

Annual Report of UNIDO 1995



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MESSAGE FROM THE DIRECTOR-GENERAL
1995 - REFORM AT WORK

For all the progress they have achieved in industrialization, most developing countries and countries in transition continue to face severe and complex challenges. These challenges are compounded by competitive pressures and technological changes that threaten to widen the gap between advantaged and disadvantaged nations. And while we have seen some developing regions progress in terms of participation in the global economy, others, most notably the least developed countries, have fallen further behind and continue to be in urgent need of international assistance.

UNIDO has responded to the changes in industrial reality and support requirements by re-examining its priorities and introducing major internal reforms. In this process, UNIDO has been in the vanguard of reform, leading the way in the United Nations system, and now stands ready to meet the demands of developing countries in support of their industrialization. The process of industrialization remains basic to economic modernization. Although this process is increasingly the preserve of market forces, Governments still play an important role in furthering sustainable industrial development. The Organization's Mission Statement, as developed in 1995, emphasizes UNIDO's role as a catalyst seeking to harness the joint forces of Government and the private sector. The overall aims are to foster competitive industrial production, develop international industrial partnerships and promote socially equitable and environmentally sustainable industrial development.

We at UNIDO are fully committed to these goals and, in a process of focusing our work, have defined new thematic priorities around which services to Member States will be consolidated. In the future, Member States will be able to closely follow how we progress in meeting these priorities. With the thematic priorities defined by the middle of 1995, we proceeded in the second half of the year to the re-engineering of key managerial and administrative processes, the aim being to improve the effectiveness and efficiency of delivery systems while strengthening monitoring, reporting and communication functions. This work was undertaken jointly with external management consultants under active involvement of a large number of UNIDO staff.

The reforms - while not introduced to combat budgetary pressures - gave UNIDO the flexibility to cope with changing resource scenarios that suddenly emerged in 1995. Due in great part to these process improvements, the Organization was able to face a financial challenge of unprecedented proportions caused by the non-payment of assessed contributions by the United States of America in 1995 and to finish the year with a positive cash balance.

The efforts at cost cutting and management reform have allowed us to present a revised budget and related contingency plans for the coming biennium, taking into account the effective withdrawal of our largest contributor by the end of 1996, with a real reduction of approximately 25 percent over the 1994-1995 biennium. UNIDO was able to introduce such drastic budgetary reductions without sacrificing the Organization's ability to deliver services to its Member States.

In spite of budgetary cutbacks in 1995, UNIDO reversed the trend of declining technical cooperation delivery since 1990, with delivery increasing 7 per cent over the previous year to \$108.5 million. At the same time, the sources of project funding were further diversified, an essential step following the drastic decline in UNDP funding in recent years.

Our efforts have not gone unnoticed. The re-emergence of UNIDO as a relevant, efficient and indispensable specialized agency supporting industrial development has been widely acknowledged in important global and regional fora. This support was reaffirmed at the sixth session of the General Conference of UNIDO in December 1995 in Vienna, which endorsed the reform results and emphasized the role of UNIDO as:

- A global forum for industrial development matters;
- A provider of specialized, integrated services to Governments, institutions and enterprises in recipient countries;
- A central coordinating agency within the United Nations system in the field of industry.

While we are proud of last year's achievements in terms of increased efficiency of staff, stronger personnel management, improved programme management and administrative streamlining, these results are not covered in the present document but are dealt with in greater detail in other documents (GC.6/30 and Add.1; IDB.16/7). Suffice it to say that the organizational changes at UNIDO have been enormous, providing a strong base for us to continue progressing in the years to come.

This Annual Report concentrates on the substantive activities of the Organization. It addresses the explicit requests of Member States to improve the quality of the report, both in terms of form and content - a process of improvement already evident in the 1994 report. The format has been redesigned in accordance with General Conference resolution GC.6/Res.2. In keeping with this resolution, this report provides:

- Aggregate statistical information on technical cooperation projects;
- A presentation of selected new, ongoing and completed technical cooperation programmes and projects, supplemented by a complete project list in Addendum 2;
- An elaboration of the work undertaken and initiated under UNIDO's global forum function.

This new approach - responding to the request in GC.6/Res.2 to avoid the presentation of overlapping information and provide a consolidated report - eliminates the need to present separate output tables for each organizational unit, as previously provided in a somewhat fragmented format in the programme performance report. The emphasis in this report lies on pointed, brief descriptions of technical cooperation activities in their thematic context. Other dimensions of UNIDO's work - including summaries of selected high-profile meetings - are highlighted under the global forum function.

The year 1995 was one of rapid change and hard decisions. It was also a year of challenges met. UNIDO is a redirected organization: flatter, slimmer, more efficient and quicker to respond to the needs of our Member States. As these demands increase, we at UNIDO will continue to meet our important responsibility of providing specialized support to industrial development.



Mauricio de Maria y Campos

CHAPTER I

GLOBAL AND REGIONAL INDUSTRIAL DEVELOPMENT TRENDS: ISSUES AND PROSPECTS FOR DEVELOPING COUNTRIES

Overview

1. In 1995, world industrial activity grew for the third consecutive year since the recession in the early 1990s. Growth was, however, weaker with manufacturing value added (MVA) increasing at 3.8 per cent compared with 4.8 per cent in 1994. The slower growth was in line with global GDP growth, which slowed from 3.0 per cent in 1994 to 2.7 per cent in 1995. Global GDP growth was dragged down mainly by the poorer performance of the industrialized countries, which account for more than three quarters of global MVA.

2. The pace of MVA growth in the industrialized countries slowed from 4.6 per cent in 1994 to 3.4 per cent in 1995 due mainly to lower demand for industrial goods. This was partly the result of the sharp rise in interest rates in 1994 that had dampened consumption and investment demands. The slower MVA growth was also due to the marked appreciation of key currencies, notably those of the major economies such as Japan and Germany. The appreciation of these key currencies had an adverse impact on the international competitiveness and export performance of these countries.

3. The developing countries, as a group in 1995, recorded the highest rate of industrial growth. MVA grew at a buoyant rate of 6.7 per cent, almost twice that of industrialized countries, although slightly lower than that achieved in 1994. Growth was largely propelled by high investment rates from both domestic and foreign sources. Higher domestic and regional demand, boosted by several years of robust economic growth, also contributed to the strong growth and the higher resilience of the developing regions. As a result of their stronger growth compared to industrialized countries, the developing countries' share of world MVA rose to about 20 per cent in 1995.

Regional trends

4. While many of the developing regions recorded higher growth in 1995 than in 1994, growth performance was unevenly distributed. Most of the Asian countries continued to display high, albeit moderating, MVA growth, while Latin America and the Caribbean as a whole slumped into recession. Sub-Saharan Africa, on the other hand, managed to display a marginal improvement in growth, but its aggregate performance was still far lower than that of the Asian countries.

Latin America and the Caribbean hit by current account deficit problems

5. Latin America and the Caribbean recorded negative MVA growth of 0.8 per cent during 1995 compared with significant growth of 6.0 per cent in 1994. Deteriorating current account deficits and declining savings rates in major countries of the region raised concern over the ability of those countries to sustain long-term growth. That adversely affected the confidence of international investors and led to a sharp reversal of capital flows in the early part of the year, which inevitably affected industrial activities in those countries.

Figure 1. Trends of World Manufacturing Value Added, 1970-1995

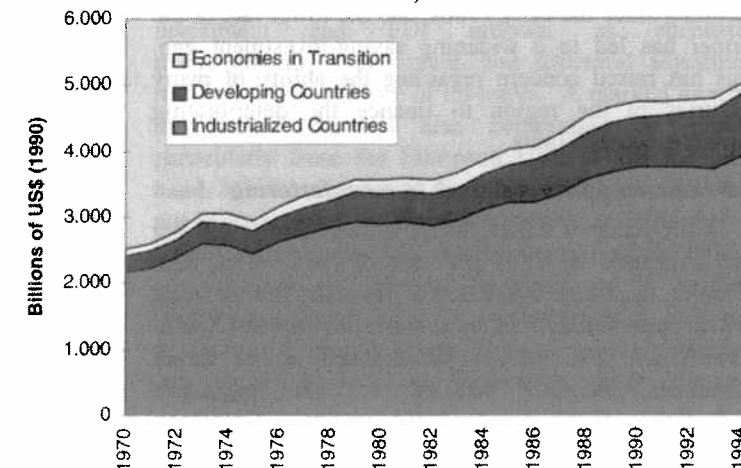
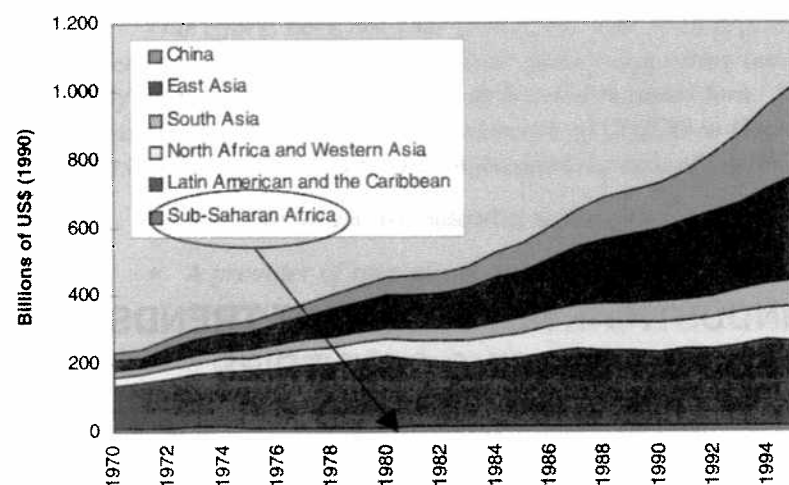


Figure 2. Manufacturing Value Added Trends of Developing Regions, 1970-1995



6. As a result, Mexico's MVA growth plunged to -7.5 per cent in 1995 from 4.8 per cent in 1994. Its financial crisis prompted the authorities to adopt a bold stabilization programme aimed at containing inflation, fostering domestic savings and reducing external deficits. Those measures led to an improvement in investor confidence towards the end of the year. Argentina, the second largest industrial producer in the region after Brazil, was also badly affected by the crisis. Its MVA growth plummeted from a buoyant 9.4 per cent in 1994 to -7.6 per cent in 1995. In Brazil, which accounts for close to 30 per cent of the region's MVA share, growth also slowed to 3.0 per cent from 6.3 per cent in 1994. On the other hand, strong policy fundamentals helped Chile to successfully withstand the effects of the crisis without significant impact on its growth performance. MVA grew at 4.4 per cent in 1995 as against 2.6 per cent in 1994.

7. As a whole, the region has been less successful in coping with competitive challenges than East Asia. Its share in world MVA has declined from a peak of about 6.0 per cent in 1980 to about 4.8 per cent in 1995. The region has also lost a considerable part of its shares of world FDI inflows to East and South-East Asia. The region's domestic saving and investment rates have been declining since the early 1980s, and the lower rate of the former has led to a widening saving-investment gap. This has raised concern regarding the ability of many countries in the region to finance the deteriorating current account deficits.

Sub-Saharan Africa still weak in manufacturing

8. In sub-Saharan Africa, MVA growth rose to 1.6 per cent compared with 0.4 per cent in 1994. That rate, however, was still much lower than the double digit growth experienced in many countries in East and South-East Asia. The weaker performance of the larger economies weighed heavily on the aggregate performance of the region. MVA growth in Cameroon

and Nigeria remained negative while that of Zimbabwe dropped sharply from 8.3 per cent in 1994 to 2.3 per cent a year later. Only a few countries such as those in the CFA franc zone and Kenya have been able to sustain growth at relatively robust rates and attract FDI in recent years. These are also the countries that have been most successful in achieving macroeconomic stability by strengthening economic policies and overall economic reform. Kenya and Côte d'Ivoire, for example, registered MVA growth of 6.8 and 7.8 per cent in 1995 compared with 5.8 and 3.0 per cent respectively in 1994.

9. The region, where two-thirds of the world's LDCs are located, is still characterized by a weak manufacturing base. During the past decade, the region's share in world MVA has dropped from 0.4 per cent to 0.3 per cent. The region has not made much headway even in labour-intensive or resource-based industries. Its share of world MVA in apparel is less than 1.0 per cent, while the combined share of leather and fur products and footwear is less than 0.5 per cent. Domestic investment rates are not only the lowest among developing countries, but they have been declining over the past decade. In addition, the region has not been able to benefit from the recent surge in global FDI flows to developing countries, accounting for an average share of about 1.3 per cent during the 1990s.

10. The region's weak performance has a range of causes. Among these must be included: low levels of savings, policy choices on trade and the role of markets, poor infrastructure, a lack of skilled human resources and, in some instances, political instability. In addition to macroeconomic management, the challenges facing African decision-makers include a refocusing of the role of the State on the provision of public goods, such as education and general infrastructure (while seeking to attract foreign private investment in the latter), fostering the efficient operation of markets, promoting foreign direct investment and building a broad array of economic, social and political institutions.

North Africa and Western Asia staged a strong rebound

11. Industrial performance in both North Africa and Western Asia improved in 1995 thanks to regional stability and appropriate macroeconomic policies. MVA grew at 3.9 per cent in North Africa compared with 1.8 per cent in 1994. In Western Asia, MVA recovered strongly from -2.8 per cent in 1994 to 6.3 per cent in 1995. In Egypt, the largest economy in North Africa, MVA grew at 4.3 per cent compared with 2.8 per cent in 1994. Morocco and Tunisia also registered better growth in 1995. Similarly, Turkey, the largest manufacturer in

Western Asia, staged a dramatic recovery with MVA growing from -8.4 per cent in 1994 to 7.8 per cent in 1995. Compared with other countries in the region, Turkey has achieved closer integration into the global economy. Iran, on the other hand, recorded a drop in its growth rate of 3.5 per cent in 1995 compared with 4.5 per cent in 1994. In overall terms, the region - in particular, Western Asia - stands to benefit from new trade opportunities with newly independent neighbours in Central Asia.

South Asia benefits from recent structural adjustment efforts

12. In South Asia, deregulation and structural adjustment efforts in major countries of the region have helped to sustain growth at above 7.5 per cent in the region in recent years. India, in particular, enjoyed a significant surge in manufacturing exports and FDI inflows: its MVA grew at 8 per cent in 1995 compared with 8.5 per cent in 1994. Pakistan also contributed to the region's growth performance, with MVA growth improving from 2.7 per cent in 1994 to 4.4 per cent in 1995.

13. The region is now faced with the problems of rising inflationary pressures, infrastructure bottlenecks and current account deficits. Investment rates remained low, albeit stable, at around 20 per cent of GDP despite a recent surge in FDI which generally formed a small proportion of total investment. Amidst a declining trend in saving rates, the main challenge of the region is to sustain growth by stimulating saving and investment and reducing infrastructure bottlenecks. The region is still highly dependent on labour-intensive industries. It needs to broaden as well as deepen its industrial structure and upgrade to higher-technology industries. Investment in the development of technological capabilities and human resources are essential.

East and South-East Asia as main engine of growth

14. East and South-East Asia, including China, continued to register the strongest MVA growth in 1995 with double digit growth of 10.7 per cent. This impressive growth raised the region's share in world MVA to 11.0 per cent in 1995, from 10.3 per cent in 1994; it represents slightly more than half of the developing countries' combined MVA. Growth was fueled by a strong demand for both consumption and investment goods from domestic as well as regional markets, amidst a lower demand from the traditional industrialized markets. The marked growth in intra-regional trade has led to higher resilience of the region in responding to external factors. Investment rates continued to surge and sharp inflows of FDI contributed further to the strong pace of investment.

15. After several years of strong growth, overheating problems have emerged in China and most of the ASEAN countries. Inflationary pressure and persistent

current account deficits are the major concerns as high investment rates stoke up high import demand for capital goods and other industrial production inputs. Meanwhile, rising income has led to higher demand for imported consumption goods which adds further pressure on current account deficits. Many countries in the region undertook considerable efforts to curb demand by tightening monetary policy so as to reduce these overheating problems. Nevertheless, growth remained buoyant in many of these countries. China, for example, continued to record double digit growth at 12.1 per cent. Indonesia, Malaysia and Thailand turned in equally impressive growth performances despite monetary tightening. Growth remained stable at 11.0 per cent in the Republic of Korea while Singapore recorded a lower growth of 9.6 per cent compared to 12.9 per cent in 1994.

16. The region has been the centre of attraction for FDI in recent years, accounting for more than 20 per cent of the global FDI inflows. Political stability, strong economic fundamentals, relatively well developed infrastructure and the availability of a pool of highly qualified workforce have combined to contribute to this attractiveness. The high saving rate of the region, at more than 30 per cent of GDP, has been a major determinant of growth. Nevertheless, the key challenge of the region at present is to bring growth down to a more sustainable level without causing too much fiscal imbalance. Higher investment is also necessary to accelerate the development of infrastructure and technological capabilities.

Economic recovery in Central and Eastern Europe

17. Signs of recovery were evident in the economies in transition of central and eastern Europe and the former Soviet Union during 1995. The aggregate negative MVA growth of these economies was reduced by more than half from -8.8 per cent in 1994 to -4.1 per cent in 1995. Their individual performance, however, depended significantly on the stage they had reached in their reform programmes. Early reformers with sound macroeconomic policies such as Albania, the Czech Republic, Hungary and Poland recorded buoyant MVA growth. They enjoyed rapid increase in productive investment and FDI inflows, as successful macroeconomic stabilization and structural adjustment restored the confidence of investors. A marked increase in external demand also contributed to growth, particularly from the European Union. On the other hand, MVA continued to decline in countries which had not made as much progress in economic reforms such as Belarus, the Russian Federation and Ukraine. Those countries are still plagued by problems of incipient institutional frameworks for market-oriented industrial development, declining investment rates, high inflation, large fiscal imbalances and major structural weaknesses.

Prospects and challenges

18. 1995 was generally a year of strong economic and industrial growth for most of the developing regions. At the same time, increasing liberalization and globalization of the world economy is expected to bring new opportunities for developing countries which they will have to seize through appropriate industrial strategies and policies. Failure to do so, particularly by the LDCs, would perpetuate the widening gap existing both between industrialized and developing countries and among developing countries themselves.

19. The prerequisites for successful integration into the global economy are the availability of an appropriate policy framework, efficient markets, adequate infrastructure, a well-trained and educated labour force and the development of a range of supporting institutions. The main challenge facing developing country policy-makers in the coming decade is therefore the development of such framework and capabilities so as to capitalize on the vast potential of the global changes and sustain the growth momentum.

20. The globalization process and rapid technological developments have changed the nature of competition considerably. While new generic technologies are permeating all sectors of industry, the adoption of new labour-saving technologies and responses to competitive pressures in the industrialized countries have contributed to growing unemployment among low-skilled labour in those countries. This may pose the threat of a resurgence of protectionism in industrialized countries.

21. Developing countries are generally weak in terms of technological capabilities compared with industrialized countries. It is therefore important for developing countries to invest not only in building productive capacities, but also in developing technological capabilities and human resources. This will require not only support by the international community but also increased domestic savings and investment rates, all the more so as those rates at present show a declining tendency in many developing countries.

CHAPTER II UNIDO REFORM: THE MAIN DIMENSIONS

1. The entire United Nations system is engaged in a thorough reform process as an effective response to the challenge of dwindling financial resources. Major issues of this reform have been the need to attain sharper focus and greater impact of programmes as well as to balance relief with development support.

2. The year 1995 saw the implementation of the main elements of UNIDO reform, which will be further refined and completed in 1996. The reform process of UNIDO was initiated at an early stage when no particular financial constraints for the Organization were anticipated. It was prompted by the perceived need to respond to changing patterns of demand for the services of the Organization and was thus, from the outset, driven primarily by substantive and efficiency considerations. At the same time, the basic postulates of the reform - the need to define a sharper substantive focus, to adjust the organizational structure accordingly, and to enhance process efficiency - have laid the foundation for a more effective and leaner UNIDO that is better able to respond to different scenarios of development and resource availability.

3. UNIDO reform has followed a logical sequence: from the redefinition of key objectives and programmes to the redesign of mechanisms to deliver quality services, and finally to savings in staff and non-staff resources. In this process, UNIDO has been at the forefront of reform efforts in the United Nations system.

Setting priorities

4. A central feature of the UNIDO reform process has been the prioritization of services. This prioritization has been based on analyses of the current and future needs and support requirements of developing countries and countries with economies in transition. Accordingly, the UNIDO work programme is now focused along three dimensions:

Geographical focus

5. While responding - in accordance with the principle of universality - to support requirements in all developing regions and in the economies in transition, the special emphasis of UNIDO technical cooperation services are the countries in Africa and the least developed countries.

Sectoral focus

6. UNIDO has accorded high priority status to a limited number of industrial subsectors (less than 50 per cent of the total number of these sectors) on which the build-up of core staff expertise and the proactive programming of support services is concentrated. Within the sectoral Branches, the following industrial subsectors will receive priority attention in the future:

- Food processing, leather, textiles and wood processing within agro-based industries;
- Metalworking and machine tools (with emphasis on agricultural machinery) within engineering industries;
- Biotechnology, water management, medicinal plants, building materials and organic chemicals within chemical industries.

7. A large number of industrial subsectors have been assigned low priority while others have been classified as non-priority subsectors without specific coverage by UNIDO.

Thematic focus

8. UNIDO has adopted seven thematic priorities as the cross-organizational focus for the 1996-1997 biennium. They will provide the overall direction towards which all substantive units of UNIDO will shift and focus their programming, conceptual and subsequent implementation work. The seven thematic priorities respond to identified demand for integrated, multidisciplinary services in support of industrial

development and draw on the core expertise of the Organization. They comprise:

- Strategies, policies and institution-building for global economic integration
- Environment and energy
- Small and medium enterprises: Policies, networking and basic technical support
- Innovation, productivity and quality for international competitiveness
- Industrial information, investment and technology promotion
- Rural industrial development
- Africa and LDCs: Linking industry and agriculture

9. Each of these seven thematic priorities has been operationalized by UNIDO in terms of the key issues faced by developing countries, the expertise available at UNIDO, the required cross-organizational cooperation and, in particular, the focus on a limited number of core programmes to be implemented in the 1996-1997 biennium.

10. Specifically, six high-impact programmes were developed in 1995 based on the following criteria:

- Respond to expressed priority demand of Member States
- Focus on and specify support services under the seven thematic priorities
- Integrate analytical work, policy advice and institutional support
- Put into effect the comparative advantage of UNIDO in the United Nations system
- Enable and foster cross-divisional teamwork within UNIDO
- Involve the private sector both as beneficiary and counterpart.

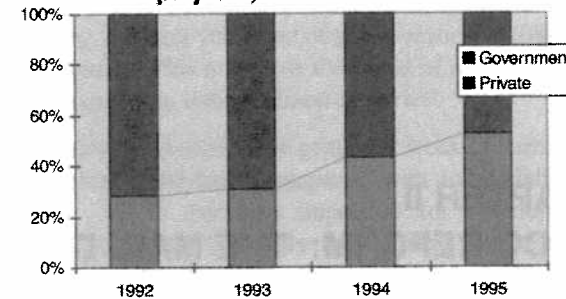
11. These high-impact programmes are described in chapter III.B. of the present report in their thematic context.

Private sector involvement

12. The growing importance of the private sector as a driving force in industrial development had been identified at the beginning of the reform process as one of the strongest trends to which a renewed UNIDO would have to respond. UNIDO has endeavoured therefore, to ensure that not only its services ultimately benefit the private sector - which applies to the great majority of technical cooperation projects - but also involve private sector entities, particularly private sector institutions and associations, more directly as project counterparts.

13. Accordingly, the importance of private sector organizations as counterparts of UNIDO projects increased from slightly more than one quarter in 1992 to more than 50 per cent in 1995 (figure 3).

Figure 3. Counterparts of UNIDO projects, 1992 - 1995



Management reform

14. As an integral part of the reform process and with support from an external management consultant, UNIDO has reviewed and, where appropriate, re-engineered virtually all its managerial and administrative processes and procedures. Major achievements comprise:

- The strengthening of key management principles, above all introducing clear accountability for delegated responsibilities, and their application in various core processes;
- The introduction of new reporting mechanisms for monitoring and control;
- The conceptualization of a revised project cycle management approach, fully aligned with the new substantive focus, giving particular attention to improving the efficiency, effectiveness, quality and timely delivery of services;
- The streamlining of administrative processes in areas such as travel, consultancies, monitoring mechanisms, personnel management, financial management and communications - resulting in significant cost reductions;
- On the basis of analytical surveys, the redefinition of key functions of and services to be provided by UNIDO field offices.

15. An area in which managerial reform is critically linked to the substantive focus of UNIDO is the management of UNIDO services (project cycle management). This issue has been under close scrutiny throughout the reform process. In April 1994, UNIDO issued new guidelines introducing transparent procedures, decentralized quality assurance, a coherent programming framework, a strong emphasis on team-building, and an early screening process in developing UNIDO services. These new guidelines were reviewed after one year of experience. While the basic new principles introduced were found to be valid, a number

of adjustments were required in order to align the guidelines with the new focus on thematic priorities and to develop large, integrated UNIDO support programmes. The revised guidelines will also streamline some procedures found to be too cumbersome, and strengthen the functions of substantive project managers in mobilizing inputs required for project implementation.

Cost reductions

16. The reform process has enabled the introduction of a streamlined organizational structure by reducing the number of Divisions from eight to six and has improved cost-efficiency. Cost reductions have, in particular, been achieved in the areas of administration and operational support. As figure 3 indicates, these costs have been significantly decreased over the reform period. Included under this heading are general operating costs, supplies and material, acquisition of equipment, electronic data-processing and some joint service costs with other United Nations agencies.

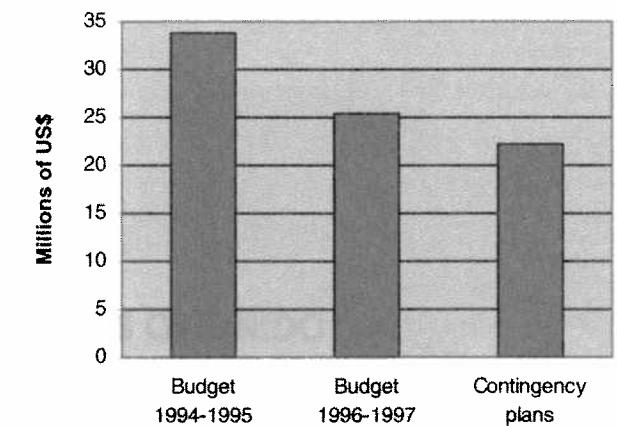
17. In addition, the reform also resulted in reduced costs in 1995 under conference servicing, meetings, printing, travel, and consultancies. The following box provides specific examples.

Example expenditure reductions in 1995 (in thousands of US\$):

Temporary assistance/overtime	450
Temporary posts	400
Language teachers/training	100
Travel savings	450
General operating costs	2,200
Supplies and materials	300
Equipment	400
Printing	500
Conference Services	2,000
Consultancies	450
Ad-hoc meetings	400

18. The total staff of UNIDO fell from 1,174 in January 1994 to 965 at the end of 1995 while the ratio of General Service to Professional staff decreased from 1:4 in 1992-1993 to 1:2 based on the productivity gains from re-engineered administrative processes and related adjustments in budgetary posts. New management principles and procedures have been introduced to accelerate decision-making and increase empowerment, accountability, transparency and effectiveness. UNIDO also introduced changes of a much broader cultural type in the areas of staff performance evaluation, staff development and training.

Figure 4. Administration and operational support costs



19. All of these reforms have enabled UNIDO to maintain its key services despite the announced withdrawal of the United States of America from the Organization and non-payment of its assessed contributions during the year. In spite of an overall 25 per cent budgetary shortfall, there has been no reduction in the delivery capacity of key substantive services. Indeed, under these stringent circumstances, UNIDO was able to maintain and even increase its delivery of technical cooperation as compared to 1994.

20. The far-reaching reform of UNIDO was commended by the sixth session of the General Conference in December 1995 which in resolution GC.6/Res.1 supported the role of UNIDO:

- To serve as a global forum to exchange information, analysis and advice on industrial policies and institutions within the field of development;
- To provide integrated services to Governments, institutions and enterprises in recipient countries for the design and implementation of industrial policies, the development of selected industrial subsectors, private sector development, the development and transfer of clean technologies, industrial partnerships and investments, and development of human resources in line with the identified priorities of the Organization;
- To function as a central coordinating agency within the United Nations system in the field of industry, for supporting the endeavours of developing countries to achieve sustainable development.

