CO-OPERATION AND DEVELOPMENT IN THE ASIA/PACIFIC REGION - RELATIONS BETWEEN LARGE AND SMALL COUNTRIES

Papers and Proceedings of the
Seventh Pacific Trade and Development
Conference held in Auckland New Zealand
August 25-28, 1975 and
sponsored by
The New Zealand Association of Economists

Edited by
Leslie V. Castle
and
Sir Frank Holmes

THE JAPAN ECONOMIC RESEARCH CENTER
TOKYO

PREFACE

The Seventh Pacific Trade and Development Conference was held in Auckland, New Zealand from 25 to 28 August, 1975. Previous conferences in the series had been held in Tokyo (1968), Hawaii (1969), Sydney (1970), Ottawa (1971), Tokyo (1973) and Mexico City (1974). Each has contributed in a different way to informed discussion of trade and development problems and policies of vital concern to countries of the Pacific Basin. Publication of the major papers and of summaries of the discussions have proved helpful to policy-makers and students throughout the region. Accordingly, it was decided that the papers and proceedings of the Seventh Conference should be published in a similar format to that used for the two preceding conferences, and thanks are due to the Japan Economic Research Center for making their facilities available for this purpose.

The countries of the Pacific Basin differ, not only in their political, social and economic systems, but also in size. With this conference being held in a country of relatively small population, which in turn has especially close relations with island nations of even smaller scale, it seemed timely for attention to be given to what effects on co-operation and development in the region flow from the differences in size of its component parts. Accordingly, the theme of the Seventh Conference was "Relations between Large and Small Countries". After two sessions exploring the issues generally, selected case studies of dependent countries in Latin America, South East Asia and the South Pacific were discussed. Development assistance was then considered from the viewpoints of both donors and recipients. Japan and Papua New Guinea provided the basis for consideration of foreign investment from the perspective of both home country and host country. Finally, this Conference broke new ground in the series by considering the topical problem of co-operation in the development of marine resources.

The Conference was sponsored by the New Zealand Association of Economists (Inc.), organised by a New Zealand committee, and administered by the Center for Continuing Education of the University of Auckland. Financial assistance was provided by the New Zealand Government and by the Asia Foundation. We should like to express our gratitude to all those who assisted with sponsorship, organization, administration and finance, as well as those who presented papers and participated in the discussions.

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C O M M U N I Q U E

The Seventh Pacific Trade and Development Conference held in Auckland from 25 to 28 August 1975 was attended by economists from developed and developing countries interested in economic problems and policies of the Asia/Pacific region.

The sponsoring organization was the New Zealand Association of Economists with administrative services being provided by the Center for Continuing Education of the University of Auckland.

For the first time participants included a number of economists from small developing countries of the South Pacific such as Papua New Guinea, Fiji and Tonga. Other participants included, in addition to those from New Zealand, economists from Australia, Canada, Indonesia, Japan, Malaysia, Mexico, Thailand, the United States and the USSR.

The conference was concerned with the general theme of economic relations between large and small countries of the region, and especially with the effects on trade, development assistance and foreign investment relationships, of differences in size and bargaining power. The conference reviewed experience over recent years in these respects having regard to the special problems that small countries face.

There was a sense of concern about recent trends in the world economy and their effects on the development prospects of small countries especially the poorer ones. The heavy dependence of small countries for their prosperity on trade access to larger Pacific country markets was emphasized and alternative means of dealing with this problem were examined. These included the reduction of protection for agricultural produce and manufactured goods in which smaller countries have a comparative advantage, and the more vigorous pursuit of adjustment assistance for industries that could be affected in the developed countries.

The extreme decline in commodity prices and uncertainty about the resumption of economic growth in industrial countries is seen as having depressive effects on incentives for smaller developing countries to develop their resources in the long term.

The conference stressed the importance of securing a fair distribution of the gains from trade, development assistance and foreign investment as between the large and the smaller countries. Particular stress was placed on the difficulties for small countries in accommodating foreign investment and aid where these flows were relatively large. This situation raised in particular a range of social and political problems which were documented in several case studies. This led to the conclusion that the achievement of a multilaterally agreed code of behaviour for foreign investment was an urgent task at least on a regional basis.

The growing problems with foreign aid were noted and attention focussed on the special problems that bilateral aid posed for smaller countries. This pointed to the need for the terms and conditions of development assistance to be more flexible and for a clearer definition of aid objectives. There was wide agreement that the complete untying of aid would be a major improvement. A greater emphasis on multilateral aid might assist in ameliorating some of

the disadvantages that small countries perceived in development assistance relationships.

For the first time in this conference series special attention was given to problems in the development of marine resources in the region, and the potential for conflicts arising from the extension of seaward jurisdictional limits was discussed.

The proceedings of the conferense will be published early in 1976.

The Eighth Pacific Trade and Development Conference will be held in Pattaya, Thailand in July 1976, on the subject of Trade and Employment. The Eighth Conference is to be sponsored, among others, by the Council for Asian Manpower Studies, and the Asian Development Institute.

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PART I

INTRODUCTION

1

OPENING ADDRESS

F. H. CORNER,
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I confess that I, a diplomat trained as an historian, feel somewhat ill at ease addressing a gathering of distinguished economists. But I try to comfort myself ; for instance, by the observation of an Englishman that it is very difficult to find any man who is not regarded by the learned as an imposter or by the unlearned as a bore; or by the thought that at a time when economics offers little reassurance a certain bleak encouragement can always be gained from the lessons of history. History affirms at least the extraordinary survivability of man, whereas I fear that before long someone's rigorous cost accounting may show that the human race is a venture that no longer pays.

As diplomat I speak more cautiously the more I am forced to admit the possibility that diplomacy may not only be incapable of dealing with the kind of crises which will determine the fate of human societies but may become almost irrelevant in the face of them. I have in mind crises of food and resources, of population, of inflation and recession, and of their associated evils ranging from famine and pollution to alienation, crime, terrorism and political chaos. The classical subjects of diplomacy have been within the realm of inter-state relationships, matters which, because governments were in control of them, could, when the will existed, be dealt with by inter-governmental cooperation: border adjustments, the emergence of new states, the control of armaments, military disengagement, the regulation of trading conditions, or radio frequencies or air routes. But now the political map of the world, transformed in the first 70 years of this century, is more or less settled; and a new era appears to be opening. Though obviously many of the traditional tasks remain, it could be that the classical period of diplomacy is coming to an end.

Our greatest preoccupation now will be with the kind of social and economic earthquakes and tidal waves already shaking and washing over us and likely to increase in number and intensity. Certainly these affect every nation, revealing every day more clearly our interdependence. This fact should lead governments to realise the need to shape their domestic policies in such a way that, while meeting their individual needs and differently perceived interests, they still converge with the policies of other countries. In such a situation one might think that the contribution of diplomacy would become more important than ever. But the great crises of our time result from such deep-seated forces <u>within</u> individual nation states that it may be that they are of a kind which can not be managed by governments and scarcely ameliorated by cooperation among natons - even if the will to cooperate became more evident than it is at present. Perhaps there can be little effective international cooperation to solve some of the major crises until many countries, not just affluent countries but the developing also, have achieved a basic reordering of certain of their domestic economic and political arrangements. Comprehension of the need for such changes and the will to make them may be developed a little by the diplomatic process, by the concentration of effort and exchange of ideas which sometimes occur at international meetings - that is, when these meet-

ings are more than mere oratory and repetition of slogans. But the issues involved touch so close to the most basic interests of individuals and the historically conditioned organisation of states that fundamental shifts obviously will not come rapidly. Few governments are likely to dare to make them except perhaps under extreme pressure of necessity - for to do so would often be to imperil their own survival as governments. Meantime events move swiftly: populations leap ahead, more people starve, the shanty towns spread, signs of chaos multiply. The resilience of nations will certainly be tested, and the resourcefulness of their leadership.

Despite such gloomy questioning of the prospect ahead, of the power of governments to control events and of the relevance of my profession I shall nevertheless proceed, if only because, assuming we believe the human race has a future, we have to start somewhere. And we do best, so I think, to start by looking at the political background. Economic and social activities, the whole development process, are after all not neutral. There is no such thing as "value-free" economic policies. They are given shape and purpose by the political goals for which they are used; and they must operate within a given international framework.

That framework has been fundamentally altered over the past five years or so. The international order under which we lived for a generation after 1945 has passed away, irretrievably. In retrospect, it may seem more comfortable than it was at the time. Most of you were witness to it, as I was. You will recall that two processes dominated the international scene during the quarter century after the Second World War: the formation of two tight coalitions, each grouped about a super-power, hostile towards one another, inflexible in their thinking; and the disappearance of the old European empires, leaving scores of infant sovereign states in their wake.

These were momentous changes. But we survived them without another major conflict. Just how, looking back, I am still not sure. The super-powers maintained a fragile peace, each confronting the other at the head of their respective alliances. Wars tended to be border wars, at the edges of each other's influence.

Then confrontation gave way to a tenuous coexistence, and coexistence to dialogue and limited cooperation. Some call this detente; we know it to be an uneasy accommodation, a moment in history when three great powers with many divergent interests and ambitions find it convenient, each for its own reasons, to blunt the sharpest edges of their rivalry. Such a balance could be easily disturbed. But it is preferable to the era of confrontation and containment. And it opens up wider possibilities for those countries which in the previous era were locked into alien ways of thinking and acting and had small room to experiment with autonomous approaches to their development problems.

The development preferences of most countries must be modified by the need to divert resources to meet the requirements of domestic and external security. But the policies of the main shakers and movers on the Pacific stage have not yet been clearly established. It will therefore be some time before countries of the Pacific region will have the evidence they need about the external strategic situation confronting them. Similarly, in the economic, trading and financial fields, it will be some time before Pacific countries can predict the likely behaviour and attitudes of the economically powerful nations and therefore establish the full range

of social, economic and even political options open to them. I shall touch upon this matter in a moment. But, as to the political framework, at least one can say that with the crumbling of the bipolar world and the unwinding of the system it had created, a looser pattern of relationships has emerged and a greater opportunity should exist for each country to contemplate more autonomous development patterns.

I now approach, with even more caution, the new battlefield where political and economic forces intersect. We have, it is surely agreed, entered a new cycle of change. It is in its early stages, but clearly centers of gravity are shifting; power, like wealth, is being redefined in new ways; governments are confronted by a whole new agenda of problems.

A new constellation of forces is at work. The world is, as a result, a more fluid and unpredictable place than it was thirty years ago - or even at the beginning of this decade. Of course, it is not unknown in history for countries to be faced with economic disequilibrium; and for this to occur at a time of political disarray. But never before have the two situations come together, on a world scale. Their impact now has sent out shockwaves which have yet to work their way clear to the edges of the international system. They are not distinct phenomena. There is substantial interaction between them.

The perception each government has of the overall political framework and what it means for them also helps determine their approach to the economic situation and their readiness to act on behalf of the interests of others. This is very relevant at present. For governments have to accept that the old world economic order has broken down as surely as the political assumptions on which it was based. The diffusion of political power in the fifties and sixties is now being matched by a greater diffusion of economic power. We have outgrown the old economic arrangements. This is partly because their very success in freeing trade and investment has burst the framework set up thirty years ago. Without quite realising it, we have indeed moved to a global economy. The major trading nations have over the past three years found themselves marching in step to the same drummer. We still do not know how to cope with the effects on our fragile economic fabric.

But a new economic order will come because the old one could not adequately accommodate the interests of the developing countries which have emerged since it was established. The old order was set up by twenty or so industrialised Western nations. Naturally it worked best for them. Now there are 140 or more sovereign states, or nearly treble the number since the war. They want a new framework that will accommodate their vision of a good society,will meet their needs, will allow them a more autonomous type of development than has hitherto been open to them. They want a progressive redirection of economic activity away from consumerism towards the goal of providing a decent minimum life for all human beings. Of course they have wanted this for years, but their views made little impact.

Now they have a certain ability to make themselves heard. The developed countries are coming to realise that unless they change their technology and their way of life - which few of their people show signs of relishing - they are hostages to at least part of the developing world and would do well to be more receptive to some of the ideas which the different historic experiences of the Third

World have brought forth. And in a fluid situation the developing countries have grasped the fact that their numbers count when they stand together. So the idea of interdependence begins to move from the podium to the world of reality.

The diffusion of power raises in sharpened form the problems of reconciling the most efficient distribution of economic activity with political sovereignties and individual social choices. The old economic orthodoxies are going to have to be reworked. This does not mean that the laws of economics have surreptitiously been repealed. But, as I have suggested earlier, economics is the servant and not the master of our political and social goals. As these change we will have to adapt the techniques and mechanisms which have been familiar in one context so that they will work in another.

The Pacific basin should be a good catchment area for new ideas. With the exception of the EEC which is, after all, a customs union, it is the most trade intensive region in the world. It contains four of the ten fastest growing economies in the world. Its fifty or so trading entities range from archipelagos to atolls - the three economic super-powers, countries in the process of economic take-off, down to the smallest island groups in the South Pacific. The pool of experience you bring to this conference cannot help being of unusual depth and richness.

What I referred to earlier as the shockwaves of recent changes have been felt, too, in our Pacific region. How could it be otherwise? How can the problems of one area be separated from the common problems of the human family? East Asia was formerly a prime area of great-power confrontation. Its problems have traditionally been seen in military terms, as security problems. We in New Zealand were not immune from this. For a long time we saw Asia as a sourse of threat. Now we approach it positively, as a region of opportunity. The relationships we have formed within and across the Pacific provide the impetus for our continuing economic development. This is the one, indeed the only, region of the world where we are able to play an innovatory role. We seek to do so, in various fields.

We are concerned now with the very theme of your conference. How, that is, to respond to the newly important relationships between large and small countries. It is newly important because it is at the heart of the problem of development. Given the practical stakes involved for many people it is perfectly possible that the rich, retreating into their old economic bastions, and the poor, relying on the leverage of their new unity, could drift into confrontation. Indeed, there were signs in the opening rounds of the great international debate that this might happen. The appeals of the Third World for their economic emancipation, so long overdue, and their denunciations of the existing order with all its inequities, were matched - in volume if not in number - by the advocates of the old order, the order on which Western preponderance has been based. It appeared that a test of strength would eventuate. Had it done so, it would surely have torn the present economic system apart. We seem to have emerged from that crucible. A confrontation could still occur, though there are growing signs that even the hotheads on both sides are coming to see that cooperation is the only alternative to deadlock and the price of deadlock could be high.

There is little evidence yet, however, of a general acceptance that a dynamic relationship will have to be built up between larger and smaller, developed and developing, to work out courses of action

which will narrow that famous gap - not so much between rich and poor as between oratory and practice. This has to come. But the process will be difficult and lengthy.

It could also be explosive. Take one basic principle that has first to be established: that a nation's autonomous political and social goals, and the economic structure which reflects them, must be the final determinant of the nature and extent of its development; and that the role of countries which desire to contribute to development is not to dictate these goals but to assist governments to achieve them and also to help create the international conditions in which they can best be realised. Though this is commonplace enough, its implications are going to shatter some attitudes so long held by the richer countries that they have been erected into economic orthodoxy; for example, the free international marketplace for commodities. Leaving aside how free it has actually been, there is nothing sacred about terms of trade. They can be altered, and the task will be to settle on the best means of doing so. Free trade? By all means; GATT principles and the gradual freeing of trade have served the world well over the past generation. But will we not now have to move further towards the principle of "selective discrimination", already acknowledged in the Generalised System of Preferences, to enable the least-developed countries to catch up at an accelerated rate? Will not richer governments have to do their planning with more and more of an eye on the creation of opportunities for developing countries? These may be opportunities for the sale of more processed and semi-processed products; developing countries do not want to be locked forever into the export of raw materials by the tariff structures of the rich. Or they may be the creation of opportunities for employment and the development of export industries in the developing countries. This is the kind of thing that New Zealand is pioneering in cooperation with its near neighbours in the South Pacific.

With each experiment we constantly get back to the question of political will. Whether, that is, the richer countries are prepared to implement ideas and undertakings worked out in international debate. It is fashionable to observe that the world has become more interdependent and it certainly is. But it has yet to be proved how effective a rallying cry interdependence will be. Our world may be as much David's as it is Goliath's. But it is still made up of sovereign states of unequal size and wealth. This is the reality. We cannot ignore it; we are not likely to be permitted to ignore it. Voting majorities may look impressive; so are oil surpluses and potential weapons of oil and raw materials; but the day of North America, Japan and Western Europe is far from over. I do not see them as an unholy triumvirate, garrisoning the rest of the world. But undeniably their individual power is enormous. In combination it would be decisive. Used creatively it is indispensable to the solution of our common problems.

Consolidating the new relationship between richer and poorer, larger and smaller, is not going to be painless. It will involve sacrifices. And that involves education and political leadership of a high order to create a general political will. If that will is not created, and if as a result a more satisfactory economic framework is not fashioned, then the prospect of sustaining tranquility on this globe will be bleak indeed. My point being that we have a choice - to work together to bring about a better distribution of economic activity - rationally and as a coordinated re-

sponse, to try to go our separate ways, jealously guarding our sovereignties. The indications are that the second course is riskier than the first and ultimately probably more painful.

In order to succeed then, for the general good, we shall also need to widen the moral and intellectual framework in which we - the privileged - have hitherto operated. We accept that, within our national societies, every citizen has a claim on that society for a decent human life. We are now required to widen this view to encompass all citizens in the global society we have brought into being. When we do, we may find it is not all sacrifice. There will be opportunities as well as burdens. Consumerism must of its nature be a transitory pursuit; the rich cannot go on piling up goods forever. After the second car and the boat, what then? A better distribution of the world's economic activity may reinvigorate the jaded super-consumer societies already emerging from the end of the assembly line of Western civilisation. Might it not put the growth of the world's economy on a healthier basis?

Having talked myself from opening gloom to a glimmer of optimism I believe it time to desist; the inevitable next stage is rich oratory. I therefore conclude by congratulating those who had the foresight to organise this timely meeting and to express my confidence that your deliberations will make a significant impact upon thinking in this country and in the Pacific region.

2

PROBLEMS OF DEVELOPMENT ASSISTANCE AND ECONOMIC CO-OPERATION AMONG LARGE AND SMALL STATES IN THE PACIFIC REGION

Grant L. Reuber

Any topic that highlights the importance of the relative size of countries in a particular region, such as the topic chosen by the organizers of this session, poses an immediate challenge for the economist accustomed to thinking in terms of conventional economic principles and international relationships. What is meant by relative size in this context? Why would one expect it to have a special influence on problems of development assistance and economic co-operation? Why would one expect this influence, if it exists, to be different among Pacific rim countries than anywhere else? Size apart, in what sense do problems of development assistance and economic co-operation differ in the Pacific area, for whatever reason, from elsewhere in the world? And if the Pacific area is, in fact, different, to what degree does it differ and what are some of the policy implications of the differences?

Posing these questions is much easier than answering them, especially for someone whose knowledge of the eastern and southern parts of the Pacific area is very limited. In the discussion that follows a few leading characteristics of the area are first briefly reviewed. This is followed by more detailed discussion which, first, identifies in general terms some of the problems associated with foreign trade, foreign investment and foreign aid; second, considers the influence of relative size on these problems; and third, questions what, if any, special factors bear upon these problems in the Pacific area.

Some Background Characteristics of the Area

In aggregate, the countries touching on the Pacific accounted for about 61 percent of world output in 1972 and 34 percent of world trade (exports plus imports) in 1971. This picture is, of course, very much dominated by the United States and to a lesser degree by Japan. If one excludes the United States, the foregoing percentages decrease to 29 percent and 22 percent respectively; excluding Japan as well, the figures are 22 and 15 percent; and excluding Russia and China, in addition, these shares decrease to 8 and 12 percent respectively. Omitting all four of these countries, the output of the area is equal to 39 percent of the output of the enlarged European Economic Community (EEC) and its trade to about 32 percent of EEC trade.

Another impressive feature of the area is its high rate of economic growth in the recent past relative to other parts of the world as well as to earlier historical periods. From 1960 to 1972 the annual rate of growth in GNP per capita for the area as a whole averaged about 4.3 percent. Again this picture is dominated by the United States, Japan, Russia and China. If one eliminates these countries, the average (weighted) annual rate of growth for the area was 3.4 percent during this period.

A third noteworthy feature of the area relates to its general level of affluence. Only 6 of the 32 countries in the area (Indonesia, China, and countries in the Indo-China peninsula) had a level of GNP in 1974 below US$200 per head. In 13 countries (Guatemala, El Salvador, Honduras, Nicaragua, Colombia, Ecuador, New Guinea, Malaysia, Thailand, North and South Korea, the Phillipines and Taiwan) per capita income ranged between US$200 and US$500; in 6 (Mexico, Costa Rica, Panama, Peru, Chile and Hong Kong) per capita income ranged between US$500 and US$1,000; and in the remaining 7 (U.S.A., Canada, Japan, U.S.S.R., Singapore, Australia and New Zealand) per capita income was above US$1,000.[1] Although there are several highly populated countries--most notably Indonesia and China --where per capita income is very low, the area generally does not have the massive, hopeless poverty found in parts of Asia and Africa, where per capita income under US$200 is commonplace.

To what degree are the countries of the area economically integrated and what have been some of the forces that have impaired and advanced closer integration? Considering the area as a whole one is immediately impressed by the enormous diversity of the area in terms of language, customs, religions, political ideals, climate, factor endowments of all kinds (both physical and human), production and consumption patterns, the size of countries (however measured), and the disparities in the level of development, income and wealth. At first blush this diversity might be expected to offer vast opportunities for specialization and mutually beneficial foreign trade and investment as well as foreign assistance. Yet the data suggest anything but a highly integrated economic area. Instead, one finds several highly integrated sub-areas or regions; and each of these regions is as much, or more closely, integrated into other areas of the world as with other parts of the Pacific area.

While economic integration in the Pacific rim area remains patchy, it has been increasing quite rapidly at many points since World War II. To use exports as an index, from 1961 to 1971 the share of exports of Pacific rim countries destined to other countries in the area increased over 10 percentage points to about 54 per cent in 1971.

One of the principal reasons why the area as a whole has not become more highly integrated economically is, of course, the enormous distance among most of the countries in the area. Recent changes in transport and communications technology--larger vessels, new deep -water port facilities, containerization and satellites, are just a few of the many innovations--have contributed to a reduction of these barriers.

But distance is only part of the explanation. Europe and other parts of the world, after all, are also very remote from most countries in the Pacific area. Probably more important than distance in impeding closer economic integration and co-operation have been the vast cultural and linguistic differences among countries in the area, differences in their history and traditions, differences in their political systems and economic philosophies and differences in their political affiliations. Since World War II these infulences have been eroded considerably by a variety of economic and other

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1) IBRD. World Bank Atlas, Population, per capita Product and Growth Rates, 1974.

influences. To what extent and how rapidly this broad range of cultural, social, political and historical influences erode in the future, opening the way to closer economic integration, is likely to depend in large part upon the relative strength of the countervailing forces of nationalistic political pressures, on the one hand, and of market pressures, on the other.

The influence of nationalistic political pressures in hampering closer economic integration in the area is evident in a wide range of policies that have been adopted by countries in the area. Virtually all of these, in one way or another, have restricted the flows of people, trade, capital and economic assistance within the area. While many of these policies have been nominally non-discriminatory among foreign countries, others have been deliberately discriminatory. Most of these measures have been espoused on grounds of safeguarding the general social, political and economic interests of the country concerned. Some of the policies have reflected genuine concern for the national interests of the country, broadly conceived. Many, however, have been based on little more than the straightforward self-interest of powerful groups in the community who, in time-honoured tradition, have cloaked vested self-interest in articulate nationalism.

Reference has already been made to the economic pressures for closer economic integration in the area. On the demand side, these arise from the relatively high and rapidly growing levels of income. On the supply side, they arise from the large and diverse factor endowments of the area and the shifting patterns of comparative costs in the world. The economic pressures for closer integration in the area seem likely, if anything, to increase in the foreseeable future. One reason is the likelihood of relatively rapid economic growth in the area, considerably increasing demand not only for more goods and services of all kinds but also for greater diversity in the range of goods and services available in each country in the area. Another reason is the likelihood of continuing changes in comparative costs in the area, reflecting changes in the availability of raw materials, labour and capital. And a third reason is the likelihood of an increasingly competitive world which will make it more important to exploit such economic advantages as are afforded by the Pacific area.

Since 1940 the Pacific area has experienced more war than anywhere else in the world--three major wars as well as numerous local wars. In the process, traditional social structures, cultural ties and political alliances have been fundamentally shaken and new patterns have emerged. On balance, these changes have reduced ties with Europe, have increased local nationalistic political forces and have increased intra-area ties. The extent to which economic pressures bring about closer integration and co-operation in future will depend not only upon the degree of economic nationalism pursued by each country but also upon the ability to maintain reasonable peace and security in the area.

Trade Relationships

So much for general perspectives. Among the more specific issues that arise, the most important, from the standpoint of offering the largest potential gains in economic welfare in the area in the long-run, are those related to trade. With rising incomes, trade makes it possible to satisfy changing and increasingly diversified consum-

er tastes more adequately. At the same time, because of wide differences in the composition and quality of productive resources, trade enables producers to specialize in those areas where they have relatives production cost advantages. Furthermore, by enlarging the size of the market, opportunities for increased productivity through economies of scale are opened up. In addition, access to larger markets makes it possible to put resources to productive use that otherwise would lie idle.

The geographic pattern of trade among Pacific rim countries in 1971 is shown in the trade matrix presented in Table 1 of the Appendix. The United States and Japan are the main suppliers of manufactured products. A large volume of manufactured products based on low-cost labour is also provided from small countries such as Korea, Taiwan, Hong Kong and Singapore. Countries like Canada, and Australia also export manufactured products in some volume. Food and raw materials are supplied by many of the developing countries. It is noteworthy however that the largest producers and exporters of food and raw materials in the area, by a considerable margin, are the developed countries.[2)]

The trade policy issues that arise may be grouped under four general headings: those related to short run adjustment and stability; those related to long-run structure of production and trade; those related to the terms of trade; and those related to the appropriate policy stance vis-a-vis the rest of the world.

The general idea of adjustment assistance is widely understood and accepted. As a practical matter, however, it has proven extraordinarily difficult to design and implement policies that simultaneously cushion and facilitate adjustment to increased international flows of factors, goods and services. Some schemes in fact are little more than thinly-disguised protectionist devices.

The specific measures adopted by countries to cope with short-run dislocations vary greatly. Some are intended to cushion the short-term impact of changes in policies designed to further longer-term objectives, such as trade liberalization policies. Others are intended to cushion the effects of relatively rapid changes in comparative costs, such as policies to cope with "low-cost" imports. Despite the great variety of such short-run adjustment policies, at least two general principles can be enunciated.

1. While temporary safegurads, such as restrictions on foreign trade and investment may be a valid means of adjusting to freer international flows of trade, capital and people, countries at present are not subject to adequate international discipline in introducing and applying safeguard and adjustment assistnace policies. Without such discipline, such safeguards all too often become permanent protective devices. As indicated by a group of experts reporting to the OECD in 1972, a common system of rules and more effective procedures for international supervision of safeguards is needed.[3)] When in-

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2) For the world as a whole, exports of food and raw materials excluding fuel from industrialized countries were almost twice as large in 1972 as those from developing countries. GATT, International Trade, 1973/74, Appendix Table 6.

3) OECD, "Policy Perspectives for International Trade and Economic Relations", 1972.

voked, such safeguards should be subject to annual review to exert maximum pressure on countries to adhere to agreed time-tables and other commitments. Also, an annual review of each country's or area's adjustment policies may be useful. If new procedures can be agreed upon internationally they should apply to all cases--there is no reason why any industry should be considered outside the agreed safeguard framework--and they should apply to "voluntary" as well as to mandatory schemes.

2. Any international safeguard system will work better if coupled with more adequate domestic policies of adjustment assistance, regardless of whether the source of disruption is foreign or domestic. While these policies will vary from country to country, reflecting circumstances and preferences, they should sustain two overriding principles: they should give every promise of, in fact, promoting adjustment; and they should minimize the diversion of adjustment costs to other countries. These principles imply that policies that directly subsidize adjustment will normally be preferable to those that are simply restrictive.

Rich countries have a greater economic capacity to bear adjustment costs than poor countries and might, therefore, be expected to have more "liberal" adjustment policies. The same can possibly also be said of countries with more highly diversified economies, of economies with more highly mobile and versatile resources, and of economies with more highly diversified markets at home and abroad. This said, it is not evident that country size, as such, has much bearing on the question of adjustment policy. Nor is it evident empirically that the range and quality of adjustment policies have much correlation with country size. What is more, the Pacific rim countries, both large and small, appear to exhibit most of the difficulties associated with adjustment policies found everywhere in the world.

Related to adjustment assistance policies are policies designed to cope with short-run instability emanating from fluctuations in international demand and supply relationships. A variety of hypotheses have been developed relating such instability to size. A recently published empirical examination of these hypotheses, measuring size in terms of both population and GNP for a cross-section of countries, failed to establish any strong and significant evidence of a relationship between size and instability in GNP, exports, imports, capital movements, exchange reserves and the terms of trade. This general conclusion remained even after allowance was made for variations among countries in their levels of economic development, their rates of economic growth, their geographic export concentration and their dependence upon foreign trade.[4] Nor is there any strong theoretical reason for expecting such a relationship. It seems doubtful if the conclusions would differ materially if one conducted a similar analysis based on Pacific rim countries only.[5]

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4) Nadim G. Khalaf, Economic Implications of the Size of Nations (Leiden: E.J. Brill, 1971), Chap. II.

5) Based on the data given in Khalaf's study, op.cit., Table 1, Appendix A, simple correlations were calculated for Pacific rim countries only, relating size to various indices of instability. These calculations support the conjucture in the text.

Table 1 The Geographic Pattern of Trade

Source of Exports \ Destination of Exports	CANADA	U.S.A.	JAPAN	U.S.S.R.	AUSTRALIA	NEW ZEALAND	CENTRAL AND LATIN AMERICA AND MEXICO
CANADA	X	12080 [68] (-)	784 [4] (14)	125 [1] (2)	181 [1] (3)	35 [0] (1)	183 [1] (3)
U.S.A	10370 [24] (-)	X	4060 [9] (-)	162 [0] (-)	1000 [2] (-)	111 [0] (-)	3171 [7] (-)
JAPAN	875 [4] (5)	7610 [32] (-)	X	378 [2] (2)	718 [4] (4)	129 [1] (1)	558 [2] (3)
U.S.S.R	14 [0] (0)	60 [0] (-)	419 [3] (3)	X	1.4 [0] (0)	1.4 [0] (0)	8 [0] (0)
AUSTRALIA	133 [3] (4)	618 [12] (-)	1440 [28] (40)	69 [1] (2)	X	268 [5] (7)	38 [1] (1)
NEW ZEALDND	40 [3] (4)	224 [17] (-)	117 [9] (10)	27 [2] (2)	120 [9] (11)	X	19 [1] (2)
CENTRAL AND LATIN AMERICA AND MEXICO [d]	50 [1] (2)	2085 [39] (-)	513 [10] (16)	18.5 [0] (1)	6.0 [0] (0)	1 [0] (0)	575 [11] (18)
INDOCHINA [e]	3.3 [0] (1)	108 [13] (-)	207 [24] (28)	6 [1] (1)	8 [1] (1)	1.1 [0] (0)	- [-] (-)
INDONESIA	1.6 [0] (0)	199 [17] (-)	545 [45] (55)	10 [1] (1)	16 [1] (2)	.5 [0] (0)	.8 [0] (0)
MALAYSIA	41 [2] (3)	209 [12] (-)	299 [17] (20)	50 [3] (3)	30 [2] (2)	7 [0] (1)	9.4 [1] (1)
SINGAPORE	21 [1] (1)	207 [12] (-)	124 [7] (8)	38 [2] (3)	84 [5] (5)	8 [1] (1)	9.4 [1] (1)
HONG KONG	87 [3] (5)	1010 [35] (-)	189 [7] (10)	.4 [0] (0)	81 [3] (4)	24 [1] (1)	29 [1] (1)
OTHER [f]	33 [1] (2)	998 [44] (-)	672 [29] (52)	- [-] (-)	58 [3] (5)	2 [0] (0)	6 [0] (0)
ALL DEVELOPED COUNTRIES IN PACIFIC AREA [g]	11432 [.98]	20592 [81]	6820 [.73]	761 [.87]	2020.4 [.88]	544.4 [.93]	3977 [.87]
ALL DEVELOPING COUNTRIES IN PACIFIC AREA	1236.9 [2]	4816 [.19]	2549 [.27]	110.6 [.13]	283.4 [.12]	43.6 [.07]	615.6 [.13]
TOTAL	11668.9	25408	9369	871.6	2303.8	588	4592.6

$ million; [ ] percentage of total world exports of the exporting country; ( ) percentage of total world exports less exports to the U.S. of the exporting country.

a = parentheses in column (1) indicate exports from Pacific rim country to other Pacific rim countries as a percentage of World Exports.

b = parentheses in column (3) indicate exports from Pacific rim country to other Pacific rim countries excluding the U.S.A. as a percentage of world exports.

c = parentheses in column (4) indicate exports from Pacific rim country to other Pacific rim countries excluding the U.S.A. as a percentage of world exports excluding the U.S.A.

among Pacific Rim Countries in 1971

INDO-CHINA	INDO-NESIA	MALAY-SIA	SINGA-PORE	HONG KONG	OTHER	EXPORTS FROM PACIFIC RIM COUNTRY TO OTHER PACIFIC RIM COUNTRI-ES	EXPORTS FROM PACIFIC RIM COUNTRY TO WORLD	EXPORTS FROM PACIFIC RIM COUNTRY TO OTHER PACIFIC RIM COUNTRIES EXCLUDING U.S.A.	EXPORTS FROM PACIFIC RIM COUNTRY TO WORLD EXCLUD-ING USA
- [-] (-)	- [-] (-)	15 [0] (0)	10 [0] (0)	20 [0] (0)	265 [2] (5)	13698 [78][a]	17670	1618 [9][b]	5590 [29][c]
441 [1] (-)	263 [1] (-)	71 [0] (-)	315 [1] (-)	424 [1] (-)	1021 [2] (-)	21409 [.49]	44130	21409 [.49]	44130 [49]
595 [3] (4)	451 [2] (3)	205 [1] (1)	509 [2] (3)	789 [3] (5)	1967 [8] (12)	14784 [62]	24020	7174 [30]	16410 [.44]
155 [1] (1)	11 [0] (0)	2 [0] (0)	5 [0] (0)	- [-] (-)	445 [.3] (3)	1122 [8]	13810	703 [5]	13391 [5]
37 [1] (1)	43 [1] (1)	69 [1] (2)	117 [2] (3)	85 [2] (2)	276 [5] (8)	3193 [63]	5070	1753 [35]	3630 [48]
7 [1] (1)	2 [0] (0)	12 [1] (1)	13 [1] (1)	8 [1] (1)	20 [2] (2)	609 [45]	1360	385 [28]	1136 [34]
1.1 [0] (0)	- [-] (-)	1.5 [0] (0)	1.1 [0] (0)	3.5 [0] (0)	15 [0] (1)	3270 [61]	5357	1185 [22]	3272 [36]
34 [4] (5)	12 [1] (2)	38 [5] (5)	59 [7] (8)	59 [7] (8)	21 [3] (3)	556 [66]	847	448 [53]	739 [61]
.3 [0] (0)	X	22 [2] (2)	148 [12] (15)	11 [1] (1)	41 [3] (4)	995 [83]	1200	796 [66]	1001 [80]
26 [2] (2)	10 [1] (1)	84 [5] (6)	368 [21] (24)	26 [2] (2)	63 [4] (4)	1222 [71]	1720	1013 [59]	1511 [67]
192 [11] (12)	- [-] (-)	401 [23] (26)	X	94 [5] (6)	51 [3] (3)	1229 [70]	1750	1022 [58]	1543 [66]
54 [2] (3)	65 [2] (4)	34 [1] (2)	122 [4] (7)	X	53 [2] (3)	1739 [61]	2870	729 [25]	1660 [39]
28 [1] (2)	12 [1] (1)	3.0 [0] (0)	25 [1] [2)	56 [2] (4)	30 [1] (2)	1923 [84]	2297	925 [40]	1299 [71]
1235 [.78]	770 [.89]	374 [39]	969 [.57]	1326 [.84]	3994 [.94]	54815 [.83]	106060 [.87]		
339 [.22]	99 [.11]	583.8 [.61]	723.1 [.43]	249.5 [.16]	274 [.06]	10921 [.17]	16041 [.13]		
1574	869	957.8	1692.1	1575.5	4268	65736	122101		

d = includes: Chile, Colombia, Costa Rica, Equador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Peru.

e = Includes: Khmer Republic, Laos, Thailand, Vietnam, Peoples Republic, Vietnam Republic.

f = includes: China (mainland), China (Taiwan), Korea Democratic Peoples Republic, Korea Republic, Papua New Guinea, Philippines.

g = All Developed Countries include: Australia, Canada, Japan, New Zealand, U.S.S.R., U.S.A.

Source: UNITED NATIONS YEARBOOK OF INTERNATIONAL TRADE STATISTICS, 1972-3

Economic analysis is richer in theoretical hypotheses relating size to the longer-term structure of trade and production. As for demand, it has frequently been suggested that nowadays consumption patterns and aspirations in less populous or poorer countries may be considerably influenced by consumption habits in large, rich and dominant economies. Consumer preferences, shaped in part from abroad, feed back upon the pattern of production and trade which in turn may confer advantages upon the suppliers in the large countries whence originates the external influence on preferences. Also, especially in poorer countries, heightened consumption aspirations, stimulated by life-styles abroad, may increase consumption at the expense of local saving, thereby hampering investment and development. While external influences along with many other factors may well play a role in shaping preferences, the significance of these influences in the present context is open to doubt. It is very doubtful whether any of the countries in the Pacific area, irrespective of size, can claim to have a dominant influence on preferences in the area, with the possible exception of the United States --and even there things foreign have considerable appeal.

Several hypotheses have been proposed on the supply side. One hypothesis, first developed by A. Hirschman and subsequently examined by S. Kuznets, M. Michaely and others, is that there is a tendency for the foreign trade, particularly exports, of smaller countries to be more highly concentrated, in terms of both the commodity and geographic pattern of trade, than that of larger countries. This is because smaller countries usually have a less diversified economic structure which leads them to greater specialization. The reason for expecting an association on the import side is much less clear nor is it apparent whether one might expect any such association to be positive or negative.[6)]

The hypothesis relating to exports is generally supported by available empirical evidence. N. Khalaf's study, already cited, considers both the geographic and commodity concentration of trade and attempts to isolate the partial effect of size after allowing for the level of development and trade dependence. His empirical results may be summarized as follows:

1. There is a strong inverse relationship between export concentration (both geographic and commodity) and size (both population and GNP) regardless of the level of development and the degree of dependence on trade.

2. The association between export concentration and size is much stronger than the association between import concentration and size.

3. The association between import concentration and size is weak and may in fact not exist at all; to the extent that there is an assoication, it seems to be positive.[7)] These general conclusions appear to be borne out for the sub-set of Pacific rim countries as well.[8)]

A second set of hypotheses concerns the relationship between size

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6) For a review of the literature see Khalaf, op.cit., Chap. III.

7) Khalaf's analysis considers only the commodity concentration of imports and with the data available is unable to test for the partial effect on import concentration after allowing for the effects of different levels of development and trade dependence.

and dependence upon foreign trade. S. Kuznets and others have suggested that because of the relatively more limited size of domestic markets and the resulting domestic constraints on the division of labour and economies of scale, because of the more limited diversity of resources and greater concentration of domestic economic activity, and because of the relatively lower internal transport costs in a small country, one would expect an inverse correlation between size and trade dependence, defined as the ratio of exports and imports to GNP. This hypothesis is borne out by Kuznets' empirical investigations which further indicate a stronger inverse relation for developed than for less-developed countries (LDCs). Kuznets also suggests that there is a lower limit to the amount of goods and services that can be made available through foreign trade.[9]

N. Khalaf's more recent examination of the data generally supports the view that size is inversely related to trade (exports plus imports) as a percentage of GNP.[10] The relationship is much stronger when export proportions alone are related to size, implying a much weaker relationship between import proportions and size as one would perhaps expect.[11] Further, this evidence indicates that the impact of size on trade dependence is unaffected by the level of economic development or the rate of economic growth. As far as Pacific rim countries are concerned, it appears that the same general conclusions apply.[12]

A third group of hypotheses relates economic growth and development to size. There is little theoretical reason why one would expect a strong systematic relationship between size and either growth or development, nor is there much empirical basis for believing that such a relationship exists.[13]

A fourth hypothesis concerns the terms of trade. It has long been recognized that, in principle, one country which has a strong bargaining position relative to another can shift the terms of trade in its favour. And it is frequently assumed that this not only provides a considerable advantage to large countries over small countries, but also that large countries have in fact availed themselves of this advantage. Two aspects of this question may be distinguished. The first concerns fluctuations in the terms of trade. It has been argued that small countries, because they have less control over export and import prices and because their trade tends to be more high-

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8) As before this conjecture is based on a recalculation of simple correlation coefficients for Pacific rim countries only, using Khalaf's data.

9) Simon Kuznets, Economic Growth of Small Nations (Berkeley: University of California Press, 1945).

10) No significant association is apparent, however, when size is measured by population. Nor is any relationship apparent between size, however measured, and foreign trade per capita.

11) The inverse relationship between export proportions and size is stronger when size is measured by population than by GNP.

12) This view is based on a recalculation based on Khalaf's data of the simple correlation coefficients between size and trade proportions and export proportions.

13) See Khalaf, Chap. V.

ly concentrated are likely to experience more severe fluctuations in their terms of trade. Khalaf's work, while revealing some traces of an inverse relationship between terms of trade, stability and size, fails to find a strong relationship that warrants much confidence. This appears to be true of the Pacific countries included in his sample as well. The second aspect abstracts from fluctuations and concerns the extent to which large countries have sought to shift the secular terms of trade in their favour relative to small countries. The main method of trying to achieve such a shift would presumably be through a combination of tax, trade and subsidy policies. Various biases are apparent in these policies for most countries, such as those against imports having higher degrees of processing and manufacturing, a bias against "low-cost" imports and so forth. These biases, however, are evident in the policies of most countries and appear to bear little or no relation to country size as such. Moreover, it is difficult to see how a deliberate attempt by large countries to rig the terms of trade against small countries could be achieved, given (i) the improbability of large countries colluding among themselves in this way (ii) that countries maintain common policies vis-a-vis all their trading partners and (iii) the volume and range of trade conducted by large countries among themselves. Indeed, for the Pacific rim countries at least, one has the impression that most of the larger countries, including the richest countries, have at least as liberal trade policies on the whole as the smaller countries. But this seems likely to be more a reflection of different levels of development, income and other factors than of country size.

A fifth group of hypotheses are concerned with trade dynamics. All of these assume that countries with higher per capita income are those more richly endowed with capital, that consumer needs can be met by a variety of differentiated goods differing not only in quality but also in cost, and that rising living standards tends to bias the search for new consumer and producer goods towards those products that are most desired in high income countries and are labour-saving. B. Linder suggests that a differentiated product must first be sold in an extensive domestic market before it can be exported--if only because of the information-cost advantage. He also suggests that manufactured exports will be destined disproportionately to other countries at similar income levels because of a greater similarity of consumer taste patterns. J. Dreze has argued that small countries are likely to find their comparative advantage in undifferentiated manufactures because scale economies in product design, advertising, sales promotion, information costs, etc., place the manufacturer of differentiated products in a small market at a disadvantage. R. Vernon's product-cycle hypothesis suggests that product innovations are likely to be developed in high-income countries and then diffused through trade, foreign investment and imitation to other countries.[14)] In addition, I. Kravis has argued that the export trade of large countries may be inflated by many "specialty" items--not because of cost advantages but simply because its large markets support production of such items which then are "available" for export.

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14) For a lucid summary of these propositions see R.E. Caves, "International Corporations: The Industrial Economics of Foreign Investment", Economica, XXXVIII, pp. 19-21 (Feb. 1971).

All of these propositions are essentially concerned with economies of scale that in some form or another may favour large over small countries. They differ from more conventional economies of scale in emphasizing the role of experience and the cumulative advantage of learning by doing. Conventional economies of scale, on the other hand, emphasize the effect of small markets, resulting in thin and inefficient transactions channels, short production runs and high fixed costs per unit of output because of small volumes. For example, one study suggests that at a per capita income level of US$300, economies of scale are significant up to a population of 100 million in most manufacturing industries (equivalent to a market of 11 million at U.S. income levels).[15] In another study evidence is presented which indicates: (i) that size creates advantages for small countries in international trade in manufactured goods; and (ii) within the manufacturing sector, small countries tend to have a comparative advantage in semi-manufactures and a disadvantage in finished manufactures.[16]

The latter study concludes that these findings support the thesis that small countries are likely to gain the most from trade liberalization and regional integration. This emphasizes the point that the smallness of the market is usually mainly the result of deliberate policies, domestic and foreign, which impede local access to foreign markets both for inputs and for outputs. One study, for example, has suggested that the combined cost to Canada in the mid-sixties of the Canadian and U.S. tariffs on industrial products was of the order of 10 percent of GNP, more than half of which represented foregone economies of scale due largely to U.S. tariffs.[17]

A central question is the extent to which trade patterns may be biased by history (who started first?) and the relative size of countries and the extent to which foregone economies of scale are mainly the result of ill-conceived policies which, in attempting to compensate for the disadvantages of history and size, have increased the constraints of market size. Though by no means conclusive, the evidence available suggests that trade barriers, even when justified on "infant-industry" grounds, have frequently done more to impede than to advance the ability of small countries to gain from economies of scale. A recently conducted study of Canada's trade options, for instance, concludes that unilateral free trade--while less advantageous than multilateral free trade or bilateral free trade with the U.S.--would be preferable economically to Canada's present level of trade barriers.[18]

The foregoing review of the relation of size to trade patterns suggest that size as such is of little consequence except as it affects the concentration of exports and economies of scale. Foreign trade, by relaxing the constraints imposed by small domestic markets,

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15) H.B. Chenery, "Patterns of Industrial Growth", American Economic Review (Sept. 1960), pp. 645-646.

16) Bela Balassa "Country Size and Trade Patterns: Comment", American Economic Review, LIX (March 1969), pp. 201-204.

17) R.J. and P. Wonnacott, Free Trade Between the United States and Canada (Cambridge, Mass.: Harvard University Press, 1967).

18) R.J. Wonnacott, Canada's Trade Options, Economic Council of Canada (Ottawa: Information Canada, 1975).

permits small countries to specialize more fully and achieve greater economies of scale. For small countries, access to foreign markets thus becomes an important factor in raising living standards and increasing economic development. In this, Pacific rim countries face much the same problems as elsewhere. What are some of these problems and how do they differ in the Pacific?

Consider first the question of dealing with the socialist state trading countries, of which there are several in the area including particularly Russia and China. Because of their proximity and future potential both as markets and sources of supply, these countries perhaps play a more important role in this area than in most others. Because of this, trade relations with these countries are not only important now but also may become more important in future. These relations pose both economic and political difficulties. On the economic side, there is the difficulty of establishing satisfactory channels for the flow of trade between private entrepreneurs on one side of the market and state buying and selling on the other. In addition, there is the difficult problem of insuring that the power of the state-trader is not used to exploit his trading position in competitive world markets or to discriminate among traders from different countries. On the political side, there is the problem of avoiding the possibility that trade may become an avenue for exercising political domination and control. These difficulties are probably greater for the smaller and poorer countries in the areas than for the larger and richer countries.

State-trading countries apart, a major preoccupation of many countries in the area is their trade relations with the United States and Japan--by far the largest and most highly industrialized countries in the region. Here the problems are primarily those of gaining access to these markets on more favourable terms, including the removal of a host of non-tariff barriers, avoiding special discriminatory measures such as dumping duties, restrictions on "low-cost" imports, restrictions on export supplies of critical production inputs and erratic changes in policy which have greatly magnified effects upon the smaller economies with which these two countries trade.

A second group of smaller but industrialized high-income countries includes Canada and Australia and to some extent New Zealand. These depend heavily upon foreign trade and therefore have a strong interest in a liberal world trading regime. At the same time, their own policies, reflecting nationalistic aspirations at home and hopes for a bigger place in the sun internationally, have, on the whole, been less liberal than those of the United States and some countries in Western Europe. Thus these countries are frequently found arguing the virtues of freer trade trading arrangements elsewhere in the world while maintaining equally forcefully that special circumstances preclude the full application of the same principles to themselves.

A third group of countries includes the small developing countries which have highly developed export sectors specializing in labour-intensive manufactures: e.g., Taiwan, Hong Kong, Singapore, and Korea. The markets of these countries are obviously too small to sustain large-volume manufacturing enterprises. For them, access on secure, non-discriminatory and liberal terms to world markets is essential. For these countries, policies in industrialized countries to cope with "low-cost" imports, voluntary as well as mandatory controls, and adjustment assistance policies have frequently been particularly troublesome.

Finally there are the remaining countries in the area, some of which are large but most of which are small and under-developed and some of which depend heavily upon primary product exports such as metals, petroleum and agricultural products. These face the traditional difficulties in foreign markets of most less-developed countries--unstable primary product prices, escalating trade barriers with higher degrees of manufacturing, direct controls and so forth.

This heterogeneous collection of countries might of course attempt to work out better trading relations among themselves through some form of regional integration. This might encompass the area as a whole or, more realistically, a series of regional arrangements within the area. Attempts have been made to develop such areas in Central and South America and the possibility of a freer trade area between Canada and the United States has a long history of discussion. However, apart from the efforts made in Latin America, the Paicfic area has apparently not been fertile ground for regional trading arrangements. One major reason perhaps has been the competitive nature of many of the economies in the area. Another major reason may be the serious political concern about teaming up with the two countries offering the largest markets, the United States and Japan. And a third major factor may be the strong relationship that most of the countries in the area including the largest and most powerful, have with the rest of the world. Whatever the reasons, rather than follow a regional approach, a more promising approach may be for the countries in the area to use their considerable influence to improve trading relationships in the world generally and with Western Europe in particular. Although the interests and affiliations of the countries in the area by no means coincide, the continued development of a discriminatory trading bloc in Western Europe which has now expanded to North Africa and the Eastern Mediterranean may provide a common motive for renewed and united efforts among Pacific countries to bring about greater trade liberalization on a world-wide basis. The machinery now available for mounting such efforts seems very weak. Moreover, as the EEC has become larger and more firmly established, many countries in the area, instead of seeking greater co-operation with non-European countries in fostering freer trade generally in the world, have followed Canada's example of trying to get their noses under the tent through individual deals.

Recent developments in primary product markets have highlighted several special problems that can only be referred to here. To deal with these, international action along several lines seems to be needed. For example, new rules need to be worked out to subject the unilateral imposition of export controls and taxes to international review in the same way as the imposition of import barriers. In addition, buffer-stock arrangements and commodity stock-piles for selected minerals and foods, built up and used in accordance with agreed international rules, might help to moderate supply interruptions and price fluctuations. These might be developed in conjunction with producer-consumer agreements for selected commodities. At the same time, as mentioned below, co-operative policies to ensure an adequate flow of capital into primary commodity development are important. And, as also mentioned below, intensified efforts are needed to foster the primary producing sectors in developing countries. Unilateral nationalistic actions to secure raw material supplies are likely to prove disruptive and self-defeating, particularly if pursued by major industrial countries.

The same may be said about recent attempts, following the OPEC

example, by producers to develop cartels and administered markets for selected commodities. The prospects for most products of maintaining such collusive arrangements over any extended period are dim. Nevertheless, because of the possibilities of earning short-term monopoly gains, such attempts at collusive action may well be made. The danger is that, even if cartels and price-fixing arrangements eventually collapse, high-cost alternatives will have been developed in the process which will continue to be protected over many years at the expense of low-cost suppliers and consumers. Moreover, to the extent that such collusive measures succeed, the gains are at least as likely to be made at the expense of the small and poor as of the large and rich.

For most Pacific area countries, whatever their special characteristics, the over-riding trade issue during the next decade seems to be how best to promote a world trading system which, as its first objective, arrests any retreat into greater protection and, as its second objective, promotes the reduction of trade barriers on a multilateral and non-discriminatory basis.

Private Foreign Investment[19)]

Foreign Investment represents an immediate transfer of real resources from the investing to the host country which, along with the return flow of interest and dividends, represents a future claim on the assets of the importing country. How beneficial an investment is to both the investing and the host countries depends upon the difference, for each, between the rate of return and the cost of the investment.

The revival of the private international capital market and the enormous growth of private capital flows has been one of the leading features of the international economy since the 1950's. Although this increase in private capital investment has been reflected in flows to developing countries, it has been concentrated mainly in flows among developed countries. Moreover, in contrast to earlier patterns, a substantial part of the increase has been in the form of direct investment associated with the growth and spread of the operations of large international enterprises. The stock of direct investment in developing countries alone grew from about US$35 billion in 1967 to US$52 billion in 1972.

Table 2 gives some indication of the stock of direct foreign investment in developed (OECD) and developing countries at the end of 1970 together with figures on the value of trade and GNP. Evidently direct investment has been more important, relative to output and trade, for developed than for developing countries. This is true not only for primary industries, where foreign investment has been especially important, but also for the manufacturing sector.

The sectoral distribution of the stock of direct investment at the end of 1970 for developed (OECD) and developing countries is shown in Table 3. The largest share is in the primary sector, but large shares are also found in the manufacturing and service sectors. The regional distribution of the stock of direct investment

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19) Parts of this section draw heavily upon the author's earlier study Private Foreign Investment for Development (Oxford: Clarendon Press, 1973).

Table 2 Shares of Developing and Developed Countries in The Stock of Inward Direct Investment at End-1970 and in Trade and GNP in 1970.

	Developing countries a)		Developed countries b)		Total	
	$ billion	%	$ billion	%	$ billion	%
Stock of inward direct investment at end-1970	39 c)	(25)	114 d)	(75)	153	(100)
Imports plus exports 1970 e)	123	(20)	490	(80)	613	(100)
GNP 1970	435 f)	(18)	1,937 g)	(82)	2,372	(100)

a) DAC list of developing countries: All Western Hemisphere except Canada and the United States, all Africa except South Africa, all Asia and Oceania except Japan, Australia, New Zealand, and Sino-Soviet bloc countries, and none of Europe except Greece, Spain, Turkey, Gibraltar, Malta, Cyprus, and Yugoslavia.

b) DAC membership as in 1972 (OECD countries excluding European developing countries included under note a) above).

c) Source: Development Assistance 1971 Review (OECD: Paris, December, 1971) derived from Tables VI-2 and VI-3.

d) Various national sources, balance of payments flow data and company reports and accounts.

e) Source: Monthly Statistical Bulletin, exports f.o.b., imports, c.i.f. (New York: United Nations).

f) Source: Derived from World Bank Atlas (I.B.R.D.: Washington, 1972).

g) Source: Main Economic Indicators (OECD: Paris).

Table 3 Stock of Foreign Direct Investment in Developing Countries by Sectors at End-1970

	Developing countries		Developed countries		Total
	$ billion	%	$ billion	%	$ billion
Petroleum	13	(33)	32	(28)	45
Mining	4	(10)	8	(7)	12
Manufacturing	12	(31)	48	(42)	60
Other	10	(26)	26	(23)	36
Total	39	(100)	114	(100)	153

Sources: See G.L.Reuber, Private Finance Investment in Development (Clarendon Press: Oxford, 1973) p.253.

among developing countries, by industrial sector is shown in Table 4.

Table 4 Regional and Sectoral Distribution of The Stock of Foreign Direct Investment in Developing Countries at End-1970

($ billion)

	Latin America	Europe	Africa	Middle East	Asia	Total
Petroleum	4.8	0.4	3.3	3.2	1.3	13.0
Mining	2.1	0.1	1.4	-	0.4	4.0
Manufacturing	7.5	1.5	1.3	0.2	1.8	12.3
Other	5.4	0.5	1.6	0.1	2.1	9.7
Total	19.8	2.5	7.6	3.5	5.6	39.0

Source: G. L. Reuber, Private Foreign Investment In Development. (Clarendon Press: Oxford, 1973), p.4.

Direct investment in production facilities in another country usually takes one of two forms: horizontial extension (producing the same or similar goods in the host country as in the home country), and vertical extension (producing inputs for the firm's operations outside the host country which fit into an integrated production process at an earlier or later stage than the firm's principle production activity abroad). Vertical investment is export-oriented; it usually reflects the availability of either cheap labour or raw materials; and it is undertaken to reduce uncertainty and to become, or remain, internationally competitive. Horizontal investment is oriented to sales in the host country. Among its leading characteristics are product differentiation, oligopoly markets, advanced technology, sophisticated management and information systems and relatively high capital intensity.

Pacific rim countries include both the largest exporters (the United States and Japan) and importers of private capital in the world.[20] Table 5 shows the net total long-term foreign investment flows for most Pacific area countries in 1970-74 (average) and in 1974. Unfortunately, with the data available it has not been possible to construct a matrix showing exports and imports of capital among Pacific area countries themselves. Figures on the stock of outstanding private direct investment among developing countries in the Paicfic area at the end of 1972 are shown in Table 6 together with data on GNP and population.

In order to test systematically for any associations that may exist between the stock of direct investment in host countries in the Paicfic area and selected economic characteristics of these

20) Little systematic information is available about the ethnically-separated "Overseas Chinese". This source of investment is ignored in the discussion that follows.

Table 5 Net Foreign Investment Flows Among Pacific Area Countries

($ U.S.millions)

	Long-Term Capital		Direct Investment		Gov't Investment		Other	
	Average 1970 -74	1974	Average 1970 -74	1974	Average 1970 -74	1974	Average 1970 -74	1974
Australia	880.8 [c]	597.0	730.2	905.0	-92.6	-214.0	243.2	-94.0
Canada	914.8	962.0	284.2	-216.0	631.2	1408.0	- .2 [b]	-230.0
Chile	155.8	109.0	2.2 [b]	12.0	136.0	97.0	17.6	-
Taiwan	158.6	466.0	56.2	83.0	4.6	13.0	98.0	370.0
Colombia	239.0	179.0	29.4	28.0	127.8	73.0	81.6	78.0
Costa Rica [a]	68.4	94.1	25.3	26.8	20.9	44.7	22.2	22.5
Ecuador	133.7	69.0	106.5	77.0	26.7	-6.4	.5	-1.6
El Salvador [a]	10.0	9.5	6.4	8.3	6.8	15.5	-3.3	-14.3
Guatemala	52.9	70.1	28.5	52.3	9.2	11.7	15.2	6.1
Honduras	36.9	52.9	5.0	-1.2	14.7	27.7	17.2	26.5
Indonesia [a]	508.0	775.0	185.8	278.0	327.3	497.0	-5.0 [b]	-
Japan	-2958.8	-3980.0	-945.0	-1811.0	-576.0	-321.0	-1438.0	-1849.0
Korea	624.4	981.0	96.2	225.0	208.6	144.0	319.8	613.0
Malaysia [a]	220.0	232.0	119.5	170.0	73.3	36.0	27.0	26.0
Mexico	1458.6	3218.0	372.6	557.0	228.2	825.0	857.8	1836.0
New Zealand [a]	22.8	-79.9	30.6	-31.0	-9.3	-56.0	1.5	7.2
Nicaragua [a]	62.6	114.8	12.9	13.2	28.6	57.8	21.1	43.8
Panama [a]	573.0	1479.0	20.2	12.0	47.1	82.3	505.8	1384.7
Peru	290.0	930.0	32.4	91.0	265.6	909.0	-8.2	-71.0
Philippines	116.6	202.0	6.6	35.0	91.8	111.0	18.4	57.0
Vietnam	20.2	81.0	2.6 [b]	11.0	17.6 [b]	70.0	-	-
Singapore	326.8	713.0	259.4	634.0	25.4	-2.0	42.2	82.0
Thailand	149.2	332.0	73.2	138.0	9.0	4.0	67.0	190.0
U.S.A.	-4010.6	-7150.0	-3706.0	-4493.0	-1307.6	449.0	1003.0	-3107.0

a) = average computed for 1970-1973.

b) = figures not available for all 5 years.

c) = average of long term capital may not exactly equal the sum of the other three averages due to rounding.

Source: International Monetary Fund, International Financial Statistics, June, 1975.

countries, regression equations (1) and (2) shown in Table 7 were fitted to a cross-section of data for 22 developing countries. These estimates suggest a strongly significant positive association between the stock of direct investment and (i) the level of income (GNP per head) and (ii) population size; but no significant association is apparent between direct investment and the rate of growth

Table 6 Stock of Private Direct Investment (End 1972), Population (1971), GNP (1971) and Rate of Growth of Real Product (1960-71, 1972), for Pacific Rim Developing Countries

	Stock of Private Investment (1)				% Growth in Real Product	
	Total ($ millions)	Per Capita ($)	Population (million)	GNP ($ billions)	1960 -70	1972
Chile	765	76.54	10.0	7.60	4.4	1.6
Colombia	910	40.76	22.3	8.26	5.2	6.7
Costa Rica	185	104.23	1.8	1.05	6.2	5.0
Ecuador	350	55.56	6.3	1.95	4.9	9.9
El Salvador	100	27.18	3.7	1.18	5.8	2.6
Guatemala	190	34.94	5.4	2.12	5.4	6.1
Honduras	200	23.23	8.6	2.58	5.2	4.0
Hong Kong	670	165.64	4.0	3.64	9.5	12.3
Indonesia	1200	10.07	119.2	9.53	3.5	6.9
Khmer Rep.	85	11.05	7.7	1.00	2.3	-5.4
Korea Rep.	360	11.30	31.8	9.24	8.7	7.3
Laos	8	2.64	3.0	.36	4.0	3.9
Malaysia	1000	89.61	11.2	4.46	5.8	5.6
Mexico	2650	50.55	52.4	36.70	7.0	7.5
Nicaragua	85	40.77	2.1	.94	7.2	4.0
Panama	1650	1116.37	1.5	1.21	7.9	8.1
New Guinea	435	172.62	2.5	.81		
Peru	880	62.81	14.0	6.72	5.1	5.8
Phillipines	870	22.94	37.9	9.10	5.7	4.6
Singapore	485	229.86	2.1	2.53	9.3	6.8
Taiwan	400	26.88	14.9	6.40	9.6	11.3
Thailand	490	13.12	37.3	7.84	8.0	3.1
Vietnam Rep.	180	9.57	18.8	4.33	3.2	5.0

1) Investments held by DAC countries

Source: OECD Development Co-operation, 1974 Review. Statistical Annex.

in output.[21)]

Long-term private portfolio capital flows remain largely concentrated among the more developed countries. With some notable exceptions, such as Mexico, many developing countries have not been able to raise long-term portfolio capital on a large scale on their own account. To the extent that they have been able to raise long-term portfolio capital, most have had to rely upon the intermediation provided by international agencies, foreign governments in

21) The specification of this equation is open to question and no causal inferences can be legitimately drawn from the estimates.

Table 7 Selected Estimated Regression Equations

1. $PODI = -226.67 + 1.18\ GNP/POP + .015\ POP + 7.93\ \Delta RP_{72}$
   (.94) (2.76) (3.52) (.25)

   R^2 = .50
   n =22

2. $PODI = -95.51 + 1.35\ GNP/POP + .015\ POP - 28.04\ \Delta RP_{60/70}$
   (.29) (2.88) (3.75) (.47)

   R^2 = .50
   n =22

3. $ODA_A = 1.13 + .00018\ GNP/POP + .00012\ POP - .33\ \Delta RP_{60/70}$
   (.74) (.085) (6.51) (1.19)

   R^2 = .75
   n =22

4. $ODA_C = 1.61 + .00047\ GNP/POP + .000031\ POP - .25\ \Delta RP_{60/70}$
   (2.37) (.50) (3.79) (2.05)

   R^2 = .56
   n =22

5. $ODA_J = -16.21 - .039\ GNP/POP + .00084\ POP + 5.38\ \Delta RP_{60/70}$
   (1.03) (1.77) (4.41) (1.91)

   R^2 = .63
   n = 22

6. $ODA_{U.S.} = 122.79 - .054\ GNP/POP + .0012\ POP - 10.61\ \Delta RP_{60/70}$
   (1.67) (.52) (1.30) (.80)

   R^2 = .23
   n =22

7. $ODA_T = 109.31 - .092\ GNP/POP + .0022\ POP - 5.80\ \Delta RP_{60/70}$
   (1.36) (.82) (2.21) (.40)

   R^2 = .35
   n =22

Notation:

PODI = stock of private overseas direct investment, end 1972 ($ million)
GNP = gross national product, 1971 ($ billion)
POP = population size, 1971 (thousands)
ΔRP_{72} =change in real product, 1971 to 1972 (per cent)
$\Delta RP_{60/70}$ = change in real product, 1960 to 1970 (per cent)
ODA = Gross disbursements of bilateral official development assistance, 1969-72 ($ million, annual average) from A (Australia),

C (Canada), J (Japan), U.S. (United States) and T (total for the four countries).
n_2= number of Pacific rim developing countries in sample.
R^2= coefficient of multiple determination
()= t - statistic

Source: OECD, Development Co-operation, 1974 Review, Statistical Annex.

developed countries and large private foreign firms. The financial intermediary role of the latter has frequently been over-looked. Because of this intermediation, direct and portfolio investment in many cases can be more accurately seen as complements rather than as substitutes. It is also overlooked at times that long-term portfolio investment which depends heavily upon the intermediation of foreign governments, either directly or indirectly through international agencies, may be more subject to external political influences than private investment based primarily upon market considerations.

Space does not permit an extensive review of the many highly controversial issues that arise in connection with foreign investment. At its simplest, the issues of foreign investment, for both the host and home countries, largely boil down to two questions, one empirical and the other political and social. The empirical question is concerned with the total net economic benefits in terms of real income and employment that the host and home countries derive from foreign investment and how changes in policies are likely to affect these benefits. The political-social question consists of two parts: is there a positive or a negative relationship between the economic benefits arising from foreign investment and the host and home countries' social and political interest? And if there is a negative relationship, how much economic benefit are countries prepared to trade off to achieve more fully their political and social objectives?

The first question raises a number of subsidiary issues. One is its short-run impact upon employment and income. Another is its effect upon the distribution of income. A third concerns the incidence of various types of market imperfections--e.g., lack of knowledge and information, unwarranted allowance for risk and uncertainty, monopolistic powers--on the supply price of capital. A fourth relates to the return flow of interest and dividends. And a fifth arises when investment is undertaken by public authorities for political and social reasons rather than on the basis of economic criteria. This points directly to what is perhaps the most serious problem in most countries, but especially in developing countries. As a result of a wide range of policies--e.g. commercial policies, exchange rate policies, tax and subsidy policies and direct controls of all kinds--market prices may provide a highly unreliable guide from a national standpoint for the efficient allocation of capital and as an indicator of the amount it pays to import--to say nothing of the efficient allocation of domestic resources.

To the extent that direct investment simply provides for a transfer of capital from abroad through a different institutional channel, its effects and the problems it raises are much the same as for portfolio investment. The additional complications and much of the

controversy associated with direct investment stem mainly from three special characteristics: (i) the degree of non-resident ownership and control frequently accompanying the direct investment, in many cases within the context of large international enterprises; (ii) the extent to which direct investment provides access to a package of auxiliary factors, including technology, management and outlets to foreign markets, at lower cost than alternative approaches; and (iii) the opportunity afforded host countries to capture a substantial share of the earnings of foreign capital and the rents earned on the package of auxiliary factors because of double taxation agreements that permit host countries to tax the profits of foreign enterprises.

Rather than view direct investment as a homogenous aggregate, it is more useful for some purposes to think in terms of the broad categories of direct investment referred to earlier, which have quite different characteristics and raise quite different policy issues. A large volume of direct investment in the Pacific area, as well as elsewhere, has been directed towards the discovery and exploitation of natural resources. In many cases the host country finds itself in a strong bargaining position in dealing with investors in this sector. A second category, which may be termed market-development investment, has been horizontal investment, intended mainly to produce processed materials, manufactures and services for sale in the host country. Some of this investment has looked forward to the future development of the local markets to an economic size with internationally competitive costs. Much of it, however, has been induced through an intricate web of subsidies, concessions and so forth, with little or no reference to present and prospective levels of demand and comparative costs and frequently intended mainly to displace imports. Because of the direct impact of domestic policies on such investment, host countries are in a strong bargaining position vis-a-vis this type of investment. The third category of direct investment which has become important during the past decade, particularly in the Pacific area, is highly export-oriented, vertical investment, intended primarily for the purpose of supplying exports of manufactured products assembled in another country--usually a developed country.[22] Such investment has been based mainly on the availability of cheap labour and a favourable investment climate in the host country. Some of the leading examples of this latter type of investment are found in Singapore, Taiwan, Hong Kong and South Korea -- all very small countries that have achieved rapidly growing levels of prosperity. Because of the characteristics of such investment, host countries find themselves in a weak bargaining position in dealing with investors in this sector.

Much of the controversy about the economic aspects of foreign direct investment has to do with the terms on which the investment is supplied. (As such it is analogous to traditional terms of trade arguments common in discussions about foreign trade). The question at issue is the extent to which market imperfections result in terms (i.e. supply prices) that are disadvantageous to host countries, compared to the terms that would prevail if markets were more per-

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22) See G.K. Helleiner, "Manufactured Exports from Less Developed Countries and Multinational Firms", Economic Journal 83 (March 1973), pp. 21-47.

fectly competitive. This leads to questions about decisions in the private sector on such matters as transfer pricing, the sourcing of inputs and the sale of output, the repatriation of profits, the transfer of knowledge and skills, employment practices, the location of production facilities, and the like. One central issue running through this discussion is the extent to which maximizing profits for the enterprise as a whole throughout the world conflicts with the national interests. Related to this is the quesiton of how the host country can collect more of the rents accruing to foreign investors without at the same time impairing the flow of investment. This turns out to be extremely difficult to answer in any practical way; and in many instances the preoccupation with gaining improved terms for the host country has resulted either in reduced flows of investment and/or in compensatory policies to maintain investment flows in the face of policies designed to improve the terms on which investment is accepted.

Examples abound of countries that over the years have developed conflicting combinations of policies, some of which attract foreign investment, some of which deter foreign investment and most of which lead to a misallocation of resources both within and among countries. Much of the legislation that now exists on local equity participation, the employment of local personnel, pre-scheduled disinvestment, local R & D activities, compulsory export quotas and the like, probably does more harm than good for at least three reasons: the losses incurred by reducing the flow of investment may well outweigh the benefits gained through improved terms; the uneven incidence of such complicated measures results in the misallocation of not only foreign but also domestic resources; and the subsidies entailed to overcome the disincentives created by such measures wipe out partially or wholly the benefits derived from such investment as does occur. In many cases, direct subsidies to develop local technology, training and the like would be more effective and cheaper than imposing restrictions and requirements on foreign investors.

Another aspect of these policies is that they frequently treat all foreign investment more or less alike with the result that the policies have important differential effects on different types of investment. For example, policies that insist upon majority local ownership are likely to discriminate heavily against vertical-type export-oriented investment relative to horizontal-type investment oriented to local markets. Such countries, wishing to attract investment in many capital-intensive industries and to increase exports produced in such industries, need to think in terms of vertical-type investments, initially at least, based on foreign markets --unless of course they are prepared to pay whatever subsidies may be necessary to overcome the constraints of market size and meet the international supply price of capital. This latter policy may cost more than the benefits are worth. If countries are prepared to accept export-oriented vertical-type investment it may also be necessary to accept some of the characteristics typical of such investments, especially in the manufacturing sector--e.g., high levels of foreign ownership, less local participation, and a relatively weak bargaining position vis-a-vis the foreign investor.

Furthermore, in many cases of investment geared mainly to export markets, the possibility of devising practical alternatives to foreign direct investment seems particularly remote. It is sometimes suggested, for example, that the various components of the package associated with direct investment might be unscrambled and that host

countries might purchase only those parts that they lack and cannot provide otherwise at comparable cost. Although such an approach may sometimes be practical, it seems likely to encounter particularly formidable difficulties when confronted with the characteristics of vertical-type export-oriented investments based on closely coordinated intra-firm purchases and sales and the easy exchange of knowledge, information and personnel across international boundaries.

These and other issues arise particularly for foreign investment in manufacturing industries in developing countries but they arise also for relatively small developed countries such as Canada and Australia. At the same time, the advantages of foreign direct investment to the large capital exporting countries have recently been more and more called into question. One reason is the loss in tax revenue to the investing country--and the gain to the host country --because of double taxation agreements. Another reason is the long-run threat of capital exports to the real income of domestic labour in the investing country. And a third reason is the high risk that the foreign investment may be expropriated wholly or in part by the host country. Thus the danger has increased that not only host country policies but also home country policies will develop in such a way as to impede the flow of investment and thereby reduce the growth and development of the world economy.

Much of the foregoing relates particularly to investment in the manufacturing and service sectors. The situation differs considerably in the raw materials sector because of the high and rapidly growing demand for many raw materials in developed countries and the abundance of cheap supplies in many developing countries. In these instances the bargaining power of the host country frequently is much stronger relative to the investor. This may make it feasible for the host countries to achieve much more favourable terms without seriously impairing the flow of investment to develop the resources in question. But even in these cases, limits are established by the opportunity cost of capital and the availability of other sources of supply and substitute materials. Inadequate capital, rather than inadequate resources, may be a more realistic constraint on primary product supplies in the foreseeable future. If pressed too hard, investors may easily be induced to direct their capital into other sectors or into the development of high-cost supplies at home--to the mutual disadvantage of countries with high-quality resources and consumers everywhere.

Whether or not these and related issues are more important or very different in the Pacific area is difficult to say and perhaps not very important. The Pacific area does, however, offer a diversity of approaches to foreign investment which may provide much useful experience as a guide for future policy developments in this area. On both the capital export and capital import sides this experience ranges from a fairly open non-interventionist approach to a much more highly controlled and closely regulated approach.

In addition, the area offers some examples of regional approaches to foreign investment, ranging from the closely-regulated formal arrangements in the Andean Pact to the attempts by private companies to establish regional production-sharing facilities among neighbouring countries for particular products. Without attempting here to assess these arrangements, any such regional approach faces two basic problems. The first is that while some form of regional organization may somewhat relax the serious constraints of uneconomic size,

even with regional arrangements these constraints are likely to remain much more limiting than if firms become more fully integrated in the world economy generally or at least with the large economies from which most foreign investment emanates. Moreover, such regional arrangements may easily result in the expansion of production which is economic from a regional standpoint but uneconomic from an international standpoint. Secondly, while regional arrangements may resolve some of the political problems associated with foreign investment, they give rise to another set of political problems that seem equally intractable. These relate to the distribution of facilities and the free exchange of inputs and outputs among the participating countries. Several attempts by private firms in the Pacific area to establish some form of regional production sharing arrangements have in fact foundered on the inability of the countries concerned to agree on the sharing of facilities and markets. Apparently this also remains a serious obstacle to greater economic integration among Andean countries.

Recently, increasing attention has been given to the possibility of international co-operation as a means of dealing with some of the difficulties, real and imagined, associated with private direct investment. Until now, international co-operation in this area has been weak and meagre--certainly by comparison to the advances made since World War II in such fields as trade, monetary policy, foreign aid and defence. The goal of international co-operation in the field of investment is the same as in the trade field: to gain as much benefit as possible for both investing and host countries by curbing the mutually harmful policies that may easily emerge in a world in which each country narrowly pursues its own interests without recognizing the reactions that its policies may evoke from others. Maintaining as free a flow of international capital as possible by curbing any systemic biases resulting from the pursuit of nationalistic policies is likely to be conducive to long-run economic growth and development in the world in the same way as is the relatively free flow of goods and services. Unfortunately, some of the recent international initiatives in this field, instead of focusing squarely on avoiding beggar-thy-neighbour policies, have seemed more like concerted efforts by capital importers, particularly in developing countries, to mount a co-ordinated beggar-thy-neighbour policy against capital exporting countries and their investors. As such, these efforts have not been very promising. Nevertheless, it is apparent that there are a number of avenues that might usefully be pursued internationally.

One important area is the collection and assembly of more and better information. Another is to try and devise a set of fairly widely agreed upon ground-rules establishing limits on the behaviour of firms and, particularly, on the behaviour of governments in both investing and host countries. In addition, agreed procedures for settling disputes would be helpful. A third area is to try to work out co-operative arrangements on a number of specific issues. Among the leading contenders for such special attention are: subsidies and investment incentives, taxation of foreign investment, the extraterritorial extension of national laws, and transfer pricing. Such an approach need not await widespread international agreement. A useful start might be made by a limited number of major investing and host countries, developed as well as developing. And indeed some countries in the Pacific area might well be among those who offer the greatest promise for an approach along these lines.

Foreign Aid[23)]

The last and, in the author's view, least important aspect of Pacific area economic relations to be considered here is foreign aid. Aid is a gift. It represents a transfer of real resources from the donor to the recipient that never needs to be repaid. From the standpoint of the donor, it represents a real cost. How much donors are willing to pay presumably reflects the utility associated with economic development abroad relative to other uses for resources and also the amount of development achieved per unit of cost. From the standpoint of the recipient, aid represents a net addition to available resources which may be used either to increase immediate consumption temporarily or, by first investing the resources productively, to raise the level of future consumption.

Table 8 shows net official development assistance from DAC to developing countries in 1963, 1967 and 1973. During this period

Table 8 Net Official Development Assistance from DAC Countries to Developing Countries and Multilateral Agencies 1963, 1967, 1973.

	$U.S. millions			as a % of GNP		
	1963	1967	1973	1963	1967	1973
Australia	95.9	157.3	285.9	.51	.60	.44
Austria	4.2	15.2	40.2	.05	.14	.14
Belgium	79.7	88.8	234.7	.57	.45	.51
Canada	64.6	197.6	514.9	.15	.32	.43
Denmark	8.7	25.9	130.4	.11	.21	.47
France	819.9	825.5	1488.4	.98	.71	.58
Germany	388.9	508.8	1102.0	.41	.41	.32
Italy	70.3	154.7	192.0	.14	.22	.14
Japan	137.6	385.3	1011.0	.20	.32	.25
Netherlands	37.8	113.5	322.1	.26	.49	.54
New Zealand	...	9.6	26.5	...	.21	.24
Norway	9.9	14.5	86.6	.17	.17	.46
Portugal	44.7	24.9	61.6	1.46	.54	.59
Sweden	22.9	59.9	275.3	.14	.25	.56
Switzerland	6.2	13.0	65.3	.05	.08	.16
United Kingdom	414.5	485.0	603.1	.48	.44	.35
United States	3566.6	3471.8	2968.0	.59	.43	.23
Total DAC	5722.4	6551.6	9408.0	.51	.42	.30

Source: OECD Development Cooperation, 1974 Review, p.201 - 202.

23) Most of the figures cited in this section have been gleaned from OECD, International Co-operation, 1974 Review.

Table 9 Gross Receipts of Official Bilateral Development Assistance by Developing Countries

1969 - 1972 (Annual Average), by Origin

Donors / Recipients	Australia		Canada		Japan		United States		Sub-total		total DAC
	$ mil-lion	% of total	$ mil-lion	% of total	$ mil-lion	% of total	$ mil-lion	% of total	$ mil-lion	% of total	$ mil-lion
Singapore	0.7	3	0.5	2	4.9	20			6.1	25	24.7
Hong Kong					0.1	3	0.3	10	0.4	14	2.9
Panama							16.3	98	16.3	98	16.6
Chile			1.5	3	0.1	0	31.0	55	32.6	58	56.5
Mexico					0.4	2	4.0	24	4.4	27	16.6
Costa Rica							11.3	88	11.3	88	12.9
Peru					2.5	7	16.3	95	18.8	52	35.9
Nicaragua					0.1	1	14.0	93	14.1	93	15.1
Taiwan					14.5	87	1.5	9	16.0	96	16.6
Malaysia	3.3	9	2.5	7	10.0	26	3.8	1	19.6	51	38.1
Guatemala							13.3	89	13.3	89	14.9
Colombia			3.1	3	0.1		91.0	87	94.2	90	105.2
El Salvador			0.5	5	0.2	2	8.5	81	9.2	88	10.5
Papua, N.Guinea	149.6	100							149.6	100	149.6
Ecuador			0.7	4	0.1	1	11.0	65	11.8	70	16.9
Honduras			0.2	2			9.3	93	9.5	95	10.0
Korea, rep.	0.6		0.8		111.4	35	202.3	63	315.1	98	322.3
Philippines	0.8	1	0.1		50.4	57	33.0	38	84.3	96	87.7
Vietnam rep.	3.3	1	2.1		5.6	1	458.8	95	469.8	97	483.4
Thailand	3.9	6	0.9	1	15.7	25	32.5	51	53.0	84	63.4
Khmer rep.	1.2	3	0.9	2	5.3	13	24.3	60	31.7	79	40.3
Laos	1.3	2	0.5	1	4.8	7	52.0	76	58.6	86	68.1
Indonesia	18.1	4	5.2	1	110.2	23	206.8	43	340.3	71	482.2
Sub-total	182.8	9	19.5	1	336.4	16	1241.3	59	1780.0	85	2090.4
Total to all Countries	197.4		237.5		473.4		2597.4		3505.7		6124.3
Pacific area as % of total	92.6		8.2		71.0		47.8		50.8		34.1

Source: OECD Development Cooperation, 1974 Review, Statistical Annex.

aid flows increased over 60 per cent, compared with almost a five-fold increase in private investment flows to the LDCs and a three-fold increase in their exports. The largest donors in the Pacific area, by far, have been the United States and Japan. United States aid, which remained fairly stable during the first part of the decade, has since declined. Japan's aid has risen fairly steadily year after year. Relative to their capacity to pay (GNP), however, the contributions of both the United States and Japan at present are comparatively small. The same is true of New Zealand. Australia and Canada, on the other hand, are at the upper end of the spectrum. Since 1967 Australia's contributions as a share of GNP have decreased substantially whereas Canada's share has increased.

What is termed development assistance is, of course, not entirely a gift. Some of this assistance takes the form of loans on concessional terms. Estimates for 1973 suggest that the grant element in Japanese aid was comparatively low: 69 per cent compared with 99 percent for Australia, and New Zealand, 94 per cent for Canada, 90 per cent for the United States and 90 per cent for EEC countries.

Where in the Pacific area has the aid gone? Table 9 shows the source and destination of aid in the Pacific area from 1969 to 1972. As indicated, about 82 per cent of Australian aid to the Pacific area was concentrated in Papua New Guinea. Japanese aid in the area was also highly concentrated--81 per cent went to three countries: 33 per cent each to Korea and Indonesia and about 15 per cent to the Phillipines. All developing countries in the Pacific area received 71 per cent of all Japanese aid disbursements. Canadian aid to the area, though more widely disbursed, has been very small, accounting for about 1 per cent of the aid received in the area and less than 8 per cent of Canadian aid disbursements. The largest volume of aid has emanated from the United States, which accounts for 59 per cent of the aid received in the area. Over a third of this aid went to Vietnam, and about one-sixth each to Indonesia and Korea. The remaining third was widely dispensed among developing countries in the area. In total, the Pacific area received 48 per cent of United States total aid contributions from 1969 to 1973.

In order to see what, if any, systematic relationships might exist between aid flows and selected economic characteristics of recipient countries in the Pacific, regression equations (3) to (7) shown in Table 7 were estimated. These assume that the flow of aid is related to the level of income (GNP per capita), the size of the country (population) and the rate of economic growth over the sixties (change in real product, serving as a rough proxy for economic performance). The only significant relationship indicated is a positive association between aid flows and population. No significant association is evident between aid flows and either per capita income or the rate of economic growth.

This result may not be very surprising given the heterogenous nature of the Pacific area. Six countries--Colombia, Papua New Guinea, Korea, the Phillipines, Vietnam and Indonesia--account for 82 per cent of the aid received by Pacific countries from Pacific donors. The characteristics, problems and prospects of these countries differ considerably. And the same is true for the other developing countries in the area which receive the remaining 18 per cent of the aid provided.

In recent years the whole question of foreign aid has increasingly been called into question in most parts of the world, reflecting considerable disillusionment on the part of both donors and recipients. Much of this has arisen out of the seeming failure of sizeable aid flows during the past fifteen years to make much of a contribution to achieving its intended objectives. At the same time, the aid-giving process has itself evoked new problems for both donor and recipient countries. This process of disillusionment has been further reinforced by the unfortunate series of crises which have more or less simultaneously beset world affairs in recent years: a raw materials crisis, a petroleum crisis, a monetary crisis and a host of political crises extending from Watergate around the world to South America, Indo-China, the Indian sub-continent, the Middle East, Africa and Western Europe.

In the words of the last DAC report, "the need for a fundamental reappraisal of development cooperation policies has been thrust upon us". The call for yet another reappraisal of this issue is not new of course. In the past such reappraisals (e.g., the Pearson Commission) have focused primarily on fostering substantially bigger and ever-growing foreign aid activities. A more appropriate focus now may be how to make the most effective use of existing foreign aid resources and how best to scale down to lower levels of aid, in real terms, that may occur during the next decade.

Among the questions that arise in this context are the following: Has the time come to withdraw most aid, except for emergency relief purposes, from large groups of recipients whose per capita income exceeds a certain level, say US$300? Any such approach might greatly reduce aid flows to most Paicfic area countries except those in Indo-China, Papua New Guinea, the Phillipines and Indonesia. Has the time come to dismantle much of the huge bureaucratic structure that has developed nationally and internationally to handle aid matters? Doing so would not only free a considerable volume of financial resources for aid per se, as distinct from the administration of aid, but also would free many talented people, particularly in international agencies, to return to their countries to participate directly in the development process. For those countries that continue to receive aid, has the time come to give much greater weight than in the past to economic and administrative criteria and demonstrated performance and less to the variety of political influences that have coloured aid policies in most countries in the past? Doing so would mean, for example, eschewing the use of aid as a means of stimulating exports from donor countries, concentrating aid more heavily in the primary producing sectors of many developing countries and in projects generally that meet reasonable economic and administrative criteria; and having both recipients and donors adhere to policies that encourage a freer flow of trade and capital in response to market forces. In this latter connection, the possibility of infusing a larger share of accumulating oil balances into the development process has special importance. And finally in conjunction with an emphasis on increasing production of food and other primary products, more viable projects and a freer flow of trade and and capital, should greater emphasis be given to reducing population growth? If so, it appears that policies will have to be adopted that not only make readily available the technical devices for reducing births but also provide strong economic incentives for the use of such devices.

None of these questions is new. Yet the current prospects for aid-giving may now give these questions greater urgency than before when the emphasis in aid discussions was different. Pacific countries because of their peculiar characteristics may perhaps have a special role to play in addressing these and related questions.

Concluding Observations

Three general observations may be added in conclusion. First, establishing firmer codes of conduct, better procedures and stronger institutional arrangements on an international basis are probably among the most important steps that can be taken to ensure the national independence and sovereignty of small countries. For those who identify sovereignty with the locus of decision-making, as we frequently do in Canada, it is doubtful whether any feature of private decision-making at present is at all comparable with the impact

of foreign government decisions in larger countries on smaller countries. Reducing the reach of these decisions through freer international trade and investment and stabilizing their influence may be seen as a major step forward in achieving national independence.

Secondly, while no one would deny that size enhances a country's bargaining power in most areas of international affairs, the scope for exercising such power in the modern world is frequently closely circumscribed by various internal and external influences (as vividly illustrated recently by the oil crisis in which the combined power of the industrial world faces a few small developing countries). Moreover, the benefits of being small are frequently overlooked. Because of their relative unimportance, small countries have frequently been able to avoid responsibilities and to engage in actions that would create major difficulties if undertaken by large countries.

Finally, in a world drifting towards greater nationalism and a series of inward-looking regional affiliations, the major significance of the Pacific rim area may be as an importnat countervailing force working towards open internaitonal economic arrangements. For most countries in the area, large as well as small, an open international system for trade and capital flows offers better prospects than a world restricted by various national and regional restrictions. In such a restricted world, many countries in the area are likely to find themselves left out because of a lack of any natural affiliation or, alternatively, drawn into affiliations that they do not particularly want for political and economic reasons.

COMMENTS ON REUBER'S PAPER

(a) HEINZ ARNDT

Professor Reuber has presented a most useful and stimulating survey of the issues before this conference, focusing appropriately on the Pacific region and more particularly on relations between small and large countries. I am probably a bad choice as discussant because I find myself very much in agreement with his policy preferences and judgements, probably more so than many other participants.

The paper begins with a characterisation of the Pacific region and makes the sound point that it is in no real sense an economic region, "anything but a highly integrated economic area". So great is the diversity of the area by almost any criterion one can think of that almost the only thing that holds it together is a Japanese dream - economic cooperation centred on Japan. Professor Reuber refers to the "Pacific rim countries" and gives a figure of 32 such countries. They include Papua New Guinea (and by extreme courtesy Honduras) but exclude all the Paicfic island mini-states -- Fiji, Nauru, Tonga, West Samoa, Micronesia and the many others which are still dependencies. These might have been given some mention in the paper. They are close to the hearts of our hosts here in Auckland and they illustrate in extreme form the problems of small countries.

The paper goes on to discuss problems of trade, investment and aid, with special reference, at least in the trade section, to the economic significance of size. After reviewing the empirical evidence, the author concludes that "size as such is of little consequence except as it affects the concentration of exports and economies of scale". One suspects that the really important differences between large and small countries, which relate to power and to feelings of inferiority, insecurity and isolation, escape econometric testing. While I agree, for example, that "a major preoccupation of many countries in the area is their trade relations with the U.S. and Japan", I doubt whether it is true that "the problems here are primarily those of gaining access to these markets". The primary problem in Latin America's relations with the U.S.A., and increasingly in S.E. Asia's relations with Japan, is fear - often obsessive fear - of dependence.

In his discussion of foreign investment, Professor Reuber touches on a wide range of issues. Again, econometric tests do not yield very interesting results. It is hardly surprising, in view of the time lags and other complex factors involved, that there is "no significant association between direct investment and the rate of growth in output" of host countries. Nor is Table 6 very convincing evidence that "small countries on the eastern rim of the Pacific have attracted much larger flows than those in the southwestern region". If the rather special case of Panama is excluded, the total stock of private investment in the more important host countries of the two regions is much the same (US$5.5 billion in Latin America and US$5.9 billion in E.-S.E. Asia).

Professor Reuber draws a distinction between "vertical" and "horizontal" direct investment reminiscent fo Professor Kojima's distinction between "trade-oriented" and "anti-trade-oriented" direct investment ("A Macroeconomic Approach to Foreign Direct Investment", Hitotsubashi Journal of Economics, June 1973). But whereas Professor Kojima was primarily interested in whether or not foreign investment promoted industrial development in line with the host country's comparative advantage, Professor Reuber seems more interested in the relative bargaining position of the host country. He suggests that this is strong vis-a-vis investors in natural resource exploration and development and in "horizontal" import-replacing industries, but weak in relation to "vertical" export-oriented manufacturing investment, based on the availability of cheap labour. I am unconvinced that this classification holds water any better than Professor Kojima's. Is not the host country's bargaining strength, in so far as it rests on economic rather than political factors, a function of the economic benefits expected to accrue to the foreign investors or to the investing country, and are these necessarily greater for the first two than for the third type of foreign investment?

For the most part, however, I find myself very much in agreement with this section of Professor Reuber's paper and especially with his implicit endorsement of Professor Kindleberger's plea for a "GATT for Foreign Investment" - "to devise a set of fairly widely agreed upon ground-rules establishing limits on the behaviour of firms and, particularly, on the behaviour of governments in both investing and host countries". It seems to me that this is an issue on which the PTD Conference may be well placed to take a public initiative.

In the third section, on aid, Professor Reuber carries the current mood of disillusion to the point of asking whether the time has come to withdraw most aid, except for emergency relief, from countries with a per capita income of more than US$300 (which would include all the Pacific island countries) and to dismantle the huge bureaucratic structure that has developed nationally and internationally to handle aid matters. We shall no doubt discuss this question further during the Conference. I would at this stage merely sound the warning that it is surely crying for the moon to suggest that aid, any more than other aspects of national policies, should be insulated from political influences. The fact that "a large share of accumulating oil balances" has in fact been infused in the development process - but almost exclusively in Moslem LDCs - illustrates the point.

While Professor Reuber's survey is comprehensive and stimulating, and while his policy preferences mostly conform to mine, I finished reading his paper with a faint feeling of unreality, of an insufficient sense of crisis. Economists are notorious pessimists, and things somehow rarely turn out quite so bad. But for someone who, like Professor Reuber and myself, would like to see "an open international system for trade and capital flows" the outlook seems to me far less rosy than one would gather from the paper. The reason is that he almost entirely neglects, or touches only lightly on, six powerful current trends in the world which, while not necessarily in every case undesirable in themselves, are all inimical to such a system. They are:

1. The extension to more and more countries of centrally planned

economic systems under various political banners of the extreme left - the past twelve months have seen another six added to the list.

2. The shift of emphasis away from economic growth (and, de facto though not by logical necessity, away from economic rationality and efficiency of resource use) towards redistribution and other social (and generally inward-looking) goals.
3. The growing threat to the survival of the Western open society, based on a mixed economy and political democracy, posed by accelerating inflation and/or stagflation.
4. The trend, following the OPEC example, towards cartelisation of world supplies of basic materials.
5. The resurgence of economic nationalism in many developed as well as developing countries, manifested in protectionist policies and hositlity towards private foreign investment.
6. The continuing tendency in various parts of the world towards the formation of regional trading blocs.

The last leads me to add a final word of caution. Professor Reuber points out that "economic integration in the Pacific rim area remains patchy". It is by no means obvious to me that a greater degree of regional integration among all or most of the countries of the Pacific is desirable if it can be achieved only by discriminatory moves away from an open trading system. There is scope for helpful economic cooperation and sub-regional groupings such as ASEAN. But moves towards large economic blocs, EEC style, are another matter.

(b) Ashok Desai

Professor Reuber has presented a comprehensive paper in which most of the economic issues relating to the relations between large and small states in the Pacific Basin find a place. His telescopic view, however, perhaps misses some of the microscopic particles. He mentions Papua New Guinea in his discussion of development asistance, but the problems of the numerous mini-states in the South Pacific - Fiji, Western Samoa, Tonga, Nauru, Cooks, Solomons, Gilbert & Ellice Islands, Niue, New Caledonia, French Polynesia - escape his moving eye. These countries, with populations of less than a million - in some cases only a few thousand - may not be important in a world of 3500 million people. But the number of small LDCs is already large, and the tendency towards the secession of better-endowed areas from newly independent countries might increase further the number of low-income small states.

A great deal of the work on small economies that Reuber relies upon - for instance, that of Kuznets or of Khalaf - entails global cross-section comparisons. Such comparisons pool together many disparate countries and correlate their size with another characteristic. One or two other variables are sometimes controlled; but the analysis is not strictly multivariate. Putting a multivariate phenomenon into a bivariate framework can lead to results biased by misspecification. For this reason, global cross-section comparisons are very useful in suggesting positive hypotheses. In particular these are two factors which have a strong effect on the level and rate of development of small economies, namely natural resources and location. If they were taken into account or controlled, global

comparisons might well give stronger results than they hitherto have. In any case, there is clearly a significant number of small economies which are favoured by neither resources nor location. Unlike the larger LDCs of Asia and Latin America, those of the South Pacific also have too small domestic markets to permit much import substitution.

If they are to develop, they must specialize and export; in this context, Reuber's emphasis on the need for freer trade is clearly right. From the viewpoint of small countries, however, the distinction between regional arrangements like association with the EEC and wider global arrangements is not so important: the markets of a trade bloc like the EEC are large enough for them. The South Pacific countries might prefer freer access to the market of nearby industrial countries like Australia and New Zealand; but they would have no strong preference between larger and smaller customs unions.

I am in close agreement with Reuber's observations regarding the heterogeneity of foreign investment and the impossibility of devising efficient general policies towards it. Most small countries of the South Pacific are, however, far from the stage when they could bargain effectively with foreign enterprises. Their governments are too small relative to foreign enterprises and their markets too small to attract competition among potential entrants. They still have to generate options among potential investors, and to foster local enterprise is a way of generating those options which, if ably used, could give a small country greater control on the rate and character of investment.

Reuber finds high correlation between aid inflows into Pacific countries and their population. In view of the enormous range of population, it would be surprising if his estimates were free of heteroscedasticity. Besides, here as in the regression estimates Reuber cites earlier, it is the missing variable that is important - in this case, the spheres of influence which explain why most United States assistance went to the coastal states of East Asia, most of Australian aid to Papua New Guinea and Indonesia and much New Zealand aid to its Anglo-Polynesian neighbours. In so far as the spheres of influence persist and compete in the Pacific, Reuber may well prove too pessimistic on the quantum of aid and too optimistic on the application of economic criteria to its allocation.

(c) General Discussion

Some speakers criticised Reuber's paper for paying inadequate attention to the importance of oligopoly in world trade. This, they said, had made the conventional models of international trade theory unsatisfactory. Small states were rightly now doing what they could to obtain a share of the oligopolistic gains of the dominant powers. However, other speakers drew attention to the dangers of generalisation about oligopoly. For example, the success achieved by collective action by oil producers was unlikely to be attainable in respect of other materials because of different conditions of supply and demand. Moreover, one should not destroy efficiency of production and trade in the attempt to secure a fairer distribution of the rents of oligopoly. There should be an attempt to devise international rules for investment and trade which approach

the problem of oligopoly and cartels as economists have done when considering domestic industrial policy, *viz*., outlaw or control oligopolies which impede competition and efficiency, encourage those which foster such objectives.

Another participant expressed concern at the paper's apparently uncritical acceptance of the view that aid must be scaled down. An international equivalent was still required to the redistribution of income and equalization of opportunity effected by individual advanced nations through budgetary policy. If aid were cut, there was a danger that developing countries would be driven to attempt to secure 'justice' by methods which would harm trade and lower world output and income. A Japanese participant also suggested that aid remained an important element in guaranteeing a minimum human requirement in food and supplies.

There was considerable discussion of whether or not Reuber had sufficiently recognized the "crisis in the old economic order". Some felt that the flaws could not be remedied solely through the structural adjustments which he recommended. However, one member asked how much of these participants' sense of crisis was an overreaction to a cyclical recession. An Asian participant pointed out that the sense of optimism which characterized Reuber's paper must be conditioned by the developments of the past few years. The capacity of developing countries to continue to pursue "outward-looking" industrial strategies and trade policies was dependent on continued expansion of market opportunities in countries like the United States and Japan. They now had to ask whether the current "crisis" was going to reverse the trend towards liberalization and structural adjustment in developed countries.

Several participants argued that regional integration had more to offer than Reuber suggested, especially for the smaller countries in the region, which could thereby make progress while wating for multilateral answers.

Reuber, while agreeing with many of the comments made, maintained a sceptical approach to the benefits of regional integration and of the "new economic order".

3

DEVELOPMENT PROBLEMS OF SMALL COUNTRIES - A SURVEY

Sir Frank Holmes

Introduction

> "Small: a., n., adv. 1. Not large, of deficient size or strength or power or number. 2. Not much of. 3. Unimportant, trifling. 4. Socially undistinguished, poor, obscure, humble. 5. Morally mean, ungenerous, petty."

Smallness is not easy to define. It is also relative. A Canadian Prime Minister has asserted that Canadians find living next to the United States like sleeping with an elephant. Yet in terms of land area, Canada is one of the largest countries. In size of gross national product (GNP) it is about eighth in the world. In population, Canadians probably see themselves as "tenants of life's middle state securely placed between the small and great,"[1] but in fact they rank about twenty-fifth in the international league table.

Economists studying the consequences of size have used each of these magnitudes - land, population and GNP - as indicators. Demas,[2] for example, measured size by the "absolute number of persons living in a national economy and its land area." He drew his dividing lines for a small country at "a population of five million or less and with usable land area of ten to twenty thousand square miles or less". Khalaf[3] used both population and gross national product as indicators of size. Lloyd[4] selected national income as the most serviceable guide.

Any single definition has deficiencies, and whatever the definition, any dividing line between large and small is arbitrary. "Usable land area" is particularly troublesome to translate into operational terms, involving as it does questions of climate, availability and accessibility of resources in demand or likely demand, topography, ease of communication and the like. In discussing development problems, where we are concerned, inter alia, with questions of the size of the market and scale of output, it seems more useful to take one of the indicators of national income or product as our main guide. A small gross national product (GNP) may be a consequence of a small population and, therefore, a small labour force; on the other hand, it may stem from low productivity, due perhaps to lack of "usable" resources but usually, more fundamentally, to lack of present capacity to put resources, domestic and imported, to effective use. It may seem odd, indeed disturbing,

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1) W. Cowper, Tirocinium, line 807.
2) W.G. Demas, The Economics of Development in Small Countries, McGill University Press 1965, pp.22 and 40.
3) N.G. Khalaf, Economic Implications of the Size of Nations, E.J. Brill, Leiden, 1971. p.4.
4) P.J. Lloyd, International Trade Problems of Small Nations, Duke University Press, 1968, pp.3-13.

that in these terms Bangladesh with about 73 million people is "smaller" than New Zealand with just over 3 million. But even if we acknowledge that comparing GNP's by the currency conversion method is fraught with pitfalls, and exaggerates real income differences between less and more developed countries, it is a reflection of the present state of the world that, in effective demand and productive power, countries of quite large population are frequently "smaller" than those with many fewer citizens.

If the dividing line between large and small in 1972 had been set at a GNP of US$10,000 million, only 36 of the 189 countries and territories in the World Bank Atlas for 1974 would have qualified as large, with Indonesia, Bulgaria, Greece, Norway, Finland, Venezuela, and Iran just making "large country" status. If the line had been dropped to US$5,000 million, fifteen others would have qualified, ranging from Puerto Rico just above the line, through New Zealand in the middle of the added range to the Republic of Korea near US$10,000 million. Taking the qualifying line down to US$2,500 million would have brought in fifteen more; with Burma, Ghana and Singapore just qualifying, and with Ireland, Bangladesh and Malaysia leading the new qualifiers in the big league. Below a GNP of US$2,500 million there were 123 other countries ranging from the Maldive Islands on about US$10 million, and Western Samoa, Seychelles and some of the smaller Caribbean islands on US$20 million, to Ecuador and Mozambique a little below the new dividing line.

We New Zealanders think of our economy as small. If New Zealand's GNP had been picked as the margin between large and small in 1972, only 46 countries would have been above the margin, 142 below. Looking at the matter geographically, the large economies are heavily concentrated in Europe and North America, as the following table indicates:

Number of Countries and Territories
Above and Below New Zealand's GNP, 1972

	Above	Below
Africa	3[c]	51
Asia[a]	9[d]	32
Europe	24	11
Indonesia and Oceania	2[e]	13
Northern and Central America[b]	3[f]	27
Latin America	5[g]	8
Total:	46	142

a. Extending to Israel and Lebanon.
b. Including Caribbean.
c. South Africa, Nigeria, Egypt.
d. Japan, People's Republic of China, India, Iran, Republic of Korea, Pakistan, the Philippines, Thailand and Israel.
e. Australia and Indonesia.
f. United States, Canada, Mexico.
g. Brazil, Argentina, Venezuela, Colombia, Chile.
Source: World Bank Atlas, 1974.

Characteristics of Small Countries

It should be evident from the foregoing introduction that the small can be rich. Of the countries with populations over one million in the world Bank Atlas, six of the top twenty in terms of income per capita had populations of less than five million. Ten had populations of less than ten million. Khalaf's study[5] found no significant association between population size and national income per head.

Small countries can also grow rapidly. Khalaf did not find any significant relationship between size (whether in population or GNP) and rates of growth of GNP, or between population and growth of GNP per head. Again, looking at the ranking of rates of growth of GNP per capita between 1965 and 1972 in the World Bank Atlas, one finds that half of the top ten and half of the top twenty had GNP's smaller than New Zealand's. Six of the top ten[6] and twelve of the top twenty[7] had populations less than ten million. On the other hand, of the twelve countries which had negative rates of growth of GNP per head during this period[8], eight had less than ten million people and five had less than five million; none of them had a GNP greater than New Zealand's. But there is no indication that their problems stemmed from size per se; their source was more probably other conditions responsible for their relative poverty and a variety of exogenous factors peculiar to the individual countries concerned.

There also seems to be no significant association between size and instability, whether of income, exports, imports, terms of trade or exchange reserves. This conclusion is not vitiated if the levels of economic development of different countries are taken into account. Smallness as such does not appear to be a significant source of instability.[9] Khalaf suggests too that factors normally associated with smallness, such as a higher than average dependence on trade and rather substantial commodity and geographic concentration of exports, are not of themselves sources of unusual instability. By the same token, policies to reduce dependence on trade and concentration of exports do not necessarily provide the key to greater stability. As Lloyd,[10] drawing on the work of Michaely[11] and Coppock[12] puts it, "no generalizations concerning instability in the trade sector are applicable to small countries generally." For the small nations, "it is the specific circumstances of each country with respect to the kinds of commodity exported, access to markets over the period of years, commodity concentration, adaptability to changes in market conditions, and numerous other factors - rather

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5) Op.cit. p.5.
6) Singapore, Libya, P.N.G., Greece, Israel, Saudi Arabia.
7) Above plus Bulgaria, Puerto Rico, Albania, Hong Kong, Mozambique, Angola.
8) Yemen, Niger, Khmer, Jordan, Bangladesh, Sudan, Cuba, Senegal, Republic of Vietnam, Guinea, Zambia, Democratic Republic of Vietnam.
9) Khalaf, op.cit., Ch.2.
10) Lloyd, op.cit., p.51.
11) M. Michaely, Concentration in International Trade, North-Holland, Amsterdam, 1965.
12) J. Coppock, International Economic Stability, McGraw-Hill, New York, 1965.

than country size or any other single variable - which must be used to explain the pattern of export instability."

In his study of the international trade problems of small countries, Lloyd cast doubt on assertions that such countries were normally characterized by a high ratio of international trade flows to GNP and a high degree of commodity and geographic concentration of exports. In his conclusion,[13] he states that "size of country was not a major determinant of the trade ratios of some sixty countries in 1964 and it was not even a significant factor in the determination of commodity concentration of exports .... If a small country is defined as any country whose GDP was less than $20 billion in 1964, it is quite clear that the trade ratios and degrees of export concentration of these countries vary widely around the all-country averages." He also found that many of the small countries which had high trade ratios had exceptionally low commodity concentration in their exports. However, in Chapter 2 of his book,[14] he makes an important qualification of this conclusion. He points out that, with the sole exception of Brazil, all countries with GDP's over $10 billion had low commodity concentration in their export trade, and all countries with DGP's over $20 billion had below average trade ratios. Thus, large countries do seem to have less dependence than the average country on trade and on a few export products. Small countries may or may not, depending on many circumstances concerning their location, past history, access to major markets, resource endowments and so on.

Khalaf[15] found some inverse relationship between size and commodity export concentration and a weak inverse relationship between size and geographic concentration of exports. He also found, like Kuznets,[16] a significant inverse correlation between size and the ratio of exports to GNP, especially when size was measured by population rather than GNP, but his figures for smaller countries were fairly widely dispersed around the average. As with Lloyd, however, he found a much weaker inverse association between size and the ratio of foreign trade (exports plus imports) to GNP. The average foreign trade ratio seemed to rise from about 0.22 for the twenty countries with largest populations to about 0.60 for ten countries with an average population of 7.6 million. For the remaining thirty smaller countries in the sample with populations less than 7.6 million, the ratio fluctuated with a slightly declining trend, being about 0.57 for the ten smallest countries, whose populations averaged 1.4 million. Finding similar relationships, Kuznets[17] had concluded that "apparently, under prevailing political, institutional and economic conditions the proportion of total available products that can be secured from foreign trade has an upper limit and the proportion of output that must be secured from within the domestic boundaries has a corresponding lower limit."

Kuznets had found a much closer inverse association between size

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13) Op.cit. p.124.
14) Lloyd, op.cit., esp. p.29.
15) Khalaf, op.cit., Chs. 3 and 4.
16) S. Kuznets, "Economic Growth of Small Nations" in E.A.G. Robinson ed. Economic Consequences of the Size of Nations, Macmillan 1960, esp. pp. 19 and 32-36.
17) S. Kuznets, Six Lectures on Economic Growth, Free Press, Illinois, 1959, p.98.

and dependence on foreign trade among richer than among poorer countries. Khalaf's study did not confirm this pattern. It suggested[18] that small developed countries tended, on average, to have the highest dependence on trade, and large less developed countries the lowest. But, in general, the inverse association between size and dependence on trade did not change with levels of development.

In assessing the characteristics of small nations, Kuznets'[19] first observation was that their economic structure was typically less diversified than that of larger units. Output and productive factors were concentrated in fewer industrial sectors. Even here, however, he had to note that diversification of industrial structure was more a function of economic development than of size, per se. Consequently, the differences between large and small nations in range or diversity of structure would be clear only in comparisons of nations of similar levels of development. Three reasons were advanced for expecting less diversity or greater concentration of structure in small countries, especially when the smaller rich were being compared with the large. Firstly, small nations were usually (though certainly not always) small in area, and since the availability of a variety of resources (including climate) was largely a function of area, their scope for diversification might be restricted by lack of resources. Secondly, small countries offered a limited domestic market. Because of the minimum scale, let alone the optimum scale, of plant required for some industries, such as those producing, as opposed to assembling, aircraft, automobiles and electrical and railroad equipment, their inclusion in the productive system of a small country would be most uneconomic unless it could count on a substantial export market. Thirdly, comparative advantage in the supply of a few resources might, with a small labour force and deficiencies of other resources, dictate concentration upon the areas of comparative advantage to a much greater extent than was required in larger nations. Hence the tendency towards greater dependence on foreign trade.

Kuznets did not present evidence on the structure of the foreign trade of smaller countries, but his analysis implies that primary products and simple manufactures tend to assume more importance in their exports than they do in larger countries. This being so, one would expect fluctuations in the terms of trade and perhaps instability of export receipts to be relatively greater than Khalaf's study suggests. However, as with trade dependence and export concentration, the position with the terms of trade seems to be that, while most of the largest countries experience fluctuations below the average, there is a wide dispersion around the average for small and medium-sized countries. And there is wide variation of the instability of export proceeds at all points in the range of size of nations.

The foregoing discussion of the characteristics of small nations should have indicated that the possibilities of making significant generalizations about their development problems are limited. Both large and small countries encouter problems in achieving stable growth. Relative size would not seem, on the face of it, to be a dominant element in determining a particular country's capacity to

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18) Khalaf, op.cit., pp.120-22.
19) "Economic Growth of Small Nations", op.cit., pp.15-18.

surmount those problems. In discussing the development problems of small economies it would seem necessary at least to distinguish between those which are relatively rich and highly productive, on the one hand, and those which are relatively poor and technologically underdeveloped, on the other. It is beyond the scope of this paper to discuss the problems of poorer countries generally, and this writer is in any case more familiar with the problems of a small developed country. However, an effort will be made to indicate some of the special problems which confront small economies which are poor. The problems which I have elected to discuss as of special relevance to this gathering are problems of structural transformation, problems of trade dependence (including those involved in schemes of regional integration designed to overcome problems arising from the difficulties which small economies may encounter because of economies of scale) and problems involved in obtaining development assistance from overseas.

Problems of Structural Transformation in Development

Economic development has been variously defined. Horace Belshaw[20] called it "a social process which results in a cumulative increase in levels of consumption." Charles Kindleberger[21] distinguishes development from growth, suggesting that while growth implies more output, more inputs and more efficiency, development involves changes in the structure of outputs and in the allocation of inputs by sectors. Demas,[22] speaking of development in small countries, takes development to mean the structural transformation of the economy. He does not regard income per capita as a good indicator of development. He draws attention in particular to the deficiencies of "enclave economies", dependent on the exploitation of a particular resource, mainly for export, perhaps through foreign-owned enterprises, where high incomes might be confined to a minority of the population engaged in operating or servicing these enterprises, and could in some instances be of limited duration, leaving only a limited residue of improved physical and human capital in the economy. To him, structural transformation of the economy is required, and this entails (1) reducing any dualism that exists between the different sectors and different regions of the economy; (2) drawing surplus labour into high productivity employment; (3) establishing a national market for goods and services; (4) increasing the share of manufacturing and service industries in the GDP; (5) increasing the volume of inter-industry transactions mainly through the growth of manufacturing; (6) lowering the ratio of imports to GDP and shifting their composition from consumer to intermediate and capital goods; and (7) making the economy more flexible and adaptable through political, social and institutional change.

Small, poor countries have similar problems of development to those faced by all countries of low productivity and low income per head. Generally, the basic problem is to convert a "traditional" society into a modern one through a social process which gradually

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20) H. Belshaw, Population Growth and Levels of Consumption, George Allen & Unwin, 1956, p.xv.

21) C.P. Kindleberger, Economic Development, McGraw Hill, 2nd ed., 1965, p.3.

22) Demas, op.cit., pp.19-20.

makes automatic an increasing accumulation of capital, improvement of technology and growth in the skills of labour and management. As H.G. Johnson[23] has pointed out, social factors are at least as important as the so-called economic in making the transformation possible. In particular, self-sustaining development requires political stability, honest government, an institutional framework conducive to planning for the future in reasonable security, a legal and judicial system which minimizes the risks of production and accumulation, and a social system which promotes mobility, recognizes accomplishment and gives incentives based on productive economic contributions rather than personal connections. Even in advanced countries, there are strong resistances to the changes required for further development where these conflict with traditional values and social controls and where the interests of important groups seem threatened. The problems are more intransigent in societies starting from a tribal level of organisation, from an elaborate culture attuned to a non-industrial way of life or from a "colonial" culture derived from eighteenth or nineteenth century models. Many of the small countries of Asia and the Pacific face complications in developing their economies because of conflicts between the requirements for economic growth and their traditional ways. For instance, the Prime Minister of Western Samoa[24], discussing his country's development problems in 1970, pointed out several suggested economic policies which had been found uncongenial - too close an embrace of tourism would jeopardise Samoa's way of doing things; the land tenure system, seen as an obstacle by visitng economists, was still the most appropriate for Samoa; with numbers threatening to double every twenty years and making serious demands on limited resources, Samoa continued to have no population policy other than an insistence that "having children is the private concern of husbands and wives." "We are unique" he said, "and wish to remain so within the common brotherhood of man."

Population Problems

Rapid population growth is a serious problem for many small economies of South East Asia and the Pacific. The tendency in the 1960's was for growth rates to accelerate; and in most countries they remain very high, ranging up to 3½% per annum in some cases. With a few significant exceptions, sucn as Singapore and to a lesser extent Malaysia, vigorous population control policies have been lacking. Yet the conclusion of Ohlin[25] in 1967 is still valid, that "it is difficult to undertake any calculation of the economic gains that might be realized from population control which does not point to very spectacular benefits. On the other hand, it is currently believed that successful family planning campaigns can be achieved at costs which are extremely low except in comparison with the negligible amounts spent so far."

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23) H.G. Johnson, Economic Policies Towards Less Developed Countries, Brookings Institution, Washington D.C., 1967, Ch.II, esp. pp.44-5.
24) Hon. Tupua Tamasese Leulofi IV, Western Samoa Faces the Modern World, N.Z. Institute of International Affairs, Wellington, 1970, pp.3-4.
25) Goran Ohlin, Population Control and Economic Development, OECD, Paris, 1967, p.120.

Even in countries with considerable resources, more investment in population controls should assist greatly in overcoming poverty by quite quickly reducing the proportion in the young, dependent age groups, by releasing more resources for saving and investment and by making some increase in consumption per head possible. The case for population control increases if lack of usable land and other resources is a severe constraint on development, as it is in several small South Pacific countries, for example. It is, of course, possible to achieve rapid growth and high living standards in small economies with limited resources, as the examples of Singapore and Hong Kong, and among the most developed Belgium and Switzerland, demonstrate. Nevertheless, history and location have been helpful to these countries in their achievements and not all economies are similarly favoured. Some of the small South Pacific countries presently rely on emigration to relieve some of the pressures of excessive population. However, this does not provide a satisfactory or permanent solution of the problems. One major difficulty is that it tends to be the more skilled and active members of the population who both wish to emigrate and are most favoured in the labour markets and immigration policies of the host countries. This makes it more difficult for the small country to establish a satisfactory base for its own development and increases its reliance on remittances home by emigrants and on aid from more developed countries. The emigrations may also be subject to erratic fluctuations. Even in countries like Australia and New Zealand, disenchantment with immigration has increased in recent years, for social as well as economic reasons. This is accentuated in conditions of recession.

Problems Arising from Economies of Scale

In effecting structural transformation, all small countries are confronted with some problems arising from the existence of economies of scale in many lines of production, including the provision of public services. Unfortunately, the quantitative evidence available upon which one might base general conclusions for policy in small countries is not very satisfactory, as all who have read the proceedings of the Conference of the International Economic Association on "The Economic Consequences of the Size of Nations" will appreciate. E.A.G. Robinson's[26] introduction to the proceedings indicated a consensus that most technical economies of production were exhausted by firms of quite moderate size but that the real value of output of the average unit of production in advanced countries was growing. It noted that while larger countries normally possess an automobile industry, an aircraft industry, locomotive building, and heavy machinery building, both mechanical and electrical, smaller countries rarely possess any of these (and, one could now add, computer manufacture). A dividing line of between 10 and 15 million of population as the necessary base for such industries was suggested, though exception, e.g. Australia, were noted. It was also observed that larger economies could enjoy greater specialization of both goods and service industries; in small markets, firms tended to be less specialized and more diversified, and as a consequence were confronted with mastering a greater variety of design and production problems.

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26) _Op.cit._, pp. xiii to xxii.

In a recent survey of empirical evidence, Simon Teitel[27] cast doubt on the methodology of the studies by Solow and Douglas which had suggested constant returns to scale for the economies which they had studied. More recent studies by Walters and by Brown and Popkin had found significant economies of scale, using different methods. Also the United Nations Study of Industrial Growth in 1963, using cross-section data for industrialized and developing countries, had estimated a co-efficient of elasticity of level of output in relation to population size of 1.12 for total manufacturing. The co-efficients for food, beverages and tobacco, leather and leather products had been less than 1; those for clothing, wood and wood products, printing and publishing, and stone, clay and glass products had been about unity. All others had exceeded the average, with the highest coefficients being found for base metals (1.65) and chemical and petroleum products (1.39). At the level of the industrial plant, Teitel cites the results of several studies demonstrating increasing returns to scale in such items as pipelines, chemical engineering, process industries (especially chemicals), capital intensive producer goods and some consumer-oriented industries like textiles. Tests of correlation between size of establishment and output per worker for Colombia, Ireland, New Zealand, the Philippines, Costa Rica and the United States had shown economies of scale in most industries in the first four countries, but the results were statistically significant in only about half the industries in the last two countries. Taking average value added as the measure of size, the ranking of industries enjoying greatest economies were (1) tobacco, (2) petroleum and coal products, (3) base metals, (4) paper, (5) chemicals, (6) beverages, (7) rubber, (8) textiles, (9) electrical machinery, (10) transport equipment. At the end of the list were leather, wood, clothing and furniture. These rankings showed a uniform pattern across a sample of 25 countries, with similar ordering in both developed and developing countries.

As indicated, it is difficult to reach general conclusions for policy on the basis of this sort of evidence, especially as many small nations can escape at least some of the penalties of smallness in particular industries by producing for foreigners as well as for their domestic markets. We shall return later to the question of how satisfactory this avenue of escape can in fact be. Meantime, we merely note the conclusions reached by Robinson and his conference colleagues in studying the matter. "Our general impression", he said, "was that most of the major industrial economies of scale could be achieved by a relatively high-income nation of 50 million; that nations of 10 to 15 million were probably too small to get all the technical economies available; and that the industrial economies of scale beyond a size of 50 million were mainly those that derive from a change in the character of competition and of specialization", which are however to be explained only partly by scale. He emphasized that "large size is not a panacea .... the better and more scientific use of resources is what ultimately matters, and size of market is only one ingredient in that more effective use." However, he concluded, there are no possibilities of diseconomies of scale arising from excessive size of the market. "There are no penalties for being bigger than the minimum size, if such there be, that will exhaust the economies of scale", provided

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27) S. Teitel, 'Economies of Scale and Size of Plant', Journal of Common Market Studies, Vol.XIII, Nos. 1 and 2, 1975.

that sensible overall management of the large economy continues to keep it operating flexibly at high levels of output.

Problems of Maintaining Efficiency Through Competition

Especially in industries subject to economies of scale, small countries may be confronted with a conflict between their desire to promote competition among domestic producers and cater for a variety of consumer needs from domestic output, on the one hand, and the high costs involved in maintaining a number of producers operating on a small scale making a diversity of products, on the other. International trade can again provide some solution to this problem, if governments are prepared to expose domestic monopolies or oligopolies to competition from imports and if growing exports of the goods and services concerned are possible. However, in practice, policies of attracting foreign investments and providing protection and support for domestic industries have frequently aggravated the problem by encouraging the establishment of several separate enterprises, often operating well below capacity and on a one-shift basis, and, especially in the more affluent societies, trying to satisfy consumers' desires for a varied choice. For example, in New Zealand, in 1969, thirty-three different models of car were assembled in average production runs of 1600 units. The potential for both New Zealand and others to gain from rationalization through expanded trade in this field are considerable, if the obstacles to doing so can be surmounted.[28] Similar remarks could be made about industrial development in many other small countries.

The problems of scale are aggravated in many small countries by competition by different centres and regions, not only for new industries but also for expensive public facilities such as international airports, container terminals, tertiary educational institutions and the like. In a democracy, the pressures are difficult to resist, especially in marginal electorates. It is unlikely that other forms of government could completely immunize themselves from them either. Nevertheless, pandering to them is expensive, as are endeavours by small countries to sustain foreign services over a wide area and to provide effective independent defence forces. Smallness calls for special attention to the costs and benefits of expanding public services of these and other kinds. It also suggests serious consideration of the potential for achieving economies through collaboration by, say, educational authorities and local governments planning the joint use by students and the local community of school facilities, or through use of defence forces to supplement certain projects in construction, health, education and transport, for example.

Strategies for Industrial Development

In planning for the structural transformation of small economies, there is a tendency to give considerable emphasis to the development of manufacturing industries. This tendency is evident in the approach of Demas, summarized in section 15, where manufacturing is seen as playing a key role in increasing the volume of inter-industry transactions, reducing dualism and employing labour released from agriculture. There is no doubt that industrialization must

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28) See W.D. Rose, Development Options in the New Zealand Motor Car Assembly Industry, New Zealand Institute of Economic Research.

be an important component of development, but governments may be led into false paths if they view industrialization too narrowly as the production of manufactured products. As Johnson[29] points out, "industrialization properly speaking involves the organisation of production in business enterprises, characterized by specialization and division of labour both within and among themselves; this specialization is based on the application of technology and of mechanical and electrical power to supplement and replace human effort and motivated by the objectives of minimizing costs per unit and maximizing returns to the enterprise .... So conceived, industrialization is an economy-wide phenomenon, applying to agriculture and the service trades as well as to manufacturing; the essence of it is not the production of the products typically considered as "industrial" but the rational approach to the production process that it embodies."

The percentage of the active population engaged in manufacturing varies widely in different developed countries, with some small economies like Switzerland, Belgium and Luxembourg exceeding the proportions prevailing in the United States and France, for example. In the United States itself, the proportion so engaged has dropped quite considerably from 30% in 1947 to 25% in 1971, as service industries have gained in significance in the "post industrial society".[30] Thus, there is no standard proportion of manufacturing to total output required for growth or prosperity; and what is economically most appropriate will vary from one country to another depending on many factors such as resources, locations, and available skills. There seems no reason why a substantial part of the adoption throughout the economy of the rational approach to the production process which is required in poor societies cannot be transmitted through the development of primary production, construction and other service industries and their ancillaries, as well as through manufactures, if the circumstances of the country make this economically feasible. Certainly, care will have to be taken that the development does not become merely an "enclave", as tourist development, for example, can become in some countries, especially if the facilities are built by foreign enterprises and draw heavily on overseas sources for the goods and services supplied to visitors. But the important thing is to seek out those activities in which each country's comparative advantages lie, having regard to as realistic an assessment as possible of the country's capacity to sell and buy overseas now and in the next few years.

The limitations of an industrial development strategy focussed upon stimulating the growth of manufacturing industries to provide substitutes for imports, without great regard for the costs involved, have become increasingly apparent to the governments of many small countries in the last few years. The costs become more obvious when they have passed the stage of providing domestic substitutes for the simpler consumer goods and are faced with the problem of providing "development in depth", with industries producing intermediate and capital goods where economies of scale are more significant. Even before that stage is reached, it is really not satis-

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29) Op.cit., p.45-46.

30) Lawrence B. Krause, "U.S. Economy and International Trade" in K. Kojima ed., Structural Adjustments in Asia-Pacific Trade, Japan Economic Research Centre, Tokyo, 1973, esp. pp.387-389.

factory to base policy on the assumption that it is necessary to protect a wide range of industries making substitutes for consumers' goods, to treat as given their requirements for imports of equipment and materials to satisfy projected consumer demand and, after comparing these requirements with projected receipts from exports, to class the remainder as the "foreign exchange gap" to be filled by overseas borrowing and overseas aid. As Hla Myint[31] has pointed out, "where domestic industries catering for luxury consumption by the urban classes have been encouraged to grow, because of ineffective taxation and a desire to possess sophisticated industries, it does not require much penetration to see that a considerable proportion of the so-called 'capital goods' and 'essential' inputs merely serve to satisfy luxury consumption inside the country." Such an approach obscures the fundamental economic problem of choice. The choice involves decisions, first as to how to convert available domestic savings into capital goods, and second as to how to use the capital goods to obtain final consumers' goods. At each stage there is a choice between the 'direct' method of domestic production and the 'indirect' method of international trade. It is unwise to accept the existing structure of import substitution as given. It is important frequently to ask which industries are 'economic', and which are 'uneconomic', and whether or not it might not make more sense to use more resources to produce goods for export and acquire more consumers' goods indirectly through trade. It may not be insignificant that Singapore, forced to switch from a policy of import substitution to one of export expansion after its separation from Malaysia, has led the field in economic growth in the past decade.

In poor economies, especially where capital formation has a high overseas content, it is important to avoid measures which promote the use of excessively capital-intensive methods. Holding interest rates artifically low can be detrimental to development in such circumstances. There is also much merit in Myint's[32] view that, especially in poor countries, it is a mistake to identify 'capital goods' with durable machinery. Among the most important needs in small developing economies are irrigation, land improvement and other investments in social overhead capital, which must be done on the spot rather than imported in prefabricated form. To provide labour for these works on the spot, it is necessary to release people who are supported by a 'subsistence fund' while they make their contribution to future output. If this is accepted, food becomes 'capital' and agriculture a major producer of investment goods. Especially in countries which have to import a good deal of food and other primary materials, because of backward agriculture and population pressure, the removal of disincentives to agricultural improvement may be a more satisfactory form of import substitution than can be achieved by heavy protection of manufacturing. Freer importation of cheap consumers' incentive goods could, in some cases, serve a similar purpose in encouraging the expansion of agricultural output.

This attitude towards industrial development strategy is just as relevant to small, relatively rich economies as it is to small poor ones. In essence, it lays the emphasis on 'export substitution' as

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31) H. Myint, "Trade, Education and Economic Development", U.M.B.C. Economic Review, Vol.VI, No.1, 1970, pp.26-27.
32) Op.cit., pp.25-26.

well as 'efficient import substitution' according to potential comparative advantage. It implies a constant review of the costs and benefits of controls over international trade and a predisposition to allow external economic forces to influence the direction which the transformation of the country's economic structure should take. The success of such a strategy will of course be determined by many other factors, notably by the skill of governments in preserving internal and external balance through fiscal, monetary, incomes and exchange rate policies. It also assumes that the external world will continue to provide opportunities for export expansion and access to basic import requirements on a reasonably stable basis. Recent developments have naturally brought the validity of this assumption under much closer scrutiny than usual.

Problems of Dependence on Trade

As indicated, international trade opens up possibilities for small countries to overcome some of the disadvantages of the limited size of their domestic markets. However, if a high proportion of GNP is derived from trade, a country is very dependent for its fortunes upon developments and policies in the major countries with which trade is conducted. It is not surprising that such dependence should be seen by many in small countries as vulnerability, especially if a high proportion of exports is in the form of primary products subject to considerable fluctuations in price and constantly under threat of restriction by controls, levies and the like in major markets. "Colony or Nation?" [33] is the kind of question which inevitably arises in many minds, particularly when export markets are depressed and the immediate future looks bleak.

Unfortunately, a policy placing primary emphasis on import substitution may not be very successful in reducing the vulnerability of a small economy. It may or may not reduce the percentage of imports to GNP. Frequently, it may merely change the composition of overseas payments, reducing the proportion spent on finished, 'non-essential' consumer goods and increasing the proportion spent on 'essential' materials, feuls, equipment, consumer goods and services. If the import substitutes are produced at relatively high cost, the interests of exporters and other more efficient industries may be adversely affected. Especially if no significant new exports are stimulated by the policy, the country may merely have altered the nature of its dependence, not reduced it. Paradoxically, more success might be achieved in genuinely reducing vulnerability and in transforming a 'colonial' structure of production by a policy which emphasizes widening the range of export products and markets, by actively promoting the development of the more efficient industries, ensuring that the currency is not over-valued and giving incentives to exports of goods and services in fiscal and credit policies. So far as small, affluent societies are concerned, New Zealand's recent experience has suggested that a small country can develop a growing export of manufactures and services in this way. Success has been achieved partly by producing on a large scale goods for which we have relatively abundant resources (e.g. in our case forest products), partly by finding 'gaps' in larger markets for custom-made manufactures not satisfactorily supplied by larger-

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33) See for example W.B. Sutch, Colony or Nation?, Sydney University Press, 1968 for a discussion of New Zealand's 'vulnerability'.

scale producers, partly by selling products and services in developing countries which, being based on the requirements of relatively small-scale New Zealand producers, are more attuned to the needs of many developing countries than are more sophisticated articles and techniques designed for producers in larger and more affluent societies. The relative success of Singapore, Hong Kong, Taiwan and Korea suggests that a strategy of 'export substitution' can also be an effective engine of growth in small developing societies without unduly increasing the risks inherent in dependence on overseas trade.

Of course, there are risks inherent in any form of business which has to cater for the freely expressed and changing requirements of consumers, whether they be domestic or foreign. The special risks of export business rest in the lack of protection against foreign competition which one's own government may accord in respect of domestic sales, the greater difficulties of keeping in touch with the changing requirements of consumers in a wide range of distant markets, the possibility of greater instability in the overseas markets than at home, and the danger that markets will be restricted by the policy actions of foreign governments. Successful exporting therefore requires considerable flexibility and adaptability, such as, for example, New Zealand's dairy industry has had to show in diversifying both products and markets in response to changing consumer demands and the restrictions which it has encountered in markets previously dominant in its trade. The risks of disruption to trade through instability in major markets have become more apparent in the 1970's than in the earlier post-war period. The pronounced demand inflation at first caused dramatic increases in the prices of many commodities exported by small countries. However, in several cases, the boom was short-lived, and the terms of trade deteriorated sharply as export prices fell, and the prices of manufactures rose in the subsequent period of stagflation in North America, Western Europe and Japan. Developments in oil have aggravated the internal and external payments problems of many small economies. Those small economies which are heavily dependent on exports which fluctuate widely in price could usually diminish the internal impact of the fluctuations on domestic liquidity, incomes and spending through the adoption of schemes of stabilization which smooth out the peaks and troughs. With payments to exporters based on some sort of moving average of receipts, and with judicious use of fiscal, credit and exchange rate policies, some insulation could be achieved. But severe instability in major economies undoubtedly aggravates the problems of smaller economies in sustaining stable growth, and any prolonged period of recession greatly strengthens the forces in those countries which advocate more autarchic policies in international trade.

The extent to which small countries can orient their development strategies towards exporting is dependent on the readiness of both consumers and governments of other countries to accept an increasing flow of the products in which they have a potential comparative advantage. Protection in the major developed market economies is an important constraint for many whose advantage lies in primary production and labour-intensive manufactures. In agriculture, the methods of support favoured by several European countries and in some products the United States, which hold domestic prices high by restricting imported supplies, aggravate the problems by restricting consumption, artificially stimulating domestic production and encouraging the output of substitutes. From time to time, do-

mestic surpluses arise which diminish market opportunities, especially if they are unloaded overseas in markets which small countries might otherwise serve. The regionalisation of this form of protection in the Common Agricultural Policy of the EEC, particularly with Britain becoming a member, has been a source of concern to many small countries. Some, like New Zealand and several developing countries closely associated with one or more of the members of EEC, have been able to make special arrangements with the Community to offset, in part or in full, the potential damage to important export products. However, this obviously accentuates the problems of those exporters not included in the arrangements, and in any case still leaves to be solved many of the problems caused by the Community's form of agricultural support. Resistance to competition from so-called "cheap-labour" countries remains strong in many countries, large and small; import controls, "tariff escalation", requests for "voluntary restraint in exporting", union opposition to ships manned or operated by citizens of "low wage" economies present considerable obstacles to the efforts of the poorer, small economies to increase their trade, and possibly reduce their dependence on borrowing and aid, in the process of structural transformation.

If these problems are to be alleviated, more efforts will have to be made to continue the reduction of barriers to all forms of international commerce by international agreement. As the proceedings of the Fifth Session of this Conference in Tokyo in 1973 indicated,[34] the success of these efforts will depend greatly on the willingness of governments, especially in the more developed countries, to adopt domestic policies which emphasize adjustment to changes in comparative advantages. Such policies, while continuing to afford protection to genuine infant industries and against dumping, would rely less on excluding competitive imports and more on assisting domestic producers to remain competitive, and to move out of activities where they are comparatively inefficient into those where their competitive efficiency is greatest. Such an approach to policy is likely to be more fruitful for developing countries in the long run than the generalized preferences to them in developed countries upon which emphasis is currently placed. While a multilateral approach is preferable, something can be done regionally or bilaterally. At present, for example, New Zealand is exploring with South Pacific neighbours the possibility of New Zealand assistance with the creation of employment opportunities in the islands, with better access to the New Zealand market for the products concerned being accepted as an important element in the scheme.

Regional Integration in Trade

The difficulties of making satisfactory arrangements for mutually acceptable reductions of barriers to trade on an international basis have led some small countries to consider the possibilities of reducing the problems of scale in economic development by regional trading arrangements. Given the costs of stimulating industrial development in watertight national compartments, it is possible that such arrangements could enable the partners to enjoy greater efficiency through increased specialization, greater enjoyment of

34) K. Kojima (ed), 'Structural Adjustments in Asian-Pacific Trade', Japan Economic Research Centre, Tokyo, 1973.

economies of scale and the stimulus of greater competition as barriers to trade among them were diminished. There are, of course, dangers of uneconomic trade diversion to be considered, along with the possibility of damaging adverse reactions by important trading partners outside the region. These have been important reasons for the relatively disappointing outcomes of attempts to establish regional trading arrangements in the Americas and Africa and for the failure of several proposals for integration in Asia and the Pacific, where the strength of ties with countries outside the region has frequently been very great and where the strength of the political and cultural links which must be associated with successful economic integration have been relatively weak. At least as important has been the problem of overcoming the fears of smaller and poorer partners in proposed regional schemes that significant numbers of their domestic industries would be unable to withstand competition from those of larger and stronger partners.

That this need not be an insuperable problem, at least for more affluent small economies, is suggested by the experience of the smaller members of the European Economic Community. Nevertheless, the "backwash" theory has had a powerful effect in many smaller countries in conditioning public opinion and policy makers to take a very cautious approach to suggestions of regional freeing of trade. The theory suggests that, if trade is freed, there will be a drift of production towards certain 'nodal centres' which already provide large markets and other advantages. Peter Elkan,[35] using this approach, contended that if trade were freed unconditionally between Australia and New Zealand, output would tend to be concentrated in a few large Australian conurbations and a substantial proportion of New Zealand's manufacturing industry would be destroyed. Despite this, Elkan favoured freeing of trade within certain constraints. He proposed a customs drawback union to cover the "backwash" problem by dividing trade between the countries into eight categories and permitting freedom to the extent to which bilateral trade remained in equilibrium within each of these categories.[36] His oversimplification of location theory and the mercantilist character of his proposed solution were severely attacked by other economists, as was the dependence of his conclusions on the overvaluation of New Zealand's currency at the time. Moreover, while the fate which he foresaw for industry in the smaller country might be a consequence if integration were attempted quickly between a large developed country and a small poor one, in this instance the smaller partner was richly endowed with skilled labour, a high rate of capital formation and an independent government which, either independently or in collaboration with its trading partner, could act to correct any tendencies for integration to produce effects contrary to the benefits expected from it.

Nevertheless, while a so-called free trade area has been established between Australia and New Zealand, the freeing of trade is severely constrained in practice, largely because of unwillingness

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35) P.G. Elkan, Freer Trade with Australia: Why and How, New Zealand Institute of Economic Research, Wellington, 1965. For a review of the debate on these assertions among Elkan, Holmes and Bentick see I.A. McDougall, 'NAFTA. A Review', New Zealand Economic Papers, VI, No.2, 1967.

36) P.G. Elkan, 'How to Beat Backwash', The Economic Journal, March 1965.

by governments on either side of the Tasman to expose sensitive industries to competition. Accordingly, while a limited contribution has been made to the expansion of trade between the two countries in items included in the free trade schedules and through other bilateral exchanges of concessions, the agreement has not really been used very effectively so far to contribute to a more rational allocation of resources. Similar political difficulties would seem to have limited the effectiveness of other attempts at regional integration in the Pacific area. This is unfortunate, because such regional arrangements between countries of similar stages of development could provide useful stepping stones towards strengthening the capacity of developing countries to participate more freely in multilateral arrangements to expand trade.

Foreign Investment, Overseas Borrowing and Overseas Aid

Governments in small countries which find it necessary or desirable to assist development or offset potential instability by obtaining funds from overseas are often confronted with acute divisions of opinion among different groups in their societies on the costs and benefits of the different means available to them. For the poorer small countries, the problems are accentuated if the flow of grant aid from multilateral sources is small or declining. Bilateral grant aid may provide a reasonably satisfactory substitute in many cases, but the net benefits are frequently reduced through obligations to purchase equipment etc. from relatively expensive sources in the donor countries, a problem sometimes also confronted in obtaining suppliers' credits and loans from official sources. However, in these respects, as with the problem of ensuring that servicing costs of official borrowing and private overseas indebtedness do not become an unduly high proportion of present and potential exchange earnings, the problems of small countries do not differ essentially from those of larger ones, although it is probably the smallest and weakest developing countries which have suffered most from the dramatic changes in balances of payments provoked by sharp increases in the price of oil and by the consequences of the 'stagflation' recently experienced in the major industrial countries.

Recession of export receipts increases the burden of servicing high overseas indebtedness, and the experience of sustaining such a burden can greatly influence attitudes of governments in small countries to further overseas borrowing. For example, in New Zealand, memories of the burden of overseas indebtedness in the Great Depression were a significant element in causing the Labour Government which was in office from 1935 to 1949 to avoid overseas borrowing, to resort to comprehensive licensing of imports and generally to eschew entanglements with overseas financiers. That these attitudes were not confined to the Labour Party is indicated in the fact that New Zealand did not elect to join the International Monetary Fund and World Bank until 1961. However, the country's large-scale resort to overseas borrowing and investment in 1974 and 1975 reflects both the fading of old memories and the speed with which the balance of payments can swing from deficit to surplus in a small dependent economy confronted with the instability which its major markets have experienced in the past four years. Pressures to resort to more protectionist policies, especially the intensification of import licensing, have been strong, but so far in the

main avoided. The relatively low level of the country's foreign debt and service payments before this deficit emerged and its good reputation as a debtor greatly facilitated the raising of large sums in a short period. Other, less fortunate, small countries would have found it much more difficult to avoid retrenchment and the imposition of trading policies damaging to others. This emphasizes the importance of the preservation of stable and expanding export opportunities for small developing countries if they are to avoid undue reliance on external aid and borrowing and maintain an outward-looking and liberal orientation in their development policies.

Private overseas investment is a much more potent source of political debate in small countries than official borrowing. Frequently, while the capital, technical expertise, assistance in finding export outlets and other direct benefits and the external economies which such investment may bring are welcomed, there is considerable concern about either real or imagined threats to political sovereignty and cultural distinctiveness. Policies attempting to avoid excessive overseas control by such means as insisting on a high proportion of local shareholding frequently reduce the benefits to be derived from the investment by the people of the host country, without greatly enhancing the scope of control already available through Government's general fiscal, industrial and labour policies. Moreover, many small countries following policies of import substitution have tended to attract foreign investment into relatively high-cost manufacture through offers of protection, tax holidays and other concessions. In doing so, they have probably made less net contribution to development and to exchange saving than they had expected, if account is taken of the relatively high price of the output to domestic users, including exporters, the exchange burden of profit remittances, and the possible external economies which would have accrued if the resources had been put into other, less protected areas. Again, these problems are not confined to small economies, and are in any case being covered in other papers before the Conference.

One problem with foreign investment and foreign aid which probably bears more heavily on small than on large economies is that of capacity to fulfil the requirements of those dispensing aid and investment while ensuring that the proposals made are consistent with the country's social and economic objectives. Most aid-giving governments and agencies adopt procedures designed to ensure that money is given for well-considered projects and spent wisely. Small, poor countries are usually woefully short of people capable of designing projects, checking projects designed by others, managing and executing approved projects and reporting in approved form on the outcomes. In the circumstances, they must place considerable reliance on the advice and assistance of overseas experts in all these fields. It is understandable that the host governments should frequently suspect that particular experts have taken inadequate account, on the basis of a brief stay, of the distinctive circumstances and life-style of their countries. The problem is complicated if, as is not uncommon, the small country is besieged by experts from several different governments and agencies proffering apparently inconsistent advice on development plans and projects, and in the process, via the demonstration effect, raising aspirations beyond the capacity of the country to achieve. Such small countries are faced with similar problems in checking the desirability of investment proposals made by foreign private companies. As a conse-

quence, one frequently finds the flow of aid and investment inhibited by delays and repetitive evaluations as the administration of the small country attempts to safequard its own interests while fulfilling the requirements of those bearing the overseas funds. Considerations such as these deserve more careful thought by aid-giving agencies. They also suggest that small countries must pay more attention than larger ones to avoiding waste of scarce management skills by unduly detailed official intervention in economic activity and by undue expansion and proliferation of governmental agencies.

Conclusion

This paper has indicated the difficulties involved in making significant generalizations about the development problems of small countries. Many countries have shown that smallness is not an insurmountable barrier in achieving stable growth and prosperity. Nevertheless small countries do have special problems stemming from more restricted access to some of the economies of scale and from the tendencies towards greater dependence on trade which provides the major avenue of escape for them. The problems are aggravated if poverty is a major reason for the smallness of a country's GNP, making assistance from foreign sources a more important condition for structural transformation. Small countries are more likely to surmount these problems satisfactorily if they can adopt development strategies which are based on expanding activities in which their comparative advantages lie and which allow external economic forces to influence the direction which their development takes. Their success will depend heavily on the extent to which larger countries maintain high levels of activity in their economies, accord well-considered aid to the poorer nations, and are ready to modify their policies of assistance to domestic producers and control of imports so as to enable smaller countries to find expanding markets for the goods and services which they can best produce.

COMMENTS ON HOLMES' PAPER

(a) MIGUEL WIONCZEK

In the first part of his well rounded paper Sir Frank offers us a review of the economic literature on the "small" nations and arrives at a conclusion that while there is plenty of them the world over, it is difficult, if not impossible, to find common characteristics that would permit them to be put in one single category. Such a conclusion should have been expected because the concept of "smallness" makes not too much sense whether in economics or elsewhere unless one answers two clarifying questions: first, small in what respect? and, second, small in comparison with what? Since most of the writers on the size of nations define the smallness by one of a few simple and very often differing indicators such as area, population or GNP, no wonder that their inquiries end with rather unhelpful general conclusions of the sort, "there are very many small countries in today's world and they differ in practically everything" or, "there is no indication that the problems of small countries arise from size as such".

It is easy to understand that in the Pacific area and particularly in Oceania, interest in the subject of "small" countries has lately been increasing because of the proliferation of small independent states in the area previously integrated in European political and economic empires. But the circumstances of this proliferation strongly suggest that perhaps we could be able to understand better its political and economic meaning, if the subject were submitted for analytical treatment to a multidisciplinary team in which political scientists and historians would labour along with economists.

Sir Frank should be commended for not abandoning the ring after finding out that there are "small" countries of all possible sorts. Since his brief general survey of the literature is followed by a detailed discussion of development problems of the relatively poor "small" countries, my comments will address themselves also to this particular subject.

The subject has been neatly divided by the author into three major parts dealing respectively with problems of structural transformation, trade dependence and those involved in external aid. Coming from a relatively poor and underdeveloped subcontinent to discuss a paper written by an economist from a relatively rich and small country, I should not surprise anyone by stating that I can agree only with some of Sir Frank's propositions while disagreeing with others.

First, I have no problem with the author's general approach in respect to the need for structural changes in "traditional" poor societies, whether small or not so small. I do however, have some difficulties when Sir Francis postulates "a social process (of modernization) which gradually makes automatic an increasing accumulation of capital, improvement of technology and growth in the skills of labour and management". While there is a large evidence that gradual and more or less automatic modernization characterized the

development of the parts of the former British empire settled by European immigrants, one should keep in mind that over one century was needed on the whole under very special conditions to achieve meaningful results of such modernization in the countries concerned. To posit that the former colonial territories in Asia and the Pacific region have enough time under the present day conditions (the population explosion, for example,) to repeat a similar process seems to me highly unrealistic.

In respect to the problems arising from economies of scale, I feel somewhat more optimistic than does Sir Frank. On the basis of the existing evidence the author seems to deny most of the "small" countries any chance of industrialization unless they will start producing for foreigners as well as for their domestic markets. Without defending a ridiculous position adopted during the Great Leap period in China that there is room in every village for a steel furnace, I consider that the issue of economies of scales is presented incorrectly in the present economic literature because it uses production scales as applied in the advanced industrial economies at the present stage of their development. I am a firm believer that there is considerable room for scaling down the size of industrial units in many sectors if an effort is made in that direction. No effort can be expected in that respect in the advanced countries because they do not need it. But if and when the present day's "poor" countries launch their own R&D effort, many ways of finding thechnologies appropriate to their market size will be found opening the way for their industrialization. All this does not solve the problems of the countries like Western Samoa, but will help others of the size of the Philippines and Thailand, to give just two examples.

I am in full agreement with the author on the subject of cooperation among "small" countries in respect to many expensive public facilities, including education. The competition in this field, particularly among newly independent countries, reflects primitive nationalism and ill conceived prestige consideration. It is both very costly and more than useless in social welfare terms.

Most of Sir Frank's observations on the industrial development strategies for "small" poor countries and, particularly, his observations about the need of modernizing agriculture which after all may become an industry seem easy to accept. There is, however, in my mind a clear limit to what a "small" country can do in that respect after it becomes selfsufficient in foodstuffs. The limit is set by agricultural policies of the "big" advanced countries and especially of the European Economic Community.

My knowledge of the operation of international trade system leads me to agree with most arguments presented in the paper's section on the problems of dependence on trade, assuming that--as Sir Frank postulates--international trade becomes really and not only formally free. I am not at all optimistic about the outcome of the present round of GATT negotiations not only because of the actual state of the world economy but because of the very high domestic political cost to the advanced "big" nations to do away with most quantitative trade restrictions. It makes little sense to me to measure the degree of trade liberalization by the height of tariffs at the moment in which quantitative restrictions are as high as ever and are even being tightened.

It is a pity that Sir Frank's paper did not look closer into the issue of regional integration. While I would admit that the problem of unequal distribution of gains from integration among partners with different levels of industrial development is particularly difficult to solve, Latin American integration schemes made some significant progress in dealing with this issue. After having lived for 15 years with economic integration attempts in Latin America I continue to be mildly optimistic about their prospects. The knowledge of our integration experiences, both achievements and misfortunes, might be of considerable use to other parts of the Pacific region.

To conclude, after having claimed with modesty that he was more familiar with the problems of a "small" developed economy than with those of "small" poor countries, Sir Frank offered us a very thoughtful paper that serves well as an introduction to our Conference. For this he deserves warm congratulations from a commentator coming from far-away Latin America.

(b) Kiyoshi Kojima

My comments on Sir Frank's really excellent paper will not be systematic but rather scattered since I have not had enough time to digest its contents and to study this new important subject: the development problems of small countries.

The definition of large, small and smallest economies is certainly not simple. Besides Sir Frank's points recalling arguments which occurred in defining the concept of an "optimum currency area", we might pay attention to the fact that the size of an economy depends upon the degree of integration, within a country or with neighbouring countries. Australia or Canada may not be large economies if the various states in each country are not well integrated with each other, whereas Belgium is a large economy for she is well integrated with her EEC partners.

Sir Frank has in mind, sometimes small-rich countries like New Zealand or Australia, and at other times smaller countries like Fiji, Western Samoa and Papua New Guinea. Problems for the latter are completely different from the former, and, therefore, each should be treated differently. I have in mind such relations as between Japan and New Zealand, Japan and Australia, and Japan and Korea or Thailand.

As I see it the major issues of large versus small economies are the following three: (i) the difficulty in transformation (especially industrialisation) of small economies and the relative efficiency of such measures (2) ambivalence or antagonism of small economies towards large economies, and (3) whether a global approach or a regional approach is the more desirable or necessary to solve the problems of small economies.

Given that a small economy aims at balanced growth of a range of industries, not only agriculture and textiles but also intermediate goods and machinery production, efficiency and economies of scale cannot be neglected and thus international intra-industry specialisation for each industry with neighbouring small countries and large economies as well is inevitable. Take for example the Japanese/Australian relationship. If Australia specialises by limiting the range of products within a certain industry (say automobiles) to obtain economies of scale, there are bound to be a num-

ber of industries in which she could produce at low cost and export to Japan and we should promote mutual direct investment to that end. How to realise economies of scale for a small economy is a crucial problem. Besides the point Sir Frank mentioned on this issue, I would like to stress the importance of economies of scale in sea-transportation. Not only a geographical remoteness of small economies in the South Pacific from the centre of world trade and separated by sea from each other, but also the small size of each export and import transaction, makes sea transportation costs high. Therefore, it might be desirable to find means such as the use of Japanese trading firms as agents whereby transport costs could be lowered and small transactions made economical.

At the same time, we have to explore what type of foreign direct investment is more suitable to the development of a small economy. Perhaps small scale investment undertaken by small or medium scale firms which are integrated by the worldwide network of trading firms, may be most suitable.

Aid to the small economy is more efficient and easier to provide from the donor country view. However, even small sums of aid from a large economy results in the feeling of domination and dependence. It is the same story with foreign direct investment and international intra-industry specialisation. The large versus small economy relation is fair as far as we can see from the economic and commercial point of view. Moreover the small economy is able to obtain greater benefits from specialisation, direct investment and aid. Therefore, the fear of dependence, domination and other hostile feeling may largely be political and social characteristics.

I feel that economic integration is particularly important for small economies in the South Pacific region. For example, Latvia, with 2.5 million people, has attained a fairly high stage of industrialisation mainly due to intra-industry specialisation with neighbouring areas. Sir Frank mentions that at least as important has been the problem of overcoming the fears of smaller and poorer partners in proposed regional schemes and that significant numbers of their domestic industries would be unable to withstand competition from those of larger and stronger partners. Is this applicable only for integration between, say, Japan and New Zealand? Or is also applicable to the integration between Australia and New Zealand? The comparison of these possible directions of integration would be interesting. It may be noted however that that kind of adjustment and consideration of its costs is necessary even in regard to a freer global trade regime.

The key problem in fostering Western Pacific Economic Integration (instead of institutional but functional) is how to harmonise interests between large and small economies. This requires a new theory of economic integration differing from the traditional one which dealt with economies that were on a more or less equal footing. A new type of integration may be fostered through the establishment of intra-industry specialisation in all fields of manufacturing industries. Foreign direct investment may have an important role to play in the development of intra-industry specialisation.

(c) General Discussion

There was general agreement that there was no simple dichotomy between large and small countries. Countries could be ranked over many spectra ranging from small to large, from underdeveloped to de-

veloped, from market-oriented to command economies.

Some consideration was given to the relationship between "economic viability" and independence. One participant contended that the independence of small countries was a political not an economic question. Independence had been thrust on some countries, e.g. Portuguese colonies, and rejected by others such as the Northern Marianas. The question was determined with little reference to economic viability. One speaker suggested that, in considering "unviable" countries, it was useful to distinguish between "God's Victims" such as small islands of the Caribbean and the South Pacific and "Historical Victims" whose size had been decided by the accident of colonization, as in Africa.

A participant from a very small state emphasized the limited policy possibilities available to countries like his own in import substitution, local investment and industrialization. An Australian suggested that trade, aid and investment could easily be biassed against small countries, because of their small markets, export concentration and skewness of production factors. A further problem to be emphasized, as it was in the paper, was the limited administrative capacity of many small countries. This must condition their approach to policy, and suggested, for example in controlling capital inflow, that they might take the opportunity to tax foreign investment relatively highly.

It was contended that small countries had most to gain from trade, that trade was inevitably a most important determinant of their capacity to grow, and that regional integration with neighbouring countries could be very important in enabling them to secure the benefits of specialization. While acknowledging the role which opening the economy to trade had had in achieving more rapid growth in the Thai economy, a participant from that country emphasized the need to consider the distribution of the gains from trade both between and within countries. He was particularly concerned that, while American and Japanese involvement with the Thai economy had boosted production, it had also provoked social unrest.

One speaker suggested that an advantage of smallness was that large centres would probably not retaliate against defensive or protective policies. This could ease the problems of insulating the economy against instability. However, the same speaker noted later that the fact that less developed countries were not under pressure to reduce barriers to imports could be a handicap to them, because their real problem was to turn infant industries into adults, and a protectionist policy might not be conducive to this.

In reply, Professor Holmes concentrated on the part which regional arrangements could play in helping small countries to develop. Most arrangements were plagued by the pressures exerted by vested interests created by past policies of protection and by fears by small countries that the larger would enjoy an undue share of the fruits of the freeing of trade. Assurances on the distributions of gains were therefore important in drawing up the programme for freeing trade. It was valuable for participants to accept that a major objective of the regional arrangement was to enhance the capacity of each of them to participate more effectively in multilateral trade with lower trade barriers.

PART II

CASE STUDIES

4

LATIN AMERICA: THE PROBLEMS OF DEPENDENCE AND ECONOMIC INTEGRATION

GERMANICO SALGADO

The probelms which mankind is facing at present have suddenly revealed to the rich countries that their destiny is not independent of that of the poor countries of our planet. The notion of inter-dependence is really an attribute of the universalist vision in western thought. In economics inter-dependence is at the heart of the theory of the international economy. But the concept is an abstract one and needs to take into account the processes that operate in the functioning of the world economy. Amongst these, dominance in relationships, inherent in the uneven rules of the game, are perceived by the powerful countries as well as by the weak. Events of recent years, especially the energy crisis, for the first time have created amongst the powerful a collective awareness that they depend on factors which, at any given moment, could escape their control. That this new awareness of inter-dependence gave rise to frustration and bitterness is not therefore surprising. Hopefully the rich and powerful countries and their leaders will now better understand the emotional attitudes of the poor countries against the extreme dependence which has tied them to the major powers and it is worth remembering that this dependence has resulted in a long-standing situation of conflict.

This awareness of dependence is a fact of life for less developed countries and part of their collective conscience. For this reason, they are probably psychologically better disposed to participate positively in the huge task of cooperating to remove the great uncertainties about of the future.

II

Latin America moved from the colonial period to the building of the actual nations without fundamental changes in economic structure. In colonial times certain resources were exploited to the maximum extent especially precious metals. Except on rare occasions, the metropolitan countries deliberately blocked the development of manufactures when the big silver and gold deposits became exhausted. Sugar, tobacco, cacao, cotton and a handful of other primary commodities constituted the whole of the exports of those countries. Some of them developed in the midst of subsistence economies, isolated even from the most elementary trade links with the West. Furthermore, as a consequence of the Independence Wars, a series of little states was created. Most including Argentina had in those times not even reached a population of one million. The most notable exception was Brazil, which was able to maintain - and also increase - its large share of the Continent which had been allocated to Portugal by the Treaty of Tordecillas. Not surprisingly, Brazil is today the most powerful States of Latin America, and the one which is able to concentrate its energies on tasks and enterprises of a much bigger scale than is possible for the other countries of the Continent.

"Independence" was accomplished - and it is convenient to empha-

sise this fact - by the descendants and cultural heirs of the Spanish and Portugese settlers. As long as they existed, the old Indian cultures, characteristic of subject peoples, relapsed into original forms, and the new ruling groups felt themselves exclusively attached to the cultural tradition of the West and its evolution, in spite of their mixed racial origins. Something similar happened in the United States, but in the case of Latin America which was associated with the decline of the metropolitan empires, the approach to independence clearly showed the characteristics of a cultural parasitism, which is only now being shaken off. It is useful to remember this characteristic in order to understand the absolute identification of the leading Latin American classes with the life style and the consumption patterns of the industrialised countries, which is not attenuated, as it could be in Asian and African countries by their indigenous values and means of expression.

With "independence", Latin America became enmeshed in the net of international exchange and its characteristic division of labour derived from the western industrial revolution, producing agricultural and mineral raw materials, receiving foreign investments for mining, for tropical agricultural plantations and for extensive cattle-raising in the River Plate region. Latin America imported manufactured goods from the West and became a permanent debtor of the industrialised countries. Only in recent years has it been possible to pay the debts which Bolivar incurred to achieve the Independence of Great Colombia. It is most probably also that the huge sums invested in the first railways built during the last century are still being paid for.

It is unnecessary to elaborate on the details of the resulting economic structure which underwent no real changes until the Second World War, a period in which most Latin American countries forced by scarcity, began the process of import substitution. The direction of trade, and the origin of foreign investment, are good indicators of the sense of dependence relations with the centres of power of the industrial world. With exception of the Republics of the River Plate and the Atlantic, which were at the beginning more attached to the United Kingdom, the Continent was entirely in the orbit and under the influence of the United States. After the Second World War British influence diminished; but in spite of the fact that Europe was still important for Latin American exports especially for the countries of the so-called southern cone of the Continent, the United States assumed an important role in the supply of imports.

In the decade of the sixties the direction of Latin American trade tended to diversify in major degree. But paralled to this tendency, direct foreign investment from the U.S. assumed a growing importance in manufacturing industry and became a major determinant of the structure of the modern productive sector. The pre-eminence of trade influences has since tended to be replaced by a more effective means: the economic and technological capacity of the multinational (transnational) enterprise.

By 1948[1)] the United States had become the destination of 30% of Latin American exports and the source of 59% of its imports. From 1955 to 1960 the corresponding mean values were 44% and 50% respectively. In 1970 these values decreased to about 30% for exports and

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1) See Indexes of the concentration of external commerce in Kuznets, "Economic Growth of Small Nations", in E.A.G. Robinson (ed.), The Economic Consequences of the Size of Nations, Macmillan, 1960, p.22.

37% for imports. However, the increase in foreign investment was evident. Examining the distribution of the "book value" in selected countries of direct foreign investment according to its origin, Constantino Vaitos[2] found a degree of concentration of United States investment in Latin America which is more or less similar to the concentration of investments from the UK, France and Belgium in countries which up to only a few years ago were their colonies.

In 1967 the US share of direct foreign investment in selected countries of Latin America was: (percent of total)

Venezuela	73.0	Colombia	86.2	Bolivia	82.9
Mexico	76.4	Honduras	97.7	Costa Rica	89.3
Panama	90.8	Dominican R.	81.1	Chile	91.3
Peru	84.4	Guatemala	84.4	(SOURCE: OECD, 1972)	

Underlying these relations there exists a political hegemony which, as Latin Americans have learned by experience, can develop into the most direct and repressive manisfestations. Already in 1823 the so-called Monroe declaration formally established the zone of influence of American imperialism. This declaration did not at first prevent intervention by France and England in this part of America, and even Spain made an unsuccessful attempt to recover its old colonies. Veracruz was bombed by France in 1838; France and England made a joint action in the River Plate in 1839. In 1848 Mexico lost a big part of its territory in a war with the United States, and in 1863 Napoleon III put Maximilian of Habsburg on the throne of that country until his death. One of the factors in this latter intervention, as well as in many others, was (and not merely coincidental) the interests of the foreign holders of the public debts of these very young and poor republics. Even in this century, e.g. in 1902, Puerto Cabello in Venezuela was bombed by England, Germany and Italy as a means of exercising pressure for the repayment of outstanding debts.

The influence of the United States over the Continent began with the end of the Civil War in that country. At first the theatre of action was Central America and the Caribe which, as from then was par excellence the "mare nostrum" of that power, although later on great importance was given to the Pacific. By the middle of last century Walker began his depredations in Central America acting as agent of the bankers Morgan and Garrison. War against Spain started in 1898 and ended with the incorporation of Puerto Rico and the Phillipines and with the so-called independence of Cuba. In 1903 the United States forced Colombia to give up Panama, as a drastic measure in their negotiations for the building of a canal, which they had been planning since the time of the Clayton-Bulwer Treaty of 1850. Then followed a long series of open or hidden interventions which Latin Americans can or will not forget. In recent years these actions end with the blockade of Cuba, the intervention in Santo Domingo and, more recently, the overthrow of the Allende Government in Chile, where we find obvious indications of intervention of the CIA and of a multinational corporation, the ITT.

Economic motivation has never been absent from these open manifestations of domination. An open reminder of this political pat-

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2) "Power, Knowledge and Development Policy: Relations Between Transnational Enterprises and Developing Countries", The 1974 Dag Hammarskjold Seminar on the Third World and International Economic Change, Uppsala, Sweden, 1975 (mimeographed).

tern is a quote from President Taft, who at the beginning of this Century stated that right and just foreign policy of the US "does not at all exclude an active intervention to secure facilities for profitable investments for our merchandise and our capitalists".[3)]

These interventions can take the violent and open form of the cases mentioned or be exercised in a more subtle way in the form of constant pressure to aid the expansion of the economic interests of the metropolitan power. In this context, the Cold War offered a splendid opportunity to inject an ideological content into this influence, consolidating by this means the alliance with the economic interests of Latin American leading groups. The effect of this was always felt in national politics whenever one or the other were in danger.

As an example of a more modern manifestation of this pressure we could quote the suspension or reduction of credits and the direct boycott of purchases of raw materials, which was important and effective having regard to the chronic weakness of the balance of payments of these countries. In analysing such measures it is always difficult to decide which part of the responsibility corresponds to the big multi-national enterprises or which to United States Government Agencies.

This is the normal experience of Latin Americans in their relations with the centre of world power, and it is not at all surprising that this domination is blamed, to a great extent, for their economic backwardness and their political structures. The author is convinced that there is a great risk in attributing many of the errors and tragic irresponsibilities to the effects of dependence, when Latin Americans themselves should be blamed. It is not important whether these errors were committed with foreign complicity or not, but amongst them, the most fundamental is that of not having been able to preserve, (as Brazil succeeded in doing) or at least rebuild a unity which would have opened up the possibility of of taking an active part in the modern world. At any rate, sensitivity about dependence exists and grows from day to day. This dependence, as we have seen, is real and the awareness of it grows especially in the presence of the technological gap which is accentuating the separation of the Third World from industrialized countries. The mastery of technology confers a power which, to those who do not possess it, it seems impossible to combat, not even by isolation, which was the last resort in the struggle against dependence and which meant the exclusive specialization in exports of primary products.

For this reason Latin America oscillates between the poles of ambivalence: either to surrender without any resistance to cultural, economic and technological domination as a price which must be paid for moving forward in the wake of the large powers, or to search tenaciously for a national identity. The latter finds its expression in an effort to recover indigenous cultural values, no matter how faded they are, and to retain the maximum possible control over the utilization of resources and the functioning of the economy, as well as to make an effort to find ways of creating structures of international ties which would strengthen the capacity to face the dominance relationship.[4)]

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3) Quoted by Eduardo Galeano: The Open Veins of Latin America, Publishing Department, University of the Republic, Second Edition, Montevideo, 1972, p.161.

The pointer of the scale is starting to move between one extreme and the other. Ideologically Latin America is getting polarized as never before. The most dogmatic positions are present, and unfortunately also the most irrational, in the concepts of their internal politics. But, nevertheless, in spite of this fact, the pervading awareness of dependence, which is only the expression of a functional insufficiency in the modern world, creates a common basis to make an effort which, of course, tends to get embodied in the acceptance of political "pluralism" in inter-Latin-American and international relations. The search for a coincidence of interests as a basis for a real solidarity is growing stronger from day to day, not only at the regional level, but also in the whole Third World. For Latin America the time is also coming, when the conflict with the old international order must find a way out, either by a constant confrontation, full of risks for all of us, including the most powerful countries, or by cooperation, grounded on a conscience of inter-dependence. The latter development will be impossible if the world powers do not really change their attitude.

No matter which way is taken, Latin America is in need of a profound change; with their actual structure it is not an apt entity to have an influence on the state, on which the bases for an era of co-operation can be forged, and even less when a positive answer is missing and a confrontation must be faced. This certainty arises from the process of introspection which has led many Latin Americans to place so much importance on the analysis of the influence which dependence has on their economic and social backwardness. Some of the contributions which these thoughts have made will be mentioned later as a basis for an examination in that light of the motivations, characteristics and potentiality of some of the Latin American integration efforts. This integration should be one of the fundamental elements of the profound changes which Latin America must undertake immediately.

III

The causes and consequences of dependence are of increasing interest in Latin America and many analyses of it have been made. This paper is only a summary of some of the most important conclusions of these analyses, and distinguishes some differences regarding the interpretation of the phenomena.

The technological breach between the industrialized countries and the Third World is seen by some as the main cause of economic and political dependence, because after all, in the modern world knowledge is in itself a source of power. For others dependence is the result of more complex connections between the "centre" and the "periphery". Of these, the identification of the ruling classes of the periphery with the interests and life style of the industrialized countries is of primary importance. This fact would be at the root of a circular process which tends more and more to deepen technological as well as economic dependence.

The first conception attributes the main reason for the fast growing breach between the rich and the poor countries to the enor-

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4) In respect to this it is interesting to notice that the real creator of the constitution of the OPEP was a Latin American: the then Venezuelan Minister Perez Alfonso.

mous scientific and technological progress which has occurred in the industrialized countries during the last decades. Technological dependence is already large and the resulting economic consequences can not be avoided if direct action is not taken to use the capacity of the less developed countries to participate in this revolution of knowledge. Salvador Lluch says: "It (technological dependence) - though at least apparently not imposed - creates an abysmal disequilibrium which is impossible to control and which is growing in an exponential way".[5)]

The economic consequences for the producers of primary products sharpen the disparities in trade and payments because the innovations tend: a) to reduce the demand for raw materials directly; b) to reduce the relative prices of these raw materials against the prices of the incorporated knowledge in goods, this knowledge being an increasingly important component of aggregate value; and c) to stimulate the rapid expansion of a demand for technology and, furthermore, for knowledge as such - which even without taking into account the imperfections of the market in which these intangible goods are traded has resulted in the value of this type of international exchange growing faster than that of material goods.[6)]

We acknowledge that the economic and political conditions in which this scientific and technological revolution has taken place, have created a critical situation of scarcity in the markets of certain natural resources and have also dangerously altered the ecological equilibrium. But there is no doubt that, by changing these conditions, scientific knowledge will be able to respond adequately to these challenges. In any case, if the third world and the international community does not make an effort gradually to narrow the gap - and that would naturally require economic and social transformations which go farther than a pure technology policy - dependency will continue to grow. Its obvious relation with the political hegemony is emphasized in a sentence of a document of the Andean Group on the subject: "In relationships between countries, the subtle line which distinguishes interdependence from the state of dependence undergoes continuous variations, depending on the extent of access to scientific and technological progress and the degree of real use which can be made of it".[7)]

The second interpretation mentioned, which on some points coincides with the previous one, starts from the observation of the problems of the economic evolution of Latin America during the latter part of the sixties, in particular the growing divergence of standards of living between the small ruling groups and the large poor majorities. This phenomena has tended to emphasize increasingly the analysis of the phenomena of "modernization", as being different from development and, consequently, one of its factors: the situation of "external dependence".

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5) The Integration and Challenge of Knowledge", Junta del Acuerdo de Cartagena, 1974 (mimeographed).

6) Lluch, op.cit. page 4 mentions the case of computer systems, for which the annual value of software sales including the training of personnel, matches the estimated values of sales of equipment (hard-ware).

7) Junta del Acuerdo de Cartagena ... Fundamentals of a Subregional Technological Development Policy, COM/XIII/dt2, Lima, Peru, 1974 (mimeograph) p.5.

The "modernization" of poor countries is seen by some, such as Sunkel, as part of the development of an international capitalistic system, which from the beginning "starting with the XIX century, put the world economy under the influence of a few European countries and the U.S.A.".[8]

"Modernization" according to others, is the process that results from the identification of Latin American "elites" and increasingly of the small middle classes with the expectations created by the evolution of the consuming society in the industrialized countries without having the capacity for technological progress nor the corresponding structure of the productive system.

Celso Furtado, one of the exponents of this thesis, refers concretely to these contrasts between the desired style of life and real production conditions, and adds that modernization is the "process of adoption of sophisticated consuming patterns (private and public) without the corresponding process of capitalization and progress in production methods".[9]

In both interpretations attention is centred on an identification of interests and preferences which, in the case of underdeveloped countries, tends to perpetuate the structure of inequality and backwardness.

It is a case of assimilation of demand and consumption patterns from the rich or "central" countries by the high income groups of the "periphery". Even if regarded, in a restricted form, as "demonstration effect" or, more generally as domination or cultural colonization, this phenomena, without doubt, is considered in the case of Latin America, as the nucleus of external dependence and one of the essential factors of underdevelopment in Latin America due to the fact of what Furtado[10] calls "the pre-existing institutional structure as regards the concentration of wealth and income".

This imitation of consumption behaviour could have a powerful influence in reinforcing these inequalities, not only because in poor countries with a low average income, that income must, by definition, be badly distributed so that a very small part of the population is able to imitate the patterns of demand and consumption of rich societies, but also because the constant diversification of these patterns, the continuous appearance of new products and consequently the obsolescence of others accentuates the differences and creates other disequilibria in the system, some of which provoke an even bigger dependence with respect to the "centre" as the source of capital and technology.

This connection between centre and periphery is, of course, nothing new. Latin American "elites" used to imitate the most costly ways of spending of the rich countries in the peak periods of export of primary products. The capital needs to maintain those exports were then fairly small, and used to depend much less than now upon imports. Surpluses originated in the increase of productivity, which, as a result of the industrial revolution, made international specialization possible, and were sufficient, not only to maintain the functioning of the system, but also to satisfy the consumption

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8) O. Sunkel, Foreign Affairs, Vol.50, No.3, April 1972, p.521.

9) The Myth of Economic Development, Editora Paz e Terra, Rio de Janeiro, 1974, p.81.

10) Op.cit. p.13.

expectations of these groups, which at the beginning constituted not more than a few dozen families in each country.

According to these theses, disequilibrium between the demand requirements of the system and its real productive capacity arose at the stage when, due to the increasing market difficulties in the primary export sector, import substitution policies were initiated. The evolution of these policies is well known. A diversified or rather dispersed industry was created, without real vertical integration or technological requirements, which superficially "mimicked" - as Furtado said - the industrial structure of the rich countries. High cost protected industries, which required both directly and in respect of infrastructure investment requisites which hardly could be satisfied given the weakness of the motives for the formation of capital and problems of the balance of payments which restricted access to the imported component of that investment. To overcome those problems dependence on foreign capital and technology increased.

According to this view, this process is the essence of the "modernization" which certain sectors of economic activity have experienced. This has created a deep division in Latin American societies which goes much farther than a "technological dualism", a disequilibrium at the level of the factors, constituting a real cultural breakdown between on the one hand the leading groups, which are eager to follow the consumption patterns of the rich economies, and on the other the big marginal majorities, especially the peasants, which live literally in another world.

The foregoing analysis for reasons of brevity leaves aside socio-political elements such as the interrelationships between the social groups in each country and external groups, as well as the displacement of some ruling groups by others, phenomena which, without doubt, contribute to explain the different variations the process has taken in Latin America.[11)]

It is a fact, for example, that in certain circumstances a tacit agreement existed between management and certain sectors of organized labour. But this has not changed the situation of the mass of the population, and it is possible, on the contrary, that the effect of margination has been to worsen it.

It is not the occasion to go deeper into this subject. For the purposes of this paper it is sufficient if we point out that this analysis insists on the fact that cultural dependence is reflected in an increasing dependence on foreign capital and technology. It increases because with industrial growth and the adaptation of industry to the diversifying demand of the high income groups and in spite of the concentration of income the necessities of capitalization press more and more on the capital formation capacity of the system in absolute terms. Furthermore, the necessity to secure access to foreign technology, to facilitate the continuous emergence of new products which is characteristic of a consuming society, is growing day by day. At the beginning, that access is nothing other than the acquisition of capital goods which incorporate that tech-

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11) The literature on this topic is already abundant. As an important exponent see Fernando Enrique Cardoso and Enzo Faletto, Dependence and Development in Latin America, XXI Century, Editors, Argentine, 1973.

nology; later on that access means attracting multi-national enterprise and depends heavily on its innovative capacity. When the existing protection is given, the dimension of the economy is sufficient to initiate the production of intermediate and capital goods, a step which is ordinarily taken under the pressure of balance of payments limitations. Even if this has not been the only nor the main reason, Latin America's experience shows that dependence on foreign capital and technology, as has been outlined, has strengthened even more.

The effect of external domination is therefore much more powerful. A new international division of labour is being imposed in the world by the action of the multi-national enterprise. As Stephen Hymer said, these "are a substitute for the market as a method of organizing international exchange".12)

For the same reason, their action not only contributes to harmonising the demand patterns of high income groups with those of capitalistic countries, but also tends to directly mould the productive structure and to adapt it to the developing exchange net of manufactured products which they organize, and which until now rested fundamentally on the possibility of obtaining fairly cheap labour. No matter what are the merits of recent policies giving priority to exports of manufactured goods in many Latin American countries, the fact is that this priority is directly related to the interests of the multi-national enterprises and that their actions will determine the directions of specialization.

There is no doubt that analyses of the dependence problem imply a deep questioning of the economic basis on which the development policies of Latin America have rested in the last twenty years. Centering the problem on the phenomenon of cultural influence or domination, many of the economic variables, which were of great importance in Latin American politics pass to a secondary place. The necessity of industrialization, for example, is not questioned, but the essence of the industrialization policies followed, which were confined to responding to the demands which the system was spontaneously creating, should be questioned. Similarly, the efforts to increase the flow of external finance and to stimulate the expansion of commerce of the less developed countries, even in manufactures, would only have the character of temporary palliatives in a basic situation of underdevelopment. From this standpoint, even the idea of economic integration - in theory so dear to Latin America - would lose its real importance for development efforts. As regards integration attempts as a means of overcoming the relative smallness of national markets, Furtado says that "in some cases they permitted an extension of the process of import substitution, but they did not modify the fundamental problem, which is rooted in a situation of dependence".13)

It refers to a structure with a cultural dimension resistant to solutions which do not go to the root of the problem: the real possibility of the existence of a diversity of systems of values, i.e. a cultural diversity in a world, which is getting more and more united through the power of communications. Logically, this implies that the first requirement for a development policy must be to suc-

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12) "The Efficiency (Contradictions) of Multinational Corporations", American Economic Review, Vol.LX, March 1970, p.441.
13) Op.cit. p.91.

ceed in obtaining a modification of the consumption patterns in order to differentiate these from the most advanced capitalistic economies. The depth of the socio-political change which such an objective would demand, is defined by mentioning, as Furtado does, that the formula for "progressively reconditioning consumption patterns as to make them compatible with the desired accumulation effort", corresponds, in its pure form, to the so-called "chinese model".[14]

It is not appropriate to analyse here the feasibility of that solution for Latin America, but simple to state it as one of the options of economic policy. But it is appropriate, on the other hand, to point out the critical elements of these analyses because they have begun to weigh more and more heavily in the worries and preoccupations of Latin Americans.

It is clear that the last twenty years have not brought about a real change in the prospect of building prosperous and just societies in Latin America, but have reinforced the situation of external dependence. In spite of the material progress reached by some countries (income per capita has grown quicker than in the rest of the less developed world) the lack of the system's equity is so notorious and the structure, on which the economy is based, so unstable, that there are reasons enough to question so-called development policies. Apart from the unresolved problems of poverty and oppression, these policies are being criticised for their passivity as regards dependence on foreign technology and also on foreign capital, which, as emphasized earlier, is still increasing, even during the prosperous periods which some Latin American countries have had.

Latin America was the first of the developing regions in the world to create a regional financial institution, namely, the Bank for Inter-American Development (BID). Because of balance of payments problems, which were especially acute during the fifties, Latin America insisted on an increase in the flow of public financing, (that was the reason for the creation of the BID) and on the urgent need to establish an international structure for co-operation with a view to securing stability of markets for primary products, and to obtain access to markets for their industrial exports. The creation of the UNCTAD was primarily an action of Latin American origin.

If little or nothing significant has been achieved since then with regard to commercial co-operation, it would not be possible, in all fairness, to say the same of public financing. This increased moderately but constantly during the sixties. But this increase, however, was not enough to avoid an increased demand for the "hard" financing of suppliers credits. The problem of external debt and rising trade deficits became more prominent and moreover instability in primary product markets was not moderated. Forecasts showed the presence of an increasing and progressive shortage of external resources, and this induced demands for an increase in external financing (preferably on concessional terms) as well as for the creation of internal and external conditions more favourable to the export of manufactured products. Several countries adopted resource allocation policies aimed at stimulating these exports, though in some cases that was only possible with heavy subsidies.

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14) Op.cit. note 1, p.91.

For this reason this was a favourable time for the activities of multinational enterprises in most Latin American countries. The production of more complex goods, and the priority given to the export of manufactured products, resulted in an almost natural effort to attract them. It should also have led to a strengthening of integration schemes which were already functioning - the Latin American Free Trade Association (LAFTA) and the Central American Common Market - but the basis on which they were established: a simple freeing of trade among different systems, was not adequate to give all countries confidence in the benefits. The first signs of restlessness appeared then between the Andean countries which came together in a new group on different bases. Further on more will be said about this integration effort.

Nevertheless, by the end of the sixties several countries had changed the emphasis in their economic policies, especially Brazil. In spite of the inertia of the past, the tendency to open the economy to the outside in search of a better resource allocation to encourage exports started to spread. The effects of this change were not reflected in the balance of payments, and the amount of external debt combined with the remittance of foreign investments, was still a point of concern in this new style of economic expansion.

World events in the first five years of the seventies underline the critical elements of the analysis of dependence. From 1969 to 1973 the expansion of Latin American exports reached figures which have no precedent since the end of the Second World War. A good number of countries shared this tendency. A few of them, especially Brazil and Mexico, but also medium-sized countries such as Colombia, substantially increased their exports of manufactured goods not only to other countries of the same region, but also to the rest of the world. Export receipts overall also grew faster than they had previously and by comparison with the rest of the developing world.

Nevertheless, by the end of 1973, when neither the effects of the world inflation nor the impact of the oil price increase were still fully felt, the amount and structure of external debt was already a nightmare for many countries. Amongst them were Brazil, Mexico and Argentine, which are relatively large economies, with a considerable production of capital goods and intermediate products. Furthermore, notably in Brazil, but also in other countries, the political system favoured a growing concentration of incomes as well as a high rate of capitalization. But in spite of this fact, it was especially in those countries that the growth of payments for external debt and the remittance of investment reached even more spectacular proportions. In Brazil just the disbursed external public debt grew from US$2,730 million to US$4,890 million between 1970 and 1973; in Mexico during the same period, from US$2,960 million to US$4,000 million; and in Argentine from US$1,800 million to US$2,600 million.

It is not strange that one of the facts to which most attention has been paid in this scene of actual or potential payment problems, is the growing weight of the remittance of dividends of foreign investment and the rapid increase of payments for technology which in the countries which have been most successful in attracting foreign investment, have multiplied in a few years. In 1972 Brazil paid for this 34.5% from its export income. If we add to this the repayments of external debt, the payment coefficient was 47.9% of exports.

Mexico remitted 17.9% for that item, and its total payment coefficient was 41.4%; in Argentine the corresponding figures were 12.1% and 34.3% respectively.

As long as it was possible to dispose of enough fresh capital to compensate for these payments, the problem was of a potential character only, and that was the case of Brazil which was at a climax of its economic expansion. The great upheaval which the world economy suffered since 1974, has changed the situation radically and in this, as well as in other cases, the problems of dependence have really come to light. Price increases for food and oil, as well as in general the effects of international inflation on the prices of imports, greatly affected Latin American countries with the exception of Venezuela and some other small oil and sugar exporting countries. In 1974 the situation showed a decrease of reserves and a steep increase in external debts. Recent data show that by 1974 the external public debt of Mexico reached nearly US$8,000 million, and in Brazil the total external debt would be US$17,200 million. By June 1975 the debt had apparently reached US$19,500 million.[15] The serious economic recession in the industrialized countries is already being felt in Latin America and this time the way of spreading of the phenomena from the centre is not only the foreign market, but a much more direct and sensitive tie: the activity of the multinational enterprises.

IV

The problems of dependence which have been analysed for Latin America are the same, with differences in degree, as those endured by all of the Third World. Perhaps the effects of cultural domination are felt more acutely in Latin America for its leading classes have always been identified with Western cultural traditions and because, proportionately, the population influenced by the consumption standards of rich countries is higher than in other regions. However, the basic conditions of dependence are the same as with the rest of the Third World for they desire from a situation of increasing inequality in the distribution of world wealth and in the opportunities offered by science and technology.

This is why solutions for the problems of dependence and, in the final analysis, of underdevelopment cannot be contemplated in isolation from the efforts which the world is capable of making to find new orientations and to construct a new international economic order which will turn interdependence into solidarity. For the purposes of this paper we are interested in highlighting only some aspects of the responsibilities accruing to underdeveloped countries in this future action and, basically the need they have to establish forms of cooperation among them.

From the start, I exclude the possibility that the countries of Latin America, to break the consumption habits of their privileged

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15) The data for Brazil are not comparable with those covering its debt for 1970-73, which refer exclusively to the public debt already disbursed. Not enough information is available for Mexico to determine if they are comparable. In any case, all indicators show very sharp increases of external debt for most Latin American countries.

minorities, will have to become isolated from Western cultural influence, to which traditionally they have belonged with no real valid alternatives since colonial times. To have this tradition, this attitude towards the world does not determine a road towards political ideologies such as capitalism, nor to deformations as the consuming society. They are forms of an evolution which took place in typical historical dircumstances wh'ch our countries cannot re-edit, even if they wished to do so. The capitalist countries themselves have started to react against consumerism and, sooner or later, the Third World will have to reflect the change that seems to be in the offing.

What does happen is that since isolation is impossible and undesirable for as long as those patterns prevail in the industrialized countries and persist in our nations' leading groups with their present privileges, the phenomenon of dependence will continue to evolve through the elements already described and with its whole accumulate nature. It is evident that to find viable and stable political solutions to this need for change is extremely difficult, not only because of the internal resistance of the affected groups but also because of the support they receive from hegemony centres. The terrible conflicts of these struggles, the extremes which might be arrived at on either side are a daily event in the Latin America of today. The hope is that gradually non-dogmatic attitudes will prevail, that do not imply the transfer from one hegemony centre to another, that are able to bring about real changes without going through chaos and that are capable of developing their own political and institutional schemes which will give rise to authentic democratic forms of popular participation. An essential component will be economic, scientific and technological policies designed to attain progressively a greater decision-making autonomy.

However, owing to the same weight of political and economic dependence, it is not only the isolated national action which can assure success in these endeavours which, in themselves, are enormously complex. The opposition of external centres, be they governments or enterprises, is a fact of the problem, because many of the measures required by this change will inevitably affect their interests. Neither is it in the domain of single national economies, which in most cases are not large enough for the scales of activities required by modern industry, science and technology, where the new economic structure required to participate without cumulative imbalances in the international trade of goods and know-how may be built.

These functional shortcomings, vis a vis the political, economic, and technological parameters of the sphere where these actions have to be deployed, pose the problem of the adequate size of States or, more precisely, the scope of governmental jurisdictions. If we assume - and this assumption is the basis for this paper - that within the limitations imposed by interdependence the achievement of greater decision-making autonomy is a preference of Latin American nations: a public or collective good which they must strive to attain, the question which immediately arises is the scope of governmental jurisdiction adequate for these objectives. In fact, given the context in which this action will take place, this objective combines two social preferences which can be considered as instrumental but which, in themselves, are public or collective goods with their own demands with regard to the scope of governmental jurisdictions. The first is to increase bargaining capacity in

its broadest sense, knowing that both "confrontation" as well as cooperation on an international scale imply negotiations. The second preference is the development of science and technology, of knowledge in itself and its application, for only they can build up the foundations for that autonomy. To the extent that industry, efficiently managed, is the activity that better encourages and incorporates the production of technology, this option is simultaneously a preference for industrialization, determined also by the other possible economic effects of industrialization which we shall not describe now.

The first objective, to increase negotiating power, must give rise to a diversity of forms of associations of states, some of which may go beyond the boundaries of a region, for example, Latin America, to link up with the action of developing peoples in other parts of the world. A good example would be OPEC. These associations may have a purely or basically political nature, e.g. the "Non Aligned Countries", or pursue concrete economic objectives, such as in the case of producers' associations. The scope results from the objectives set up and the broadening of the necessary governmental jurisdiction is limited to the action needed to attain them. To this same extent the degree of conflict among the members, unavoidable in this broadening which implies a potential or real giving up of sovereignty, is generally less than that implied by deeper cooperation efforts, such as the so-called economic integration schemes and, therefore, make it relatively easier to set these groups up. Of course we are not excluding the possibility that the objective sought be of such importance and complexity and be so demanding as to the increase of the necessary negotiating power that it may only be feasible through the close inter-dependence and solidarity implied by these forms of integration. An example of this would be the action to set up common rules for multinational enterprises. But this is a special case of these associations of States being inspired by the desire to attain a better international negotiating position. We shall refer to this later. In general terms it can be said that the limited objectives of these associations give them more flexibility and it could be expected that given the world situation their number will increase in the future.

As regards Latin American countries it is obvious that this will take place if some of the consequences of dependence are to be counteracted. It is not always easy to do so, as is evident from the problems found in the creation of UBEC (Union of Banana Exporting Countries). But the need is felt and there are many efforts under way in this regard: the creation of SELA (Latin American Economic System), for economic and political objectives, among others, and coordination of positions _vis a vis_ negotiations with the United States, is a symptom of this trend, which becomes even more significant since it is taking place concurrently with the crisis of the Organization of American States (OAS) of which the United States is a member.

The problem of the size of nations or states really arises when they are related to the second class of preferences mentioned above which, to simplify things, we shall call preferences for industrialization and technological development. The element becomes significant given the relationship of manufacturing industry and technological development to certain technological factors such as economies of scale and externalities. Here is when the most complex forms of association of states to constitute a single market or a

single economic space by means of economic integration, become relevant. And it is in dealing with them when the generic name of Latin America, which up to this point in this paper has been used as related to phenomena of general scope such as dependence, must give way to the diversity of situations of the countries which form this continent.

Initially it can be stated that without the support of schemes of this type none of the countries of Latin America has the necessary size to develop its industry and its technology in such a way as gradually to reduce the gap between them and industrialized countries, that is to say, to attain the relative decison-making autonomy which is compatible with the interdependence of the world economy.

It would be futile to try to determine an optimum size for a state, even if we limit ourselves to the relationship between the size of an economy and the economic development achieved, no matter how it may be defined[16]. However, in view of the political and economic fact of dependence, above all if it is increasingly due to technological backwardness, it is reasonable to admit prima facie that the advantages favour the large state in terms of economic size, regarding which the gross domestic product could be an acceptable rough indicator for these purposes.

This disadvantage of the small state vis a vis the large state in its efforts to avoid economic and political dependence is a fact which requires no proof. The political effects of this vulnerability are evident. It could very well be stated with Leduc and Weiller[17] that "a small nation should best be defined as one which is unable to resist outside influences and which must accept the worst of them together with the best".

As is logical, with population growth, economic development and technological change, the scales of reference to define large and small states, world powers and dependent countries, have changed with time. For example, K.J. Beloch in studying XVIIth Century Europe and the characteristics of the three major powers which were then struggling for supremacy: The Ottoman Empire, the Spanish Empire, and Louis XII and Richelieu's France, comes to the conclusion that about 17 million people was the population level that had to be attained by a State to hope for the role of a major power.[18] We would have to multiply this figure many times to be able to arrive at an equivalent in population for the major powers of today. Looking at the other extreme, the small country, and bearing in mind only the economic effects but with similar indicators, by 1960 Kuznets called any country of a population of 10 million people or less, a small country. He recognizes that this is a rule of thumb and highlights the changes in size with time in stating "were I to draw

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16) See, for example, C.N. Vakil and P.R. Brahmananda, "The Problems of Developing Countries", in E.A.G. Robinson (ed.), The Economic Consequences of the Size of Nations, op.cit., p.135

17) C. Leduc and J. Weiller, "The Size of the Economy and its Relation to Stability and Steady Progress: II", in E.A.G. Robinson, (ed.), The Economic Consequences of the Size of Nations, op. cit., p.218.

18) Quoted by Fernand Braudel, "Capitalism and Material Life, 1440-1800", Harper and Row, Great Britain, 1972, p.23.

a hundred years hence, the dividing line would be far higher, assuming no devastating demographic catastrophe".[19]

Only 15 years after this definition the dividing line must already be much higher. It is not only a question of a constant increase of the optimum scales of activity of many industries (the chemical industry is a case in point) but rather of the development of more complex products, with a high content of scientific and technological know-how which is at the disposal only of the larger nations. Of course the value of those products is much higher than the value of the products they replace. A good example can be found in the armaments industry; on the one hand it illustrates this type of innovation while, at the same time, it serves as an index of the expenses incurred, rightly or wrongly, by a state for its defence and security. A United States fighter plane used in the Korean War cost roughly 53,000 dollars; in 1971 a fighter plane was worth 5 million dollars. A submarine went from a cost of about 5 million to 170 million dollars.[20] Many other examples could be given. As stated by Lluch "(technological) change allows for effective sovereignty only for those nations who can carry out very important economic efforts. This is equivalent to stating that its enforcement is reserved not only for the rich but also for the large".[21]

As can be seen in Table 1, the largest country in Latin America, Brazil, with over 100 million people, has a total product which is no more than 50 percent higher than that of Spain. The whole of Latin America is equivalent to the Federal Republic of Germany. Comparisons become even more relevant if they are based on demand data which qualifies the rough indicator, the GDP, considering, among other elements, the effect of income distribution. Table 2, taken from a recent paper by ECLA,[22] shows that the demand for non-electric appliances for the whole of Latin America for 1970 amounted to 65 percent of the demand in France. It was higher than France in chemicals, but in that case, even the largest country, Brazil, was scarcely higher than 50 percent of French demand. The differences are enormous, of course, for medium-sized countries in the Latin American scale, such as Colombia or Peru, and for the small ones, Ecuador or Bolivia.

It is evident that the fragmentation of Latin America is a powerful brake on industrialization and it becomes increasingly more so to the extent that technical progress is reflected in more sophisticated processes or in an enlargement of production scales. Commenting on Latin American Industrialization ECLA has the following to say: "Production of a large quantity and diversity of goods has grown considerably. But all of them definitely depend on a technology which is totally generated abroad and which is imported with little or no adaptation through the capital goods in which this technology is embodied".[23] This even applies to clothing and food products.

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19) Op.cit. p.14.
20) Salvador Lluch, Op.cit., pp.2-3.
21) Op.cit. p.3.
22) Economic Commission for Latin America, "Integration, Import Substitution and Economic Development of Latin America", ECLA/PC/DRAFT/109, April 1974 (mimeographed).
23) Economic Commission for Latin America, Op.cit., p.15.

Part of the blame for this type of industrialization must be attributed to the import substitution policies restricted to small domestic markets which have been referred to before. But even if an attempt at specialization had been made, with all the risks involved, these efforts would not have found an adequate environment intthe size of a good part of Latin American economies. This is due to the fact that to gradually create the capacity for innova-

TABLE 1 LATIN AMERICA AND DEVELOPED COUNTRIES

BASIC PARAMETERS - 1973

Latin America*				Developed Countries			
COUNTRIES	Gross Domestic Product 1/	Population (Thousands)	Gross Domestic Product Per capita $US	COUNTRIES	Gross Domestic Product 2/	Population (Thousands)	Gross Domestic Product Per capita
Bolivia	1.431	5.147	278	Germany	210.190	61.967	3.392
Colombia	13.672	24.327	562	Belgium	29.570	9.742	3.035
Chile	7.932	10.261	773	Canada	98.360	22.125	4.446
Ecuador	2.766	6.649	416	Denmark	17.640	5.027	3.509
Peru	8.353	14.452	578	Spain	39.710	34.730	1.143
Venezuela	14.036	11.524	1.218	United States	1136.900	210.404	5.403
Subtotal				France	171.530	52.177	3.288
ANDEAN GROUP	48.190	72.360	666	Italy	103.350	54.888	1.883
				Japan	252.230	108.350	2.328
Argentina	32.012	24.720	1.295	England	134.720	56.021	2.405
Brazil	58.023	103.613	560	Sweden	35.110	8.138	4.314
Mexico	53.630	55.460	967	Switzerland	22.780	6.431	3.542
Costa Rica	1.376	1.888	729				
Dominican Republic	2.086	4.795	435				
El Salvador	1.625	3.860	421				
Guatemala	2.677	5.782	463				
Haiti	592	5.585	106				
Honduras	835	2.831	295				
Nicaragua	956	2.168	441				
Panama	1.554	1.586	980				
Paraguay	960	2.500	384				
Uruguay	2.640	2.990	883				
TOTAL LATIN AMERICA	207.157	290.138	714				

Notes: 1/ Gross Domestic Product at factor cost expressed in US$ at 1970 prices and rate of exchange.

2/ Gross Domestic Product at market prices expressed in US$ at 1970 prices and rate of exchange.

* Excluding Cuba and English speaking Caribbean countries.

Prepared by: Board of the Cartagena Agreement - Programming Department.

Sources: Economic Commission for Latin America, Latin American Development and the International Economic Situation, 21 February, 1975 (for the Latin American data).

O.E.C.D., Observer, No.74, March-April, 1975.

TABLE 2 COMPARISON OF MARKETS OF NON ELECTRIC MACHINERY AND CHEMICAL PRODUCTS BETWEEN LATIN AMERICAN COUNTRIES AND SELECTED DEVELOPED COUNTRIES*

	NON ELECTRIC MACHINERY						CHEMICAL INDUSTRY					
	Data Year		ID. (Millions of US$)	GPV (Millions of US$)	Population (Millions)	ID. per Inhabitant (Dollars)	Data Year		ID. (Millions of US$)	GPV (Millions of US$)	Population (Millions)	ID. per Inhabitant (Dollars)
United States	1967	(Current US$)	46,938	50,000	198.7	231 a/	1970	(Current US$)	45,107		198.7	227
France	"	"	4,471	4,292	49.6	90	"	"	6,541		49.6	132
Italy	"	"	1,965	2,570	52.3	38	"	"	6,282		52.3	120
Spain	"	"	1,041	481	32.7	32	"	"	2,913		32.7	89
Latin America	1970	(1960 US$)	2,938	1,087	238.2	12	"	(1960 US$)	8,373	7,208	238.2	35
Brazil	"		1,026	649	93.3	11	"	"	3,518	3,259	93.3	38
Mexico	"	"	535	131	50.7	10	"	"	1,851	1,598	50.7	37
Argentina	"	"	363	123	24.4	15	"	"	1,337	1,297	24.4	55
Venezuela	"	"	362	26	10.8	34	"	"	495	303	10.8	46
Chile	"	"	190	44	9.8	19	"	"	222	114	9.8	23
Peru	"	"	184	79	13.6	14	"	"	362	287	13.6	27
Colombia	"	"	175	26	22.2	8	"	"	399	254	22.2	18
Ecuador	"	"	43	1	6.0	7	"	"	82	33	6.0	14
Uruguay	"	"	33	5	2.9	11	"	"	88	55	2.9	30
Bolivia	"	"	28	3	4.7	6	"	"	21	8	4.7	5

Note: Internal Demand = ID = GPV ÷ M - X
GPV: Gross Production Value
M: Imports
X: Exports
a/ Argentine production figures seem to be underestimated.

Source: Document ECLA/PC/DRAFT/109: *Integration, Imports Substitution and Latin American Economic Development*, Economic Commission for Latin America, April 1974.

tion along the lines of some specialization, presupposes having available a technological "critical mass" which does not exist in most, if not all, of the Latin American countries due, among other reasons, to their size.

The influence of the economic size of a country on technological development in its different manifestations: market, governmental financial capacity, etc., is a fact, even though it is difficult to measure. Attempts have been made to develop some quantifiable elements of this "critical mass" such as the minimum necessary infrastructure of research,[24)] but the evidence derived from the economic evolution of the industrial world is so overwhelming that it scarcely needs any measurement. For example, the information revolution caused by cybernetics not only demands enormous expenses to continue in constant innovation but its effects have multiplied managerial capacities creating new scales in many economic activities. On the other hand, the development of engineering services, which are so important for technological development, requires stable demands which will make possible functional specialization.[25)] Lastly, we have the economic capacity of the government and of major enterprises which finance the enormous expenses of scientific and technological research which are the backbone of the economic growth of industrial countries.

Among Latin American countries Brazil would seem to be near the size in which it is possible to start some activities and to implement policies designed to gradually create its own capacity for technological development. Because of its size it can concentrate public resources in significant amounts to this purpose and, through its rapid growth in the last ten years, it has become a market which is sufficiently attractive to pursue consistent policies with regard to technological imports, to maintain engineering and consulting services of international scope, and to develop activities having certain technological content, such as for example, production of automobile engines for export. The contract recently signed with the Federal Republic of Germany for the installation of an uranium enrichment plant emphasises that this country is getting close to a threshold of capacity in technological development. For the time being and in this area it is the only illustration of national vitality in Latin America.

Even so, despite its size, Brazil is not a country which has been able to significantly reduce its dependence on the centres. As stated before, the policies followed have made this dependence more evident in certain ways. All of this indicates that intensifying efforts for cooperation and, more properly, for integration is one of the conditions for a future dynamic evolution of Latin America.

It has already been pointed out that Latin America's experience in its first attempts at economic integration have generally been discouraging. The Latin American Free Trade (LAFTA) formed by 11

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24) Amilcar Herrera, Science and Policy in Latin America, XXI Century Editors, Mexico, 1971.

25) F.R. Sagasti, "Economic Integration and Technological Policy: The Case of the Andean Group," Integration Magazine, Institute for Latin American Integration, Vol.VIII, N° 18, January 1975, p.173

countries of different sizes and degrees of development was set up in 1960 for purposes of establishing a free trade area. At the same time the Central American Common Market was launched with all the countries of that region with the exception of Panama, which are certainly much more similar as regards size and economic structure than are the LAFTA countries. In both cases the basic integration instrument was the opening of markets by means of the gradual liberalization of trade. Basically, both were inspired in the "classical" integration formulas, conceived both on the theory as well as on the experience of developed countries, especially the European Economic Community.

These two integration efforts, after promising beginnings, have ended by getting bogged down and, in the final analysis, the major cause seems to be the same: neither of the two had effective instruments to influence in the allocation of the benefits and costs of integration. Some countries, the largest ones in the case of LAFTA - Brazil, Argentina and Mexico - and those relatively more advanced in the Central American Common Market, tended to reap all the benefits of integration, which was reflected in the increasingly defensive attitude as well as an increasing resistance from those countries which felt deprived. This situation, with only a difference in timing in both cases, was reflected in a halting or a reversal of the process. It is not strange that in both cases the actions of multinational enterprises have contributed to this concentration of benefits in one or a few of the member countries, given their capacity to profit rapidly from the possibilities which these efforts could offer them, settling in those areas which were already more developed in the countries which were also more advanced.

It is not the time to evaluate these experiences in detail. It is enough to point out that from them a new concept of the characteristics of a formula for economic integration among developing countries emerges, a concept which is different from that suitable to rich countries. In the case of developing countries, integration is now beginning to be seen as a means to build an industrial base which is totally different from the existing one and to encourage a gradual technological development; it is increasingly becoming one of the means to reduce foreign dependence. Integration among industrial countries may have been partially motivated by political objectives, e.g. a defense of their autonomous decision-making capacity at an international level - as it was the case in the ECC - but the system to implement it in the economic field has been directed mainly to bringing about an improvement in the efficiency of activities already inserted in a mature industrial structure, by means of market enlargement.

These new concepts have already given rise to two regional groups in Latin America: The Andean Group and the Caribbean Community, and are also influencing the work which is being carried out at present to redesign the Central American Common Market and, to a certain extent, LAFTA. The Andean Group can be considered as representative of this new thesis of economic integration among developing countries, a thesis whose scope is certainly not limited to Latin America. This is why it would be worthwhile to briefly discuss their major elements.

The Andean Group is formed by six countries of South America: Bolivia, Colombia, Chile, Ecuador, Peru and Venezuela which, by 1974, had a total population of 73 million people with a total gross domestic product of approximately 50 billion dollars, that is to

say, the equivalent in economic size of the two largest Latin American countries, Brazil and Mexico. The States which form part of it are also members of LAFTA. Both schemes are compatible[26], and thus the Andean Group is a sub-regional grouping within the context of a larger region, in this case nearly all of Latin America. The six countries are medium or small sized as compared to Brazil, Argentina and Mexico, their partners is LAFTA.[27] This fact led them to join forces in the Cartagena Agreement which was signed in 1969 and came into operation as of 1970.

As a grouping of countries they expressly follow the priorities mentioned in previous pages: a) to create a new economic space which will make possible a change in the structure of economic activities, consistent with the preferences for industrialization and technological change; and b) to obtain an increase in the negotiating capacity in foreign policy, mainly as regards the transfer of technology and multinational enterprises. This is the first time that an integration scheme among developing countries is directed concretely to these latter aspects of foreign relations setting up deadlines for the implementation of some common measures, for example, the adoption of a common system as regards foreign investment.

The scars left in these countries by their experiences in LAFTA led them to the commitment of maintaning within their integration scheme an "equitable" distribution of the benefits and costs. It is therefore a question of reconciling efficiency with "equity" in the creation of a new structure of activities. To this end a preferential system to the benefit of the weaker countries was set up. The purpose is that all member countries, whatever their relative strength or weakness may be, participate in the creation of the new industrial base and in the opportunities which the new space implies for technological developments. This "equitable" participation was considered essential to maintain the stability of the grouping and the priority assigned to this objective meant, as commented below, a radical change in the policy instruments which until that time had been usual in integration.

In effect, the integration effects of the market forces unleashed by the liberalization of trade, has a secondary role in this formula, at least as pertains to the most important industrial activities. In these, the allocation mechanism is a system of regional planning which must set down the allocation of specific manufacturing industries among the countries by means of what are called the industrial sectorial programmes. In the sectors under programming reduction of customs duties has, therefore, a secondary nature, as well as other complementary measures. On the other hand, liberalization of trade is a major instrument for the remaining activities which are, above all, those already established in the countries.

This combination of instruments highlights the originality of the Andean Group system and is reflected in its instruments and institutions. Joint planning cannot exist without a planning organism which should also be of a collective nature. To perform such function, this agency must not only have the required power but also have the exclusive capacity to initiate. This is the Board of

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26) In the sense that, for example, Benelux, is compatible with the EEC.

27) See Table 2.

the Andean Group formed by three persons and their staff. The voting systems chosen, which do not require unanimity, except for some limited cases, makes the Board's authority to submit proposals a very efficient working tool.

The system has been in operation for over five years. Customs duties reduction has progressed at the rate decided upon in the Cartagena Agreement. Trade among the countries of the Group, which initially was very low, has been multiplied several times and is at present close to one billion dollars with a high component of industrial products. The weaker countries participate in it. Action vis a vis foreign dependence has been translated into the adoption of common regulations for foreign investments, patents and royalties. This is Decision 24, which is very well known in international circles. Common regulations on industrial property have been adopted, as well as a system of Andean multinational enterprises and an agreement on double taxation. The Group has furthermore implemented a common technological policy which, for the time being, has concentrated on: a) improving the systems for importation of technology, not only to save in these transfers, but also to encourage the development of engineering services and the manufacture of capital goods; and b) gaining experience in the adaptation and creation of technology by means of specific technological development programmes linked to the economic priorities of the area. Two of these are already under way: one on copper refining and the other on the utilization of tropical timbers. Action in the area of technology is only a modest starting point in such a complex field, but this is also the first time that a grouping of countries tackles it in a systematic manner.

As could be expected, industrial planning has been the most contentious and most complex element in the work of Andean Group. The first sectoral programme pertaining to the metal working industry was approved and is being implemented. Recently, the petrochemical programme was approved after a long period of negotiations. Two very important sectoral problems are under discussion: the automotive and the fertilizer programmes, and their approval seems to be near. In fact, already the Group has overcome the major obstacle to all integration efforts among developing countries: reaching consensus in the allocation of industrial activities.

This description, which covers only the most significant aspects in the evolution of the Andean Group may be used to define the probable direction of cooperation among developing countries in this period in which a new international order is being designed. The author feels that if the Third World is not capable of getting organized to overcome the limitations inherent in the present fragmentation, it will be very difficult for it to have any significant influence on the course the world should take and to fruitfully participate in the network of relationships which is about to be built. Integration in regional groupings is only one of the methods to escape from the present backwardness, and it is not the most important one, but it is undoubtedly a prerequisite for change.

This reference to the integration of the Andean Group has not been made with the purpose of suggesting the model which could be followed by cooperation efforts of this type in the Third World. The experience of the Group cannot be easily transferred. Its major elements were designed on the basis of a concrete experience in the operation of LAFTA and answer to unique national conditions. It

could not, for example, apply to countries whose differences in economic size and industrial development were even greater than those existing in the Andean Group, where they are at the limits of what is viable as regards heterogeneous conditions. What the experience of the Andean Group does indicate is that integration efforts among developing countries have to be based on variables different from the simple enlargement of markets which were rightly criticized by Furtado, if the purpose is really to foster economic change and reduce foreign dependence.

COMMENTS ON SALGADO'S PAPER

(a) H. Edward English

It is dangerous to generalise about Latin America. Dr. Salgado has, however, focussed on some of the most ubiquitous elements affecting Latin American economic development and this encourages me to comment in general terms.

To oversimplify, Dr. Salgado and many others characterize Latin American investment decision-making as historically dominated by elite groups which do not reflect social preferences of the Latin American people. The impact of foreign influences and in particular direct investment has been much affected by the role of the domestic elite, and indeed has led to something of an alliance between domestic and foreign elites to serve their mutual purposes.

The question under these circumstances is whether the external forces have played a necessary role in frustrating democratizing forces in Latin America and the kind of social and economic development that would be preferred by the indigenous majority. If the social structures of Latin America would be much the same anyhow, and are merely somewhat further entrenched by foreign direct investment then the relevance of dependency theorizing in such circumstances can be challenged.

The industrial revolution in Europe and North America suggests that under these circumstances traditional social elites based on feudal institutions need not become identified with and allied to the new industrial "class" whether this class is the product of its internal social revolution or external forces.

In the Latin American case the strategies for industrial development that have worked so imperfectly according to Salgado and Wionczek, may well have ensured that historical forces led inexorably to the entrenchment of traditional elites. First the policy of import substitution permitted by higher levels of protection fostered inefficient manufacturing unable to compete outside a restricted domestic market thus limiting scope for the development of the industrial class, and making it easier for domestic capitalists to retain control of industrial capital.

Secondly, the earlier efforts at integration such as the Latin American Free Trade Association failed to achieve rationalisation of industry because the vested interests that evolved under protection had no strong incentives to restructure so long as external trade barriers remained high.

Finally, when it came to finding a new strategy in the promotion of exports and rationalisation of domestic production it has become necessary to impose through more or less democratic political regimes explicit agreements for the purpose of distributing industrial activity so as to reduce wasteful duplication of manufacturing activity, and selection of foreign direct investment. In effect governments have found it necessary to intervene in investment decisions that might otherwise have served only the ends of domestic and foreign elites acting collectively in their mutual and individual interests.

Such intervention may indeed be necessary, at least sometimes but the important point is that it has been the policy of the host country that has created the circumstances in which the conspiracy

of elites becomes inevitable. A protectionist policy environment would have imposed a market discipline on early stages of industrial development and substantially reduced the opportunity for concentration of economic power.

It is now to be hoped that whatever the new strategy of rationalisation it will take place in the context of a commitment to declining levels of external protection for regional integration schemes such as the Andean group. It is my understanding that this is intended by leaders of that group.

For its part the United States might, if it were interested in the success of this group, promote such rationalisation by offering free access (or at least freer) access to its market for any regional group that became committed to reducing its external trade barriers to levels that eliminated the least efficient manufacturing units and expanded the exports and efficiency of those that remained in operation.

(b) General Discussion

In the absence of Dr. Salgado the discussion of his paper was rather cursory. The thesis that international contact had brought about increasing economic, social and political dualism between Latin American elites and the poor majority was questioned. It was suggested that the paper did not contain persuasive evidence that the position of domestic elites was dependent on foreign economic activities; and if they had a domestic power base, policy would be unchanged and governments just as corrupt. The desire for greater autonomy in decisions and for increasing participation in international economic and political decisions was recognised, but to an important extent this was within the competence of Latin American countries themselves. Dr. Wionczek noted that the problems of dependency could not be viewed solely on economic grounds and that in any case Latin America was not satisfied to accept the traditional economic order. He agreed that the linkage between internal factors and external domination was not detailed in the paper but pointed out that the colonial heritage was important. There was a Spanish sense of values, a tradition of high consumption and this was reinforced by observation of high mass consumption in the United States.

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THAILAND'S INTERNATIONAL ECONOMIC RELATIONS WITH JAPAN AND THE U.S.: A STUDY OF TRADE AND INVESTMENT INTERACTIONS

SEIJI NAYA AND NARONGCHAI AKRASANEE*

I. Introduction

By international standards, the Thai economy has, since 1950, been an "open" one, relatively free of import quotas or other direct measures of trade restrictions and closely connected through trade with the rest of the world. While tariffs and taxes do affect the market price of goods, they have not been prohibitive. As a result, Thailand has relied mainly on competitive forces and prices to determine the size and composition of its imports. Similarly, Thailand has traditionally retained an "uncritical" policy toward the volume, sources, and objects of foreign investment in the post-war period. This attitude has allowed a large inflow of foreign capital to Thailand. This "openness" has thus appealed to the developed nations of the world, particularly to Japan and the U.S., which have been lured by different factors to trade with and invest in Thailand. However, as the dominance of these two industrial countries in Thai economic affairs grew, so did antagonistic public sentiment against them. Japan, in particular, has more recently been the primary target of student demonstrations, owing to her rapid ascent to primacy as Thailand's leading trading partner and source of foreign investment. Increasing public awareness of and reaction to the influence of these industrial nations on the Thai economy has often been based on broad generalities.

Although America's political, military, and economic influences in Southeast Asia has already peaked and is likely to decline further, its present impact on Thai economic affairs is unmistakable. Even as the Japanese made inroads into areas once dominated by the United States, pockets of American influence persist, making it impossible for the researcher to neglect the latter, especially in any discussion of foreign investment.

Simultaneously, it is the phenomenal worldwide trade performance

*We would like to thank the Rockefeller Foundation for providing funds for research assistance. We are also thankful to Alan Murakami and Ornumpai Piyaratana for statistical and other assistance; and to the Bank of Thailand and the Board of Investment for providing us with some of the data used. We would also like to acknowledge Professor Atsushi Murakami for helpful comments.

of the Japanese during the 1960's that has surfaced as the highlight of our discussion on Thailand's trade patterns. It appears that Thailand's industrialization and import-substitution policies have been highly complementary to the responses of the Japanese to changing trade and investment conditions. However, it would be an oversimplification to say that the Japanese merely stepped in where and when the Americans lost ground or could not expand further. The contrasting responses of Japanese and American businesses over recent years provide a fruitful backdrop for an analysis of differential export performance, import composition, foreign investment behaviour, and trade and investment interaction arrangements of these two countries. Despite the increasing attention to the role and significance of Japanese economic involvement in Thailand as well as in other Asian countries, relatively few studies have been made to analyze various effects of this involvement. One of these studies has dealt with the tremendous growth and changes to the pattern of Japanese trade with and foreign investment in Thailand in the 1960's.[1]

This study laid the ground work for this paper, in which the United States has been included in an examination of Thai trade and foreign investment relations. In addition, Japanese involvement has been evaluated in the light of more recent data.[2]

Nevertheless, it is unfortunate that, as in many developing countries, relevant data, especially on investment, are scanty and inadequate. With the use of existing limited data alone, it is difficult to make a full scale, and meaningful, empirical analysis of many of the issues and questions that have arisen. But certain broad characteristics and implications of some of these factors can be identified and examined in this paper. The main focus will be on trade and investment-trade interactions.[3]

Accordingly, the paper is organized around the aforementioned areas in four separate sections. Section II deals with import patterns, concentrating on the contributions of Japanese and American commodities to the import requirements of Thailand. For comparative purposes a few other major import sources are also included. This section identifies the major commodity sub-groups that exhibited most growth and utilizes a constant-market-share analytical device to determine what factors were responsible for changes in im-

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1) Seiji Naya and Narongchai Akrasanee, Thai-Japanese Economic Relations: Trade and Investment, The Economic Cooperation Centre for the Asian and Pacific Region, Study No.9, December 1974, Bangkok, Thailand.
For useful information and analysis on the status, conditions and problems affecting foreign investment in Thailand, also see two studies prepared for the Economic Cooperation Centre for the Asian and Pacific Region, Thomas Allen, Direct Investment of Japanese Enterprises in Southeast Asia, Study No.1, February 1973, and Charles Draper, Private Foreign Investment in ASEAN, Study No.7, February 1974.

2) For a broader treatment of various issues, economic and otherwise, see Naya and Akrasanee, ibid, Chapter 1.

3) This paper however omits altogether another important aspect of Thailand's external relationship: foreign aid. Two leading sources of aid are the United States and Japan in that order. The security interests of the former and commercial orientation of the latter country have highlighted the contrast between the two.

port volume and composition. Section III highlights the Thai export performance in Japan and the United States, identifying the commodity groups that were most prominent in the changing export patterns of Thailand and the major factors involved in these changes. Section IV discusses the size and types of Japanese and United States investment in Thailand and reveals the major differentials in these contributions. Section V is devoted to an evaluation of trade and investment interaction and again highlights the major differentials in American and Japanese trade arrangements. A final Section contains a summary of the results and implications for policy.

II. The Pattern of Thailand's Imports

Over the years, Thailand has continued to rely on imports for a large part of its requirements of manufactures, both consumer and capital goods. Accordingly, Thailand's imports are largely of manufactured items (SITC 5 to 8), which comprise about 75% of its total imports. In the past 20 years or so, this proportion has remained roughly the same. But the industrial structure of Thailand has been highly oriented toward the production of consumer goods and intermediate products used chiefly for the production of consumer goods, with relatively little capacity to produce capital goods. Industrialization and import substitution have induced a rapid change in the commodity composition of imports in favour of capital goods and against consumer goods, but imports have continued to grow rapidly, slackening only in 1970-71.

In the 1950's, during Thailand's initial period of industrialization, imports of miscellaneous manufactures (SITC 8) as a proportion of total imports were reduced substantially. By the early 1960's, this proportion became as low as 5%. Even since then, the composition of total imports has continued to change, and the shift has been away from basic manufactures (SITC 6) and toward machinery and transport equipment (SITC 7) and chemicals (SITC 5). The combined share of the latter two groups rose from 39% in 1962-63 to about 50% in recent years.

The major source of total imports and imports of manufactured goods has been the developed countries. For example, combined imports from four developed countries (Japan, the United States, West Germany and the United Kingdom) comprise about 70% of the total imports of Thailand. The role of Japan as a supplier has been growing rapidly, both in absolute terms and in relation to other countries.

In order to examine Thailand's bilateral trade, especially in relation to the country's industrial structure, it is useful to classify imports by the end uses of these products. On the basis of the Bank of Thailand's classification, the commodity compositions of total imports, of imports from the four developed countries and of those from the rest of the countries as a group as well as their bilateral trade shares are given in Appendix Table 1. The change in the commodity structure of total imports is clearly evident in the table: a rapid shift away from consumer goods, especially non-durable consumer goods, towards intermediate and capital goods. For example, the proportion of non-durable consumer goods in total imports declined from 24.8% in 1962 to 12.9% in 1970 whereas the proportion of intermediate and capital goods rose respectively from 17.1 and 28.2 to 24.9 and 34.7% during the same period.

The commodity composition of imports from Japan resembles that of total imports. But the compositional change in imports from Japan is shown to have been even greater than for total imports. Only about a decade ago, imports from Japan were most heavily weighted in favour of non-durable consumer goods, comprising as much as one-third of its total. Also, this proportion was even larger than that of the same commodity group in the total imports of Thailand, e.g. 32.2% and 24.8% respectively in 1962. But the reverse has been shown in recent years as the relative importance of this commodity group has declined sharply. Non-durable consumer goods are the smallest component of imports from Japan. Also imports from Japan have become less concentrated in this commodity group than in total imports of Thailand (e.g., 8.3% and 12.9% respectively in 1970). This is due to a large relative decline of clothing and footwear, a sub-item of "non-durable consumer goods". On the other hand, imports from Japan of chemicals, iron and steel and machinery have been rising very rapidly. Consequently, intermediate and capital goods have become the dominant import groups.

The composition of imports from other developed countries also resembles that of total imports but has been more heavily concentrated in capital goods and less so in non-durable consumer goods. But the proportionate size of capital goods imports from the United States has been declining sharply in contrast to those of total imports and those from Japan. For example, the size of capital goods in imports from the United States declined from 40% in 1962 to 36% in 1970 and further to 26% in 1972. As a result of this, the United States share in Thailand's total imports of capital goods fell from 25% to 15% and to 13% during the same periods.

As mentioned earlier, Thailand's imports of intermediate and capital goods have been rising much faster than those of consumer goods. Japan has been extremely successful in increasing its share of fast-growing imports (i.e. capital goods) and reducing the share of slow-growing imports (non-durable consumer goods). The reverse is generally shown for other countries, with the exception of West Germany.

II.1 Trade Performance - Analytical Procedure

The previous discussion suggests that the varying trade performances of Japan, the United States and other countries in gaining or losing shares in Thailand's import market are closely related to: 1) the commodity composition and 2) the "competitiveness" of these countries. An attempt is thus made to measure these factors explaining imports of Thailand from these countries, treating these imports as their exports to Thailand. The actual growth rate (a) of, say, Japanese exports to Thailand, is partitioned into the following components.[4]

Average growth factor, W This is the trend of total imports of Thailand (or world exports to Thailand) measured by its average growth rate. Thus, if Japanese exports to Thailand were to grow at this rate, Japan's share in Thailand's imports would remain constant.

Commodity compositional effect, C = (H-W) Japan's exports to Thailand may be more or less concentrated in those commodties which are growing rapidly or slowly in Thai import demand. In order to assess this influence, a hypothetical growth rate of total exports, H, is measured by assuming that, for every given product, exports have

risen as rapidly as the average growth of Thai imports. The difference between H and W would show the effect of Japan's commodity composition differing from that of Thai imports and this is defined as the compositional effect.

The share effect, $P = (A-H) = (P_1+P_2)$ In H, the effect of favourable or unfavourable commodity composition (hence stagnant or buoyant Thai import demand) is taken into consideration. But the export growth (A) usually differs from the projected rate. This additional export growth or the difference between A and H would indicate whether or not Japan has been able, on the average, to expand its exports of individual products more rapidly than competing exporters to Thailand. Since this effect reflects changing export shares of individual commodities in the Thai market this is defined as the share effect, and more broadly as the competitive effect.

The share or competitive effect of export growth is influenced by the size of imports in which the Japanese share of individual commodities changes. But the share may be changing in rapidly or slowly growing commodities. Thus, the share effect can be further divided into two sub-components, one measured with the initial va-

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4) The analytical device is known as the constant-market share model. For a good theoretical evaluation of this model, see J.D. Richardson, "Constant Market Shares Analysis of Export Growth," Journal of International Economics, I (1971), pp.227-239.

The algebraic formula used is

$$ds \equiv s^0 dM + (\Sigma s_k^0 dM_k - s^0 dM) + (\Sigma ds_k dM_k^0 + \Sigma ds_k dM_k) \quad \ldots\ldots\ldots\ldots (1)$$

where x, M, and s refer to Japanese exports to Thailand, total imports of Thailand, and x/M respectively; exponents 0 and ' denote the initial and end periods respectively; and the subscript k, commodity k. Although the constant market share model is usually discussed in terms of the share, it is useful to express it in terms of the growth rate as follows:

$$dx \equiv gx^0 + (\Sigma g_k x_k^0 - gx^0) + [(dx - \Sigma r_k x'_k) + (\Sigma r_k x'_k - \Sigma g_k x_k^0)] \quad \ldots (1')$$

where g and r are the growth rate of imports with M^0 and M' as the base and end periods respectively. The three right hand terms in each equation correspond to W, C and P $(=P_1+P_2)$ discussed in the text though all of these terms in the text are expressed as a proportion of x^0 or the growth rate of exports.

It is useful to measure various effects in terms of the end period structure, especially when there has been a rapid structural change. One could then draw certain conclusions about changing structure on the basis of structural effects at two points in time. The formula for this, corresponding to the equation (1') is as follows:

$$dx = rx' + (\Sigma r_k x'_k - rx') + (dx - \Sigma r_k x'_k) \quad \ldots\ldots\ldots\ldots (2)$$

The difference in (1') and (2) is that the different period of the export structure is applied and import growth rate is measured differently. Also, these equations indicate that in (1'), the hypothetical exports of the end period are measured assuming the constant export structure of the base period are (e.g., gx^0) whereas in (2), such exports of the base period are derived assuming the constant structure of the end period (e.g., rx').

lues of imports and other with the changes in these values. The former is defined as the pure share effect (P_1) and the latter, the interaction effect (P_2).

In examining bilateral export growth it is useful to compare the actual growth of exports (A) with the average growth (W) as the difference (A-W) indicates how A has deviated from the world trend. This difference is referred to as export performance.

In explaining export performance, it is reasonable to suppose that the commodity compositional effect is affected more by external (or Thai) than internal (Japanese) conditions, and vice versa for the share effect.[5] That is, external factors (e.g. import demand and policies of Thailand), favouring or not favouring the particular export structure of Japan is regarded as a major determinant of the compositional effect. On the other hand, the share effect is regarded as reflecting competitive position and whether and to what extent Japan has kept up with external demand. This would also indicate the scope for the country to encourage or discourage (directly and indirectly) its exports through appropriate policies. There are many factors associated with "competitiveness", including not only the price variable but also such non-price variables as the quality of the product, the speed of delivery, and financial arrangements.

II.2 Trade Performance - Results

Appendix Table 2 gives the numerical values of trade growth effects of various countries measured in terms of total imports of Thailand consisting of the fifty commodity items. Thailand's imports grew at a simple average rate of 16.9% (a compound rate of 11.3%) from 1962 to 1970. This is the average growth effect (W). But Japan's exports rose by 25% per year (a compound rate of 15%), thus exceeding the average effect by 8% per year (A-W). As the result of this growth differential, Japan's share in the total imports of Thailand increased from 29% in 1962 to 37% in 1970. On the other hand, the annual growth rate of United States exports to Thailand was 13.2% (a compound rate of 9.4%), less than the average growth by 3.7%, reducing its share in Thailand's imports from 17% in 1962 to 14.9% in 1970. The export performance of different countries suggests that Japan (and W. Germany to a smaller extent) have gained at the expense of the United States, the United Kingdom and the rest of the world.

To explain the growth of a country's exports, it is as important to examine how its commodity share changes as to look at the structure or composition of its exports. There is one notable feature that distinguishes the export performance of Japan in the Thai import market from those of other developed countries, viz. a negative commodity compositional effect but a positive share or competitive effect. It is somewhat surprising that the growth pattern of Thailand's import demand has been, on the average, unfavourable to

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5) This interpretation is only a matter of degree and, for example, the commodity share of a given item can be altered as a result of such factors as a change in the country import quota rather than as a change in the competitive position of this export. Also, the commodity structure of exports can be altered by internal conditions and measures.

the export structure of Japan and favourable to other developed countries. This has had the effect of reducing Japanese exports to Thailand by 2.2% per year whereas it has raised the export growth of other developed countries by 4 to 7% per year. This unfavourable composition has not, however, deterred Japan's exports at all, since Japan's share or competitive effect has been large enough to more than offset the negative commodity compositional effect to yield a favourable export performance. A sharp contrast with Japan's positive share effect is the negative value of this effect for all other countries. This is especially so for the United Kingdom and the United States where negative share effects contributed to the fall of their exports by 8 to 10% per year and overwhelmed their favourable compositional effects.

The favourable competitive effect of Japanese goods in the Thai market is comprised of two components. The first component is the pure share effect (P_1) reflecting the success of Japan in capturing a higher fraction of the Thai import market over time. The second is the positive interaction effect indicating the success of Japan in diversifying and expanding her exports toward more rapidly growing items and in reducing its share in less rapidly rising imports. This second effect has had an especially large role in the rapid export expansion of Japan (7.8% per year). Thus, Japan, despite an unfavourable initial commodity structure, has taken full advantage of the changing market opportunities available to her.

Since the above result is based on all products classified into 50 items, the numerical values of factors accounting for Japan's export expansion may have been influenced more by certain commodity groups than by others. In order to examine the relative strength of export performance in different products, the fifty commodities here divided into six groups, to produce empirical results set out in Table 3. Although the average growth effect (W) and actual export growth (A) of different countries differ by commodity groups, the results reveal clearly the relative strength of Japanese exports. One finds that a positive difference (A-W) or the favourable export performance of Japan and also West Germany is recorded in almost all commodity groups. Japan has done poorly only in one group, non-durable consumer products, and West Germany only in durable consumer products. In four out of six commodity groups, Japan's export growth is greater than that of any of the other countries.

Referring to the commodity and share effects, what has been said about total exports of Japan applies to almost all individual commodity groups. That is, the export structure of Japan, even when individual commodity groups are considered, has not generally been favourable to expanding her exports.[6] Two groups, durable consumer goods and other commodities, do show a positive C effect but it is very small, contributing to export expansion by less than one-half

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6) As mentioned there has been a considerable change in the commodity make-up of Japanese and United States exports to Thailand. In view of these structural changes, it is useful to measure two explanatory effects (C and P) with the end period structure. This has been done though only for Japanese exports, which indicates that when individual commodity groups are considered, the negative C effect is shown in all groups with the only one exception of the other commodity group. Furthermore, the P effect in enabling Japan to capture a larger fraction of the Thai import market is still important, although the average growth effect (W) becomes the major expansive force.

of one percent a year. In the remaining groups, this effect has reduced Japanese exports by between 1.7 and 3.4% per year. Nevertheless, Japan has been able to offset this relatively unfavourable commodity effect by the positive competitive effects(s) in all but non-durable consumer products. In terms of growth rate, the share effect in capital goods is especially large, raising exports of this group by a simple annual rate of 31%. In fact, the increase in Japanese exports of this group and intermediate products has comprised almost all of its total increase from 1962 to 1970.

For other countries listed, the signs of their compositional and share effects are generally the reverse of those of Japan. There are, however, some deviations among individual commodity groups. For example, a favourable export performance of 3.8% is shown for the United States in durable consumer goods and in non-durable consumer goods to a smaller extent. This performance is associated with a negative compositional effect (-1.7%) but positive share effect (5.5%) - the only commodity group in which the share effect is positive. But the size of the favourable export performance of the U.S. in consumer goods is small, and Thailand's import expansion in these goods has been among the smallest.

Of the factors explaining Japanese export performance, its positive share effect has been shown to be very influential. In our discussion, the positive (negative) share effect has been interpreted as an indication of an improved (worsened) competitive position in a given country's exports in relation to those of others. It is however, very difficult to pin-point the important determinants of "competitiveness". Obviously, price is an important variable. But other factors such as the quality and uniqueness of the good, distance (transport cost), the speed of delivery, after-sales-service, and commerical and financial ties and arrangements can be important factors.

We have been obliged to measure the share effect in trade values, although quantity shares would be preferable. To explain the share effect in terms of price competitiveness, it is necessary to assume that quantity demanded of Thailand's imports from a given country in relation to that from other countries responds well to a change in their relative price. More precisely, in terms of our analytical framework, the elasticity of substitution between sources of imports must be greater than one. If not, the measure of the share effect may move in the wrong direction from what is suggested by the change in relative competitiveness i.e., an increase in relative prices could lead to an increase in shares.

Due to certain constraints e.g., insufficient reliable data, a comprehensive investigation of the price-quantity relationship has not been made. But partial evidence on the value of the elasticity, based on selected commodities, is presented below.

The following nine commodities were selected: electric appliances, radio receivers, television receivers, fertilizers, pesticides, tractors, tubes and pipes, buses and trucks, and motor cars. The quantity-price relationship for each of these commodities imported from Japan has been compared with that from the United States and West Germany, the two major competitors of Japan in the Thai market. Each of the selected commodities tends to be homogeneous and has relatively few 7-digit sub-items, thus reducing the errors involved in grouping them. The log-linear regression of the form

$$\log(q_f/q_j) = a + b \log(p_f/p_j)$$

has been estimated where the subscript f refers to the United States or West Germany and j refers to Japan.[7] The regression coefficient b indicates a proportionate change in the quantity ratio given a similar change in relative prices, or the elasticity of substitution between the respective sources of imports.

The estimated regression equation is presented in Appendix Table 4, with R^2 and t values given in parenthesis. There are 18 estimated elasticities of substitution, equally divided into those of Japan and the United States, and Japan and West Germany. The value of R^2 ranges from 0.01 to 0.81. In seven, R^2 is only 0.3 or less. However, all estimates of substitution elasticities have the expected negative sign, and a great majority of them are larger than one (in absolute value). Also, all the b coefficients are statistically significant, except two fertilizer coefficients and one for television receivers (Japan-W.Germany). The estimated value of substitution elasticities implies that the import share is positively correlated with relative competitiveness. If the relative price competitiveness of Japan is improved (worsened) Japan will increase (decrease) its value share of Thailand's imports in the selected commodities. On the other hand, the revaluation of the yen in terms of the dollar and the baht in recent years causes the price of Japanese goods to be higher to Thai consumers and reduces its relative price competitiveness with its major competitor, the United States.

The relatively low value of R^2 suggests that factors other than price have an influence in determining the relative share of imports in Thailand. As analyzed in the investment section, the pattern and growth of Japan's direct investment in Thailand and its involvement in related areas have the effect of increasing its share in the Thai import market. Although without a comprehensive study one can say very little about the relative importance of non-price factors, such financial arrangements as supplier's credits tie certain imports to Japan.

The discussion has thus far dealt with Thailand's imports from developed countries. Since these are the latters' exports to Thailand, we should also look at the trade picture from the other side. As is well known, Japan's exports during the 1960's grew faster than any major developed country in the world. Industrial products, especially machinery and equipment, chemicals and steel and non-ferrous metals grew at an annual rate in excess of 20%, shifting the commodity structure of Japan's exports rapidly toward heavy and chemical industrial products. Japan's comparative advantage has been shifting toward technologically sophisticated goods for which world demand has been buoyant and away from consumer and labour-intensive commodities.

Japan's export performance and penetration into the Thai market, therefore, corresponds closely to what Japan has been accomplishing in the world market. Nevertheless, comparison of export growths suggests that Japan has not done as well in the Thai market as in the world market. For example, from 1962-63 to 1972-73, her exports to the world grew by 20% per annum but to Thailand by 14.2%. Also, of the four one-digit manufactured commodity groups of SITC which

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7) The data used are Thailand's import statistics published by the Department of Customs for the year 1960-71. The price (p) and quantity (q) indices are then computed by using the Paasche formula, for the year 1962 as the base.

together comprise a large part of Japan's exports, only in chemicals did Japan's exports to Thailand expand faster (though only slightly) than its total exports. In the remaining three groups, Japan's exports to Thailand grew considerably less than its total exports. Consequently, the proportion of exports directed to Thailand, which has not been large, went down considerably (e.g. from 3.2% in 1962-63 to only 1.9% in 1972-73). Thus, where as Thailand has become more dependent on its imports from Japan, Japan's reliance on exports to Thailand has decreased.

U.S. exports to Thailand have been extremely small, only about one-third of one percent of the former's total exports. Total exports grew by 10.4% per year from 1962-63 to 1972-73, or only one half of the rate of Japanese export growth. During the same period, American export expansion to Thailand was 9.4% a year, or slightly less than that of total exports. Thus, the loss of export share for the United States was not unique to Thailand's market alone. But it was in manufactured groups that United States exports to Thailand grew far less than total exports. During the period from 1962-63 to 1972-73, exports to Thailand expanded only 5.9% a year in contrast with 10.8% for its total exports. As discussed earlier, in these manufactured products, Japan out-competed the United States (and some other countries), capturing a larger share of the expanding Thai market.

III. Thailand's Exports to Japan and the United States

In sharp contrast to its imports, Thailand's exports have always been concentrated in agricultural and other primary products. Exports of primary goods still comprise more than 80% of total exports and are dominated by a relatively small number of commodities. During the 1960's, two-thirds of exports were accounted for by the four items, rice, maize, rubber and tin. But over the years, a considerable degree of diversification has taken place. The diversification until the late 1960's was largely within the primary products group with fish, kenaf, fruits, teak and maize growing substantially to offset in part the slow growth of exports such as rubber and rice. In recent years, however, the basket of exports has begun to include a number of very rapidly growing manufactured products of light industrial origin e.g. textile fabrics, clothing, and wood products.

The leading markets of Thailand, as of most other developing Asian countries, are Japan and the United States, together absorbing about 35% of total exports. There are, however, substantial differences in the growth and commodity pattern of Thai exports to these two countries. Thai exports to Japan have grown more rapidly than its total exports as well as its exports to the United States. For example, as indicated in Table 5, these exports rose by 15.4% a year from 1962-63 to 1972-73, in comparison to 10.7% for the total exports. Consequently, the proportion of total exports directed to Japan rose from 16.8% to 25.6% during the same period, although this is still considerably smaller than the degree of Thai import dependency on Japan. The size of the United States market is substantially smaller and less than half that of Japan (i.e. 10.2% in 1972-73). Thai exports to the United States, as well as these exports as a percent of total exports, have been fluctuating much more widely than those to Japan (although they have been growing steadily since 1970). In the early 1950's, as much as 35% of total exports went to the United States in comparison with only about 11% to Japan. In the past

12 years or so, however, these exports have grown relatively fast and also faster than have total export, i.e. 13.2% and 10.7% respectively from 1962-63 to 1972-73.

These trends reflect the forces of both complementary and competitive specialization. A vertical trading pattern is implied between Japan and Thailand as for other South East Asian countries. The primary products of Thailand and Southeast Asia are greatly demanded in resource-scarce Japan, whereas some of these same products encounter considerable competition in and from the United States.

As shown in Table 5 in the Appendix, the composition of Thai exports to Japan is basically similar to that of total exports and is concentrated mostly in food and live animals (SITC 0) and crude materials (SITC 2). During the 1960's and since, a large proportion of new primary and agricultural commodities belonging to SITC 0, i.e. corn, fish, fruits, have been directed to Japan. On the other hand, rice, once a major export to Japan, has virtually disappeared, as Japan's rice policy has helped to expand domestic production and eliminate imports.

The commodity make-up of Thai exports to the United States has been much more concentrated in crude materials than that of its total exports and of exports to Japan. Two sub-items of this group, rubber and tin, have typically comprised a large share of total exports to the United States.

As with other Southeast Asian countries, exports of manufactures are still very small. But these products are proportinately even smaller in exports to Japan than total exports whereas the reverse is shown to be the case for Thai exports to the United States. Manufactued products in recent years have, nevertheless, shown the most impressive growth rate and are emerging as a very important source of export expansion. These exports to Japan grew at the remarkable rate of 73% per year and, to the United States 38% from 1962-63 to 1972-73, although they started from very small values.

III.1 Thai Export Performance in Japan and the United States

Presented in this section are statistical results on how internal and external factors may have contributed to the growth of exports to Japan and the United States, using the same analytical device as that of Section II.1. In computing various effects of export performance, import data (the three digit SITC items) of Japan and the United States are used, i.e., treating United States imports from Thailand as the latter's exports to the former. In all computations, the standard with which Thai exports are compared is not total imports but only a respective subset of Japanese and United States imports or those commodities which these countries imported from Thailand.[8)]

Table 6 gives a summary finding on Thai exports to Japan and to the United States. Two sets of computational results are presented: set A based on the export structure of the initial period (1962-63) and set B based on the end period (1972-73). Also, each set contains the result based on total exports (SITC 0-9), on exports of primary

8) The reason is that since Thailand exports only a limited range of commodities it is more meaningful to compare Thai performance and structure with those supplying similar goods to these two countries.

products (SITC 0-4) and on exports of manufactured products (SITC 5-8).

Referring first to total export performance given in set A, a number of interesting points are shown in the table. Total imports of Japan and also of the United States have grown very rapidly, serving as an expansionary factor for Thai exports. Pulled by this high average growth effect (W), Thai exports have risen by a very respectable rate, a simple average annual rate of 28.6% (a compound rate of 14.5%) to Japan and 24.5% (a compound rate of 13.2%) to the United States. The average growth effect of Japan has been substantially larger than that of the world average, especially in primary products. This has been a major factor behind the faster expansion of exports of Thailand (and other countries) to Japan than to the U.S. and the rest of the world. Nevertheless, Thai export growth to Japan falls short of Japan's average effect by 12% (a compound rate of 3.2%) whereas the reverse is shown in the United States market, or A exceeds W by 4.9% (a compound rate of 1.8%). Consequently, the share of Thai goods in total imports has declined in Japan but risen slightly in the United States.

The most revealing aspect is the large negative value shown in the commodity compositional effect in sharp contrast with the large positive value of the share effect for both countries. The pattern of Japanese and American import growth has been unfavourable to the structure of Thai exports, deterring its export expansion. Thai exports are highly concentrated in relatively slow-growing items of their imports. The unfavourable commodity compositional effect has reduced the growth rate of Thai exports to Japan by as much as 24% (a compound rate of about 12%) and to the United States by 10.6% (a compound rate of 5.7%) per year.

One might suspect that this extremely unfavourable commodity compositional effect has been due to the combined treatment of both primary and manufactured products. After all, the pessimistic view concerning export prospects is often related to the contrasting growth trends of these two commodity categories. Surprisingly, however a proportionately greater deterring influence of this effect is shown in exports of primary products than in all products. This effect has lowered exports of primary products to Japan by as much as 18.8 percent per year (a compound rate of 2.3%) and to the United States by 5.9% (a compound rate of about 3.7%), i.e., even when primary products alone are considered, the growth pattern of Japanese and American imports has been unfavourable to the structure of Thai exports. It is interesting that this negative effect is considerably larger for Thai exports to Japan than to the U.S. This large deterrent effect indicates that the problem of increasing Thai exports is extremely difficult, especially because this effect is influenced more by economic factors and forces originating from Japan and from the United States than from Thailand.

In contrast to the unfavourable compositional effect, a large positive share or competitive effect is encouraging. As previously noted, the positive (or negative) share effect measures the impact of the growth rate of exports in individual commodities exceeding (or falling short of) that of respective Japanese and American imports. Thai exports to Japan and the United States have grown as much as 12% and 15.6% (a compound rate of about 2.9% and 4.5%), respectively, due to the share effects. Of total export increases to Japan and the United States 40% and 63% respectively, are accounted for by this effect. The share effect has, to a large extent, offset the unfavorable commodity effect and had a great influence in

sustaining export growth. In short, given the unfavorable commodity effect, the ability of Thailand to keep up with foreign import demand, or to increase the market shares of individual commodities, appears to be a very important factor behind its export growth. The interaction term comprises almost one half of the total share or competitive effect for Thai exports to Japan and even a larger percentage for Thai exports to the U.S., reflecting the success of Thailand in raising (lowering) its export share in more rapidly (slowly) growing items.

The share effect in exports to Japan is found to be positive for almost all individual commodities (SITC three digit). Among primary commodities, those which have made a relatively large contribution to the share effect of total exports include such items as meat, fish, fruits, vegetables, rubber, rough wood (SITC 242) and jute. Japanese imports from the world of such items as fish and vegetables have grown very rapidly while others, e.g., rubber and jute, have been stagnant. For each of these items, Thai exports to Japan have grown faster than the respective imports of Japan from the world. In several other commodities, however, Thailand has failed to maintain its export share, e.g. in maize, and skin, wood simply worked (SITC 243) and oil seeds, nuts and kernels (SITC 221). In the case of rice, total Japanese imports and imports from Thailand have fallen absolutely.

A similar result is found in the share effect of Thai exports to the U.S. as of those to Japan. Among individual commodities, fish, fruits, vegetables and tin have accounted for a large part of the positive share effect of primary product exports. On the other hand, United States imports of rubber and crude vegetable materials have been stagnant while these imports from Thailand have grown even less, thereby reducing the value of the share effect.

Turning now to a brief analysis of manufactured exports, an impressive rate of Thai export growth is clearly revealed by the data. Not surprisingly, the average trend factor W, which is 121% for Japan and 27.8% for the United States (a compound rate of 29% and 14% respectively), has played a large expansionary role. But unlike primary products, exports of manufactures to Japan and the United States have risen at a simple annual rate of over 400% and 200%, respectively, which far exceeds the average trends. Although the compositional effect is not shown to be favourable for both Japan and the United States, its negative influence is small in comparison with that of primary products. The export performance is (mainly) explained by the strikingly large share effect, accounting for about 90% of the total increase in manufactured exports to Japan and the United States.

An examination of individual commodities reveals that exports of Thai manufactures to Japan began to include such products as wool products, paper, textile and woven fabrics, clothing and precious stones in the late 1960's and have been rising rapidly since then. The exports of these products have grown faster than have the respective imports of Japan, accounting for the positive share effect of Thailand. In terms of individual commodity make up, the share effect of Thai exports to the United States is basically similar to those to Japan. As previously mentioned, Thai exports to the United States contain a greater proportion of manufactures than do Thai exports to Japan. But, as in the case of primary products, manufactured exports to the United States are more concentrated in a few items than

those to Japan. For example, in 1972-73, clothing accounted for 47% of total manufactured exports to the United States whereas this item was no more than 2% of such exports to Japan.

Discussion has so far been based on results given in Set A measured with the export structure of the initial period. But in this period values of many export products, especially those of manufactures, were very small or did not exist at all. This tends to give an upward bias to the share effect. Also, to assess future export growth patterns, it is more relevant to examine various effects measured with the present or end period structure. When this is done, as shown in Set B of Table 6, a somewhat different picture emerges.

First, one finds a large improvement, though still negative, in the compositional effects of total and primary exports to Japan and to the United States. Also, this effect in manufactured exports to Japan is, though small, no longer negative. In other words, the Thai export structure has been shifting and becoming less unfavourable in relation to the import pattern of Japan and of the United States. Secondly, the favourable share or competitive effects, especially of manufactured exports to both countries, are not as dominant as in the first set of the computations. Finally, referring to manufactured exports, the average import growth effect (W) of Japan and the United States is shown to be the most important factor for export expansion.

IV Size and Type of Japanese and American Investments in Thailand

The overall presence of Japanese and American economic influences on the Thai economy is felt, not only in bilateral trade, but also in the large inflow of Japanese and American capital (both private and official), as well as in the interaction of trade and capital. Japanese and American businesses and enterprises have been participating in production and service activities in Thailand through their ownership of capital investments and lending of financial capital. The influence of Japanese and American investment has spread out over many types of business activities, e.g., manufacturing, construction, banking, and hotel and restaurant operations. They are, however, different in their areas of interest. This section describes the size and types of Japanese and of American private investment and capital flow. Implications of the impact of these investments on Thailand's trade with Japan and the U.S. are considered in the next section.

IV.1 Japanese and American Capital in Promoted Industries

It is commonly held in Thailand that Japan has been the leading source of private foreign investment. This is often confirmed by the data published by the Board of Investment. As shown in Table 7 registered capital owned by all foreign sources accounts for 28.8% of total (domestic and foreign) registered capital of all firms granted promotional certificates from October 1960 to December 1974. [9] The size of foreign registered capital is less than in some of Thailand's neighbouring countries. But the Japanese share is substantilly larger than any of the individual foreign sources. Of all foreign registered capital, 41.6% is comprised of Japanese capital,

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9) This percentage declined slightly from that at the end of the previous year, which was 31%. See Naya and Akrasanee, op.cit., p.44.

while this share for the United States is 14.6% and for the Republic of China, 12.3%.[10] American capital ranks second, but is less than one-half of Japanese capital. In terms of total (domestic and foreign) registered capital of all promoted firms, Japanese capital comprises only 11.96%. Table 7 also shows that most of Japanese registered capital is in joint ventures. Registered capital owned solely by Japanese is 15.2% of total capital and 5% of total capital owned by one country. But when the registered capital of these promoted manufacturing firms in which Japanese investment entered between October 1960 to June 1973 is considered, the Japanese share increases to 54.3% (see Table 8). Also, 74.1% of total Japanese capital is in those enterprises in which the Japanese share exceeds 50% or more. When registered capital from the United States is considered, the share in joint ventures is larger than that of Japanese registered capital, i.e. 93%. For the United States, registered capital solely owned by one country is less than 1% of the total. But for promoted firms in which American investment entered, the proportionate shares of registered capital are on the average even greater than those of Japanese, whereas the United Kingdom share is smaller.

Given the overall Japanese and American shares, there is a considerable variation in individual industries. In Tables 9(a) and (b), the registered capital and total investment (assets) of manufacturing firms with Japanese and American participation are classified according to the four digit International Standard Industrial Classification. In 10 cases out of 30, the Japanese share of registered capital exceeds 50% (as of June 1973). In the remaining 20 industries the share falls below 50%, although in four of them the share is 49%, and only in five cases is the Japanese share 30% or less. These figures do not refer to individual firms. Nevertheless, they do suggest that, in most cases in which Japanese firms have invested, they hold a large share of registered capital. But when firms with United States investment are considered it is found that they hold an even larger share of registered capital. Out of the 25 industries listed in Table 9(b), the United States share of registered capital exceeds 50% in 18 industries; in only one industry is the United States share less than 30%. These findings imply that, in industries in which the United States and Japan have invested, they tend to hold a larger share of registered capital.

Although Japanese investments are found in a variety of industrial sectors, they have been concentrated in certain selected industries. The largest investment has been in textiles and apparel, followed by chemicals (including tyres and tubes in this group) and by fabricated products. These three industries accounted for 87% of total Japanese registered capital, although the share of textile and apparels alone was 52% (as of June 1973). Japanese firms have, thus far, tended to concentrate their investments on those activities commonly regarded as traditional and small scale industries, e.g. textiles. On the other hand, American firms have tended to concentrate relatively more of their investments on chemicals and basic metals, and far less on textiles than Japanese firms.[11] In terms

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10) Note that despite the anti-Japanese movement and the talk about declining Japanese interest, the share of Japanese registered capital in all foreign capital increased from 37% at the end of 1973 to 41.6% at the end of 1974. See Naya and Akrasanee, ibid., p.40.

of sub-sectoral or four digit classifications, thread and yarn, and textile fabrics accounted for 20.1% and 26.3%, respectively, of the total registered capital owned by Japanese firms. The next two largest were synthetic resins and related products, 10.2% and motor vehicles, 7.6% (followed by iron and steel, fertilizers, radio and communications equipment and tyres and tubes). For United States investment non-ferrous metal accounted for 23.1% of the total registered capital. This was followed by tyres and tubes (15.9%) and petroleum refinery (10.6%).

The above discussion suggests that Japan has been the leading source of foreign investment in Thailand. But what has been compared is the size of foreign investments in terms of registered capital of only promoted firms. When the record of the balance of payments statistics compiled by the Bank of Thailand is examined, a somewhat different picture of the relative size of foreign investment is revealed. According to this record (to be presented in the next subsection) the United States is shown as the leading source of net direct foreign investment with Japan being a close second.

The discrepancy in these two sources of data arises from the use of different definitions of foreign investment as well as the different purposes for which such data are collected. The coverage in the balance of payments statistics is broader and more inclusive than that of the Board of Investment data. Registered capital refers to the approved amounts of capital of those business enterprises receiving investment promotion certificates. It is related to, but falls short of, the concept of stockholder's equity or net worth. Registered capital indicates, albeit incompletely, certain shares in ownership by the holders of such capital. But for various reasons, the extent to which individual holders will have actual control over management, operational and other business decisions can not be easily determined by the relative size of their capital holding alone. For example, the foreign ownership of the registered capital in a joint venture may be comparatively small but a large amount of loans may come from the same foreign source. In such a case, the foreign participant may have a greater degree of control over the policies of the firm than is implied by the size of the equity holding.

IV.2 Flows of Foreign Private Capital

From the Bank of Thailand's balance of payments statistics, the flows of private medium and long term capital, classified by broad types, are shown in Table 10. They refer to accumulated values of capital flows from 1965 to 1974. Although there have been considerable yearly fluctuations, Thailand has received a large amount of foreign capital over the years. From 1965 to 1974 total inflow (credit) was 47.5 billion baht, offset by total outflow (debit) of 27.5 billion baht, to yield a net inflow of 20.0 billion baht. The two largest foreign sources are the United States and Japan respectively, accounting for 31.7% and 30.9% of the total net balance of

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11) For comparison on the scale of manufacturing between Japanese and American firms, see Lawrence R. Krause, Evaluation of Foreign Direct Investment: the U.S. and Japan, Brookings, Washington, D.C., 1973, and Donald R. Sherk, Foreign Investment in Asia: Cooperation and Conflict between the U.S. and Japan, Federal Reserve Bank of San Francisco, San Francisco, October, 1973.

capital flow. Although the inflow of capital has taken different forms, direct investment has been the single largest contributing item for net total capital inflow from all foreign sources as well as from Japan and the United States. This investment (including equity and loans) accounted for 60.4% of total capital, whereas the Japanese component of this capital is smaller at 59.5% and the United States component larger at 70.1% than the national average. As in the case of total capital inflow, the accumulated net inflow of direct investment from the United States (4.4 billion baht) is larger than that from Japan (3.7 billion baht) by almost a billion baht. This finding is rather surprising and contrary to our expectations.

It is the equity investment (not total direct investment) given in Table 10 that is most comparable to the registered capital of promoted firms in Table 7. The comparison of these two investments indicates that total Japanese ownership of the registered capital (1.544 billion baht) is substantially smaller than the 49.8% of accumulated net inflow of equity investment from Japan from 1965 to 1974 (3.101 billion baht). This proportion for Japan is, however, larger than that of the national average (39.3%) and in particular, larger than that of the United States (15.1%).[12] Since the definition and coverage of these two investment statistics differ, these proportions do not indicate the relative size of foreign capital receiving investment privileges. The registered capital is only that of promoted firms and does not include paid-up capital, whereas the equity investments are those of all firms and individuals and for accumulated flows only from 1965 to 1974. But they do suggest that, as a whole, Japanese firms have been concentrating their investment effort relatively more on those business ventures receiving promotional certificates and encouraged by national investment policies than have other foreign firms as a group. This is so, not only relatively, but also absolutely. As mentioned before, the size of promoted registered capital owned by Japanese is the largest of all foreign sources and is twice as large as that of the second leading investor, the United States.

There is another interesting aspect of capital transactions when their credit and debit balances are examined separately. Unlike the case of the net balance, it is Japan, not the United States, which has the top position in the size of these balances. Japan has been the leading supplier of gross capital into, and also the leading recipient of capital outflow from, Thailand, accounting for 35.6% and 39.0% respectively, with the United States shares being 25.1% and 20.2%. The explanation for this is found in the composition and movement of different forms of capital flows, especially in the flow of suppliers' credit from Japan.

As seen in Table 10 a flow of capital is stimulated not by direct investments but by loans and credits. By direct investment, a "permanent" interest in the operations of a business enterprise is presumably being established. Reflecting this and other factors, e.g., a favourable investment climate in the past, the movement of direct and especially equity investment has mostly been a one-way flow into Thailand. For example, from 1965 to 1974, 3.2 billion baht of equity capital came in from Japan but only 64 million baht went to Japan. The latter is only 2% of the former. The national average is 5.9%, while the United States average is 6.7%. The same cannot be said for the other two major categories of capital flows, namely

12) The United States ratio is unexpectedly and surprisingly low.

loans and suppliers' credits. They are of a transitory nature, and repayments have to be made soon, although the maturity may be more than one year. This is well reflected in the movement of these two types of capital - a large inflow combined with a large outflow and each flow exceeding that of direct investment by an overwhelming margin. Especially noteworthy is the movement of suppliers' credit from and to Japan. It is in this field of suppliers' credit that Japan has surpassed all. Of total capital inflow from Japan between 1965 and 1974, 67.4% was suppliers' credit, and the repayment of such credits accounts for 90.9% of total capital outflow to Japan. Also, suppliers' credit from and to Japan, respectively comprises about 54.3% and 57.1% of total flows of capital into and out of Thailand.

These observations on suppliers' credit as well as on other capital flows are based on accumulated yearly flows from 1965 to 1974. This is, misleading, however, especially for the movement of Japanese suppliers' credit since they appear to have been discontinued in 1973. After reaching a peak value of over 2 billion baht in 1970 and 1971, the inflow of this capital from Japan fell drastically, being only 111.7 million baht in 1973 or only about 5% of the peak value. But it went up again to 665.8 million baht in 1974. On the debit side, repayment declined from 1.6 billion baht in 1970 to 800.7 million baht in 1974. As the outflow has begun to exceed the inflow, there has been a net debit balance with Japan in suppliers' credit for the first time, minus 235 and minus 876 million baht respectively in 1972 and 1973. However, the net debit balance fell to minus 134.9 million baht in 1974. It is not yet known whether the inflow of supplier's credit will continue to grow after its revival in 1974. If that is the case, the role of suppliers' credit will become important again, just as it was during the period from 1967-1972.

V. TRADE AND INVESTMENT INTERACTION

It has been concluded earlier that Japan has been successful in riding with the changing structure of Thailand's imports while the United States has not done so well. Imports from Japan have changed considerably over the years. They now consist mostly of industrial raw materials, and of machinery and equipment, which support Thailand's growing domestic industries. Imports from the United States are quite similar to those from Japan, but the United States has not been able to compete with Japan in capturing the Thai market. Perhaps, as will be discussed below, this is due to the competitive strength of Japanese products, but this can explain only part of the story. A more important factor is the link between imports from Japan and its investment. The content of financial flows from Japan and its large investment in promoted industries have had an obvious impact on Thailand's bilateral trade pattern with Japan.

The complaint is often heard that Japanese direct investments have contributed to import growth but have not done very much to expand Thai exports. There is a great deal of truth in this complaint, but this depends very much on the period under consideration. As much as one half of imports under suppliers' credit is known to be related to those enterprises receiving privileges of investment promotion. Also, as indicated below, a large amount of imports is related to Japanese direct investment. Exports of promoted industries as a whole have been relatively small, although certain items, e.g. textile products, are beginning to be shipped abroad. Japanese

trading firms are highly linked to, and directly involved in, investment ventures. With their trading networks well established all over the world, they can play a significant part in export expansion. It appears, however, they have just begun to do so within the last 2-3 years.[13)]

American firms have tended to invest relatively more in industries for exports. American investment in import-competing industries does not appear to have a link to Thai imports from the United States.

Decisions on foreign investment are influenced not only by domestic conditions but also by conditions and government policies of the host country. In the 1960's, Thailand pushed policies of development biased toward import substitution, by means of investment incentives and tariff protection. As a result investment was heavily concentrated on products chiefly for consumption, and on the assembly of consumer durables. Most of the firms awarded promotion certificates had proposed to produce goods for the domestic market. It is important to recognize that all of the promoted investment projects with foreign participation were approved by government authorities. Thus, the pattern and effects of Japanese and American investment need to be viewed in this over-all policy context, which Thailand is currently reassessing.

V.1 Suppliers' Credit and Direct Investment

Suppliers' credit channels imports of various products without requiring immediate payment for them. These credits have been granted mainly for the purpose of financing imports of raw materials, plant and equipment for promoted industries and of motorcars. As shown in Table 11, 8.5% of total imports of Thailand during the period from 1966 to 1973 were financed by suppliers' credit. At the peak level of these credits in 1969 to 1971, they supported over 12% of Thailand's total imports. Considering the fact that close to 60% of total credits had come from Japan, they could have very well financed more than 20% of the total imports from Japan.[14)] Subsidized by the Japanese government, suppliers' credit has clearly been a powerful means to promote exports. Since the practice is not used by the United States to the same extent, suppliers' credit has been a relatively less important source of financing Thailand's imports from that country.

To the extent that interest rates charged on suppliers' credit are lower than those on commercial loans, there is an aid element in such credits as well as for other subsidized loans. There is an economic gain accruing to individual Thai recipients of such credits. But there is a resource allocation effect which may not be socially desirable. The benefits mostly go to relatively large investors

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13) More recently, as shown earlier, there has been a rapid expansion in manufactured exports (of a relatively small number of items) from Thailand to Japan and the United States. It is not known whether these exports were carried out by Japanese or American invested firms.

14) The Japanese share of imports was about 30%. Since suppliers' credit from Japan financed about 7% (12 x 60) of Thailand's total imports, and assuming that it only financed imports from Japan, then it should account for about 23% of imports from Japan.

(e.g. those investing in large-scale manufacturing for import substitution, transportation, heavy construction, and modern hotels) at the expense of small investors, and to consumers of imported durables, e.g. passenger cars. Since imported capital goods, e.g., equipment and machines, are financed by suppliers' credit, the use of capital is subsidized and encouraged.[15] Another questionable long-run effect is that, even after the practice has been discontinued, imports tied to a given source often sustain their own demand, due to the need for new replacements and spare parts.

Direct investment does not imply the type of trade dependence that suppliers' credit does. But it does imply a different degree of control over industry. Japanese firms probably tend to have more indirect control and American firms more direct control over the businesses in which they have invested.

V.2 Japanese and American Investment and the Foreign Trade of Thailand

The motivations of Japanese firms investing abroad have been investigated by the Export-Import Bank of Japan. One of its statistical summaries, "Sales Objectives of Japanese Investment in South-East Asia, East Asia and Developing Areas", is shown in the table below.

Sales Objectives of Japanese Foreign Investment in Manufactures*

Objectives	S.E. Asia	E. Asia	Developing Asia
1. Market protection related to exporting difficulties	31.3	12.0	19.3
2. New ventures	16.4	16.2	17.4
3. Sales expansion	35.8	24.8	30.0
4. Exports	15.0	45.3	31.9
to Japan	7.5	12.8	10.6
to other areas	7.5	32.5	21.3
5. Others	1.5	1.7	1.4
Total %	100.0	100.0	100.0
(Number of enterprises)	(67)	(117)	(207)

* Based on approved investment ventures by Japanese government in 1968 and 1969.

Source: JETRO, White Paper on Overseas Market 1972: Present Conditions of Overseas Investment, p.8, quoting Export Import Bank of Japan Information 1971.

Two interesting and relevant points stand out. First, the dominant motives for investment in Southeast Asia are either to maintain or to increase exports. The extent of these motives is shown to be considerably larger for their investment in Southeast Asia than that in East Asia or in developing areas as a group. Secondly, exports back to Japan or to other areas played a very small role in their

15) The Japanese policies of using suppliers' credit as a means to promote exports from Japan and the concentration of Japanese investment in import substitution industries have been criticized by Atsushi Murakami. See his paper, Economic Policies of Japan toward Developing Asian Countries - The Role of Japan in Economic Cooperation, Paper presented at SEADAG Conference, Bangkok, 20-22 January, 1972.

decision to invest in Southeast Asia, although this factor is shown to be the most important consideration for their investment in East Asia. What is suggested by these two points is that Japanese investment in Southeast Asia tends to be import- but not export-inducing to the region.[16)]

This finding relates to the whole Southeast Asian region and not to Thailand alone. Variables considered are not only loosely defined but also interdependent on each other, and no statistical significance is given. But the finding confirms the partial evidence available about Thailand.

Table 12 shows the value of domestic and imported raw materials and machinery used by a selected group of 53 firms with Japanese investment participation in 1971. From the Table it is apparent that the production of commodities in these industries had to rely heavily on imported raw materials which, most likely, came from Japan. For example, 61.7% of raw materials in iron and steel industries were imported. The proportion of imported materials was 70% for rubber products, 74.2% for consumer electrical goods, 80.9% for glass products, 82.4% for the motor vehicle industry, and as high as 97.4% for chemical materials. The textile industry, the largest Japanese investment, also imported a large proportion of raw materials. For example, 41.8% of the raw materials in the production of textile fabrics and 33.3% in thread and yarn industries were imported. In the textile articles industry, however, domestic materials constituted 91.0% of the total.

In addition to imported raw materials, imported machinery and spare parts for Japanese-invested firms also registered a very large volume (see Table 12(a)). For example, 9 firms producing textile fabrics imported 709 million baht or 78% of the total value of machinery and spare parts used by these firms. Most machinery and spare parts in other firms were also imported. This, together with the import demand for raw materials, has contributed significantly to the increase in demand for imports during the last decade.

We have not been able to obtain comparable data on the sales objectives of American foreign investors. American firms appear to rely on imported raw materials and machinery just as much as Japanese firms. Table 12 (b) shows the value of raw materials and machinery used by selected industries with United States investment in 1971. For raw materials, the proportion in value terms of imported raw materials ranged from 53% for iron and steel to 100% for synthetic fibre, if we exclude the food industry. The use of imported machinery and spare parts was also large in these industries, as expected (see Table 12 (b)).

That Japanese investments in Southeast Asia have thus far not contributed much to the region's exports appears to be the case for Thailand alone. In 1972, total exports of all promoted industrial firms (both domestic and foreign) were reported to be 3,728.3 million baht according to the Board of Investment. Of this total only 18.6% was destined to Japan in contrast with 34.4% to the U.S.[17)] Although

16) This was true at the end of the 1960's. In recent years it seems the export motive has also become more important in Japanese investment in South East Asia. Unfortunately the authors have not yet been able to obtain data to verify this observation.

17) Udom Kerdpibule, "Thailand's Experience with Multinational Corporations," Department of Economics, Kasetsart University, June 1974, p.2 (mimeo.)

these figures refer to exports of all firms (e.g., including exports of Japanese trading firms to the United States), they do indicate that exports of promoted firms directed to Japan were small both relatively and absolutely.

According to surveys by the Board of Investment and by the Japanese Chamber of Commerce, exports comprised only about 5.5% of total sales made by Japanese firms and Japanese ventures in 1972 (see Table 13). This contrast rather sharply with exports of United States firms and joint ventures, which shipped almost 40% of their total sales abroad in the same year. But this high figure comes almost solely from a high export-sales ratio of 49.77% of a single commodity group, mineral and ceramic products. (The ratio for Japanese-based firms in the same commodity group is only 6.6%.)

The Japanese have invested heavily in textile and related industries, not only in Thailand but also in other Asian countries. Exports from this type of relatively light and labour-intensive industry can be potentially very large. They have been a dynamic source of export expansion for countries such as Korea and Taiwan. As shown earlier, Thailand's manufactured exports, consisting largely of such products as textiles, wood products and precious stones, have just begun in recent years, and a large volume went to Japan and to the United States. But a more detailed investigation is required to identify the types of firms which have carried out these exports.[18] Nevertheless, based on the data shown in Table 13, it appears that the proportion of exports to total sales of textiles by Japanese firms in 1972 was still less than 10%.

The findings that Japanese firms induce imports and do not export their products very much does not, of course, mean that they do not contribute to the Thai economy. One case study on the textile industry finds that the relative contributions of foreign firms, as measured by indices such as output, local employment, the use of scarce resources and taxes, was larger than that of purely domestic firms.[19] The group of those textile firms with a foreign majority capital share, mostly Japanese-controlled firms, was the most efficient user of a given amount of scarce resources. However, whatever the efficiency or economic contribution of Japanese firms may be, there is one important drawback: Japanese direct investments have been serving as a means of import substitution rather than export promotion for Thailand.[20]

Another interesting aspect of Japanese investment is the amount of profits and dividends remitted abroad, although it may be too early to evaluate the profit experience of Japanese investment with any certainty. The inflow of Japanese investment has been comparatively large, but there is little indication that an especially large amount of profits and dividends is being sent back to Japan. In fact, according to balance of payments statistics, of a total combined outflow of profits and dividends (a sum of annual flows) from

18) The export boom of textile products from Thailand to the United States in 1973 could perhaps be due largely to the country quota imposed by the United States, which forced foreign investors to invest in Thailand.

19) Ruchada Buddhikarant, "A Case Study on the Economic Contribution of Private Direct Foreign Investments in the Textile Industry", M.A. Thesis, Faculty of Economics, Thammasat University, June 1973.

20) With regard to the export boom in a few manufactured products in 1973 it remains to be seen whether there has been a real structural change.

1968 to 1972, of 2,575 million baht, only 17.1% went to Japan, whereas 34.6% and 29.6% were directed to the United States and the United Kingdom respectively.[21]

One possible explanation is that American and British firms started earlier and many of them are now well established. On the other hand, Japanese investments are newer ventures which take some time to turn a profit. It is true that profit conditions of firms can not be inferred from the balance of payments statistics alone. Nevertheless, the comparative remittance of profits and dividends does suggest that criticism of foreign investment making a large amount of money and sending most of it home is exaggerated in the case of Japan. American and British firms seem to be better targets for such criticism. Some may argue that profits of Japanese firms are concealed in their pricing practices or other transactions. But without evidence, such arguments remain speculative and not empirically justified.

V.3 Trade, Investment and Industrialization

Several factors have combined to produce a sharp increase in Japanese foreign investments. As shown in the table below, the avail-

Host Country Factors Associated with Japanese Foreign Investment in Manufactures*

	S.E.Asia	E.Asia	Developing Areas
Protection - Subsidy Policies	62.5	19.0	36.5
Availability of	20.3	67.2	47.3
Labour	10.9	65.5	42.4
Natural resources, raw materials and energy	9.4	1.7	4.9
Consumption market orientation	15.6	8.6	11.8
Trading links between host and third countries	1.6	5.2	3.9
Others			
Total %	100.0	100.0	100.0
(Number of enterprises)	(64)	(116)	(203)

* Based on approved investment ventures by Japanese government 1968 and 1969.

Source: JETRO, White Paper on Overseas Market 1972: Present Conditions of Overseas Investment, p.9, quoting Export-Import Bank Information, 1971.

ability of labour is listed as the most decisive host-country factor associated with Japanese foreign investment ventures in East Asia (65.5%). In the case of Southeast Asia, however, Japanese investment in search of inexpensive labour is shown to have played a relatively small role (10.9%). Rather, it is the protection-subsidy policy that had been the most crucial host country factor in Southeast Asia. This was also found to be the most important factor af-

21) Information supplied by the Bank of Thailand.

22) Thomas W. Allen, Direct Investment of U.S. Enterprises in Southeast Asia, ECOCEN Study No.2, March 1973, Bangkok.

fecting American investment in Thailand.[22] An examination of industrial and trade policies in Thailand during the 1960's and in the early 1970's shows that protection-subsidy was an important feature of investment promotion policy and of the tariff structure.

In a study carried out by Narongchai Akrasanee, the incentives provided by the system of taxation and industrial promotion policy were quantified for the year 1969, using the concept of effective protection.[23] It was found that protection-subsidy policies in Thailand during the 1960's were creating incentives for investment in import-substituting industries, and were strongly biased against exports. They were also encouraging imports of intermediate inputs and machinery, through the exemption of import tariffs and business taxes on these items. Towards the end of the 1960's, the incentives under the industrial promotion policy were revised. Tax privileges were reduced, and more privileges were given to manufactured exports. In the Third Development Plan the development of maufactured exports was given high priority. The investment promotion scheme was revised in 1972 to create higher potential benefits for exports. In addition, several tax and credit subsidy schemes were put into effect to promote manufactured exports.[24]

The existence of the bias in favour of the domestic market and against exporting manufactured goods in the 1960's due to the protection of outputs of products to be used as inputs, and the currency over-valuation, could partly explain why there was no appreciable development of non-traditional manufactured exports during the period, save for some processing of raw materials, while import substitution did not slow down the rate of growth of imports. In a study on sources of industrial growth during the period 1960-1972, the process of industrial growth in Thailand was discussed in terms of the three sources, i.e. export expansion, import substitution, and the increase in domestic demand.[25] The results, a summary of which is reproduced in Table 14, show clearly the relative significance of each source of growth. From the results the author concluded that,

"... for the whole period under study, which covers the two development plans and the beginning of the third plan, industrialization of Thailand was characterised by import substitution and production for the domestic market, with a growing contribution from export expansion in a number of industries in the early 1970's. Import substitution was not effective during the period 1960-66 because of the rapid increase in domestic demand for manufactured products, both domestically produced and imported. In the second sub-period, the import substitution effect became more effective as the domestic market was expanding less rapidly. As for the export expansion effect, more traditional exports became relatively less important in the second sub-period, while the development in many new manufactur-

23) See Narongchai Akrasanee, The Manufacturing Sector in Thailand: A Study of Growth, Import Substitution and Effective Protection, 1960-69, Ph.D. dissertation, Johns Hopkins University, Baltimore, 1973.

24) For a detailed discussion of the development in industrialization policies in Thailand since 1970 see Narongchai Akrasanee, The Structure of Effective Protection in Thailand: A Study of Industrialization and Trade Policies in the Early 1970's, mimeo., Thammasat University, March 1975.

25) Narongchai Akrasanee, "Import Substitution, Export Expansion and Sources of Industrial Growth in Thailand, 1960-1972," in Prateep Sondhisuwan, ed., Essays in Honour of Khunying Suparb Yossundara, Sompong Press, Bangkok, 1974.

ed exports took place."[26]

When we consider the overall effect of industrialization policy (which is referred to as the system of protection) upon the development of trade and investment with Japan and the United States, we observe certain significant developments which were consistent with these policies. The system of protection in the 1960's encouraged imports of intermediate inputs and machinery and substitution for imports of products usually at the final stage. This could partly explain the structural change in imports discussed earlier, particularly in the case of Japan. The structure of Thai imports from Japan became more concentrated in machinery and transport equipment. Foreign investment was also concentrated in import-substituting industries, which received high incentives from tariff protection and industrial promotion.

For some industries, protection effectively (but not necessarily efficiently) curtailed or prevented imports. For example, imports of rubber products, textile fabrics, consumer electrical goods, consumer chemical products, dairy products, and gourmet seasoning, most of which faced competition from domestic firms established with significant foreign investment, increased by only a small percentage.

The discrimination against exports due to the system of protection in the 1960's corresponded to the period of minimal development of manufactured exports. It was only recently that the structure of Thai exports began to change, perhaps partly due to a new set of export promotion policies.

Thus through its influences upon imports, exports, and domestic production, protection contributed to the growth and structural changes of trade and industrialization. Owing to the relationship between protection and import substitution, the influence of protection was most apparent in intermediate products at higher levels of fabrication, consumer durables, machinery, and transport equipment industries. Almost all industries in these categories had several common characteristics: their effective protection rates were relatively high, except for paper products; they benefitted substantially from the industrial promotion policy because of a large proportion of imported inputs and machinery; increases in outputs went mostly into import substitution, with few exports; and finally the heavy investment in these industries did not slow down the demand for imports. Foreign and domestic investment continued to require more imported inputs, thus exerting pressure on the balance of payments.

The above description only relates industrialization to trade and to foreign investment in general. What appears certain is that industrial development in Thailand has induced structural changes in trade and has attracted foreign investment to mostly import-substituting industries. The changes in trade could have been with any country according to the law of comparative advantage, and foreign investment could have come from any country. But in the 1960's, Japan was actively promoting exports through various means, including foreign investment. In more recent years, Japan began to encourage imports of non-durable consumer products. Japan tends to execute both of these trade strategies through their own companies overseas. So in the case of Thailand, Japanese trade and investment have been closely related, and Japan has been able to capture a larger share of Thai imports as well as of exports. On the other hand, the Unit-

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26) *Ibid.*, pp.275-276

ed States does not seem to have the Japanese type of trade and investment relationship. Although American investment in Thailand has responded to industrail development policies, United States firms have invested relatively less in promoted industries than have Japanese firms. Furthermore, when products are exported to the United States, they need not come from firms based on United States investment. Thus American investment does not seem to lead to the pattern of Thai imports and exports followed by the Japanese. The United States therefore has been losing its share in trade with Thailand, even though the volume of trade between the two countries has been growing rapidly.

VI. CONCLUSION AND POLICY IMPLICATIONS

In this paper we have analysed trade and investment aspects of Thai economic relations with Japan and the United States. It has been found that Thailand has become more and more dependent on Japan for her imports as well as for her exports. Imports into Thailand, which have been concentrated in intermediate products, raw materials, machinery and equipment, have come largely from Japan. Thailand has also been exporting a growing volume of primary products to Japan. Only very recently have there been more exports of manufactured products to Japan. As a whole, Thai products still represent a very small proportion of Japanese imports.

A similar picture has been found in the case of Thailand's trade with the United States, except that the United States has not been able to increase its trade with Thailand as rapidly as has Japan. Consequently the United States' share in Thailand's imports shrank during the period under study; and her share in Thailand's exports has likewise declined. We have also found that there has been more fluctuation in Thailand's trade with the United States than in her trade with Japan.

The success of Japan in capturing an increasing volume of foreign trade of Thailand has been due to several factors. During the 1960's, Japan was exporting mostly capital and intermediate goods which were in high demand by Thailand for the latter's industrialization. Japanese products were found to be very competitive. The Japanese policy of export expansion, coupled with the policy of foreign investment expansion was implemented at a time when Thailand was encouraging industrial investment. Thus, a large inflow of capital from Japan was recorded. A significant proportion of the inflow was in the form of suppliers' credit, a method which the Japanese government used to promote exports of capital and intermediate goods from Japan. (These were also encouraged by the Thai industrial promotion policy.) Japanese trade and investment with Thailand were, therefore, closely linked. Unfortunately for Thailand, during the period 1960-72, the linkage was largely in terms of imports and investment in production for the domestic market, with relatively small export expansion from enterprises with Japanese investment. The Japanese trade policy during the 1960's was also restrictive, thus discouraging exports from Thailand as well as from other developing countries.[27)]

27) For excellent review of Japanese trade policy, see Kiyoshi Kojima, "Reorganisation of North-South Trade: Japan's Foreign Economic Policy for the 1970's", Hitotsubashi Journal of Economics, February 1973 and Ippei Yamazawa, "Industrial Growth and Trade Policy in Japan", Hitotsubashi University, July 1973.

The changing pattern of Thailand's trade with the United States cannot be explained in terms of the interaction of trade and investment policies of the two countries. Thailand's imports from the United States have been similar to those from Japan, responding to the industrialization needs of Thailand, but the United States has not been able to compete with Japan. Thai exports to the United States have been concentrated much more in crude materials. In addition, when Thailand began to export manufactured products to the United States, most of them were clothing and precious stones.

Our findings on foreign investment indicate that Japan was the largest foreign investor in promoted industries. But for the whole economy the United State has had more direct investment in Thailand. A larger proportion of Japanese investment has gone into promoted industries of Thailand than into those of other countries. These investments should be regarded as "approved" by the Thai government. In contrast, American investment has gone relatively more to non-promoted industries, and to exploit natural resources for exports.

It was pointed out that Japanese investment in Southeast Asia was responding significantly to the protection-subsidy policies of these countries. In Thailand, the structure of protection-subsidy policies, especially in the 1960's was found to have encouraged investment in import substituting industries, and encouraged imports of capital goods and industrial raw materials. These commodities have come mostly from Japan, thus completing the circle of Thai-Japanese trade and investment.

A conclusion implicit in the preceding discussion is that Thai-Japanese economic relations in terms of trade and investment, which show Thailand to be very much linked to Japan, have been the outcome of trade and industrial policies of both countries, and of their stages of industrial development. It is difficult to deny that Thailand was partly responsible for the close relationship she enjoyed with Japan at the end of the 1960's. To a certain extent this is also true in the case of the United States. This has led to several problems to which both trading partners have contributed. Problems related to management and ownership, labor relations, transfer of technology and its cost have surfaced. These have been manifested in the form of an anti-Japanese movement, and, more recently, an anti-American movement. Most of these problems, however, were not unexpected since Thailand still lacked many important conditions and the infrastructure needed for foreign investment and rapid industrialization. The system made it very attractive for foreign investment to concentrate on the domestic market, and very easy for it to dominate the business in which it was involved. The situation thus appeared as one in which a weaker partner, Thailand, was being exploited by stronger partners such as Japan and the United States. The recent developments and recommended changes in policies affecting trade and investment outlined below, came in response to the problems created by foreign investment and the industrialization in the 1960's.

First, the Board of Investment realized as early as 1967 that the incentives given under the Promotion Act of 1962 were too generous, and in many cases were not justified. Thus, in 1967, the 100 per cent and 50 percent exemptions from tariffs and business taxes on raw materials and machinery were dropped. In 1972, the government announced a new Investment Promotion Act which gave tariff and business tax exemptions only to machinery imports, except for promoted industries, in specified areas. But for promoted export industries,

complete exemptions from tariffs and taxes on material inputs and machinery are allowed.[28)]

The encouragement of exports provided for in the new Investment Promotion Act is consistent with the overall development plan of the early 1970's, which adopted export promotion as one of its high priority activities. In recent years, an important development in trade and industrial policies aimed at promoting exports occurred. Exporters of industrial products are now entitled to receive several kinds of benefits, such as refund of business and excise taxes, exemption from import duties on material inputs, credit subsidization and provision of credit facilities by the Bank of Thailand and by the Industrial Finance Corporation of Thailand. These combined provisions create considerable incentives for exports. For example, only promoted export industries now receive complete exemption from import duties on material inputs. The tax refund for domestic material inputs given by the Ministry of Finance is also quite substantial. Within two years of operation, the amount of tax refund given by the Fiscal Policy Office was 58.5 million baht.[29)] The discount rate charged by the Bank of Thailand was as low as 5%. The IFCT charges 10.5% for its loans in Thai currency, 9.5% for foreign currency, strong preference being given to export industries.[30)] In addition, procedures for obtaining these benefits have been greatly simplified.[31)]

Parallel to the developments of manufactured exports, Thailand has adopted a more protective attitude towards local industries and businesses and a more cautious attitude towards foreign investment and participation. The changes stem from concern over and criticism against foreign domination in the new industries. Japanese companies have most often been singled out for attack, simply because of their over-representation in the Thai economy. The new attitude is demonstrated by the Alien Business Law of November, 1972, and the Alien Occupation Law of March, 1973.[32)] These two laws specify certain kinds of industries and activities in which foreign-owned companies and foreigners are not allowed to be engaged or allowed only to a certain extent. The intention is to encourage joint-ventures, to reserve certain activities for Thais, and, perhaps most significantly, to keep a close watch on foreign participation in the Thai economy.

Further evidence demonstrating the concern of Thailand about foreign investment was the appointment of a Foreign Investment Committee in early 1974 to discuss problems of foreign investment and to make recommendations to the government on foreign investment policies. Several issues were discussed, and it was generally agreed that foreign investment problems must be taken seriously. Concern was expressed over the domination of Japanese investment, and a preference expressed for diversification of the nationality of foreign capital. Investment in the form of joint ventures was strongly recommended, but the degree of participation could vary according to the nature

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28) See the Section on Thailand in Draper, op.cit.

29) Fiscal Policy Office, Ministry of Finance, as of July 9, 1974. The rate is now 10.5% for all currency.

30) The amount of loans committed (signed) by the IFCT increased more than 5 times since 1970, totalling 1.14 billion baht as at the end of 1973.

31) For a more detailed discussion on recent development in industrial policies, see Akrasanee, The Structure of Effective Protection in Thailand, op.cit.

32) For a detailed discussion of these laws see Draper, op.cit., pp.164-167.

of the industry. For example, an electronic product assembly industry for export could be entirely foreign owned. Industries should also be classified according to the need for foreign investment, and to the extent of foreign participation allowed. Finally, it was felt strongly that if privileges were to be given to an industry with foreign investment, a thorough benefit-cost analysis of the project should be made. Factors such as cost of technology, market control, pollution, utilization of resources, etc., should be taken into consideration to identify the full benefits from foreign investment, and to avoid political problems.

The Japanese economy and economic policies themselves have been undergoing a series of readjustments following a decade of rapid economic growth, and of reactions to its overseas expansion and involvement. It is expected that the pace of industrialization in Japan will slow down. In addition, owing to a growing concern over environmental conditions, some of its heavy industries will be moved overseas. As Japan adjusts its industrial structure to concentrate on the production of more sophisticated, knoledge-intensive, goods and more fashionable products, the demand for consumer good imports will grow. The United States is also moving in the same direction as Japan. Thus it can be expected that there will be a good opportunity for Thai exports of these products to the United States.

These recent developments will have important effects on Thai international economic relations. For Japan, the growing complaint in Thailand about anything Japanese must be recognized. The point is that "anything Japanese" often refers only to "business". For the United States the complaint is that it has been too concerned with politics. Since there are many other aspects of the relations between any two nations that are social, cultural, and educational in nature, they should be explored and encouraged. In the past they have been given too little attention, especially in the case of Japan. Even the business relationship could be improved. In terms of trade and investment, Japan could play an important role in the development of Thai manufactured exports, through her worldwide network of trading firms.[33] The United States could also help in the development. Investment in the form of joint ventures should be encouraged, with increasing participation from the Thai side in as many aspects as possible. This will help Japan and the United States in their competitive position on investment projects since Thailand is likely to adopt a policy to diversify sources of foreign investment.

It may be expected that the role of Japan in the Thai economy will grow rather than decline, whereas United States business involvement may decline, following recent political developments, especially the newly-established Thai-Chinese relations. The Thai policy of export promotion during the 1970's coincides with the new attitude towards "better living" in Japan. Thus there is a strong tendency for Japan to invest in Thailand in the production of commodities to be exported to Japan by companies with Japanese investment. Some industries in Japan considered to be environmentally "dirty" may be

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33) According to the existing Alien Business Law this is inconvenient. Export trade is considered to be "commission trade" and a foreign company with more than 50% foreign participation is prohibited from such trade. However Japanese companies have been forming companies with a Thai majority.

set up in Thailand. Therefore, to prevent the ill-effects of these industries, and ill-feeling against Japanese investment, Thailand must lay out guidelines, set up rules and regulations, for the industries to follow. Thailand should also take advantage of Japanese trading firms in the promotion of her exports.

For the long run, one should take a multilateral approach to Thailand's economic relations with countries like the United States and Japan. In short, relations should be viewed in the context of ASEAN, East Asia, and North and South trade. For example, foreign investment in ASEAN could be made complementary among ASEAN countries instead of competitive if inter-ASEAN trade in manufactures could be developed. With a growing interest in regional cooperation, this seems a very interesting prospect for further investigation.

Appendix Table 1 Commodity Composition and Share of Thailand's Imports by Broad Industrial Classification (%)

(Number of Items)	Total			Japan			U.S.		
	1962	1970	1972	1962	1970	1972	1962	1970	1972
Commodity Composition									
1. Non-durable consumer goods (10)	24.77	12.91	10.66	32.17	8.26	5.80	14.86	9.52	18.72
2. Durable consumer goods (8)	7.09	7.36	7.86	9.53	9.66	7.15	5.74	7.65	13.06
3. Intermediate products chiefly for consumer goods (8)	11.36	15.32	19.04	11.53	15.85	17.38	16.35	21.74	30.96
4. Intermediate products chiefly for capital goods (3)	5.75	9.57	10.53	11.23	15.30	17.28	3.84	6.43	6.42
5. Capital goods (14)	28.23	34.70	31.69	20.94	35.83	38.60	40.44	36.30	26.40
6. Other commodities (7)	22.79	20.14	20.20	14.60	15.11	13.79	18.76	18.35	14.44
7. Total (50)	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Share									
1. Non-durable consumer goods (10)	100	100	100	37.89	23.95	20.05	10.18	10.96	12.82
2. Durable consumer goods (8)	100	100	100	39.22	49.09	33.48	13.72	15.44	25.97
3. Intermediate products chiefly for consumer goods (8)	100	100	100	29.61	38.70	33.71	24.41	21.07	25.49
4. Intermediate products chiefly for capital goods (3)	100	100	100	57.03	59.78	60.60	11.35	9.98	9.57
5. Capital goods (14)	100	100	100	21.64	38.64	44.99	24.29	15.54	13.06
6. Other commodities (7)	100	100	100	18.69	28.08	25.01	13.96	13.53	11.21
7. Total (50)	100	100	100	29.18	37.42	36.93	16.96	14.85	15.68

(Number of Items)	West Germany			U.S.			Others		
	1962	1970	1972	1962	1970	1972	1962	1972	1972
A. Commodity Composition									
1. Non-durable consumer goods (10)	10.51	8.44	9.08	12.70	11.07	13.46	29.97	21.57	16.61
2. Durable consumer goods (8)	8.57	6.56	10.27	11.82	6.70	12.41	4.42	4.89	5.14
3. Intermediate products chiefly for consumer goods (8)	10.87	13.94	17.68	10.25	12.31	15.80	9.35	12.78	16.21
4. Intermediate products chiefly for capital goods (3)	1.93	3.37	5.31	2.44	5.76	3.95	3.87	6.86	7.31
5. Capital goods (14)	50.00	52.97	44.05	44.24	47.07	41.17	20.47	24.85	22.67
6. Other commodities (7)	18.12	14.73	13.60	18.55	17.08	13.21	32.83	29.05	32.06
7. Total (50)	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
B. Share									
1. Non-durable consumer goods	3.05	5.54	6.29	4.56	6.40	6.62	44.32	53.15	54.18
2. Durable consumer goods (8)	8.70	7.55	9.61	14.83	6.79	8.25	23.53	21.13	22.67
3. Intermediate products chiefly for consumer goods (8)	6.89	7.71	6.85	8.03	5.99	4.35	31.06	26.53	29.59
4. Intermediate products chiefly for capital goods (3)	2.42	2.98	3.72	3.78	4.49	1.97	25.42	22.77	24.15
5. Capital goods (14)	12.75	12.93	10.26	13.95	10.12	6.82	27.37	22.77	24.87
6. Other commodities (7)	5.72	6.20	4.97	7.25	6.32	3.43	54.39	45.87	55.18
7. Total (50)	7.20	8.47	7.38	8.90	7.46	5.25	37.76	31.80	34.77

Note: Compiled from Department of Customs data.

Appendix Table 2

Export Performances of Selected Countries in Thailand from 1962 to 1970 (%)*

Country	Actual Growth	Average Growth	Commodity Composi-tional Effect	Share Effect			Export Performance
				Total	Pure	Inter-action	
	(A)	(W)	(C)	(P)	(P_1)	(P_2)	(A-W)
Total export, based on export structure of 1962							
Annual growth rate, simple rate (compound rate)							
Japan	25.1 (14.8)	16.9 (11.3)	-2.2	10.4	2.6	7.8	8.2
U.S.	13.2 (9.4)	16.9 (11.3)	4.3	-8.0	-3.4	-4.6	-3.7
West Germany	22.0 (13.6)	16.9 (11.3)	6.9	-1.8	0.1	-1.9	5.1
U.K.	12.1 (8.8)	16.9 (11.3)	5.6	-10.4	-2.6	-7.8	-4.8
Others	12.2 (8.9)	16.9 (11.3)	-3.1	-1.6	0.1	-1.7	-4.7
Proportionate share of export increase							
Japan	100.0	67.0	-8.6	41.6	10.3	31.3	33.0
U.S.	100.0	127.7	32.7	-60.4	-25.5	-34.9	-27.7
West Germany	100.0	76.4	31.6	-8.0	0.2	-8.2	23.6
U.K.	100.0	139.4	46.6	-86.0	-21.6	-64.4	-39.4
Others	100.0	137.9	-25.6	-12.3	-1.0	-11.3	-37.9

* The figures are based on Thailand's total imports classified into 50 items. Various export growth effects are measured in terms of absolute values using the rates of total import expansion of these fifty items from 1962 to 1970. These values are then converted to growth rates using the initial period exports as the base. See text for definitions and computational procedures.

Appendix Table 3

Export Performances of Selected Countries in Thailand by Commodity Groups from 1962 to 1970 (%)

	Actual Growth	Average growth Effect	Commodity Compositional Effect	Share Effect			Export Performance
				Total	Pure	Interaction	
	(A)	(W)	(C)	(P)	(P_1)	(P_2)	(A-W)
Based on export structure of 1962 Annual growth rate, simple rate (compound rate)							
Non-durable consumer goods		(2.5)					
Japan	-2.8(-3.2)	2.8	-3.1	-2.6	-2.9	-0.3	-5.6
U.S.	4.0 (3.5)	2.8	4.2	-3.0	-2.7	-0.3	1.2
West Germany	15.2(10.5)	2.8	6.8	5.8	4.0	1.7	12.5
U.K.	8.9 (7.0)	2.8	6.7	-0.6	1.7	-2.3	6.2
Others	5.8 (4.9)	2.8	0.5	2.6	2.6	*	3.1
Durable consumer goods		(11.8)					
Japan	25.6(14.9)	18.0	0.1	7.5	3.4	4.1	7.6
U.S.	21.8(13.4)	18.0	-1.7	5.5	2.8	2.7	3.8
West Germany	13.9 (9.8)	18.0	-	-4.1	-1.9	-2.1	-4.1
U.K.	1.5 (1.4)	18.0	-1.1	-15.4	-6.5	-8.9	-16.5
Others	14.8(10.3)	18.0	1.5	-4.6	-2.7	-1.8	-3.1
Intermediate products chiefly for consumer goods		(15.5)					
Japan	39.2(19.4)	27.1	-1.7	13.8	4.7	9.2	12.1
U.S.	21.7(13.4)	27.1	-2.2	-3.2	-2.7	-0.5	-5.4
West Germany	31.8(17.1)	27.1	5.3	-0.6	0.4	-1.0	4.7
U.K.	17.0(11.4)	27.1	-0.2	-9.9	-2.6	-7.3	-10.1
Others	21.3(13.2)	27.1	*	-5.8	-2.2	-3.6	-5.8
Intermediate products chiefly for capital goods		(18.6)					
Japan	38.8(19.3)	36.4	-3.4	5.7	1.6	4.1	2.4
U.S.	30.5(16.8)	36.4	-0.4	-5.5	-3.8	-1.7	-5.9
West Germany	47.7(21.7)	36.4	6.5	4.7	1.6	3.1	11.3
U.K.	45.5(21.2)	36.4	4.5	4.5	-	4.5	9.0
Others	31.3(16.9)	36.4	6.4	-11.5	-2.0	-9.5	-5.1
Capital goods		(14.1)					
Japan	51.9(22.7)	23.6	-2.6	30.9	10.1	20.8	28.3
U.S.	10.6 (8.0)	23.6	0.4	-13.4	-4.8	-8.6	-13.0
West Germany	24.1(14.4)	23.6	4.7	-4.2	-0.8	-3.4	0.5
U.K.	13.7 (9.6)	23.6	2.9	-12.8	-3.4	-9.4	-9.9
Others	17.5	23.6	-2.4	-3.7	-1.5	-2.2	-6.1
Other commodities		(9.5)					
Japan	26.5(15.3)	13.4	0.4	12.6	2.2	10.4	13.1
U.S.	12.6 (9.1)	13.4	8.2	-9.0	-3.2	-5.8	-0.8
West Germany	15.6(10.7)	13.4	1.9	0.3	0.5	-0.3	2.2
U.K.	10.1 (7.6)	13.4	7.2	-10.5	-1.5	-9.0	-3.3
Others	9.2 (7.3	13.4	-3.1	-1.0	0.2	-1.2	-4.1

* Less than 0.05

Appendix Table 4

The Estimated Elasticity of Substitution between Japan, the U.S. and W. Germany in Nine Selected Commodities

Commodity Group	Constant	Elasticity of Substitution	R^2
I. Electric Appliances			
1. Japan - U.S.	0.05 (1.44)	-1.32 (-4.60)	0.68
2. Japan - W. Germany	-0.01 (-0.32)	-0.83 (-2.07)	0.30
II. Radio receivers			
3. Japan - U.S.	0.70 (4.07)	-1.12 (-1.64)	0.21
4. Japan - W. Germany	0.15 (1.70)	-1.20 (-2.90)	0.46
III. Television receivers			
5. Japan - U.S.	-0.85 (-4.18)	-9.85 (-4.06)	0.62
6. Japan - W. Germany	-0.21 (-2.15)	-0.83 (-1.34)	0.15
IV. Fertilizers			
7. Japan - U.S.	-0.02 (-0.21)	-0.21 (-0.33)	0.01
8. Japan - W. Germany	-0.11 (-2.31)	-0.30 (-0.30)	0.09
V. Pesticides			
9. Japan - U.S.	-0.02 (-0.16)	-1.26 (-2.94)	0.46
10. Japan - W. Germany	-0.29 (-5.92)	-1.46 (-4.34)	0.65
VI. Tractors			
11..Japan - U.S.	-0.08 (-0.57)	-0.87 (-2.00)	0.29
12. Japan - W. Germany	-0.03 (-0.46)	-0.97 (-2.74)	
VII. Tubes and Pipes			
13. Japan - U.S.	-0.31 (-2.75)	-2.64 (-4.15)	0.63
14. Japan - W. Germany	-0.32 (-2.31)	-2.77 (-2.84)	0.44
VIII. Buses and Trucks			
15. Japan - U.S.	-0.13 (-1.50)	-1.67 (-6.46)	0.81
16. Japan - W. Germany	0.09 (0.83)	-3.31 (-4.63)	0.68
IX. Motor Cars			
17. Japan - U.S.	-0.56 (-4.59)	-1.34 (-1.64)	0.21
18. Japan - W. Germany	-0.24 (-3.50)	-3.59 (-3.51)	0.55

Note: The value in parentheses is the t-statistic.

Appendix Table 5

Commodity Composition Share and Growth of Thailand's Total Exports and Exports to Japan and the U.S. by Broad Commodity Groups (%)

SITC	Commodity Composition						Proportionate Share of Exports to				Compound Rate of Annual Growth from 1962-63 to 1972-73		
	Total		Japan		U.S.		Japan		U.S.				
	1962-63	1972-73	1962-63	1972-73	1962-63	1972-73	1962-63	1972-73	1962-63	1972-73	Total	Japan	U.S.
0 Food and Live Animals	53.46	45.40	40.48	36.51	19.44	12.20	12.74	20.57	2.96	2.75	8.8	14.2	8.1
1 Beverages and Tobacco	0.42	1.20	0.16	0.73	-	1.04	6.41	15.65	6.38	8.84	22.8	34.4	*
2[a]Crude Material Excluding Fuel	42.71	33.18	58.92	46.51	74.30	52.45	23.20	35.87	23.21	16.15	7.9	12.7	9.3
3 Mineral Fuel, etc.	-	1.33	-	0.26	-	-	-	5.04	-	-	*	*	-
4 Animal & Vegetable Oil & Fat	0.12	0.09	-	**	-	-	-	1.31	-	-	7.6	*	-
5 Chemicals	0.11	0.45	0.08	0.56	0.08	0.43	11.18	32.10	5.68	9.77	26.9	51.1	33.9
6[b]Basic Manufactures	1.69	10.78	0.08	9.14	2.31	9.74	0.76	21.68	11.09	9.23	33.1	86.2	30.7
7 Machinery & Transport Equipment	0.04	0.25	-	0.03	-	0.21	-	3.32	-	8.48	34.9	*	*
8 Miscellaneous Manufactures	0.45	2.65	0.07	0.87	1.25	16.99	2.71	8.46	22.94	65.61	32.2	48.4	46.9
9 Goods not Classified	1.00	4.67	0.22	5.37	2.61	6.94	3.74	29.42	21.34	15.18	29.2	58.8	24.8
(0 to 4)[a] Primary	96.71	81.20	99.55	84.02	93.74	65.69	17.32	26.47	7.89	8.26	8.7	13.4	9.2
(5 to 8)[b] Manufactures	2.29	14.13	0.23	10.61	3.65	27.37	1.65	19.21	12.97	19.79	32.7	73.0	38.5
(0 to 9) Total	100.00	100.00	100.00	100.00	100.00	100.00	16.82	25.58	8.14	10.21	10.7	15.4	13.2

Notes: a = including Tin (SITC 687)
b = excluding Tin (SITC 687)
* = no value in the first period
** = less than 0.005

Sources: U.N., Commodity Trade Statistics (various issues) for 1962, 1963 and 1972; Department of Customs, Foreign Trade Statistics of Thailand for 1973

Appendix Table 6 Thai Exports to Japan and the United States

	Actual Export Growth	Average Growth Effect	Commodity Compositional Effect	Share Effect			Export Performance
				Total	Pure	Interaction	
	(A)	(W)	(C)	(P)	(P_1)	(P_2)	(A-W)
A. Based on export structure of 1962-63							
I. Annual growth rate, simple average (compound rate)							
a) Exports to Japan							
1. Primary products	22.98(10.1)	35.31(16.3)	-18.89	6.56	5.61	0.95	-12.33
2. Manufactured products	484.72(47.7)	121.19(29.3)	-73.23	436.75	17.52	419.23	363.53
3. Total	28.58(14.5)	40.92(17.7)	-24.04	11.70	5.74	5.96	-12.34
b) Exports to the U.S.							
4. Primary products	15.21(9.7)	13.98(9.1)	-5.87	7.11	1.90	5.21	1.23
5. Manufactured products	263.98(39.3)	27.82(14.2)	-8.63	244.79	63.11	181.68	236.13
6. Total	24.47(13.2)	19.51(11.4)	-10.60	15.59	4.11	151.48	4.96
II. Proportionate share of export increase							
a) Exports to Japan							
7. Primary products	100.00	153.66	-82.20	28.54	24.39	4.15	-53.66
8. Manufactured products	100.00	25.00	-15.11	90.10	3.61	86.49	75.00
9. Total	100.00	143.17	-84.12	40.95	20.10	20.85	-43.17
b) Exports to the U.S.							
10. Primary products	100.00	91.90	-38.63	46.73	12.52	34.21	8.10
11. Manufactured products	100.00	10.54	-3.27	92.73	23.91	68.82	89.46
12. Total	100.00	79.73	-43.32	63.58	16.70	46.88	20.27
B. Based on export structure of 1972-73							
I. Annual growth rate, simple average							
a) Exports to Japan							
1. Primary products	6.97	7.79	-2.53	4.73	-	-	-0.82
2. Manufactured products	9.80	9.24	0.21	0.35	-	-	0.56
3. Total	7.41	8.04	-2.12	1.49	-	-	-0.63

(continued on next page)

Table 6

(continued)

	Actual Export Growth	Average Growth Effect	Commodity Compositional Effect	Share Effect			Export Performance
				Total	Pure	Interaction	
	(A)	(W)	(C)	(P)	(P_1)	(P_2)	(A-W)
b) Exports to the U.S.							
4. Primary products	6.03	5.83	-0.55	0.75	-	-	0.20
5. Manufactured products	9.63	7.36	-0.03	2.30	-	-	2.27
6. Total	7.10	6.61	-0.71	1.19	-	-	0.49
II. Proportionate share of export increase							
a) Exports to Japan							
7. Primary products	100.00	111.85	-36.25	24.39	-	-	-11.86
8. Manufactured products	100.00	94.29	2.10	3.61	-	-	5.71
9. Total	100.00	108.49	-28.59	20.10	-	-	-8.49
b) Exports to the U.S.							
10. Primary products	100.00	96.64	-9.16	12.52	-	-	3.36
11. Manufactured products	100.00	76.36	-0.26	23.91	-	-	23.64
12. Total	100.00	93.14	-9.94	16.70	-	-	6.86

* The result is based only on those 3 digit SITC items, which Japan (the U.S.) imported from Thailand either in the initial or end period, comprising about one-third of the former's total imports. Both sets of the computation (A&B) are measured in terms of the absolute value, using the rates of Japan's (the U.S.) import expansion from 1962-63 to 1972-73. Converting these values to average growth rates, the initial and end period export values are used as the base in sets A&B respectively. See text for definitions and computational procedures.

Source: U.N., Commodity Trade Statistics (various issues)

Appendix Table 7
Registered Capital of Firms Granted Promotion Certificates Classified by Nationalities from October 26, 1960 - December 31, 1974

Serial Number	Nationality of Ownership	Registered capital owned by one nationality		Registered capital of joint ventures		Total Registered capital		Foreign Registered capital
		Thousand Baht	%	Thousand Baht	%	Thousand Baht	%	%
1	Thailand	4,326,038	93.66	4,851,066	58.86	9,177,104	71.22	-
2	Japan	234,194	5.02	1,309,836	15.89	1,544,030	11.96	41.57
3	U.S.A.	39,740	0.85	500,526	6.07	540,266	4.19	14.54
4	Republic of China	3,000	0.06	453,228	5.51	456,228	3.53	12.28
5	United Kingdom	11,000	0.24	126,085	1.54	137,085	1.06	3.69
6	Malaysia	-	-	102,855	1.26	102,855	0.80	2.77
7	Israel	-	-	80.750	0.98	80,750	0.63	2.17
8	Hong Kong	-	-	175,863	2.13	175,863	1.36	4.73
9	France	-	-	60,000	0.73	60,000	0.46	1.62
10	Singapore	11,138	0.24	42,557	0.52	53,695	0.42	1.45
11	West Germany	16,750	0.36	35,942	0.44	52,692	0.41	1.42
12	Netherlands	-	-	50,226	0.61	50,226	0.39	1.35
13	India	8,000	0.17	41,787	0.51	49,787	0.39	1.34
14	Switzerland	-	-	39,646	0.48	39,646	0.31	1.07
15	Panama	-	-	35,151	0.43	35,151	0.27	0.94
16	Philippines	-	-	18,705	0.23	18,705	0.14	0.50
17	Australia	-	-	19,134	0.19	19,134	0.15	0.52
18	Denmark	-	-	15,935	0.19	15,935	0.12	0.43
19	Portugal	-	-	13,128	0.16	13,128	0.10	0.35
20	Others	-	-	269,534	3.27	269,534	2.09	7.26
	Total	4,649,860	100	8,241,954	100	12,891,814	100	100
	of which: Foreign	323,822	6.96	3,390,888	41.4	3,714,710	28.8	-

Source: Board of Investment

Appendix Table 8 Foreign Share of Total Registered Capital
October 1960 - June 1973 (percentage)1/

	Average Share of Registered Capital			Composition of Registered Capital		
	Foreign	Others2/	Total	Foreign	Others2/	Total
Japanese Share						
Exceeding 50%	60.6	39.4	100	74.1	57.2	66.4
Less than 50%	41.9	58.2	100	25.9	42.8	33.6
Total	54.3	45.7	100	100.0	100.0	100.0
(฿ 1,000,000)				(1,077.0)	(905.0)	(1,982.9)
The U.S. Share						
Exceeding 50%	66.9	33.1	100	95.1	85.3	91.6
Less than 50%	37.4	62.6	100	4.9	14.7	8.4
Total	64.4	35.6	100	100.0	100.0	100.0
(฿ 1,000,000)				(609.0)	(336.0)	(945.0)
The U.K. Share						
Exceeding 50%	88.4	11.6	100	29.7	3.5	1.4
Less than 50%	31.9	68.1	100	70.3	96.5	86.2
Total	39.1	60.9	100	100.0	100.0	100.0
(฿ 1,000,000)				(156.6)	(244.0)	(400.6)

1/ Compiled from the Board of Investment data. The number of firms included was 96 Japanese, 46 U.S., and 27 U.K.

2/ Mostly Thai owned.

Appendix Table 9 Registered Capital and Total Investment of Promoted Firms with Japanese Investment (Oct. 1960 - June 1973)

ISIC Industries Group	Registered Capital (฿1,000)				Total Investment (assets) (฿1,000)	Sectoral Composition (%)			
						Registered Capital			Total Investment
	Japanese	Other 2/	Total	Japanese Shares (%)		Japanese	Other 2/	Total	
Agriculture, forestry, & fishing	7,150	16,350	23,500	30.4	79,000	0.7	1.8	1.2	1.4
1110 Agriculture product, curing	5,400	14,600	20,000	27.0	70,000	0.5	1.6	1.0	1.2
1301 Ocean & coastal fishing	1,250	1,250	2,500	50.0	5,000	0.1	0.1	0.1	0.1
1302 Fishing nes. (cold storage)	500	500	1,000	50.0	4,000	0.046	0.1	0.1	0.1
Food, Beverage & Tobacco	11,200	16,800	28,000	40.0	67,000	1.0	1.9	1.4	1.2
3113 Canning & pres. Food	8,000	12,000	20,000	40.0	50,000	0.7	1.3	1.0	0.9
3122 Prepared Animal Feed	3,200	4,800	8,000	40.0	17,000	0.3	0.5	0.4	0.3
Textiles & Apparel	562,390	444,760	1,007,150	55.8	3,304,700	52.2	49.1	50.8	57.3
3211 Thread & Yarn	216,950	159,550	376,500	57.6	1,599,105	20.1	17.6	19.0	27.7
- Textile Fabrics	282,975	262,125	545,100	51.9	1,535,478	26.3	28.9	27.5	26.6
3212 Manf. of fertilizers	10,000	4,300	14,300	69.9	48,500	0.9	0.5	0.7	0.8
3213 Knitting mills (outerwear)	4,700	6,300	11,000	42.7	22,617	0.4	0.7	0.6	0.4
3213 Cordage, rope & twine	40,905	5,345	46,250	88.4	85,000	3.8	0.6	2.3	1.5
3220 Wearing apparel	6,860	7,140	14,000	49.0	14,000	0.6	0.8	0.7	0.2
Chemicals, Petroleum, Rubber & Plastics	222,230	146,270	368,500	60.3	901,650	20.6	16.1	18.6	15.6
3511 Manf. of basic incl. chemical except fertilizer	17,550	20,450	38,000	46.2	202,500	1.6	2.3	1.9	3.5
3512 Manf. of fertilizers	48,000	72,000	120,000	40.0	232,000	4.5	7.9	6.1	4.0
3513 Synthetic resins, plastic materials, man made fibre	109,900	12,100	122,000	90.1	207,000	10.2	1.3	6.2	3.6
3521 Paints, varnish, lacquer	8,080	9,920	18,000	44.9	14,800	0.8	1.1	0.9	0.3
3530 Petroleum refineries	1,000	1,500	2,500	40.0	8,000	0.1	0.2	0.1	0.1

Table 9 (a) (Continued)

ISIC Industries Group	Registered Capital (฿1,000)				Total Investment (assets) (฿1,000)	Sectoral Composition (%)			
						Registered Capital			Total Investment
	Japanese	Other[2/]	Total	Japanese Shares (%)		Japanese	Other[2/]	Total	
3551 Tyre and tube industries	34,900	25,100	60,000	58.2	223,350	3.2	2.8	3.0	3.9
3559 Other rubber products	2,800	5,200	8,000	35.0	14,000	0.3	0.6	0.4	0.2
Non-Metallic Mineral products	23,360	35,640	59,000	39.6	247,595	2.3	3.9	3.0	4.3
3620 Glass and glass products	11,760	12,240	24,000	49.0	151,000	1.1	1.4	1.2	2.6
3691 Structural clay products	8,400	18,000	27,000	31.1	62,595	0.8	2.1	1.4	1.1
3699 Non-metallic mineral products	3,200	4,800	8,000	40.0	34,000	0.3	0.5	0.4	0.6
Basic Metal Industries	83,951	113,049	197,000	42.6	605,977	7.8	12.5	9.9	10.5
3710 Iron & steel(only rolled steel)	62,951	64,049	127,000	49.6	423,977	5.8	7.1	6.4	7.4
3720 Non-ferrous metal	21,000	49,000	70,000	30.0	182,000	1.9	5.4	3.5	3.3
Fabricated Metal Production	161,444	126,355	287,799	56.1	547,202	14.9	13.9	14.5	9.5
3819 Fab. metal except machinery	950	4,050	5,000	19.0	9,000	0.1	4.5	0.3	0.2
3831 Electric industrial machinery	19,720	25,680	45,400	43.4	58,650	1.8	2.8	2.3	1.0
3832 Radio & communication equipment	38,520	39,980	78,500	49.1	137,856	3.6	4.4	4.0	2.4
3843 Motor vehicles	82,004	37,895	119,899	68.4	263,696	7.6	4.2	6.0	4.6
3844 Motorcycles and bicycles	18,750	10,250	29,000	64.7	63,000	1.7	1.1	1.5	1.1
3853 Manf. of watches and clocks	1,500	8,500	10,000	15.0	15,000	0.1	0.9	0.5	0.3
Miscellaneous Manf.	5,300	6,700	12,000	44.2	12,775	0.5	0.8	0.6	0.2
3902 Sporting athletic goods	4,900	5,100	10,000	49.0	10,000	0.5	0.6	0.5	0.2
3909 Manf. industries, nes.	400	1,600	2,000	20.0	2,775	0.04	0.2	0.1	0.04
Total	1,077,025	905,924	1,982,949	54.3	5,765,889	100.0	100.0	100.0	100.0

1/ Compield from the Board of Investment Data. The number of Japanese firms included was 96, the same as in Table 4.2.
2/ Mostly Thai owned.

Table 9 (b)

Registered Capital and Total Investment of Promoted Firms with U.S. Investment (October 1960 - June 1973)

Industry Group	Registered Capital (฿1,000)				Total Investment (assets) (฿1,000)	Sectoral Composition (%)			
						Registered Capital			Total Invest-ment
	U.S.	Other	Total	U.S. Share (%)		U.S.	Other	Total	
Agriculture, forestry & fishing	-	-	-	-	-	-	-	-	-
Mining and energy,	41,028	347	41,375	99.2	306,180	6.7	0.1	4.4	10.8
2200 Crude petroleum, natural gas	30,875	-	30,875	100.0	293,680	5.1	-	3.3	10.3
2301 Metal ore mining	160	340	500	32.0	2,500	*	0.1	0.1	0.1
2901 Stone quarrying, clay & sand	9,993	7	10,000	99.9	10,000	1.6	*	1.1	0.4
Food, Beverage & Tobacco	46,040	39,400	85,440	53.9	143,653	7.6	11.7	9.0	5.1
3112 Dairy products	26,000	13,000	39,000	66.7	19,600	0.4	3.9	4.1	0.7
3113 Canning & preserving of fruits & veg., fish, similar food	16,480	24,520	41,000	40.2	98,552	2.7	7.3	4.3	3.5
3116 Grain mill products	1,720	1,720	3,440	50.0	20,343	0.3	0.5	0.4	0.7
3122 Prepared animal feeds	1,840	160	2,000	92.0	5,158	0.3	0.1	0.2	0.2
Textiles & Apparel	48,140	44,982	93,122	51.7	430,900	7.9	13.3	9.9	15.2
3211 Thread & yarn	580	1,942	2,522	23.0	2,000	0,1	0.6	0.3	0.1
Textiles fabrics	30,480	30,120	60,600	50.3	301,600	5.0	9.0	6.4	10.6
3219 Mnf. textile, nes.	15,120	10,880	26,000	58.2	121,300	2.5	3.2	2.8	4.3
3220 Wearing apparel	1,960	2,040	4,000	49.0	6,000	0.3	0.6	0.4	0.2
Paper pulp & printing	20,170	16,300	36,470	55.3	64,320	3.3	4.8	3.9	2.3
3411 Pulp, paper and paterboard and paper product	20,176	16,300	36,476	55.3	64,320	3.3	4.8	3.9	2.3

Table 9 (b) continued)

Industry Group	Registered Capital (฿1,000)				Total Investment (assets) (฿1,000)	Sectoral Composition (%)			
						Registered Capital			Total Investment
	U.S.	Other	Total	U.S. Share (%)		U.S.	Other	Total	
Chemicals, Petroleum, Rubber and Plastics	221,497	75,860	297,357	74.5	768,583	36.4	22.6	31.5	27.0
3511 Basic industrial chemicals	33,000	11,000	44,000	75.0	53,550	5.4	3.3	4.7	1.9
3513 Synthetic resins, plastic material	2,997	360	3,357	89.3	19,178	0.5	0.1	0.4	0.7
3530 Petroleum refineries	100,000	-	100,000	100.0	100,000	16.4	-	10.6	3.5
3551 Tyre & tube industries	85,500	64,500	150,000	57.0	595,855	14.0	19.2	15.9	21.0
Non-metallic mineral products	12,500	12,500	25,000	50.0	45,000	2.1	3.7	2.6	1.6
3610 Pottery and earthen ware	12,500	12,500	25,000	50.0	45,000	2.1	3.7	2.6	1.6
Basic Metal industries	134,116	112,884	247,000	54.3	781,082	22.0	33.6	26.1	27.5
3710 Iron & steel basic industries	15,116	13,884	29,000	52.1	110,780	2.5	4.1	3.1	3.9
3720 Non-ferrous metal	119,000	99,000	218,000	54.6	670,302	19.5	29.5	23.1	23.6
Fabricated metal production	85,544	33,865	119,409	71.6	302,610	14.0	10.1	12.6	10.6
3819 Fab. metal except machinery	23,755	1,245	25,000	95.0	38,100	3.9	0.4	2.6	1.3
3822 Agricultural machinery	9,900	20,100	30,000	33.0	50,000	1.6	6.0	3.2	1.8
3829 Other non-electrical machine and equipment	5,000	-	5,000	100.0	18,000	0.8	-	0.5	0.6
3831 Electric industrial machinery	41,090	11,910	53,000	77.5	85,000	6.7	3.5	5.6	3.0
3833 Electrical housewares	300	100	400	75.0	6,000	0.1	*	*	0.2
3841 Ship building and repairing	499	510	1,009	49.5	5,300	0.1	0.2	0.1	0.2
3843 Motor vehicles	5,000	-	5,000	100.0	100,210	0.8	-	0.5	3.5
Total	609,035	336,138	945,173	64.4	2,842,328	100.0	100.0	100.0	100.0

* less than 0.05

Source: Compiled from the Board of Investment Data. The number of U.S. firm included was 46.

Appendix Table 10 Flows of Private Foreign Medium and Long Term Capital Cumulative Total from 1965 to 1974

	Total	Direct Investment			Loans	Suppli-er's Credit	Others
		Total	Equity	Loans			
A. Values in ฿1,000,000							
Net Balance							
Total	20,000	12,086	9,469	2,616	2,615	3,908	1,400
U.S.	6,338	4,442	3,586	855	751	540	604
Japan	6,182	3,678	3,101	576	704	1,650	149
U.K.	2,347	610	387	223	1,478	219	40
Others	5,144	3,356	2,395	962	- 318	1,499	607
Inflow (credit)							
Total	47,463	14,328	10,060	4,268	10,450	20,979	1,706
U.S.	11,892	5,429	3,846	1,582	4,085	1,728	650
Japan	16,897	4,021	3,166	855	1,204	11,394	279
U.K.	4,825	689	456	233	2,364	1,712	60
Others	13,850	4,190	2,592	1,598	2,797	6,145	717
Outflow (debit)							
Total	27,451	2,241	590	1,651	7,834	17,070	305
U.S.	5,552	986	259	726	3,333	1,187	46
Japan	10,716	343	64	278	499	9,743	130
U.K.	2,478	79	69	11	885	1,493	20
Others	8,705	833	198	636	3,117	4,647	109
B. Country Distribution (%)							
Net Balance							
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
U.S.	31.7	36.8	37.9	32.7	28.7	13.8	43.1
Japan	30.9	30.4	32.7	22.0	26.9	42.2	10.6
U.K.	11.7	5.0	4.1	8.5	56.5	5.6	2.9
Others	25.7	27.8	25.3	36.8	- 12.1	38.4	43.4
Inflow (credit)							
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
U.S.	25.1	37.9	38.2	37.1	39.1	8.2	38.1
Japan	35.6	28.1	31.5	20.0	11.5	54.3	16.4
U.K.	10.1	4.8	4.5	5.5	22.6	8.2	3.5
Others	29.2	29.2	25.8	37.4	26.8	29.3	42.0
Outflow (debit)							
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
U.S.	20.0	44.0	43.9	44.0	42.5	7.0	15.1
Japan	39.0	15.3	10.8	16.8	6.4	57.1	42.6
U.K.	9.0	3.5	11.7	0.7	11.3	8.7	6.6
Others	31.7	37.2	33.6	38.5	39.8	27.2	35.7
C. Composition (%)							
Net Balance							
Total	100.0	60.4	47.3	13.1	13.1	19.5	7.0
U.S.	100.0	70.1	56.6	13.5	11.8	8.5	9.5
Japan	100.0	59.5	50.2	9.3	11.3	26.7	2.4
U.K.	100.0	26.0	16.5	9.5	63.0	9.3	1.7
Others	100.0	65.2	46.6	18.7	- 6.2	29.1	11.8
Inflow (credit)							
Total	100.0	30.2	21.2	9.0	22.0	44.2	3.6
U.S.	100.0	45.6	32.3	13.3	34.4	14.5	5.5
Japan	100.0	23.8	18.7	5.1	7.1	67.4	1.7
U.K.	100.0	14.3	9.5	4.8	49.0	35.5	1.2
Others	100.0	30.3	18.7	11.5	20.3	44.4	5.2
Outflow (debit)							
Total	100.0	8.2	2.1	6.0	28.5	62.2	1.1
U.S.	100.0	17.8	4.7	13.1	60.0	21.4	0.8
Japan	100.0	3.2	0.6	2.6	4.7	90.9	1.2
U.K.	100.0	3.2	2.8	0.4	35.7	60.3	0.8
Others	100.0	9.6	2.3	7.3	35.8	53.4	1.3

Source: Bank of Thailand

Appendix Table 11 Financing of Merchandise Imports

(million of U.S. dollar)

	1966	1967	1968	1969	1970	1971	1972	1973	1966-73	%
Imports under grants	28.0	36.8	45.5	28.2	33.3	25.9	21.1	19.0	237.8	2.3
U.S. grants	15.6	29.5	37.8	24.6	17.9	14.5	12.5	9.1	161.5	1.5
U.N. and other specifided agencies	9.8	5.1	6.0	2.8	11.8	6.8	6.1	5.6	54.0	0.5
Colombo plan	2.6	2.2	1.7	0.8	3.6	4.6	2.5	4.3	22.3	0.2
Imports under project loans	38.3	42.1	48.8	53.6	43.0	35.1	55.2	68.9	385.0	3.7
Official	35.1	36.5	46.6	45.3	43.0	34.5	47.5	59.6	348.1	3.3
Private	3.2	5.6	2.2	8.3	-	0.6	7.7	9.3	36.9	0.4
Imports under Suppliers' credits	53.1	93.5	102.1	158.4	156.1	142.3	103.2	67.9	895.6	8.5
Official1/	-	0.5	3.6	16.5	16.5	10.5	0.7	0.7	49.0	0.5
Private	53.1	93.0	98.5	141.9	158.6	131.8	102.5	67.2	846.6	8.1
Machinery and parts	27.8	52.7	41.9	56.9	88.8	55.0	51.8	53.0	427.9	4.1
(of which weaving machinery)	(-)	(-)	(-)	(25.0)	(50.9)	(38.9)	(37.8)	(25.1)	(177.7)	1.7
Cars, buses and trucks	15.8	23.2	44.4	52.9	48.9	31.9	29.8	7.4	254.3	2.4
Tractors, rollers graders	6.8	12.4	9.7	9.1	6.0	5.0	9.0	3.1	57.1	0.5
Others	2.9	4.7	2.5	23.0	14.9	39.9	15.9	3.7	107.3	1.0
Others Imports under foreign investment	0.1	0.8	0.9	0.3	0.5	0.5	0.1	-	3.2	*
Imports induced by U.S. military expenditures	75.7	120.3	143.0	109.6	106.5	96.3	113.0	109.7	847.1	8.1
Direct	31.0	49.3	58.6	20.6	20.0	18.1	21.2	20.6	239.4	2.3
Indirect	44.7	71.0	84.4	89.0	86.5	78.2	91.8	89.1	634.7	6.0
Imports not subjected to foreign exchange payments	10.0	110.0	13.4	19.3	23.8	26.6	26.9	24.3	155.3	1.5
Subtotal	205.2	304.5	353.7	369.4	382.2	326.7	319.5	289.8	2,551.0	24.3
Imports financed by own resources	684.4	762.2	805.1	879.0	916.3	961.5	1,164.9	1,784.0	7,957.4	75.7
Total Imports	889.6	1,066.7	1,158.5	1,248.4	1,298.5	1,288.2	1,484.4	2,073.8	10,508.1	100.0

1/ including local government
* less than 0.05
Source: Bank of Thailand

Appendix Table 12(a) Value of Raw Materials and Machinery Used by Selected Industries with Japanese Investment, 1971[1]

(Percentatage in parenthesis)

Industry	No. of firms	Raw Materials			Machinery & spare parts		
		Domestic	Imported	Total	Domestic	Imported	Total
1. Agricultural products processing	3 3	43,407,440 (100.00)	-	43,407,440 (100.00)	3,328,377 (8.01)	38,221,813 (91.99)	41,550,190 (100.00)
2. Iron and steel	8	173,034,406 (38.28)	278,957,635 (61.72)	451,992,041 (100.00)	40,576,789 (12.70)	278,989,678 (87.30)	319,566,467 (100.00)
3. Chemical materials	1	600,000 (2.65)	22,026,487 (97.35)	22,626,487 (100.00)	8,000,000 (27.44)	21,157,653 (73.56)	29,157,653 (100.00)
4. Thread, yarn and rope	4	20,510,915 (66.68)	10,251,040 (33.32)	30,761,955 (100.00)	628,189 (1.01)	58,864,985 (98.94)	59,493,174 (100.00)
5. Textile fabrics	9	337,962,935 (58.17)	243,001,134 (41.83)	580,964,069 (100.00)	192,913,471 (21.39)	709,096,669 (78.61)	902,010,140 (100.00)
6. Intermediate chemical products	4	25,877,254 (49.83)	26,058,648 (50.17)	51,935,902 (100.00)	51,000 (0.01)	79,422,146 (99.94)	79,473,146 (100.00)
7. Rubber products	1	18,725,000 (30.00)	43,692,000 (70.00)	62,417,000 (100.00)	21,695,000 (20.00)	86,780,000 (80.00)	108,475,000 (100.00)
8. Glass and glass products	1	2,321,306 (19.07)	9,852,544 (80.93)	12,173,850 (100.00)	-	163,672,132 (100.00)	162,672,132 (100.00)
9. Other textile articles	3	181,419,573 (91.00)	17,952,040 (9.00)	199,371,613 (100.00)	380,210 (2.62)	14,115,123 (97.38)	14,495,333 (100.00)
10. Consumer electrical goods	9	39,144,126 (25.81)	112,532,923 (74.19)	151,677,049 (100.00)	25,716,301 (40.86)	37,223,862 (59.14)	62,940,163 (100.00)
11. Motor vehicle industry	10	63,267,038 (17.62)	295,898,411 (82.38)	359,165,449 (100.00)	431,278 (0.63)	67,626,183 (99.37)	68,057,461 (100.00)

1/ Compiled from the Board of Investment survey data. Firms included in this table were the ones whose data appear more "consistent and reasonable" in terms of value of import, output, machinery, amount of investment, etc.

Appendix Table 12(b) Value of Raw material and Machinery used by Selected Industries with U.S. Investment, 1971

(Percentages are in parenthesis)

Industry	No. of firms	Raw Materials			Machinery & spare parts		
		Domestic	Imported	Total	Domestic	Imported	Total
1. Food prepared preserved & canning	2	336,100,744 (93.46)	23,524,000 (6.54)	359,624,744 (100.00)	271,350 (1.08)	24,799,935 (98.92)	25,071,285 (100.00)
2. Mineral oil prospecting	1	-	-	-	631,844 (39.16)	981,457 (60.84)	1,613,301 (100.00)
3. Dairy products	2	17,057,731 (37.19)	28,802,773 (62.81)	45,860,504 (100.00)	5,090,000 (12.23)	36,515,367 (87.77)	41,605,367 (100.00)
4. Animal feed	1	4,225,165 (100.00)	-	4,225,165 (100.00)	213,754 (14.27)	1,284,514 (95.73)	1,498,268 (100.00)
5. Cement	1	61,463,908 (42.27)	83,942,074 (57.73)	145,405,982 (100.00)	56,455,380 (20.00)	225,821,522 (80.00)	282,276,902 (100.00)
6. Iron and steel	3	92,225,620 (47.03)	103,878,695 (52.97)	196,104,315 (100.00)	131,408,000 (28.64)	327,444,658 (71.36)	458,852,658 (100.00)
7. Synthetic fibre	1	-	1,350,727 (100.00)	1,350,727 (100.00)	347,692 (16.51)	1,758,365 (83.49)	2,106,057 (100.00)
8. Rubber product	2	28,118,689 (19.80)	144,188,113 (80.20)	142,376,802 (100.00)	11,219,478 (3.14)	346,557,876 (96.86)	357,777,354 (100.00)
9. Paper product	1	4,448,528 (24.38)	13,798,402 (75.62)	18,246,930 (100.00)	- -	26,801,526 (100.00)	26,801,526 (100.00)
10. Other textile articles	2	20,548,392 (43.67)	26,509,488 (56.33)	47,057,880 (100.00)	6,819,148 (57.01)	5,141,217 (42.99)	11,960,365 (100.00)
11. Consumer electric goods	3	6,708,662 (26.11)	18,983,839 (73.89)	25,692,501 (100.00)	4,257,299 (19.58)	17,480,371 (80.42)	21,737,670 (100.00)

Source: Compiled from the Board of Investment survey data.

Appendix Table 13

Export of Foreign-Based Promoted Firms as Percentage of Total Sales by Commodity Group, 1972

U.S. firms and joint ventures	
All items	39.56
Agriculture-based products	9.14
Mineral and ceramic products	49.77
Machinery	5.36
Textiles	3.83
Rubber	2.16
Japanese firms and Japanese joint ventures	1.91
A. Board of Investment Survey	
All items	5.40
Mineral and ceramic products	6.60
Rubber products	1.09
Textiles	8.79
B. Japan Chamber of Commerce Survey*	
All items	5.5
Chemical products	6.2
Motor vehicles	0.1
Textiles	7.3
Steel and iron products	6.3
Food products	19.4
Other manufactures	5.9

* covering firms that are promoted as well as non-promoted.
Source: Udom Kerdpibul, "Thailand's Experience with Multinational Corporations," Department of Economics, Kasetsart University, June 1974, Table 3 (mimeo.)

Appendix Table 14

Sources of Growth of Domestic Production, by Industry Groups, 1960-66, 1966-72, 1960-72

(Percentage contribution to the increase in million of bahts)

	1960 - 1966				1966 - 1972				1960 - 1972			
	ΔX*	DE*	EXE*	IMSE*	ΔX	DE	EXE	IMSE	ΔX	DE	EXE	IMSE
Processed food	8,544.8	68.5	42.1	-10.6	4,602.8	107.3	-7.8	0.54	13,147.5	84.5	24.7	-9.2
Beverages and tobacco	2,159.4	125.8	0.1	-25.9	3,441.9	73.6	-0.1	26.4	5,601.3	99.6	0	0.6
Construction materials	987.5	112.0	0.6	-12.6	1,955.8	69.5	10.9	19.6	2,943.3	87.6	7.5	4.9
Intermediate products I	5,088.1	33.3	27.6	39.1	5,198.6	65.8	10.5	23.7	10,286.7	35.4	19.0	45.6
Intermediate products II	1,604.3	98.4	10.3	- 8.7	4,408.3	33.6	15.9	50.6	6,012.6	52.2	14.4	33.4
Consumer nondurables	1,756.2	124.4	8.2	-32.6	5,745.8	51.8	12.6	35.6	7,502.0	74.1	11.6	14.3
Consumer durables	239.6	81.9	4.1	14.0	347.7	31.7	1.6	66.7	587.3	50.9	2.6	46.5
Machinery	429.8	68.1	0.2	31.7	991.8	48.3	2.7	49.0	1,421.7	46.5	2.0	51.5
Transport equipment	848.4	151.4	0.5	-51.9	2,061.2	24.7	0.1	75.2	2,909.6	66.8	0.1	33.1
Total manufacturing	21,657.9	88.9	24.7	-13.6	28,753.8	64.1	6.5	29.4	50,412.0	77.9	14.3	7.8
Total manufacturing excluding food, beverages and tobacco	10,953.8	80.0	15.8	4.2	20,709.1	47.2	10.7	42.1	31,662.9	57.6	12.5	29.9

*ΔX = increase in domestic production

DE = domestic demand effect = $u_o \Delta D_t / |\Delta X_t|$

EXE = export expansion effect = $\Delta E_t / |\Delta X_t|$

IMSE = import substitution effect = $(u_t - u_o) D_t / |\Delta X_t|$

Source: Narongchai Akrasanee, ibid.

COMMENTS ON NAYA/NARONGCHAI PAPER

(a) DAVID LIM

I find the paper interesting in spite of its great length. However, I find it also a frustrating paper.

The authors have made use of the constant-market share model to provide a useful analytical framework with which to assess first, Japanese and American economic performance in Thailand and second, Thai economic performance in Japan and the United States.

Actual export growth is seen to consist of three parts:

(a) Average growth effect - the trend component;
(b) commodity compositional effect and
(c) competitive or share effect, which is broken into two parts:
   (i) the pure effect
   (ii) the interaction or diversification effect.

In their analysis of Japanese export performance in Thailand they find, whether at the aggregative or the disaggregated level, that Japan has the competitive edge over her competitors. Their conclusion is based on the finding that the competitive or share effect is the most dominant one among the three effects. Japan's ability to expand its exports in rapidly expanding items and areas (or the diversification effect) is found to be especially remarkable.

These results are all very interesting and it is therefore all the more frustrating that the authors do not go into the factors behind Japan's competitiveness in great detail.

They recognise the need to "pin-point what the competitiveness is comprised of or what it means", and indeed suggest factors such as relative price, quality, distance, speed of delivery, after-sales-service, and commercial/financial ties (such as supplier's credits).

However, apart from conducting simple regression analysis on the relationship between relative price and quantity exported and some discussion on the relevance of supplier's credit in determining imports from Japan, nothing was offered. The omission is especially serious if we examine the results of the simple regression analysis. The R^2's will be much smaller if adjustment is made for the degrees of freedom. The number of observations is only 12. Shortage of statistical data is mentioned for not carrying the analysis a bit further. Perhaps one may say that certain variables cannot be quantified. Yet unless we make an effort to collect the data and attemp to quantify more of these variables we can only go a limited distance in saying why Japan has been more successful than other competitors in the export market.

These comments are made not as criticism but rather as suggestions for further work. I think that these suggestions have special relevance in the discussion in Part III of the paper where they analyse the performance of Thailand in the Japanese and American import markets. Again the constant-market-share model is used and they find that the share/competitive effect is very important for the period 1962-63. What lies behind this? When the period 1972-73 is analysed, we are told of a change in the relative importance of the various effects. The share effect is less important and the trend effect more. Why?

In Sections IV and V of the paper, the authors discuss the types of Japanese and American investment in Thailand and the interaction between trade and investment. This is a useful discussion. It provides useful data, and leads to an interesting and necessary discussion on the costs and benefits of foreign investment in Thailand. The study of Thai dependence on Japan and on the United States must of necessity refer to the costs of Japanese and American investment in Thailand. However, in this discussion I encounter the same frustration that I had in reading the earlier sections. They found that Japanese firms "induce imports and do not export their products very much" and went on to say that this did not "establish the fact that they do not contribute to the Thai economy".

However, nothing is established by the authors _either_ way. A case study is quoted but one is not quite sure what are being compared.

(i) Is the greater "output" mentioned, output _per se_ or productivity? If the former, it is hardly surprising since foreign companies are usually larger than local ones.

(ii) What does "local employment" refer to? K/L or employment _per se_? Or is it the willingness to employ and train Thais?

(iii) Mention is also made of "efficiency" in the use of given scarce resources. What is "efficiency"? Is it X-efficiency in the sense meant by Leibenstein?

(iv) Lastly, the authors mentioned transfer pricing and remittances of profits. I think that their comment (suggestion) that Japanese firms remitted less profits and dividends than did British and American firms, might have been due to greater transfer pricing on their part sums up, I think, both the limitations of the study and the frustrations of the authors.

(b) General Discussion

Participants pointed out that one factor in the different pattern of United States and Japanese activity in Thailand was that the Thai market was far more important to Japan than it was to the United States. It was also remarked that there had perhaps been a too uncritical acceptance of foreign investment especially from Japan and the United States. The increasing volume of imports of intermediates was however a sign that industrialization was progressing, but perhaps Thailand was in too much of a hurry to industrialize - a process that in Japan had been proceeding for over 100 years.

Commenting on the technical aspects of the paper it was suggested that the Vernon model for constant market share analysis might have been preferable and that insufficient attention had been given to the effects of devaluation of the Japanese yen and the United States dollar which could affect the results.

6

SMALL ISLAND ECONOMIES: PROBELMS OF EXTERNAL DEPENDENCE

ASHOK V. DESAI

The propositions are well-established that small countries are more dependent on trade, that their exports are less diversified and that their trade is geographically less concentrated than of large countries.[1] However, the inference that the greater trade dependence of small countries makes them more vulnerable to external schocks has been disputed on theoretical as well as empirical grounds.[2]

The object of this paper is to examine how far these propositions apply to certain small island economies of the south Pacific. The evidence is drawn from three countries: Fiji, Western Samoa and Papua New Guinea; and most of it refers to Fiji. Whilst the South Pacific has a large number of small countries or colonies, their value for case studies must depend on the availability of statistics. The three economies selected here are among the better placed for data, though as will emerge in the course of this paper, statistical data available for even them are unequally abundant.

I. GOODS AND FACTORS OF PRODUCTION

Economic theory separates international trade in goods and services from movements of factors of production. We have a theory of trade which assumes that factors are immobile between countries; international capital movements are dealt with separately, as is the international migration of labour.

This treatment is inappropriate for small countries. Some of them derive sizeable receipts from the export of labour. Others occasionally receive substantial foreign investment and use it to finance current imports. A few receive foreign aid with the same effect. In 1972 for instance, Western Samoa received WS$2.7 million from remittances and pensions against WS$7.2 million from exports of goods and services (Table 3). Papua New Guinea earned A$157 million from visible and invisible exports, A$158 million of foreign investment and A$142 million of official grants and loans in 1971-1972 (Table 2). Fiji was not so dependent on export of labour as Western Samoa or on import of capital as Papua New Guinea; but a capital inflow of F$24 million was recorded in 1972 against current receipts of F$117 million; and there is a suspicion that the large

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1) Kuznets, S., "Economic growth of small nations" in E.A.G. Robinson (ed.) Economic Consequences of the Size of Nations, Macmillan, London, 1960, pp.18-23.

2) Tarshis, L., "The size of the economy and its relation to stability and steady progress" in E.A.G. Robinson (ed.), Economic Consequences of the Size of Nations, Macmillan, London, 1960, pp. 190-199. See also MacBean, A.I.; Export Instability and Economic Development, Allen and Unwin, London, 1966.

entry of F$19.5 million for errors and omissions consisted mainly of unrecorded capital imports. (Table 1).[3]

TABLE 1 BALANCE OF PAYMENTS: FIJI, 1968-1972

F$ Million

	1968		1969		1970		1971		1972	
	Cr	Dr	Cr	Dr	Cr	Dr	Cr	Dr	Cr	Dr
Merchandise	39.9	55.3	43.9	63.4	50.8	73.6	51.8	97.3	54.7	114.9
Nonmonetary Gold	3.5		3.4		3.3		2.7		4.0	
Freight & Insurance)							0.3	13.4	0.1	15.7
Freight)							(0.1)	(12.8)	(0.1)	(15.0)
Insurance)							(0.2)	(0.5)		(0.7)
Other Transport)	9.2	16.7	10.3	18.4	11.6	21.0	12.5	5.9	12.3	5.6
Passenger Fares)							(3.2)	(3.8)	(3.3)	(4.4)
Port Disbursements)							(8.5)	(0.2)	(8.5)	(0.2)
Other)							(0.8)	(1.9)	(0.5)	(1.0)
Travel	13.9	1.8	18.5	1.8	23.4	2.2	33.1	3.1	37.0	4.3
Income	1.6	8.4	2.2	10.1	2.4	10.6	3.3	13.4	4.7	13.9
Private							(1.1)	(12.6)	(2.1)	(13.2)
Government							(2.2)	(0.8)	(2.6)	(0.7)
Other Government	1.6	0.4	1.8	0.5	1.8	0.3	3.1	0.6	3.3	7.7
Military							(n)	(n)	(n)	(n)
Other							(3.1)	(0.6)	(3.3)	(0.7)
Other Private	1.2	1.5	0.9	1.7	1.9	1.9	2.0	1.7	1.3	2.4
Unrequited Transfer	2.5		4.2		2.4		8.9	5.9	12.1	5.0
Private		(0.9)		(0.9)		(1.6)	(4.6)	(5.9)	(4.7)	(4.0)
Government	(3.4)		(5.1)		(3.8)		(4.3)	(1.0)	(7.4)	(1.1)
Net Goods		(12.0)		(16.1)		(19.5)		(45.5)		(60.2)
Services		1.3	1.2		5.1		18.1		20.2	
Transfers	2.5		4.2		2.4		2.9		7.0	
Current Account		10.8		10.7		12.2		24.5		33.0
Private Long Term	4.7		5.5		5.6		12.4	1.6	24.1	2.1
Short Term										
Government Liabilities	1.4		1.4		1.4		1.8		1.0	
								0.2		0.6
Assets		0.8		7.7	3.1					
Banks				3.6		2.3	1.2		2.4	
Assets								0.4	9.2	
Central	0.2			1.4		3.9				
SDRs									1.2	
		1/		1/		1/		7.0		21.8
Reserves										
Gold										
SDRs										
IMF Position								(2.0)		(0.1)
CMA								(3.5)		(19.2)
Other								(1.5)		(1.1)
Errors & Omissions	5.3		16.5		8.3		17.6		19.5	
Net CapitalAccount	10.8		10.7		12.2		24.5		33.0	

1/ Included in government assets.
Sources: Bureau of Statistics, Suva.

By and large, export of labour is governed by demand and immigration policies of New Zealand and the United States. It is substantial from the eastern islands whose Polynesian people find readier acceptance in those two countries. For instance, 24 per cent of the population of American Samoa migrated to Hawaii and mainland USA between 1950 and 1960.[4] New Zealand has a larger po-

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3) Errors and omissions have long been a large credit entry in Fiji's balance of payments, and attempts to track down their origin have hitherto failed. Our guess is that they consist largely of retained profits and loans from Australian parent companies to their subsidiaries in Fiji. Much of the subsidiaries' business is in the nature of trade and storage with consequent need of working capital.

4) Economic Development Program for American Samoa, Wolf Management Services, New York, 1969.

TABLE 2 BALANCE OF PAYMENTS: PAPUA NEW GUINEA, 1967-1973

A$ Million

	1967-8		1968-69		1969-70		1970-71		1971-72		1972-73	
	Cr	Dr	Cr	Dr	Cr	Dr	Cr	Dr	Cr	Dr	Cr	Dr
Merchandise	58.2	122.6	64.1	136.2	70.7	193.2	76.8	242.0	93.4	218.5	229.1	209.8
Non monetary gold	0.8		0.8		0.8		0.7		0.8		0.6	
Transport	6.0	22.2	7.4	27.1	9.3	35.3	11.9	41.4	12.9	47.5	15.0	60.1
Travel	9.1	14.2	10.4	15.3	14.1	16.5	17.8	17.5	21.2	18.5	17.8	19.5
Inv.income	9.9	19.3	12.8	18.6	17.6	22.1	21.6	25.1	22.6	39.2	23.0	138.3
Private transfers		0.2		0.1		0.2		0.8		1.8		2.0
Other services	5.8	19.3	3.1	6.6	3.7	22.8	5.3	33.6	6.1	20.2	6.1	24.4
Net												
goods		64.4		72.1		122.5		165.2		125.1	19.3	
transfers		0.2		0.1		0.2		0.8		1.8		2.0
Current Account		108.1		105.3		174.0		216.3		188.7		162.5
Investment	34.7	5.1	43.0	1.9	130.3	14.1	230.9	8.4	158.1	5.0	n.a.	
Remittances		38.2								112.6	n.a.	
Private				60.6		80.3		147.2			n.a.	
Missions	5.7		5.9		6.2		6.4		6.6		n.a.	
Government	110.9		119.0		131.9		134.6		141.6		n.a.	
Net Capital Account	108.1		105.3		174.0		216.3		188.7		n.a.	

Source: Australia (1973): Compendium of statistics for Papua New Guinea. Prepared by the Statistics Section, Department of External Territories, Canberra.

pulation of Cook Islanders than has the Cooks, as well as substantial populations of Samoans and Tongans. On the other hand, Melanesian and Micronesian populations of the South-west Pacific do not have easy access to the Anglo-Saxon countries around the Pacific. Canada has admitted a few thousand migrants from Fiji in recent

TABLE 3 BALANCE OF PAYMENTS: WESTERN SAMOA, 1967-1972

WS$ Million

	1967		1968		1969		1970		1971		1972	
	Cr	Dr	Cr	Dr	Cr	Dr	Cr	Dr	Cr	Dr	Cr	Dr
Merchandise	3.2	5.6	3.8	5.5	4.8	7.4	3.5	9.8	4.7	9.6	3.5	15.7
Non monetary gold												
Freight & insurance												
Other Transport									0.1	0.2	0.5	0.6
Travel	0.2	0.1			0.9	0.3	1.3	0.3	1.6	0.3	1.9	0.5
Investment income	0.2	0.3				0.1		0.1	0.1	0.1	0.2	0.1
Non-merchandise insurance		0.2								0.1	0.1	0.3
Other	1.1	0.5			0.3	0.4	0.4	0.6	0.3	0.6	1.0	0.7
Trade Balance		2.4		1.7		2.5		6.3		4.9		12.2
Other goods and services	0.3				0.5		0.7		0.6		1.5	
Unrequited Transfers	1.8	0.5	)1.8		2.4	0.3	2.6	0.6	2.9	0.7	4.1	1.2
Pensions & remittances)	1.6	0.5			1.8	0.3	2.0	0.3				
Other)									0.2		0.2	
Government	0.3				0.6		0.6	0.4	0.8	0.3	1.2	0.3
Net requited transfers	1.3				2.1		2.0		2.3		2.9	
Net current account		0.8	0.2					3.7		2.0		7.8
Net Capital Flows					1.4		4.0		2.4		6.3	
Private investment					0.5		1.0		1.5		4.2	
Private short term					0.6		1.9		0.2		1.3	
Government allocation of	0.3	0.4	0.9	0.8	0.3		1.0		0.7		0.7	
SDRs											0.1	
Reserve												
Creation											0.2	
Net change in reserve				0.3		1.4		0.4		0.3	1.7	
Monetary gold										0.3		
SDRs												0.1
Foreign Exchange CB)	0.7					1.4		0.1	0.1		1.1	
Government)						0.1		0.3		0.1	0.5	
Change due to revaluation											0.2	
Net errors and omissions	0.2						0.1			0.1		0.1
Net Capital Account	0.8			0.2			3.7		2.0		7.8	

Sources:

Western Samoa (1968): Satistical yearbook, Prime Minister's Department.
Western Samoa (1971): Annual statistical abstract 1971, Department of Statistics.
Western Samoa (1972): Annual statistical abstract 1972, Department of Statistics.
Western Samoa (1974): Quarterly statistical bulletin, 1st quarter 1974.

years, mainly Indians; but the number of potential migrants to Canada greatly exceeds the number admitted. The net earnings of the south-western islands from remittances are therefore negative - substantially so in the case of Papua New Guinea whence A$113 million was remitted in 1971-72 (Table 2).

Import of capital is closely related to the growth of export industries based on natural resources. The discovery of copper on Bougainville island attracted a heavy flow of foreign investment from 1969 onwards into Papua New Guinea (Table 2). The development of hotels and other tourist facilities simiarly attracted investment into Fiji from 1971 onwards (Table 1).

Investment into the development of natural resources tends to be distributed very unevenly in the region. Although the boom of the early seventies in primary materials led to feverish exploration and the consequent discovery of bauxite, copper and phosphates on a number of islands in the Pacific, the major discoveries were confined to Papua New Guinea and Fiji. It might be thought that the natural resources required for tourism - sun, sea and sands - are more uniformly distributed among the tropical islands. But even here Fiji has seen far more development than all other islands together, because it sits astride the main air route between Hawaii and Australia-New Zealand: the supply of tourists to a country is governed by air services, and owing to the high overhead costs of aircraft as well as ground facilities, airlines tend to concentrate traffic into narrow channels and a small number of airports. It is noteworthy that although Papua New Guinea is on the path of Australian tourists travelling to the Far East, tourism has bypassed it; airlines prefer instead to stop over in Singapore and Bangkok.

Statistics of remittances and of capital movements are neither available for such long periods nor so accurate as trade statistics, and it would be idle to try to make a precise estimate of the relative instability of exports and of other sources of exchange receipts. Migrant labour tends to concentrate in unskilled jobs and is therefore less securely employed. Hence its remittances are sensitive to the trade cycle. But the available statistics do not suggest greater instability in labour export earnings than in commodity export receipts. Even a casual study of tables 1-3 is however enough to show the extreme instability of capital imports; and this impression would be strengthened if more recent payments statistics were available, for investment in the Bougainville project tapered off after 1972, and investment in tourism in Fiji collapsed with the fall in tourist arrivals in 1974. The South Pacific economies are subjected to large fluctuations in exchange receipts owing to fluctuating capital inflows; their commodity exports would give a very misleading and inadequate impression of the external instability faced by them.

II. THE MULTIPLIER

Let us now look at the argument that although the exchange receipts of a small country may fluctuate, their impact on the economy will be small owing to leakages. Tarshis[5] wrote,

".... [A] small region is likely to be specialized to one or a

5) Op.cit., p.194.

few types of economic activity; from this standpoint, it is likely to show somewhat greater instability than a larger one. But its very smallness is also likely to mean that its marginal propensity to import will be high, and this will mean that, other things being equal, most of the effect of any de-stabilizing development that has its source inside the region will be passed on to other regions which will find their 'exports' changing."

This argument was given a quantitative form by MacBean[6] who modified the multiplier formula as follows:

$$\frac{\Delta Y}{\Delta X} + = \frac{1 - p_x - m_x - t_x}{m_y + s_y - t_y}$$

where ΔY is the change in income, ΔX is the change in exports, p_x is the proportion of export proceeds repatriated to foreigners, m_x is the proportion of export proceeds paid for re-exported imports, t_x is the proportion of export proceeds taxed away, and m_y, s_y and t_y are the proportions of the change in domestic income that are spent on imports, saved and paid in taxes.

McBean applies the formula to average values for six relatively small trade-dependent countries, and gets a multiplier value of 1.02. If we put average 1972 values for Fiji, the multiplier works out to be .78.[7]

However, MacBean's formula strongly underestimates the multiplier effect. The multiplier is the sum of an infinite series whose first terms is one; it cannot therefore be less than one. The McBean multiplier comes to less than one for Fiji because its numerator is less than one: it is equal to the fraction of exports that is spent on domestic goods. This fraction would be different for different types of autonomous expenditure, such as exports, investment, change in stocks or government expenditure. The multiplier can however hardly vary accoring to the type of autonomous expenditure: it is just the reciprocal of the ratio of leakages to change in income. It is therefore clear that it is only that part of autonomous expenditure which is spent on domestic goods and services that can have a multiplier effect.

Second, the Keynesian convention of regarding taxes as a leakage is justified only when government revenue and expenditure are unre-

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6) Op.cit., pp.93-96.
7) The relevant figures are -
Exports F$65.6 million[a]
Re-exports F$13.8 million[a]
Imports F$131.5 million[a]
Savings F$30.9 million[b]
National Income F$238.2 million[c]
Sources: a) Fiji: Current Economic Statistics, April 1975, Table 39.
b) Calculated from Fiji: The National Accounts of Fiji 1968-1972, Table A4, and Current Economic Statistics, April 1975, Table 38.
c) Calaculated from GDP of F$247.3 million by deducting net outflow of overseas investment income of F$9.1 million.
Profits repatriated by export industries were assumed to be 10 percent of exports. There were no export taxes in 1972.

lated. If the government's expenditure depends on its revenue, a change in revenue can hardly be regarded as an equivalent change in savings; instead, one should work out the government's propensity to save out of revenue. The appropriate term ty would then be the product of the proportion of income taxed away and of the government's propensity to save. If the government's propensity to save is low, ty can be ignored without much error in the multiplier.

Third, it would be a mistake to take the propensity to import as equal to the ratio of total imports to national income: it should appropriately be the ratio of consumer goods imports to national income. The two can be very different for a trade-dependent country.

After the necessary modifications, the multiplier becomes

$$M = \frac{1}{s_y + m_y}$$

which works out to be approximately 3.28 for Fiji in 1972[8] and 3.39 for Papua New Guinea in 1971-72.[9] The values, while undoubtedly lower than for less open economies, are not so low as MacBean's calculations suggest.

It may be stressed that only domestic expenditure has multiplier effect; if exports or other autonomous expenditure has a high import content, its impact on domestic demand will be lower. But countries which are more dependent on imports are also more dependent on exports, foreign investment or aid, and the lower the multiplier effect of a change in autumomous expenditure, the greater, by and large, will be the first-round effect. Consider, for instance, a country like Nauru where almost all economic activity is oriented to phosphate exports and virtually all consumer goods are imported apart from services that cannot be imported. The multiplier in Nauru may well be a little different from unity; but a fluctuation in exports will nevertheless lead to an almost proportional change in incomes and employment.

A low multiplier effect is therefore just a reflection of heavy dependence on exports or capital imports, and cannot be taken to mean a low level of vulnerability to external shocks. The general conclusion must be that small countries are highly sensitive to external disturbances.

III. INFLATION AND DEFLATION

Even if it is conceded that the multiplier in small economies is appreciably large, its relevance may be contested. The multiplier would indicate the effect of changes in autonomous expenditure on output and employment if there are no supply bottlenecks: how far does it work in underdeveloped economies with a limited stock of capital?

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8) Consumer goods imports into Fiji in 1972 were estimated to be F$41.7 million. (Source: Fiji Current Economic Statistics, April 1974, Table 40.)

9) In 1971-72, the national income of Papua New Guinea was A$574.7 million, savings were A$69.7 million and imports of consumer goods were approximately A$100 million.

The multiplier effect of a fall in autonomous expenditure faces no obstacles in a less developed economy. The fall in the demand for labour may be disguised in the form of underemployment; but it can be argued that this is not the case in the economies of the South Pacific. For in these economies the commercialized sector is an enclave which has few linkages with the subsistence sector. In fact, one of the conditions of emergence of the commercial sector was the breaking of the links between the worker and his rural connections by indenture (which prevailed in Papua New Guinea till recently and still continues in New Caledonia) and transportation far away from home. Commercialization in the South Pacific is different from the commercialization of peasant agriculture such as is encountered in Asia or Europe: it is more akin to plantations or mines, whose work force subsists on purchases of subsistence goods. There is thus no adjunct of subsistence agriculture to absorb workers released by the commercial activities during slumps.[10] There are urban workers who live on subsistence farms in surrounding areas, but the farms are far too small to give work to the workers if they lose their jobs: they are rural dormitories with a subsistence sideline.[11]

In upturns, a progressive increase in demand would normally encounter an increasing number of supply bottlenecks, and would result in a progressively smaller increase in production and employment and a correspondingly larger rise in prices. Decelerating increases in output and accelerating rises in prices are the characteristic outcome of an upswing. In a highly trade-dependent economy however it is possible that an upswing would affect the balance of payments rather than prices: that the domestic price level would be determined by import prices and the exchange rate, and that domestic supply bottlenecks would be circumvented by imports, which would rise faster than GNP.

However, evidence does not support the view that the price level is determined by import prices. Only 24 percent of the private final consumption in Fiji in 1972 consisted of imported goods.[12] The import content of consumption in Papua New Guinea also was approximately 25 percent in 1971-72.

More direct evidence is given in Table 4, which compares the food price index for Fiji with an index of food import prices. Whilst both rose considerably in the period 1971-74, the pace as well as the timing of the rise differed. The overall price index was rising in 1971 when the import price index was stable, and rose sharply after the hurricane in November 1972: in the two following

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10) Open unemployment in Fiji was estimated at about 20 percent of total surplus labour in 1966. But underemployment consisted of (a) potential female workers and (b) surplus labour in sugar cane farming, which was a fully commercialized export sector. See Desai, A.V., "The unemployment problem in Fiji", Economic Bulletin for Asia and the Far East, XXIV (2/3), 1973, pp.23-25.

11) Desai, A.V., "Commercialization of the subsistence sector in the South Pacific" in J.B. Hardaker (ed.), The Subsistence Sector in the South Pacific, University of the South Pacific, Suva and University of New England, Armidale, 1976 (forthcoming).

12) Fairbairn, I.J., R. Jofre and P.H. Kruck, A Survey of Industry and Its Potential in Western Samoa, Final report, UNIDO/IPPD, 1973, p.69

TABLE 4 FOOD PRICE INDICES, FIJI 1971-1974

Year and quarter	Imported food (Av 1969=100)	All food (July 1968=100)
1971.1	112	117
2	110	117
3	113	117
4	111	122
1972.1	112	126
2	115	126
3	120	129
4	124	145
1973.1	131	159
2	148	152
3	158	156
4	193	166
1974.1	216	169
2	244	180
3	248	189
4	256	195

Source: Fiji (1975): *Current economic statistics*, April 1975, Bureau of Statistics, Suva, Tables 53 and 58.

quarters the food price index went up by 22 percent against a 9 per cent rise in the import price index. In the two years 1973 and 1974 however import prices nearly doubled while the food price index rose by only about a quarter. In spite of the import dependence of food consumption therefore food prices in Fiji retained considerable independence of import prices. Thus, prices in small economies are substantially subject to domestic influences; inflation is not entirely imported into them. Hence increases in capital inflows or exports can have strong inflationary effect owing to the sectoral unbalances they create.

Investment has a high import content in small economies: the proportion of capital goods imports to investment in Fiji was 72 percent in 1972. Whilst its high import content may be expected to reduce its domestic impact, most of the domestic content of investment consisted of building and construction. The demand it generated for construction was reinforced by demand from local savers, who find residential and commercial buildings the most attractive form of investment in the absence of a local financial market. Consequently there were grave shortages of labour and construction materials in the 1969-73 boom which delayed construction, raised construction costs and slowed down investment. There was a particularly serious shortage of skilled labour; construction firms were not prepared to train workers since they did not know how long the boom would last, and they found it easy to attract workers away from other firms; they thereby reduced the returns on investment in training still further.

Further, imports as well as exports have strong sectoral effects. For foreign trade depends on four activities that are normally mono-

polized or oligopolized and are spatially concentrated - docks, airlines and airports, banks and telecommunications. An increase in imports raises the demand for these services and increases their profitability. Even if they are public monopolies whose profits are controlled, they are easy to unionize, and unions push up wages during booms. Thus, airline and dock workers are among the highest paid in Fiji; and cable and wireless workers achieved the highest rate of wage increase - 72 percent - between December 1973 and January 1975.[13)]

IV. MICRO-ECONOMIC EFFECTS

Historically, the countries of the South Pacific have never had a feudal or a trader class which could have initiated indigenous capital accumulation. Insofar as the countries have entered the world trading system - and they are more commercialized today than most Asian and African countries - it has been through foreign enterprise. Their markets are small in relation to available supply, and their exports in relation to world markets. Hence it is easy to monopolize imports and exports. Even where an industry begins with a competitive structure, it tends to get monopolized over time. In the early days of the Fiji sugar industry for instance there was a large number of cane growers who made their own sugar for sale; in time however economies of scale and control of refineries in Australia enabled the Colonial Sugar Refining Company to monopolize production. Similarly, there has been keen competition in the hotel industry in recent years. But hotel development in Fiji is highly land-intensive, and the best sites are being rapidly exhausted. The current slump in tourist arrivals has led to some takeovers, and it is likely that as the more lucrative investment opportunities get exhausted, hotels will become more dependent on the patronage of airlines and of travel agents, and the industry will be oligopolized.

The tendencies towards monopoly were reinforced until recently by colonial regimes which excluded foreign enterprises from outside their respective empires. It was not necessary to restrict entry by law, for the state had other powers to ensure or deny success to an enterprise. Most of the industry in South Pacific countries was based on natural resources. Some of them, like copra, were put under the control of semi-official bodies on which the existing enterprises had powerful representation. Others, such as minerals, required public investment in roads and infrastructure which could be used to ensure that an incoming investor had the government's approval. It is no accident therefore that almost all foreign investment in Fiji and Papua New Guinea is Australian.

Once a country becomes independent, the power of business interests from the erstwhile mother (or sister) country is weakened. Soon after independence for instance Fiji allowed an Indian company to set up a flour mill. Although Carpenters and Burns Philp control the bulk of Fiji imports, the share of local importers has been on the increase since independence, especially in duty-free goods and textiles. In banking services also the share of the Big Two, the

13) Fiji: Inflation in Fiji. A Further Account of the Work of the Prices and Incomes Board, Prices and Incomes Board, Suva, 1975, p.3

Bank of New Zealand and the Bank of New South Wales, has declined. In 1974 Fiji introduced a one-line tariff; the abolition of Commonwealth preference is likely to erode monopoly positions (Western Samoa, Tonga and Papua New Guinea however continue to have two-line tariffs).

Foreign enterprises do however still have a number of instruments for maintaining monopoly of production and imports. First, they exert pressure on suppliers abroad to give agencies to their branches in Fiji or not to give franchises to potential competitors in Fiji. A number of instances are given in Howie.[14)] Such restrictive practices continue to be common. For instance, the Colonial Sugar Refining Company used to export molasses produced in Fiji to its alcohol plants in Australia at throwaway prices. After nationalization of CSR's Fiji interests, the Fiji government opened negotiations with Mitsubishi in 1973 to set up an industrial alcohol factory in Fiji. Late in 1974 Mitsubishi contracted to buy molasses from CSR (Australia), and at about the same time broke off negotiations with Fiji government.

Second, foreign enterprises buy up competitors in Fiji. With the setting up of a flour mill in Fiji in 1972, the Australian flour millers lost a large part of their export market; even the bakeries in Fiji affiliated to them had to buy flour from the local mill as a result of a ban on imports. Periodically since then, Suva Bakery, the major affiliate of an Australian miller, has carried out campaigns in the press, the radio and the government to create the impression that the locally produced flour is of poor quality - and each time been proved wrong by tests made by the Government in local as well as Australian laboratories. In early 1974, Suva Bakery and Cope Allman, a large biscuit producer, ran their flour stocks sharply down and threatened to throw their workers out of employment unless their stocks were imediately replenished. The Flour Mills of Fiji did not have enough capacity to meet their demand, and they were given import licences. Throughout the period since 1973 the flour mill has from time to time received takeover offers from Australian millers.

Finally, legislation to promote industry can itself become a strong protector of monopoly. The Fiji government has passed legislation which enables it on discretion to give new investors cheap land, a tax holiday, concessions in import duty on machinery and raw materials and a promise not to allow competing enterprises to be set up for a number of years. The concessions are so powerful that no one thinks any more of setting up a large industry without getting at least some of them; the government's discretion regarding concessions therefore acts more or less like industrial licensing powers. When they come to know that the government is considering the application of a potential competitor for concessions, importing firms either submit a proposal of their own to set up the industry or promise to do so. The proposal is never implemented, and the import monopoly is maintained. This is how glass production in Fiji has been prevented by the importer.

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14) Howie, I., "The effects of foreign investment" in Fiji: A Developing Australian Colony, International Development Association, North Fitzroy (Victoria, Australia), 1973, pp.59-70.

What is the result of these monopolistic practices? They undoubtedly maintain and augment the profits of enterprises that are either owned abroad though situated in Fiji or are exporters to Fiji. No estimate can be made of the profits, however. No information is given out which would permit the separation of profits in Fiji from the total profits of the foreign enterprises. There are no provisions for public disclosure of annual accounts in any country of the south Pacific such as one finds in any developed countries. The corporate income tax returns submitted to Inland Revenue authorities are not even available to other departments of the government, including the price control authorities in Tonga and Fiji. Foreign businesses in these countries pay taxes more or less as voluntary contributions, and any scrutiny is prevented by extreme secrecy in all financial matters. And since most of them export to or import from parents or affiliates abroad, there is considerable scope for transfer pricing.[15)]

Whatever happens to profits, however, the major effects of foreign monopolies are undoubtedly the frustration of the growth potential and the high foreign exchange cost of whatever growth does take place. It has often been noticed how backward the resource-based industries in the south Pacific are. Although coconuts have probably been growing almost since the islands emerged, the production of coconut byproducts is virtually unknown. Whilst starchy foods have been the staple for centuries, the production of starch from manioc is not undertaken although it is well established elsewhere in the world. The blame for the general lack of dynamism is placed on the culture of the local population. The truth is, however, that foreign enterprise has proved to be a particularly ineffective dynamizer of south Pacific economies.

V. CONCLUSION

The external dependence of small economies, described in some detail in this paper, is implicitly assumed in most discussions of development in the south Pacific. Typically the argument runs like this: the population of country X is rising rapidly, and it will need to create Y jobs by the year Z. Its savings rate is quite insufficient, and it has little managerial or technological expertise. Hence it must attract foreign capital. In order to do so it must give a series of concessions such as tax holidays, duty-free imports, freehold land etc.

Now, this model of development is not all that different from the actual arrangements in colonial days. Nowadays concessions are written into laws and formally negotiated between governments and enterprises. In the earlier days the mechanism was more informal. The CSR could get the government to build roads and do other services on the strength of the CSR's economic importance to Fiji. The Emperor Gold Mines obtained an unconditional subsidy from the government to keep it going in the sixties. The Australian government made considerable infrastructure investment in Bougainville. The colonial governments assisted large foreign enterprises in the interests of imperial prosperity; the newly independent governments

15) Fairbairn, I.J., R. Jofre and P.H. Kruck, A Survey of Industry and Its Potential in Western Samoa. Final report, UNIDO/IPPD, 1973, p.69.

are asked to do so for domestic employment and production. Whatever the differences in motivation, the policies are the same. And they will have the same effect of perpetuating vulnerability and long-run stagnation.

Is there an alternative to this instability? It should be said straightaway that alternatives are not equally available to all countries and islands. The population of many small islands does not permit anything beyond a Robinson Crusoe economy; their people face the choice between a permanently limited mode of subsistence and migration, and the greatest contribution to their development would come from freer migration across the Pacific. The migration opportunities could be created by the metropolitan countries around the Pacific: it might be politically easier to do so, although economically it would be undersirable insofar as the immigrants end up as racially distinct underprivileged minorities. The economically optimum solution would be the creation of two or at the most three federations in the Pacific within each of which labour and capital could move freely: politically however this would be more difficult to achieve. The point is that unless larger and more viable nations or federations emerge from the jumble of countries and territories emerging from the piecemeal decolonization of the South Pacific, many territories have no development prospects to speak of.

Assuming that the islands can be regrouped into more viable federations, policies would be required to increase their autonomy. They would not be policies of import substitution: in fact, the current policies of import substitution have enabled many foreign enterprises to tighten their hood on markets behind the shelter of tariffs and quotas. The areas where greater local participation and control is required are services and investment.

The direction of foreign trade and the terms on which it is conducted is strongly influenced by the ownership of services - shipping, airlines, banking and insurance. The countries of the south Pacific cannot diversify their trade relations unless regular transport services are developed with the USA, Canada, Japan etc., and unless they are supported by ancillary financial services.

Whether in those services or in other sectors, foreign and domestic capital are not substitutes. International capital is highly mobile, and dependence on it of a country whose labour does not have the same opportunities of movement entails unemployment and economic distress. It is therefore necessary to make capital formation more autonomous and to bring it under greater local control. This could be done in a number of ways.

One is greater state finance (as distinct from control) of capital formation. The proportion of government current revenue to GDP in 1973 was 28 percent in Fiji and 30 percent in Papua New Guinea. The high share of the government permits substantial finance of capital formation. It may take the form of direct infrastructure investment or of indirect investment in industry and agriculture. Fiji as well as Papua New Guinea have development banks, and Western Samoa has recently set up a finance corporation. Their operations have remained limited in scope because there has been no preference for domestic as against foreign capital. If such a preference is introduced into policy, local demand for finance will grow, and the development banks will need greater funds which could be provided from government revenue.

Finally, south Pacific countries need a type of institution that would channel domestic savings into local risk investment. Hitherto the major form of financial investment available to savers has been bank deposits which give a low rate of return. Some foreign companies have issued shares locally, but the demand for shares has been dependent on the public's estimate of the management which has often not been high. Whilst the Government of Fiji offers its bonds for sale and is prepared to buy them at periodically announced prices, their yield is not much higher than of bank deposits. The result is that in the absence of attractive channels of final investment local savings go largely into housing and real estate. To attract domestic savings into risk investment a type of institution is needed that would spread the risks by diversifying investment. The development banks could serve the objective if they issued equity shares to the public; but they would have to shed a good deal of their conservatism if they are to participate substantially in risk investment. Another alternative would be unit trusts. Either way, the countries of the south Pacific should get away from a situation where domestic savings are channeled into low-yield fixed investment or property speculation while high-yield risk investment in new industries is financed from imported capital.

COMMENTS ON DESAI'S PAPER

(a) John Macrae

I can see four main themes emanating from Professor Desai's paper:

1. The economic instability question.
2. The limits of diversification imposed by the small market size of mini-states and the associated question of foreign monopoly capital.
3. The question of regional integration or co-operation, or the search for a more rational basis for resource allocation across the region as a whole.
4. The need for a rationalisation of the capital market.

I shall make comments on the first three of these themes, but will preface these by two general critical comments on the paper.

The first general comment is my disappointment that the paper did not attempt to categorise mini-states more adequately, or to recognise the variety or diversity, even amongst the small island economies of the South Pacific. This is important because new projects and new industries will naturally move towards the already more developed areas, in terms of infrastructure and other facilities. Hence the response of other mini-states to new projects will be strongly influenced by their relative position as it currently prevails.

A second comment that can be made is the failure of Desai's paper to recognise strongly enough the likely long-term importance of migration from mini-states. With their consumption aspirations and expectations rising and rising faster than their consumption possibilities, which are constrained by size, uncertain terms of trade and feudal land tenure systems, then the obvious and quickest way out is by the spatial relocation of the factors of production particularly labour, to economies where such constraints do not exist.

Thus to specific themes:

1. Economic stability: the theme is that small countries are highly sensitive to external disturbances. Shock waves of a greater magnitude are felt throughout the entire economy and to a degree relatively greater than that felt in large countries. The effects, to a greater or lesser extent, of this instability are reflected in prices, the factor markets and construction investment. I felt a little unconvinced that this was either <u>a</u> major problem or one of <u>the</u> major problems confronting these states. It is not clear from the evidence that instability is either more of a problem in mini- than in maxi-states, nor that it is greater currently than it has been historically, nor is it more amongst mini- than maxi-states for those commodities or substitutes produced by both. Evidence suggests that the Commonwealth Sugar Agreement has had a strong influence in reducing the export price instability of Fijian sugar. The actions of Metropolitan France have had a dominant and determining influence in reducing the fluctuations in the New Caledonian economy imparted by the vagaries of the nickel market.

Even if the case is accepted, what policy conclusions can be drawn? The obvious response-diversification has been noted by Professor Desai particularly in relation to the role of migrant labour remittances as an extra source of foreign exchange receipts. But, if

these new sources are (a) as variable as traditional sources and (b) have strong co-variability, then one is jumping out of the frying pan into the fire. The point is surely not, as Professor Desai considers, that the variability of labour earnings remitted is less or greater than commodity export receipts, but whether together the two five greater variability overall.

Another point is that undue stress on export instability can be an excuse for movement to inward looking policies, biased away from true sources of efficiency. I would like to ask whether such policies of diversification as have been undertaken have had determined effects on traditional exports. Has it meant less attention being paid to the possibility of processing further these traditional commodities, to the clawing back of more value added from these, and to the generating of more linkages?

2. The limits of diversification. The argument here is clearly that the limits to any policy of diversification, based on inward-looking policies, are reached much more quickly in a mini-state than elsewhere. There is often room for only one or two producers and thus the potential for exploitation is high.

One's immediate response is to recommend more outward looking policies, not based on market size. But we all know the problems associated with that option. Another comment is that if these states must have domestic import substitution, then most of these policies listed in the paper seem quite sensible because they do not involve a tax on trade. But why should governments be interested in maintaining monopolies? Is there some pay off? Does the inducement package have to be much greater for mini-states? The obvious goal seems to be to get as much competitive private foreign investment as possible. Perhaps some form of market concentration norms or more discrepant choice procedures are necessary.

3. The question of Regional Integration or Co-operation. The major points of the paper under this theme are a stress on easier migration as the greatest contribution to the development of many small island economies, the possibilities of regional integration with metropolitan powers and the preferred option of two or three regional federations of small Pacific states amongst themselves. The problem with integration or federation amongst the islands themselves is that they will cut across existing economic and political ties. The South Pacific still divides up into three 'ex-colonial' spheres of influence: New zealand, Australian and Common Market (U.K. and French) spheres. Economic and other relations take place along these lines. There is very little intra-regional trade amongst the states themselves. These states are scarcely competitive in economic structure or have complementary resource endowments. There are conflicts of interest amongst them.

Thus, I do not see any future in any grandiose ideas for political integration in the South Pacific. But areas of potential benefit exist where collaboration on some scale could assist. Some of these areas where pooling of resources could reduce costs to each are in:

(1) common facility developments: transport, infrastructure, information industries.
(2) bulk purchase arrangements
(3) joint ventures - say in simple component manufactures.
(4) cartelisation - cannot the OPEC model be adapted to fit the

case of copra?

The main problem with all these possibilities is, of course, that of the fair distribution of gains.

I will conclude with a few comments on migration. This is basically a problem in optional location - should the Islander be brought to the jobs in Auckland or should the jobs be exported to the Islands. A full scale cost-benefit analysis remains to be done, but for the moment there is no choice. The Islander must come, and the distribution of gain for the moment seems rather unjust. The skills received are of little long run value, while Islanders suffer discrimination in economic and social life and lack protection and recognition of their qualifications. For me, much closer attention needs to be paid to a fairer distribution of benefits to the minority immigrant.

(b) JOHN VULUPINDI

Professor Desai draws attention to commonly held views that: (a) small countries are more dependent on trade; (b) their exports are less diversified; and (c) their industries are geographically less concentrated than those of larger countries. He goes on to say, however, that the inference that small economies are more vulnerable to external shocks has been disputed both on theoretical and on empirical grounds. In the rest of the paper, Professor Desai explores these issues with special reference to Fiji, Western Samoa and Papua New Guinea.

Professor Desai conducts his examination under the following broad headings:

(1) Goods and factors of production.
(2) The Multiplier.
(3) Inflation/Deflation.
(4) Microeconomic effects.

As the paper (in my opinion) appears to have been very soundly researched, I have no great argument with the broad concepts which are developed in its main body. In this connection, I do not intend to examine the issues in question in terms of their wider philosophical implications. Instead, I wish only to address myself to the conclusions which Professor Desai draws from his research. Prior to this, however, I must draw attention to a few errors of fact relating to Papua New Guinea. First, Professor Desai lists Papua New Guinea among other countries which operate a two-line tariff. This is incorrect. Although Australia does apply preferential treatment to certain exports from Papua New Guinea, there is no reciprocal treatment of Australian exports by Papua New Guinea. Second, in the discussion under "inflation/deflation", Professor Desai states that ".... evidence does not support the view that the price level is determined by import prices". In Papua New Guinea, there is a very close correlation between domestic price levels and movements in import prices. This has been particularly conspicuous in recent times when price increases in the rest of the world were closely followed by price rises in the domestic market. It clearly reflects the fact that most consumption goods one finds in urban areas are almost entirely imported. [Even in the case of fresh foods where domestic production is possible, the structure of production is such that prices tend to be based on imported foodstuffs. In the subsist-

ence sector, pricing is obviously a non-issue - being quite detached from the market economy and hence not entering the relevant calculations.]

With respect to the conclusions which Professor Desai draws, I would make the following observations. [I find Professor Desai's analysis of the motives for seeking foreign investment both under colonial rule and in newly independent countries most enlightening and interesting, to say the least!] I am a bit wary of the alternative suggestion for greater State financing of capital formation. Taken in isolation, this would be a great improvement. However, when one looks at Sri Lanka, a country where the Government has State Corporations in almost every sector of the community, the results are not too encouraging. Papua New Guinea appears to be following the same path in that the Government has taken options in various large foreign firms, some of which it has exercised. From another angle, the Government buys established foreign enterprises and sells them (over time) to indigenous interests. These developments in Papua New Guinea are very recent and hence it may be too early to judge whether Papua New Guinea will make a success of it.

Professor Desai's proposal for an institution for channelling domestic savings into local risk (high return) investment is a sound one. I should mention that in Papua New Guinea such an institution has been established in the form of the Papua New Guinea Investment Corporation, which operates as a unit trust. It acquires shares from various operating firms and resells them in "packages" to indigenous Papua New Guinean nationals. The system is organized so that a person who holds shares in the Corporation in effect has interests in at least eight different concerns at any one point in time, thereby limiting the risk element substantially while keeping dividends well above what one would get from the same amount of investment in a savings bank account.

Finally, I should like to ask what is meant by choosing between foreign capital and domestic capital, mentioned in connection with the Development Banks in Fiji and in Papua New Guinea. If it means borrowing from any source by the Development Banks and lending in turn to indigenous entrepreneurs, then I should point out that Papua New Guinea is already doing this. Although the Papua New Guinea Development Bank has had to rely on government grants initially, the current policy is to borrow on commercial terms and then on-lend to local clients.

(c) General Discussion

The first participant in the discussion suggested that, in the past, developing countries had been badly informed as to the true value of natural resources and hence exploited (in various degrees) by multinationals. The situation now was radically changing. Agreements such as those in Papua New Guinea on the mining of copper and in New Caledonia on the mining of bauxite were 19th century anachronisms. Developing countries were bound to rebel against the negative effects of such agreements by forming producers' cartels such as OPEC. They were also increasingly concerned about the question of who makes critical political and economic decisions in developing countries: their governments, or interfering multinationals. Recent interference by multinationals in Latin American political and economic decision making was cited as an example.

Others challenged the references made to Papua New Guinea and the Bougainville Copper Agreement. One member said that, while he was not happy with the initial agreement, recent modifications to the Copper Agreement following unheard of peaks in copper prices in the early 1970's had made the agreement quite acceptable. He suggested that price stability and high prices were in the interests of both multinationals and developing governments and did not support the exploitation thesis. The effectiveness of cartels in securing a higher share of the proceeds from sales of a commodity depended on the supply and demand conditions of that commodity. Certainly in the short run, OPEC had benefited from a producers' cartel, but oil was a commodity with very low cross elasticity of demand and producers' cartels in other commodities might only result in substitution.

An Australian participant adamantly denied that the Bougainville Copper Agreement in any way resembled a 19th century-style agreement. The Papua New Guinea Government revenue had doubled by taxation of the Company and revenue arising from the development. The Papua New Guinea Government had a 20% equity share in the mine. It could have had full ownership, but it had felt valuable administrative staff could not be spared for the running of the mine. Papua New Guinea was a special country and general judgements that might apply to other countries could not be made in this case.

A New Zealander suggested that South Pacific economies could be classified in a manner analogous to residential accommodation - furnished, semi-furnished and unfurnished. Australia and perhaps New Zealand were the only furnished economies, and the remaining developing economies in the South Pacific were of the semi-furnished or unfurnished type. Whether these island economies were viable or not, they were political units 'par excellence' in so far as each island group was very nationalistic. He agreed with Desai that their options were very limited economically - the people of these islands faced the prospect of a subsistence standard of living or migration. However, migration need not be of the uni-directional type now in existence - e.g. from the Islands to New Zealand. Two-way migration could be encouraged. When there was a demand for labour in New Zealand, Islanders could migrate to New Zealand, but when there was a demand for labour, for example in the Cook Islands during the orange harvesting season, labour could return to the Cooks.

One of the participants from the South Pacific emphasised that the problems of South Pacific island economies could not be analysed through Western (or Latin American) eyes. Whereas the average developing country may want per capita GNP of $US800-900 he suggested that if the level of per capita income was lifted from its present level of $US200 to US$250-300 this could prove quite satisfactory. He also pointed out that there were two types of migrants to New Zealand - those who had free access to New Zealand and could achieve permanent status as New Zealand citizens and those on a temporary (3 months) basis. Migration, therefore, needed to be analysed in a two-fold manner.

In reply to a question why competition was not encouraged by Fiji, Desai said that foreign monopolies were promoted because Island Governments hoped that inflows of foreign capital and job creation would help with their problems of unemployment. Historically, foreign investment had not been the dynamizer of economic growth in

the South Pacific Island economies to the extent it had been elsewhere. This did not mean that it would not be a dynamizer in the future.

Desai emphasised that, while it might be possible to have successful producers' cartels in the production and sale of oil, and perhaps bauxite this was not the case in the sale of coconut oil and bananas (for example), because of different conditions of supply and demand.

Dealing with migration, Desai drew an analogy between exports of goods and exports of labour in the migration question. He suggested that Pacific Islands' labour forces should become more mobile, but for this to happen Australia and New Zealand would have to liberalise their controls on labour movement in the same way as freedom of movement for goods was desirable.

PART III

DEVELOPMENT ASSISTANCE

7

DEVELOPMENT ASSISTANCE: THE PROBLEMS OF A LARGE DONOR, THE UNITED STATES

LAWRENCE B. KRAUSE

One may well question why another paper on United States development assistance - or foreign aid for short - is worth writing. While there are many possible answers, the most cogent one from my point of view is that the world has changed so drastically and quickly in recent years that a reassessment seems desirable. There is no reason, however, to have another normative paper on foreign aid. Poverty is still "bad" and if rich countries can help alleviate it in poor countries, it would still be "good." I thus make no effort to review the issues involved in the redistribution of world income. Rather my purpose is to explore the positive aspects of foreign aid within a realistic political setting in an effort to discover what are the sustainable bases for foreign aid primarily bilateral in character from the point of view of a large donor country. Such an assessment is useful in evaluating the prospects for a continuing programme by the United States. Underlying this discussion is the belief that the central issue of development assistance is not economic development which is not greatly influenced by bilateral programme, but rather the relations between countries which is greatly affected.

Changes in the World Environment

For many years it has been said that the world economy was developing a structure of greater interdependence among countries. This was not surprising since it conformed to the expectations of economic theory, was the natural result of trends in industrial technology and was actively sought through the policy measures of most governments. Nevertheless the implications of an interdependent world economy were not well understood. In developed countries, policy makers tended to consider world economic problems within a decision-making frame dominated by developed countries. The United States was no exception, but by no means the worst in ignoring the less developed countries (LDCs). One has only to think back to how international monetary problems were handled in the 1950s and 1960s to be convinced of the correctness of this observation. One did things for developing countries, not with them. Meetings like those of UNCTAD, which were specifically designed to include both developed and developing countries as participants, were relegated to talking forums in which rhetoric was expected and as a result nobody listened. Negotiations within an UNCTAD-like setting were excluded because of the "unwieldy nature" of the group, and, of course, decision-making there was out of the question.

Developing countries showed little better understanding of inter-

* The views are those of the author and should not be attributed to other staff members, officers or trustees of the Brookings Institution.

dependence. They knew full well that they were greatly affected by developments in other countries, but they considered themselves as objects, not participants in the world economy. There was little recognition of the positive and negative power they possessed to influence and even to shape world events. Some LDC spokesmen decried the fact that their countries were controlled by the actions of foreigners without recognizing that all countries in an interdependent system are so controlled even if in greatly differing degrees.[1] Thus developing countries forsook forming coalitions for bargaining purposes and instead relied upon the goodwill of developed countries and their cold-war inspired political leverage to attain economic ends.

The lack of participation of LDCs in the trade negotiations under the sponsorship of the General Agreement on Tariffs and Trade illustrates the point. Developing countries requested and received special treatment in GATT negotiations. They were not required to offer tariff concessions and as a result had no means to direct the negotiations to products of special interest to themselves. It soon became evident that non-reciprocity meant non-attention. Furthermore, developing countries overlooked the opportunities of forming coalitions and alliances among themselves because the benefits appeared small. Indeed the most untended foreign relations of developing countries were amongst themselves.[2] One might dispute this contention by pointing to the formation of common markets among LDCs. In fact most of these efforts have explicitly failed or simply atrophied. One common market after another has been formed in Africa only to be quickly dissolved. Even in Latin America, where a great deal of intellectual and political capital has been expended in such endeavours integration efforts have failed well short of their promise because of the absence of a long run commitment.[3]

Thus developing countries made little use of their collective economic power. In the face of obvious motivation to do so, one can conclude that it was caused by a lack of understanding of the nature of interdependence. An interdependent world economy has existed for some time, but its meaning was not recognized. Thus it is the perception of interdependence which is new and which fundamentally affects the relations of rich and poor countries and is the prime reason why a reassessment of development assistance is required.

Watershed in International Economic Affairs

Another reason to reassess development assistance, I believe, is that the world economy has reached a kind of watershed and may oper-

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1) Osvaldo Sunkel, "The Patterns of Latin American Dependence," in Victor L. Urquidi and Rosemary Thorp, editors, Latin America in the International Economy, Proceedings of a conference held by the International Economic Association in Mexico City [John Wiley & Sons, New York, 1973] pp.3-25.

2) H. Jon Rosenbaum and William G. Tyler, "South-South Relations: The Economic and Political Content of Interactions Among Developing Countries," in C. Fred Bergsten and Lawrence B. Krause, editors, World Politics and International Economics, The Brookings Institution, 1975.

3) Miguel S. Wionczek, "Latin American Growth and Trade Strategies in the Post War Period," in Kiyoshi Kojima, editor, Structural Adjustments in Asian-Pacific Trade, Papers and Proceedings of the Fifth Pacific Trade and Development Conference [JERC, Tokyo, July 1973], Volume I, pp.191-229.

ate quite differently in the immediate future than it has in the immediate past. The watershed has been caused by the confluence of a number of factors affecting all countries and some other factors peculiar to the United States.

The oil crisis of 1973-74 was not just another disruption of the world economy like the monetary or trade upsets of the past, but rather the most important economic event in the postwar period. It is the equivalent of a world war in its power of disruption and involves a transfer of income and wealth among countries that is unparalleled in the history of the world. As James W. Howe has argued, oil developments herald the beginning of a new era in the global economy.[4] The oil crisis in particular will affect the relations between rich and poor countries. The fourfold rise in the oil price in a single stroke shifted some countries from the column of the have-nots to that of the haves. The loose association of LDCs in the Group of 77 has been solidified into a strong coalition under the initiative of OPEC countries and the resource leverage they command. The full implications of these changes are yet to be seen.

The world economy has gone through an inflation and is currently in the midst of a recession that exceeds any experienced in the postwar period. One consequence is that world trade volume is actually shrinking in 1975. When a cyclical swing of this size occurs, it indicates that a great deal of basic adjustment is required and is taking place. Large relative price changes, for instance, improve the profitability of some industries and destroy the prospects of others, and correspondingly aid the trade position of some countries, while undermining it for others. Within domestic economies, the structure of investment must be adjusted to the new economic realities which may require and lead to institutional changes of entrepreneurship and ownership. It would be surprising if such far-reaching changes were not reflected in alterations in the world economy.

For the United States, two additional factors need to be cited which require a reassessment of development assistance: the end of the war in Vietnam and the political changes resulting from Watergate. The prosecution of the war in Vietnam had eroded some political support in the United States for aid.[5] The belief that the United States had sufficient resources and desire to decisively influence affairs in Vietnam also had supported the idea that U.S. aid could have a measurable impact in advancing the economies of poor countries. The questioning of American power by Americans led to a decline in support for foreign assistance since the military and economic issues had become linked in the minds of the questioners - if the United States could not achieve one target, it also could not achieve the other. Furthermore a direct link was seen between economic assistance and military involvement.[6] If the United States Government became committed to a particular foreign government through economic assistance, it would only be a short step to direct U.S. military involvement to support that government against enemies both foreign and domestic. The end of the Vietnamese War may have improved the political climate for aid by reducing the virulence of the anti-aid feeling within the country, but it has not necessarily add-

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4) James W. Howe, Interdependence and the World Economy, Headline Series, No.222, [Foreign Policy Association, October 1974].

5) Frank Church, "A Farewell to Foreign Aid" in Robert E. Hunter and John E. Rielly, editors, Development Today , [Praeger, New York, 1972], pp.249-261.

6) J. William Fulbright, The Arrogance of Power, [New York: Random House, 1966].

ed to pro-aid sentiment.

Watergate has had a very important effect upon American politics which will affect foreign policy in general and foreign assistance in particular. The American political system is properly characterized as a two party system, but for some issues, the parties of interest are not the Democrats and the Republicans, but rather the party of the President and the party of the Congress. Democrats and Republicans are found in both of these parties. Watergate seriously undermined the party of the President in favor of the Congress. One major area that a stronger Congress has moved into is foreign policy. On the one hand this improves support for foreign assistance since Congress need no longer fear the link between aid and military involvement; Congress has asserted itself directly in controlling military actions. On the other hand, foreign assistance will be the major foreign policy instrument of the Congress in dealing with LDCs. It is to be expected that no aid legislation will emerge from Congress without encumbrances which the Secretary of State will find constraining in the conduct of foreign relations with developing countries.

Aid Recipients

If the central issue of foreign assistance is the relations among countries, as I contend, then some characterization of aid recipients need be kept in mind in order to set the stage for detailed analysis. Theodore Geiger has described LDCs as countries experiencing profound change in all their constituent institutional systems including economic, political, governmental, and educational and in the cultures of their societies.[7] The current rate and extent of sociocultural change differs greatly among these countries. For instance, the changes are more extensive in the newer countries of Africa and Asia than they are for the Latin American Republics such as Mexico where much stability has existed for some time. Nevertheless the transformation of all these countries is profound and is likely to continue for the foreseeable future. These changes are so complex that they cannot be guided from the outside and certainly not through the single instrument of foreign assistance. This provides some insight into the possible role of aid as a foreign policy instrument.

While developing countries show some similarities in sociocultural change, in most characteristics, they are diverse. They are at very different levels of national and per capital incomes. They have great diversity in their natural resource endowments. Furthermore they differ greatly with respect to population and physical size. Over one half the developing countries are quite small with populations of less than 10 million. Indeed the seven largest developing countries with populations each in excess of 50 million contain more people than the combined total of all the rest. Thus, with diffferent levels of natural and human resources, individual countries have different roles to play in the international system and different power bases for those roles.

Furthermore world price developments in the last three years have had different effects among developing countries. Obviously the OPEC countries have benefited greatly. Many other raw material

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7) Theodore Geiger, "Why Have a U.S. Foreign Aid Effort?," in Looking Ahead, Vol. 16, No.10, January 1969, (National Planning Association).

producers made gains during the price upswing of 1972-74 which have not been completely eroded by subsequent declines. Yet there is a further group of countries - the so-called fourth world or most seriously affected countries (MSAs) - that have lost on all counts from recent developments. They have had to pay more to import oil, food and fertilizers and many of them have not been able to obtain external financing from commercial sources because they were among the poorest countries to begin with. On a world basis, therefore, a new urgency has evolved for foreign assistance.

In the face of these diversities, it is quite remarkable that the developing countries have forged a strong coalition through the Group of 77 (now actually including close to 100 countries) for concerted action in various bodies of the United Nations. Their unity has been based on the belief that through the coalition they can obtain gains at the expense of developed countries. This has created the era of confrontation that has permeated recent special and regular sessions of the U.N. General Assembly. It is becoming quite evident, as Stanley Hoffman has observed, that North-South relations (the rich and the poor) are becoming the biggest issue on the world scene.[8] It is thus with a group of diverse and complex countries within a confrontational setting that one must analyze the role of foreign assistance.

The Politics of Economic Assistance

Making sense out of any economic process, whether domestic or international, requires an analysis of the political and institutional setting. If the structure has been in place for some time, well understood, and without serious challenge, then an explicit analysis of the structure can be dispensed with. But this is clearly not the case with foreign aid. Indeed the structure of bilateral foreign aid has been in a constant state of flux so that one could conclude that much can be learned from a political analysis. Aid is a *quid pro quo* process involving costs and benefits for both donor and recipient. It thus makes sense to examine basic political factors with respect to both the United States and the recipients of U.S. foreign aid.

In an effort to discover the continuing and secure bases for foreign assistance, I will examine in turn national security, other political factors, and economic interests. Following that is a brief description of U.S. foreign aid programme and some lessons from that experience. Then the prospects for future U.S. foreign aid efforts are discussed.

National Security

The original purpose of foreign aid was to improve the national security of the United States by helping selected foreign countries enhance their security against attacks by hostile powers. In the words of William S. Gaud, former administrator of the Agency for International Development, "Foreign aid was originally fashioned as a prime weapon in the Cold War. The purpose of the Marshall Plan, the Truman Doctrine, U.S. aid to Greece and Turkey - the purpose of

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8) Stanley Hoffman, "A New Policy for Israel," in *Foreign Affairs*, Vol.53, No.3, April 1975, pp.405-431.

all the early foreign aid programmes - was clear and unequivocal: to help buttress the Free World against Communism.

"Development assistance as we speak of it today - giving assistance to the countries of the Third World for the express purpose of enabling them to get on with their development plans and improve the lot of their citizens - was not our objective."[9]

National security is the most obvious and important political factor involved in foreign assistance. To deny that national security is a major focus, or to suggest that it should not be so, is equivalent to suggesting that aid is not a part of foreign policy which is nonsense on the face of it.[10] In this context national security should be considered rather broadly to include defense against hostile acts other than just military attacks and thus foreign assistance includes more than just aid for military establishments.

Security issues were also clearly of great importance in U.S. foreign assistance for developing countries at the inception of that programme. The debates in the United States in the 1950s and early 1960s made this quite explicit. It follows directly that aid would be distributed to countries like Turkey, Greece, Iran, Pakistan, Korea and Taiwan because of their geographic position and the international politics of the time.[11]

Can foreign assistance promote the security interests of the United States or other donor countries? The answer is yes as long as the limitations of the instrument are clearly kept in mind. To repeat, the basic evolution of developing countries cannot be guided from the outside through the instrument of aid nor through any other single instrument. Thus aid can make a marginal contribution, but will fall far short of determining the coloration of a regime. It can be helpful to a donor country for instance in the short run in securing overseas military bases and military cooperation. Aid can also be useful at times in maintaining a particular regime in power over a longer period of time.[12]

The relationship between aid and national security has sometimes been misrepresented or misunderstood, particularly in the United States in the 1960s. At that time it was argued that aid would lead to economic development; that development would lead to the emergence of stable and democratic governments; and that the existence of these governments would ensure peace and cooperation among countries. Whether all of the links in this chain of reasoning are defective or only most of them is a matter of contention, but it is obviously not a correct theory.[13] National security can be furthered by aid, but not guaranteed.

Can aid improve the national security of recipient countries? The answer is also yes, but probably a distinction need be drawn be-

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9) William S. Gaud, "Rethinking Foreign Aid," The Conference Board Record, Vol. 12, No.7, July 1975, p.43.

10) For an excellent and concise discussion see Samuel P. Huntington, "Foreign Aid: For What and For Whom?" in Hunter and Reilly, Development Today, pp.21-79.

11) Charles R. Frank, Jr. and Mary Baird, "Foreign Aid: Its Speckled Past and Future Prospects" in Bergsten and Krause, World Politics and International Economics, pp.133-167.

12) Stephen Kaplan, "United States Aid and Regime Maintenance in Jordan," in Public Policy, Spring 1975.

tween the short and long run. In the short run a developing country by accepting foreign military assistance can build up its military forces to provide minimal security needs without diverting resources from other uses in the country and can more easily obtain development assistance as well. By identifying itself with a stronger military power, it can also deter pressure or outright blackmail by a hostile power. Furthermore foreign assistance can help maintain the stability of a regime by providing resources to the government which can be utilized to satisfy certain claimants who would otherwise be dissatisfied. But again the limitations are obvious. Foreign aid cannot long maintain a government in power that in its absence would be unsustainable because of insufficient indigenous political support. Nevertheless, national security may be the soundest and most secure basis for bilateral foreign assistance. The donor and the recipient receive benefits which are mutual, understandable, visible, and self-contained.

In the long run the situation may be somewhat different for a recipient country. Foreign military privileges which may have been granted as part of the quid pro quo , while beginning as an asset, may grow into an embarrassment. Unilateral abrogation of a military treaty at best will cause strained relations and at worst considerable hostility with the other partner. Over time security interests between countries can diverge as the politico-military situation in the world changes. This does not suggest that arrangements for foreign assistance based on national security should not be entertained, but only that they should not be longlasting. The long run can be converted into a series of short runs. Failure to renew a contract at time of termination may make one of the parties unhappy, but it should not yield hostility. A series of short term arrangements can provide protection for both parties, but the need for frequent renewals or renegotiations adds uncertainty and risk to the relationship.

The involvement of national security with foreign assistance has been subjected to criticism, some justified and some not justified. It has been argued, for instance, that national security has subverted the true purpose of foreign aid, namely economic development. This criticism turns reality on its head. Foreign assistance began as a national security measure and it is those who want to turn it into an engine for growth that have changed the rationale; but there is no basic inconsistency between the two goals and thus no reason why both cannot be pushed simultaneously. Furthermore, as noted earlier, some critics have charged that foreign aid may lead the United States down the slippery slope into direct military involvement as it is alleged to have done in Vietnam. But it should be obvious that foreign assistance to promote national security and direct military involvement are very different commitments. The United States can make foreign assistance agreements without committing itself to direct military involvement as it has done with many countries including some who have engaged in hostilities, e.g. Israel and Jordan. One might also note that the Soviet Union has provided foreign assistance and much of it of a direct military nature without engaging in direct military conflict since the Second

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13) Frank and Baird, "Foreign Aid: Its Speckled Past ...." They cites Max F. Millikan and Walter W. Rostow, A Proposal: Key to an Effective Foreign Policy, [New York: Harper & Brothers, 1957] for a development of these ideas. Not all observers were convinced at that time. See Hans J. Morgenthau, "A Political Theory of Foreign Aid," The American Political Science Review, June 1962 (Vol.56, No.2), pp.304-5.

World War. (It is not clear how one should count the Russian invasion of Czechoslovakia in 1968.)

Some criticisms of foreign assistance for national security are justified and need be addressed. It has been argued, most forcefully by India and recently by Greece, that American military assistance has been used by recipients for purposes not intended by the United States. An aid recipient can become so militarily powerful as to constitute a threat to its peaceful neighbor. Without making a judgement as to the actions of Pakistan and Turkey, it must be recognized that military assistance can be overdone and encourage offensive intentions among recipients. Care to limit direct military foreign assistance to reasonable levels must be part of a national security programme.

A second criticism with merit points out that some foreign assitance for national security has been masquerading as promoting economic development. While there is no reason why aid could not both enhance national security and promote development, it is important not to mislabel the package. It is more than a concern over truth in advertising. Programmes create expectations which, if unfulfilled, can lead to frustration and disillusionment. If Congress is told that economic progress will result from foreign aid and none occurs, then support will be lost.[14] One of the most important elements in sustaining a foreign aid effort is creating realistic expectations and thus mislabeling national security assistance is serious and should be avoided.

A third criticism related to the second, charges that the United States has misused its position in international organizations to promote its narrow security interests. Organizations such as the World Bank (IBRD), the Inter-American Development Bank (IADB), etc. have been created for the specific purpose of promoting economic development. It would be an abuse of power and not in its long run interest for the United States to use its great leverage in these institutions to direct loans and grants only to those countries in which it has a security interest. These institutions have set up a system for disbursing their resources that is based on criteria such as need, development potential and absorptive capacity and it would be a great disservice to these institutions to undermine their professional judgements. However the point should not be pushed too far. The United States is not and should not be indifferent to the country distribution of loans and grants by international organizations. An organization that concentrates its resources in countries hostile to the United States cannot expect support from the United States. The overall interest of the United States either in the short or long run should be served by the operations of an organization or else it will not long command support in the Congress or among the American people.

What I conclude is that bilateral foreign assistance can be used successfully to promote the national security of the United States and recipient countries. The foreign assistance should be direct, open, limited in scope and directed only to those countries where a strong security interest exists. Selectivity is important to avoid unnecessary entanglements and needless military proliferation. Under these circumstances foreign assistance for security is defensible and will likely command support in the Congress. The amounts of money devoted to foreign assistance for security will have to be

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14) Robert E. Asher, Development Assistance in the Seventies: Alternatives for the United States, [Washington, D.C., The Brookings Institution, 1970].

tested against other uses of the defense budget, but a claim can clearly be established. It is important for its supporters to recognize, however, that security is not the only purpose of aid.

Other Political Interests

Providing foreign assistance to poor countries has come to be regarded by the international community as a responsibility of rich countries. The United States by its actions and pronouncements since the Second World War has been the leader in creating this international consensus. It is still recognized that economic assistance programmes are an essential element in the foreign policy of the United States.[15] The status which countries command in the eyes of other countries will result in part from whether they are seen as carrying out their proper role in helping the poor of the world. Thus aid programmes help enhance the status of donor countries and the United States in particular.

Status is a rather abstract concept which is perceived in reality in more specific terms. The United States has political interests in other countries beyond narrow security or economic concerns. I have in mind neighbouring countries in the Western Hemisphere and other countries with historical ties such as the Philippines. The U.S. Government has a political interest in invoking sympathetic responses in these countries to American aims. Foreign aid is seen as an instrument to help bring this about and, if possible, to foster institutions such as political democracy and libertarian ideals.

Individual Americans and the Congress perceive status in somewhat different terms. As people, Americans want to be respected abroad rather than held in contempt, liked rather than despised, and welcomed rather than rejected when going to other countries. Being generous in providing foreign aid is thought to further the creation of positive images and responses. Furthermore Americans harbour strong humanitarian interests. Their concern with poverty and starvation does not stop at their country's border and provides support for foreign assistance along with strong backing for disaster relief.

Problems arise in trying to convert this sentiment into continuing support for foreign assistance in the Congress. Americans desire to maintain respect for the United States in other countries, but they are less eager now than they were a decade ago.[16] In 1964 international affairs and defence were at the top of the list of concerns of the American public. These concerns were reflected in large and growing foreign assistance programmes. The size was extraordinary as measured by the share of U.S. gross national product devoted to them and in relation to the efforts of other countries as seen in Table 1. The United States provided well over half of all the aid classified by the OECD as official development assistance and was second only to France in aid as a percentage of GNP. (The French figures need to be interpreted with some care as is true of other countries as well.) By 1974 international concerns among Americans were at the bottom of the list after having slipped rather steadily

15) Donald M. Fraser, "The Politics of Aid Legislation," in Hunter and Rielly, Development Today, pp.239-248.

16) William Watts and Lloyd A. Free, State of the Nation, [Washington, D.C., Potomac Associates, 1974]. The surveys for this study were taken in the Spring of 1974; after the oil crisis but before the resignation of President Nixon.

Table 1 Official Development Assistance Net, In Relation to Gross National Products,a/ 1960 - 1974

	1960-64	1965-69	1970-74
Australia	0.45	0.56	0.54
Canada	0.20	0.29	0.45
France	1.14	0.70	0.62
Germany	0.41	0.39	0.32
Japan	0.18	0.27	0.23
Netherlands	0.36	0.46	0.60
Sweden	0.11	0.28	0.51
United Kingdom	0.54	0.43	0.37
United States	0.55	0.40	0.27

a/ At market prices and net of repayments. Preliminary for 1974.
Sources: OECD, Development Assistance Committee, Development Assistance Efforts and Policies of the Members of the Development Assistance Committee, 1969 Review. Also 1973 Review and 1974 Review.

over the decade. The reasons for the decline relate both to greater public awareness of domestic problems and a rather sophisticated recognition of changes in the world. As seen in Table 1, the American aid effort mirrored this sentiment.

Public views of the state of the world and the role that the United States should play in it have changed drastically during the last decade, a decade marked by the Vietnamese War and detente. Because of publicity about detente with the Soviet Union and China, Americans see international tensions as having been substantially relaxed and the Vietnamese War has sharply reduced their willingness to become directly involved in another military conflict abroad. Because of the progress made between 1969 and 1974 in furthering detente and ending U.S. participation in the Vietnam War, the American public approved of the foreign political and military policy conducted for the country. Quite perceptively they were dissatisfied with U.S. foreign economic policy as well as being unhappy over domestic economic policy. They perceived the United States as the most powerful country in the world, but recognized that the relative position of the United States had eroded over the last decade and expected further erosion during the next decade. Americans believed that respect for the United States in other countries had declined and the U.S. prestige was at a fairly low level in other countries. While Americans are unhappy with this situation, their concern does not get translated into a desire to spend more money for foreign assistance because of competing demands on the budget for domestic needs. In response to a question concerning U.S. aid to less developed countries, only 9% of the public thought it should be increased, 43% thought it should be kept at the present level, 33% believed it should be reduced, 11% wanted it ended altogether and 4% did not know.[17] The weak support given for aid to developing countries was still greater than that suggested for the political work of the United Nations, maintaining U.S. military bases abroad, or military aid to some of our allies. Foreign aid and foreign military expenditures

17) Watts and Free, State of the Nation 1974, p.250. Also chapters VIII and IX.

are closely associated in the minds of the public so that disenchantment with military expenditures may be weakening support for aid.

The opinions of the American public in 1974 can be summed up as moving away from the internationalist views of a decade earlier, but this does not mean that Americans are reverting to isolationism. The American public still supports ideas of freer trade, still supports the United Nations, still wants to maintain troops abroad in critical countries to maintain peace and is interested in third world countries. With respect to foreign assistance, a statistically significant increase in support was recorded in 1974 as compared to two years earlier. This resulted from the sympathetic response of Americans to the more difficult plight of poor countries stemming from the food and energy crises. It was also reflected in the Congress through a redirection of the aid programme to concentrate it more directly on the problems of the poor.

Capitalizing on political and humanitarian motivations brings its own problems to the American foreign assistance programme. In view of the limitations of aid as an instrument in affecting policies of rapidly changing developing countries, how can aid be used to help the poor and to further political democracy and libertarian ideals? For instance, should aid be maintained or reduced to a country governed by a repressive military regime? Recognizing which groups in the society might suffer from an aid cutback, a good case can be made on both sides, particularly if a distinction is drawn between the short and long run. Furthermore, if the purpose of the aid programme is to help the poor in developing countries, can aid be used for industrial development which most developing countries want? Evidence seems to support the belief that industrial development improves the position of the urban middle class and leaves untouched the rural sector where poverty is the worst. Studies of income distribution show incomes in developing countries to be much less equally distributed than they are in the United States.[18] The trickle-down theory may ultimately be verified, but it is of little help in answering the the critics of aid who claim that foreign asssitance helps the rich in other countries at the expense of the poor at home.

Moreover the political impact of foreign assistance is totally asymmetric. While foreign assistance enhances the status of governments of donor countries, it has the reverse effect on recipient countries. No government wants to be seen as maintaining itself on foreign largesse or selling its sovereign rights over policy for foreign aid. Being on the dole undermines the self-respect of countries as well as individuals. Thus the recognition that donor countries desire often cannot be given. Some countries seek foreign aid in private while taking a public stance of indifference. In some extreme cases, countries have even denied the reality of starvation within their borders rather than publicly seek foreign help. Thus political concerns on the part of recipients may stand in the way of a bilateral aid programme.

The political difficulties of aid recipients suggest either that bilateral aid programmes should be quite modest or that they be coordinated in a regional setting to reduce the visibility of the control by the donor country. The United States utilized the Alliance

18) Roger Hansen, "The Emerging Challenge: Global Distribution of Income and Economic Opportunity," in James W. Howe and the staff of the Overseas Development Council, The U.S. and World Development: Agenda for Action 1975, [New York: Praeger, 1975], pp.157-188.

for Progress for Latin America for this purpose and presumably New Zealand is similarly employing the South Pacific Forum.[19] Alternatively aid could be channeled through multilateral institutions which can more fully serve the political needs of recipient countries, but because the process is so very different from bilateral programmes, they may serve the short-term political interests of donor countries less well. In summary, status and other political interests will be importantly involved in the bilateral foreign assistance programmes of donor countries and, because of these concerns there will be much contention and difficulty with recipient countries.

Economic Welfare

As a general rule, when one country experiences rapid economic advance, other countries also benefit. This is one of the manifestations of an interdependent world economy. Thus donor countries have reason to provide development assistance to increase economic growth of developing countries. Economic welfare is more like national security than political status in that it provides a mutually satisfying basis for the extension of aid by donors to recipients. Nevertheless the economic self interest of donor countries in development assistance should not be overdrawn. Resources devoted to foreign assistance cannot be utilized domestically and thus the economic wellbeing of donor countries is reduced, at least in the short run. Two exceptions can be cited. First, no loss occurs if the rate of return on a foreign aid loan is equal to or greater than could be earned on alternative domestic investments, but I would not consider such a hard loan as containing any aid component, even if the interest rate charged is below what the recipient country would have to pay in the commercial market. Second, if the resources provided by foreign assistance are utilized to expand the productivity of an export activity, then the donor country might receive benefits through an improvement in its terms of trade equal to the resources it provided, assuming no losses in competing domestic industries. Such a complete offset is unlikely.

The economic burden to the donor of providing aid will be increased if balance-of-payments problems are created; (the classical transfer problem). During the period of fixed exchange rates, this was a serious problem for the United States. As a result the United States began tying aid to American exports which did not solve the problem of the overvalued dollar, but did manage to reduce the value of U.S. aid to recipient countries.

The American aid programme has been accused by its foreign critics and, at the same time, claimed by its supporters as promoting U.S. exports in general (beyond tying) and furthering the interests of American private investors. There seems to be very little support for the charge (claim) other than through the indirect route of increasing the economic growth of recipient countries. American exports and direct investment have been directed primarily to developed countries rather than to aid receiving developing countries. Furthermore, among developing countries, little relationship exists between importance of a country as a market for American exports or host to American investment and receipts of American foreign aid.

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19) Norman Kirk, "New Directions in New Zealand's Foreign Policy," Millennium, Vol.3, No.2, Autumn 1974, pp.91-99.

A distinction, of course, need be drawn between using the aid programme to promote new private investment in developing countries and using the programme to secure just compensation for private American investors for property nationalized by governments of developing countries. The latter use of aid has occurred and is probably strongly supported by the American public as legally and morally correct.

The economic welfare basis for economic assistance rests on the belief that aid does promote the economic advancement of developing countries. But is this measurably the case? To be effective in promoting growth, aid must increase the amount of resources and/or improve the efficiency of resource use within developing countries. From the outset it is clear that for other than exceptional cases, aid cannot have made much of a difference in the evolution of these countries. The amount of additional resources provided through aid has simply been much too small relative to total resources to have made a significant difference except for a few cases such as Taiwan, South Korea and - with respect to aid from the Soviet Union - possibly Cuba. Even magnifying the importance of aid because of its ability to relieve foreign exchange constraints cannot make it comparable to the myriad domestic factors impacting on the complex growth process through their effect on the efficiency of resource use. It is thus wise to recognize the limits of the potential of aid programmes.

Some extreme critics of foreign assistance have charged that aid has made no difference whatsoever. This is conceivable if, for instance, aid flows lead to offsetting governmental policies by developing countries that reduce domestic savings by an amount equivalent to the aid or distort markets and investments and reduce overall efficiency.[20] I find these highly critical arguments to be unconvincing. Some leakage from domestic savings to consumption is possible and maybe likely, but not a complete offset. Furthermore, some evidence exists from case studies that seem to point strongly in the opposite direction. Aid may not make all that much difference, but the sign is positive.

United States Programmes of Foreign Assistance

A mixture of motivations has provided the basis for American efforts at foreign assistance and they can be identified within the various programmes. There are four major components of these programmes; military assistance, economic programmes administered by the AID (and predecessors), the Food for Peace programme (PL 480), and contributions to international lending organizations. In Table 2 a summary is presented of expenditures under the programme beginning in FY 1953. Total expenditures over the 21-year span 1953 through 1973 exceeded US$100 billion. Average annual obligations and loan authorizations for economic and military assistance were US$3.5 billion in 1953-61, rose to about US$7 billion in 1962-70, and amounted to about US$8 billion in recent years. All of these figures are in current dollars so that when a correction is made for

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20) Keith B. Griffin, "Foreign Capital, Domestic Savings and Economic Development," Bulletin, Oxford University, Institute of Economics and Statistics, 32 (May 1970) pp.99-112 and Peter T. Bauer, Dissent on Development: Studies and Debates in Development Economics, [Cambridge, Mass.: Harvard University Press, 1972].

Table 2

U.S. Foreign Assistance, Summary for Less Developed Countries

(U.S. Fiscal Years - Billions of Dollars)

Program	1953-61	1962-70	1971	1972	1973
I. Total Economic Assistance[a/]	21.1	36.8	3.4	3.6	4.1
Loans	5.4	16.7	1.3	1.3	1.4
Grants	15.7	20.1	2.1	2.3	2.7
A. AID and Predecessor Agencies	14.8	20.3	1.9	2.1	2.0
Loans	3.1	10.5	.7	.6	.6
Grant	11.7	9.9	1.1	1.4	1.3
B. Food for Peace (PL 480)	5.5	11.7	1.2	1.2	1.1
Title I - Total	3.6	7.8	.7	.7	.7
- Repayable in U.S. Dollars-Loans	-	2.1	.5	.7	.7
- Payable in foreign currency. Planned for Country Use	3.6	5.7	.2	.06	-
Title II - Total	1.9	3.9	.4	.5	.4
- Emergency Relief, Economic Development & World Food	.6	1.8	.2	.3	.2
- Voluntary Relief Agencies	1.4	2.1	.2	.2	.2
C. Other Economic Assistance	.7	4.8	.3	.3	1.0
Contributions to International Lending Organizations	.2	2.8	.2	.1	.7
Peace Corps	-	.7	.09	.08	.08
Other	.5	1.2	.08	.1	.1
II. Total Military Assistance	10.4	20.1	4.2	4.6	4.2
Credits of Loans	.1	1.5	.7	.6	.5
Grants	10.3	18.6	3.5	4.0	3.7
III. Total Economic and Military Assistance	31.5	56.9	7.7	8.2	8.3
Loans	5.5	18.2	2.0	1.8	1.9
Grants	26.0	38.7	5.6	6.3	6.4

a/ JDA

U.S. Agency for International Development, U.S. Overseas Loans and Grants - Obligations and Loan Authorizations, July 1, 1945 - June 30, 1973, pub. May 1974, p.9.

the effects of infaltion, it is clear that assistance as a whole has actually declined in real terms in recent years. In terms of the budget of the U.S. Federal Government, foreign assistance has declined from over 5% to less than 3% of the total.

The distribution of American foreign assistance tended over time to go more toward military and less to economic assistance. In the 1953-61 period, two-thirds of all programmes were in economic assistance and only one-third military. The military programmes rose somewhat in the 1962-70 period and in the early 1970's were taking over half of total effort. The reason for the rising military share was more than just the Vietnamese war although the war was obviously of great import. National security has simply been a more stable basis for bilateral foreign assistance than political and economic bases. Security assistance need not be primarily of a military character, but it tends to be so. Thus the military programme was sustained, but the economic programmes eroded in response to changing domestic and international conditions. Within the last few years official development assistance has taken only slightly more than 1% of the U.S. government budget.

Within economic assistance, a great of programme stability is seen, although important changes have occurred in the way the AID has utilized its funds as different views became persuasive on issues such as loans versus grants, programmes versus projects, and resource transfers versus technical assistance. The Food for Peace programme maintained its support because of its importance to the American farmer and the humanitarian instincts of the American people. The world food crisis has given further impetus to this programme in 1974-75 (not reflected in Table 2). U.S. contributions to international organizations have tended to rise as more reliance has been placed on multilateral lending institutions, but the amounts are subject to great year-to-year variance because of the U.S. legislative process and the multi-year nature of replenishments to international lending agencies.

The regional distribution of U.S. foreign assistance is shown in Table 3. One is struck by the fact of continued concentration of the U.S. effort in Asia. In earlier years, the major recipients were South Korea, Taiwan and India. In more recent years South Vietnam and, to a much lesser degree, Indonesia grew in importance. Also seen in Table 3 is the chequered history of U.S. relations with Latin America. During the early years of the U.S. aid effort, Latin America received a relatively small share of the total. This might be defended on egalitarian grounds since Latin America is quite advanced relative to the countries of Africa and most of the developing countries of Asia, but the more likely explanation is nothing more than the inattention (or indifference) of the United States to the problems of Latin America. In the 1960s under the challenge of Cuba, the United States mounted a greatly expanded effort under the Alliance for Progress, but as time passed and exaggerated expectations were disappointed, enthusiasm for the programme waned.

Lessons from U.S. Experience

While there were many bases for establishing foreign assistance programmes, in one way or another they were all supposed to further the wellbeing of recipient countries. A review of U.S. experience in promoting development through foreign assistance yields some interesting lessons. The major lesson learned in the early years of the programme was that LDCs are not like European countries; hence

Table 3

U.S. Foreign Assistance,
Regional Summary - Less Developed Countries
Total Economic and Military Assistance
(Millions of Dollars - U.S. Fiscal Years)

Region	1953-61	% 1953-61	1962-70	% 1962-70	1971-73	% 1971-73
Near East and South Asia	11,089.6	35	15,868.2	27.9	4,487.5	18.6
Latin America	2,076.4	6.6	9,598.6	16.9	2,133.7	8.8
East Asia	12,625.4	40	21,271.5	37.4	13,378.0	55.4
Africa	1,161.7	3.7	3,472.0	6.1	993.2	4.1
Europe	3,029.4	9.6	849.9	1.5	179.6	0.7
Oceania a/	47.0	0.1	229.0	0.4	175.4	0.7
Interregional	1,510.2	4.8	5,598.7	9.8	2,805.4	11.6
	31,539.7	100	56,887.9	100	24,152.8	100

(percentages round to 100%)
a/ Economic assistance only
U.S. Agency for International Development, U.S. Overseas Loans and Grants - Obligations and Loan Authorizations, July 1, 1945. June 30, 1973. Pub. May 1974. pp.10, 33, 66, 84, 130, 134, 138.

the successes of the Marshall Plan could not be expected. In the European case, all the U.S. had to do was to make resource transfer. The United States did some urging to get the Europeans to reduce their trade barriers and make their currencies convertible with fewer restrictions so as to take advantage of larger markets, but essentially the Europeans did the rest. It soon became evident that LDCs could not make efficient use of additional resources without further help and thus began the trend toward greater involvement of the U.S. in the economics and politics of recipient countries.

Surprisingly no attempt was really made to apply the European experience with discriminatory trade liberalization to developing countries. The United States permitted (and probably urged) Europeans to liberalize partially amongst themselves even if they felt they had to maintain restrictions against the dollar area. LDCs were never encouraged to discriminate against developed countries in favor of other developing countries so as to promote intra-LDC trade and specialization. As a result, import-replacement strategies were not properly challenged. Apparently the infant industry argument for trade restrictions overwhelmed the more basic theories of Adam Smith concerning wealth and the size of markets.

In attempting to administer programmes in the field, Americans found that developing countries generally lacked the technical expertise to formulate overall development plans and to design efficient development projects in a way to satisfy AID in Washington. Since Americans know best what Americans want, it was rather natural to move into the requesting function to match the giving function. Furthermore development turned out to be a very complex business. Unpredictable and uncontrollable factors persistently intervened. It also became evident that development depended crucially on recipient government policies, local institutions (both private and government), available technologies and the culture of the country in addition to

resources. It appeared that some of these factors could be made more development oriented and it was discovered that resource transfers provide some leverage to the donor government over the policies of recipients. Thus given the need and the ability, Americans began to get even more involved in the recipient countries. Economic performance criteria set by the United States began to be added as a condition of receiving foreign aid. As time went by development strategies became more sophisticated and were focused more on politically potent broad resource-use qeustions.[21)]

David Denoon has examined U.S. foreign assistance programmes and developed an analytically useful typology to examine foreign relations of bilateral aid programmes.[22)] He has characterized bilateral aid relationships as being either High Politics, Technocracy, or Farce. His example of High Politics in the U.S. programme in India in the mid-1960s, Technocracy marked the programme in Indonesia in the latter 1960's; and Farce is used to characterize the incidents in Ghana at the end of the 1960's. Some interesting lessons grow out of his examination, particularly of India and Indonesia.

In the mid-1960s the United States along with some other aid donors and international institutions was heavily involved in trying to improve the economy of India. The U.S. had committed a substantial amount of aid funds already and was prepared to put up more. Many economists, both foreign and Indian, believed that the efficiency of the economy could be improved if India would correct the overvaluation of the currency, liberalize various restrictions on internal and external trade, and give higher priority to agriculture. Devaluation of the rupee and economic liberalization were resisted because of the difficult adjustment burden involved and its adverse effects on politically important segments of the Indian population. After much study, discussion and negotiation at the very highest levels of government (thus High Politics), a deal was negotiated in which India would make the policy changes in return for a substantial aid package. Almost simultaneously with the scheduled execution of the deal, political relations between India and the United States soured and the structure of the deal fell apart. India quickly aborted the liberalization programme although the devaluation was effected. The lesson from this experience is that developing countries cannot sustain politically sensitive decisions without the proper domestic political support and leverage from the outside is not sufficient to overcome the problem.

The Indonesian case was quite different. Immediately after the fall of Sukarno, foreign experts also became heavily involved in the economy because of a substantial aid package. The foreign experts thought a stabilization package was needed which ultimately included a devaluation, but in this case, the main discussions and negotiations were at the technical level (ergo Technocracy). Foreign experts could make common cause with national experts because they were communicating at a technical level (i.e., what is the problem and what is the best solution.) The stabilization package could be implemented despite its great impact and short run adverse consequences for some of the population because of the strong political position of the regime. In fact Indonesian economists became import-

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21) Joel Bernstein, "Thoughts on Development Assistance," Processed paper dated November 25, 1974.

22) David B.H. Denoon, Aid: High Politics, Technocracy, or Farce?, Unpublished thesis, The Massachusetts Institute of Technology, June 1975.

ant actors in the government despite the absence of a politicalbase. Essentially policy could be made without political constraints. Such a situation cannot endure forever because of the basic incongruity of making important political decisions at a technical level. Furthermore aid relationships between a donor and recipient cannot be sustained at a technical level because important issues of foreign relations are involved and will require attention at the political level. The strong position of the technocrats will collapse if their policies fail, but their role might still erode even if they are successful as in Indonesia. Once macro policy issues are settled, then attention will turn to micro programmes which have more visible distributional consequences and thus even greater political content. Such decisions will not be left to technicians and thus even success at policy making may be a self-limiting constraint on the role of technocrats. Thus from the Indian case we learn that a large aid effort is very difficult to maintain precisely because of the difficulty of sustaining understanding at the highest political level and the Indonesian case suggests that it is hard to sustain at a technical level also.

The high water mark for U.S. involvement in the workings of developing country economies came in the mid-1960s. The generally disappointing economic outcome of direct interferences by the United States led to the recognition that programme change was needed. A painful lesson was learned that no one can relieve developing countries from making the fundamental political decisions on use of resources available to them. Development is such a complex business with so many domestic vested interests involved that Americans can not make the decisions or even get too closely associated with the decision making process. Even if foreigners are really given some decision making authority, it may not be wise to exercise it because it will undermine the process of creating decision making capacity in the developing countries upon which success at development will ultimately depend. Furthermore foreigners unfamiliar with the nuances of life in developing countries may not have the correct solutions to development problems. It is clear that developing countries will not for long accept solutions to problems that others have determined for them; they must do it for themselves. In a similar vein even certain apparent successes like creating new institutions will ultimately wither and possibly die after foreigners leave leadership positions if there is insufficient national identification with the institution. Furthermore it is clear that there are few if any imported technological fixes that can really solve a significant development problem (like inadequate food production).

Some of the problems that necessarily grow out of a bilateral aid relationship can be overcome or moderated through multilateral arrangements. Frank and Baird summarize the arguments for multilateral assistance as follows:

1. Multilateral aid programmes avoid the political antagonisms and conflicts that come about in bilateral programmes when the donor attempts to impose performance criteria in giving aid.

2. Multilaterl donor agencies are more efficient in stimulating development because they make decisions based on more technical and objective criteria.

3. Less developed countries are likely to be more receptive to the advice of policy experts when that advice emanates from multilateral institutions, since they will be less suspicious that the advice is politically motivated.

4. With the use of multilateral institutions, less developed countries can

feel a sense of greater participation in the aid process and are, therefore, more likely to cooperate with donor countries.

5. Channelling aid through multilateral institutions promotes a feeling of cooperation rather than competition among major aid donors and reinforces the humanitarian as opposed to the strategic objectives of foreign aid.[23)]

There is force in these arguments, but they should not be overdone. Development inevitably has political dimensions which cannot be depoliticized. Leverage exerted by an international organization may be more accepted than that by a single donor country, but it is still unlikely to be acceptable for important policies in developing countries. For continuing aid relationship, developing countries will resist external pressures; they want their checks slipped under the door with no questions asked. Of course international organizations cannot oblige the demand for reasons of economic efficiency as well as politics. International institutions cannot be apolitical; they must know who are their constituents and what they desire if they are going to survive. For instance the U.S. Congress will demand some check on these institutions to make sure the money will be well spent.[24)] Moreover all participating countries are going to use political, not efficiency criteria in determining the resource distributions of these institutions. Thus while some gains are made through multilateralizing the process, some of the basic problems remain.

There are also many positive lessons that Americans have learned as a result of giving foreign asssistance. One of the most important lessons is that the focus of the aid programme should be directed to countries where good leadership exists for they will have the greatest potential for development since success is based on the behavior of decision makers in the developing countries themselves. Second, problem-solving resources are transferable through technical assistance even when specific answers to problems are not. Thus aid can be provided through technical people, through training and research and development facilities, through access to others' experiences when combined with local people under local control. Third, that the best experience for the United States grows out of concentrating in areas of mutual interest with recipient countries, often in joint problem solving efforts. Fourth, food aid can play a special and important role in development by keeping the cost of living from soaring during periods of rapid growth. Food aid bridges the time gap between increasing food demand and supply. Fifth, the U.S. comparative advantage seems to be in helping developing countries grow more food, provide health and educational services and in improving their techniques of problem analysis. Finally, cultural factors should be recognized, but not considered unchangeable since market incentives have at times been able to alter traditional modes of behavior.

Special effort was made to learn the lessons of the U.S. aid effort in South Korea because of its success. It is believed that aid did make a substantial contribution to increasing the Korean rate of growth.[25)] In addition to relatively large amounts of resource transfers, a number of other characteristics were found to

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23) Frank and Baird, "Foreign Aid: Its Speckled Past ....", p.158.

24) Charles Paolillo, "Development Assistance: Where Next," in James W. Howe and the staff of the Overseas Development Council, The U.S. and the Developing World: Agenda for Action 1974, [New York: Praeger, 1974], pp.107-123.

25) Charles R. Frank, Foreign Trade Regimes and Economic Development: South Korea, [New York: National Bureau of Economic Research, 1975], forthcoming.

be of importance which relate to the Korean people and which support the proposition that developing countries must do it for themselves. Success in development was found to depend on strong worker discipline, the relative openness of the society to change, the ingenuity of the people, their achievement motivation, and their resilience in the face of adversity. These characteristics cannot be trnasferred from abroad and make all the difference.

The Future of American Foreign Assistance

Some important elements of American foreign assistance are in the process of change while others are being maintained. National security remains important, but even here the amounts of money required in direct military support and support assistance are sharply reduced because of the end of fighting in Indochina. The changes in U.S. foreign assistance reflect a new realism about development and the American role in the world. Grandiose schemes promising that aid will radically increase the rate of economic growth of developing countries are no longer given credence. Americans no longer believe that they can or should determine the destiny of developing countries. The most obvious sign of the new less-intrusive U.S. role in LDCs was the closing of the U.S. aid mission in India. Furthermore Americans have become painfully aware of the limitations of U.S. resources available for both domestic and foreign purposes. While these realizations call for a smaller American aid effort, they are counterbalanced by the recognition that grinding poverty still grips many people on earth and some of them are at the point of starvation.

Despite common international practice, the appropriate size of the American aid effort cannot be related to the size of the U.S. gross national product. Rather foreign assistance must compete for resources allocated through the Federal budget and thus must be related to budget aggregates. Periods of budget stringency will be reflected in lean foreign assistance programmes which can only be reversed when budget ease becomes possible. Furthermore elements of U.S. foreign economic policy in addition to aid are related to development such as international trade opportunities, access to capital market facilities, availability of export credit and private direct investments and must be considered in an overall legislative framework.

Significant revisions in the bilateral American aid programme have been determined by the Congress in the 1973 legislation.[26] The legislative directives can be summarized as requiring AID to concentrate on the problems of the poor in recognition of the need for social justice. Thus something more than just an increase in growth is being sought. The problems of poverty should be attacked directly through help in the provision of basic necessities like food and shelter; through spreading the benefits of development more widely; through helping reduce population growth as well as trying to accelerate overall economic growth. Thus American bilateral aid efforts are to be concentrated in agricultural projects, in rural development schemes, in support of improved nutrition and better health and in promoting population control and education. Problems of course will arise in trying to promote more equal distribution

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26) Charles Paolillo, "Development Assistance: Where Next?", Agenda for Action 1974.

of incomes while at the same time maintaining a less intrusive U.S. presence but problems are endemic in an aid programme.

Moving bilateral aid toward a people oriented programme seems to be in conflict with a lesson of U.S. experience regarding the importance of concentrating efforts in developing countries with greatest potential. This is not the case, however, since major resource transfers are to be left to multilateral development organizations. Support for international organizations is a basic ingredient of U.S. policy. How large the American contribution should be is related to competing budgetary demands and to the amounts provided by other countries. The U.S. contribution should not dominate an institution or else the institution will necessarily have to become an agent of American policy. Strings have to accompany resource transfers. Attaching strings, some of which may appear to be political rather than economic or technical, is the best procedure to ensure continuity of contribution and in reality is the only procedure possible. Thus the American contribution should be diluted by appropriate contributions from other countries.

New procedures were also set up in the 1973 legislation which included the creation of a Development Coordination Committee within the Executive. The Committee will present an annual report to the Congress and through this mechanism greater coordination in American development efforts is to be sought. In his letter of transmittal of the first report to the Congress, President Ford stated: "Our policies must continue to reflect our belief that American wellbeing is intimately related to a secure and prosperous international environment and humanitarian and economic concerns that have for so long motivated our assistance programmes."[27] If this belief is fully incorporated into American policy, then the new legislation will mark a new direction for U.S. foreign assistance. Executive requests for aid funding will likely rise and Congress will be forthcoming.

Nevertheless I have a feeling of some unease. There seems to be remarkably little public understanding of the importance of the international environment to American wellbeing and slight recognition of the importance of developing countries in the world environment. Before a new foreign assistance programme can be brought into full operation, greater understanding of international interdependence will be required in the United States. Only then can the Congress give proper budget support to foreign assistance.

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27) Development Coordination Committee, Development Issues: First Annual Report of the President on U.S. Actions Affecting the Development of Low-Income Countries, Washington, D.C., May 1975, p.i.

COMMENTS ON KRAUSE'S PAPER

(a) SEIJI NAYA

The experiences and problems of the United States, as the largest donor of foreign assistance, are discussed in this paper. The analysis, largely devoid of sentimentality, is concerned with what has been and is likely to be. A number of factors affecting the United States and the recipient countries are generally well presented, permitting a coherent interpretation of events and circumstances. Many arguments are also presented which would provide the United States with a more rational policy of foreign assistance than in the past. But the author's discussion of national security as the primary basis of bilateral assistance is highly controversial, and it is on this point that I shall focus.

Beginning aptly with an historical sketch of the changing political climate both at home and abroad in which the United States has sought to administer its aid programmes, the author covers a wide range of topics. They include the heterogeneity of receiving countries, the role of national security as the central focus of foreign aid to developing countries, the marginal effect that aid has imparted on economic development, and negative as well as positive lessons of the United States experience. In discussing prospects for the future of American foreign assistance, several practical and rational approaches to maintain a viable programme are suggested: less paternalism, less domination, fewer expectations of grandiose development schemes, and also more support for international organizations, more attention to the plight of poor countries and to social justice, and recognition of the importance of national security as an element of foreign assistance. But the writer concludes on a note of pessimism, citing a lack of understanding of international interdependence on the part of the American public and, hence, the United States Congress, who must deliberate on the Federal budget.

He maintains that national security may be the soundest basis for bilateral foreign assistance, though he properly cautions it is not the only purpose for aid. He answers two related questions affirmatively: (1) can foreign assistance promote the security interest of the United States? and (2) can it promote the security of recipient countries? His criteria for aid are that it should be "direct, open, limited in scope, and directed only to those countries where a strong security interest exists".

However, the author neither clearly distinguishes between economic and national security objectives nor defines national security interests. This weakness permeates the paper because the reader senses that significant overlap exists between economic, political, and national security interests. To be sure, he mentions a possible relationship of these ends, but there is no mention of what constitue a national security interest. Indeed, the term has been vastly expanded in past years to justify both economic assistance, e.g., for construction of the Panama Canal, as well as military involvement, e.g., for pursuing the Vietnam War. As a result, I remain confused as to the significance of this interest in foreign assist-

ance programmes. Undoubtedly, a grey area exists in this regard, but the author seems clearly to distinguish between economic and national security interests. Perhaps a typology analogous to the one by David Denoon as presented in this paper would be a helpful framework from which to proceed. Otherwise, different readers may interpret differently the references made to national security vis-a-vis political or economic interests of the United States.

Secondly, development assistance is not defined nor its components identified. Hence, not separating military aid from all assistance, for example, seriously confuses the discussion because of differences in the management of funds for economic assistance and for military operations. A dinstinction is especially critical in light of the author's insistence on the importance of national security in United States foreign assistance objectives.

Although the author contends that assistance can be granted without a commitment to direct military involvement, I wonder whether he has thoroughly evaluated the possible reaction of the United States in countries where substantial aid or investment commitments are threatened. Furthermore, it may be appropriate to discuss the cases of Korea and Taiwan in this context. Would the threat to the presently endorsed regimes in these two nations and the loss of the commitments made to them be considered a national security threat? The question is indirectly posed but receives no treatment. Where is the line drawn when national security, as undefined, is at stake? Finally, if national security is stated to be the main purpose of aid how do the others temper this primary interest?

(b) Mosese Qionibaravi

Dr. Krause has presented a very candid paper on United States development assistance and although he prefaced his remarks by saying that his paper presents an American view, one gauges from discussions in the United Nations and other international forums that the tone of the paper reflects fairly well the current American view on development assistance. The paper highlights the predominance of national security in the consideration of American aid. Coming from Fiji, a small island territory in the South Pacific, I now appreciate why United States development aid to Fiji has not been significant.

The paper also reflects the air of disenchantment about aid which emerged in the earlier discussions. This feeling is based on the view that several decades of development assistance do not appear to have made any significant impact on the development of less developed countries. This view is to my mind based largely on assessment of development in purely quantitative terms. Development however involves essentially the betterment of the way of life of people. Thus while aid may not have made any significant contribution to accelerating the growth of G.N.P., to the extent that in many countries it has meant better water supplies, improved means of communication, the opportunity for better education, it has in my view contributed significantly to development.

In assessing the impact of aid on growth of less developed countries one ought to take account of the directions to which aid has been channelled. In most countries aid has been directed to the

provision of basic infra-structure. The presumption seems to be that given such infra-structure, investment to exploit the resources of a country would follow. But as pointed out by Dr. Krause the development process is much more complex. Systems of values, socio-cultural factors, administrative constraints, lack of know-how and many other factors could slow the development process. In this connection the Marshall Plan succeeded because Europe had the requisite socio-cultural environment and systems of values to utilise such aid for reconstruction and post war economic expansion.

The disenchantment about aid could also arise from the high expectations of its results. The non-economic constraints to development were not appreciated. But this should not in my view lead to too much disillusionment. After all it has taken developed countries centuries of change to be where they are today. It would therefore be unreasonable to expect less developed countries to go through the same process within a few decades.

With the current disenchantment about aid it seems to me that less developed countries could look more to promoting foreign investment in their countries. But in order to avoid resentment and gain greater benefits from such investment it would be preferable that they be in the form of joint-ventures between local and foreign enterprises. Such forms of assistance could introduce technical know-how and overcome the problem of status mentioned by Dr. Krause.

(c) General Discussion

There was some criticism that the details of aid given in the paper included items such as military assistance which could not properly be regarded as aid at all. More fundamentally it was suggested that while the paper recognised the existence of growing tensions between the developed and the developing world, a reduction in large international transfers as seemed to be proposed would not help in reducing international inequalities which were at the root of these tensions.

There was also the question of tied aid and the effects this had on recipients, though participants disagreed as to whether the effects in the United States case were as bad as often represented. A more important policy issue in the view of one participant was the need for greater recognition by the United States of the close links between trade and aid. Trade access was most important for developing countries.

Replying to these points, Dr. Krause supported by other participants asserted that his paper was intended to show the way in which thinking and action on aid was heading in the United States. It was not concerned with the question of what policies should be. The United States public is no longer persuaded by the old arguments for aid programmes and the links with United States security interests were part of the political requirements for securing continuing support for aid. Humanitarian aspects in the United States had weakened and this was in part the result of inflation and disenchantment with foreign involvement generally. Humanitarian issues would however arise again and perhaps the emphasis on security decline. One had to face the fact however that what do-gooders wanted is not necessarily what the political system provides. The world crisis was not going to be solved simply by large international resource transfers. Bargaining processes over a range of inter-related issues were

involved. Dr. Krause added that for a large country such as the United States it was difficult to make a clear cut distinction between what was national security and economic assistance. In any case in democratic political systems aid competes for resources with domestic and other programmes and aid policy had to recognise this.

It was true that GATT had not conceded much to developing countries because they were not part of the system. They must develop bargaining positions and become part of the system. The main point is that one cannot take normative stands on public issues and stay in touch with reality. He also did not think multilateral institutions are apolitical. They could help but it was wise not to become too enamoured with them.

8

USSR: ECONOMIC CO-OPERATION WITH THE DEVELOPING NATIONS OF ASIA AND THE PACIFIC AREA

ANDREI I. CHEKHUTOV

Economic cooperation of the Soviet Union and other socialist countries with the developing nations of Asia and the Pacific area comprises an ever-increasing part of modern international economic relations. This cooperation marks the making of a new type of economic ties between highly developed industrialized countries and nations with lower levels of economic development which in the past were colonies of the Western powers. Principles of equality, mutual benefit, respect for national sovereignty and providing all-round assistance in the struggle for political and economic independence were taken, at the initiative of the socialist states as a basis for relations with the newly independent nations. These principles are observed by the socialist countries irrespective of which geographic area a particular developing nation belongs to, whether that nation is big or small. Such principles are unprecedented in the history of economic relations between countries with different levels of economic development.

Economic cooperation of the USSR with the newly independent states proceeds along various directions. It covers foreign trade, economic aid, scientific and technical assistance. In recent years USSR economic relations with the developing countries were persistently expanding beyond the confines of foreign trade. Mutually beneficial trade relations are added to and strengthened by broadening economic and technical co-operation. The latter two form the principal focus of the present report.

Characteristic features of economic and technical co-operation

As part of economic and technical co-operation with the developing countries of Asia and the Pacific area, the USSR participates in a range of development projects including geological prospecting, and provides equipment and materials for newly constructed or modernised enterprises. Soviet experts are sent to provide assistance in the construction and operation of new enterprises. Schools for professional training and higher learning establishments are organized and large-scale training of national personnel is done with Soviet assistance. The volume of economic and technical cooperation keeps increasing from year to year as the following table demonstrates:

Growth of the USSR Economic Cooperation
with the Developing Countries of Asia

(percent)

1965	1970	1971	1972	1973
100.0	166.1	173.9	194.1	215.0

Average annual increase reached 10.7 percent during the years 1966-1970 and 9.0 percent in 1971-1973. In terms of growth, Soviet economic and technical assistance to the countries of Asia and the Pacific area exceeds bi-lateral official development assistance provided to those countries by the Western states. According to the OECD 1974 Review the average annual increase in Western assistance was 6.5 percent during the period 1971-1973. High rates of increase in economic co-operation were characteristic for the USSR not only at the initial stages of co-operation, but also in the period when the volume of Soviet economic assistance became rather substantial.

Some particular features had been present in USSR economic co-operation with the developing countries of Asia since the very beginning. Subsequently these features have become even more apparent, contributing to greater efficiency of co-operation for both the newly independent states and the USSR.

Among those features one should first notice the inter-state nature of economic relations. Direct participation of states as economic partners allows for large-scale projects which would exceed the capabilities of even the biggest private companies. In India, metallurgical plants in Bhilai and Bokaro, heavy machine-building in Ranchi and heavy electric engineering in Hardvare can be cited as examples. All those plants are the largest of their kind in Asia.

The inter-state nature of economic relations allows for another significant advantage, namely the harmonisation of the aims and goals of co-operation with the national objectives of the participating states. Thus, Soviet economic assistance to the developing nations is closely co-ordinated with their national plans and programmes and contributes to the solution of the most difficult tasks of their national development: strengthening economic independence, increasing rates of national industrial development, changing its structure and implementing progressive socio-economic reforms.

The fact that the Soviet Union assists first of all in strengthening the position of the state-owned sector in the economies of the developing countries is another way in which economic co-operation is a means of fulfilling national aims. As a result the material base for further strengthening the role of state in economic construction is broadened, which plays a decisive role in economic and social progress of the newly independent states. Experience of these states demonstrates that narrow mercenary motives of private enterprise are an obstacle to overcoming economic backwardness and social inequality in a short period of time.

Another important feature of USSR economic co-operation with the developing countries of Asia is the increased use of bilateral intergovernment agreements covering major aspects of the USSR economic and technical co-operation. Thus, in 1955 the Soviet Union had intergovernment agreements on economic and technical co-operation with just Afghanistan and India. By 1973 the number of Asian countries with which co-operation was based on intergovernment agreements had reached 20. They include Afghanistan, Bangladesh, Burma, India, Indonesia, Jordan, Iraq, Arab Republic of Yemen, People's Democratic Republic of Yemen, Cambodia, Kuwait, Laos, Malaysia, Nepal, Pakistan, Singapore, Syria, Turkey and Sri Lanka.

The rapid increase in the number of developing countries which have intergovernment economic agreements with the Soviet Union, il-

lustrates the persistent expansion of the geographic area of mutually beneficial co-operation. At the same time it proves the efficacy of the instrument of intergovernment agreements in relations between countries with different levels of economic development and different socio-economic systems. These agreements provide favourable conditions for dovetailing short and long term plans of national development of each of the partners with their mutual co-operation. They provide a reliable legal foundation for development of economic relations between the two groups of countries and allow for this task to be solved on the basis of overall state interests of the co-operating countries.

Arising from the system of bilateral intergovernment agreements is another significant feature of co-operation, namely a trend towards establishment of close co-ordination between different elements in foreign economic ties. An evergrowing number of the developing countries combines their trade relations with the USSR with the use of Soviet economic, scientific and technological assistance and financial aid. As a result, foreign trade relations, participation in construction of various projects and in training of local personnel, providing credits and so on are not separate and independent directions of USSR economic co-operation with the developing countries, but make a single complex of economic co-operation. This is in line with the ideas of the "International Strategy for the 2nd Development Decade", adopted by the XXV General Assembly of the United Nations in October 1970. That document considers the principle of co-ordination as the leading method in promoting the economic relations of the developing nations with other countries.

Another important feature is the favourable terms of credits provided by the USSR to the developing countries of Asia. The total sum of Soviet credits to all the developing countries is at present about 6 billion roubles a substantial part being provided to the newly independent states of Asia. In intergovernment agreements the USSR usually provides loans for a period of 10-15 years at 2.5-3 percent interest rates. Soviet credits are favourable not only in respect of their terms. They do not imply any additional demands, neither open nor latent, which would increase the price of credit or interfere with the political sovereignty or economic independence of the receiver. Repayment conditions are also favourable. Repayment of capital sums and interest is effected mostly by deliveries of goods including those produced by enterprises constructed with Soviet credits. This mode of repayment places no additional burden on the balance of payments, but on the contrary, contributes to increasing exports of the developing countries.

Structure of Economic and Technical Co-operation

With all the diversity of needs of the developing countries of Asia it seems obvious that the expansion of the foundations of their economies is of decisive significance for them. By this is meant the creation of production capacities capable of solving major tasks of newly independent states - those of increasing industrial output and employment, forming domestic sources of capital accumulation and strengthening economic independence. These very current and prospective tasks facing developing nations shape the structure and material composition of economic and technical assistance of the Soviet Union. A breakdown of such assistance is given in the follosing table:

USSR Economic and Technical Assistance
to the Developing Countries
by purpose
(at the beginning of 1973, per cent)

Industries and power engineering	76.6
Transportation and communications	7.6
Agriculture	5.9
Geological prospecting and surveying	5.4
Education, science, culture, health care, etc.	4.5

As will be observed, about 90 percent of resources provided under economic and technical co-operation agreements between the USSR and the developing countries, is for the development of basic production industries.

It should be noted that distribution of Soviet assistance between particular branches and enterprises of production lies within the competence of governments of the developing nations. Taken into consideration is the role and significance of every object of co-operation in manufacturing products that are most important for a particular country. Naturally, efficiency of an enterprise, whether a new or a modernized one, depends on the availability of basic raw materials and components of domestic origin and on the existence of sufficient domestic or prospective foreign markets. All that, of course, is taken into consideration. At the same time, when choosing objects for co-operation, preference is given to those enterprises and industries which could markedly contribute to general growth of the national economy by either processing local natural resources or providing power, raw materials, semi-manufactured products, machines and equipment for other branches of the national economy.

A major part of Soviet economic and technical assistance to the developing countries of Asia is directed to various industrial projects. Those are the key (and most dynamic) branches of modern industry capable of making major contributions to increasing national production. Formation of a stable industrial base makes it easier for the national governments of these countries to fulfil the historical task of consolidating all forces of national reconstruction. Depending on more rapid industrial development also is the general improvement of the position of liberated countries in the system of international division of labour and, in the final end, their economic independence.

Industrial infrastructure and agriculture are also given serious consideration, along with industry, in USSR economic co-operation with the developing countries of Asia.

Practical economic co-operation of the USSR with the developing nations of Asia is determined by a desire to increase their production potential as well as to provide assistance in overcoming major imbalances in their national economies. As examples of such imbalance one can cite underdevelopment of industries, - above all heavy industries, - weak connections between various branches of the economy and individual enterprises, and the low technological level of many industries. For that very reason creation of production - technical complexes of national or sectoral significance has a notable place in Soviet economic assistance to the developing nations of

Asia. Such complexes are usually formed on the basis of large industrial or power enterprises within the framework of a state-owned sector. They normally include several enterprises organised on the basis of either "vertical" integration (survey, prospecting and exploration of a particular type of raw materials up to the stage of finished product) or "horizontal" one (participation of various industries in manufacturing a particular kind of product). Construction of industrial projects is combined with training personnel for them.

Organization of such complexes is a difficult and time-consuming task. Its success depends not only on the USSR but also on the volume of co-operation already achieved and on the reciprocal efforts of governments of the developing countries. That is why the most valuable experience in organizing production-technical complexes with Soviet participation was accumulated in co-operation with India, Afghanistan and Iran.

In India, a complex was built - and is now being expanded - for extraction of raw materials for the metallurgical industry, pig iron and steel production and manufacturing of machines and equipment. This complex covers iron ore extraction, coal mines and quarries and a lime-pit. Pig iron and steel produced at metallurgical combines in Bhilai and Bokaro, are made use of by machine-building plants in Ranchi, Dorghapour and Hardvare. Forty thousand people were professionally trained while constructing and operating these objects.

With Soviet assistance, an industrial-and-power complex is being set up in Afghanistan on the basis of huge deposits of natural gas. In Iran, an industrial complex is under way on the basis of a metallurgical plant in Isfagan and linked to local resources. Also several enterprises are being established for natural gas extraction and transportation. Specifically, the coke and chemical division of the Isfagan metallurgical plant produces such items as phenol, toluol and various resins. Production of cement is being organized on the basis of coke waste products of this plant.

Results and Prospects of Co-operation

Economic and technical co-operation with the Soviet Union is getting stronger and playing an increasingly positive role in the life of the developing countries of Asia. In a number of newly independent states enterprises constructed with Soviet assistance take a leading place in the output of major industrial products. In India, for example, they account for production of 60 percent of metallurgical equipment, 60 percent of power turbines, more than 50 percent of oil production, 30 percent of oil refining, 30 percent of steel, and about 20 percent of electric power.

The positive impact of co-operation with the Soviet Union upon socio-economic processes in liberated countries is further strengthened by the fact that enterprises constructed with Soviet assistance belong mostly to the state-owned sectors of these countries' economies. More rapid development of this sector makes it possible for the national governments to concentrate in their hands commanding levers of economic construction, to more successfully counteract private capitalist chaos of market competition and expansion of international monopolies. Strengthening the position of the state sector is a necessary precondition for shaping the socio-economic structure of the newly independent states, for making possible their

progressive domestic and foreign policies.

Owing to the equal and mutually beneficial nature of relations, USSR economic and technical assistance to developing nations in construction of industrial projects serves, together with foreign trade and other types of economic relations, to bring about a more complete satisfaction of the needs of Soviet economy as well. This co-operation stands as an important factor in the rapid growth of exchange between the USSR and the developing countries and contributes to broadening the range of Soviet imports and exports. The USSR receives from the developing countries large quantities of raw and other materials and finished products including those manufactured at enterprises built with Soviet assistance.

The mutually beneficial nature of the USSR economic relations with the developing countries of Asia, and the increase in mutual demands for economic exchange raises new tasks in further increasing the scale and efficiency of economic co-operation. Equal international division of labour between the USSR and the developing nations of Asia can develop both through greater exchange of traditional goods and joint organization of production of new products. A number of measures could contribute to a new, higher level of mutual co-operation. The following ones deserve consideration: concluding complex long-term economic agreements between the USSR and the developing countries of Asia, which would cover both foreign trade, economic and technical co-operation. An example of these is the Agreement on further development of economic and trade co-operation between the USSR and the Republic of India, signed in November 1973 for a period of 15 years. Furthermore, it would appear useful to supplement bilateral agreements by multilateral ones, with several socialist and developing countries participating. Co-ordination of plans of production for mutual exchange by interested coutries could become another stimulating factor of co-operation. Strengthening the organizational structure of co-operation - such as improving operation of the permanent intergovernment commissions on economic, scientific and technological relations - as well as making use of new and prospective forms of economic co-operation, could also contribute to this development. These and other measures, in my opinion, are capable of broadening the scale of mutually beneficial co-operation, and of ensuring the even more stable, long-term and efficient nature of that co-operation.

COMMENTS ON CHEKHUTOV'S PAPER

(a) V. YAKUBOVSKY

Supplementing Dr. Chekhutov's remarks Professor Yakubovsky said that there is now more mutual cooperation between the Soviet Union and developing countries, as these countries have changed in recent years. Foreign trade is important between the Soviet Union and the Asia and Pacific countries, especially with the South Asian group which have been the main recipients of Soviet aid. New directions of trade are being opened up, e.g. Phillipines. Due to rapid trade growth in respect of Latin America and Africa the share of Soviet trade with the Asia and Pacific region has dropped slightly.

The initial trend was for the Soviet Union to export machinery and to import raw materials. This is changing, particularly in respect of Pakistan and India which are now sending finished goods including some machinery and equipment. Trade barriers to imports of finished and semi-finished goods have been removed since 1965.

The Soviet Union also enters production cooperation agreements, e.g. in Afghanistan, fruit produced on land irrigated with Soviet assistance is imported into the Soviet Union. Joint enterprises are also being established, e.g. fish products in Singapore.

Multilateral arrangements are a possibility, bringing in other members of CMER (COMECON). These arrangements would be useful in cases where there was a considerable trade imbalance between the Soviet Union and the developing country involved. The Soviet International Investment Bank has a special fund of 1 billion roubles which it can invest on medium (5 year) or long (15 year) credits in transferable roubles which can be utilised in any CMER country and for international settlements.

Problems are the distances involved, the lack of cultural ties, lack of knowledge of markets in developing countries and, on the other hand, of the system of operation in the Soviet Union, the difficulties in raising the export capacities in line with developing countries' requirements, political factors, e.g. end to the Indo-China War. A rapid development of trade is not foreseen but it will grow. Countries which felt caught between Japan and the United States could seek an alternative outlet in the Soviet Union.

(b) GENERAL DISCUSSION

A number of questions were raised seeking elaboration of points in the paper. These included whether there were any limits on Soviet Union aid, whether there were any links between economic and military aid and what was the attitude of the Soviet Union to aid through multilateral or regional development institutions. In reply Dr. Chekhutov said that the limits to assistance were primarily those of the Soviet Union's resources and the situation in particulalr developing countries. Absolute figures were available here only for some Asian countries which might be misleading. Only economic assistance is given; the links with military aid are not close. The importance

given to the role of the public sector hinges on marxist theory. In practice, this importance is accepted in many developing countries, and it is believed that this is the only way to achieve reconstruction and overcome economic backwardness. The objectives of aid are to co-ordinate and achieve planned targets, subject to the needs of developing countries, and to promote radical changes and revolutionary movements. If the aim is to establish sound peaceful relationships, it could be described as anti-military. The Soviet Union dislikes the character and the Articles of Agreement of the IMF and the development banks, but is not against multilateralism as such.

9

PROBLEMS OF THE SMALL DONOR: THE AUSTRALIAN EXPERIENCE

NANCY VIVIANI

In considering the general question of the problems of the small donor, there is at the outset the implication that these are not simply similar problems to those experienced by large donors writ small, but that small donors as a group face a different set of constraints that derive from the scale of their aid.

Some of these constraints are self-evident: small donors have less money to spend, and they swing less weight in international councils on aid. To this extent at least, small donors face common problems, of a kind that differ from those of large donors. Yet in this context the more interesting and more useful question can be posed: are the problems that arise from the small scale of these donors' aid more or less important than those deriving from other factors such as geopolitical location, historic and political links with recipients, and so on. Further, it is not clear on the face of it that the effects of small size are overwhelmingly negative. Such limitations may be balanced by opportunities related to the scale of aid.

Within the confines of this paper, an examination of Australia's recent aid experience can throw some light on this question, and some comparison with other small donors will broaden this narrow focus.

The question of what is a small donor is not unimportant. Donor size is relative first to the scale of other donors' aid. Is size to be related to number of dollars, percentage of GNP or to some other measure of political or economic power? For the purposes of this paper, absolute size of official development assistance (ODA) will serve as the most useful criterion of size.[1] Here, only those countries which are DAC members are compared, because of the prob-

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1) Official development assistance as a percentage of GNP is not a useful measure of size, however broadly defined. This ODA/GNP ratio was intended as a target and also as measure of relative national effort devoted to aid. There is no apparent relationship between the number of aid dollars spent and ODA/GNP ratios for particular groups of countries (see table I column 2). On the other hand, it seems clear that the impact of size of aid depends not only on the number of dollars, but importantly on the political and economic characteristics of the donor. Generally, large donors are powerful politically, economically and militarily, and small donors are weaker in these respects. It is the differentiation of power within such groups that is interesting in relation to size of aid (for example, Germany and Japan, or the UK and Canada).

lems of data with communist bloc countries, the OPEC countries and also those other developing countries, like India and Singapore, which are donors in their own right.[2] Using a fairly arbitary cut off point, the class of large donors will include the big six (in descending order): the United States of America, France, Germany, Japan, the United Kingdom and Canada.[3] All of these donors gave more than US$500 million in calendar year 1974, the smallest donor in this class being Canada with US$713 million. It is worth noting in passing that were the criterion of total net flows (which includes private investment) used to discriminate between large and small donors, the large group would have the same membership.[4] One is inclined to classify the rest of the DAC countries as small donors, but there is a case to be made for a middle range of donors (US$200-500 million) including (in descending order), Australia, the Netherlands, Sweden, Belgium, and Italy.[5]

While it might well suit Australian predilections to be regarded as a middle power in international political terms, its peers in aid are those countries with which more recently it has sought to identify itself - the small European countries. This identification has some importance in relation to the question of scale. It is not clear that this middle range of donors regard the scale of their aid as an unrelieved handicap. Their perception seems to be rather that they can avoid some of the more oppressive features of large donors, and through innovation and co-operation with similar donors have an effect disproportionate to the size of their aid both on recipients and other donors.[6]

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2) The following table sets out disbursements from DAC countries, communist countries, OPEC countries, and others for 1973 and 1974. These figures are all estimates. A more reliable measure for OPEC countries is that of commitments. In 1974 OPEC commitments were A$8 million (excluding A$2.1 billion to the World Bank and A$3.2 billion to the IMF oil facility).

Flows from Principal Donor Groups 1973 & 1974 (US$ million)

	1973		1974	
	Total Flows	ODA	Total Flows	ODA
DAC	11,995	9,408	14,000	11,400 (b)
Communist countries	1,400	1,100	1,400	1,100
OPEC countries	850	531	4,800 (a)	2,500
Other countries	40	40	50	50
	14,285	11,079	20,250	15,050

Notes: (a) IMF oil facility contribution of $3.2 billion excluded.
(b) excludes Portugal
Source: The OECD Observer, No.74, March/April 1975.

3) See Table I.
4) See Table I. In 1974, ranking of members of the large group for both ODA and total flows levels was the same. In previous years, the high level of Japanese private investment overseas has generally placed Japan close behind the US in total flows. The significant reduction in Japanese private investment in 1974, due to recession conditions following a period of rapid growth in overseas investment explains this coincidence.
5) See Table I.

Table I

NET OFFICIAL DEVELOPMENT ASSISTANCE AND TOTAL FLOWS OF RESOURCES FROM D.A.C. COUNTRIES TO DEVELOPING COUNTRIES AND MULTILATERAL AGENCIES, 1974

Country	O.D.A.		Total Flows	
	US$ m.	as % of GNP	US$ m.	as % of GNP
United States	3,439.0	0.25	9,931.0	0.71
France	1,638.4	0.60	3,385.9	1.23
Germany	1,434.6	0.37	3,177.3	0.83
Japan	1,126.2	0.25	2,962.3	0.65
United Kingdom	721.8	0.38	1,500.4	0.79
Canada	713.4	0.50	1,677.0	1.18
Australia	430.3	0.55	543.8	0.69
Netherlands	428.8	0.62	899.1	1.30
Sweden	401.7	0.73	640.4	1.15
Belgium	263.4	0.49	590.2	1.11
Italy	204.4	0.14	405.8	0.27
Denmark	168.3	0.54	190.8	0.61
Norway	131.4	0.57	186.1	0.81
Switzerland	67.3	0.14	(300.0)	(0.64)
Austria	59.9	0.18	202.8	0.61
Finland	37.9	0.18	60.1	0.29
New Zealand	37.2	0.30	46.0	0.37
Total D.A.C Countries	11,304.0	0.33	26,699.0	0.78

Source: OECD Resources for Developing Countries 1974

Australia's position at the top of the middle range, though significantly below Canada at present, should be seen in the context of its expectation that its aid programme will grow rapidly in the next five years. Thus Australian aid administrators are tending to see Australian aid in a state of transition from relatively small to relatively large, and the emerging problems in Australian aid relate in part to this perception.

As a general rule of thumb, the smaller the donor the greater the need to concentrate aid on a limited number of recipients, and within these recipients to concentrate on a limited number of programme.[7)]

While donor size is importantly related to the distribution and

6) Because the volume of aid of the middle range donors is of significantly different order from that of large donors, their models in the experience of aid administration tend to be each other. Further they have more scope for collaboration in the programmes and for collaboration with multilateral agencies. Politically, because their commitments are weaker, they can and do serve a useful bridging role in developed/developing country conflicts in international discussions.

concentration of aid, the extent to which particular recipients are dependent on aid, in their economy and their capacity to attract a number of rival donors, tend to offset the influence of concentration by particular donors. The point of relative size and influence is simply illustrated: a great power with a small aid programme may wield influence disproportionate to the number of dollars employed (for example, China's aid to Tanzania); conversely a small donor, like New Zealand, can, by concentrating its aid to the South Pacific, enjoy important influence. Australia is a particularly interesting example in this regard. As a small donor to Indonesia it supplies some four percent of Indonesia's aid receipts,[8] but it is the dominant donor in Papua New Guinea supplying more than 95 percent of that country's aid. Both Indonesia, and Papua New Guinea are dependent on foreign aid - the latter of course to a more marked extent. The impact and influence of particular donors in these cases relate as much to the recipient having available alternative sources of aid (as a countervailing bargaining power) as it does to the absolute size of any donor's aid.[9]

This consideration of Australia's experience as an aid donor related to questions of scale, is concerned with Australian aid policy and administration, rather than with its impact and effectiveness within developing countries. This is admittedly a somewhat parochial view, but one which is relevant to the framework of this general discussion.

Successive Australian governments, since the inception of Australian aid in the early 1950's have sought with varying energy a policy rationale for aid which would sit more easily with their international political preoccupations than the purely humanitarian justification. One early Minister justified aid through the argument that aid would produce economic growth, which would increase people's incomes, which would make them less susceptible to the siren calls of communism.[10] Later Australian Ministers, informed by the experiences of countries in their region, eschewed this simple wisdom, and looked to aid to achieve more modest goals: to reinforce their diplomacy; to show that Australia was doing its share in the international effort; to assist Australian trade with some particular developing countries; to contribute modestly to the development (however vaguely defined) of poorer countries.[11]

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7) DAC countries tend less to concentrate their aid geographically than either OPEC or communist countries (excluding China). Among DAC countries geographical distribution is more concentrated among smaller donors than larger, although the importance of post-colonial links among countries like France is a mitigating factor.

8) This is not to assert that Australia's influence is negligible in the Indonesian aid scene. It can be cogently argued that Australian influence is in fact greater than might be expected from the amount of aid disbursed, because of the kind of aid given, because of the strength and longevity of the political relationship between Australia and Indonesia, and because of Australia's willingness to intercede on Indonesia's behalf in particular situations, for example in the Inter Governmental Group for Indonesia.

9) Perhaps a classic example in this regard was Indonesian bargaining with US aid in the early 1960s. See Ambassador H.P. Jones' account in his Indonesia: the Possible Dream, N.Y.: Harcourt, 1971

10) Mr. P. Spender, Commonwealth Parliamentary Debates, House of Representatives, 9 March 1950, vol.206, p.628 ff.

More recently, while the political and economic interests persist, the Australian government has begun to pay more serious attention to the grievances of developing countries and in this light has come to a more realistic view of the worth of its aid and its place in the set of its relationships with developing countries. Further, Australian aid has undergone a significant reassessment to the extent that as a donor Australia has asserted a new interest in the purposes of its aid and the distribution of the benefits that flow from that aid.[12] This reassessment derives from a recognition that changing economic and social policies within developing countries will be needed if there is to be an improvement in people's welfare.

This progression in Australian aid thinking follows similar trends in other Western countries, albeit with time lags, due partly to Australia's derivative stance and the relative dearth until recently of critical Australian thought on aid policy. It is also, in part, a consequence of the scale of Australia's aid. Aid to Papua New Guinea, earlier some three-quarters of total Australian aid, and in this year some half of it, has been until recently properly regarded as colonial aid, administered by Australians on Australian priorities. While there has been an important continuing discussion on development in Papua New Guinea, the remainder of Australia's aid has been so small as to hardly merit the application of a great debate as to dependence and distribution.

This situation is changing. It is not a coincidence that the assertion of an Australian interest in the purposes and distribution of its aid has arisen in conjunction with substantial increases in aid to countries other than Papua New Guinea. The adoption of such a stance can be in potential conflict with the doctrine of "aid without strings" (which probably applied only to small amounts of aid) and with the political doctrines of non-interference in the domestic affairs of other countries - again a doctrine more often observed in the breach than in the reality.

This is emerging as an important preoccupation in Australian aid. It relates not to the small scale of aid, but to its growing significance in some particular countries in Australia's region. It involves a balancing of the assertion of an Australian interest in the uses of its aid with its political relations with some countries. There are several ways of going about this problem. The Swedes have stated generally that their assistance will be directed to countries which pursue policies of 'independence and social and economic justice'.[13] The Dutch have announced conditions on the use of their aid to Indonesia within a particular time frame. Australia, because of the perceived importance of its political relationship with Indonesia, has taken the view that Australian interests in the use of its aid are in broad accord with the objectives stated in Indonesia's second Five Year Plan, and that, through a process of dialogue, a shift in Australian aid can be attained. This pro-

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11) See statements by Mr. W. McMahon, 3 September 1970, Australia's External Aid, and Mr. N. Bowen, 21 September 1972, Australian Foreign Aid.

12) Senator D. Willesee, statements in Australian Foreign Affairs Record, June 1974, p.369 ff and May 1975, p.233 ff.

13) Sweden's Policy for International Development Cooperation, Ministry for Foreign Affairs, 1974.

cess is still in its infancy, but it will be a valuable experience as, in the long run, Australian aid to countries other than Papua New Guinea increases. In Australia's aid to Papua New Guinea, the shift to the status of a post colonial donor will pose similar kinds of problems for Australia.

It may be inferred that where small donors give aid that is significant in volume terms to a particular recipient, they will perceive opportunities to further their interests, whether in aid or political terms. For a small donor the extent of the impact and influence of its aid depends, not on its classification as a small donor, but on the significance of its aid compared with that of other donors in particular countries. For their part, recipients generally will be able to resist the assertion of such interests to the extent that they can find alternative, more congenial sources of aid supply, or they can use other aspects of the bilateral relationship to offset such pressures. Countries like Indonesia and Malaysia have these countervailing powers at their disposal to a reasonable extent, while other countries such as Papua New Guinea and some South Pacific nations lack them. Clearly scale, in terms of political power is of significance in the bargaining opportunities of recipients.

It is possible that small donor like Australia, Sweden and the Netherlands see more opportunity for asserting an aid policy interest in the distribution effects of their aid than do the larger donors. Sweden's emphasis on "justice" in its aid, and the Netherlands' emphasis on the extent to which recipient policies benefit the entire population can perhaps be forwarded strongly - precisely because they are not large donors, which feel their political interests more heavily, and which lack strong public support for such policies.

In terms of total volume of aid, Australian aid has grown quite rapidly from a small base of A$109 million in 1965-6 to A$377 million estimated for 1975-6.[14] Prior to 1972, growth in the aid budget

Table II TOTAL EXPENDITURES ON OVERSEAS AID, AUSTRALIA 1965-66 to 1975-76

	Multilateral Programmes (net)	Bilateral Programmes	Papua New Guinea (net)	Total External Aid
	A$000	A$000	A$000	A$000
1965-66	8,545	25,717	75,362	109,624
1966-67	13,166	28,175	84,321	125,662
1967-68	14,633	34,242	92,432	141,307
1968-69	13,419	37,499	100,829	151,747
1969-70	11,934	39,541	116,248	167,723
1970-71	12,261	43,285	125,040	180,586
1971-72	13,012	50,971	136,536	200,519
1972-73	14,495	60,038	144,302	218,835
1973-74	17,969	65,712	177,076	260,757
1974-75	49,568	109,740	168,835	328,143
1975-76 (estimated)	58,279	108,950	209,711	376,940

Source: Senator D.R. Willesee: Australia's Overseas Development Assistance, 1975-76.

14) See Table II.

appeared to be related to several factors, principally by the growth in total government expenditure together with increases for new aid initiatives. The aid budget grew very fast in 1973-4 and 1974-5, mainly because of the Labour government's commitment in 1973 to move towards an ODA/GNP target of 0.7% by 1980. However, these were years of high inflation, so that in real terms the aid budget increased less rapidly and was hard put to improve on previous ODA/GNP levels. In 1975-6 the aid budget in total is a no growth budget, maintained in real terms, due to government restraint on expenditure. As the Australian aid budget becomes a significant item of government expenditure it appears to become more vulnerable to the slings of domestic economic misfortune.

If Australia's internationally announced commitment for aid to reach 0.7% of GNP by 1980 is to be fulfilled, then some fairly rapid, and possibly indigestible increases in the volume of aid will have to occur. A very rough guess, in the absence of GNP projections for 1980, might indicate that aid will have to approach A$300-1,000 million to reach this target.

This may bring Australia to the lower rungs of the big league aid donors and it is clear that many of the nascent problems being talked about now by Australian administrators will soon become insistent realities. This reassessment derives primariy from the realisation that Australian aid is in a state of transition as a matter of conscious policy choice.

In the past, one of the distinguishing marks of small donors has been the high grant commponent of their aid, and Australia has been no exception in this regard. More recently the trend among large donors has been for the grant element of their aid to increase significantly.[15)]

In Australia, until recently, there has been relatively little argument that aid should, with minor exceptions, continue to be grant aid. The Treasury has desultorily attacked this principle, but has been unsuccessful for the most part. The chief bureaucratic argument in favour of grant aid has been that since half goes to Papua New Guinea, which is clearly unable to repay it, and since the rest is so small when split among a number of recipients, then grant aid is the simplest way of giving aid, and one which has political benefits. However, as the aid budget grows significantly, then the pressure for a mix of grant and loan funds increases. One might expect the outcome of the dispute over this to depend at least in part on the future relative strengths of the Treasury and the Department of Foreign Affairs, the former looking to stretch the aid dollar further; the latter seeking to maintain the political advantages of grant aid.

Again, until quite recently, Australian aid has been overwhelmingly bilateral, with only a small multilateral component, some 6 percent in 1972-3.[16)] This derived again from the large share of bilateral aid directed to Papua New Guinea and the importance placed on the remainder of bilateral aid by the Department of Foreign Affairs for its potential political impact. This situation was quite unlike that of other similar sized donors - such as Sweden, Norway and the Netherlands who give large proportions of their aid multilaterally.[17)] Australians tend to explain this in terms of contrast to their position: unlike Australia these countries do not

15) See OECD Development Cooperation, 1974 Review, p.121.
16) See Table II.

live in the region to which they give aid; therefore they do not have the incentive to gain political benefit that Australia has. This explanation of Australia's position is broadly true. Proximity to the region of desired policical influence reinforces bilateralism for small donors and the converse is also true. More recently, the proportion of aid directed through multilateral channels has increased to 16 percent. This is the result of a conscious government policy to strengthen the Australian presence in multialteral institutions, and to make an effort, wider than its traditional recipient areas, to assist those countries most seriously affected by recent economic changes. In this, Australia reflects a more general shift among larger donors to channel more resources through multilateral institutions.

With a rapidly expanding aid programme, with the Papua New Guinea proportion at least held constant and declining proportionately in the long term, it will be possible for Australia to increase both its multilateral aid and its aid to countries other than Papua New Guinea. But Australian geopolitical perceptions and the significance of aid to Papua New Guinea will restrict the growth of multilateral aid to proportions smaller than those of its peers. Australia's emphasis on bilateral aid derives principally from the exigencies of its geopolitical perceptions. For other small donors lacking these incentives, the move to multilateralism is far easier.

While the questions of grants v. loans, and multilateral v. bilateral give indications of the relative importance of aid and other political and economic factors in shaping donors' aid programs, the question of the geographical distribution of aid is a litmus test in this regard. It is generally true that small donors tend to use need as a principal criterion in the distribution of their aid. Apart from Italy and Australia in the middle donor group, all other countries gave more than 60 percent of their aid to countries with per capita incomes of less than US$200 in 1973.[18)]

The geographical distribution of Australia's aid has not been a subject for important discussion until quite recently. Aid to Papua New Guinea has always been budget support aid (although a rose by a variety of other names). Until self government in Papua New Guinea in 1973, this gap was calculated by Australia, then filled by Australian aid. For the rest the principle of regional concentration sufficed, in which Indonesia was the principal recipient followed by Malaysia, Thailand, Philippines and South Vietnam.[19)] Frequent exceptions to this principle occurred in the shipping of large amounts of food grain to India, Bangladesh and occasionally Pakistan, but these countries have never been seen as important foci for Australian aid. The principle of regional concentration was also applied, on a much smaller scale to the South Pacific. In the last year or so, the geographical distribution of Australia's aid has become perhaps its most vexed problem.

The Labour government, soon after coming to power, set up the Australian Development Assistance Agency, to reassess Australian aid policy and gather in the aid functions which had previously been scattered among a number of government departments. Before this, the Department of Foreign Affairs, either in collaboration or in

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17) In 1973, the multilateral proportions of ODA were 45% for Sweden, more than 50% for Norway and 29% for the Netherlands. OECD, Development Cooperation, 1974 Review, p.215.

18) DAC, Geographical Distribution of Official Development Assistance, 1975.

19) See Table III.

Table III

Geographical Distribution of Australian Bilateral Aid

Year ended 30 June

(A$'000)

	1973	1974	1975
I. Europe	5	8	159
II. Africa	1,344	2,955	7,812
III. America	65	44	100
IV. Asia	56,490	58,499	93,710
Middle East	83	64	65
South -	13,048	20,116	43,886
Bangaldesh	5,691	10,598	15,436
India	1,312	1,358	10,732
Pakistan	1,688	2,617	4,606
Other	4,357	5,543	13,112
Far East -	42,414	36,911	48,342
Indonesia	23,248	21,367	22,866
Malaysia	3,418	2,875	3,858
Philippines	1,528	1,923	5,114
Thailand	3,724	3,119	4,423
Vietnam, Rep. of	6,262	3,728	5,557
Other	3,834	3,898	6,524
V. Oceania	146,379	181,207	175,847
Fiji	1,277	2,629	3,418
Papua New Guinea	144,302	177,076	168,835
Other	800	1,502	3,594
VI. Unspecified	57	75	947
VII. Total	204,340	242,788	278,575

Source: Australian Development Assistance Agency, Australian Official Development Assistance, Financial Statistics, 1975.

conflict with the Treasury, had controlled the major decisions, including those of distribution. There were good practical reasons, as well as good political reasons, for a policy of regional concentration and the new body did not find these unpersuasive. However the arena of dispute was widened in bureaucratic terms and also in the number of issues brought to bear on the question of distribution in the context of a rapidly expanding volume of aid.

First, the "needs" criterion arose, and this was given much point by the emergence internationally of the "most seriously affected" (M.S.A.) category of developing countries. Two kinds of argument, usually unsupported by hard facts, were heard: Papua New Guinea should not receive as great a proportion of Australia's aid, as it does because on grounds of need, defined usually as GNP per capita, it was clearly better off than the African drought-stricken countries or the subcontinental countries. Therefore aid to Papua New Guinea should at least not be increased, thereby releasing resources to poorer countries. Again, it was argued that since Indonesia's oil resources had doubled its domestic revenue and the economic situations of Malaysia and Thailand were clearly improving, then their aid should not grow, and funds should be diverted to other poorer countries. These arguments were resolved in the negative in 1974-5 when an additional A$40 million was found for

the UN Special Fund for M.S.A. countries (including A$6 m. for Papua New Guinea). This year, in a time of budget stringency, it will be extremely difficult to increase aid to the poorest countries.

Second, the political arguments have become more pointed. Leaving aside the question of Papua New Guinea, there is now an important political discussion in the process of resolution, concerning the relative balance of aid as between the ASEAN countries in the subregion, the new Indo-China states and the subcontinental states of India, Pakistan and Bangladesh.

The outcome of this argument probably depends as much on the assessment of Australia's foreign policy objectives as on the application of reasonably consistent aid criteria. The Australian government has announced a commitment to "generous reconstruction and rehabilitation aid to Indo-China.[20] The experience so far with the Indo-China states of Laos and the PRG of South Vietnam is that these countries, like North Vietnam, are considerably more critical of foreign aid than previous governments, and that the process of coming to some kind of mutual agreement is likely to be a slow one.

Aiding the Indo-China states will be a new kind of experience for Australia. The umbrella of United States bilateral aid has gone, and regional multilateral associations may suffer from a loss of United States support. Australia may have much to learn from its Scandinavian peers who have been operating successfully in Indo-China and hopefully the experience will be mutually enriching for Australia's aid to other countries.

In all, the distribution of Australian aid is a response to historic circumstances and present perceptions of geopolitical necessities, which happen also to satisfy the criteria of need to a greatter or lesser degree and the necessity for not spreading the jam too thinly. In this, Australian aid distribution is related in part to the scale of aid, but more importantly to Australia's character as a post-colonial power and one resident within a region of the Third World. Australia belongs not to the North but is anchored firmly in the South. It is this which differentiates Australia most markedly from its peers in development assistance.

If Australia perceives itself to have little flexibility in the geographical distribution of its aid, it has in fact even less in the forms of its aid. The half of its aid that goes to Papua New Guinea is of course budget support aid, and although some Australians thought a major conversion from budget support aid to a large concentration of project aid would somewhow make Papua New Guinea less dependent on Australia (and allow Australia to control its aid more closely after Papua New Guinea's independence), it has become increasingly clear, that Papua New Guinea's primary needs are not for capital works with recurrent high maintenance costs, which would distort the whole direction of its development, but for maintenance extension and redirection of existing and new types of government services. This lesson of past aid is widely recognised in Papua New Guinea and is at last penetrating slowly in Australian thinking.

Not only is Australia atypical of other small donors in the amount of budget support aid it gives deriving from its post-colonial relationship with Papua New Guinea, but it is atypical in that it is a significant food donor,[21] albeit on a far smaller scale than the

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20) See Australian Foreign Affairs Record, May 1975.
21) See Table IV, Bl.

Table IV

AUSTRALIAN DEVELOPMENT ASSISTANCE TO LESS-DEVELOPED COUNTRIES
BILATERAL AID BY FUNCTION

FUNCTION	1972/73 A$'000	1972/73 %	1973/74 A$'000	1973/74 %	1974/75 A$'000	1974/75 %
A. Contributions Allocable by Sector						
1. Economic Planning and Public Administration	21,693	10.6	27,373	11.3	21,629	7.8
2. Development of Public Utilities	37,775	18.5	33,011	13.6	38,110	13.7
3. Agriculture	13,691	6.7	16,994	7.0	21,888	7.8
4. Industry, Mining, Construction	10,018	4.9	7,524	3.1	7,475	2.7
5. Trade, Banking, Tourism	1,623	0.8	12,077	5.0	1,815	0.6
6. Education	40,794	20.0	43,764	18.0	40,739	14.6
7. Health	15,662	7.7	14,569	6.0	13,315	4.8
8. Social Infrastructure, Welfare	1,652	0.8	2,906	1.2	2,483	0.9
9. Multisector	5,203	2.6	5,631	2.3	5,693	2.0
10. Unspecified	44	x	72	x	293	0.1
B. Contributions Not Allocable by Sector						
1. Contributions to Finance Current Imports (food aid)	23,149	11.3	31,768	13.1	50,157	18.0
2. Emergency, Distress Relief	884	0.4	558	0.2	5,762	2.1
3. Contributions not Directly Linked to Imports	31,357	15.3	32,402	13.4	39,757	14.3
4. Debt Reorganisation	–	–	–	–	–	–
5. Other	795	0.4	14,139	5.8	29,459	10.6
TOTAL BILATERAL AID	204,340	100.0	242,788	100.0	278,575	100.0

Source: Australian Development Assistance Agency, _Australian Official Development Assistance, Financial Statistics_, 1975.

United States or Canada.

Australians are well aware of the problems associated with food aid, but as a major grain-producing and exporting country, they expect, and are expected to be, significant food aid donors. The World Food Conference drew attention to the need for reform of the international trading and aiding systems of food supply and distribution. The system, as is well known, is a self-fulfilling disastrous one. Shortages of food grains in developed countries usually lead to major purchases on the world market followed by increases in the price of food grains. Developing countries with food gaps are unable to afford to fill these gaps at high commercial prices. They therefore look in part to increased food aid on concessional terms. Because of the increased world price, the Australian food aid dollar buys less wheat and Australia is unable to respond to the extent that it would normally wish to. Senator Wriedt, the Australian Minister for Agriculture, announced at the World Food Council that Australia's food aid in 1975-6 would be of the order of 305,000 tonnes. At present prices, the present allocation for food aid will fund less than 300,000 tonnes. Australian food aid is only a minute fraction of Australian grain exports. Yet it is a major continuing problem for Australia to devise, on its own or in concert with others, a system of food aid reserves which could mitigate this continuing problem. The experience of the recent World Food Council Meeting is absolutely depressing in this respect.

A large proportion of Australia's project aid is aid associated with physical infrastructure - the design and construction of major public works.[22] This is not surprising for a number of reasons: it is what Australians have learnt to see as "development" within their own country; Australians are perceived to be successful in carrying out such projects and because of this and the thrust of prevailing development strategies, developing countries have sought Australian aid for these purposes. Two circumstances have combined to disturb the complacency with which Australians have regarded their project aid.

The international criticism of development strategies pointed, in part, to an unnecessary concentration on capital works to the neglect of support for increasing productive assets and the more

Table V AUSTRALIAN BILATERAL AID CONTRIBUTIONS ALLOCABLE BY SECTOR IN SELECTED SOUTHEAST ASIAN COUNTRIES 1974-5, A$'000

	Economic Planning & Public Administ.	Development & Public Utilities	Agriculture, Fishing Forestry	Industry Mining Construction	Trade Banking Other Services	Education	Health
Indonesia	224	9,704	2,181	-	9	1,296	182
Malaysia	-	1,537	123	300	38	1,139	-
Philippines	760	2,724	94	9	-	225	-
Thailand	-	1,122	1,657	26	2	921	137
Vietnam (Rep. of)	-	4,383	-	29	-	1,070	

Source: Extracted from, Australian Development Assistance Agency, Australian Development Assistance Financial Statistics, 1975

22) Table IV sets out bilateral aid allocated by sector. These allocations include aid to Papua New Guinea. If Papua New Guinea is excluded, the preponderance of development of public utilities in aid, other than food aid, is apparent. See Table V.

equitable distribution of the fruits of increased productivity. This has had some impact on the Australian conventional wisdom about projects. The second is the realisation that to attain the distributive objective of Australia's aid policy new kinds of projects and programmes and a reassessment of the purposes and benefits of the old kind of projects is necessary. This kind of view has met resistance within the aid agency itself and also from other government departments concerned to continue a practice that suits Australia admirably, in terms of control and accountability.

Further a new emphasis on agricultural production in Australia's aid will need a new assessment of Australian skills in this area, and an understanding of how the bias against funding local costs and tying procurement to Australia can handicap such programs.[23] This is a fertile field for the aid administration and one which could change the face of Australian aid substantially.

Administratively, the two major problems with Australian project aid are those of indicative planning and project size. The annual budget process in Australia has had the effect of inhibiting aid planning over several years and has led to severe unevenness of expenditure and adhoccery in choice of projects. It has been realised that forward country programming is essential to avoid inefficiencies and ineffectualness for both donor and recipient, and it is to be hoped that the Australian Treasury will take a broader perspective on this issue given its importance.

Again, one of the costs (particularly in terms of administration) of a small aid programme is a large number of small projects. Given the increase in the volume of Australian aid, it is expected that there will be a shift to larger programmes and projects, concentrated in regions within particular countries.

The problems associated with these kinds of reassessment of project aid appear to be shared by a number of countries pursuing similar kinds of strategies. The reform of the purposes of Netherlands and Swedish aid has not occurred without some strains. These derive in part from conflicting expectations from donor and recipient. They derive also from the search for a new development ideology which can bridge the chasm between the former concentration on economic growth and the new emphasis on distribution.

A similar reassessment is occurring with Australian technical assistance. Generally, the use of experts in conjunction with projects is seen to have been successful, and Australian techniques in using agency arrangements for this are developing well. The picture with the use of individual experts is less clear. This is an expensive process, yet one in which particular pay-offs can justify the whole exercise. However, while Australia has expertise in some important fields, for example, some particular aspects of agriculture, the supply of expertise in Australia for overseas assignment is becoming less available as the demands of the aid programme increase. This imposes real limits on the expansion of this type of aid.

The more noticeable need for action is in the student training field. Considerable change has occurred in the shift from undergraduate training to short course specialised training in Australia, but it is proving difficult to place a greater effort in education

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23) At present Australian aid is tied in a variety of ways: food aid and technical assistance is generally tied, while procurement of goods labours under the 66 2/3% Australian content rule.

in recipient countries. Many countries in Southeast Asia still wish to have their students trained in Australia, either privately or under government sponsorship. Some 10,000 of both kinds are presently studying at Australian institutions. However, while both Australia and the home countries recognise the problems with this kind of training, they have yet to devise workable arrangements for an upgrading of recipient country institutions.

The most important problem in Australian aid at present and for the foreseeable future is that of aid to Papua New Guinea. The present difficulties in the aid relationship between Australia and Papua New Guinea derive on the one hand from the way in which the colonial financial and administrative relationship operated and on the other, from a failure, mainly attributable to Australia, to recognise that its post-colonial role requires a radically different approach to aid to Papua New Guinea.

In recent weeks[24] the first major public breach between the Papua New Guinean and the Australian governments has appeared. Given the history of previous post-colonial relationships one should not be surprised that this has occurred over the question of aid and in particular over the question of colonial pensions. In 1974 the Australian government promised the government of Papua New Guinea A$500 million over the three years 1974/5-1976/7 as support for its economic development and its independence. At the time of its announcement, this commitment was primarily political, but the Papua New Guinea government took away from the meeting the understanding that this sum would not include employment security scheme (ESS) payments for Australian public servants (totalling some A$100 million). Australian Ministers and officials on the other hand believed firmly that these payments were included in the A$500 million. This issue has been a running sore in the aid and political relationship, and it has erupted in the last month because of its impact (A$50 million) on this year's aid to Papua New Guinea. The Papua New Guinea government argues that the "golden handshake" is demonstrably not development assistance. The Australian government's response is that it is always included in the international accounting of development assistance. The Papua New Guinea government argues further that the large sum for ESS payments has distorted the level of other aid and that there has been a decline in other aid in real terms.[25] This dispute is at present at a standoff, and apart from its effect on the bilateral political relationship, it has seriously inhibited the consideration of the framework of a long-term aid relationship.

The problem of setting a level of aid to Papua New Guinea is an extremely difficult one given three factors: the importance of Australian aid to the budget of Papua New Guinea where it provides some 45 percent of revenue; its importance as a proportion of Australian aid budget (in this year it is 55 percent of total aid); and the difficulty of finding a method of setting the figure which can encompass the interests of both countries.

It would be surprising if the figure set upon in the context of Australian budget discussions bore a close relationship to the needs of Papua New Guinea in its present stituation, and it is this institutional method that leads to problems in the aid relationship. It will be necessary to remove this process from the Australian domes-

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24) Written in August, 1975.
25) See Table VI.

Table VI

AUSTRALIAN AID TO PAPUA NEW GUINEA

(A$ Million)

	Actual 1972-3	Actual 1973-4	Actual 1974-5	Estimated 1975-6
Grant in Aid	30.0	25.0	41.2	56.0
Development Grant	48.2	52.1	40.0	41.3
	78.2	77.1	81.2	97.3 (incl. defence)
ASAG Salaries[a]	41.3	53.8	51.5	53.0
Termination[b] and retirement benefits	2.8	14.1	29.5	49.0
Other items (not including transfer and sale of assets)	21.0	30.7	7.2	10.7
Impact on Australian Budget	143.4	175.7	169.4	210.0

Note: a Payments to Australians working in Papua New Guinea Administration.
b Benefits for Australians terminating employment in the Papua New Guinea Administration.
Source: Extracted from Australian Budget Statements, 1973-4, 1974-5, 1975-6.

tic political arena, and to find some new arrangements, more firmly-based, for Australian-Papua New Guinean cooperation in aid.

Both governments have agreed that a long-term aid working group should be set up to work out the criteria on which the aid level might be based. This should be the first step in a long period of actual de-colonisation.

In this outline of the composition of Australian aid and in the explication of its most pressing problems, it has become clear that most of these problems are related only indirectly to the notion of scale. The major problems spring directly from Australia's post-colonial relationship, from its geopolitical location and from the previous structure of its aid programme. Scale is a factor in most problems, but not a preoccupation for Australian administrators. In fact, it is in the range of choices opened up by a rapidly expanding aid programme that the problems lie - a static, small programme offers few of these difficulties.

Further, this discussion has indicated that apart from some aspects of ideology, Australia has relatively little in common with its aid peers. There is no doubt that Australia is now more interested in the aid programmes of its European and Scandinavian colleagues, but the necessities of Australian aid are quite unlike those of these other countries. It may be that in ten years or so when Papua New Guinea looms less large on Australia's aid horizon, more commonalities will become apparent, and even then Australia may be a large donor of quite different character.

COMMENTS ON VIVIANI'S PAPER

(a) GRAEME THOMPSON

Dr. Viviani's paper addresses a number of current Australian aid issues, seen from the standpoint of the aid policy maker and administrator. It is a very useful paper, carrying Dr. Krause's analysis a shade further because it clearly exhibits the practical political view of what aid is about, in the donor's own context.

The word "donor" can be misleading. Lender, or perhaps soft lender, is a more accurate representation of what most aid involves. However, the description fits Australia because it provides aid in the form of grants, not loans. This is felt to be generous, but it is not always an unmixed blessing. The provider of a gift expects some gratitude, while the recipient has very little standing in the aid transaction. With development loans, even if they include a large grant element, the borrower is incurring an obligation and has the right to bargain. The bargaining is often quite hard and the recipient ends up getting, or thinking he is getting, the aid he wants.

Another point is that donors have few reservations about providing tied aid. Lenders are usually less adamant. Significantly, Dr. Viviani hardly mentions tied aid. I think the Australians might ask the recipients whether they would prefer tied loans to outright grants, if they have not already done so.

There is a large emphasis in the paper on aid performance, using the ratio of ODA/GNP as the measure. This has not much significance except for Australia itself, particularly when such a large proportion of its total bilateral aid is directed to Papua New Guinea. The same issue bulks large in New Zealand's debate on aid, half of which goes to the small South Pacific economies (The New Zealand ratio is currently around 0.5% of GNP and rising with 35% going to the agricultural sector.) The main practical effect is that a good aid performance by a relatively small country gives it standing in those forums in which the issues of international development are discussed.

While Dr. Viviani's paper is strong on aggregates it is rather short on the discussion of the composition of aid, especially technical assistance, which is in some ways what I think countries like Australia and New Zealand do best. She deals with distribution issues (the orientation towards agriculture, rural development and things for people) but in the main demostrated that the state of play in Canberra is behind that in some other aid-giving countries and in institutions like the World Bank and Asian Development Bank.

I do not think that her paper does full justice to Australia's role in international development. Australia provides the resources for the economic development of Papua New Guinea, which in terms of the inner Pacific is a big country. Furthermore, it has the capacity to make a large impact wherever it decides to concentrate its aid.

I was involved for a period with the Inter Governmental Group on Indonesia (the Aid Consultative Group). Although Dr. Viviani

says that only 4% of Indonesia's aid comes from Australia, I can assure you that Australia was considered, by the Indonesian Government and by the IGGI as a whole, to be a major member of that group. One reason, perhaps, was the composition of its aid. Food aid (which Australia could readily provide) and specific types of other programme aid, were particularly helpful at certain stages of the Indonesian recovery. Furthermore, Australian aid had a reputation for flexibility and good timing. Australia was responsive to urgent needs, and its influence was correspondingly large. So, where it wants to be, Australia is in the category of a major donor.

Let me speak very briefly about New Zealand aid because it compleetements some of the discussion this morning. New Zealand's aid programme is divided into three parts. It has very direct responsibilities for certain Pacific Islands - the Cooks, Niue and the Tokelaus. It finances development in these Islands to the point of extravagance, meeting perhaps two-thirds of public expenditures in the Cooks, over 80% in Niue and practically the lot in the Tokelau Islands. Per capita incomes there remain low, but levels of living, in terms of the main welfare indicators, are rather good by the standards of developing countries. Those in Rarotonga, for example, are good enough to be viewed by some Pacific Islanders as models for their region. Furthermore, people in those islands have the opition of moving to mainland New Zealand. Many have exercised the option - over half the population of each territory now lives in this country. This two-pronged approach viz. to the most one can to help develop small island economies, but let the people concerned transfer to a high-income country if they so desire offers in my opinion a viable solution to the problem of micro-states.

The second area of special involvement for New Zealand aid is the rest of the South Pacific. Here New Zealand is also a major donor. But its aid is probably less important than its other policies affecting the Islands. Trade, transport and tourism, investment and immigration policies are also relevant. For example, Professor Desai showed that migrant worker's remittances from New Zealand to Western Samoa and Tonga are an important resource for those islands and could be significant for others.

In the wider Pacific zone, New Zealand is a very small donor but its contribution in specific areas of technical assistance is both valuable and significant. The transfer of technology is a very important aspect of international aid, yet I did not find any mention of it in the paper under discussion.

In the broader context, the flow of financial resources that can be generated by a country of New Zealand's size, or Australia's, is indeed small in relation to the dimensions of international development. Apart from their relatively small size, countries like this have a structural problem over capital aid. Mainly because they have uncompetitive industrial sectors, they find difficulties in transferring real resources other than food, or people. Capital aid is thus expensive in terms of net foreign exchange costs. As importers of capital, also, they find it costly to transfer funds.

Before oil prices escalated, the industrial economies were not bound by the sort of balance of payments constraint which limited the financial aid of small donors. Now they are transferring resources with a vengeance and finding it a fairly painful process, not least because the transfers are to developing countries with a balance of payments surplus. Oil-importing developing countries, and the small donors, are of course doing the same.

In the new international environment devised by OPEC, capital transfers have become a different and much more urgent issue. While the question of commodity trade remains vital, the solution to new problems of development and external balance are likely to be found mainly on capital, not current, account, and through foreign borrowing, not conventional aid - borrowing which has as its source, directly or indirectly, the surpluses generated by oil.

This seems to me to put a new dimension on the development process which was not noted in either the Krause or Viviani papers. The importance of conventional bilateral aid is diminishing - though still significant - and much greater stress now has to be placed on the capacity of developing countries to manage for themselves and attract a flow of resources on the open market. This seems to me a promising and overdue development.

(b) GRANT REUBER

I cannot comment on the details of Dr. Viviani's interesting description of Australian aid policy, about which I know little. Instead, I shall focus on a number of more general issues raised in the paper. As one who several years ago assisted in making a reappraisal of Canadian aid policy, I found myself meeting several old friends as I followed Dr. Viviani's paper from page to page.

Before proceeding to my general remarks, I should like to raise one quibble about the classification of donors into two groups: "Large" and "Small". I do not find this basis of classification very useful from an analytical standpoint. For example, although Canada is marked as "large" and Australia as "small", Canadian aid policies in my view have far more in common with Australian aid policies than with those of the U.S. and Western Europe.

Dr. Viviani, quite rightly, I believe, emphasized that smallness, in so far as it plays a role at all, does so because small donors face a different set of constraints due to their smaller scale of activity. One major constraint is the lack of talent available for the effective planning and administration of aid - as distinct from the number of persons engaged in aid-giving activities, of which there is an abundance. Thus, the policies followed by smaller donors have frequently been weak conceptually; broad concepts have not been converted into operating principles very effectively; and day-to-day administration has often been unimpressive.

These difficulties have been compounded by confusion about why aid is being given. Few seriously believe that the future of the world will be much affected by the marginal contribution made by any small donor to the resources available to the L.D.C.'s. For some aid is seen mainly as a way of subsidizing exports; for some it is a way of increasing the value of the country's diplomatic calling card; for some it is essentially a humanitarian activity, in many ways comparable to the annual United Appeal for charitable purposes; for some it is seen as a way of buying off pressure from the L.D.C.'s to liberalize domestic trade and immigration policies; for some it is a method of recognizing national political pressures, (e.g., Canadian aid to Francophone Africa); and for a few, foreign aid is seen as a way of hastening economic development among the L.D.C.'s.

The perceived purposes of aid obviously influences the administration of aid. For example, those who emphasize export promotion

are more interested in contributions to the richer rather than to the poorer L.D.C's; exactly the opposite is emphasized by those focussing on humanitarian purposes. As a result of the ill-defined and complex purposes of aid in most small donor countries, the policies pursued in such countries have frequently been lacklustre and deficient from various points of view.

The policy of concentration, referred to by Dr. Viviani, reflects the limited capacity of smaller donors to handle aid policies as well as an attempt to achieve a greater impact in a few selected areas. Over time such programmes have generally become less concentrated because of both internal and external political pressures. As a consequence resources tend to remain severely stretched even though the level of contribution increases. Furthermore, it is frequently discovered that by concentrating aid even a small country can in fact become too visible and, as a result, provoke much the same adverse political reaction in recipient countries as has frequently been directed against the United States and other large donors.

Our obvious alternative to bilateral aid that might be employed to relax the constraints of size is multilateral aid. Such aid, however, avoids many of the parochial interests that influence bilateral aid-giving. This, of course, is one of the main reasons why multilateral aid receives only limited support and remains small. Another major reason is the generally low and diminishing confidence most donors have in the capacity of most international agencies - with the possible exception of the World Bank group - to plan and administer aid effectively.

A second alternative to conventional bilateral aid is simply to turn over aid funds to those recipient countries to be helped, leaving the planning and administration entirely in their hands. Many national administrations among L.D.C's now are probably as capable of planning and administering aid as most multinational agencies. Moreover, even in situations where national administrations are weak, one can argue that turning the resources over to the L.D.C's and relying entirely upon them for planning and administration will promote a process of "learning by doing" that in time will give rise to a strong administration able to manage not only foreign but also local resources more effectively. One major difficulty with this approach is that in the short-run it can give rise to serious difficulties that might result in a serious erosion of public support generally for aid in donor countries. Moreover, domestic interests in donor countries who gain from the subsidies offered by conventional bilateral aid are likely to find such a policy less acceptable.

A third alternative which conceivably might be pursued is to develop aid-giving consortia of middle-rank, like-minded donors - e.g. Canada, Australia, New Zealand and the Scandinavian countries. By pooling resources in this way, the constraints of size might be relaxed. Such consortia would, however, be feasible only if there were general agreement among the participants upon the scope and purposes of aid-agreement which is far from evident.

(c) General Discussion

The paper provoked discussion on the definition and forms of aid. It was contended that loans should not be counted as aid, and that what mattered was the quality and form of aid. A decline in United States military aid would pose no problems. The question was rais-

ed whether Australia might have unused capacity for technical assistance in arid zone agriculture or agricultural technology generally.

An Australian replied that Australia could make a good contribution in technical assistance but there were problems, particularly of recruitment and administration. The cost was not cheap. Administration was also difficult for project aid, both for donor and recipient, and small projects could have administrative costs out of proportion to their size. The policy of small donors entering into small projects should be reconsidered. In general, the new thinking on aid might be limited to a few and not have penetrated far into official or public consciousness. It might therefore be a temporary phase, not without some long term influence. A Thai participant felt that consideration should be given to using more people from the recipient countries in aid projects, as this would ease problems of administration and probably give better results.

The possibility was also raised of negotiating international codes of behaviour for investment overseas on a bilateral or regional basis (e.g. possible N.Z. involvement with a shipping line in the Pacific). A politically accountable watchdog organisation concerned with investment in the South Pacific might be helpful.

Other questions were asked about the goals of aid in Papua New Guinea. In reply, it was pointed out that aid spending in Papua New Guinea had risen as administration extended to more difficult terrain and independence approached. The new government wanted priority given to maintaining the services already on the ground. This had led to some conflict with Canberra where there were pressures to shift assistance to Papua New Guinea in the direction of project aid. Papua New Guinea had been trying to convince Australia of the need to maintain aid in its present form until there had been time to develop its national resources.

Summing up, Dr. Viviani said that Australia had been handicapped by lack of knowledge about experience of other decolonising countries. There had also been bureaucratic conflict within Canberra. Grants were preferred to loans, but this did not deprive the recipient of bargaining power. There was a flexible rule on tied aid that there must be a 2/3 Australian content. There were physical limits on the availability of technical assistance, and on training facilities within Australia. Financing part of a project along with a multilateral organisation provided a chance to spread overhead costs in large projects.

10

FOREIGN AID AND INDONESIAN DEVELOPMENT

ADRIANUS MOOY

Introduction

Before 1966, foreign aid had contributed little to Indonesian economic development. This was partly due to the type and terms of aid received, but mainly to policies of the Government which had grossly negelected economic considerations in favour of purely political motives. Despite the sizeable amount of aid received, the Indonesian economy deteriorated progressively, particularly during the first half of the 1960's.

Political upheavals were also frequent during this period, climaxing in the abortive coup d'etat attempted by leftist elements in late 1965. When the new Government took over in 1966, the economy was beset by a huge budgetary deficit, runaway inflation, balance of payments crisis, accumulating foreign debt repayment obligations, and little real growth. The economic system which had developed in the late fifties and early sixties had excessive government interference and control. Foreign aid which came in this context had impeded rather than assisted economic development.

The new economic policy adopted in 1966 placed stabilization and rehabilitation at the top of national priorities. A set of measures was introduced in October 1966 aimed not only at overcoming the financial and economic crisis but also at the reorganization of the economic system. The immediate concerns were to halt the runaway inflation as soon as possible and to get the economy running again after years of stagnation and neglect. Under the new rules, a much larger role was given to free market forces.

The inflation was brought under control with remarkable speed. This enabled the Government to undertake a more serious programme of economic rehabilitation and development. The First Five Year Development Plan was launched on April 1, 1969. This Plan, more popularly known as REPELITA I, was basically a public investment programme with two objectives: first, to emphasize agricultural rehabilitation and development and second to rehabilitate the infrastructure, particularly the part connected with agricultural production and the marketing of its output.

Considerable progress was made during the First Plan period with respect to both growth and stability. With these achievements, Indonesia started its Second Five Year Development Plan (REPELITA II) on April 1, 1974 with the much broader objectives of accelerated economic and social development and a more equitable distribution of development gains among all sections of the community. By necessity, the task of the First Plan dealt with the urgent needs of national stabilization, rehabilitation, and early stages of development. It was fully recognized that constraints on available resources necessitated inadequate attention to other urgent problems such as employment, equitable distribution of income, balanced regional growth, education and health. The accomplishment of the First Plan,

however, laid a strong foundation which enabled the Second Plan to focus on not only further general economic growth but also social and regional problems and to set the order of priorities accordingly.

On the external front, it was recognized that the internal measures introduced in 1966 had to be supported from abroad, on the one hand by postponing international debt repayments, on the other by securing new capital. Decreasing exports and very low national savings made foreign debt repayments an impossibility. In addition, there was an extreme shortage of essential goods, raw materials, spare parts, etc. Additional foreign financing was required to achieve stabilization and start rehabilitation within a reasonably short time.

Confidence in the new Government economic policy began to attract foreign capital in the form of both official aid and private foreign investment. A group of donor countries met in February 1967 and formed the so-called Inter-Governmental Group on Indonesia (IGGI). It has been an informal group which has served since then as a forum for raising and coordinating international assistance to Indonesia. Through IGGI, Indonesia has been assured of additional funds to overcome deficiencies in foreign exchange, domestic savings, project formulation and implementation, and human skills and technology. In this way, foreign aid provided within the framework of IGGI has played an important role in the stabilization and development of the Indonesian economy. It is expected to continue to contribute importantly to Indonesia's efforts to accelerate economic and social development under the Second Plan, although providing a smaller proportion of total investment. It has always been recognized that development has to be based increasingly on domestic capacity and capabilities, and that foreign aid is an important supplement but in no way a substitute for domestic efforts. Therefore, Indonesia's own savings effort has steadily been stepped up. Since 1973, the rise in oil prices has increased domestic savings markedly.

In this paper we will try to identify the main features of Indonesia's stabilization and development policies since 1966 which have been the basis for the achievements made so far. These are then related to the foreign aid received during the period. We will also discuss some aspects of aid provided with respect to amount, type, terms and conditions, and other relevant factors and how they fitted into and met the changing requirements of Indonesia's stabilization and development.

In this paper, discussion will be confined to official aid provided within the framework of IGGI. This corresponds closely to the DAC definition of Official Development Assistance provided by foreign governments and international institutions, under concessionary and semi-concessionary terms, for the promotion of economic development and welfare. Technical assistance will not be included directly, since reliable and unambiguous estimates for this type of assistance are not yet available.

Economic situation up to 1966

During the period preceding 1966, a series of attempts had been made, with no success, to achieve greater economic stability, rehabilitation and development. In fact, economic decline and stagna-

tion had started as early as the 1930's, when Indonesia's major exports crumbled because of the Great Depression. Over the years, Indonesia lost its position as a major exporter of sugar, copra, tea, and rubber.

Aside from the Great Depression and the Second World War, the most dramatic event had been the hyperinflation of 1963-1966. This started out as a creeping inflation in the 1950's, but gradually picked up speed, reaching its peak in 1966 when the cost of living index in Jakarta rose by more than 635 percent. This rampant inflation brought industrial production to a halt, depleted infrastructure, and drastically reduced normal trade.

Although no adequate statistics are available to evaluate the economic performance of the 1950's, economic growth was roughly estimated at a moderate annual rate of 3.7 percent, mostly due to investment and growth in import substituting industries during 1955-1958. The year 1958 was a turning point for the worse in Indonesian economic affairs due to rebellion in Sumatra and the expulsion of the Dutch over the West Irian controversy. The growth rate declined throughout the early part of 1960's averaging only about 2.5 percent per annum during the period 1960-1966.

State interference with economic life was substantial during the early 1960's, partly as a reflection of ideological convictions and partly because of the necessity to secure large funds to carry out the political programmes through direct control of the slowly growing economy. Under the slogan of "guided economy", the Government increasingly interfered with the normal workings of market forces through a system of rationing and price control and allocations of scarce foreign exchange.

Facing increasing expenditures, but unable to raise adequate revenues, the government budget ran huge and increasing deficits. Since these budget deficits were financed by Central Bank advances, they were the immediate cause of the increase in the money supply, and the major cause of the inflation.

On the external front, exports were discouraged because of inflation, artificially low fixing of prices of many commodities, and unrealistic foreign exchange rates. Imports on the other hand showed a strong tendency to expand, partly because of the general increase after the war and partly because of rising domestic prices and fixed exchange rates. With continuous deficits in the net services account, the balance of payments was in chronic deficit. Indonesia's net foreign exchange reserves, which had accumulated during the Korean War, dwindled rapidly. They were practically exhausted in 1964, and became negative in 1965.

Since export earnings were low, part of imports had to be financed by credits, particularly short-term trade credits and foreign aid. By June 30, 1966, Indonesia's foreign debt amounted to about US$2.1 billion. More than 40 percent of this debt was owed to the Communist countries because of the credits previously extended for the purchase of military goods. While the magnitude of the debt was not overwhelming, the terms on which it was incurred, including the speed of amortization, made it very onerous.

<u>The emergency period of 1966-1968</u>

In October 1966, the new Government introduced a set of measur-

es aimed at overcoming the financial and economic crisis and reorganizing the economic system. The immediate concern was to combat inflation. These measures were preceded by fiscal action at the beginning of September 1966 consisting of a tax intensification programme and austerity measures which formed the basis for an overall balanced budget policy. In the monetary field, a restrictive but selective credit policy was pursued, the bulk of new bank credits being directed to financing exports and various productive sectors of the economy.

Aside from the measures to put in order the financial management of the State, steps were also undertaken to correct the distorted price structure caused by the prolonged inflation. A general policy of decontrol was adopted. A much larger role was given to free market forces and private initiative. The old slogan of "guided democracy" was replaced by "economic democracy". The system of price controls and its accompanying quota and license system were dismantled. Most state enterprises were allowed to adjust their selling prices, previously fixed by the State, in accordance with their productive costs. Most subsidies on imported goods were abolished or limited to only essential items. Interest rates for loans from Government banks were also adjusted upwards to approach the real rate in the free market.

In the field of international trade, import and export procedures were simplified and clarified. A new foreign exchange system known as the BE (Bonus Export) system was introduced. The objective was to improve the balance of payments by stimulating exports. Through the BE system, a greater share for exporters was secured and direct interference in foreign trade was lessened. Import licensing was abolished and the new system was used to limit total imports to the amount of foreign exchange available as well as to ensure that the limited amount of foreign exchange was used to the maximum extent possible for the improvement of the economy. This BE system played a big role in the foreign assistance efforts of the IGGI countries during the stabilization period.

Since the main source of foreign exchange was exports, exporters were required to hand in their foreign exchange proceeds, which were calculated by multiplying the quantities exported with a "check-price". In return they received BE certificates for a certain portion of these surrendered proceeds depending on the nature of goods exported. BE certificates were made freely negotiable for a price in rupiah which was determined by supply and demand. Thus the foreign exchange rate, or specifically the BE certificate rate, was floated. Importers could purchase the BE certificates to import goods included in an approved list of commodities. Aid and credits received by the Government were also sold under the name of Credit BE. Aside from these two markets there was also the DP (Devisa Pelengkap) or Supplementary Foreign Exchange market. Here, supplementary exchange could be obtained from proceeds arising from the "check-price" being officially established somewhat below the actual international market price. The DP exchange was meant to provide an additional incentive to exporters. It was less restrictive than the BE exchange because it could be used to import services and a wider range of goods than were included in the BE list. In order to control the type and the financing of imports, import items were divided into various lists according to their essentiality and tariff rates adjustments were made accordingly.

Since 1966 the BE system has been modified and simplified seve-

ral times as the foreign exchange situation has improved. In April 1970, the "overprice" system was abolished and the DP and BE markets were merged into a General Foreign Exchange market except for the sales of aid funds. Later, the Credit or Aid Foreign Exchange was also integrated into the General Foreign Exchange. The multiple exchange rate structure was, thus, gradually simplified, and Indonesia finally adopted a unified exchange rate system in December 1970.

Finally, as part of the stabilization programme, steps were taken to reschedule the debts incurred during the previous regime, to attract private foreign capital to help exploit natural resources, and to seek foreign assistance to support the balance of payments.

Paris Club and the Inter-Governmental Group on Indonesia

When the internal stabilization measures were taken in 1966, it was realized that, to be successful, those measures had to be supported from abroad; on the one hand, by rescheduling international debt repayments and, on the other hand, by obtaining new capital in the form of foreign official aid as well as foreign private investment.

In 1966, the Government of Indonesia suggested discussion with its creditors about arrears in debt repayments and the heavy payments due in the near future. It soon appeared preferable to have the discussion and negotiation of the terms of a possible debt rescheduling in a multilateral forum to avoid discrimination among the creditors. The first meeting with the western creditors was called by the Japanese Government and held in Tokyo in September 1966. Bilateral agreements were later concluded with eastern countries resulting in the rescheduling of all debts to these countries. Although the subject of the Tokyo meeting was the need of Indonesia for balance of payments support, including rescheduling of foreign debts, the meeting decided to separate the debt discussions from the aid discussions, giving priority to the former. The second creditors' meeting was held in Paris in December 1966, when it was agreed to reschedule Indonesia's debts contracted before July 1966 and falling due in 1966 and 1967. Subsequent debt meetings were held annually in the "Paris Club", chaired by France, to discuss the rescheduling of debt repayments falling due in the following year. By 1968, it was felt that this year to year approach was too costly and created too much uncertainty. The German banker, Dr. Herman Abs, was asked to work out a long term solution. At the beginning of 1970, the Paris Club accepted Abs' recommendations for a long term solution of all outstanding debts as of July 1, 1966. The repayment of the principal of US$1.7 billion was spread out over 30 years beginning in 1971. No moratorium interest was to be charged for the the rescheduling. The loan interest of US$0.4 billion was to be repaid within 15 years after 1985. A portion of the first 8 years' debt repayment could be rescheduled to the last 8 years of the 30-year period.

The Tokyo meeting in September 1966 did not succeed in obtaining new aid for Indonesia. In October 1966, the Government of Indonesia made known its stabilization measures and after the Paris Club meeting in December of that year, the Government of the Netherlands offered to invite all donor countries willing to assist Indonesia to a conference to be held in Amsterdam in February 1967. At this meeting, it was estimated that Indonesia's need for direct balance

of payments support in 1967 amounted to US$200 million. This first meeting in Amsterdam was called the Inter-Governmental Group on Indonesia (IGGI). Since then, the IGGI has conducted a series of meetings to discuss Indonesia's economic plans, to estimate aid requirements and to formulate policies of assistance to Indonesia. The Group is informal. It meets twice a year, in December to discuss the Indonesian economic situation, its plans and its foreign aid requirements for the following fiscal year, and in April to consider actual aid commitments and plans announced. In 1974 there was only one meeting in April.

Aid has not been aimed solely at the support of Indonesia's economic programme. Each donor country has its own aid policy based on its experience, its views and its own national self-interest. Indonesia, like other developing countries, has therefore been confronted with the problem of how to adapt the different forms of aid to its particular situation - hence the need for an international coordination of aid. For Indonesia, IGGI has been an extremely useful forum:
1. To review Indonesia's performance and needs,
2. To discuss economic and financial policies, and
3. To get donors to pledge amounts of project and programme aid to meet the needs.

Aid during the stabilization period

Aid to Indonesia has been in the form of both programme aid and project aid. Programme aid has not been restricted to imports of commodities tied to a specific project designated in advance. Project aid is restricted to such projects. Programme aid consists of Aid BE, now called Credit Foreign Exchange, and food aid. Both are sold through the market mechanism and generate counterpart rupiah funds for the budget. Project aid is used to finance imported goods for specific projects and does not generate counterpart funds.

Indonesia's total aid request for 1967 amounted to US$200 million, all consisting of programme aid. Total commitments amounted to US$167 million. Of this, US$23 million consisted of food, but there was a carryover of about US$38 million from bilateral assistance committed in 1968. Thus, altogether, total aid available was a little over the requested amount. No project aid was requested, partly because no prepared projects were available and partly because programme aid was considered the best and quickest way to support the stabilization programme.

The process of negotiations took much time, and aid disbursements during the first part of 1967 were very low, partly because of the hesitation of the donor countries in accepting the new foreign exchange system, while Indonesia proposed that foreign aid should be integrated into the foreign exchange market. This meant that the use of funds for imports would not be decided by bilateral negotiations with the donor countries, but by the Indonesian market. The Indonesian delegation finally convinced the donor countries of the necessity of the new system as the quickest way to disburse aid and therefore the best way to support the stabilization programme.

For 1968, the Indonesian aid request amounted to US$325 million, consisting of US$250 million programme aid and US$75 million project aid but there was a delay in aid commitments. The expectation

of a bad second rice crop in late 1967 caused speculative rice price increases. This again generated uncertainty among the donor countries about the soundness of the stabilization programme. But when the crisis was brought under control, total commitments for 1968 reached US$292 million in programme aid, (including US$103 million for food) and US$71 million in project aid.

By the end of 1968, the stabilization policy had taken hold. The inflation rate was brought down from 635 percent in 1966 to 113 percent in 1967 and 85 percent in 1968. Exports also increased from around US$475 million in 1966 to about US$872 million in 1968. In 1967, part of the government routine budget was still financed by foreign aid, but in 1968 all the proceeds from foreign aid were utilized for the development budget. Total money supply which had increased by 770 percent in 1966, increased by 130 percent in 1967 and by 121 percent in 1968. There were still three factors that posed a threat to stability. First, gross foreign exchange reserves were still low and net reserves were negative. Second, foreign debts were still rescheduled annually. And third, rice production remained below rice consumption.

Amount and composition of aid in development

Since 1967, the amount of aid to Indonesia through IGGI has been growing and the composition has been changing. This development goes hand in hand with Indonesia's requirements for stabilization and development.

When stabilization took hold in 1968 many of the donors seemed inclined to reduce the programme aid progressively. But after a long debate, it was accepted that programme aid should be continued, since it was needed both to provide imports for the development of the private sector and to generate counterparts for the development budget of the public sector.

Food aid was an important part of programme aid. The serious drought in 1967 affected rice production and the general cost of living index went up. Therefore, in the aid request of 1968, which amounted to US$325 million, in addition to the general commodity aid, food aid was also added to obtain required wheat, flour, bulgur, and rice imports. Food aid has provided additions to domestic rice production and hence dampened price fluctuations. On the other hand, food aid is also a form of programme aid, not tied to a specific project although consisting of specific commodities. It, therefore, diminishes the need to import food out of free foreign exchange. It is also sold in the foreign exchange market and generates counterpart rupiah to finance the Government development budget. Beginning in the fiscal year of 1969/70, food aid was identified as a separate category of aid to Indonesia.

While stabilization efforts were in full swing, efforts were also gradually moving toward the direction of rehabilitation and development particularly after 1969/70. In this framework, project aid moved into the foreground. From US$71 million committed in 1968, it has been increasing every year in line with Indonesia's increasing effort of rehabilitation and development.

In the initial stages of 1968, project aid was used for rehabilitation of projects. Gradually, however, it moved toward expansion and development of new projects. The growth of project aid reflected Indonesia's step into its First Five Year Plan in 1969.

It is now in the second year of the implementation of its Second Plan. If during the stabilization period the programme aid became an integral part of the stabilization programme, during the development period project aid became firmly integrated into the development plans. This means that the type, nature, and priority of the projects were determined by the Indonesian Government forming a part of the annual programme in line with the priorities and objects delineated in the annual plans. Proposals for projects suitable for foreign aid financing were assembled in an annual project aid list and submitted to the December IGGI meeting. Aid commitments generally followed the projects in the list.

The Planning Agency (Bappenas), with the Departments, has been responsible for the preparation of the project list. The project aid programme has been based on the foreign exchange cost of projects although it has, in some cases, also covered some local costs. The development budget has accordingly allocated rupiah funds for the development projects and programmes covering the local cost of projects financed by foreign aid. The project aid programme has been a part of the development budget in that the rupiah fund required to cover the local cost of aided projects have been a regular part of the budget.

With the growth and the increasing role of project aid in Indonesia's development, Indonesia is also assited by the IMF and by the World Bank, which set up a permanent mission in Indonesia in late 1968.

Total international payments have increased during the past eight years, mainly because of the increase in imports which accompanied increasing economic activity. The total volume of aid also increased but its role in financing import payments (See Appendix Table 1) has declined. While in 1968 foreign aid still constituted about 22 percent of total payments, its share had declined to only 6.9 percent by 1974/75. The role of aid as a source of savings to finance the development programme has also declined.

The composition of aid has also changed. Total IGGI commitments increased from about US$363 million in 1968 to about US$956 million in the fiscal year of 1974/75. The percentage share of project aid in the total increased from 20 percent to about 81 percent in 1974/75.

Building up of public investment programmes required careful identification and selection of projects. The capacity of the Government organization to prepare economically sound projects and programme had been eroded during the long years of inflation. The need for technical assistance therefore grew with the growing investment and project aid programme. Thus in addition to the official aid programme there was also the technical assistance programme. Initially, the technical assistance programme was concentrated more in the fields of fellowships, library programmes, and those activities closely related to the transfer of skill and knowledge proper. Gradually its purpose became broader and was integrated with the development plan. The technical assistance programme now provides skills and equipment which are geared to meet the need for surveys and feasibility studies, to develop projects, do project designs, etc. A technical assistance list has also been prepared every year. In order to keep the project assistance in line with the development priorities, there has been further integration of the development budget, the project aid list and the technical assistance list.

Terms and Conditions of Aid

While the volume and composition of aid are important in Indonesia's development effort, the terms of aid are no less important. Indonesia received part of the IGGI aid in the form of grants, but in many cases aid was given as a loan and must be repaid in accordance with the terms of the loan.

Given the old debt settlement scheme it was recognized that new debt should not be made without regard to Indonesia's economic repayment capabilities. The new debt should be made with proper terms that did not burden the economy too heavily in the future, given the prospective growth of exports.

In general, Indonesia has received loans on the so-called DAC terms, i.e. 30 years for repayment with 10 years grace, at the rate of interest of 2 percent per annum. In several cases, Indonesia obtained much more favourable terms from the creditor countries, such as complete grants from Australia or the Netherlands for commodity aid. The United States, while making no grants in total commitments, accorded very soft terms on all types of aid namely 40 years maturity, 10 years grace, with interest at 2 percent during the period of grace and 3 percent during the repayment period. Up to 1974, ADB and IDA charged interest, or the equivalent, at 2.5 percent and 0.75 percent respectively. ADB loans had 25 years amortization and 7 years grace period. IDA credits were for 50 years maturity with 10 years grace and 10 years reduced amortization payments. These terms have been helpful in allowing aid funds to produce significant results, and in nursing the economy into higher growth.

In various instances, the Indonesian Government passed along soft loans to recipients such as state enterprises on much harder terms. The logic behind this was to impose a realistic cost structure on the enterprise, but without involving the country in a supplier's credit arrangement on hard terms.

Both budget performance and the balance of payments position improved in 1974/75 owing to a substantial increase in oil prices as well as significant but smaller increases in the prices of other export commodities. Fiscal revenues increased, and the deficit in the current account of the balance of payments became smaller than previously. This strengthening of the balance of payments position enabled Indonesia to look for semi-concessionary funds beyond what is commonly referred to as Official Development Assistance. By semi-concessionary terms we mean those with a repayment period of around 10 to 20 years, including a grace period of around 2 to 5 years, and bearing interest of between 4 and 8.5 percent. Thus, beginning in 1974/75, some of the World Bank's loans were obtained with a 15 to 20 year repayment period, at a rate of interest between 7.25 and 8.5 per cent a year. Some of the ADB loans were also obtained from ordinary funds carrying an interest rate of 8.25 percent and a repyament period of 20 years. Indonesia also began to look for a mixture of semi-concessionary and commercial loans, under export credit facilities from United States, Netherlands, Belgium, United Kingdom, Germany, Canada and France, to finance telecommunications, electricity, irrigation, roads, bridges, and other priority projects. Efforts were also directed toward East-European and Middle-Eastern countries. The problem of debt repayment, however, is a constraint that is constantly borne in mind in arriving at an approximate mix of concessionary, semi-concessionary and other types of capital.

In addition to the softness of the terms of the loan, the untied nature of the loan is also important. In most cases, aid must be used for imports from a specific aid giving country, for financing specific projects or the foreign exchange component of those projects. Such an arrangement, without the possibility of world wide competitive bidding, may lead towards higher costs of projects and, thus, lower the real value of aid. Untied aid would also benefit the developing countries if aid from a donor country to Indonesia, for example, could be used for imports from another developing country.

The desirability of untying aid has been brought up at the IGGI meetings. So far there are about five project aid donors to Indonesia - ADB, World Bank, Germany, Japan and the United States - that provide assistance in greater or less degreee on a basis which permits suppliers in low income countries to compete.

Utilization of Aid

Disbursement of programme aid takes place more rapidly than that of project aid. Of the total aid committed in the 1968-1974/75 period, more than 88 percent of the programme aid has been disbursed. In the case of project aid, only about 39 percent had been disbursed by the end of March 1975.

The terms of aid and the contribution of aid to development are affected by the rate of disbursement. It is therefore important for both the recipient country and the donor to strive to accelerate the utilization of aid, particularly project aid. Since the rate of utilization depends on the process of project identification and preparation, as well as the implementation and procedures, steps have been continuously undertaken to improve each of these elements. Although the size and scope of programmes are significantly expanding, Indonesia's implementation performance has also been steadily improving. A recent internal review indicates that the rate of growth of loan agreements, contracts, letters of credit, and disbursements has generally surpassed the rate of increase in general commitments. This means that, while undisbursed funds have naturally grown in absolute amounts, they have increased at a declining rate through the past three financial years. The Government has been reviewing procedural and other steps that would further improve project aid and financial utilization. As part of this programme, it is reviewing methods to expedite the processes of project preparation, approving contracts, and project procedures, since these factors seem to be the critical elements in terms of timing of project implementation.

Aid and Domestic Resource Mobilization

Indonesia is now in its ninth year of receiving aid under the new Government. The last eight years have shown an increase in aid volume and a broadening of the composition of aid with terms that suit Indonesia's repayment capacity. Foreign aid has formed an integral part of the Indonesian stabilization and development efforts. This does not mean that aid has no shortcomings or disadvantages. Apart from the technical problem of tied aid, it may also be argued that aid can affect a country's freedom of political and economic decision making. As such obtaining aid invites risk.

Realizing this, the problem is how to maximize the positive while minimizing the negative aspects of aid, either technical or political. Indonesian experience so far has been generally favourable.

The essential reason for this has been that Indonesia's own resources, plus the amount of foreign assistance, have generally been adequate and in accordance with the objectives of the Indonesian Government. While the volume of aid was increasing, efforts were also undertaken to step up domestic resource mobilization. Various savings schemes were introduced after 1968, and several measures were introduced during the past eight years to increase government revenues. Domestic savings, both public and private, have thus been increasing to finance an increasing proportion of the development programme. No adequate data are available to compare domestic savings with total investment, but looking at the governmental development budget one sees that public savings have been financing an increasing proportion of the public sector development programme. In 1967 foreign aid was still used to finance government routine expenditures but in 1969/70, the first year of the First Five Year Plan, the Government managed to finance 23 percent of the development budget from public savings. Five years later in 1974/75, the first year of the Second Five Year Plan, public savings financed about 75 percent of the development budget.

The above review indicates that, while foreign aid has served as an important source of technical and financial assistance in Indonesian development over the post-1966 period, it has been used as an important supplement to national efforts and plans, and as a programmed part of them. This has been due to the planning efforts of the Government and to the cooperation of the IGGI and the donors.

Overall Review and the Future Outlook

The above review of the role of foreign aid in Indonesian development since 1966 suggests that it has served three important functions.

First, it has helped increase resources and flexibility. Initially, when domestic finance and exports were extremely limited, it allowed investment and basic consumption to increase and enabled domestic efforts in stabilization, rehabilitation and development to change the overall picture from one of inflation and stagnation to one of stability and growth. Then as domestic revenues, savings and exports expanded, programme aid - at the margin - allowed domestic investment to increase faster than domestic savings and tax revenues would have permitted. However, the emphasis of aid - following Government direction - shifted increasingly toward project aid. Project aid centred upon reconstruction and, then, further development of capacities in agricultural estates, irrigation, transportation and communications, power and other infra-structure. More recently, the emphasis has been on fertilizer capacity, ports, shipping, mining and industry. And with Government aiming in Repelita II at social and regional development, more and more emphasis on project aid and technical assistance is being programmed and committed in these fields.

Secondly, the process of aid has provided experience in technical project formulation and analysis, preparation, contracting, tendering and implementation. While again there have been problems in some of these aspects, Indonesians are playing a larger role in aided projects and a determining position in new projects for semi-concessionary financing.

Lastly, with Indonesia's own resources increasing in 1975 large-

ly as a result of the increase in prices and quantities of oil and other exports, IGGI has recognised that Indonesia's pace of development must be sustained and possibly accelerated to meet its needs for investment, employment and social and regional development. Thus at the 17th IGGI meeting in Amsterdam last May, there was an understanding that ODA assistance would continue and possibly expand, and that Indonesia should seek additional semi-concessionary and mixed commercial credits.

These three elements have meant that in general aid has been geared to and has adapated to meet Indonesia's changing development requirements over the past nine years and promises to continue to do so in the future.

A word is needed regarding the future. At the last IGGI meeting, a review of Indonesian external financing requirements for future growth indicated that a larger amount of foreign capital inflow for the public sector was needed. It was estimated that an amount of about US$2 billion is needed for 1975/76.

Recent balance of payments developments indicate that, as a result of the recession and slow recovery in the world economy, the volumes and prices of timber, rubber, tin and almost all other major export commodities have fallen while prices of most of Indonesia's imports have continued to rise. Oil exports and production, which contribute about 60 percent of both total exports and government revenues have declined. These developments have led to a fall in Indonesia's net foreign exchange assets. Thus while development demands continue to increase, the resource situation - both foreign and domestic - has grown much tighter. And while Indonesia is expanding its semi-concessionary borrowing, there are limits to non-ODA foreign financing since higher interest rates and shorter grace and maturity periods involve much harder terms and conditions for this financing. The Government is assessing this situation, along with its programmes for further raising domestic resources and exports. These uncertainties mean that the level, flexibility and terms and conditions of ODA assistance remain important at the margin, even though the Government's own resource capabilities have increased.

TABLE I FOREIGN EXCHANGE PAYMENTS AND MEANS OF FINANCING, 1968 - 1974/75

(in US$ million)

	1968		1969/70		1970/71		1971/72		1972/73		1973/74		1974/75[3]	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
A. Means of Financing	1,203	99.3	1,477	93.7	1,706	104.1	1,994	104.9	2,900	113.2	4,805	108.0	7,746	104.1
1. Exports (fob)	872	72.0	1,044	66.2	1,204	73.4	1,374	72.3	1,939	75.7	3,613	81.2	7,186	96.5
(Oil)	(569)	(47.0)	(660)	(41.9)	(761)	(46.4)	(784)	(41.3)	(974)	(38.0)	(1,905)	(42.8)	(2,033)	(27.3)
(Non oil)	(303)	(25.0)	(384)	(24.3)	(443)	(27.0)	(590)	(31.0)	(965)	(37.7)	(1,708)	(38.4)	(5,153)	(69.2)
2. Private Foreign Investment (net)	10	0.8	53	3.4	104	6.3	186	9.8	254	9.9	331	7.4	572	7.7
3. Aid	266	22.0	371	23.5	369	22.5	400	21.0	431	18.8	556	12.5	510	6.9
(Programme)	(246)	(20.3)	(308)	(19.5)	(283)	(17.3)	(286)	(15.0)	(336)	(13.1)	(281)	(6.3)	(177)	(2.4)
(Project)	(20)	(1.7)	(63)	(4.0)	(86)	(5.2)	(114)	(6.0)	(145)	(5.7)	(275)	(6.2)	(333)	(4.5)
4. Others	55	4.5	9	0.6	29	1.8	34	1.8	226	8.8	305	6.9	-522	-7.0
B. Other items[1]	8	0.7	99	6.3	-67	-4.1	-94	-4.9	-338	-13.2	-355	-8.0	-303	-4.1
C. Total Payments	1,211	100	1,576	100	1,639	100	1,900	100	2,562	100	4,450	100	7,443	100
1. Imports (fob)	831		1,097		1,102		1,248		1,651		3,074		5,107	
2. Net Services	328		435		469		545		805		1,245		2,189	
3. Official Debt Service[2]	52		44		68		107		106		131		147	

1) Includes change in reserves and errors and omission. Negative means an increase.
2) Principal and interest repayments.
3) Preliminary

TABLE 2 SELECTED ECONOMIC INDICATORS, 1967 - 1974/75

	Unit	1967	1968	1969/70	1970/71	1971/72	1972/73	1973/74	1974/75
1. DGP growth rate[2] (real)	percentage	1.4	6.8	6.8	7.6	6.7	8.1	11.2	7.6
2. Change in Cost of Living Index, Jakarta	percentage	120.0	85.0	10.6	7.8	0.9	20.7	47.4	20.1
3. Government Domestic Revenues	billion rupiahs	60.2	149.7	243.7	344.6	428.0	590.6	967.7	1,753.7
4. Government Development Expenditures	"	17.5	57.9	118.2	169.6	195.9	298.2	450.9	961.8
5. Public Savings	"	- 7.2	-	27.2	56.4	78.9	152.5	254.4	737.6
6. Outstanding Bank Credits (end of year)	"	31.2	126.7	262.1	380.6	522.6	769.8	1,215.6	1,755.8
7. Money Supply (end of year)	"	51.5	113.9	210.7	270.2	360.3	530.3	784.3	1,025.8
8. Time and Savings[3] Deposits (end of year)	"	2.7	11.1	51.5	89.7	159.5	284.5	460.9	697.4
9. Exports (f.o.b)	US$ million	770	872	1,044	1,204	1,374	1,939	3,613	7,186
10. Imports (f.o.b)	"	805	831	1,097	1,102	1,248	1,651	3,074	5,107
11. Net Service Payments	"	263	328	435	469	545	845	1,295	2,249

1) Preliminary
2) All in Calendar Years. Before 1972 in 1960 prices. After 1971 preliminary estimates based on 1973 prices.
3) Before 1972/73 included only rupiah time deposits. Since 1972/73 includes rupiah as well as foreign exchange time and savings deposits.

TABLE 3 IGGI AID COMMITMENTS BY TYPE OF AID, 1967 - 1974/75

(in US$ million)

Type of Aid	1967	1968	1969/70	1970/71	1971/72	1972/73	1973/74	1974/75[2)]
1. Programme Aid	167.3	292.3	329.7	352.8	350.7	416.6	249.5	186.1
(BE AID/DK Exchange[1)])	144.7	(188.9)	(194.6)	(201.7)	(200.2)	(284.7)	(170.6)	(84.0)
(Food Aid)	(22.6)	(103.4)	(130.1)	(151.1)	(150.5)	(131.9)	(78.9)	(102.1)
2. Project Aid	-	71.0	236.2	249.1	292.7	406.5	610.6	770.2
Total	167.3	363.3	560.9	601.9	643.4	823.1	856.1	956.3

1) Including Cotton Aid and yarn.
2) Preliminary

TABLE 4 IGGI AID[1)] COMMITMENTS BY DONOR, 1967 - 1974/75

(in US$ million)

Donor/Country	1967	1968	1969/70	1970/71	1971/72	1972/73	1973/74	1974/75[2)]
1. Australia	5.8	13.6	14.9	18.0	19.0	28.9	31.4	30.1
2. Austria	-					-	-	0.6
3. Belgium	-	0.4	2.1	3.6	5.0	6.2	9.2	10.6
4. Canada	-	0.3	1.8	5.0	8.0	19.0	67.0	16.9
5. Denmark	-	-	4.0	-	-	4.3	-	-
6. France	-	11.1	14.2	14.9	18.7	25.4	39.3	37.1
7. West Germany	25.0	26.3	31.9	35.5	38.8	47.0	60.2	73.2
8. Italy	-	0.4	0.4	0.9	0.3	-	6.3	3.4
9. Japan	60.0	110.0	120.0	140.0	155.0	207.2	226.2	140.2
10. Netherlands	15.0	25.9	46.1	30.0	34.2	44.1	54.3	67.2
11. New Zealand	-	-	-	0.6	0.6	1.9	3.5	4.7
12. Switzerland	-	-	-	-	-	-	9.6	-
13. United Kingdom	1.4	4.2	4.2	11.4	23.3	26.1	30.5	-
14. U S A	60.1	163.9	223.9	247.0	230.5	268.0	150.0	176.0
15. ADB	-	-	3.4	20.1	30.8	25.0	33.3	91.3
16. IDA (World Bank)	-	7.0	94.0	74.9	80.0	120.0	135.3	305.0
Total	167.3	363.3	560.9	601.9	643.4	823.1	856.1	956.3

1) Includes programme and project aid.
2. Preliminary.

TABLE 5 IGGI PROJECT AID COMMITMENTS BY DONOR, 1968 - 1974/75

(in US$ million)

Donor / Country	1968	1969/70	1970/71	1971/72	1972/73	1973/74	1974/75[x]
1. Australia	1.6	2.1	4.0	4.5	6.4	14.2	18.3
2. Austria							
3. Belgium	-	-	0.8	1.7	2.2	3.7	6.6
4. Canada	-	-	-	3.0	8.0	38.0	16.9
5. Denmark	-	4.0	-	-	4.3	-	-
6. France	4.3	6.3	7.2	10.0	14.3	25.0	31.6
7. West Germany	10.5	14.2	18.8	20.5	24.4	33.9	48.8
8. Itay							
9. Japan	40.0	55.0	60.6	70.0	94.8	115.8	140.2
10. Netherlands	6.5	26.8	12.1	15.3	20 0	25.7	47.7
11. New Zealand	-	-	-	-	0.9	2.2	3.8
12. Switzerland	-	-	-	-	-	9.6	-
13. United Kingdom	1.1	-	2.8	12.0	18.2	19.9	-
14. U S A	-	30.3	47.9	45.7	68.0	150.0	60.0
15. A D B	-	3.4	20.1	30.0	25.0	33.3	91.3
16. I D A (World Bank)	7.0	94.0	74.9	80.0	120.0	135.3	305.0
T o t a l	71.0	236.2	249.1	292.7	406.5	606.6	770.2

x) Preliminary.

TABLE 6 IGGI AID DISBURSEMENTS[x], 1968 - 1974/75

(in US$ million)

Type of Aid	1968	1969/70	1970/71	1971/72	1972/73	1973/74	1974/75
Programme Aid	246	308	283	286	336	281	177
Project Aid	20	63	86	114	145	275	333
T o t a l	266	371	369	400	481	556	510

x) Based on estimated letters of credit openings, Bank Indonesia.

COMMENTS ON MOOY'S PAPER

(a) Saburo Okita

My first visit to Indonesia was in 1955 to attend the First Asian African Conference held in Bandung and my second visit was in 1962 with ECAFE's mission on regional cooperation. I have visited Indonesia several times since 1966. Because of this experience I can compare Indonesia of pre- and post-1966. In 1962 I stayed at the Hotel Des Indes in Jakarta. In the toilet there was just one shabby towel and the eclectric light was as dark as candle light. I felt this was really an economy of disinvestment. As I have observed the stage of rehabilitation and development since that time I feel the case of recent Indonesia was a successful one. Rice production, for exmaple, increased from 8.3 million tons in 1965 to 14.0 million tons in 1974. Capital formation as a percentage of GDP increased from 8% in 1965 to 15% in 1972. Those are remarkable improvements in a relatively short span of time.

When I visited Jakarta in 1968 President Suharto told me that his government would concentrate on economic issues and the priority policy areas were:

i) to stop inflation,
ii) to increase rice production,
iii) to repair infrastructure such as road, railways and irrigation, and
iv) to promote export trade.

I felt the President's idea was most relevant for an economy of disinvestment. As the economy recovered policy priorities have naturally shifted to broader areas.

Concerning Japanese aid to Indonesia, the terms of lending had been gradually softened and in 1973 and 1974 government to government loans were mostly on the basis of 2.75% interest rate, 10 year grace and 30 year repayment period. Recently the terms of lending were slightly hardened to 3% interest rate due to the increased oil revenue of Indonesia. The volume of aid from Japan to Indonesia is also increasing and the principle of the IGGI to have "one third each from Japan, the United States and Western Europe" has more or less been maintained, though for the latest commitment Japan's share is greater than one third. Out of the total lending during the 1974 fiscal year of the Overseas Economic Cooperation Fund nearly 45% was directed to Indonesia as this lending included the oil and natural gas projects which are outside the IGGI arrangement. Most loans from Japan to Indonesia are LDC-untied, that is the money can be spent either for local bidders, or for bidders from other developing countries and Japan. It can be said that when the national interests of both the donor and the recipient coincide the volume of aid tends to expand. Such a relationship exists in the case of Japan and Indonesia.

Concerning the types of aid project, the Indonesian Planning Agency seems to give preference to concrete projects such as fertilizer factories, dams, power stations, etc. while leaving projects for social development in the hands of the government. This is partly due to the difficulty of preparing projects of social development type suitable for foreign loans.

It is sometimes said that the big projects undertaken with foreign aid or with loans from international institutions have little

effect on employment creation, but we should not forget about the secondary effects of these projects enabling the country to spend a larger amount of money for projects directly creating employment opportunities by easing the foreign exchange constraints of the economy.

Concerning the future of the Indonesian economy continued care will be needed to ensure the use of capital for productive purposes, particularly those which will benefit the majority of the population. It should also be desirable through fiscal measures to syphon back part of the income and wealth which tends to concentrate in big cities in market oriented private enterprise economies, to rural district. In this way some of the social and political problems often accompanying the widening gap in income and wealth between the urban and rural areas might be avoided.

(b) PETER DRYSDALE

First let me say how very much more comfortable I feel making my comments on Dr. Mooy's very informative paper up here alongside Dr. Okita. Down there, sandwiched between Professor Arndt on my right and Dr. Viviani on my left, I was bound to give offence to someone. Alongside Dr. Okita I can pretend to be Robin Hood, taking from the poor in rich countries and providing for the rich in poor countries, without giving offence to anyone, even Dr. Narongchai.

In my comments I want to take up some general issues for aid recipients that have been raised by Dr. Mooy's paper and in the discussion so far, rather than focus specifically on the Indonesian case. Doing that would be about as informative as a conversation between Dr. Wionczek and Professor Arndt on the Bougainville Copper Agreement.

What I want to say may be seen as a retreat from the grand themes of discussion earlier today: but in fact what I want to attempt is to give some precision to the more important questions raised before.

Three key issues are raised in Dr. Mooy's paper quite explicitly. The first issue concerns the appropriate channel for aid (bilateral, multilateral, multilateral/bilateral) from the viewpoint of protecting the interests of a recipient country in sound development programming. The second is the issue of aid tying. A third and related issue is the heavy project-orientation in donor aid programmes.

The first question - the question of the appropriate channel for aid - was taken up to some extent in earlier discussion. I think that Dr. Mooy is absolutely right in stressing, both in his paper and in his comments, that multilateralisation of the approach to Indonesian rehabilitation and recovery and subsequent development aid operations has been very valuable in the more effective use of available aid resources. In the case of such a large recipient in which several donors have a significant interest, the consortia approach and the involvement of the multilateral organisations adds to aid effectiveness and limits interference with the development objectives of aid. At the same time, we need to heed Dr. Krause's warning that multilateralisation does not eliminate politics. Nonetheless, my judgment is that multilateralisation encourages elevation of the aid objective over other objectives and, bluntly, that

it makes the politics more open and less dirty.

The second question, of aid tying, is also much more important than the casual remarks made about it in earlier sessions or Dr. Mooy's polite reference to it in the paper would both suggest. Aid tying can reverse the concessional flow of resources from donor to recipient country. It is not true, as was suggested earlier, that major donor country tying is unimportant because major donors are generally competitive suppliers of industrial commodities. Both the United States and Japan have indulged in tying at what has almost certainly been massive cost to developing countries. There is too little hard evidence, but what evidence there is - for example, the work of Mahub ul Haq and others - provides a damning indictment of major donor performance. Estimates of the excess cost of tied aid range between 20 percent and 150 percent and more. The United States food programme, and transport requirements and Japanese industrial export credit programmes, both have been costly to poor countries. Tied aid programmes, involving concessional loans, can easily turn into rich country taxes on poor countries. It is thoroughly naive to suggest that because big donors are generally competitive suppliers of industrial commodities that such commodities will be supplied competitively under tied aid arrangements. Tied aid provides institutionalised monopoly power by developed country suppliers over developing country consumers. Australian aid officials defend tying of grant aid to countries other than Papua New Guinea on the grounds that at least, with grant aid, the concessional flow of resources must be in the right direction, from Australia to poorer countries, even if the flow is considerably smaller than it nominally appears. But even tied grant aid can be associated with reversal of the concessional flow of resources.

A tied grant is often associated with a continuing stream of costly services and supplies on bad commercial terms - indeed, this is quite common experience - the excess cost of the whole package of which can offset the concessional element in the initial grant. Even tied grants can thus reverse the direction of the concessional flow of resources.

The third question is closely related to the second and also another question, the question of onshore versus offshore cost financing. It is the question of project orientation in aid programmes, which Dr. Mooy touched upon in his paper. The term 'project aid' can mean many things but usually project aid, as Professor Arndt observed, involves a distortion in development planning towards large infrastructural investment.

Pressures from Australia to convert Papua New Guinea's aid programme to a project basis illustrate the damage project orientation in aid can inflict in a particularly extreme form. Project oriented aid tends to force recipients into expenditure on large identifiable but wasteful physical capital formation using tradeable commodities and diverts public expenditure away from crucial non-physical infrastructural investment and services.

The record of donor countries in their development assistance efforts is open to serious criticism on these grounds. They are not insignificant in the context of the moral imperatives that are now emerging as the focus of debate about the conduct of the international economic system. For, despite the reminder of the hard world of <u>real</u> politics in our discussion of the American approach to foreign aid policy, questions of justice and generosity as well

as power do insert themselves into the conduct of economic and political relations between nation states. The criticisms do not recommend a retreat from the objective of making aid work for development but they do recommend considerable re-direction and reform in developed countries' aid policies.

(c) General Discussion

The discussion began with questions to Dr. Mooy in clarification of certain points in his paper. These included the level of Japanese aid, the influence of the World Bank and the Inter-Governmental Group on Indonesia (IGGI) in guiding development, and the role of Eastern European countries as donors. Dr. Mooy confirmed that the Japanese aid levels quoted in his paper did not include assistance for oil and natural gas development.

Dr. Mooy accepted that in the early period, 1968/69, Indonesia had to step up its applications for technical assistance and had to draw on World Bank expertise in the formulation of development programmes. He cautioned against giving undue importance to the initial accommodation of foreign experts in Bappenas premises! The numbers of foreign experts in Indonesia have declined over recent years.

As for the apparent lack of Eastern "donor" countries to Indonesia, Dr. Mooy pointed to the deterrent posed by the considerable burden of old debts, over $2 billion, which Indonesia had yet to discharge in the earlier years. Some countries were concerned with rescheduling of debts rather than joining IGGI. Others offered assistance but on harder and less acceptable terms. Indonesia is however currently looking to other countries including Eastern Europe and Russia as sources of assistance, not necessarily reflecting a political change of attitude but more a refocus of economic considerations.

Dr. Mooy accepted also that Indonesia, like other developing countries, has been confronted with problems of adaptation to different forms of assistance given the objectives of the donor but he emphasised the mutual benefits that both the donor countries and Indonesia, as a recipient, have enjoyed particularly with the formation of IGGI. The policy of integrating foreign aid into the foreign exchange market, while met with initial hesitation on the part of donor countries, has meant that the use of such funds for imports has been determined by the Indonesian market and not by bilateral negotiations with the donor countries. Dr. Okita also pointed out that the customary practice was for donors to select a project from an Indonesian project list.

The discussion then turned to more general considerations. The possibility of channelling aid through groupings such as ASEAN was raised. This had been done by Australia but it had been found that competition for resources was keen with the consequence that the aid was split up into uneconomically small amounts instead of pursuing a policy of development priorities between countries.

Participants then pursued the question of tied aid. It was pointed out that there has been an appreciable increase in real transfers on concessionary loans to the developing countries given the rate of inflation. A 2% interest rate could only be considered minus interest lending.

The opinion voiced earlier in the conference that the question of tied aid was of little importance in the United States case given their competitive position was questioned. Rice was given to Indonesia on a 40 year loan but was valued in U.S. prices at 3 or 4 times as high as Indonesia could have purchased the rice in Asia. A more serious point for consideration was that the transport of all United States supplies in United States ships added greatly to the cost of the supplier. It was noted, however, that it was a percentage of United States aid, approximately 60-70%, that was subject to such constraints and then only if the ships were available. The devaluation of the U.S. dollar to a certain extent undermined this tying aspect in addition to rendering United States aid more valuable.

Referring to the question of possible distortions from the influence of donors on projects, one participant felt it right to point out that such distortions very often arise from pressures within the recipient countries; for example, the bureaucratic infrastructure in Indonesia. He felt it was too easy to criticise the large donor countries on the grounds of a foolish preference for capital intensive Western technology. One must also consider the question of what can efficiently be done and very often many undeniably worthwhile projects do not lend themselves to assistance.

In a final comment, Dr. Okita stressed the importance of seeking appropriate policies for different categories of developing countries. He distinguished four:

(1) Oil rich countries with no financial problems but who still need technical assistance.
(2) Those primary producing countries who may benefit from buffer stock and other stabilization schemes.
(3) Those who, as exporters of manufactured goods, may benefit by the opening up of developed country markets.
(4) The least developed of the LDCs where export promotion is difficult and the opening of developed countries markets may be inappropriate. For some such countries a transfer approach rather than an efficiency approach to foreign aid may be more appropriate.

In addition, many countries are moving toward an intermediate stage where they are both givers and receivers of aid.

PART Ⅳ

FOREIGN INVESTMENT

11

JAPANESE FOREIGN INVESTMENT - PROBLEMS OF THE LARGE HOME COUNTRY

Atsushi Murakami

I. INTRODUCTION

Since 1951, when, for the first time after World War II, Japanese private capital was invested in the mining industry of India, private foreign investment of Japan has increased tremendously. The accumulated balance exceeded US$10,000 millions at the end of March 1974. Outflow of investment was considerable in 1972 and 1973, but it suddenly decreased in 1974 due to the serious setback of economic activity in Japan.

As the foreign investment of Japan increased, it evoked a strong anti-Japanese movement in some of developing countries in Southeast Asia. In Thailand, for example, a campaign of boycotting Japanese products was organized by the National Students Centre of Thailand in November, 1972. Many students and other people demonstrated in January 1974 against economic invasion by Japan when the ex-Prime Minister Tanaka visited Bangkok. A riot also occurred in Indonesia during Mr. Tanaka's stay in Djakarta after his Bangkok visit, with the purpose of protesting against Japanese domination. Although such visible movements were not seen in other countries in Southeast Asia, it cannot be denied that anti-Japanese sentiment has been prevalent elsewhere, in response to the rapidly increasing inflow of Japanese foreign investment. Today it is impossible to discuss the experience of Japan as a large source of investment without paying due consideration to this anti-Japanese sentiment in small host countries.

This paper aims to discuss the relationship between Japanese foreign investment and antagonism to it among Southeast Asian countries. It suggests that antagonism springs from certain features of the Japanese investment channelled into these countries, and suggests ways to harmonize the interests of both parties. It is convenient to begin by describing the general characteristics of Japanese investment and of that directed towards Southeast Asian countries in particular.

II. GENERAL CHARACTERISTICS OF JAPANESE FOREIGN INVESTMENT

As is shown in Table 1, Japanese foreign investment expanded year by year throughout the 1960's and at the beginning of the 1970's. It accelerated in 1972 and in 1973 under the particular circumstance of yen revaluations.[1] Although a sharp decline was recorded in 1974, mainly due to the serious depression of economic activity,[2] it seems likely that Japanese foreign investment will continue to expand steadily in the long run provided that the underlying factor of foreign investment - enlargement of the size of the Japanese economy - continues. According to the report of the Council on Industrial

Structure, the accumulated sum of Japanese foreign investment is expected to reach US$80,700 millions at the end of 1985, which would be 6.6 times larger than the level at the end of 1974.

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1) Factors accounting for the upsurge in these two years are as follows: (a) Since the end of 1960 Japanese balance of payments turned favourable, providing ample funds for foreign investment. The inflow of dollars on the eve of yen revaluation was also added to the foreign reserves of Japan. (b) The Japanese Government increased domestic money supply for fear of serious depression after revaluation. Together with the expansion of the money supply due to the favourable balance of payments, this provided firms with huge liquidity to invest abroad. (c) From 1969 to 1972 regulations on foreign investment had been substantially lifted in the context of liberalizing international capital movements. Moreover the Japanese Government promoted foreign investment in one way and another in order to avoid yen revaluation. (d) The yen revaluations themselves in 1971 and in 1973 improved the terms of foreign investment. (e) As a result of revaluation, international competitivness in some Japanese industries was so weakened that it became necessary for them to undertake overseas production through foreign investment.

2) Expanded money supply was followed by severe inflation. The rise of oil prices in 1973 accentuated it. The government was forced to take strong anti-inflation measures, which depressed economic activity to a great extent. The rate of growth was negative in 1974 in real terms. The rise of oil prices also led to deterioration of the balance of payments position.

Table 1 Trends of Japanese Foreign Investment[1)]

Year (fiscal)	Number of Cases		Value (Million US$)		Average Value per case (B/A) (million US$)
	Annual (A)	Accumulated	Annual (B)	Accumulated	
1951-61	790	790	447	447	0.57
62	171	961	98	545	0.57
63	213	1,174	126	671	0.59
64	184	1,358	119	790	0.65
65	197	1,555	159	949	0.81
66	244	1,799	227	1,176	0.93
67	290	2,089	275	1,451	0.95
68	369	2,458	557	2,008	1.51
69	545	3,003	665	2,673	1.22
70	730	3,733	904	3,577	1.24
71	904	4,637	858	4,435	0.95
72	1,773	6,410	2,338	6,773	1.32
73	3,097	9,507	3,497	10,270	1.13
74(2)	-		1,940	12,210	-

Note: (1) Approved basis. Including acquisition of equity, loans, and properties and establishment of overseas direct undertakings and branches.
(2) From April to December.

Source: Approved Performance of Japanese Foreign Investment (Kaigai Toshi Kyoka Jitsuseki), Ministry of Finance, Tokyo.

However, in spite of the rapid expansion of Japanese foreign investment, it is still less than that of other developed countries. According to Table 2, the accumulated balance of Japanese foreign investment at the end of March 1973 was only 3.9 percent of the total of all DAC member countries. It was equivalent to just 2.3 percent of Japan's GNP and 23.7 percent of its exports in 1972 respectively. The accumulated balance per capita was no more than US$63. Compared with the foreign investment of other developed countries, Japan's has been of limited importance both in the domestic economy itself and in the world. This limited importance is also reflected in the smallness of the average value of investment per case, as is shown in Table 1.

The distribution of Japanese foreign investment by region and by industry at the end of March 1974 is shown in Table 3. This table indicates that nearly half of the investment - 53.7 percent of the number of cases and 49.2 percent of the value accumulated - has been directed towards developing countries. Asian developing countries in East and Southeast Asia have absorbed 38.2 percent of the number of cases and 23.9 percent of the value accumulated. That is a strong concentration of Japanese foreign investment in developing countries by comparison with that of other developed countries. The ratio of the accumulated balance channelled into developing countries was only 26.0 percent for the United States and 29.0 percent for West Germany at the end of 1973. A corresponding figure for the United Kingdom was 33.3 percent at the end of 1970.[3] It is obvious that developing countries, particularly those in Asia, have been the more attractive region for the overseas investment activity of Japanese firms, while firms of other developed countries have invested mainly in developed areas.

3) Present Situation of Japanese Foreign Investment (Wagakuni Kaigaitoshi no Genjo), JETRO, Tokyo, 1974, p.21.

Table 2 Relative Size of Japanese Foreign Investment

(at the end of 1972)

	Accumulated Balance (Million US$)	Share in DAC Member Countries(%)	Ratio to GNP in 1972(%)	Ratio to Exports in 1972(%)	Accumulated Balance per capita (US$)
U.S.A.	94,031	53.8	8.1	191.0	450
U. K.	25,511[1)]	14.6	16.5	104.6	457
France	10,062[1)]	5.8	5.1	38.6	195
West Germany	8,253	4.7	3.2	17.9	134
Japan	6,773[2)]	3.9	2.3	23.7	63
Canada	6,319[1)]	3.6	6.1	30.1	289
DAC Member Countries	174,883[3)]	100.0	6.9	62.2	275

Note: 1) Accumulated balance at the end of 1970 (U.N. Data) plus net outflow of private direct investment in 1971 and 1972.
2) At the end of March 1973.
3) Accumulated balance at the end of 1970 (U.N. Data) multiplied by the rate of increase in listed six countries up to 1972.

Source: Present Situation of Japanese Foreign Investment (Wagakuni Kaigaitoshi no Genjo) JETRO, Tokyo, 1974, p.19.

Looking at the distribution by industry, one sees that the relative share of Japan's investment in manufacturing has not been so large as that of other developed countries. It was limited to 35.1 percent of the number of cases and 33.0 percent of the value accumulated, compared with 41.3 percent for the United States, 77.2 percent for West Germany and 53.6 percent for the United Kingdom respectively, though these were data for the end of 1970.[4] Table 3 shows that 82.7 percent of the number of cases and 72.5 percent of the value accumulated of investment in manufacturing industries was in developing countries. In particular, Asian developing countries absorbed 68.8 percent and 37.2 percent of the total investment in manufacturing industries in terms of the number of cases and of the value accumulated respectively. The average value of investment in manufacturing industries in Asia was quite small, being equivalent to US$0.56 millions. While investment in manufcturing industries has been concentrated in developing countries, investment in other fields especially in commerce, finance and insurance, has been directed mainly towards developed countries. Within manufacturing in-

4) Japanese Multi-Nationals Facts and Figures (Kaigai Kigyoshinshutsu Soran) Toyo Keizai, Tokyo, 1973, p.349.

Table 3 Distribution of Japanese Foreign Investment[1]

(a) Number of Cases

	World	Developing Countries	Asia
Manufacturing Industries			
Food	2.6(100.0)	3.1(64.4)	2.8(41.6)
Textile	6.1(100.0)	10.3(90.6)	10.9(68.4)
Lumber, Pulp	1.9(100.0)	2.8(80.1)	3.7(69.3)
Chemical	3.6(100.0)	5.5(82.9)	6.4(67.6)
Ferrous, Non-ferrous	3.0(100.0)	5.0(89.2)	5.5(70.3)
Machinery	3.8(100.0)	5.2(74.1)	5.6(57.1)
Electric Machinery	6.0(100.0)	9.9(88.6)	12.2(65.5)
Transport Equipment	1.0(100.0)	1.6(85.7)	1.6(58.2)
Others	7.1(100.0)	11.6(87.5)	14.8(79.0)
Sub-total:	35.1(100.0)	54.0(82.7)	63.2(68.8)
Others			
Agriculture, Forestry,	2.8(100.0)	3.3(63.7)	3.5(47.8)
Fishing, Marine	1.8(100.0)	2.4(70.7)	1.7(34.8)
Mining	3.5(100.0)	3.9(60.0)	3.0(32.1)
Construction	1.4(100.0)	1.8(70.2)	1.8(49.2)
Commerce	28.4(100.0)	15.2(28.7)	14.7(19.8)
Finance, Insurance	3.5(100.0)	3.4(51.6)	2.6(28.0)
Others	23.5(100.0)	14.9(34.1)	14.8(15.6)
Total:[2]	100.0(100.0)	100.0(53.7)	100.0(38.2)

Note: 1) Approved basis, accumulated at the end of March 1974. Excluding establishment of overseas branches.
2) Total cases are 8,947.

Source: Approved Performance of Japanese Foreign Investment (Kaigai Toshi Kyoka Jitsuseki), Ministry of Finance, Tokyo.

dustries, textile, electrical machinery and "others", which contained many miscellaneous items of sundry goods, were the three main directions into which Japanese foreign investment was channelled. Relative shares of investment in these three industries were 10.3 percent, 9.9 percent and 11.6 percent in the number of cases and 14.3 percent, 5.3 percent and 3.3 percent in the value accumulatedly invested in developing countries. The tendency to concentrate on these three industries was more conspicuous in the investment in Asia. The three industries together accounted for 37.9 percent of the number of cases and 33.6 percent of the value accumulated in this region. It goes without saying that these industries are labour-intensive ones in which Japan had a comparative advantage and on which Japanese exports largely depended till quite recently.

To sum up, investment in the labour-intensive manufacturing industries of developing countries, particularly those in Asia, has constituted one of the most important streams of Japanese foreign investment.[5] Although some investment has occurred in commerce, finance and insurance in developed countries, it has not burst into bloom so as to operate manufacturing industries there.

Table 3 Distribution of Japanese Foreign Investment

(b) Value

	World	Developing Countries	Asia	Average Value per case in Asia (Million US$)
Manufacturing Industries				
Food	1.7(100.0)	1.9(56.0)	2.0(28.1)	0.48
Textile	7.5(100.0)	14.3(93.7)	20.5(65.0)	1.29
Lumber, Pulp	3.7(100.0)	1.8(24.7)	3.0(19.5)	0.62
Chemical	5.4(100.0)	9.5(85.7)	3.2(14.2)	0.35
Ferrous, Non-ferrous	4.9(100.0)	5.4(54.0)	4.2(20.4)	0.52
Machinery	2.2(100.0)	2.9(65.9)	2.1(22.5)	0.26
Electric Machinery	3.3(100.0)	5.3(78.1)	7.8(55.9)	0.44
Transport Equipment	2.2(100.0)	4.2(91.4)	3.3(34.7)	1.45
Others	2.1(100.0)	3.3(81.4)	5.3(63.8)	0.25
Sub-Total:	33.0(100.0)	48.6(72.5)	51.4(37.2)	0.56
Others				
Agriculture, Forestry	1.5(100.0)	2.2(69.6)	3.4(53.0)	0.67
Fishing, Marine	0.8(100.0)	1.1(66.9)	1.0(29.7)	0.40
Mining	28.2(100.0)	27.6(48.2)	25.6(21.7)	5.99
Construction	0.7(100.0)	1.1(79.9)	0.5(17.2)	0.18
Commerce	12.1(100.0)	4.0(16.4)	3.2(6.2)	0.15
Finance, Insurance	8.7(100.0)	7.2(40.8)	5.4(14.9)	1.45
Others	15.1(100.0)	8.2(26.7)	9.6(15.2)	0.70
Total:	100.0(100.0)	100.0(49.2)	100.0(23.9)	0.69

Note: Total value is US$9,884 millions.

It is of great significance that the distributional characteristics of Japanese foreign investment summarized above are deeply related to the fact that it has remained limited in total amount. As mentioned earlier, the accumulated balance of Japanese foreign investment is quite a small portion of GNP and exports. In a sense it still remains a marginal activity of Japanese economic potentialities.[6)]

Foreign investment is concerned with the transfer of managerial resources - a package of resources consisting of capital, technology of production, skill and talent in management and so forth - from home country to host country. In spite of the spectacular expansion of its economic activity, Japan has not succeeded in accumulating suffícent managerial resources to develop world-wide investment activities, because of the lack of R & D factors and of well-qualified personnel with international training and experience, including linquistic talent. Thus as a result of limited managerial resources, Japanese foreign investment has had to be limited in its total amount. Japanese firms have been obliged to confine their foreign investment activity mainly to the neighbouring developing countries, and to the labour-intensive manufacturing industries there, in which they have accumulated relatively abundant managerial resources through their rigorous export activities in earlier decades.[7)]

III. THE CHARACTERISTICS OF JAPANESE FOREIGN INVESTMENT AND ANTI-JAPANESE MOVEMENT IN SOUTHEAST ASIA

The fact that Japanese foreign investment has been limited in its total amount, and has concentrated on labour intensive manufacturing industries in Asia due to the insufficient accumulation of managerial resources, is largely related to the widely prevailing antagonism to it among Southeast Asian countries.

First of all, although the accumulated balance of Japanese foreign investment is only a small part of total foreign investment of developed countries and is also small relative to GNP and exports of Japan, when its outlet is confined to a particular region and industries, its influence on host countries must be serious.

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5) Needless to say, investment in natural resources has been another important constituent of Japanese foreign investment. Given the endowment of natural resources, the importance of this type of investment for Japan will be greatly increased in the future. However at present it is far from being firmly established as exemplified by the system of buying ores in exchange for providing funds for development and by the weakness of oil exploitations. Since investment in natural resources depends upon the availability of resources each case poses particular problems and further consideration of this investment is omitted in this paper.

6) It is said that, even from the individual firms' standpoint, the ratio of overseas production to total proceeds was only one or two percent for big textile producers like Toray and Teijin and nearly five percent for electric firms like Matsushita and Hitachi at the beginning of 1970.

7) The tendency to concentrate on a few industries is accelerated by the bandwagon effect of investment. In Japan, not only big firms, but also many small firms, compete excessively with each other. Therefore once a firm attempts to invest abroad it is usually followed by many rival firms, with the purpose of continuing competition in new ventures.

This is especially so when the economic size of the host countries is small. By the end of March 1974, a sum amounting to US$1,483 millions was invested by Japan in five ASEAN countries in Southeast Asia, and a sum of US$783 millions in three East Asian countries.[8] These are equivalent to 14.4 percent and 7.6 percent respectively of the total accumulated balance of US$10,270 millions.

At present Japanese foreign investment ranks first among total foreign investment, at least in Indonesia, Thailand and Korea. It is also a substantial proportion of the total in other countries in this region. The number of cases of investment by Japan is shown in Table 4. According to this table, 855 cases of investment were carried out in Southeast Asia, and 1,024 cases in East Asia, in a variety of forms by the end of 1973. Here again Japanese foreign investment has been concentrated in manufacturing industries, especially in labour-intensive ones such as textiles, electric machinery and "others".[9] Such concentration of Japanese foreign investment naturally leads to the "overpresence" of Japan in small host countries in Asia. When it occupies the predominant share in total foreign investment, and a considerable proportion of investment as a whole in the country concerned, and when it also exerts an overwhelming influence in particular industries, it can not be denied that it is likely to evoke psychological resistance through being excessively perceptible to the people.[10]

The fact that industries dominated by Japanese foreign investment are mainly consumer good industries which are closely concerned in the lives of the people should be remembered

Of course, it is impossible to define the terms "overpresence", "predominant", "considerable", "overwhelming" on an objective basis, because resistance against Japanese foreign investment essentially stems from psychological feelings of the people. However, one can infer that the psychological resistance is a kind of external diseconomy stemming from investment by private firms in small host countries and an important social cost for Japanese foreign invest-

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8) Approved basis, including various type of investment. See Note (1) in Table 1. Distribution by country is as follows:

Southeast Asia		East Asia	
Indonesia	US$814 millions	Korea	418
Malaysia	201	Hongkong	223
Singapore	174	Taiwan	142
Thailand	163		
Philippines	131		

9) In the case of Hongkong and Singapore, there was much investment in commerce, finance and insurance, and other service industries, relecting the nature of economic activity in these countries.

10) It should also be emphasized that the psychological resistance to Japanese investment depends upon the economic condition of host countries. If their economies expand successfully, they are able to absorb more investment without strong psychological resistance. However, developing countries in Asia, particularly Southeast Asian countries, have been frustrated in achieving steady economic growth in recent years. This is one indispensable factor in explaining why antagonism to Japanese foreign investment has been so strong in these countries.

ment. The cost increases suddenly and sharply when the accumulated balance of investment goes beyond some point in the host country as a whole and in its particular industries.

Secondly, the implications of the type of industries on which Japanese foreign investment has concentrated should be considered in the context of the industrial structure of developing countries. As mentioned earlier, textiles, electric machinery and "others" were the main export industries of Japan to the world and to developing countries in Asia. When developing countries launched their industrialization in the 1950's and the 1960's, they tried to restrict imports from Japan through protective measures and to introduce these industries into their economy by providing favourable terms to foreign investors. Therefore, Japanese foreign investment in

Table 4 Japanese Foreign Investment in Asia and Involvement of Trading Companies

	East Asia				Southeast Asia			
Manufacturing Industries	A	B	C	%	A	B	C	%
Food	22	(5)	(1)	2.1	32	(11)	(10)	3.7
Textile	133	(58)	(52)	13.0	102	(73)	(64)	11.9
Lumber, Pulp	6	(2)	(2)	0.6	37	(18)	(15)	4.3
Chemical	41	(12)	(8)	4.0	48	(36)	(30)	5.6
Ferrous, Non-ferrous	64	(17)	(15)	6.3	65	(44)	(39)	7.6
Machinery	80	(7)	(5)	7.8	34	(12)	(7)	4.0
Electric Machinery	178	(17)	(11)	17.4	73	(19)	(10)	8.5
Transport Equipment	3			0.3	22	(10)	(10)	2.6
Others	242	(33)	(19)	23.6	125	(42)	(34)	14.6
Sut-Total:	769	(151)	(113)	75.1	538	(265)	(219)	62.9
%:	100.0	(19.6)	(14.7)		100.0	(49.3)	(40.7)	
Others								
Agriculture, Forestry	3	(1)	(1)	0.3	24	(15)	(15)	2.8
Fishing, Marine	8	(1)	(1)	0.8	25	(13)	(10)	2.9
Mining	5	(3)	(1)	0.5	40	(11)	(10)	4.7
Construction	6			0.6	36	(14)	(13)	4.2
Commerce	129	(36)	(13)	12.6	73	(24)	(11)	8.5
Finance, Insurance	23			2.2	40	(1)	(1)	4.7
Others	81	(18)	(17)	7.9	79	(31)	(30)	9.2
Total:	1,024	(210)	(146)	100.0	855	(374)	(309)	100.0
%:	100.0	(20.5)	(14.3)		100.0	(43.7)	(36.1)	

Note: A...Number of cases of investment.
B...Number of cases of investment in which trading companies are involved.
C...Number of cases of investment in which major ten trading companies are involved
At the end of 1973, including planned investment and excluding loans.
Source:
Produced from Toyo Keizai, Japanese Multi-Nationals Facts and Figures (Kaigai Kigyoshinshutsu Soran) 1974.

developing countries in Asia was a substitute for shrinking exports from Japan.

Once introduced into developing countries, these industries have contributed much to them in creating huge employmnent opportunities, in training workers, in transferring the technology of production and management, and in spreading forward and backward linkages. As international competitiveness has been strengthening, on the basis of suitable factor endowments in developing countries, these industries are expected to expand exports and to produce a net surplus, if possible, by offsetting the increasing imports of raw materials, intermediate goods and machinery and equipment needed for them.[11) It is necessary to pay due consideration to these contributions of Japanese foreign investment. These are regarded as external economies, making the social benefit of investment greater than the private benefit. Furthermore, it is reasonable to conclude that the external economies produced by Japanese foreign investment are larger than those produced by the foreign investment of other developed countries because Japanese investment, which has concentrated on labour-intensive manufacturing industries seems to fit better the relative factor endowment and absorptive capacity of technology in developing countries in Asia than does the more advanced and sophisticated investment of other developed countries.

However, in the context of the anti-Japanese movement, another side of the coin should not be overlooked. Japanese foreign investment might have a destructive impact upon the native industries which had existed before it was introduced. It may prevent native newcomers from getting into the same line of economic activity. The more Japanese foreign investment fits the economic environment of host countries, the wider will be the range of people who may be actually or potentially affected by it. This will not be so for foreign investment by other developed countries which is channelled into fields beyond the reach of developing countries, although its contribution will be most limited. In these circumstances, it is not surprising that the people affected accuse Japanese foreign investment and bring their hardship to the notice of the nation, pouring oil on the flame of psychological resistance. Generally speaking, when a country expands its economic relationships with other countries, it necessarily brings about economic loss to the particular sector of the country concerned. The loss is usually outweighed by gain for the national economy as a whole. Nevertheless the voice of the loser is louder than that of the gainer, and serves to stir up popular feelings against expansion of international economic relations. Thus the damage to particular groups, and its amplified influence in the host countries, constitute important external diseconomies for investment activity, implying that the social cost curve for Japanese foreign investment shifts upward to that extent.[12)]

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11) This point has been strongly emphasized by Professor Kojima on various occasions. For example, see Kiyoshi Kojima, "Reorganization of North-South Trade: Japan's Foreign Economic Policy for the 1970's", Hitotsubashi Journal of Economics, February 1973, and "A Macroeconomic Approach to Foreign Direct Investment", ditto, June 1973.

12) Incidentally, the unfavourable impact of Japanese foreign investment on the remaining firms of labour intensive manufacturing industries in Japan should be taken into account. As Japanese foreign investment supplies the domestic market of developing countries and begins exports to third countries, they

(continued)

Thirdly, the fact that Japanese foreign investment is just a marginal economic activity of the Japanese economy as a whole seems to explain the critical attitude of host countries to it. For individual firms investing abroad, their overseas production in subsidiaries forms only a small portion of their total output and proceeds. Subsidiaries are marginal and auxiliary suppliers, supplementing the whole production system of parent firms. This means that the control of parent firms is so strong as not to allow subsidiaries to behave freely as independent production units. In the case of the foreign investment of other developed countries, on the contrary, subsidiaries are strong enough to be placed on the same level as the parent firms, keeping a free hand in their productive operations. In this sense, Japanese foreign investment may be referred to as extremely home-country-oriented. This feature, which reflects insufficient accumulation of managerial resources in Japan, has led to the dissatisfaction with Japanese foreign investment in host countries.

For example, it has been insisted that Japanese managers in subsidiaries have always turned their faces to their parent firms and have introduced a Japanese style of management in ignorance of the particular problems of the host countries. They are not in a position to make final decisions and to implement their own policies.[13)]

The interests of parent firms have been pursued with the utmost priority, at the expense of subsidiaries.[14)] To train local staffs and workers, promote them to management and develop new technology has been unusual. As long as these complaints hold true, they are attributable to the fact that Japanese foreign investment has been too much home-country-oriented. Needless to say, the dissatisfaction of host countries with the behaviour of Japanese subsidiaries is another external diseconomy entailed in its foreign investment. Here again, the psychological resistance to the overpresence of Japan would be given a concrete target for attack.

It is obvious that the anti-Japanese movement in Southeast Asia has very complicated motivations.[15)] However, in order to understand it in the context of the characteristics of Japanese foreign investment, the three points developed above seem to be important.

IV. SOME SUGGESTIONS ON THE FUTURE OF JAPANESE FOREIGN INVESTMENT

In the face of the anti-Japanese movement in some of Southeast

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(continued)
have to lose their important export market. Moreover, if its products flow into Japan their survival will be in danger. They strongly criticize Japanese foreign investment and claim protection.

13) The so-called rotation system of staff, under which a manager can not stay at one place for several years, has also promoted this tendency.

14) It is reported that many subsidiaries in Southeast Asia have been forced to curtail their operations in order to keep the production and exports of parent firms constant in the face of the serious depression since 1974.

15) In some Southeast Asian countries it is extremely difficult for the people to criticize their government directly and openly. Therefore the anti-Japanese movement was an alternative way to attack the government, which, in turn, found it convenient to support the movement with the intention of avoiding a direct attack from the people. Thus, Japan was a suitable scape-goat in the complicated political situation in this region.

Asian countries, Japanese foreign investment became the subject of heated discussion in Japan. The arguments have been generally naive, enumerating the demerits of investment activity and expressing one-sided repentance to the people of the countries concerned. Five business associations, including the Japanese Chamber of Commerce and Industry, announced a Code of Investment Behaviour in Developing Countries in June 1973, which emphasized the necessity of localizing Japanese subsidiaries and of returning profit for social and cultural works in host countries. However, this is nothing but a manifestation of moral obligation. With the intention of regulating the excessive competition of Japanese firms abroad, the Association of Japanese Overseas Enterprises was set up in April 1974. It is too early to evaluate its activities. However, it is estimated that the larger part of Japanese foreign investment in future will be directed to Asia. According to a recent survey of the Ministry of International Trade and Industry, 476 cases of investment are planned in Asia from 1975 to 1980 (fiscal years), which is equivalent to 42.4 percent of the total planned. Among the 476 cases, investment in manufacturing industries is predominant.[16)]

Thus it is urgent to consider how to harmonize Japanese foreign investment with the interests of host countries.

Undobtedly foreign investment will be carried out as long as its profit exceeds the profit of domestic investment. Therefore, the issue relevant here is how to increase the social benefits and to decrease the social cost of foreign investment.

As far as the arguments in the previous section are concerned, the first way to reduce the social cost of Japanese foreign investment is to compensate the group of people adversely affected by it. It is impossible to compensate potential losers but due attention should be paid to the actual losers by the firms investing abroad. This seems to have been neglected in the case of Japanese foreign investment. Investing firms must be prepared to pay an extra cost for that purpose, or a special tax may be levied on the investing firms by the government of the investing country in order to internalize the external diseconomies in question. Tax revenue will be transferred to host countries in compensation for the losses incurred in the process of investment.

Secondly, the home-country-oriented features of Japanese foreign investment should be altered. As the accumulation of managerial resources increases and the scale of Japanese foreign investment expands, it may be expected that these features will begin to change.

However, for the present, responsibility falls on the shoulders of individual investing firms. Some improvement has been made, for example, in extending the terms of rotation of managers and in transferring a larger part of the decision-making process from parent firms to subsidiaries. Further internationalization of Japanese foreign investment has to be accelerated as an urgent necessity. If the external diseconomies involved are considered too large, it may be necessary for the government of the investing country to intervene, setting some guideline for internationalization.

As for the ways of increasing the social benefits of Japanese foreign investment, it is possible to consider a number of approach-

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16) Survey on Overseas Activity of Japanese Firms (Wagakuni Kigyo no Kaigai Jigyokatsudo Chosa), Ministry of International Trade and Industry, Tokyo, 1975.

es to conform with the economic policies of host countries. In the light of the special needs of the developing host countries, however, it appears to be adequate to focus on the contribution of Japanese foreign investment in expanding the exports of manufactured goods from Southeast Asian countries. Table 5 shows with what purposes and by what incentives Japanese firms have invested in manufacturing industries in East and Southeast Asia. From this table it is apparent that their investments in Southeast Asian countries have been mainly induced by the availability of abundant labour and by the protective policies of host countries' governments. They have aim-

Table 5 The Purposes and Incentives of Japanese Foreign Investment

	In East Asia		In Southeast Asia	
	Total Investment	Investment in '70 & '71	Total Investment	Investment in '70 and '71
Purposes				
Market defense in the face of export difficulty	15%	14%	28%	25%
Sales expansion in the local market	24	23	38	35
New entry into the local market	14	16	16	17
Export to the third countries	24	21	10	12
Export to Japan	19	24	5	9
Others	4	2	3	2
Total:	100 (453)	100 (165)	100 (367)	100 (137)
Incentives				
Protective policies of the host countries' government	14	16	34	28
Advantage of producing near the consumer's market	13	12	19	18
Availability of abundant labor	48	47	30	34
Availability of abundant materials and energy	3	3	7	8
Availability of land and water for industrial use	4	4	4	5
Advantage of trading with third countries	16	18	3	5
Others	2	-	3	2
Total:	100 (522)	100 (191)	100 (490)	100 (180)

Note: Manufacturing industries only. Percentage of the number of response from investing firms, whose numbers are shown in the parenthesis. Double entry is allowed.

Source: Present Situation of Japanese Foreign Investment and Direction of its Development. The Fourth Survey Report on Foreign Investment (Wagakuni Kaigaitoshi no Genjo to Tenkai Hoko), The Export and Import Bank of Japan, Tokyo, March 1974.

ed largely at supplying their domestic markets. Their investments in East Asia have also been induced by the availability of abundant labour but they have been aimed at exporting to third countries and to Japan.

Although a shift to an export orientation has been observed in recent years, the bias towards production for the domestic market - import substitution for host countries - was undeniable. This is also verified in Table 6, which presents the actual destination of proceeds by Japanese foreign investment. In the case of investment in Southeast Asian countries, exports to third countries and to Japan make up only a small portion of total proceeds in contrast with the cases of Korea, Taiwan and Hongkong, where the export-oriented investment was dominant. The different pattern of investment in different sub-regions is partly due to their different stages of economic development. The different strategy of development in each sub-region - import substitution in Southeast Asia and Export Promotion in East Asia - is another important explanation. However, as is well known, Southeast Asian countries are changing their strategies in the direction of encouraging exports of manufactured goods. This is certainly the most effective way for them to take off from a frustrated situation and to achieve a high rate of economic development. Therefore, Japanese foreign investment should cooperate with the host countries and make greater efforts for the expansion of exports from them.

In this connection, it is interesting to look at Table 4 again. Table 4 indicates the extent to which trading companies have been involved in Japanese foreign investment. According to this table, in many cases of investment in manufacturing industries in Southeast Asia, trading companies, particularly the major ten (general) trading companies (Sogo Shosha), participate.

The participation of the trading companies in productive activity abroad is, of course, a unique feature of Japanese foreign investment. Since trading companies are well equipped with a global network of information and very anxious to match supply with de-

Table 6 Destination of Proceeds by Japanese Foreign Investment[1)]

	To Domestic Market	To the Third Market	To Japan
Korea	52.4	34.4	13.3
Taiwan[2)]	45.2	42.7	9.4
Hongkong	29.6	61.9	8.4
Singapore	62.5	32.2	4.9
Malaysia	87.3	4.8	7.8
Indonesia	96.0	0.1	3.9
Thailand	93.9	5.5	0.6

Note: 1) Proceeds of subsidiaries in 1972.
2) Destination of 2.7 percent was unknown.
Source: Overseas Activity of Japanese firms (Wagakuni Kigyo no Kaigai Jigyo Katsudo) - The Third Survey Report, Ministry of International Trade and Industry, Tokyo, 1974.

mand elsewhere in the world, Japanese foreign investment is bound to be well qualified to contribute to export promotion and thus increase social benefits. It should play its expected role. It is advisable for the Japanese government to encourage this by compensation for the loss of remaining labour-intensive manufacturing industries and by promoting industrial adjustment.

After trying to reduce the social costs and to increase the social benefits of Japanese foreign investment, it becomes necessary to weigh costs and benefits and to limit the total outflow of investment to a particular country to that amount at which social cost is equal to social benefit. At this point the private rate of profit of foreign investment may exceed that of domestic investment, and there may be an incentive for firms to invest more. However, as long as the anti-Japanese movement is concerned with the social costs and benefits of Japanese foreign investment, it is indispensable to limit its total amount in social terms. If Japan fails to do so, there is a danger that Japanese foreign investment will be totally destroyed. Here again the role of the government of the investing country is of crucial importance.

V. CONCLUSION

Japanese foreign investment has caused an anti-Japanese movement in small host countries in Southeast Asia, not because it is gigantic and strong, but because it is limited in total amount and remains merely a marginal activity of the Japanese economy, due to the lack of managerial resources in Japan. It has been obliged to confine itself to manufacturing industries in neighbouring Asian countries. It was impossible for Japanese investment to spread to the world, particularly to developed countries. This led to the overpresence of Japan in this region. Japanese foreign investment has affected adversely some native industries, and choked their development, because it suited the factor endowment in developing countries. It was highly home-country-oriented and strongly controlled by parent firms. All of these were a concomitant, in a sense, of the limited extent of Japanese foreign investment. Therefore it is expected that these limitations will be overcome as Japanese foreign investmnt grows further. However, for the moment, an effort must be made to reduce social costs, increase social benefits and limit Japanese investment to the level at which cost is equal to benefit, regardless of private profitability. In all aspects, the intervention of the Japanese government is crucially important if catastrophe in Southeast Asia is to be avoided.

COMMENTS ON MURAKAMI'S PAPER

(1) Hugh Patrick

This paper is divided into three parts - an analysis with considerable empirical evidence of the general characteristics of Japanese foreign direct investment, a rather general but highly suggestive discussion of the rising hostility in Southeast Asia to Japanese economic penetration, and recommendations as to how Japan might respond to this anti-Japanese sentiment. Professor Murakami's paper confirms the predictions and concerns expressed by Professor Koichi Hamada at the Third Pacific Trade and Development Conference in 1970: Japanese foreign direct investment would grow rapidly, and the Japanese involved would make a mess of their personal relationships with nationals in the smaller, host countries, especially in Southeast Asia.

The general features of Japan's foreign investment are clearly described. Its growth has been rapid, but from a small base, and relative to Japan's economic size is still small. It is widely distributed geographically and by sector, though relatively more concentrated in LDCs and in Asia than that of other large foreign investor nations. The average recorded size of each investment is low, mainly because there are many cases of relatively small-scale investments in consumer goods industries using relatively labour-intensive methods of production, especially in East and Southeast Asia.

Perhaps the most interesting point - which the author might have stressed even more - is how well Japanese firms respond to the goals of host countries as reflected in the incentive structures for investment their economic policies provide. South Korea, Taiwan and Singapore have stressed foreign investment for exports rather than home markets, as did Hong Kong implicitly through its completely open economy; Japanese investment in those countries is substantially export-oriented. In contrast where the purpose of foreign investment has been to support import-replacing industrialization programs - as in Malaysia, Indonesia, and Thailand - the Japanese cheerfully and rapidly hurtled the trade barriers erected for those purposes and invested in production for domestic markets. If Japanese firms in those countries did not export, it was not their fault; the host governments simply did not set up the incentive structure for them, or for any manufacturer, to do so. The moral appears to be: profit signals are effective in these countries, in that at least Japanese firms respond well to the opportunities for profit provided by the combination of local resources and host government policy.

The main thrust of the paper concerns the problem of the anti-Japanese reaction in Southeast Asia. There are a number of important questions, some of which Professor Murakami delicately raises only indirectly. How substantial - how widespread, severe, and

fundamental - is the anti-Japanese reaction? What have been its main causes? It is apprently greater in Thailand than elsewhere: why? What has been its actual impact? Has further Japanese investment in those countries been retarded, or terms substantially changed? Professor Murakami's judgment is that the Japanese portion of the cause of the anti-Japanese reaction has not been so much the overwhelming economic presence of Japan due to its very large size as that Japanese firms have regarded these foreign investments as only marginal in their overall operations so that they have not devoted the effort and managers of sufficient quality to them. While this is true, the analysis deliberately focusses only on Japanese defects. Suppose Japanese managerial practices in their Southeast Asian subsidiaries had been excellent? Would anti-Japanese sentiment have evaporated, or been seriously ameliorated? I think not.

It is the combination of the size and the visibility, as well as the character, of the Japanese presence, that makes it such an easy foreign scapegoat for what usually are domestic political conflicts. It probably would be more effective in reducing Japanese visibility to develop local brand names for Japanese consumer products than to stop direct investment, or to expect Japanese subsidiaries to alter their internal features greatly. Moreover, I suspect that Southeast Asian countries are not trying hard to keep Japanese foreign direct investment out, or even to restructure in any major way the conditions for that investment.

It seems inevitable that the Japanese economic presence in developing Asian countries will become larger over time - in trade as well as in Japanese direct investment. While the economic benefits to both sides will expand, so too will be the temptation occasionally to use the Japanese presence as a scapegoat in internal political and social conflicts. Moreover, the sense of frustration vis-a-vis Japan in developing Asian nations is likely to rise, as their relationship is perceived increasingly as one of dependence rather than interdependence. Japanese will have to become very skillful to minimize these frustrations and the emotional outbursts they engender.

Much of the paper focusses on the lack of supply by firms of adequate Japanese managers to their foreign investment subsidiaries. A fundamental problem is that the decision-making and information-flow processes which are such a great strength for Japanese management in their domestic operations become a major weakness in foreign operations. Each company has its own style, its own signals; the managers, from a common background and with long experience together, can communicate effectively and often without many words in reaching concensual decisions. But in foreign operations one needs local managerial and supervisory talent; they have immense difficulties in communicating and reaching decisions with the resident (much less home office) Japanese managers since they do not know the company's decision-making system or Japanese language.

However, Japanese managerial practices in their international operations are evolving, and some of the supply problems to which Professor Murakami refers may be disappearing. They are learning by doing. More importantly, as the international component of their production activities rises the internal structure of the Japanese firm changes. More, and higher quality, managerial re-

sources and power are devoted to their foreign activities. This pattern of evolution is similar to that of large American firms in their early stages of international activities.

What can the Japanese government do in response to anti-Japanese sentiments in developing Asian countries arising from increased direct investment and other forms of economic presence. The government can only indirectly, and perhaps minimally, influence the actual behaviour of Japanese firms and Japanese residents and visitors abroad. It can, and should, preach the importance to Japanese of being good corporate and personal citizens abroad. It can help develop, and enforce, rather concrete and specific, national or preferably international, codes of conduct for foreign direct investment behaviour. Professor Murakami suggests the government might limit the outflow of Japanese capital to sensitive areas despite high profitability and host-country willingness to accept it. I am not yet fully persuaded that would be appropriate or desirable. Nor do I see it as sensible that the Japanese government (as opposed to the direct Japanese business interests) compensate those in the host country actually or potentially harmed by the investment. After all, there is only so much that the home government (Japan) can be expected to do. It is the main responsibility of the host country government to determine the conditions in which it will make possible Japanese or other foreign investment in their own country. Perhaps the most beneficial Japanese government policy is to be sympathetic and responsive to the legitimate policies of the host country government rather than regarding its role narrowly as supporting the interests of specific Japanese firms investing abroad. Those interests do not necessarily coincide with the Japanese national interests.

(b) David Lim

Professor Murakami begins by providing a useful statistical backdrop on Japanese global foreign investment relative to that of other developed countries. The main findings and conclusion of this section of the paper are:

(i) Japanese foreign investment is small relative to that of the United States, United Kingdom, France and West Germany in absolute terms.

(ii) It is also relatively insignificant when the comparison is made in terms of the share of foreign investment in the investing country's GNP and exports.

(iii) In spite of these unimpressive positions in the international league table, certain features of the geographical and product concentration of Japanese foreign investment are important, according to the author, in explaining the rise of anti-Japanese feelings in South East Asian countries. One of these is the relatively greater concentration of Japanese foreign investment in LDC's in general and in East and South East Asian LDC's in particular. While the direct foreign investment of other developed countries has been concentrated within the developed countries themselves Japanese foreign investment tends to be in LDC's.

(iv) Another important characteristic of Japanese foreign investment is that while the relative share of this in manufacturing is <u>less</u> than that in other developed countries this investment in LDCs is concentrated in a few industries. These

are textiles, electronics and "others". "Others" being miscellaneous items of sundry goods. These industries are labour-intensive ones in which Japan "has comparative advantage, and on which Japanese exports largely depended until quite recently".

These four features are the ones that most characterize Japanese foreign investment. According to Professor Murakami they are the consequence of a shortage of managerial talent and skill in Japan with "international training and experience including linguistic talent". Up to this point, Professor Murakami has said nothing convincing to show why there should be antagonism ill-feeling towards Japanese foreign investment in South East Asia. In fact one gets the distinct impression that these features might have put Japanese firms operating in South East Asia in good stead. These firms are, after all, in labour-intensive activities and this pattern of investment fits the relative factor endowment of these countries. They create significant employment opportunities and comply with the Hecksher-Ohlin hypothesis of comparative advantage.

Why then the antagonism? A number of reasons were given but I am not entirely convinced of their validity as described by Professor Murakami. Let us look at each of these in detail.

(i) The first is that Japanese foreign investment though unimportant to Japan, is important to South East Asia in view of the smallness of the South East Asian economies. Japanese foreign investment turns out to be the most important of developed country investment in these LDCs. It also dominates the textile and electronics industries.

Largeness in itself is a necessary but not a sufficient condition for the type of anti-Japanese feeling that we are talking about. It is surely what has been done with this largeness that matters. The use of terms such as "overpresence" and "predominance" has only limited use in this context.

(ii) The second reason given is that Japanese foreign investment "may prevent native new comers from getting into the same line of economic activity". I presume Professor Murakami is talking about the backwash effects that industrialization has on the traditional handicraft activities.

I was not entirely clear what the net effect of his arguments are. He begins by paying tribute to Japanese foreign investment in South East Asia by saying that it has "contributed much in creating high employment opportunities, in training labour, in transferring technology of production and management and in spreading forward and backward linkage."

Then he argues that there are backwash effects, especially as Japanese penetration and dominance are in industries which are within the reach of LDC's technologically. I am not certain that such backwash effects are significant in the type of industries (textiles, electronic, "other") listed as the ones favoured by Japanese firms. Professor Murakami himself said that "the loss is usually outweighed by the gain to the national economy as a whole".

The positive effects as painted by the author, are such that the statement that "the voice of the loser is louder than

that of the gainer and serves in stirring up common cry against the expansion of international economic relations' loses much of its significance.

(iii) The third reason given is that the Japanese foreign companies operating in LDC's are, to quote the author too, "home-country oriented".

I think that this is one area in which Professor Murakami might have spent much more time exploring. He did, of course, say that the interests of the parent companies had often been pursued at the expense of the interests of their subsidiaries in South East Asia. But nowhere did he go into any detail. Thus he mentioned only very briefly the fact of the widespread retrenchment of workers in Japanese firms in South East Asia in 1974 in order to keep production and employment in the parent companies in Japan constant.

He also mentioned but again only very briefly that the training of local labour and the promotion of local staff to positions of responsibility in Japanese firms has been limited. I would have liked to see more data and research done on this as I would on issues such as the comparative efficiency of foreign and local firms, and the remittance of profits and dividends by Japanese firms. It is perhaps in these areas that we may find the reasons why Tanaka had such a rough reception in Thailand and Indonesia.

As it is, the paper leaves the discussion at a very general level. The discussion, whether at the academic or the non-academic level, on the rate of foreign investment in South East Asia has usually been conducted at a general and at an emotional level. Our understanding of the issues will not be increased by continuing in this vein. I am sorry to see that Professor Murakami has not taken this opportunity of guiding the discussion in a more fruitful direction. His recommendations for policy changes, based as they are on casual observations about the behaviour of Japanese firms in South East Asia do not have the impact that they deserve.

(c) General Discussion

It was suggested that the pattern of Japanese foreign investment should not surprise as it was similar to that taken by United States foreign investment which was also initially close to home. As United States investment spread into more sophisticated industries, so it also spread geographically. Also some studies had found that within particular industries in some host countries, Japanese investment has not necessarily been more labour intensive.

A further point made was that the Japanese have viewed criticisms as superficial, emotional and as problems of perception. If the problems are of this nature, the code of conduct adopted by five Japanese firms in 1973 should have had some impact. The suggestion that individual Japanese abroad do not fit into the local culture raised the question of whether the training programmes for Japanese managers involved in foreign investment had had any impact. Dissatisfaction with foreign investment often reflects dissatisfaction with local enterprise which often appear to be of lower quality than foreign businesses and this may be one of the reasons for the troubles Japan

had encountered. To some extent it was made a scapegoat.

The comment was also made that in studying foreing investment we must distinguish between economic and socio-political aspects. Economic analysis will fail in the investigation of the socio-political aspects. Murakami's paper used economic reasoning.

Analysis of the problem in South East Asia needed to take these into account. The Japanese have expanded outwards in trade and travel. The sheer number of Japanese travellers has caused antagonism from locals, especially those in the travel and hotel accommodation industry.

It was pointed out also that there are various patterns in the presence and absence of conflict. There had been conflict surruounding American investment in Latin America; British investment in East Africa and so on. But there are not major conflicts over European investment in Latin America, Japanese investment in Brazil and the like. There must be an explanation of these patterns. It involves a number of factors:

1. There is the problem of the economic, social and political gains.
2. Vital decisions are made abroad.
3. There is the problem of the degree of development. Domestic firms are less competitive than foreign ones.
4. Cultural values conflict. This conflict cannot be studied through economics.
5. There is the problem of the power of the donor, and also the distance of the host from the donor country.
6. Historical memories also shape attitudes.

It was thought by one participant that some of the sources of hostility to foreign investment lack remedial possibilities. But we must not just leave things at that.

Japan is closer to South East Asia than is the United States. Also it is more suited to the factor proportions of the region. This apparent advantage has also led to problems. Japanese participation has relatively more impact on local competitors.

Also, Japan is important in ways other than direct investment such as aid, imports, exports etc. Professor Murakami's paper is a partial analysis on direct foreign investment. Japan's involvement adds up to a large total impact. The protest is often against the size of the total Japanese influence. The Japanese firm is the local focus for this protest.

A further point is that foreign investment is very heterogeneous. There are questions of dynamics. For example, to what extent does foreign investment fade away in the future? Some types of investment are temporary, e.g. resource depletion. Other types involving product differentiation etc. are, however, not so temporary.

In response to the discussion Professor Murakami said that the role of the Japanese government may be limited but necessary as a last resort. Though Dr. Lim thought that the paper's generalizations were not enough to support his ssertions it was possible to pick up other types of evidence. Professor Murakami noted also that many developing countries have frustrating economic experiences. The frustration in the local economy finds expression in the anti-Japanese movement. He realised that there were non-economic influences in foreign investment; but there were problems

in incorporating these influences into economic analysis. The paper took these other factors into account as much as possible.

Further points made in response to specific questions were:

(a) The code of conduct for foreign investment has had some impact in changing the impact of Japanese firms in South East Asia. There is, however, a conflict in practice between the profit motive and "good behaviour" in the LDC. The code of conduct is just a guideline.

(b) The average salary in Japanese firms in Asia is less than in United States firms there but is as high as in local firms. But there are many fringe benefits with Japanese companies. Japanese efficiency is superior to that of local firms. Many local firms working with Japanese ones have bad conditions. Even if there are beneficial effects of investment, you only need one or two "losers" for dissatisfaction to arise.

(c) A special training academy for managers expecting to go abroad was established 10 years ago. But the Japanese are still in the process of learning by doing. It takes a great deal of time to gain a deep understanding of local conditions: Japan is making a great effort to do so.

12

PROBLEMS OF THE SMALL HOST COUNTRY

PAPUA NEW GUINEA EXPERIENCE

Ross Garnaut

Papua New Guinea is a small, new country which is already integrated closely into the Western Pacific economy. It faces all of the problems of instability and uncertainty that are well-known characteristics of the small, open economy. But in many ways its international management problems are unusually acute, as Papua New Guinea could never have existed as a single political entity without large resource transfers from overseas, and it can only survive in future if it manages successfully a massive aid relationship with Australia and a huge investment and trade relationship with the rest of the world.

There could hardly be a worse year for Papua New Guinea to be despatched to independence. Recession and inflation at home have shortened Australia's horizons to Cairns and Darwin. The world is uncertain about whether it wants more of the minerals, energy and other natural resources that Papua New Guinea must sell in large quantities if it is ever to loosen the aid ties to Australia with which it was born. Large investors are uncertain about the future profitability of possible investments and the criteria which they should apply to new investments.

And yet there is no _autarchic_ option for Papua New Guinea. The little internal integration that has been achieved is dependent on high levels of public expenditure. Internal trade and specialisation is too limited in scale and profitability to support even a small proportion of the required expenditure. Papua New Guinea must plot a course amongst the hazards of the international economy in the mid-seventies.

This paper discusses the importance of the international economy to this small, new country and some of the hazards, and looks at some approaches to management that have been adopted. In particular, it takes examples from Papua New Guinea's relationship with Japan - the dominant influence in the Western Pacific economy.

Resources scarcity: Is an export strategy viable?

The cycles in economic thought are as pronounced as those in real economies. When the prices of commodities are low, theories are developed to explain why they will remain low, just as businessmen who expect prices to remain low hold back from investment and sow the seeds of the next commodity boom. The rises and falls through the trade cycle are large and dramatic, while the trends inch towards increasing scarcity or abundance.

The world economy experienced more or less steady growth throughout the 1950's and 1960's. But, despite the exponential growth of demands on resources, there was a consistent decline in the money prices of primary commodities taken as a whole. The trend in the United Nations price index for all primary commodities was upward from 1968, but between 1968 and 1971 the rise in prices for primary commodties was still lower than for manufactured goods. There was an historic change between 1971 and 1974, when the prices of primary commodities rose much faster than those of manufactured goods.[1)]

The downward trend in the real prices of primary commodities during the 1950's and 1960's contrasts with earlier periods of sustained world growth, such as the decade before 1914, and the 1920's prior to the crash in 1929. The literature is replete with explanations of declining primary goods prices, and so raises large questions about price behaviour since 1971. It is an impressive phenomenon that must be explained: during the three-year commodity boom, the relative price of all primary commodities rose to about one-quarter above the Korean War peak.

Early in 1974 many of us were asking whether the commodity boom was only an exceptionally pronounced cyclical peak, or whether increasing scarcity was raising permanently the rent value of natural resources.[2)] When the slump came in mid-1974 it was so severe and it has endured so long that some resource exporting countries are nervously asking an opposite question: does the slump in prices for resources other than energy reflect an incapacity within the industrial countries to adjust to the high resource prices of 1973-4, or to other consequences of sustained growth?

From a great volume of speculation and analysis on these matters over the past few years there has emerged something of a consensus, although question marks still hang over many of the major issues. The main general factor was the unprecedented coincidence of boom in the industrial economies in 1972 and 1973. Average growth rates at 6.5 percent exceeded the trend by one quarter, strained supply capacity to its limit and raised quasi-rents sharply in all resource industries. Specific factors increased the pressure on several commodity markets, especially foodstuffs. There was no general secular trend towards increased scarcity.

However, increased scarcity was important for some commodities. The world economy in the early 1970's was three times as large as it had been two decades earlier. The burgeoning resource demands of the industrial countries was spawning new industries in distant and difficult environments, most spectacularly in the Western Pacifice region under the influence of explosive Japanese growth.

There is little doubt that increasing scarcity, and the expectation of future scarcity, contributed to rising energy prices and paved the way for the initial successes of the OPEC cartel. There is widespread awareness that exponential growth in world consumption of organic fuels at the rate of the 1960's and early 1970's could

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1) Fifteen Economists, Trade in primary commodities: coflict or cooperation, Brookings, Washington, 1974.

2) Ross Garnaut and Ron May, 'Towards a Papua New Guinea Trade Policy', in Ross Garnaut (ed.), 'Foreign Economic Relations of Papua New Guinea', New Guinea Research Bulletin, No.56, Canberra and Port Moresby, 1974, p.174.

continue only for one or two generations before known resource limits are met. The probability of greatly increasing the known limits through new discoveries are relatively small for the organic fuels.

The picture is not so simple for mineral ores. Reserves of most mineral ores could supply world demand, expanding exponentially at the rate of recent years, well into the twenty-first century. Copper is one of a few exceptions: reserves of this strategic metal would be exhausted after two decades of such exponential growth. But the limits to copper reserves are more economic than physical: it has not been worthwhile to invest heavily in proving reserves in many areas of known mineralisation in advance of the immediately foreseeable needs of the mining industry.

The mining industry has been moving steadily into lower grade ores of many minerals, but the costs of mining have been contained by technological improvements. There is no logical reason why such technological change should remain abreast of declining ore grades, and upward shifts in real mining costs and prices are possible if world demand continues to expand. But there is no question of absolute supply limits being reached in the foreseeable future, or of rises in costs coming to represent an important component of world incomes.

The increased expense and scarcity of petroleum and anxieties about resource supplies contributed to pessimism about continued growth in the industrial countries and to world recession in 1974 and 1975. Energy constraints would certainly prevent a return to long, sustained growth in the post-war pattern, unless there are major changes in patterns of energy use. The policy stances of several resource-exporting countries and misapprehension about those stances has been the origin of anxieties about the continued supply of resources in some major industrial economies, including Japan, and close international co-operation in trade, investment and technological development is required for the structural change in energy use that is necessary for continued growth. Continued expansion of income within an open world economy is necessary for the maintenance of high prices for all but a few commodities. Thus, the policy reactions of resource-rich countries are important determinants of whether there is a solution to current world economic problems short of drastic falls in living standards in all countries. The rich and poor countries are linked by trade in resources and investment in a relationship that is critically important to the prosperity of both. The nature of some of the links is illustrated below with examples from the region, in Japan and Papua New Guinea.

Resources and development: Papua New Guinea

Papua New Guinea has been a beneficiary of expanding resource markets throughout the 1960's and of the commodity price boom of the early 1970's. The long period of world trade growth, and especially the expansion of the proximate Japanese market, created opportunities for several new industries, of which the most important was mining on Bougainville. The new industries and older primary industries both enjoyed high, windfall gains in 1973 and 1974. All are suffering difficulties through the current world recession, which also threatens to have major, adverse effects on investment in resource industries, and so on the prospects for long-term na-

tional financial self-reliance and growth.

Late colonial policy in Papua New Guinea was influenced powerfully by the worldwide growth and growth optimism of the 1960's. There was rapid expansion of administrative services and subsidised infrastructure, supported by massive injections of Australian financial aid and personnel. One result was that the first national government, which took office in 1972, inherited a large administration, financed largely by foreign grants and loans, which provided a range of services of varying usefulness to part of the population. Mr. Somare's Government faced the awful choice of dismantling most services and moving quickly towards a high degree of financial self-reliance, or of modifying the most highly valued services and seeking to extend them to areas which did not have them. By choosing to maintain and to extend services, the new Government was bound to seek an accommodation with foreign governments on long-term aid and with foreign corporations on major resource investments.

Papua New Guinea's only viable route to significantly greater financial self-reliance is via revenues from major investments in minerals and energy. The resource base is in the early stages of evaluation, but it is probably sufficiently rich to support several such projects over the next decade, given a favourable domestic political and external economic environment. But the resource-investments route to greater national self-reliance is a testing one in a volatile and uncertain world economy.

The world commodity boom, which gathered steam from late 1972 and faltered in the first half of 1974 and collapsed in the second half, brought unprecedented prosperity to Papua New Guinea. The magnitude of these effects is demonstrated most simply by reference to the balance of commodity trade, which moved from a deficit of $125 million in 1971-72 (including the first three months' exports from the Bougainville project), to a small surplus of $20 million in 1972-73, and a large surplus of $220 million in 1973-74. Falling export prices and rising import prices have led to a return to very large deficits in 1974-75.

High commodty prices raised rural incomes to unprecedented levels, especially in coastal areas. They also contributed to very buoyant government revenues and to some short-term reduction in aid requirements. The prodigious profitability of the Bougainville project over this period allowed the renegotiation of the tax-agreement along lines that preserved the viability of the company while greatly increasing government revenue.

The Bougainville renegotiation, in particular, brought major long-term benefits to Papua New Guinea. But the high intensity of the boom also had costs, most importantly through the upward shift in the wage structure that was spurred by high company profits throughout the 1972-74 period.

One by one, the prices of major export commodities collapsed from mid-1974. The buoyant first half of 1974 kept total government revenue from Bougainville Copper's 1974 income at the healthy level of $93.5 million. However, revenue from the company's income for 1975 may be only about one-third of that figure. Government revenue was also affected adversely, although less dramatically, by the reduced prices of agricultural commodities.

Papua New Guinea is well-protected from the cyclical variations in copper revenues by the Mineral Resources Stabilisation Fund,

which was established by legislation in late 1974. But it is not protected against other major effects of the recession, including some reduced investment associated with current world economic problems.

The revenues that are likely to be available from major investments in minerals and energy are affected greatly by uncertainties both in the domestic political environment and the external economic environment. The two types of uncertainty are intertwined, as they both affect the terms upon which investments are undertaken, and the terms themselves are important determinants of domestic political responses.

Evaluation of new, major minerals and energy projects is progressing steadily, despite the uncertainties. Following the lift in oil-prices, oil exploration expenditures have increased enormously, especially in the drilling of promising structures on-shore and off-shore in the Gulf of Papua. A major feasibility study is in progress of the Purari hydroelectric resource, financed under unique arrangements by grants from the Japanese, Australian and Papua New Guinea governments. Three major porphyry copper deposits are being explored intensively, two financed privately by Australian and Japanese consortia, and one, at Ok Tedi, financed by the Papua New Guinea Government following the failure of negotiations about the terms upon which a major project might be mounted by the Kennecott Corporation.

It is inevitable that there will be tensions and domestic political controversy associated with major resource investments, despite their importance to Papua New Guinea's economic strategy. Whether or not the tensions are so large as to make such projects unacceptable depends principally on the effectiveness of government administrative control over the activities of private companies, and on the fiscal and associated terms upon which the projects are mounted.

The difficulties of maintaining effective administrative control of resource developments is essentially a domestic problem, which must be given high priority among the many administrative problems of the new Government.

On fiscal arrangements, the Papua New Guinea Government has adopted as policy an approach that would give a high proportion of profits in excess of a 'reasonable return on investment' to the Government as taxation. Under this approach, a 'reasonably' profitable project would be subject only to normal corporation taxation, but a project that turns out to be highly profitable is taxed, on average over its life, at a higher rate. This progressiveness with rate of return is designed to overcome an almost universal problem associated with resource projects in developing countries: profitability is highly uncertain at the time of investment, conventional taxes and royalties are set at rates that would not cause the project to fail with _ex post_ profitability at the lower end of the range of possibilities; and the national share of benefits is unacceptably low when profitability turns out to be at the higher end of this range. In many countries, realisation of this problem has given rise to pressures for nationalisation and to other responses which in Papua New Guinea would be inimical to further, major resource investments. There is wide political support in Papua New Guinea for the Government's approach and, as one example of this approach, for the terms of the renegotiated Bougainville Agreement.

There are difficulties in applying the precise formula of the Bougainville Agreement, which was designed for a highly profitable, established project which had enjoyed almost two years tax-free income at the time of the renegotiation, to new projects. Statements by the Papua New Guinea Government on taxation of new resource projects indicate an awareness of and willingness to make allowance for the difficulties. There are principally those relating to the effects of inflation, the arbitrary effects of profit fluctuations on average profit, and the rather indirect relationship between the rate of return on an annually calculated 'total investment' and the discounted cash flow concepts that are most important to new investors.

One rather special and important source of uncertainty at the present time relates to the investment criteria used by investors. High inflation during the early 1970's and low profits for most major mining companies have caused companies to be uncertain about the investment criteria that should be employed in new projects. Interest rates have been lower than the general rate of price increases in many economies since 1973, and many major resource development companies have had to accept low or negative rates of return, when adjusted for inflation. The familiar investment criteria that were developed in times of low inflation - a range of from 13 to 18 percent in expected discounted cash flow returns on total cash flow seems to have been widely accepted as justifying mining investment in the late 1960's and early 1970's - are used more cautiously, and some companies are tempted to 'look for' inflation-adjusted returns as high as these old benchmarks. This is unrealistic in the light of the current market, but it is difficult to judge what is realistic in times of such rapid economic change on a global scale. This uncertainty seems to have been important in inhibiting new investment in non-energy resources in many places, and, despite the current market glut, there is a danger that current under-investment will lead to a fierce boom in metal prices as the world emerges from recession (though probably with a considerable time-lag while excessive stocks are absorbed into consumption).

The general uncertainty about the expected rate of return that justifies major investment becomes a major feature of negotiations related to resource developments when a tax system is progressive with rate of return. The progressive tax system reduces disputes about cost and price parameters in negotiation of agreements and shifts dispute on to what constitutes a 'reasonable return' in a given set of market circumstances. Negotiation becomes an easier task, but it can only be an easy task in more settled circumstances than those existing at present.

Investors' perceptions of political risk, which can be well or poorly based, raise the expected rate of return at which investment in developing countries is attractive to well above the rates applied to investment in the industrial countries. This factor can be viciously destabilising in relation to major investments in developing countries, especially when the projects are to operate within conventional royalty and taxation systems. *Ex post* rates of return well in excess of international norms are, of course, magnets for political concern, so that there is some tendency for companies' perceptions of risk to be self-fulfilling. As a new country, Papua New Guinea inevitably attracts some 'risk premium'. However, sophisticated corporations are aware that the successful implementation of progressive tax systems is an important insurance against arbit-

rary interference with negotiated agreements. Different companies perceive risk in a particular environment in different ways, and there must clearly be a 'sorting out' of investors by this criterion over the next few years.

The Papua New Guinea Government has not yet enunciated a fiscal policy on oil and gas developments, but it has been reported that policy on these developments is likely to incorporate many characteristics of mining policy. The major petroleum companies tend to be more experienced than mining companies in evaluating commercial and political risk in an international environment, and the chances of extremely profitable projects being launched is higher in the petroleum industry at present prices than in mining. There should not be great problems in reaching agreement on the fiscal terms upon which major petroleum developments would be undertaken.

Negotiations on the terms of investment in processing industries based on hydroelectricity resources may be more difficult. It is only recently that high world energy prices and awareness of future scarcity have made large-scale investment in export industries based on the hydroelectric potential of developing countries potentially highly profitable. There is no tradition of successful investment of this kind. Investing companies will no doubt argue that the types of fiscal concessions that were once offered by many developing countries to investors in industrial activities will be necessary to attract sufficient users to the enormous Purari potential. This could create problems for the development, especially if investors are reluctant to trade tax relief in the case of low realised profitability against high tax in more favourable circumstances.

The commencement of projects at any two of the half-dozen major resource prospects under intensive investigation is likely to place Papua New Guinea well on the road to fiscal self-reliance at an attractively high standard of living in the early 1980's, given the continuation of effective administration and appropriate policies in other areas of government, and given the maintenance of something like present world energy prices and the return of metal prices to postwar averages in real terms. Both the prospects of launching new projects and the national benefits associated with those projects, together with the established project on Bougainville, are very dependent on the existence of an expanding and open regional and world economy. At the same time, Papua New Guinea's willingness to participate in the regional economy through the exports of resources contributes to the re-emergence of these conditions. Judgements on whether it is sensible to take the risks of an export-oriented strategy are assisted by analysis of the recent boom and recession period in the industrial countries. Here we look for signposts in the important case of Japan.

Resource limits to growth: Japan

Continued economic growth at over 10 percent per annum throughout the 1960's raised anxieties about resource supplies earlier in Japan than in other countries. Japan's specialisation in the importation of mineral fuels and non-ferrous metals and ores strengthened during this period of rapid growth, and Japanese demand had important effects on world markets for these commodities.[3] Japan accounted for

3) See Jenny Corbett and Ross Garnaut, Japan and the Resource-Rich Developing Countries, Institute of Developing Economies, Tokyo, 1975.

more than one-quarter of the expansion in world petroleum imports and more than one-half of world imports of non-ferrous minerals and metals during the late 1960's and early 1970's. Thus, Japan contributed significantly to the pressures on resource supplies in the early 1970's, although many Japanese react sensitively to the suggestion that this was the case.

Japan reacted constructively to impending resource problems well ahead of the 1973 price peaks and the 'oil crisis' of late 1973. The problem of securing future resource supplies was linked creatively to problems of environmental deterioration, domestic labour shortages, inflation and payments surpluses in the development of a new foreign economic strategy, and in a series of policy initiatives between 1971 and 1973. Within the new strategy, Japanese export specialisation was to be shifted towards 'knowledge-intensive' products, making less demands on imported natural resources, on less-skilled labour and on the domestic environment. Processed goods were to become more important in imports. New, overseas sources of labour-intensive and resource-intensive goods were to be encouraged in supplier coutries by direct Japanese investment. The new strategy was supported by tariff cuts, several yen revaluations, the lifting of controls on private foreign investment, and the expansion and liberalisation of foreign aid.

The Japanese balance of payments had already turned around in response to these measures when the oil supply restrictions and price increases struck in late 1973. The turn-around accelerated sharply, and the new payments deficit became the major concern of Japanese economic policy. The long-term adjustments lost their priority in the face of more urgent problems.

Japan applied savage constraints to money supply expansion and demand, as means of combating external payments deficits and domestic inflation. Just as Japan contributed greatly to bringing the world into boom in 1972 and 1973, the sharp contraction in Japanese incomes and imports, and in capital outflow, added significantly to world recessionary tendencies in 1974 and 1975.

The Japanese recession had massive effects in some commodity markets. The volume of petroleum imports fell from 289.7 million tonnes in 1973 to 278.4 million tonnes in 1974 contributing to the world's excess petroleum supply that was becoming apparent in late 1974. This was to become a major problem for Indonesia. More dramatically, the rate of Japan's copper consumption in the first half of 1974 was 17 percent below the 1973 level. By June and July, the rate of consumption was 46 percent below the 1973 level. Japan became one of the world's largest exporters of copper metal, as smelters poured the surplus over domestic demand back on to world markets, and contributed to the shift fall in London Metal Exchange prices from £1400 sterling in April to about £500 sterling at the end of 1974. Under pressure from the CIPEC governments, Japanese smelters agreed to cease exports in November 1974, and in return secured an undertaking that CIPEC countries would reduce total exports by 10 percent and apply the whole of the cutback to the Japanese market, and that new copper industries in Indonesia, the Philippines and Papua New Guinea would reduce shipments to Japan by 15 percent. Further cutbacks were agreed to under pressure from Japanese smelters early in 1975.

The Japanese recession has been very costly for Japan, whose real gross national product fell by 1.7 percent in 1974, and even more

so for developing countries in the region. Recovery in regional and world commodity markets over the next few years requires recovery in Japan.

However, rapid growth on the pattern of the 1960's may never return in Japan. An emerging consensus in Japan is that the costs of such high growth, including international tensions associated with the securing of resource supplies, are too great. Official growth projections have been lowered to between 6 and 8 percent per annum over the next decade.

However, it is doubtful whether the energy supplies will easily be available to support even these more modest growth projections. The plans after the oil crisis provide for 7 percent annual growth in energy consumption, compared with over 14 percent per annum between 1965 and 1970. It is anticipated that nuclear sources will provide between 10.3 percent and 11.4 percent of total energy supply by 1985, and that Japan's share in world petroleum imports will remain at about the present level. But, early plans for the installation of new nuclear capacity have been damaged, and their implementation delayed, by local, political opposition. Moreover, the maintenance of the current Japanese position in world petroleum trade may leave the country feeling too vulnerable to the vagaries of international politics.

The realisation of Japan's revised growth goals requires significant progress in the implementation of the new foreign economic strategy. Perhaps most important of all in the strategy, it requires the shifting of much of its metal-processing industry outside Japan, to sites with access to abundant power. This requires the building of confidence both in Japan and in other countries in the reliability of the international economic order. It also requires the avoidance of what must appear as a 'soft option' in Japan: undiminished reliance on fossil fuels, available in glut proportions during the first half of 1975 as a temporary result of the lift in petroleum prices and the world recession. The successful movement towards the importation of heavily resource-intensive commodities would loosen the constraints on continued Japanese growth and facilitate a return to growth in many resource-exporting countries.

The chances for a small, new economy

What are the chances for a small, new country that must succeed in developing new resource exporting industries to survive? Is good management of its foreign economic relations enough for Papua New Guinea to make its way out of extreme aid dependence, or are the dice weighted too heavily the other way? Will there be an expanding, open world economy over the next decade?

There are few serious opinions that there can be a return to the high growth that led to the 1973-4 boom. Deputy Prime Minister Fukuda expressed a more common view in his economic policy speech to the Diet early this year:

> ... the world economy has to bid farewell to the age of prosperity and shift to a new age of 'low growth'. Moreover, the new age will be far from stable. In view of the new 'resource nationalism' and other trends, we must presume that it will, in all probability, be an age of 'low growth', fraught with the danger of unrest. Our country, therefore, should steer its economy with circumspection to

> achieve and maintain a steady and a moderate growth, which will also be in harmony with the economic and related activities of the international community as a whole.[4]

To achieve even a "steady and moderate growth", Japan and the resource-importing industrial countries must accept major structural adjustments in their domestic economies. At least in the case of Japan, the required structural adjustments have a large international content, and depend on a high degree of confidence in the stability of the international economy.

Like investors' perceptions of political risk in a developing country, fears of a decline in international trade tend to be self-fulfilling. If Papua New Guinea judges that there are no prospects for establishing new, profitable resource industries over the next decade, it makes sense for her to attempt to adjust now to much lower incomes and standards, no matter how painful or disruptive the adjustment. Similarly, it is sensible for Japan to adjust now to a reduced level of foreign trade and to lower incomes if there is likely to be a future failure of resource supplies. If Japan is likely to retreat from increasing integration into the international economy, the necessary conditions for the launching of new resource projects in Papua New Guinea are unlikely to be met. If the resource exporting countries believe that Japan is likely to retreat from trade-oriented growth, they are unlikely to commit themselves to heavy investment in resource industries.

The reactions of the rich, Western Pacific countries to the current recession have been insensitive to their effects on confidence in the international economy. Cutbacks in both countries' aid programmes have raised anxieties in neighbouring developing countries, and Australian aid reductions have had an especially severe effect in Papua New Guinea. Japanese reduction of copper concentrate imports below the levels specified in sales contracts early in 1974 has introduced a new element of uncertainty into all mining investments. Australian restrictions on imports of labour-intensive products have produced a similar effect on a much smaller scale. Australian policies which encourage the extravagant use of scarce hydrocarbon fuels and which might in future inhibit the processing of Australian minerals at low cost through the use of renewable energy sources in other countries, fly in the face of adjustments that are necessary for maintaining world prosperity in the long term.

The world's return to a moderate and steady growth must be a highly co-operative task. The developing countries are potentially the major losers from uncertainty in resource trade and investment. Papua New Guinea is one small country that has sought to manage the uncertainties that are inevitably associated with outward-looking growth. But the possibility must be faced that she could fail because of myopic policies in the region's rich economies.

A moderate and steady growth through the region would quickly restore demand for resource-intensive commodities, and would provide very important opportunities for trade in energy-intensive commodities, because energy would again become scarce. Energy scarcities raise difficult problems of adjustment in the industrial countries, that could defeat the opportunities they provide for resource-rich countries. All countries in the region share an inter-

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4) Economic Policy Speech by Director-General Takeo Fukuda, Ministry of Foreign Affairs, Tokyo, 1975, p.2.

est in the co-operation that is necessary to avoid this defeat, which would be fatal for the smallest and newest among them.

COMMENTS ON GARNAUT'S PAPER

(a) GEOFF BRAAE

I have found that this interesting paper by Dr. Garnaut highlights a number of the specific aspects or themes which have kept re-occurring in many if not all the papers presented. I want briefly to discuss these in the setting of this paper and then to ask some questions on certain specific points in the paper which I would like elaborated. These may of course reflect my ignorance of the Papua New Guinea economy, but I think they fit in with the topic of foreign investment in a small developing country. Dr. Garnaut has in fact made some reference to these in his opening remarks.

The first point is that of viability and continued development, of a small newly independent economy. In this respect Papua New Guinea faces problems similar to other countries of the region, and it has perhaps an added interest in viability because of its "newness" although there has been a period of preparation. As was mentioned in previous discussions these matters are relative. But given the build up of the infrastructure and administration before independence it would seem the first national government would have had little option in reversing the trends. Papua New Guinea like most countries has great interests in the expansion of the world economy, with links through trade and investment, and Dr. Garnaut's paper recognises that an autarchic option for Papua New Guinea is not on.

The second point concerns the sharing of the gains from foreign investment. What are the strategies open to the governments of these economies and Papua New Guinea in particular? For the major investment in Bougainville copper the tax arrangements may perhaps be unique as Dr. Garnaut recognises. Bargaining on a reasonable rate of return however, can obviously involve concessions and other adjustments or what could be called mixed strategies. I refer here to the range of options mentioned e.g. by Professor Desai with respect to Fiji and these may be used for other investment. There may however be other controls. One factor could be restraints or limits on remittances of profits, and I ask whether this has been or is likely to be implemented as a policy variable either in isolation or in conjunction with other factors. From time to time large remittances of profits can become highly controversial issues and in any case can raise balance of payments difficulties. One could also ask about controls through a stake in the investment. This presumably will be limited to Papua New Guinea for some time. New Zealand, I understand, has a sort of vetting process in order to decide on the local share. This could be seen as an alternative to the purely tax gains. There is we have been told a 20% share in Bouganville Copper held by the Papua New Guinea government. We remember too Dr. Wionczek's point about problems of negotiating with the multi-national corporations. A skilled and knowledgeable team of administrators is necessary and Dr. Garnaut has given us some reassurances in this matter.

The other general aspect is to point up what may appear to be a difference between Papua New Guinea and some other economies that have been discussed. We have been reminded many times that the L.D.C's of the Pacific region have limited options for development.

Papua New Guinea has minerals in addition to traditional primary products. The development of these has started, and there are also prospects in energy products, oil and natural gas, and hydro-electric power, which we are told would back investment in processing industries. To many of the other Pacific region economies this range of prospects must appear attractive to say the least and puts Papua New Guinea in a special position. These are however potentialities and not actualities - the realities depend on an expanding and open regional and world economy with special emphasis on Japan and Australia.

I now turn to some specific points:

1. There is a reference to a Mineral Resources Stabilisation Fund. Could we have some details on this? This is not directly connected with foreign investment but clearly has an effect on that investment.
2. What has been the influence of foreign investment on the wage structure, on the availability of labour for the lesser paid jobs and on the growth of unionism? It is mentioned that inflation led to an upward shift in wage structure - but has foreign investment caused a division between a relatively small well-paid group which may also have other foreign benefits and the larger group of lower paid workers in primary and other industries?
3. Has it created other social problems - in e.g. housing, health?
4. Finally has it created or is it likely to create marked regional differences within Papua New Guinea which would in time lead to political problems about development and sharing of the gains?

One final comment. When asked to participate in this conference it was mentioned that a main purpose was "to explore various feasible alternatives in order to minimise the disadvantages of small countries, without them or the larger countries losing benefits of relatively full trade and investment flows." It seems to me that Dr. Garnaut's paper comes into this framework. Both large and small countries as he has shown can gain from trade and investment.

(b) General Discussion

Participants raised a number of questions on which they sought further information. These included the speed at which independence was achieved and whether this meant that Papua New Guinea was being forced to develop at a faster pace and in different directions than the inhabitants really wished. This could mean too great a reliance on foreign aid and investment and it was perhaps questionable that, given that local managerial talent was very short, foreign experts could negotiate in Papua New Guinea's best interests. The Bougainville Copper Agreement was cited in this connection.

Concern was also expressed at the possible effects on Papua New Guinea's development if the flow of aid and private investment were significantly reduced. Though Australia would retain a major role as an aid source in the immediate future, aid and investment from elsewhere would continue to be necessary. The need to develop other projects would also be important if the Bougainville separatist movement were to succeed.

Replying to comments, Dr. Garnaut said that the downward readjustment that now appeared to be inevitable could be the result of Australia's having pushed Papua New Guinea too far off the ground. Giv-

en the geographical fragmentation of the country impeding communication and integration, the very short time for which some tribes had been in contact with the Australian administration (as little as a decade in some cases) a high level of expensive infrastructure investment was necessary in order to achieve the degree of political integration necessary for independence.

He agreed that stages of development have been skipped. Some Papua New Guineans have not handled this as easily as others. But the Papua New Guineans themselves have had very little choice in the matter. Their rapid development had been forced upon them by outside pressures.

Responding to Professor Braae he said that the new government does not want investment at any cost. It fully recognises the potential costs and wanted to keep these to a minimum but given Papua New Guinea's development needs this would have to be a fairly high minimum. The government's deliberate policy is to be interested in foreign investment only when benefits to Papua New Guinea are substantial.

On the question of controls on the remittances of profits these are regarded as being self defeating in the long run.

Turning to the Mineral Resources Stabilization Fund, the fund's purpose is to even out the flow of revenue to the government from mining operations in the face of severe cyclical fluctuations. The fund's managers have the task of projecting long term trends in copper prices and managing revenues accordingly.

The suggestion of one speaker of investing the stabilization funds in equities in real estate suffers from the problem of liquidating those funds. When copper prices are low equities and real estate value are also likely to fall.

Replying to questions about how indigenous is the process of negotiation and administration, Dr. Garnaut said that Papua New Guinea's negotiating strength is still heavily dependent on foreigners although Papua New Guineans hold several key posts and are right on top of developments.

The Bougainville Copper Agreement had been renegotiated and the new terms are considered satisfactory. There was no evidence that multinationals are behind the Bougainville secessionists. Rio Tinto Zinc would be very prudent in this given the experience of the last ten years or so.

As regards future state involvement in development projects most projected state developments relate to agriculture, education and infrastructure. It is important not to direct too many scarce administration resources away from these areas into the management of mining projects. However, there is no ideological commitment either way. It is something to be decided case by case.

The point regarding internal transfer mechanism is important and Papua New Guinea is paying considerable attention to this. Diversifying capital services is also important but a borrowing strategy is surely dangerous at this stage of transition. It would involve an even greater commitment to continual expansion rather than taking one thing at a time. Dr. Garnaut concluded that in his opinion Papua New Guinea will succeed despite the problems that beset it. Among other things it has unusually good political leadership.

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COOPERATION IN NATURAL RESOURCES DEVELOPMENT: MARINE RESOURCES

LEWIS M. ALEXANDER AND FRANCIS T. CHRISTY, JR.

The process of developing the natural resources of the oceans is taking place against a background of continual change: change in the political map of the world as countries become independent; change in demands for marine resources and in abilities to explore for and exploit them; and change in the law of the sea, whereby the public order of the oceans is maintained. In few parts of the world are these changes more in evidence than here in the Asia/Pacific region where new states are emerging, new resource demands are surfacing, and there are new perspectives of the ocean and its wealth potential. During this period of transition from the era of the free seas to one of a managed sea there are strong opportunities for cooperation and joint development; but there are also increased possibilities of conflict as States vie with one another for their share of the benefits derived from the sea. Such conflicts need be not only between developing and developed countries, but also among developing States themselves, or between those which are developed. In this area of the world ocean, where continents and islands are in such relatively close proximity to one another, cooperation in ocean use is a vital need; and the new law of the sea should provide impetus for such interaction.

It is difficult to generalize on conditions of marine resources development, because of the disparities existing among and within ocean regions of the world. There are, for example, differences in coastal configurations and in the relation of islands to one another. Some island groups are clustered together as archipelagos, while others are widely strung out. There are differences in the extent of underseas platforms adjoining land masses. And there are certainly wide variations in the existence of marine resources off countries' coasts. Some areas constitute rich fishing grounds, while others are biological deserts. Some continental margins are known to have vast oil and gas resources; for others no indications of hydrocarbons, have yet been found. A new type of ocean resource are the manganese nodules of the deep seabed. Here again the pattern of distribution is uneven. Nodules with particularly high concentrations of nickel and copper have been found to exist in an east-west band of southeast and southcentral North Pacific, beyond the limits of the Asia/Pacific Region. But the effects of large-scale nodule production may in time be felt by land producers of the same minerals, such as New Caledonia in terms of nickel, Papua New Guinea with respect to nickel and copper, and Australia in terms of copper and manganese.

New advances in technology are making possible marine exploration and exploitation in increasingly hostile environments; they also make possible greater harvesting capacities of fish, and the ability to de-

stroy natural reefs, create artificial islands, drain off wetlands, and otherwise alter the marine environment, sometimes with disastrous effects.

In this paper, three issues will be stressed. First there will be a summary of ocean activities and the changing jurisdictional needs. This will be followed by a brief discussion of the on-going Law of the Sea Conference. With these two topics as background the text will then turn to the theme of cooperation and conflict in marine resources development, with special emphasis on the role of fisheries management. Through these discussions runs the theme that in the case of marine development there is considerable opportunity for less-developed States, particularly here in the Asia/Pacific Region, to find themselves in a fairly strong bargaining position vis-a-vis the developed countries, in part because of the LDCs' control over critical ocean areas and marine resources, and because of the growing need for these countries' cooperation in regional marine programmes, such as those involving fisheries and pollution control.

Ocean Activities and Jurisdictional Needs

General ocean activities might be divided into two broad categories: natural resources development, and non-resource uses of ocean space. The two categories are often interrelated; activities under each of the headings may take place within a State's coastal zone, or up to a considerable distance offshore.

1. Natural Resources Development

Among the resources of the sea, a distinction must be drawn between living and non-living. The former are renewable on a yearly basis, assuming they are exploited under proper management conditions; the latter are non-renewable, except over long periods of time.[1] Among the non-renewable resources, by far the most valuable are offshore oil and gas.

According to recent estimates[2] offshore exploration for hydrocarbons is in progress on the continental shelves and slopes of 80 countries, with commercial production reported from 26 of these. Discoveries of commercial hydrocarbon potentials have been made off 13 additional countries, although no commercial exploitation is in progress. Worldwide oil production from offshore accounts for about 18 per cent of total output, and this figure is expected to rise to 30-35 per cent of the total by 1980.[3]

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1) There are, of course, special cases of renewal, such as sediments which are continually being replenished at the mouths of rivers.

2) John Albers, "Offshore Petroleum: Its Geography and Technology," in Gamble, J.K., and Pontecorvo, G., eds., Law of the Sea: The Emerging Regime of the Oceans (Cambridge, Mass. : Ballinger Publishing Company, 1974). pp. 293-313. See also "Summary Petroleum and Selected Mineral Statistics for 120 Countries, Including Offshore Areas, "Geological Survey Professional Paper 817 (Washington, D.C.: United States Government Printing Office, 1973).

3) McKelvey, V.E. and Wang, F.F.H., "World Subsea Mineral Resources," U.S. Geological Survey Misc. Geol. Inv. (Washington, D.C.: U.S. Department of the Interior, 1970).

Offshore hydrocarbons have to date been exploited only on continental shelves, in depths of up to 450 feet, but technology will soon permit recovery beyond 600 feet, out on the continental slopes and ride. There are considerable areas of continental shelves along the East Asian littoral (particularly the Yellow, East China, and South China Seas), in Indonesia and the Philippines, and off Australia and New Zealand. Indonesia ranks second among the countries of the world in terms of total area of the continental shelf off its coasts, and Australia ranks third. From the standpoint of extent of total continental margin (shelf, slope, and rise) Australia ranks first among the world's coastal States, Indonesia second, and New Zealand sixth. There are extensive areas of margin surrounding and to the east of Papua New Guinea; marginal belts also adjoin the New Hebrides, New Caledonia, Fiji, and Tonga, but many of the smaller pacific islands and island groups have little or no continental margins off their coasts.

So far as bydrocarbon reserves are concerned the Far East is generally credited with 3.6 billion barrels of ultimate recoverable offshore oil reserves, or 2 per cent of the world's total recoverable reserves; and Oceania with 2.9 billion barrels, bringing the ultimate recoverable offshore reserves of the Asia/Pacific Region to use under 4 per cent of the world total.[4)] For natural gas the figures for the Region are 16.3 trillions of cubic feet, or 15 percent of the worldwide recoverable offshore reserves.[5)]

The total figures for hydrocarbons are perhaps less important than is the distribution. Which of the LDCs of Asia/Pacific Region would be in the position to profit from these offshore resources? Indonesia, certainly, in the Java Sea, Makassar Strait, and off West Irian. Malaysia, particularly off Sarawak and Sabah; Brunei, although not yet an independent State, as well as South Vietnam, off its southeasternmost coast; and there are good indications off Papua New Guinea. But at this stage of knowledge, not many others. There are few indications of hydrocarbons within and around the Philippines, off Fiji and Tonga, and in the vicinity of the smaller Pacific islands. Australia, on the other hand, has considerable hydrocarbon potential off its northwest coast, and there are some recoverable reserves off New Zealand. In the Yellow and East China Seas, large-scale production of hydrocarbons by the littoral States may before long be underway.

A potential resource problem of the future involves the possibility of maganese nodule resources existing in the economic zones of the myriad of islands and atolls spread out across the Asia/Pacific Region. One of the proposals receiving considerable support at the Third Law of the Sea Conferance is for the establishment off each country's coast of an economic zone out to a maximum distance of 200 nautical miles. Within the zone the coastal State would have rights to both living resources of the waters, and to the non-living resources of the seabed and subsoil, even beyond the limits of the continental margin, if this margin ends less than 200 miles from shore.

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4) Albers, op cit., p. 295. Percentages are based on a total which includes the Persian Gulf with 60 per cent of the worldwide ultimate recoverable offshore oil reserves.
5) Albers, op cit., p. 297

A map of the 200-mile limits in the Asia/Pacific Region shows that the establishment of such a zone would "enclose" virtually all of the ocean space of the area, except for a gap between Australia and New Zealand, another to the north of New Zealand, and a third to the east of the Philippines.

No strong support has yet appeared at the Law of the Sea Conference for distinguishing among islands, rocks, and atolls, in terms of their use as bases for describing a 200-mile economic zone. One mid-ocean rock could theoretically be entitled to an economic zone measuring 125,000 square nautical miles of ocean space; in fact, however, most economic zones of the world overlap one another so that the extent of area closed off by a single basepoint would be considerably less. But two issues are important here. One is that within the economic zones of small islands important manganese nodules resources may in time be discovered; these presumably would belong to the State which owns the island or islands in question. A second point is that the ownership of a number of islands and island groups of the Pacific are in dispute. Among these are the Northern Cook Islands and the Tokelaus, contested between the United States and New Zealand, and the southern Ellice, Pheonix, and Line Islands, claimed by both the United States and the United Kingdom.[6)]

Turing to the exploitation of living resources, we are faced with problems of great complexity. First, there are the dimensions of the resource itself, second the nature and extent of the commercial fisheries, and third, the opportunities for cooperation and for conflict among the exploiting States. These issues are for the most part covered later in this paper. At this point consideration will be given only to the general extent of fisheries resources of the region.

According to Gulland,[7)] the natural fisheries wealth of the Asian Pacific might be considered under the following headings: (1) the Northwest Pacific, with an estimated annual potential catch of about 7 million metric tons; (2) the Western Central Pacific (including the South China Sea, Indonesia, and the Philippines), with an estimateed annual potential of somewhere between 11 and 19 million metric tons; and (3) the Southwest Pacific with an estimated annual potential of less than 2 million metric tons, the majority of this off southern Australia and New Zealand. Gulland notes the low fisheries potentials for the waters off the smaller islands of the Pacific, and reports that of the considerable potential of the Western Central Pacific, probably less than 3.5 million tons are actually harvested each year. The estimates suggest that this region is one of the most productive of the world, but it has not yet attracted the traditional long-distance fleets. Gulland feels that local fishing could be increased tremendously in the Indonesian and Phillippine archipelagos, as well as in adjacent waters underlain by continental shelf. Despite the unutilized fisheries potential, particularly in the Western Central Pacific, there are many problems

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6) For a description of these disputes, and their possible effects on marine resource development, see F.M. Auburn, "Some Legal Problems of the Commercial Exploitation of Manganese Nodules in the Pacific, "Ocean Development and International Law Journal, Vol. 1 (Summer, 1973), pp. 185-201.

7) J.A. Gulland, ed., The Fish Resources of the Ocean, FAO Technical Paper No. 97 (Rome: Food and Agricultural Organization of the United Nations, 1970).

of possible conflict as certain stocks become overfished, as vessels from two or more countries share in a common fishery, and as congestion of ships and of gear occur in heavily-fished areas. Closing off the inter-island waters of archipelagos as national waters would have the effect of protecting fisheries resources there from foreign fleets; extending economic zone limits to the 200-mile maximum would further expand coastal State jurisdiction over species traditionally harvested by foreigners, particularly vessels from Japan, but also from Thailand, Republic of China, Republic of Korea, and other States which are beginning to develop distant-water capabilities.

2. Non Resource Uses of Ocean Space

The principal woldwide activity in this category, at least from the standpoint of economics, is shipping. Much of this involves shipping among the countries of a region, or through a region from one part of the world to another. But a considerable amount of movement of goods and people, particularly in the Asia/Pacific Region is between two parts of the same country. For an area so closely associated with waterways as this is two special issues are important; safety of navigation, and freedom of transit. The second issue is of particular import to law of the sea concerns.

Within the Asia/Pacific Region are some of the world's most important international straits, among them Malacca, Sunda, Lombod, Torres, Formosa, and Bashi Channel. Countries bordering on straits used for international navigation have traditionally been concerned first about the unrestricted use of such waterways by potential polluters; and second, by foreign military vessels. In the first case, oil tankers, nuclear vessels, and others may fail to adhere to certain safety standards, and carry inadequate liability to compensate the coastal State in the event of a major environmental disaster. In the second instance the State may be reluctant to permit the free passage of submerged nuclear submarines through its coastal waters, or the unrestricted overflight of foreign military aircraft. These issues are complicated in the case of archipelagos where traditional sealanes pass through the inter-island waters.

Countries contemplating a 200-mile economic zone frequently refer to the "free" transit of foreign vessels through the zone beyond narrow territorial limits, but such transit, as in the case of straits, may in time become subject to restrictions in the interests of pollution control and/or of national security. Clearly, in the Asia/Pacific Region, possible infringements of navigation may prove to be an extremely controversial issue in coming years.

Another non-resource use of ocean space is scientific research. Fundamental research has traditionally been looked upon by the major maritime powers as one of the freedoms of the high seas, althouth research involving a foreign State's continental shelf requires prior consent from that State before being carried out. But the impending 200-mile economic zone may threaten freedom of research. Coastal States may look upon their economic zone as a part of the national territory, within which they should have jurisdiction over oceanographic research activities, both with respect to the ocean floor, and to the water column itself.

One emerging trend may be the establishment of regional science centres throughout the world. Countries with oceanographic capabili-

ties might join and help support such centres in return for permission to carry out research in the other member States's waters.

Still another ocean use involves control over pollution. Within the coming economic zone ought a coastal State have the right to establish its own standards, particularly with respect to vessel-source pollution, or should it abide by internationally-set rules and regulations, such as those laid down by the Intergovernmental Maritime Consultative Organization(IMCO)? If the coastal State is a developing one, should it have the right to adopt double standards - one set for its own vessels and those of its developing neighbours and another set for ships of developed countries? Finally, who should bear the responsibility for enforcing pollution control standards, the coastal State through whose waters a vessel is passing, or the State whose flag the vessel is flying?

Here again is a chance for regional cooperation. Littoral States about semi-enclosed seas have the opportunity of setting common environmental standards (as occurred recently in the Baltic) and of cooperating in pollution abatement programmes for the area.

There are other types of current or impending ocean use which might be discussed here. Among these are military use, recreation, use of the sea for fresh water, or as a coolant, and the utilization of ocean space for storage or as a site for power plants. And in coastal areas, oil refineries or nuclear power complexes may be constructed. But space limitations preclude discussion of these uses, and of impending ones, such as the generation of energy from tides, currents, or geothermal gradients. What is important here is that increases in the extent and nature of ocean uses bring with it increases in potential conflict, and in the need for cooperative management efforts by the countries of a region. But the institutional mechanisms for achieving such cooperative efforts are often virtually non-existent, and it becomes difficult to identify the short-term incentives which would bring such management efforts into being.

Developments in the Law of the Sea

Many of the standards now generally accepted as part of the international law of the sea were laid down at the First Law of the Sea Conference, which was held in Geneva in the spring of 1958. These standards pretty much reflect the views of the developed maritime States. In the years since the First Conference about 60 former dependent territories have become independent. Many of these have joined with developing countries having longer histories of self-rule to form the so-called "Group of 77" (which now numbers over one hundred members) to press for changes in the ocean regime which would appear to make it more favourable to the States of the Developing World.

There was a Second Law of the Sea Conference in 1960 which tried unsucessfully to reach agreement on one single issue - a uniform breadth of the territorial sea. Seven years later the United Nations General Assembly took the initial step toward the convening of a Third Law of the Sea Conference, and after a number of years of preparation, the third Conference held its first substantive session in Caracas during the summer of 1974. Instead of the 86 delegations which were present at the First Conference, 138 attended the Caracas meeting. Nothing conclusive emerged from Caracas, and during the

past spring, a second substantive session was convened in Geneva. Although a great many issues remained unresolved after the eight weeks of negotiation, there did emerge from the Geneva sission an Informal Single Negotiating Text prepared by the Chairmen of the three Committees of the session, with the help of their staffs. While the Text does not purport to represent in any way an agreed position on law of the sea issues, it does have the advantage of spelling out the major themes of the Conference, and of constituting a basis for further negotiations. These negotiations will probably take place beginning in March, 1976 in New York City.

It should be stressed that the Third Conference is but a part of a long-term transition process from the relatively "free seas" regime of the past, to one of national and international management of the oceans and their resources. The impetus for UN action in 1967 was provided by an address to the General Assembly by Ambassador Aivid Pardo of Malta in which he suggested that the mineral resources of the deep seabed beyond the limits of national jurisdiction should be the common heritage of mankind, and that a portion of the revenue derived from their exploitation should go to an international fund to be distributed among the less developed States of the world. Ambassador Pardo's concept has since become widely accepted, and has been one of the driving forces behind the willingness of many countries to contribute the expenses and time necessary for the long preparations and for the formal sessions of the Third Conference.

There are several approaches to a discussion of the Law of the Sea Conference. One involves the Committee structure. Much of the real work of the Conference has been done through its Committees. The First Committee is concerned with the regime of the deep seabed beyond the limits of national jurisdiction. In some respects this is the most controversial of the three groups, because of the wide divergence of views between developed and developing States on the proper nature of the impending International Seabed Authority.

The Third Committee handles questions of protection and preservation of the marine environment, scientific research, and technology transfer. The Second Committee is something of a potpourri, since it deals with many aspects of offshore jurisdiction. Among its responsibilities are offshore zones and boundaries, the continental shelf, the high seas, straits used for international navigation, the regime of islands, land-locked States, archipelagos, and semi-enclosed seas. Its concern with offshore zones and boundaries involves it also in the whole question of fisheries.

A second method of considering the Conference might be in terms of the groupings of States on the basis of common interests. One, already noted, is the "Group of 77" composed of developing countries at the Conference. The solidarity of the Group was enhanced by an agreement among its members that decisions should be based on the consensus rule. But on many issues consensus was impossible because of the wide diversity of conditions and interests among the developing States. For example, the more than twenty land-locked States felt their special needs were not being sufficiently recognized at the Conference; on several issues they were joined by a number of shelf-locked and other "geographically-disadvantaged" countries.

Other interest groups banded together for specific purposes. The archipelagic States sought recognition of their unique geographic

characteristics; the straits States were concerned with the conditions of passage of foreign vessels close to their coasts. The scientific research group sought to maximum freedom of research beyond territorial limits, while some States bordering on semi-enclosed seas were anxious to have special regimes authorized for such water bodies. There were the usual regional groups, such as the Latin American, African, and East European States, and one informal working party, the so-called "Evensen Group" which met continually during the conference in order to prepare a draft text on the economic zone.

Still another way of viewing the Third Law of the Sea Conference is in terms of the Single Negotiating Text which emerged from the Geneva session. In his charge to the Chairmen of the three Committees the President of the Geneva session stressed that the text should take account of all formal and informal discussions held so far, that it would be imformal in character and would not prejudice the position of any delegation, and that it would not represent any negotiated text or accepted compromise. Rather, it should be seen as a procedural device which could provide a basis for further negotiation.

The three parts, representing the work of each of the three Committees are somewhat uneven in nature. The Chairman of the First Committee would not accept the draft text prepared by his staff, and instead wrote himself the 75 Articles which comprise Part I. Delegates, particularly from developed conutries contend that Part I is more a statement of the developing countries' position on the highly-controversial seabed regime question than it is an attempt to reflect "all the formal and informal discussions held so far" at the Confererence. On the other hand Parts II and III of the Single Text seem much more balanced in their treatment of the issues to be included in a new ocean regime. Accompanying the Single Negotiating Text is a Text on Settlement of Disputes, prepared by an informal Working Group at Geneve. In this case only the first four Articles represent a consensus of the Working Group; the remaining Articles appear as Annexes.

It should be re-emphasized that the Caracas and Geneva sessions are but a part of a long-term process of working out a new law of the sea. Negotiations at next spring's session, and perhaps at still later sessions, may fail to produce a comprehensive ocean treaty acceptable to all or most of the States of the world. There may be no global treaty whatever emerging from the Third Conference. But there has been considerable progress toward a general acceptance of rules for quite a number of issues; and the alternatives possible for other, more controversial topics, have been greatly narrowed. Probably the greatest stumbling bloc at this time involves conflicting concepts as to the structure and functions of the future international seabed authority, a topic which will be considered again further in this paper.

In summary, activities in the law of the sea would appear to be working in favor of developing States in at least three respects. First as new independent countries continue to emerge, the Third World is coming to control ever larger areas of ocean space and greater resource potentials. Second, the LDCs as a group have increased voting strength at international conferences. Third, through regional arrangements developing States can pool their resources in joint efforts for the development and management of ocean resources.

Problems of Conflict and Cooperation

Using the Third Law of the Sea Conference as a background, we turn now to some of the issues dividing and uniting States, with special reference to the Asia/Pacific Region. Some of these issues have already been alluded to earlier. Four categories will be considered here: (1) Offshore Zones and Boundaries; (2) Transit and Pollution Control; (3) the Regime of the Deep Seabed; and (4) Fisheries.

1. Offshore Zones and Boundaries

The three principal offshore zones of control recognized by the Conventions adopted at the 1958 Geneva Conference are (1) the zone of internal waters, (2) the territorial sea, and (3) the continental shelf. Over its internal waters, which lie landward of the baseline from which the breadth of its territorial sea is measured, a State exercises complete sovereignty. The coastal State also exercises sovereignty over its territorial sea, subject to the right of innocent passage of foreign vessels through the territorial waters. The breadth of the territorial sea claimed by coastal States generally varies between three and twelve nautical miles.

The continental shelf is defined in the Geneva Conventions as the submerged area adjacent to the coast extending seaward to a depth of 200 meters (656 feet), or beyond to a depth where exploitation of the resources of the shelf is possible. Up to now no country has claimed jurisdiction over its shelf beyond the 200-meter isobath on the grounds of the exploitation criterion. Over its adjacent continental shelf the coastal State has the exclusive right to explore and exploit the mineral resources, as well as certain living organisms which at the harvestable stage are in constant physical contact with the shelf.

Two changes are evolving with respect to offshore zones. One is a move to extend coastal State control over shelf resources, even without proof of ability to exploit, out beyond the 200-meter isobath, to include the continental slope and at least a portion of the rise, to some point which will be fixed as "the outer edge of the continental margin". This situation arises, of course, only if the "outer edge" is more than 200 miles from the coast. Within the 200-mile economic zone all resources of the seabed, at whatever the depth, would belong to the coastal State.

A second trend involves archipelagos. The move to close off their inter-island waters raises a host of questions. By what criteria should "legal" archipelagos be defined? Some island groups are too small in land area and too widely scattered over the ocean to be closed off by a system of straight baselines. And once an archipelago is defined, what should the status be of the waters within the closing lines? Are they internal in nature, should innocent passage of foreign vessels be guaranteed through these waters, and should "archipelagic sealanes" be established following traditional navigation routes through archipelagos? In such sealanes, free transit by all foreign vessels might be guaranteed, much as in the case sought for in international straits.

These archipelago issues are particularly germaine to the Asia/Pacific Region where, in addition to Indonesia and the Philippines, there are a number of other island groups such as Fiji, Tonga, and Papua New Ginea which might also seek archipelagic status. And new island groups may before long achieve independence and then declare

themselves "legal" archipelagos. In no other area of the world does the possibility exist of closing off so much ocean space with archipelagic lines as here in the Western Pacific.

A major source both of conflict and of possible cooperative action are the maritime boundaries between adjacent or opposite States. In the past there have been boundaries on the seabed, partitioning jointly-held continental shelves, and boundaries separating adjacent or opposite territorial seas and internal waters from one another. In the future there will also be problems of placing limits between adjacent or opposite economic zones.

The general procedure for delimiting offshore boundaries is first that their location should if possible be settled by agreement between the States concerned. There also may be "special circumstance situations" which should be taken into account in the boundary determination, although the exact nature of these circumstances, and the effects to be given to them, has never been spelled out. Finally, an alternative system of delimitation is the use of the median line every point of which is equidistant from the baselines of the respective countries from which the breadth of their territorial seas is measured.

Dispite the complex mozaic of mainlands and islands in the Asia/Pacific Region, only seven offshore boundaries have been delimited and accepted by the States concerned. Indonesia has defined its offshore boundaries with Malaysia, Singapore, Australia, Thailand, and India. Thailand has agreed on its maritime boundary with Malaysia, and Japan with the Republic of Korea. While in coming years commercial fisheries may come to represent a source of potential conflict between States in the absence of defined common maritime boundaries between them, the principal importance of such boundaries today involves offshore oil.

In the Yellow and East China Seas, for example, scientific investigations have resulted in indications of considerable hydrocarbon potential, and some years ago exploratory leases were issued to oil companies by Taiwan, the Republic of Korea, and Japan. Several of these leases overlapped one another; in one sector each of the three countries had leased out the same area of seabed. The situation was further complicated by the failure of the People's Republic of China to release maps indicating where it considered its seabed boundaries with South Korea and Japan to be, by the dispute between the People's Republic and the island of Taiwan as to the latter's political status; and by the announcement by the People's Republic of its claim to ownership of the Senkaku Islands, northeast of Taiwan. These islands, which were at that time claimed both by the Republic of China and by Japan are important as basepoints for calculating median line boundaries in the East China Sea. Controversy also exists with respect to the Gulf of Thailand where islands are in dispute, and where the littoral States (Malaysia, Thailand, Cambodia, and South Vietnam) are issuing exploratory leases; and in the South China Sea where similar conditions exist, as evidenced by recent activity in the Spratly and Paracel Islands. Disputes such as these are divisive enough now; how much more so will they become when and if substantial resources are proven to exist in boundary zones?

It is not difficult to describe conflict situations with respect

to boundary issues. It is more difficult to suggest means of conflict resolution. One procedure, at least in the short-term, might be to delay any permanent delimitation, and rather for neighboring States to proceed jointly with hydrocarbon exploitation in the general zone through which their common boundary would pass. Revenues from the exploitation might be held in escrow until a final boundary determination is made, or applied to other joint developemnt projects.

So far as a final settlement of an offshore boundary issue is concerned the Single Negotiating Text which emerged from Geneva last spring has a blanket provision calling for dispute settlement of all contested law of the sea issues. But we suggest this may not be enough; that regions such as the Asia/Pacific may not wish to run the full gamut of a global dispute settlement mechanism for each unsettled boundary. Rather, what might be wanted is some sort of a multi-stage regional operation. First you would need a fact-finding body, including geologists, resource economists, boundary experts, and fishing authorities. And considering the number of potential problems, the fact-finding group might almost be considered as a permanent body. Second, you would need an arbitral body to try to work out agreements between the interested parties, based on the facts as presented. Finally, you might need some sort of juridical body in case arbitration failed. In this case the dispute might go to some form of Special Regional Tribunal, to the Law of the Sea Tribunal as outlined in the Text on Settlement of Disputes, or to the International Court of Justice.

2. Transit and Pollution Control

Both of three issues have already been noted. What is important to emphasize here is first that so much of the waters of the Asia/Pacific Region lie close to the coasts of developing countries, and second that some of the transit through these coastal waters is by vessels of developed States, either located within the region (i.e. Japan, Australia, New Zealand), or outside the region. Unimpeded transit through, over, and beneath the waters of straits used for international navigation, and through archipelagic sealanes, may seem to some affected States as an unfair abridgement of their sovereign rights. Yet the unwarranted imposition of restrictions on the freedom of vessel movement might wreak havoc on the economic and security interests of developed maritime countries.

There is no simple answer to this dilemma. With respect to the passage of foreign military vessels and aircraft the coastal State could be guaranteed that they would respect navigational and other safery standards, and would in no way interfere with the internal affairs of the State. Tankers and other potential polluters could be required to adhere to traffic separation schemes in congested areas, to abide by uniform pollution control standards, and to be adequately insured against damage to the coastal State resulting from accidents. In fact, a worldwide insurance pool, amounting to perhaps several billions of dollars, might be established to take care of emergencies. And the coastal State should be assured of speedy settlement of claims, involving perhaps a tightening up of the rules for flag-of-convenience operations. Certainly if the world maritime community wants continued freedom of transit there are certain steps it should take to ensure more rational procedures for operation.

We leave this issue with a question. Might not the presence of an important international waterway close to its coast (and more par-

ticularly within its twelve-mile territorial sea) be considered by the coastal State as one of its natural resources, along with fish, oil, or scenic coastlines? If so, should the State have the right to capitalize on this resource by charging rents for the use of the waterway? Over a century ago this issue of tolls for passage through narrow waterways was presumably settled in favor of the maritime States. But in the new ocean regime it might in time be reopened as a factor in helping to balance developing coastal State with developed maritime State needs and intersts. The use of tolls may even tend to work over the long run to the advantage of the maritime States. In heavily congested areas a graduated toll system might guarantee priority passage to vessels with particular time constraints, such as those carrying perishable goods.

3. The Deep Seabed Regime

It has been estimated that of the more than two-thirds of the earth's surface which is water, about 40 per cent could be closed off within the limits of national jurisdiction should a 200-mile economic zone be universally adopted, and if broad margin States extended their resource jurisdictions beyond 200 miles to the outer limits of the continental margin. This leaves some 63 million square nautical miles, or about 42 per cent of the total earth's surface, beyond the limits of national jurisdiction, and thus, perhaps, subject to some sort of international regime. The principal commercial resource of the deep seabed, known at present, are the manganese nodules. These nodules, containing small percentages of manganese, nickel, copper, and cobalt, have not as yet been recovered commercially in any quantity, but their exploitation by some of the developed countries appears a virtual certainty within the next few years.

The debate on the nodule exploitation has become laced with ideology. In the New Economic Order who should have the right to exploit these "common heritage" resources, who should set the conditions of exploitation, who should receive the wealth derived from their production and sale?

In broad terms there are two models. The developed countries' model would be essentially an international licensing Agency which would issue permits on some sort of competitive basis to individual companies or to State agencies to exploit the nodules under certain minimal operating conditions. A portion of the revenue derived from this exploitaion would be turned over to an international fund to be distributed among the LDCs. The Agency or Authority would have jurisdiction only over the nodule exploitation on the seabed. Scientific research, military operations, and other activities associated with the deep seabed would not be within its purview.

The counter-model would be one of an enterprise Agency which alone would have access to the seabed resources. It would set the rules for exploitation, and would have the right to contract out mining operations as it saw fit. There could be production and price controls to protect the interests of developing States which are land-based producers of manganese, nickel, copper, and cobalt. The Authority would also have jurisdiction over non-resource activities on the seabed, and within the Authority, the supreme policy-making body would be the Assembly, in which each member-State would have one vote.

It is not the intention here to go into all the ramifications of the seabed machinery issue. A number of the developed States are

ready to start manganese nodule exploitation with or without an ocean treaty. But for them to do so might cause considerable alarm among developing States, and perhaps wreck any chances of a new ocean treaty being concluded within the forseeable future. It is within this area of deep seabed resources that some developing States perceive their opportunity - in part because of the sheer weight of their votes at the conference - of obtaining a strong bargaining position vis-a-vis the developed States, and perhaps of winning concessions from the developed countries on both seabed and non-seabed issues.

4. Fighery Issues

With regard to fishery resources, the problems of cooperation and conflict will be particularly difficult to resolve and are likely to persist for many years to come. This is due to certain characteristics of the resources and the industry that distinguish them from most other resources and uses of the sea.

(1) Characteristics of Fisheries

A fundamental characteristic of marine fishery resources is that, with a few exceptions, they are wild stocks not readily susceptible to cultivation. There is a limit to the yield that any particular wild stock can sustain over time - a limit known as the "maximim sustainable yield" (MSY). While it may be possible to produce catches that are greater than that limit in any one year, such catches cannot be sustained and will lead to lower catches in subsequent years. When this happens and the catches become lower than MSY, the stock is said to be depleted.

There are a few species of marine fish that can be cultivated and whose yields can be increased beyond the natural maximum. These, however, are very few in number and generally limited to species whose environment can be easily controlled and which command high prices in a luxury market (i.e., oysters, salmon). In the future, techniques will be developed that will make cultivation of more species possible, but the total amount will probably always be a negligible proportion of the total world catch of marine organisms.

Another important characteristic of fish stocks is their fugitiveness. Although this varies widely, ranging from sedentary oysters to species such as salmon and tuna that swim thousands of miles, there are numerous stocks of fish that are spatially extensive. Since any particulat stock must be managed as a single unit, wherever it occurs, cooperation among States is essential where a stock extends to the waters of two or more countries. The problems of cooperation may also be complicated by inter-relationships among stocks of different species. In some cases, the biological niche of one species may overlap with that of another and there may be competition between the two. In other cases, there may be a predator/prey relationship between the species. In these situations it may be necessary to manage both stocks as a single unit, even though they jointly cover a vast area.

A third important characteristic is that different species may occupy the same space and threfore, be caught by the same fishing gear. This has already become a major problem for cooperation in the northern temperate regions as vessels fishing primarily for cod

(pollock) incidentally take large amounts of haddock (or halibut). Since different countries fishing in the same waters place different values on the different species, the problems of determining how much of which species to harvest are not readily reasonable. These problems become even more complicated and difficult in tropic waters, where there tend to be large numbers of species but small populations of each one. In the South China Sea, "It is, for example, not uncommon to take as many as 200 species in a single trawl haul, a factor which has major implications for fishery development and management."[8)]

Another important characteristic is that of the difficulty of gaining knowledge about the resources. The sea is a three dimensional, opaque, and fluid medium that is difficult to penetrate and highly complex in nature. There are no inexpensive and accurate techniques for determining and evaluating all of the factors that affect the population and yields of individual stocks. This has two different kinds of effects. First, and most obvious, the difficulty of obtaining information creates severe problems for management. While there is frequently evidence that a stock has been depleted, there is generally little basis for determining what the level of catch should be in order to overcome the problems of depletion and restore the stock to a maximum sustainable yield. Indeed, it is often very difficult to determine the MSY itself, particularly for those species, such as certain kinds of herring and anchoveta, that are subject to extremely wide fluctuations in population and yield.

The other effect of the high costs of fisheries research is that information is much more fully available for stocks of the northern temperate zones than it is for those of the tropic regions. By and large, most fishery scientists have been trained in northern, developed countries. And most research has focused on the selective fisheries that are typical of temperate waters where there are few species but large populations of each one. This means that, not only is there less research devoted to the tropical waters of developing States, but also that the training received in northern developed countries is not fully applicable to the problems of tropical waters. For example, the concept of maximum sustainable yield, which has been the basis for fisheries management in northern waters for decades, is relatively easy to apply where there are highly selective fisheries for stocks that have large populations.[9)] But in tropical waters where large numbers of defferent species are caught in the same nets, the concept is not readily applicable. For example, to maximize the sustainable yield of shrimp would require a relatively small mesh in the trawl nets. This would catch large numbers of other species, most of which would be "trash" fish

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8) John C. Marr, Fishery and Resource Management in Southeast Asia, RFF/PISFA Paper 7 (Resources for the Future, Washington) (In press)

9) Whether the concept of MSY should be applied is another question. It is solely a physical goal and, by itself, has no relevance to societal needs. Nevertheless, the concept is a fundamental part of the training of most fishery scientists as well as a fundamental part of conventional fisheries management. And it does have some value when applied in conjuction with social and economic criteria.

of low unit value or no value at all. But some of the species taken in the shrimp-size mesh might be of equal or greater value than shrimp if they were marketed at a larger size. In other words, to maximize the sustainable yield of shrimp could mean lower than maximum sustainable yields of other more highly valued species.

In these kinds of situations, training that has been focused on the population dynamics of individual species and on the determination of the maximum sustainable yields of individual species, is not particularly valuable. The problems of management, which are inordinately complicated, will require different kinds of approaches than those suitable for the selective fisheries of temperate zones.

In addition to the natural characteristics discussed above, there are critically important institutional and legal characteristics that have traditionally governed the use of marine fisheries. These are the principle of the freedom of the seas and the general treatment of fisheries as common property natural resources. It is these characteristics that provide the fundamental cause for the biological and economic waste that pervades the world's fisheries.

The principle of the freedom of the seas was advanced on the assumption that the costs of acquiring and maintaining exclusive rights over the sea's resources (beyond a short distance from land) were greater than the benefits that could be obtained from the exclusive rights. At the time that Hugo Grotius advanced the principle of the freedom of the seas (Mare Liberum was published in 1608) there was some degree of truth to the two parts of this assumption. Certainly it was true that exclusive rights over vast areas of the sea could not be fully enforced. And it was at least partially true that fishery resources were sufficiently abundant that fishermen, if excluded from one region, could turn to others at only moderate increases in costs. But while the former aspect is still significant - that is, costs of enforcement are still high - the latter aspect no longer exsists. Demand has increased rapidly, but supplies are relatively fixed, so that value of exclusive rights to resources in situ has become very high. This is, in large part, the reason why attempts to acquire exclusive rights through the unilateral extension of jurisdiction have become so prevalent throughout the world and why the principle of the freedom of the seas is being dismantled.

And indeed, from an economic point of view, the principle should be dismantled; for as long as the principle is maintained it means that access to fishery resources is free and open and that the resources are treated as common property. Under this treatment, both biological and economic waste is inevitable as demand increases.

Where resources are common to a group of users, no individual user can afford to take an interest in future returns. If a fishery stock is depleted and requires some restraint on present catches in order to achieve higher future yields, the common property condition means that no individual fisherman by himself, has an incentive to exercise such restraint. Anything that he leaves in the sea for tommorrow will be taken by others today. And since all fishermen operate under the same system of incentives, depletion is inevitable unless all fishermen agree to accept some form of control.

The record of depleted fishery stocks is long and has been growing rapidly in the past few years. Virtually all of the fish stocks that are of historical importance in the North Atlantic and North Pacific have been depleted. Of the six major species of tuna, all but one are being fished at or beyond the point of maximum sustainable yield, in all oceans of the world. Furthermore, modern fleets of highly specialized vessels are so effective that a stock can be depleted within two or three seasons.

In addition to the biological waste through depletion, the common property condition also results in significant economic waste. Under common property treatment, access to a resource is free and open and there are no controls on the amount of capital and labour that can be used. Inevitably in this situation, capital and labour will flow into the industry until total costs and revenues are equal rather than marginal costs and revenues. For a common property resource there is no owner or agent that can prevent the application of redundant units of capital and labour.

In fisheries, the economic waste is very large, as has been indicated by several studies. For example, it was estimated several years ago, that the same amount of Northeastern Pacific salmon (and some total revenues) could have been taken with $50 million less capital and labour per year than was then being used.[10] A recent study has estimated that large reductions in the number of vessels in the U.S. yellowtail flounder fishery could lead to significant increased profits, amounting to as much as $6.9 million per year.[11]

It is most likely that every international fishery, with even a short history of use, is marked by redundant capital and labour and by economic waste. Although there are no estimates of the total amount of economic rents dissipated in all world fisheries, it would not be unreasonable to guess that they might amount to more than $1 billion per year.

These kinds of wastes can only be prevented by removing the condition of free and open access. Capital and labour inputs have to be controlled, either directly by limiting the number of vessels or amount of gear, or indirectly by extracting economic rents through taxes or user fees. However, the exercise of such controls requires a high degree of authority, as well as the removal of the principle of the freedom of the seas. Since authority can best be exercised when it is least diffused, there is some merit to the unilateral extensions of jurisdiction by coastal States - at least in the sense of improving the basis for economic efficiency.

(2) Distribution of Fisheries Wealth

But extensions of jurisdiction directly affect the distribution of wealth, providing thereby a source of conflict, and they are only partly satisfactory in providing the necessary authority. The distribution of wealth is affected in two ways. First, those countries whose fishermen have traditionally fished off the coasts of foreign

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10) James A. Crutchfield and Giulio Pontecorvo, The Pacific Salmon Fisheries (Baltimore: Johns Hopkins Press, 1969).
11) John M. Gates and Virgil J. Norton, "The Benefits of Fisheries Regulation: A Case Study of the New England Yellowtail Founder Fishery." University of Rhode Island Report No. 21.

States will lose the free and open access they have enjoyed in the past. They may either be excluded from the waters or required to pay for the privilege of fishing. The second effect is that of uneven distribution due to accidents of geography. Not all States will gain proportinately from the extensions of jurisdiction. Landlocked States, such as Laos, and shelf-locked States, such as Singapore, will acquire no increased wealth. At the other extreme, an extension of jurisdiction to 200 nautical miles, will provide the Philippines, Indonesia, and several other States, authority over vast areas of the sea. These kinds of distribution effects mean that the extension of jurisdiction over fisheries will provide a potential source of conflict. Attempts to reduce this conflict can be found in some of the provisions suggested for a treaty on the law of the sea - provisions discussed more fully below.

But a potential source of conflict can also be found in the fact that extensions of jurisdication only partly provide the basis for an effective exercise of authority. There are numerous situations where stocks will continue to be shared by two or more coastal States no matter how far out jurisdiction is extended. In these situations, the sharing States will have to reach agreements among themselves as to how to distribute the benefits and how to manage the fisheries.

Five kinds of situations can be depicted. (1) Those in which a stock is found entirely outside of national jurisdiction. (2) Where a stock lies both outside of national jurisdiction and within the jurisdiction of two or more States. (3) Where a stock uses the fresh waters of a coastal State but can also be found beyond that State's jurisdiction. (4) Stocks that are found within the waters of two or more coastal States but not on the high seas. And (5) Stocks found only within the jurisdiction of a single State.

Obviously the classification is determined both by the migratory patterns of the stock and the extent of the coastal States' borders, along the coast as well as away from the coast. For example, most stocks off the south coast of Australia would fall within the exclusive authority of that State if it extended its jurisdiction to 200 nautical miles. Conversely, many stocks in the South China Sea would still be subject to exploitation by several States even with extensions of jurisdiction.

These different kinds of situations are associated with different kinds of problems - three of which are particularly critical for the Asia Pacific Region. The first is that of developing arrangements for the species (tuna, in particular) that swim both inside and outside of areas 200 miles from shore. The second - at the opposite extreme - is that of determining what, if any, rights or privileges a coastal State should provide to other States. And the third, and perhaps most difficult and persistent problem, is that of facilitating effective cooperation among States sharing the same or closely interrelated stocks.

(3) Tuna Issues

Unless there is a dramatic improvement in cooperation among States it is likely that many tuna stocks throughout the world will become severely depleted in the next decade. As stated above, only one

of the six major species of tuna - skipjack - still provides opportunities for increased catches.[12] And yet there continues to be a very rapid increase in the construction of large, modern tuna fishing vessels capable of fishing anywhere in the world. The aggregate expectations of the tuna-fishing (and potential tuna-fishing) countries are probably greater than the total sustainable yields that can be expected. The rapid increase in fishing effort, the global mobility of tuna vessels, and the wide ranging movements of the tuna stocks make it diffucult to arrive at acceptable and effective international arrangements.

The two major interest groups are the countries that have extensive distant-water tuna-fishing operations, such as the United States, Spain, France, Republic of Korea, Japan, and Taiwan, and the countries off whose shores the tuna stocks are fished, such as Ecuador, Peru, Brazil, and the Ivory Coast. The issue between the two groups is one of wealth distribution and the techniques for achieving controls. Essentially, the former group is interested in dividing up tuna resources on the basis of historic rights, while the latter chooses proximity to the resource as the major criterion.

With regard to the former interests, the most likely technique would be that of a system of national quotas - a division of the total allowable catch on the basis of past (or present) records of catch. The obvious difficulty is that of determining the basis for the division. In the case of tuna, this difficulty is particularly intransigent because of the rapid increases in investment in fishing vessels and the concomitant expectations that most States have for increased levels of catch. As noted above, these expectations may well add up to more than the total sustainable yields available to present fishing techniques. Thus, in order to reach agreement, either the expectations have to be sacrificed or the States would have to choose a total allowable catch beyond that which could be sustained. This latter course of action was followed by the States using Antarctic whales, with the resultant severe declines in annual yields. There is some indication that this shortsighted course of action may also be adopted for tuna. In the regulatory area of the Inter-American Tropical Tuna Commission, scientists recommended a total quota for yellowfin tuna for 1975 of 130,000 metric tons. The fishing States, however, insisted upon a total quota of 185,000 tons. While it is not clear that this is an excessive amount, the pattern of rejecting scientific recommendations is reminiscent of the difficulties experienced by the International Whaling Commission.

Even if the tuna-fishing States were able to reach agreements among themselves on national quotas, such agreements would not be acceptable to the coastal States. These States tend to prefer a system that permits them to extract benefits in the form of license fees, taxes, or other items of value. Such an approach can significantly improve economic efficiency by extracting economic rents and forcing out the less efficient and redundant fishermen. However, the problem of determining the appropriate fee schedule would not be easy. In the first place, the fees should cover entire stocks

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12) Saul Saila & Virgil Borton, Tuna; Status, Trends, and Alternative Management Arrangements, RFF/PISFA Paper 6 (Washington: Resources for the Future, Inc., 1974).

wherever they are caught - both within and outside of a 200-mile zone. And second, the fees should be determined on a unified basis reflecting the value of the fishery area.

Unless there is a unified authority over the stock throughout its range, the situation is unstable. If the fees are not appropriate to the value of the waters of the different States, fishing effort will flow to the area where the greatest profit can be obtained. Other States will then have an incentive to lower their fees in order to attract more fishing in their waters. Such competition could well be mutually destructive to the interests of all parties since it could lead eventually to excessive levels of catch and excessive investments in effort. In short, there are no forces in shared fisheries that will correct imbalances or control instability until the stock has been fished to the point of profitlessness. The challenge is to prevent the imbalances from occuring, and this can only be done in the tuna fisheries if there is a high degree of cooperation among the coastal States and the fishing States in setting up a unified authority with a carefully developed system of fees and quotas.

(4) Coastal State Controls

One of the chief areas of contention at the UN Conference on the Law of the Sea is that of defining the rights that can be exercised by coastal States within a 200-mile "economic zone". Some delegations propose that coastal States should have complete discretion to dispose of the resources within their zones as they see fit. Others argue, however, that the rights of the coastal States should be constrained by certain general principles and rules that would provide for foreign access to the resources. Those arguing the latter view include States with distant-water fisheries and States that are land-locked or with only small toe-holds on the oceans. The distant-water States want to protect their investments in the large vessels and fleets that fish off foreign shores hundreds or thousands of miles from their home ports. The land-locked and shelf-locked States see that a large amount of ocean wealth is being distributed and want to share in the distribution.

The chief proposal advanced to meet these interests is that a coastal State's right to fish should be restricted to the amount that it can catch. It is proposed that each coastal State be able to catch only that portion of the yield of a stock that it has the capacity to catch, and that the balance of the yield be made available to foreign fishermen. It is assumed that this requirement would permit "full utilization" of the sea's fisheries wealth.

Several questions can be raised about such proposals. First, although the proposal is advanced by distant-water and land-locked States, it is not at all clear that they would stand to gain more from a "full utilization" approach than from one in which coastal States operate without constraints. Most of the "full utilization" proposals permit coastal States to charge fees to the foreigners who gain access to their surplus yields. If the fees accurately reflect the values of the stocks, then the coastal States would be appropriating the full wealth of the stocks, just as they would be were no such constrains in effect.

A second question can be raised with regard to the costs associated with the implementation of a "full utilization" scheme. Such a scheme calls for a large amount of information. It requires estimates not only of the yields of all stocks of interest to foreigners but also of the coastal State's capacity to harvest the various stocks. Most proposals would also lead to fairly high negotiating costs, because of the provisions intended to protect the interests of distant-water States and neighboring land-locked and shelf-locked States. There are suggestions for allocating the rights of access to the surplus yields, but there are no clear-cut criteria. It is not unreasonable to expect that such suggestions, if adopted internationally, could lead to long periods of difficult negotiations between coastal States and the foreign States desiring to fish in the economic zone. If coastal States were not so constrained but could freely dispose of the resources within their zones, such costs could be largely avoided.

A third question about the "full utilization" concept has to do with the effect it may have on a coastal State's allocation of capital and labor resources. Under a principle in which a State can have as much as it can harvest, there would be a natural temptation for a State to increase its fishing capacity, particularly if it were not receiving full rents for foreign fishing of the surplus. Such a temptation may lead to greater investments in fishing effort than would be in the best interests of the coastal State.

Each of the three questions raised above hinges, in part, on the degree to which coastal States can extract full rents from the foreign fishermen. It was noted above that the extraction of economic rents is an important technique for overcoming the inefficiencies of common property utilization. But the use of monetary measures, such as taxes or user fees, is also an important technique for allocating access rights among foreigners. The ability to determine who gets the right to fish by finding out who is willing to pay the most would simultaneously maximize the rents collected, reduce economic waste, and reduce the costs of negotiation. It would seem preferable, in these regards, to permit coastal States to operate as free as possible from such constraints as the principle of "full utilization".

One of the arguments made by the advocates of the "full utilization" principle is that coastal States with fully exclusive rights may be tempted to prohibit all foreign fishing and let resources go unutilized. While this is likely to occur in some instances, it is not likely to be significant for the world as a whole nor to persist for very long. But even if this were a problem, it is doubtful that the principle of "full utilization" would be sufficiently enforceable to prevent a dedicatedly xenophobic State from sitting on unutilized resources.

(5) The Problems of Shared Stocks

The above remarks refer largely to situations where stocks are fully enclosed within the zones of individual coastal States. Where a stock is shared by two or more States, then some kinds of international principles or rules are necessary, even if these simply obligate the sharing States to confer with each other. The problems of shared stocks are extremely difficult to resolve and are likely to provide the most persistent challenges for cooperation of all of the problems of the law of the sea. The nature of the problems

can best be described in terms of the four major functions of fisheries administration - distribution, research, management, and enforcement. All of the problems described below exist today. And in most situations, they are not handled very well. The extension of jurisdiction, by diminishing the diffusion of authority, will ameliorate some of the difficulties. But it will also make those States acquiring the authority face up to the problems more directly and fully than they have in the past.

There are two aspects to the problems associated with the distribution of fisheries wealth. The first is that of defining wealth. To some countries a particular stock may be valued primarily because it provides important employment opportunities in an area where alternative sources of employment may be scarce or non-existent. To other countries, however, the same stock might be valued because of its contribution to the growth of the economy. Such differences in values present a major dilemma, for the former countries would wish to maintain or increase employment opportunities while the latter would wish to improve economic efficiency and reduce employment and total costs. A single stock cannot be managed so as to maximize simultaneously the amount of fisheries labor and the amount of net economic resources.

One solution to this dilemma is to divide up the total yield into national quotas and then permit each country to use its quota to maximize whatever it wishes. While this solution has a lot of merit in many situations, it also has a lot of difficulties. As already noted, national quotas for individual stocks may not be very meaningful in tropical waters where many different species intermingle. Another problem may occur if different States value the species at different sizes. Cooperation would also be hard if the most efficient harvesting were to take place in the waters of only one of the sharing States, requiring that State to permit foreign access. In short, national quotas may be useful in some situations but not all, and even where they are useful their adoption may incur high costs.

The second distribution problem is that of negotiating the shares. As noted above with regard to tuna, there are no objective economic or social criteria for determining who should get what from the sea's wealth. Past history of use, as a criterion, depends upon how history is defined - 1 year, 3 years, 12 years? Proximity to share depends not only upon the choice of a limit but also upon the amount of time spent by the fish, or the amount of growth achieved, while within that limit. Economic dependence, a criterion suggested in some proposals, would be very difficult to apply. In short, there are no criteria likely to be fully acceptable to all parties sharing a stock of fish. It will be necessary, in each case, to negotiate the distribution of the benefits of shared stocks.

In addition to the problems associated with the distribution of benefits there are also problems in the distribition of costs. Information requirements could be quite high, depending upon the distribution systems and management techniques that are adopted. The States sharing the stock or stocks will have to agree on the kinds of information required, the conduct of the research, and how the costs are to be shared. The formulation and adoption of management measures will also require a high degree of cooperation and, probably, the creation of some kind of administrative machinery.

Perhaps the most diffucult problem for States sharing stocks will be that of enforcement - many coastal States may be unwilling to permit patrol vessels of neighboring states within their economic zones, even though the vessels are patrolling catches of stocks shared with their neighbors. But unless the neighbors can be assured that the rules are being followed, they will have no incentive to restrain their catches when the stocks are in their waters, and the whole system is likely to collapse. As noted above with regard to tuna, shared fisheries are fundamentally unstable fisheries. Once it is believed, rightly or wrongly, that one of the sharing States is violating the rules and that it cannot be forced to stop the violations, then all sharing States will operate without restraint. There are no national or economic forces to prevent this from happening until the fishery reaches the point where total costs and revenues are equal and all economic rent has become dissipated.

(6) Summary

Among the various issues raised in the law of the sea, those councerning fisheries are likely to be the most persistent and difficult to resolve. While they are not generally of great economic importance, they can be very significant in political terms and they are likely to provide a continuous source of conflict among States for many years to come.

A careful calculation might indicate that the transaction costs involved in achieving and maintaining effective distribution and management systems are greater than the benefits that could be obtained. The costs of negotiation may be very high, particularly where a shared stock is valued for different purposes by different States. Research necessary to provide the desired information can be extremely costly. And enforcement of complicated rules for highly migratory or inter mixed stocks can also require heavy expenditures. These costs, in aggregate, could outweigh the benefits that might be obtained, and the wisest policy might be to offer the fisheries the condition of benigh neglect.

Such a conclusion, however, fails to take into consideration the political importance of fisheries. Governments cannot afford to ignore either the interests of their own fishermen or the confrontation with the fishermen of other countries. As limits are extended and as the principle of the freedom of the seas is dismantled, fishery issues must receive increasing attention if cooperation is to be effective and conflict is to be reduced.

COMMENTS ON CHRISTY AND ALEXANDER'S PAPER

(a) LESLIE CASTLE

In arranging commentators for this programme I had considerable diffuculty in finding two participants who were prepared to accept the role for this paper and so I appear simply as a last resort candidate without presuming to know very much about the subject. Perhaps the reluctance I encountered is because many economists consider that the issues involved are primarily of a technical, legal or political nature and that economics has little to contribute. While it would be perilous to ignore those other factors, economics has plenty to offer at least in understanding the nature of the problems and recent years have seen the development of areas of theory - externalities, public goods, common property resources and choice under uncertainty - which are all highly relevant. It is worth noting too that economics rests within a framework of law and custom, a point well appreciated by our classical forbears as Robbins and others have been at pains to remind us. What in essence we are faced with in the management and exploitation of the world's ocean resources is the establishment of a system of property rights pertaining to a major common property (or access) resource and to do that in a way that (unlike the enclosure of the commons) is regarded as equitable and enables its exploitation to be undertaken in the most efficient way. The Christy/Alexander paper sets out very comprehensively the complex issues involved but it is not a very optimistic picture and one has the impression that an accommodation among the widely differing objectives and circumstances of the world's nations in each of the four basic areas set out in the paper is rather remote.

For my part I see no particular sense in the division of oceans in a geographical sense with exclusive property rights being accorded to particular nations within these zones; nor much in the argument that because some nations have few resources they should gain exclusive control over a larger share of the spoils to be divided up. But to have no agreed allocation of property rights is to invite the dissipation of all rents from the resource as we have already observed in the case of many fisheries. Only by sheer accident is the allocation of rights on a simple geographical basis likely to lead to optimal management of ocean resources.

The functional approach in my view offers more promise since it recognises the many facets of the ocean as a resource, for fisheries of different kinds and requiring different spatial arrangements, for minerals, for waste disposal, for communications and many others. This does not however readily dispose of many of the issues considered at successive Law of the Sea conferences. There is the problem of accommodating existing property rights acquired by power and superior technology with those demanded by new nations and by further technological innovation. While the idea of a single world body managing the resource optimally has superficial attractions, experience with such bodies does not inspire one with confidence that it could do the job. Apart from being administratively cumbersome, the costs of information enforcement and compliance are likely to be very great and I find it hard to envisage that within one such body it would be possible to reconcile the often conflicting objectives in the use of oceans. But then a constellation of such bodies covering different aspects of the resource

might be even more of a Tower of Babel. As an alternative there is the possibility of devolving resource management to coastal states, but that is not an adequate answer in the case of those uses of the resource which are not in their nature the sole concern of any one. Further, looking at past experience, one is certainly not inspired with confidence that single states themselves can be relied upon to optimally or sub-optimally manage the ocean resources that lie within their jurisdiction.

(b) Ross Garnaut

This is a very important and interesting paper.

The paper takes us to the frontiers of technology, law and international relations. There is no law on the frontier, and yet a system of law and custom is necessary for resources to be used effectively. For any stable system of law to emerge from the current international discussion of the law of the Sea, it will have to blend consideration of power and of justice. It will have to be acceptable to the big and rich maritime states, especially Japan, the Soviet Union and the United States, and it will have to seem fair to the many developing countries that have an interest in the matter.

The Christy-Alexander paper presents an interesting description of the problem, but the practical importance of the jurisdictional problem may have been overplayed a little, especially as it now seems very likely that the 200 mile economic zone concept will become very widely accepted over the next year or two. The 200 mile limit will cover nearly all of the world's commercial fisheries, leaving a residual problem of international control only over a small volume of deep sea fishing and the fishing of the small number of commercial species subject to large-scale inter-jurisdictional migration. Similarly, there are at present few prospects of petroleum exploitation outside the 200 mile limit. The deep sea nodules present a problem for international co-operation on the high seas, but my own brief contact with the subject has suggested that deep sea mining is still a plaything of millionaires, and that large-scale mining of nodules is still a long way off. I am very interested in the suggention that commercial nodule production may in fact be very close, and I would be interested in more facts on this possibility.

Very difficult problems of administration and international relations will remain, even if the 200 mile limit removes the most important jurisdictional problems. As the paper recognises, it is very difficult to assess profitability of the fishing industry, and to tax and to control it, most importantly because of the geographic mobility of capital and labour employed in the industry. But the world can probably go a long way towards solving its law of the sea problems if it can develop systems whereby boats from fishing countries are licensed to work within the 200 mile limits of other countries with the "host country" taxing away most of the rents of the fisheries.

If a licensing and taxing system is to be successful, it must preserve the following interests: (i) The interest of fish importing countries and the world in conservation and stability of supply. (ii) The interest of fishing countries in preserving employment and quasi-rents of capital and labour that is committed to fishing. (iii) The interest of poorer maritime countries in raising their share of fisheries rents.

The fundamental economics of the system suggest that a stable

system may be possible to achieve, subject only to the ingenuity of man in devising satisfactory administrative arrangements. The possibility that total fisheries rents could be raised with more rational controls is important, because it may be possible for many countries to feel better off without any feeling worse off. If a large part of the rents of fisheries are being appropriated by the "host" countries, there will be relatively little cause for disrupting in the short term employment of specific fishing capital and labour. The most important re-distribution of rents will be favourable to the developing countries, and so is likely to appear just. The main problems will probably arise in the licensing of Japanese boats in North Pacific waters of the Soviet Union, United States and Canada. There, a redistribution of rents away from Japan will not seem fair, and special arrangements will probably be necessary.

(c) General Discussion

Participants devoted most of their attention to the question of whether the establishment of a large corporation was a feasible approach to ocean resource management. On this opinion was divided. It was suggested that the problem could not be solved simply by the allocation of shares but only by an approach which aimed at optimal resource management. The large corporation was one approach but this would not in itself solve the resource management questions, indeed these would still remain. The United States had originally supported the idea of a single corporation but the conflicts among divergent internal interests on this idea and the policies to be adopted had been impossible to reconcile.

Some participants argued that rather than a new international body it would be better to try to adapt existing bodies such as IMFO, FAO and UNESCO which could all play a role in different aspects of the problem.

Responding to the discussion, Professor Alexander said there was a limited role for existing agencies - the Soviet Union for example was not a member of FAO. He feared that others (Canada and Mexico) might follow the United States to a unilateral 200 mile declaration and personally he regretted the prospect. The only revenue which could realistically be contemplated for possible funding purposes was from offshore hydrocarbons. On fisheries any institution would have to allocate quotas and at present the only regional arrangement which was workable was the common fisheries policy of the EEC.

14

CO-OPERATION AND DEVELOPMENT IN THE ASIA/PACIFIC REGION - RELATIONS BETWEEN LARGE AND SMALL COUNTRIES: A SUMMING UP

HARRY G. JOHNSON

My assignment is to sum up and evaluate the Conference. I must begin by confessing that it has proved a more difficult assignment than I expected. I was not there the first day, because I was persuaded that I should stop off for rest on the way here, on the assurance that the proceedings would be carefully kept by the rapporteurs and made available to me on arrival. As it turned out, the papers themselves were only distributed here, too late for me to read them, and the record-keeping was less up-to-date than predicted. Dealing with the first day has been like a problem in detection: I began with the discussion record, then got some of the official commentators' notes. It was like reconstructing "Hamlet" by starting with Rosenkranz and Guildenstern, then making what one could of the words of Polonius and Fortinbras, but never reading Hamlet's part or seeing the full script; or like building a house by starting with installing the roof, then putting up the walls, and finally guessing at the foundations. What I offer is very much inference about a past civilization from its archaelogical remains.

The first session was the official opening, which struck a natural but ultimately awkward note - that of a changing world, a world crisis, and the need for new ideas and a new world order. The theme reflects a dominant strand of thinking and concern in the larger countries of the Atlantic region - especially the United States and the European Common Market countries - in the wake of the oil crisis, the sharp rise in food prices in 1972-73, and stagflation; and the intellectual news has not surprisingly reached the Antipodes, and been purveyed by some members of the Conference.

I find this theme difficult to get excited about, largely because I have spent a lot of my career waiting for disasters, changes, and transformations that ultimately failed to happen. These included the euphoria of the election of Labour in Britain in 1945, the expected descent of the American economy into an unprecedented postwar slump, and the creation of United Europe as a counterweight against the U.S.A. and U.S.S.R. superpowers. As regards the developing countries, there was the expectation politically of a third force wed to peace and justice on a basis of democratic central planning; and economically, the idea that Egyptian claims to the Suez Canal would introduce a new world order giving developing countries their due, and later the UNCTAD I demand for a new world trade order based on trade preferences and price-raising commodity agreements. Be that as it may, I do not see the O.P.E.C. oil policy as constituting a precedent for a basic change in the world trading system; and it has had very undesirable developmental side effects. The general theory of development indicates that any income redistribution achievable by monopoly would be small in relation to the capital investment needed to fill the development gap; that monopoly in fact affects a very small part of total world trade; and, contrary to common assertion, monopoly does not reverse comparative

advantage theory but merely restricts its opeation. After all, monopoly is only a private tariff on trade, dependent on trade still going on; and its effects are mostly redistributive, with second-order efficiency losses.

These remarks pertain to general matters running through the first day's proceedings.

I turn now to the specific papers and sessions.

Reuber's paper on development assistance and regional cooperation among large and small countries in the region put its finger on a major point: the region is geographical, not cultural or historical. Hence many European and Latin American ideas - also for that matter ideas that used to be held about "the Indian sub-continent" - which rely on an assumption of an historical "community" are inapplicable. This point, however, cuts somewhat against Reuber's general scepticism about regional arrangements and aid for development. More may be possible in the Pacific, precisely because it is not an historical and cultural entity, provided that the approach is pragmatic (e.g. free trade association as contrasted with common market).

Reuber was criticized on two main grounds. One was the lack of a sense of crisis. I regard that as a virtue. Man's mouth works much faster in predicting change than his hands work in producing it, with the result that too many non-critical crises are announced and debated. Intellectuals and governments live by the mouth, and advertise themselves by crisis-mongering; but the plain man who lives by his hands may be better advised to wait until the crisis is clearly present. One relevant question would be, when we look back over, say, twenty years of intermittent announced crises, how much evidence can we find of them in statistical series of output, employment, growth rates, etc.

The other ground for criticism was that Reuber assumed competition, whereas it was contended that the oil crises proved that trade is characteristically monopolistic. The oil crisis proves no such thing - in fact, the consternation caused by OPEC's action would be evidence on the other side. Trade remains largely competitive, and it is well for the developing countries that it does, because it is the rich who win the most in trials of economic strength, not the poor. I am still less sympathetic to the contention that the oil crisis requires us to re-think basic theory; almost invariably, in my experience, the demand for "radical re-thinking" is a demand to stop thinking at all, and accept instead the unsupported emotional prejudices of someone who does not understand theory well enough to be able to judge when re-thinking is necessary. The "new world trade order" that UNCTAD I was all about amounted in the end to no new comprehensive commodity agreements, a few token preferences carefully designed to limit the expansion of competitive exports by developing country beneficiaries, and a sharpened developed country disillusionment with the whole process of development aid-giving. It was almost ten years before any decisive action occurred on the commodity front; and it came where studies had concluded was the only place where it might succeed - oil, not the product that the typical developing country produces and is concerned about. And there is reason for doubt that the oil price will hold up as time passes - and the same reason for doubting that tea, coffee, sugar, cocoa and bananas permit any similar action.

The third session was devoted to Holmes's paper surveying the

development problems of small countries. I was unable to obtain much information about that session, other than the general view that the paper was a good survey of a lot of relevant problems. I suspect that, like any useful work on development, it had to discard the idea that developing countries can be categorized and typed easily, and therefore was led into surveying more problems than could easily be discussed. I understand that the session tended to drift into rather unsatisfactory efforts to find larger but still manageable classification systems.

The fourth session was intended to discuss two case studies on the problem of "dependence". This term I first came across in a study of New Zealand by an economist still active here; it is a very vague concept. Unfortunately Dr. Salgado, author of the American paper, was unable to come, and sent a paper in Spanish. Professor Wionzcek charged manfully into the breach, in an effort to translate the paper into English for discussion, but could not finish the job in the inadequate time available. The only information I have on it is that it was very general and did not lend itself to Conference discussion.

The study of investment in Thailand, by Narongchai and Naya, makes an awesome wodge of paper. It is a commendable attempt to use the tools of market share analysis to throw light on Japanese investment in Thailand. Unfortunately, the technique, due to Tyszynski has the grave defect of embodying an insoluble identification problem. Are the data produced by supply forces, demand forces, or both together? It also tends to generate interminable statistical objections and questioning, which the paper did not surmount too well. This session introduced a question that reappeared in later sessions - Thai hostility to Japanese investment and production activity in Thailand - to which I shall return in due course.

The first session on Tuesday, concerned with Ashok Desai's paper on "Small Island Economies: Problems of External Dependence" concluded the section of the conference devoted to case studies - at least nominally, since the case approach necessarily dominates any Pacific Region conference. The paper, as Macrae pointed out in his comment, dealt with four themes - export dependence and economic instability; the limits to diversification, with special reference to the tendency to foreign monopoly; the possibilities of regional cooperation; and the possibility of rationalizing the capital market to give local investors more participation and a higher return on their savings. On the first subject the paper contained some interesting statistical work regarding the multipliers for foreign investment and for migrants' remittances; but there was not much interest in pursuing this technical subject very far. At this point of time, one might suggest that the issue in its conventional form is now moribund or dead. It grew out of a particular set of ideas derived from the 1930s experience of primary producers, conjoined with an identification of their problems in an inappropriately Keynesian way with fluctuations in employment rather than real income in the more usual welfare sense, and lasted as long as it did largely through the determination of some armchair theorists of development to disregard facts if they were inconsistent with attractive economic myths.

The subject of regional cooperation was also not discussed at any great length; the reasons are familiar from previous Conferences. Here too, one senses an undue and inappropriate application to the

Pacific of ideas originated in Latin America, where the concept of a "region" of countries of similar background potentially capable of cooperating makes much more sense. The one idea that should probably have received more attention than it got was that of improving the capital markets, interpreted in a broad sense. Unfortunately, this idea usually is confined to giving the government, or already prosperous local capitalists, a bigger share in the profits of foreign enterprise, rather than identified with giving small potential savers better returns on forms of saving they can cope with. Here there is often a conflict between the desire, in effect, to tax the small saver by low administered yields, usually for the government's benefit, and the objective of encouraging locally-based development. Most attention was devoted to the second point, limited diversification, and the subheading of government-supported trade and investment monopolization by foreign enterprises.

Wionzcek repeated his assertion that a new world order of exploitation of monopoly power by primary producers was on its way in the wake of OPEC, expressing a view of the Bougainville agreement as a 19th century agreement that evoked strong protest from Arndt. A more interesting question, raised by Macrae and others, was why governments cossetted foreign monopoly so assiduously. The answer provided - but not extemely satisfactorily - was "employment neurosis", together with the indirect suggestion of bribery and corruption. One suspects that the answer lies deeper, in the sense that vested interests became more quickly and strongly vested in the typical developing country as a result of the political weakness of government and hence its intrinsically conservative attitude towards any economic activity that comes into existence. The most interesting idea that came out of the more general discussion was the importance of easy migration as a way of compensating for the limited diversification possibility of the small island economies. This idea is useful, and the phenomenon itself probably peculiar to this part of the world; as such I think it needs more careful analysis.

The Conference then turned to the next section of its program, on development assistance. Krause's paper was unfortunately largely misunderstood. Its purpose was "positive" and not "normative" - to evaluate the various motives for aid - given with a view to predicting the size and type of future U.S. aid; but it was interpreted by many as a cold-hearted refusal to preach what the United States owed to other countries. I think this misunderstanding very important to recognise and watch out for. There is a strong temptation to all the rest of us to tell the United States what it should do for us, without asking whether anyone is listening, or whether if we were in the place of the United States government and dependent on American votes rather than only handing out advice to the United States government about how it could please us best, we would take our own advice. Too often, discussions of development assistance assume both that aid-giving governments are elected by saints rather than by ordinary citizens, and that sanctity is measured by what the not-noticeably-saintly governments of poor countries consider their moral rights to revenue. Some agreement emerged eventually, however, on the acceptance that governments run on self-interest and that the aim must be to convince them that assistance is mutually beneficial. There was also a suggestion from English, that it might be advisable to shift attention from aid to the alteration of the rules of world trade to give more benefit to the developing countries.

The Conference then digressed to consider a paper presented by the Soviet economist colleagues. The paper circulated and presented by Dr. Chekhutov was felt to be rather short of hard facts, but the supplementary comment by Yakubovsky contained much if not all of the statistical information expected, and the discussion ranged widely over the whole field of Russian development methods and policies in the Pacific region.

The Conference then returned to the printed programme, with Dr. Viviani's paper on Australia as an example of the small donor and its problems. Australian policy has been changing significantly, presumably in part in accordance with the general disillusionment with aid, and a new emphasis on effectiveness of aid and an associated swing towards project aid have been emerging. In commenting on the paper, Thompson pointed out that aid ostensibly in the form of non-repayable gifts does not really mean a pure gift, because gratitude is expected, and gifts give a freer hand for aid-tying. The importance of migration as a source of flexibility to the aid recipients was again stressed. Reuber developed the point that the small donor faced a different set of constraints than the large donor, a point revealed by a Canadian re-evaluation of aid policy similar to the Australian one. Wionczek emphasized the positive contributions that small donors could make, mentioning in particular the possibility of assisting in improving agriculture. Arndt and others, on the other hand, got on to the actual great cost and difficulty involved in the apparently simple idea of providing technical assistance with a small-scale programme. This led Narongchai to suggest the solution of using local people rather than nationals, an idea which was not taken up.

Both this subject, and the suggestion made earlier that migration was a means of overcoming the limited possibility of domestic substitution, called to my attention the extent to which aid discussion tend to be governed by implicit assumptions. Specifically, both the implicit assumption that technical assistance will be rendered by nationals, and the form of migration automatically assumed as the natural one for South East Asia, implicitly accept the idea of people being attached to nation-states, and of development as consisting of raising peoples' standards of living by means that leave them tethered to their native territories. Since territories are defined by governments and states rather than people as human beings, the inevitable consequence is conflict between the idea of development as improvement of people's personal welfare, and development as a means of increasing the power of nation-states and of the elites that control these states.

The final session, of the day and of the programme section, described as concerning the problems of the aid recipient and presented by Dr. Mooy, was a case study of Indonesia. There was considerable disagreement over the meaning of the main constituent of this success story, the multilateral aid consortium. This was generally thought to have been a great advantage to Indonesia, though it was pointed out that the members of the consortia were all western countries. The discussion then turned extensively to more general matters, specifically the two topics of the effects of aid tying, which in some cases may effectively come to reverse aid, and the different "types" of developing countries that need to be distinguished in the wake of the success of OPEC.

Wednesday morning and half the afternoon were devoted to the new programme topic of foreign investment. Professor Murakami's paper

for session 9 dealt with Japan as a case of the large home country, and had as its central theme the willingness of Japan to invest, the hostility in South East Asia towards Japanese investment and recommendations for overcoming it. Of the commentators, Patrick suggested that Japanese willingness to meet host country requirements might have been emphasized more, recommended more careful research into the nature and distribution of anti-Japanese reaction, and argued against Murakami that limited managerial talent was not the real reason for the feeling. What was indicated was the maintenance of a low profile through, for example, the establishment of local brand names. The other commentator suggested that Murakami's reasons for anti-Japanese feeling were insufficiently persuasive, and recommended more research. The discussion tended to follow this theme of uncertainty about facts, feelings and recommendations, with the exception that Narongchai stressed that economic analysis cannot expalin socio-political factors. Wionczek made a strong criticism, in his usual style, of economists for not understanding sociology and other relevant matters, and Arndt a graceful speech in _his_ usual style stressing the persistence of historical memory.

I found myself, during the discussion, impressed by the lack on the part of _all_ kinds of economists and policy-makers of historical and comparative knowledge of problems; and the lack on the part of those who criticize economists for not understanding sociology and history of any serious effort to use their assumed superior knowledge to contribute more than debating points in their own favour.

I can recall, a decade and a half ago or so, the efforts of American firms and officials to find out why American foreign investment was so resented, and to remedy the situation by teaching better manners to Americans operating abroad. More to the point I recall the efforts of Professor English, Professor Safarian, and a number of other Canadian economists to find out the facts about American firms operating in Canada, and the results, which were generally a clean bill of health for the corporations. I also know that the economic facts do not convince anyone who does not want to be convinced; that has certainly been the story of Canadian political attitudes towards American investment. But having confronted the problem in many different parts of the world, I am not content to describe it as sociology, and criticize the economists for not understanding it. I find economics, plus a little social psychology, pretty useful here. Briefly, societies are organised in hierarchies, and equiped with attitudes of superiority over foreigners. It hurts to realize that foreigners are more efficient than you are, especially if they stand lower in their society than you do in yours. You would like their wealth, and your social mythology suggests that you deserve it more than they do. But you have a very limited possibility, if any, of extracting it; and to justify robbery, or attempted robbery, you naturally call on all the xenophobia your traditional culture can muster. In the course of time, your society will have to change, and control shift to those who are prepared to work at the new technology instead of claiming an unearned right to it by virtue of traditional status in a more traditional system of property ownership. In the meantime, I see no particular intellectual or social contribution in siding with the traditional elite - including the self-styled radical elite, and the educated leisure class of students and intellectuals - and no particular justification for claiming the support of a superior understanding of political science and sociology in so doing. In short, there is no reason to expect development policy to be guided by considerations of efficiency

and competition rather than by considerations of preserving and expanding what might be called sociological monopoly profit; but equally there is no reason why the economist should accept as true, and superior to economic analysis, the logic that would-be monopolies seek to impress on his thinking.

To return to the subject of the session, I am not surprised at hostility to Japanese foreign investment no matter how well-behaved and docilely conformist the firms involved are. In this conncetion, I am reminded of the story of the American in England during the Second World War, who was so stung by deliberate anti-American rudeness that he eventually asked an Englishman why the English were so irrationally anti-American. "It's not at all irrational" the Englishman replied, "there are four very good logical reasons for our hostility; you Americans are overfed, over-paid, over-sexed and over-here." But I should add in conclusion that there are some aspects of hostility to Japanese investment worth investigating on a scientific basis: various people in fact suggested such questions as type of industry (extractive, manufacturing, export-promoting, import-substituting, intermediate or final product, labour-intensive versus capital or technology-intensive) and type of country (ethnic character, always independent or one-time colonial, which country's former colony).

Session 10 dealt with the small host country as exemplified by Papua New Guinea. Garnaut's expertly knowledgeable paper started an interesting discussion of technical issues such as the stabilization fund. Desai made the good point that what is involved there is not stability but profitable investment of funds that a rational producer would carry over from good years to bad - and the government's interest rate is not very interesting in an inflationary period or a growing economy. I was rather surprised, myself, to hear no reference to the long British discussion in the early 1950's, published in the Economic Journal, that followed Peter Bauer's devastating exposure of West African marketing boards and ended with Milton Friedman applying his permanent income concept to the problem. One gets from this a feeling of gloominess and disillusionment about development economics - though of a different kind than Holmes complained of - or perhaps recognition of immutable sociological laws that lead to repetition in country after country of exactly the same mistakes. On my first visit to Papua New Guinea, I was schocked to hear the then Professor of Economics at the University advocating a heavy protective tariff on infant-industry grounds, in sublime ignorance of, among many other historical experiences, the Prebisch - UNCTAD I criticisms of inward-looking development policy. In this discussion I felt a similar excess of optimism about the possibility of developing the territory, if only enough foreign investment could be captured and tamed (or gelded) into docile development service.

The afternoon session, on Alexander's paper on "Cooperation in Natural Resources Development: Marine Resources", brought a welcome change of pace and style. Alexander gave us a brisk no-nonsense account of the main uses of marine resources - fishing, offshore oil and gas, and shipping - and the implications of the extensions to the 200 mile limit. Castle, in commenting, put his finger on the essential economic problem - developing property rights in the only remaining major common property resource (outer space has not yet become valuable). But he left a problem, inasmuch as he (rightly in my view) saw no sense in rectifying inequalities among count-

ries by giving the disadvantaged disproportionately large shares in this particular resource, but also regarded an international authority as doubtfully useful because of the large enforcement costs that would be entailed. Garnaut, in contrast, favoured the extension of the limit as a means of deriving revenue from the resource for the poor countries, though Alexander's later expressed opinion was that there was little prospect of revenue in the near future from fishing - oil and gas, and minerals perhaps, being a different story. My own expressed view is that the 200 mile limit is no way to solve the common property resource problem. I was also reminded of the work that Pincus and I independently did ten years ago on the possibility of price-raising commodity agreements, which showed how badly distribution of profits according to production (here, ownership) shares matches any humanitarian concept of who deserves the gains. Doubts on the probability of a tidy solution were enhanced by Krause's brief description of all the lobbies and pressure groups in the United States that have come out in favour of and against the 200 mile limit.

I conclude with some brief remarks on the Conference as a whole. First, I am confident that we have fulfilled the objectives of this Conference, even though they bulked less in the total programme than in the intentions of the committee. They were to devote attention to the specific problems of development of small island economies in the Pacific. Though formal discussion of the problems has concentrated on Papua-New Guinea, other cases have been discussed, and ideas of general applicability have been generated. There is only one small island economy in the Pacific I would have liked to know more of, and this is our host country New Zealand. A second objective was to consider marine resources and their development; and here the session based on Alexander's paper has led us to think seriously about aspects of the development problem we have not heretofore devoted much attention to.

A second comment is that the Conference has certainly been of value to the continuing work of the Conference, especially in filling out our concept of the Pacific. As I have mentioned, the Pacific is a geographical but not a cultural area; and our mental picture of it tends to be dominated by those parts of it that fit into our own Atlantic or continental cultural and historical perceptions. In my own case, as a boy in Canada the Pacific meant China and the Indian Empire, with Japan somewhere out there too. When I moved to the United Kingdom, the Pacific became Pakistan, India, Ceylon, Burma, Malaya, Australia and New Zealand. But when I moved to the United States, it became Japan, Korea, Taiwan, Viet Nam, Cambodia and so forth, and the shadowy presence of mainland China. Each of these conceptions is only a partial view of the picture of the Pacific, and Arndt has reminded us of the existence of a host of small island economies that fit into no-one's colouring of the Pacific.

Third, the question of "the new world order" apart, the conference has come to see various standard problems in a new light. This includes both trade liberalization and preferences, and the problems of achieving more orderly stable trade in foodstuffs, as well as the problems of direct foreign investment and especially the problem of instability that may be associated with it in a small, one-main-resource economy.