STRUCTURAL ADJUSTMENTS IN ASIAN-PACIFIC TRADE

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by
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FOREWORD

There have been academic endeavors since 1968 among economists of the countries surrounding the Pacific Basin to shed light on trade and development problems of common interest to their countries and find solutions thereto and make policy recommendations.

They first met in Tokyo in January 1968. The Japan Economic Research Center hosted this conference. Next they met in Hawaii in January 1969 and for the third time in Sydney, Australia, in August 1970. In October 1971 they again got together in Ottawa, Canada.

These economists came back to Tokyo in January this year for their fifth conference. The Japan Economic Research Center and The Japan Institute of International Affairs co-hosted the conference. The present volume contains the papers and proceedings of this Conference.

Both institutions hereby express deep gratitude to all the participants, especially to those who came from outside Japan, and the organizing committee of the Conference chaired by Professor Kiyoshi Kojima for the success of the Conference. Acknowledgement is again due to Professor Kojima for the editing of this volume and also to Professors Peter Drysdale, Ippei Yamasawa, Makoto Ikema and Thomas Burlington who assisted him in the work.

We are also indebted to the Asia Foundation for its financial support of the Conference.

July, 1973

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EDITOR'S PREFACE

The Fifth Pacific Trade and Development Conference was held in Tokyo from 9 to 13 January, 1973 to further the objectives of the Conference series. The first Conference in this series was held in Tokyo in January 1968; the second in Hawaii in January 1969; the third in Sydney in August 1970; and the fourth in Ottawa in October 1971. The Pacific Trade and Development studies are establishing their own influence upon trade and development policies in Pacific basin countries. This book contains the papers and proceedings of the Fifth Conference, discussion at which focussed on issues related to the development of a new world economic order and structural adjustment in Pacific trade.

In the coming year, a good many of the uncertainties in the international monetary and trading system that have now appeared are likely to continue. Planning a new order for the international economy, in which steady growth and adjustment is encouraged, deserves high priority.

Structural adjustment and adjustment assistance policies appear to be a basic pre-requisite to the monetary re-alignments that now have to take place, as well as to continuing the trade liberalization that is essential to the dynamic expansion of Asian-Pacific trade among developed and developing countries alike.

The book covers three broad subjects. The first part deals with "monetary re-alignments and trade adjustment in the world economy." Professor Harry G. Johnson was expected to introduce the general issues involved in trade adjustment and monetary reform. Due to his illness this was not possible. Thus Mr. Royer and Professor Ishikawa introduced the problem as it affects the Asian-Pacific economies by analysing the impact of the enlarged European Community and China on this region's trade structure and trade growth.

The second part focusses on export growth in Asian developing countries--its role in development and employment programmes. One

paper analyses overall problems of the entire developing world from the viewpoint of industrialization policy. Two other papers deal with areal trade and adjustment problems in East and Southeast Asia. Another paper looks at the Latin American economies.

The economic development of developing countries depends very much upon their export growth, but this poses problems both of shifts in policies from import-substitution to export promotion, and determination of proper industrial priorities for export. In turn this depends, not just on comparative advantage but on foreign trade prospects and barriers. Thus there is an important interaction between development and trade policies in developing countries with trade policies and structural adjustments in developed countries. Past experience, future prospects and difficulties are explored.

The third part deals with adjustment assistance policies in developed countries: Japan, Australia, New Zealand, the United States and Canada. The future structure of world trade are drawn out by each writer in order to set the position of each country in perspective. Structural adjustments are required both to harmonize trade with advanced countries and to expand trade with developing countries. Adjustment assistance policies are required not only for contracting inefficient sectors but also for developing efficient and export sectors. How overall unemployment can be cured is another problem which relates directly to the degree of felxibility and cost of adjustment programmes. Successful and unsuccessful experience of structural adjustments and structural adjustment policy is analyzed.

As indicated in the Summary by Professor Hugh Patrick and the Communique issued by the Conference, there was intensive discussion at the Conference, but some urgent policy priorities were agreed upon in the search for a new world economic order and the successful structural adjustment of Asian-Latin American-Pacific trade.

Finally, I would like to express my gratitude to all those who made possible the success of the Conference and the preparation of this volume. My special thanks are due to Peter Drysdale, Ippei Yamazawa, Makoto Ikema, Tom Burlington, and Yoko Ota for their assistance with this work.

July 1973

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COMMUNIQUE

The Fifth Pacific Trade and Development Conference has just completed meetings at the Japan Economic Research Center in Tokyo to discuss the development of a new world economic order and the nature of structural adjustments in Asian-Pacific trade. The Conference was jointly sponsored by the Japan Economic Research Center and the Japan Institute of International Affairs. Participants came from Australia, Canada, Europe, Hong Kong, Japan, Mexico, New Zealand, the Philippines, Thailand, the United States, the Asian Development Bank, the International Bank for Reconstruction and Development, and the International Labour Organisation.

There was discussion of the considerable growth in the interdependence among world economies and the importance of trade and capital flows for the economic growth and welfare of those in the Asian-Pacific region in particular.

Participants expressed great concern over the drift towards protectionism, especially affecting agricultural and light manufactured goods, in major trading regions.

The importance of the coming round of trade negotiations in checking protectionist forces and opening up trade opportunities in these areas was stressed in this connection. World leaders were called upon to adopt a forward-looking approach to trade and economic policies and to resist pressures to solve domestic problems by policies which sacrifice the considerable gains from international specialisation.

The emergence of the enlarged European Community as a major world market was given special attention. There is the danger that the enlarged Community will persist with established protectionist policies towards agriculture and the extension of discriminatory and restrictionist trading arrangements affecting the European market for processed and manufactured goods most likely to come from developing countries. The need, therefore, to involve Europe in a meaningful round of comprehensive trade negotiations with the United States, Japan, Australia, Canada, New Zealand and other countries

was seen to be of significance not only to the welfare of these major economic regions but the whole world economy, including the smaller Asian-Pacific economies.

Japan now has new and enlarged responsibilities in world trade and economic arrangements. The sheer size of the Japanese economy, its wealth, and the nature of its inter-relationships with the rest of the world, all dictate a major role for her in the formulation of a new world economic order. Whilst recognizing the achievement of Japan's programmes of trade liberalization, her more flexible attitude to monetary adjustments, the growth of her development assistance programmes, and her increased importance as a source of capital funds, it was felt that a significant re-direction of policies was still required from the viewpoint of her own interests as well as the interests of the rest of the world, especially the smaller economies in the Asian-Pacific region to whom Japan is of such growing importance. Alongside the United States, Japan together with Australia, Canada, and New Zealand now has a special part to play in negotiations over international economic policies designed to secure open trading arrangements and through them world prosperity.

Liberalization of agricultural trade, trade in light manufactured goods, the extension of aid programmes on more generous terms, and leadership in monetary readjustments were seen as major elements in this new responsibility in world trade policy.

An important theme of the Conference was the nature and scale of the adjustment processes in economically advanced countries where the possibility of structural and regional unemployment may slow the process of trade liberalization and encourage protectionism in response to changes in relative competitive positions. The Conference surveyed the weaknesses and strengths of adjustment assistance programmes in Japan, the United States, Australia, Canada, New Zealand, and Europe. There was clearly a need to develop adjustment devices which mitigate any social costs resulting from the transfer of resources from inefficient to efficient sectors of these economies. Any safeguards should be temporary and designed to speed adjustment to new trading conditions and efficient specialisation.

The Conference noted the huge structural and employment problems in most developing economies in the Asian-Pacific region. Wider

trading opportunities are an important element in the solution of these problems. But it was also felt that the industrialization strategies of developing countries themselves have frequently thwarted trade and economic growth and that, in consequence, there has been a failure to take advantage of trading opportunities that already exist. Excessive protection and the nature of incentives offered to the production of tradable goods in Asian-Pacific developing nations reduces the efficiency with which both domestic resources and foreign capital resources are used, adversely affecting employment, incomes, and social welfare.

The development strategies of China and their impact on the Asian-Pacific region was also considered. No firm conclusions were reached but it was felt that Chinese participation in future discussions would be valuable.

Participants in the Conference stressed the need for public discussion of these issues in all the countries involved and their serious consideration by the governments concerned. The Conference welcomed an offer from Dr. Wionczek, of the Center for Economic and Monetary Studies in Latin America, to initiate the organisation of a further conference in about a year's time in Mexico City.

CONTENTS

VOLUME I

VOLUME II

Part III Structural Adjustment in Advanced Countries

Part IV Summary

PART I

PROBLEMS IN THE WORLD ECONOMY

1

GREATER EUROPEAN ECONOMIC INTEGRATION

Jean Royer

Among the factors which have required and will require in the future structural adjustments in the pattern of production and trade of the countries in the world, including those of the Pacific area, the process of economic integration in Western Europe can be singled out as being of major importance as well as unprecedented. Whereas European integration has probably perturbed the trade flows and the world financial balance far less than other trends such as the instability of capital movements, the growing mobility of the factors of production thanks to the development of multinational enterprises or, for that matter, the spectacular growth of the Japanese economy, the building-up of a widening trading and financial system based on regionalism has raised more difficulties of a theoretical nature and caused more misgivings than all the other factors taken together. This is probably due to the fact that the phenomenon was considered as unpredictable in its implications and that it challenged principles which were believed by many to be permanent conditions for the working of a successful system of economic cooperation.

The European Economic Community - and the European Free Trade Association - have been in existence for more than ten years and it is now possible to take stock of the situation and to draw some conclusions from the actual record of European integration before an attempt is made to assess the possible consequences for the partner countries as well as for outsiders of the enlargement of the EEC which will bring together, as from January 1973, the six Members of

the present Community and three other West European countries, viz the United Kingdom, Denmark and Ireland as acceding members; to this group should be added the fringe of European, Mediterranean and developing countries from Africa and possibly other continents which will be associated in some way with the Community in a near future.

I. The results achieved so far by the Community of the Six

To assess the achievements of the EEC, one should take into account both the political and economic aims of the integration movement. The relative importance of these aims varied from time to time. In the beginning, the political objectives were predominant; afterwards, the governments gave priority to purely economic aspects of integration; during the last few years, however, renewed attention has been paid to broader policies.

When the Schuman Plan was adopted and the European Coal and Steel Community was set up, the political overtones were obvious. The integration of these major sectors of production was intended to knit together the interests of enterprises playing an important role in any warlike activity, to put an end to Franco-German rivalry and to lay down the foundations of the future United States of Europe. As the US representative to Luxemburg explained to me at that time, the ECSC institutions were modelled on those of the United States of America: the High Authority had to become the Federal government, the Council of Ministers the Senate of the future Federation, the Assembly was the House of Representatives and the Court was to act as a Supreme Court. This view was shared by the staff of the High Authority who gave priority to constitutional matters.

This first attempt was not conclusive. While the Coal and Steel Community achieved its objectives with respect to the integration of the industries concerned, it was unable to expand to other sectors and eventually to grow into a federal political unit. When the Rome Treaty was negotiated, the political aspects were not entirely discarded, but they were considered as of less immediate importance. The executive powers were vested, not in the Commission, but in the Council of Ministers whose decisions had to be adopted unanimously on any point of substance. The Assembly and the Court remained part of the structure, but their influence cannot be compared to that of the US institutions. On the other hand, the Community was never considered only as a trade organization: the Six successfully resisted

the pressure exercized by the United Kingdom and other European countries to merge the Community into a broader Free Trade Area; for them, integration should go far beyond the removal of trade barriers and imply a gradual harmonization of other aspects of government policies; it should lead eventually to a political federation of Western Europe.

The customs union The rationale of the Rome Treaty was that the removal of all trade barriers inside the Community would increase competition among producers, lead to a better allocation of resources, improve productivity and strengthen the economies of the Six. The programme of trade liberalisation was implemented more rapidly than contemplated and the removal of tariffs and other barriers for manufactured goods was achieved smoothly and with practically no resort to the escape clauses which were provided in the Treaty.

The results of the elimination of trade barriers brought about the expected benefits. From 1957 to 1971, intra-Community trade increased more than five times (on an fob basis) whereas world trade doubled.

Table 1: Trends in World and intra-EEC trade: 1957-1971
(in million US dollars, fob)

	1957	1971	Increase in %
World trade:			
a) incl. intra-EEC trade	109,740	346,150	215
b) excl. intra-EEC trade	101,880	296,930	191
Intra-EEC trade	7,860	49,220	526

Source: GATT, International trade in 1965 and 1971.

In spite of the spectacular expansion of intra-Community trade, the trade of the Six with the rest of the world developed at least as rapidly as that of other areas with the exception of Japan. EEC imports from non-EEC countries increased by 193 percent and EEC exports to these countries by 230 percent as against 191 percent for total exports and imports of the rest of the world (including Japan). As exports expanded more rapidly than imports, the trade balance of the Community improved substantially until 1971.

Contrary to what some economists believed, European integration did not lead to over-concertration on the soft regional market and the EEC significantly increased its share of world markets which accounted for 28.6 percent of world exports in 1970 against 15.4 percent in 1950 and 23.1 percent in 1960.

Table 2: Trade balance of the EEC with the rest of the world (in million US dollars, fob)

	1957	1960	1971	Increase 57/71
EEC exports	15,310	19,480	50,640	230%
EEC imports	15,475	17,375	45,420	193%
balance	-165	+2,105	+5,220	

Source: GATT, International trade, Supra

Table 3: Trends of export trade of the EEC and of other areas (1957/71 in percentages)

EEC to the rest of the world	230%
World less EEC	185%
Industrial areas less EEC	208%
North America	155%
Western Europe less EEC	194%
Japan	742%
Developing countries	140%
Australia, New Zealand, South Africa	107%
Eastern trading area	216%

Source: GATT, loc.cit See also Appendix, Table I.

So much for trade. Production in the EEC also increased more rapidly than in other industrial areas, with the exception of Japan. The share of the EEC in the aggregate real gross national product of the OECD countries moved from 19 percent in 1950 to 23 percent in 1960 and to 24 percent in 1970.[1] The structure of production changed in line with the trends visible in other industrial countries; the share of labour force in agriculture declined by 37 percent in the 60's - a figure equal to that of the United States and comparable to that of Japan; the share of services in total employment also increased, although it is still lower than in North America and in the United Kingdom, and even in Japan; but the share of manu-

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1 United States International Economic Policy in an Interdependent World, Washington, July 1971, page 344.

2 OECD, Policy perspectives for international trade and economic relations, Paris 1972; Table 13, page 152.

3 OECD, loc.cit., Table 2, page 139.

facturing industry continues to grow in the EEC - although less than in Japan - whereas it has decreased in the United States, in Canada and in the United Kingdom.[2] The expanding production of manufactured goods had to find outlets in the domestic market and in the other EEC countries, but also in the rest of the world.

In the 60's, the share of the EEC industrial production which has been exported increased substantially, especially in Italy and in the Benelux countries, and that extra share was absorbed by the regional market, the share of extra-area trade remaining about the same.[3] This implies that domestic consumption increased rapidly in the Six, as was expected by the negotiators of the Rome Treaty. It is certain that, as a result of trade liberalisation, the prices of specific goods such as durable consumer goods (refrigerators, washing-machines and the like) came down and that the saving made incited consumers to buy more of such or other goods. But even when the price reduction was not passed on to the consumer but retained by the middle-man, the economy as a whole was able to enjoy a higher standard of living in real terms. This is shown by the figures of per capita GNP of industrial countries. With the exception of Japan, the rate of increase in France, Germany and Italy was greater than the rate in other countries, such as the United Kingdom, the United States and Canada. Although the existence of maladjustments in the exchange rates and differences in the purchasing power of the national currencies may somewhat distort the picture, the trend is clear enough.

Table 4: Per capita GNP of industrial countries
(in constant 1970 US dollars)

	1950	1960	1970	Increase	
				1950/60	1960/70
United States	3147	3640	4754	16%	31%
Canada	2143	2624	3650	23%	39%
United Kingdom	1355	1709	2092	26%	22%
France	1281	1819	2847	42%	57%
Germany	1019	2105	1016	107%	43%
Italy	650	1071	1684	65%	57%
Japan	427	734	1898	72%	159%

Source: US International economic policy,....loc.cit.p.348

The strengthening of the economies of the Six can also be derived from data showing the increase of productivity, the unit wage cost and the export prices of manufactured goods in US dollars. During the period 1965-70, productivity improved more in the EEC than in the United States, Canada and the United Kingdom, though far less than in Japan; the unit wage cost increased less (in national currency) than in the three Anglo-Saxon countries, but more than in Japan and export prices in dollars have increased less than in the United States and Japan, but more than in the United Kingdom.

Table 5: Productivity, Unit Wage Cost and Export Prices
(Indices 1970 : 1965 = 100)

	Productivity (Output per man-hour)	Unit Wage Cost (in National Currency)	Export Prices (Manuf. goods) in US dollars
United States	113	114	119
United Kingdom	119	125	110
Canada	121	118	122
Germany	130	110	114
Italy	130	115	108
France	141	110	108
Japan	189	108	114

Source: Policy perspectives for international trade and economic relations, OECD Paris 1972, p. 148.

Taken in isolation, these findings might not be conclusive, but the convergence of all the trends is a reasonable evidence of the steady expansion of the economies of the Six since the EEC was set up. While it would still be possible to ascribe part of the achievements to other factors, there is no doubt that the integration process has contributed largely to the present prosperity of the EEC countries. So far we have considered what might be called the mechanical effects of the customs union, which could have been achieved to a large extent by looser forms of association, such as a Free Trade Association. The EEC, from the start, was more ambitious and attempted to move from a customs union to an economic union, and later, to a political union.

The progress of economic integration As early as 1948, the Benelux countries found out that the removal of tariffs and other trade barriers was not sufficient to guarantee a normal free flow of trade. The operation of independent policies in other fields brought about

a number of distortions which either hampered trade or stimulated uneconomic movements of goods. This applies more particularly to fiscal and agricultural policies. For goods which attracted very different consumption taxes in Belgium, Luxemburg and the Netherlands, such as spirits and tobacco massive speculative exports took place from the low-tax to the high-tax country. In the case of agricultural products, the different level of support prices retarded the opening of the frontiers for a long time.

It became soon apparent that some harmonization of tax policies had to take place before goods could move freely and that some rapproachement would have to be agreed upon in the agricultural field before the temporary safeguards such as minimum import prices could be done away with.

The EEC had the same experience. The Rome Treaty had not provided any detailed blueprint for the liberalization of trade in agricultural products, but it became rapidly apparent that free movement of staple temperate-zone foodstuffs could not be envisaged if the member States insisted on maintaining independent agricultural policies. To avoid a deadlock on that issue, the governments hammered out a Common agricultural policy which involved joint decisions on support prices, export subsidies and plans for structural improvements. This Common policy was adopted and carried out after a transitional period and required an elaborate regional administrative machinery. This impressive construction, however, proved to be vulnerable to exchange fluctuations, since all prices were quoted in a common unit of account. When the French franc was devalued, the French prices had to be disconnected from the Community prices to avoid windfall profits for French producers and a complex system of border taxes and premia had to be introduced; the system was however dispensed with after a few years. The situation became far more awkward when the Deutsche mark was revalued, because the German producers were not prepared to accept a reduction in their prices in their domestic currency; there again a system of border taxes and subsidies had to be re-introduced and the complications became nearly unbearable until the Deutsche mark ceased to float against other EEC currencies.

The governments became aware of the need to harmonize their exchange policies if they wanted to maintain the free circulation of their agricultural products. We shall come back to this point later on.

Sor far as fiscal policies are concerned, progress has been slow. Until now, each government has kept its own system, both as regards direct and indirect taxes. Differences in direct taxation do not seem to cause excessive distortions to regional trade or to create undue advantages to the producers of individual countries. As a matter of fact, Swiss producers have been accustomed for many years to adjust to significant variations in the tax rates of the various cantons. In the case of indirect taxes, the solution adopted for the time being was to apply the general rule according to which exports are exempted and imports are liable to a border tax equivalent to the consumption tax levied by the importing country on like domestic products. This rule ensures the neutrality of the tax, but has the disadvantage of maintaining in existence the customs frontiers inside the Community - a situation considered as frustrating by Mr. Mansholt, President of the Brussels Commission.

The record is, however, not entirely negative in this field, since the Six have agreed on a common system of indirect taxation, the Tax on Value Added. After some hesitations, the system is now in force. The second stage would be the unification of the rates; only then will it be possible to let goods move freely and to do away with customs control inside the Community.

Again with a view to removing distortions hampering intraregional trade, the EEC has been active in other forms of policy harmonization. A number of regional technical standards have been elaborated by the Commission and submitted to the Council of Ministers. Generally speaking, these proposals are consitent with the recommendations of international standardization organizations and independent standards are contemplated only when no world-wide formulae have been hammered out. Transport regulations and rates have been harmonized to a certain extent and achievements in other areas have contributed to a cleaner, more transparent competition.

Moving still further, the Community examined the possibility of harmonizing policies directed to production and to the allocation of resources. Although the Rome Treaty relied on increased competition to re-orient the distribution of factors of production in the individual countries, the governments seem ready now to stimulate the reorganization of production units to take advantage of the economies of scale. Substantial progress has been made in the replacement of smaller units in each country and closer contacts have developed

among producers in the EEC on a regional basis, but mergers have been mostly confined to the enterprises of the same country. Integration moves across the frontiers have been very few, such as the association between Agfa and Gevaert in the photographic industry. There are many legal and fiscal obstacles to regional mergers. To overcome them, it is contemplated either that a new legal status be set up for regional companies or that national laws be closely harmonized.

Common industrial and energy policies are now under consideration which would avoid existing divergences in national practices regarding access of foreign investments, incentives to individual sectors, location of plants, regional policies, coal, oil and nuclear energy competition. Gradually, the scope of harmonized policies should reach out to the entire economy.

Special mention should be made of exchange and monetary policies. The absence of harmonization in this field was felt in relation to the common agricultural policy, but the chaotic situation of the international payments system in recent years encouraged the Six to accelerate their efforts to build up a common monetary system. Paradoxically, the crisis in the US balance of payments situation hampered at first these efforts because the German government believed in floating rates as a means to adjust to exchange fluctuations whereas the French government refused to float the franc and introduced a dual exchange market buttressed by controls on capital movements. Eventually, the Six agreed to maintain fixed exchange rates between the EEC currencies and to halve the spread agreed upon in Washington in December last as a first step. The floating of the pound introduced a new hazard lately but it is expected that the practice will be abandoned in due time.

So long as a new international payments system is not finally agreed upon, the tentative monetary arrangements of the EEC will remain vulnerable. The governments do not yet see eye to eye with respect to the techniques to be applied to keep the system on an even keel and the basic problem of the relative priority of the monetary and of the economic policies is still unresolved; the German government still feel that coordinated economic policies should come first whereas the French insist that harmonized monetary policies should be secured before economic policies are unified. In both cases, the resistance to a severe limitation of sovereignty remains strong.

The Summit Conference where the Six and the three acceders discussed these broad issues as well as the possibility of a better coordination of their foreign policies has indicated that there is agreement on the general objectives but it remains to be seen how rapidly the trade integration which has been successfully achieved will be followed by an integration of the other aspects of economic life and a close coordination of non-economic policies.

At the present juncture, it can be said that the experience of the EEC - and that of the EFTA leads to the same conclusion - proves that the elimination of trade barriers among neighbouring countries at a comparable level of development and with close commercial ties leads to a rapid expansion of the foreign trade of the constituent parties and to a strengthening of the economic structure of these parties. To a significant extent, however, the trade expansion is hampered by the distortions resulting from the existence of independent and often conflicting policies on other matter.

The resistance to harmonization of such policies is much greater than the reluctance to eliminate commercial policy obstacles. Progress has been slow even in the EEC where the governments accepted the principle of common policies in many fields. It should not, however, be under-estimated. No doubt, such progress had been made possible by the existence of strong regional institutions which were able to defend the interests of the Community as a whole and to check the centrifugal tendencies of national governments. But the EEC, on the eve of its enlargement, is still far from being the United States of Europe which were contemplated some fifteen years ago. This inconclusive record may explain the disappointment of the United States which supported the idea of European integration as a means of strengthening the political stature of Western Europe rather than its economic competitiveness.

II. The impact of the European Community on world trade

We have considered so far the advantages which the EEC members have derived from the setting up of the Community and the consequences for their economies of the curtailment of their sovereign rights in the field of commercial and a few other policies. It is time now to examine whether these benefits have not been obtained at the expense of the rest of the world or whether the sum total of advantages is sufficiently high to preserve the interests of non-EEC countries.

When the Rome Treaty was concluded, opinions among economists and policy-making officials were divided regarding the probable effects of the proposed integration. Some contended that a customs union (or a free trade area for that matter) was nothing but a magnified preferential agreement and that - as is the case for such agreements - the more favourable treatment granted to the goods from the member countries would have a net trade diverting effect; imports from and exports to the outsiders would decline, relatively if not absolutely; in other words, such arrangements were bad for third parties. Others contended that this gloomy view was unjustified. Admittedly, a trade-diverting effect would take place and trade among the members would increase more rapidly than trade with non-members; this was precisely the reason why the members were prepared to accept a severe limitation of their sovereign rights. But things would not stop there; the removal of trade barriers inside the union would stimulate competition, bring prices down, raise the purchasing power in real terms of the consumer and quicken the rate of economic growth. This process would have a trade-creating effect. Increased demand would require additional supplies which would be met by regional producers but which would also involve larger imports from outside the region. Provided the level of protection round the union is not higher or more restrictive than before, the trade-creating effect should be sufficient to balance the trade-diverting effect and no adverse effect would be felt by outsiders. In other words, the benefits enjoyed by the members would not be at the expense of other countries and there would be a net increase in world welfare.

After fifteen years of experience, is it possible to determine which theory is correct? No final answer can be given because it is not possible to compare the actual situation with the situation which would have obtained if the Rome Treaty had not been put into force. But it can at least be asserted that if the former theory were correct, the trade-diverting effect would have modified the structure and destination of exports of non-EEC countries in such a way as to reveal diverging trends in exports to the EEC and to the rest of the world. Conversely, if exports of non-EEC countries to the Community have in effect expanded at least at the same rate as exports to other areas, there are valid reasons to conclude that the trade-creating effect of European integration has been of the same magnitude as the trade-diverting effect and that the verdict could be of damage not proven.

Let us look at the export statistics of the various groups of non-EEC countries:

Table 6: Exports of non-EEC countries to the world and to the EEC

(in million US dollars; fob)

	To the world Increase 1957/71	To the EEC Increase 1957/71
All non-EEC countries	185%	193%
Industrial areas less EEC	208%	210%
North America	155%	161%
Western Europe (other than EEC)	194%	223%
Japan	742%	1071%
Developing countries	140%	173%
Australia, New Zealand, South Africa	107%	9%
Eastern trading area	216%	396%

Source: GATT, International Trade. See also Appendix, Table 1.

For the world as a whole and for all main trading areas with the exception of the semi-industrialized countries (Australia, New Zealand and South Africa) and of the sub-group of developing countries in South and East Asia, exports to the EEC have expanded more rapidly than total exports. The difference is small in the case of the industrial areas taken as a whole; for North America, the rate of expansion for exports to the EEC has been slightly better than the rate recorded for total exports, in spite of the automotive agreement between the US and Canada which boosted intra-North American trade by several billion dollars. For Western Europe, the EEC market has been more dynamic than others, which is natural in view of the proximity of such market. The difference is very large in the case of Japan and the Eastern trading area; but as the figures of that trade in the late 50's were comparatively low, the data can only be taken as an indication of the trend.

In the case of the developing countries, the EEC has, on the whole, been a more dynamic market than other areas; this is easily explained by the greater dependence of the Community on imports of primary products and its rapid economic growth during the period under review; as a result, the Third World improved its trade balance with the EEC

by nearly 3 billion dollars on a fob basis at a time when its balance with other industrial areas deteriorated substantially.

However, the impact was far from uniform. The main beneficiaries were the Middle East in Asia because of vast increases in the supply of oil and petroleum products and Africa because of the steady demand for minerals and some expansion in the consumption of tropical products. Latin America whose total exports expanded far less than those of other areas comes next. Whereas in all these areas, exports to the EEC increased more than total exports, the reverse was true for the countries in South and East Asia.

In the case of that area, the dissymmetry between the two flows of trade resulted from the action of a number of factors apart from the setting up of the EEC. The EEC was never an important outlet for the products of that area; during the period under review, North America and Japan became eager purchasers of primary and manufactured products of that region, and the Eastern trading area also con-

Table 7: Exports of developing areas to the world and to the EEC (in million US dollars, fob)

	to the World			to the EEC		
	1960	1971	Increase	1960	1971	Increase
Total developing countries	27,490	61,140	122%	6,225	15,260	145%
Middle East in Asia	4,240	13,500	218%	1,280	4,300	235%
Africa	5,390	13,410	148%	2,320	6,000	158%
Latin America	8,610	15,250	77%	1,580	3,045	92%
South and East Asia	7,670	16,040	109%	845	1,550	83%

Source: GATT, loc.cit

Table 8: Trends of exports of South and East Asia in the period 1960/71 (increase 1960/71 in percentages 1960=100)

Total	Industrialized area	North America	EEC	EFTA	Japan	Developing areas	Eastern trading area	Australia, New Zeal., S. Africa
109%	141%	226%	83%	21%	247%	74%	112%	50%

Source: GATT loc.cit.

cluded large contracts with some countries in Asia; on the other hand, trade with all the other markets such as the UK and other EFTA countries, the group of semi-industrialized countries and the developing areas expanded even more slowly than trade with the EEC.

The only group of countries whose exports to the EEC were practically stagnant during the 60's comprises the three semi-industrialized countries of Australia, New Zealand and South Africa. As these countries are mainly exporters of agricultural products, the first explanation which comes to the mind is that the Common Agricultural Policy of the EEC slowed down purchases of foodstuffs from these countries. There is no doubt that the lack of competition between the EEC agricultural producers reduced to a minimum the trade-creating effect of integration in that sector; but the effect of that policy in the case of Australia, New Zealand and South Africa seems to have been negligible. Before the EEC was set up, these countries exported marginal quantities of foodstuffs to the EEC, their main exports being wool and ores and non-ferrous metals which are practically duty-free. As in the case of Asian countries, there has been a striking re-orientation of the export trade of that group towards Japan, the developing areas and North America; sales to EFTA were a shade more sticky than sales to the EEC.

Table 9: Exports of Australia, New Zealand and South Africa, 1960/71
(increase 1960/71; 1960=100)

Total	Industrial area	North America	EEC	EFTA	Japan	Developing areas	Australia New Zeal. S. Africa	Eastern trading area
115%	101%	166%	44%	26%	360%	192%	141%	28%

Source: GATT, loc.cit.

From the foregoing analysis can be drawn the conclusion that, on the whole, the trade-creating effect of the EEC has been sufficient to make-up for the trade-diverting effect which speeded up the intra-regional movement of goods; the main beneficiaries of the rapid economic growth of the Community have been most developing countries, European trading partners and Japan whose exports expanded significantly; the other countries held more or less their ground. It should be mentioned in this connection that the Common External Tariff - and therefore the margins of preference enjoyed by EEC exporters - was greatly reduced as a result of the Dillon and Kennedy

Rounds of negotiations under the auspices of the GATT and that such concessions mitigated the trade-diverting effect.

Although the misgivings of non-EEC countries centered mainly around the differential treatment accorded to the exports of outsiders, the EEC brought about other changes in the balance of economic forces. A better allocation of resources and, in the agricultural sector, a greater readiness to support exports of foodstuffs have increased the aggressiveness of EEC exporters. The Community has captured a bigger share of world markets (from 23% to 28% in the 60's)[4] and moved from a slight deficit in its balance of trade in 1957 to a surplus of more than 5 billion US dollars in 1971. The improvement is remarkable, though far less spectacular than in the case of Japan and is more significant on the European market than for trade with other regions. While the EEC enjoys a hefty surplus in Western Europe and exports more to Eastern Europe than it imports from it, it is still in the red with North America; except in 1968 and 1971, the deficit ranged from one to two billion dollars, on a fob basis; the deficit with Japan is also sizeable and we have seen that EEC imports from developing areas, largely on account of increased energy requirements, substantially exceed its exports.

Table 10: Trade balance of the EEC with its partners in 1971
(in million US dollars, fob)

	N. America	Japan	Developing countries	
Adverse with	-740	- 700	- 2,570	
	Other W.Europe	Eastern trading area	Australia, New Zealand & S. Africa	Total
Positive with	+ 7,560	+ 270	+ 680	+ 5,220

Source: GATT, loc.cit.

Trading nations have still other worries with the EEC; they sometimes complain that the administrative set-up is too rigid as a result of the unanimity rule which is strictly applied when instructions have to be given to EEC negotiators and that the division of powers between the Commission responsible for tariff matters and the individual governments which decide on other matters seriously complicates the process of discussion with the Community. The bureau-

4 OECD, loc.cit., Table 3, Page 140.

cratic structure is indeed formidable in Brussels, but EEC negotiators claim that similar difficulties are faced in other capitals such as Moscow and Washington where differences of opinion between departments may be as frustrating as divergences between individual EEC governments.

Another source of complaint which shall be considered later is the tendency of the Community to expand along unethical lines through preferential agreements and to build up around the Customs Union a new trading system which would discard the time-honoured principle of the unqualified most-favoured-nation.

Finally, some fear that the economic strength of the EEC may encourage the adoption by its Members of policies stressing their independence vis-a-vis the big powers. Neither Washington nor Moscow relishes the prospect of a Third Force which raises its ugly head from time to time and which could eventually be far more damaging than any foreseeable impact on trade flows.

III. The enlargement of the EEC and its possible effects on the economic interests of the Pacific area

Ever since the EEC was set up, the other West European countries tried to work out some form of association with the EEC which would provide them with the benefits of free trade in manufactured goods but would avoid the broader commitments involved in the Rome Treaty. When the Six flatly refused to consider the Maudling scheme or any similar formula, most of these countries retrieved the main elements of the European Free Trade project of the United Kingdom and organized, among themselves, the EFTA which was considered more as a pressure group or a bargaining counter than as a permanent institution. Eventually, when the mountain showed no inclination to move to Mohammed, Mohammed went to the mountain. The British government, followed by Denmark, Norway and Ireland decided to accede to the Rome Treaty; they will become full members in January 1973 with the exception of Norway whose public opinion was frightened by the autocratic (or rather bureaucratic) image of the EEC instituions as well as by increased competition from farmers and fishermen of other EEC countries.

For various reasons, mainly political, the other members of EFTA were not prepared to accept the terms of accession and they negotiated agreements which are very similar to the free trade arrange-

ments of the Stockholm Convention. Thus enlarged, the EEC group covers the bulk of Western Europe. When the special agreements which have been concluded earlier or which are contemplated with members of the British Commonwealth are taken into account, the influence of the enlarged EEC may reach the whole of Western Europe, the Mediterranean Basin, a large slice of Africa, part of Asia, the Caribbean area and part of the Pacific islands.

Leaving aside the political implications of this unprecedented redeployment of forces, the countries remaining outside of the group may fear a profound upsetting of the world economic and commercial structure. For them, the enlargement of the Community is a shot in the dark. The giant may become stronger but it may also acquire feet of clay. No doubt, the newcomers may influence the policies of the Community in the right direction or soften some of the more obnoxious features of the institution, such as the Common Agricultural Policy and the French government was at times shuddering at the thought that the United Kingdom might prove a modern Trojan horse teleguided from Washington. It seems that these fears were exaggerated and that, for the time being, Whitehall shows the ardent faith of the newly-converted in the European creed. It is clear, however, that while the team is larger it will be more difficult to keep in line.

Addressing ourselves now to the more pedestrian task of assessing the possible impact of the enlargement of the EEC on the trade interests of countries in the Pacific area, we shall be guided by the lessons of the experience gained with the original Community of Six. It seems fairly well established that regional integration unleashes two sets of conflicting forces: a trade-diverting element resulting from the preferential treatment accorded to the exports of the partners and a trade-creating element generated by the quickening of the pace of economic growth which is caused by the removal of internal barriers and the increased competition inside the area. If the former element is stronger than the latter, the group will be inward-looking and degenerate into a closed bloc; if the latter is at least as strong as the former, the export interests of outsiders will not adversely affected and the integration will have a positive effect on world welfare.

It would appear that, so far at least, the trade-creating and

trade-diverting effects of the EEC have been nicely balanced. This may be due, to a certain extent, to some special factors. The Dillon and Kennedy Rounds have greatly checked the trade-diverting trends and the inflationary atmosphere of recent years has re-inforced the trade-creating undercurrents. Moreover, there are significant differences between the former project and the present one.

In the late fifties, trade with Europe was still hampered by many obstacles: tariffs were high in several countries and import controls against non-European suppliers were still numerous. Concurrently with European integration, trade with other continents made continous progress; many foreign manufactured goods, especially consumer goods, became freely available to the European consumer or producer. Things have changed and there is very little pent-up demand for such products; moreover, the Community producers are better equipped to meet foreign competition and they enjoy a sufficient elasticity of production to satisfy a growing demand. It would be safe to discount somewhat the positive impact of increased growth on the propensity to import as compared with recent experience.

On the other hand, there are some bright points. The alignment of the British tariff will lead to a significant lowering of its incidence for non-Commonwealth countries and the disadvantage of Commonwealth preferences for such suppliers will be reduced in many instances. Conversely, the countries enjoying such preferences will lose their privileges and find continued access to the British market far more difficult than before. Of course, many of the smaller Commonwealth developing countries will have the opportunity of negotiating special agreements with the enlarged Community; all British dependent territories, with the exception of Gibraltar and Hong-kong will be offered association under the terms of Part IV of the Treaty of Rome; the independent Commonwealth developing countries in Africa, the Caribbean, the Indian Ocean and the Pacific will be able to choose between association under a renewed Yaounde Convention, some other form of association (without development aid) or the conclusion of a commercial agreement.

Apart from the offer to negotiate such agreements and the promise to examine with the Commonwealth countries concerned any trade problems which might arise, the only specific safeguards which were secured from the EEC relate to the Commonwealth sugar agreement and to the exports of dairy products by New Zealand. Australia and Canada

had to be content with minor concessions affecting lead, wood products and phosphorus.

The main question-mark, however, is whether accession to the European Community should revigorate the British economy. This is the chief objective of the UK government and there are valid reasons to believe that this aim could be achieved. The EFTA arrangements did not provide the necessary medicine to British anoemia; indeed, exports to Western Europe increased but the EFTA markets were in any case limited and with a few exceptions, competition from their partners did not force the British producers to proceed to the necessary shake-up. This time, the medicine will be stronger and there are signs that British industrialists will meet the challenge. Moreover, the entry of the United Kindom into the Community involves a drastic reorientation of British trade. Until now, the United Kingdom was less dependent on European markets than its partners and this special situation cannot persist in the new environment. Of course, the process has already started and accession to the EEC only means that it will be accelerated; but the impact of such a re-orientation of traditional trade flows may be one of the most conspicuous consequences of the enlargement of the European Community.

Problems arising out of greater European integration for individual countries of the Pacific area

For the sake of convenience, we shall consider separately the case of the developing countries in the area, Australia and New Zealand, Japan, China, Canada and the United States

Developing countries The exports of the developing countries in the Pacific area and its hinterland (ranging from Burma to Fiji) to the enlarged EEC amounted to a little less than 2 billion US dollars (on a cif basis) in 1970; the Six absorbed 1,238 millions, the United Kingdom 604 millions, Denmark 45 and Ireland 10. Whereas the British purchases came predominantly from Commonwealth suppliers, the EEC bought a little more from non-Commonwealth countries. The proportion of manufactured goods imported by the UK was greater than that of the EEC purchases, but this was mostly accounted for by imports from Hong-kong. As in the case of other trade flows, sales to the EEC increased more than sales to the United Kingdom (by 160% against 84% during the period 1958/70). With the exception of Indochina and, since 1965, of Burma and Indonesia, all countries and

territories shared in the expansion of trade with the EEC, whereas exports to UK increased mainly from Hong-kong.

The EEC as well as the United Kingdom bought raw materials (rubber, jute, wood, oilseeds, tin), foodstuffs such as vegetables from Thailand and Indonesia, roots and tubers from Taiwan, feeding stuffs and tropical beverages (coffee for the EEC and tea for the UK). The major imports of manufactures relate to cotton fabrics, clothing, toys, telecommunication and other electric equipment, footwear and processed materials such as vegetable oils, wood shaped and veneer.[5]

The enlargement of the EEC is unlikely to check the recent expansion of exports to the Six, especially if the generalized preference scheme continues to operate and the markets of Denmark and Ireland are likely to follow the same trends as those of the Six. The situation, however, may be different in the case of the United Kingdom. The non-Commonwealth countries which so far have had only a toehold on this market may well expand their sales in the absence of the existing Commonwealth preferences. On the other hand, the Commonwealth countries, and in particular Hong-kong are likely to suffer from the accession of the UK. Admittedly, Hong-kong will be eligible for the EEC preferential regime and the UK will probably see to it that tariff quotas for sensitive items will be enlarged so as to maintain the present flow of goods; on the other hand, the EEC system will be more restrictive than the controls now in force in Britain and the other members of the Community will be reluctant to let them in by the back-door. This may, to a lesser degree, apply to Singapore. Fiji's interests as a sugar exporter are covered until the Commonwealth Sugar Agreement comes to an end and are likely to be duly taken into account thereafter. The other developing Commonwealth countries would benefit from the more rapid growth of the British economy which is expected to result from accession.

Asutralia and New Zealand It was always assumed that Australia and New Zealand would be seriously affected by the entry of Britain in the Common Market. In 1970, Australia exported sligtly more to the UK than to the EEC and New Zealand exported three times as much to the former than to the latter. The bulk of New Zealand's exports to the UK is made up of meat and dairy products which come under the Common Agricultural Policy. Although Australia depends less on exports of agricultural products, it remains a major exporter of wheat,

[5]See Appendix, Table II.

meat, sugar and fruit to the British market. For both countries, the EEC has never provided significant outlets for the export of foodstuffs, before or after the conclusion of the Rome Treaty. Exports to Denmark and Ireland are insignificant (10 and 15 million dollars in 1970).

Table 11: Trade of Australia with the EEC and the UK
(in million US dollars, cif basis)

Exports to	EEC		UK	
	1958	1970	1958	1970
Total	382	567	569	622
of which:				
Wool	284	253	175	63
Hides and skins	39	69		
Ores n.ferrous metals	12	49	7	34
Iron ore	-	38		
Copper	4	30		
Lead, zinc, nickel	2	16	23	87
Foodstuffs	22	38	299	327
of which				
Meat & prep.	1	3	132	69
Butter	-	-	33	47
Wheat, barley	14	19	20	92
Fruit	7	16	72	66
Sugar and honey	-	-	34	44

Source: OECD, EEC and UN import statistics

During the period 1958/70, Australian exports to the EEC expanded only moderately, though more than sales to the United Kingdom. Wool is still the main export item to the EEC, but its share declined as compared with other materials, especially ores and non-ferrous metals; foodstuffs remained at a very low level. In the case of the UK, sales of wool have contracted substantially; foodstuffs account for about the same values as in 1958, even though the composition of such exports has changed; ores and metals have expanded as in the case of the EEC.

To offset the shrinking of its outlets in the United Kingdom - and in Western Europe as a whole - Australia looked for other mar-

kets and it has already succeeding in diversifying its export trade as other semi-industrialized areas (See Table 9, page 16 above).

Table 12: Trade of New Zealand with the EEC and UK
(in million US dollars, cif basis)

Exports to:	EEC		UK	
	1958	1970	1958	1970
Total	118	153	453	488
of which:				
Wool	93	90	94	52
Hides	11	25	5	11
Chemical products	1	12	3	3
Meat and Prep.	2	11	170	224
Butter			109	111
Cheese	1	-	41	39
Fruit			6	10

Source: OECD, EEC, UN import statistics.

During the early 60's New Zealand's exports to the EEC and to the UK had increased substantially, but after 1965 they have come down to a level close to the 1958 figure; the decline of wool exports to the UK, however, has been continuous during the whole period. The EEC purchases mainly wool, hides and chemical elements; purchases of the staple New Zealand agricultural products are negligible. The situation is very different in the case of the United Kingdom which buys mainly meat and dairy products. Dairy products still account for 15 per cent of New Zealand's exports, and 85 per cent of these products are sent to Britain. The loss of the preferences and the application of the Common Agricultural Policy by the enlarged Community could involve serious losses for New Zealand. To prevent such an adverse effect, special arrangements have been negotiated between UK and the EEC which provide at least a valuable breathing space. For cheddar cheese which does not compete directly with EEC production, the quantities for which a market in the UK is guaranteed will be gradually brought down to 20 percent of the present level; for butter, the reduction will be smoother, by 4 percent each year to a level of 80 percent after five years. In terms of milk equivalent, the total reduction will be of about 30 percent, but returns per unit should be more attractive as the guaranteed price will be higher than the average of recnt years. So far as lamb is concerned,

the 20 percent tariff which will be introduced gradually is not considered to be a serious obstacle.

Other commitments and promises have been made to ensure that New Zealand's interests would be duly taken into account by the enlarged Community. New Zealand whose trade with Western Europe as a whole remained more or less stagnant during the period under review will probably continue to maintain its exports at the present level and will therefore have to speed up its policy of diversification of markets to reach a reasonable rate of expansion.

Australia did not obtain any special treatment for its exports with the exception of small tariff adjustments for some metals and it cannot expect any advantage for its sugar after the Commonwealth Sugar Agreement comes to an end. The loss of preferences is, however, less dramatic than in the case of New Zealand. The share of the UK market in Australia's exports has already gone down to 12 per-cent and sales to London of Australian wheat, sugar and dairy products comprise only 1 per cent of total Australian exports. Meat should not raise any serious problem and the booming trade in minerals will not be affected. If the rate of production in industrial countries continues to grow rapidly, Australia should not suffer serious damages as a result of the enlargement of the EEC, but it will have to pursue the re-orientation of its foreign trade which is already well advanced and look more and more in the direction of its Pacific neighbours.

Japan The position of Japan is fundamentally different from that of other industrial countries; the trends of its foreign trade were far more influenced by internal than by external factors, at least until August 1971. Its exports, propelled by a spectacular expansion in industrial production, increased at a breath-taking pace in all directions; but the most rapid growth was certainly to the EEC (more than ten times, against an average of seven times). The Community which absorbed a little more Japanese goods than the United Kindom in 1958 now buys three times more than Britain. Japanese exports to Denmark and Ireland have also expanded substantially and amounted in 1970 to 79 and 15 million dollars, respectively.

The structure of Japanese exports to the EEC and to the UK is very similar - and this applies also to exports to other acceders - but it differs substantially from that of exports to North America;

Table 13: Trade of Japan with the EEC and the UK
(in million US dollars, cif basis)

Exports to:	EEC		UK	
	1958	1970	1958	1970
Total	116	1,232	99	317
of which:				
Fish prepar.	12	58	54	43
Chemicals	4	47	1	14
Plastic mat.		37	-	22
Textile yarns and fabrics	23	40	9	10
Iron and steel	4	175	-	10
Office machines		56	-	15
Machinery	1	97	-	19
Telecommun. equip.	1	68	-	16
Electric. machin.	2	63	-	17
Road motor vehicles		53	-	13
Clothing	4	22	1	5
Scient. instr.	3	88	-	17
Musical instr.		44	-	9
Toys and games.	4	33	-	5

Source: EEC, OECD and UN import statistics.

the only main difference between the EEC and the UK concerns iron and steel products which represented by far the main EEC import item in 1970 and were not of real importance for the UK. Textiles and clothing play a minor role as a result of restrictions; new items such as plastic materials, office machines made their appearance in the 60's whereas scientific instruments (including photographic material) and musical instruments are expanding rapidly; machinery and electrical equipment have become major export items.

Is it likely that the enlargement of the EEC will slow down the progress of Japanese trade? Apart from fish, all the products exported are manufactured goods; the tariff advantages wihch European producers will enjoy on the enlarged EEC market are not likely to blunt the competitive edge of Japanese exporters who have been able so far to overcome the protection accorded to the local industrialists on their domestic or regional market. The only moot point

concerns the "sensitive" items which are subject to import or export contols. The degree of restriction in the EEC and in the acceders is not very different and it is probable that the actual situation will remain unchanged, with or without enlargement of the Community. In this connection, much will depend on the import policy of Japan. European countries complain that a reasonable balance can only be restored if Japan increases its imports of manufactured consumer and capital goods. The shares of manufactured consumer goods (Sections 6 and 8 of SITC) and of capital goods (Section 7) account for 37 and 14 per cent of total US imports; 31 per cent ant 22 per cent of EEC purchases, 28 per cent and 17 per cent of British imports; the corresponding figures are 35 and 28 per cent for Denmark and 31 and 27 per cent for Ireland. The differences correspond either to the lower development level and the smaller size of Denmark and Ireland or to the inflationary trends in the US or to the relative economic stagnation which influenced industrial investments in the United Kingdom. The structure of Japanese imports is very different: manufactured goods represent only 18 per cent of imports for Sections 6 and 8 and 11 per cent for Section 7; even when the very high share of raw materials and the improvement achieved recently are taken into account the outlets for foreign manufactures are still narrow in Japan. It will be difficult for European governments to relax significantly their present restrictions unless they can see the outlets for their manufactures in Japan improve substantially.

On the other hand, Japan would be among the major beneficiaries of any stimulation of economic growth which would result from the enlargement of the EEC. Its main export items enjoy a high income-elasticity of demand, whether they are addressed to the final consumer or the industrialist.

China Exports of Mainland China remain small; in 1970, sales to the EEC were of the order of a quarter billion dollars - about as much as those of Hong-kong; those to the United Kingdom reached a figure of about 70 million - four times less than those of Hong-kong and exports to Denmark and Ireland were marginal. That trade flow does not seem to be much influenced by the EEC arrangements; China's sales to the Community expanded significantly whereas its exports to the UK remained stagnant. The structure of such sales is similar for all European destinations: the larger share is taken by raw

materials; then a few consumer goods such as textiles (fabrics and carpets) and clothing; the balance is composed of foodstuffs (meat, cereals, tea, fruit, fish), vegetable oils and crude chemical products.

The future of Chinese trade with Western Europe will depend more on the evolution of broad economic and political relations than on commercial policy measures on the part of the enlarged EEC. Indeed few of the main Chinese export items are vulnerable to competition from European producers.

Canada As a member of the British Commonwealth, Canada has a big stake in the British market. Although Canadian exports to Britain have been sluggish during the period under review, they still accounted in 1970 for more than one and a half billion US dollars, about one-fourth more than exports to the EEC; Britain spent in that year roughly the same amounts in Canada and United States to purchase consumer goods whereas the EEC spent nearly three times more in the US than in Canada. It was of course more advantageous for American firms to sell to Britain through their Canadian subsidiaries but, in addition, the bulk of these sales concerned processed local materials such as paper and non-ferrous metals.

From 1958 to 1970, purchases by the EEC from Canada increased more rapidly than those by the UK, in spite of integration, and from 1965, far more rapidly than its purchases from the US (by 113 per cent against 59 per cent).

If we leave on one side for a moment trade with Denmark and Ireland which absorbed in 1970 respectively 23 and 25 million US dollars thinly spread over cereals, paper, non-ferrous metals, wood and fish, Canada exports to Western Europe mainly primary products and processed goods such as non-ferrous metals and paper, which account for 75-80 per cent of the EEC and UK imports from Canada. The share of metallic ores and metals has become much larger than that of wood, pulp and paper, on the one hand, and of foodstuffs, on the other, which are about equal in size in both cases. The share of machinery and transport equipment remains small, except for certain deliveries of aircraft equipment to the EEC in 1970.

Exports to the United Kingdom have suffered the same erosion as those of Australia and New Zealand in so far as foodstuffs are concerned; in spite of the substantial increase recorded for ores and metals, the UK only absorbs 9 per cent of Canadian total exports,

Table 14: Trade of Canada with the EEC and the UK
(in million US dollars, cif basis)

Exports to:	EEC		UK	
	1958	1970	1958	1970
Total	427	1,260	864	1,593
Section 0	120	206	312	262
of which:				
Cereals	113	176	268	168
Section 1 (Bev. & tob.)	2	1	16	40
Section 2 (Raw materials)	146	588	235	436
of which:				
Wood & pulp	16	195	91	162
Min. ores	51	132	76	216
Section 6 & 8	138	300	250	642
of which:				
Paper	4	24	68	116
Non-ferr. met.	71	192	165	398
Section 7 (Machinery)	9	126	11	92
Non-el-mach.	5	35	7	45
el. mach.				
Aircraft equ.	3	72	2	38

Source: OECD, EEC and UN import statistics.

against 17 per cent in 1960. The loss of preferences is however not so dramatic as might be assumed on the basis of aggregate trade figures. Nearly one-third of UK's purchases of Canadian goods will remain duty-free and special arrangements will maintain a reasonable flow of trade at low or zero duty, either indefinitely or for some years to come, for major items such as newsprint, plywood, wood pulp, phosphorus and aluminium. In the case of cereals exports to Britain have already declined substantially and it is likely, as surmised by the British government, that the remaining hard core, i.e. hard wheat and malting barley obtained from Canada will not be displaced by EEC supplies; this assumption is borne out by the experience gained so far in the Community.

Even though less than 10 per cent of Canadian exports go to the UK, this flow of trade is worth one and a half billion dollars as pointed out earlier, and, in spite of the energetic efforts of the

Canadian government to look for other outlets in Latin America, in Asia and even in Communist countries, alternative outlets are not so easy to find if one does not want to be too dependent on the US market.

United States Before examining the possible effects of the enlargement of the EEC on the trade interests of the US, it is necessary to get the facts straight concerning the impact of the original EEC on US exports and imports. According to the High-level OECD group, the compound annual rate of growth of US exports to the EEC during the period 1960/70, was slightly higher than the rate for total exports (7.8% compared with 7.6%) while the rate for EEC exports to the US and to the world was exactly the same (11.5%); but US imports from the EEC increased less than those from Canada or Japan. As regards US exports of agricultural products, the annual growth rate from 1960-62 to 1968-70 was 5.1 percent to the EEC and 4.9 percent to the world, so that the EEC absorbed in 1970 a little more than 23 percent of total US exports of agricultural products, i.e. the same share as in 1960. On a fob basis, the trade deficit of the EEC with North America (essentially with the United States) exceeded one billion dollars each year except in 1968 and 1971 and reached a figure of more than 2 billions in 1970. To this deficit should be added the growing outflow of direct investment income which, on the basis of a 20 percent share in total US direct investments abroad in 1970, was probably of the magnitude of 1.2 billion dollars in that year.

The picture is different in the case of the UK (and EFTA as a whole). The rate of growth of US exports to those countries during the 60's was below average (5.9% as compared with 7.6%) while exports of EFTA to the US increased more rapidly than exports to other destinations, but US imports from that area expanded less than those from other areas. The difference is still more striking in the case of agricultural trade: US exports of such products to the EFTA increased only at the rate of 1% of a year, much less than US imports of such products from EFTA. The trade deficit of the EFTA with North America declined substantially since 1964 and exceeded the billion mark only in 1970; trade was balanced in 1971. Moreover, the outflow of investment income was less important - about two-thirds of the EEC figure in 1970, as US direct investment in the UK

Table 15: Trade of the US with the EEC and the UK
(in million US dollars, cif basis)

	E E C			U K		
	1958	1965	1970	1958	1965	1970
Total	2,803	5,688	9,035	988	1,886	2,754
Section 0 (Foodstuffs)	317	955	1,093	221	297	291
of which:						
Cereals	206	602	580	154	169	166
Fruits, veg.	52	108	112	27	50	46
Feedstuffs	68	152	309			
Tobacco	9	123	130	132	96	136
Section 2 (Crude materials)	657	863	1,386	179	175	198
of which:						
Oilseeds	89	271	500	2	20	26
Pulp	31	76	166	22	32	58
Wood shaped	13	67	92			
Cotton	277	110	28	97	25	4
Crude miner.	30	84	141			
Metal. ores & scrap	114	98	285	28	22	46
Section 3 (Fuels)	529	343	368	55	29	25
of which:						
Coal & coke	455	178	276			
Section 5 (Chemicals)	250	554	998	76	201	265
of which:						
Elements	106	295	498	29	75	99
Med. pharm.	34	109	81			
Plastics		88	180		57	71
Sections 6 & 8 (Manufact. consumer goods)	331	862	1,724	169	457	666
of which:						
Paper	13	76	161	21	45	57
Iron & steel		51	334		21	117
Non-ferrous metals	163	238	378	99	118	85
Scient. inst. phot. equipments	33	133	263	10	63	110
Section 7 (Machines & transport equipment)	549	1,396	2,950	146	558	1,132
of which:						
Non-elect. m.	298	745	1,498	108	355	674
(Off. machines)	28	124	468		75	270
Electr. machines	87	332	752	22	136	259
Transport equip.	164	318	700	15	67	199
(Aircraft)	109	228	570	-	29	167

Source: OECD, EEC and UN import statistics.

which was of the same magnitude as investment in the EEC in the late fifties increased less rapidly in the sixties.[6]

To assess future trends, a more detailed analysis of the trade in the main categories of products is necessary.

Generally speaking, US exports to the EEC have been more influenced by broad factors affecting the US export trade as a whole than by special features of the European integration process; on the other hand, the slow economic growth of the United Kingdom during the period under review played a major role in the evolution of US exports to that country.

Firstly, there is a striking similarity between the rate of growth of the main categories of US exports destined for the EEC and for the rest of the world, i.e. less than average for agricultural products, about average for raw materials, and much higher than average for manufactured goods, especially for capital goods.

In addition, the structure of EEC imports from the US is also very similar to that of total EEC imports (including intra-EEC

Table 16: Growth of US exports to the EEC and to the world by broad categories

	EEC (1958-1970, cif)	World (1960-70, fob)	Annual rate of growth of US exports
Total	222%	109%	7.6%
of which:			
Section 0 + 22+263 (agric. prod.)	137%	49%	4.0%
Section 2 - 22-263 (crude materials)	195%	92%	7.3%
Sections 6 & 8 (consumer goods)	521%	104%	8.7%
Section 7 (capital goods)	438%	154%	

Source: Import statistics and GATT; Trends in US merchandise trade.

[6] The data and figure quoted in the last two paragraphs are taken or derived from OECD, Policy perspectives, etc. Tables 5A, 17 and 23 and GATT, Trends in United States Merchandise Trade 1953-1970, Geneva July 1972; Table 16 and 17).

trade); primary products account respectively for 27 and 25 per cent and manufactures for 52 and 53 per cent of the total, although the share of machinery and transport is higher for US products (33 per cent against 22 per cent); the main difference relates to fuels for which imports from the US are much smaller. The pattern of UK imports from the US differs far more from that of its total imports: primary products play a much more reduced role (18 per cent as compared with 35 per cent and, in the sector of manufactures, the share of capital goods in total is much larger for the US (40 per cent against 17 per cent) whereas there is very little difference for consumer goods (24 per cent against 28 per cent).

US exports to Denmark and Ireland amounted to 122 and 37 million dollars respectively in 1958 (on a cif basis) and reached the levels of 327 and 110 in 1970; the increase was slower than in the case of the EEC; as a result, the share of these countries in US exports declined during the 60's as for other Western Europe as a whole though less than that of the UK, which dropped from 7.2 per cent to 5.9 per cent whereas the importance of the Six for US export trade increased slightly from 19.3 per cent to 19.5 per cent.[7]

The probable effects of the enlargement of the EEC on US trade

In view of the structure of US exports, the impact of the enlargement will be different in the various sectors. The sector of capital goods will probably be least affected in view of the comparative advantage enjoyed by US producers in industries which rely to a large extent either on research or on economy of scale, unless multinational companies substantially increase the rate of transfer of producing facilities from North America to Western Europe; however, the pooling of resources in some sectors such as transport equipment may stimulate a shift to European producers. The consumer goods sector is more vulnerable, although a large part of the trade with the US is related to metals (mainly non-ferrous metals) which will not meet a more aggressive competition in the enlarged EEC market, with the exception of larger supplies from Norway (if that country concludes an association agreement with the group). The imports of chemical products from the US have expanded continuously in all countries (EEC, UK, Denmark and Ireland), especially with respect to plastics; the trend will probably continue except perhaps in the case of pharmaceutical products where British and Continental pro-

ducers are competitive; it should, however, be pointed out that the production of such items is largely in the hands of multinational companies which have already set up production facilities in the consumer countries of Western Europe to cope with national regulations.

In the field of raw materials, the UK does not buy much more now than in the late fifties; on the other hand, the Six and the other acceders have more than doubled their purchases from the US. For non-agricultural materials, there is very little competition with EEC producers, and in any case, these imports usually enter duty-free. For fuels, the only sizeable item is coal and coke; it is not very likely that Britain could displace the remaining EEC imports of US coal and petroleum products are of secondary importance. The main factor affecting materials and fuels will probably be the rate of growth in the enlarged EEC and, especially in the United Kingdom.

The situation is more difficult to assess in the case of US agricultural exports. The impact of the EEC on such exports has been much less adverse than is sometimes stated. It has already been noted that the rate of growth of US exports of agricultural products to the EEC over the period under review was slightly higher than that for total exports and that the EEC accounts for the same share as in 1958. The parallelism is also apparent in the moves up and down: an expansion until 1966, then a recession until 1969 and a recovery in 1970; the magnitude of the swings is about the same in both cases.

The same applies for individual products. The following table shows the trends for the main items during the 60's; with few exception, the moves were similar and make it difficult to detect the correlation between the variable levies and the trade flows which is often considered as of overwhelming importance. It is true that oilseeds and cakes have fared better than other items and that they are not subject to variable levies, but US exports of cereals which are subject to levies have expanded more in the trade with the EEC than in the trade with the rest of world; in 1970 the EEC disbursed the same amount of dollars for wheat as in 1966 wherease total sales declined nearly by half. No doubt cotton has lost more in the case of the EEC, but there is no duty, no variable levy and no other restriction on that material. Finally tobacco which is considered as

[7] US international economy policy, loc.cit. Chart 32, page 370.

Table 17: Growth of US exports of major agricultural products to the EEC and to the world (index 1960 = 100)

	EEC			World		
	1960	1960	1970	1960	1966	1970
Total agric. exports	100	146	155	100	142	148
Cereals	100	248	185	100	180	146
of which:						
Wheat	100	207	212	100	150	108
Other grains	100	259	178	100	224	200
Oilseeds and cakes	100	292	458	100	207	319
Cotton	100	21	6	100	44	38

Source: GATT loc.cit. Tables 5 and 7.

a sensitive item followed the same trend as total US exports of the product.

The enlargement of the EEC may affect, on the one hand, the terms of competition with acceding countries on the markets of the Six and, on the other hand, the competition with all EEC members on the UK, Danish and Irish markets. So far as the Six are concerned, it is unlikely that the terms of competition will change in the near future as the acceders are not exporting the same type of goods as the US; it is not very likely either that the policies followed by the EEC will be very different from the present ones. The British government has stated its intention of encouraging an increase in British farm output, estimated at some 8 per cent by 1977 as a result of accession and part at least of that additional supply requires a fairly high level of protection to be maintained around the regional market. Clearly, the UK has an interest in influencing the EEC policy in the direction of cheaper outside supplies but it is doubtful that this could be successful so long as the British government is prepared to guarantee a high level of support to its own farmers.

With respect to the UK market, the outlets have shrunk during the 60's and the US exports less than in 1960 (431 as compared with 527 million dollars). This was the result of a greater degree of self-sufficiency achieved through the payment of sizeable deficiency payments to British farmers; the impact of protection through subsidies has been felt also by other suppliers. After accession, the protection will not be less effective and it should be difficult for US ex-

porters to regain the ground lost. In addition, the other EEC members will enjoy privileged access to the British market and may displace US exports. In view of the composition of British imports, such increased competition would be confined to a few sectors such as wheat and fruit; it may be that, as in the case of Canada, the varieties of cereals which are usually sold to the United Kingdom are not available in Continental Europe and that the area of substitution is therefore limited. In the case of Denmark and Ireland, US trade is not large and the main item is oilseeds and cakes since sales of cereals have considerably declined in recent years.

The implications of the enlargement of the EEC are not confined to the export trade of the US with the group; a more aggressive export policy on the part of the Community, especially in the agricultural sector, may adversely affect US interests either through a penetration of the US market or as a result of displacement of US exports on world markets. So far, there has been no special attention paid to the US market by the Six who have not taken advantage of its high propensity to import, except in a few lines, such as steel. Of course, overall EEC exports have been very dynamic and the enlargement will probably stimulate that trend, but this temporary disequilibrium should be eliminated if and when US exports regain their former competitiveness.

In the agricultural sector, however, the EEC has increased its exports to non-EEC countries at the rate of about 6 per cent during the 60's. The additional supply generated by high support prices cannot always be absorbed by the regional market; part of the surplus concerns products which do not compete with major US exports such as sugar and dairy products or are sold to markets such as the Communist countries which so far were neglected by US exporters, but part of it already competes with US exports to developing countries and to Japan. This trend may well continue if production is unduly encouraged in the enlarged Community.

IV. Conclusions

The enlargement of the EEC will create substantial changes in the pattern of world trade and may require painful adjustments for some outside countries. Judging from past experience, the direct impact of integration may be manageable if there is no recession in the future and if the United Kingdom is able to accelerate its rate of

growth. The loss of preferences on the British market is likely to be more awkward for Commonwealth developed countries; the shock may well be more psychological than material as the accession may simply lead to some acceleration of a process which has already started some years ago and is well under way. The countries most affected such as New Zealand, Canada and Australia will strengthen their economic ties with their neighbours and may try to penetrate new markets in the developing world or in the socialist countries.

Apart from the accession of three new members, the Community is attracting other countries in its orbit; its influence will be felt over practically all Western Europe, the Mediterranean Basin, a large part of Africa and other countries in the developing world through a variety of association agreements based on free trade or on preferential concessions. Although the effect of such preferential arrangements may be marginal in trade terms - about 4 per cent of the total Community imports, according to some members of the Rey group, the multiplication of such agreements is disquieting, because it encourages people to think in bloc terms and to move away from the concept of one yardstick for all.

In order to reduce the adverse effects of such regional arrangements, it becomes imperative to whittle down the preferential margins in the course of broad trade negotiations aiming at a gradual elimination of tariff and other barriers. It seems pretty certain that the Dillon and Kennedy Rounds effectively prevented the distortions arising out of the Rome Treaty from causing serious problems to third parties; a new round should do much to protect the trade interests of the outsiders in the future. Preferably, this negotiation should have a more ambitious objective than the preceding rounds; time has come to plan a gradual elimination of trade barriers to the flow of manufactures on the basis of reciprocity and to extrapolate the European arrangements on an intercontinental basis.

So much for the trade aspects. As stated in the Treaty of Rome and reaffirmed on many occasions, and in particular at the Summit meeting last October, the Community is not planned solely as a means to free movements of goods. As President Pompidou put it, it should not be a Community of traders, but it should have a soul. In other words, integration should cover all aspects of economic and social policies and eventually lead to some sort of political federation.

The Community liberalization of trade in agricultural products involved the adoption of a common agricultural policy; the operation of that policy requires monetary stability and close coordination of national monetary decisions; a first step has been taken with the setting up of a Monetary Fund which should enable governments to eliminate over a period fluctuations between the national currencies. Other common policies dealing with energy, industry, and taxation are already on the drawing-board. The next step would be a gradual harmonization of social and foreign policies.

The building-up of such policies will strengthen the Community and enable it to exercise a greater influence over world affairs. Some people still fear the possibility of having to face a Third Force. This is still far remote and national policies are still divergent on many issues; but the implications of a European construction have already a constraining effect on world policies. In the monetary field, for instance, the EEC cannot go too far in the direction of flexibility without endangering the Common Agricultural Policy which remains a corner-stone of the edifice. The experience gained in the reconciliation of different national policies may prove beneficial for others if and when a world-wide system becomes unavoidable. On the other hand, the need to consult among a number of European governments before any position paper is adopted and negotiations can start will delay proceedings and hamper prompt decisions. In addition, the Community tends to develop into a bureau - or rather a Euro-cratic monolithic contraption which stays aloof of realities and inspires misgivings to the citizens. This lack of confidence in the machine was conspicuous in the Norwegian and Danish referendum campaigns.

The European Community is a fact and one has to live with it as with other facts; it has good and bad points. Its action has not been as positive as some expected nor as negative as others feared. It is still in a fluid state and much will depend on the progress to be made in the course of the next few years in the streamlining of its institutions and in the awareness of its Members of the Community's responsibilities as a potential major power. It is not likely that a similar integration system could develop in other parts of the world and lead to the formation of conflicting blocs; on the other hand, it is highly desirable that the principles of trade liberalization and harmonization of national policies accepted by the

EEC be gradually recognized as valid by all developed nations and, later on, by other countries when they reach a certain level of development with a view to an eventual merger of individual states into a world-wide unit.

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APPENDIX

Table I: Exports to the world and to the EEC (in million US dollars, fob basis)

Exports from	To the rest of the world			To the EEC		
	1957	1971	Increase	1957	1971	Increase
World less EEC	86,570	246,290	185%	15,475	45,420	193%
Industrial areas less EEC	45,750	140,970	208%	8,280	25,680	210%
of which:						
N. America	23,820	60,760	155%	3,595	9,370	161%
W. Europe less EEC	19,070	56,120	194%	4,545	14,670	223%
Japan	2,860	24,090	742%	140	1,640	1071%
Developing countries	25,440	61,140	140%	5,590	15,260	173%
Australia, New Zealand, S. Africa	4,090	8,450	107%	900	980	9%
Eastern trading area	11,300	35,730	216%	705	3,500	396%

Source: GATT International trade in 1965 and 1971.

Table II: Exports of developing countries in the Pacific area to the EEC and to the UK (in million US dollars, cif)

Exports from	To the EEC			To the UK		
	1958	1965	1970	1958	1965	1970
Burma	7	21	13	19	17	10
Thailand	26	97	126	10	20	13
Malaysia	152	165	270	113	93	112
Singapore	17	6	40	57	45	80
Laos, Camb. & Vietnam	55	41	21	1	7	3
Indonesia	123	228	219	31	11	17
Philippines	71	118	75	7	11	14
Hong Kong	19	125	275	76	197	300
Taiwan	6	38	127	1	4	14
Korea	-	14	69	-	4	17
Fiji	-	-	3	14	27	24
Total	476	853	1,238	329	436	604

Source: OECD, EEC, UN import statistics.

Comments and Discussion of Royer's Paper

Peter Drysdal opened the discussion: Mr. Royer presents a challenging and optimistic view of the impact of an enlarged European Community on the rest of the world economy, even trading opportunities for countries in the Asian-Pacific Region. Let me say at the outset that, unlike some of my countrymen but like Mr. Royer, I believe that, on balance, the emergence and growth of the European Community has been a major positive force in world affairs in the postwar period - but perhaps the contributions have been greater to non-economic than to economic affairs. Nonetheless, there remain for me many difficulties with the view of the Community's role presented in Mr. Royer's paper.

He argues that European economic integration has been at least as trade creating as it has been trade diverting, and the trend in his reasoning is that the benefits from integration in Europe itself have provided a powerful stimulus to world trade and economic growth beyond the Community itself. Surely, some third parties have been injured by the protectionist effects of European integration - most significantly the semi-industrialised primary product exporters - but one is left with the impression that even they may have gained more than they lost through the growth effect of the union. The enlargement of the community, so the argument runs, will produce even more of the same and roughly in the same direction.

Of course there are grounds for doubt about this analysis of the economic effects of integration and the data available to us here do not remove that doubt. The argument that the superior growth performance of member countries has, in large measure, been a consequence of economic union is difficult to substantiate. In fact, as Mr. Royer concedes on p.6, a large number of other factors acacount for divergent growth performances and perhaps they were more important. Japan, for example, is not yet at least, a member of the European Community and she enjoyed high growth rates too. Despite the mountain of literature on the subject, the case remains unproven. Anyone who has tried to grapple with the analytic problems

of trying to measure the various independent influences of freer trade arrangements on trade and income flows will sympathise with Mr. Royer on this score.

Unfortunately the issues are somewhat clouded by the way in which certain of the data in the paper are presented. For example, the trade growth indices reported in Table C are intended as evidence of the trade creating effect of European integration on most major trading regions. But this evidence is perfectly consistent with the fact that the intensities of trade with the EEC (or relative trade shares) of all regions outside Europe, with the exception of some Eastern bloc countries and Japan, have declined and, of course, the growth of Japan's trade has been from a very small base. Moreover, the apparently impressive growth in developing country trade with the European Community dissembles into an impressive growth in oil trade and a modest growth in trade with preferred African markets.

Mr. Royer is perhaps inclined to underplay the trade diverting or protectionist effects of an enlarged Community. This ground has been well worked over but let me make one or two brief points. As he points out, in the Australian case most of the required adjustments in trade structure have already been effected. But not without economic cost and, perhaps more importantly, cost in terms of the retrogressive effects of the closure of Europe on our approach to commercial policy, which might be described as Mr. Royer describes CAP, as a very impressive construction! Yet there will still have to be more adjustment even in Australia. The statement on p.25 that Australian sales of wheat, sugar, and dairy products sales to the United Kingdom each account for only one percent of total Australian exports understates the adjustment problems involved for those sectors of the economy. The position of New Zealand is, of course, much worse, but that is the subject of another session.

All this aside, Mr. Royer's paper raises more serious questions. Let me focus briefly on just two related questions. They are the question of the evolution of Japan's economic relations with the extended Community and their effect on the world's approach to trade and international economic policies. And there is the related question of what might be called the potential bloc-extending effects of the Community's enlargement and strengthening.

Again, on both these issues Mr. Royer takes an optimistic view.

Indeed, the various possible responses among the world's trade leaders are not explored in his paper. First, he appears confident that the extension of the protectionist elements in an enlarged Community will be constrained or reversed by the coming round of negotiations in Gatt, rather in the same way, he argues, in which the Dillon and Kennedy Rounds checked the inward-lookingness of the old EEC. This will be a major exercise in commercial diplomacy. Second, he believes that the pre-conditions do not exist in other parts of the world for the development of a European-type bloc and that the emergence of competitive preferential systems is therefore so much less likely.

What will finally emerge is perhaps somewhat more problematic. If Japan and Europe were the only two elements in this equation, the probabilities are that the sort of trade deal that might be effected between them would have quite damaging side-effects on Asian Pacific trade prospects and a retrogressive effect on world trade policies. The temptation of preferential arrangements of some kind would be very powerful. Already, of course, the inclination towards extra-official market-sharing arrangements is strong and these may become an acceptable 'adjustment' measure all round. Moreover, Japan's agricultural policy still has much in common with European agricultural policy and, to Japan, arrangements with Europe on supported agricultural exports may seem a small price to pay for less restricted entry to the European market. Any of these eventualities would have damaging effects on access to manufactured goods markets and agricultural markets for developing country and developed country exporters in the Asian Pacific region alike.

There are three important factors in the Japanese-European relation. First, Japan already has substantial trading problems with the Community. There remain over 100 discriminatory restrictions on Japanese exports to Europe. Second, European sensitivities about the accommodation of Japanese trade expansion have been roused, even by the relatively modest Japanese penetration of the European market to date. The Community still obtains only 1-2 percent of its import supplies from Japan whilst Japan herself accounts for around 7 percent of total world import supplies. Third, Europe's bargaining position in any trade deal with Japan, independent of multilateral negotiations, has been strengthened by enlargement. That is precisely the reason for suspension of the earlier round of preliminary

talks.

Fortunately, Japan and Europe are not the only two elements in the equation. The United States may have its difficulties with Japan on issues of trade and monetary policies, but she remains a major ally of Japan and the smaller traders in dealing with Europe. This is really the source of Mr. Royer's optimism. It is doubly important therefore that the repercussion costs of American impatience or protectionism be constantly exposed. At least it would appear wise for those interested in the expansion of opportunities for trade and income growth in Asian Pacific countries to be forewarned about some of the possible dangers.

And this raises a very serious question of Mr. Royer's paper. His judgement, expressed at several points in the paper and stressed in the conclusion, is that CAP remains the cornerstone of the whole European edifice. What grounds are there then for his optimism that the United States and others will in fact be able to succeed in constraining the potential excesses of European protectionism in the years immediately ahead, when agriculture is much of what the United States wants and has to bargain with?

No one could disagree with Mr. Royer that the EEC is a fact and that one has to live with facts. But there are better and worse ways of living with facts. It would seem important to the future of world trade policy for Asian Pacific countries to develop their leverage against Europe in a more co-ordinated fashion. Failure to do this could certainly change, quite dramatically, the long run course of Japanese international economic policy, giving strength to the small voices for Mongolian trade alliances or stronger vertical arrangements with less developed countries.

Lawrence Krause continued the commentary: Mr. Royer has given us an excellent and generally well balanced paper. Yet there are some points on which I disagree with him in terms of emphasis and approach.

First, I would like to make a point that is only incidentally raised by the paper but is felt of some importance. Mr. Royer stated that the share of manufacturing industries continues to improve in the EEC. By "improve" he really means "increase". Unfortunately some observers really believe that manufacturing activity in particular is good for a country and should be encouraged, while agri-

culture and service activity should be discouraged. Presumably this belief arises from the expectation that gains in productivity are easier to achieve in manufacturing. In this respect we may be at the mercy of GNP - accountants who are unable to measure productivity gains in services and therefore, often assume they do not exist. I am concerned because encouraging manufacturing activity often leads to uneconomic subsidizing of exports of these industries and in turn to international disagreements among countries.

Second, I would emphasise possibly a bit more than Mr. Royer, the other factors than joining a common market as a source of growth stimulation for the European countries. Common markets are no assurance of faster economic growth.

The main difference that I have with Mr. Royer concerns agriculture and agricultural policy. He believes that the Common Agricultural Policy (CAP) has been the most important attribute of the EEC aside from trade liberalization, and I agree, but I do not believe that the CAP deserves very high marks as an economic policy. It has led to high and rising agricultural prices that are clearly uneconomic from a social point of view. Also the price structure has been rigidified so that farmers are not given the proper signals as to what to produce. Furthermore, the CAP has complicated the process of necessary exchange rate adjustments among member country currencies.

The CAP has also had an important consequence on the international trade of agricultural products both by restricting excess of imports into the European market and through subsidized exports to third country markets. Exports of the United States as well as other temperate zone producers have been held back as a result. My estimate is that U.S. exports alone could be close to $5 billion higher in the absence of the restrictive policies (at current prices). This estimate comes from U.S. supply capabilities combined with an estimate of European absorptive needs in the absence of CAP and U.S. displacement of European exports in the absence of subsidization (by both the EEC and the U.S.).

I also think Mr. Royer has not given enough attention to the distorting effects of the preferential trade agreements the EEC has been making with a growing number of associated countries. There is a point of principle involved as discrimination becomes the gene-

ral rule rather than the exception in international trade. Also the trade potential of many developing countries is much greater than current levels of trade and thus future consequences may be more serious than current flows indicate.

As far as the expansion of the EEC is concerned, I agree with Mr. Royer that the major consequence will be on the British economy and no one now can be sure exactly what those consequences are likely to be. The areas under the CAP will increase and cause further difficulties in agriculture. Some countries might also be affected through the loss of preferences in the British market.

In conclusion, I think it is fair to say that the EEC has not been a disaster for other countries, but it has not been much of a benefactor either. The most disappointing aspect of the EEC is that it has not developed the sense of responsibility toward world trade commensurate with its position as the world's largest trader. The U.S. waited in vain for Europe to develop an initiative toward more liberal commercial policy. Unless Europe becomes more responsive, the American initiative that President Nixon has indicated will be forthcoming, might end in failure and international trade will seriously suffer under moves toward protectionism by many countries, as Drysdale pointed out.

Subsequent discussion focussed on the effects of the enlargement of the European Community on agricultural trade and trade in labour intensive manufactures from developing countries. Mr. Royer elaborated other points made in his paper.

There was a considerable measure of agreement that there was no cause for optimism about the effects of the enlargement of the European Community on non-member countries. Several participants agreed with the discussants that the European attitude towards the Common Agricultural Policy represented a major stumbling block to progress in international trade policies. But one participant saw the increasing tax burden of agricultural policies on European consumers as providing an eventual reason for their modification.

Another participant was concerned about the effect of quantitative restrictions on manufactured goods imports from developing countries. He suggested that these restrictions had primarily been adopted for protection rather than for adjustment purposes.

Mr. Royer agreed that Europe had a poor performance in its importing of manufactured goods from developing countries, but argued that

there were good historical reasons for that. He stressed that the Common Agricultural Policy could not be assessed merely on economic efficiency criteria. And he said that he had not intended to imply that the European Communities' policies had not disadvantaged non-members, but merely that, on balance, the Community had had beneficial economic effects for the world economy.

2

THE IMPACT OF THE EMERGENCE OF CHINA ON ASIAN-PACIFIC TRADE*

Shigeru Ishikawa

I. Introduction

1. The aim of this paper is to attempt to answer the question: What are the likely international economic implications of China's emergence as a full-fledged member of the international community, especially in the Asian-Pacific area? This question is certainly much more difficult to answer than a similar question regarding impacts of it upon international politics. I myself am inclined to consider that there are a series of possible answers to this question which can be summarized as follows:

(1) China will continue to occupy a relatively minor position at least in the near future. Any change towards a larger and more major role, should such a change occur, will only be a gradual one.

(2) Despite this, however, the western industrial powers will not be able to abandon their strong expectations of China becoming a potentially great market and/or natural-resource base. This will bring about a variety of political-economic repercussions in the Asian-Pacific area.

(3) If the Chinese economic policy in its present phase (which began in the second half of the 1960's) continues to be successful, and

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if the present economic difficulties in many developing countries are not resolved by relying on the conventional mechanisms of international trade, capital movements and economic aid, China's economic impact will become more significant in that the Chinese model of economic development will gradually be disseminated among these developing countries. This dissemination will be facilitated by the extension of China's economic aid, which will serve as a sort of missionary of the Chinese model. In that event, the economic relationships of the industrial powers with these developing countries will be made similar, at least partly, to that with China.

However, I am not arguing that this series of possibilities will be realized even with a reasonable degree of certainty. There are a number of unclear and unpredictable elements both inside and outside China, which make it necessary to add important reservations to these statements.

2. Among these various unclear and unpredictable elements, those of the domestic aspects are worthy of particular note. To elaborate, let me first describe what seem to me to be three major characteristics of the Chinese economy:

(1) The Chinese economy in its present stage is still an under-developed economy. Statistically, this is reflected in the very low level of per-capita income and in the relatively large weight of agricultural output, to take but two aggregative indicators.[1] (Refer to Appendix Table 1.) More importantly, the economy is still in the grip of those factors that tend to bring about "structural imbalances" when a dynamic force emerges and the economy begins to develop. These factors may be called "built-in depressors" and in China, as in many other developing countries, the "food and agricultural problem," the "un- and under-employment problem" and the "foreign trade problem" are among the most serious depressors.[2]

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[1] My own evaluation of the present state of these aggregative indicators is given in Ishikawa, "Prospects of the Chinese Economy: Trends and Cycles," Pacific Community, Jan.1973.

[2] I have discussed the questions of "structural imbalances" and "built-in depressors" in greater detail in Ibid. and in Ishikawa, "China's Economic Landscape: 1966-1995," in J. Bhagwati, ed., Economics and World Order, Macmillan, London, 1971.

(2) The Chinese economy is large in size, and hence, is capable of benefiting from the economies of large-scale, once other requisites are effectively met. In actuality, this scale merit has been brought into full play: China has by now a well developed system of modern industry equiped with techniques and technologies of internationally high standards.
(3) In contrast to the other developing countries, most of age-old institutions and organizations which often act as elements obstructing economic development were effectively eliminated. In their place, very efficient but, at the same time, quite unique administrative, economic and social institutions and organizations have been established along the lines which, while socialist, are also peculiarly Chinese.

I consider that any attempt to evaluate the present state as well as the future course of China's economic development should be made in terms of the interrelationship among these three major characteristics. This interrelationship is sometimes hard to identify, thus resulting in the above unpredictable elements. Yet, some broad outlines are clear. Thus, for example, despite the well developed system of modern industry indicated in (2), the prospects for its development seems to be seriously constrained by the prospects for the structural problems described in (1). Next, the effectiveness of the new institutions and organizations of (3) has been demostrated in their contribution to the establishment of modern industry of (2). It has not yet demonstrated, however, with regard to the solution of the structural problems of (1). As will be discussed in detail, the Chinese government is now endeavoring to tackle the "food and agricultural problem" and the un- and under-employment problem" with major reliance on intensifying these new institutions and organizations in the vast area of China's countryside. And, it seems certain that the success of the former is at least partly on the success of the latter.

The most unclear and unpredictable elements are perhaps involved in the individual evaluation of the nature of (1) and (3) above. Regarding (1), it is extremely difficult to foresee when and how the structural problems will be resolved. Regarding (3), the difficulty of the evaluation comes mainly from the fact that China's choice of institutions and organizations is not necessarily made under the sole criterion of practicability of resolving the structu-

ral problems of (1) and of accelerating the building-up of modern industry of (2). Another and presumably more important criterion is to adhere to the ideology of China's economic policy and, with it, to the blue-print of the Chinese society that this ideology instructs to create.

3. To elaborate on this last point, two points are essential:

(1) For the sources of the dynamic force of economic development, China's economic policy relies not only upon such conventional factors as capital formation and technological progress, but also and heavily upon "human initiatives" (or "subjective activity" in China's terminology). Also, as the transmittance apparatus of this dynamic force throughout the entire economy, it relies heavily on the non-economic institutions that are expected to come into play when the human initiatives are in full operation. The role of the transmittance apparatus played by the planners' direct allocation of resources and, additionally, by the market mechanism is to be reduced accordingly.

(2) China's economic policy regards as a basic objective of economic development the creation of a society in which the so-called "Three Big-Differentials" (between mental and manual labor, be-we tween industrial and agricultural labor and between urban and rural areas) are eliminated and, with it, human creativity is brought into full play. This seems primarily to be a long-run objective and, hence, can be contrasted to a second objective of economic policy which is to raise the productive force of the society, an objective which is both immediate and long-run. Yet, the former is sometimes also looked upon by the Chinese even as the objective to be applied immediately.

There are many unknowns that should be clarified before one can be sure that the institutions and organizations carrying the characteristic described in (1) above are firmly established and that the objective described in (2) becomes really effective. To be noted especially are the cases in which reliances upon "human initiative" and, with it, the elimination of "Three Big Differentials" tend to conflict with the productivity objectives. We are not yet sure how the these cases will be dealt with effectively by the Chinese government. Yet, one must also admit that the "human initiatives" and the elimination of "Three Big-Differentials" are crucial elements that are in fact differntiating even the current course of China's economic deve-

lopment from those of other developing countries and the U.S.S.R. as well. The three possibilities which I have described earlier regarding China's impact on the international economy also arise ultimately from these two elements of the Chinese economic policy.

4. In the following, I shall in Section 2 analyze in greater detail current economic policy in terms of the pattern of the national economy it is bringing about. The pattern of China's foreign trade will be discussed in Section 3 partly as a corollary of the discussions in Section 2. The impact of the emergence of China on Asian-Pacific trade will be studied in Section 4 on the basis of the findings derived in these discussions.

II. Economic Structure of "Self-Reliance"

1. The economic policy and the resulting economic structure to be discussed in this section are those which have been formulated and built up gradually since the second half of the 1960's. One of the prerequisites for a proper understanding of the characteristics of thie economic policy and structure is to have a sound knowledge about the conditions prior to that period. While we have not sufficient space to dwell on them here, it is essential to note that the present economic policy and economic structure are the end results of a serious trial-and-error process. Two comments are in order.

(1) For some years after the establishment of the People's Republic, China followed an economic policy of rapid and large-scale industrialization modelled after the pre-war U.S.S.R. pattern. Toward the end of the 1950's China adopted the so-called Great-Leap-Forward policy which aimed at a nearly complete reversal of the previous Russian type policy, but this policy failed. The current economic policy has been formulated since the end of the period of economic stagnation following the failure of the Great-Leap Forward. The historical period before the advent of the People's Republic was what the Chinese call a "colonial and semi-colonial period" in which the modern sector, consisting mainly of foreign interests in mining, manufacturing, railways, shipping and banking, was imposed as an enclave upon the traditional agricultural sector. (See Appendix Table 1 on changes in the economic policies of the PRC government).

(2) China's economic growth in the period of the People's Republic

seems to be characterized by a "steady growth with the fluctuations of a big amplitude." The growth of foreign trade has shown a similar pattern. (These are illustrated in Appendix Chart 1. In Appendix Table 2 are shown official estimates of national income which I have inferred for 1957 and 1970.)

2. In terms of comparative economic systems, the present economic policy can be said to maintain "planners' sovereignty" in determining the basic direction of the economy. It, however, has altered a decision-making process that had been heavily concentrated in the central government, and has transferred much of the decision-making power to both the local governments and the production and management units. It has also come to rely upon the "human initiatives" of individuals at all levels (rather than to rely upon the price mechanisms), in order to make up for the shortcomings of a system of physical directives as the instruments for transmitting the planners objectives.

Detailed analyses of the economic policy under this new economic system can conveniently be made according to the division of the economy into three sectors that have especially become manifest in the course of implementation of the current policy. They are, as shown in a triangular diagram of Chart 1, a Central Economic (or Industrial) Sector, a Local Industry Sector and an Agricultural sector. (The latter two constitute a Local Economic Sector.)

3. Economic Policy with regard to the development of the productive force of the society seems to consist of three major components:

(1) Agriculture Increase in agricultural output by introducing labor-using and land-saving technological progress on the basis of the application in an incresing amount of "modern inputs."[3]

(2) Local industry Establishment of a fairly comprehensive and self-sustaining system of local industry in each economic region and district which aims at supporting the increase in agricultural output along the lines indicated in (1).[4]

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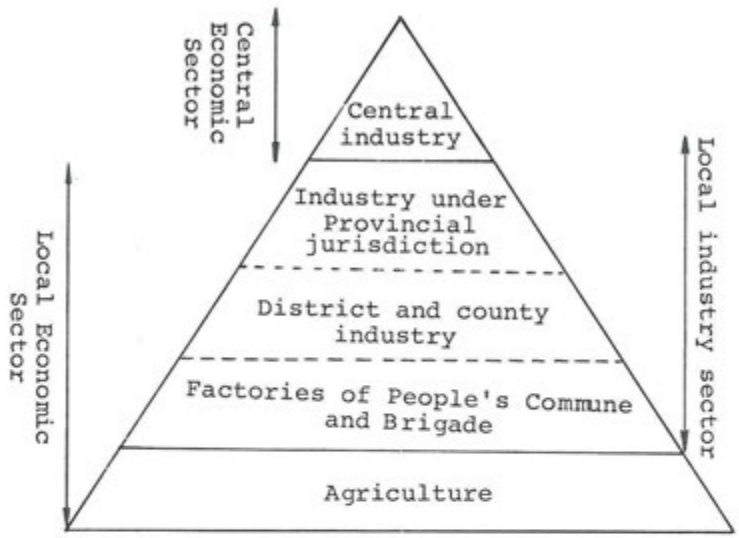
[3] See Ishikawa, "Changes in the Structure of Agricultural Production in Mainland China," in W.A.D. Jackson (ed.), Agrarian Policies and Problems in Communist and Non-Communist Countries, Univ. of Washington Press, 1971.

[4] See Ishikawa, "A Note on the Choice of Technology in China," Journal of Development Studies, Jan.1973.

Chart 1 Sectoral Division of the National Economy under the New Economic Policy



Remarks: The demarcation areas of the Local Industry Sector with the other sectors are in fact blurred. On the one hand, while the Provincial industry is formally part of the local industry sector, some of it is technologically almost identical with the central industry sector. On the other hand, the factories in the People's Communes are essentially part of the agricultural sector.

(3) Central industry Maintaining and strengthening the already established system of modern manufacturing, mines, public utilities, transportation and communication in the Central Economic Sector. Side by side with this, establishing new industrial branches equipped with internationally up-to-date technologies on a selected basis.[5]

The policy priority order over these three sectors differs from that of the earlier policy of socialist industrialization following the U.S.S.R. pattern. The earlier policy tended to concentrate resources in the establishment and development of central industry while sacrificing the development of local industry and even agriculture. Utmost priority is placed on agriculture at present and this is reflected in the official expression "agriculture as the base of the economy". This priority stems from the very serious Chinese concern to increase food grain output and is reflected in part in recent changes in the price policy in which the producers'

[5] Ibid.

prices of farm products have been raised and the retail prices of manufactured farm inputs reduced. A more important reflection is seen in an increasing amount of supplies of these farm inputs. The present focus of the policy regarding local industry is the establishment of factories, mines and power plants which constitute inter-industrially an integral linkage system within the county boundary that connects ultimately with local agriculture. Some change in the international aspects of the policy toward central industry can also be seen. While the policy of domestic development under a closed system working through the mechanism of state monopoly of foreign trade still remains in operation, Chinese attitudes towards international trade appear to have become much more flexible, aiming at introducing into central industry the most up-to-date technologies developed in the western countries.

4. However, the major economic mechanism which transmits the policy on agriculture and local industry to the production units is after all not the market mechanism. It is, as described earlier, the non-economic institutions based on the"human initiatives." Also, profitability, if it does exist as an incentive, appears to be playing a minor role in local industry. Only in the People's Communes does it seem to be playing a significant but not decisive role. The decisive role here is played by the "human initiative" itself. The policy measures to convert the "human initiatives" to an incentive and even a policy transmittance instrument for economic construction correspond to what is often called the policy of "self-reliance,"or the policy to convert each production enterprise or region to a "self-reliance" unit. To elaborate:

(1) People's Communes Contrary to common-place understanding, the basic decision-making units regarding production, distribution and investment in a People's Commune are at the present stage not the overall governing body of the People's Commune, but its Production Teams consisting of twenty to thirty farm families in the traditional boundary of natural villages. The upper-level organizations, the Production Brigades and the People's Commune are cooperatives or jointly operating schemes of the Production Teams. These organizational measures appear to be contributing to (a) the harmonization of the individual member families' motivation to secure family welfare with the motivation to serve the public cause and (b) the successful introduction of the new techniques

by purchasing on joint-schemes irrigation and drainage pumping sets, farm processing machinery and even tractors that cannot be purchased by individual Production Teams, not to mention by individual families.

(2) Local industrial enterprises Most importantly, the leadership of the local government or party officials is playing a critical role in establishing and maintaining an expanding inter-industry linkage system of local industry in each locality. It is these local officials who perceive the emergence of new demand for particular industrial materials and products as consequences of a new agricultural program. They then respond to that demand using all the means at their disposal to mobilize the machinery and equipment, technicians and skilled workers that are required for new factories. Consultation and negotiation with the officials of the upper-level government and the subordinate enterprises for obtaining these equipment and manpower and the reallocation of resources existing within their own local jurisdiction are among the methods particulary used. The technologies used in the local industrial enterprises may properly be called "intermediate technologies", a recently fashionable concept in development economics. The fact that these technologies are widely diffused can be seen from the clearly observable popular dissemination of elementary or even secondary-level technical knowledge. Production costs in the chemical and metal industries are said to be in general higher than prices, thus resulting in losses. Yet, these losses tend to be counterbalanced by the surplus in other industries.[6]

5. The effective operation of these new institutions and organizations in the local economic sector may probably be traced back to an activation of the "human initiatives" of the local people, which, in turn, must have been inspired by the ideal of creating a new society by eliminating the "Three Big Differentials." Now, one important problem arises from the fact that if these new institutions and organizations are to continue, the same principles should be in operation in the central economic sector as well. The principle of "human initiatives" seems to have been already in operation in various forms: a new factory administration system, a wage reform in which the previous wage differentials between white and blue color

[6] A good account is made about these in Jon Sigurdson, "Rural Industrialization - A Travel Report," (Sussex), Feb.1972, mim.

workers have significantly been reduced, and the system of the "Three Combinations of Managers, Engineers and Workers" in which the former two classes must regularly engage in manual labor and the latter have a say in management and technical innovations. A recent education reform which has opened the chance of university enrolment only for those workers and the People's Commune members who worked three years or more may also have been facilitating this principle. These reforms and measures must have had an effect in raising the status of workers in central industry and of increasing their willingness to serve the public cause. The capability of adaptation of western technology which the Chinese have exhibited so far (which is equivalent to what the Chinese call a "self-development of technology" or "self-reliance" in technological development) may be partly explainable by these reforms and measures. Yet, as the technical and management levels required in this sector will continue to rise, it may be that the sector will be faced with an increasingly serious task of harmonizing this requirement with the organizational principle of relying upon "human initiatives". With regard to the principle of eliminating the "Three Big-Differentials," the problem may become even more serious. For it is yet to be seen how the present pattern of up-to-date industrial technology and of the accompanying industrial management can be reconciled with this principle, which is after all equivalent to the elimination of the present pattern of the division of labor in the society.

6. Leaving aside for the moment the questins to be tested in the future, the economic policy in the present stage can be summarized, in terms of a model of contemporary economic development, in the following way. It aims to protect the entire national economy from international competition and furthermore, to protect the local industry from the competition of the central industry. Under these conditions, present economic policy aims to initiate economic development by "self-reliance," in each of the central and local economic sectors.

Of particular interest is the fact that by following this model, the local economic sector has now come to become viable. The question may be raised as to whether this model is erroneous, violating as it does the doctrine of comparative advantage. Another question will be whether the domestic allocation of resources and efforts in this model is mistaken, considering that the central economic sect-

or is a higher-prdoctivity sector whereas the local sector is lower-productivity sector. Perhaps the Chinese government would answer to these questions on the basis of their own value judgement. Apart from this value judgement issue, however, there is a probability that in so far as the vast amount of un- and under-utilized local resources has come to be more fully utilized only through following this model, the allocative efficiency even when judged by western criteria is of a high standard. A rigorous evaluation of this change, however, is not possible at present.

As was indicated earlier, the performance of the model in selective introduction of western technology has so far been satisfactory. This point, together with the questions relating to it will be discussed in the next section.

III. The Foreign Trade Aspect of Economic Policy

1. China's foreign trade policy can be understood fundamentarily to be a corollery of the economic policy discussed in the last section.[7] Two points should be noted in this connection:

(1) A persistent principle of foreign trade throughout the period of the People's Republic has been that the foreign trade be conducted not with the aim of maximizing national welfare in accordance with the doctorine of comparative advantage (what might be called a principle of international equilibrium), but of maximizing it through establishment and development of a self-contained and self-sustaining national economy (a principle of domestic equilibrium). This principle has remained unchanged in the present stage.

The Chinese government usually calls this foreign trade policy a policy of "Equality and Mutuality, and Filling Each Other's Needs." Specifically, this policy aims to satisfy the demand for imports under the constraint of export capacity. The demand for imports arises mainly from the need for intermediate and capital goods for industrialization, which, in turn, can be classified into categories: one is those which China does not yet have the technological capability to produce, and the other is those for which China has that capability, but due to insufficiency in capi-

[7] I have previously discussed China's foreign trade policy in "Strategy of Foreign Trade under Planned Economic Development - With Special Reference to China's Experience," Hitotsubashi Journal of Economics, Jan.1965.

tal accumulation, there is excess demand. Because of this policy, the ratio of China's exports and imports to national income is very low even when compared with other big economies: My tentative estimate of this ratio are 2.7 percent for exports and 2.6 percent for imports in 1970.[8] Moreover, this foreign trade dependency ratio will tend further to decline with the progress of capital accumulation in the central industry, if China's willingness to catch up with a continuously advancing technological progress in the western countries is not large enough to counterbalance such a tendency.[9]

(2) A significant characteristic of China's foreign trade policy at the present stage is that the Chinese government has been active in catching up the western technologies in a variety of industrial brances. China also made big efforts throughout the 1950's to introduce new technologies from the U.S.S.R., though in that period, China had no discretion to choose the technologies to be introduced, nor the technical capability to exercize such discretion.

China's willingness to introduce the western technologies was first demonstrated by her imports in the second half of the 1960's of a series of complete plants in the chemical and metal industries. These imports were interrupted during the period of the Cultural Revolution. The visits to Japan of a number of Chinese industrial missions during 1972, however, seem to reflect their willingness to reactivate such imports.

The important question to be faced by the foreign trade planners seems to be how to deal with the constraints of export capacity if and when the demand for those imports outlined in (2) above should continue to increase. Explorations of answers to this question form the main theme of this section.

2. First, let me discuss the constraints of export capacity,

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[8] In estimating this ratio, the amounts of exports and imports expressed in foreign prices must be converted to those in domestic prices. In my estimates, this was done by using the comparative domestic and foreign price data shown in Appendix Table 3 and the data on price deflators indicated in Appendix Table 2.

[9] I have previously attempted a crude projection for 1975 of China's foreign trade which focused on changes in the foreign trade dependency ratios. Ishikawa, "Impacts of China's Economic Deveropment upon the Countries in Southeast Asia," in Japan's Future in Southeast Asia, the Center for Southeast Asian Studies, Kyoto University, 1966.

which is the essential content of what I have referred to in Section 1 as the "foreign trade problem." In Table 1 estimates by the U.S. government sources are shown of China's exports and imports in recent years by categories of commodities. These commodity categories can be rearranged, such as shown in Table 2, according to the domestic sectors to which imports are destined or from which exports are originated. By referring to these tables the following may by noted:

(1) The import flow to the central industry sector, which should be the major flow under China's foreign trade policy, has been reduced to only one half of total amount of imports, a very low proportion that has been necessitated by the pressure of a heavy demand for imports of food grains and chemical fertilizers, which combine to amount to about one fourth of total imports.

(2) The major export commodities are still farm products. They amounted more than half of total exports. Prospects for the expansion of such exports are, however, limited. While the production structure of agriculture, as we noted earlier, has been significantly modernized, agricultural policy emphasis has continued to be on increasing the production of food grains which, in turn, are raised mainly as subsistence crops of the producers. (This is especially the case for Kaoliang and maize produced in the northern China which are often expected to emerge as major export commodities to Japan). Even if China's agriculture should develop to the extent of attaining import substitution and of producing a sufficient amount of export surplus, the world export market for agricultural commodities is generally characterized by low income and price elasticities of demand.

(3) Mineral products, especially iron ore and coal, were until recently China's major export commodities side by side with farm products. With the progress of industrialization, however, these exports have declined drastically. Unless China is willing to accept a "development export" formula frequently offered in recent years by the industrial powers to the resource-rich developing countries, China will no longer have a significant export surplus in mineral resources. The same condition applies to the oil resources which have been discovered and considerably developed in recent years.

(4) The textile industry is what may be called China's export in-

Table 1. Estimates of China's Exports and Imports by Usack and Batsavage, 1966,1969, and 1970.

unit: million U.S. $

	Exports			Imports		
	1966	1969	1970	1966	1969	1970
Foodstuffs	615	615	645	510	350	355
Of which:						
Animals meat and fish	230	210	215	...	...	...
Grains	150	115	110	400	260	280
Fruits and vegetables	120	175	170	...	...	...
Crude materials, fuels and edible oils	480	450	430	340	310	360
Of which:						
Oil seeds	90	75	65	...	...	...
Textile fibers	105	120	100	150	90	110
Crude animal materials	90	130	115	...	...	...
Rubber	...	...	...	85	145	80
Chemicals	90	90	105	250	310	330
Of which: Fertilizer	...	...	...	155	205	230
Manufactures	920	820	860	910	850	1,115
Of which:						
Textile yarn and Fabric	305	310	340	35	30	45
Clothing	185	195	155	...	...	...
Iron and steel	90	35	40	225	275	390
Nonferrous metals	40	35	25	55	225	210
Machinery and equipment	... 1)	... 1)	... 1)	455	240	395
Other	105	55	10	25	10	10
Total	2,210	2,030	2,050	2,035	1,830	2,170

Source: A.H. Usack and R.E. Batsavage, "The International Trade of the People's Republic of China," in Joint Economic Committee, Congress of the United States, People's Republic of China: An Economic Assessment, May 1972.

Note: 1) The estimates do not indicate the estimation results for this row. U.N. estimates, which are subject to the reservation described in Table 3 indicate that the amount of exports of machinery and equipment (SITC 7) was U.S. $63 million for 1969 while the amounts of import was U.S. $600 million.

dustry, making up currently about one-fourth of total exports. Analyses of production costs suggest that it has already a sufficient competitive power in the international market. Yet, the prospects for its further expansion seem to be limited by protectionist policies in both the advanced and developing country markets.

(5) Exports of processed metals, chemical products and, especially, machinery and equipments are still very limited in amount. The low volume of exports for these products should be assessed against the well-know fact that the export market for these com-

Table 2 Destinations of Imports and Origins of Exports within the Domestic Economy: 1970

A. Imports

Domestic sectors of final destination	Uses	Categories of traded commodities: Amount (million U.S. dollars)
Central economic sector	For technological progress	Machinery and equipment (395) Chemicals (100)
	For making-up deficit supply	Metals (600)
Export industry sector	For supplying raw material for export commodities	Textile fibers (110)
Local industry sector	?	?
Agricultural sector	Agricultural inputs	Chemical fertilizer (230)
Household consumption sector		Grains (280)

B. Exports

Domestic sectors of origins		Categories of traded commodities: Amount (million U.S. dollars)
Central economic sector		Metals (65) Machinery (?)
Export industry sector		Textile yarn and facrics and clothing (495)
Local industry sector		Foodstuffs (645)
Agricultural sector		Oilseeds, fibers, crude animal materials (280)

Remarks: Traded commodities indicated in the last column are by no means complete; the traded value shown in the bracket only shows that amount identified in Table 1.

modities is the only one among China's export markets where the income elasticity of demand is high and there is no artificial barriers that restrict their free trade.

3. The important implication of the above discussion is that the development of metal, chemical and machinery industries as new branches of export industry would countribute most easily to weakening of the existing export constraints. The question which immediately follows is why the Chinese government has not yet initiated measures in that direction. To answer this question, one needs to

make detailed studies by industry on the technical quality, prices and costs of the products and on the export market conditions. I shall dwell on some of these topics shortly by taking up machinery industry as an example. Before, that, however, a few general remarks may be in order. As shown in Appendix Table 3 on comparative Chinese and Japanese price level, the Chinese side was at a serious comparative disadvantage for the commodities under question were in the 1950's. With the progress of capital accumulation and advancement in technologies, the comparative disadvantage position of these commodities appears to have become less[10], though precise estimations are difficult at the present stage. On the other hand, Chart 1 indicates that the overall commodity structure of China's foreign trade, which is of a pattern exhibited by developing economies, is largely reflected in the structure of China's trade with the western advanced countries, whereas the structure of China's trade with the developing countries is moving gradually toward the pattern exhibited by developed countries. This suggests that should the commodities under question become major export commodities, their markets will at first be located in the developing countries.

5. Turning to China's machinery industry, it will be useful at first to summarize the evaluation of a Japanese machine-tool engineer (who has a profound experience in technical interchange with China) on the technological level that China's machine-tool industry has now reached.[11]

(1) Machine-tool factories in China are at present manufacturing almost all the kinds of machine-tools being manufactured in the world. A considerable amount of them have been manufactured by the Chinese according to their own designs. There is very little simple straight copying of imported machine-tools. In most cases, some kind of improvement or devise is added to the domestically manufactured machine-tools.

(2) Large-scale and super-large-scale machine-tools do not seem

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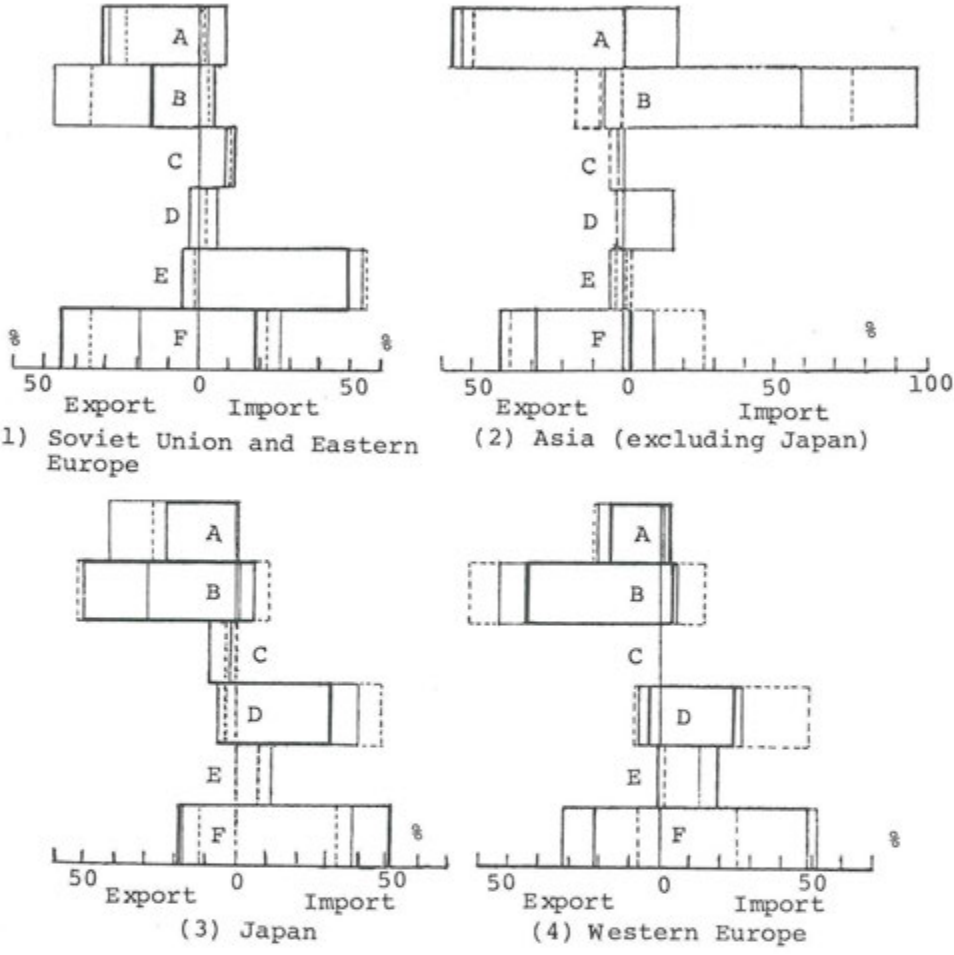
10 On the basis of the price changes in industrial and agricultural goods between 1957 and 1970 shown in Appendix Table 2, and also by using the Japan's wholesale price indices, we can estimate that during the same period, the Chinese prices relative to the Japanese prices declined by 11 percent for foodstuffs and crude materials and by 25 percent for all of the other commodities.

11 Hajime Miyazaki, "The Machine-tool Industry in China," Nippon no Kagaku to Gijutsu (Science and Technology in Japan) August 1972.

Chart 1. The proportion of China's Exports and Imports by Commodity Groups: Four major Trade-Partner Groups, 1955, 1959 and 1969



(1) Soviet Union and Eastern Europe

(2) Asia (excluding Japan)

(3) Japan

(4) Western Europe

Sources: UN, Monthly Bulletin of Statistics, March 1961, March 1964 and March 1970 and Government of Japan, Tsusho Hakusho. (White Book on Foreign Trade) for 1960, 1964 and 1970.

Notes: In this diagram, both exports and imports are classified according to US's SITC in the following way:

A:	SITC Sections 0 and 1	Food, beverages and tobacco
B:	SITC Sections 2 and 4	Crude materials, exc. fuels; and fats
C:	SITC Section 3	Mineral fuels and related materials
D:	SITC Section 5	Chemicals
E:	SITC Section 7	Machinery and transport equipment
F:	SITC Sections 6 and 8	Other manufactured goods

The percentage of the export or import amount of each group to total export or import amount is indicated proportionally by the area of the quadrangle corresponding to each group.

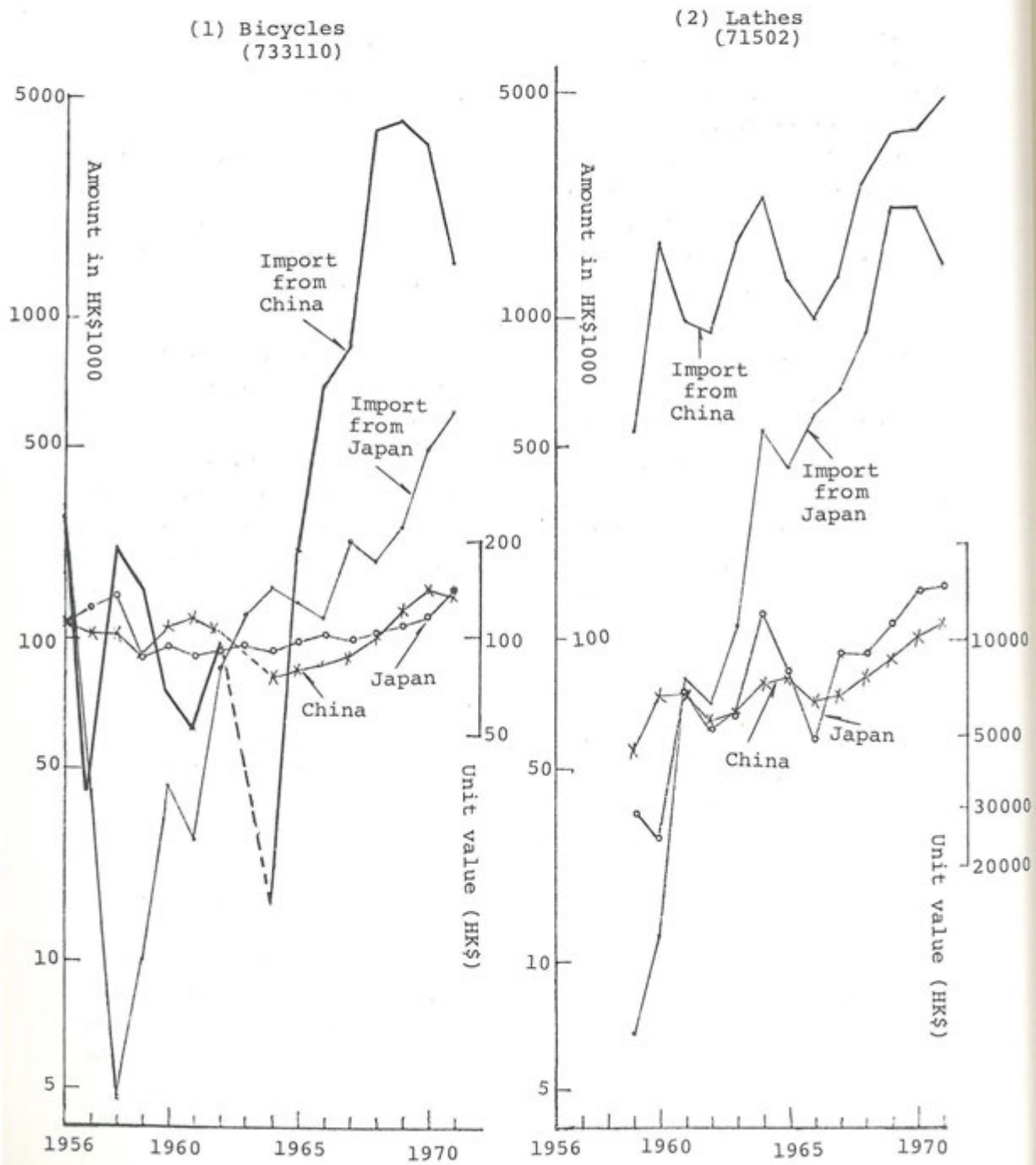
The line———indicates the year 1955 (for Japan 1957), ---- 1959 (for Japan 1964) and —— 1969.

to have been manufactured. Processing that requires the aid of these machine-tools is being done either by imported machine-tools or by various means: remoulding of the existing machine-tools, manufacturing of special machines and simple devices.
(3) There is no problem about precisions, except in the case where the precision of a specially high standard is required.
(4) There are shortcomings in the quality of materials and in the divison of labor and cooperation among those factories which are still underdeveloped.
(5) The differential in technological levels is still substantial among regions and among factories. Yet, an elementary technical knowledge of manufacturing machine-tools has been widely diffused. Many factories producing ordinary machines are, in order to meet the deficit in supplies, self-manufacturing a number of special purpose machine-tools as well as such general-purpose machine-tools as lathes and friase milling machines. Even local small-scale enterprises and the factories of the People's Communes are engaged in self-manufacturing of such items.

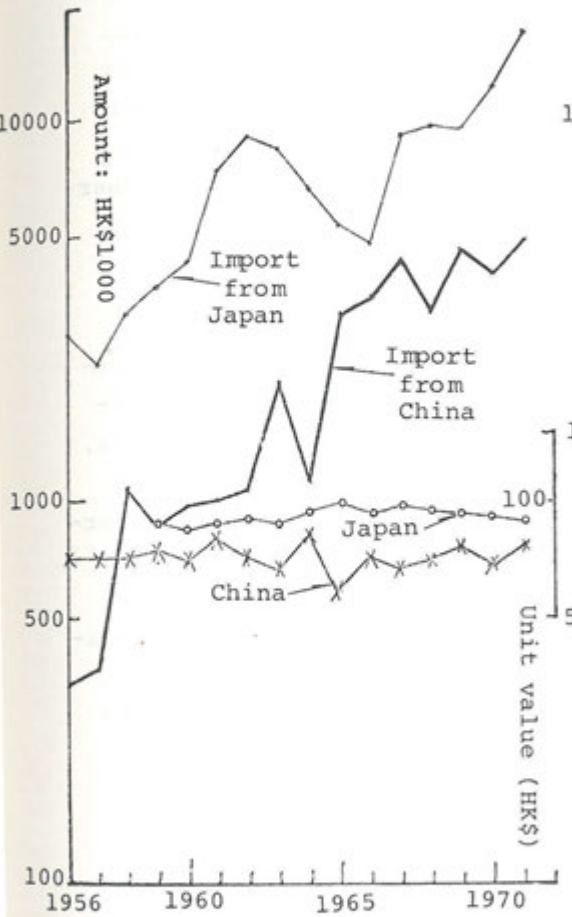
Japanese engineers admit that together with the development of machine-tool industry, China has now reached a stage in which almost all types of industrial machinery can be independently manufactured. Depending on the branch of industry the levels of technology at the most advanced factories are said to be similar to those of Japan ten or fifteen years ago.

In Chart 3 the fierce competitions in the Hong Kong import market between Chinese and Japanese products of consumer durables, industrial machinery and machine tools is illustrated. Since the state trading system in China is able to determine the export prices of commodities without regard to domestic costs and prices, this state of competition does not necessarily reflect the competitive power of these commodities in terms of production costs and prices. Yet, my earlier references regarding the general tendency toward a price decrease in manufactured goods suggest that the production costs of those machines which do not require a high degree of precision and whose structure is relatively simple should be decreasing. Moreover, the chart indicates that the competitivre power of these commodities in terms of quality is certainly sufficient and even increasing. An implication of these discussions is that, if she wishes to do so, China may be now in the position of being capable of exporting much

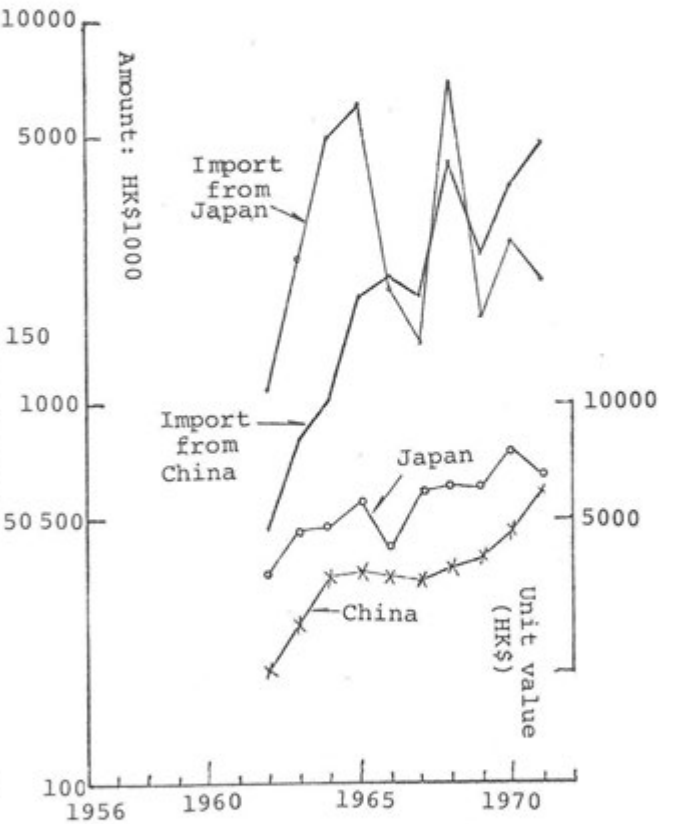
Chart 3 Competition between Selected Chinese and Japanese Commodities in the Hong Kong Market as Reflected in the Shares of H.K. Import from the Two Countries



(3) Electric fans (725034)



(4) Cotton power looms (717120)



Source: Census and Statistics Department, Hong Kong Government, Hong Kong Trade Statistics, Imports, December issues of 1957-1971.

larger quantities of machinery products than at present.

6. If the above observation is essentially valid, the reasons why China has not yet initiated export promotion measures of intermediate and capital goods seem to be either one or two of the following three. (1) China's intention to introduce the western industrial technology has not been serious to date; hence, China has not felt keenly the necessity to increase the total amount of exports substantially. (2) Domestic demand for intermediate and capital goods has been too large to cater for export. (3) The Chinese government might have considered the measures to promote the exportation of these goods but abandoned them, because it was found to require not only reallocation of resources and man-powers from other important branches of industry, but also additional importation of parts, metals and even mineral products.

7. In terms of the future possibilities, reason (3) seems likely to be the most important and, hence, worthy of a further comment. This reason suggests that under the present economic and resource conditions in China, measures for export promotion of metals, chemicals and machinery products would require at least some shift of the policy criterion of domestic equilibrium toward that of international equilibrium. If this shift is substantial, the resultant economic structure may come into conflict with the economic structure of "self-reliance," and the ideal of a new society based on elimination of the "Three Big-Differentials" may lose its dynamic elements. Yet, this seems to be a dilemma that the Chinese government must face, if they want to introduce western technology as quickly and as comprehensively as possible.

IV China in Asian-Pacific Trade

1. The central interest of this section is to explore the possible place, role and impacts of the Chinese economy with its unique behavior patterns outlined above in the international economy, especially in the Asian-Pacific area, where different behavior patterns of nations, enterprises and (perhaps also) people prevail.

The question is novel. In the prewar era, foreign trade of the U.S.S.R. drastically declined (from 1930) once the foundation of her capital goods industry was established, and the economy was almost closed to the international economy. China's economic policy is similar to that of the U.S.S.R. in that the economy is guided by

"planners' sovereignty" and aims at industrialization on the principle of "domestic equilibrium." Yet, there are at least two dissimilarities. First, China is much more "outward-looking" in feeling the necessity to introduce western technology. Second, China has emphasized that "human initiatives" is to be relied on as the important dynamic force in economic development. Although this second point concerns domestic policy, China seems to believe that a model of economic developmnet along these lines should be relevant to other developing countries as well.

2. First, with regard to the place of China in the international trade. Up to this time, it has been quite minor. As is shown in Table 3 of the international trade matrix centering on China, the values of China's exports and imports in 1969 occupied only 0.8 percent and 0.9 percent respectively of total world exports and imports. In the Asian-Pacific area, the proportion of exports to and imports from China in total exports and imports of a country was 1.5 percent and 4.4 percent for the Asian countries combined excluding China and Japan ("Other Asia" in the Table), 2.7 percent and 2.0 percent for Japan, almost nil for the U.S., 0.8 percent and 0.5 percent for Canada and 2.5 percent and 0.8 percent for Australia and New Zealand combined. The import percentage figure for "Other Asia" is misleading, because China's export trade with "Other Asia" is concentrated in three countries: Malaysia (in 1969 US$133 million), Singapore (US$140 million) and in particular Hong Kong (US$446 million)[12]; the weight of the China trade is only significant for these countries. The issue, therefore, is whether and how the above position of China's foreign trade will chane in the near future.

3. Exploration of this issue can be first made by separating the conceivable determining factors of China's foreign trade into three groups: The first group concerns China's own policy, the second the policies of the advanced western countries to China and the third with the possible course of economic development in developing Asia.

(1) The discussions in the previous sections suggest that depending upon Chinese government policy, there are conceivably three broad alternative paths of development in China's foreign trade in

12 The contribution of Hong Kong to the foreign currency receipt of China is well summarized in A.H. Usack and R.E. Batsavage, "The International Trade of the People's Republic of China," in Joint Economic Committee, U.S. Congress, People's Republic of China: An Economic Assessment May 1972.

Table 3 International Trade Matrix centering on China: 1965 and 1969

unit: million U.S. dollars

		China	Other Asia	Japan	U.S.A.	Canada	Aust. N.Z.	Other Developed Market Economies	Eastern Europe	Other Developing Market economies	World
China	1965		620	220	3	12	25	310	600	230	2 020
	1969		760	245	2	25	36	412	475	290	2 250
Other Asia	1965	170	2 280	1 180	1 660	140	295	2 275	570	720	9 290
	1969	190	3 080	1 920	2 960	220	345	2 485	680	940	12 940
Japan	1965	265	2 200		2 510	215	375	1 240	210	1 440	8 450
	1969	425	4 450		5 020	480	560	2 340	340	2 370	15 990
U.S.A.	1965	-	3 090	2 070	.	5 560	930	9 580	140	5 830	27 190
	1969	-	3 470	3 460		8 960	950	12 700	250	7 660	37 460
Canada	1965	97	145	295	4 670		165	1 990	280	455	8 110
	1969	115	220	580	9 800		190	2 200	28	620	13 750
Aust. N.Z.	1965	180	285	550	400	55	220	1 735	130	285	3 910
	1969	125	465	1 160	740	120	250	1 760	100	385	5 110
Other Developed	1965	368	2 980	725	6 370	1 230	1 720	53 105	3 320	10 280	80 520
Market Economies	1969	515	2 415	1 550	10 320	1 770	1 810	81 180	5 242	14 405	120 880
Eastern Europe	1965	700	650	215	140	45	19	3 691	12 460	1 440	19 710
	1969	970	560	435	200	68	23	5 494	16 620	2 340	27 500
Other Developing	1965	340	650	1 580	5 100	590	275	13 015	1 310	4 000	27 200
Market Economies	1969	210	1 050	3 150	6 280	780	325	17 935	1 520	5 200	36 840
World	1965	2 120	12 890	6 840	20 890	7 840	4 030	86 930	19 030	24 690	186 390
	1969	2 550	17 470	12 500	35 320	12 420	4 500	126 500	25 240	34 220	272 710

Source: UN, Monthly Bulletin of Statistics, March 1967 and 1971

Notes: The UN's estimates of China's exports and imports are made as an entity inclusive of Mongolia, Democratic People's Republic of Korea and Democratic Republic of Viet-Nam. Theoretically, this treatment results in (1) the inclusion in the amount of China's foreign trade of the amount of foreign trade of these three countries with other countries (excl. China) and (2) the exclusion of the foreign trade of the three countries with China. A check on the resulting errors can be made by referring to more detailed estimates of China's foreign trade for 1964 done in The Institute of Developing Economies, Foreign Trade of China, 1964, I.D.E. Statistical Series No.3:

	Exports	Imports
U.N. estimates (million U.S. $)	1 917.7	1 366.8
I.D.E. estimates (million U.S. $)	1 870	1 640
% difference with the former taken as 100	-2.5	20.0

the near future.

The first alternative is that China decides to develop her central economic sector as quickly and as comprehensivly as possible. The demand for imports would increase to such an extent that the export promotion of metals and machinery would require additional imports of raw materials and parts, and mineral and oil resource development for exports would require the acceptance of the "development-import" formula offered by the Western countries. Under this alternative, the principle of "domestic equilibrium" would have to be substantially replaced by that of "international equilibrium," and this may force the existing domestic economic structure to be substantially remoulded. The second alternative is one in which the policy of the recent past remains to be in operation. The rationale for this would be that the economic policy of development an economic structure of"self-reliance" should be adhered to as ideologically only valid policy; any measures which may impair the principle of "domestic equilibrium" should be kept as minimall as possible. Under this alternative, the economy's foreign trade dependency ratio may tend to decline further as the capital accumulation in the central industry sector grows. The Chinese economy would be left isolated and remain as a low-productivity and, hence, low-income economy, though the economy may work quite effectively. The third alternative would be somewhere between the above two alternatives.

It is by no means easy to attempt any useful projections of China's foreign trade which would correspond to each of these alternatives. Yet, the following comments may be made. Probably the case where the present import dependecy ratio of the economy continues to remain the same would correspond to some variant of the third alternative. The trend value of the annual growth rate in China's national income seems to be in the 4 to 6 percent range if past performance is made the base of the inferrence.[13] Stabili-

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13 Refer to Ishikawa, "Prospects of the Chinese Economy: Trends and Cycles" (op.cit.)

14 In Ishikawa, "Hypothetical Projection of the Chinese Economy: 1966 to 1981," The Developing Economies, September 1970, four different assumptions were used for alternative projections. A practicable variant based on one of these assumptions indicates a growth rate of around 5 percent. Neither of these assumptions take up the case where the introduction of western technology would create a favorable situation for growth.

ty of economic policy and a more active introduction of western technology would raise somewhat this range of growth rates, maybe 5 to 8 percent level.[14] With this range of rate of growth in national income, and starting from 1970 (Table 1) the value of China's total imports would increase as follows (the values of total exports would similar in each case, if the present practice of roughly equalizing the value of total exports and total imports continues):

	Value in US$ billion		Index	
	5% case	8% case	5% case	8% case
1970	2.17		100	
1975	2.76	3.19	127.6	146.9
1980	3.53	4.69	162.9	215.9
1985	4.51	6.88	207.9	317.2

The import or export dependency ratio may increase somewhat even under this alternative. Income elasticities of import and export, however, may not be as high as 1.5 or 2.0, such as observed in Taiwan during the 1960's (income elasticity of export was 1.426 and that of import 1.906 between 1960 and 1969). Such ratios would be only possible under the first alternative. I attempted previously a hypthetical projection (1965-1975) on the basis of an assumption that is essentially similar to the second alternative.[15] The import dependency ratio of the demand for machinery and equipment was assumed to decrease from 40 percent in 1957 to 15 percent in 1975. For other import categories, various assumptions with regard to income elasticity of imports were made. The result of the projection indicated an annual growth rate of 2.5 percent of both exports and imports.

Of these three possible alternatives, I am inclined to consider that the third is most probable. However, as discussed in the last section, this alternative seems to carry an unstable element which tends to bring the economy sooner or later back to the first alternative. Politically, this would, in turn, tend to invite a reaction resulting in a swing to the second alternative. The Chinese government, therefore, would prefer a cautious path even

[15] See note 9. For details, refer to Ishikawa, ed., Chugoku Keizai no Choki Tembo (Long Term Projections of the Chinese Economy), Vol.II, The Institute of Developing Economies, 1966, Chapter 1.

under this third alternative.

(2) The future of China's foreign trade will be affected by the policies of the advanced western countries toward the China trade, either through their impacts on Chinese policy or directly through their impacts on the commodity flows. Paticularly noteworthy is the growing interest in China as a possible export market that Japanese manufacturers in almost every branch of heavy-chimical industry have shown in the past year. This is understabdable especially in fields such as iron and steel products, machine-tools and chemical fertilizers whose ratios of dependency on exports to China are already very high.[16] The expectation that China will emerge as a source of supply for minerals and especially oil is also growing. This growing interest has led directly or indirectly to pressure exerted on the government to relax or remove export and import controls on the China trade, controls on export credit terms extended to China by the Export-Import Bank and other artificial restrictions.

(3) The future of economic development in other Asian countries may also affect China's foreign trade, mainly because it will dtermine the size of the potential market for China's exports of metal, chèmical and machinery products. In the case that China chooses to adopt the first alternative course of development foreign trade described above, the possibility will arise in which China's demand for the primary products of these countries will tend also to increase and the course of their economic development will affect even this primary product trade.

While the prospects for economic development in other Asian countries is a big subject to study, three issues seem to be among the most crucial factors - one: the so-called Green Revolution, two: industrialization through the direct investment in manufactures by enterprises from advanced countries and three: the advanced countries' policies toward imports of primary and light industrial products from these countries. The first two represent the dynamic elements which have emerged since the second half of the 1960's. Already in a few countries, these two factors have con-

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16 The ratio of total value of exports which were exported to China was 9.0 percent in 1970 for iron and steel, 20 percent for machine-tools (in terms of total value of production 20 percent) and 53 percent for chemical fertilized in 1969 (in terms of total volume of production 44 percent).

tributed a great deal towards increasing the growth rates of food and manufacturing production, though not to the extent of reducing the foreign exchange gap significantly. On the other hand, they have also created new problems. The Green Revolution has brought with it an increasing differentials in income and wealth positions among the rural families. Industrialization through direct investment of foreign capital has aroused the fear of foreign dominance over the economy among the urban residents. These problems will have a long-run impacts upon the course of economic development. Perhaps the most crucial issue, at least in the immediate future, will be the third one. Insofar as the basic principles of economic development policy in these countries continue to remain the same, and barring an appreciable increase in the current flow of international aid, a more drastic change in the import polices of the advanced countries in favor of the developing countries is what is urgently required for the economic development of the Asian countries.

To summarize, it is not probable that China's foreign trade will follow the first alternative path of development. It is safer to assume that China's export and imports will grow at a rate of 5 to 8 percent or a little above that. If this estimate is valid, the issue of the place of China's foreign trade in the Asian-Pacific trade may also be estimated. If, as projected by other authors,[17] the foreign trade of other countries in the Asian-Pacific area will also increase at a growth rate that is similar to or higher than that indicated above for China, the relative position China has held in the recent past will not change significantly.

4. The subject of the impact of the emergence of China does not end with the discussion of the China's place in international trade. The challenge of the emergence of China may rather come from the Chinese model of economic development the essensial ingredients of which are, as discussed in the previous sections, (i) the policy of "domestic equilibrium" rather than "international equilibrium"; (ii) the policy of constructing a viable local economic sector with the primary reliance on "human initiatives" of local people and (iii) the policy of constructing gradually, selectively and with-

[17] Kiyoshi Kojima, Saburo Okita and Peter Drysdale, "Foreign Economic Relations," in Asian Development Bank, Southeast Asia's Economy in the 1970's, Longman, London, 1971, and Saburo Ohkita, Economic Development in the 1970's - Japan and Asia, The Japan Economic Research Center, June 1972.

in her own means a central economic sector which has an international competitive power. There is certainly a problem how far the countries of Southeast Asia would be able to follow the first ingredient of the Chinese model, since the economic structure of the countries are significantly exposed to the foreign trade and the size of the economy is mostly small. However, the second and third ingredients may become attractive, and when this happens the present pattern of foreign trade of these countries would be modified accordingly.

Space does not permit further elaboration. Following comments, however, are in order. (1) The challenge would become when real when the following two situations arise: first, in China the current economic policy continues to be enforced and her domestic economy progresses in a way that may be slow but is nevertheless steady, and second, in other Asian countries the Green Revolution and the industrialization mainly through direct investment by foreign enterprises will have definitly unfavorable social effects, and the advanced western countries' import policies will remain substantially as they are now. (2) The dissemination of the Chinese model as an alternative economic development model for the developing countries would be facilitated by a steady growth of their China trade, by an increase in exchanges of tourists and cultural and academic missions and by a growing volume of technical and economic aid by China. The role which will be played by the Overseas Chinese residing in these countries (including these naturalized) is not entirely certain, but is potentially very important. (3) China's economic aids, which amounted to 2.2 billion U.S. dollars from 1953 to 1972,[18] seems to be peculiarly Chinese, especially in the sense that the aid projects are being undertaken using technological and organizational methods similar to those used in China. (4) Responses to Chinese aid and methods have so far been much more significant in Africa than Asia. While there are cultural, political and historical reasons for this, this may not hold in the future should conditions in (1) and (2) come to be satisfied.

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[18] Leo Tansky, "Chinese Foreign Aid," in Joint Economic Committee, U.S. Congress, People's Republic of China, An Economic Assessment. This paper gives a good account of characteristics of China's aid projects.

Appendix Table 1 Changes in the

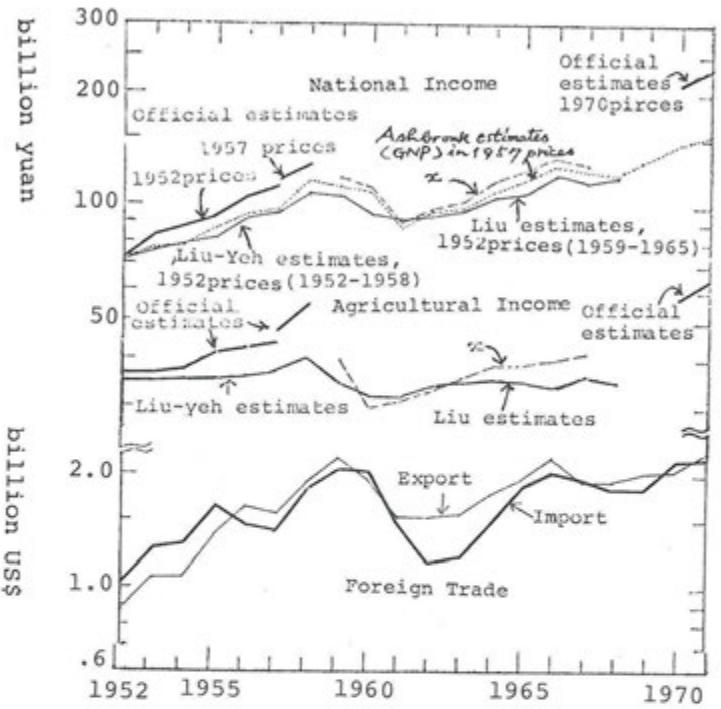
	Restoration Period 1949-52	1 FYP Period 1953-57	GLF Period (2 RYP) 1958-60
Overall pattern	Recovery policy	Soviet model of planned industrialization	Chinese method of dualistic industrialization
Organizational policy	Democratic institutional reform	Toward establishing organizations on the Soviet Model	Toward decentralization
Industry	Take-over of the state enterprises; San-fan and Wufan movement	Emphasis on central state enterprises; centralized management system of state enterprises with khozraschet and incentive wages;	Emphasis on local state enterprises, especially hsien and hsiang enterprises: Simplification and "revolutionalization" of management.
Agriculture	Land redistribution	Gradual cooperativization and collectivization	Reorganization into People's Communes as a basic economic and administrative unit
Allocational policy	Restoration of normal market mechanism	Emphasis on heavy industrialization which is also considered as prerequisite to agricultural modernization	Emphasis on increased production of foodgrains and steel
Industry	Deflationary measures; Fiscal centralization; restoration of the Northeast base	Investment priority on (1) heavy industry (2) large-scale factories (3) highly advanced techniques (4) the existing industrial bases	Emphasis on building of small-scale local industry with native techniques, mainly by local resources
Agriculture	Reconstruction of internal trade channels between the rural and urban districts	Strengthening of marketing control	Strengthening of intensive farming methods (improved cropping systems, water conservancy, manuring) with local resources

Economic Policies of the PRC Government

Readjustment Period 1961-65	3 FYP Period (Cultural Revol.) 1966-1970 incl.	4 FYP Period 1971-
Readjustment aiming at recovery	Formulation of a new economic policy	Revised Chinese method
	Toward decentralization with a revised method	
Elimination of inefficient hsien and hsiang enterprices	Emphasis on local state-enterprises in close connection with People's Commune; Decentralized management system: "three combination," reduction of wage and salary differentials	
Reorganization of PC into decentralized fashion	People's Commune with Production Teams as basic decision-making units	
	Creation of self-reliant regional economic zones with priority on agricultural modernization; gradual shift in the emphasis to the central modern sector.	
Priority on the industries supporting agriculture; readjustment of small enterprises; and technical reforms in the existing large-scale enterprises	Local industrial structure centering on agricultural-input industry, small and medium scale and intermediate technology. Technological transformation of central industry.	
Relaxation and renewal of intensive farming methods	Intensive agriculture with increased use of modern inputs	

Appendix Chart 1

Changes in National Income, Agricultural Output and Foreign Trade of China 1952-1971



Remarks: Official estimates refer to the reconstructed version in Ishikawa's National Income and Capital Formation in Mainland China, Institute of Developing Economies, Tokyo, 1965 and those shown in Appendix Table 2. Liu-Yeh estimates refer to those in Liu and Yeh, The Economy of the Chinese Mainland: National Income and Economic Development, 1933-1959. (Note 2). Liu estimates refer to those in T.C. Liu, "Quantitative Trends in the Economy" in Eckstein, Galenson and Liu, ed., Economic Trends in Communist China, Aldine, Chicago, 1968. The growth line indicated by x represents one of a few other estimates derived by use of the structural estimation equations developed by Liu and by the series of estimated outputs of selected commodities that are independent from those used in Liu estimates. This corresponds to Version 1 I attempted in this way in my "A Hypothetical Protection of the Chinese Economy; 1966 to 1968." Ashbrook's estimates: refer to A.G. Ashbrook, Jr., "China: Economic Policy and Economic Results: 1949-71," in Joint Economic Committee, Congress of the U.S., People's Republic of China: An Economic Assessment, May 1952. His GNP indexes are converted here to the GNP series expressed in the yuan values of 1955, the base year of his estimates. The figures for exports and imports are taken from the estimates made by Usack and Batsavage referred to in Table 1.

Appendix Table 2 Official Estimates of China's National Income which are Converted to U.S. Dollar Values by Official Covernsion Rate: 1970 and 1957

	1970 (in 1970 prices)	1957 (in 1957 prices)	Annual growth rate in 1957 prices
1. NDP (in $billion)	88.3	46.6	6.4
of which,			
Agricultural output	24.5	18.3	1.7
Industrial output	27.3	10.1	10.1
2. Population (million persons)	750-800	634	1.3-1.8
3. Per capita NDP (in $)	110-118	73	4.6-5.1
Per capita agr.output	31- 33	29	-0.1-0.4
Per capita ind.output	34- 36	16	8.0-8.5

Source: S. Ishikawa, "Prospects for the Chinese Economy: Trends and Cycles," Pacific Community, Jan.1973.

Remarks: In deriving the annual growth rate in 1957 prices, allowances are made for the price increase between 1957 and 1970 of 7.9 percent in agriculture and the price reduction of 21.9 percent in industry. For agriculture and industry combined the average price reduction was 15.5 percent between 1957 and 1970, and this is assumed to be equivalent to the index of NDP deflator for the same period.

Appendix Table 3 Comparative Chinese Price Level with Respect to Japan (the Chinese prices expressed as ratio to the Japanese prices, when the latter is converted to yuan at the official exchange rate)

	1951	1957
1. Textile materials	.52	1.01
2. Fuels (coal)	.94	.79
3. Matal and metal products	4.06	2.24
4. Building materials	1.44	1.23
5. Chemical products	1.38	2.41
6. Miscellaneous producers' goods	1.22	2.63
7. Agricultural products for food	.53	.54
8. Other food	1.05	1.17
9. Textile products	2.20	3.35
10. Miscellaneous ordinary consumers' goods	2.07	1.96
11. Miscellaneous durable consumers' goods	4.06	2.24

Source and remarks: Toshiyuki Mizoguchi, "Comparison of Chinese and Japanese Prices", in Ishikawa, ed. Chugoku Keizai no Tokei-teki Kenkyu (Statistical Studies of the Chinese Economy), Vol.II, 1962. The figures are estimated by using the whole-sale price data in Tokyo (compiled by the Bank of Japan) and in Shanghai (compiled by Shanghai Economic Institute of Accademia Sinica, Collected Prices Materials Before and After the Liberation of Shanghai, 1921-1957, Shanghai People's Publishing Co., 1958. The Chinese prices of textile products (9) seem to include excise duties which are quite high.

Comments and Discussion of Ishikawa's Paper

Ronald Hsia opened the discussion: With China taking over the UN Security Council seat, the expectation of the world is to see her play an active role not merely in world politics but also in international trade, particularly trade in the Asian-Pacific Region.

Such an expectation, however, should be examined against reality. This constitutes the task of Professor Ishikawa in his paper.

At the outset, I wish to point out that I find Professor Ishikawa's paper highly informative and extremely interesting. It contains a wealth of information and ideas concerning the impact of China on the economies of the Asian-Pacific Region.

This impact, as Professor Ishikawa sees it, will be more likely in the broad field of general economic strategy than in the narrower field of trade, although it is the latter field to which he has addressed himself in the paper. This, perhaps, explains why he has devoted a substantial portion of his paper to examining the nature of the Chinese economy and the economic policy of China.

As far as this portion of the paper is concerned, I find myself in general agreement with the author. There are, however, a few minor points which I might raise.

While the decentralization of economic administration began in 1958, Ishikawa treats it in the paper as if it were a recent development. Similarly the reliance on "human initiative" dates back to the 1950s rather than the second half of 1960s. In fact, ever since the beginning of the Chinese Communist regime, "human initiative" has been played up as in the emulation and technological innovation campaigns.

Professor Ishikawa has singled out human engineering and the narrowing of gaps between industry and agriculture between town and country, and between mental and physical labour as the major characteristics which distinguish China from other socialist countries. It seems to me that these characteristics are common to all socialist countries and that the difference between China and other social-

ist countries is a matter of degree rather than kind.

Regarding the Great Leap Forward policy, Professor Ishikawa's view that it is a nearly complete reversal of the previous Russian-type policy appears to have somewhat contradicted the Leap policy of "walking on two legs", that is, equal emphasis on modern capital-intensive technology and large scale of operation, on the one hand, and traditional labour-intensive technology and small scale of operation on the other.

Similarly the discussion of people's communes in this paper gives the impression of uniformity among commune practices. In fact, commune practices differ widely in different parts of the country. While in many communes, the production team is the accounting unit and makes decisions on production distribution and investment, in some other communes the production brigade is the accounting unit and makes similar decisions. There are also communes where investment decisions are made at the commune level.

Turning to external trade, Professor Ishikawa correctly points out that China's foreign trade policy is to satisfy the demand for imports arising mainly from the country's industrialization need for intermediate and capital goods under the constraint of export capacity. However, China's low foreign trade dependency ratio (which are estimated to be 2.7 percent for exports and 2.6 percent for imports in 1970) cannot be attributed solely to her policy of self-reliance, as Professor Ishikawa seems to infer. Equally responsible for the low ratios are the vast size of the Chinese economy and the rich and divergent endowment of natural resources. Without these basic conditions, self-reliance would have been a disastrous policy from the viewpoint of economic development.

I am somewhat puzzled by the lack of discussion in this paper on possible trade diversion. Surely with China's increasing diplomatic relations direct trade will develop with countries with which China has newly established diplomatic relations. Some of this direct trade would undoubtedly develop at the expense of entrepot trade hitherto carried out in Hong Kong or Singapore. Any discussion of trade diversion may well tie in with the export constraint emphasized in this paper. It should be noted that trade diversion is not something new to China. After the Sino-Soviet rift, there was a substantial diversion of China's trade from the Soviet Union to Western countries and Japan. Prior to the rift, China was getting

three quarters of her imports from the Soviet Union. Following the rift, this proportion dropped down to less than one quarter.

The prospect for developing China's external trade, as Professor Ishikawa sees it, is not particularly bright. His judgement appears to be based on the export constraint, which he feels can be weakened only by developing metal, chemical and machinery into export industries, in as much as exports of these commodities are not subject to man-made trade barriers and because of the relatively high elasticity of demand for these commodities. But he feels that owing to price disadvantage and other difficulties the prospects for developing these industries for export are not especially good. In this connection, China's offer of selling a substantial amount of crude oil (which falls into the same category as the above mentioned commodities) to Japan reported in Tokyo newspaper yesterday will, perhaps, brighten somewhat the outlook for China's external trade.

Arthur Paul continued the commentary: Because Professor Hsia has commented on Professor Ishikawa's conclusions and on some of the more general aspects of this paper, I shall direct my remarks more to the description of the Chinese economic structure, the new institutions, and the methods used to increase productivity and for the selection of technology. Success or failure of the structure or of the methods could influence Chinese foreign trade policies and thus affect the conclusions of the paper.

I had the privilege of hearing Professor Ishikawa describe the economic structure of China on an earlier occasion, and since then I have been thinking about its implications for the rest of Asia. Now, after reading his paper, several questions have come to my mind.

The first qeustion pertains to the special features of the economic structure that China has built in order to carry out the policy of "reliance on human initiative." Were the formation of agricultural Production Teams of twenty and thirty farm families, the creation of Combinations of Managers, Engineers and Workers for local industries and the active efforts to eliminate the Three Big Differentials" steps that were improvised in order to relieve the pressures created by a surplus of labor supply, by unemployment and underutilization of farm labor? Or are these steps the result of planning? Were they tested in various areas before they were generally

adopted?

In his paper Professor Ishikawa states that there is not yet enough information to judge the results of this approach to development, but I am wondering if there are some indications of whether the use of these methods is expanding or contracting.

It seems to me that to obtain further information about the results achieved by these Chinese methods of tackling the problem of achieving optimum labor utilization is a matter of great importance to the other countries of Asia, and to other parts of the world as well.

If the Chinese practices reduce industrial productivity or result in poor choices of technology for agriculture and small industries, then no doubt they will be greatly modified or discarded as time goes on. On the other hand, if the results that China achieves are positive, if she obtains more effective utilization of labor by these methods and thereby increases productivity, then the economic structure and the methods used in China will spread to those neighboring countries that are struggling with problems created by the existence of vast pools of unutilized human energy. This could have far-reaching effects on economic planning in other areas, as well as important political repercussions.

Another observation that I would like to make pertains to what seems to be a downgrading of the functions of planners, the decentralization of the decision making process, much of which will now take place at local levels. In the local industrial sector, decisions are to be in the hands of the "Combinations" of managers, engineers and workers. Presumably the views of economists and sociologists are reflected in the determination of the basic general direction of the economy and particularly of the Central Industrial Sector, but they will not have any direct influence on the important decisions to be made at the operating level.

I am wondering how this will affect the choice of technology for the local economic sector. The most interesting and impressive technological devices that make effective use of excess labor and at the same time increase productivity are those that reflect in their designs the ideas of economists (and sociologists) as well as those of highly specialized engineers. These can be relatively simple tools, but they embody sophisticated and modern engineering

practices. It is hard to see how the Production Teams of farm families and the local industrial Combinations can have access to or make proper use of the fruits of this highly specialized division of labor unless they are furnished from the top of the structure, which does not seem to be contemplated in China at this time.

In the West, most of the results of the efforts to create new industrial and agricultural technology appear in the form of labor saving devices. There are now some important and well-organized efforts to create new technology that is suitable to areas where there is excessive unemployment and where farm labor is underutilized. These efforts involve the attribution of proper weight to the existence of surplus labor; but they disregard neither modern engineering principles nor the possibility of using (as components) technology created in other parts of the world. It is possible that the Chinese approach may over weight the labor supply factor and many disregard other factors that could contribute more effectively to development.

Professor Ishikawa has mentioned the Green Revolution. He refers to increasing differentials in the income and wealth positions of rural families that have followed the modernization of agriculture in other parts of Asia and to the possibility of further unfavorable social effects of the Green Revolution. The reports that I have seen on the results of the Green Revolution vary greatly in their conclusions. The first reports from India tended to confirm Professor Ishikawa's references to unfavorable economic and social effects. The way in which India introduced the new seeds and mechanized cultivation in the Punjab did have such effects, but the methods that India used reflected political objectives which called for the achievement of self-sufficiency in food production in the shortest possible period of time. Somewhat similar methods have been used in Pakistan. On the other hand, there are other areas of India where different methods brought forth different results. In those areas, credit to finance the needed inputs was more readily available to small farmers and so was access to water and to supplies of the new seeds themselves. Reports from those areas regarding the effect on local employment and income distribution are very different from the reports of the experience in the Punjab.

There are also important studies of the impact of the introduction of the new rice seeds in the Philippines. The results are not yet conclusive, but they already indicate patterns that are different from the Indian experience.

Professor Ishikawa has performed a valuable service by gathering the information contained in his paper and presenting it in a clear and concise form. The information will be of great interest and use to those planners in Asia who are struggling with the imponderable problems created by vast surpluses of unutilized labor. They will watch, not only with curiosity, but with intense and vital interest, the results of the Chinese efforts to meet these problems.

Subsequent discussion focussed on the possible emergence of China as a major trading nation, either as an exporter of agricultural and other primary products or as an exporter of light manufactured goods. In particular, the possibility of intense competition between other developing countries and China in the export of light manufactured goods was stressed.

Professor Ishikawa agreed with other participants who argued that adoption of the Chinese development strategy was unlikely to change the trade dependence of Southeast Asian countries greatly, both because of the size of their domestic markets and because of the nature of their resource endowments.

In reply, Professor Ishikawa said that he had presented these alternative courses for the future course of China's foreign trade and had deliberately refrained from concluding whether she would take the first alternative of 'import dependence' or the second alternative of 'self reliance'. But he was not so pessimistic as had been suggested about the future course of China's foreign trade.

He added that the success of China's development strategy was still uncertain. Further, it did not appear that the employment effects were a major consideration in the choice of a particular development strategy. There was more concern about the linkage mechanism by which industrial development put energy into agriculture and thus led to agricultural development and the absorption of labour by the agricultural sector.

PART II

INDUSTRIALIZATION AND TRADE GROWTH IN DEVELOPING COUNTRIES

3

TRADE AND INDUSTRIALIZATION POLICIES: THE POLITICAL ECONOMY OF THE SECOND BEST[1]

Helen Hughes

I. Introduction

Empirical evidence of the costs of high protection and the benefits of trade has in recent years added so much weight to the conclusions of trade theorists that not only in the literature, but also in the minds of sophisticated policy makers, there is little doubt that in a global context, the more outward looking an economy the better. Trade policies on the other hand, continue to be strongly protectionist, and steps taken toward trade liberalization have turned out to be of minor value to developing countries. There has been little attempt and no success in explaining actual geographic and commodity patterns of trade in terms of trade theory. Thus, in spite of the attention devoted to the economics of international trade, and in spite of the considerable advances made in the field in the last 20 years or so, there is also considerable disillusionment with the state of the art.[2]

This paper does not argue that the theory of trade is irrelevant. Nor does it suggest that private persons and governments are not

[1] I am indebted to Naimeh Hadjitarkhani for the preparation of the data for this paper.

[2] R.N. Cooper, reviewing the international economics articles in the new International Encyclopaedia of the Social Sciences, concluded that "there is a serious question about the relevance of the pure theory of trade", Journal of Economic Literature, June 1970,p.436.

motivated, by and large, by their economic interests. It does, however, contend that the factors usually hidden in simplifying assumptions for the convenience of trade theory models - technological change and economies of scale, product differentiation and imperfect competition, the costs of administering trade policies, historical trading patterns and temporal dimensions, and problems of income distribution - are critical in determining private economic behavior and government policy. After summarizing the characteristics of the international trading structure which face developing countries, this paper examines these factors in the context of industrial policy formulation. Because political conditions influence and sometimes determine economic goals, those too are taken into account where they are of particular importance. The options open to the developing countries are then discussed.

II. Characteristics of the International Trading Structure Facing Developing Countries

The economic evaluation of the efficiency with which resources are allocated depends on the identification of appropriate market and social prices. In an open economy, and among open economies, this means prices in an international trading context. The domestic resource cost,[3] effective protection,[4] and the Little-Mirrlees[5] method of project evaluation have focused on international prices as the relevant social prices. The more recent Sen Gupta-Sen-Marglin project appraisal method, emphasizing the problems of using international prices as social prices in a second-best world,[6] concluded that international prices should be viewed as market prices which require adjustment according to a country's optimizing objectives. An analysis based on shadow pricing similarly uses international prices as reference points. Thus, whatever the method of approach, the identification of an international price is essential. Paradoxically, these cost benefit methodologies have been refined at a time when

3 M. Bruno, "The Optimal Selection of Export-promoting and Import Substituting Projects" in UN, Planning the External Sector: Techniques, Problems and Policies, 1965.

4 M. Corden, The Theory of Protection, 1971, brings together the various threads of effective protection theory as well as noting its historical evolution in Appendix 1, p.245 ff.

5 OECD, Development Centre Studies, Manual of Industrial Project Analysis in Developing Countries, Vol.1, Methodology and Case Studies, 1968.

6 UNIDO, Guidelines for Project Evaluation, 1972.

trading conditions have made an international price largely of historical interest.[7]

The erosion of 'international prices' has been essentially an economic process. It has taken some considerable time, and it cannot be understood without reference to the economics of industrial organization. In retrospect, World War II was the watershed between the largely outward looking nineteenth century and the neo-mercantilism of the twentieth. Though to a lesser extent than in World War II, the demands of a war economy accelerated economic change, making production more complex and capital intensive. The cost reducing advantages of economies of scale were accentuated. In the 1920s mass production techniques were applied to mass consumption products, bringing capital intensiveness and economies of scale to marketing. Product differentiation emerged as a marketing technique, adding quality differentials to price differentials as a means of competition. Vertical and horizontal integration was stimulated. Increased concentration in production and distribution spilled over national boundaries, replacing indirect by direct foreign private investment. The multinational corporation emerged as a fact of economic life.

The growing importance of the economies of scale provided a time dimension rationale for discriminatory pricing. Marginal costing today would be recouped by average costing on a larger scale of production tomorrow. The potential benefits of economies of scale gave a new impetus to pre-meditated investment in excess capacity, and then looked to marginal pricing in export markets to minimize losses until the market grew to catch up with the capacity installed. In some capital and intermediate goods industries this led to cyclical movements with peaks of excess capacity driving prices below marginal costs in international markets so that investment was halted. After a few years, however, demand caught up with existing capacity, shortages developed and prices rose, and a new investment - marginal pricing cycle began. International steel prices have for many years been an example of such a latter day "cobweb" theorem.

Product differentiation and increasing concentration, with attendant monopoly and oligopoly, gave new opportunities for discriminatory pricing. Firms in the lead of a "product cycle" were in a parti-

[7] Although work such as R.E. Lipsey and I.B. Kravis', Price Competitiveness in World Trade, 1971, acknowledges the difficulty of determining "international prices", the problem has received curiously little attention in the considerable literature concerned with the consequences of their measurement.

cularly favorable position because they could use the intra-marginal profits earned by their monopoly of knowledge as a base for "marginal pricing". Colloquially and widely used this came to mean any prices below average fixed and variable costs. Oligopolistic firms were often able to establish a comfortable non-price competitive environment in a domestic market, but had to compete with oligopolistic firms from other countries in international markets. For many products international markets became more competitive than domestic markets, and "marginal pricing" became more and more concentrated in exports. In extreme cases, marginal pricing could be used as a temporary measure to capture export markets from existing competitors, prevent their entry, or to prevent local production. Once a dominant market share was gained prices could be raised to average costs, or higher, in a classical "dumping" tactic.

Vertical integration on an international scale began to affect the pricing of raw materials. As multinational corporations invested abroad to assure themselves of raw material supplies, mineral product and some agricultural raw material markets ceased to be international in any meaningful sense. The multinational corporations priced products to minimize tax, royalty and other costs, generally lowering the "international market" prices of such products by taking their profits in their home country. Processing tended to be undertaken in a firm's home country, usually because it was economic to process close to final markets, but sometimes merely because this was convenient for the parent firm.[8]

At the other end of the spectrum, in the production of consumer goods, the advantages of a location close to final demand began to lead some multinational corporations to taking firstly final assembly, and later other production, abroad. But here too intra-firm pricing did not reflect market values, but rather a cost minimizing process with respect to direct and indirect taxes.

Vertical integration into shipping, insurance and banking services led to a further erosion of market pricing. Trade credit and freight and similar service costs became extensions of the pricing system, greatly complicating the measurement of international prices.

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[8] In time protective tariffs were used to reinforce such locational choices. See B. Balassa, "Tariff Protection in Industrial Nations and its Effects on the Exports of Processed Goods from Developing Countries", The Canadian Journal of Economics, August 1968.

The infant industry argument for protection was as old as the endeavours of the first French and Germany manufacturers to catch up with the English industrial lead in the late eighteenth century, and by the nineteenth century protective duties were a widely established form of trade policy. After World War I agricultural and manufacturing interests formed a mutually supporting protectionist alliance in continental Europe. In third country markets, moreover, all the industrialized countries began to feel competition from China, through Hong Kong, its export entrepot port, and more importantly, from Japan. These newcomers to world markets were very poor countries; the "pauper labor" argument for protection became important.

In several primary producing countries the dislocations in the supply of manufactured goods during World War I, together with the declining elasticity of demand for primary products in industrialized countries led to the first wave of protectionist arguments on both infant industry and balance of payments grounds particularly in Latin America. The decline of employment opportunities in agriculture and mining added to this argument in Australia, New Zealand and Canada, and the first signs of population pressure of a different kind became an argument for industrialization in the Netherlands East Indies and Indo-China. Nationalist influences helped to push primary producing countries into an interest in wanting to shift primary processing back to raw material resources, evoking a strong protectionist reaction from industrialized countries.

It is worth emphasizing that protectionist policy trends were evident in rising tariffs and pegged currencies before the Great Depression. It is true that there was a strong nationalist element in protectionism after World War I both in industrial and primary producing countries, but the growing imperfection of international trade, arising out of the imperfections of industrial markets, was an important factor in the growth of support for protection. Thus Maynard Keynes' 1920s protectionism, which he never really abandoned as a national approach to policy, can not be blamed on his never spending "the twenty minutes necessary to understand the theory of values;[9] rather, it was due to the same sharp understanding of the reality of a less than optimal economic world which led to his pub-

[9] Gerald Shove, quoted in Joan Robinson, Economic Philosophy, 1962, p.79.

lication of the General Theory in 1936.

The balance of payments crises of the late 1920s and early 1930s of course greatly strengthened protectionist trends. The industrial countries which had already used "infant industry" arguments in the nineteenth century to build up industrial strength in the face of England's lead became more protectionist, and the newly industrialising countries strengthened trade barriers. Great Britain itself succumbed to protectionism in the wake of its loss of industrial leadership. The Imperial Preference Scheme of 1932, which introduced a new element in the trading environment by attempting to stimulate trade through diversion among countries with strong political ties, was the result. Countries affected by competition from Japan either directly, or in third country markets, also took particular, discriminatroy tariff and quantitative trade diverting measures against Japanese imports. What little now remained of the nineteenth century mobility of labor and capital was further restricted. The 1930s saw further tariff and non-tariff barriers to trade together with more currency controls. The further erosion of "international prices" and growing discrepancies in factor prices with consequent departures from comparative advantage in production were not the only results. The multinational corporations thrived on the rents created by the multiplicity of barriers to the international movement of factors and goods. Once the worst of the depression was over, they grew rapidly at the expense of their smaller competitors operating within national boundaries.[10]

World War II stimulated technological advances to a new level, greatly strengthening the effects of economies of scale on production and marketing. Technological advances in the communications industries particularly favored the multinational corporation both in production and marketing. There was, however, also, a new direction in policy. It had long become evident to economists like Keynes that the 1930s nation by nation approach to international economic problems merely exacerbated them. The creation of the In-

[10] In the very considerable literature which has attempted, without conspicuous success, to analyze the multinational firm, Edith Penrose's "Foreign Investment and the Growth of the Firm" in the Economic Journal, June 1950, remains the best exposition of the way in which the multinational firm can take advantage of strictly economic rents. In recent years, however, it appears that the "rent" opportunities created by trade policies have been even more relevant to the growth of the multinational corporation's importance.

ternational Monetary Fund at Bretton Woods, and the meetings which led to the establishment of the General Agreement on Trade and Tariffs, therefore sought international cooperation in payments and trade measures as a path to less distorted factor and commodity prices. Without the I.M.F. and GATT factor and commodity movements would probably be even more constrained than they are now. However, several trends have tended to undermine and run counter to international cooperation.

Most industrialized countries remained basically protectionist in the 1950s and 1960s. The members of the European Economic Communities (EEC), and to a lesser extent, the European Free Trade Association, sought to benefit from wider economies of scale than their national boundaries permitted, without, however, abandoning protection against the rest of the world. They were prepared to cooperate internationally in liberalizing trade in manufactures - where they were not seriously affected by competition - but not in agricultural products. Thus while the Kennedy Round of tariff reductions substantially reduced international tariff levels for sophisticated manufactured products, the rate of effective protection was even raised on some primary processed products (Table 1). Political pressures excluded textiles from the negotiations, and quantitative restrictions generally began to be imposed more often and more widely against developing country imports. Japan used, and is still using, non-tariff as well as tariff barriers to build up its technological expertise and as a base for vigorous export growth. Its strategy has included fostering horizontal and vertical integration for international competitiveness and the use of the domestic market and credit incentives as a base for marginal pricing. Some developed countries, notably Canada, Australia and New Zealand continued to follow intransigently protectionist policies for their domestic manufacturing, while inveighing against the agricultural protectionism of other developed countries.

Neo-mercantilism and "marginal pricing" for export markets gained new strength when GATT was persuaded to make drawbacks of indirect taxes a legitimate form of export subsidy. This introduced some extremely dubious concepts into the rules of international trade. The proposition that indirect taxes fall on consumers rather than on producers, whereas direct taxes fall on producers, was given credence without evidence that this is in fact so. Because in-

Table 1 Nominal and Average Effective Tariffs Before and After the

Commodity	SITC No.	U.S. Nominal	U.S. Effective
I. Meat			
1. Fresh & frozen	pre KR 011	5.2	5.2
	post KR	4.6	4.6
2. Meat preparation	pre KR 013	5.9	6.1
	post KR	4.7	5.6
II. Cocoa			
1. Cocoa beans	pre KR 072.1	0	0
	post KR	0	0
2. Cocoa powder & butter a/	pre KR 072.2	4.6	36.7
	post KR 072.3	1.3	11.6
3. Chocolate	pre KR 073	9.5	12.7
	post KR	4.8	1.3
III. Copra			
1. Copra	pre KR 221.2	0	0
	post KR	0	0
2. Cocoanut Oil crude cake b/	pre KR en 422.3	5.5	46.3
	post KR en 081.3	5.5	47.2
3. Cocoanut Oil refined	pre KR 422.3	30.0	30.0
	post KR	30.0	30.0
IV. Leather			
1. Hides & Skins	pre KR 211	1.1	1.1
	post KR	1.1	1.1
2. Leather	pre KR 611	9.6	25.7
	post KR	4.7	12.0
3A. Leather Goods, other than shoes	post KR 612	15.5	24.5
	post KR 831	7.7	11.4
3B. Shoes	post KR 851	16.6	25.3
	post KR	14.9	26.3
V. Iron			
1. Iron Ore	pre KR 281.3	0	0
	post KR	0	0
2. Pig Iron, Ferro Alloys	pre KR 671	1.8	9.3
	post KR	0.7	0
3. Steal Ingots	pre KR 672	10.6	106.7
	post KR	6.3	62.2
4. Rolling Mill Products	pre KR 673	7.1	-2.2
	post KR 676	3.5	-4.8

/a Weighted average of duties: cocoa powder 40%, cocoa butter 60%.
/b Weighted average of duties: coconut oil 80%, oil cake 20%.
Source: UNCTAD, The Kennedy Round Estimated Effect on Tariff Barriers, 1968.

on Selected Products in the Major Industrial Countries
Kennedy Round (percentage)

U.K.		EEC		Sweden		Japan	
Nominal	Effective	Nominal	Effective	Nominal	Effective	Nominal	Effective
8.3	8.3	19.8	19.8	0	0	10.0	73.5
4.2	4.2	17.8	17.8	0	0	6.2	6.2
11.1	15.2	23.8	46.1	0	-7.0	24.8	73.5
8.3	10.4	19.5	44.3	0	-5.7	16.4	47.3
1.5	1.5	5.4	5.4	6.0	6.0	5.0	5.0
0	0	3.2	3.2	3.6	3.6	3.0	3.0
1.1	-3.3	22.8	150.0	9.2	34.2	17.4	106.7
0	-2.5	18.2	126.6	3.9	31.6	12.2	98.3
10.0	26.3	30.0	42.7	15.0	42.7	35.0	43.0
10.0	28.6	18.0	19.3	11.3	27.0	35.0	68.6
10.0	10.0	0	0	0	0	0	0
10.0	10.0	0	0	0	0	0	0
14.0	52.3	10.0	66.4	0	0	10.0	65.4
14.0	50.0	10.0	85.4	0	-1.0	10.0	85.4
15.0	15.0	15.0	183.3	0	0	10.0	10.0
15.0	15.0	15.0	186.3	0	0	10.0	10.0
5.4	5.4	0	0	0	0	0	0
0	0	0	0	0	0	0	0
14.9	34.3	7.3	18.3	7.0	21.7	19.9	59.0
11.4	30.3	4.8	12.3	1.7	4.3	11.6	34.7
18.7	26.4	14.7	24.3	12.2	20.7	23.6	33.6
9.3	8.1	7.3	10.4	10.4	22.1	11.8	15.0
24.0	36.2	19.9	33.0	14.0	22.8	29.5	45.1
20.4	32.7	11.9	19.3	11.9	22.8	22.9	36.5
0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0
3.3	17.9	4.0	-13.8	0	0.7	10.0	54.3
0.8	-2.9	4.0	3.5	0	-4.3	1.9	2.9
11.1	11.1	6.9	6.9	3.8	3.8	13.0	58.9
9.4	88.8	4.0	1.1	3.8	41.1	6.4	16.6
9.5	7.4	7.2	10.5	5.2	13.2	15.4	29.5
7.4	3.6	5.5	11.5	5.1	12.6	8.9	20.5

direct tax drawbacks were legitimate whereas direct tax drawbacks were not, the collection of revenues through indirect taxes was implicitly encouraged. The proposition that consumers of imported goods do not have to bear the social costs of producing them has curious implication indeed for international resource allocation.

The formation of the EEC also revived the dying preferential trade concepts of the 1930s, and extended them, in complex forms, on a country by country basis, throughout the Mediterranean basin as well as maintaining them in relation to developing countries which had formerly been French colonies.[11] In the 1960s the developing countries devoted much of their energy, and spent a great deal of their bargaining power, negotiating the one way Generalized Preference Scheme adopted initially by Australia, and in 1971 by the EEC and Japan. While it is not yet clear which groups in which countries have benefitted from the EEC ties with developing countries, all the available evidence suggests that the trade creating effects Generalized Preference Scheme have been negligible.[12]

The socialist countries, with the exception of Yogoslavia, have remained aloof from even such limited co-operation for freeing world trade and payments as the persuasive powers of the I.M.F. and GATT have achieved. The Cold War contributed to a return to barter trade on an international scale, with governments pricing goods, credit and currency according to the exigencies of balance of payments situations and political objectives rather than in relation to costs.

The flow of aid to developing countries has emphasized prevailing patterns of trade discrimination. Aid in the form of surplus agriclutural products has tended to be high cost both in the short run and in terms of countries' following their comparative advantage in production. It has accentuated bilateral historical trading patterns which were not always in the interest of the developing country. Not only has the initial volume of aid frequently been reduced

11 Naimeh Hadjitarkhani, "Preferential Arrangements between Developing and Developed Countries, and among Developing Countries", IBRD Working Paper No. 162, 1973 (mineographed).

12 See P.J. Lloyd, "The Value of Tariff Preferences for the Developing Countries: Australian Experience", Economic Record, March 1971 for an examination of the very limited Australian scheme. D. Wall in "The Commonwealth and the Generalized System of Preference." A Study prepared for the Commonwealth Secretariat, 1972 (Mimeographed), a more broadly based enquiry, is typical of the rather more pessimistic views prevalent among trade economists.

by high procurement costs, but subsequent spare parts and investment costs have often been unduly high because a country was tied to high cost suppliers. Government support for "aid" export credits has accentuated the irrationality of international prices, and made it difficult for the more industrialized of the developing countries, which are now beginning to produce capital goods, to compete effectively. All in all the developed countries' aid represents a small proportion of the costs that their protection imposes on developing countries in limiting their ability to export products in which they have a comparative advantage in production.

Thus while international trade discussions, and, indeed, trade negotiations, have continued to focus on tariffs, non-tariff barriers to trade have become more and more important, and frequently the most important, obstacles to trade.[13]

III. Industrialization Policies

Industrialization has of course been a continuing process, with new entrants coming into the industrial sphere, and older ones graduating to greater industrial maturity. For many of today's industrializing countries, the beginnings of modern industrial experience go back to the end of the nineteenth century. The pace of industrialization, however, accelerated when at the end of the 1940s the former neo-colonial and colonial countries wished to consolidate their political independence in economic terms. The primary export experience of the 1920s and 1930s, the further wartime interruptions of manufactured product supplies, actual and looming unemployment, and the evident correlation between advanced industrial technology and high standards of living, suggested that industrialization was the way to economic prosperity. Tariffs, import licensing and foreign exchange controls were seen as fulfilling three functions: balance of payments control, revenue mobilization, and protection for infant industries. In many countries incentives to foreign investors were added to the protectionist threats to multinational corporations' export markets to ensure the availability of capital and

[13] Apart from R.E. Baldwin's Non-Tariff Distortion of International Trade, 1970 and UNCTAD studies, summarized in "Non-tariff Barriers and Restrictive Trade Practices and their Impacts on the Export of Less Developed Countries", 1972 (mimeographed) there has been little serious study of non-tariff trade barriers despite their increasing importance.

advanced technology.

"Marginal pricing" or "dumping" as it was usually seen from the developing countries' point of view, was viewed as a major, and often as a concerted, threat against the developing countries' industrialization endeavors. It frequently seemed that no matter in which direction a country turned, c.i.f. prices were lower than those of locally produced goods, though they were often also lower than the ex-factory prices in the exporting country. In practice, whether the prices of imported goods were genuinely lower, permanently or temporarily "marginally priced", or "dumped" in the true sense of the word, was extremely difficult to judge. The multinational corporations' transfer pricing, particularly where complicated "depletion allowances" were involved, confused the issues of long term comparative advantage even further. Industrialization was in any case a powerful political as well as economic objective. Most of the larger developing countries during the 1950s and 1960s built up protective barriers around their growing industries in which tariffs and non-tariff barriers to trade were combined with incentives to capital investment through exchange, credit and import regulations exempting capital goods, and in many cases raw material and intermediate imports, from import duties and restrictions, and giving varying degrees of income tax holidays to local and foreign investors.

Given the increasing complexity of industrial "catching up" due to technological advances and increasing benefits of the economies of scale, some "infant industry" protectionism by developing countries was inevitable. Combined with the developed countries' trading practices and their unwillingness to deal with the employment and income distribution adjustments which a rational international economy required, the multinational corporations' monopoly of advanced production techniques, and their ability to exploit the imperfections of the international economy, even the excesses of developing countries' protection become understandable.

In the 1950s the only exception to this pattern was Hong Kong which was able, on the basis of its pre-war export entrepot experience and the inflow of capital, entrepreneurship and skills from China, to enter world markets in textiles and other labor intensive products. Hong Kong started exporting from a free port base, and its laissez-faire policies enabled it to thrive in a world trading

environment in which it could buy raw materials at "marginal prices", and sell the products of its highly productive low cost labor, without affecting the importing countries' markets significantly. When Taiwan sought to follow Hong Kong's lead in the early 1960s, textile markets were still fairly open, but it started from a highly protected base. The alternative was either to reduce protection and devalue, or to introduce export subsidies. Politically, disturbing the economic rent structure established by the protective system was impossible, and the path of export subsidies was chosen. As Israel, Pakistan, Korea, and later other developing countries with import replacement industrialization strategies ran into stagnation, balance of payments problems and income distribution difficulties, they chose the same export subsidy option, sometimes to the point at which they were exporting foreign exchange. Singapore has been the only new entrant with a sufficiently small total output of a number of labor intensive products to enable it to pursue a basically free trade policy from the mid 1960s. The developed countries reacted to the developing countries' exports with quantitative import restrictions. Although only a small share of the domestic market was affected (Table 2), together with the loss of third country markets, this led to labor and capital dislocation with which the developed countries were not prepared to deal.

For all but the two exceptional city states - Hong Kong and Singapore - the issue now is thus not one of protection versus free trade. Barriers to their exports are as much as a reality as their own distorting, protectionist domestic policies. Inefficient productive capacity has been established, but much of it is depreciated, and the issue is for the most part not how to eliminate it altogether, but what is worth retaining, and how to minimize the cost of production in such industries.[14] Given the past and present biases against agriculture because of the subsidies to industry, the problem is not how to reverse the trend, but by which policies and instruments can agricultural and industrial development become mutually reinforcing. Agreed that in the past industrial development has, with minor exceptions been pursued at the cost of employment and the low income groups, the issue is not growth or employment, but how can both these objectives be fulfilled.

[14] See. S. Guisinger and D.C. Meade, "Foreign Exchange Saving as a Measure of Economic Efficiency", 1973, (mimeographed) for an elaboration of this point.

Table 2

Share of Imports of Textiles from Developing Countries as a Share of Apparent Consumption of Textiles in the EEC Countries and U.K. 1967

(percent)

	Germany	France	Italy	Belgium	Netherlands	U.K.	U.S.
Spun Yarn/a							
Cotton	2.3	0.2	0.3	2.7	2.2	7.4	0.1
Cotton & mmf	1.5	0.2	0.4	2.4	1.9	n.a.	0.3
Woven Cloth/a							
Cotton	2.3	1.5	9.5	1.7	7.4	35.0/c	6.2
Cotton & mmf	1.3	1.1	7.1	1.5	6.0	24.4/c	3.6
Clothing/b							
Cotton & mmf	1.18	0.05	0.06	0.27	0.74	1.65	/d

/a Percentages are calculated from quantity figures.
/b Percengates are calculated from value figures based on consumer expenditure.

It should be noted that imports include figures for imports intended for re-export as well.

/c U.K. share declined in 1969 to 31.5 and 23.2.

/d Aggregate figures are not available, but in almost all categories imports are below 20% of total consumption.

Source: Calculated from L. Keough, "Export of Cotton and Cotton Type Textiles from Developing Countries to the United States", IBRD Working Paper 122, 1971 and G. Shepherd, "Exports of Cotton Textiles from Developing Countires to the European Economic Community and the United Kingdom, 1958-1967", IBRD Working Paper 52, 1969.

Trade policies remain central to industrialization policies, establishing the levels of effective protection and export subsidy which determine the basic allocation patterns in an industrializing economy. In a narrow sense effective protection is determined by the rate of exchange, the level of tariffs, the incidence of quantitative restrictions, import duty exemptions on inputs, the relation of internal indirect taxes to the duty structure, and the competence with which these regulations are administered. It is now well established that the variations in the level of effective protection as well as its absolute height have an important bearing on the efficiency with which resources are used. The gross inefficiency of "tailor made" tariffs which encourage the establishment of industries on a cost plus basis has been well known for some time, but

the complexities of "tailor made" effective protection in the sense of combining the effect of tariffs, quantitative restrictions, indirect internal taxes, and exemptions from import duties, are only now becoming arrpeciated in countries deepening their industrial structure from final assembly to intermediate and capital goods manufacture. The traditional end product oriented "tailor made" effective protection frequently means negative effective protection for industrial inputs. In general, intermediate and capital goods are far less protected than final goods, with a corresponding lack of incentives to intermediate and capital goods manufacturing.

The devaluation of the exchange rate is the obvious policy for improving a country's international trading situation, and to the extent that the rate of exchange is overvalued at present levels of tariff and other instruments of protection, this is a basic requirement of a move toward a better policy framework. However, as the existing tariff and other protective measures in most countries are of the "made to measure" type, with large variations in protective levels,devaluation alone will not result in a structural improvement in the economy. After a time, the same strains and stresses which led to the need for the original revaluation will reappear. For most countries, therfore, devaluation is not enough, and if currency is not overvalued at prevailing tariff and non-tariff protective levels, it may indeed, without other policy changes affecting the structure of industry, have very little positive effect.

The approaches to a better tariff structure are well known. A low, moderate uniform tariff is least likely to encourage inefficiency, but it is unlikely that political pressures, and existing inefficient firms' adjustment costs will enable countries to move as far as this in one step. A more piecemeal approach would suggest that establishment of a revenue tariff, commensurate with a country's revenue needs and at the same level as domestic sales or excise taxes. (Such taxes must either be imposed on a value added basis,on final sales, or kept low to avoid cascading which has arbitrary effects on relative costs and leads to undue vertical integration.) One, two or three protective "bands" could be added to the revenue tariff to take into account existing protection levels, at the same time reducing them and making them more uniform. Reductions and the progress to uniformity can be made more palatable if manufacturers are put on notice that a government intends to implement such a program gradually. Many are likely to react by reducing their costs.

Such reductions may bear in mind that existing plants have written off their investment and may lower costs accordingly. New investments would be within the bands established for various product groups. Import duties would become easier to administer. In exceptional cases, higher tariffs could be granted, but again on a reducing scale. The rationale for the levels of bands and the products they covered would not be whether the product is a consumer or producer good, but the comparative cost of producing it. Public enquiry and open hearings where consumers as well as producers would be represented would serve to avoid excessive protection in such cases. Moreover, it is generally true in developing countries which have gone even some way in industrial development that new enterprises do not usually require greater protection than existing firms. By taking advantage of the external economies being built up, and by filling market gaps, new investors frequently need less protection than existing ones have obtained.

Taxes on luxury goods, however defined, require special consideration. It is usual to impose high tariffs on luxury imports, and yet this encourages high profits for local producers, without necessarily cutting down consumption and eroding revenues. Luxury taxes have to be imposed equally on imports and local production if they are to be effective.

Once a rational tariff structure is established, the need for import duty exemptions on capital goods and raw materials and other inputs is eliminated. This avoids much of the excessive protection which often has particularly adverse effects because manufacturers establishing production with such high effective protection find they can not remain profitable without it when their initial privilege period expires. The threat of dismissing workers in countries with high unemployment is generally very persuasive. The elimination of import duty holidays also diminishes the subsidy to capital intensive production, and removes the disincentive to the production of intermediate goods. This often enables small scale sub-contractors to begin import replacing production.

The treatment of quantitative import restrictions is more complex. A number of developing countries have noted the developed country stratagem, used with particular effectiveness by Japan, of using quantitative import restrictions to limit a domestic market to local producers to enable them to export on the basis of low

"marginal" prices. Some developing countries, notably Iran, have followed this approach quite successfully in recent years. The difficulties of successful implementation are, however, considerable. Such an approach is only effective if domestic prices can be kept to desired levels and this means control over entry and pricing. A special argument for quantitative controls arises if this is the only practicable administrative method of stopping technical smuggling to maintain revenue collections. The "marginal pricing" of smuggled goods, which prevents industries in which a country may build up a comparative advantage in the long run, is another reason for quantitative controls over imports. This type of smuggling does occur, but more commonly smuggling is a positive element in trade, preventing protectionist excesses in countries with highly distorted price signals.

Once various protective measures are introduced as a defense mechanism against the existing world trade framework, a bias against other domestic activities and against exports follows. The bias against other domestic sectors, particularly agriculture must largely be regarded as the cost of industrial development; equal general subsidies to agriculture can be only justified in a situation in which a country is seeking to change its total terms of trade. However, if a country does not wish to be locked into a small autarkic industrial economy, if it wishes to export manufactures to benefit from economies of scale in production as well as for balance of payments reasons, then it has to introduce export subsidies to offset the negative effective protection on its exports. Export subsidies may be seen as existing at three levels. The first level includes drawbacks on import duties, temporary admission systems and exemptions from import prohibitions, or the establishment of free trade export zones to establish these objectives where this is administratively simpler, to offset the direct costs of protection. A second level of subsidy through income tax exemptions and cheap credit may balance the general excess cost of domestic factors and goods due to protection generally. Beyond such measures, subsidies may have some justification if they are used, on the "infant industry" argument to penetrate new markets. Otherwise they are simply subsidizing the importers who are generally in developed countries, and domestic manufacturers. At this point a country is frequently unaware of both the costs and incidence of its export subsidies.

As markets become more restricted, importing countries are, moreover, likely to use the evidence of subsidies outside the GATT as a reason for excluding such imports. There is at present a considerable threat that the United States will impose countervailing duties on imports from Mexico, Korea and the Philippines.

The higher and the more unequal protection, the higher and more complex will the subsidy system have to be, and the less liekly is it to lead to an optimal allocation of resources. Sound export policies do not thus merely require the imposition of a subsidy system to match protection; a decline in overall protection, and a reduction in its variability, are essential.

Most countries are not satisfied with the protection afforded manufacturing industries by trade policy measures, but subsidize manufacturers further by giving them income tax holidays of varying duration. Introduced largely on the advice of the International Chamber of Commerce in the 1950s to attract foreign investment, the high costs of these policies have now been well established. They include a further layer of protection to industry, a stimulus to capital intensiveness, and in the case of foreign investment, frequently transfers of revenues to the government of the lending country. The benefits are known to be small. Yet developing countries throughout the world continue to compete with each other in the extent and duration of such give-aways.[15]

Subsidized credit similarly gives domestic manufacturers an extra layer of protection. Originally intended to equalize the cost of capital to investors in developing countries with costs in developed countries, in many cases, where exchange has been overvalued and inflation has been rife, credit costs fell far below those of developed countries, and sometimes became negative. As access to such sources of credit has been largely limited to the large and medium firm, there has been severe discrimination against small scale entrepreneurs. By distorting factor prices, capital intensive production methods have been encouraged. In some countries complementary labor legislation, artificially raising the labor costs through high severance allowances which make it impracticable to dismiss workers, artificially high minimum wages, family allowances

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[15] See H. Hughes, "Assessment of Policies Towards Direct Foreign Investment in the Asian-Pacific Area", in P. Drysdale, ed. Direct Foreign Investment in Asia and the Pacific, 1972.

and similar measures, have reinforced the effects of credit subsidies, severely constraining the long term growth of employment at the cost of preserving a small proportion of existing jobs. An industrial labor elite benefits from such measures at the cost of labor generally.

Trade and credit measures do not exhaust the list of subsidies frequently provided for manufacturing industry. Unduly low priced serviced land, uneconomically low utility charges and similar measures are sometimes added incentives, further distorting the econony in favor of manufacturing.

Even a moderate protectionist policy, not accompanied by further subsidies, imposes further controls on an economy.[16] Once protection may be obtained, the possibility of making profits merely by exploiting the economic rents created by the protective system arises. At worst manufacturers may plan to establish plants that are less than economic and internationally competitive because they know that once they are in business, with workers employed, the threat of closing down and dismissing a hundred or more workers will be too great a political risk for the government to bear. The same reasoning leads to excessive entry secure in the knowledge that governments will be too weak politically to allow the firms to compete until the inefficient go out of business, but permit protection to rise until a cozy oligopoly is established. The situation is generally at its worst when strong, aggressive multinational corporations combine with local "partners" to play this game for defensive investment reasons. The ensuing fragmentation of production, with excessive capital intensive capacity used at low levels, and incapable of competing internationally is the most common form of industrial organization in industrializing countries. Nor are these excesses confined to domestic production. The emphasis on exports is leading firms to build spuriously large plants for exports, safe in the knowledge that the host country will enable them to finance such exports by domestic market sales. This is for example happening under the automobile rationalization plans for Southeast and East Asia. Two plants producing 70,000 manual transmissions annual-

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[16] This point is being increasingly noted in the analysis of protective systems. See for example, S. Guisinger, "Tariffs and Trade Policies for the Ethiopian Manufacturing Sector", 1972, (mimeographed).

ly have been licensed in the Philippines for exports to a regional market which totals less than 70,000 cars annually. The market for manual transmissions in other developed countries is small.

Where economies of scale are important in production, a country wishing to start such production usually has a choice of oligopolistic competition which can not become cost competitive for many years until the domestic market expands rapidly as world markets for such products are very competitive and subject to "marginal pricing" or a monopoly or duopoly which would have lower costs because some economies of scale would be reaped, with some opportunity of "marginal pricing" for exports. As economies of scale tend to become more important with the deepening of production, industrial planning has to take into account problems likely to arise in the future. Where two automobile assembly plants might not be too uneconomic, it is almost certain that two piston or transmission plants will be. A planning agency has to be sure it can persuade the assemblers to use a common parts supplier before permitting both assembly plants to operate. This implies control over entry for industries with significant economies of scale.

Once control over entry is established, price and quality controls become mandatory unless the scale of production is large enough to enable the firm or firms established to be exposed to international competition.[17] The administrative problems become difficult indeed. Quantitative import restrictions, with a threat of exposing manufacturers to competition if they do not follow reasonable price or quality policies are a possible instrument of control. However, only a few countries have been able to maintain reasonably successful entry and price control policies.

The establishment of an administrative system implied by protectionist and other subsidy measures for manufacturing, together with even the minimal controls necessary to prevent political lobbying leading to a constant pressure for raising protection, create a situation in which the manufacturers' opportunities for profits through manipulating the "rules of the game" often exceed profits which may be gained in the ordinary course of business. The multinational corporation with its superior managerial, legal and other

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[17] Assuming also that the country can be reasonably sure that such prices will be "average" rather than "marginal".

resources, which frequently include political pressure through its own government, is usually in a very strong position to benefit from such "rents", and does so accordingly. It pays entrepreneurs to spend more time in Minister's waiting rooms than on the shop floor. The developed countries' lobbies are soon duplicated and extended, albeit on a smaller, more personal basis.

Profits arising from the administrative structure not only benefit the large scale producers, but necessarily, unless special steps are taken, discriminates against the small entrepreneur. This is particularly acute where effective protection is available on a "tailor made" basis, together with firm by firm income tax holidays, subsidized credit and other subsidy measures. The small entrepreneur can not obtain protection tailored to his needs, and he is often excluded by minimum fixed investment clauses from benefitting from import duty exemptions. Even if he is entitled to it, he frequently can not obtain subsidized credit. Generally speaking he can not get his foot inside a Ministry door. The typical system of protective measures and subsidies encourages vertical integration by large firms which can obtain the benefit of special incentives, and against small entrepreneurs who can not. Such discrimination is frequently the principal reason for the poor performance of the small scale sector, its failure to engage in sub-contracting for large enterprises, and its low productivity and growth.[18]

The metropolitan concentration of manufacturing beyond the point at which external economies of such concentration would normally be outweighed by congestion and other costs, is another effect of profits reaped from administratively created economic rents. The lack of infrastructure in the countryside and poor communications are contributing factors, but pressure to improve them is unlikely to become important while manufacturers are in effect tied to central government offices.

Small enterprises are an important reservoir of entrepreneurship in countries where this is generally the scarcest factor of production. Other things being equal, small scale enterprises are generally more labor intensive than large. A thriving small scale sector reduces the skewness of income distribution. For all these reasons, removing the discrimination against small enterprises is im-

[18] c.f. S. Watanabe, "International Subcontracting, Employment and Skill Promotion", International Labor Review, May, 1972

portant to healthy industrial growth. Stimulating industrial processing in the countryside where this is economic is a parallel aspect of sensible industrial development. Given the distortions created by existing policies, this paradoxically, requires further administrative remedies.

IV. The Options for Developing Countries

China and the United States are the only countries bordering the Pacific large enough, and well enough endowed with natural resources to make autarkic, inward oriented economic policies feasible. Even for these countries such policies would not be optimal, and for the other countries international trade is even more important. The favorable effects of international trade on growth, employment and a relatively favorable distribution of income have been demostrated for a number of Southeast and East Asian countries; for the small countries particularly, a trading orientation is essential to rapid economic improvement. (Table 3 gives some indicators of industrial and trade characteristics of countries bordering the Pacific. It of course has to be interpreted with great caution).

The developing countries' trade and industrial policy options are however constrained by the present and likely international trading framework. An improvement in trading conditions would require considerable policy changes in developed countries to compensate low income groups affected by changing trade patterns. Initially the developed countries would of course also be the principal benefactors as they account for the bulk of world trade, and the initiatives for improving trading conditions should, therefore, in their economic self interest, come from them. If the current restrictive trends were replaced by an opening up of markets for labor intensive products, and if there was a significant move to average rather than "marginal" pricing, the signals facing the developing countries would enable them to pursue much more rational trade policies. Greater economic competitiveness together with improved and coordinated tax policies in developed and developing countries would, moreover, curtail the multinational corporations' ability to exploit international trade for their private interest. The outlook

[19] B. Balassa and Associates, The Structure of Protection in Developing Countries, 1971; B. Balassa, "Industrial Policies in Taiwan and Korea", in L.E. di Marco, ed, International Economics and Development: Essays in Honor of Raul Prebisch, 1972 and Singapore, Economic Development Board, Annual Reports, passim.

for a rapid improvement in international trading relations is not, however, hopeful, and the developing countries would therefore be well advised to seek their own solutions to their problems.

An examination of the structure of protection and incentives suggests that at present the highest protection is afforded luxury consumer durables and automobiles. Yet bicycle, bus and truck assembly does not require the same economies of scale as automobile production, and provide more scope for employment, and for backward linkages. In general mass consumption goods such as textiles, building materials and simple agricultural implements require less protection, small scale enterprises are more common, and where high tariffs exist there is either some protection redundancy or very high profits. Most developing countries could substantially reduce their levels of protection by shifting their product mix from a largely urban, upper and middle class orientation to one catering to the rural population and the urban poor. A shift in government expenditures toward labor intensive public works, particularly in rural areas, and to low income site and services and housing projects, could stimulate the largely domestically based construction material industry. Cement block, bricks and drainage pipes can be made largely of local materials, and their bulk and weight encourages decentralization far more effectively than income tax holidays.[20]

Such changes in the product mix would make trade among developing countries much more attractive. A move toward technologically simpler and more labor intensive products would make a decline in protection possible without a decrease in employment, but on the contrary with increasing industrial employment perspectives. Because of the their high trade barriers, developing countreis have until now failed to benefit from intra-industry trade which has dominated trade among industrialized countries in the last twenty years. Intra-industry trade is generally self-adjusting because workers of an industry can move fairly readily into another industry branch, and whole industries are not affected.[21] This approach is leading to a

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[20] See M. Haq, "Developing Country Alternatives", in H. Hughes,ed., Adjustment or Confrontation: Industrialization and Trade Policies in the 1970s,(forthcoming) for a view of alternative strategies open to developing countries.

[21] B. Balassa, "Tariff Reductions and Trade in Manufactures among the Industrial Countries", American Economic Review, June 1966.

Table 3: Some Industrial and Trade Indicators

	GNP per Capita 1970 Market Prices	Population mid-1970	Gross Value Added in Manufacturing as % of GNP	Gross Value Added in Manufacturing as % of Gross Value Added in Commodity Production	Gross Value Added in Manufacturing as % of Gross Value of Output
	(US$)	(million)	1968	1968	1969
East Asia					
China, People Rep. of	160	836.0	..	..	..
Hong Kong	970	4.0	37.8	87.5	..
Japan	1,920	103.4	30.2	61.3/a	35.1
Korea, North	330	13.9	64.0/b	78.0/b	..
Korea, Rep.of	250	31.9	17.9	33.0	40.5
Singapore	920	2.1	12.6	65.9	21.2
Taiwan	390	14.0	22.6	45.9	32.7
Southeast Asia					
Indonesia	80	115.6	11.0	13.7	..
Malaysia	380	11.0	11.1	19.1/c	30.1
Philippines	210	36.9	17.3/e	32.0	40.6
Thailand	200	36.2	13.2	27.9	50.6/f
Viet Nam, North	100	21.2	..	..	..
Viet Nam, Rep.of	100	18.3	10.0/f	24.2/f	..
East Pacific					
Canada	3,700	21.4	25.1/f	65.5/f	40.7
Chile	720	9.8	28.5/g	65.2	52.2/f
Colombia	340	21.6	16.8	44.4	44.1
Costa Rica	560	1.7	19.4/h	23.4	42.9
Ecuador	290	6.1	16.9	32.3	37.5
El Salvador	300	3.5	18.2	38.7	..
Guatemala	360	5.2	15.7/i	35.4	39.4/j
Mexico	670	50.7	23.0/i	61.2/f	..
Nicaragua	430	2.0	15.1	31.0	..
Panama	730	1.5	15.8	37.2	36.5
Peru	450	13.6	14.0/f	33.9/c	46.9
U.S.A.	4,760	204.8	28.1	80.5	47.2
Australia					
Australia	2,820	12.6	28.2	67.1	39.2
New Zealand	2,700	2.8	23.4/f	55.7/f	31.4/j

/a Includes transportation and communication. b/ 1965, /c 1966. d/ 1960-68. e/ Net material product. f/ 1967. ket price. /j 1968.

Note: (1) Commodity production includes agriculture, mining,
(2) Exports of (non-resource-based) manufacturing, loping Countries: 1970 Review.
(3) The average annual growth rate of (non-resource- as the same for gross value added of output and possible, local currencies have been used in the and gross value of output.

Source: U.N. and country data.

for Countries Bordering the Pacific

Exports of Non-resources based Manufacturing as % of Gross value of Manufacturing Output	Exports of Non-resource based Manufacturing as % of total Merchandise Exports	Total Merchandise Exports as % of GNP	1960-1969 Average Annual Growth Rate		
			Gross Value Added in Manufacturing	Exports of Non-resource based Manufacturing	GNP per Capita
1969	1969	1969	(%)	(%)	(%)
..	..	..	..	..	6.4
73.1	88.6	64.6	14.3	15.0	8.7
9.4	96.0	10.9	14.1	18.2	10.0
..	..	..	..	..	5.9
13.8	76.2	9.4	14.2	66.5	6.4
31.2	28.0	14.4	19.0	6.4	4.5
23.9	79.3	25.3	13.5	50.9	6.3
0.3	19.7	6.1	1.2	22.0	0.8
16.3	13.2	36.7	12.0/d	12.4	3.8
3.1	11.0	11.4	4.3	15.1	1.9
7.9/f	11.7	12.4	8.1	9.8	4.7
..	..	..	..	..	3.2
..	3.0	0.3	..	-3.5	1.0
19.6	69.3	24.7	6.6	15.9	2.8
1.5/f	5.7	21.9	5.6	2.4	1.7
1.8	10.8	9.5	4.5	27.8	1.5
14.1	18.9	22.4	..	27.2	2.9
0.6	1.4	13.1	5.4	-0.5	1.2
17.5	33.2	20.3	9.0	21.0	1.9
16.1/j	26.6/j	14.8	7.9	29.0/d	1.9
8.3/j	25.9	5.0	10.0	14.3	3.5
4.9/c	14.4	20.3	12.0	29.0	3.5
1.0	2.6	12.6	10.7	41.0	4.8
11.5/j	30.4/j	19.8	2.9	14.6	1.4
4.4	76.0	4.3	6.1	8.6	3.2
4.2	22.6	15.0	6.1	23.0	2.9
3.3/j	10.7	19.1	6.3	22.0	2.0

includes mining, electricity, gas and water, net material product. /g Net domestic product. /h Includes mining. /i In manufacturing, electricity, gas and water.

defined as Total A in UNCTAD, Trade in Manufacturing of Developing Countries, 1970.

based) manufacturing is calculated at current prices, whereas GNP per capita are computed at constant prices. As far as time series for export of (non-resource-based) manufacturing

new approach to increasing trade among developing countries. An arrangement under GATT auspices, for reciprocal preferences among 16 developing countries at roughly similar levels of economic development is currently being negotiated. Developing countries would have much to gain from increasing their efficiency through competitiveness in products suited to their level of development. Such trade would, moreover, be likely to stimulate product and production process innovation, broadening the choice of techniques, and making adaptation to scarce capital and low cost labor easier.

Such an approach would be particularly suitable for regional trade, where the history to date has not been particularly successful. The Central American Common Market, the only functioning one bordering the Pacific, has 11 million people. Investment in industries which, though reaping some economies of scale, are still uneconomic, but which the countries would not have undertaken separately, has nevertheless been encouraged. While it is theoretically possible to have an outward looking common market, in practice there has been a tendency to raise tariffs to the highest common denominator, and they have not been offset by export incentives. Politically this would have been impossible because of the varying incidence effect on the member countries. The concentration of production in the most developed countries, exacerbating income differentials, has been encouraged, leading to critical strains. Countries which could have turned to world markets on their own have been locked into high cost import replacement by the product mix fostered by the Common Market upper income consumer good oriented policies. Alternative approaches to regional trade, based on lower protection and a better product mix can hopefully be worked out in the future.

There is a considerable range of industrial development among industrial countries, and consequent opportunities for the relatively industrialized ones to dominate trade just as the developed countries have established "the rules of the game" in a broader context. On the other hand, some of the relatively industrialized countries are becoming the most efficient, least cost producers of a growing range of capital equipment, and greater trading opportunities for them could mean a substantial overall reduction in the cost of capital

equipment, as well as better adaptation to the factor proportions of poor countries. For all developing countries the greater efficiency following from mutual trade would provide a better basis for market penetration to developed country markets for these need not be neglected in stimulating trade among developing countries. The degree of attention to developed country markets would depend on a country's estimate of its developed country market prospects.

The instruments of policy for an industrialization strategy which would aim at greater efficiency and lower prices, the encouragement of small indigenous entrepreneurs, the choice of more labor intensive techniques, and hence improved icome distribution, are not difficult to devise. Many are inherent in the policy changes necessary to any move toward a less distorted policy framework. The differences are mainly those of emphasis; reducing effective protection on luxury goods, limiting entry into luxury good production even at the expense of consumers' (upper income) sovereignty, reinforcing such measure with appropriate luxury taxes, and ending discrimination against small entrepreneurs. Trade policy alone can not of course carry development forward. Other measures would have to include an agricultural development policy, a strong public works program particularly in rural areas, and a steeply progressive and strictly administered income tax policy to mobilize the necessary public revenues. Unfortunately, such a policy package is likely to prove as indigestible to upper income groups in the developing countries as adjustment assistance is in developed countries.

Comments and Discussion of Hughes's Paper

Perry Chang opened the discussion: The paper started by saying that "there is little doubt that in a global context, the more outward looking an economy the better". But as the author has so ably demonstrated to us, trade barriers and questionable trade practices are increasing and the prospect of increasing industrial exports from the developing countries in this or any other region is not at all bright.

The question then arises as to what would be the "second best" solution to industrial and economic development for the LDC's?

Since "outward looking" policies have their limitations, one might be tempted to say that the solution may be found in some "inward looking" policies. But the author categorically dismissed this possibility by saying that in this region only China and the United States could afford to adopt inward looking economic policies, and that even for these countries, such policies would not be optimal. Her own prescription is that the LDC's in this region should try to change their industrial mix "from a largely urban, upper and middle class orientation to one catering to the rural population and the urban poor". In addition, she reminded us that "other measures would have to include an agricultural development policy, a strong public works program, particularly in rural areas, and a steeply progressive and strictly administered income tax policy to mobilize the necessary public revenues".

There is, of course, much wisdom and insight in these recommendations. But I wonder if these are not really "inward looking" policies? I do not mean to take this up merely as a semantic problem. What is more important is that the distinction between the so-called "inward" and "outward looking" policies seems to have resulted in much confusion regarding the true relations between trade and development.

First, the importance given to the "outward looking" policies is apparently based on the traditional theory that trade is the "engine

of growth". But Chinese experience, as we discussed this morning, seems to indicate that this may not be true for all countries. Even though the author insisted that among the LDC's in this region only China can afford inward looking policies, many, if not all of her recommendations, it seems to me, are basically the same as what has been tried in China. Moreover, while trade constitutes only a small part of China's GNP, one cannot say it is unimportant to her economy. Nor can it be said that China is really "inward looking".

The truth is perhaps that no country can be entirely inward looking or entirely outward looking. To what extent trade could serve as "the engine of growth" would depend on the special circumstances in which the countries find themselves. It might be more feasible for some countries to follow mainly the Western pattern and for others, basically, the Chinese pattern. I am not convinced that only China can grow with relative little foreign trade, especially trade in manufactured products.

A second point I would like to make is that trade expansion does not necessarily depend on industrialization; it may depend more on the modernization of the primary production sector. It is very likely that primary products, including fisheries, forestry and mining products, will continue to be the main foreign exchange earners in many LDC's in this region.

I am, of course, not against industrialization; I am only concerned about how it can be achieved. To change the industrial mix in the manner suggested by the author is indeed worth considering. To try to expand the market through regional co-operation in industrial development is another possibility. But I believe that the future of industrial development for the LDC's in this region would depend perhaps even more on the economic conditions of the developed countries. It hardly needs saying that only when the world economy grows at a faster rate will the LDC's have a better chance to grow with it.

Let me add that the LDC's would fare even better if more and more highly industrialized countries, such as Japan, could also become truly "high comsumption" societies. There are, of course, both institutional and psychological difficulties in this process. But with continuous prosperity and increasing trade surpluses, this transformation seems to be more than a possibility.

Susumu Watanabe continued the commentary: Hughes raises many important points, and her policy suggestions are generally sound and deserve serious consideration. I have, however, some doubts and do not agree with the author on a few points.

First, the author advocates outward looking policies because greater efficiency will be attained thereby than by inward looking policies. As a goal and trend to be realized in the long run, I fully accept this view. But, in discussing immediate and shorter-term policies for developing countries, I would not readily agree that "there is little doubt that in a global context, the more outward looking an economy the better". True, the most successful developing countries (for example - Hong Kong, Singapore, Taiwan, South Korea, Mexico and Brazil) are those which have adopted outward looking policies. With the exception of the two city states, that is Hong Kong and Singapore, however, they all had completed inward looking import substitution programs before embarking on outward looking policies. It seems that the accumulation of industrial skills and experience during this earlier period may have been an essential pre-condition to the success of outward looking policies. If so, which of the two types of policies should be recommended would depend on the stage of development of the economy in qeustion.

Incidentally, no close correlation appears to have been established in Table 3 between international trade, employment and income distribution, in spite of the suggestion made by Hughes in the paper.

Second, it is difficult to be optimistic about the prospect of the contribution which reduced trade barriers will make to the expansion of labour intensive manufacturing in developing countries. As UNCTAD reports indicate, imports of labour intensive manufactures and semi-manufactures from developing to developed countries come mainly from very few countries in the Far East, namely, Hong Kong, Taiwan and South Korea. Little progress has been made by other countries. In order to predict the outcome of a reduction in trade barriers, it is necessary to ask why these few countries remain exceptions and why other countries have failed to follow their example. It is indeed unfortunate that "there has been little attempt and no success in explaining actual geographic and commodity patterns of trade in terms of trade theory".

It is obvious that miscellaneous factors influence trade patterns; for expample, climate, endowment of raw materials and traditional mode of life. In my view, the most important explanaiton of the

exceptional position of these few developing countries in the Far East is the quality of their labour force. Their workers are known for discipline, industriousness, and dexterity. Taiwan and South Korea have built up human capital by industry in adequate elementary and secondary school education. Hong Kong and Singapore have absorbed a large number of Chinese workers. If this diagnosis is correct, then, reduction in barriers of trade in labour intensive manufactures and semi-manufactures will benefit, under the present conditons, only those countries with rich human resources, and the gap between them and the rest of the developing world will widen still further. Such a tendency may be re-inforced by mounting competition from China in export markets for labour intensive products, as already evidenced in developed countries.

Third, it is possible to take a more positive view of foreign investment and multi national corporations than Hughes. All the "successful" developing countires rely heavily upon multi national corporations for capital, entrepreneurship and marketing. Even when they do not directly depend upon multi national corporations, they often do indirectly, through international subcontracting arrangements. It is, indeed, wondered whether these countries could have been so successful in their outward looking policies without the help of foreign investment and multi national corporations.

Finally, sometimes Hughes seems to have been rather carried away in advocating less restrictive policies. Her argument about the discriminatory effects of protective measures and subsidies upon the small scale industry sector is one example. Hughes argues that this is the main reason for this sector's failure to play a significant role in growth. That this is not true is demonstrated by the record of the Japanese economy in the past. In most of the developing countries, the small scale industrial sector benefits from subsidies and other promotional measures specifically designed for it, and in some cases, for example in India, the amount of funds allocated to it is more than it can absorb within the plan period. It seems that the main reason for the failure of the small scale industries in developing countries is the lack of such co-operation between large and small sectors as was practised in Japan and other developed countries in the form of subcontracting.

Dr. Hughes also attributes the failure of intra-industry trade

among developing countries to their high trade barriers. But these are a partial and probably only a minor factor. More important are the lack of necessary industrial skills and experience as well as organizational problems. Political antagonism among developing countries is often another important explanation.

Discussion was concentrated on questioning the analytical framework of Hughes' paper, especially the first half. Many participants agreed that the paper may have reached the right conclusions but not for the right reasons. It was suggested that trade theorists were hardly to blame for the 'muddled and irrational structure' of trade that has developed in large part because of muddled and irrational policies. Distortions in the international market were a matter for concern, but many of those mentioned by Hughes were considered amenable to policy manipulation and the correct approach, in terms of mobilizing as many resources for development as possible, was to correct them directly. The observation that distribution policies were important as well as allocation policies was accepted by most, but few conceded that this led to rejection of basic comparative advantage concepts in planning development strategies. Others thought that the idea that marginal cost pricing by industrial countries was necessarily disadvantageous to developing countries was based on a theoretical confusion. One participant questioned over-stress on the role of scale economies.

Dr. Hughes insisted that trade theorists, in their neglect of the role of scale economies, the effects of the product cycle, and the multi national corporatin, produced policy conclusions that were largely irrelevant to the policy issues facing developing countries.

4

THE GROWTH OF EXPORTS AND ECONOMIC DEVELOPMENT IN LABOR SURPLUS ECONOMIES -- WITH PARTICULAR REFERENCE TO KOREA, TAIWAN, AND HONG KONG

Soon Chough

Introduction

Korea and Taiwan belong to that particular family of developing countries which could most aptly be characterized as small, labor surplus, dualistic economies with poor natural resources. Hong Kong, by and large, shares these characteristics except the dualistic aspect. The cultural and historical background of these three countries contain discernible differences, but looking at it from the global vantage point, the three countries do share enough similarities in their Northeast Asian heritage.

With more or less similar economic and non-economic conditions, these three countries embarked on ascent for economic development towards the middle of 1950's. Their economic performances are now recognized as among the most successful of all developing economies.

The similarities in economic and non-economic conditions as mentioned in the preceding paragraph would lead one to expect a similar pattern of economic development to emerge in these countries in the course of the two decades of development effort. This in fact is borne out in our analyses. On the other hand, there are enough dissimilarities in resource endowment, initial conditions, socio-political environment, and the pattern of development policies, and one would naturally expect that the success stories of these countries would contain enough differences as well. It is the purpose of this paper to trace and compare these similarities and dissimilarities of

these economies in the pattern of development, with particular emphasis on foreign trade and structural transformations.

It is plainly impossible to discuss all aspects of economic development of these countries in a short paper, and the author is constrained to discuss only those which are considered to be most directly relevant to the growth of foreign trade and the structural change of the economy that occurred concomitantly with the growth of trade.

In section one, I will try to describe the pattern of growth of trade and the structural change that is expected to be observable in a small, labor surplus, dualistic economy with poor endownment of natural resources. The discussion is necessarily in general terms, but it will provide the rest of the paper with the conceptual framework that could help clarify the basic similarities in the trend of development of the three countries, and help limit the scope of the discussion.

The subsequent sections deal with the highlights of economic development and the growth of trade of these three countries and analyze the pattern of structural change of these countries, and the last section deals with future prospects and sets forth main conclusions.

1. The Pattern of Economic Development and the Growth of Trade

First of all, the three economies under survey are all relatively small economies. The size of an economy could perhaps be best measured by the size of GNP. The GNP of Korea in 1970 was approximately $8.1 billion, and those of Taiwan and Hong Kong were about $5.5 billion and $2.6 billion respectively. This means that these three countries put together generated less than 8 per cent of that of Japan in the same year. Second, none of these economies are endowed well with natural resources. In this regard, Taiwan is best situated of all three countries: Korea has bery little natural resources, and Hong Kong has virtually no natural resources to speak of, except having a harbor strategically located.

Third, three economies are labor surplus economies. The word labor surplus is interpreted to mean an unusually high labor land ratio. Korea and Taiwan are among the most densely populated countries in the world. Taiwan has the population density of 408 persons per square kilometers in 1970, Korea 323.4 persons in 1971, and Hong Kong 3,714 persons in 1970. In all these countries the liter-

acy of the population is very high.

Fourth, Taiwan and Korea dualistic structure with respect to the modern industrial sector and traditional agricultural sector. In Korea the proportion of agricultural production in GNP was 36.2 per cent in 1960, while the corresponding figure for Taiwan in the same year was 31.4 per cent.

It seems that the development of a small, labor surplus, dualistic economies with poor natural resources tends to go through a few phases, though these phases are by no means uniform in sequence and duration.

The first phase is the one in which modern development has not yet occurred. The predominant industry is agriculture. The foreign trade is still at the infant stage, and exports consist mostly of primary products.

The second phase is one of establishing import substitution industries. The word import substitution industries refers to those industries that are newly established to cater mainly to the domestic market. The establishment of import substitution industries are financed in many cases by borrowing from abroad. In recent years the attempt of industalization by fostering import substitution industries have been criticized severely, mainly for the reasons that they tend to be inefficient, increase the propensity to consume, and aggravate the balance of payments problem. In spite of the weight of these observations, however, developing countries like Korea and Taiwan seem to have no choice but to develop a well-chosen bundle of import substitution industries at the initial stage of industrial development. What is wrong would not necessarily be import substitution industries as such, but those which are excessively capital intensive and merely help increase the propensities to consume and import, rather than develop domestic resources and inter-industry relations. Should a developing country give adequate heed to these pitfalls, the establishment of import substitution industries of enough magnitude would help develop entrepreneurial ability and the technological skill of labor force, and break the underdevelopment equilibrium.

At the stage of import substitution, one can expect the developing country to start exporting manufacturing products. It may sound contradictory to assert that export of manufacturing goods would

take place when most of the manufacturing industries are of import substitution type. But, export of manufacturing products do take place at this stage because (1) import substitution industries, if chosen wisely, would entail diversification of resources that have hitherto been left undeveloped, and mere exploration of new use of idle resources alone would render some industries to produce exportable products and provide these industries with incentive to do vent-for-surplus exporting, and (2) increasing pressure on the balance of payments induces the government to take a variety of export promotion measures.

The third phase of development marks the emergence of a variety of export industries and the reduction in the propensity to import. Export increases because, (1) on the supply side, an increasing number of labor intensive industries are able to reduce the cost of production through improvement in the technological and managerial skill, and (2) on the demand side, the hitherto untapped overseas markets are explored. The propensity to import decreases because the increasing number of intermediate products which are imported during the Phase II are now domestically produced. The sooner, however, the country tries to achieve import substitution of heavy industries, the more difficult it would be to reduce the propensity to import.

The last phase is the period of developing capital and technology intensive industries. As this phase comes, the comparative advantages of these countries start shifting from merely unskilled labor intensive industries to the skilled labor intensive industries. At this stage, the economy in question should be wary not to indulge in an indiscriminate attempt to build excessively capital intensive industries without paying adequate regard to cost of them. During this phase, the proportion of export of capital intensive goods in total exports will increase. As more of technology intensive goods can be exported, the economy is no longer a "labor surplus", "dualistic" one.

2. An Overview of Economic Development

For the benefit of those readers who are not acquainted with a broad outline of the development picture of these countries a minimum account of the picture of development is presented below.

(1) Korea

The country engaged in reconstruction effort after the cease-fire was signed in 1953, and thanks partly to the U.S. economic aid, the economy was able to establish minimum amount of import substitution industries and to curb runaway inflation by the end of the 1950's.

Looking at Table 1, we see that during the 1950's, annual average rate of growth of GNP was approximately 5 per cent, rate of investment 11 per cent, and that of saving less than 5 per cent of GNP. The proportion of production of secondary industries in GNP was less than 15 per cent, and as we shall see later, the annual value of exports, consisting predominantly of primary products, fluctuated arround $30 million. All in all, the economy during 1950's was still at Phase I as defined in the preceding section.

The country launched its first economic development plan in 1962, and this opened the Phase II of development. The primary target of the plan was to establish import substitution industries. The U.S. economic aid decreased during this period, and the public and private loans from abroad was the primary means to finance the great variety of import substitution industries established during this period. Thanks to the vent-for-surplus exporting and vigorous export promotion measures taken by the government, exports also increased very rapidly.

During the second five year plan period, 1967-71, the country witnessed the annual average rate of growth of GNP at 11.4 per cent, and the rate of growth of exports at 33.8 per cent. In spite of the great increase of exports, however, imports also increased greatly. The great increase in exports is partly due to a continued expansion in import substitution industries -- and the consequent export drive as discussed in the previous section -- and partly to the emergence of a few important export industries. By and large, the second five year development plan period could be characterized as the period of the Phase III.

The annual imports of foreign capital, particularly the short-term commercial loans, increased greatly until 1969, when it reached the peak of $560.3 million. The feeling became widespread that the economy was in need of arresting the expansionary trend. In late 1969, the government adopted tight monetary and fiscal policies, restricted commencial loans, and the local currency was devalued in a

Table 1, Major Economic Indicators of Korea and Taiwan,1953-1970

	KOREA						TAIWAN					
	Annual Average RateOf Growth of GNP	RateOf Investment	RateOf Gross Domestic Saving	Percentage of GNP Primary Industries	Secondary Industries	Tertiary Industries	Annual Average RateOf Growth of GNP	RateOf Gross Investment	RateOf Gross Domestic Saving	Percentage of GNP Primary Industries	Secondary Industries	Tertiary Industries
1955	6.1 (54-55)	11.9	4.9	44.8	12.2	43.0	9.3 (52-55)	15.3	8.7	32.4	20.8	46.8
1960	4.4 (56-60)	10.9	1.6	36.9	15.7	47.4	6.1 (56-60)	22.9	12.0	32.3	24.6	43.1
1965	6.5 (61-65)	14.7	7.6	38.7	19.5	41.8	10.0 (61-65)	26.4	19.6	26.9	28.1	45.0
1970	9.3 (66-70)	26.1	16.4	28.1	22.2	49.7	10.0 (66-70)	30.0	25.7	19.1	31.9	49.0

Source: Director-General of Budgets, Accounts and Statistics, Executive Yuan, National Income of Republic of China, October 1970, October 1971.
Bank of Korea, Economic Statistics Yearbook, various issues.

series of exchange rate readjustments.

Furthermore, various measures for increasing agricultural productions were taken, and heavy doses of investments were undertaken in such fields as iron and steel, petro-chemical industries, and machinery and equipments.

The Korean economy in 1972 still contains elements of Phases II and III, but it has launched a full-scale program of establishing heavy industries. It entered into the phase IV around 1970.

(2) Taiwan

Taiwan's industrialization effort started with the first five year development plan of 1953. The postwar economic development of Taiwan falls into two phases; one spans the 1950's and the other the 1960's. The first period can be characterized as import substitution period (Phase II) and the second the export growth period (Phase III). As shown in Table 1 GNP grew at an annual average rate of 6-7 percent throughout 1950's. The gross domestic capital formation grew steadily, and so did exports. When the economy enters the Phase III in the early 1960's, all the above magnitudes grew at an accelerated pace.

The picture of healthy development is clearly portrated in Table 1. The rate of increase of GNP was accelerated towards the middle of the 1960's, investment and domestic saving increased greatly, and the proportion of secondary industries in GNP increased rapidly. Inflation was rapidly subsided, and the balance of payment deficit became visibly narrowed every year, thanks to the great increase in exports and reduction in imports. The economy displayed typical features of the Phase III in the 1960's, and an increasing number of capital and technology intensive industries started to be established in the late 60's. Taiwan also entered into the Phase IV towards the end of the 1960's.

(3) Hong Kong

The economic growth of the small island-port of Hong Kong is even more remarkable than that of Korea and Taiwan. Hong Kong naturally followed quite a different pattern of development from Korea and Taiwan. Thanks to the size of the area, and lack of traditional sector, Hong Kong's Phase I which lasted until 1954, has different meaning from Korea and Taiwan. During this phase, Hong

Kong had very little industry. It was around the middle of 1950's that Hong Kong started developing manufacturing industries, and the Phase II covers the period of 1955-59. Though Honk Kong did not develop import substitution industries as such, it is noteworthy that Hong Kong resorted to developing local manufacturing industries, though, unlike Korea and Taiwan, the industrialization effort was not accompanied by measures to protect domestic industries. Druing the second half of the 1950's and in the first of the 1960's, a variety of sophisticated labor intensive industries were established. It is important to note that Hong Kong's trade is based upon the island's industrial strength. The Stage III set in early 1960's, and since then Hong Kong's trade increase was phenomenal.

The per capita export of Hong Kong in 1969 was approximately $546, while the corresponding figures for Taiwan (1969) and Korea (1970) were $78 and $26, respectively, This means that Hong Kong is by far the most vigorous trader among the three countries, and that Hong Kong's income is generated mostly from export of goods and services. Hong Kong's industrial structure in recent years is becoming increasingly technology-intensive, though naturally no attempt is made to launch a major drive for establishing iron and steel and petro-chemical industries.

The economic performances of the three countries may now be compared. The pattern of development of all three countries are strikingly similar; all three countries displayed similar phases, as their economic development proceeded. However, there are a few important differences. The most outstanding difference between Korea on the one hand and Taiwan (and Kong Kong) on the other hand, is that the initial conditions (i.e. economic conditions when the Phase II was open) were much more favorable for Taiwan (and Hong Kong) than for Korea. Taiwan had been better developed than Korea when the two countries were liberated both in manufacturing industries as well as in agriculture. The proportion of secondary industry production in Taiwan was already 20.8 percent in 1955, while the corresponding figure for Korea was only 12.2 percent in the same year. The agricultural conditions were far better in Taiwan than in Korea both in terms of overhead capital and climatic conditions. The rates of investment and saving were far larger in Taiwan than in Korea, as shown in Table 1. These conditions rendered it possible for Taiwan to achieve much faster rate of growth than Korea

during the late 50's and early 60's.

The second difference is that Korea's conscious industrial development program started in 1962, while it started in the early 50's for Taiwan and Hong Kong. The fact industrialization effort started much later in Korea than the other two countries has led the former to have much greater sense of urgency and to become much more ambitious in development planning than the latter. Korea's Phases II and III took approximately 5 years each - with much overlapping - while Taiwan and Hong Kong took twice as much time to go through these stages.

Korea has been trying to accomplish so much in such a short time, so that many problems that would have normally been solved during the Phases II and III were carried over to the Phase IV, while for Taiwan and Hong Kong, much greater degree of structural adjustment was achieved during each phase before the new phase was open. We shall continue to discuss this problem in subsequent sections.

3. The Trend and Structure of Exports

(1) The Trend of Exports

The general picture of development of foreign trade is summarized in Table 2. The average annual rate of growth of exports during the 1950's was about 8.3 percent for Korea, for Taiwan, and 7.6 percent for Hong Kong. The corresponding figures during the 60's were 39.4 percent for Korea, 31.5 percent for Taiwan, and 17.0 percent for Hong Kong. Thus, the trade of all three countries became greatly accelerated in the 60's. As shown in the table, the phenomenal increase of export is reflected by the increasing proportion of export in GNP and the increase in the ratio of exports to imports.

The more favorable initial condition of Taiwan compared to Korea is also discernible in Table 2. The proportion of export in GNP in Korea was only about 1.4 percent during the first half of 1950's and 2.4 percent during the second half of the 1950's, while the corresponding figures for Taiwan were 7.8 percent and 10.7 percent respectively. Even in 1970, the proportion of exports in GNP for Taiwan was 24.9 percent while it was only 12.8 percent for Korea.

The trade balance of Korea was extremely unfavorable in the 50's, and it became gradually mitigated in the 60's. Taiwan's trade deficit became completely wiped out in early 70's, and Hong Kong late-

Table 2 The Trend of Exports

	KOREA			TAIWAN			HONG KONG		
	Average Annual Rate of Growth(%)	% of GNP[1]	Exports[1] / Imports	Average Annual Rate of Growth	% of GNP[1]	Exports[1] / Imports	Average Annual Rate of Growth	% of GNP	Exports[1] / Imports
1950-1955	7.3	1.4	0.10	6.8[2]	7.8	0.66	5.2	n.a.	0.68
1956-1960	9.2	2.4	0.18	3.7	10.7	0.60	9.9	n.a.	0.67
1961-1965	40.0	6.0	0.38	24.2	16.2	0.85	10.8	n.a.	0.74
1966-1970	38.8	12.8	0.42	26.1	24.9	1.00	18.5	n.a.	0.87
1971	27.8	9.8	0.45	36.8	30.6	1.03	12.4	n.a.	1.18

1) Figures show those of the last year of each quinquenium.
2) 1953-1955 average rate of growth.

Source: Bank of Korea, Economic Statistics Yearbook, Director General of Budgets, Accounts, and Statistics, National Income of the Republic of China, various issues, International Monetary Fund, Direction of Trade, various issues.

ly has almost established the balance between exports and imports.

(2) Composition of Commodity Groups

Tables 3A, 3B, and 3C summarize the commodity group composition of export. These data are compiled by comparable statistics with the same method of classification, the comparison of these tables would be of particular interest.

As we have already observed in the previous paragraphs, in both Korea and Taiwan, the export largely consisted of food and live animals, and crude materials during their Phase II (i.e. for Korea 1950-1964, and for Taiwan 1950-1959), but exports of manufactured goods have since become greatly important. In the case of Hong Kong, the proportion of manufactured goods in total export was large from the beginning, but even here, the proportion has been steadily increasing.

The second point to note is the strength of primary, and especially, agricultural, products. In the case of Taiwan, the export of agricultural products is still very vigorous. As Table 3B shows, export of food and live animals constituted approximately 30% of total products in 1968, whereas the corresponding figure for Korea

Table 3A Commodity Group Composition of Exports, Korea (in millions of U.S. dollars)[1)]

	1955	1960	1965	1970
Total	18.0	32.8	175.1	835.2
(%)	(100.0)	(100.0)	(100.0)	(100.0)
Food and Live Animals	1.1	9.7	28.2	65.5
(%)	(6.1)	(29.6)	(16.1)	(7.8)
Beverages and Tobacco	0.0	0.5	0.9	14.2
(%)	(0)	(1.5)	(0.5)	(1.7)
Crude Materials, Inedible, Except Fuels	14.7	15.8	37.0	100.0
(%)	(81.7)	(48.2)	(21.1)	(12.0)
Mineral Fuels, Labricants and Related Materials	0.5	1.1	1.9	8.8
(%)	(27.8)	(3.4)	(1.1)	(1.1)
Chemicals	0.0	0.4	0.4	11.4
(%)	(0)	(1.2)	(0.2)	(1.4)
Manufactured Goods, Classified by Materials	0.9	3.9	66.4	220.9
(%)	(5.0)	(11.9)	(37.9)	(26.4)
Machinery and Transport Equipments	0.2	0.0	5.5	61.5
(%)	(1.1)	(0)	(3.1)	(7.4)
Manufactured Goods, Miscellaneous	0.5	0.0	34.5	352.5
(%)	(2.8)	(0)	(19.7)	(42.2)
Other Commodities	(0)	(0)	(0)	(0)
(%)				

1) Figures in parenthesis show percentage in total exports.
Source: Bank of Korea, Economic Statistics Yearbook.

Table 3B Commodity Group Composition of Exports, Taiwan (in millions of N T Dollars)

	1950	1955	1960	1965	1968
Total	1,984.3	1,916.9	5,965.7	17,987.3	31,567.6
(%)	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)
Food and Live Animals	1,791.5	1,680.0	3,953.9	9,322.0	9,441.5
	(90.3)	(87.6)	(66.3)	(51.8)	(29.9)
Beverages and Tabacco	2.4	0.7	14.6	76.8	95.0
	(0.1)	(0.04)	(0.2)	(0.4)	(0.3)
Crude Materials, Inedible, Except Fuels	54.9	74.3	284.0	973.0	1,398.8
	(2.8)	(3.9)	(4.8)	(5.4)	(4.4)
Mineral Fuels, Lubricants Related Materials	38.0	11.0	116.7	76.4	379.0
	(1.9)	(0.6)	(2.0)	(0.4)	(1.2)
Chemicals	44.8	68.8	157.7	732.7	801.2
	(2.3)	(3.6)	(2.6)	(4.1)	(2.5)

(continued)

(Continued)

	1950	1955	1960	1965	1968
Manufactured Goods, Classified by Materials	33.4	49.8	1,185.4	4,501.9	8,848.8
(%)	(1.7)	(2.6)	(19.9)	(25.0)	(28.0)
Machinery and Transport Equipments	0.0	0.5	46.5	780.6	4,164.5
(%)	(0.9)	(1.6)	(3.4)	(8.3)	(20.8)
Other Commodities					
(%)					

Source: DGBAS, National Income of the Republic of China, Oct 1970

Table 3C Commodity Group Composition of Exports, Hong Kong (in millions of Hong Kong Dollars)

	1950	1955	1963	1970
Total	3,715	3,210	4,991	15,239
(%)	(100.0)	(100.0)	(100.0)	(100.0)
Food and Live Animals	470	335	417	500
(%)	(12.7)	(10.4)	(8.4)	(3.3)
Beverages and Tobacco	57	20	73	75
(%)	(1.5)	(0.6)	(1.5)	(0.5)
Animal and Vegetable Oils	215	35	21	13
(%)	(5.8)	(1.1)	(0.4)	(0.08)
Crude Materials, Inedible, Except Fuels	819	383	212	403
	(22.0)	(11.9)	(4.2)	(2.6)
Mineral Fuels, Labricants and Related Materials	85	29	14	42
(%)	(2.3)	(0.9)	(0.3)	(0.3)
Chemicals	458	203	263	597
(%)	(12.3)	(6.3)	(5.3)	(3.9)
Manufactured Goods, Classified by Materials	1,072	1,250	1,233	3,042
(%)	(28.9)	(38.9)	(24.7)	(20.0)
Machinery and Transport Equipments	150	120	251	1,733
(%)	(4.3)	(3.7)	(5.0)	(11.4)
Manufactured Goods, Miscellaneous	389	834	2,481	8,791
(%)	(10.5)	(26.0)	(49.7)	(57.7)
Other Commodities	0	1	26	42
(%)	(0)	(0.03)	(0.5)	(0.3)

Source: S.C. Fan, The Postwar Economic Development of Hong Kong, The Center for Southeast Asian Studies, Kyoto University, p.41.

was less than 8 percent.

The third point to note is that in all three countries, export of technology and capital intensive goods is becoming increasingly pronounced as these economies enter the Phase IV. The increase of export of chemicals is steady in all three countries, and the increase of machinery and transport equipment is particularly vigorous in Taiwan.

(3) Major Export Items

Let us now look at the major items in exports of Korea and Taiwan. Export goods are greatly diversified in recent years, but by and large, exports are led by a few major products. As Table 4A shows, the Korea's export in recent years is dominated by five most important articles, plywood and veneered panels, textile products, clothing, machinery and transport equipment, and wigs and false beard. These five items accounted for only about 22.4 percent of total exports in 1967, and the proportion increased to 66.5 percent in 1970. All these items are labor intensive goods, and they eloquently testify Korea's comparative advantage in these products. They also point at the need for developing new export industries the products of which command higher income elasticity in international markets.

As pointed out in previous paragraphs, Taiwan's export of agricultural products and the processed agricultural products are still fairly important. Rice and sugar, which constituted 78 percent of total export in 1953, decreased to mere 4.3% in 1970, but one notes the emergence of new export substitution products such as canned pineapple, canned mushrooms, and canned asparagas spears. As for manufactured goods, much the same picture as that of Korea prevails, i.e. the major export items are plywood, textiles, clothing and footwear, plastic articles, and electrical machinery. In 1970, these five items constituted 53.6 percent of total exports. Particularly noteworthy is the phenomenal increase in the export of electrical machinery and appliances.

Roughly the similar picture prevails in Hong Kong. In 1970, the five major export items were: clothing and footwear, toys and sporting goods, textile products, telecommunications apparatus, and electrical machinery. These five items were responsible for about 60 percent of her total exports.

Table 4A Proportion of Major Export Items in Total Exports, Korea

(%)

	1960	1965	1970
Plywood and Veneered Panels	0	10.3	11.2
Textile Products	12.1	19.4	10.2
Machinery and Transport Equipment	0.3	3.1	7.4
Clothing and Footwear	10.0	14.2	25.6
Wigs and False Beard	0	1.3	12.1
Total	22.4	48.3	66.5

Source: Bank of Korea, Economic Statistics Yearbook, various issues.

Table 4B Proportion of Major Exports in Total Exports, Taiwan

(%)

	1955	1960	1965	1970
Agricultural Products	80.7	54.5	55.0	6.4
Processed Agricultural Products	4.2	4.8	10.4	5.9
Manufactured Products				
Plywood	0.1	1.5	5.9	5.5
Textiles	0.9	11.6	10.3	13.8
Clothing and Footwear	1.4	2.6	4.9	16.8
Plastic Articles	-	-	2.6	5.1
Electrical Machinery and Appliances	-	-	0.4	12.4
Total of the above manufactured products	2.4	15.7	24.1	53.6

Source: Kou-Shu Liang and T.H. Lee, Process and Pattern of Economic Development in Taiwan, The Center for Southeast Asian Studies, Kyoto University, 1972, p.17.

4. Expansion of Overseas Market - Direction of Export

Table 5 shows the direction of exports of Korea and Taiwan. For all three countries, the U.S. and Japan are the two most important export markets. In 1960, the share exports to the U.S. from Korea, Taiwan, and Hong Kong were 11.0 percent, 11.5 percent, and 17.9 percent respectively, and these figure were changed in 1970 to 47.3 percent for Korea, 39.5 percent for Taiwan, and 35.7 percent for Hong Kong. On the other hand, the Japanese market did not expand very greatly. In 1960, the share of export to Japan in total export was 61.6 percent for Korea, 57.7 percent for Taiwan, and 5.4 percent for Hong Kong. But these shares declined in 1970 to 28.1 percent for Korea, 15.1 percent for Taiwan.

Table 5 The Proportion of Export to the U.S. and Japan in Total Exports

(%)

	Korea		Taiwan		Hong Kong		
	U.S.	Japan	U.S.	Japan	U.S.	Japan	U.K.
1955	49.0	41.0	4.4	59.5			
1960	11.0	61.6	11.5	57.7	17.9	5.4	14.3
1965	35.2	25.1	21.3	30.6	27.6	5.1	13.9
1970	47.3	28.1	39.5	15.1	35.7	7.1	10.2

The Proportion of Import to the U.S. and Japan in Total Imports

(%)

	Korea		Taiwan		Hong Kong		
	U.S.	Japan	U.S.	Japan	U.S.	Japan	U.K.
1955	22.8	5.6	47.5	30.5			
1960	39.0	20.5	38.1	35.3	11.7	15.3	10.8
1965	39.3	36.0	31.7	39.8	11.1	17.3	10.7
1970	29.5	40.8	23.9	42.8	13.2	23.8	8.6

Source: Bank of Korea, Economic Statistics Yearbook, various issues
International Monetary Fund, Directions of Trade, various issues

On the other hand, the proportion of import from the U.S. in total import decreased, while that from Japan increased tremendously during the period. Toward the end of the 1960's, Taiwan and Hong Kong had trade surplus with the U.S. but trade surpluses with the U.S. were more than offset by the trade deficit with Japan.

The general picture of trade of these countries in recent years is all these countries import producers' equipments and half-finished goods from Japan and, export labor-intensive goods to advanced countries and especially to the U.S. The export success of three countries in the last two decades owes to the sustained strength of demand for labor intensive goods in the U.S. and other developed countries.

The expansion of the U.S. market cannot be counted on forever. The trade balance between Taiwan and Hong Kong on the one hand and the U.S. on the other are already significantly unfavorable to the U.S. On the other hand, Japan might not, as she should, abandon overnight the traditional policy of maintaining self-sufficiency as regards labor-intensive goods.

Under the circumstances the three countries would have to explore other markets in Western Europe and other parts of the world. Furthermore, the three countries should try to expand production of those export goods with high income elasticity of demand. These are products of technology-intensive industries.

5. Export Promotion Policies

The tremendous increase of exports of Korea and Taiwan owes much to government policies on export promotion. Both Taiwan and Korea have instituted a variety of export promotion measures. These measures, in case of Korea, range from rebates of indirect taxes, tariff exemptions for imports of raw materials and intermediate products for exportable goods, reduction in income taxes on export profits, wastage allowances, the export-import link system, preferential rate on railway charges, and the establishment of free trade areas.

It is impossible to describe and analyze in this paper the operation and the economic consequences of these systems, and I shall simply make a few points that appear to be particularly important.

First of all, these measures seem very elaborate and might give one the impression that the extent of export subsidies is preponderant. It is fair to point out, however, that the magnitude of subsidies per dollar of export in Korea in recent years is less than what the list of the promotion measures would lead one to anticipate. What appears as subsidy seems to a large extent to be "defensive" measures to offset the widened gap between domestic price increase and the rate at which the local currency is depreciated. In other words, the export subsidy has been acting in large measure as a substitute for devaluation, they have been necessary as "defensive", rather than "positive" export promotion measures. Devaluation of local currency has been resisted because it increases the debt burden in local currency of those firms which borrowed from abroad, and it tends to reinforce inflation. Promotion of exports with as little devaluation as possible in an inflationary economy tends naturally to accumulate various make-shifts in policy arsenal to offset depreciation of local currency.

Second, one possible consequence of substituting for devaluation a variety of ad hoc export promotion measures, however, is that they

would maximize the gross rather than net value of exports, and these measures tend to encourage exporting by those goods, the domestic value added of which is small, and discriminate against those exporters who use and develop locally produced inputs. As a further consequence, these policies retard the development of industries which produce intermediate products for export purpose, which the government has been trying so streneously to encourage.

In order to maintain the present rate of economic growth, Korea would have to transform the structure of export commodities from those which need relatively little local processing to those commodities which use more local resources, particularly the skilled labor. As mentioned previously, the structure of the present export promotion schemes, which encourage mainly those industries which process rather mechanically the imported intermediate products should be replaced in favor of a systematized scheme to maximize foreign exchange earnings. Continued reliance on present system of export promotion may be effective from the short-run objective of maximizing value of exports, but it would be detrimental to bring about long run structural readjustment that the Korean economy needs to achieve.

At the present stage of development of Korea and Taiwan, the export promotion system should be conceived, not as giving incentive to the act of exporting, but as an organic system of fostering export industries by inducing them to produce and sell abroad those goods which can be competitive in the international market from the long-run point of view.

6. Capital Intensity and Productivity

Export of a developing country is due to many factors. From the supply side, the simple fact of expansion of production in the import substitution phase is the most important single factor responsible for the exports of manufactured goods. But, as the economy reaches the Phase III, continued growth of export has to rely on decrease in average cost of production in export industries. The decrease in cost can be attributed to either the economy of scale or increase in productivity through improvement in productive and managerial skill. For a developing country whose comparative advantage lies in labor-intensive industries, the latter cause of cost reduction seems more important than the former.

As we saw in Section III, a sizable amount of export of manufacturing goods did occur during the Phase II of the three countries. In order, however, for exports to increase, the productivity of export industries had better increase rapidly, so that some of the import substitution industries can be transformed to export industries.

In the present paper, we have not attempted to study productivity increase in major industries of three countries, and we would merely cite the results of a few studies that have been done on Korea and Taiwan.

There seem to be some indications that increase in productivity of export industries of Korea is less than what one would expect from the rate of increase in export.

An analysis has been done by Dr. Chuk Kyo Kim as regards productivity increase in export, import substitution, and domestic industries during the period 1966-70.[1] The study does have a few limitations because some strong assumptions are made in these calculations and the period of study is limited to 1967-70. But these limitations do not seem to negate the validity of conclusion. According to the study, the findings of which is summarized in Table 6, one notes the remarkable fact that the growth rate of total productivity is in general much lower in the export sector than in the import substitution or the domestic sector. Total factor productivity showed an average annual rate of growth of 8.6 per cent, while exports grew at an average annual rate of 36.7 per cent between 1966 and 1970.

At industry level, most export industries indicate a low productivity growth as compared with import substitution and domestic industries except textiles, leather products, basic metal industries, and electrical machinery and apparatus.

It is fortunate for Korea that productivity did increase in such major export industries as textile and leather products, and electrical machinery and, but the above findings show that the Korean exports in general, in spite of the fact that they have grown very fast, have not been able to increase their factor productivity fast enough even in the Phase III. Increase in exports can be ascribed more importantly to vent-for-surplus type of exporting than produc-

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[1] Chuk Kyo Kim, "Productivity analysis of Korean Export Industries", Korea Development Institute, Collected Papers, 1972, p.29.

tivity increase. This fact, together with the observation that the capital intensity of export industries is so much lower in the export sector than in the rest of the manufacturing sector indicates the strong need of technical innovations in the export industries and greater capital investment in the export sector.

I have not attempted to study productivity change of Taiwan, comparable to Kim's study on Korea. But impression one gets on this problem is that even in Taiwan, where structural adjustment has been more thorough-going than in Korea, expansion in production appears to have been a more important cause of export expansion than improvement in technology.[2]

Table 6 Total Factor Productivity Index for Export, Import Substitution and Domestic Industries, Korea

(1966=100)

	Export Industries	Import Substitution Industries	Domestic Industries
1966	100.0	100.0	100.0
1967	105.5	103.5	92.9
1968	120.7	140.9	121.3
1969	131.6	185.1	143.5
1970	140.5	219.2	165.3
Average Rate of Changes	8.9	21.4	14.2

Source: Chuk Kyo Kim, "Productivity Analysis of Korean Export Industries", in Korea Development Institute, Collected Papers, 1972. P. 29

7. Agriculture and Trade

We emphasized earlier that a satisfactory extent of agricultural development is one of the most crucial requirements for sustained industrial development in the subsequent period. The importance of agriculture to economic development is well-known, and does not have

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[2] See for example Kou-shu Liang and T.H. Lee, Process and Pattern of Economic Development in Taiwan, Center for Southeast Asian Studies, Kyoto University, 1972, pp. 45-46.
W.Y. Kuo, Taiwan no Keizai Kozo (Economic Structure of Taiwan), Kansai Economic Research Center, 1971. pp.121-124. .

to be recapitulated here, but the fact that agriculture of Taiwan has, whereas that of Korea has not, generated what might be termed as Green Revolution, accounts for so many of the differences in performance of the two economies during the last two decades, and in directions to which the future developments is expected to take.

The rate at which the agricultural sector diminished in Taiwan in the 1960's was noticeably faster than that of Korea. In Taiwan the income accruing from the agricultural sector was 31.4 percent of GNP in 1960, and it decreased to 18.7 percent and in Korea, the agricultural orgin of GNP in 1960 was 39.0 percent and it decreased to 29.6 percent.

The satisfactory development of agriculture in Taiwan has enabled Taiwan to increase the export of agricultural products and processed goods related to agriculture, to release labor and capital from agricultural sector to industrial sector.

First, let us see the volume of trade of agricultural exports and imports. Though Taiwan might eventually have to import food and other agricultural products, its agriculture at the crucial stage of industrialization has earned a substantial quantity of foreign exchange. The proportion of agricultural goods export in total export even in the late 60's was approximately 14 per cent of total export. Since in Taiwan the estimated average rate of net foreign exchange earnings by exporting agricultural products and processed agricultural products is approximately 85 per cent of the value of exports, while the rate of foreign exchange earnings by exporting manufactured products is only 55.5 per cent, the importance of agricultural exports tends to be much greater than is indicated by the gross export figure.

Compared to this, agriculture of Korea was not able to produce exportable surplus at the initial stage of import substitution, and a substantial proportion of food consumption was, and still is, met by imports. Though the increase in agricultural production during the last two decade were by no means negligible, the green revolution apparently did not occur to the extent that has happened in Taiwan.

Second, as regards the release of resources from the agricultural sector to industrial sector, one notes, first, that the proportion of agricultural saving in total investment was roughly same in both Korea and Taiwan, in the early 1950's --- 17.6 per cent for Korea

during 1955-57 period and 16.7 per cent for Taiwan during 1952-54 period --- but, during 1967-69 it became 24.3 per cent for Taiwan while it became only 1.0 per cnet for Korea.[3] This means that the Korean agriculture generated virtually no saving at all, while Taiwan's agriculture generated as much as a quarter of total domestic saving. The proportion of non-agricultural saving to total investment in Korea during 1967-69 was 51 per cent, so that the remaining part of investment in Korea was financed by foreign savings.

As for movement of labor from agricultural and non-agricultural sector, one notes that in 1950's, the Korean industrial sector absorbed relatively more labor from the agricultural sector than Taiwan's industrial sector, but in the 1960's the trend was reversed, and Taiwan's industries absorbed more labor from the agricultural sector than Korean industries. This is shown by the rate of growth of industrial labor force in the two countries. According to a study done by Professor Gustav Ranis,[4] in Taiwan the industrial labor force increased at 3.1 per cent per annum between 1953 and 1959, while in Korea it increased by 5.5 per cent between 1956-62. But in the 1960's the trend was reversed. In Taiwan, the industrial labor force increased at 8.1 percent per annum between 1960 and 1968, while in Korea it increased by 6.3 per cent between 1960 and 1968.

8. Foreign Capital and Domestic Saving

The discussion on structural transformation for Korea, Taiwan and Hong Kong cannot dispense with a glance at investment and saving. Korea and Taiwan in 1950's are the greatest recipients of the U.S. economic aid. Taiwan received a total of $1,444.3 million over the 1950-65 period, or an average of almost $100 million a year, whereas Korea received twice as much during the same period, or an average of about $200 million a year. The U.S. economic aid provided both countries not only with consumption goods to help relieve the stringent post-war conditions, but also with the materials, and foreign exchange to establish the basic import substitution industries during phases I and II.

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[3] See Gustav Ranis, "The Role of Industrial Sector in Korea's Transition to Economic Maturity", in S.H. Jo and S.Y. Park (ed.) Basic Documents and Selected Papers: Korea's Third Five Year Development Plan, Sogang, Seoul, 1972.

[4] ibid, p.50

Both countries started borrowing heavily from abroad in the form both of official loans and private loans. The long-term capital imports to Taiwan amounted to $122 million U.S. dollars in 1970, whereas it amounted to $548.1 million in Korea in the same year.

The foreign capital has undoubtedly contributed greatly to economic growth of the two countries. But, needless to say, it cannot of course be an unmixed blessing. Too much borrowing and undisciplined way of spending will result in excess capacity in import substitution industries, increase rather than decrease the propensity to import, and aggravate debt service burden.

Both Taiwan and Korea (and especially Korea) would need a large quantity of foreign capital in the future, in order to establish capital- and technology-intensive industries, and to help improve technical levels. But it is also true that for both economies in recent years, the constraint on development lies not so much in the shortage of foreign exchange as in the shortage of domestic resources, real and financial.

The fact that Taiwan has established self-reliant economy is shown by the rate of saving. Taiwan's investment expenditure in 1970 was as much as 30.0 per cent of GNP -- a very high rate of investment for a developing economy -- and this is matched by an equally high rate of saving. In fact the proportion of domestic saving in domestic investment has risen from about 45 per cent in 1955 to 103 per cent in 1970. This desirable state of affairs has been achieved, thanks to high propensity to invest induced by the high rate of profit which in turn is the result of improvement in technical and managerial innovations.

Korea started borrowing from abroad in early 60's and the amount of borrowing especially in the form of private commercial loans increased tremendously towards the middle of 1960's. The total amount of foreign capital import during 1959-71 period was approximately $2.7 billion, out of which the short-term commercial loans was $1.7 billion, or about 63 per cent.

Several factors contributed to the heavy borrowing from abroad, particularly in the form of commercial loans.

First of all, the government encouraged importation of capital to implement the investment programs. Both the letter and the spirit of laws and regulations governing foreign capital were very favor-

ble to induce importation of it. Secondly, the rate of increase of domestic prices was much higher than the rate at which foreign exchange was appreciated. Thirdly, domestic interest rates on bank loans was much higher than interest rates on foreign capital.

The heavy inflow of short-term capital created noticeable excess capacity in some import substitution industries, and the rate of profit in these industries gradually decreased. The problem of debt service started to loom large towards the second half of 1960's, and the emphasis shifted from private short-term capital to public loans and direct investment.

The fact that a great portion of investment has had to be financed by foreign saving indicates that Korea needs to promote domestic saving, and thereby release more domestic resources for investment, especially in export industries.

9. Future Prospects and Conclusions

We have so far characterized the three economies as small, labor surplus, dualistic ones, and have traced the patterns of development of these economies. During the last two decades, these economies were able to lay the basic foundations of an industrial economy, upon which the growth can be accelerated in the 1970's, provided that the major economic policies take the right directions.

By and large, the economic future of these economies appears quite bright. Though the tremendous change in international political relations that the East Asian area has witnessed in recent years would exert substantial influence on the future of the three countries under survey, the economic conditions of these countries are sound and robust. Korea, to be sure, has shown for the last two years a few signs of structural imbalance, which were manifested by temporary slowdown of economic activities. But, as the great export spurt shown this year indicates, the economy has been successfully recovering from recessions, and is expected to continue to grow with renewed strength.

As we have seen, the advantage of having "labor surplus" condition will exist only to the extent that agriculture and other primary industries can be developed and release enough saving and labor from the primary sector to the industrial sector. The need for

this is particularly strong in Korea. Korea needs to have the kind of Green Revolution that Taiwan and other South Asian economies have achieved. It is very encouraging that agricultural sector is growing satisfactorily in recent years, and the third Five-Year Development Plan is giving priorities to agricultural development.

In the industrial sector, a continued improvement in productivity has to occur in both export industries and import substitution industries. The borrowed technology must be assimilated to local conditions by local entrepreneurs and labor force.

As has been emphasized in this paper, the future of the three economies lies in continued exports, and the structural readjustment that is required to bring this about. Productivity in export industries has to increase and new technology-intensive export commodities will have to be developed. As long as the major export commodities consist as they do today of plywood, textile products, clothing and footwear, the kind of export growth which these countries experienced thus far cannot be expected to continue.

In order to improve technology, these countries will have to increase investment. High investment calls for high saving and inducement of large volume of foreign capital. The basis for continued increase in income and export is found in high investment, particularly in private fixed investment.

Foreign capital import will be continued. However, it should not be done indiscriminately, and the use of foreign capital must be judiciously distributed in order to overcome the disadvantage of unbalanced structure. The countries ought to be advised to make use of foreign capital to develop agriculture and fishing industries, and to enhance technical and managerial skill of the local labor force and entrepreneurs.

It ought to be borne in mind, bowever, that it is domestic saving that is nowadays acting as constraint on development in all these countries. Policies to induce voluntary domestic saving should be taken. The structure and functions of monetary and financial institutions, of taxes and government expenditures should be carefully reviewed toward this end.

At the stage of development of these three countries, care should be taken not to develop excessively capital intensive industries.

Excessively capital intensive projects should be scrutinized on stringent criteria as regards the possibility of exploiting enough economies of scale, the requirement of imports of raw materials and cost of production.

The new overseas market must continue to be tapped. The growth of export of these three countries during the last decades relies heavily on the U.S. market, and exploration of new markets in Western Europe, and South America and other parts of the world is essential to ensure a continued and healthy growth of export.

Because of her preponderant economic strength, Japan is expected to play a decisive role in the economic future of these countries, as a supplier of machines, equipments, and new technology, and as demander of labor intensive products of these countries. It is expected that an increasingly larger amount of Japanese investment will be done in these countries, but a conscious effort should be made on the part of the Japanese government and industries to adopt trade policies to help these economies achieve the kind of structural adjustment that need in the future.

Comments and Discussion of Chough's Paper

Amado Castro introduced the discussion: I am grateful for the opportunity to comment on the experience of countries outside my own sub-region of Southeast Asia because I have found Dr. Chough's paper both informative and instructive. Here in my remarks I shall speak more from the view point of an economic historian than as an economic theorist. In these three countries - Korea, Taiwan and Hong Kong - we are privileged to be witnesses to contemporary cases of economic development. For me as a student of economic history, I am gratified that the industrial revolutions of the nineteenth century are also taking place in the twentieth century in our part of the world.

These three countries, as Professor Chough points out, are labour surplus, poor-resource base, dualistic economies and yet they are on the way to successful economic development. What are the reasons for their success? I shall mention some which appear to be significant, without implying that the list is exhaustive.

1. The first reason is hard work in an atmosphere of political stability. Then other factors are:
2. Great support from other countries, especially the United States.
3. At the same time (and this is important) openness towards foreign investment especially in the period since foreign government support was withdrawn.
4. Proximity to a large market, namely Japan.
5. In the cases ot Korea and Taiwan, language - many Koreans and Taiwanese speak Japanese, so that it is possible to have foreign co-operation not just in large scale industries but also in medium scale and even small enterprises.

Nevertheless, Professor Chough points out problem areas, especially in Korea. The value added in Korean export industries which are often processing enterprises is not as large as, for example, in Taiwan. In Korea the savings rate is not as large as desirable, with consequent high dependence on imported capital.

There has not yet been a "Green Revolution" in Korea to the extent that Taiwan has had. Am I right, however, in believing that this is a high priority concern in Korea now.

The improvements in productivity have been disappointing, especially in Korean export industries.

A fifth problem, in Taiwan as well as in Korea, is the need to modernize production, management, and the structures of firms.

Among the lessons for Southeast Asian countries from the experience of the East Asian developing economies seem to me to be the following: The first lesson for economic development is the importance of such traditional virtues as hard work, determination, political stability and strong and enlightened national leadership. Another lesson, which should have some meaning for a chauvinistic or over-nationalistic national leadership is the advantage to be gained from openness towards foreign investment. It is a fact, and perhaps a persuasive argument for openness, that in Asia those countries which have grown fastest have been relatively open towards foreign investors. A third set of lessons concerns what Gamani Corea at a recent meeting called the "new conventional wisdom". Paradoxically, Taiwan and Korea are often cited to buttress the "new conventional wisdom". Here I shall figuratively turn the arguments on their heads.

The first point concerns import substitution as a development strategy. This is supposed to be bad. Yet the experience shows what any economic historian will readily appreciate; that there is a time and place for almost everything. Import substitution is, or at any rate should be, a transitional phase in development. Another prescription in the new conventional wisdom is that countries should choose labour intensive industries using simple processes. Now Professor Chough is pointing out that Korea should move towards high technology processes, especially since textiles and other products are very vulnerable to shifting trade restrictions in the developed countries.

We hear that high dependence on imported inputs - "import dependent import substitution" - is unsound. Yet here in Korea (as in Japan) we see "import dependent export substitution" and it is shown to have economic basis.

The high interest rate policy which has in the past been a conspi-

cuous reform in Korea is not discussed at length in Professor Chough's paper, even though I for one would have been interested to hear more about it. High interest rates are a prescription we often get. But recent experience in Korea indicates that the interest rate cannot and should not be kept abnormally high in more normal conditions because it causes distortions of its own.

Lastly there is the issue of protection. This is not the nicest thing to do, it is not the very best behaviour from the point of view of theory. But from the Korean case the pragmatic judgement can be made - protection works! It brings about the required transformations.

Still the favourable experience of the East Asian countries, while instructive, is not completely transferable to Southeast Asia; the formula cannot be adopted lock stock and barrel. In the first place, Southeast Asia, has in varying degree, higher man-land ratios and relatively better natural resource bases. Therefore the Taiwan-Korea model of development is not quite so obviously desirable as a path of development. As Professor Chough metntions, the East Asian countries share the same basic culture and are geographically located near Japan. Southeast Asians do not have that same cultural heritage and they are more distant from Japan. The Southeast Asian countries generally have less favourable human resource endowments than Korea and Taiwan had even at the start. But at the same time many of the Southeast Asian countries have larger internal markets than did Korea and Taiwan when they began.

To conclude, here in Taiwan and Korea we are seeing rapidly rising GNP, greater employment and better income distribution. These cases illustrate how economic growth by itself contributes substantially to solving the problems of employment and income distribution which disturb many economists today. It is heartening to witness success in economic development and to see how human beings can overcome obstacles. Even if there are mistakes, even if the process of development is not perfect, the hits are more than the misses.

Finally it can already be perceived that these East Asian countries will be going along the same path of development as Japan and so they should find much to learn from Japan's experience. At the same time we should all call on Japan to so change its policies that these countries will be easier able to follow the Japanese pattern

of development.

Shinichi Ichimura continued the commentary: In order to make a fair comparison of the Korean economy with the Taiwan and Hong Kong economies, the Korean War and political instability must be mentioned. Perhaps the kind of political stability prevailing in Korea in the recent years will bring about economic achievement similar to Taiwan with a time lag of about five years. Another factor important for Korean development is her closeness to Japan. This will become increasingly important and advantageous for Korean development.

Both the Korean and Taiwan governments bore very heavy military budget. Was there any difference between the two governments' taxation policies? The relatively poor performance of the Korean agricultural sector must have necessitated different taxation policies. The agricultural policies in Korea are sometimes criticized on low-pricing of rice. The fact described on P140-P141 must be at least partly due to such policies. The author should try to evaluate this critically important issue.

The process of industrialization of a predominantly agricultural economy goes through several stages: (1) development of import-substituting industries - the prices of manufactured goods go up, devaluation takes place, the import to GNP ratio goes down; (2) the emergence of export industries - the ground is prepared by (1), export to GNP ratio goes up (2) capital goods industry begins to be built up. The Taiwan economy passed the first stage in the 1950s. It took about 10 years to reach (2). Korea is about to reach the first start-line of stage (2) now. In this connection, overvaluation of Korean wan may be a problem. We would be interested in learning what the author would say on this burning issue in any developing country.

One of the well-known characteristics of Korean economic policies is the very high rate of interest. What does Dr. Chough think about this policy? In Japan the postwar policies have always been "low-interest rate" policy. Can it really promote saving? Can private banks make profit? How were funds allocated? Outstanding economists in Korea should present their views on this issue.

Further discussion touched upon agricultural policies in Korea, the valuation of the Korean wan, the Korean attitude towards East

Asian economic integration, and the comparative savings ratios in Korea and Taiwan.

Professor Chough emphasised that Korean agricultural policies which stressed the maintenance of low agricultural prices had checked agricultural output expansion and saving in the agricultural sector. However, these policies had undergone change in the 1960s.

Chough argued that devaluation of the wan was likely to increase the debt burden and cause inflation in the Korean economy. An alternative to devaluation, which he thought preferable, was the adoption of non-monetary measures to stimulate the expansion of export industries.

Asked about the Korean attitude to economic integration between Korea and Taiwan, Professor Chough pointed out that the Korean people were presently pre-occupied with many short-run problems which made interest in integration with other East Asian countries remote. In the long run such integration may become feasible.

Asked why the Korean savings ratio appeared lower than Taiwan's, Professor Chough said that this could be attributed largely to lower per capita incomes and the aftermath of the Korean war.

Professor Chough agreed with another participant who suggested that the productivity figures presented in the paper may tend to overestimate gross productivity because capital inputs used for deriving the figures were understated.

5

TRADE POLICY AND PROBLEMS OF EXPORT EXPANSION

THE CASE OF SOUTHEAST ASIA

Seiji Naya

and

Udom Kerdpibule

Introduction

The Southeast Asian region includes many countries with similar climatic conditions and, to some extent, resource endowments. These countries' most distinguishing economic characteristic is their abundant supply of unskilled and semi-skilled labor. With similar climatic and topographic conditions, they tend to have similar economic structures. However, there are great differences in social, political and economic factors as well as the growth strategies of the individual countries. The region includes a potentially large scale economy in Indonesia with a population of over 120 million and rich natural resources as well as the city-state economy of Singapore with a population of only 2 million. The countries in Indo-China have been frought with internal division and in a persistent state of war. Burma has been following a policy of economic isolation, characterized by strict control over resource allocation, trade and capital flows. Until the mid 1960s, Indonesia also pursued an inward-looking development strategy. Malaysia, Singapore, Thailand, Indonesia and the Philippines have had relatively open trade policies in recent years, relying on indirect means such as tariffs rather than on quantitative and exchange controls or prohibition. Although within this latter group there is still a difference in the degree of economic liberalism, Singapore being the most open and the Philippines the least.

Politically speaking, their foreign policies are somewhat diverse.

While Burma has been in isolation, Thailand has been strongly anti-communist and closely allied with the U.S. Malaysia and Singapore, on the other hand, are pushing for a neutralized Southeast Asia.

A number of these Southeast Asian countries have, however, shown interest in regional cooperation. Indonesia, Malaysia, the Philippines, Singapore and Thailand have formed a formal, through lossely tied, subregional organisation called ASEAN. Because it was indigenously founded and includes five countries with somewhat similar, outward-looking economic policies. ASEAN may be potentially important as a framework for future cooperative ventures. But the economic and political issues involved in regional economic cooperation are extremely complex, and regional ventures of major significance have not been attempted so far in trade and industrial areas.

The Southeast Asian countries entered into the second development decade with their GDP growing at a rate ranging from 2.2 percent per annum for Indonesia to 7.6 percent per annum for Thailand. Much of the increase in the GDP was, however, offset by a rapid growth of population of the order of 3.0 percent per annum. During the past decade these countries have witnessed two major events: one is the so-called Green Revolution and the other is the deliberate attempt to accelerate the pace of industrial development.[1] Although the Green Revolution may have appeared at first to be merely a technological breakthrough in the production of rice, several economists anticipate a number of far-reaching economic consequences. It may well be for example, that the reallocation of resources resulting from the introduction of the high yielding variety of rice will result in an increase in the output of other food grains, other foodstuffs and raw material. The Green Revolution is also seen as a dynamic force; the reduction in the price of rice is equivalent to an increase in real income to be spent on manufactures. The lower price of rice also helps keep down the cost of living and money wages, two factors which together help accelerate industrialization. However, there has not been much concrete evidence of the Revolution.

Until very recently the industrial development policy of the Southeast Asian countries had been basically that of import substi-

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[1] For detailed discussion of these events and related policy suggestions, see ADB, Southeast Asia's Economy in the 1970s especially "Overall Report" by Hla Myint and "The Manufacturing Industry Sector" by Helen Hughes, Longman Group Limited, 1971.

tution. Such a policy was considered desirable in helping to develop both the manufacturing sector and to lighten the burden of the trade balance deficit. A number of deterring effects have, however, been induced by import substitution policies and programs. Industrial output has grown rapidly, but it may soon reach its limit because of the shallowness of the domestic market. Industrial growth may have created employment opportunities in the non-agricultural occupations but it is not likely to be very large because investment incentive measures tend to favor capital-intensive techniques rather than labor-intensive ones. The tariff structures in some countries also encourage the production of luxury consumer goods, and these industries are likely to reach the limit of the domestic market quickly. It is also not certain whether the import substitution policy has helped the trade balance situation. While the composition of imports in favor of capital goods and against consumer goods has been taking place, total imports have been growing rapidly. Singapore is said to be the only country not building up a balance of payments burden with imported inputs for industrialization as the domestic manufactured exports have been pushed forward by its outward looking industrialization strategy.[2]

Many Southeast Asian countries are now realizing the limitation of an import-substitution policy and have been gradually shifting their emphasis to export-oriented industries. Modernization of agriculture has also received some impetus as a means toward diversification of exports and as a basis for the development of more highly processed forms of primary exports. The shift to export-orientation may be more difficult for these Southeast Asian countries than the East Asian countries and Singapore; there has been less pressure for doing so in the past because of their relatively abundant natural resources which were easily sufficient to provide for minimum subsistence.

In the 1960s, exports of Southeast Asia, influenced by both external and internal factors, did not grow as rapidly as they could have. A few countries, e.g. the Philippines and Thailand, were able to achieve export growth in the order of 6 to 7 percent a year whereas exports of some others even recorded an absolute decline. In general, the record of export expansion has hardly been sufficient in view of their steadily mounting imports and employment

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[2] Hughes, Ibid., p. 186.

creation needs.

A rapid increase in population in this area is bringing about an unemployment problem, though the magnitude of this problem varies among individual countries. This problem is being felt most seriously in urban areas so that the political pressures arising from it are more likely to present threats to government policies and governments than in the past. If agricultural as well as industrial sectors grow more rapidly, employment problems can be kept within torelable limits. In part this depends on trade opportunities and the external economic relationships of these countries.

In view of the overwhelming importance of exports in the Southeast Asian countries' development efforts, this paper examines various problems of their export expansion.[3] In the following section, (II), their export performance in the 1960's is presented. The emerging pattern of export expansion and various factors, internal and external, of their export growth are evaluated in light of the forces of demand and supply and some commercial policy problems. Internal and external policy measures that have impaired the export expansion of the region are described in Section III, followed with concluding remarks (IV). Although the focus is on Southeast Asia, export growth of other Asian countries is presented for comparative purposes.

II. Export Performance of Southeast Asian Countries[4]

Export Pattern and Growth

As is now well known, world trade in the 1960's grew at a much faster rate than in the decade before, contributing to an export expansion for both developed countries (DC) and developing nations (LDC) as a whole. Among individual countries and sub-regions of the LDC, however, there has been wide variation in export growth. This variation is important in terms of possible explanations for it and policy implications that can be drawn from it.

In Asia, per-annum export expansion in the 1960's has varied from the highest rate of 34 percent for Korea to a decline of 20

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3 An Appendix Note, "The Projection of Demand and Capacity to Export Manufactures," made by Udom Kerdpibule, is attached.

4 This section draws considerably from Seiji Naya, "Toward Expanding Southeast Asia's Extra-Regional Exports," mimeo.

percent for South Vietnam (See Table 1).[5] Though hardly comparable with the impressive performance of the East Asian countries, exports of Thailand and the Philippines have done relatively well, growing annually by 6-7 percent. The same holds for Singapore and Indonesia although their entrepot trade and the inaccuracy of trade statistics make evaluation of their trade patterns difficult.[6] The figures given in the table, for example, do not seem to reflect the extent of the export-oriented economy which Singapore has been successfully developing, nor does it show the rising export earnings which have become increasingly important in Indonesia's redevelopment program.

Contrasting greatly with the performance of the ASEAN countries is the sharp decline of the absolute value of exports of other Southeast Asian countries.

An export growth of 6 percent or so, however, is hardly sufficient in view of the steadily mounting imports and employment creation needs of the Southeast Asian countries. Also, the rise in this region's exports has been considerably less than the world average and even less than that of both the Asian and LDC groups. This is so even if only ASEAN exports are considered. Part of this lag can be attributed to the region's continued heavy reliance on exports of primary products, though this explanation is often over-emphasized.

In world trade, combined primary products have been rising at only about one-half the rate of manufactures. In comparison, ASEAN has actually achieved export growth rates for both primary products and manufactures which are comparable, in fact higher, than the world averages for these two categories. But, for these countries, growth in primary goods continues to determine that of total exports.

The growth of world trade, measured, for example, by the DC's total imports, varies among individual primary products (see Appendix Table 1). Still, in only four out of the 29 primary product groupings, did DC's imports from the world grow at an annual rate of 8 percent or more (fish, animal feeds, wood and lumber, and non-

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[5] Throughout this paper, Asia and its sub-region, East Asia refer only to developing Asian countries.

[6] The trade data of Indonesia since 1963 and of Malaysia in recent years, which are used in the table, are based on returns of their trading partners. The returns, especially of intra-Southeast Asian trade, are found to be inadequate, i.e., Singapore's records omit altogether its trade with Indonesia since 1964.

Table 1 Annual Compound Rate of Export Growth, 1959-70 (in %)

Country	Exports		
	Total	to DC	Intra-Asian
World	8.5 (a)		
DC	9.1 (a)		
LDC	6.5 (a)		
Asia	5.7 (a)	8.5	3.3
Southeast Asia			
ASEAN	3.8 (a)	6.6	0.3
Indonesia	1.0	8.7	-16.9
Malaysia	4.0 (b)	5.8	4.2 (b)
Philippines	6.8	6.2	19.7
Singapore (c)	3.3	4.4	4.2
Thailand	6.4	9.3	3.7
Other S.E. Asia	-8.2	-5.4	-10.3
Burma	-7.3	-0.9	-9.8
Cambodia	-3.5	-6.0	-2.8
Laos	-2.5 (a)		
South Vietnam	-19.9	-16.4	-30.1
East Asia	16.0	20.6	11.7
Hong Kong	12.4	17.8	7.0
Korea	34.2	34.6	30.6
Taiwan	20.1	22.1	18.9
South Asia	3.5	3.1	2.8
Ceylon	-1.0	-1.1	-1.6
India	3.4	3.1	1.7
Pakistan	7.1	6.5	5.7

Notes: a: 1960-69
b: 1959-67
c: excluding trade with Indonesia

Sources: U.N., Commodity Trade Statistics and Monthly Bulletin of Statistics (various issues) and I.M.F., Direction of Trade Annual, 1958-62 and 1963-67.

ferrous metals), the last being the only one which increased by more than 9 percent. The DC's imports of such traditional primary products as rubber, cotton, jute, and tea which comprise a large proportion of Southeast Asian exports, either fell absolutely or rose very little.

Although East Asian countries have been able to diversify their exports into manufactures by pursuing intensive export promotion measures, Southeast Asia has not. Singapore is the only country which shows signs of rapid export diversification into manufactures. But Singapore, with its lack of primary resources, resembles East Asian countries and not its neighbors. In view, then, of the overwhelming importance of the primary exports of Southeast Asia, those factors which retard world trade expansion of traditional agricultural and raw materials only serve to impair the development efforts of these countries.

There is, however, more to these countries' export performance than the slow-growing world demand for primary products; the wide range in export growth among individual countries cannot be explained by exogenous factors alone. For commodities such as rubber, jute and sugar, they have, in fact, been unable to meet even a low demand and have consequently been losing out in the DC's markets (see Appendix Table 1).

Contrasting to and offsetting these stagnant exports have been ASEAN's exports of other primary products, most of which are growing faster than DC's total imports from the world; thus raising this group's share in the world market. The export growth of 11 primary products listed (out of 29) exceeded 10 percent per annum; these include fish, maize, fruits, vegetables, and wood and lumber. Along with manufactured goods, these emerging exports have begun to play an important role in the region's export performance. Thus, ASEAN has been relatively successful in directing their resources into new areas of primary products, both in raw and processed forms. If the extent of export diversification is measured by the "commodity concentration" index, the Philippines and Thailand show about the same rate of diversification as Hong Kong, though the first two export largely primary commodities whereas the latter relies almost entirely on manufactures.

Also, in contrast to their over-all export expansion in primary

Table 2 Manufactured Exports of ASEAN Countries[a]

Country	Per Capita Value[b] (US $)		Percentage of GNP	
	1961	1969	1961	1969
Singapore (c)	50.78	123.13	10.33	18.08
Malaysia (d)	6.50	11.06	2.65	4.03
West Malaysia (e)	6.62	10.65	--- (n.a.)	---
Sabah	4.76	7.38	--- (n.a.)	---
Philippines	0.69	1.17	0.47	0.69
Thailand (f)	0.28	2.63	0.30	1.88
ASEAN (g)	2.38	4.83	1.66	3.26

Notes: (a) SITC Sections 5 to 8 excluding 687.01 (tin).
(b) Valued at 1964 constant prices
(c) Including re-exports but not rubber manufactures.
(d) Excluding Sarawak; total exports include intra-Malaysian trade.
(e) Excluding tin.
(f) Including tin.
(g) Excluding Thailand's tin.
Source: US, Yearbook of International Trade Statistics.

products, the ASEAN group (in fact, LDC's in general) have been quite successful with their exports of manufactured and semi-manufactured goods. It is true that the world trend for these products has been more favorable than for primary products and that exports of manufactures grew from a small base and still comprise a small part of their total exports. But ASEAN's exports of manufactures grew about 13 percent per annum in the 1960s.

As shown in Table 2, the size of manufactured exports by different ASEAN countries varies, both in terms of per capita value and as a proportion to GNP. Singapore shows the highest level of per capita exports as well as the highest percentage of exports to the GNP; per capita exports more than doubled within the eight year period. The Philippines and Thailand show very low per capita exports, and both countries have managed to develop these exports faster than the rate of growth of GNP.

A breakdown of total manufactured exports into commodity groups shows that there is a high export concentration on resource-based manufactures (SITC 6). In 1969 they constituted 43.04 percent of the total for the ASEAN countries taken together. Moreover, ASEAN's rate of growth of these manufactured exports exceeded the world

average. Included in this commodity group are wood products, cotton textiles, rubber and leather products. Miscellaneous manufactures (SITC 8), covering a large number of labor-intensive goods, shows the most rapid growth.

There is also an indication that the pattern of comparative advantage of the ASEAN countries bears a certain relationship to the level of industrial development, as indicated by the size of per capita manufacturing production. Countries with higher levels of per capita manufactured GDP appear to export proportionately more commodities requiring a higher level of technology and human skills than countries with lower per capita GDP.[7]

The average annual growth rate for ASEAN as a whole is 12.3 percent per annum, which is quite comparable to the average performance of all developing countries during 1960-69 (13.0 percent). But in view of the fact that the growth rates of ASEAN manufactures are higher than the average for all developing countries, the figure suggests that manufacturing production in ASEAN countries is relatively more oriented toward the domestic market than for exports.

Another feature of Southeast Asia's trade has been the proportionately large size of intra-regional exports in its total. But common to other LDC's as well, there has been the tendency of its intra-regional exports to grow more slowly than its trade with DC's (see Table 1).[8] This has partly been policy-induced; their polici-

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[7] Percentage share of commodity groups in total manufactured exports and per capita manufactured GDP, 1969

Country	Per capita manuf. GDP (US$ at 1964 constant factor cost)	Percentage share of total manufactured exports		
		SITC5	SITC6	SITC8
Singapore	116.41	14.72	39.80	25.08
West Malaysia	31.68	18.50	44.27	15.85
Philippines	29.53	11.24	79.79	8.54
Thailand	20.26	4.50	62.03	22.50

[8] A surprisingly large part of the falling intra-Asian trade can be explained by the inaccurate intra-regional trade data (Seiji Naya, "Patterns of Intra-Asian Trade and Regional Cooperation," a paper presented at the SEADAG meeting, Bangkok, Thailand, January, 1972.) When a certain adjustment on Singapore's trade is made and Indonesia is excluded, intra-regional trade as a proportion of Southeast Asia's total exports rises slightly from 1962 to 1967 (see Appendix Table 2).

es of import substitution and self-sufficiency are generally biased toward commodities for which their neighbors have a comparative advantage (e.g. rice).

Also, many of these countries have responded to a buoyant demand for various commodities in DC's, particularly Japan and the U.S., by expanding such exports to them. These two countries are the largest trading partners of the region; exports to Japan and the U.S. comprised 37 percent (19 percent and 18 percent respectively) of Southeast Asia's total exports in 1967 (Appendix Table 2). This percentage has been considerably larger for Japan in recent years; but the U.S. is by far the larger market for manufactures of the region since exports to Japan consist mostly of primary products.

If the importance is measured in terms of the growth of the region's exports, Japan has been outstanding. The Japanese market for both primary and manufactured grew extremely fast in the 1960's. For example, her imports from ASEAN rose 10.2 percent per annum in primary products and 21.6 percent in manufactures, in contrast to 5.3 percent and 13.3 percent for respective ASEAN imports of the DC's as a group (see Appendix Table 3). The rapid growth of Japan's income and trade, the structure of her import growth, and geographical proximity all point to the increasing importance of the country's role as a determinant of the region's export expansion.

Export Performance

To summarize the discussion above, four inter-related factors can be identified in order to assess export growth: the world trend, the compositional effect, the directional effect, and the share effect. The quantitative assessment of these effects for Southeast Asian exports is, however, confined to the DC's market because of the data limitation posed by intra-regional trade.[9] But factors in-

[9]Trade data used are import statistics of the developed countries consisting of the U.S., Japan, Australia, New Zealand, Canada, the EEC, the U.K., and other Europe (combining Denmark, Finland, Norway, Sweden and Switzerland). Their imports from the developing countries are treated as LDC exports to DC. Based largely on the 3-digit SITC with major export items from Asia identified separately, total trade is classified into 29 primary commodities, 22 manufactured items, and Unclassified (SITC 9). The trade values of two years, 1968 and 1962, are used. Because of the tremendously high growth rates of some specific exports (e.g., of Korea) during this period, the average annual growth rates are calculated with the average value of the two periods as the base and 1968 as the end period.

fluencing trade performance in these two markets should not differ much.[10]

As the method of analysis, the actual growth rate of ASEAN's exports to the DC's, (A), is compared with the world trend measured by the average growth rate of DC's imports from the World (W). The difference, (A-W), which indicates how A has deviated from the world trend, is referred to as export performance. This is decomposed into three effects[11] so that (A-W) = (HC-HD) + (HD-W) + (A-HC). The three effects are defined here:

(HD-W) Commodity Compositional Effect. HD refers to a hypothetical or projected growth rate of total exports measured by assuming that, for every given product, exports have risen as rapidly as the average import growth of all DC. Since this difference (HD-W) would show the effect of one's commodity mix differing from that of DC's imports from the world, it is defined as the compositional effect.

(HC-HD) Directional Effect. HC is another hypothetical growth rate based on the assumption that, for every commodity, exports directed to a given DC rose as rapidly as imports of this DC. In this projected rate, the export share of each commodity remains the same in a given DC market whereas in HD a similar share in the combined DC market is held constant. The difference between HC and HD would show the effect of export expansion accounted for by the directional difference of export products.

(A-HC) Share Effect. In HC, the effect of favorable or unfavor-

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[10] Suggestive evidence of this is the very high correlation between the growth rates of exports to DC and intra-Asian exports; those countries which perform well in DC's market also do well in the regional market, and the same is true for countries which perform poorly.

[11] HD and HC of a given exporting country are:

$$HD = \sum_{c} r_{wc} \cdot M_{ic} / \sum_{c} M_{ic} \text{ and}$$

$$HC = \sum\sum_{cj} r_{jwc} \cdot M_{jic} / \sum\sum_{cj} M_{jic}$$

where r is the average annual rate of export growth; and M, DC's imports in the average base year. To illustrate what the subscript denote, r_{jwc} refers to r of jth DC from the world (w) in commodity c and M_{jic} denotes M of j from country i in C. When j is not given, the reference is to all DC as a group.

Table 3 Export Performance of Asian Countries by Asia and other Country Groups in Primary Products in 1960's (Annual Average in %)

Country Groups	Growth Rate			Difference Accounted for by			
				Composition			Share
	Actual	World Average	Difference	Direction	Commodity	Total	
	(A)	(W)	(A-W)	(HC-HD)	(HD-W)	(HC-W)	(A-HC)
Asia	4.09	6.14	-2.05	1.73	-1.56	0.17	-2.21
Southeast Asia	4.69	6.14	-1.45	1.75	-0.88	0.87	-2.32
Asean	5.35	6.14	-0.79	1.91	-0.87	1.05	-1.84
Other	-7.48	6.14	-13.62	-1.19	-1.18	-2.38	-11.25
East Asia	13.70	6.14	7.56	6.20	0.10	6.30	1.26
South Asia	0.40	6.14	-5.74	0.25	-3.71	-3.46	-2.28
Indonesia	8.61	6.14	2.46	0.76	-0.41	0.35	2.12
Malaysia	0.81	6.14	5.33	1.67	-1.86	-0.19	-5.14
Philippines	6.98	6.14	0.84	3.55	0.58	4.13	-3.29
Singapore	8.89	6.14	2.75	-0.14	-1.60	-1.74	4.49
Thailand	7.00	6.14	0.86	1.83	-2.06	-0.23	1.09
Burma	-5.23	6.14	-11.37	-1.54	1.31	-0.22	-11.15
Cambodia	-2.11	6.14	-8.25	1.76	-4.31	-2.55	-5.70
So. Vietnam	-19.87	6.14	-26.01	0.56	-6.33	-5.77	-20.24
Hong Kong	7.82	6.14	1.68	3.89	0.73	4.63	-2.95
Korea, Rep.	15.29	6.14	9.15	7.17	0.94	8.10	1.05
Taiwan	14.37	6.14	8.22	6.32	-0.38	5.95	2.28
Ceylon	-1.71	6.14	-7.85	0.09	-6.04	-5.94	-1.91
India	1.18	6.14	-4.97	0.50	-2.27	-1.77	-3.19
Pakistan	0.29	6.14	-5.85	-0.12	-6.06	-6.18	0.33
Other LDCs	5.96	6.14	-0.18	-0.18	0.62	0.44	-0.62
All LDCs	5.64	6.14	-0.51	0.15	0.24	0.39	-0.90

able commodity composition (hence stagnant or buoyant world demand) is taken into consideration. Thus, given the commodity composition, the difference between A and HC would show whether or not a country has been able, on the average, to expand its exports of individual commodities to DC more rapidly than competing exporters. Since this difference would reflect the effect of changing export shares of individual commodities in DC's market, this is defined as the share effect.

Although factors responsible for export performance are complex and difficult to identify, it is reasonable to suppose that the commodity compositional (HD-W) and the directional (HC-HD) effects are affected more by external than internal conditions, and vice-versa for the share effect (A-HC). It is thus assumed that the commodity mix and concentration of LDC's exports, as well as the countries to which they are directed, are not readily changeable in the short run and that factors affecting them are often beyond their control. On the other hand, the share effect (A-HC) reflects the extent to which LDC have or have not kept up with the import demands of industrial countries. Thus, their own economic conditions and policies to encourage or discourage (directly or indirectly) their exports become quite relevant to this effect.

Since the total export expansion of all Southeast Asian countries (with the exception of domestic exports of Singapore) is overwhelmingly determined by primary commodities, their performance in this commodity group is analyzed separately first, followed by manufactures and total exports. Table 3 presents summary findings on the export performance for primary products of individual Southeast Asian countries and also other Asian countries and groups for comparative purposes.

In the 1960's, the annual growth rate of these exports to industrial countries ranged from 15 percent for Korea to -5.2 percent for Burma and -19.8 percent for South Vietnam. All ASEAN countries, except Malaysia, show an annual growth of about 7 percent or more in primary product exports. Although several Asian countries, e.g. Ceylon and Pakistan, have had very unfavorable compositional effects deterring their export growth in primary commodities, this effect for Asia as a group is expectedly small since only primary products are considered. On the other hand, the share effect has had a greater influence on the inter-country difference in the growth rate

among Asian countries than has the compositional effect. In general, the larger the effect of maintaining their commodity market shares, the greater has been the rate of export expansion of their primary products. For example, for 14 Asian countries listed, the (rank) correlation coefficient between the share effect and export expansion is as high as .80 and highly significant. The commodity compositional effect is also positively correlated with export growth, but the correlation coefficient is lower (.54) and only barely different from zero at the 95 percent level. The share effect, then, is important as it suggests that exports of primary commodities can be made to increase more if suitable policies are followed and exports are encouraged.

Countries such as Indonesia, Singapore and Thailand have been able, to a large extent, to offset their unfavorable commodity compositional effect by their positive share effect. But a large negative value in share effect for most Asian countries suggests that they have not exploited the market opportunity for primary products as fully as possible. For example, Southeast Asian exports earnings from primary commodities could have been greater by 2.3 percent annually, had the share of each product been kept in individual DC.

As mentioned previously, Asian countries, especially Southeast Asia, direct a large proportion of their exports to Japan. The positive directional effect shown for most ASEAN countries primarily reflects their heavy reliance on exports to Japan and the rapid import growth of Japan compared with other DC. For ASEAN countries, export expansion of primary goods to Japan has been considerably greater than to other DC (Table 4). At the same time, the largest negative value shown in the export performance as well as the share effect of the region's exports to Japan suggests that ASEAN countries have not fully exploited the market opportunities available in this country.

The commodity distribution of the negative share effect for ASEAN is highly concentrated in several select commodities, e.g. rubber, iron ore, sugar, wood and lumber, and rice.[12] For various reasons, rubber, sugar and rice (largely of Malaysia, the Philippines, and

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[12] Of these items, only exports of wood and lumber rose rapidly, whereas the export value of the remaining items either grew little or declined.

Table 4 Export Performance of ASEAN's Primary Products in Developed Countries (Annual average in %)

	Growth Rate			Difference Accounted for by	
	Actual (A)	World Average (W)	Difference (A-W)	Composition (HC-W)	Share (A-HC)
Total DC	5.35	6.14	-0.79	1.05	-1.84
5 Pacific Basin DC	7.06	7.67	-0.61	1.43	-2.04
U.S.	4.45	4.82	-0.37	0.01	-0.38
Japan	10.20	12.86	-2.65	0.81	-3.46
All Europe	1.21	5.29	-4.08	-2.71	-1.36
EEC	3.02	6.60	-3.59	-2.46	-1.13
UK	-3.01	2.14	-5.15	-4.29	-0.85

Thailand respectively) can hardly be regarded as items for which shares can readily be increased in DC's markets. The market share of rubber, for example, is already so large that a vigorous attempt to raise the share even further may induce a reduction in price rather than an increase in share. The large deterring effect that these few major traditional products have had on ASEAN exports indicates that the problem of increasing their primary products is extremely difficult.

Turning now to a brief analysis of manufactured exports, a summary finding on export performance is given in Table 5. The impressive rate of Asian export growth is clearly revealed. Unlike primary products, the world trend factor W, which is 11.9 percent, has played an expansionary role. Not surprisingly, the East Asian group came out on top again in growth rate. But the difference in the growth rate between this sub-group and many other Asian countries is far smaller than it was for primary products. In fact, manufactured exports to DC by such ASEAN countries as Thailand, Singapore and Malaysia grew at the remarkable rate of 15 percent or more per year. For Malaysia (and a few others, e.g. Pakistan) there is a striking contrast between its favorable export performance of manufactures and its unfavorable performance of primary goods.

It is interesting to note that the commodity mix of manufactures has been favorable for the export expansion of all Asian countries (with the notable exception of India and Pakistan). The varying abilities of individual countries to be able to keep up with world

Table 5 Export Performance of Asian Countries in Manufactured Products in 1960's

(Annual Average in %)

Country Groups	Growth Rate			Difference Accounted for by			
				Composition			Share
	Actual	World Average	Difference	Direction	Commodity	Total	
	(A)	(W)	(A-W)	(HC-HD)	(HD-W)	(HC-W)	(A-HC)
Asia	15.26	11.90	3.36	0.06	-0.69	-0.63	3.99
Southeast Asia	12.89	11.90	1.00	-0.28	1.04	0.77	0.23
Asean	13.33	11.90	1.44	-0.27	0.97	0.70	0.74
Other	-1.06	11.90	-12.96	-0.58	3.45	2.87	-15.83
East Asia	19.29	11.90	7.39	0.49	0.38	0.86	6.53
South Asia	8.31	11.90	-3.58	-0.79	-3.10	-3.89	0.31
Indonesia	6.96	11.90	-4.94	1.87	-1.29	0.58	-5.52
Malaysia	15.79	11.90	3.89	-0.20	0.10	-0.10	4.00
Philippines	9.85	11.90	-2.05	-0.43	1.25	0.83	-2.88
Singapore	19.66	11.90	7.76	-0.67	0.49	-0.18	7.94
Thailand	24.91	11.90	13.01	0.04	2.62	2.66	10.35
Burma	-6.88	11.90	-18.77	0.33	3.55	3.88	-22.66
Cambodia	-19.29	11.90	-31.19	-2.12	1.47	-0.65	-30.54
So. Vietnam	33.33	11.90	21.44	-3.61	4.09	0.48	20.96
Hong Kong	16.16	11.90	4.26	-0.04	0.47	0.43	3.83
Korea, Rep.	31.49	11.90	19.60	2.07	0.20	2.27	17.32
Taiwan	25.28	11.90	13.38	1.84	0.07	1.91	11.47
Ceylon	12.76	11.90	0.87	-2.77	3.17	0.40	0.47
India	6.38	11.90	-5.51	-0.98	-3.01	-3.99	-1.52
Pakistan	17.94	11.90	6.04	0.06	-3.81	-3.75	9.79
Other LDC	13.34	11.90	1.44	0.76	0.32	1.07	0.37
All LDC	14.09	11.90	2.19	0.48	-0.08	0.41	1.79

demand or maintain the market share of individual manufactured commodities appears to be the important factor behind the different rates of growth. For example, the rank correlation of coefficient between (A) and (A-HC) for 13 countries listed is found to be .97 in contrast with a low and negative coefficient of -.21 between (A) and (HD-W).

Having treated primary and manufactured exports separately, we now look at their combined performance. After all, the pessimistic view concerning export prospects is generally related to the contrasting growth trend of these two commodity categories. And the relative unimportance of the commodity effect may have been incorrectly and unduly influenced by the separate treatment.

To do this, all individual commodities of the two product groups are included in the computation, the summary result of which is presented in Table 6. The adverse influence that the commodity compositional effect has on LDC export expansion is now sharply revealed. The large negative value of this effect is shown for all Asian countries with the notable exception of East Asia. For example, this effect pulled the growth of ASEAN exports down by an average annual rate of 3.6 percent.

Notwithstanding the deterring influence of an unfavorable commodity mix, the share effect is still shown to be very important in explaining export performance, inasmuch as it can also offset the "unlucky" compositional effect. For example, the rank correlation coefficient for the actual growth (A) and share effect for 14 Asian countries is found to be 0.89 as compared with 0.61 for (A) and the commodity effect (HD-W). Hence, to explain why the export performance of individual countries deviates from the average (A-W), it is as relevant to examine how their market share changes as to look at the composition of their exports.

III. Institutional Factors Affecting Export Growth

Domestic Industrial Policy

The export performance of the Southeast Asian countries as evaluated by the share effect criterion is not very encouraging and, as suggested earlier, it is the domestic conditions and policies that could adversely affect the performance in this respect.

Table 6 Total Export Performance of Asian Countries in 1960's by Asia and Other Country Groups

(Annual Average in %)

Country Groups	Growth Rate			Difference Accounted for by			
				Composition			Share
	Actual (A)	World Average (W)	Difference (A-W)	Direction (HC-HD)	Commodity (HD-W)	Total (HC-W)	(A-HC)
Asia	7.67	9.35	-1.68	1.28	-2.70	-1.42	-0.27
Southeast Asia	5.18	9.35	-4.18	1.69	-3.69	-2.00	-2.18
Asean	5.83	9.35	-3.52	1.84	-3.67	-1.83	-1.70
Other	-7.13	9.35	-16.48	-1.15	-4.05	-5.20	-11.28
East Asia	18.30	9.35	8.94	1.78	1.69	3.47	5.47
South Asia	3.20	9.35	-6.15	-0.07	-4.70	-4.77	-1.38
Indonesia	8.63	9.35	-0.73	0.78	-3.56	-2.78	2.05
Malaysia	1.24	9.35	-8.11	1.65	-4.86	-3.21	-4.90
Philippines	7.34	9.35	-2.01	3.20	-1.99	1.21	-3.22
Singapore	10.35	9.35	1.00	0.08	-3.78	-3.70	4.70
Thailand	7.87	9.35	-1.48	1.80	-4.76	-2.96	1.48
Burma	-5.31	9.35	-14.66	-1.45	-1.52	-2.97	-11.69
Cambodia	-2.43	9.35	-11.78	1.70	-7.31	-5.62	-6.16
So. Vietnam	-17.67	9.35	-27.03	0.56	-8.93	-8.37	-18.66
Hong Kong	16.06	9.35	6.70	0.37	2.71	3.08	3.62
Korea, Rep.	25.71	9.35	16.36	3.97	0.96	4.93	11.43
Taiwan	19.81	9.35	10.46	4.15	-0.51	3.63	6.82
Ceylon	-1.45	9.35	-10.80	0.08	-9.00	-8.92	-1.88
India	3.42	9.35	-5.93	-0.10	-3.34	-3.44	-2.49
Pakistan	6.23	9.35	-3.12	-0.00	-6.59	-6.59	3.47
Other LDCs	6.96	9.35	-2.39	-0.03	-1.87	-1.90	-0.49
All LDCs	7.11	9.35	-2.24	0.25	-2.05	-1.80	-0.44

Among the domestic economic policies that can significantly affect export performance in both primary goods and manufactures is the development policy that emphasizes the manufacturing sector. Such policy is especially prevalent among the ASEAN countries with the exception of Singapore. The most distinctive feature is the practice of import substitution behind a tariff wall.

Tariffs are high on most items of finished products, some of which are agricultural inputs. The tariffs, therefore, directly raise the cost of production in the agricultural sector. The high input cost not only makes the processed primary exports of the ASEAN countries less competitive in the world market; in the long run, it also delays the introduction of modern technology to agriculture since technological progress generally involves the use of new inputs that have to be purchased from the manufacturing sector. Although in all ASEAN countries tariffs on agricultural machinery and insecticides are relatively low, tariffs on fuel and transport equipment are still high. The relatively slow spread of the Green Revolution could be partly explained by the high cost of inputs necessary for the cultivation of the new varieties of rice.[13]

The over-valued exchange rates designed to keep down the cost of imported industrial capital and material penalizes primary exports by raising their prices in the foreign market.

Another way of protecting domestic industries is through the operation of a multiple exchange rate system under which the rate for export is over-valued and the rate for import is under-valued the difference between each rate and the free market rate is the implicit tax on exports and imports respectively. This is to make imports relatively expensive. Until 1970 Indonesia had a multiple exchange rate system under which 90 percent of foreign exchange proceeds from primary exports were required to be surrendered to the monetary authority. This system was replaced by a 10 percent exchange tax levied on foreign exchange proceeds from exports and settled in foreign exchange.

The Thai rice export is subject to a tax, the rate of which varies, according to quality grades, being higher for higher grades.

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[13] H.S.H. Prince Sithiporn Kridakara, Some Aspects of Rice Farming in Siam (Siva Phorn, Bangkok, 1970), p.14)

The purpose is to maintain a low domestic price of rice as a form of indirect subsidy to the manufacturing industry. In effect, the tax has hampered exports by both raising the price of Thai rice in the world market and lowering the price received by rice growers.

A policy of granting tariff concessions on imports of industrial raw material is widely adopted by ASEAN countries. This type of incentive encourages expansion of the finishing stage, assembly plant-type industries relying on imported material. Forward and backward linkages are, therefore, extremely weak. There is no spread of external economies to the primary sector, delaying the pace of modernization in the primary sector thereby reduces the competitiveness of the ASEAN countries' products in the world market.

When we consider the manufacturing industry itself, the inward-looking protective policy can be said to have an adverse effect on export performance also; the high protective tariffs and, in some cases, the maintenance of over-valued foreign exchange rates create a sheltered market in which several inefficient producers can survive. Producing at high cost, they cannot compete effectively in the world market. The industrial development policy based on tariff protection also discriminates against export industries. It has been pointed out that the system of protection in the Philippines during the 1950's penalized exports heavily. Export industries were not protected from world competition but had to pay high prices for imported inputs.[14] Furthermore, over-valuation of the peso distorted the rate of return on investment in favor of industries producing for the domestic market and penalized those who produced for exports.

The combination of high tariffs on finished products and low tariffs on imported material can lead to the development of industries in which the country does not have an inherent comparative advantage; yet the country may manage to export, if there exist other distortions in the domestic economy which make it appear as if the country had a comparative advantage in certain lines of industry. Under such circumstances, the export of manufactures may lead to a reduction in welfare compared with no trade al all.[15]

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[14] John H. Power, "The Structure of Protection in the Philippines" in B. Balassa and Associates, The Structure of Protection in Developing Countries (Johns Hopkins Press, 1971), p. 284.

This type of phenomenon can become widespread in Southeast Asia unless the industries that are to be granted tax privileges are carefully selected, since in practically all ASEAN countries, the emphasis now is on export industries; for example, tax incentives are given only to industries that export a certain portion of their output.

Trade Barriers

Among the external factors that may account for the relative lack of export performance of the ASEAN countries during the past decade are the trade barriers in developed countries and in the Southeast Asian countries themselves. In general, developed countries tend to rely more on quantitative restrictions while ASEAN countries use tariff protection almost exclusively.

The most heavily protected industry in the developed countries is the textile industry. Most developed countries have one or more forms of quantitative restriction, ranging from the least restrictive liberal licensing to the most restrictive bilateral quotas and export restraint.[16] Australia employs a relatively less restrictive global quota but heavily supplements this with tariffs. Germany has the most comprehensive system of restriction on the imports of textiles and clothing articles; some of the quotas discriminate in favor of associated members of the EEC. Canned fruits are also subject to strong restrictions; Germany is the most restrictive while Denmark is the most liberal. It is also worth mentioning that most commodity items subject to strong quantitative restrictions in developed countries fall under SITC Section 6, the resource intensive basic manufactures, a group in which the ASEAN countries tend to have a comparative advantage. Also subject to restrictions are some labor-intensive manufactures such as footwear, tablewares and cuttery, and electronic equipment.

Tariff protection in the ASEAN countries usally takes the form of high rates across the board rather than a systematic escalation of tariffs that is generally practiced in developed countries. Among the developed countries, Japan and Australia have relatively

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15 H. G. Johnson, "Optimal Trade Intervention in the Presence of Domestic Distortions," in Baldwin et. al. Trade, Growth and the Balance of Payments (Rand McNally, Chicago, 1965).

16 See, for example, GATT Document L/3391/Rev. 1, 15th March 1971, Report of the Joint Working Group on Import Restrictions, Annexes I, II, and V.

high tariff barriers; these two countries are of special significance to ASEAN countries because of their proximity and rapidly rising income. Within the ASEAN group, Thailand and the Philippines have the highest tariff barriers, especially on resource-intensive basic manufactures and on labor-intensive miscellaneous manufactures. Countries that are least protected by tariffs are Sweden and Singapore.

IV Concluding Remarks

The analysis of this paper suggests that the course of the Southeast Asian countries' export performance is very much in their own hands. Although the ASEAN countries have introduced a number of rapidly growing items to their total basket of exports (e.g. vegetables, fruits, wood, and fabrics), they have not generally taken full advantage of the market opportunities available to them. This suggests that export earnings could very well be raised if these countries would adopt a shift from an inward to an outward-looking development strategy and increase their ability to keep up with world demand. As Hla Myint points out, half the battle for export expansion is won if various distortions and rigidities from import substitution are corrected.[17]

Korea's and Taiwan's policies of selective and moderate import substitution and vigorous export promotion almost certainly account for their large positive share effect and rapid export growth of manufactures. But, setting aside Singapore, a shift in strategy for the Southeast Asian countries raises special problems and constraints. And, surely, the application of East Asian experiences must necessarily be tailored to fit the conditions of Southeast Asia.

Although manufactured exports of many Southeast Asian countries have been growing rapidly and are promising, they are still small. Obviously, these countries will have to continue relying on primary and processed primary commodities as their mainstay; even promising

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[17] He goes as far as to say: "...the pessimistic assumption concerning the declining trend in the world market demand for primary exports is not applicable to Southeast Asia, and that the region should continue to enjoy rapid economic growth through export expansion during 1970's provided it adopts to the changes in the pattern of demand for its exports." Hla Myint, "Over-all Report," Southeast Asia's Economy in the 1970's, p.30.

manufactures tend to lean on their abundance of resources and labor. Thus, domestic policies and efforts designed to rectify biases against primary exports induced by import substitution measures and to increase the productivity of their huge but largely dormant agriculture can serve as a major impetus for export expansion. A policy mix that stimulates exports of both manufactures and primary products would be more appropriate and effective than that which promotes manufactures alone.

After a decade or more of import substitution, Southeast Asian countries are turning more toward export orientation. How rapidly exports of these countries actually expand depends not only on the strengthening of their competitive position but also on the extent to which the developed countries' economic policies inhibit exports from them. In this regard, it is regrettable that DCs have been slow in opening their markets and still impose considerable trade restrictions. A number of external factors contribute to sluggish world demand for some major Southeast Asian export items, yielding unfavorable commodity compositional effects. Such commodities as rubber and jute often meet with severe synthetic competition. DC's agricultural policies, their protective barriers against agricultural policies, their protective barriers against agricultural commodities (e.g. rice) and their escalated tariff and non-tariff structure are some of the other restraints on the export expansion of Southeast Asian countries.

Finally, as previously pointed out, the favorable directional effect of Southeast Asian countries has largely been due to their exports to Japan. Japan has played an increasingly important role in the export expansion of Southeast Asia, and economic interdependence between the two has become greater. But the fear of Japanese economic domination, whether real or imagined, has been subtly building up. The student demonstration and protest against her economic domination staged in Thailand recently does not appear to be an isolated incident. But two crucial questions remain. How rapidly will Japan be willing to alter its economic structure and open its market more to accommodate imports from Asian countries? Also, what will the social and political impact on Southeast Asian countries be with growing economic ties with Japan?

APPENDIX NOTE BY UDOM KERDPIBULE

Projections of Demand and Capacity to Export Manufactures by ASEAN countries

Projections for the demand for the ASEAN countries' manufactured exports have been made for two groups of importing countries; the developed countries and ASEAN itself (for intra-trade).[18] The projections are based on the values of income elasticities of demand for different commodity groups. The elasticities were, in turn, estimated by the least squares method, based on a single-equation demand function of the following form:

$$E_{ij} = f(P_j, Y)$$

The E_{ij} is the per capita value for exports of commodity j from country i, in terms of the population of the importing countries taken together. The value at constant prices was used. This value was estimated by deflating current price figures with the index for the unit value of exports of developing countries to the world for commodities under SITC Sections 5 to 8.

For the price variable P_j, two separate series of indices were used depending upon the main destination of the exports. For commodity groups that are absorbed mainly by developed countries, an adjusted index for the unit value of exports of developing countries to developed countries was used. The wholesale price indices in the developed countries were used for the adjustment. For commodity groups in which developed countries do not dominate the market, the index for the unit value of exports of developing countries to the world was used. In both cases, only the index for the aggregate of commodities under SITC Sections 5 to 8 is available and it was used in the demand function for every commodity groups. The price variable is assumed exogenous.

The income variable Y is the per capita income of the importing countries taken together, also valued at constant prices.

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[18] The developed countries include the U.S., EEC, EFTA, Australia, Hong Kong and Japan. The ASEAN group consists of Malaysia, Philippines, Singapore and Thailand only; Indonesia is left out because of the lack of data.

The model was fitted with time series data covering a period between 1954 to 1969. The statistical fit for most of the regressions are quite good with the R^2 values range from 0.84 to 0.96. The coefficients of the income variable show acceptably high degree of significance, i.e., at 0.02 level but the significance levels of the price variables are not as good. It could be that there was an identification problems inherent in the use of the single equation method. The failure to use the more precise indices for the price variable for the individual commodity groups separately could also bring the same effects. It is the lack of separate price indices that prompts the author to choose the single equation model rather than the simultaneous equation model.

The values of elasticities derived from the regressions are summarized in Table 1.

The price elasticities of the demand for exports of ASEAN as a group appear to be quite high, especially for commodities under SITC Sections 7 and 5, machinery and chemical products. This could have certain implications for possible trade expansion through tariff preferences or tariff reductions among ASEAN countries.

The income elasticities are also quite high, ranging from 3.75 to 6.60, the highest being that for machinery and transport equipment. This reflects the dominance of the ASEAN countries among the buyers of these commodities.

Based on the value of income elasticities of the demand in conjunction with a priori information on the income growth in the importing countries, projections of the demand for exports of the ASEAN countries were made for the years 1975 and 1980. Upon the projected value of exports, the compound rates of growth over the period 1969 to 1978 and 1980 were calculated. The results show varying growth rates for different countries as well as for different commodity groups (see Table 2).

Among the most rapidly growing demands for exports of different countries are basic manufactures of the Philippines, chemical products and machinery for Malaysia and machinery and transport equipment for Singapore. These reflect the intra-ASEAN demand rather than the demand from outside. For the total SITC 5 to 8, the country that could expect the most growth in exports is the Philippines; however, the largest absolute increase in exports would occur to Singapore and Malaysia.

Table 1 Elasticities of Demand for Manufactured Exports of ASEAN Countries (percent)

Commodity group	ASEAN a/	Philippines	West Malaysia	Singapore b/	Thailand
SITC 0 c/					
price elasticity	n.a.	n.a.	-0.0923	n.a.	-1.9793
income elasticity	n.a.	n.a.	1.5882	n.a.	4.5548
SITC 5					
price elasticity	-1.7740	-0.2051	-2.7362	-1.8730	n.a.
income elasticity	4.2220	1.4486	5.4173	2.1387	n.a
SITC 6					
price elasticity	-1.5377	-2.0274	n.a.	n.a.	-1.9222 d/
income elasticity	3,7550	5.4609	3.6747	n.a.	8.1007 d/
SITC 7					
price elasticity	-4.1030	n.a.	-1.0386	-2.5022	n.a.
income elasticity	6.5980	n.a.	4.0197	2.3112	n.a
SITC 8					
price elasticity	-1.1602	n.a.	-1.6296	-1.7980	n.a.
income elasticity	3.8715	n.a.	4.0016	2.6680	n.a.
SITC 5 to 8					
price elasticity	-2.0316	-2.2768	-2.1374	-1.1632	-1.5114 d/
income elasticity	4.3762	4.7008	4.8051	1.0213	7.3037 d/
All Groups					
price elasticity	n.a.	n.a.	-1.7427	n.a.	-1.6983 d/
income elasticity	n.a.	n.a.	4.1820	n.a.	6.4114 d/

a/ Without Singapore and Thailand's SITC 6.
b/ Includes reexports.
c/ SITC Sections 013, 032, 052, 055, 0713 and 0723.
d/ Includes tin.

Projections of the Capacity to Export of ASEAN Countries

As an indication of the growth of export capacity over the same period, an extrapolation of the past trends has been made. It would be more satisfactory if the projections were based on the value of parameters on the supply side but data problems prevented this. The projections based on the time trends are not very satisfactory either since some of the ASEAN countries have begun to export manufactures only recently with a very rapid growth during the second half of the 1960's.

Table 2 Projected Rates of Growth of Demand for Manufactured Exports of ASEAN Countries 1969-1975, 1975-1980 and 1969-1980[a/]

(percent per annum)

Country and period	SITC 0[b/]	SITC 5	SITC 6	SITC 7	SITC 8	SITC 5 to 8	All Groups
ASEAN[c/]							
1969-1975	n.a.	13.8	12.9	18.0	12.1	13.9	n.a.
1975-1980	n.a.	9.7	9.4	11.0	9.0	10.0	n.a.
1969-1980	n.a.	11.9	11.3	14.7	10.7	12.0	n.a.
Philippines							
1969-1975	n.a.	7.2	15.2	n.a.	n.a.	14.3	n.a.
1975-1980	n.a.	6.5	10.1	n.a.	n.a.	10.7	n.a.
1969-1980	n.a.	6.9	12.9	n.a.	n.a.	12.6	n.a.
West Malaysia							
1969-1975	7.5	16.5	10.4	14.2	13.0	13.0	12.3
1975-1980	6.7	10.6	8.3	9.8	9.4	9.4	9.1
1969-1980	7.1	13.8	9.5	11.2	11.3	11.3	10.8
Singapore[d/]							
1969-1975	n.a.	10.5	n.a.	12.4	11.5	11.7[e/]	n.a.
1975-1980	n.a.	8.3	n.a.	9.2	8.8	6.8[e/]	n.a.
1969-1980	n.a.	9.5	n.a.	10.9	10.2	10.4[e/]	n.a.
Thailand							
1969-1975	14.9	n.a.	12.2[f/]	n.a.	n.a.	11.8	12.6
1975-1980	10.1	n.a.	9.1	n.a.	n.a.	8.9	9.2
1969-1980	12.7	n.a.	10.7[f/]	n.a.	n.a.	10.5	11.0

a/ Compound rates of growth, based on values at 1964 constant prices.
b/ SITC Sections 013,032,052,055, 0713 and 0723.
c/ Without Singapore and Thailand SITC Section 6.
d/ Including re-exports.
e/ SITC Sections 5, 7 and 8 only.
f/ Including tin.

Results shown in Table 3 are likely to be underestimated because they were based on the "long period" time trends, excluding the years in which the exports increased rapidly. An interesting feature is that the capacity to export labor intensive miscellaneous manufactures (SITC 8) of the ASEAN countries would be growing much faster than the demand for them, even with the underestimated figures. The capacity to export machinery and transport equipment,

Table 3 Projected Rates of Growth of Capacity to Export Manufactures of ASEAN countries[a/]

(percent per annum)

Commodity group	1969-1975	1975-1980	1969-1980
SITC 5	13.0	13.0	13.0
SITC 6 [b/]	12.2	11.4	11.8
SITC 7	8.3	6.2	7.4
SITC 8	16.7	16.7	16.7
SITC 5 to 8	12.4	10.9	12.2

a/ Based on time trends over the period 1954-1964, excluding Singapore.
b/ Excluding Thailand.

on the other hand, is likely to be lagging behind the growth in demand. This suggests the need for ASEAN countries to develop new markets or expand the existing ones for labor-intensive manufactures, and the possibility of developing a large-scale machinery industry on a regional basis.

The projections discussed above were made under the assumption that prices, industrial development policies and trade policies of the countries involved remain unchanged. In view of the fact that the emphasis of the industrial development policy of the ASEAN countries is changing from import substitution to manufactures for export, the growth of the capacity to export would be higher than the figures indicate. On the demand side, the growth of the demand for the export would also be somewhat different from what the figures indicate. On one hand, it is likely that Japan would gradually relax its restrictions of imports from developing countries. This is because of the mounting foreign exchange reserves from the persistent trade surplus which prompts pressure for the revaluation of the yen. Besides, political pressure in Southeast Asia is also calling upon Japan to play a more active part in the development of Southeast Asia. It could therefore be expected that trade restrictions on exports of developing countries, would be gradually liberalized, especially on items for which the ASEAN countries have a comparative advantage. On the other hand the tariff preferential arrangements between the Philippines and the U.S. are due to terminate in 1974. The termination will adversely affect the demand

for exports of the Philippines and, of course, our projected figures.

If the export-oriented industrial policy of the ASEAN countries is successful and Japan agrees to liberalize the trade policy, we could expect a substantial expansion of trade beyond what the projected figures indicate. If, on the other hand, the growth of demand is not so favorable, the ASEAN countries would face a problem of over-production with a consequent deteriorating terms of trade. The ASEAN countries would have to rely on themselves to absorb the surplus. Regional cooperation and mutual tariff reduction may become necessary.

Appendix Table 1

Imports of DCs from the World and LDCs, Commodity Composition and Annual Growth (in %)[1]

Commodity	Commodity Composition, 1968				Average Annual Growth Rate, 1962-1968			
	World	LDCs			World	LDC		
		Total	Asia			Total	Asia	
			Total	ASEAN			Total	ASEAN
Total Imports[2]	100.00	100.00	100.00	100.00	9.4	7.1	7.6	5.8
Primary	40.62	79.88	62.65	93.32	6.1	5.6	4.1	5.3
excluding fuels	29.67	45.56	57.32	82.10	5.3	3.5	4.0	5.5
Manufactures	57.62	19.15	35.81	5.97	11.9	14.0	15.2	13.3
Primary Products								
1. Fish	0.99	1.10	1.61	1.02	8.13	11.68	23.59	31.89
2. Rice	0.11	0.16	0.44	0.53	7.57	-1.11	-4.11	1.49
3. Maize	0.79	0.78	0.52	1.18	6.73	6.99	15.22	15.32
4. Fruits	1.97	3.83	3.26	2.17	5.14	7.87	12.48	10.43
5. Vegetables	1.02	1.20	2.02	1.54	5.93	7.13	17.15	10.72
6. Sugar	0.95	3.08	3.36	5.05	4.42	3.45	-0.42	-0.30
7. Coffee	1.48	6.57	1.02	1.98	4.34	4.17	14.89	16.09
8. Cocoa	0.43	1.63	0.04	0.06	6.48	10.04	10.62	15.40
9. Tea	0.28	1.18	4.53	0.76	-1.05	-1.69	-3.21	5.62
10. Spices	0.07	0.23	0.58	1.06	4.73	2.91	0.91	9.24
11. Animal feed	0.88	1.57	0.95	1.03	8.27	3.83	-3.39	12.90
12. Beverages	0.87	0.33	0.01	0.03	5.21	-14.80	6.89	7.47
13. Tabacco	0.68	0.55	1.28	1.20	4.00	-4.07	4.68	-1.70

Appendix Table 1 (Continued)

Commodity	Commodity Composition, 1968				Average Annual Growth Rate, 1962-1968			
	World	LDCs			World	LDC		
		Total	Asia			Total	Asia	
			Total	ASEAN			Total	ASEAN
14. Hides & skins	0.36	0.42	0.23	0.32	2.21	-0.05	-7.95	9.06
15. Copra, etc.	0.96	1.63	2.94	6.73	5.07	0.16	3.91	4.82
16. Rubber	0.60	1.71	9.95	15.16	-0.96	-4.40	-4.63	-3.80
17. Wood & lumber	2.35	2.86	8.12	16.83	8.56	10.26	13.13	13.76
18. Silk	0.07	0.06	0.26	0.0	5.21	20.31	19.55	0.0
19. Wool	1.00	0.62	0.21	---	-2.80	-4.88	-10.81	-23.18
20. Cotton	0.87	2.49	1.00	---	0.30	0.62	2.15	33.00
21. June	0.09	0.37	1.73	0.64	-1.62	-2.40	-2.42	-0.27
22. Other fibers	0.40	0.29	0.48	0.59	4.11	-8.62	-7.04	-11.84
23. Iron ore	1.72	3.08	3.54	2.41	6.90	6.52	2.99	-5.32
24. Non-ferrous metals	1.71	3.04	2.98	5.29	12.13	8.02	12.15	14.91
25. Other crude materials	0.66	0.74	1.30	0.73	5.30	3.37	1.81	4.30
26. Nut (coconut) oils	0.24	0.88	2.16	4.75	5.22	6.01	14.86	16.71
27. Tin	0.26	1.00	4.18	9.81	7.75	8.94	9.42	9.35
28. Other (non fuel)	7.84	4.14	1.58	1.23	5.54	0.35	1.52	2.36
29. Mineral fuels	10.95	34.32	5.33	11.22	8.48	8.87	4.51	4.43
Manufactures								
30. Perfume materials	0.17	0.16	0.17	0.11	8.87	2.88	-4.79	14.03
31. Leather	0.35	0.43	1.30	---	8.63	13.06	10.85	33.00
32. Plywood & veneers	0.52	0.62	2.15	1.80	13.06	17.63	20.68	15.46
33. Other wood products	0.17	0.09	0.24	0.16	6.92	18.17	20.72	25.74

Appendix Table 1 (Continued)

Commodity	Commodity Composition, 1968				Average Annual Growth Rate, 1962-1968			
	World	LDCs			World	LDC		
		Total	Asia			Total	Asia	
			Total	ASEAN			Total	ASEAN
34. Paper & products	1.64	0.02	0.03	---	7.74	0.74	12.64	0.0
35. Yarn & thread	0.88	0.21	0.48	0.02	8.18	8.40	4.14	33.00
36. Cotton fabrics	0.52	0.59	2.52	0.12	3.34	8.64	8.01	23.10
37. Non-cotton fabrics	1.27	0.87	3.96	0.04	7.52	7.70	7.55	14.49
38. Other fabrics & products	1.02	0.77	1.90	0.16	9.25	6.26	6.41	12.19
39. Mineral manufactures	1.18	0.11	0.19	0.01	9.21	11.14	19.53	33.00
40. Precious stones	1.25	1.40	1.49	0.36	19.35	21.39	22.33	27.48
41. Non-electric machinery	9.44	0.23	0.31	0.09	10.17	10.18	8.55	-2.11
42. Electric machinery	4.41	0.70	2.60	0.01	11.79	26.24	27.25	-17.80
43. Transport equipment	9.00	0.17	0.22	0.19	16.05	1.65	15.02	24.08
44. Sanitary fixtures	0.22	0.04	0.16	0.01	13.00	11.43	9.99	10.10
45. Furniture	0.42	0.05	0.14	0.02	17.68	13.89	10.18	12.98
46. Handbags, etc.	0.13	0.12	0.50	---	15.15	25.60	27.42	33.00
47. Clothing (non-fur)	1.87	2.13	9.22	1.74	13.82	17.37	17.44	9.72
48. Footwear	0.62	0.26	1.11	0.05	15.35	19.84	19.94	22.72
49. Toys, etc.	0.51	0.36	1.49	0.01	15.03	22.45	21.58	4.72
50. Jewelry, etc.	0.15	0.07	0.27	0.01	7.06	11.75	13.93	13.60

Appendix Table 1 (Continued)

	Commodity Composition, 1968				Average Annual Growth Rate, 1962-1968			
	World	LDCs			World	LDC		
		Total	Asia			Total	Asia	
			Total	ASEAN			Total	ASEAN
51. Other manufactures	21.91	9.74	5.34	1.05	11.78	13.76	18.98	22.70

Notes 1: DC includes the U.S., Japan, Australia, New Zealand, Canada, the EEC, the U.K., and other Europe (Denmark, Finland, Norway, Sweden, and Switzerland).
- The growth rate refers to the one-third the rate calculated with the average value of 1962 and as the base and 1968 as the end period.
2: The total includes SITC 9 which is not listed.
Source: U.N., Commodity Trade Statistics, (various issues).

Appendix Table 2

Commodity Composition and Direction of Southeast Asia's Exports, 1962 and 1967 (in %)[a]

	Total		Primary Products[b]		Manufactured Products[b]	
	1962	1967	1962	1967	1962	1967
Commodity Composition of Exports						
Total	100.0	100.0	81.6	79.2	17.0	19.4
Developed Countries	100.0	100.0	87.1	80.9	12.0	18.0
U.S.	100.0	100.0	79.2	67.6	20.5	31.8
Japan	100.0	100.0	93.4	90.0	6.3	9.7
Intra-Asian	100.0	100.0	68.3	73.9	29.1	23.8
Intra-S.E. Asia	100.0	100.0	64.5	69.5	32.6	27.9
Direction of Exports						
Total	100.0	100.0	100.0	100.0	100.0	100.0
Developed Countries	58.1	57.4	62.0	58.7	41.0	53.1

Appendix Table 2 (Continued)

	Total		Primary Products[b]		Manufactured Products[b]	
	1962	1967	1962	1967	1962	1967
U.S.	17.5	18.2	17.0	15.5	21.1	29.7
Japan	13.7	18.8	15.6	21.3	5.1	9.3
Intra-Asian	31.5	33.5	26.4	31.3	54.0	41.1
Intra-S.E. Asian	25.7	26.0	20.3	22.8	49.3	37.3
Director of Intra-Asian Exports						
Total	100.0	100.0	100.0	100.0	100.0	100.0
S.E. Asia	81.6	77.5	77.0	72.9	91.3	90.8
ASEAN	77.3	65.3	72.8	59.3	87.3	82.1
East Asia	13.1	15.9	17.6	19.6	3.5	5.0
South Asia	5.3	6.6	5.4	7.5	5.2	4.2

a. See Table 2 for the countries grouped but Burma and Indonesia are excluded due to their insufficient data.
b. Primary products include SITC 0 through 4 whereas manufactures cover SITC 5 through 8.
Source: U.N., Commdity Trade Statistics, (various issues).

Appendix Table 3

Direction, Share and Expansion of Total Imports of DC from LDC groups (in %)*

	Imports of								
	All DC	U.S.	Japan	Canada	Aust-ralia	New Zeal.	Common Market	U.K.	Other Europe
Direction (1968)									
World	100.0	20.7	8.1	7.1	2.4	0.6	38.6	11.8	10.7
LDCs	100.0	25.5	15.1	2.8	1.6	0.4	36.0	13.8	4.9

Appendix Table 3 (Continued)

	Imports of								
	All DC	U.S.	Japan	Canada	Aust-ralia	New Zeal.	Common Market	U.K.	Other Europe
Other	100.0	23.3	11.9	2.9	1.0	0.3	41.5	13.8	5.3
Asia	100.0	33.6	26.7	2.5	3.6	0.7	15.9	13.8	3.2
S.E. Asia	100.0	29.4	37.4	1.3	4.2	0.4	18.0	6.2	3.2
ASEAN	100.0	30.3	38.1	1.3	3.7	0.4	17.4	6.0	2.8
Other	100.0	3.5	19.1	0.0	17.8	0.7	33.9	11.1	14.0
East Asia	100.0	50.7	14.0	4.4	2.5	0.7	10.4	13.3	3.9
South Asia	100.0	22.7	19.7	2.6	4.0	1.2	18.3	28.8	2.7
Share (1968)									
World ($Mil)	(160.326)	(33,114)	(12,988)	(11,431)	(3,858)	(896)	(61,055)	(18,958)	(17,125)
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
LDCs	21.6	26.7	40.3	8.6	14.2	15.6	20.2	25.2	9.8
Other	17.0	19.2	25.0	6.9	7.2	9.7	18.3	19.8	8.5
Asia	4.6	7.6	15.3	1.6	6.9	5.8	1.9	5.4	1.4
S.E. Asia	2.0	2.9	9.4	0.4	3.5	1.4	1.0	1.1	0.6
ASEAN	2.0	2.9	9.3	0.4	3.0	1.4	0.9	1.0	0.5
Other	0.1	0.0	0.2	0.0	0.5	0.1	0.1	0.1	0.1
East Asia	1.4	3.3	2.4	0.8	1.4	1.7	0.4	1.5	0.5
South Asia	1.2	1.3	2.8	0.4	1.9	2.6	0.5	2.8	0.3
Annual Growth Rate									
World	9.4	11.4	13.2	10.8	9.1	4.5	8.9	6.8	7.1
LDCs	7.1	6.5	13.9	6.2	4.7	9.2	7.0	2.8	7.8
Other	7.0	5.1	15.6	5.5	5.5	13.4	7.2	3.6	8.1
Asia	7.7	10.6	11.5	9.3	3.9	3.6	5.1	0.4	6.1

Appendix Table 3 (Continued)

	Imports of								
	All DC	U.S.	Japan	Canada	Aust-ralia	New Zeal.	Common Market	U.K.	Other Europe
S.E. Asia	5.2	5.1	10.1	6.6	1.5	-2.4	2.1	-3.5	1.3
ASEAN	5.8	5.3	10.4	6.6	1.3	-3.3	3.4	-1.5	0.8
Other	-7.1	-13.5	-1.3	0.0	2.8	33.3	-9.9	-18.1	4.6
East Asia	18.3	21.6	15.9	21.8	17.3	14.3	18.8	9.8	18.3
South Asia	3.2	3.3	15.9	-2.6	1.7	2.2	3.8	-1.8	2.2

* See Appendix Table 1 for explanations.

Comments and Discussion of Naya and Kerdpibule's Paper

Chong-ki Choi offered the following comments: This paper is impressive and offers much valuable information about Southeast Asia's trade policies and the problems of trade expansion.

The authors have explained the characteristics of the Southeast Asian region's economic structure and placed particular emphasis on the abundant supply of skilled and semi-skilled labour. Southeast Asian countries also have similar climatic and topographic conditions and therefore tend to have similar economic structures. But the authors did not mention their past colonial experience. As most of them attained independence only recently, they are very sensitive about national sovereignty. Also in this area their political situation tends to be unstable and the political and social systems are not homogeneous. Racial strife and the heterogeneity of socio-cultural traditions also lead to a lack of mutual confidence. But most of them eagerly desire to promote economic development and export expansion.

During the past decade Southeast Asian countries witnessed two major events: one is the so-called Green Revolution; and the other the deliberate attempt to accelerate the pace of industrial development. The Green Revolution is a dynamic force; a reduction in the price of rice is equivalent to an increase in real income which can be spent on manufactures. The lower price of rice also helps keep down the cost of living and money wages and these two factors together help accelerate industrialization.

I agree that the adoption of industrial development policies by the Southeast Asian countries based on import substitution is a pattern shared by many less developing countries. Such a policy is considered desirable in helping to develop both the manufacturing sector and to lighten the burden of deficit in the balance of trade. Industrial output has grown rapidly, but it may soon reach its limit because of the shallowness of the domestic market.

Southeast Asian countries are now realizing the defects of import-substitution policy and have been gradually shifting their emphasis to export-oriented industries. The authors point out that the shift to export-orientation may be more difficult for the Southeast Asian countries than East Asian countries since there has been relative little pressure in this direction in the past, and their relatively abundant natural resources have been absorbed in catering for minimum subsistence. It seems to me that industrialization efforts in Southeast Asian countries are lacking. I think, there needs to be more investment in industry. Without such industrial activities, we cannot expect the trade expansion of the Southeast Asian countries to progress rapidly.

The authors seem to have neglected the effect of the climatic conditions on the economic development effort. Also level of the education and the technical know-how of the population in the Southeast Asian region is lower than in East Asian countries.

Finally, I think more importance should be given to political leadership and political and social stability. East Asian countries seem to have more political and social stability and strong leadership than Southeast Asian countries.

In Part Two of their paper the authors described clearly Southeast Asian countries' export performances. Note should be taken of the fact that intra-regional exports grew more slowly than trade with developed countries. Japan and the United States are the region's largest trading partners. I wonder how those countries can maintain their trading relationship with Japan and the United States forever?

The author says that in order to promote trade expansion in the Southeast Asian region, there is a need for regional economic integration. I can fully understand this from the political point of view. But there is a question: what kind of economic co-operation and economic integration can be implemented and what benefits will be brought to the Southeast Asian countries? It seems to me that Malaysia, Indonesia and the Philippines have more extensive trade relations than other Southeast Asian countries, but why in the past decade has the movement towards economic co-operation been so slow and ineffective?

I would also welcome some explanation of the role of foreign

capital and domestic saving for economic development in the Southeast Asian countries.

Professor Kojima has suggested that East Asian countries, including South-North Korea, Taiwan and Hong Kong should form an economic bloc and jointly approach Mainland China. What do you think of this idea, and do you think it feasible to have economic co-operation between Southeast Asian countries and East Asian countries, for example, economic co-operation within the ASEAN and ASPAC group of countries?

Discussion focussed on the reconstruction and development of the Indonesian economy, the problems of an increasingly protectionistic policy, the dependence of Southeast Asia on Japan, the authors' replies to questions raised by Chong-ki Choi.

First, Seiji Naya pointed out that it was difficult for Southeast Asian countries to shift to export-oriented policies because of the important revenue considerations behind tariff policies; the size of the agricultural sector and its organization; and the slow growth of traditional export commodities. More detailed study would reveal fast growth commodities such as maize, shrimps, and wood products, but rapid growth has to rely heavily on the 'share effect'. Another problem has been the failure of such countries as Thailand and the Philippines to introduce export promotion measures to complement import substitution programs from the beginning. And there has also been heavy reliance on protectionistic measures to solve balance of payments problems.

Foreign investment appeared to be more of a social than an economic problem for most Southeast Asian countries.

As for the scope for regional integration, although intra-regional trade in Southeast Asia has been high by the standards of other less developed areas, it has been declining, especially among ASEAN countries. This has resulted from regional protectionism, overvaluation of currencies vis à vis developed countries, and data problems. However, the authors felt that co-operation was possible and would lead to increased stability in export earnings, rationalization of regional industrialization, and stronger bargaining power in trade and other economic relations.

Important changes in the Indonesian economy, not discussed in the paper, were elaborated by one participant. First, the recent census

seems to suggest maintenance of a high rate of population growth. Secondly, the rate of growth of regional exports has been 5 percent since 1966, but for Indonesia the growth rate has been 10 to 13 percent. This is partly a recovery factor but, oil, timber and foodstuffs exports to Japan, notably, have continued rapid growth. Perhaps the size of the Indonesian market recommends some inward lookingness in development policies, although the excesses of import substitution are being avoided by Indonesian policy makers. Two major problem areas are the growth of labour availability and the heavy dependence on foreign investment, especially from Japan. But the extent to which rising domestic demand is being met from local industry, such as textiles, construction, and petroleum, is encouraging.

Another participant suggested that this represented an excessively optimistic view of the success of Indonesian policies. Indonesia was one of the worst examples of industrialization without employment, it was suggested, and income distribution worsened this distortion.

The same participant accused Southeast Asian countries of a failure to respond to the best advice in correcting protectionist policies, and fragmenting markets through licensing and manufacturing arrangements with foreign firms. This combination of wrong policies induces persistent balance of payments problems.

Finally, several participants raised the problem of over dependence in trade and investment on Japan. The assymetry in dependence was noted as, too, was the effect, or potential effect, of Japan's attempts at diversification in trade and investment. A Japanese economist suggested a 'peril point' approach to the trade dependence problem by Japanese policymakers.

6

LATIN AMERICAN GROWTH AND TRADE STRATEGIES IN THE POST-WAR PERIOD

Miguel S. Wionczek

The terms of reference of my paper - as I understand them - call for the general assessment of the Latin American foreign trade performance in the recent past and particularly of the role of the export growth in the present and the future economic development of that region, because as the prospectus for this Conference distributed last summer postulated the economic growth of the developing areas depends very much upon their export expansion. Under present conditions of the world economy and trade this expansion in turn poses problems both of shifts in policies from import substitution to export promotion and determination of proper industrial priorities for export. Moreover, whatever shifts are made and priorities defined on a country or a region level, the final results of the new trade and development policies will largely depend upon trade policies and structural adjustments in advanced countries.

Covering these topics for the Latin American subcontinent as a whole is not an easy task. Seen from the other side of the Pacific, Latin America may look as a more or less homogenous unit, considerably more developed than either Africa or the eastern and southeastern rim of Asia extending from Korea to Pakistan. But a closer look at the subcontinent strongly suggests that Latin America is hardly more than a geopolitical and geoeconomic concept. Twenty five economic indicators for Latin American republics (that exclude Cuba and four ex-British colonies in the Caribbean that have gained the independence recently - Jamaica, Trinidad, Guyana and Barbados), contained

in Table I, disclose that the regional quantitative averages hide in practically every respect tremendous differences within the region.

Some examples are here in order. As shown in Table I population-wise the region comprises giants like Brazil (90 million people in 1969) and mini-states like Panama (1.4 million); the annual demographic growth rates vary from 3.8 percent in Costa Rica to 1.1 percent in Uruguay; the average annual GDP growth oscillated in the sixties between 8 percent in Panama and -0.3 percent in Haiti; the per capita product ranges (1969) between US$980 in Argentina and US$98 in Haiti; population employed in agriculture accounts for close to 67 percent of labor force in Honduras and only 15.6 percent in Argentina; annual prices increases differed in the sixties from 47.5 percent in Uruguay to 0.4 percent in El Salvador, investment coefficients as percentage of GDP were in 1969 as high as 23.7 percent in Paraguay and as low as 5 percent in Haiti. Finally in respect to the importance of foreign trade for the individual economies, one witnesses on the one end of the spectrum countries such as Brazil with about 6 percent of exports and imports as the ratio of the GDP and on the other - Panama with export coefficient of 39 percent and Honduras with import coefficient of 32.6 percent.

Traditionally, one looks at the subcontinent as a conglomerate, composed of three large and semi-developed economies (Argentina, Brazil and Mexico), a half a dozen intermediate developing countries (like Venezuela, Colombia, Peru or Chile) and about a dozen republics that inspite of the large territorial size of some (Bolivia or Paraguay) represent the hard core of Latin American underdevelopment. In fact, however, the picture is much more complicated. The region includes semi-industrial and also heavily agriculture-based economies rapidly growing in conditions of relative financial stability and more or less solid structural balance of payments position; stagnant semi-industrial and agricultural economies with high degree of inflation and increasing external sector constraints; economies with similar productive structure but highly dependent in some cases on public domestically-financed investment and in others - on private foreign capital; dynamic as well as stagnant economies with different degrees of dependence on foreign trade; economies with fairly developed financial structures along with those lacking rudimentary network of financial intermediaries, etc.

If additional economic indicators at national level were included

Table I Regional Differences within the Major-Indicators of Economic Growth in Latin America during the 1960's

	Average	Highest	Lowest
Population (19 countries) (millions 1969)	13.6	90.6 Brazil	1.4 Panama
Annual growth rates of GNP (1959-1969)	5.4%	8.0% Panama	1.1% Uruguay
Annual population growth (1960-1969)	2.9%	3.8% C. Rica	1.3% Uruguay
Annual per capita growth rate of GNP(1960-1969)	2.5%	4.8% Panama	-0.3% Haiti
GDP per capita 1969	514 Dls.	980 Dls. Argentina	98 Dls. Haiti
GDP per employed person (at 1960 prices)	1,269 Dls.	2,628 Dls. Argentina	216 Dls. Haiti
Percentage of population employed in industry and basic services 1969	--	36.9% Argentina	12.3% Honduras
Rate of growth of industrial output (1959-1969)	6.4%	9.3% Nicaragua	0.9% Uruguay
Percentage of pupulation empoyed in agriculture 1969	--	66.9% Honduras	15.6% Argentina
Rate of growth of agricultural output (1959-1969)	3.5%	5.4 C. Rica	1.4% Uruguay
Average annual changes in consumer prices (1960-1969)	--	47.1% Uruguay	0.4% El Salvador
Participation of agriculture in GDP 1969	17.3%	45.9% Haiti	7.8% Venezuela
Changes in the relative participation of industry and basic services in GDP between 1960 & 1969	--	37.7% Honduras	-2.2% Venezuela
Changes in the relative participation of employment in agriculture between 1960 and 1969	--	- 22.2% Venezuela	-3.8% El Salvador
Changes in the relative participation of empolyment in industry and basic services between 1960-1969	--	15.6% Panama	-6.9% Ecuador
Participation of capital and intermediate goods in total industrial output 1969	--	60.1% Argentina	8.1% Guatemala
Direct taxes as percentage of the total tax revenue 1967-1968	--	67.6% Venezuela	22.5% Guatemala
Ratio between government savings and public investment 1967-1968	--	123.8% Ecuador	7.1% Bolivia
Investment coefficient of GDP 1969	19.6%	23.7% Paraguay	5.0% Haiti
Participation of net foreign financing in total investment, average 1967-1969	7.1%	43.4% Dom. Rep.	-1.4% Uruguay
Participation of public sector in total fixed investment, 1969	--	58.6% Chile	17.2% Uruguay
Export coefficient of GDP, average 1967-1969	10.7	39.0% Panama	6.1% Brazil
Import coefficient of GDP, average 1967-1969	9.8	32.6% Honduras	12.3% Honduras

Source: ECLA, Economic Survey of Latin America, annual issues corresponding to the years 1964-1971.

in Table I, one would face a whole universe of socio-economic development models, starting with highly centralized socialist or semi-socialist economies, passing through those with the large degree of state intervention and participation and ending with almost free-market economies. Combining the characteristics of economic structures, political and economic policy instruments and social objectives one would discover in Latin America an even more impressive array of socio-economic performance. In terms of historical comparisons and using such indicators as literacy and income distribution, one finds in the area the societies clearly still at the beginning of the present century, side by side with those whose degree of modernization is somewhat similar to that reached by the industrial countries between the two world wars. Moreover, even in the most advanced in respect to the level of per capita income Latin American republics it is easy to detect the socio-economic intra-regional and intra-sectoral dualism - the presence of dynamic growth poles and the depressed areas together with the coexistence of modern and traditional low productivity activities in each of the major economic sector.

Only once these deep differences present among and within Latin Amirican republics are clearly established, one can search for the similarity of their economic development patterns in the past quarter of centry with particular stress upon the behaviour of the external sector. Between 1945 and 1970 Latin America as a whole - but with the different intensity and degree of success reflecting the inequalities in development levels - tried successively three development strategies: import substituting industrial policies on national level, regional trade integration, and developing manufacturing for the extrazonal markets. The instruments, mechanics and results of each of these stages will be commented upon briefly in the remaining sections of the paper.

I. Import-Substitution Oriented Industrialization: Policies and Problems

Modern quantitative economic history is a very recent social discipline largely cultivated in the advanced countries, where the wealth of long-term statistical data series have been discovered, processed and analyzed lately.[1] Such economic history has not been written yet for Latin America as a whole although the first valiant attempts that go back to the colonial times of the region and of major countries and end with the analysis of the post-war develop-

ments have seen light in the past few years.[2] The difficulties of writing an economic history of the modern Latin America can be deducted from the introductory remarks of this paper. Fortunately enough, the literature of the import-substituting industrialization period is fairly abundant and of relatively high quality, although as a rule it covers only the 1945-1970 period experiences.[3]

This does not mean - as some believe - that import substitution industrialization started in Latin America during the Second World War. Its beginnings can be traced back in Brazil to the third quarter of XIX century and in Argentina and Mexico to the 1880's. Thus, it

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1 The most outstanding examples of this literature are represented by the contributions of Simon Kuznets, Modern Economic Growth - Rate, Structure and Spread (Yale University Press, New Haven, 1966); W.G. Hoffmann, The Growth of Industrial Economies (Manchester University Press, Manchester 1958); Alexander Gerschenkron, Economic Backwardness in Historical Perspective (Harvard University Press, Cambridge, Mass., 1962); Charles P. Kindleberger, Economic Growth of France and Britain, 1851-1950 (Harvard University Press, Cambridge, Mass. 1964) and E.J. Hobsbawn, Industry and Empire (Weidenfeld & Nicholson, London, 1968).

2 For example, Stanley J. and Barbara H. Stein - The Colonial Heritage of Latin America - Essays on Economic Dependence in Perspective (Oxford University Press, New York, 1970) and various authors La historia economica en America Latina, Vol. I -Situación y metodos, Vol. II, Desarrollo, perspectivas y bibliografia (Collection of essays presented at the 39th International Americanist Congress, Lima, 1970, SEP/SETENTAS, Mexico, 1972).

3 The major contributions in this field are represented by ECLA, The Process of Industrialization in Latin America (New York, 1965); ECLA, Economic Survey of Latin America, 1970 (New York, 1971); Keith Griffin, Underdevelopment in Spanish America - An Interpretation (George Allen and Unwin Ltd. London, 1969); Santiago Macario, "Protectionism and Industrialization in Latin America, Economic Bulletin for Latin America, (Santiago, Vol. X, No. 1, March 1965); Albert O. Hirschmann, "The Political Economy of Import Substituting Industrialization in Latin America" in A Bias for Hope - Essays on Development and Latin America (Yale University Press, New Haven, 1971, pp.85-113); S. Sideri, "The Industrial Development Deadlock in Latin America: From Import Substitution to Export Promotion?", Development and Change, (The Hague, 1971-72, Vol.III, No.2, pp.1-17) and Werner Baer, "Import Substitution and Industrialization in Latin America: Experiences and Interpretations", Latin American Research Review (Austin, Texas, Vol.VII, No.1, Spring 1972, pp.95-122).

For analysis of import substituion experiences of major Latin American republics, see among others, recent books and articles by Carlos F. Diaz-Alejandro, David Felix and Aldo Ferrer (on Argentina); Werner Baer, Paul G. Clark, Nathaniel Leff and Maria Conceicao Tavares (on Brazil) and Roger Hansen, Leopoldo Solis and Clark W. Reynolds (on Mexico). References to some studies of the same problems in Central America, Chile, Colombia and Peru can be found in Werner Baer's review essay quoted above.

followed by some 25-30 years the import-substituting industrialization model adopted in Europe and the United States in the middle of the past century, transfigured there after a period of initial industrialization ended, around 1900, into industrial specialization among all advanced countries. The "early-comers" in the import-substituting industrialization (continental Europe, the United States and later British white dominions and Japan) aimed at breaking the hold of the British industrial empire over the world economy. The "latecomers" like Latin America attempted in turn to break out of the world division of labor that become consolidated in the early part of the present century, leaving for this subcontinent, Asia and Africa the role of suppliers of foodstuffs and raw materials and importers of manufactured goods from North Atlantic area.

While the long-range historical analysis falls beyond the scope of this paper, it may be pertinent to recall that while Latin American industrialization in the 1880-1914 period did not amount to much, it received strong impetus from the First World War, the Great Depression and the Second World War when because of the severe dislocations of the international economic system the subcontinent faced concurrently extreme stortages of imported consumer manufactures and the slow but constant demand for sucu goods, particularly in the rapidly growing urban areas. It is of common knowledge, however, that the import-substituting industrialization became in Latin America a deliberate and principal policy tool only after the end of the last World War. As the ECLA literature of the fifties has been insisting[4] and the later studies have proved,[5] after 1945 Latin America together with the rest of the underdeveloped world faced relatively slow growth of world demand for its traditional exports and consequently was forced into alternative economic strategies promising more dynamic growth, particularly in face of demographic explosion and large migrations of labor force from rural to urban areas.

[4] See on this point, among others, ECLA, The Economic Development of Latin America and Its Principal Problems (United Nations, 1950); ECLA, International Cooperation in the Latin American Development Policy (United Nations, 1954) and Raul Prebisch "Commercial Policy in the Underdeveloped Countries", American Economic Review. 1959, Vol. 49, pp. 251-273.

[5] Among abundant literature on this subject, see, for example, Don Humphrey, American Imports, (The Twentieth Century Fund, New York, 1955); Bela Balassa, Trade Prospects for Developing Countries (Richard Irwin Inc., Homewood, Ill., 1964) and UNCTAD, Trade Prospects and Capital Needs of Developing Countries (New York, 1968).

For the purpose of creating modern industrial structure that was to diminish Latin American dependence upon the world economy a surprisingly large number of policy instruments were put to work in Latin America in the fifties. In his critical appraisal of the import-substituting industrialization experiences of the subcontinent Werner Baer mentions protective tariffs and/or exchange controls; special preferences for domestic and foreign firms importing capital goods for new industries; preferential import exchange rates for industrial raw materials, fuels and intermediate goods; cheap loans by public development banks for favored industries; the financing by the state of infrastructure designed to foment industrial activities; and the direct participation of government in certain industrial sectors, especially the heavy ones, which in some cases were considered "politically strategic" and, in others, where no private financial resources, domestic or foreign, were available.[6] While this list of policy instruments is far from complete, it is interesting to note first, that it contains almost exclusively financial, fiscal and monetary measures; second, that it looks very similar to the array of policy instruments used by the "earlycomers" in the United States and continental Europe one century ago, and third, that while it puts emphasis on capital accumulation in the private sector (by effects of protection and open and hidden State subsidies to the manufacturing sector), very little has been done in respect to improvement of domestic human capital and technological infrastructure. According to leading students of the present economic growth performance in the advanced countries these two factors are largely responsible for the acceleration of growth rates in the developed world in the past quarter of century.[7]

In the light of the unequal development levels and the varying

6 Werner Baer, "Import Substitution and Industrialization...", op. cit. p. 98.

7 Simon Kuznets, op.cit. Simon Kuznets, Economic Growth of Nations; Total Output and Production Structure (Harvard University Press, Cambridge, Mass., 1971); Edward F. Denison (assisted by Jean-Pierre Poullier); Why Growth Rates Differ: Post War Experience in Nine Western Countries (The Brookings Institution, Washington, D. C., 1967); Angus Maddison, Economic Growth in the West - Comparative Experience in Europe and North America (The Twentieth Century Fund, New York, 1964), among others. While Kuznets is widely known for his statement that "the cause of economic growth is knowledge", the Maddison's study postulates that "...the basic problems of an economic growth policy ...are not technical but political and institutional", op.cit. p. 22.

size of domestic markets the results of import-substituting industrialization differed considerably in Latin America. While no clear pattern of the coherent economic development strategy can be discerned even in the major countries of the area, the promotion of new industries was in most, if not all, cases indiscriminate, the mix of policy instruments largely improvised, and the appearance of new manufacturing activities reflected as a rule the existing demand profile defined by two major non-economic factors - inherited income distribution patterns and the demonstration effect of the consumption patterns in the advanced high-income countries upon the upper and middle-income sectors of Latin American societies.

In respect to the overall import-substituting industrialization performance three major patterns can be discerned in the region. In the small and most of the intermediate underdeveloped republics import substitution has never passed the consumer industries stage;[8] in others, like Argentina, Chile and Venezuela - in David Felix words-

> ...the initial industries are generally consumer goods or building materials products with a relative simple technology and a low capital requirement per worker and per unit of output. Then they are followed by consumer goods industries requiring a more sophisticated technology and larger capital outlay, shading subsequently into industries producing relatively complex consumer durables, steel, engineering and chemical products.[9]

Only in Brazil and Mexico some kind of strategy was adopted by the State aimed at maximum vertical integration: the simultaneous promotion of final consumer goods industries (generally in the private hands) and intermediate and capital goods (owned or heavily subsidized by the State).

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8 In the Caribbean and Central America even that stage has not been reached. Imports of consumer goods were substituted by and large by assemblying activities with fractional domestic value added. For analysis of this "spurious" industrialization process see, among others, Miguel S. Wionczek, "The Central American Common Market" in Peter Robson (ed.), International Economic Integration, (Penguin Modern Economic Readings, Penguin Books, Ltd, London, 1971) and Philipp C. Schmitter, Autonomy and Dependence as Regional Integration Outcomes (University of California Institute of International Studies, Berkeley, 1972).

9 David Felix, "Monetarists, Structuralists and Import-Substituting Industrialization: A Critique", in Werner Baer and Isaac Kerstenetzky (editors), Inflation and Growth in Latin America, Richard Irwin Inc., Homewood, Ill., 1964, p. 383).

In face of heavy protection, faulty fiscal systems, high consumption coefficients of the upper and middle-level income sectors and the haphazard allocation of resources among new manufacturing activities, it can hardly surprise anyone that the political, welfare and financial price of the Latin American import substituting strategy of the fifties and the sixties was much higher than expected by the ECLA ideologists of the early post-war period who had claimed then that import-substituting industrialization would bring to Latin America greater economic and ipso facto political independence from the advanced world.

The ECLA's early position could be defended by pointing out that that regional "brain trust" did not postulate autarkic industrialization on national level that eventually prevailed in the region, and that ECLA was not in the position to foresee the changes in the world industrial production structure due to the intensity of technological progress and the successful emergence of giant transnational industrial corporations. According to the ideological father of that development strategy, Raul Prebisch it was about to be exhausted by the late sixties:

> The possibilities of intensifying the rate of substitution in recent years exclusively on the basis of domestic market depends in large part upon the costs which each country would be willing to incur. This cost has been generally very high in the past. And also speaking in the general terms, it is quite possible that it will be very much higher when it involves the intermediate and capital goods industries in which import substitution will be based in the future.[10]

Did any substantial changes occur in the position of the manufacturing sector in the Latin American economies between 1950 and 1970, if one assumes that, inspite of efforts in the field of regional trade cooperation in the sixties and the most recent attempts (after 1965) to produce manufactures for exports to the advanced countries, the main post-war strategy concentrated on import-sustituting industrialization? Available data do not suggest such deep changes.

The content of Tables II and III strongly suggest that the progress of import-substituting industrialization run into heavy diffi-

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[10] Raúl Prebisch, Transformación y desarrollo (Fondo de Cultura Económica, México, 1971), p.101.

Table II Latin America: Participation of Manufacturing in GDP, 1950 - 1970

	1950	1960	1970[p]
Argentina	28.9	31.3	35.7
Bolivia	12.0	10.7	13.2
Brazil	16.5	23.4	24.7
Colombia	14.2	17.0	18.9
Chile	16.7	18.8	25.5
Ecuador	16.0	15.7	16.9
Paraguay	19.4	17.3	18.6
Perú	14.6	17.7	22.9
Uruguay	17.4	21.2	22.3
Venezuela	9.6	11.6	11.9
Mexico	18.4	20.5	23.2
Panama	8.2	12.6	17.3
Costa Rica	12.1	12.9	19.6
El Salvador	5.7	7.3	17.1
Guatemala	10.0	10.6	14.0
Honduras	8.5	12.1	15.7
Nicaragua	8.0	9.8	15.9
América Latina c	18.9	21.8	25.6

p Preliminary
c Includes estimates for Haiti; excludes Cuba and Dominican Rep.
Source: for 1950 and 1960 - ECLA, Economic Survey of Latin America, 1964, Table 161.
for 1970 - ECLA, Economic Survey of Latin America, 1970, preliminary individual country data.

Table III Changes in the Industrial Sturcture in Latin America, 1955 and 1968 (Percentages)

	1955		1968	
	Consumer non-durables	Others[a]	Consumer non-durables	Others[a]
Argentina	52.2	41.8	39.8	60.2
Bolivia	82.5	17.5	71.4	28.6
Brazil	52.5	41.8	41.9	58.1
Colombia	69.3	30.7	63.2	35.8
Chile	57.1	32.9	47.5	52.5
Ecuador	75.8	24.2	65.5	34.5
Paraguay	n.a.	n.a.	n.a.	n.a.
Peru	66.7	3.3	57.3	42.7
Uruguay	62.3	37.7	61.3	38.7
Venezuela	52.6	47.4	48.0	52.0
Mexico	52.9	47.1	41.2	58.8
Panama	75.8	24.2	73.7	26.3
Costa Rica	n.a.	n.a.	n.a.	n.a.
El Salvador	n.a.	n.a.	n.a.	n.a.
Guatemala	94.2	5.8	91.9	8.1
Honduras	n.a.	n.a.	n.a.	n.a.
Nicaragua	n.a.	n.a.	n.a.	n.a.
Dominican Rep.	94.6	5.4	85.7	14.3

a Others = consumer durables, intermediate and capital goods.
Source: ECLA, Economic Survey of Latin America, 1970, Table 14.

culties in Latin America rather rapidly. Between 1950 and 1970 the manufacturing output participation increased from about 19 percent to only 25.6 percent of the region's GDP. Only in five countries (Argentina, Chile, Brazil, Mexico and Peru) it exceeded 20 percent by 1970, while in the rest of the region it hovered on the average around 16 percent of the GDP. The annual growth rates of the industrial product, while obviously higher than those of the growth of the whole economy, declined perceptibly in the past three decades - from 6.8 percent in the forties to 6.3 percent in the fifties and 5.4 percent in the sixties, suggesting the Prebisch-mentioned exhaustion of import-substituting industrialization on the national level. As should have been expected, because of its concentration on final consumer non-durables that strategy debilitated rather than strengthened the Latin American position in the world trade and created serious pressures on trade balance with the outside world. Latin America's participation in the world exports declined from 10.6 percent in 1950 to about 5 percent in 1970, while import coefficient continued unchanged: the value of imports of goods and services represented 10.2 percent of GDP in 1948-1949 and 9.9 percent twenty years later.[11]

Moreover, there are reasons to believe that import-substituting industrialization did not help to any extent to solve or even alleviate socio-economic problems facing Latin America in the post-war period. Its costs were paid in part by the agriculture and in part by the urban consumer, leading to the further deterioration of intra-country income distribution.

Furthermore, the import-substituting industrialization was unable to contribute in a tangible way to the improvement of the employment problem. While the industrial product of Latin America expanded in the fifties and sixties at the average rate of 6 percent, industrial employment grew between 1950 and 1968 by only 2.8 percent, resulting in the accentuation of these major socio-economic difficulties: the growing unemployment and underemployment in the rural areas, large and growing migration of a part of the surplus of agricultural labor force to the cities, and the tremendous expansion of the urban underemployment in the low-productivity traditional service activities.

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[11] For details see Joseph Grunwald and Phillip Musgrove, Natural Resources in Latin American Development (Johns Hopkins Press, Baltimore, 1970).

On the other hand, the import-substituting industrialization created or strengthened monopolistic rents accruing to "domestic" industrial firms, many of them owned by foreign interests. Moreover, it increased the international indebtedness of the region. The total external debt of Latin America (public debt and foreign direct investment) grew between 1950 and 1969 from US$9,600 million to US$35,000 million and the service of that debt in the same period increased from 18.5 percent to 37.0 percent of the total foreign exchange income originating in Latin American commodity exports.[12] Finally, the expected technological modernization of Latin American productive structure did not take place. Instead the "prematurely old" industrial sectors had emerged.

One of the many recent attempts to evaluate the success and failures of the import substituting industrialization in Latin America, and particularly in Brazil offers the following verdict

> Hindsight makes it easy to point out specific mistakes, even to suggest some modifications in policy that clearly would have avoided the greatest inefficiencies. It is much harder to compare actual results with those that might have come from some totally different policy that would not have included industrialization.[13]

Such a statement, however, begs the question since it would most probably have been impossible to postulate for the post-war Latin America or any other part of the developing world an economic policy that would have totally excluded industrialization. Not only industrialization has been part and parcel of economic growth everyplace since the first Industrial Revolution in Great Britain in the mid XVIII century, but any alternative development policy would have been rejected in Latin America not only on economic but also on political grounds. Thus, the question cannot be reduced to postulating ex post other development venues but should try to ascertain why the import substitution industrialization efforts spent themselves so rapidly without bringing the results expected ex ante.[14]

This rephrasing of the issues involved forces us to resume the

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12 For details see ECLA, Economic Survey of Latin America, 1971, Vol. I, Latin American and World Economy: Some Prospects and Trends, (New York, June 1972, mimeo).

13 Joel Bergsman and Authur Candal: "Industrialization, Past Successes and Future Problems", Howard S. Ellis (ed.) The Economy of Brazil (University of California Press, Berkeley and Los Angeles, 1969, p.47) as quoted by Werner Baer, op.cit.

multiple criticisms of the Latin American post-war quasi-autarkic industrialization.[15] The abundant literature on the subject makes it possible to distinguish between the two groups of critics whom Baer classifies conveniently in two categories - "market critics" and "structural critics".

Leaving aside the particularly conservative economists within the first school that have seen anything wrong in the region's post-war industrialization because it has been running against the principles for world-wide comparative advantage, the "market critics" see the following drawbacks in the import-substituting industrialization model:

a) the across-the-board promotion of manufacturing activities without regard even to potential comparative advantages and the emphasis on autarky;
b) the disregard of economies of scales;
c) the abuse of the "effective" rates of protection;
d) attempts - in the case of major countries - to foster and and maximize vertical industrial integration;
e) the anti-economic allocation of investment resources, particularly by the State, at cost to the agricultural sector;
f) the failure to stimulate traditional exports and diversify the export structure along with the progress of industrialization process, and
g) the negative impact of price distortions between the sectors upon the industrial employment due to the fact that no incentives were created to adopt labor-intensive production techniques.

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[14] Not all the literature on the subject is outright pessimistic. While insisting that "the fact that import-substituting industrialization can be accommodated relatively easily in the existing social and political environment is probably responsible for the widespread disappointment with the process", Albert O. Hirschmann concludes that his exploration "has made it possible to discern avenues toward continued industrial growth that remain open to the late latecomers", op.cit. p. 123.

[15] Particularly useful in that respect are Baer and Sideri review articles referred to earlier, and various chapters of ECLA, Economic Survey of Latin America, 1970, and Economic Survey of Latin America, 1971 that introduce into the analysis of the Latin American post-war industrialization strategy two earlier neglected factors: world-wide technological change and transnational industrial corporations.

The "structuralist critics", on the other hand, stress the following negative aspects of the model:

a) its effect upon the income distribution already very bad - except in few southernmost Latin American republics - resulting in the increase of the income concentration and putting a severe brake upon the growth of the demand for industrial products after the import substituting industries have been established;

b) the neglect of the potential domestic demand in agriculture and low-income groups employed in the service sectors due, among others, to the implantation of import-substituting industries that produced goods saleable only to high and upper-middle income groups;

c) a strong regional concentration of industry and income for the sake of the external economies, not only in the three major republics (Argentina, Brazil and Mexico) but elsewhere as well increasing regional income inequalities and reinforcing economic dualism;

d) the indiscriminate inputs of advanced technologies from the industrial countries without any serious attempts to adjust them to factor proportions prevailing in Latin America and thus introducing "technological" unemployment in the societies cursed by an almost unlimited supply of labor, and

e) the absence of clear policy toward foreign private investments that resulted in foreign investors' accumulating monopolistic rents from industrialization fostered, under high, if not excessive, protection in the small-size markets inviting oligopolistic practices.

Some of the criticisms of the two schools represent the formulation of similar drawbacks and deficiencies of the model in the different conceptual languages. But, in general terms, one is tempted to acknowledge that the "market school" shows particular preoccupation for the resources allocation results of the import-substituting industrialization, while the "structuralists" criticize the model for its following almost blindly industrialization policies of the other societies in earlier periods. Practically no consideration was given - they insist - to the socio-economic peculiarities of the Latin American region in second half of the XX century and to the social welfare objectives. As a growing number of Latin Ame-

rican economists were willing to admit in the late sixties, the social cost of the postwar industrialization model was very high; the results amounted to a quantitative economic growth instead of the economic development, and the region as a whole found itself facing the "structural lock" situation, characterized, among other things, by high excess productive capacity, intra-sectoral and intra-regional imbalances, extremely high prices of industrial goods and the stagnation of demand closely related to the low absorptive capacity of labor by the manufacturing sector. Consequently, some "structural critics" add, after two decades of industrial efforts, Latin America found itself more dependent than at any previous time on the outside advanced countries both financially and technologically. The attempt to diminish that dependence became largely aborted.

While considering fairly convincing the "structural school" critique it is only fair to state that Latin Americans realized rather lately, perhaps as late as in the mid-sixties that there is no such a thing as "easy industrialization".[16] As Bruton, Sideri and other writers point out, import substitution as a strategy of Latin American development was to a very large extent arrived at by default; could hardly be described as a development strategy in the sense of a selection of alternative policies aimed at a well-defined objective; and, moreover, was based upon somewhat theoretically shaky assumption that the import structure of a country was the best indicator of what the country should start producing, given the composition of its factors of production and the available technology. This last assumption left aside two important questions: what kind of socio-economic reality the import structure reflected and whether the available technology - mostly transferred indiscriminately from abroad - was not only the adequate but the only available in the international technology market. In the early ECLA literature that represented theoretical underpinning of the import-substituting industrialization as practised in Latin America since the fifties these issues have hardly even been raised.

As this paper will attempt to demonstrate in its final part the neglect of those two issues: the backwardness of social structures and the lack of technological policies on national and regional

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16 For more details see Sideri, op.cit., particularly pp. 2-8, and Henry J. Bruton, "The Import-Substitution Strategy of Economic Development: A Survey", The Pakistan Development Review, Vol. 10, No.2, Summer 1970, pp.125-140.

level have been largely responsible for the very meager results of not only the Latin American import-substituting industrialization of the post-war period, but also of the two following development models, based first in the sixties upon the regional economic and trade integration model, and in the past few years upon the industrialization for export to the more advanced parts of the world.

II - Regional Economic and Trade Integration: The Disappointing Record of the Sixties

In the mid-fifties ECLA technocrats and many economists and reformist politicians started having second thoughts in respect to the longer-term results of import-substituting industrialization strategy followed by the individual Latin American countries since 1940. Consequently, as a corollary to that development strategy regional economic integration based upon trade liberalization was postulated in the area.[17] According to this new strategy a Latin American Common Market would stimulate the abandonment of the patterns of traditional primary commodity trade with industrialized countries, the

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17 In addition to mountains of ECLA, LAFTA and SIECA technical documentation, made public in the sixties, persons interested in the subject might find it useful to consult, among others, the following studies of the Latin American economic integration process: Sidney Dell, Problemas de un mercado común en América Latina, (CEMLA, México, 1959); Victor L. Urquidi, Trayectoria del mercado común latinoamericano, (CEMLA, México, 1960): Sidney Dell Trade Blocks and Common Markets, (Alfred A. Knopf, New York, 1963); Bela, Balassa, Economic Development and Integration, (CEMLA México, 1965); Donald B. Baerrensen, Martin Carnoy, Joseph Grunwald, Latin American Trade Patterns (The Brookings Institution, Washington, D.C., 1965); Miguel S. Wionczek, (ed.), Latin American Economic Integration, (Frederick A. Praeger, New York, 1966); Sidney Dell, A Latin American Common Market? (Oxford University Press, London, 1966); Miguel S. Wionczek, (ed.), Economic Cooperation in Latin America, Africa and Asia (M.I.T. Press, Cambridge, Mass. 1969); Roger D. Hansen, Central America: Regional Integration and Economic Development, (National Planning Association, Washington, D.C., 1967); James D. Cochrane, The Politics of Regional Integration: The Central American Case, (Tulane University Press, New Orleans, 1969); William G. Demas, The Economics of Development in Small Countries with Special Reference to the Caribbean, (McGill University Press, Montreal, 1965);Havelock Brewster and Clyve Y. Thomas, The Dynamics of West Indian Economic Integration, (University of Jamaica Press, Kingston, Jamaica, 1967); Osvaldo Sunkel, (ed.) Integración y politica económica, (Universidad de Chile, Santiago de Chile, 1970); Joseph Grunward, Miguel S. Wionczek and Martin Carnoy, Latin American Economic Integration and US Policy, (The Brookings Institution, Washington, D.C. 1971) and Christopher Garbacz, Industrial Polarization under Economic Integration in Latin America (Bureau of Business Research, The University of Texas, Austin, 1972).

argument used earlier by the import substituting industrialization proponents, and, moreover, that it would help to modernize the Latin-American economies by forcing them to specialize within the framework of an expanded and protected regional market. The general ECLA proposition was phrased convincingly:

> Latin America's basic long-run development problems can be solved only if the following fundamental fact is recognized: Latin America, however great assistance it receives, however high the rate at which its exports expand - and they cannot do so very rapidly - will be unable to carry out its development plans, will be unable even to regain the rate of growth achieved in the ten post-war years, unless it makes a sustained effort to establish within its own territory the capital goods industries of which it is in such urgent need today, and which it will require on a large scale during the next quarter of the century... In order to produce these capital goods and develop all the intermediate goods industries required to launch these highly complex dynamic industries... Latin America needs a common market.[18]

While accepting ECLA's general development thesis, some individual political figures also saw in economic integration an important vehicle that would permit them to redress somewhat the lack of balance in hemispheric political relations.

Beset by foreign trade problems, lacking external capital assistance and moved by the idea of spiritual and cultural unity, Latin Americans found the proposals for regional economic cooperation attractive. Between 1958 and 1960 the Central Americans established their common market. At the same time, in a parallel but giographically broader movement, six South American republics (Argentina, Brazil, Chile, Paraguay, Peru and Uruguay) and Mexico opted for a free trade zone scheme that would -it was hoped- evolve during the 1970s into a common market covering the whole subcontinent. Drawing upon the example of Western Europe, both schemes put an accent upon trade liberalization as a vehicle for regional division of labor. The Central American arrangement provided for the creation of a common market by 1966 for all but a few commodities. The Latin American free trade zone was to be set up by 1972, through annual product-by-product tariff negotiations.

The Central American regional cooperation scheme provided not

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[18] ECLA, The Latin American Common Market, (United Nations, New York, 1969, p.1).

only for commercial but also for financial, monetary, fiscal and industrial cooperation. In the early 1960s, an impressive array of institutions supporting the common market emerged in the area, among them a regional development agency (the Central American Integration Bank), a monetary council, a clearing house, and an industrial research institute. While these agencies worked with relative efficiency, coordination of major economic policies, particularly in respect to the siting of new industries and the common treatment of foreign investment, has proved very difficult. The inalibity to reach agreements in the key field of industrial cooperation, partly because of an absence of national economic planning mechanisms in Central America and partly because of the opposition of powerful external political and economic interests, proved in the late 1960s to be the major source of CACM's difficulties.

The LAFTA agreement (known as the Montevideo Treaty) was less specific in respect to non-commercial cooperation mechanisms. However, it did commit the participating countries -whose initial number of seven increased to eleven by 1968- "to facilitate increasing economic integration and complementary economies" by making "every effort to reconcile their import and export regimes, as well as the treatment they accord to capital, goods and services from the outside the Area". Furthermore, the Montevideo Treaty envisaged "progressively closer coordination of the corresponding industrialization policies" through agreements "among representatives of the economic sectors concerned". Very little, however, has been achieved in these fields during the first ten years of LAFTA's life. No regional agreement about the coordination of foreign trade and industrialization policies has been reached and none is in sight. Neither was it found possible to agree upon a common treatment for private foreign capital. Only some agreements designed to make industrial developments complementary, by specialization of production in individual industrial branches with concommitant freeing of trade for their output, have been signed. While some degree of cooperation was achieved in respect to the multilateral clearing of regional trade balances and maritime transport, these agreements had very little impact upon the expansion of intra-LAFTA trade and no effect whatsoever upon the acceleration of regional economic growth.

The achievement of CACM and LAFTA have been measured to date mainly by the growth of trade within their respective areas. Con-

sequently, in the mid-sixties it appeared that the Central American Common Market was an unqualified success, whereas the Latin American free trade zone was making slow and hesitant progress. In fact, trade within Central America responded to the establishment of a common market with amazing dynamism. Regional trade flows, measured in terms of imports, increased from U.S.$37 million to U.S.$250 million between 1961 and 1970, or by about 35 per cent a year. About two-thirds of intra-Central American trade consists of manufactured, mainly consumer goods, suggesting - on the surface - a significant diversification of zonal commerce and the progressive although limited impact of the common market upon the region's production structure.

LAFTA's trade achievements are much less impressive. The signing of the Montevideo Treaty was followed by several years of a relatively rapid intra-regional trade expansion, partly in response to early progress in tariff negotiations -70 percent of all bilateral tariff concessions granted between 1961 and 1970 corresponded to the first three years of LAFTA existence (1961-1963). By 1970 intra-LAFTA import trade exceeded U.S.$1,300 million (11 percent of the member countries' total import trade) as compared with U.S.$600 million (8 percent) in 1961. The regional trade of some newcomers in intra-Latin American trade -Mexico, Peru and Ecuador- grew very rapidly from the low levels registered at the end of the 1950s. The bulk of commercial exchange continued to be concentrated in the three southern republics -Argentina, Brazil and Chile which had a long tradition of reciprocal trade and still accounted in 1970 for close to two-thirds of intra-LAFTA commercial exchange. In spite of the impressive number of tariff reductions (exceeding 11,000 by the end of 1970), very little was achieved in respect to regional trade-product diversification. In 1967 foodstuffs and the other primary products, traditionally exchanged by South American republics prior to the LAFTA appearance, still represented something like 70 percent of intra-LAFTA trade. But the biggest setback to LAFTA was that while regional trade continued to grow and exceeded 11 percent of the total of LAFTA's foreign trade in 1970, the trade expansion did not affect in a tangible way the productive structures of the member countries. They continued to be dominated (in respect to primary activities) by the traditional trade relations with the outside world; while on the national level, in manufacturing and in indus-

try supporting sectors (energy, transport and infrastructure) the road of inward-directed and import-substitution-based policies has largely been followed by all LAFTA members.

Thus, it seems that while the rapid setting up of a common market in Central America helped to accelerate trade and growth within that small area (until the issue of the equal distribution of integration benefits broke the CACM's back in the late sixties), the trade liberalization measures of the Montevideo Treaty were too weak to produce a similar effect within LAFTA. But it is not only LAFTA which became progressively paralyzed at the close of the 1960s; the CACM run into even more serious difficulties as the result of the 1969 Honduras-El Salvador was with Honduran withdrawing from the common market arrangement in late 1970 and Costa Rica facing presently the most serious payments problems with the rest of the area.

A. An Overview of the CACM's Drift into Disaster

A close analysis of CACM's experiences suffices to suggest that the positive impact of common market arrangements of a traditional type upon the economies of its underdeveloped member countries has been heavily overrated. In the absence of joint or even national long-term development policies, particularly in industrial and fiscal fields, the establishment of a common market brought relatively little real growth to Central America, all the impressive figures on intra-area trade notwithstanding. Some sources estimate that only 1 percent of the annual 7 percent average growth rate in Central America in the sixties resulted from common-market-induced activities.[19] The setting up of a regional trade barrier considerably higher than the previous tariffs of the individual countries did not lead to serious industrialization but rather to the rapid expansion of various types of 'final-touch' industries in the integrated area. Many consumer goods imported in finished form before 1960 are now imported in parts or at intermediate stages of production. After undergoing final processing (only bottling or packing in some extreme cases) they circulated in the whole region as "Central American" manufactures until the El Salvador-Honduras crisis and continue to do so, with the exception of the trade flows suspended between

[19] Donald H. McLelland, "The Common Market's Contribution to Central American Economic Growth: A First Approximation," in Ronald Hilton (ed.), The Movement Toward Latin American Unity (Frederick A.Praeger, New York, 1969).

these two countries since the summer of 1969.

The high regional protection offered to finished goods, the low tariffs extended to raw materials and intermediate products, the race of CACM member countries for "new industries", together with the oligopolistic structure of the market, led to a statistically impressive expansion of intra-regional trade in manufactured goods -from U.S.$18 million in 1961 to U.S.$225 million in 1970- at a considerable economic and social cost to the area. Among the economic costs of this particular type of regional integration are a rapidly growing bill for imports of capital and intermediate goods from third countries at "administered transfer prices"; a steep decline in fiscal revenues; high prices of new regional "manufactured goods", and exorbitant profits accruing mainly to foreign-owned manufacturing enterprises which moved massively into CACM once they became aware of the profitability of the new ventures under that scheme. To make matters worse, the haphazard industrialization that followed the emergence of CACM led to political complications by accentuating differences in intra-regional development levels. Most of the new "final-touch" industries settled in the more advanced countries - Guatemala and El Salvador - which, followed by Costa Rica, became the principal exporters of manufactured goods to the area. Since the liberalization of agricultural trade proved an intractable issue, the two least developed members - Honduras and Nicaragua - found themselves in an uncomfortable situation. They became markets for expensive manufactures from the rest of the region while being unable to increase tangibly their intra-regional exports of traditional non-competitive agricultural commodities.

As long as the over-all balance-of-payments position of Central America was satisfactory, relatively few complaints about the growing imbalance in regional development and trade were heard. But by the mid-sixties the area found itself facing a major payments problem vis-à-vis the outside world. The rapidly growing import bill was due both to CACM industrialization and to the high level of imports of luxury goods. The latter reflected the extremely unequal income distribution in the area, symptomatic of its social backwardness. Subsequently, the CACM scheme ran into heavy criticism from its less-developed members. The unequal distribution of benefits accruing from integration became the key issue, and Honduras and Nicaragua began to press the rest for special concessions. The con-

flict became exacerbated when the attempts to deal with the regional balance-of-payments difficulties, through tariff surcharges on most imports from third countries and an equalized consumption tax on a large list of luxury commodities of regional origin, met with opposition from Costa Rica, dictated by purely domestic political considerations. In early 1969 Nicaragua, which had accumulated a sizable commercial deficit within the region and was unable to export agricultural goods to neighboring countries, introudced -without warning and in clear contravention of the CACM treaty- levies on regional imports. It lifted them only after the other members ratified the pending regional protocols. The most important of these was a protocol for the equalization of fiscal incentives, its absence in the original treaty having permitted the initial free-for-all fight aimed at attracting foreign industrial investment at almost any cost to the economy.

Shortly after the Nicaragua-induced crisis had been resolved, a war that broke out between El Salvador and Honduras in the summer of 1969 put the entire future of the CACM into question. Although some sort of political peace has been restored to the region by the early 1972, the CACM stopped functioning, although trade flows in the area continue except between El Salvador and Honduras. Honduras formally withdrew from the market and the continuing long-simmiering conflict of economic interests between the more developed CACM members (Guatemala, El Salvador and Costa Rica) and the poorer ones (Honduras and Nicaragua), have been reinforcing lately nationalist attitudes in the individual countries. Negotiaions even to keep CACM alive do not seem to lead anywhere.

While the issue of equal benefits for all CACM member countries may somehow be resolved one day, yet another one continues to overshadow the area. Both the Central American left and many local conservatives insist with growing vehemence that whatever gains from CACM may accrue to the region, foreign industrial investors are the principal beneficiaries of the common market arrangement. Given the force of nationalism in the underdeveloped countries, such a frame of mind can hardly be considered conductive to an orderly future for the Central American scheme for economic integration, especially in view of the fact that, ten years after the setting up of the common market, the area is socially and politically as backward as before.

B. LAFTA's Irrelevance for Latin American Development

LAFTA has not been a success story either. Disenchantment with its performance began even before the rate of growth of intra-regional trade started declining in the second half of the sixties. From 1964 onwards a number of attempts to accelerate the implementation of the non-commercial commitments of the Montevideo Treaty members were made by the main proponents of regional integration, including the then President Eduardo Frei of Chile, Raúl Prebisch, and Felipe Herrera, the head of the Inter-American Development Bank. These initiatives led to the establishment of LAFTA's Council of Ministers and indirectly to the conference of American presidents, held at Punta del Este in the spring of 1967. But after two meetings, the Council of Ministers ran apparently out of ideas, while the Punta del Este presidential declaration calling for the establishment of a Latin American common market by 1980 was quietly shelved. External and regional political and economic difficulties proved stronger than the superficial idea of Latin American solidarity.

LAFTA's inability to proceed on schedule with the original commitments of the Montevideo Treaty was finally admitted openly in mid-December 1969 at the Ninth Annual Conference of LAFTA's Contracting Parties held in Caracas, Venezuela. The protocal singed on that occasion postponed, from 1973 to 1980, the establishment of a free trade area between eleven Latin American republics; it slowed down the pace of tariff negotiations by committing each LAFTA member country to making annual tariff cuts equivalent to only 2.9 percent (formerly 8 percent) of the weighted average of duties applicable to all imports; and it suspended the implementation of the so-called common list of products freely traded until at least 1974, the date by which negotiations toward a "new stage" of LAFTA are to begin. It is no secret in Latin America that the Caracas Protocol represented a victory for the three major countries (Argentina, Brazil and Mexico), who have lost interest in all but the purely commercial aspects of regional economic integration and who assume -perhaps correctly- that the point reached in tariff cuts assures them enough room for export expansion in the area for some time without forcing them to undertake any non-commercial commitments toward the less-developed LAFTA members. Significantly, the Caracas Protocol made only a token reference to a common market by resurrecting two rather nebulous articles of the Montevideo Treaty that called for "creating

conditions favorable to the establishment of a Latin American Common Market" and "adapting [LAFTA] to a new stage of economic integration". The Protocol fixed no deadline for the setting up of a Latin American common market.

While there are many reasons for LAFTA's disappointing performance and the clear lack of enthusiasm for a common market, some of them are particularly important. One is the ambitious geographical scope of LAFTA. In the name of a Latin American community of interests, economies of all sizes and levels of development were put under one roof. In spite of highly publicized declarations of regional solidarity, the events of the last few years have proved that each of the three groups within LAFTA (the industrial "giants" - Argentina, Brazil and Mexico; the middle group led by Chile, Colombia and Venezuela; and the most backward republics - Bolivia, Ecuador and Paraguay) faces specific problems which hardly lend themselves to joint action. All the major conflicts that arose in LAFTA involved the economic relations among these three groups. The poor members and the middle group insisted, quite correctly, from the beginning that they were getting little, if anything, from the regional free trade scheme and were, in fact, running the risk of becoming markets for the industrial surplus of the "big three". And while Argentina, Brazil and Mexico are obviously interested in markets in neighboring countries, their dependence on exports to the rest of LAFTA is not large enough to force them to grant these unilateral commercial and other concessions for which the less fortunate republics have asked persistently. Recently Argentina made it clear that its interest in LAFTA and any future regional common market is strictly limited by considerations of domestic economic developments. Although Brazil and Mexico abstain from making public statements on their future LAFTA policies, their position is basically similar. It is interesting to note that in the most recent past Brazil shifted its interests in Latin American outlets for its manufactures to Africa.

While the differences in economic development levels between the LAFTA subgroups may be the main reason for its disappointing performance, a second obstacle has its roots in the flaws in the ECLA doctrine that served as the rationale for the establishment of a Latin American free trade zone in 1960. ECLA claimed that the Latin American countries had to integrate because import-substitution on a

national level had run its course by the mid-1950s. But the post-LAFTA experiences of the "big three" have shown that inward-directed national industrialization programs can continue in some parts of Latin America for a considerable time without an increase in the level of protection but not without additional political and economic costs. In response to the differentiation of domestic demand for industrial inputs and final goods, new manufacturing establishments continue to spring up in Argentina, Brazil and Mexico ten years after ECLA's warning that this type of industrial growth was running into a blind alley. It may be mentioned in passing that this vertical integration is heavily controlled by foreign direct investment.[20] Eventually, perhaps within another decade, these large republics may encounter the difficulties predicted by ECLA, but as long as the constraints upon industrialization for the home market are not too severe and some outlets for manufacturing exports are found elsewhere none of these three countries will see a manifest necessity to support LAFTA fully.[21]

A recent very incisive survey of LAFTA's problems[22] points out that the nationalist ideology present in the three major LAFTA countries does not explain fully their aims-length attitudes vis-à-vis that regional integration scheme. Ibarra correctly stresses that any expansion of the trade liberalization program beyond the limits reached by 1967 would have in fact affected negatively vested interests of large domestic industrial sectors that might have become exposed to competition both from other larger LAFTA members and the less-developed republics as well. To avoid such competition, local industrial interests (and many foreign-owned manufacturing firms) opted for so-called "industrial complementary agreements" that have some characteristics of sectoral cartels. The attractiveness of

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20 For details see ECLA, Economic Survey of Latin America, 1970, Part IV, Special Studies, The Expansion of International Enterprises and their Impact on the Latin American Development, and Miguel S. Wionczek, Inversión y tecnología extranjera en América Latina, (Joaquín Mortiz, Mexico, 1971).

21 The potential conflict between the UNCTAD scheme for preferential treatment of manufactures produced by semi-developed countries and the regional trade integration schemes among the developing countries has been pointed out in Joseph Grunwald, Miguel S. Wionczek and Martin Carnoy, Latin American Economic Integration. op.cit.

22 David Ibarra, "Notas sobre la integración latinoamericana" Comercio Exterior (Mexico, Vol. XXI, No. 11, October 1971).

these agreements from the viewpoint of the industries involved consists of the fact that they include only some countries, are exempt from the application of the most-favored-nation clause to other LAFTA members (with the exception of the least-developed ones that cannot offer any competition) and, finally, can be denounced on a short notice if the gentlemen's agreements among the participants are broken by some party. Such deviation from the original program of regional trade liberalization to sectoral cartel-like arrangements suggests that the rationalization of productive structures through regional competition is further away than many think. The progress along the alternative route of industrial specialization through regional industrial planning is even less probable in view of the complete absence of interest of the major LAFTA members in regional economic planning.

The possibilities of continuing inward-directed industrialization in the middle group of countries are considerably more limited. This may explain in part their interest in an Andean subregional common market, a project under negotiation since 1966 and translated into a formal treaty, signed at Cartagena, Colombia, in July 1969 by Bolivia, Colombia, Chile, Ecuador and Peru. At the last moment Venezuela opted out of the Andean scheme, proving that the private sector in that republic believes that national industrialization programs are still feasible in most places regardless of the market size, extent of natural resources, and the high cost of modern technology. Industrial entrepreneurs in Venezuela have been very vocal in their opposition to the Andean scheme, predicting a major national disaster if Venezuelan borders were to be opened to the "cheap labor" products of neighboring countries. There is little reason why industrial interests in Venezuela should have thought otherwise in 1969/70. After all, they were reaping very handsome profits behind high protective barriers, and, in traditional and conservative Latin America, profits and national interest are easily equated. Only recently, after the abrogation of the U.S.-Venezuela trade treaty under which in exchange for special treatment for Venezuelan oil in the U.S., Venezuela was granting special tariff concessions to U.S. goods, Venezuelan interest in the Andean common market increased. It is quite possible that during 1973 it will translate itself into Venezuela's adhesion to the Andean scheme.

Paradoxically, the third major obstacle to regional economic co-

operation arose from some improvement in the international commodity trade picture, registered in the second half of the sixties under the impact of conditions of economic boom in the advanced countries. Contrary to the pessimistic ECLA predictions in that respect, the external demand for Latin America's traditional commodities improved considerably in the past decade. Although the rate of expansion of the region's exports lagged behind that of trade among industrial countries, the results were better than expected. Between 1963 and 1970 Latin America's commodity sales increased by 25 percent from US$9,200 million to US$13,700 million. If Venezuela's oil exports, which behaved sluggishly over the period, are excluded, the seven-year increase in export revenue of the region amounted to almost 50 percent. The improvement of the export picture made internal industrialization efforts much more easy in domestic political terms than the alternative regional trade liberalization or a negotiation of regional industrial cooperation schemes that might have affected certain powerful domestic and foreign interest groups in individual countries. As at other times and in other places, once the atmosphere of the external sector crisis that was hanging over Latin America in the fifties and the early sixties seemed to dissipate, longer-term problems were conveniently forgotten.[23]

The priority given by the capital-exporting countries for the practices of tied public loans and of private suppliers' credits in lieu of united public foreign aid only strengthened the propensity of Latin American countries to think in terms of national inward-directed development and industrialization. Whatever their external payments situation might have been, Latin American republics were swamped in the 1960s with offers of external credit for individual industrial projects involving imports of capital goods. These offers were readily taken up, with the result that the duplication and overlapping previously characteristics of primary activities in the region was extended to the industrial sector. With

[23] The improvement of the Latin American external sector in the late sixties was largely an illusion. The public foreign debt of the region doubled between 1961 and 1969 from US$8,800 million to US$17,600 million and the cost of servicing that debt grew in the same period from US$1,250 million to US$2,200 million. In 1969 a number of Latin American countries (including the three major ones) was spending over 20 percent of their gross revenue on current account on servicing external public debt. See UNCTAD, Debt Problems of Developing Countries, (Santiago, Chile, TD/118/Add.6, December 1971, mimeo).

new high-cost, foreign-financed, self-contained industrial plants springing up even in the most backward countries, economic and industrial regional integration became more, rather than less difficult, to attain during the past decade.

The absence of coordinated aid policies toward Latin America among the donor countries, and the US's lack of interest in supporting LAFTA politically and financially created another important obstacle to integration.[24] Through its aid agencies the U.S. gave financial support to the CACM from the very start. CACM members agreed in turn to accept the "proper" rules of the game by abstaining from any interference with "free market" forces and foreign investment. Moreover, the possibility of a political challenge to the United States from the Central American scheme for integration was virtually nil, while the acceleration of growth within the area was considered by the U.S. as a possible means of lessening sociopolitical tensions in a strategically important part of Latin America.

The United States attitude towards LAFTA has been considerably more ambivalent. In the 1950s the U.S. gave no support to Latin American integration efforts, even if only because the initiatives came from the ideologically suspect ECLA. With the emergence of the Alliance for Progress in 1960, the U.S. position began to fluctuate between a "hands-off" policy and one of "neutral benevolence". Only in 1965 did the U.S. begin to express qualified support for Latin American integration. In the winter of 1966-67 and prior to the conference of American heads of state, President Johnson offered aid for the readjustment of those economies that might be affected in the process of the gradual establishment of a regional common market. But the U.S. Congress refused to support the executive's offer, and in any case the amount of aid offered was considered by most Latin Americans to be ridiculously small.

This aid, informally promised, has never materialized. The U.S. claimed that Latin America's lack of interest in the implementation of the Punta del Este agreement made any external financial help

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[24] For details, see Miguel S. Wionczek, "Latin American Integration and United States Policies," in Robert W. Gregg (ed.), International Organization in the Western Hemisphere (Syracuse University Press, Syracuse, N.Y. 1968), and Joseph Grunwald, Miguel S. Wionczek and Martin Carnoy, Latin American Economic Integration... op. cit.

superfluous. The Latin American countries, in turn, were pointing out that they would perhaps be ready to take Punta del Este common market proposals more seriously if only the U.S. had not backed out of its promises. Obviously, this was mere verbal shadow-boxing. Both the U.S. and Latin America put the matter of broad and serious regional economic integration low on their list of priorities, and both were fairly satisfied with the traditional, bilateral methods of hemispheric aid distribution. Given the attitudes prevalent in the U.S. Congress in the late sixties, the Executive Branch could hardly ask - even if he would have like to - for additional funds for supporting integration. Moreover, in a period of declining aid, the maintenance of bilateralism was not at all unattractive to the aid-receiving countries. Each of them hoped that it would somehow get more than others because of its "special" relation with the powerful donor. Moreover, since the earmarking of certain funds for integration might have affected the amount of bilateral aid available, no Latin American country was willing to press for financial assistance for integration. Thus, traditional aid distribution patterns continued, while both Latin America and the U.S. found themselves in the comfortable position of being able to blame each other for the failure of the agreements arrived at by the heads of state in 1967.

The final major obstacle to LAFTA's efficient functioning and to its evolution toward a regional common market arose from the growing conflict between Latin American middle classes and intellectuals and foreign private investment, particularly the giant multinational corporations.[25] In many Latin American quarters fears are felt that, because of their managerial and technological power, these corporations would reap the major benefits from integration, and in the process destroy many weak domestic industries.[26] In principle,

[25] For details see Miguel S. Wionczek, Inversión y tecnología extranjera en América Latina, op.cit.

[26] There is a growing evidence that these fears are well founded. For the latest findings see Fernando Fajnzylber, Estrategia industraial y empresas internacionales - Posición relativa de América Latina y Brasil (ECLA, Rio de Janeiro, November 1970, mimeo), Hector Vazquez Tercero (ed.) Inversiones extranjeras directas en México (Comité Bilateral de Hombres de Negocios Mexico-Estados Unidos, Mexico, 1970); Roland E. Müller, Foreign Investment in Latin America (The American University, Dept. of Economics, Washington, D.C., 1971, mimeo.), Carlos F. Díaz Alejandro, "Direct Investment in Latin America," in Charles P. Kindleberger, The International Corporation - A Symposium (The M.I.T. Press, Cambridge, Mass. 1970, pp.319-344).

these problems might have been solved by regional harmonization of policies toward foreign private capital, and by special financial and technical assistance on a regional scale to domestic industries. In practice, the harmonization of such policies on a regional scale seems a forbidding task. Less-developed LAFTA members claim that the introduction of equal regional treatment for foreign investment would result in its concentration in the few large countries. The latter, in turn, insist that offering the poorer republics the right of more liberal treatment for foreign capital, on the top of unilateral regional trade concessions, would result in swamping of Latin America with manufactured goods assembled by foreign firms in the less-developed republics. Unable to resolve this particular regional dilemma, LAFTA members - with the exception of the Andean group - continue to maintain highly varied national foreign investment policies geared mainly to individual industrialization needs. Thus, on the regional level a curious argument emerges: While each country talks about the dangers of foreign domination of the free trade zone or a future common market, only foreign investment located outside one's own national territory is considered to constitute a threat. And once local foreign-owned enterprises become somehow the extension of national economic power, negotiating battles are fought by the host-countries to give them access to neighboring markets. Under such conditions, the elaboration of a regional foreign investment policy is more than a forbidding task. It appears an impossible exercise.

C. The Andean Common Market: Achievements and Prospects

It may well be that the Cartagena Agreement of May 1969, that set up the Andean Common Market with the participation of Bolivia, Chile, Colombia, Ecuador and Peru, offers the way of difficulties that are blocking the progress of LAFTA and CACM. The Agreement is considered to be an extension of the Montevideo Treaty and not a separate international legal instrument. It is built around an assumption, proven correct by the experiences of the two previously launched schemes, that efficient progress towards economic integration among developing countries cannot be based on more or less automatic trade liberalization, but must attempt to solve from the very beginning such important issues as, among others, the problem of equal distribution of benefits arising from industrialization

(i.e., provide for harmonized distribution of new important industrial projects), that of common trade and investment policies vis-á-vis the rest of the world, and also that of a strong regional institutional framework with some degree of supernational power.

In respect to a trade liberalization program the subscribers to the Cartagena Agreement took the middle way between the complicated system of annual negotiations of trade concessions product-by-product, embodied in the Montevideo Treaty, and the immediate freeing of most of the subregional trade - at the price of considerable increase of external protection - provided by the CACM treaty of 1960. After prolonged and sometimes dramatic negotiations, the five Andean countries opted for a flexible, albeit firm in respect to the timing of subsequent liberalization moves, program with rather few and moderate escape clauses. Complete freedom for most intra-Andean trade is to be achieved within ten years or not later than before the end of 1980. Freedom of intra-regional trade means the elimination of not only tariff barriers but quantitative restrictions as well, including those that might arise from exchange controls and import licensing measures practiced by most of the members' countries.

The trade liberalization program starts with the adoption of the stand-still principle that prohibits the introduction of new restrictions of any kind in regional trade after the entry into force of the Cartagena Agreement by the end of 1969. Furthermore, it provides for the following positive steps toward full trade liberalization within the 10-year period: Trade in goods included in sectoral complementation agreements, such as those governing the petrochemical industry and other heavy manufacturing, will be freed at the pace specified in such agreements, involving as the rule new industrial activities. Trade in some 100 products orginally included in LAFTA's Common List, covering mostly agricultural goods with some degree of processing, was freed shortly after the entry into force of the Cartagena Agreement, and trade in goods not produced in any member of the common market was freed totally in February 1971. Duties on all other commodities entering intra-Andean trade are to be reduced every year by 10 percent of the starting duty, defined as the lowest duty for each product in force at the end of 1969 in Colombia, Chile or Peru, but in no case exceeding 100 percent ad valorem. During 1970 all duties were brought down to the

lowest duty applied in either of the three "major" countries, with the 10 percent cuts from that level starting at the end of 1971, so that by the end of 1980 they would reach zero. The Cartagena Agreement provided for quite limited in scope exception clauses that principally took form of rather modest lists of exceptions in respect to trade in manufactures. Agricultural trade liberalization also provided for some escape clauses. Finally, the problem of the less-developed countries, Bolivia and Ecuador, has been resolved by postponing their obligations to introduce annual across-the-board tariff cuts until 1975, although their own exports to the more advanced Andean countries will benefit from a program of liberalization started by Colombia, Chile and Peru by the end of 1971. Moreover, the production of some goods under sectoral complementation agreements may be reserved for Ecuador and Bolivia by common agreement. The Andean Development Corporation, established as early as January 1968, is also expected to give some preferential treatment to the two poorer countries in respect to the provision of financial resources for infrastructure and manufacturing.

A common external tariff is to be established in two steps: By the end of 1975 a minimum common external tariff should be established, and five years later all the member countries are expected to complete the transition to the same tariff, whose level has not been, however, set by the Cartagena Agreement. As in the trade liberalization program Bolivia and Ecuador will have more time to fulfill their obligations in respect to a common external tariff.

While the Andean agreement committed the member countries to harmonization of industrial and agricultural programing, integration of physical infrastructure, and financial and monetary cooperation, the elaboration of adequate measures was left to the common market authorities, composed of a Ministerial Commission and a technical secretariat (known as Junta de Cartagena), made up of three members with their own staff and charged with acting only on behalf of the Andean community interests. Most of the Commission's decisions require the affirmative vote of four out of five members. The drastic limitation of the veto power within the Commission, together with the obvious need to arrive at decisions agreeable to all parties concerned, led to the introduction into the work of the Andean market authorities of a healthy practice of continuous negotiations between the Junta and the respective governments in advance to the

formal meetings of the Andean Commission.

Within the first three years of their existence, the Andean Common Market authorities did not run into any major difficulties in agreeing - within the time schedules provided by the Cartagena Agreement - upon a number of important regional decisions. The agreements relate to the first stage of trade liberalization, including that of setting the level of duties in the region from which automatic reductions started at the end of 1971, - the minimum common external tariff, and immediate freeing of trade in commodities - contained in LAFTA's Common List. They cover also a list of industries to be affected by regional industrial programing (including petrochemicals, steel and automotive industry). The Common Code for Foreign Capital and Technology is in force in the region since the end of June 1971 and in mid-1972 the first industrial agreement has been reached in the field of metal working industry.[27]

For many outsiders, it may look strange that the Andean Common Market seems to be making substantial progress in spite of growing disparities in the political and economic structures of the member countries. At the time of the negotiations of the Cartagena Agreement in 1967-1969, all of the present members of that common market scheme were governed by liberal or left-of-center political groups committed in varying degree to laissez-faire economic policies. Today, the group comprises at least two major countries (Chile and Peru) that chose leftist, although somewhat different, political and economic policies. The fact that these developments do not seem to affect the workings of the common market may be explained in two opposite ways: the "socio-political" innovators do not want to burn bridges to the rest of the embryonic Latin American-Pacific economic community; or, alternatively, the steady deterioration of world conditions for the developing countries, as perceived by Andean political and economic elites, creates a new cohesion independent from the respective ideologies practised on national level.

Each of these two hypothesis seems to work in favor of the Andean Common Market, although it is too early to indulge into prophesies about its long-term success. The hardest decisions related to im-

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[27] The longer-term objectives and strategies of the Andean Common Market are analyzed in Junta de Cartagena, Bases generales para una estrategia de desarrollo subregional, 3 Vol. (Lima, March 1971, mimeo.)

plementation of regional industrial policies and harmonization of national policies in fiscal and monetary fields still lie ahead. But if the Andean Common Market scheme fails, it will become evident that no economic integration program in Latin America or some parts of that subcontinent is possible.

III. New Strategy: Exports of Manufactures to Advanced Countries

In the light of obstacles facing the import-substituting industrialization and meager results of regional economic integration, described in the main body of this paper, Latin American region started playing around 1965 with another strategy putting emphasis upon production of manufactures for sales in the advanced countries. This most recent strategy, in the words of an ECLA study just released,

> would reflect the emergence of a new "international division of labor" this time in the field of manufactures. Latin America would export those products in which the developed countries would be losing their interest in the light of evolution of demand and technological change. Latin American manufactured exports would thus complement other more technologically sophisticated goods produced by the advanced countries[28]

Latin American manufacturing export performance, stimulated by the recent entry into force - except in the U.S. - of an UNCTAD-sponsored general preference scheme for the entry into the advanced countries of the less developed countries' manufactures and semi-manufactures - has not been yet evaluated in detail, although some literature on the subject has been available lately.[29] The scant existing evidence suggests that a) Latin American manufactured exports grew during the sixties more rapidly than the region's exports as a whole; b) these exports were concentrated in the three major republics (Argentina, Brazil and Mexico) and c) their participation in the GDP and total trade of the region has been still below that of many countries of similar or even lower development level in Asia.

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[28] ECLA, Economic Survey of Latin America, 1971, Vol.III, Special Studies (New York, 1972, mimeo). p.87

[29] In addition to ECLA's document quoted in the previous footnote, see ECLA, Economic Survey of Latin America, 1970 (New York, 1971); UNCTAD, Study of Manufacturing Trade of Developing Countries, 1970 (Report of the UNCTAD Secretariat) (Geneva, December 1970, TD/B/C. 2/102, mimeo), and R. Banerji and J.B. Donges, Economic Development and the Patterns of Manufactured Exports, (Kieler Diskussionbeiträge 16, Institut für Weltwirtschaft, Kiel, January 1972).

Between 1962 and 1968 the total manufactured exports of Latin America (excluding petroleum products and semi-processed non-ferrous metals) increased threefold: from US$280 million to US$905 million. Their destination and origin are shown in Tables IV and V:

Table IV

Exports of Latin American Manufactures, 1962 and 1968

(million dollars)

	Total	Developed market economies	Socialist countries	Latin America	Other LDC's
1962	279	176	5	79	12
1968	905	444	20	421	20

Source: UNCTAD, Study of Manufacturing Trade in Developing Countries, 1970.

Table V

Exports of Manufactures by Selected Latin American Countries, 1962 and 1969

(million dollars)

	1962	1969	Annual percentage increase 1962-1969
Mexico	107.1	379.7	19.8
Brazil	85.5	244.2	16.2
Argentina	95.6	207.7	11.7
Colombia	7.5	26.3	19.6
Chile	12.9	22.7	8.4
Uruguay	14.8	20.2	4.5
Paraguay	14.4	18.3	13.5
Honduras	5.3	17.9	15.1
Cuba	6.3	10.5	7.5

Source: The same as in Table IV.

Additional estimates for 1970 for such countries as Brazil, Colombia, Mexico and Peru indicate that these trends continued in the last two years and that the rate of acceleration increased, particularly in Brazil and Mexico. In these two countries manufactured exports (excluding petroleum products and semi-processed raw materials) amounted in 1970 respectively to US$580 million and US$405 mil-

lion. Available projections for 1971-1975 suggest the growth rate in manufacturing sales abroad of Brazil at the average of 30 percent and of Mexico at 20 percent a year.[30]

The statistics cited above should be taken, however, with necessary caution. Because of the heavy participation of the transnational corporations in this trade, there is a partial evidence to the effect that a large part of these exports is considerably underpriced.[31] Moreover, in the case of Mexico the data most probably include exports of the US-owndед assembly plants located in the Mexican northern border zone. As long as the information about local value added in Latin American manufactured exports are not available, it is hard to judge the degree of their real impact upon the changes in productive structure of individual countries and their respective balance of payments position. Comments made in the previous section upon the growth of "trade in manufactures" within CACM make such studies imperative.

An interesting policy-oriented study about the manufacturing export potential of Latin American countries suggest that the room for additional expansion is considerable.[32] Starting from the assumption that to device such policies, it is necessary to understand whether and how the share of manufactures in a country's total exports is related to certain supply characteristics, a survey was made of the actual and "expected" export performance of some 70 advanced and developing countries with the use of multiple regression analysis on the basis of cross-sectional data. While the weakness of the study consists of not taking into consideration world-wide demand characteristics and trade policies of advanced countries

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[30] For Brazil estimates see IBRD, Current Economic Position and Prospects of Brazil, Vol.III, Brazil's Exports of Manufactures (Washington, D.C. 1971) and for Mexico - local unpublished data.

[31] According to the survey of over 100 Latin American foreign-owned manufacturing firms, mostly subsidiaries of transnational corporations, their exports - within the respective corporate systems - to other Latin American countries and the rest of the world are underinvoiced by average 50 percent in comparison to prices obtained by other Latin American firms exporting on the open market. For details see Ronald E. Müller and Richard Morgenstern, The Impact of Multinational Corporations on the Balance of Payments of LDCs: An Econometric Analysis of Pricing of Export Sales (Washington, D.C. 1972, unpublished manuscript).

[32] R. Banerji and J.B. Donges, op.cit.

(especially non-tariff trade barriers), it shows that over the period of 1960-1968 only in three Latin American republics (Chile, Peuru and Nicaragua) actual shares of manufactures exceeded the "expected" shares. In twelve others, including Argentina, Brazil and Mexico, manufactured exports were below the "estimated" shares.

As both actual and "expected" shares of manufacturing exports include in the study semi-processed metals and considering that Chile and Peru are major exporters of these commodities, one arrives at a conclusion that, in fact, in all Latin America manufacturing export potential has been used only fractionally. The study admits, however, its limited value: almost 40 percent of variations between actual and "expected" manufacturing exports could not be explained by that sort of analysis and "a large part of 'unexplained' variations may reflect among other factors, (like endowment of natural resources), the various forms of impediments and trade stimuli that are in existence of national and supranational level".[33]

An attempt to explain some of these impediments related to import-substituting industrialization policies and regional economic integration difficulties was made in the previous sections of this paper. A thorough analysis of obstacles to exports of Latin American manufactures arising from trade policies of the developed countries would imply writing another paper. Hopefully assuming that these policies affect in the similar way other less developed countries of the Pacific region and that the subject will be covered in detail in other papers presented at this Conference, they are not discussed here.

Final Comments

Some final comments are in order now. Whatever external obstacles to rapid expansion of Latin American manufactured exports exist, their presence does not invalidate this writer's general proposition that the absence of coherent internal and regional economic policies in the post-war Latin America resulted in the high cost of import-substituting industrialization, the lack of acceleration of economic growth through regional economic integration, and the limited results of the latest strategy based upon the high priority for manufactured exports. While the conflict of the objectives between im-

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[33] Ibid, p.16.

port substitution and regional trade cooperation looks obvious, no such conflict seems to exist in the case of economic regionalism and manufacturing for world-wide exports.

In fact, it has been demonstrated that regional industrialization policy would have helped immensely the objective of manufacturing for export strategy.[34] A study of fourteen products in six industrial branches, aimed at quantifying their costs under the conditions of working for a Latin American area in the optimum or near-optimum patterns of location, disclosed that in practically all the cases, such patterns of production would be competitive with imports from any developed country. The study suggests, furthermore, that "whenever output moves to the levels where economies of scale operate, as it would for many commodities in a Latin American common market, and transportation costs are significant, production costs would permit competition with developed countries even without tariff protection".[35]

Given the fact that many Far Eastern developing economies, the less developed countries of Southern Europe and Israel did in the post-war period better in terms of economic growth and export trade than Latin America,[36] there are reasons to believe that the rather disappointing Latin American performance has largely been due to political, social and technological backwardness and not to traditional productive factors endowment. If it is true, as Linder postulated that the export possibilities depend upon the size, the structure and the growth of domestic demand[37] and as Georgescu-Roegen noted that without the changes in the domestic demand profile, an industrializing low-income country runs rapidly into "structural

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[34] Martin Carnoy (ed.), Industrialization in a Latin American Common Market (The Brookings Institution, Washington, D.C., 1972).

[35] Ibid, p.69-70.

[36] Economic Commission for Europe, Some Aspects of Manufacturing Development in Southern Europe: Production, Trade and Transfer of Technology (Geneva, October 1971, TRADE/254, mimeo) and Centre for Industrial Planning, Plan for the Development of Industry in Israel, 1969-1975 (Ministry of Industry and Commerce, Jerusalem, February 1971).

[37] Staffan Burenstam Linder, An Essay on Trade and Transformation (Almqvist & Wiksell, Uppsala, 1961).

[38] Nicholas Georgescu-Roegen, "Structural Inflation-Lock and Balanced Growth", (Economies et Societés, Cahiers de l'I.S.E.A., Geneva, 1970, Vol.IV, No.3.)

lock" dilemma,[38] then it is relevant to stress that all the Latin American post-war economic strategies studiously avoided making the internal socio-economic structural changes, including the improvement of human resources quality and of the modes of social organization. This would lead us back to the Simon Kuznets dictum that "the cause of economic growth is knowledge" and to Maddison's proposition that "the basic problems of an economic growth policy ... are not technical but political and institutional".

As this paper has been written for an international economic meeting and not for a gathering of political scientists and sociologists let us leave the matter at this point.

Comments and Discussion of Wionczek's Paper

Ted English opened the discussion: Wionczek provides us with a clear and comprehensive treatment of Latin American development experience. He reveals, especially in the first table, the great variety in that experience. As he states, no clear pattern emerges in the growth rates. Size of country, system of economic organization, level of per capita income already achieved, - none of these appears as a consistent explanatory factor for the rates of growth in recent decades.

The paper focuses on three development strategies - import substitution, regional integration and export encouragement.

Import substitution is considered as nothing new, having been used in 19th century Europe, but some of the tactics for achieving import substitution by Latin American countries were not commonly employed in the last century, for example, preferential exchange rates for imported materials, and direct government participation in heavy industry. The Latin American countries have really "pulled out all the stops" in following this policy. Basically, I feel that the expression "import substitution" is not the best label for this policy option. The crucial point is that protection of domestic industry is involved. The import substitution that occurs as a more or less incidental consequence of other policies may have entirely different efficiency implications. But that which depends on protection clearly involves an economic cost and can be assessed in accordance with the size of that cost and the term over which it must be borne.

Some other more specific points about the discussion in this part of the paper might be mentioned. Wionczek cites declining growth rates in Latin America as one moves from the 1940s to the 1960s, and appears to agree with Prebisch's view that this indicates exhaustion of import substitution possibilities. He also cites the decline of Latin America's share of world trade as evidence of the same trend. It is difficult to be fully satisfied with these broad statistical

indications since so many factors are involved in explaining overall growth rates and international trade shares. Changing trade shares for example were much affected in this period by the recovery of Europe and Japan and the creation of so many independent states in Africa.

Some question may also be raised about the point that protective (or import substitution) policies result in larger monopoly rents for the multinational or other companies that grow up behind the protection. While this is true in some cases, especially in resource industries, in secondary manufacturing the effect is often merely to encourage the setting up of inefficiently small and diversified production units.

Finally, I find the two types of critics of import substitution - the 'market' critics and the 'structure' critics - really to be focussing on two related aspects of the same problem. One can certainly agree with Professor Wionczek that the Latin American countries should have made more effort to combine protectionist policies with redistribution, technological and other policies that might have made the choice of the resulting protected industries more appropriate to socio-economic conditions of the countries concerned.

Turning to regional integration, Professor Wionczek gave plenty of evidence that Latin American regional integration schemes have fallen well short of their goals. However, I think the criticism turns out to be more a criticism of the specific handling of LAFTA and the CACM rather than the basic idea of regional economic integration in developing countries. In LAFTA there was considerable rhetoric and limited serious effort to achieve substantive integration, especially by larger countries of the group. In the CACM, political squabbles arose, partly as a consequence of the high external trade barriers erected around the American market. This left much more scope for the building of small and efficient units.

Prof. Wionczek rightly emphasises the failure of developed countries, notably U.S. policies, toward the Latin American groups. There were many offers of loans and credits but these took forms which merely encouraged national and often competing units in small regional markets such as the CACM which could really only support a single unit in many industries.

I would have added that the United States perhaps with Canada's

support, might have encouraged sounder industrial project choices if they had offered free access to their markets along with more co-ordinated capital assistance.

The Andean group, as Prof. Wionczek stresses, is a more promising scheme, having perhaps learned from the mistakes of its predecessors. There is a greater uniformity in the stage of development in this group than in LAFTA and some indications of compatible development plans. Wionczek calls for 'harmonized distribution of new important industrial projects' and 'common trade and investment policies'. I can agree that such a group would need to avoid providing excessive protection, to adopt a moderate external tariff ceiling (though not necessarily completely uniform policies, provided that no country could raise tariffs to levels promoting high cost units). I can also agree that there should be some co-ordination of development strategy for large scale industries and industries offering opportunities for achieving complementarity of specialized lines of production among the partner states. I certainly favour harmonization of fiscal incentives. But I would caution against requiring a high degree of supranationality in the institution of the group if much of the same effect can be achieved by relying in part on international competition as a discipline, something which has apparently not been done to date in the Latin American regional groups.

Finally, Professor Wionczek introduces the strategy of promotion of manufactured exports, the newest emphasis from the Latin American. This has more appeal for precisely the reason just cited - it would require the Latin American countries to meet international market disciplines. However if promotion of manufactured exports means the adoption of a wide variety of export subsidies it may prove to be economically costly and to provoke retaliation in countries that are expected to import the subsidized manufactures. To encourage such countries to accept such products, they would have to be reassured that viability without subsidy was reasonably soon to be achieved. As Wionczek notes this strategy can be effectively combined with the previous regional integration strategy, thus to ensure the larger home market base for viable export activity.

None of these comments is intended to detract from my general satisfaction which the useful and analytically stimulating paper.

Hiroshi Kitamura continued the commentary: This paper provides a very important and incisive discussion of the basic development issues in Latin America. Being little qualified to discuss the development problems specific to Latin America, however, I shall try and put the issues into the context of generalized observations on the growth and trade strategies of present day developing countries.

In the present paper, Dr. Wionczek discussed the three development strategies which were adopted successively by Latin American countries after the second World War: import substituting industrialization policy on the natinal level, regional trade integration, and more recently export-oriented industrialization strategy; and concludes that none of these strategies has thus far succeeded in accelerating the pace of economic growth planned. Nor have they brought about the structural changes hoped for. The root cause of this failure is, in Wionczek's view, 'the lack of coherent internal and regional economic policies', which has 'resulted in the high cost of import-substituting industrialization, the lack of acceleration of economic growth through regional economic integration, and the limited results of the latest strategy based upon the high priority for manufactured exports.' (p.227)

I am a little concerned about the prevailing trend of Western economic thought to lay the blame on 'inward-looking' import substitution and protection policy for everything that has gone wrong on the development front. I believe Wionczek's is a message that should be taken to heart by everybody who is seriously concerned with the development policies of the less developed countries. It is a healthy reminder to those of us who tend to argue as if every inefficiency were caused by the 'inward-looking' type of strategy, and as if a shift to 'outward-looking' export orientation would solve all the complex problems of development at one stroke. In fact, the issue before us is not one of inward-looking versus outward-looking, import substitution versus export promotion nor, for that matter, import substitution on the national versus regional level. The choice among markets and activities is a general problem of resource allocation. What is needed for efficient industrialization is a 'coherent economic policy', both in domestic and trade spheres, meaning the setting up of carefully worked-out priorities and the formulating and implementing of policies geared to these priorities.

Let me briefly comment on each of the three strategies. In the historical perspective, it is important to remember, as Wionczek puts it, that the import substitution of the present-day developing countries is an exact replica of the development model adopted in Europe and North America in the 19th century and pursued in Japan further into the 20th century.(p.196) Moreover, the policy instruments being used are essentially of the same nature as those adopted in Europe and the United States a century ago. It is fair to say that, in ECLA's ideology, this policy did not have any autarkic connotation.(p.199) Historically, however, it was Raul Prebisch's specific contribution to have established the rationale of import-substituting industrialization for the Latin American countries in the face of the then prevailing American doctrine that comparative advantage would predestine them to be perpetual suppliers of primary products.

Why has this development model which led to a successful industrial transformation in the now developed countries failed to produce such structural changes in the developing countries in our time, with a few exceptions? I am particularly interested in what Wionczek calls the 'structuralist' view of the critics who point to the social and economic regidity in Latin American societies which has often led to a kind of 'structural lock' situation. Policies have not been sufficiently adapted to the changed environment of international trade, as analyzed by Ragnar Nurkse. In the absence of a development strategy 'in the sense of a selection of alternative policies aimed at a well-defined objective' (p.205), it is no wonder that the policy failed to show the degree of rationality as implied in a coherent economic policy. The failure is not necessarily a proof of the alleged fallacy of the import-substitution strategy itself.

As I understand it, ECLA's proposal for regional economic and trade integration was meant to aim at import substitution on the basis of a broader regional market which should be more efficient than that on the national level. Exports to a broader regional market would, from the regional point of view, represent a production within the region in substitution for imports from extra-regional sources. There was obviously no dichotomy between import substitution and export expansion, and Wionczek's second strategy was nothing but a logical development of the first one in response to market expansion.

The sad story that Mr. Wionczek tells us of the past integration efforts in Latin America clearly suggests that efficient progress towards economic integration among the developing countries cannot be based on the techniques of trade liberalization alone. In conditions so different from those in Europe, there is no point in following blindly the pattern of integrative arrangements of the traditional Common Market or Free Trade Area type. The first requirement would be rather the establishment of common trade and investment policies, involving some degree of joint regional industrial planning, to deal with the problem of equitable distribution of benefits arising from industrialization. (p.221) The lessons Wionczek draws from the relatively successful experience of the Andean integration scheme are suggestive to policy makers in any sub-regional grouping in Asia or in other parts of the developing world. One would expect rather favourable prospects for intensified harmonization of trade and investment policies in the case of the ASEAN, for instance, in which a small number of like-minded countries with common outlook and at a similar level of economic development cooperate with each other.

Finally, a few words of comment about the 'new' strategy of export-oriented industrialization, to which the usual reference to Hong Kong's success story is of course as little relevant as the experience of limited export processing zones. Japan's experience seems to suggest that, provided that the size of the home market permits and that the right kinds of industry are chosen, a successful export expansion would inevitably follow extensive import substitution. The essential point is again that import substitution and export expansion are both integral parts of the same industrialization strategy.

Going one step further, it may be argued that in most countries with a sizeable domestic market import substitution must precede a successful export development. Many industrial activities are subject to important economies of scale, and for many of these products the development of a substantial home market may be an essential condition of developing significant export markets. Thus, the success of the strategy of export-oriented industrialization will, in an important manner, depend on the efficiency of the process of import substitution.

As Wionczek rightly points out (p.228), the regional market or,

for that matter, regional economic integration (his second strategy) may greatly facilitate the task of manufacturing for export strategy. Given the relatively crude nature of many exportable manufactures in the early stages of development, it stands to reason that the prospects for their exports are more favourable in the neighbouring markets of developing countries than in the sophisticated markets of advanced countries. Wionczek's data in table IV (p.225) show that between 1962 and 1968 exports of Latin American manufactures to Latin American markets have grown twice as fast as those to the advanced country markets. This particular advantage gives an added importance to regional trade integration in the context of export-oriented indsutrialization. Considering the important economies of large scale which can be fully exploited only on the basis of an assured larger market, it seems evident that the efficiency of the development through export strategy will crucially depend on the success of the first and second strategies.

I cannot help referring back to Dr. Helen Hughes's important contribution to the present Conference which forcefully advances the thesis that the present world economy and the underlying international market prices are far removed from being optimal. It logically follows that there is considerable rationale for the developing nations to operate what Charles Kindleberger calls a 'disequilibrium system'. Despite the prevailing trend of the typically Western advice, there is in principle no doubt about the justification of the use of protection and subsidies for import-substituting and export-oriented industrialization, and economic logic does not allow us to dismiss totally the use of partially discriminatory devises in regional integration schemes among the developing countries. The question for us is, however, how to make the operation of the 'disequilibrium system' more efficient in the long run. To take the import substitution strategy for example, there are several ways in which the efficiency of the process may be improved, as Dr. Hughes suggests. In many cases the actual process of import substitution has not followed carefully worked-out priorities. Precisely this failure is to be blamed for the high social and economic cost in which the import-substitution policy of many developing countries has actually resulted, rather than the strategy itself. This is, in my interpretation, an important lesson we can learn from Mr. Wionczek's valuable paper.

Subsequent discussion took up the questions of export subsidisation policies in developing countries, the conditions for successful integration, and lessons to be learned by other developing countries from Latin American experience.

An American participant suggested that, as Wionczek's paper explains, there has been a succession of extremisms in policy formulation in developing countries. The latest in over-emphasis on export promotion policies. This extremism involves the danger that the developing country government might end up subsidising, through excessive export incentives, multinational corporations, or, in any case, consumer groups in foreign countries. There was another important danger that protectionist elements in developed countries had their hand strengthened by appeal to the moral argument that protection was required against dumping. This was an important factor in thinking in the United States.

Another participant spelled out the conditions for successful integration, which he believed would only result if integration were motivated by a real desire to improve group efficiency in open competition in world markets. Regionalism is likely to be successful as an economic strategy only if it is designed to serve as a means towards freer trade.

This theme was taken further with a comment that Latin American attempts at integration to date were not so motivated and largely based on verbalism and superficiality. There appeared no real commonality of intersts. Nor could one be optimistic about the preconditions for successful integration emerging in Southeast Asia, except, perhaps, among the smaller group of ASEAN countries.