

THE IMPACT OF STABILISATION PROGRAMMES ON INDUSTRIALISATION IN OIC MEMBER COUNTRIES

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The paper argues that less industrially developed OIC countries can achieve sound industrial development by supplementing SAP stabilisation measures with determined efforts to remove supply-side constraints. Macroeconomic stability, however, is a necessary, but not sufficient, condition for accelerating the pace of industrial development; to make it sufficient, productive efficiencies should be strengthened.

The paper suggests that a redesigning of macro strategies should give equal importance to relieving supply-side rigidities. It draws lessons from the experience of selected OIC member countries in fostering the pace of industrial expansion and in implementing stabilisation measures. To that end, it outlines the key components of industrial policy. It recommends policies to build domestic capacities such as increase of public and private investment in infrastructure and in skill-augmenting activities. It advocates the proviso of performance-linked incentives to the private sector that are in accord with the 'correct' price signal. Overall, the paper promotes a selective and flexible industrial strategy which targets a high-growth sector that is capable to adjust to change.

1. INDUSTRIAL RESPONSE TO STABILISATION PROGRAMMES

Since the mid-1980s, a large number of member countries of the Organisation of the Islamic Conference (OIC) have adopted macroeconomic strategies within the framework of stabilisation and adjustment programmes sponsored by the IMF and the World Bank. It is being increasingly realised that macroeconomic fundamentals are necessary to foster a healthy pace of industrial expansion and that stabilisation measures and structural adjustment initiatives will need to be supplemented by determined efforts to remove supply-side constraints. Past industrialisation strategies with a mix of import substitution, overvalued exchange rates, heavy investment in "strategic" state-owned enterprises and widespread controls of foreign currency allocations, prices, wages and investment needed a critical review in the light of rapidly changing determinants of industrial efficiency and expansion. Microeconomic efficiency and the resultant pace of industrial expansion depend on macroeconomic stabilisation and largely on the removal of supply-side

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rigidities. Without relieving major supply-side constraints on industrial sector growth policy fine tuning can have little effect on firm performance.

Significant differences in performance among OIC member countries exist both geographically and between large and small countries, resource-rich and resource-poor countries, and among countries which have successfully implemented structural adjustment programmes and others which have achieved some degree of industrial progress without total commitment to structural adjustment and stabilisation programmes. While it is difficult to gauge the degree of responsiveness of the manufacturing sector in terms of supply response to new growth impulses stemming from structural adjustment and stabilisation programmes, an attempt is made in this paper to draw lessons from the experience of selected OIC member countries in fostering the pace of industrial expansion and in implementing stabilisation measures.

Dwelling on selected OIC member country experiences, it is suggested that macroeconomic stability is a necessary condition and that in order to make it a sufficient condition for accelerating the pace of industrial development productive efficiencies should be strengthened. Non-price factors are as important as currency devaluation and demand management policies. A redesigning of macro strategies requires that equal importance be given to relieving supply-side rigidities. This is not primarily a matter of providing incentives and "correct" price signals to private investors but of increasing public and private investment in infrastructure and skill augmenting activities. Measures to relieve supply-side constraints should, therefore, supplement incentive restructuring initiatives.

2. UNEVEN MANUFACTURING GROWTH ACROSS OIC MEMBER STATES

Differences in manufacturing growth rates across OIC member countries are readily observable at scales ranging from double-digit growth to subdued and even negative growth rates. Each developing region has a small contingent of industrially fast growing OIC member countries while a number of OIC countries have been falling behind. A quick glance at Table 1 reveals the highly skewed pace of manufacturing expansion among OIC member countries. Growth of manufacturing value added (MVA) was fastest in Uganda, with MVA growing at an average annual rate of 13.4 per cent during 1990-1996. The second fastest growing OIC member country in terms of MVA growth during the same period was Malaysia (13.2 per cent), followed by Indonesia (11.1 per cent), Jordan (10.8 per cent), Burkina Faso (9.8 per cent), Bangladesh (7.3 per cent), Pakistan (5.5 per cent), Turkey (5.3 per cent),

Tunisia (5.2 per cent), Mali (4.9 per cent) and Iran (4.6 per cent). Of the 55 OIC member countries listed in Table 1, four countries experienced negative average annual growth rates of MVA during 1990-1996. A few countries such as Malaysia and Indonesia emerged as newly industrialising countries (NICs) in the 1980s, using manufacturing as the principal propellant of economic progress. Foreign trade and increased interaction with the global economy were the major sources of growth in these economies. Manufacturing growth remained subdued in the 1990s at around 1 per cent in Gabon, Gambia, Niger and United Arab Emirates.

As many as 19 OIC member countries are late-comers in the sphere of industrialisation, and the opening up of international financial and commodity markets is yet to create an impact on the pace of industrial development in a large number of least developed Islamic countries. Of the 19 least developed OIC member countries 15 are in Africa. Fast-growing countries have been those that have managed to industrialise by developing a comparative advantage in manufactured exports to the point where these manufactured exports have become the engine of growth.¹ This pattern of growth, characterised by a growing share of manufacturing value added in GDP and a rising ratio of manufactured exports in total exports, marks the first phase of globalisation of industry in developing countries.

Table 1. Average annual growth rate of MVA in OIC member countries, 1990-96

Country	Average annual % growth	Country	Average annual % growth
Afghanistan	..	Maldives	..
Albania	..	Mali	4.9
Algeria	-8.9	Mauritania	2.1
Azerbaijan	..	Morocco	2.5
Bahrain	..	Mozambique	..
Bangladesh	7.3	Niger	1.2
Benin	..	Nigeria	-1.5
Brunei	..	Oman	..
Burkina Faso	9.8	Pakistan	5.5
Cameroon	-2.1	Palestine	..
Chad	-2.6	Qatar	..
Comoros	..	Saudi Arabia	..

¹ UNIDO, *The Globalization of Industry: Implications for Developing Countries Beyond 2000*, December 1996.

Country	Average annual % growth	Country	Average annual % growth
Djibouti	..	Senegal	3.5
Egypt	4.3	Sierra Leone	..
Gabon	0.2	Somalia	..
Gambia	1.6	Sudan	..
Guinea	..	Suriname	..
Guinea Bissau	..	Syria	..
Indonesia	11.1	Tajikistan	..
Iran	4.6	Togo	-0.1
Iraq	..	Tunisia	5.2
Jordan	10.8	Turkey	5.3
Kuwait	..	Turkmenistan	..
Kazakistan	..	Uganda	13.4
Kyrgyzistan	..	United Arab Emirates	1.3
Lebanon	..	Uzbekistan	-5.6
Libya	..	Yemen	..
Malaysia	13.2		

Source: World Bank, World Development Indicators 1998.

With very low MVA per capita the least developed countries are at a serious disadvantage. In a number of LDCs, industrial growth remains demand-constrained due to the lack of purchasing power. While LDCs as a group registered just 1 per cent average annual growth of GDP and less than 1 per cent growth of MVA during 1985-1995, a number of LDCs did perform much better. Manufacturing value added in Uganda and Bangladesh grew significantly. The way these OIC member countries emerged as examples of best policy practice merits mention.

3. LESSONS FROM SELECTED COUNTRY EXPERIENCES

3.1. Uganda: Sustained stabilisation and industrialisation

Against the backdrop of economic collapse, and faced with limited options, the National Resistance Movement (NRM) Government launched in 1987 a comprehensive programme of IMF-inspired and supported economic recovery, designed explicitly to redress the prevailing macroeconomic disequilibria. A major component of the programme has also been to rebuild the country's physical infrastructure, rehabilitate the productive capacity of the economy, as well as strengthen key institutions to underpin prospects for sustained economic growth.

In the early 1990s, Uganda replaced Ghana as the African «miracle» economy. During the period 1986/87 to 1995/96 GDP growth averaged about 7 per cent per annum, although annual fluctuations have been wide. Investment grew rapidly in the early years of the recovery (up to 1989/90) but subsequently slowed. The investment-GDP ratio in 1995 is estimated at 16 per cent which was lower than the average figure for Africa as a whole during the 1987-1995 period. Much of the investment during the 1987-1994 period was in land and buildings while the share of machinery and equipment in investment was very low. This trend has partially been offset since 1995. Nevertheless it remains true that for most of the period Uganda has grown with only a modest level of investment.

Uganda's economic recovery has been accompanied by wide ranging SAF/ESAF-related stabilisation measures. Since the new Government assumed office three consecutive agreements have been signed with the IMF and four structural adjustment and ten sectoral and other adjustment loans from the World Bank have been obtained. The emphasis of the structural adjustment programmes have been on fiscal and monetary policy changes. The fiscal deficit to GDP ratio has, however, risen from 4.2 per cent of GDP in 1985/86 to 11.6 per cent in 1993/94. Revenue shortfalls were severe in 1996/97 amounting to \$30 million and resulting in the introduction of an austerity budget for 1997/98. Tax revenue as a proportion of GNP is about 11 per cent, well below the Sub-Saharan African average of 18 per cent. Aid finances roughly 40 per cent of current outflows and 80 per cent of development expenditures in a typical year.

Since 1992/93 credit and fiscal management policies have been changed significantly. Controls over domestic bank lending, apart from prudential controls, have been removed. Financial institutions are not obliged to lend to the Government; Government borrowing takes the form of Treasury Bill auctions in which banks and non-banks may participate. Uganda has stopped direct loans to public enterprises, as well as excessive overdraft facilities for commercial banks. In addition, interest rates have been fully liberalised. Inflation control has been one of the main achievements, as annual average inflation declined from 42 per cent in 1991/92 to about 3 per cent in 1995/96.

The number of public development programmes has been reduced from about 800 in the late 1980s to about 160 in mid 1990s. While marketing monopolies have been removed, the Government of Uganda continues to have a large parastatal sector which contributes 7 to 8 per cent of GDP and formal employment. The public enterprise reform and divestiture programme have

suffered from design problems and slow progress. Government has overhauled its strategy recently to stress effective financial control of all parastatals, faster speed of privatisation, predictability of the divestiture exercise, and consensus building among Ugandans on privatisation. The reform is yet to produce the expected results but recent efforts are promising in achieving a leaner parastatal sector and more efficient provision of services.

Until the end of 1991, the real effective exchange rate (REER) was depreciating strongly (by about 40 per cent in 1990-1991). It then remained more or less stable until mid-1993 when it appreciated by more than 30 per cent in June 1994. Since then, the REER has depreciated slightly. Initially, after the introduction of the interbank market, the central bank intervened modestly by market smoothing, but since September 1994 the Bank of Uganda has been accumulating foreign reserves as a consequence of coffee price increases. Uganda's export-GNP ratio fluctuates widely depending on the price of coffee which provides the bulk of export earnings. In 1985, when prices rose sharply, coffee accounted for 73 per cent of total export earnings. Non-traditional export earnings (gold, fish and fish products, beans and hides) have also tended to fluctuate widely. Non-traditional agricultural exports have, however, done well on the whole.

Overall, the coherent implementation of adjustment measures has produced significant macroeconomic gains and placed the economy on the path of sustained low-inflationary growth over the medium term. Real GDP growth averaged in excess of 6.0 per cent annually over the decade 1986-1996, while inflationary pressures have been contained, with annual inflation falling below 6.0 per cent in 1996. Greater stability and predictability have proven supportive to domestic manufacturing activity, and the sector has grown dramatically from late-1980s onwards, registering annual average growth of almost 10 per cent over the period. The corollary of robust manufacturing growth has meant that the share of manufacturing output to aggregate economic output rose from a low of 4.8 per cent in 1986/87 to 7.2 per cent in 1994/95.

Within the manufacturing sector, however, there has been very little structural change in output over the past two decades. Manufacturing continues to be dominated by the processing of locally produced agricultural commodities - indeed, food processing, tobacco and beverages, and textiles and clothing together account for over 60 per cent of aggregate manufacturing output. With respect to quantitative trends in employment, the contribution of manufacturing to total employment remains small, with employment in manufacturing, and industry more broadly, dwarfed by the agricultural sector.

Various estimates place the figure at between 3 and 5 per cent. Crucially, most workers in industry are now can be found in small-scale activities. According to the latest official figures, manufacturing enterprises with five or more workers together accounted for just about one quarter of the total industrial workforce and less than 1.0 per cent of the labour force.

One of the most radical changes which has been observed in industry over the past two decades has to do with the institutional framework within which industry operates. With the advent of economic liberalisation in 1987, the Government of Uganda has endeavoured to create an institutional framework conducive to industrial development. To do that, it has had to tear down many of the organisational structures, and psychological barriers that had acutely inhibited manufacturing development. The key activities have been the dismantling of government monopolies and the explicit encouragement of the private sector to participate in large-scale manufacturing activities. For instance, in addition to re-organising the Ministry of Trade to get it to effectively play the crucial policy and facilitating role required of it, new institutional structures that promote industrial development have emerged in the private sector. The most notable is the establishment of the Uganda Manufacturers' Association, an umbrella organisation which represents all of the country's manufacturing firms.

As may be expected, a decisive shift away from the dominance of public ownership has been a central theme of the post-1987 liberalisation programme. The process of privatising public assets has been hamstrung by several factors, not least of which is the fact that the Government has been loath to write off the public enterprises' bad debts, preferring instead to rehabilitate many of the companies so that they can be sold as 'going concerns'. Nevertheless, the Government's commitment to privatisation is unchallengeable, as underscored by its avowed aim of divesting some 85 per cent of the country's parastatals by 1998. In fact the Government has categorically stated that public ownership of assets will be limited only to sectors that are of clear strategic importance, such as utilities and rail transportation. Quicker movement in the transition from public to private ownership has been more noticeable with respect to properties expropriated in 1972.

While the rebound in manufacturing activity is intimately linked to the broader rejuvenation of the economy, one major factor has been the introduction of a more industry-friendly investment code, which provides a general set of investment incentives, guarantees profit repatriation and provides protection against expropriation of assets. The new code has also led

to the establishment of the Uganda Investment Authority (UIA) as a 'one-stop shop' designed to promote and facilitate investment, issue investment licenses and certificates of incentives, determine the terms and conditions imposed on investment, and make recommendations to Government on national policies towards investment. Indeed, since the early-1990s, international confidence in Uganda has been on a sharp ascendancy as potential investors have come to believe in the country's commitment to reform.

3.2. Bangladesh: Selective and targeted growth

The growth of the manufacturing sector has mainly been a consequence of the success achieved by successive governments in maintaining macroeconomic stability. Inflation has been kept at about 5 per cent. There has been a surplus in the current account in recent years and the real effective exchange rate has not fluctuated erratically (in dollar terms the taka has depreciated at an annual average rate of about 2 per cent during 1991-1996). While the fiscal deficit remains high (about 6 per cent of GDP during 1990-96) the Government has had significant success in increasing revenue. In 1990/91 only 10 per cent of development projects could be financed by the Government, but by 1995/96 this proportion had increased to 40 per cent. Public investment played an important part in industrial growth.

Despite Structural Adjustment Facility (SAF) and Enhanced Structural Adjustment Facility (ESAF) programmes, the Government proceeded cautiously with economic liberalisation. While fiscal reform has proceeded apace, monetary policy has been sparingly used. The privatisation programme has remained largely suspended, financial liberalisation progresses slowly and emphasis has been on increasing the efficiency and profitability of state owned enterprises. Tariff reductions have also been modest. These measures were accompanied by reforms related to encouraging private investment. Investment and manufacturing output have grown in a sustained manner for almost a decade in response to these measures.

Manufacturing value added has grown at an annual average rate of over 7.3 per cent during 1990-1996 but the share of manufacturing in GDP is still only 12 per cent. The outstanding success has been the phenomenal growth of the clothing industry which now accounts for almost 60 per cent of total export earnings (as against 10 per cent a decade ago). The share of the clothing sector in MVA has risen from less than 1 per cent in 1985 to about 11 per cent in 1996. The textile branch is twice as large with an MVA share of over 23 per cent. In constant dollar prices productivity has declined in the clothing industry at a significantly faster rate than it has declined in the manufacturing sector as a whole. Employment has grown at a much faster rate in the former. The share of value added in gross output in the clothing branch is significantly lower than the manufacturing sector average. In 1993 the wearing apparel branch ranked 24th out of a total of 28 manufacturing branches in terms of the value added to output ratio. On the other hand, the wage share of value added is higher than the sectoral average and has increased over time. This means

that the gross margin to output ratio was only about 15 per cent in the mid-1990s and has declined significantly over the past decade.

The growth of the wearing apparel industry has been made possible due to government policy initiatives taken in the mid-1980s. They deregulated the industry, establishing bonded warehouses and export processing zones (EPZ) and exempting firms from taxes and customs duties. The industry benefited from the availability of external finance in the form of back to back letters of credit. International subcontracting also allowed firms access to major foreign markets. However, the relatively simple technology and heavy use of unskilled labour has meant that Bangladesh can specialise in low-price standardised products only. The heavy import dependence of the industry means that net export earnings are usually a third of gross foreign exchange earned.

This growth has been almost entirely domestically sourced, financed from corporate and household savings, financial sector borrowing and increasingly important inflows of non-resident workers remittance (these now exceed 5 per cent of GNP and are over \$1.5 billion annually, although it is not clear what proportion of that goes to investment). Foreign direct investment has been very small and although there have been surges of portfolio investment they have been mainly of a speculative character. Concessional assistance has been high averaging \$1.68 billion disbursements annually during 1990-1996.

The country cases discussed above show that there is a wide range of experiences on which a successful industrial strategy can be based. Some broad themes may be enumerated.

- Countries starting at about the level of economic development in which most industrially less developed countries are now can develop viable and dynamic industrial sectors. This does not mean that there is a standard «model» of replication which guarantees success. Useful lessons can be learned from successful cases and elements of strategies can be partly replicated or adapted in the context of a specific national and sectoral environment.
- The two country cases illustrate that the provision of macroeconomic stability, especially inflation control and avoidance of major fluctuations in the exchange rate, is a principal prerequisite to be provided by Government.
- The industrial strategy must be selective and targeted at potentially high growth industrial branches and firms as is the case in Bangladesh. This selective strategy must be flexible and capable of

adjusting to changing circumstances and altering targets and priorities over the medium run.

- Developing a close working relationship between government and private enterprise is crucial. Bangladesh has made some progress in this respect. The incentives and subsidies that government provides must be clearly linked to enterprise performance. Export performance is an effective indicator of the impact of an incentive system on enterprise competitiveness and maturation.
- An important part of the incentive system is the provision of support for technological upgrading and the development of human skills. Bangladesh and Uganda have not achieved marked success in this respect. The type of rapid structural change of MVA that took place in the first and second generation of NICs did not take place in Uganda and Bangladesh despite rapid MVA growth.
- An industrial strategy which neglects the domestic market is unlikely to stimulate broad-based industrial development. Import substitution and export orientation must be seen as complementary policies. Export success must be built on the basis of strong domestic demand growth. Export industries must not be developed as «enclaves» since in this way product quality upgrading becomes difficult. Bangladesh is currently facing this problem.
- The Ugandan case shows that foreign concessional assistance remains very important in the early phase of industrial development; it must be effectively utilised to increase productivity. Foreign private capital cannot play a catalytic role in the early stages. Direct or portfolio investment from international financiers is not attracted by elaborate incentive schemes, nor can it be relied on as the main source of industrial financing.
- However, the building up of strategic partnerships between domestic and carefully selected foreign firms in key sectors remains important. Much of Bangladesh's success in the clothing industries is due to close collaboration of local firms with international suppliers and financiers. There are signs that such co-operation is also growing in the Ugandan agro-business sector.
- Finally, co-operation with neighbouring developing countries is overwhelmingly important. Both Bangladesh and Uganda have benefited from subregional co-operation. Co-operation among OIC member countries could provide important sources of financing and

markets for these countries. The late-comers among the OIC member countries will need to develop strong trade and investment links with at least one of the industrially more developed Islamic countries.

3.3. Egypt: Deepening structural reforms

The reform process in Egypt began to accelerate in the early 1990s under the supervision of the International Monetary Fund (IMF), with which the Government concluded an Economic Reform and Structural Adjustment Program (ERSAP) agreement in May 1991, and the World Bank, which granted a structural adjustment loan (SAL) worth \$300 million in November of that year. A second agreement with the IMF, arranged under its Extended Fund Facility (EFF) was approved in September 1993. Under the conditions attached to the disbursement of these funds, interest rates were gradually freed to encourage the repatriation of funds and credit ceilings were imposed on bank lending to help ease inflationary pressures. By mid-1992, the country's multi-tiered exchange rate system had also been completely reformed, resulting in an effective devaluation of the Egyptian pound and making it internationally convertible. Additional measures introduced to date have included further reductions of subsidies, a reduction and revision of import controls, the enactment of new banking and capital market laws, the commencement of a major privatisation programme and the introduction of a sales tax.

These measures have contributed to a significant improvement in the performance of the Egyptian economy. The trade and payments balances have recorded a particularly dramatic improvement, with the value of petroleum exports soaring to almost \$2 billion in the 1991 fiscal year (ending 30th June) from \$1.3 billion in fiscal 1990, and the current account deficit of \$1.6 billion in fiscal 1990 giving way to a surplus of \$2.2 billion in fiscal 1991, which rose further to \$3.6 billion in fiscal 1992 before falling back to an estimated \$1 billion in 1993. This improvement in the balance of payments was accompanied by a significant decline in Egypt's external indebtedness, which fell from a peak of \$51.9 billion at the end of fiscal 1988 to \$40.6 billion at the end of fiscal 1991.

In addition, the reforms have stimulated a significant growth in industrial output. After 18 months of disagreement between the Government and the IMF, formal negotiations resumed in March 1996, leading to the signing of a new two-year stand-by arrangement in October 1996.

The Programme concentrated *inter alia* on:

- keeping the budget deficit below 1 per cent of GDP;
- containing the rate of inflation at 5 per cent in 1997/98;
- targeting privatisation to yield 5-6 per cent of GDP;
- moving maximum tariff rate to 40 per cent;
- setting July 1999 as a deadline for the elimination of subsidies on petroleum; and
- raising gas and electricity tariff.

Initially it took almost one year for the manufacturing sector to rebound. The rate of growth of manufacturing value added (MVA) increased to 9.3 per cent in 1992 from -1.1 per cent in 1991. Manufacturing value added grew at an average annual rate of 4.3 per cent during 1990-1996. Despite sharply increased profitability of private sector enterprises in response to growth impulses stemming from macroeconomic stability in recent years, a rapid pace of industrial expansion continues to be constrained by the heavy public sector debt burden, and industrial growth seems to remain demand constrained.

3.4. Nigeria: Weak industrial response to macroeconomic stability

The economic performance of Nigeria, Africa's most populous country, has been overwhelmingly influenced by its oil exports. The 1970s oil boom saw a rapid appreciation of the country's real exchange rate, which eroded the competitiveness of non-oil exports such as cocoa, and of import-competing activities including foodstuffs. Oil revenues fell from \$26 billion in 1980 to \$12 billion in 1985, and to \$6.4 billion in 1986 as oil prices collapsed. The Government's response to this massive terms of trade shock to the economy was inflationary financing. The extreme overvaluation of the exchange rate was not addressed until the substantial devaluation in late 1986 under Nigeria's newly started and home-grown Structural Adjustment Programme.

Under the SAP, economic growth restarted and averaged around 6 per cent annually. However, real GDP per head fell by some 5 per cent from 1992 to 1994 as reform policies were abandoned, but resumed thereafter. Accelerating inflation had been brought under control again by 1996 and a series of annual budgets tightened fiscal and monetary policies and introduced attempts at business tax reform. A free market in foreign exchange was permitted, though government transactions continued to be conducted at the highly overvalued official exchange rate.

Box 1. A Vision of Nigerian Manufacturing in 2010

Recognising the importance of industrialisation as an engine for sustained long-run economic growth, Nigeria aims to be the leading industrial economy in Africa and a significant world industrial player by the year 2010. The intention is to raise the share of manufacturing industry in GDP to 25 per cent by that date compared to its 6.7 per cent share in 1996.

Short-term policies to achieve Nigeria's long-term goals include:

- fiscal measures to boost consumer demand and raise industrial capacity utilisation without causing inflation. These include direct tax reductions, although VAT collections will rise, and accelerated depreciation allowances
- selective, time-limited protection of local industries
- reduction in bureaucratic obstacles to investment

Medium and longer term measures include:

- action to improve Nigeria's run-down infrastructure
- a stress on raising domestic savings as the main source of increased investment
- the creation of an enabling environment for investment, including easier access to landed property.

Source: Nigeria, Vision 2010 Committee (Subcommittee on Industry), *Final Report: Manufacturing Industry*, 1997.

Average annual growth rate of manufacturing value added remained negative at -1.5 per cent during 1990-1996. Agro-related industries are important in Nigerian manufacturing. Food, beverages and tobacco generated a third of manufacturing output in 1996, and this share rises to almost a half if textiles and apparel are included. There are multinational companies involved in a number of industrial sectors including food processing and tyre manufacture. Industry in Nigeria still faces many constraints and a legacy of inefficiency as a result of past import-substituting industrialisation policies. Average capacity utilisation was under 30 per cent in 1996, though it was higher in resource-based industries such as food processing, compared to more import-dependent activities such as the electrical subsector. Low capacity utilisation results in part from lack of consumer purchasing power as a result of government retrenchment and macroeconomic restrictions. There are also many infrastructural constraints, including an almost non-functioning rail system and many deficiencies in electricity and water supply and

telecommunications. Despite some attempts at trade reform, effective rates of protection against industrial imports remain high and variable, though informal imports increase the competition which domestic enterprises face.

Despite its achievement of a degree of macroeconomic stability and a largely market-based exchange rate by the mid-1990s, Nigeria's real income and consumption per head still had not regained the levels of the early 1970s before the oil boom. The country now has plans to accelerate its development by fostering more rapid industrialisation within the framework of Vision 2010. Nigeria undoubtedly has great potential both in terms of future domestic market growth and competitiveness in a range of agro-related industries both internationally and regionally. Within ECOWAS, Nigeria is already a significant informal exporter of textiles and agricultural machinery.

3.5. Indonesia and Malaysia: Lessons from the rise and fall of economic miracle

Using manufacturing as a dynamic force, Indonesia and Malaysia achieved rapid economic transformation and emerged as newly industrialising countries. The countries' macro- and micro-economic fundamentals stood as models of best policy practice for other countries to replicate. The East Asian economic flu emanating from Thailand in mid-1997 spread across the region and infected Indonesia and Malaysia. It is useful to reflect on what really went wrong in the face of liberalisation and deregulation. The obvious cause of the sudden demise of the so-called dynamic growth models of the 'Tigers of East Asia' was the liberal-lending-induced excessive levels of investment in increasingly unprofitable manufacturing activities and real estate, disproportionately funded by bad debt. The situation was exacerbated by the fact that this investment was concentrated in manufacturing activities characterised by global excess capacity. Triggered by some of these countries' reluctance to accept outside equity, these investments relied heavily on domestic and, to a large extent, external finance. As the private sector's indebtedness to financial institutions rose, heavily-indebted manufacturing sectors became increasingly vulnerable to a change in the attitude of short-term lenders.

As the crisis sent stocks tumbling around the globe, opinion- and policy makers urged governments to boost growth through domestic demand. What turns out to be important is that bold and decisive action is needed to control capital flow and monitor the banking system. Thus, it is being increasingly

realised that the State has a crucial role to play in strengthening the mechanism for capital monitoring. The East Asian financial crisis resulted in:

- falling GDP and manufacturing output;
- exchange rate depreciation;
- loss of investor confidence;
- capital flight;
- skills flight;
- massive speculation;
- industrial excess capacity;
- and redundancy of accumulated skills.

3.6. Key issues

There are three major issues highlighted by the East Asian crisis.

- First, the key issue is whether financial liberalisation has failed. Does the East Asian economic crisis imply end of globalisation? The East Asian vulnerability to international financial outflows was created by the escalated pace of financial liberalisation undertaken by the Asian countries. OIC countries would need to be cautious in introducing similar policies of financial liberalisation.
- Second, the least developed countries' main source of development finance must continue to be ODA. Such flows are less volatile than portfolio foreign investment (PFI) and foreign direct investment (FDI), since ODA commitments are usually of a long-term nature. LDCs will need to ensure (a) that ODA flows are not reduced in real terms - that is, that the Asian and Russian bail-outs are not at the expense of the LDCs; and (b) that the maturities of ODA funds are not reduced and that they are assured for financing projects that increase LDCs' productive capacity to service their debts.
- Third, the main concern must be to stimulate the growth of domestic savings. A strengthening of the supervision and performance monitoring system for financial institutions is needed. Re-capitalisation and restructuring of banks could be accompanied by the introduction and implementation of rigorous prudential regulations. Credit planning could be introduced since interest rate liberalisation has failed to stimulate savings and to improve the efficiency of investment decisions. Efforts could also be made to facilitate and monitor intra-OIC member countries financial flows.

The causes of the East Asian financial crisis are rooted in private sector financial mismanagement, weakness of national financial structures, instability of the international financial system, lack of capital monitoring and transparency, and increased vulnerability to external private financial flows. The potential impact on industrial development in OIC member countries of the Asian crisis may therefore be viewed in the context of:

- declining competitiveness in relation to Asia's increased devaluation-induced competitiveness;
- falling commodity prices affecting economic performance;
- reduced growth of world output which may have spill-over effects; and
- worsening trade prospects of OIC member economies.

The key policy issues which would need to be addressed by OIC member country policy makers in this context include, *inter alia*:

- reassessing the viability of financial liberalisation;
- improving the institutional framework for capital monitoring;
- preventing a resultant fall in ODA flows to least developed OIC member countries;
- mobilising domestic capital;
- reducing the vulnerability of OIC member countries to external shocks; and
- strengthening intra-OIC trade and investment.

4. KEY INDUSTRIAL POLICY COMPONENTS

Industrial policy components will need to supplement stabilisation measures through the strengthening of domestic capacity to remove supply-side rigidities and thereby supplementing stabilisation and structural adjustment initiatives towards accelerating industrial growth. UNIDO plays a crucial role in strengthening the required domestic capacity for sustainable industrial development. Domestic capacity building involves conversion of human capital into human capability, technological upgrading, strengthening of the infrastructural base, and creation of an efficient institutional framework capable of sustaining a healthy pace of industrial expansion.

4.1. Domestic capacity building for productivity growth

Domestic capacity building for productivity enhancement is being increasingly recognised as the principal determinant of economic growth and prosperity. A period of rapid industrial growth experienced by England when it emerged as the pioneer of industrial revolution was characterised by a dramatic increase in domestic productivity growth. The rapid economic transformation of the US and Japanese economies was also primarily ascribed to domestic capacity-building in general and significant increases in domestic productivity growth in particular. The first and second generations of newly industrialising countries accorded top-most priority to domestic capacity-building for domestic productivity growth as the principal propellant of a rapid pace of industrial growth. These developments lend credence to the fact that rapid industrial growth and the resultant increase in living standards are determined largely by domestic factors, primarily the rate of growth of productivity growth.

OIC member states' endeavour to achieve a rapid economic transformation is apt to be won or lost in the sphere of converting the reservoir of human capital into human capability for productivity enhancement. Human and technological capacity-building is important even for the development of low technology, labour-intensive and resource-based industries and for enhancing their capability to increase value added, employment and competitiveness. The processing of natural resources needs skills similar to those of more general manufacturing development. There is no contradiction between specialising in low-technology activities in the initial phase of industrialisation and higher degree of industrialisation in the longer term. Modification of imported capital equipment to local conditions (for example, to different qualities or types of raw materials) facilitates technical learning among domestic technicians and thereby contributes to industrial efficiency through productivity growth.

It is crucial to remove supply-side constraints in order to make stabilisation measures sufficient to exert a positive impact on industrial growth. A weak infrastructural base is generally recognised as a major constraint adversely affecting the efficiency of industrial production. Industrially more developed OIC member states have provided substantive policy support for the creation of a strong infrastructural base. Infrastructural bottlenecks in industrially less developed OIC member states constrains productivity gains in almost every aspect of industrial activity, from primary production to downstream processing and marketing.

Another important constraint on productivity growth and on entrepreneurial development is a serious malfunctioning of the industrial financing system in industrially less developed OIC member countries. Domestic savings, both household and corporate remain very low and financial intermediation processes are becoming increasingly ineffective. Enterprise upgrading and increased international competitiveness are not possible while the domestic industrial financial system is not effective and foreign concessional assistance is targeted almost exclusively at relieving balance of payments constraints. Equally important is the creation of an enabling environment for attracting foreign direct investment.

4.2. Technology policy

Technology policy should take account of local conditions and levels of development. Sources of competitiveness vary according to socio-economic conditions prevailing in a country. At early stages of assembly operations standard technologies and engineering skills are of primary importance. Traditional skills also play an equally important role. The industrial miracle of Sialkot in Pakistan lends credence to the fact that traditional skills could also be attuned to a high degree of precision and export dynamism. Much of Sialkot's success in making tennis rackets, hockey equipment, footballs, and surgical instruments is the result of cultural spillover, effectively enabling every other household to be a complete export-oriented unit in an environment of export dynamism.²

Technology policies could aim at stimulating market demand for innovation and establish a domestic capacity for the management of R&D systems. International competitiveness growth requires that several firms grow rapidly through technological learning. Buyers - anxious to ensure product quality - can be of invaluable help in technology sourcing. Governments can also play a catalytic role by setting ambitious targets. Similar pressures can also be put on public and private research institutes by forcing them to be self sustaining through links with firms. Finally, governments can also stimulate technological upgrading by encouraging the growth of venture capital initiatives among OIC member countries.

4.3. Promoting micro and small industry clusters

² UNIDO, *New Trends and Challenges in Industrial Policy: Proceedings and Seminar Papers*, Vienna, 16-17 October 1997.

An overwhelmingly large proportion of industrial enterprises in many OIC member countries can be characterised as micro or very small enterprises. These small and micro enterprises are usually survival mechanisms - exploiting diseconomies of scale, thriving on informal contacts (especially for information and credit) and absorbing displaced labour from agriculture, large-scale manufacturing and the service sector.

They proliferate at a rapid rate, but survival rates are low. What is even more significant is that these small and micro enterprises hardly ever graduate into the formal sector. This is the problem of the missing middle; the virtual absence of medium-sized modern formal sector firms in many African countries.

The growth of industrial districts and firm clustering has been noted in several developing countries. These clusters include both large and small firms and in some instances make a significant contribution to export growth and "collective efficiency". Such clusters are characterised by high levels of subcontracting based on firm specialisation and inter-firm co-operation, which leads to the emergence of industrial associations that establish co-operative institutions for the organisation of trade fairs, technology upgrading and marketing. Empirical evidence seems to illustrate that such collaborations are a response to market conditions and firm level co-operation has to be strongly supported by the Government for it to thrive. Appropriate policies could be adopted to encourage industrial clustering among small and micro enterprises and to foster closer links between major producers and their suppliers.

4.4. Support to industry associations

The private sector industrial associations should be made the main conduits for the transfer of information technologies, marketing and training support to the individual entrepreneur. It is important to use these associations as nodal points for delivery of services and support to large groups of small and micro enterprises. Large commercial users and distributors of small and micro enterprise products can also play this role. Using such commercial channels ensures that support provided is specific to the needs of the targeted sectors and immediately useful in eliminating supply constraints and enhancing collective efficiency. A move from generalised sector support to support targeted to the achievement of specific output and organisational efficiency bench markers can be most productive.

The development of efficient small and micro enterprises clusters is crucially important for increasing their competitiveness specially in

international markets. Typically such clusters are formed around and under the leadership of large firms which facilitate concentration on core competencies by even small producers. The challenge of globalisation requires increased inter-enterprise co-operation. In Pakistan large firms have provided effective leadership in reorganising small firms and in internalising their operations by physically linking them to large firm production structures. Obligational relationships have developed and small and micro enterprises have been able to take advantage of the closer links that major firms have developed with buying groups - a major consequence of globalisation has been the increased power of these groups.

Policy support for small and micro enterprises could encourage the type of clusters in which a core company responsible for logistic functions of financing, innovation and marketing emerges and consolidates the cluster. This is essential to prevent free riding within the cluster. The overall policy framework must "regard the existing national/local tradition and structure the provision of inputs (education, training, research, marketing) within this context. Policy should concentrate on upgrading (technologically and financially) a group of dynamic small and micro enterprises and establish conditions of regrouping among them.

4.5. Micro credit schemes

A major constraint on small and micro enterprises development is the scarcity of institutionalised credit. Many innovative schemes have been adapted, indeed this seems to be something of a growth industry. Such schemes have suffered from two structural weaknesses. Firstly, they have usually been initiated and operated by NGOs with mainly social, rather than commercial, orientation. Hence the problem of multiplicity of objectives has obstructed the growth of efficient resource allocation. Secondly, even highly publicised schemes such as Grameen Bank are subsidised by external sources and are concerned primarily with employment growth of specific segments of society, not with enterprise upgrading *per se*. Loans extended by such institutions are very small, quite insufficient to meet capital or technology upgrading needs required for enterprise transition to formal, medium level status. It is clear that such NGO-run schemes cannot make a major contribution to addressing the problem of the "missing middle" in the industrial enterprise structure of particularly OIC countries in Africa.

For a micro credit scheme to be a successful means for increasing enterprise efficiency and achieving technological upgrading it should have the following characteristics:

- It should be sponsored by a major domestic commercial bank (the business orientation of foreign banks make them unsuitable sponsors).
- It must provide supervised credit in appropriate financial packages; leasing of machinery and technology could be a major financial channel.
- Credit should not be subsidised; the scheme should aim to become fully self-sustaining and market-competitive within a specific period.
- The scheme should be administrated by micro credit officers based in localities where credit is extended. The micro credit officers should be responsible for project assessment, credit disbursement, monitoring and recovering of loans. A credit officer should handle a maximum of 20 cases. A 95 to 98 per cent recovery rate should be normally achieved.
- Incentives should be provided for enterprise clustering both among small and micro enterprises and between small and micro enterprises and medium- and large-scale firms.

4.6. Financial restructuring and privatisation

The development of commercially viable micro enterprise credit schemes can also prove useful in the mobilisation of informal and household sector savings. A bank in Pakistan which successfully ran such a scheme during 1993-1995 mobilised deposits in excess of the credit it extended to micro enterprises.³

Formal financial institutions are in a state of crisis in many least developed OIC member countries. Uncollectible debts have mounted, credit lines have dried up and profits have been further squeezed due to the virtual disappearance of credit worthy clients. A major restructuring of the financial sector is thus a pre-requisite for the restoration of investors confidence. The restoration of financial capability must involve major institutional restructuring. It could involve the construction of new financial institutions out of the debris of the old, the putting together of viable business segments of existing institutions through mergers and acquisitions, the recapitalisation of

³ Ansari, J.A., «Microenterprise credit schemes in Pakistan», *Journal of the Institute of Bankers and Corporate*, 1995, Vol. 18, pp. 23-60.

these new viable institutions and the establishment of a closer link between financiers and enterprises that are financed. Rebuilding the financial system with a policy accent on capital control and monitoring is needed.

Privatisation programmes of many OIC countries have stalled. If the privatisation programme is to be revitalised, an attempt must be made to restore viability of major projects in the process of privatisation. The effort to attract foreign investment to the projects could focus on non-speculative portfolio investment which has shown encouraging trends in recent years. ODA funds may be used to attract FDI to privatisation and project rehabilitation initiatives.

A large and increasing proportion of aid is in support of macroeconomic adjustment programmes. Aid dedicated to enterprise restructuring, project rehabilitation and the promotion of privatisation initiatives is very small. There is a case for using funds mobilised by the Islamic Development Bank to revitalise the privatisation and project rehabilitation programme. Intra-OIC financial flows can be dedicated to the revitalisation of industrial projects. It could also be used for part-financing industrial sector projects which can earn or save foreign exchange. It could be seen as a mechanism for creating conditions and providing a bridge head for the inflow of private sector capital to OIC member states. Participation by OIC official agencies in project rehabilitation and privatisation programmes can enhance creditworthiness, reduce risks and induce international private investors to participate.

Another important contribution OIC can make to industrial development in OIC member states is the development and organisation of capital markets. So far SAF/ESAF and structural adjustment programmes sponsored by the IMF have mainly been concerned with the redesigning of regulatory procedures. The injection of new funds has not been a major concern. During the 1990s several African countries have established stock and bond markets, and there is some evidence of broad investors interest. OIC member countries' support for country and regional funds and for the promotion of venture capital can play a useful role in this respect. Of greater importance is co-operation extended by industrially more developed OIC member countries. Supervision of capital flows across OIC member countries in the light of recent lessons learned from the East Asian financial crisis is required for sustaining economic stability, and co-operation among OIC member countries in this regard is crucial.