve a balanced industrial and economic development. I believe that UNIDO's Technology Foresight Summit in Budapest conclusively demonstrated this fact.

---

\* Rector, Budapest University of Economic Sciences and Public Administration. Former Minister of Economy. This text is based on an edited transcript of the spoken presentation.

The third issue relates to corporate structure. Of course, there are many different kinds of small and medium-sized enterprises, or SMEs, in an economy, and what we usually have in mind in most of the cases is the small enterprise meeting local demand. I believe, however, that the role of medium-sized enterprises is probably at least as important as that of the previous group. It is these SMEs that act as suppliers of multinational companies, and thus play a decisive role in converting a country into a regional player. They also have a catalytic effect on other SMEs.

I therefore believe that the development of the supply chains in which SMEs take part as suppliers of multinational companies is of crucial importance. This process will also help the development of financial institutions and technological management in the country concerned. I think that UNIDO can help, especially if it puts more emphasis on the knowledge-based economy and perhaps helps to educate those companies.

In the early 1990s I took part in a conference in Hungary at which one of the large multinational companies announced what kind of requirements it has for its suppliers. In the break, I was standing with Hungarian managers who were just crazy about what they had heard, and they thought these people didn't know what they are talking about. They could never meet those requirements and, moreover, they didn't want to meet those requirements. That was in the early 1990s. Now these companies are suppliers of those multinationals and meeting the requirements because they have learned. I think that these things can be learned, and this establishes a very important base for future development.

The fourth issue is corporate social responsibility. Unfortunately, there is no proof either in theory or in practice that it pays off if a company's products or if the company itself is meeting, for example, environmental requirements. I think we can proceed successfully only if the reasons we tell to companies as to why they should be socially responsible are directly related to their business. If business interest and corporate social responsibility can be combined organically, then corporate social responsibility will spread.

## Presentation by Ms. Danuta Hübner\*

In the past 15 years Poland has moved from central planning with massive macroeconomic disequilibria and political instability to a market economy and a stable democracy, accompanied by rising living standards. Internationally, it has become an integral member of the OECD and in the coming year will join the European Union. Obviously, we did something right!

Let us look at one or two figures in Table 1 to illustrate the changes:

**Table 1. Main economic indicators at the start of the transition in 1990**

	<b>Czechoslovakia</b>	<b>Hungary</b>	<b>Poland</b>
GDP per capita (US\$)	3,126	3,179	1,630
Consumer price inflation (annual average, %)	10.8	28.9	585.8
GDP (real growth rate, %)	- 1.2	- 3.5	-11.6
Debt service ratio (% of current account revenues less transfers)	11.4*	48.2	53.7
Unemployment (end year, %)	0.8	1.9	6.3

\* Data for 1992 in % of exports

The starting position of Poland was dramatic as these figures show. It was particularly unfavourable when compared with Hungary and Czechoslovakia in 1990.

Poland undertook immediate steps from the beginning of 1990 to re-establish macroeconomic stability and to initiate the essential reforms required in a market economy. These reforms were very successful and came to be known, I think without justification, as the “big bang” reforms. They were the kind of reforms that had to be undertaken quickly: Price liberalization, trade liberalization, reducing the government deficit by slashing subsidies and re-establishing confidence in the national currency by making it internationally convertible.

It was possible to undertake these reforms in 1990-1991 even though they were socially painful, because the new government had the unlimited sympathy of the greater part of the public.

Other countries which started out on the road to reform retreated from some of these early measures. The result was of course either very slow recovery or the continued decline of the economy, or the need to recommence the reforms at a very high social and political cost. The first lesson from Poland was therefore to undertake the essential market economy reforms quickly, if possible making use of the period of voter tolerance, which generally occurs at the beginning of the reform period.

Poland took more time over other systemic and structural reforms in the economy. Privatization and restructuring proved to be very complex, both legally and economically. I think we were wise not to tackle these problems all at once at the beginning of the reform period. The objective was above all to ensure that there would be an improvement in the management of enterprises on the one hand, and to attract foreign investment embodying new or improved technology on the other. This is a difficult exercise, however, which is not only about efficiency but also about the social acceptability of the reforms.

We certainly made errors in Poland and were too slow in certain areas – banking and telecommunications are two areas which might be mentioned, as they also have vital importance for

---

\* Minister for European Affairs of Poland. This text is based on an edited transcript of the spoken presentation.

the whole reform process. The development of small and medium-sized enterprises (SMEs), which the UNIDO paper refers to, relies to an important extent on an efficient banking system and is held back by inefficient and expensive telecommunications. Nevertheless, we have carried out privatization across all but a very small part of the economy, and we did moderately well in ensuring improved management in our enterprises.

I think the lesson from our transition is that these systemic reforms should be thought out very carefully. Authorities should keep the objective of improving the management of enterprises as the main guiding principle. Certain sectors which affect the whole success of the reform programme should be given priority. Privatization and restructuring must be carried out in any event, as state enterprises are generally less efficient and potentially a major burden to the budget.

Rapid and thorough reform avoids some of the danger that economic agents continue to be able to protect their economic rents in society. I will not say that this danger was totally avoided in Poland; but the anti-reform forces were certainly unable to protect themselves in the same way as happened in some countries.

Foreign direct investment (FDI) appears to have been a crucial factor in almost all the successful examples of transformation. FDI brought new and efficient management techniques as well as massive capital inflows to Poland. These enterprises introduced quality requirements in all their supply chains, which had an excellent effect on domestic enterprises. FDI also stimulated other service branches like advertising and public relations, legal and financial services, and general business services. Making progress in the transformation without substantial FDI is difficult.

It needs to be stressed that FDI is attracted not only by low costs and a domestic market, but also by a predictable and stable business environment. In Poland we were quick to adopt new legislation and to create or change the institutions necessary for the development of businesses in the market economy. The reform of the judiciary and parts of the central or regional administrations is always a problem, with progress always being slower than hoped for, but creating the right environment is essential.

Corruption has been shown to be poison for the attraction of foreign investment. Corruption has to be combated wherever it occurs if foreign companies are going to be attracted and persuaded to stay. It is a difficult fight in economies where many in the public services are paid very low wages.

In Poland we began to attract substantial FDI only from around 1995 onwards. It took us that long to establish our reputation internationally. A reputation for a sound business environment is something which is difficult and takes a long time to achieve – but rather easy to lose if things go wrong. Poland was of course helped here by its aim to join both the OECD and the EU.

Importing regulation from international institutions protects the reform from backsliding under pressure from interest groups in the economy. The *acquis communautaire* of the EU is very substantial – perhaps too substantial – but it represents one legal interpretation of a liberal market economy. European countries trying to integrate with the Union are compelled to adopt all (in the case of accession) or part of the *acquis*. Governments are able to refuse anti-reform demands by invoking the possibility of a breakdown in relations with the Union. Tying in reforms through integration with powerful international bodies is therefore important in protecting or accelerating the reform process.

So was the pain worth it? What did we achieve? Well let me end as I began by looking at the data in Table 2:

These show that the answer is yes! There will clearly be losers in any systemic reform, but across the whole nation and economy there is no doubt that the thoroughgoing reform has paid off in Poland. Of course, the problem with reform is that one is never finished. We have reformed to create a market economy, then we reformed to join the European Union, and now we need to continue to reform to



tackle problems associated with demographics and the pension system, as well as with retaining our competitive edge as we move into the Union.

**Table 2. Main economic indicators for 2002 after twelve years of transition**

	<b>Czech Republic</b>	<b>Hungary</b>	<b>Poland</b>
GDP per capita (US\$)	6,742	6,220	4,803
Consumer price inflation (annual average, %)	2.1	4.8	1.7
GDP growth 1991-2002 (1991 = 100)	119	132	158
Labour productivity growth, 1990-1999 (1990=100)	159.5	172.4	195.7
FDI net inflow 1989-2002 (US\$ billion)	35.2	22.5	38.6

Source: EBRD (2003).

Nevertheless our experience in Poland has been a good one and I think we can give some help to those who are still struggling to reform. Beyond a clear strategy for reform, however, one needs determined politicians who are good communicators to convince a doubting public. This is more difficult, and the best reformers must be prepared to sit with the opposition in Parliament, sometimes for long periods.

#### **References:**

EBRD, *EBRD Transition Report Update*. London: European Bank for Reconstruction and Development, 2003.

## **Presentation by Mr. Valeriy Khoroshkovsky\***

Thank you very much, Ladies and Gentlemen.

Thank you for this opportunity to address this Round Table.

The subject that we are discussing today is of course very broad, and I don't think that we can have a comprehensive discussion of all aspects at this Round Table meeting. However, we may certainly touch the highlights of these issues. Each of the countries we are talking about presents its own issues. All of them have different starting points, and today we can compare the status and prospects for the future with the understanding that they are all different.

Talking about Ukraine, we started from a very complex situation. The gross domestic product (GDP) had been halved and inflation was more than 10,000 per cent per year. Today we have a symmetric economic stability. The monetary situation and the financial situation have been fairly stable for the past four years. Inflation amounted to 4-6 per cent, and the growth rate of GDP amounted to 8 per cent.

What are the most important accomplishments of the past 15 years? What are the most important achievements that make us hopeful that the 15 years have not been wasted? It is the development of a private sector, of private business. This is indeed the backbone, the foundation, of everything else. We keep saying that we need to develop the private sector. How can this be affected? It has happened; this makes us hopeful about the future.

The restructuring of the economy within our country has resulted in a major transformation. Resource mobilization, increasing integration within the European Union, HIV/AIDS – this is far from a complete list of the challenges that Ukraine has had to face along with the rest of the world.

Of course, one always wants to move faster to accomplish more, but the most important thing for us is that Ukraine has made a strategic choice. Joining the European Union is our objective. We welcome the fact that new member states are acceding to the European Union. This prospect is still ahead of us. This is something that we are looking forward to, even though we may also have problems that suddenly arise. We are working on this process.

We are making as precise economic calculations as we can about the implications of our joining the Union, and the effects it will have on our trade and export possibilities. Ukraine has common borders with the European Union and this is an advantage.

We think this is an advantage today and we are talking about retaining it to the extent possible. The trade solutions that have been arrived at are in view of expanding the Union.

What are our objectives for the future? Economic growth is absolutely essential if one wants to be a truly European country. Today, economic growth is both a means to an end and an end in itself for us. I am always asked why we emphasize growth so much; why do we need growth so much? The answer that I would like to give to that is that if we stay faithful to our strategy, standards, microeconomic standards, living standards will all rise. In the short-term, another objective is for Ukraine to join the World Trade Organization (WTO). I have every reason to hope that next year, 2004, Ukraine will be able to join the WTO. We still have a number of things that have not been adjusted, but in my estimation we have covered 95 per cent of the requirements. I think that it is

---

\* Minister for Economics and European Integration of Ukraine. This text is based on an edited transcript of the English interpretation of the speaker's original presentation in Russian.

important to join the WTO and I am working on a report to the WTO. We are involved in multilateral negotiations and I hope we will join the WTO in 2004.

Getting back to the issue of economic growth: The other question is, where are the resources? What is the potential? I mentioned a figure of 8 per cent GDP growth. This year we are expecting 10 per cent growth. What are the engines of that growth? There are three: First, the development of small and medium-sized enterprises (SMEs); second, attracting foreign direct investment (FDI); and third, bringing the shadow economy into the legitimate economy.

We have conducted a study with a European bank, and we have found that about 40-60 per cent of the economy today is accounted for by the shadow economy, the black-market economy. It's a major resource for future economic growth if we can bring the shadow economy back to the legal economy. This will be a major policy objective. Foreign investment this year increased 40 per cent in Ukraine. This was not sufficient in our view. There are larger absolute numbers that are more appropriate for a country like ours. Again, we hope that having a border with the European Union will further stimulate foreign investment.

In conclusion, let me refer briefly to international technical assistance. International technical assistance and cooperation sound very important for us. We are preparing a new law, involving donors, countries and organizations. We are bringing all previously classified issues into the discussion as well. What are we looking for is to make the procedure for foreign investment as simple as possible. There are fixed standard criteria for technical cooperation. If you look at the amounts of technical assistance to Ukraine in the past ten to 15 years, they appear large enough, but the efficiency of these projects leaves a lot to be desired and we would like to correct that situation.

Thank you for your attention.



## **SPECIAL ROUND TABLE**

### **POVERTY REDUCTION IN LATIN AMERICA IN THE CONTEXT OF SUSTAINABLE DEVELOPMENT**



## Issue Paper

# Poverty Reduction in Latin America in the Context of Sustainable Development

*UNIDO Secretariat*

### Introduction

According to the World Bank: “Poverty is hunger. Poverty is lack of shelter. Poverty is being sick and not being able to see a doctor. Poverty is not being able to go to school and not knowing how to read. Poverty is not having a job, is fear for the future, living one day at a time. Poverty is losing a child to illness brought about by unclean water. Poverty is powerlessness, lack of representation and freedom.”

At the Millennium Summit of the United Nations, member states agreed on a series of targets and objectives for the fight against poverty, hunger, disease, illiteracy, environmental degradation and discrimination against women. The first objective of the Millennium Declaration is to free the world from hunger. The goal is to reduce by half the percentage of persons living in poverty by the year 2015 as compared to 1990.

Last November, the XIII Ibero-American Summit, which was held in Bolivia, dealt with the subject of “Social integration, motor of development in Ibero-America”. The 21 heads of state and government decided to move towards policies with a greater social content after a decade dominated by neo-liberal economics. During the last decade, the structural reforms of the neo-liberal model demanded great sacrifices by the people without yielding sufficient results in terms of reduction of inequalities, exclusion and poverty. Privatizations, budgetary discipline, financial liberalization, deregulation, among others, characterized these structural reforms, whose results were less than what was expected. In some cases, these policies even led to an increase of those indicators. The Summit highlighted the importance of the fight against poverty and its roots as a vehicle for the consolidation of democracy in the region. That will require the application of integrated policies, designed and implemented by the state, but with the participation of all sectors of society. In order to ignite industrial development, efforts must be made to eliminate obstacles to market access and to stimulate economic growth.

Most developing countries do not have the capacity to solve their problems alone and, to a certain extent, the international community is responsible for this. To make even modest progress, multidisciplinary assistance from the industrialized countries is necessary. This includes improving the standards of governance, health, education, agricultural productivity and basic infrastructure, among others. If higher standards in these areas cannot be achieved, the necessary dynamism for combating poverty and embark on a trip towards sustainable growth cannot be created. This is also valid for countries where reasonable growth rates have been achieved in parts of the country but where pockets of poverty still remain.

The Latin America and Caribbean region is, after sub-Saharan Africa, the region with the highest level of inequality in areas such as income, consumption, political influence, health and education. The richest 10 per cent of the population has 48 per cent of the income, while the poorest 10 per cent only has 1.6 per cent. This compares with the developed countries, where the richest account for 29.1 per cent and the poorest for 2.5 per cent respectively (World Bank).

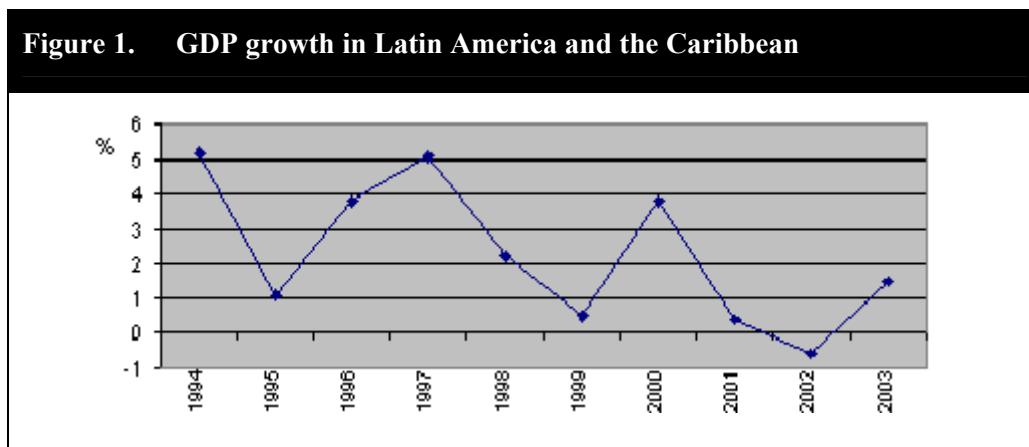
Education is an opportunity to reduce social inequalities and, in the long term, reduce the levels of poverty. In developing countries, such as those of Latin America and the Caribbean, child labour is common and this severely affects education levels.

In order to achieve lasting poverty reduction, it will be necessary to combine economic growth with measures to close the gap between rich and poor.

## Economy

### *Gross Domestic Product (GDP)*

The development of GDP in Latin America and the Caribbean showed a slowing down of economic growth as of 1998, triggered by economic crises in various countries of the region. After a brief peak of around 4 per cent in 1999, growth has been close to zero with a forecast for 2003 of less than 2 per cent for the region. These low levels of growth clearly do not allow for any significant reduction of poverty.



Source: ECLAC (2003).

### *Foreign Direct Investment (FDI)*

The decrease in GDP brought with it a drop in FDI. In 2002, a decrease of more than a third was recorded, with a further decline foreseen for 2003. This may be associated with a global decline on the stock markets and also in the number of international transactions. At the national and regional levels, the drop was provoked by recession and political instability in some countries.

In the 1990s, some countries attracted FDI thanks to a massive privatization of their public sectors. The lack of transparency of these privatizations did not help, and led to a lack of confidence in government policies. Today, this process has stagnated and, although some attempts at further privatizations were made in 2002, these met with political resistance and were cancelled or postponed.

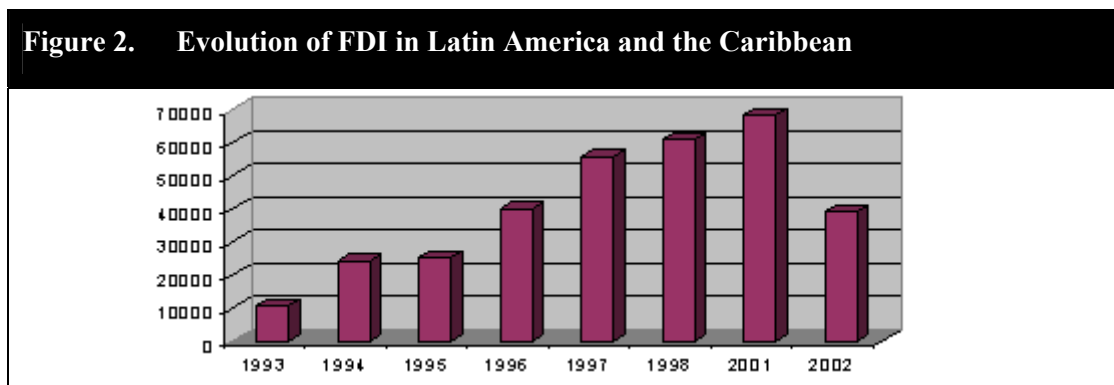
FDI destined into the exploitation of natural resources remained largely at 2001 levels, with the exception of Venezuela where it decreased. Forecasts for 2003 are for a continued deterioration of FDI after the dramatic drop in 2002.

### *Industrial Development*

The main role of industrial development, given the need for structural change, is to generate lasting employment and better income to pull people out of poverty. This includes the direct and indirect



contribution by industry not only to the objectives of the Millennium Declaration but also to other non-economic objectives related to social well-being.



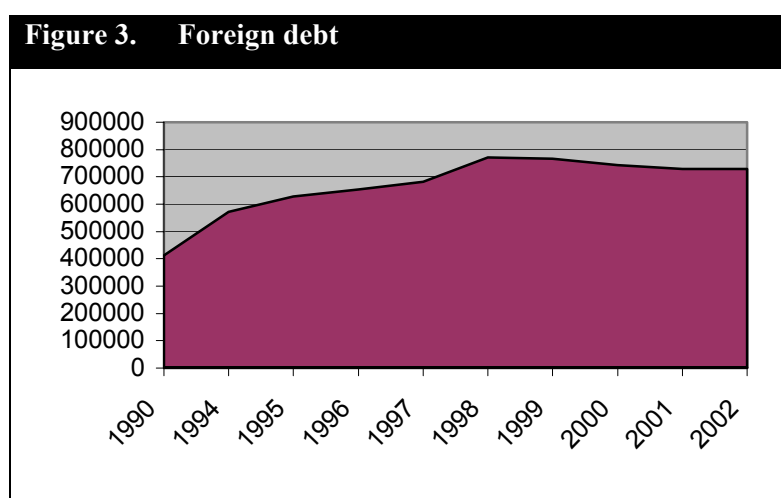
Source: ECLAC (2003).

To ensure success in economic development, it is necessary to identify some basic preconditions, such as the establishment of a technological infrastructure that responds to the needs of private small and medium-sized enterprises (SMEs). This would involve offering services that promote the spread of technological processes, which could lead to improved productivity. The developing countries that have managed some degree of industrialization, have all had good help from institutions that facilitate the spread of technological advance.

#### *Foreign debt*

Another relevant aspect has been the evolution of foreign debt in the region, which has grown constantly since the 1980s and which has worsened lately due to the financial crises of some countries. These crises forced governments to focus their efforts on reducing foreign debt and not on reducing poverty.

The pressure on governments to service their debts severely limits the possibility to increase public spending to attend to social needs.



Source: ECLAC (2003).

## Foreign trade

As a result of an increase in the production of manufactured goods, exports doubled during the 1990s. Imports went the same way as the need for raw materials and intermediate products increased. Export and import figures peaked in 2000 while 2001 saw a slow-down in world economy and trade. Imports decreased and produced the first trade surplus the region had seen for a decade. This reduced significantly the balance of payments deficit.

Outward flows of capital started in 2000 and by 2002 had reached unprecedented levels, probably triggered by the crises in Argentina, Brazil, Uruguay and Venezuela. These net transfers reached 2.5 per cent of GDP in 2002, of which half is attributable to the situation in Argentina.

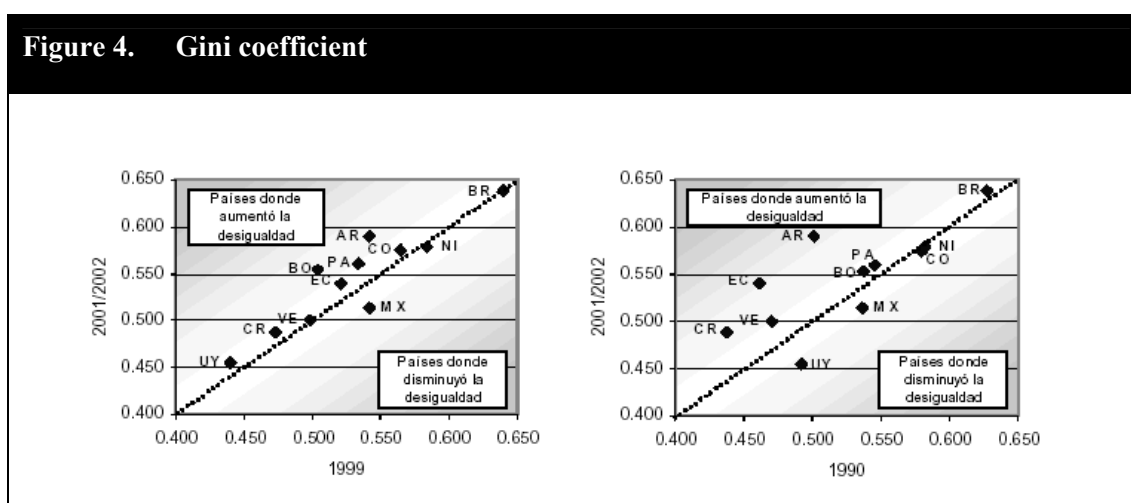
## Levels of poverty

The statistics related to poverty reduction demonstrate that the levels of poverty and extreme poverty as a percentage of the total population have been practically constant since 1997, while the total number of people living in poverty has increased. In absolute terms, this means that in 1990 there were 200 million people living in poverty or extreme poverty in the region, and the estimate for 2003 is for some 225 million.

The main countries that witnessed a deterioration in living standards were Argentina and, to a lesser degree, Uruguay. In the urban areas of Argentina, the poverty rate doubled from 23.7 per cent to 45.4 per cent between 1999 and 2002. The only areas that showed a reduction in poverty levels were urban Mexico and Ecuador.

Forecasts for 2003 are for further increases in the levels of poverty and extreme poverty due to stagnating economic growth.

However, a more equitable income distribution may improve the effect on poverty of economic growth when it materializes. In general, the prevailing inequality has been and is still a major obstacle to development in Latin America and the Caribbean.



Source: ECLAC (2003).

The graph relating to the most recent period (1999-2002) shows that practically all the countries in the survey suffered a stagnant or deteriorating Gini index, i.e. an increase in inequality, which clearly does not help to reduce poverty.

The Gini index is a statistical measure of inequality where zero means perfect equality. The average Gini for Latin America and the Caribbean increased from 50.5 per cent to 51.4 per cent in the decade of the 1990s, reflecting a slight worsening of the situation. Interestingly, two Latin Americans of five are poor although they live in middle-income countries.

The regional inequality has historical roots from the colonial days when exploitation of indigenous groups was the norm. Today, the Latin American inequality is caused, according to the World Bank, principally by four factors: inequality in the access to education; the income of people with higher education is unreasonably high; the poor have more children to support; and public spending is inefficient.

### *Employment*

Economic growth during the 1990s did not lead to a reduction in unemployment. On the contrary, a steady increase in this indicator could be observed.

Although open unemployment lies at or below 10 per cent for the region, widespread underemployment makes the real situation considerably worse than the official figures would suggest.

The decrease in employment rates has led to informal economic activity being constant or on the increase throughout the region. A major problem with the informal sector is that it is characterized by a lack of labour rights, in particular where women and children are concerned.

Since 1995, the portion of economically active persons working in the informal and low-productivity sectors has been around 46 per cent of all employed persons in Latin America and the Caribbean. This percentage has remained practically constant until this year.

According to a UNDP report, seven out of ten new jobs created since 1990 belong to the informal sector. For the same period, only six out of ten new jobs in the formal sector come with some form of social security. In addition to the shortcomings of conditions of employment in general, many employees of the region are at risk of a complete lack of protection when they reach retirement age.

### *Migration*

With virtually no possibility for a better life or to find employment in the rural areas, large numbers have migrated to the cities or to more developed countries.

Ever since colonial times, the cities have been extremely important in Latin America. That is where the economic and political powers are concentrated, and where the immigrants expect to find a better life. Although the predictions for 2015 show that in Latin America and the Caribbean some 66 per cent of the population will live in the cities, in some countries the figure will be much higher. So, for instance, in Argentina, where the figure will be some 92 per cent, while in Uruguay it could be as high as 94 per cent.

With regard to emigration to foreign countries, the USA has been the classic recipient country since the 1950s. At present many go to Europe, in particular to Spain and Italy. It is expected that the crisis in Argentina will produce new flows of emigration. While the emigrants are the source of considerable income for their countries of origin, they also constitute a threat in that they often are highly educated people and thus deprive the country of innovative capacity by leaving it.

### *Society*

Ethnic and gender issues become important when poverty is being discussed. In many countries of the region, women have on average a higher education than their male counterparts. In spite of this,

they, along with the indigenous groups, appear to be more exposed to low salaries and unemployment. This would suggest that there is an ethnic and gender issue to this type of discrimination.

The disadvantage that women face in the case of salaries is compounded by their limited access to productive resources, such as employment, land, capital, information, new technologies, natural resources and housing.

The social relations between women and men are based on the division of labour by gender, which results in women performing almost all household work. Apart from being an added burden on the women, the work does not receive any social recognition.

### *Environment*

There is a link between poverty and the state of the environment in that most developing countries are engaged in the exploitation of natural resources. Therefore their livelihood is intrinsically dependent on the quality of the environment. Furthermore, an economy based on only natural resources, and therefore not diversified, exposes its population to great risk.

The cost to the environment of regional economic expansion is already very high and is predicted to increase further. Industrialization, and its impact on social and economic development, has proven to have a cost in terms of public health and environment and thus to have been on the agenda for the debate on sustainable development during the last decade.

As industry has contributed to the degradation of the environment, there is now pressure on the sector to provide the solutions for an environmentally sustainable industrialization that also addresses the problem of poverty.

One of the big problems, and one that waits for a solution, is the concentration of two thirds or more of the population in the cities. This makes it crucial to improve housing, sanitary infrastructure and public transport. Another challenge is how to promote a sustainable use of the rain forest and the biodiversity.

In summary, some of the most important environmental issues are: Over-exploitation of land and maritime natural resources; erosion and over-use of the soil; deforestation; degradation and loss of biodiversity and habitat; contamination of waters; conflicts over access and use of water; air pollution; contamination by heavy metals and problems related to urban waste disposal.

The area covered by rain forest continues to shrink in all countries of the region. A total of 5.8 million hectares were destroyed per year during 1990-1995.

The environmental cost of improving agricultural technologies has been very high. During the decade of the 1980s, Central America increased its agricultural production by 32 per cent but using twice as much fertilizer.

UNIDO works to improve local industry from an environmental point of view by promoting the transfer of clean technologies and the use of renewable and more efficient sources of energy, in particular in rural areas. Much of this work is undertaken as part of the implementation of the Montreal and Kyoto protocols.

### **References**

ECLAC (CEPAL), *Balance preliminar de las economías de América Latina y el Caribe, 2003*. Santiago: Economic Commission for Latin America and the Caribbean, 2003.

## Moderator's Introduction

*Raimundo Gonzalez Aninat\**

Good afternoon,

Welcome to all our friends who are present here in the room. It gives me great pleasure indeed to be able to be here at such a decisive meeting for Latin America. I am very grateful to UNIDO for having efficiently arranged this Special Round Table at very short notice. We are about to discuss a very important subject, albeit in a very casual atmosphere.

How can one act as a moderator on something that cannot be moderated? We are actually moderating in an outrageous situation, both at the conceptual and the real level. We are dealing with the realities of the situation on the continent. There are various circumstances, which can only be qualified as scandalous or outrageous in spite of the great professionalism applied by the various governments, but about which something can undoubtedly be done. The situation, especially for those outside the formal restructured sector, is really incredible. The challenge for us diplomats is to act in coherence with the nature of our functions in representation of the great majority in the marginalized sectors of our peoples. This could be a point of departure for our reflections. Diplomats must, once and for all, focus on preventive diplomacy and try to represent all those who are marginalized and poor and who are not part of the system.

On the other hand, I would like to emphasize another fact, which might guide our discussions today. We have some panellists here with very great experience in the matter and I feel very honoured to be at this meeting. We must take into account also poverty from the human rights' perspective. Poverty is an issue that dominates the political sphere because of the enormous inequalities that exist. It is not only the distribution of income, but also inequality of opportunities on our continent, which present an enormous challenge, not only for present generations, but also for those who follow. We must reduce this gap, which is becoming increasingly wide.

The security of individuals is becoming more and more compromised. From a legal and policy point of view, these considerations have become extremely important at the national level. We have to emphasize and mainstream all these human security aspects, addressing the new challenges and dangers that we are facing. The mere fact of being born gives the human being dignity and, by definition, should start his life on a level playing field characterized by an equality of conditions. That is not the case in our world nowadays. There is an asymmetrical situation. This is a fact that cannot be questioned and that is something that we all agree upon.

This forum will give us the opportunity to discuss such matters openly. Half of the world's population survives on less than US\$ 2 a day. We cannot speak of dignified survival at that level. What can we demand, what claims can we make, vis-à-vis the governments, and also vis-à-vis the international community. Latin America is not a capsule, is not isolated from the rest of the world. No, it is part of a global structure and so the obligations at the international level cannot be merely rhetorical, but must take into account Resolution 26/25 of the General Assembly on the seven fundamental principles of international law.

One of those principles speaks of the duty to cooperate. On the other hand today, the issue of poverty is not only something relevant to the North-South dialogue, poverty is also being found in the so-called rich countries, which have a high unemployment rate. High unemployment rates are common

---

\* Ambassador Extraordinary and Plenipotentiary, Permanent Representative of Chile to UNIDO. This text is based on an edited transcript of the English interpretation of the speaker's original presentation in Spanish.

in developed countries, but they have also been around 9.1 per cent lately in Latin America. This is very high indeed.

Lastly, in this age of globalization, inequalities that prevail in Latin America can produce inequalities outside our region and vice versa. Tolerating such scandalous and outrageous situations as the ones I was speaking of is not consistent with what was laid down in the Millennium Declaration, which has been much talked about and discussed so intensively in these past few days. We have to think of social integration, the rich cultural heritage of our continent, the need to incorporate, to include and involve the most vulnerable sectors of our population within a system that gives them access to skills and knowledge. In particular, the kind of skills and knowledge that UNIDO can put at our disposal to help us fight poverty. In this endeavour, we must also help the most vulnerable within these vulnerable groups, which are the women and children.

Well, I am sorry to have made rather lengthy reflections here, but I wanted to set the conceptual framework in order to have a rich discussion. Beyond these reflections, which will help us to design or think about our actions, we must aim at an excellent international cooperation.

## Keynote Speech

*Peter Stania* \*

Good afternoon.

I am honoured to have been invited by the Chilean Ambassador to talk to you today at this Round Table. When I say that it is an honour, my intention is to thank all those who organized this Round Table. For someone like me, a person who loves Latin America, it is not only an honour but also a great joy to be here today. It is through this joy that I am able to analyze this continent and to visit that region once in a while. If I could do as I wished, I would be living there the whole time, but unfortunately it is not possible.

This morning when I left my house and went downtown, I was listening to the radio and I listened to a speech by a bishop from a monastery here in Austria. He talked about the Christmas period. He said that in the past, a luncheon or a dinner party would be a time for peace during the Christmas period, a time reserved for sitting around the table, far away from hunger, a time to celebrate. This is the time of the year that we are now celebrating Advent, the last four Sundays before Christmas, and he was saying that it is very sad that not all the peoples of the world could sit around this table to celebrate. We have many of the European countries sitting around this table of peace. We have countries from other parts of the world, but there are many countries that are missing around the table of peace.

When I heard his words, I thought that it would be worthwhile bringing them up this afternoon because I believe that the church is a very important factor within the Latin American region. Even for me, although I am not so experienced in religious matters within South America. But the reality in the region is different. There is, in fact, a desire for everybody to join around the table and have a dinner. But the reality is very different, unfortunately. We have a lot of problems that arise from poverty. Just to mention a few of them: There are conflicts regarding sovereignty, there is civil war, and violence in the streets. There is a wide range of social problems as a result of poverty.

Such economies are greatly distorted and I just have to refer to the words that were said by the Chilean Ambassador a while ago, when he said that there is a great scandal or great outrage on this continent. It is true that there are problems caused by poverty and shortages. But there is another factor that should be mentioned as well, which is corruption. Corruption still exists in Latin America, but we cannot say that it only belongs to that region. We find it everywhere in the world, including in Austria. But in Latin America it is not only a moral phenomenon, but also a highly economic issue. With corruption, it will not be possible to construct or build a just economy. If we do not change the “I” and put in its place a “we”, corruption will continue to be a very important factor in the negative growth in the continent. This means that the struggle against corruption should be a struggle against poverty as well, because corruption distorts and disturbs development within a country. As a matter of fact, it is not only a problem at the national level as it can also encompass the whole region.

I began by speaking about peace, and referring to street violence and conflicts. This is something natural, for somebody who comes from an institute in charge of studying peace matters. This is a very important issue and should be investigated. I remember that a few years ago, I was visiting one of the Andean countries, in a region where some Indian communities lived. There is a war of destruction among the tribes, different groups. It is not a classical conflict between rebelling groups or against an oppressor. It is rather a case of Indian groups killing each other. We were the first Europeans to visit this area and to study this conflict. The reason for this conflict is poverty. I don't

---

\* Director, International Institute for Peace, Austria. This text is based on an edited transcript of the English interpretation of the speaker's original presentation in Spanish.

want to refer to other terrible ongoing conflicts that we can find in certain countries of the region, but rather to refer to a conflict that nobody knows about, not even in Europe.

The conflict that I am referring to makes us see clearly that wherever there is a shortage of conditions for a dignified existence, there will be the emergence of conflicts and those who have to live within this conflict will take by force away from those who have more. This is the case of the country that I am referring to, a country that I hold very dear to my heart. This country very recently went through a rebellion, a rebellion that was created by the Indian population. As a result, they now have a new president. I am just giving you this example of such conflicts, which arise from poverty and in turn encompass the ethnic factor, because they are becoming increasingly important in Latin America. If we take a look at other parts of the region, for example further to the north, we see that this is the case. These conflicts cannot be seen as isolated phenomena.

There are also factors such as drugs within this same region. With the money from the drug trade, the conflict groups are being provided with weapons. In the Vienna International Centre there is an organization that is in charge of discussing and debating this subject. Drugs are also a result of poverty. Because it seems to be, and I repeat this expression it seems to be, that there is no possible substitute for the coca bushes. So those people who are fighting against the peasants who are cultivating these plants, these coca bushes, are the same people who then have to live from it. This is once again the case of poverty, this is once again poverty bringing about conflict between those who are harvesting these coca plants and those in the army who are called upon to fight against this type of production.

As a European, if I were to compare the safety of Vienna with the streets of most of Latin American cities, I would not only find the phenomenon of violence as a result of poverty, but also the fact that because of poverty, the migration to large cities is becoming greater and more and more difficult to control. In the document you will be analyzing, you will find very interesting figures with regard to this fact. The bottom line is that poverty thrives in distorted economies, be it within cities or in urban circles in Latin America.

We also have another phenomenon that should be taken into account, and that is inequality in development. If we do not incorporate all segments of the population and leave out some very important groups of the population, and this is the case in most countries of Latin America, then the development of an economy that should bring about the reduction of poverty will not be a successful.

With regard to living conditions, Latin Americans are better prepared than myself to talk to you about the ways of life over there. When I see the poor areas around the cities and when I visit the cities themselves, I always ask myself why it is that when I am in New Delhi I can cross a slum area and nothing will happen to me. It could be that they would try to steal something from my purse or from my bag, but that is all that could happen. But if I were to cross a slum area in Buenos Aires, I would be risking my life. What is the reason for this difference? This is a point that should be looked into. Both phenomena are a result of poverty, but they find a very different expression in the different areas.

Among the very important factors are the damages to the environment, as a result of which less and less people have access to the great wealth of Latin America, and that because of poverty. Unfortunately, I don't have enough time to give you more in-depth arguments or present you with some figures. As regards ecological catastrophes, I can only think of Venezuela right now, but I think that many things have happened in recent years. There seems to be a vicious circle. Those who are damaging the environment are suffering in turn. It is not the very beautiful houses or the high-rise buildings, but the people themselves, who are damaging the land. This is not because they want to create this damage, but because they are forced to do so in their struggle to survive.



We can also find some external factors behind all of this. This is something that should be mentioned during my presentation and the very few minutes that I have been allotted. We also have to refer to foreign influences within the region.

About ten years ago, I did a study and I figured out that the external debt of Venezuela was equivalent to the sum of all banking accounts of private Venezuelans in Miami. Mr. Jeffrey Sachs will be able to show me that one thing has nothing to do with the other. I am not an economist, but it was a great coincidence to see at that time, ten years ago, that those amounts were practically identical. What does that mean? It means that the flow of foreign investment to Latin America is very necessary, but we have to try to see when and how these investments take place. If US\$ 4 comes in and US\$ 8 goes out, there will be no benefit for Latin America. That is why I said that we have to take a look into external factors as well.

There are other things that should also be considered, which are a consequence of poverty, and this is the gender factor. Women in Latin America enjoy the same rights as their counterparts in Austria according to the law, namely that they should enjoy the same rights as men. In spite of the fact that this is what the law says, this is very far from reality. According to statistics, what women earn for the same job is much less than a man. That is why we see that women and children are those more affected by poverty. This is the reason that we should pay special attention to those groups.

In order to conclude my presentation, I would like to present three points:

The debate that will take place should focus on how to reach an equal basis integrating all levels of the population in Latin America. The neo-liberal system nowadays has the tendency of not bringing together, but rather polarizing or dividing the population. A few rich people will become richer, the poor masses will become larger and larger, and this seems to be the prevailing situation. The consequence should also be the strengthening of institutions in all struggles, for example in the struggle against corruption. It is not enough to have goodwill on the part of the government or goodwill on the part of an individual within the government. Pure simple and honest will is necessary to create institutions that will play an active role in the struggle against corruption. What does this mean? It means that there is a need for institutionalism. There is a lack of necessary institutions in many sectors, which would in turn bring about this situation of disgrace and scandal or outrage that Ambassador Gonzalez referred to a while ago.

Democracy in Latin America is another factor, which should be looked at closely. It is true that most people who live in Latin America can go to the polls every four or five years. They have a right to vote and to elect governments. This is a fact. But the time that passes between one election and the next is also a time in which the population should be able to participate. This is the difference between a representative democracy and participatory democracy. There is this phenomenon that we can also find in Europe nowadays. We should try to allow all levels of the population to constantly participate in the democratic process in Latin America. This is unfortunately not the case in all countries.

Finally, as I said before, the economies should be structured on the basis of a more equitable distribution of wealth. The neo-liberal process is doing exactly the opposite, and we would need to strengthen the states so that they can have the necessary weapons to fight against this inequality. The neo-liberal movements seek to weaken the state, in order to have a very "lean" state. However, the state would need to count on institutionalized instruments that would enable them to fight against this greatest of evils, which is poverty. In most countries we do not have this strong state. If I demand a stronger state, it is not a state with more repression. It is not that I am asking for more weapons. I do not need more armies. I do not need the military. I just need institutions within a strong state in order to fight against this evil that we have been referring to. When we demand institutions, when we ask for a stronger state, we are clear on where we want to go.

Thank you very much.

## Presentation by Mr. Guillermo Oliveri\*

Thank you very much.

Before I begin, if you allow me I would like briefly to thank UNIDO and the Director-General, Mr. Magariños, for having given me the opportunity to be here with you. My thanks go to Madame Ambassador Elsa Kelly as well, for having me here and having invited me to Vienna to be part of this panel.

I have a few reflections I would like to make here along the lines of what was said by Dr. Stania. The Ministry for Worship in Argentina, among other things, is the competent authority for religious worship and in establishing relations between the Government of Argentina and various religious groups. Among the subjects that are always present are the relationships with these groups and the reflection of a situation that has come about in our country and which is very related to the topic we are dealing with today. In Buenos Aires there is a series of groups, temples and other centres of religious worship, catering to the needs of our citizens to develop on a spiritual level, and there are different religions that have what amounts to factories, so to speak, as a basis of worship. Many of the groups, Protestant or Catholic, have searched for spirituality in centres and premises that ten years ago were productive factories. It might seem to be a contradiction, but on the other hand, it is a sign of the experience that we are living nowadays in Latin America in general and in Argentina in particular.

The content that we give to our agenda of political reform includes putting in place economic development strategies that incorporate sectoral analysis and productive change and social dialogue. All these are elements that can contribute to a high degree to poverty reduction. Latin American countries have the primary responsibility of identifying the political, social, economic and also environmental problems that they are facing. At the same time, they must mainstream aspects that ensure that the policies they formulate are sustainable. International cooperation for development and economy must support the efforts of Latin American countries to protect the environment, reduce poverty, develop the system of political institutions, contribute to economic development, not only in the country involved, but also on a broader scale.

As we heard from Dr. Stania, it would be nice to have a table where we could all sit, sharing bread without excluding one group or another. In spite of decades of development efforts and in spite of progress made in our indicators of life expectancy and national output, the gap between rich and poor countries has widened and more inequalities have also been created within the countries themselves. There are still serious situations of economic and social inequalities; there is gender inequality and other aspects, which present an obstacle to the efforts being made to try to improve their living conditions. Hundreds of millions of people must face hardship in these countries. Approximately one billion persons live in poverty and this number is on the increase.

Many developing countries and countries with economies in transition face very serious obstacles in development, making it very hard to improve the quality of life. These obstacles include persistent imbalances in the terms of trade, the slump in the global economy, problems of debt servicing, obsolete technologies, among others. Widespread poverty is still the main challenge in any development effort. In many cases poverty is accompanied by unemployment, malnutrition, illiteracy, a low status of women, environmental degradation and limited access to social and health services. All these factors contribute to high mortality rates and decrease economic productivity.

---

\* Ambassador, Secretary of Worship, Ministry for Foreign Affairs, International Trade and Worship, Argentina. This text is based on an edited transcript of the English interpretation of the speaker's original presentation in Spanish.

Poverty is also very closely related to the inadequate distribution of the population. The unsustainable and inequitable exploitation of natural resources, such as land and water, and serious environmental degradation also contribute to the present situation. Action aiming to fight against this challenge should be at three different levels: Integrating population strategies in development; integrating sustainable economic growth and the fight against poverty; and protection of the environment.

Some of the efforts to eliminate poverty would require investments in basic education, sanitation, providing drinking water, homes, security, and infrastructure for communities whose number is rapidly increasing. This is an overload for economies that are per se already very weak, and they limit the development options. There must be jobs generated for the increasing number of young people who join the work force at a time when there is widespread unemployment. At the same time, we have a large number of senior citizens who also need government support, and we have to find a way to attain economic development to enable us to attend to all these different needs.

Additionally, priority attention must be given to the attainment of strategic national budgets, to human resource development, to job generation, to training and to education. Measures must be taken to eliminate inequitable situations, to eliminate barriers against women in the work force and against their access to productive resources, to strengthen policies and agricultural programmes. Issues such as security, nutrition and the involvement of women in policymaking need to be addressed.

Our country, as practically all of Latin America, has recently experienced the implementation of orthodox economic measures and neo-liberal adjustment measures to adapt it to the structural processes related to globalization. We expected a positive spillover effect from these measures. We felt that they might be well designed for the future and that they would affect the population as a whole. The cost of this model, as certain sectors of the population were excluded from the process, was meant to be offset by social emergency policies. Now we have an increase in unemployment with 15 per cent of the potentially active population unemployed, more than 40 per cent of our households are below the poverty threshold, more than 17 per cent of households are living in destitution. These emergency social policies did not only not reach these sectors, but they also did not succeed in drawing these people out of the circle of marginalization.

In conclusion, besides the adjustment and structural reforms that have been implemented and which was deemed to be a model for the rest of the world, Argentina has not solved the problem of sustainable development. However, in the new phase of the new economic cycle in Argentina, with monetary stability and economic growth carried out within the proper strategy of sustainable development, we think that we will succeed in our economic efforts and also in the field of social, institutional, legal and political reforms. We think that this, together with the results of changes in economic policies and tendencies towards international integration of the country, will bring results.

Against this macroeconomic backdrop, we think that government policies should be complemented by smaller scale measures. Such measures, which should have a wider reach or coverage in terms of job and income generation, should be aimed at improving access to finance and to the markets, meeting special needs, and implementing production schemes, will be able to counteract the inequality in the demographics and allow for the integration in value-added changes.

Dr. Stania made a reference to certain areas or places in Latin America and Argentina. In Buenos Aires we have 2.9 million residents. We have about 150,000 people in the periphery of the city and it is undeniably true that human security and the problem of drugs are results of this situation, and that social exclusion and marginalization is one of the central factors in this context. Most of the people who live in these slums, for instance around Buenos Aires, still try to keep up with the spiritual needs in order to counteract the situation and consequences of this past decade, which has had such catastrophic economic results.

Thank you very much for your attention.

## Presentation by Mr. Carlos Alberto Zarruk Gómez\*

Thank you Mr. Moderator.

Good afternoon to all of you.

I think that this is an excellent opportunity to make some comments on the Poverty Reduction Strategy Papers on Latin America. Taking into account developments in Latin America over the past few years, these papers reflect the situation in Latin American countries and also reflect precisely some of the concrete aspects related to the problems of our country, Colombia. In general, as I said, the situation is well reflected in the document and I would like to present here the situation that we have been living in the most recent times and the perspectives for the economic development in the immediate future, speaking also of some of the policies for poverty reduction we are laying down at the government level.

We think the papers are right: In order to reduce poverty, you have to combine economic growth with reduction of social inequalities. It seems obvious, but economic growth and policies that seek to redistribute the gains of growth to the various sectors of the population, especially the most vulnerable groups of the population, which do not have access to the fruit of this growth, is something indispensable. I would like to give you an example because we are living in very special times. During the 1970s and 1980s, when the greatest disturbances to Latin American economies were taking place, Colombia was an exception. There was hyperinflation in the southern part of the continent in the 1970s. There were great recessive gaps during the 1980s. Colombia was an exception throughout all this time. We had a relatively stable growth rate; we had good rates without any internal or external turbulence.

Between the 1970s and 1980s, Colombia's growth was based on two pillars. Internally, growth was fuelled by a strong construction sector. There was a system of housing finance, which was a powerful incentive for the construction sector. Created in 1972, it still exists, although it did suffer a certain downturn during the 1990s. However, in the 1970s and 1980s it became one of the most important engines for our development. We all know how peculiar the construction sector is because it can generate employment and economic activity in general. That was one of the pillars.

We had a second pillar, which was the exchange rate model. We had a system that was established in 1977 and administered by the Central Bank. In the 13 years from 1977 to 1990, the value of money was well established. It was a period during which we saw a proper management of the exchange rate system and a relatively good growth in exports, which, in turn, was one of the motors for development and growth. There is no economy that can be compared to the great dynamism of the world market. If countries manage to insert themselves into the global markets, then they can benefit greatly, and I would say that Colombia was able to establish its pillars in the 1970s and in the 1980s and we were able to grow very well. The average growth rate was 3.8 per cent for ten years, and then in the 1980s it was 4.8 per cent. In 1978 and 1980 we had reached an annual growth rate of close to 8 per cent. These were decades when we were growing in a very sustained fashion with a very important basis with regards to the reduction of poverty and the development of social dynamics that would enable a good distribution of wealth.

However, in the 1990s something happened, which was very different. The 1980s, known in Latin America as the lost decade because of some economic difficulties and some social and structural changes that took place during that decade, was a good time for Colombia. In the 1990s, the opposite

---

\* Vice-Minister for Entrepreneurship Development, Colombia. This text is based on an edited transcript of the English interpretation of the speaker's original presentation in Spanish.

happened. We lost all the gains and today we have a per capita income that is lower than we had in the 1990s. Thus, we went back ten years with a crisis that we had in the middle of the 1990s. This crisis was caused for the following reasons:

First, the Colombian economy was affected by some important structural changes. The first of these was a liberalization of external markets and international trade systems, combined with a very strong revaluation of the peso, as a result of which we suffered a loss of competitiveness of about 15 points in the 1990s. Because of an economic process that started in the 1980s, there was a revaluation of the peso by around 30 per cent, with inflation rates up to 20 per cent combined with a devaluation of only five to 8 per cent per year. Hence the export sector lost competitiveness.

The second structural change that our economy underwent in the 1980s was the crisis of coffee. The change in conditions on world markets and the termination of quotas at the end of the 1980s and in the early 1990s changed the whole scenario for the trading of this commodity. Colombia was highly dependent on coffee exports between 1970 and 1980. Coffee accounted for about 80 per cent of all our exports. Today it accounts for only 10 per cent of our total exports. The scenario changed dramatically in a matter of five or seven years. In the 1970s and in the 1980s, we also went through a time where we had very good prices for coffee. There were three or four years where we had price booms. We got US\$ 2.50-3.00 per pound of coffee in the 1970s and the early 1980s, while we now have prices of 62 cents per pound. Furthermore, US\$ 2 at that time would be worth about US\$ 7 today.

In the construction sector, there were also big surprises. This very important pillar of our development partially collapsed. There was a major contraction in construction due to some disturbances in the financial system for long-term loans between the 1980s and 1990s. In earlier times, the financial system for construction was linked to the consumer price index, which in turn would reflect the increase in salaries of individual people. From the end of the 1970s and throughout the 1980s, it was no longer linked to the rate of salaries, but rather to interest rates in the financial markets. These rates do not reflect very well in the short run what will happen to these debts in the long term, and this is what triggered the crisis: Because prices fluctuated violently and the debtors were not able to repay. This came together with a great revitalization of assets, which brought about a collapse of US\$ 1.5 billion in debts. This was the downfall of a big pillar for construction in the previous decades. We went from very high peaks of construction in the 1970s and 1980s, and this brought about a big surplus of employment because the construction sector typically generates a great deal of economic activity and many job opportunities.

In 1998 to 1999 there was a crisis in the financial sector. High interest rates meant that industries and families were not able to pay back their debts. The financial sector had to be injected with large sums from public resources in order to avoid a collapse of the Commercial and Trade Bank of Colombia. Finally, at the beginning of the 1990s, we had begun a very strong decentralization process within our constitution, which implied a large-scale transfer of fiscal revenues to the different regions in 1991. This brought about a very high increase in public expenditure during the decade of the 1990s. All these structural imbalances contributed to the destabilization of the whole economic system. In the middle of the 1990s we had three or four elements coming together at the same time, thus generating the conditions for the recession that lasted until 1999.

We have had economic statistics for 50 years and we have never gone through a recession ever since we have had statistics. We had only been close to zero growth rates on two occasions. The combination of factors listed a few moments ago brought about the situation in 1991 when we had a zero per cent growth rate, which later dropped to -4.2 per cent. This was a very difficult situation for Colombia, whose economy had always performed in a relatively stable manner in the past. In 1999 we witnessed an unemployment rate of 20 per cent, which was something new for us. Unemployment had been about 7-8 per cent in Colombia in the previous years, but in 1999 we reached 20 per cent.

There we lost what we had gained in terms of reducing poverty during the previous 15 to 20 years. We were back to the figures of ten years before. One could say that we lost a decade. The social improvement indexes and our struggle against poverty had made a lot of progress in the previous years, but in 1998 we finally reached the average of all Latin American countries. As the document says, 64 per cent of the inhabitants in Latin America live under the poverty line and 23 per cent live in extreme poverty. This was the result of the second part of structural imbalances in the second half of the 1990s.

I also have to mention another problem that has affected us for many decades, namely violence and terrorism, which has also negatively affected economic growth and generation of economic activities. The economic recovery is one of the main objectives of our current government and I think that we have made very important progress over the past year and a half. We are beginning to see a better future, slowly recovering what was lost over the past years. It cannot be denied, however, that this was another factor that worsened the economic situation in Colombia in the middle of the 1990s.

This brings us to the present, the beginning of our current government about a year and a half ago. After having had unemployment rates of up to 20 per cent and a drop in GDP, we are now working in three main areas. The Government has delineated the following basic points:

1. To secure the democracy. We have to generate the conditions for safety and security at all levels. In the economic field, it is clear that there is a prerequisite for stability. Democratic safety and security as well as the struggle against violence and terrorism are very important issues and constitute a central line of work.
2. The struggle against corruption, as mentioned in the UNIDO issue paper and also referred to by those who took the floor before me. As in all Latin American countries, we find this problem in our country. This increases the transaction costs among private agents and ends up being a negative factor for the economic growth.
3. To work actively in pursuit of social and economic reactivation. With regard to social and economic reactivation, which is the basic prerequisite for the reduction of poverty, the generation of growth and redistribution of wealth are central.

In relation to social and economic reactivation, we are first of all trying to adjust the basic economic variables. As we have seen earlier, those variables were deeply affected during the second half of the 1990s, so they now have to be readjusted. Inflation rates are now firmly established below the 10 per cent line and in the past three years substantially less. Projections for 2003 show a level of up to 6 per cent, and for 2004 of 5.0-5.5 per cent. The interest rates have stabilized at the level that fosters credit reactivation. Before the end of the 1990s we had interest rates of more than 30 per cent and between 1995 and 1997 of more than 50 per cent per year. Today we have interest rates that are quite acceptable with a view to generating recovery of credit once again.

Among the things that are still pending for consolidation or readjustment, is the exchange rate. We were able to recover our levels of 1992-1995. Today we have an exchange rate that has reached the most competitive level for 15-20 years. We think that this has also been a very important factor in the recovery of our export capacity. In a very short time this year, we have been able to substitute the drop in commercial trade activities with Venezuela, caused by problems in that country. Indeed, Venezuela is one of the most important trading partners for Colombia along with Ecuador and the USA. The drop in trade with regard to Venezuela was 70 per cent in the past year and that represents 25 per cent of our trade balance. Fortunately, this could be offset by increasing our exports to the USA and other countries in the region. The exchange rate, which is one of the most important motors for the generation of economic growth, is well balanced again and we expect it to stay that way so that it can continue to generate economic activity.

In the fiscal area some adjustments still have to be made. Traditionally we cannot say that there have been great imbalances in the fiscal area. We had a consolidated fiscal deficit of 1.5-2.0 per cent at the end of the 1980s, but we are now reaching almost 3.0-3.5 per cent. This still has to be adjusted. Recently there was a proposal for work in the fiscal area, but this is still being studied in Congress.

There is a tax reform that could address this element, one of the remaining macroeconomic elements that are necessary in order to achieve proper economic recovery.

Parallel to all of this, it is necessary to generate redistribution policies, social policies – policies that will allow the insertion of all citizens in the economy so that they can enjoy the fruits of development. We are working hard to support small and medium-sized enterprises. This is another very important goal for the government, and we have still have certain resources in our budget for that purpose

We also support micro-enterprises in Colombia. We are carrying out very important work with all available resources to give all the small enterprises access to credit. The only sources that we are not using for this type of credit are resources from the national budget. We do not think that the government should act as a bank in this case, and that we should not be giving loans to the small enterprises. However, we are working very closely with private banks and non-governmental organizations (NGOs) that are working with small entrepreneurs in the country. They in turn receive international assistance at considerable levels. We are also working on programmes for the strengthening of the guarantee system that will facilitate credit for our entrepreneurs.

After the first 15 years of government, we have developed a credit programme that grants US\$ 350 million to US\$ 400 million of credit to small enterprises that had no access to loans in the past. Whether they do this in an autonomous way or through an agent in charge of giving the loans, this is a way of constructing the social network to strengthen enterprises in times of such high unemployment rates. We also have a social policy for health with direct subsidies to the most vulnerable population groups. These are very ambitious goals. For example, in the case of schooling, the goal is to increase the number of scholarships to one million.

In the beginning of the 1990s, there was a reform in the health system of Colombia, which achieved great progress in family coverage in 1993. Before, there was a personal affiliation to the health system just for the workers but in 1993 the whole family of the worker was included in the social system, which brought much greater coverage. We still have to continue working, because there is a great percentage of the population still without coverage. Still, we have to say that we have seen a lot of improvements.

These are the fundamental lines for social and redistribution policies, together with subsidies, that are being redirected to the most vulnerable groups. This is being done by the presidency of the country. We believe that the basic variables are beginning to be adjusted. We have recovered our growth rates, and we no longer have the high inflation rates of the past. In 2002, growth was 1.3 per cent, and for 2003 we forecast 3 per cent. The figures for the last quarter that ended in September were quite good at 3.95 per cent. We are thus beginning to recover the lost time and also mitigate the great suffering of the majority of the Colombian population. This is the necessary way back after having gone through such difficult years because of these fundamental structural imbalances. We have to work harder to generate work and generate more wealth, which should also be complimented by policies of social redistribution so that all can share the wealth.

We also face the challenges of open economies and negotiation of trade treaties within the American region. This is something that is being constantly discussed within Latin America, and within the American countries in general. We believe that this is a very delicate and complex issue, and also one that might change the productive system and life in general in the Latin American countries.

This is a process that needs to be undertaken with great responsibility. No matter how difficult, no matter how asymmetric, it should be tackled because of the great importance that it might have for the development of all countries. This is a process that should be carried out together between the government and the private sector. If we go about it carefully, it will enable us all to be winners in the end. However, we must be aware of all the asymmetries that could arise if we do not find a way to gain entrance to the international market.

This has been a very quick glance at what has happened to us. We suffered disadvantages and advantages of growth, we saw recession, and we recently understood for the first time in our economic life that these difficulties in growth make poverty problems become more acute. As Latin Americans we should all work together if we want all Latin American economies to once be able to reduce poverty to the level of zero.

Thank you very much for your attention.







**UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION**

Vienna International Centre, P.O. Box 300, A-1400 Vienna, Austria

Telephone: (+43 1) 26026-0, Fax: (+43 1) 26926-69

E-mail: [unido@unido.org](mailto:unido@unido.org), Internet: <http://www.unido.org>