

THE STATE OF SMALL-SCALE INDUSTRIES IN ETHIOPIA: PROBLEMS AND POLICY ISSUES

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I. INTRODUCTION

The role small-scale industries play in the process of industrial development has attracted a large number of studies for the past three decades. No wonder this is the case in view of the fact that the importance of small-scale industries in less developed countries (LDCs) is gaining momentum at the present time.

The reasons are obvious. Since, for LDCs, industrial development is considered to be a means for economic development, substantial effort has gone to promote industrialization. There is no country that has not given priority to industrial development in its development plans. In terms of success story, however, few have done well in achieving the desired goal of industrialization.

For the large majority of LDCs, industrialization has remained a far cry. Industrial development pursued along the path of large-scale industries has not been able to generate the expected economic impact and sustained development. In fact, it is not uncommon to see idle capacities due to both supply side constraints and lack of absorptive markets. In view of the huge amount of resources and long gestation period required by large-scale industrial projects, such low performance has an unbearable cost to the economy.

Thus the development of small-scale industries, it is argued, would have a number of advantages for the industrial development of LDCs. First, since the size of the domestic markets of most LDCs are limited due to their small geographical size and the low purchasing power of their population, small-scale industries would be appropriate to exploit economies of scale. In most cases, even cottage industries would be sufficient to meet the marginal needs of the rural areas. Secondly, since capital required per job created in small industries is relatively small, they can assist in coping with the growing unemployment problems. Thirdly, since small-scale industries do not require much capital, particularly foreign exchange, it is easier to set up many industries in many regions with relatively smaller investment. Fourthly, small-scale industries would be seedling grounds for the growth of entrepreneurship in LDCs. For these and other reasons, the arguments in favour of small-scale industries have been accepted both by governments of LDCs and international organizations like the United Nations and the World Bank.

The development of small-scale industries should not be considered as isolated from and independent of the wider spectrum of industrial development. Categorizing the process of industrial development by scale of operation can be meaningful to development policy applications, although the boundaries between small-, medium-

and large-scale industries are at best shadowy or arbitrary. And in practical terms, the nature of the process of production of certain products requires specific scale of operation. For example, it may not be logical to talk about the viability of small and medium industries for iron ore smelting. The distinction of industries in terms of size is only valid for functional and promotional purposes. Otherwise, the process of industrialization and the efforts made towards this end must be seen as integral parts of the development process of the national economy.

The main purpose of this paper is to show the state of small-scale industries in Ethiopia and to point out some policy issues that may be relevant for the development of these industries. The first part examines the state of small-scale industries in Ethiopia using available information at the Ministry of Industry. The second part tries to show the recent development trends of the sector. The third part indicates the major problems and constraints the small-scale industrial sector is faced with. The fourth part will be concerned with major policy issues to be considered in the development of the sector in Ethiopia.

II. THE STATE OF SMALL SCALE INDUSTRIES IN ETHIOPIA

To start with, any attempt towards making a meaningful examination of the small-scale industrial sector should consider the policy environment under which the it had been operating in the past decade or so. Industrial development was pursued along the expansion of large-scale public industries while the expansion of small-scale industries was deliberately suppressed. In line with its socialist ideals, the previous government issued laws and regulations which deliberately suppressed privately owned small-scale industries. Investment was restricted to certain areas of activities. Excluding building and land development costs, allowable private sector investment in small-scale industries was no more than Birr 500,000. And a one-man-one-license principle was in force. A number of discriminatory mechanisms in project financing, foreign exchange allocation and raw material rationing were also applied. The combined effect of this policy environment is obvious. Although it has not been able to shadow the dynamism of the sector altogether, the policy instruments of the past government have hampered the rate of development of small-scale industries in the country. In fact, the misguided policy of the past has restricted the domain of private initiatives only to small-scale industries, so much so that private and small used to be identified as one and the same.

Before going into the assessment of the state of small-scale industries in Ethiopia, it is necessary to indicate two problems faced while conducting this study. In the first place, there is lack of current information about the small-scale industrial sector, because there is no organized and consistent information gathering. The information presented in this paper is largely based on the results of the small-scale industries and handicrafts survey of 1984/85 conducted by the Handicrafts and Small-scale Industries Development Agency (HASIDA). Whatever fragmentary current information is available has also been used.

In the second place, the 1984/85 survey has its own problems of industrial classification. For example, it indicates the existence of 7,684 small-scale industries in the country. Of these 4,090 establishments or 53 per cent were manually operated while 3,594 establishments (47 per cent) employed motor-driven machinery and equipment. When motor-driven small grain mills, which number 1,293, are excluded, the number of small-scale industries using motor-driven machinery would be 2,301 or 30 per cent of all the establishments covered by the survey. In fact, according to one sector review made in 1986, the number of establishments that can reasonably be categorized under modern small-scale industries was no more than 1,360 [Hagos 1986: 25].

Thus, since the result of the survey includes small cottage industries, it is not possible to separate the state of those considered as modern small-scale industries from that of cottage industries. The reason for such gross classification seems to be political rather than economic, for the intention was to show how large the sector was and thereby attract the attention of the government towards its development.

According to the survey report of 1984/85, all small-scale establishments employed a total capital of about Birr 235 million and a total work-force of 36,846. The total gross value of production recorded by the survey was about Birr 408 million, contributing about 3.8 per cent of GDP. Of the total number of establishments covered by the survey, over 50 per cent were engaged in food processing activities. Within the food processing activities, about 33 per cent were small motor-driven grain mills and 18 per cent were oil mills and bakeries. The second major branch of production was textiles, constituting 28 per cent of the establishments. As can be observed from Table 1, food and textile industries accounted for 79 per cent of the total number establishments while other industries constituted the remaining 21 per cent.

Table 1: Number of Establishments and Structure of Output of Small-scale Industries (1984/85)

	Food	Textiles	Wood	Metals	Leather and Shoes	Paper and Printing	Chemicals	Non-metallic Minerals	Beverage	Others
No. of establishments	51	28	6	4	4	1	1	1	1	3
Share of Output (%)	51	12	5	7	4	10	5	3	2	1

Source: HASIDA, *Survey Report, 1984/85*.

One feature of the Ethiopian manufacturing sector as a whole is that it is highly dominated by the production of light consumer goods. This is more true to the small-scale industrial sector. The structure of output is concentrated in the production of non-durable and household-oriented durable goods. Again food constituted the largest component followed by textiles (see Table 1). These two industries accounted for 63 per cent of the total gross value of production in 1984/85.

In terms of employment, as is the case for the manufacturing sector as a whole, small-scale industries are not the major source of employment in Ethiopia, employing no more than 36,846 people. The largest employer, including grain mills, is the food industry which employed 48 per cent of the total work-force. Within the food industry itself, the predominant employers were grain mills, accounting for 59 per cent, followed by bakeries. The second major employer was the textile industry, employing 21 per cent of the total work-force followed by the wood (8 per cent) and metal industries (6 per cent).

Of the total employment recorded, 3 per cent can be categorized as professionals or semi-professionals, 13 per cent as having an educational level of 9th to 12th grade, and the remaining 84 per cent as below 8th grade. The other striking aspect of the pattern of employment in the sector is that the share of family members and relatives of owners in the total work-force was quite substantial, accounting for 36 per cent of the total employment in the sector.

One argument in favour of small-scale industries is that the industries are characterized by high level of domestic raw material utilization. This seem to be true in the case of Ethiopian small-scale industries, for 60 per cent of their raw material requirement is met domestically while 40 per cent is imported.

Table 2: Percentage Share of Imported Raw Materials by Industrial Branch

Food	Beverage	Textiles	Leather and Shoes	Wood	Paper and Printing	Non-Metallic Minerals	Chemicals	Metals	Average
4.7	13.4	70.6	52.6	4.8	17.5	30.2	84.5	55.8	39.6

Source: Hagos Tsehay, *The Ethiopian Handicrafts and Small-scale Industries Sector Review*, 1986.

An examination of Table 2 indicates that the most import-dependent are the chemical, textile, metal and leather industries, in that order. Due to the nature of the production process, the wood and food industries are least import-dependent.

On the export front, the performance of small-scale industries is rather modest. There are only two export-oriented enterprises in the country, both located in Addis Ababa. One started operation in 1985 and the other in 1989. Both enterprises are engaged in leather tanning (see Table 3).

The fact that only two enterprises are actually engaged in export-oriented activities indicates that virtually all small-scale industries are geared towards the home market. What is more, the sector's annual requirement of foreign exchange for purchasing raw materials and spare parts is slightly over Birr 100 million, implying that the export earning of the sector in 1990, for example, covered only 40 per cent of the total import requirement.

Table 3: Export Earnings of Small-scale Industries (1985 - 1990)

Name of enterprise	Export Values (in '000 Birr)					
	1985	1986	1987	1988	1989	1990
Dire Tannery	3,088	8,556	15,383	18,796	25,998	31,556
Melaku Alemayehu Tannery	-	-	-	-	1,531	9,253
Total	3,088	8,556	15,383	18,796	27,529	40,809

Source: National Bank of Ethiopia, Foreign Exchange Control Department.

From the above brief discussion, there are some observations one can make about the state of small-scale industries in Ethiopia.

- In the past decade, the economic policy pursued by the government has hampered the expansion and growth of small-scale industries in the country. As a result, small-scale industries are characterized by low level of development, contributing no more than 3.8 per cent of GDP, 25 per cent of manufactured value added and 6 per cent of the export trade of the country. If the share of cottage industries and grain mills is left out, their contribution is even lower.
- The structure of output of small-scale industries is dominated by the production of food and textiles while the share of the engineering and chemical industry is rather low. The nature of output of small-scale industries as well as that of the large-scale manufacturing sector indicates that industrial development in Ethiopia is still at the first stage of import substitution.
- In terms of employment, the contribution of the sector in 1984/85 was about five persons per establishment. This situation may be explained by the fact that the survey included cottage industries employing one person or more. Only 25 per cent of the establishments covered by the survey employed ten or more people.
- The low export performance of the small-scale industrial sector reflects the apparent lack of encouraging industrial exports, which appears to be paradoxical for a country like Ethiopia.

III. RECENT DEVELOPMENT TRENDS OF THE SECTOR

In the preceding section, an attempt was made to give a birds eye view of the small-scale industrial sector using available information. In this section, the development trends in the last few years is briefly presented.

In the first place, despite the restrictive and prohibitive practices imposed on the sector, the Ethiopian small-scale industry has entered into machine-building activities -- an activity hitherto unknown in the manufacturing sector of the country. To date, there are 27 small-scale enterprises engaged in the fabrication of machinery and in providing engineering services in Addis Ababa. Twenty one enterprises produce machinery for bakeries, oil mills, hollow blocks, cement tiles and soap, as well as potable alcohol-fermenters and mixers for paints, glues, etc. The remaining six

enterprises provide engineering services such as modification and fabrication of automotive and industrial spare parts.

The machines produced in these enterprises may not have good workmanship and performance as compared with imported ones. The important point is rather the fact that such dynamic transformation has taken place within the unfavourable environment of the past years. Given conducive policies, proper incentives and adequate assistance, such enterprises will have a far-reaching impact on the industrial development of the country.

In the second place, following the policy changes initiated in 1990, the existence of entrepreneurs willing to participate in industrial investment has become apparent. The policy of mixed economy declared in 1990 abolished entry barriers which were enforced through project screening and capital ceiling requirements without, however, changing the discriminatory mechanisms applied by way of raw material rationing and foreign exchange allocation.

Moreover, the timing of the policy change appears to be fraught with two problems. The first is the problem of credibility. It would be difficult to believe a government characterized by long years of political and economic centralism to genuinely change its heart to encourage economic liberalism. Secondly, the policy change came at a time when the government was losing political support at home and abroad and suffering defeats at the war fronts. It was a time when, on the one hand, the downfall of the regime has become evident and, on the other, there was uncertainty about the economic policy the next government would follow after taking power. In fact, the new policy was introduced at a time when every citizen has been worrying about his safety, let alone invest his scarce capital in fixed assets. For an observer of the time, it may thus seem that the political environment would not encourage private investment in industry.

This has not been the case, however. Before the policy declaration, the annual applications for industrial licenses were no more than 150, on the average. Soon after the policy declaration and particularly after the Special Investment Decree No. 17/1990, the number of applicants for industrial licenses increased substantially. Between July 1990 and June 1991, for example, a total of 2,355 temporary licenses were issued by the Ministry of Industry to small-scale investors. The total amount of the investment was estimated to be over Birr 547 million with a potential for creating employment opportunities for 2,355 persons [Ministry of Industry 1991].

It is interesting to note the composition of output and capital structure these industries would have when they become operational. Most of the investment is planned in the food and non-metallic mineral industries. Between them these two industries accounted for 77 per cent of the total licenses issued. In fact, 59 per cent of the total licenses were issued to investors in the food industry, distantly followed by the non-metallic industry (18 per cent). The reason for this state of affairs can mainly be explained by the fact that, since the machinery and raw materials required

for these industries are locally supplied, investors prefer to invest in these industries rather than in activities which require imported equipments and inputs in a country where foreign exchange is strictly rationed. Lack of knowledge about alternative investment opportunities, anticipation of quick returns, lack of larger investible capital, and ease of operation are the other reasons.

In terms of size of capital, most of the undertakings would require small investment expenditure. Of the total 2,355 investment proposals, 87 per cent would require up to Birr 300,000, 5 per cent between Birr 301,000 and Birr 500,000, 4 per cent between Birr 501,000 and Birr 1 million, 3 per cent from Birr 1 million to Birr 5 million, and 1 per cent over Birr 5 million investible capital [Ministry of Industry 1991].

From the above brief discussion, it is possible to make the following observations:

- The composition of output, which will remain dominated by the food industry in the near future, implies that private investment in the small-scale industrial sector is still imitative rather than innovative. Nevertheless, it appears that a new class of entrepreneurs having the technical know-how and experience as well as the will to enter into innovative and skill-intensive manufacturing activities is emerging. A few enterprises started building machines and providing engineering services on their own initiative without any outside support. Indeed, such enterprises can be the basis of industrial development in Ethiopia provided that they are supported and encouraged. To realize the benefit of this dynamic potential, adequate incentives and technical assistance by way of design, prototype development, industrial training, etc. need to be given to such enterprises to enable them develop into modern large-scale operations.
- The trend observed in the past few years does not only indicate the emergence of a new class of entrepreneurs but also shows that the country has private entrepreneurs willing to invest whatever amount of capital they have even at times of political uncertainties.
- The future industrial development of Ethiopia may be hampered not by the lack of willingness to invest in industry but by lack of the means of investment. The fact that, of the total 2,355 investment proposals, only two undertakings would require over Birr 10 million and that 96 per cent of them require no more than Birr 1 million signify that the generation of capital for industrial development would be the challenge the country may face in the near future.

IV. PROBLEMS AFFECTING THE DEVELOPMENT OF SMALL SCALE INDUSTRIES

The problems affecting small-scale industries are many and diverse, ranging from lack of conducive policies to day-to-day operational constraints. It is not possible to treat all of the problems in a small paper like this. Only the major problems, divided into two broad categories, are outlined in this section.

A. Operational Problems

The most crucial problem the small-scale industries have been facing is shortage of raw materials. With regard to domestic raw materials, the problem lies in the centralized distribution system, on the one hand, and in the acute shortages of raw material supply from domestic sources, on the other. Small-scale industries are required to submit their raw material requirements through the Ministry of Industry to the Ministry of Domestic Trade. But they could not get much of what they require, and there are times when they do not get any raw material at all. What is more, those enterprises which became operational since April 1990 have been excluded from the quota system practiced by the Ministry of Domestic Trade. As a result, small-scale enterprises are forced either to stop operation, operate below capacity or purchase raw materials in the open market at exorbitant prices.

The problem faced by those enterprises using imported materials is also severe. The government has not allocated foreign exchange to small-scale industries since 1989. Even during the earlier years, the foreign exchange allocation was not sufficient to fully utilize productive capacities. As Table 4 indicates, the amount of foreign exchange allocated to the sector between 1985 and 1988 was no more than 17 per cent of the total requirement.

Table 4: Foreign Exchange Allocation to Small-scale Industries (1985- 88)

Year	Foreign exchange allocation (in Birr)				As % of total requirement
	Raw materials	Spare parts	Machinery	Total	
1985	10,744,457	278,585	2,467,212	13,490,254	17
1986	9,911,356	525,354	-	10,436,710	13
1987	9,817,252	639,088	2,620,791	13,077,131	16
1988	6,097,748	486,854	-	6,584,602	8

Source: HASIDA, *Internal Reports of Industry Promotion Department*, 1989.

Most of the industries try to overcome this problem through *franco-valuta* imports. Here again the industries are discouraged by the existing customs

regulations which range from an outright ban on *franco-valuta* imports as in the past years to levying of high customs duties and surcharges.

The shortages of raw materials, both domestic and imported, have forced industries either to close down or operate below capacity. Presently, it is estimated that, on the average, small-scale industries utilize less than 20 per cent of their production capacities.

Transportation problems, high income tax rates, shortage of construction materials, lack of skilled manpower and inadequacy of infrastructural facilities are also some of the problems affecting the proper operation of the small-scale industrial sector in Ethiopia.

B. Development Problems

There are a number of problems that hamper the development of industrialization in general and small-scale industries in particular. The most important development problem of the industrial sector as a whole has been the macroeconomic policies pursued by the government in the past decade. Excessive centralization of the economy has created a complex and inefficient bureaucracy which shadowed the importance of economic efficiency in state-owned enterprises and had adverse effects on the rest of the economy.

Industrial development is an integral part of the whole process of economic development. Constraints faced in one sector affect other sectors creating a chain of problems throughout the economy. Recognizing this fact, it becomes necessary to point out the major development problems faced by small-scale industries in Ethiopia.

Any meaningful effort towards industrialization requires the generation of investible capital. Lack of investible capital is a stark reality in the case of Ethiopia. Both the government and the private sector have little surplus capital for industrial investment. The shortage of investible capital could be mitigated through loan financing.

The Ethiopian experience in the small-scale industrial sector, however, indicates that loan financing is not only unavailable but also discriminatory and time-consuming. The procedure of project appraisal by the financial institution (namely, the Agricultural and Industrial Development Bank) before issuing loan takes much time. Even the acceptance of applications has its own time-consuming procedures. The license issued by the Ministry of Industry is not sufficient for application. First, it must be accompanied by a letter of recommendation from the ministry. Second, an applicant must show ownership right of the land where the factory is to be set up. Thus, an applicant has to come twice to the ministry to get a license and thereafter obtain a letter of recommendation for loan. And he/she will also have to secure the required plot of land before applying for loan.

Even after taking too much time, the bank may not be able to cover the foreign exchange component of the project costs. Available information at the Agricultural and Industrial Development Bank indicates that there are 25 projects with a total capital of Birr 20 million which have not been able to get the foreign exchange component.

What is more, small-scale investors are faced with discriminatory interest rates. The rate of interest varies for co-operatives, state undertakings and private projects. A private investor in industry pays a 9 per cent interest rate while the rates for co-operatives and public undertakings are 6 per cent and 8 per cent respectively.

The other major problem is getting land for setting up a factory. This is relatively more crucial in Addis Ababa than other towns. The problem seems to arise from the urban land policy which does not attach economic value to land and the resulting strong demand vis-a-vis the limited capacity of the Addis Ababa City Council to process and issue the required plot of land to private investors. Currently, the Addis Ababa Administrative Office can give land for 300 business entities per year, of which 200 are industrial establishments. On the other hand, the Ministry of Industry has written recommendations to the City Council for 2,000 investors in the past 12 months alone. This, in short, implies that it will take about 10 years to accommodate the current 2,000 applications.

The third problem is lack of promotional activities geared towards strengthening the existing establishments and attracting new investment in the sector. It is true that the Ministry of Industry has abolished entry barriers and bureaucratic procedures. An investor is free to invest in any field of activity without capital ceiling. In terms of licensing, since October 12, 1992, temporary licenses are issued within 24 hours.

But the development of small-scale industries cannot be facilitated only through the removal of entry barriers or through facilitating the issuance of licenses. It requires carrying out a number of promotional activities and provisions of technical support to the sector. This again requires some sort of definition as to what is meant by small-scale industry as well as analysis of needs and capabilities to give appropriate promotional activities. To date, no standard definition has been in use by institutions responsible for the development of the sector. It seems that the Ministry of Industry is trying to pursue a goal of industrial development through a parallel promotion of public industries and private sector industries in general.

V. SOME POLICY ISSUES

The history of industrialization shows that industrial development is a complex process having no ready made policy prescription. The formulation of industrial development policies is not an easy task because various policy elements are not independent of each other and also depend on the availability of human, financial and material resources, the size of the market, etc. The formulation and

implementation of policies for the development of small-scale industries is even more problematic as the nature and role of the sector changes along with the level of industrial development. Consequently, any attempt to design and implement policies for development of the sector requires adequate knowledge about the present and vision about the future.

Actions aimed at developing small-scale industries should start from defining what is meant by small-scale industry and then setting up appropriate organizational structures to carry out promotional activities. Currently, industrial development promotion in Ethiopia is pursued along ownership lines. This is clearly reflected by the present organizational structure of the Ministry of Industry, which is broadly divided into main departments for the promotion of public and private industries. This may have an advantage in terms of following a coordinated industrial development strategy. The problem is that this organizational setup would not allow carrying strong promotional activities for the development of small-scale industries. Consequently, it would be much desirable to define what small-scale industry means and to set up a separate professional, as opposed to bureaucratic, organization to carry out promotional activities.

The next important measure is to abolish the existing policy of discrimination in favour of government-owned industries to solve the current operational problems the small-scale industrial sector is faced with. In this regard, it is important to improve the problems of raw material supplies (both domestic and imported) in order to increase the production capacities of the existing enterprises. In addition, import liberalization and decentralization of the current distribution system can have a positive impact on relaxing the supply of raw materials. Improvement in the rate of taxation, availability of transportation facilities, etc. are also necessary.

Financing is another area where adequate policies need to be formulated. The current practice of loan financing is not only time-consuming but also discriminates against small-scale industries and in favour of large-scale public industries. Given the low level of industrial development in Ethiopia, it is important to determine a balanced and attractive rate of interest that can contribute towards the realization of the industrialization objective of the country.

The other important policy issue that must be tackled is how to shorten the time it takes to start industrial operation. The current experience is fraught with a number of problems. The most serious problem is the acquisition of land. The solution to this could be to set up industrial zones equipped with the necessary infrastructure, so that any investor will be assigned a plot of land immediately after the issuance of industrial licenses. This will not only facilitate business start-up, but will also enable to adequately monitor land utilization so that speculative investments in land are discouraged.

Theoretically, one importance of small-scale industries is the complementary role they play in the process of industrial development. This is an issue of the

linkage effects small-scale industries have within the industrial sector as well as with the rest of the economy. For countries like Ethiopia, the linkage effects small establishments would have within the industrial sector need to be given adequate considerations. Small-scale industries create markets for the outputs of large-scale industries. At the same time, they can provide inputs and components to large-scale industries through sub-contracting. This type of relationship will be important particularly in developing engineering industries. Consequently, a policy of ancillerization or sub-contracting is necessary to exploit the benefits of linkages within the manufacturing sector in order to facilitate the creation of a sound industrial base.

The most important argument in favour of small-scale industries is the creation of entrepreneurship, which is lacking in a backward country like Ethiopia. Whatever policy issues are considered, this fact must not be overlooked. The dynamism of small-scale industries lies in their ability to create a private entrepreneurial class capable of going into large-scale operation. For this reason, any policy intervention in favour of small-scale industries should aim at inducing the sector to expand the scale of operations and to diversify into different areas of industrial activities so that it can positively influence the long-term characteristics of the industrial sector. This is particularly important for Ethiopia which has a good potential for the creation of entrepreneurship, as witnessed by the existence of such elements even within a sector characterized by low level of development.

The point being made is that policies should be geared not merely for the sake of expanding the small-scale industrial sector but also towards spotting promising entrepreneurs and speed their development. Otherwise, initiating non-growth inducing policies designed to promote small-scale industries, without having the long-term objective of creating a dynamic entrepreneurial class would simply look like bringing a crippled child into a dynamic world and destine it to permanent infancy and dependence. The beauty of smallness should be in its ability to evolve into big and dynamic, not in its retention of smallness and infancy. Therefore, whatever policies are adopted, assistance to small-scale industries, should aim at generating the inertia of growth and not at perpetuating smallness. Like anyone who wishes to have a healthy and strong child, future small-scale industrial development policies should consider the destiny of the sector lest it remain crippled for good.

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