SELECTED ISSUES IN INDUSTRIAL COOPERATION

David Wall
University of Sussex
March 1977

Prepared for
The Commonwealth Secretariat
London

Contents

1. Introduction

This note is concerned with three issues which are currently receiving attention in the debate over the prospects for the industrial development of the Third World. These issues cover, first, the nature (and potential) of policies which the developed countries might consider adopting in order to promote the transfer of uneconomic or declining industries, or parts of industries, to the developing countries and the nature of possible institutional frameworks for supporting such industrial cooperation. The second issue concerns the nature (and potential) of policies which the developed countries might adopt in order to encourage greater public and private sector involvement in industrial development in developing countries. And the third issue concerns policy frames which developing countries might consider in order to promote their industrial development, and the institutional frameworks they might adopt in order to support such a programme. Each of these issues will be examined in turn, with particular attention being given to the possibilities for international cooperation efforts to overcome the problems identified.

The starting point of the examination is the theory that industrial development on a national basis concerns two crucial parties - profit orientated industrialists (in both the public and private sector) and the government. Any analysis of industrial development which ignores the basic profit orientation of industry is naive and irrelevant. In the international dimension we are concerned with two sets (at least) of industrialists and two sets of governments, and our analysis must show how possible solutions to various problems relate to the interests of these four groups. In particular we must be able to show that the creation of industrial opportunities which are profitable to both sets of industrialists can also be politically acceptable to both sets of governments; any proposal which fails to meet this criterion is leading to a conflict situation which reduces the chances of the proposal achieving its objectives. This point can be best illustrated in the context of the first of the issues identified above - that of redeployment.

2. The Redeployment Issue

It is of the nature of the dynamics of comparative advantage that the cost minimizing location of given industries will change over time, so that an industry which located in one country at one point in time will later find that its unit total costs of production could be lowered by moving to another location. This fact provides the essence of the standard argument for redeployment, which in its efficiency form holds that, in order to ensure the efficient exploitation of the world's resources, measures should be taken to ensure that uneconomic and declining industries are transferred to minimum production cost locations. In its equity form it holds that governments should not take measures to protect their declining and uneconomic industries as this impedes the development of those countries where those industries could be more efficiently located. The proponents of both forms of the argument have carried out extensive research to develop possible mechanisms for redeployment, once their arguments have been accepted, and this aspect of the subject needs no further expounding here. This note will concentrate on the implications of the need to obtain common cause positions among the two sets of governments and two sets of industrialists before redeployment actually takes place.

The first thing to note is that while the debate on redeployment issues has been proceeding in academic and intergovernmental circles, considerable redeployment has actually been taking place. This indicates that, for one reason or another, common cause on redeployment is not an uncommon occurrence. The argument can be maintained only because the proponents are not content with the speed of redeployment, so that the question we are faced with is "what are the constraints thought to be slowing down the speed of redeployment?". The common response to this question by the proponents of the argument for redeployment is that there is a lack of political will on the part of the governments of the countries in which the declining and uneconomic industries are located. To substantiate this response, those who make it will point to the extensive protection (in various forms) that governments throughout the world, developed and developing (this case being ignored by those who maintain their position on equity grounds - incorrectly) provide for what they argue to be uneconomic and declining industry. One implication of this line of reasoning is that the governments which provide such protection might not share the objectives of global efficiency or equity. Another implication is that such governments might not be willing to adopt redeployment policies derived from such global objectives on a unilateral basis, on the grounds that such a move might not improve either world efficiency or equity. And a third implication is that even if a government completely or partially accepts the implications of an objective of global industrial efficiency or of equity it might disagree that redeployment might be called for in specific instances. We will take each of these points in turn.

It should be obvious that, unless all the governments of the world shared an objective which implied a specific level and distribution of the world's industrial production, there need be no basis for an agreement on what level of redeployment should take place over a period of time, nor for any agreement on the composition and distribution of the industry it is proposed to redeploy. To put it another way, if there is no agreement on what constitutes acceptable levels of inefficiency and inequity for governments to accept when establishing their individual industrial strategies, then there is unlikely to be consistency between their planned rates of industrial development, or on the scope for aggregate redeployment. Thus in this case the lack of political will for redeployment in general or a specific programme of redeployment is simply the reflection of a legitimate difference in the objectives being sought by different governments. In the absence of agreement on global objectives attempts to reach agreement on a sub-group basis, such as by the members of the EEC, the COMECON, or the Group of 77 and its supporters (e.g. the Lima Declaration) are likely to produce targets which are inefficient, inequitable, and/or non-operational (except in those cases where the bulk of an industry is contained within the sub-group members' territories). Even if it were possible for the world's governments, or some sub-group of them, to agree on a programme for redeployment it does not follow that such a programme would be carried out - such an agreement would be based on a social evaluation of the costs and benefits involved and they might not correspond to the private evaluations of those costs and benefits as perceived by the industrialists concerned.

The second reason why governments might lack the political will to support redeployment programmes is that they might feel that the resources released by such a programme might not be taken up by industries where they could in theory be efficiently employed because of foreign distortions imposed on the expansion of those industries. While the multifarious discriminatory trade and aid relationships, which characterize the world economy, and the protectionist commercial policy regimes maintained by most developing countries can be justified in terms of the objectives of those participating in and maintaining them, it should be realized that those objectives will not be shared by those countries being requested to implement redeployment measures. While such divergences from the efficiency criteria could be justified on equity grounds, the realpolitik is such that any country being requested to implement a redeployment programme leading to the transfer out of its economy of industries which have been identified as uneconomic and/or declining will be looking for evidence of expanded opportunities for their other industries, so that they can feel assured that beneficial internal redeployment will actually take place. [1] If they do not feel assured of such an outcome then they will be less inclined, that is to say they will appear to lack the political will, to take part in a redeployment exercise.

The third reason why a government may actually or apparently "lack the political will" to implement a specific redeployment programme is that as there are no unambiguous criteria for identifying uneconomic and/or declining industries they can have legitimate grounds for questioning the selection of any given industry as a candidate for redeployment and might seem to lack the political will to redeploy it; but it might well be that the government has strong grounds for arguing that the criteria used by the

---

[1] We are assuming through this brief note that the current state of the art of designing adjustment assistance measures is such that if a decision to implement a redeployment programme were to be taken, resources which were unemployable in other uses would be compensated to their satisfaction.

advocates of redeploying that particular industry are inappropriate or misapplied in that specific case. In a world characterized by stochastic shifts in the international spectrum of input prices it is difficult to see how it could be otherwise. An industry which would be classed by all as uneconomic in a given location on the basis of one set of actual or assumed input prices might appear perfectly commercially viable on the basis of a different set of input prices, or input availability, which might be reasonably assumed to be likely to obtain in the same location in the near future; the argument holds in reverse with respect to the case made out for the location to which it is proposed to transfer the industry. In the absence of any clearcut operationally significant definitions of the concepts of "uneconomic" and "declining" it is clearly possible for a government to agree with an industry's assessment of its future as commercially viable, and to reasonably resist proposals to redeploy it. To those proposing the redeployment such a position may well appear to indicate a lack of political will to redeploy.

In sum, a government might legitimately lack a political will to mount a redeployment programme because (i) such a redeployment would not be seen by it to be in the interests of its people; (ii) it might not see that it is able to obtain the benefits from such redeployment due to what it considers to be the failure of other governments to mount compensating complementary redeployment programmes; and (iii) it might disagree on the choice of specific industries to be included in the programme. It may also be the case in the democratic developed market economies that the government may have the political <u>will</u> but not the political <u>ability</u> to carry out a programme of industrial redeployment. In other words a government may well accept that a programme of redeployment would be in the national interest, but be unable to carry out such a programme because of actual or potential political resistance from those who would be affected by the programme. In such a situation a government may shelve the programme in order to maintain itself in office or to maintain the political support of the vested interests in question. The potential gainers from the redeployment can mostly be ignored politically as they either have no political weight (foreigners), or their power is diffused (consumers), or they are unaware of the potential gains and therefore form no lobby.

As indicated above, considerable redeployment continually takes place in all market economies in response to pressures of market forces and, although of wider theoretical significance, the redeployment issue usually attracts attention in those cases where vested interests are successfully resisting their redeployment and have obtained protective support from their government. In such cases the pressure for redeployment, while it might come from consumer groups (particularly where the product in question is an intermediate industrial good and the consumer therefore an industrialist), normally comes from foreign competitors and their diplomatic representatives. The resulting conflict is resolved between government officials of the two countries and the outcome will be normally in favour of the position taken by the stronger of the two countries, which in the case of a developing country/developed country confrontation will usually be that of the developed country.

In conclusion, then, because (a) redeployment as a general policy proposal is likely to highlight inconsistencies between the objectives of participating countries (witness the complaints from the Third World countries at the 1976 World Employment Conference that the sort of proposals put forward by the developed countries would turn the developing countries into "hewers of wood and drawers of water"); (b) currently developed countries see no quid pro quo in a redeployment programme based solely on the developed/developing country framework; (c) there are no unambiguous criteria for identifying uneconomic and declining industries; (d) the way in which specific redeployment issues currently emerge (an industrialist in a developing country complains to his government of restricted access to a given market, his government then negotiates the issues with the government of the market) pushes the governments of the developed countries into a defensive position where they are the stronger; and (e) redeployment cannot be forced on unwilling industrialists; developing countries would be best advised not to make redeployment a key element of their international industrialization negotiating strategy. Few, if any, "issue" approaches to such negotiations are likely to provide the basis for progress in international industrialization, because they are unlikely to find common cause agreement among the four parties required for the successful implementation of any negotiated strategy - the two sets of governments and the two sets of industrialists. A successful strategy would take account of the fact that there are many examples of common cause being found in specific product lines which has led to effective redeployment - and such examples are not restricted to declining and uneconomic industries. (It should be noted that the reasons why an industry might be uneconomic or declining in developed countries might also be good reasons for developing countries not to enter those lines.) Common cause occurs when, and only when, industry on both sides considers the industrial venture profitable and both governments consider the profit making activity to be in their national interests. If we take note of this and of the facts that (a) multilateral based intergovernmental agreements are more likely to be honoured than bilateral agreements, (b) many firms in developed countries are suspicious of investing in or collaborating with firms in developing countries, (c) firms in developed and developing countries are suspicious of multilateral agencies acting as intermediaries in their business, and (d) continued industrial development in developing countries is to some extent dependent on direct investment from or collaboration with private sector business in developed countries, then we can begin to move towards the establishment of an international programme of industrial cooperation which will result in redeployment without making what we have indicated is a nihilistic issue out of it. The key elements of such a programme would be ones seeking to achieve:

1) Improvement of the potential for expansion of trade in industrial products via mutually binding negotiations for the liberalization of world trade under GATT and via negotiations for a GATT based procedure for the international surveillance of discriminatory and non-discriminatory escape clauses, and a multilateral procedure for supervising appeals against their invocation.

2) The establishment of a code of conduct for international business operations of all sorts. Such a code is long overdue and could be negotiated either in the context of the UNIDO/UNCTAD Joint Study or some other OECD/Group of 77 dialogue; it should have a legal framework enforceable in international courts or in some specially established quasi-legal international entity. Such a code of conduct, backed up by arbitration and guarantee

schemes, would seek to ensure that when businessmen in two countries undertake an investment or collaboration programme according to the rules established by the code of conduct, and with the support or acceptance of the two governments, either or both of those governments or firms could not change the rules of the game on the basis of which the calculations of profitability were based. If either or both governments or firms did change the rules of the game on which the venture was based,then the firms would have rights of appeal, arbitration and compensation under international guarantee. Such a code of conduct would help remove the suspicions which currently constrain the development of international industrial ventures and would also help developing countries towards the achievement of their industrial development targets.

The establishment of these two key elements of an industrial cooperation programme would be the responsibility of the governments and would be best negotiated and maintained within a global, multilateral framework. Emphasis is put on the word "global" because any sub-global arrangement would necessarily involve discriminatory practices, which should be avoided in order to remove the potential for political conflict and in order to maximize the potential social and commercial advantages of the programme. The emphasis on the word "multilateral" is there partly for the same reason and partly because the greater the number of governments involved in government-to-government negotiation, the greater will be the scope for application and the greater the confidence of business in the framework; but perhaps most importantly it would reduce the grounds for suspicion that the developed countries involved in the negotiations are primarily concerned with the interests of business in their own countries. These first two elements of an industrial cooperation programme involve bringing together two of the four sets of parties involved in international industrialization - the two sets of governments - in order to establish a framework within which the two sets of industrial firms can seek and engage in mutually profitable industrial ventures which are acceptable to their governments. While as far as governmental cooperation is concerned we can pose the rule "the more the merrier", for cooperation between firms we can pose the opposite rule - "the fewer the better". Successful business ventures (and we do not distinguish between private or state owned businesses) are based on the commercial exploitation of specialized knowledge, and firms understandably prefer to negotiate on a confidential firm-to-firm basis. This fact allows us to identify the third key element of an industrial cooperation programme.

3) Any industrial cooperation framework established by governments should seem to create a business climate which encourages and supports the secure negotiation of mutually profitable contracts for industrial business ventures between firms in developing and firms in developed countries; such contracts would be enforceable under the code of conduct.

The first three key elements of an industrial cooperation programme would establish the all important climate for the development of commercial industrial cooperation and, to some extent, the market itself would respond to them and accelerate the rate of industrial expansion in developing countries. The market itself is, however, unlikely to stimulate sufficient industrialization to satisfy the objectives of the developing countries. To be acceptable to the developing countries, therefore, any industrial co-operation programme must contain within itself schemes for the positive stimulation and support of industrialization in developing countries. At this point we can simply specify two further key elements for an industrial cooperation programme; each of them is the subject of more detailed examination below.

4) Developed countries should establish mechanisms for stimulating the interest and involvement of their industries in the industrial development of developing countries.

5) Developing countries should take appropriate measures to establish a domestic policy frame which will encourage and support the rate of industrialization which they have set as their objective.

3. Positive Policies for Developed Countries

It is worth reiterating at this point that in the developed market economies, industrial concerns, both private and public, are profit orientated and to the extent that industrialization in the developing world requires the collaboration of Western industry in any form then any industrial cooperation programme which fails to take full account of this basic fact will not have much operational significance. The point is reiterated here because it is essential to realize, but frequently forgotten, that Western governments cannot force their industry to involve itself in the industrialization of the developing world but only (a) point out that there are profitable opportunities to be found in such involvement, and (b) enhance through their domestic policy-frames the net realizations which their industrialists obtain from taking advantage of such opportunities.

The most obvious way in which developed country governments can enhance the net realization accruing to their domestic industrial concerns from their business activities in developing countries is via favourable tax treatment of profits generated from those activities. The scope of such a scheme is obvious and needs no amplification. A second way to enhance net realizations is for the government to subsidize, or provide on less than market cost basis, inputs supplied from their countries which are required by their businessmen for undertaking their industrial activities in developing countries. Again, the possibilities are obvious and do not need spelling out.

Perhaps less obvious to those involved in debating and negotiating programmes for industrial cooperation - for the simple reason that they tend not to have had industrial experience - is the significance of risk and information gaps which can slow down the flow of investment and other collaborative industrial activities from developed to developing countries. The riskiness of such activities would be reduced to some extent by the introduction of an international code of conduct such as that discussed above, but there is also scope for individual governments of developed countries to introduce national measures providing insurance schemes to cover risks involved in industrial ventures undertaken in developing countries by their businessmen. Risk of losses from natural disasters, civil and international strife, abnormal exchange rate movements or failure to abide by a negotiated code of conduct could be covered by such schemes. There are two sorts of information gap, relating to the two crucial prerequisites of a successful business partnership. First, a businessman must have the knowledge that a potentially profitable business venture exists, and then must be aware of the existence of a foreign partner with whom he feels able to establish a collaborative business arrangement. The first required systems for filtering, screening and disseminating information to relevant businessmen and/or for moving businessmen to the information sources. The second requires systems for bringing businessmen into contact with one another. On the assumption that governments know their own businessmen, and their needs, best, such systems are best arranged on a national basis, although there is no reason why such national systems should not be integrated into an international network, except insofar as commercially confidential data is involved.

Developed country governments could make a significant contribution to the flow of crucial industrial information to developing countries by harnessing the considerable storage and retrieval potential of modern computer systems. The use of such systems would, of course, necessarily be restricted to non-confidential data, but there is an all-important stock of technical knowledge which is in the public domain and which would be of benefit to industrialists in developing countries. Such information covers bibliographical material on industrial processes, the ownership of patents, the structure and location of existing facilities and firms in different product lines, and trade and market data. From such a system a domestic or foreign firm considering the possibility of establishing a production facility in a developing country, or a developing country examining its own industrial prospects, could obtain a portfolio providing a profile of the industry in question. The system could also contain an annotated register of industrial design consultants, engineering consultants and marketing agents with expertise in the relevant product or process, and of existing firms currently engaged in the business and their willingness to engage in collaborative activities. The staff of such an information service could help fill the second information gap mentioned above: initiators of requests for product (or process) reports from the system could either open up direct firm-to-firm contacts, or they could request the staff of the system to make the initial enquiries and thus retain anonymity. The staff could also act as initiators by arranging seminars, field visits or industrial fairs in product lines or areas for which several of their clients had indicated general interest, or for which they had made their own assessment of potential. Finally the staff of the system could maintain a capacity for assessing the commercial viability of project proposals emanating from their activities and also the capability for evaluating the appropriateness or the technological components of the projects. A limited version of such an information and contact development system is planned to be one of the basic functions of the Centre for Industrial Development being established under the Lome Convention. Access to the system would however be restricted to member states of the ACP/EEC. It could be argued that advantages would accrue from having the system mounted on a multilateral basis, perhaps under the auspices of UNIDO, although in that case emphasis might have to be placed on the establishment of national centres with terminals linked to the system in order to maintain contact with, and the confidence of, potential clients in industry. Once the system was established it would be essential to provide it with an advertising budget in order to make industrialists aware of and interested in its facilities.

4. Policies for Developing Countries

Assuming the developing countries were to press for and avail themselves of the schemes outlined in previous sections, they would still need to ensure that their domestic industrial policy frames were so designed as to allow them to reap the maximum benefits from those schemes. The optimal policy frame for any single developing country will vary with its economic circumstances and its politically established targets for, and constraints imposed on, its industrial sector. Recalling, however, the terms of reference for this note, and recalling that we have dismissed the seeking out of declining and uneconomic industries in developed countries as a meaningful basis for an industrialization strategy, and recalling further that we have restricted our attention to industrialization which involves collaboration, in one form or another, with the (public sector and private sector) industry in the developed market economies, then we can indicate some general guidelines for industrial policy formulation (the elaboration of which would take us beyond the scope of this note).

On the assumption that general domestic economic policies have been established with domestic objectives in mind and their consequences for collaborative activities have been assessed and calculated, then we can restrict our attention to those policies which bear directly on the involvement in domestic industry of foreigners through the various possible forms of collaborative arrangements. It will be appreciated that the attraction to foreign firms of collaboration agreements with domestic industries will be determined by how far the nature of such policies assist or constrain the foreign interests in the attainment of their own legitimate objectives. It is a fundamental assumption of this note that the rate and composition of the industrial development of a developing country will be determined by the nature and extent of the collaborative arrangements its industrial sector maintains with industry in developed countries, and that the nature and extent of that involvement will be affected by the attitude of the government of the developing country towards that collaboration, as expressed through those of its economic policies which directly affect the interests of those involved in the collaborative agreements. Domestic and foreign Governments have three basic options in this respect: they can establish their policies towards such issues as foreign ownership, repatriation of capital, dividend and royalty payments, restrictive business practices (such as market sharing arrangements), and patent law etc., and then accept whatever collaboration arrangements emerge on the basis of those policies; they can decide to fix their industrialisation targets, assess the extent to which they are dependent on collaboration arrangements, and then set their policies in such a way that the required degree of collaboration is forthcoming; or they can establish a dualistic policy framework, with different policy treatment of collaborative arrangements depending on whether or not the collaboration takes place in areas (product-wise or geographical-wise) in which the government wishes to encourage or discourage collaboration. The important point is that it is necessary to appreciate that there will be a trade-off between the treatment of collaborative arrangements implied by the government's policy frame, and the amount of collaboration which it is able to attract.

The second general guideline for industrial policy in developing countries follows from the first. It is that governments of developing countries should have well defined industrial strategies - not in the sense of a catalogue of industries they would like to have, but in the sense of well defined and stable views on the areas of their economies within which they would be prepared to accept industrialization - and on the social and economic conditions such industrialization should meet. Only in this way can industrialists know whether or not ventures in which they would have an interest will be acceptable to the government or not. The government can of course seek to interest industrialists - domestic and foreign - in those ventures for which it would welcome investment and can modify its policies to attract industrialists into them - but it must be emphasized that the basic policy frame itself must be seen to be stable. Unless a government is prepared to accept the losses from ventures which are not commercially sound, and such a strategy is obviously not applicable to a country's whole industrial sector, it must make clear the areas in which it is prepared to accept industrial ventures and the conditions on which it expects or insists such industrial ventures should be based; the market itself will then respond (or can be encouraged to respond) to the opportunities which are available and determine the actual production lines to be established.

Finally, governments of developing countries which are not satisfied with the rate and speed at which the market produces proposals for industrial ventures should, as a matter of policy, create industrial promotion centres (of any institutional form) charged with the responsibility of establishing a research capability aimed at generating and maintaining a register of industrial ventures which it believes would be commercially viable if undertaken. Such centres could then use existing and proposed information systems to seek out industrialists in order to inform them of and interest them in investing in the ventures.

5. Conclusion

The subject of the industrialization of developing countries is a complex issue with many ramifications of which our understanding and experience is limited. This note has been written on restricted terms of reference and has necessarily left untouched many crucial problems in the subject area. It has argued that the redeployment approach to industrialization is of limited value, on the grounds that, basically, there are no criteria for identifying declining and uneconomic industries in developed countries and that, even if there were, there can be no presumption that such industries as were identified in this way would be a suitable basis for the industrialization of developing countries. Furthermore, such a process would have a limited chance of success, as it would proceed by creating vested interests against its potential success. This note has offered some ideas towards an alternative strategy for the international community, the governments of the developed countries, and the governments of the developing countries, which would be instrumental in fostering the industrialization of these countries. This strategy is based on the assumption that international cooperation is a prerequisite to successful industrialization and that such cooperation requires the identification of common cause among the industrialists and governments - private and state, domestic and foreign - of the countries involved in collaborative ventures of any form. It has stressed measures for the expansion of world trade in industrial products, measures to expand the flow of information about industrial opportunities in developing countries, measures to increase the flow of contacts between industrialists in developing and developed countries, measures to establish a code of conduct for international industrial ventures, and measures to be taken by developing country governments to encourage the collaborative industrial ventures required to sustain the industrialization of their economies.