DEVELOPMENT CHALLENGES IN ASIA

AND THE PACIFIC IN THE 1990s
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Edited by

Seiji Naya
Stephen Browne

East-West United Nations Center
United Nations Development Programme
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Foreword

Regional cooperation is based on the premise that countries can achieve certain objectives better through collective than through individual efforts.

Among the developing countries of Asia and the Pacific, an awareness of the development virtues of cooperation is quite recent and is still emerging. Although the concrete benefits are as yet quite limited, there is evidence of stronger bilateral economic ties and, in the subregions of the South Pacific, Southeast Asia (ASEAN), and South Asia, a growing sense of common identity. Furthermore, we may soon be seeing new links among the countries of continental East Asia.

The current climate is unusually propitious for increased cooperation. But countries need to perceive the potential dividends of cooperation before embarking on new initiatives. The motivation for regional cooperation therefore begins with national development priorities. If cooperative initiatives do not respond clearly to those priorities, they will be difficult to sustain. The cooperative premise, in other words, has to be demonstrated.

The Symposium on Cooperation in Asia and the Pacific, held jointly by the East-West Center and the United Nations Development Programme (UNDP) in May 1990, was an attempt both to identify the contemporary development priorities of the countries of the region and develop the premises for cooperation as a basis for UNDP’s next phase of regional programming. The Symposium brought together a large group of experts together with East-West Center and UNDP staff, constituting a broad pool of technical and practical experience of the region.

The first part of this volume begins with an introductory chapter on the major themes underlying regional cooperation in the Asia-Pacific. An edited summary of the proceedings of the Symposium discussions follows. The discussions were mainly conducted within four concurrent working groups: three to consider the needs of South Asia, ASEAN, and the South Pacific, respectively, and a fourth to examine regionwide issues. Parts II and III of the volume reproduces the nine papers that were written for and presented at the Symposium.
This distillation of four days' intensive deliberations provides many clear and authoritative messages to guide the future direction of UNDP's regional programme. Three are worthy of special emphasis. In the first place, the Symposium demonstrated the importance of examining collective development priorities from the viewpoint of subregions, within which economic, social, and cultural identities underscore the utility of geographic proximity. Secondly, the Symposium confirmed the preeminence of priorities based on major development themes rather than economic sectors, suggesting that UNDP sponsorship should be increasingly policy-oriented. Thirdly, the number of primary themes was confined to three only: human development, reflecting the importance of putting people back at the centre of concern; environmental and natural resource management as the basis for sustainable development in resource terms; and economic reform and management to continue the process of policy review and adaptation to changing needs.

The Symposium could not have reached these satisfying ends without the extensive involvement of Dr. Seiji Naya and his team at the East-West Center. This volume provides, we hope, adequate evidence of the success of our partnership.

Krishan G. Singh
Assistant Administrator and Director
Regional Bureau for Asia and the Pacific
United Nations Development Programme
Note on contributors

Dr. Florian Alburo
Professor of Economics
School of Economics
University of the Philippines

Mr. Stephen Browne
Deputy Chief
Division for the Regional Programme
Regional Bureau for Asia and the Pacific
United Nations Development Programme, New York, USA

Dr. Lawrence Hamilton
Research Associate
Environment and Policy Institute
East-West Center, Hawaii, USA

Dr. Mahbub ul Haq
Senior Advisor to the Administrator
United Nations Development Programme, New York, USA
Former Finance Minister, Pakistan

Dr. Abulmaal A. Muhith
UNDP Consultant
Former Finance Minister, Bangladesh

Dr. Seiji Naya
Professor and Research Associate
Institute of Economic Development and Policy
East-West Center, Hawaii, USA

Dr. A. Terry Rambo
Research Associate
Environment and Policy Institute
East-West Center, Hawaii, USA
Mr. Victor Santiapillai
UN Consultant
Former Executive Director
UNCTAD/GATT International Trade Centre

Mr. Savenaca Siwatibau
Head
Pacific Operations Centre
United Nations ESCAP, Vanuatu

Mr. Ricardo Tan
Programs Manager
Programs Department (West)
Asian Development Bank, Manila, Philippines

Dr. Anthony Tang
Visiting Professor
Department of Operations and Systems Management
The Chinese University of Hong Kong
Part I: Overview
Development involves more than rising real incomes. Recently there has been a renewed emphasis on the quality of life, on education and health, and on general social well-being. This is not to say that we are no longer concerned with economic growth, but rather, social and human development in conjunction with economic growth. A key concept that captures this concern is sustainable development or growth. Sustainable development is related to how a country can meet the development needs of the present generation without compromising the opportunities of future generations. It involves thoughtful consideration of the values of natural, human-made, and cultural environments.

What does the achievement of sustainable development entail? Economists have generally concentrated on the role of good economic policies and getting prices right to promote economic growth. Country experiences have shown us the importance of using the market as a guide to policymaking. But economic growth alone is not a sufficient condition, though it is a necessary condition, for sustainable development. To achieve sustainable development, we must look beyond traditional economic concerns and consider ways to manage and improve both human and natural resources which form the foundation upon which the development of the economy is based.

Although admittedly an oversimplification of complex and interrelated issues, the above suggests that the issues discussed in the Symposium can be divided into two broad categories: (1) economic policies and their effect on economic growth and regional interdependence, particularly as they relate to externally generated issues that result from closer trade and investment linkages; and (2) issues regarding sustainable future development. The latter includes topics such as environmental concerns and human development which if not addressed now will negatively affect the welfare of future generations. Although these issues were thought of as mainly national problems in the past, they have now taken on regional and international significance.
ECONOMIC ISSUES IN SUSTAINABLE DEVELOPMENT

Starting with the first point, strong economic performance has distinguished Asia from other developing regions. In particular, several of the East and Southeast Asian countries in the region have achieved the highest rates of economic growth in the world for the past three decades. Some South Asian countries have also grown rapidly in the 1980s.

A major reason for this strong economic performance has been the emphasis on market-oriented, outward-looking policies. These policies contributed to the remarkable growth of exports that have been an important element in the region’s economic success. The NIEs (newly industrializing economies) have been especially successful and were able to more than triple their share of world exports since 1960. More recently, ASEAN (Association of Southeast Asian Nations) countries have also achieved rapid export expansion. This emphasis on market-oriented policies is becoming even more notable as privatization and market reforms are now occurring throughout the region. As discussed in my paper for the symposium, governments in the region have moved to encourage private-sector development through privatization, deregulation, and liberalization, and are relying more and more on the private sector as the engine of growth. This movement is occurring in the state-controlled, large-population economies, although at a much slower pace, and, as pointed out by Ricardo Tan, also appears to be budding in previously economically isolated areas such as Indochina. However, market reforms in China, which accompanied the country’s vigorous opening-up process, appear to have stalled even prior to the turbulent events in the spring of 1989. As Anthony Tang has indicated, the direction of China’s future reform measures is heavily dependent on the willingness of its leadership to abandon or drastically alter its doctrinaire underpinnings.

Several important regional issues may be drawn from the above. First, there is no universal nor easy road to market reform and liberalization. Even some of the NIEs are facing domestic opposition to further market reform. For other countries in the region that are attempting overall market reform, economic theory has little to say about the speed, sequencing, and timing with which reform should occur. Nor does successful experience in one setting automatically translate into success in other areas.

For the socialist economies, the problems are more severe. How does one go about introducing the market into socialist economies? The market socialism model suggested by Polish economist Oskar Lange some 50
years ago has been vigorously challenged on a theoretical level and is yet to be validated in any empirical setting. Nevertheless, comparative analysis and the sharing of experiences can contribute to the continued movement toward market-oriented and outward-looking growth in the region.

A second implication of the high growth and the openness to trade and investment in the Asia-Pacific is the growing regional interdependence. Not only has trade and investment flows increased in total, they have also increased among the countries in the region, where the developing countries have forged especially close economic ties with the more developed countries. In particular, the United States has been the most important market for the exports of the developing countries in the region while Japan has provided necessary imports and has more recently greatly expanded aid and investment. Moreover, linkages among some of the developing countries themselves are also rising.

With this growing interdependence, however, has come increasing tension and conflict. Developing countries in the region are concerned that the market of the developed countries will not remain open to their exports. In addition, as their export capabilities increase, there is concern of excessive competition and market saturation. The sluggish pace and uncertain outcomes of the present GATT negotiations heightens this uneasiness. The increasing number of bilateral or regional arrangements among developed countries, such as the EC in 1992 and the U.S.-Canada Free Trade Agreement, adds to uncertainties about the future of export markets.

The conflicts and pressures resulting from the greater interdependence and uncertain world trading environment call for greater regional cooperation. Interestingly, the interdependence in the region was not the result of institutional factors; there was no regional organization like the EC which stepped forward to promote expanded regional trade and investment. Instead the interdependence came about through a natural process of growth and development in the region.

There are a few formal regional subgroups in existence, but as discussed by Victor Santiapillai and as shown in the workshop discussions of the individual subregional groups, efforts at regional economic cooperation have progressed slowly due to the diversity of the nations involved and their concern with the loss of national sovereignty with closer regional cooperation. The countries differ not only in terms of culture, but also in terms of geography, religion, levels of development, and ideology.
For the South Pacific countries, as mentioned by Savenaca Siwatibau, this problem is especially severe because of the large distances between the countries. As discussed by Abulmaal Muhith, the dominant role of India in SAARC compounds the problems. Even in ASEAN, which is often considered to be the most successful regional grouping among developing countries, progress in economic cooperation has been slow. As Florian Alburo puts it, although ASEAN has just begun to make significant moves to expand economic cooperation, much more should and can be done.

Several broader regional cooperative efforts exist, but there is no regional organization where conflicts can be resolved, a consensus reached, and important policies or agreements set forth. For example, the Pacific Economic Cooperation Conference (PECC) is a widely-based organization that has been an informal setting for dialogue among businessmen, government officials in an individual capacity, and academic specialists. Through its meetings, ideas have been exchanged and critical issues have been discussed, but the assemblage, like other existing regional organizations, is loosely organized. There are also forums for business executives, such as the Pacific Basin Economic Council (PBEC), and for scholars, such as the Pacific Trade and Development Conference (PAFTAD).

The more recent Asia-Pacific Economic Cooperation (APEC) was formed to fill the gap, but it is still in its infancy. Further, as expressed by Florian Alburo, there is some concern that the push for a broader regional cooperation framework will reduce the influence of ASEAN and other subregional groups. The question of membership of China, Hong Kong, and Taipei-China is also problematic.

Clearly, however, closer economic cooperation is needed to deal with the issues arising from interdependence and growth and with the uncertainties in the international environment. Problems concerning domestic market reform or external markets may best be dealt with in a regional setting. Symposium participants were in unanimous agreement that UNDP can contribute to the growth and progress of the region by providing technical assistance to deal with these issues.

ENVIRONMENTAL AND HUMAN RESOURCE ISSUES

Before highlighting some of their recommendations for further consideration and action, we must turn to the second of the broad issues which underlay Symposium discussion of sustainable develop-
ment—namely, the roles of environmental protection and human resource development. These issues are linked both directly and indirectly with economic growth. Without proper management and safeguard of natural and human resources, sustainable development cannot occur. In the case of the environment, it was felt in the 1970s that there was a trade-off between economic growth and environmental protection. This view, in turn, led to the conclusion that environmental issues were of concern only to developed countries. That is, developing countries could not afford to worry about environmental concerns lest this hampered necessary growth.

But, as several of the papers have pointed out, the choice does not seem to be so simple. The exclusive choice between growth and environmental protection would be true only if there were no other way to protect the environment besides reducing output. The most pessimistic growth scenarios do not consider the effect of recycling, pollution controlling devices, shifting to less polluting activities, and other technological developments. Nor have they grappled with the issue of property rights—that is, whether or not a more rigorous definition or determination might result in more or less beneficial social consequence.

On the other hand, the debate has shifted toward a more fruitful discussion in terms of the complementarity of growth and environment. Environmental quality can improve economic growth by improving the health of the work force and by creating jobs in the environmental sector. The economy is not separate from the environment. Of course, there are some trade-offs between short-term economic growth and environmental protection. The Symposium participants agreed that social decisions must be made with full understanding of the issues involved, the choices available, and the costs or benefits to the groups affected, and this fuller understanding can only come with deeper research and analysis, and more open discourse and debate.

Economic management and environmental quality in the dominant Symposium view can no longer be treated as if they are separate, noninteracting elements. This is clear not only in the case of developed countries but also in developing countries. The immense pollution problems which have come to light in the Soviet Union, East Germany, and other Eastern European countries accentuate this point. The high cost of industrialization without concern for the environment will be borne by future generations. It is no longer believed that developing countries can afford to wait until later to worry about the environment. Furthermore, pollution is not the only concern for sustainable development; conservation and proper manage-
ment of renewable and nonrenewable resources are also important. For example, excessive logging affects the immediate and long-term profitability of the timber industry. This two-way interaction between the environment on the one hand and economic growth and well-being on the other is basic to sustainable development. In other words, protection of the environment is a necessary condition for sustained economic development.

The paper by A. Terry Rambo and Lawrence Hamilton clearly shows the need for environmental management in developing countries and the complexities involved. The farmer clearing the land or peasants availing themselves of firewood consider only the benefits and costs of those acts upon themselves. They do not consider additional costs to the larger community of the soil erosion in watersheds that accompanies deforestation. Nor do they consider the even larger effect of destruction of tropical rain forests which add to global warming. The lesson here is that when considering overall social well-being, we have to include externalities—those costs that are not normally part of the cost and benefit calculations of the individual—in our decision-making processes. The social costs of poor resource management can go far beyond the costs and benefits immediately affecting individuals or even countries, and can have vast regional if not global impact.

Because of these externalities and their cross-boundary effects, environmental concerns often require intercountry cooperation. The arduous efforts and difficulties in coping with acid rain pollution between the United States and Canada is but one current example. Resource degradation in the Himalayas and the Mekong peninsula are other prominent regional issues. Understandably, one country acting on its own may be reluctant to bear the costs of environmental protection, but each country affected may be more willing to do so on a regional basis. Again, participants pointed to an important role that UNDP can play in this area. UNDP, by convening workshops and providing direct technical assistance, can assist countries to fully understand environmental issues and offer viable options for dealing with them. This includes complicated issues involving costs and benefits of externalities, specification or negotiation of property rights, and uses and management of common property resources or public goods.

The issues involving human resources are closely related to environmental concerns in that economic growth also clearly depends on human resource development. A country must develop a healthy, skilled workforce with flexible and innovative management in order to succeed in
Regional cooperation in Asia and the Pacific: major themes in the 1990s

devlopment. This was clearly demonstrated by the experience and performance of the NIEs, which placed early and heavy emphasis on education, training, and research and development as well as measures which upgraded health and nutritional standards. These lessons are being learned the hard way by other developing economies. For example, one of the major bottlenecks faced by rapidly growing Thailand is the shortage of skilled workers. In fact, inadequate attention to education, especially for secondary education, is seen by many to be a major constraint to Thailand's continued progress and development. As in the case of the environment, participants reechoed the prevailing consensus that human development is a necessary condition for sustained and beneficial development.

As the paper by Mahbub ul Haq graphically points out, economic growth in the region has been combined with remarkable progress in human development in most cases, especially in the NIEs. But the effect of economic growth on human development is not always clear-cut. In some countries like Pakistan, low literacy rates, discrimination against females in school enrollment, and widening inequalities continue to prevail despite rapid economic growth. In other countries like Sri Lanka, remarkable progress has been made in human development despite generally slow rates of economic growth.

Obviously, the indicators of human development do not always keep pace with economic growth. The question that must be asked is what factors are not influential or consequential in determining the extent or degree of human development that will occur with economic growth. The trickle-down theory has not always worked, and in ul Haq's view, has not proved effective in attaining specified human development goals.

The importance of correct economic policies is clearly relevant in this context. Experience has shown that countries that have maintained outward-looking, market-oriented policies have made the most progress in human development. Early emphasis on labor-intensive production processes for nontraditional exports made effective use of human resources and allowed the general population to share in the growth of the country. Import-substitution policies, in contrast, tend to favor large-scale, capital-intensive production processes and negatively affect the agricultural sector and labor-intensive production.

Although policy environments cannot be replicated between countries, much can be learned through the sharing of experiences of other countries
in the areas of human and natural resource development. There is also much to be done on a cooperative regional basis to improve environmental and human living conditions. These areas are critical to sustainable economic development in this and other developing regions.

A REGIONAL FORUM ON SUSTAINABLE DEVELOPMENT

The salient conclusion which resulted from the Symposium discussions may now be reiterated. While economic reform has been mainly responsible for Asia-Pacific successes, its momentum needs to be sustained in a multidimensional effort, and countries can learn from strategies, policies, implementations, and actions undertaken by others both within and outside the Asia-Pacific region. From this mutually reinforcing conclusion came the proposal for the establishment of an Asia-Pacific Forum on Sustainable Economic Development, through which this mutual learning experience could be achieved, and the suggestion that UNDP support a study process which might lead to the formulation of the forum.

The mission of the forum would be to provide a means for extension of knowledge and for open discussion of issues involving sustainable economic development in the Asia-Pacific region. To clarify this mission and its underlying objectives, sustainable economic development was taken to include not only management of the economy in its macroeconomic, sectoral, and enterprise aspects, but also issues of natural resource and environmental management, as well as underlying institutional and human resource development. A more specific connotation to be clarified with further research would be that the forum be concerned mainly with the more dynamic issues of economic reform measures and how they affect or are affected by resource and environmental problems.

Nevertheless, the forum’s objectives would be to (1) provide a feasible and practical means for scholars and practitioners to come together to exchange information and views, to compare and contrast relative experiences, and to introduce and discuss various methodologies and technologies, with the overriding purpose of maintaining or increasing the momentum for sustainable economic reform or development; (2) reach out and develop a clientele for sustainable development among policymakers, managers, opinion leaders, private sector representatives, academic and research institutions, and other informed members of the lay public; and (3) establish and maintain an information and data base relevant to documentation of the policy and institutional environment for sustainable development.
The research agenda required to deal with issues posed by the indicated forum objectives would include:

1. Surveillance research on: What has been said or written on sustainable development and sustainable economic reform? Why has the issue come up? How can progress be measured? What have been the major constraints? What about the sequencing of reforms? What sort of country and international environment would be necessary for sustainable development?

2. Country specific studies: Where and when has reform been successful? What were the initial conditions for success? What were the respective roles of government and the private sector? What institutional, regulatory, and macro policy changes are conducive to sustainable development? Why did reform efforts prove less successful or fail in other cases? What lessons can be learned from these successes and failures? How can regional cooperation efforts promote sustainable development?

3. Role of international agencies: What has been the role of key international agencies (WB, IMF, GATT, UN, ADB), major regional groupings (ASEAN, SAARC, PECC, APEC, etc.), and advanced industrialized countries (the United States, Japan, EC, OECD) in promoting sustainable development? Have these roles responded to changing economic conditions? How might their objectives or activities be altered to meet emerging issues in the decades ahead? What role can the proposed forum play in this international environment?

4. Finally: What should be the ultimate audience or clientele—policymakers, international agencies, media and opinion leaders, private sector executives, research institutions, the lay public? What sort of network of interested and cooperating institutions or personnel might be set up to maintain interaction and continuing progress toward forum objectives?

Overall, a broader-based approach to the cooperation that the UNDP symbolizes is called for. It is important to build stronger links between the countries in the region, in particular drawing the countries that have been isolated back into the regional community. Identifying the priorities and targeting on specific areas of concern in a supranational approach may
alleviate some of the problems that have plagued other regional groupings in the past.
REGIONWIDE CONCERNS

Economic Reform

Managing economic reform, and in particular the transition from a strongly guided economy to a more decentralized one (as in parts of East Asia), demands a combination of responses including macroeconomic and sectoral policy reforms, and adjustments at the enterprise level. Exchanging of experiences and identification of strategies common to several countries of the region could provide valuable information to economic decision makers. Some of the strategies common to countries in the region include: enhancing domestic resource mobilization; strengthening the integrity and efficiency of banks and the financial intermediation system; strengthening of capital markets; promoting greater harmony between trade and investment policies; and improving the capacities of fledgling independent enterprises to meet their financing requirements, to gain access to competitive technologies, and to learn how to market their goods and services effectively. Regional activities can support such an exchange of experiences and strategies.

Regional activities could also facilitate intercountry exchange among private sector interests operating in business environments in transition. Improving the management of public enterprises includes both the upgrading of the skills of managers as well as contriving appropriate management strategies. While this problem is obviously pertinent for the socialist economies, it is not exclusive to them. The need for improved performance applies to public enterprises of all kinds across the region. However, there are specific needs in at least three areas in which public enterprises often play important roles: tourist industry development and management, foreign investment management and regulation, and special economic zone development and management.

In addition, management concerns apply not only to large, but also to small and medium-sized enterprises, both in state sectors as well as in emerging private sectors. As economies become more competitive domestically and more outward-looking, and as governments move
towards deregulation and decentralization of decision making, enterprise management will need to become commensurately more efficient and competitive. Because of the role rural industrialization will have to play in meeting the growing challenge of unemployment and underemployment, small and medium-sized rural enterprises are of special concern.

The need for institutional development raises two related issues. One, implicit in the foregoing, is the manner in which those institutions that are needed to support a more open and competitive market system are to be strengthened. The second concern is more methodological: 'How to utilize the institutions within the region more effectively to support the above initiatives. In this regard, regional cooperation arrangements which clearly meet perceived country needs should be encouraged; a good example of this is the Mekong Committee.

In the context of reform, additional areas of concern are social security arrangements; civil service improvements, and the upgrading of administrative systems. As labor markets become more open, issues of social security will grow in importance. As the roles of government shift from direct management of the economy to supportive and facilitative roles, civil service and administrative systems will need to be reoriented and strengthened. While these concerns apply a fortiori to the Asian socialist economies, they are not exclusive to them since matters of institutional development are shared by countries in all parts of the region.

Donors can play a role in supporting economic reform, but it is important that they work very closely with governments, as well as with each other.

Human Development and Natural Resource and Environmental Management

There are three interrelated problems—environmental deterioration; stagnating or declining productivity growth associated with natural resource management; and continuing, and in some cases deepening, poverty and unemployment. Each of these problems has received separate recognition, but in the 1990s it is the conjunction of these three problems that will constitute the major challenge.

Addressing these problems poses challenges to existing strategies for several reasons. First, natural resource productivity, particularly in agriculture, has been declining in many lower-income countries throughout
the 1980s. If this trend continues in the 1990s (despite assumptions to the contrary by many national planners and the donor community), food security could be threatened as productivity growth falls behind the increases in population and income. Second, labor forces in the region are growing by 3–5 percent each year. Most of the new entrants are coming from rural areas, and no feasible or sustainable degree of agricultural intensification can absorb these large numbers. Third, education rather than just schooling is the key factor in addressing the triple problem enunciated above. However, for a number of reasons, there is evidence that educational services are deteriorating in some countries. Sometimes the trend is part of a more general decline in basic social services; in other cases, supporting resources have been reallocated, leading to the emergence of a dualistic social service system with better services going to preferred areas and population groups. One disturbing observation is the apparent association between the progress of economic reform including deregulation and decentralization, and the deterioration of local social services. The problem may be transitional to the extent that lower-level government units will take time to develop the resources to support needed services. However, there will be continuing problems for services in lagging and economically less-developed areas within countries. It appears that social service subsidies will be needed, but serious consideration must be given to how these subsidies are to be determined, managed, and evaluated. Fourth, every government is concerned about problems of environmental deterioration but these concerns have not been matched by a commitment to implement amelioration measures. The lack of commitment is manifested by unclear legal provisions and cumbersome adjudication processes, meager financing, insufficient attention to technological issues, and inadequately prepared staff and administrative systems.

Despite these constraints, various opportunities for intercountry cooperation suggest themselves. For example, rapid deforestation is a serious regionwide problem with complex ramifications. Intercountry cooperation is needed to better deal with forest management, reforestation, and forest protection. Cooperation could cover topics ranging from technical issues (e.g., species selection) to social issues (e.g., the role of local organizations) and policy issues (e.g., land-use regulations). There is promising potential for linking country institutions which are working on common problems of deforestation and examining similar solutions to them.
Sustaining the productivity of agriculture has been as recently as the mid-1980s primarily a matter of intensifying land use through irrigation, roads, and improved seed technology; applying a variety of chemical inputs; and improving the economic and policy environment for producers. It is increasingly clear that while elements of these strategies will remain valid in the 1990s, sustained productivity growth in the 1990s will have to rely to a greater extent than in the past on agriculture sectors that are more science-based and that are more judiciously managed to ensure environmental sustainability.

Important networks involving agricultural research and extension have been built and supported by donors, most notably through the Consultative Group on International Agricultural Research (CGIAR), but it is doubtful that national agricultural support systems, especially those in lower-income countries, are strong enough to confront the challenges of the 1990s. While some of their needs are better met through national programs, there are several areas where regional cooperation is preferable. These include strategies for germplasm collection and maintenance, biotechnology research, secondary and noncereal foodgrain technologies, low chemical input strategies, and improved water use efficiency.

Of special importance is the need to develop strategies for more intensive but sustainable upland agriculture, especially in areas that have been subject to slash-and-burn cultivation for longer periods. Strategies are needed not simply to assist indigenous upland populations practicing a relatively sustainable swidden agriculture, but are needed for recent upland immigrants whose cultivation practices threaten upland environments. In these areas, as noted earlier, there are very promising possibilities for putting technical and socioeconomic institutions across the region which are already working on these problems in touch with each other through network arrangements.

Regional cooperation can also help to address hazards that destroy natural resources and environment. Flooding, sedimentation, salinization, lowering water tables, and ground and water pollution are both natural and human-made hazards. Countries in the region can work together to determine the seriousness of these problems and develop solutions. The Mekong Committee provides an example of cooperation on issues related to water. Across the region, a number of countries have in common productive but fragile natural resource environments. The challenge is how to manage these environments in the face of the complex demands made on them.
Resource management involves property rights: a clearer definition of property rights appears to be associated with more careful resource management, although it is not certain that individual proprietorship is always the solution. Some forms of collective resource management are necessary—especially in circumstances of poorer and limited resources—to ensure that sustainable resource management is also consistent with sustainable human development. In countries undertaking processes of decollectivization, there is mixed evidence about the environmental consequences. For lowland monocropped agriculture, it appears to be a positive step; but for upland, polycropped agriculture, there is evidence that decollectivization has been associated with a breakdown of established procedures for managing natural resources needed in common by many. These are problems that merit further collective examination.

In the 1990s, several major environmental issues are likely to emerge, of which two in particular may be cited. The first issue is the conservation of biological diversity for which there is justification based on fundamental practical reasons besides those of an aesthetic and ethical nature. More science-based resource management will depend on maintaining a reservoir of genetic diversity in the natural world. Biotechnology, for example, is highly dependent on such resources and the challenge of conserving biological diversity is a global concern that requires a range of local decisions. External assistance of different kinds, including public education, technical cooperation, and economic evaluation, can help to ensure equitable access to these resources.

Secondly, environmental health is rapidly reemerging as an important issue. The dangers are epitomized by the reappearance of malaria as a serious problem. One effective drug remains to combat the disease and, although in lowland areas traditional strategies of control are still possible, new forms of malaria are rampant in upland regions where physical controls are more difficult. Where deforestation is proceeding, there are rapidly expanding populations of malarial mosquitoes. There are some collaborative measures to deal with this problem already, but more cooperation within the region is needed. But malaria control is only one example of environmental health problems. As natural environments are transformed, human populations are being exposed to a variety of new health risks that will require extensive monitoring research, and intervention.
SOUTH ASIA

Trade Policy

In some ways the transition from excessive regulation to liberalization is more difficult in democracies, including those in South Asia. Import-substituting industrialization has been promoted in many countries and strong lobbies that seek to perpetuate the status quo exist in South Asia. It is necessary to build a consensus for liberalization among exporters, consumer groups, and in government.

One excuse given for the failure to liberalize trade is balance-of-payments problems. But countries should respond to their balance-of-payments difficulties by expanding exports, not contracting imports, if they are to become part of the dynamic process of Asian economic expansion. Product quality should be upgraded and markets should be sought out in Japan and elsewhere. Examples of export promotion success stories exist in South Asia (for example, gloves and machine tools in Sri Lanka, and textiles in Bangladesh).

Small and medium-sized enterprises (SMEs) have played a large role in India's recent export growth, and assistance with their upgrading through technology, marketing, and subcontracting linkages could be beneficial. Subcontracting has been a source of growth in India, but SMEs elsewhere need to be upgraded before that strategy can be effective. In Korea, venture capital for SMEs has come from both government sources and large industries, with the intention of developing subcontractors. The system has become self-sustaining after start-up funding from international banking sources.

South Asian countries should also examine currency alignments as a policy measure. Devaluation used to be taboo but is now seen as a necessary part of every country's export-promotion strategy. South Asia might study the feasibility of establishing a joint monetary system along the lines of the system in Europe (perhaps building on the Asian Clearing Union).

Research and development (R&D) should also be thought of as elements of trade policy, but R&D efforts should be tailored to the specific needs of each local industry. Tax holidays and other fiscal measures could be used to encourage private sector R&D but should not be open-ended. Since some South Asian countries will remain dependent on primary
product exports, more attention should be given to increasing value added through better processing and marketing.

Financial Market and Investment Deregulation

Deregulation of capital markets is important. In addition to the needs for resource mobilization, the role of interest rates in promoting allocative efficiency should also be given due prominence. An impediment to financial liberalization is the large share of capital under public control. Savings rates are adequate in India and Sri Lanka, but are quite low in the other South Asian countries. However, the large share of resources appropriated by the public sector combined with the inefficiency of public investment leads to slower growth and lagging employment creation. For example, India's growth in the near-term could be generated by the emergence of a new entrepreneurial class, but there is insufficient private credit to support SME development.

South Asia should, as a subregion, begin to open up more to foreign investment rather than merely giving the appearance of doing so. While in principle investment regulations in India are being relaxed, the perception of India's investment climate in Japan and other investing countries have not changed. The commitment to reform is best displayed by taking regulations off the books and by disbanding regulatory agencies. Consideration might be given to combining investment reforms in all countries to develop a common investment code for South Asia and to avoid excessive competition for foreign investment funds.

External assistance could be an agent in promoting economic dynamism in this area. Governments could be assisted to mobilize domestic savings and reduce dependence on foreign borrowing by nurturing domestic securities and equities markets. Multilateral agencies could play a valuable role in helping to transmit lessons of experience from one country to another.

Public Sector Reform

Reform should be directed at rendering the public sector more efficient, and releasing the dynamism of the private sector. The performance of public enterprises should be closely examined to determine the reasons for failure. Their management could be improved in many instances and privatization may be viewed as an option. In some countries, the better-organized telecommunication companies have been
put into private hands, and privatization can be contemplated in transport and utilities, including power distribution, although problems of unionized labor will be encountered in large privatization projects.

Public sector reform raises questions of political economy. Even when there is a clear rationale for reform, the needed measures are most often not taken. In order to guarantee the sustainability of reform, moreover, it is not enough to abolish controls; the controllers should also be reassigned.

Public spending patterns also deserve closer attention, particularly with respect to the priority given to defense expenditures. Defense lobbies are secretive and antidemocratic, and public opinion should be effectively mobilized to counteract their influence. In general, nondevelopmental expenditures—including defense, administration, public enterprise losses, subsidies, and interest payments—should be controlled or reduced so as to allow expansion in spending on basic education, health, and other services that directly promote human development. Policies that divert resources away from vital public services and public sector activities are inimical to the poor of the subregion.

Human Development

Human development can be defined as improvements in health, basic education, skill formation, and other manifestations of an enhanced quality of life. It therefore includes, but goes beyond, poverty alleviation. Four important areas of concern can be identified, each suggesting public action.

First, macroeconomic policies which promote growth with equity are necessary for poverty alleviation. However, growth alone is not sufficient; specific policies targeted to the very poor are also needed. Therefore, a two-pronged strategy that combines sound macroeconomic policies with identification and attention to the needs of the poorest segment of the population is called for.

Second, widespread poverty can best be addressed through employment creation measures, particularly in South Asia where unemployment and underemployment are chronic problems. Traditional agriculture and modern manufacturing together will not generate sufficient numbers of new jobs, and some service employment is not productive. Countries should
encourage labor-intensive industry, including regionally dispersed agrobased activities, and should support public works projects.

Third, population growth should be reduced in order to halt the spread of poverty. Together with a traditional emphasis on family planning programs, increasing rural literacy, especially among females of child-bearing age, is the key to reducing population growth in the medium term.

Fourth, there is a lack of political commitment to basic education in South Asia; a change in policy stance at the national level should precede approaches to external donors for assistance in this area.

In implementing programs, a distinction should be drawn between targeted policies (such as education of rural females) and across-the-board approaches, including literacy comparisons, food, security measures, and preventive medicine. Access to credit targeted at the poor is another element of a comprehensive poverty alleviation strategy. An example in rural areas is provided by the Grameen Bank in Bangladesh, which provides access to credit without collateral and uses peer pressure to reduce default rates.

Various roles can be envisaged for regional programs in human development, combining the United Nations and other multilateral sources. Programs should be linked to national efforts and assist in disseminating country experiences through exchange. Regional programs should examine the reprioritization of funding, working with government budgetary agencies to restructure expenditure and generate revenues.

Environmental Concerns

Environment and economic development are linked in the long term. Expenditures which enhance the environment are productive, complement other developmental expenditures, and should not be viewed as consumption. Yet developing countries, given their paucity of resources, typically assign a lower priority to such spending than do industrialized countries. Externally funded environment programs should not detract from other development expenditures but should be additional to spending on other development needs. Currently, donors are looking for large-scale projects to fund; however, for such projects to be effective, the countries will need to, and should be helped to, build absorptive capacity.
Turning to more specific areas of concern, poverty and population growth are linked to environmental degradation. Upland watershed areas are especially vulnerable to overuse and therefore warrant special attention. Where environmental systems transcend national boundaries, regional cooperative efforts are particularly appropriate. External assistance can help foster exchanges of information on alternative energy sources, reforestation, and other subjects. Assistance with environmental impact studies and project assessments can also make an important contribution to building greater awareness. Grassroots support for environmental programs should be cultivated since their success depends on the creation of consensus among nongovernmental organizations and the public at large.

Developing countries can also be helped at their request in the formulation and implementation of national environmental strategies which should be integrated into broader national plans. The incorporation of resource accounting systems into national accounts would allow planners to monitor resource utilization and balancing.

ASEAN COUNTRIES

Trade and Finance

Having been in existence for over 20 years, the Association of South East Asian Nations (ASEAN) has the longest record of formal economic cooperation in the Asia-Pacific region. It therefore deserves special attention, both as an important entity within the region and as an example for other regional cooperation endeavors.

ASEAN has reached an important stage in its existence. Although progress has been achieved in many areas, its potential is still substantially unfulfilled. ASEAN could be assisted to achieve its goals of economic growth and equity through market sharing and resource pooling, as well as other means of cooperation.

A review of ASEAN economic cooperation is already underway (with UNDP assistance). A study is being conducted of current UNDP-funded projects in ASEAN in terms of assessing their effectiveness and making recommendations for the coming 1992–1996 funding cycle. An analysis of how to strengthen the role and the functions of the ASEAN Secretariat is also being undertaken. These studies could be used as the basis for
three types of initiatives under the proposed rubric "ASEAN: Thirty Years After Bangkok."

In the first place, there should be a detailed examination of how the ASEAN Secretariat might become a catalytic agent in advocating and promoting ASEAN cooperation. This new role would imply the need, inter alia, to provide the Secretariat with greater resources and professional staff.

Second, in order to facilitate information exchange between the private economic interests of the ASEAN countries, the feasibility of creating an integrated computerized network for the private sector should be examined. This network would allow easy access to an ASEAN database consisting of relevant information—for example, information on the differing investment codes, business laws, and standards within the ASEAN countries—for the private sector. The establishment of ASEAN trade and investment representatives, along the lines of the EC, within the ASEAN member countries could also be explored.

Third, ASEAN has a particularly strong need to bolster its cooperative efforts in the area of finance. The possibility should be explored of creating an ASEAN Development Bank and/or establishing an ASEAN window at the Asian Development Bank, followed by efforts to enhance professional staff development to increase the capacity for project development. There is also a need to reassess the various institutions such as the ASEAN Finance Corporation, ASEAN Venture Capital Fund, and ASEAN Investment Forum.

The rapidly changing global economic environment has many implications for future trade policies particularly in the ASEAN countries which are following outward-oriented development strategies. For example, there are uncertainties surrounding the relationship between ASEAN and the Asia-Pacific Economic Cooperation (APEC) organization if indeed APEC survives. One example is the impact of APEC on ASEAN's relations with its dialogue partners, as well as its relations with other countries in the region not currently part of APEC but which may join (including USSR, China, and Taiwan). To this end, the role of the ASEAN Secretariat would also have to be examined: a strong and dynamic Secretariat might again be implied by the need for ASEAN to play a pivotal role within APEC.

Moreover, the progress of the European Community towards a common market in 1992 and the disappearance of communism from
Central Europe could also have far-reaching consequences for ASEAN, affecting trade, investment, and aid flows and demanding new imperatives for ASEAN economic cooperation. There are also implications of bilateral trade arrangements which have been growing in number and scope, notwithstanding the current Uruguay Round of GATT talks due to end in December 1990. If the round does not produce significant results, bilateralism may continue to flourish. The consequences of recently concluded accords in the developed world—such as the U.S.—Canada Free Trade Area and the ‘closer economic relations’ free trade pact between Australia and New Zealand—for ASEAN would also need to be examined. ASEAN will also need to determine its response to possible new accords in the region, for example, a U.S.—Japan free trade area. Whatever happens, ASEAN’s role in the international economy is changing. Apart from trade consequences, ASEAN will need to examine how it can continue to absorb direct foreign investment flows, taking advantage of the changing international division of labor.

The UNDP supported a United Nations study on ASEAN in the early 1970s and could make an important further contribution to the enhancement of ASEAN cooperation through its sponsoring of a new study. In addition to studying ways in which ASEAN could act to promote intra-regional trade and investment, a UNDP-funded project in the 1990s could look at:

1. **Technology transfer.** ASEAN countries have reached different stages of development. While Singapore’s developed country status will most likely be confirmed by the turn of the century, and Thailand and Malaysia are emerging as members of a new tier of newly industrializing economies, the two other large ASEAN countries have not yet captured this dynamism. It has been argued that one explanation for the differential performance lies in divergent rates of technology absorption. A mechanism might therefore be found whereby the more advanced ASEAN states, especially Singapore, would serve a more active role in assisting technology transfer and contributing to growth and equity in the subregion.

2. **Economic policy issues.** The outward-looking development policies of the ASEAN countries have helped to optimize employment generation opportunities. These types of policies are an important means of meeting the dual goals of alleviating poverty and reducing income distribution inequalities. The
dynamics of the process should be studied so as to provide recommendations to the ASEAN countries on how to improve their respective economic policies to achieve the highest possible sustainable growth with equity. The conclusions would also have bearing on technology transfer issues insofar as they relate to investment policies.

3. **Comparative experience.** Finally, an examination could be conducted on the lessons that could be drawn from the ASEAN experience for other developing countries embarking on cooperative programs, such as the members of the South Asian Association for Regional Cooperation (SAARC). ASEAN could utilize some of its existing institutions (e.g., the ASEAN Central Bank Training Institute) to help share experiences and develop trade links with other parts of the region.

**Human Development**

There is an important distinction between the narrower idea of human resource development and the more general one of human development. Human resource development tends to consider people as factors of production and focuses on actions to improve the capacity of human beings to perform productive roles as economic agents. Human development embraces a more general view of the promotion of the well-being of people, including not only material aspects but also basic cultural and spiritual needs.

Under the rubric of human development, three major themes are pervasive. First, it is necessary to stress the need for human development initiatives to be sustainable. Second, in studying the means to improve human development, the cultural identity of individual nations should be respected. Third, and notwithstanding the previous point, efforts should be made to strengthen the links that bind Asian peoples together, recognizing the common traits which they share.

Because human development highlights the need to strengthen the totality of human beings, a study should be undertaken to identify and clarify the particular needs of industrializing nations such as those in ASEAN. The ASEAN countries should not concentrate narrowly on catching up with the level of material well-being of developed countries at the cost of losing their cultural and spiritual identities. The study would also make recommendations about ASEAN programs that might be
developed to take account of these needs, and other proposals on how UNDP could serve a supporting role in the future. Too frequently, readily available and often quoted "vital statistics" are narrow in scope and only consider material product measurements such as per capita GNP without reference to more general social statistics and indicators. Many additional types of material and social statistics and indicators need to be taken into account and a readily available means to access these data through a computer-linked network needs to be developed. This would allow for a better assessment of human development needs in the region. Such a network, which could also encompass environmental indicators, could be developed with the assistance of external funding.

Training and education have long been key themes in human resource development, but their targeting has not been sufficiently addressed. In particular, more explicit attention should be paid to the status of women who lag behind men in most of the indicators used to gauge the economic welfare of a country; to training the young age group; to designing programs that prepare young people to function productively in a modern work force; to strengthen indigenous capabilities in the areas of food, energy, and other basic needs; and finally to increase appropriate information targeted at youth so that population growth could be decreased, hopefully leading to a stable population size by the middle of the 21st century.

Institutional Development

Although each country in ASEAN has its own training and higher-educational institutions, there are few such institutions at the regional level. Significant benefits might be reaped by establishing a well-designed regional institution, and creating better links between existing institutions. For example, each country in ASEAN could be home to one of the campuses of a new ASEAN University which would specialize in a certain area of expertise pertinent to the development process. In any case, there should be better network linkages between existing universities in the region. There is little functional communication between them as yet, and limited knowledge of the "comparative advantages" to be exploited. In addition to increasing intraregional exchange of students, ASEAN countries should start to look more to the East for their higher-educational needs, rather than maintaining their traditional reliance on Western academic institutions.
Nongovernmental organizations (NGOs) could also establish more linkages. Many NGOs in the ASEAN countries contribute to training and education, but there is little harmonization of programs. Two other proposals are for a feasibility study on the establishment of a regional "social security system," particularly targeted at aging populations, and a forum for policy dialogue on human development.

Environmental Concerns

The subject is a very broad one and the points which follow pertain mainly to regional concerns amenable to external funding support. In the area of sustainable resource use, there are several issues. The problem of preserving the subregion's forests transcend ASEAN needs. The ASEAN countries, together with Myanmar, Brazil, and Zaire, account for over 65 percent of the tropical forests in the world and means should be found at the regional and/or interregional level to develop an effective way of restricting the wasteful exploitation of this resource, while keeping intact socially beneficial development. The socioeconomic implications of atmospheric pollution need to be carefully studied; global warming effects are of great importance to the agriculture-based ASEAN countries. ASEAN countries share many great bodies of water including the Malacca Straits, the South China Sea, and the Pacific Ocean, offering opportunities for the joint promotion and sustainable management of sea, coastal, and marine resources. The large majority of energy consumption in ASEAN is fossil-fuel based. Cooperation could assist the search for cost-effective alternative fuels; ASEAN can also learn from the experiences of other countries in this area. Technology changes also imply that less reliance is being placed on nonrenewable resources such as minerals; the sources of these changes and how they affect the subregion could be jointly examined. A further problem that might call for cooperative solutions in ASEAN is the management of access to clean water and the development of effective sanitation in both rural and urban areas.

Economic and environmental linkages are also important. While GNP measures do not take into account externalities, it is necessary to include pollution considerations to capture the real costs of industrialization. If a country launches a program to clear up its environment, economic growth in the short run may fall, but economic welfare will increase. Moreover, in the long run, a clean environment is conducive to economic growth; for example, reducing congestion and pollution in a major urban area would facilitate trade and reduce demands on the urban infrastructure, as well as make that city a better place to live for its population. Hence, it is
important to stress that expenditures on the environment should not be looked at as costs, but more as investments in the long-run economic and social well-being of the country.

Many opportunities are suggested for technical cooperation. Environmental protection in ASEAN is costly but because of the global implications, a strong case can and should be made to help ASEAN countries defray those costs. Many multilateral lending institutions are inhibited from lending on concessional terms for environmental projects because of the difficulty in assessing economic costs and benefits. However, since these projects are investments that enhance the resources of ASEAN and of the world, a systematic and effective way to account for their environmental implications needs to be found. Other opportunities include: (1) harmonization of policy options regarding the environment with ASEAN countries working together to promote common regional interests; (2) development of a common ASEAN framework for environmental social impact analysis; (3) regional cooperation on environmental rehabilitation, specifically with respect to the dumping of toxic wastes, in which it is in ASEAN’s interest to develop a common approach; (4) common approaches to problems of urban development, particularly the existence of slums in cities with more than five million people. Attacking the problem of cleaning up these slums and making the environment more conducive to human well-being could be approached jointly; (5) the creation of an ASEAN environmental institute and/or the closer linking of national institutes dealing with economic/environmental issues; and (6) promotion of a wider awareness of issues related to the environment. Among other things, awareness should include knowledge of the real socioeconomic benefits of environmental programs. More specifically, it is recommended that the feasibility be examined with a view to creating a “green window” at the Asian Development Bank (ADB), which would provide concessionary loans to developing member countries for projects aimed at solving environmental problems. An ASEAN Fund might also be considered to finance environmental projects in the subregion, to be administered by ADB on behalf of ASEAN.

SOUTH PACIFIC

Economic Reform

The Pacific Island economies are generally heavily dependent on foreign aid for their economic sustainability and growth. This high degree of aid dependence, involving both bilateral and multilateral donors, is one cause of the relatively low priority attached to economic and structural
reforms by the Pacific governments. Economic reforms should encourage a stronger market orientation of the Pacific economies and lead to an increase in the competitiveness of their products in international markets. In particular, the reforms considered necessary are: (1) liberalization of labor markets, commerce, and finance, including measures to enhance domestic savings and promote the efficient utilization of resources; (2) stabilization policies to ensure greater financial stability; (3) corporatization and progressive privatization of state enterprises as well as reduction in the size of the public sector; (4) adjustment of effective real exchange rates to enhance export competitiveness (implying the end of wage and salary indexing); and (5) diversification of the agriculture and industrial sectors. External assistance can help to initiate dialogue and encourage the sharing of knowledge on these structural reforms.

Countries already undertaking reforms or intending to do so are likely to encounter short-term difficulties in their domestic budgets and their balance of payments. Some short-term financial assistance would probably be required during transition periods, but the total requirements of each country might not be sufficient to meet the thresholds required by lending institutions such as the World Bank (IBRD), the International Monetary Fund (IMF), and the Asian Development Bank (ADB), of which only Fiji and Papua New Guinea are members. Although it could assume special responsibility in the Pacific to assist in mobilizing short-term financial aid from bilateral and multilateral donors specifically to assist the reform process in the countries which do not qualify for World Bank, IMF, or ADB assistance, the UNDP should also sensitize governments to the need to reduce their dependence on long-term external aid flows. The Pacific governments will have to face up to the need to adjust in light of evolving circumstances in the world economy which will affect them adversely. Two of these circumstances are the growing aid fatigue among the donors of the Pacific region and the declining trade preferences for the Pacific developing countries in the wake of global trade liberalization.

Finance

Opportunities for UNDP assistance in the area of finance can be discussed in two phases. In phase 1, the UNDP's assistance would entail provision of technical expertise in management, as well as project appraisal, to national development banks. Availability of funding for projects is not a problem in the Pacific Islands, but rather there is a severe lack of expertise in bank management, technical, and lending expertise. In fact, financing of projects is available, but is often withheld until the
management capacity of the national development banks can be strengthened. The banks’ capacity to examine, develop, and "package" bankable projects could be financed through lines of credit from institutions such as the World Bank, the European Investment Bank (EIB), the International Finance Corporation (IFC), and ADB. Also, the UNDP could make the national development banks more aware of the various modes of financing that are available including equity windows from the ADB, the EIB, and the IFC.

In phase 2, the UNDP could fund a feasibility study for the establishment of a regional development bank acting as an intermediary in obtaining and dispensing external funding. Once the national development banks’ managerial expertise have been strengthened, a regional development bank that is able to attract development financing and act as a redistributive vehicle to allocate additional funding to the individual island nations could be established. In this phase the regional development bank could also provide financial assistance in starting up new industries or enterprises either through national development banks or directly. In countries with a lack of entrepreneurial skills, a regional development bank would encourage national development banks to engage in such start-up activities and take up venture equity or participate directly in joint ventures.

Trade and Transportation

The likely erosion of privileges enjoyed by the Pacific Island countries through preferential trading arrangements such as the ACP should be recognized and responded to. The UNDP could provide advisory services to the Pacific countries in assessing the impacts of the changing world trading environment and the appropriate policy responses to address these changes.

A good transportation network is one of the most important factors for trade expansion. However, in the South Pacific, transportation facilities remain a serious impediment that has not been effectively addressed. The feasibility of reconstituting a regional airline or building closer cooperative arrangements among existing airlines are some of the options to be reexamined with UNDP assistance.

Transnational corporations (TNCs) could play an increasingly important role in the future development of the Pacific economies and in the movement towards economic reform. UNDP assistance could help these countries to better understand the importance of foreign investment
and the manner in which the involvement of TNCs could be mutually beneficial.

Environmental Concerns

The environment is very fragile in the Pacific Island countries, especially the small atolls. Among the most serious problems are deforestation as a result of excessive cutting of timber and mangroves for short-term economic benefit and lack of replanting schemes; soil erosion and pollution of water supplies resulting from deforestation; over-fishing in particular geographical pockets and the depletion of fish and other marine resources; and inadequate and unsafe disposal of toxic wastes. Pressures on the environment are likely to continue with rapid population growth which is often as high as 3 percent per annum.

A concern for the environment is directly tied to the sustainability of development itself. Increasing environmental awareness in the South Pacific countries demands action at various levels and could be supported by external assistance.

First, people should be "sensitized" to the importance of protecting the fragile environment in the islands. If external assistance is provided, it should be based on demands by the countries themselves. It is also important not to confine awareness generation only to national and local government officials, but also to direct it towards nongovernmental organizations (NGOs), particularly church groups, which play a significant role in the community of Pacific Island cultures. Education of local groups and villagers increase their awareness as stakeholders in the resources that may be adversely affected by polluting activities.

Second, the geographical dispersion of economic activities within the Pacific Island economies makes it difficult for any government organization to efficiently undertake the task of enforcement and monitoring. This task will fall mainly on local groups and villages. Greater awareness of the negative effects of deforestation, for example, would contribute to improvement in enforcement of relevant legislation.

Third, it is important to realize that small enterprises are often the main perpetrators of environmental pollution. Training of managers of small enterprises in the environmental impact of their activities and the development of alternative means to reduce pollution is important.
Managers and owners of enterprises should be convinced of the benefits that could accrue from reductions in levels of pollution.

The impact of polluting activities on water resources is considered an appropriate starting point from which to address environmental protection. Not only is the availability and management of water resources of immediate concern in most of the Pacific economies, it is also an issue in which the linkage between environmental protection and sustainable development could be most clearly perceived.

Assistance could also be provided to develop guidelines for environmental protection in the South Pacific economies. Legislation needs to be formulated within which guidelines on environmental protection could be included. At present, the necessary expertise is lacking in many Pacific Island countries.

Technical assistance and training could also be given in the assessment of environmental impacts of projects activities or investments. There is a lack of know-how in appraising the full costs of a development activity, including the cost imposed on society in terms of negative externalities. Foreign investment, which should nevertheless be encouraged, could in particular incur such externalities. With the move to enhance the industrial sector and private sector development, investments from abroad (and domestically) will need to be carefully assessed.

Human Development

Among the most prominent issues confronting the Pacific Island countries is the extremely high level of unemployment, particularly among the young. In some economies, unemployment of youth ranges as high as 30 percent. Explanations of the high rates derive from three factors: (1) lack of employment opportunities due to the low levels of activity, (2) mismatch between the skills available and the skills that are needed, and (3) overregulated labor markets (such as the existence of minimum wage laws in the Pacific Island economies) which not only lead to inflexibility in the market and uncompetitive wages but also have direct impacts on the potential for employment creation.

Related to this problem of high unemployment is the outmigration of skilled and professional people to Australia, New Zealand, and the United States. Several factors can be adduced to explain these flows, including limited private sector opportunities, difficulty of reintegrating into Pacific
Island culture once ties have been broken, and the failure of some governments to discourage emigration because of their perception that the resulting inflows of remittances are beneficial.

External assistance can help Pacific Islands to address these human resource development problems in a number of ways. First, a manpower planning program should be developed to assess the needs for specific skills in the Pacific Island economies and to train labor to fill them. Countries would also benefit from exchange of experiences.

Second, countries could be made more aware of the long-term impacts of the brain drain and governments could be sensitized to the need to address the problem. While remittances received from skilled and professional labor abroad have positive short-term effects, in the long term there are negative repercussions on the sustainability of the countries' economic development. It is necessary to make the Pacific governments more aware of the breadth of the problems involved in migration.
Part II: Issues papers
Cooperation in trade and finance in the Asia-Pacific region

Victor Santiapillai

The average rates of economic growth and expansion of exports of the developing member countries of the Asia-Pacific region as a group during the 1970s and 1980s is noteworthy, though the experiences of the individual countries vary widely. However, in order to sustain growth in the future, the countries in this region face the following major issues:

1. In most of the Asia-Pacific developing countries, the sequencing and timing of policies, trade and financial deregulation measures, and institutional reforms need to be reexamined in order to ensure outward-looking growth with social equity. The management of the export-oriented development process needs to be improved to attain both objectives.

2. Intraregional and intra-subregional trade expansion can no longer be the main goal of economic cooperation within the Asia-Pacific region. The direction of economic growth and cooperation in trade and finance have to take account of the globalization of markets. The objectives of regional trade and financial cooperation, therefore, must be broadened.

3. Global events such as the GATT Multilateral Trade Negotiations, the European integration in 1992, and the North American Free Trade Association will have an impact on the trade of developing countries in both goods and services. Thus, the developing countries will have to keep abreast of the trade diversionary effects and trade creation prospects, the new rules of the trading game, and the impact of these developments on export marketing channels and techniques.

4. Trade and financial cooperation in the region must harness the full support of Japan—which is poised to become the world’s leading center of industrial, technological, and financial power—and must also recognize the growing potential of the multinational corporations that have played a significant role in the private sector in the region.
5. A key element of trade expansion in the developing countries of
the region is increased flows of non-debt-creating resources. Reform of financial sector policies, and restructuring and
development of financial sector institutions is an urgent need.

Cooperation among the developing countries in all five areas will be
most rewarding to all and, in particular, to the middle-income and lower-
income developing countries of the region. This paper seeks to discuss
the aforementioned issues in this context.

ECONOMIC PERFORMANCE OF DEVELOPING COUNTRIES OF THE
ASIA-PACIFIC REGION

An overview of the economic performances of the region's developing
countries during the past two decades indicates several broad features.
First, the Asia-Pacific developing countries as a group have achieved the
fastest rate of real economic growth in the world during this period,
averaging over 6 percent per annum in the 1970s and 1980s (Table 1).
This contrasts with the growth rate achieved in other developing countries
which averaged 4 percent and in industrialized countries which averaged
slightly less than 3 percent per annum over the same period. The fastest
growth has been in the industrial sector followed by the services sector.

Second, although the Asia-Pacific developing countries as a group
have attained impressive economic growth rates, the experiences of the
individual countries varied considerably. The higher-income countries (i.e.,
the newly industrializing economies or NIEs) achieved the fastest GDP
growth of almost 10 percent in the 1970s and over 7 percent in the 1980s.
This growth was characterized by rapid industrialization, a dramatic
increase in exports, and a fairly quick recovery from the recessions of the
mid-1970s and early 1980s. For the middle-income countries, GDP growth
decreased from 7 percent per annum in the 1970s to 4 percent in the 1980s
due mainly to declining commodity prices and the world recessions; many
countries in this income group were obliged to curtail both their
investments and external borrowing programs in the face of large
budgetary and external deficits and increasing debt service burdens.
Lower-income countries, on the other hand, were able to raise their GDP
growth rate from over 4 percent in the 1970s to more than 7 percent in the
1980s. This performance was the result of greater export orientation, a
contraction of consumer imports, and continued availability of external
resources (mostly from official sources) all of which helped them to deal
with adverse external developments.
A third feature is that trade among the developing countries in the region has kept pace with the expansion of their total foreign trade (Tables 2 and 3). The proportion of intraregional export trade flow was maintained between 20 and 27 percent of their total export trade and for imports the proportion remained between 20 and 25 percent of their total import trade; fluctuations were largely the result of changes in oil and commodity prices. There were no discernible dynamic components that would increase these percentages, although there has been a progressive change in the product composition of intraregional trade in the direction of an increased proportion of manufactures, machinery, and transport equipment, which now account for well over 50 percent of intraregional trade (Table 4). On the other hand, there was a consequential reduction in the percentage of trade in food and raw materials. It is relevant to note, however, that a significant proportion of manufactures consisted of products that face protectionism in the industrialized countries and competition from other developing countries outside the region (e.g., textiles and clothing, and leather goods).

A fourth feature is that the principal markets for over 60 percent of the region's developing country exports have been the developed market economy countries, with the United States, in the latter half of the 1980s, overtaking Western Europe as the lead market; Japan fell to third place (Table 5). The NIEs export performance in the face of protectionist pressures in these areas was noteworthy.

Fifth, a significant change has taken place in a number of developing countries in the area of savings and investment, in contrast to the decade of the 1960s (Table 6). The ratio of gross domestic savings to GDP in the developing countries as a group averaged 26 percent in the 1970s and 1980s, surpassing the 23 percent savings ratio for other developing regions of the world. Higher levels of savings enabled the financing of higher levels of investment, although in some developing countries savings went into questionable public sector investments. In the lower-income countries, however, the ratio of savings remained stagnant at about 8 percent throughout the 1980s, with the exception of China and India, which recorded 30 percent and 19 percent savings ratios, respectively.

Sixth, Japan was the largest investor in the developing countries of the region. The flows of development finance and other resources between the Asia-Pacific developing countries were not significant until the end of the 1980s when there were large outflows from Korea, Hong Kong, and Taiwan to the other countries in the region.
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a. 1980 market prices.
b. GDP data are at factor cost unless otherwise indicated. Calendar-year data except for Bangladesh, Burma, India, Indonesia, Pakistan, Papua New Guinea, and Thailand which are fiscal year data.
c. The aggregate data shown in this table for the various country groups may not be exactly the same as those appearing in the tables in Appendix III of the Report due primarily to a difference in the aggregation methodologies used. Moreover, due to data limitations the aggregates in this table do not include several lower-income DMCs.
d. Based on GDP at market prices.
f. Based on 1986 GDP at market prices.
g. Based on net material product.
h. Based on 1985 GDP at market prices.

Table 2  Inter- and Intraregional Exports and Imports: 1970, 1980, 1986, and 1987 (percentage of total trade)

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| Japan                        | 14.6   | 6.8    | 6.0    | 27.4   | 0.0    | 4.1    | 14.7   | 30.6   | 23.2   | 100.0  |        |        |        |
| Australia and New Zealand    | 10.2   | 3.7    | 5.3    | 19.3   | 21.5   | 7.7    | 20.3   | 16.2   | 15.0   | 100.0  |        |        |        |
| European Community           | 2.1    | 0.8    | 1.5    | 4.3    | 3.0    | 0.8    | 58.2   | 7.8    | 25.9   | 100.0  |        |        |        |
| United States                | 11.7   | 2.6    | 2.5    | 16.8   | 17.2   | 1.6    | 21.6   | 0.0    | 42.8   | 100.0  |        |        |        |

## Table 3  Inter- and Intraregional Imports: 1970, 1980, 1986, and 1987 (percentage of total imports)

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At a more general level, intraregional, intergovernmental economic arrangements of various kinds between the groups of developing countries appear to have made little contribution to these developments in the region. All available evidence, though somewhat scattered, suggests that multilateral and bilateral development finance institutions and private sector direct foreign investment, mostly through multinational corporations (including those from the NIEs), played a significant role particularly with regard to resource inflows into the region’s countries (Table 7). The bulk of direct foreign investment, however, mainly benefited seven Southeast Asian and East Asian countries; although the amount was small in relation to total resource inflows, direct foreign investment acted as a catalyst in transferring management skills, technology, and marketing know-how to enterprises in these countries.

In addition, industrial growth, which has been the main dynamic growth sector, has been largely confined to metropolitan and urban areas in a number of the Asia-Pacific developing countries. The Philippines presents perhaps the most striking example of this undesirable trend which has markedly aggravated the problems of urbanization and the imbalances between the urban and rural sectors, with the rural sector often subsidizing the urban sector. In unforeseen ways, industrial progress itself has brought about problems of urbanization and environmental degradation due to insufficient attention to broad-based, integrated development policies.

On the social level, the experiences of the Asia-Pacific developing countries suggest that rapid economic growth facilitates the realization of social objectives and higher standards of living. Korea, Singapore, and Taiwan, for example, are countries where rapid growth has been accompanied by a more even income distribution, as well as improved access to housing, public health, education, and technical training. On the other hand, countries such as China, Sri Lanka, and parts of India (e.g., Kerala) have shown that, even with slower GDP growth rates, great improvements in health, education, and expansion of prospects for self-employment can be affected by governments directly confronting these issues by reordering their public investment programs (see ul Haq, this volume).

Despite all that has been achieved with respect to structural adjustment, growth and diversification of exports, and improvements in social infrastructure and living standards of segments of the people, the Asia-Pacific developing countries still have an unacceptably large
<table>
<thead>
<tr>
<th>Year</th>
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<th>Higher-income countries</th>
<th>Middle-income countries</th>
<th>Lower-income countries</th>
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<th>Australia and New Zealand</th>
<th>European Community</th>
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**1987**

| All Asia-Pacific Developing Countries | 14.6 | 4.5 | 6.8 | 25.9 | 14.7 | 1.9 | 14.3 | 33.3 | 9.8 | 100.0 |
| Higher-Income Countries           | 9.0  | 5.4 | 8.9 | 23.4 | 11.4 | 2.1 | 13.7 | 45.5 | 4.0 | 100.0 |
| Middle-Income Countries           | 17.7 | 3.9 | 4.6 | 26.2 | 25.3 | 2.1 | 14.5 | 19.8 | 12.0 | 100.0 |
| Lower-Income Countries            | 27.5 | 2.4 | 2.9 | 32.7 | 14.8 | 1.3 | 15.7 | 11.1 | 24.3 | 100.0 |
| Japan                            | 16.2 | 4.2 | 5.5 | 25.8 | 0.0  | 2.7 | 16.6 | 36.8 | 18.1 | 100.0 |
| Australia and New Zealand         | 11.3 | 4.1 | 7.7 | 23.2 | 23.6 | 7.8 | 17.0 | 12.1 | 16.2 | 100.0 |
| European Community                | 1.7  | 0.6 | 1.7 | 4.0  | 1.6  | 0.8 | 58.5 | 8.7  | 26.4 | 100.0 |
| United States                     | 8.8  | 2.3 | 2.4 | 13.5 | 11.3 | 2.5 | 24.2 | 0.0  | 48.5 | 100.0 |

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<th>Gross Domestic Investment&lt;sup&gt;a&lt;/sup&gt; (percent of GDP)</th>
<th>Current Account Balance&lt;sup&gt;a&lt;/sup&gt; (percent of GDP)</th>
<th>Import Volumes (annual percent change)</th>
<th>Export Volumes (annual percent change)</th>
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<td>2.2 6.7</td>
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<td>10.0&lt;sup&gt;c&lt;/sup&gt; 4.1</td>
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a. Gross domestic savings exclude net factor income from abroad. Thus, the gap between gross domestic savings and investment will not necessarily equal the current account balance. All data are on calendar year basis except for Bangladesh, Burma, India, Pakistan, and Papua New Guinea which are fiscal year data for gross domestic savings, investment, and GDP, and Indonesia and Thailand for gross domestic investment and GDP.


g. Output based on Net Material Product.
l. Percent of GNP.

### Table 7 Aggregate Net Resource Flows to Asia-Pacific Developing Countries, 1978–1987 (US$ billion)

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<td>6.6</td>
<td>7.2</td>
<td>7.5</td>
<td>7.2</td>
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<td>0.2</td>
<td>0.3</td>
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<td>1.6</td>
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<td>n.a.</td>
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<tr>
<td>Total Asian Development Bank</td>
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<td>0.5</td>
<td>0.5</td>
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<td>0.8</td>
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<td>3.3</td>
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<tr>
<td>1. Total net resource flows (I + II + III)</td>
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**Source:** Organisation for Economic Co-operation and Development (1987, 1988).

- Includes negative net flows of US$8 billion from Korea and excludes over US$10 billion of short-term inflows into Taiwan.
- Organisation for Economic Co-operation and Development.
- Includes long- and short-term transactions.
percentage of people who live in abject poverty and their numbers have increased in the 1980s. Given the population growth trends, the forecast for the region is that there will be approximately 200 million new entrants into the labor force in the 1990s. Hence, there will be a need for a rapid and sustained increase in the number of job opportunities each year, most of which will have to come from the private sector, especially since governments have realized during the 1980s the serious limitations of public sector enterprises. Improving the quality of life for nearly half a billion poor persons and providing employment opportunities to youth are challenges that are faced by all governments and international institutions concerned with the next phase of Asia-Pacific development.

It would appear that high rates of economic growth accompanied by a rapid expansion of exports resulting from structural adjustment policies and programs adopted by a number of countries have not been able, by themselves, to improve the living standards of the poorest groups in the region. This issue has come to the forefront of political concern, especially in democratic societies, because the 1980s have witnessed the reversal of the postwar trend towards the gradual reduction of the numbers affected by abject poverty in the developing countries. Questions about the sustainability of such growth are being strongly voiced in these countries.

There is, therefore, a great deal of rethinking on development strategies and sustainable structural reforms that will bring about economic growth, external equilibrium, and social equity. While most governments now recognize that economic growth, important as it is, is not an end in itself and should be made to contribute more directly to overall development objectives (e.g., expansion of social infrastructure and human resources development, including poverty alleviation), they are far from being clear about the policies, institutions, and instruments to be used to achieve this end. Most countries do not have access to know-how on alternative strategies that will enable each country to determine the right balance between the scope and roles of the public and private sectors; between government planning and the extent market forces and mechanisms should play; and between policies that promote economic growth and those that pay attention to social imperatives. Unfortunately, the knowledge base for the pursuit of such approaches is still very inadequate, and hence policy makers and planners in many of the region’s developing countries have been floundering or improvising less than optimal solutions in the face of competing priorities. While there is no doubt that the problem of abject poverty will persist in the region’s developing nations well beyond the year 2000, the continued viability of
Victor Santiapillai

democratic systems demands that governments must be seen to be initiating more effective policies and measures than in the past to combat increasing poverty and to improve living standards of the poorest communities. It is, of course, recognized that development models are not simple packages of policies; they are configurations of political, social, institutional, and historical circumstances, and hence have to be adapted to individual country situations by the institutions in each country.

IMPACT OF WORLD ECONOMIC DEVELOPMENTS

Since, as noted earlier, the main export markets of the Asia-Pacific developing countries are the industrial, market economy countries, it would be useful to have a quick overview of events in these countries and any significant developments that may have an impact on the developing countries in the region. The economic situation of the industrial countries has improved in many ways during the 1980s. Following the economic recession of 1981-1982, there has been a long period of expansion with reduction in both unemployment and inflation. Although the widespread resurgence of inflationary pressures during the last years of the 1980s required a substantial increase in short-term interest rates, government policies in most industrial countries appear to be focused on avoiding a downturn in economic activity while containing inflationary pressures. Projections of GDP growth in the industrial countries in the first half of the 1990s have an upper limit of 3 percent per annum, a figure that is lower than that of the second half of the 1980s. Nevertheless, it is expected that there will be a steady expansion of international trade, though not as high as the rates of the late 1980s. The trade expansion will be beneficial to exports of developing countries, particularly the Asia-Pacific developing countries whose GDP growth is expected to surpass that of both Africa and Latin America in the 1990s. While primary product exporters will gain only marginally in the 1990s with their terms of trade failing to improve significantly, there is positive news for developing countries with the capacity for exporting manufactures.

However, the realization of this global scenario will depend to a great extent on the outcome of a number of international economic arrangements that are being forged at the present time. These arrangements will determine the access of goods and services to markets in the industrial market economy countries. If these arrangements diminish export opportunities, the Asia-Pacific developing countries, whose export trade is so heavily dependent on these markets, will be adversely affected. It is impossible to adequately cover in a brief paper all the economic
arrangements that are under negotiation at the present time. Hence, the observations below will be confined to a few selected issues that could be of special relevance to the Asia-Pacific countries.

GATT Multilateral Trade Negotiations

The Uruguay Round launched in September 1986 (the seventh in the series of GATT Multilateral Trade Negotiations) covers firstly the traditional aspects of GATT’s international role. These include (1) further trade liberalization and improvement of access to markets of its member states, (2) improvement of GATT rules relating to international competition (e.g., safeguards, protection, measures relating to subsidies and dumping), and (3) strengthening of GATT’s institutional machinery (e.g., improving dispute settlement procedures and surveillance of trade policy measures). Secondly, the Uruguay Round includes negotiations on three new subjects including (1) trade in services, (2) trade-related intellectual property rights, and (3) trade-related investment measures.

With the exception of some tariff concessions relating to trade in tropical products that were announced in April 1989, none of the fifteen negotiating groups that are dealing with the old and new issues had reached any conclusions or understandings by June 1990, despite the fact that agreements have to be wrapped up by next February at the latest to enable U.S. Congressional approval to be obtained before June 1, 1991. A great deal has been written about the Uruguay Round of negotiations, but much of this reflects the personal perceptions of the authors and may have little relevance to the final outcome. Indeed, GATT negotiations have been characterized by cliff-hanging up to the final stage, last-minute trading of concessions, and eventual compromises, some of which have been less than satisfactory. Hence, it is impossible at this stage to guess what the final package of arrangements will be.

The new issues, even more than the old, touch on sensitive areas of national development strategies such as investment policies, acquisition of technology, and national control of such vital services as transport, finance and banking, and patents. The differences between developed and developing countries on several of these issues were very wide at the commencement of negotiations, particularly in the area of trade in services where the major stumbling block has been the different concerns of different participating countries on different types of services. While the developed countries have tended to focus on the more capital-intensive service industries—e.g., banking and financial services—the developing
countries have been more interested in market access for labor-intensive services such as construction which require cross-border movements of persons for the delivery of the service. Because the services sector in a number of Asia-Pacific developing countries is expected to contribute strongly to growth and exports in the 1990s, the outcome of the negotiations on services is of great significance to them.

Another item of special interest to a number of countries in the region is the phasing out of the Multifiber Agreement (MFA). It would appear that there is agreement in principle to phase out the MFA and bring the trade of textiles and garments under normal GATT rules, and the current negotiations are discussing the steps to be taken for this phasing out process. These steps have implications for the immediate future of those developing countries in Asia and other regions that have relied heavily on the MFA quotas to promote exports of their textiles and garments rather than adopting improved product adaptation and marketing measures.

There is concern about the impact the developing countries as a group will make on the ultimate outcome of the Uruguay Round. Unlike earlier GATT negotiations, the scope of the Uruguay Round is much wider and it covers hitherto unexplored, complex issues; and the negotiating mechanisms are cumbersome. The emergence of two large trading blocs—the EC and North America each linked together by special economic arrangements—has diminished the role of individual countries in the negotiations, has eroded GATT's basic principle of most-favored-nation (MFN) treatment, and has strengthened the concept of reciprocity in negotiations. The capacity of developing countries to participate effectively has been put under greater strain and it is possible that on certain issues, developing country views may not be given the weight they deserve. Hence, it is all the more important that, when the final outcome of the negotiations is known, the Asia-Pacific developing countries have access to expert advice on the implementation of the arrangements agreed upon, and the actions they should take in order to exploit the benefits offered by the arrangements and circumvent any obstacles created by them. The impact of the results of the Uruguay Round will also depend on the efficacy of the monitoring and dispute settlement mechanisms that emerge from the negotiations. The developing countries in the Asia-Pacific region should be able to take full advantage of these mechanisms and cooperate with each other in this endeavor.
The Unified European Market 1992

The recent enlargement of the European Community (EC) and the deepening of the European integration process leading to the 1992 goal of a unified trading region where there will be free movement of goods, services, labor, and capital, have raised questions about the impact of these arrangements on access to imports into these markets and on the international trading system as a whole. These concerns arise from the possible trade diversionary effects of these arrangements which, by their very nature, are discriminatory vis-à-vis third countries. Any such adverse effects will weigh more heavily on the economically weaker developing countries. On the other hand, if the formation of the single European market leads—through intensified flows of innovation, new processes and technology, and new products—to a higher long-term EC growth rate of around 5 percent per annum as has been argued by some, then trade creation would occur and developing countries could experience a long-term rise in demand for their exports in the European market.

The U.K. Overseas Development Institute’s Briefing Paper (1990), The Developing Countries and 1992, made the following observations:

The Commission (of the European community) estimates the direct effect of the removal of barriers as a reduction in manufactured imports of some 10 percent. Extrapolating to take account of economies of scale and other industrial rationalization on the basis of the Commission estimates of growth effects, this number should be raised to 15 percent. Taking an import elasticity of 3, the trade creation effect on LDC manufactured exports, of say, a 5 percent increase in Community GDP would be of about 15 percent. On balance, trade creation and trade diversion in manufactures will probably offset each other.

For agricultural raw materials and minerals which cannot be produced in the EC, the Commission has estimated that, assuming 1992 will result in boosting EC GDP by 5 percent per annum, there will be an increase of imports of these items from developing countries of just over US$5 billion or 6 percent of the value of current annual imports, though about 80 percent of this increase will consist of fuel imports.

It is, however, difficult to quantify in any detail such macroeconomic projections relating to third country exports to the EC, because the
outcome of almost 300 legislative proposals arising from the Single European Act of 1987 remains unclear. Furthermore, the fourth Lome convention (Lome IV) which bears upon the relations between the EC and the Association of African, Caribbean, and Pacific (ACP) countries and which is also under negotiation, could have an impact on Asia-Pacific developing country exports to the EC, including coffee and tobacco.

Dr. Alan Roe, Director of the Warwick Research Institute, University of Warwick, makes the following points in his paper, "Trade prospects for developing countries in the 1990s with special reference to developments in the EEC":

First, there are some reasons to expect that the overall growth of world trade in the 1990s will be such as to provide developing countries with a reasonable overall environment in which to build their trade. Secondly, the prospects for primary product exports are far less encouraging than the prospects for developing country exports generally. Thirdly, the general drift of the trade reform under both Lome and the Single European Act seems likely to ease market access somewhat in general, although the complexity of some of the 1992 reforms is such as to make clear judgements difficult. Fourthly, the particular issues where Lome, GATT, and 1992 reforms seem likely to cause problems for particular commodities, are nearly all issues where one group of developing countries will benefit at the expense of another group. This is true, for example, of the banana arrangements under Lome; the reduced rate for coffee tariffs under GATT; the differential effects of EEC tax harmonisation on coffee as opposed to tobacco; the easier ACP access for some temperate agricultural products which may harm southern European producers; and, of course, the easier EEC access available to Eastern European countries which may have detrimental effects for manufacturing exports in other relatively low income countries.

Quite apart from issues relating to commercial policy and access to the EC market, the unified European market will result in far-reaching changes in the operational aspects of trading. Uniform community product standards and uniform rules for import are likely to snap historical trade linkages. Marketing in the Community will involve new dimensions and innovative approaches. For example, it would be more essential for exporters to the EC to find a foothold for effective distribution and servicing
at an appropriate location in the EC than it was before. Likewise, warehousing would become a necessity since EC importers would rely increasingly on fast electronic data systems to control inventories and reorder supplies, which will, in turn, demand a quick response from suppliers. Location of such warehouse facilities will have to be done with some care since with a unified European market, Mediterranean ports could assume more importance because of sea and road networking facilitated by the removal of national barriers to movement of goods; at the same time, the role of traditional ports such as Rotterdam and Hamburg in the north could diminish.

Cooperation among the developing countries of the Asia-Pacific region in keeping abreast of both the policy provisions relating to access to the EC market and, perhaps more importantly, the evolving operational needs of trading with EC enterprises, can be most fruitful.

The Integrated North American Market

The United States-Canada Free Trade Agreement (FTA) which came into effect on January 1, 1989 has initiated the creation of an integrated North American market in which tariff barriers on goods between the United States and Canada will be phased out by January 1, 1998. There is no intention to establish a common external tariff for imports from third countries. In the area of trade in services, the FTA is the first international agreement to attempt to set rules for service industries. The provisions dealing with trade and financial services recognize the rapid internationalization of financial markets and the desirability of having fewer domestic regulations in this sector. Another interesting feature of the FTA is the liberalization of Canadian direct foreign investment in the United States. Other provisions of the Agreement relate to (1) a code of conduct for the two governments in their regulation of both private firm behavior and for their own economic policies, (2) energy exchange, (3) liberalization of the automobile trade, (4) business travel facilitation, and (5) bilateral dispute settlement.

Although the FTA is said to merely create a free trade area between two contiguous countries and does not attempt economic integration as in the case of the EC, it can have far-reaching implications for third countries. A close examination of the provisions under the FTA indicates that in certain manufactured products, trade diversion may be significant, even though trade diversion in aggregate terms may be negligible. Garments and textiles, which are of export interest to a number of Asia-
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Pacific developing countries, are examples of managed trade sectors that are subject to restrictive rules-of-origin criteria. These products qualify for free trade between the United States and Canada no matter where they are produced, if at least 50 percent of the value of the materials and processing embodied in the goods originates in either the United States or Canada. In effect, the fabric will have to be of U.S. or Canadian origin. Likewise, transportation equipment, which is exported by some developing countries of the Asia-Pacific, is also subject to restrictive rules of origin.

On the other hand, it would appear that the Pacific Rim developing countries could benefit from the FTA. In trying to identify the areas of opportunity within Canada that exist for Pacific traders and investors outside North America, the trading patterns between the United States and Canada and thirteen Pacific Rim countries (Japan, five ASEAN countries, Hong Kong, Taiwan, Korea, China, Australia, and New Zealand) were examined by the Canadian Committee of the Pacific Basin Economic Council. The overall conclusion is that the FTA should stimulate new trade and investment opportunities on both sides of the Pacific, and that Pacific Rim companies should view Canada as a favorable location from which to supply the entire North American market while Canadian entrepreneurs will see increased opportunities across the Pacific through new trade and investment linkages:

Major increases in trans-Pacific trade are more likely to result initially from increased investment by Canadian firms across the Pacific, and by Pacific Rim entrepreneurs in North America, and from nontrade links such as licensing and other agreements, as well as by similar arrangements by North American entrepreneurs. The FTA also provides a window of opportunity for Pacific Rim investors and companies to enter into joint research and development arrangements with Canadian companies.

Pacific Rim countries interested in increasing their share of the North American market may well decide that their best strategy is to establish assembling or finishing facilities in either Canada or the United States and serve the larger, integrated market from a more secure base. Such suppliers will wish to take a close look at the rules of origin and other aspects of the agreement to determine the best way to establish facilities in North America to use offshore technology, capital, and components.
Japan, the NIEs, and Other Asia-Pacific Nations

The rise in protectionism in the two economic super blocs, Western Europe and North America, has brought Japan and the developing Asia-Pacific countries closer to each other in the 1980s. Today, there are frequent references in the literature on international affairs to the emergence in the 1990s of a third economic bloc that is loosely organized around Japan, which has a very special economic leadership role in the region, and that parallels the European Community and North America. Whether this will in fact happen depends largely on Japan’s policies towards its Asia-Pacific neighbors as well as on the perceptions of the numerous multinational corporations that are active in the region.

A look at Japan’s past investment and trade in the developing Asia-Pacific economies is, therefore, useful. While Japan is the largest supplier of investment capital to Asia and although Japanese overseas investment in Asia has increased in absolute terms (Tables 8 and 9), it has fallen markedly in terms of the percentage of total outflows from Japan. Japanese overseas investment in Asia in 1986 was only about 10 percent of total Japanese overseas investment, whereas in 1975 it was nearly 34 percent. Furthermore, a review of the figures of trade between Japan and the developing countries of the region shows that the share of imports into the developing countries increased steadily and more than doubled from 9.5 percent in 1960 to 22 percent in 1970, and has remained at this level since then; on the other hand, the share of imports into Japan from the developing economies expanded from 6.5 percent in 1960 to 15 percent in 1987. The only countries in the Asia-Pacific region from which Japan imported significantly more in the second half of the 1980s were the NIEs. In contrast, the United States became the largest market for exports from the developing Asia-Pacific countries. While it is true that the industrial North American and enlarged EC markets, with 265 million and 320 million consumers, respectively, will continue to offer the greatest opportunities to the region’s exporters, it is nevertheless reasonable to expect that the most highly developed country in the region will be able to take a steadily increasing share of exports from the developing countries of the region. Statistical data such as these raise questions as to what Japan’s role vis-à-vis the Asia-Pacific countries will be in the future. It is hoped that the economic restructuring process that is underway in Japan will open new opportunities for Asia-Pacific developing country exports to Japan.

Numerous multinational corporations originating in the region—e.g., the expatriate multinationals from the colonial period, international Chinese
### Table 8: Total Net Flow of Official Development Financea: 1970 and 1986

<table>
<thead>
<tr>
<th>From/To</th>
<th>1970</th>
<th>1986</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount (US$ b)</td>
<td>Share (%)</td>
</tr>
<tr>
<td>Multilateral</td>
<td></td>
<td></td>
</tr>
<tr>
<td>of which:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>World Bank</td>
<td>0.352</td>
<td>10.1</td>
</tr>
<tr>
<td>Asian Development Bank</td>
<td>0.231</td>
<td>6.6</td>
</tr>
<tr>
<td>Bilateral</td>
<td>0.017</td>
<td>0.5</td>
</tr>
<tr>
<td>of which:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>OECD-DAC</td>
<td>3.136</td>
<td>69.9</td>
</tr>
<tr>
<td>United States</td>
<td>1.596</td>
<td>45.7</td>
</tr>
<tr>
<td>Japan</td>
<td>1.006</td>
<td>28.8</td>
</tr>
<tr>
<td>Other OECD-DAC</td>
<td>0.535</td>
<td>15.3</td>
</tr>
<tr>
<td>Australia</td>
<td>0.012</td>
<td>0.3</td>
</tr>
<tr>
<td>Canada</td>
<td>0.083</td>
<td>2.4</td>
</tr>
<tr>
<td>France</td>
<td>0.083</td>
<td>2.4</td>
</tr>
<tr>
<td>Germany</td>
<td>0.117</td>
<td>3.4</td>
</tr>
<tr>
<td>Netherlands</td>
<td>0.086</td>
<td>2.5</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>0.230</td>
<td>6.6</td>
</tr>
<tr>
<td>Others</td>
<td>-0.076</td>
<td>-2.2</td>
</tr>
<tr>
<td>Total</td>
<td>3.490</td>
<td>100.0</td>
</tr>
</tbody>
</table>

a. Defined as gross disbursements of grants and loans less repayments on earlier loans.
b. For Bhutan, Cook Islands, Kiribati, Maldives, Tonga and Vanuatu, breakdown of official flows between multilateral and bilateral sources are not available; thus, these flows are shown in total official flows only.
c. Organisation for Economic Co-operation and Development, Development Assistance Committee.

<table>
<thead>
<tr>
<th>Year</th>
<th>World</th>
<th>Asia</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>Manufacturing</td>
</tr>
<tr>
<td>1975</td>
<td>3,280</td>
<td>924</td>
</tr>
<tr>
<td>1976</td>
<td>3,462</td>
<td>1,025</td>
</tr>
<tr>
<td>1977</td>
<td>2,806</td>
<td>1,074</td>
</tr>
<tr>
<td>1978</td>
<td>4,598</td>
<td>2,038</td>
</tr>
<tr>
<td>1979</td>
<td>4,995</td>
<td>1,693</td>
</tr>
<tr>
<td>1980</td>
<td>4,693</td>
<td>1,706</td>
</tr>
<tr>
<td>1981</td>
<td>8,932</td>
<td>2,305</td>
</tr>
<tr>
<td>1982</td>
<td>7,703</td>
<td>2,076</td>
</tr>
<tr>
<td>1983</td>
<td>8,145</td>
<td>2,588</td>
</tr>
<tr>
<td>1984</td>
<td>10,155</td>
<td>2,505</td>
</tr>
<tr>
<td>1985</td>
<td>12,217</td>
<td>2,352</td>
</tr>
<tr>
<td>1986</td>
<td>22,320</td>
<td>3,806</td>
</tr>
</tbody>
</table>

\(^a\) Includes transport and electric and electronic equipment as well as general machinery.

\(^b\) Share (in percentage) of investment in machinery as a proportion of manufacturing investment.

**Source:** Japan, MITI (1988).
capital institutions (some of which date back to the Manchu era in China), and Japanese and Asia-Pacific multinationals that are based in the NIEs and the ASEAN countries—contributed significantly to the growth of the Asia-Pacific region in the 1970s and 1980s. To these must be added multinationals based in Europe and North America who are operating in this region. There are over 100 multinationals operating out of Singapore alone that have established units in Malaysia, Thailand, and Indonesia. Available evidence suggests that a considerable part of intraregional trade in the past two decades is accounted for by the increase in intraindustry trade reflecting the role of multinationals in the region. In fact, a new phase of industrial development has already begun, with production becoming more regional and the market more global. Even many medium-sized companies are operating more and more on a global scale. The result is global competition in terms of price and quality, a steady increase in manufacturing productivity, and a rapid expansion of intraindustry trade (see Figures 1 through 5). The operations of the multinationals have been facilitated by the globalization of capital markets.

China, since 1979, has opened its doors to direct foreign investment, giving preference to investments that foster export development. The multinationals took full advantage of this open-door policy. China's foreign trade rose remarkably from US$26.6 billion in 1978 to US$82.7 billion in 1987. Among the top leading merchandise traders, China moved from 26th position in 1978 to 12th position in 1987.

However, most of the multinationals with origins in the Asia-Pacific region are now looking for opportunities further afield. Both expatriate and Chinese multinationals have been diversifying their investments and activities away from their regional bases to North America and Europe. The unprecedented internationalization of the Japanese multinationals during the past two decades is well known. The “hollowing out” of segments of Japanese industry has resulted in the transfer of these activities mainly to the developed countries. The Asia-Pacific multinationals are also following suit because many of them are dependent on external material resources and need to sell their manufactured products in advanced, high-volume markets. There is no doubt that the movement towards North America and Europe was also motivated to a considerable extent by the fear of growing protectionism in these two areas. This trend could accelerate as a result of Europe 1992 and the North American FTA, and could have consequences for the future evolution of industry and trade in the Asia-Pacific region.
Figure 1

Audio Equipment Plant in Singapore (Matsushita)

Singapore
$\text{value: } 70\%$
- Remote Control Unit
- Motor
- PCA
- Electronic & Electrical Components

Malaysia
$\text{value: } 5\%$
- Magnetic Head
- Tape Deck
- Electronic & Electrical Components

Japan
$\text{value: } 16\%$
- Magnetic Head
- Electronic & Electrical Components
- Integrated Circuits

Taiwan
$\text{value: } 8\%$
- Antenna
- Electrical Components

Others
$\text{value: } 1\%$
- Electrical Components

Markets
\begin{align*}
\text{USA: } & 50\% \\
\text{Europe: } & 15\% \\
\text{ASEAN: } & 35\%
\end{align*}

Figure 2

Color TV Plant in Singapore (Thomson)

Singapore
$\text{value: } 40\%$
- Picture Tubes
- Integrated Circuits
- Electronic Components
- Metal & Plastic Parts

Malaysia
$\text{value: } 6\%$
- Electronic Components
- Integrated Circuits

Japan
$\text{value: } 24\%$
- Electronic Components
- Integrated Circuits

Taiwan
$\text{value: } 15\%$
- Picture Tubes
- Metal Parts
- Electronic & Electrical Components

S. Korea
$\text{value: } 10\%$
- Picture Tubes

Others
$\text{value: } 3\%$
- Electronic Components

Markets
\begin{align*}
\text{Europe: } & 85\% \\
\text{ASEAN: } & 15\%
\end{align*}
ASIA-PACIFIC ECONOMIC COOPERATION ARRANGEMENTS

Trade and Industry

The Asia-Pacific is one of the most diverse regions of the world. The region is characterized by major and minor cultures, religions, and ideologies, and encompasses over one-third of humankind that interact over a sprawling geographical area which, though representing barely 10 percent of earth’s land mass, is separated by vast physical barriers. The region includes countries as huge as China and India and others as small as some of the Pacific Islands. Because of this diversity, efforts at any kind of regional cooperation in the Asia-Pacific region have been based on clusters of countries or subgroups that have some common historical affinity or some common goal for the future. Economic cooperation among the countries in the region has been initiated through the following institutional arrangements comprising different groups of countries: The Association of Southeast Asian Nations (ASEAN), the Agreement on Trade
Negotiations among Developing Countries of ESCAP (Bangkok Agreement), the Asian Clearing Union, the Asian Reinsurance Corporation, the South Pacific Forum, and the South Asian Association for Regional Cooperation (SAARC).

While ASEAN, SAARC, and the South Pacific Forum were initiated by their respective members for diverse political and economic reasons, the other groups came into being as a result of initiatives taken by UN agencies such as ESCAP and UNCTAD. Although each group has had different motivations, objectives, and activities, cooperation to expand trade and promote industrial development within each group has been a subject on the agenda of all these institutions (of course, the Asian Clearing Union and the Asian Reinsurance Corporation play special roles). However, little progress has been achieved. Part of the lack of progress is due to the diversity of the countries within each group, their different national priorities, and their inability to obtain an equitable distribution of gains between each other, all of which have weakened the commitment of governments to implement the arrangements. Most of these countries have not been prepared to sacrifice short-term national gains for long-term group or regional benefits. Second, in view of the trend towards the globalization of markets and regionalization of production, it would appear that the objective itself of collaboration—namely, trade expansion and industrial development—within each group was not well conceived; perhaps, it was a desirable goal when the institutions were created, but it has since been overtaken by developments in the region. It has also been said that the agreements relating to these institutions were generally negotiated by government functionaries without adequate participation of business operators such as chambers of commerce and industry, banks, and industrial and trading enterprises, and hence lacked a degree of realism and were not followed up by the business operators. In fact there is very little knowledge about the provisions of these agreements among senior members of the business community in most of the countries concerned.

Of the existing subregional bodies, ASEAN would appear to have the best potential and the institutional base to develop into a useful institution for economic cooperation and development. Though the Preferential Trading Arrangements (PTA) of 1977 have not really created trade and have perhaps outlived their usefulness, the existence of the Committee on Trade and Tourism provides the ASEAN countries with a forum for exploring new avenues for trade liberalization. The ASEAN Swap Arrangement is a useful instrument but its efficacy has been hampered by
Cooperation in trade and finance in the Asia-Pacific region

The dearth of resources; this can be remedied. The ASEAN Finance Corporation has functioned as an investment bank. AFC has been able to develop closer ties with its counterparts in the industrialized countries, which are important sources not only of investment funds but also of technological expertise for ASEAN industrial projects. The ASEAN Bankers Acceptance was established with the objective of financing intra-ASEAN trade; but problems associated with foreign exchange regulation and conflicting fiscal and monetary policies have prevented the ABA market from developing. Other consultative arrangements, such as the Committee on Finance and Banking and the ASEAN Banker’s Association, also exist within ASEAN. This institutional infrastructure can be mobilized to move forward from its erstwhile role of establishing Pax ASEANA to becoming an economic force in Southeast Asia. This, of course, assumes that there is the political will to eschew economic nationalism, to harness the fullest participation of the business sector, and to seek new avenues of industrial cooperation in the region (e.g., exploitation of industrial complementarity between ASEAN and the NIEs).

The ministerial meeting of ministers from twelve countries (Japan, Korea, the six ASEAN countries, the United States, Canada, Australia, and New Zealand) in Canberra in November 1989 has opened another door for new initiatives for Asia-Pacific Economic Cooperation between countries of the Pacific Basin. Cooperation in trade and investment figured importantly in the discussion. The establishment of a working party of senior officials reflects a sense of urgency in pursuing the ideas considered at the meeting. It is still too early to comment on how far and in what direction this initiative could go, but it does reflect the growing relevance of the pace of Asia-Pacific economic development to the rest of the world.

Finance

In the field of finance, there have been few developing-country government initiatives for cooperation. The Asian Clearing Union is designed to alleviate the burden on foreign exchange reserves as a result of financing the intraregional trade of participating member countries. It is basically a multilateral clearing scheme for the member countries. While the ACU has been of limited operational value to the countries covered, it has provided the opportunity for closer consultations between the central banks of these countries.

The Association of Development Financing Institutions in Asia and the Pacific (ADFIAP) has been a useful consultative body of development
bankers which has brought a number of vital issues concerning development finance to the attention of central banks and development banks in the region. These issues often escape the attention of bankers who are preoccupied with the problems of day-to-day operations, which have sharply escalated due to the changing national and international environment in which they function. The ADFIAP's capacity seems to have been underutilized.

A new reality in a number of developing countries in the 1980s is the increase in debt as a percentage of GDP and the increase in debt servicing as a percentage of export earnings. In addition, project costs, in terms of both foreign exchange and local currencies, have reached unprecedented heights and servicing of the loan components of projects has become most difficult due to exchange rate fluctuations and escalation of interest rates. Against this background, development projects, especially export projects, that have to be inter alia cost-competitive in international markets have to drastically cut down their commercial term loans and rely more on equity finance. Traditional norms of gearing ratios have to be abandoned and more equity has to be pumped into projects.

Some of the middle-income countries and all of the lower-income countries have experienced difficulties in obtaining an increasing proportion of external resources in the form of non-debt-creating inflows such as direct and portfolio investment. Within each country at the enterprise level, the growth of small and medium-sized enterprises (SMEs), which constitute the backbone of democratic societies, has been hampered by a chronic dearth of equity. The collapse of several development finance institutions in the 1980s has adversely affected the potential of SMEs to contribute to development. New channels have to be found to provide additional equity to SMEs if development in the Asia-Pacific region is not to depend solely on large conglomerates. In this context, the recent initiative taken by the Asian Development Bank to create a modest facility, namely, the Asian Finance and Investment Corporation (AFIC), for providing direct financing to private enterprises is a step in the right direction. Nevertheless, more has to be done in this regard.

The adoption of appropriate policies and the creation of the necessary institutions to increase the flow of non-debt-creating resources for private enterprise will be crucial to the development of several middle-income and lower-income countries of the Asia-Pacific region. Cooperation between them and the higher-income countries and Japan is essential in order to forge arrangements to meet this need. Such
cooperation will also have an impact on national policies and institutions in the financial sector, which has to be reformed and developed to encourage the flow of direct foreign investment as well as portfolio investment. ADB and ADFIAP could serve as focal points for organizing such cooperation.
Note

1. The grouping of the developing countries into higher-income, middle-income, and lower-income groups has been adopted from the Asian Development Bank's statistical tables (Asian Development Bank 1989).
Cooperation in trade and finance in the Asia-Pacific region

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INTRODUCTION

In an effort to improve economic performance, most if not all developing countries in the Asia-Pacific region have been relying more on the private sector and less on the government as economic planner, economic regulator, or direct entrepreneur. The change in development strategy in favor of private sector development is indicative of a growing belief in Asia that economic growth and equity can be enhanced by promoting private sector development.

The strong relationship between private sector development and economic growth received a great deal of attention in the 1980s. The concept of the private sector as a prime engine of growth promises to play a paramount role in the 1990s as well, touching countries in every corner of the globe, developed and developing alike. The ideologies that shaped development strategies in the past and encouraged public-sector-oriented policies have been eclipsed by a more practical approach to development. Indeed, it is perhaps inappropriate today to refer to the "evolving" emphasis on private sector development in the Asia-Pacific, and to focus mainly on the developed world and give a few examples of developing countries in the region who were following this trend. Today, this "evolution" has reached a critical mass. The Asia-Pacific is now characterized by a policy approach that embraces liberalization, deregulation, and privatization, which are essential ingredients in promoting development of the private sector.

Of course, the Asia-Pacific is not unique in this regard; the economic revolutions in Eastern Europe and the Soviet Union, unthought of even a year ago, have private sector development as their lifeblood. Moreover, Latin American governments at the end of the 1980s began to accept the idea of the private sector as a partner in development. More stable macroeconomic policies are in the making in many Latin American countries, and policies to render the economy more efficient and to lay the groundwork for future development are being adopted. Indeed, the Asian success stories of the 1980s contrast significantly with the "lost decade" for Latin America; this observation has not escaped the notice of academics, government officials, and representatives of the private sector.\(^1\) Asia is
serving as an impressive example, and the 1990s in both continents, as well as others, looks promising.

Following Japan, the newly industrializing economies (NIEs)—Hong Kong, Korea, Singapore, and Taipei-China—clearly demonstrate the benefits of outward-looking, market-based development policies. Per capita income and other social measures of economic well-being have grown at phenomenal rates, and it is probable that at least some of these economies are set to become members of the Organisation for Economic Co-operation and Development (OECD) before the turn of the century. These economies will be the first examples—after Japan—of graduation in the postwar period. To replace them is a new tier of NIEs emerging from the Association of Southeast Asian Nations (ASEAN) which already has a bona fide NIE in Singapore (its other members are Brunei Darussalam, Indonesia, Malaysia, the Philippines, and Thailand). The ASEAN countries have experienced generally high rates of economic growth in the 1980s, despite severe exogenous shocks such as the fall in commodity prices, especially that of petroleum, in the mid-1980s. Annual income growth in Thailand has been at double-digit rates in recent years, and in Malaysia it has been greater than 8 percent. The OECD has now included Thailand and Malaysia along with the NIEs in a new category called Dynamic Asian Economies (DAEs).

An excellent illustration of how great strides in improving economic efficiency and sustainable economic growth with equity can be achieved is provided by the Indonesian experience in recent years. Indonesia discarded an inward-oriented development strategy with a large government role in favor of an outward-looking approach including a greater role for the private sector. With the collapse in petroleum prices in the mid-1980s and the ensuing crunch in government revenue and export earnings, Indonesia began the implementation of a radical reform program to change its high-cost, import-substitution policies of the past in favor of an outward-oriented development strategy based on international trade and investment. Although the transition period was difficult, Indonesia improved its product diversification and economic performance; its manufactured exports have been growing at an annual pace of 34 percent, and the share of nonoil exports in total exports has increased from less than 20 percent in 1981/82 to over 64 percent in 1988/89 (Afiff 1990). Gross domestic product has rebounded from only 2.3 percent annual growth in 1986 to 4 percent in 1988 and 6.2 percent in 1989, making it one of the fastest growing economies in the world. Growth is expected to be in the range of 6.5 percent to 7 percent in 1990 (Far Eastern Economic Review 1990).
Various measures to liberalize the economy and to reform enterprises have been adopted in South Asia as well, a region that in the past was characterized as very inward-looking. Partly as a result of these reforms, the recent growth rates of several of these economies have been impressive and the stage is being set for even higher rates of growth with an equitable distribution of income through private sector development. In particular, India, the largest country in South Asia, has surpassed its historically modest growth rate of 3.5 percent and is now posting GNP growth of about 5 to 6 percent each year. Pakistan has also maintained high growth rates in the 1980s. Even Sri Lanka, plagued in the 1980s by severe internal political problems, is now implementing policies designed to spur economic growth in the 1990s, including foreign investment and trade.

Yet, private sector development is only now getting started in the socialist countries in Asia, such as Viet Nam, Laos, Cambodia, and Burma. While a loosening up of government control of the economy is taking place in most of these countries, especially in Viet Nam and Laos, enormous difficulties are involved in introducing economic reform (whether it be privatization, deregulation, or liberalization) to command economies. A great deal of assistance is needed to help the process.

This paper examines the current movement toward more private-sector-oriented policies in the Asia-Pacific and focuses on the developing countries in the region. First, the characteristics of private sector development and some of the factors behind the change are reviewed. In this regard, some findings are presented on the effect of government involvement on growth and development, and some theoretical issues are discussed. Second, the effects of government involvement on economic growth is analyzed; this is followed by a review of the role of macroeconomic policies and public-private cooperation. The problems involved in privatizing public sector enterprises and a review of privatization in the Asia-Pacific region are discussed in two sections. The paper concludes by emphasizing the role of the external environment in sustaining the pace of economic reforms underway in Asia today.

Before proceeding, a brief note regarding definitions is called for since "private sector development" itself is a concept that is subject to a wide variety of differing interpretations. Throughout this paper, we will refer to three forms of government action to encourage private sector development: (1) privatization, (2) deregulation, and (3) liberalization.
The most visible—and, perhaps, the most difficult to implement, for reasons discussed below—is privatization, which itself has many different aspects. First, the most literal form of privatization is the government's partial or complete sale of equity shares in a state enterprise to the private sector. Second, the government can subcontract certain state functions to private sector firms. A well-known example of this form of privatization is the Indonesian government's decision to contract out certain functions of its customs bureau to a Swiss firm (Societe Generale Suisse). Third, the government can grant more autonomy to state enterprises themselves. By granting this independence, the state firm can improve its ability to run its activities efficiently. And fourth, professional managers can be hired to assume managerial leadership in a state firm, a tactic known as "corporatization." These latter two forms of privatization are more common in socialist economies.

The second form, deregulation, relates to government policies that are designed to increase efficiency and competition in industries through less direct government regulation on economic activities of the private sector. Included are policies such as, inter alia, freer entry and exit, and flexibility with respect to private firm participation, standards of service, and rates of return, or other microeconomic policies that reduce constraints to the private sector. Examples of deregulation in the region include Malaysia's creating a "one-stop" investment facility to approve private sector ventures, Indonesia's deregulation of the banking sector by, for example, freeing up interest rates and loosening requirements on composition of loan portfolios, and India's reducing the number of licenses required to operate in the manufacturing sector. In the region's developing economies, deregulation is a more common form of private sector development compared to privatization; this is especially true in India and Indonesia. The Thai Prime Minister Chatichai, an advocate of private sector development and outward-looking development strategies, faces strong labor union opposition to privatization and is known to have said that he is unfamiliar with the term privatization.

The third form of privatization, liberalization, is the most general; it overlaps with the other two, as well as with policies that are not usually associated with private sector development. Indeed, all three forms of private sector development could be subsumed under the liberalization rubric. We will define liberalization as the adoption of trade and industrial reforms to improve economic efficiency in the economy. Hence, liberalization is the promotion of outward-looking industrial development strategies, and trade is viewed as the "handmaiden" in an efficiency sense rather than
in the Keynesian sense. Examples of liberalization abound in the region, including the freeing of the financial markets in Korea and Indonesia, and unilateral reductions in tariffs and nontariff barriers among many countries in the region.

RATIONALE FOR PRIVATE SECTOR DEVELOPMENT

Although the movement toward private sector development is occurring throughout the world, the movement is especially pronounced and advanced in Asia. Three basic factors behind the growing trend toward a more market- or private-sector-oriented approach to development in the region can be delineated.

First, many of the justifications used for government intervention have been proven to be less or no longer applicable. For example, the most important microeconomic justifications for government intervention came from market failures and public or merit goods. Market failures are cases where a market economy may not produce the most efficient and appropriate mix of goods and services because, for various reasons, prices give incorrect signals to consumers and producers. An example of a market failure is the existence of externalities (cases when a third party is affected by a transaction but whose costs or benefits are not considered) or natural monopolies (where increasing returns to scale in production encourages a monopoly situation) have in the past provided a case for public regulation or ownership.

Public goods are those goods that once produced are available for consumption by all, and where consumption of the public good by one individual does not reduce the availability of the good to any other individual, and where it is generally difficult to collect fees for the benefits they provide. Because of these characteristics, the producer of a public good typically cannot exclude nonpaying users and as a result may not find it profitable to produce the good. The government therefore becomes responsible for providing these goods. Services provided by communications and transportation infrastructure are considered to be examples of public goods.

Unfortunately, in the name of market failures or public goods, government intervention often went too far and into areas where the private sector was already present. Public firms began to intrude and crowd out the private sector. Part of the movement toward privatization is aimed at reducing these cases.
Additionally, recent technological changes have reduced the validity of some of the arguments for market failure and public goods. For example, in the telecommunication industry, optimal plant sizes have been reduced, allowing multiple firms to compete and coexist in the same industry.

Second, a major impetus toward private sector development has come from the general disappointment with the performance of public sector enterprises and the government in general, in sustaining economic growth. The growing government budget deficits have persuaded these nations to look at the private sector to carry out some of the tasks of development.

Third, several countries that have emphasized market-based growth have had phenomenal success. Historically, there appears to be an inverse relationship between large-scale government intervention and growth. The countries with significant government involvement in the production and allocation of goods and services have not done as well as the countries with vigorous private sectors. In particular, the benefits associated with an outward-looking, market-based development strategy as followed by the NIEs and more recently by the ASEAN-4 are clear.

In any economic liberalization program, there are important questions to be addressed that are unique to each country. This is particularly true in the diverse Asia-Pacific region. For example, while economic theory does provide guidelines for the direction of policy reform, it has a difficult time in prescribing the manner in which liberalization should take place and its sequencing. Economic theory gives little insight into the practical application of liberalization policies and no insight into the problems that will be incurred in the process of transition. Hence, analyses of real-world experiences of other countries are necessary.

Liberalization is meant to reduce disincentives for exports and create a more neutral policy environment, as opposed to inward-oriented policies which discriminate against exports. There is no reason to give larger incentives to the export sector, but what is needed is simply to reduce disincentives and allow prices to allocate resources efficiently. Because the recommended policy is one of neutrality, some prefer the term "outward-looking" policies rather than export-promoting policies. Liberalization will neutralize incentives in all sectors, including for imports, import-substitutes, and exports.
But outward-looking policies cannot work in isolation; the success of outward-looking policies depend on sound macroeconomic policies. A noninflationary monetary policy and reasonable fiscal measures will create an environment that will enhance the effectiveness of trade policies. This point is made clear by the Latin American case.

MEASURING THE EFFECT OF GOVERNMENT INTERVENTION

Measuring the effects of government involvement in the economy is extremely difficult given the many ways in which it works. Moreover, when privatization, deregulation, and liberalization are combined as part of a policy package, quantitative analysis becomes even more complicated because isolation of the effects is close to impossible. Nevertheless, qualitative analysis, however imprecise, can give us a good idea of some of the effects of government intervention in the economy.

Although casual evidence—such as the experience of the NIEs as compared to other countries—suggests that government intervention has a negative effect on economic growth, there are only a few studies that have actually measured the effect of government expenditure on GNP. For example, two studies have found a negative relationship between the share of government expenditure in GDP and the growth of per capita GDP, and between tax/GDP ratios and economic growth (Landau 1983, Marsden 1983). Another study found that the greater the intervention of the government, the smaller the rate of growth of GNP (Singh 1985).

There are two main reasons for the small number of studies in this area. First, it is difficult to measure and compare the estimates for the size of the government. For example, the share of the public sector in Asian developing countries is large in terms of both total GNP and total investment in most of the NIEs and ASEAN. However, definitions vary across countries for public expenditure and government investment, making cross-country comparisons of the numbers less revealing. Second, the size of government as measured by tax revenue or expenditure does not capture the real extent of government involvement in the economy. It is also important to look at government regulations and the degree of control the government has on economic activities, or the "quality" of government involvement. But again, this approach is extremely difficult to assess quantitatively.

An indirect way of looking at the effect of government intervention is through the government's share of the resource gap. The resource gap
shows the difference between total investment and total saving (including the private sector and government component) in an economy. If total investment exceeds total saving, external borrowing is required. Large resource gaps use up scarce resources and may crowd out private investment. Government's share of the resource gap will therefore give one indication of the effect of government involvement in the economy.

The government sector has been a negative factor in most cases, as the majority of the Asian developing countries suffered central government deficits throughout the 1980s. Although this problem has been improving in most countries in recent years, one must nevertheless be careful in interpreting the budget deficit as an indicator of government intervention and its likely effect. This is particularly true for developing countries which generally experience large government deficits in the early stages of their development. The real issue is the nature of the deficits. If the deficits arise primarily because of productive investments made to increase the economic and social capacities, most economists would agree that there are less grounds for concern. On the other hand, if government current consumption is the primary reason behind such statistics, future debt-servicing problems become a matter for great concern.

A more direct indicator of the effect of government intervention in the economy is the performance of public sector enterprises. The share of nonfinancial public enterprises in GDP has risen from 7 percent in the beginning of the 1970s to over 10 percent in the 1980s and the share of public enterprise investment in total national investment has risen to about 25 percent (World Bank 1983). In Asia, the number of public sector enterprises has ranged from 86 in Korea to 900 in Malaysia.

Generally, studies have found that public enterprises have not performed as well as private enterprises in terms of profitability. For those enterprises that had a high rate of return, one study found that the principal reason behind the financial success of these enterprises was their monopolistic positions and the heavy protection from foreign competition that they received (Auyub and Hegstad 1987).

However, similar to interpretations of resource gaps and budget deficits, one needs to be careful in interpreting public sector enterprise performance as an indicator of the effect of government intervention. For example, public sector enterprises are expected to be in industries where economies of scale occur; at the initial stages of an industry's development, higher costs and losses can be expected; and in empirical studies
of public sector enterprises, not much care is taken to distinguish between public goods and private goods. Since cost structures facing these types of enterprises can be expected to vary, one is unsure about the interpretation of the results.

These concerns are addressed by comparing the performance of private and public firms in the production of a private good under broadly similar market conditions. In the case of Bangladesh textiles, the performances of private mills and public sector mills were examined and the former were found to be significantly more efficient than the latter (Syed 1989).

What has been the source of the generally poor performance of public sector enterprises? In general, the poor performance of public enterprises can be traced to several factors including inadequate planning and poor feasibility studies which lead to the wrong choice of investment projects. Even when investment projects are based on sound economics, granting of monopoly power and protection from new entry gives rise to a noncompetitive environment which can reduce efficiency. Sometimes, government expect these enterprises to follow multiple objectives that are unclear and inconsistent. Because public enterprises are often seen as a means for creating employment, overstaffing and unfavorable cost structures may result. The property rights literature provides another set of explanations for the comparative poor performance of public enterprises.

THE ROLE OF MACROECONOMIC POLICIES AND COOPERATION

Government policy in the region has come full circle with the age of direct government intervention nearing its end. However, this does not mean a return to a laissez-faire system. The government’s role in providing some public goods and in framing the basic rules of economic activity in terms of safety standards, pollution control, and law and order, continue to be important. In addition, as discussed above, the government must provide a good macroeconomic environment under which the private sector can flourish.

In this regard, the role of the government can extend beyond those called for by market failures and public goods. Most neoclassical economists take the position that government has a limited, if any, role to play. But the governments of the Asian developing countries have all (with the possible exception of Hong Kong) been a determining force in economic development and have contributed to the rapid industrial growth
of their economies to a greater extent than is explained by neoclassical economics. This observed association between the phenomenal growth of Korea, Singapore, and Thailand, for example, and the active roles that their governments have played in their economies has raised many new questions. It appears, however, that the kind of intervention used by the government differs from the heavy-handed approach often used elsewhere; rather, governments in Asia have played a facilitating role which can be called "neoclassical intervention." The essence of neoclassical intervention is to create a good overall economic environment.

A few elements of this development strategy should be highlighted. First, the outward-looking policies of the NIEs have led to the export of manufactures that intensively used labor, the most abundant factor of production found in these countries. This resulted in a more balanced distribution of income between labor and capital. Openness of the domestic economy required that domestic prices reflect world prices; therefore, prices provided the right signals to producers and consumers alike. Domestic manufacturers were forced to adopt the most cost-efficient production techniques. This, in turn, greatly facilitated technology transfer to their economies and allowed these countries to be more flexible in adjusting to changing international economic conditions. Although there is still more to be done in the Asian developing countries—particularly in Korea and Taiwan—their relative openness has been an important element in their rapid growth.

Second, fiscal, financial, trade, and industrialization policies need to emphasize market-based, growth-promoting strategies. The importance of domestic resource mobilization cannot be overemphasized; financial policies must encourage domestic saving to finance necessary investment as has been in the case of the NIEs.

Third, the manner in which these interventions are undertaken is quite different from the frequently adversarial government-business relations found in the West. In many Western countries, planners and the private sector operate in isolation, with no mechanism for facilitating the flow of information between the two. This is generally not the case in Asia. The close cooperation between the government and private sector in Japan is well-known, and a similar situation is developing in other Asian countries. For example, in Korea, considerable efforts have gone into engaging the industrialists, bankers, and government officials in deliberations over the selection of the most economic and appropriate investment projects. The country has combined strong planning with flexible policies; the plans are
not treated as the final pronouncements of the government. In fact, between the early 1960s and early 1980s, each of the four plans that were launched was substantially revised immediately after its inception. As circumstances changed, individual policies were also revised to make the system flexible.

Thailand has also moved in a similar direction. The Joint Public and Private Sector Committee that was established in Thailand several years ago is proving to be an effective means of policy coordination. While the committee initially spent a great deal of time listening to private sector complaints, the committee is now engaged in policy dialogue that allows the private sector to play a more useful role in Thailand's industrial development.

The approach adopted by Korea and Thailand (as well as some steps taken by Malaysia) show the benefits of consultative planning where the concerns and requirements of both the government and the private sector can be expressed. In this way, the private sector can share its knowledge and experience with the planning authorities.

Like all cooperative dealings, public-private cooperation can become unstable and needs to be approached with some caution on at least three grounds. First, such cooperation is easy to form and maintain when the economy is still at an early stage of development. However, as the economy becomes more sophisticated and linked with other economies, it becomes progressively difficult to sustain the form and content of this type of cooperation. Second, it may reduce the effectiveness of an otherwise sound macro-policy framework. This is especially true if a "pick-the-winner" approach—a characteristic feature of public-private cooperation in which certain sectors are favored over others—is pushed too far. Third, public-private sector cooperation can degenerate into corruption which imposes a deadweight loss on the society.

PROBLEMS INVOLVED IN PRIVATIZING PUBLIC SECTOR ENTERPRISES

Although privatization has become popular in the Asia-Pacific region, the privatization process in many of these countries faces a complex array of difficulties. First, some countries lack the technical skills to appraise the value of public enterprises and to finalize other aspects of divestiture. Second, sale of public sector enterprises most often involve unprofitable units and it is not always easy to find buyers for them. A prime example is Malaysia's unprofitable railway system which still cannot find a buyer.
Third, privatization poses a threat to jobs and incomes of those employed in these enterprises. In many Asian countries, jobs in the public enterprises are a form of social security. In other countries like Malaysia, the public sector is a large employer of indigenous people; privatization in such cases can involve a socially difficult problem. Trade union resistance to privatization in countries like Thailand and the Philippines remains strong. Fourth, the domestic capital markets in many Asian countries are still in their formative stage, and the most likely outcome of privatization in such instances will be a sale of public enterprises to a handful of rich people; a result which may be politically unacceptable. Foreign capital can augment domestic capital, but the extent to which governments will allow this remains uncertain.

Because of these difficulties, there are important considerations that must be addressed in any privatization program. First, it is unwise to privatize all enterprises at once. Many public enterprises do not have enough economic strength to survive as private businesses. The first priority would be to relax restrictions on public enterprises and encourage them to adopt a more business-like attitude and recruit executives from the private sector. Therefore, "corporatization" of public enterprises would be an important part of the program. This is especially true in socialist countries such as China where privatization is not a viable option. An important element of corporatization that has occurred in China is the hiring of professional managers rather than party officials to run public enterprises. Indonesia's decision to hire Societe Generale Suisse to help run its customs bureau provides another interesting case.

Second and most importantly, the benefits of privatization are limited unless liberalization and deregulation take place at the same time. Privatization in a protected environment will simply mean a shift from a public monopoly to a private monopoly and may not entail any gain in social benefit. Privatization is just one facet of private sector development which is essentially an attempt to increase efficiency of domestic economies and improve growth prospects. This means that a vigorous private sector requires good macroeconomic policies in a competitive environment, suggesting a need for overall liberalization of the economy.

PRIVATIZATION IN THE ASIA-PACIFIC ECONOMIES

The individual experiences of the region's economies can be instructive in studying the nature of private sector development. Thus in
this section, a brief review of the salient trends in the privatization movement in Asia-Pacific economies is given.  

**Developed Countries**

The two main cases of privatization in Japan have involved the railway (Japan National Railways) and telecommunication (Nippon Telephone and Telegraph) industries. In addition, in the financial sector, competition has been increased and there are plans to partially privatize the state monopoly in tobacco. In the future, deregulation is likely to be the main thrust of efforts to promote the private sector and to open Japan to greater competition from the private sector abroad.

A dramatic reorientation of New Zealand's economic policy towards increased reliance on the private sector, competition, and liberalization of international trade has taken place since 1984. The restructuring has involved corporatization, especially in the energy sector, and privatization in industry, transport, and communication. New Zealand has moved to privatize New Zealand Steel, and is selling shares in Air New Zealand and some government financial institutions as well.

Deregulation has also been a prominent aspect of efforts to stimulate the private sector in Australia. The airlines, petroleum refining, shipping, and banking and finance industries have been considerably deregulated. Australia, like New Zealand, has unilaterally reduced tariffs and protection of its industrial sector. The deregulation in the petroleum industry has been accompanied by tax reform in order to encourage greater exploration by private firms. Australia's move to privatize banking and airlines are backed by studies that demonstrate private banks and airlines are more efficient and profitable than those of the government.

**Newly Industrialized Economies**

In Hong Kong, there is not a great deal of scope for privatization and, given concerns over the future of this city-state, government commitment to infrastructure projects is welcomed as a means of boosting confidence in the private sector. The scope for privatization is larger in Taipei-China and there have been moves to privatize the large government banks in recent years as part of the larger effort to liberalize the financial sector and deepen the stockmarket.
Public enterprises played an important role in the development strategy of the Korean government, particularly in the 1960s and 1970s. The rationale behind the direct involvement of the Korean government in key industries was basically the same reason espoused by other developing countries: to develop industries that were considered strategic to economic growth. Beginning as early as the 1970s, privatization of some companies and industries began. This movement has continued throughout the 1980s. Examples include Korean Airlines, Korea Oil Company, Korean Telecommunications, and several national commercial banks. Competition in the financial sector received a further boost in 1982 by the granting of licenses to 43 new mutual savings and finance companies, and 10 short-term finance companies. The list goes on.

In the 1990s, the Korean government appears to be committed to continuing its privatization program to improve efficiency throughout the economy. A major strength of the privatization movement is that the government and the private sector regard themselves as partners in development. The two groups are engaged in a continuous dialogue to improve the performance of the economy, to provide it with new directions, to seize new opportunities, and to learn from past mistakes.

Contrary to popular belief, the state does have a strong involvement in the Singaporean economy, and efforts have been made to substantially reduce its role. In 1984, the Ministry of Finance reviewed the government’s role in the economy and presented a series of guidelines for the role of government companies. It was decided that the government would (1) set up priority industries only when the private sector lacked the will or resources to launch these projects on their own; (2) step in when it was essential for it to provide entrepreneurship; (3) continue to retain its controlling interest in companies considered vital to the national interest; and (4) dispose of its minority holding of public sector enterprises that were listed on the Stock Exchange of Singapore and in which government control was no longer necessary. However, the government of Singapore has been rather cautious in its privatization program, and although some steps have been taken, many moves are being done gradually.

Association of Southeast Asian Nations (ASEAN)

As mentioned earlier, Indonesia’s economy is characterized by large public sector involvement; the total sales of output from the 214 state enterprises constitute two-thirds of Indonesia’s GDP. However, since late 1988, the government has embarked on an impressive privatization
program to stop the drain on the government budget and to improve the operating efficiency of some of the larger, strategic government-owned companies. For example, in October 1988, the banking sector was substantially deregulated, and in the new five-year development plan, the private sector is being called upon to play a more significant role in the development of the Indonesian economy.

Recently, the Malaysian government has come to realize that government spending on state-owned enterprises has reached untenable proportions and cannot be sustained indefinitely. A committee on privatization has been formed and its "Guidelines on Privatization" was issued in 1985. Some of the recommendations made include the privatization of some of the 900 public, nonfinancial corporations and an improvement in the performance of public enterprises through adoption of better accounting and monitoring standards. But despite the consideration and implementation of privatization measures in a number of state-owned enterprises, the Malaysian government has not followed a consistent pattern in its privatization program. While the government is emphasizing privatization and private sector development, it continues to involve itself in heavy industries such as manufacturing of iron, steel, chemicals, and automobiles. Nonetheless, the Malaysian government, faced with budget problems and constraints, would like the private sector to play a greater role in stimulating the economy and to provide greater vocational and industrial training consistent with modernization trends.

In the Philippines, the government has been involved in a wide range of industries and services. The need to privatize some of these industries was first recognized in the early 1980s. Thus far, the privatization efforts of the Philippine government have attained limited success. The coconut and sugar monopolies have been disbanded and a number of small firms have been privatized, but key industries and large entities with coveted assets—including Philippine National Oil Company, Philippines Airlines, and the National Steel Corporation—have managed to avoid or delay privatization. Nevertheless there are some signs that the government's commitment to privatization has been solidifying; the recent sale of 30 percent of the shares in the government-owned Philippine National Bank may be the government's most successful demonstration of this. Prospects are not altogether bleak and, in fact, there are many potential buyers of asset-backed state enterprises, particularly for those with strong cash flows.
In Thailand, the conversion of state-owned enterprises to private sector ownership began taking hold in the mid-1980s. At that time, most of its public enterprises were inefficient and were suffering losses. The move to privatize government-owned firms occurred in January 1985, when the Thai government announced it would divest part of its holdings in the Electricity Generating Authority of Thailand and Thai Airways International. More recently, 70 percent of the shares in the North East Jute Mill and 100 percent of the shares of Erawan Hotel have been sold to the private sector. Furthermore, the private sector has been invited to participate in some infrastructural projects. In electricity generation and sales, the Thai government ruled earlier this year that private investment is to be permitted. However, as mentioned above, it appears that the privatization trend in Thailand, at least in the form of selling equity shares to the public, is currently at a standstill mainly due to the opposition of labor employed in the state firms.

South Asia

In India, the current five-year plan emphasizes the development of the private sector more than any of the previous plans. The plan reflects and formalizes a distinct move towards policy reforms that have been underway in India for some time. Progress has been made in deregulating the domestic market and promoting exports, and the legal and regulatory procedures have been simplified. Most recently (April 1990), India has designed a new three-year import-export policy aimed at reducing the country’s deficit by dismantling some of the “procedural irritants” dampening trade (Bangkok Post 1990).

The private sector in India is responding to the new opportunities now available to them, which is further boosting the continued strong performance of the Indian economy. Privatization itself, however, does not receive the kind of attention that is found in other countries in the region. Nevertheless, serious effort toward the overall liberalization program is being made.

In Pakistan, the government in recent years has introduced several measures designed to improve public sector efficiency and to stimulate private enterprise activities. Economic growth has been strong over the past five years, ranging from 5 to 9 percent. With the new Sixth Five-Year Plan, which endeavors to have 85 percent of all investments in manufacturing be in the private sector, industries that were nationalized in the 1970s are gradually being privatized. Soon after the change in government in
1977, nationalized units such as cotton-growing, rice-husking, and flour-milling entities were returned to their previous owners. Other nationalized units that were divested include Ittefaq Engineering and Foundry at Lahore and Nowshera Engineering Company. However, divestment of nationalized units will likely proceed at a slower pace, as in the case of Thailand, because of increasing opposition from organized labor and a reluctance on the part of former owners to take back their firms that have experienced heavy losses over the years.

Nevertheless, in Pakistan, the performance of the private sector has been quite impressive in recent years compared to the 1970s. In 1984–1985 the private sector’s share of industrial investments rose to 70 percent, compared to 26 percent in 1977–1978. The government has also allowed the establishment of private banks and financial institutions, which should help to channel savings to the private sector.

A similar trend toward private sector development can be found in other South Asian countries. In Sri Lanka, which is now trying to set the economy back on track after the ravages of seven years of internal political conflict, the government announced in December 1989 a new industrial policy with the goal of increasing foreign investment, promoting tourism, and stimulating the private sector. In short, the government is trying to bring back the period of dynamic growth that it enjoyed after it rejected its socialist policies in 1977 and prior to the ethnic violence which began in 1983. An economic turnaround is already being experienced; the Colombo Stock Exchange is currently at its highest level ever, having risen almost 50 percent in the first four months of 1990.

Efforts to harness private sector forces are also being undertaken in Bangladesh, which is planning a return of jute mills and other enterprises that were poorly managed by the public sector to private ownership. These changes will be needed in order to speed up growth rates in this very poor country, whose GNP has been growing in the 3 to 6 percent range. Nepal has recently changed its political system in favor of democracy, and, hopefully, this dramatic change will manifest itself in an improving economic situation with a more equal distribution of wealth.

China

Although China has had one of the fastest growing private enterprise sectors in recent years, the size of China’s state-owned enterprise sector remains the largest among the Asia-Pacific nations. Yet, state-owned firms
accounted for 60 percent of gross industrial output; private firms only accounted for 4 percent.

Private firms operate at the discretion of the authorities and, therefore, are not on equal terms with state enterprises. Legitimizing private enterprise would encourage businessmen to expand investment and operate based on long-term considerations rather than seeking quick and easy returns. China can seek to establish a partnership between the government and private enterprise in creating a clear framework and more transparent economic policies that are neutral with respect to ownership patterns. As it is, the institutional framework for private business and government cooperation is either weak or nonexistent.

CONCLUSION

This paper has given a general review of some of the issues involved in the area of privatization and the role of the private sector in the Asia-Pacific region. Privatization, trade liberalization, and macroeconomic reforms are helping these countries to sustain growth and prosperity in an environment marked by rising protectionist sentiments in some countries, reduced foreign capital flows, and rising debt problems.

A basic lesson for developing countries is that the government should not intervene in markets that work reasonably well. The private sector in these cases will provide the most efficient allocation of resources and will spur economic development. In addition, the government should maintain a stable environment in which the private sector can work and in which correct economic signals can be given to the private sector through deregulation, the reduction of distortions, and facilitating adjustment with correct industrial policies.

Yet, we have seen that privatization, deregulation, and liberalization in the Asia-Pacific economies are encountering many difficulties from different directions. The type of difficulty, of course, depends on the country; after all, the Asia-Pacific region is extremely diverse. Moreover, developing countries in the region are not exempt from problems specific to developing countries, such as an underdeveloped capital market which precludes efficient valuation of assets.

Privatization, deregulation, and liberalization are inordinately complex issues that necessitate careful analysis in each of the countries; as we have seen by the wide variety of experiences in the region, few generalizations
can be made apart from stating that the process is moving forward. Hence, it is necessary to carefully study country experiences to understand regional developments in this area. Nevertheless, the Asia-Pacific movement toward greater liberalization, deregulation, and privatization is significantly augmenting the efficiency of its many economies and is serving as a shining example for other developing nations.

The momentum gathered in Asia to adopt a more private sector–oriented development strategy and to liberalize economic policies may be greatly assisted by good external conditions. It is particularly important that the developed countries keep their economies buoyant and open, and help by providing the necessary capital and expertise in implementing deregulation and liberalization programs. This is particularly true for Japan, who has long been hailed as an exporting superpower but has been criticized as being too restrictive with respect to imports, particularly imports of manufactures, which are so important to the economic strategies of developing countries in the region. Hopefully, the results of the "Structural Impediments Initiative," which are discussions between the United States and Japan concerning trade and investment matters, will lead to a more open Japanese market.

By following more outward-oriented development strategies, the economies in the region are becoming more interdependent; and with greater interdependence, there is naturally room for greater conflict. Keeping this conflict to a minimum is in the interest of all; thus, economic cooperation and consultation is of the essence in order to ensure free markets and economic harmony. An institution for international economic communication exists in the GATT, but a forum for regional cooperation is also needed in order to deal with issues specific to the region. The formulating of such an organization for Asia-Pacific cooperation is an important task facing us in the 1990s.
Notes

1. For a comparison of the Latin American and Asian development experiences, see Naya et al. (1989).

2. Of course, much of this increase in the share of nonoil exports is attributable to the large decrease in the value of oil exports over the relevant period. However, even in nominal terms, nonoil exports doubled from US$6.2 billion in 1985/86 to US$12.2 billion in 1988/89.

3. Throughout this paper, we are concerned specifically with the government's role in economic regulation. We exclude for simplicity of analysis the broader category of social regulation, e.g., health, safety, and environmental protection.

4. For a more in-depth discussion of country-specific experiences, see Naya (1990).
References


INTRODUCTION

Human development which is reemerging as a growing global concern is not a new issue. Indeed, the idea that economic growth and income expansion are but a means towards the ultimate goal of improving people's lives goes back to Aristotle. The same concern can be found in the writings of the leading political economists of the 18th and 19th centuries: Adam Smith, David Ricardo, Robert Malthus, Karl Marx, and John Stuart Mill.

While excessive preoccupation with GNP growth and national income accounts has often obscured this perspective during the past decades, recent development experiences have, once again, underlined the need to pay close attention to the link between economic growth and human development. The reasons include:

1. Many fast-growing developing countries are discovering that their high GNP growth rates have failed to reduce the socioeconomic deprivation of substantial sections of their population.

2. Even industrial nations are realizing that high income is no protection against the rapid spread of such problems as drugs, alcoholism, AIDS, homelessness, violence, and the breakdown of family relations.

3. At the same time, several low-income countries have demonstrated that it is possible to achieve high levels of human development if they judiciously utilize the available means to expand basic human capabilities.

4. Human development efforts in many developing countries have been severely squeezed by the economic crises of the 1980s and the ensuing adjustment programs.

The recent development experiences are thus powerful reminders that the expansion of output and wealth is only a means; the end of development must be human well-being. How to relate the means to the ultimate
end should once again become the central focus of development analysis and planning.

How can economic growth be managed in the interest of the people? What alternative policies and strategies need to be pursued if people, not commodities, are the principal focus of national attention? This paper addresses some of these issues, with special reference to the Asia-Pacific Region, and draws upon the data and analysis presented in the Human Development Report 1990 (UNDP 1990).

The UNDP report defines human development as a process of enlarging people's choices to acquire certain capabilities and to put their capabilities to use. Some of the most critical choices are the option to lead a long and healthy life, to be knowledgeable, and to enjoy a decent standard of living. Income is, according to this definition, an important choice, but not the totality of human aspirations.


Overall Progress

When examining some of the key indicators of human development in the Asia and Pacific region—including such indicators as life expectancy, education, and income per capita—it is evident that the region has achieved considerable progress in human development during the past three decades.

In terms of child mortality, for example, several countries of the Asian region are pacesetters among developing countries. Asia compares favorably with all developing countries as a group, Africa, and the Middle East (Figure 1). For example, China and Malaysia succeeded in increasing their life expectancy from 47 years to 70 years and 54 years to 70 years, respectively. Similar progress is reflected in the region's average life expectancy, which rose from 46 years in 1960 to 64 years in 1987. Moreover, Hong Kong, China, and Singapore are among the developing countries which reduced their infant mortality fastest by respective annual rates of reduction of 5.91 percent, 5.48 percent, and 4.83 percent, respectively.

Asia's literacy rate which is 59 percent is close to the average literacy rate of developing countries (Figure 2). In East and Southeast Asia, secondary enrollment ratios have risen to 90 percent for both females and
males. In addition, the region as a whole has extended access to safe water from less than one-third of the population to more than one-half between 1975 and 1985.

The overall progress in human development in Asia has been supported by a fairly consistent, and in some cases high, rate of economic growth. Whereas the economies of most developing countries slowed down during the 1980s, this did not happen in Asia. Between 1980 and 1986, GDP per capita rose 20 percent in South Asia and 50 percent in Southeast and East Asia.

Within-country Disparities

The region's progress in human development has been tempered by a huge undertow of human deprivation. There is significant variation in the progress achieved by individual countries. Moreover, this uneven progress is compounded by economic, gender, geographic, and social disparities within these societies.
Figure 2
Regional Comparison of Enrollment Ratios
(Gross Ratios)

Level/Sex of Schooling

- Primary Male
- Primary Female
- Secondary Male
- Secondary Female
- Tertiary Male
- Tertiary Female

Percentage

- All Developing Countries
- Middle East/North Africa
- Industrial Countries
- Africa
- Asia
- Latin America
Three-quarters of the world's illiterate (900 million in 1985) live in the five most populous Asian countries—China, India, Pakistan, Bangladesh, and Indonesia. South Asia's literacy rate was only 41 percent in 1985, the lowest of all regional rates. Four of the countries in this region had extremely low rates—Bangladesh (33 percent), Pakistan (30 percent), Nepal (26 percent), and Afghanistan (24 percent).

These low rates are further accentuated by social disparities. In some Asian countries, rural illiteracy rates are generally twice as high as the urban rates. For example, in a South Indian village the upper caste Brahmins had a 90 percent literacy rate while the people at the lowest end of the caste spectrum had a bare 10 percent literacy rate. And although, in the region as a whole, net primary school enrollment ratios are well over 80 percent for males, female enrollment remains extremely low.

While the countries of East and Southeast Asia have made remarkable progress in alleviating poverty, two-thirds of the 138 million nearly-landless households in developing countries and two-thirds of the hungry in the developing world live in Asia. In Asia, the percentage of poor people is decreasing, but the greatest number of the world's poor live in this region (Figure 3). This amounts to almost three-quarters of a billion people.

In Bangladesh, more than 80 percent of the population is poor. While access to safe water has increased in Asia, in Bangladesh access has
declined by 10 percentage points since 1975. Again the countries which reflect slower progress reveal significant internal disparities. In Nepal, for instance, access to sanitation facilities in urban areas was 17 times higher than in rural areas.

Within-country disparities in human development are wide in terms of other indicators as well. For example, in rural Punjab, child mortality among the landless is 36 percent higher than child mortality among the land-owning classes; malnutrition was found among 14 percent of the young girls in Bangladesh in contrast to 5 percent of the boys; and families in rural Punjab spend twice as much on medical care for male infants as they do for female infants.

PROMOTING HUMAN DEVELOPMENT: SELECTED COUNTRY EXPERIENCES

The development experience of Asia encompasses a wide and varied range of policy strategies and efforts. The region's countries have faced different initial socioeconomic conditions and have pursued human development in different ways—through compensatory "meso" policies or through more radical transformation of the economy. Many of these strategies have met with significant success both in expanding and utilizing human capabilities. In most Asian economies, for instance, the labor force has increased rapidly, but Indonesia and Thailand have registered an increase in wage employment faster than the increase of the labor force.

In this section, the experiences of Korea, Malaysia, and Sri Lanka are examined. These three countries are representative of different paths taken by the Asian countries to sustain success in human development.

The Korean economy has been a strong performer, making it possible to sustain the improvement of human development levels through effective meso policy interventions even during difficult periods. These interventions, moreover, have made it possible to protect the poor despite a relatively inequitable income distribution. In social expenditures, for instance, the coverage of the population by health insurance was increased from one-tenth in 1978 to almost one-third in 1981 to more than one-half in 1985. In addition, a medical program provided free or subsidized health care, especially maternal and child care, to poor families. During the period of recession in the early 1980s, public works and other programs were expanded to provide more employment and food security (among other benefits) to the unemployed and the indigent.
Malaysia’s path to human development had to compensate not only for an initially inequitable income distribution but also for its deterioration. Consequently, Malaysia placed great emphasis on well-structured across-the-board meso policies. Public spending in the social sector averaged about 8 percent of GDP during 1973–1981, and central government expenditures per capita for education, health care, agriculture, and pensions were higher in rural areas.

Sri Lanka’s experience demonstrates that despite low per capita income, strong interventions in the social sectors can make high levels of human development attainable. The experience also shows the importance of design in ensuring that subsidies actually reach the needy. Free medical care and universal free education up to the university level were introduced as early as 1945. During the period before 1978, the distribution of income was reasonably equitable although growth rates were only moderate at about 2.3 percent. After 1978, although per capita GDP accelerated, the distribution of income worsened. This period also saw a major change in the nature of social subsidies. For example, the nearly universal food subsidy was replaced by a food stamp scheme. Studies have shown that mistargeting contributed to the subsequent decline in the per capita calorie consumption of the poorest section of the population; in contrast, the calorie consumption of the rich rose as they appropriated a greater share of the fruits of accelerated growth.

The experiences of other Asian countries, China and Pakistan for example, show that in the absence of careful management of economic growth and its translation into social benefits, it is not possible to sustain or even pursue human development. China made remarkable initial progress in meeting the basic needs component of human development and in providing health care and food security to the people, by integrating these functions into the production system of communes. Recent economic reforms, however, while increasing production incentives, have adversely affected the factors contributing to human development. As a result, the rapid progress that was recorded during the earlier period has not been sustained. Pakistan, on the other hand, exemplifies the failure to translate respectable rates of economic growth into human development. Although per capita income was broadly similar to Sri Lanka, life expectancy in Pakistan was only 58 years compared to Sri Lanka’s 71 years and even below the 61-year average for low-income countries. Similarly, Pakistan’s mortality rate for children under five years of age was 166 in 1988 compared with 43 in China. Pakistan spends very little of its budget on the social sectors and a large amount on the military. Moreover, a
large part of social sector expenditure goes to low-priority activities, such as tertiary education which receives 24 percent (compared with 7 percent in Sri Lanka).

POLICY OPTIONS FOR THE FUTURE

The Asian economies have been fairly resilient through the difficult period of the 1980s. The squeeze on government budgets that occurred elsewhere has not taken place in Asia to the same extent. The countries of Asia have, therefore, a facilitating economic environment to accelerate their human development and to eradicate the backlog of deprivation.

The experience of several countries shows that it has been possible to eradicate basic human deprivation even at lower levels of per capita income, so long as well-structured meso policies are in place and a floor level of social security for the vulnerable is maintained. It is clear from the region’s experiences that there are many routes to success and many workable strategies to overcome basic deprivation that can be easily modified to suit particular conditions. Many of these measures are of relatively low cost and are easy to implement.

In comparison to 1960, military expenditure in Asia has declined marginally from 6.3 percent of GNP to 5.9 percent (Figure 4). There is a
corresponding marginal rise in education expenditure (from 2.1 percent to 3.4 percent of GNP) and health expenditure (from 0.7 percent to 1.1 percent of GNP). A stronger and clearer shift from military to social expenditure can provide the countries of the region with the resources needed to diminish human deprivation.

Asia’s share of the world’s population is expected to rise from 51 percent in 1960 to 55 percent in 2000. Although population growth has been declining in the region, concerted efforts will be essential to ensure that population growth does not outstrip development opportunities and progress in human development.

The experiences of the countries of the region show that the education of females contributes to reducing fertility and controlling population growth (Figures 5 and 6). Sri Lanka and Thailand, countries with over 80 percent female literacy, have population growth rates of just over 1 percent. In contrast, Afghanistan and Pakistan, with female literacy rates below 20 percent, have population growth rates of over 4 percent and nearly 3 percent, respectively. Investment in providing education to
females should, therefore, be an important priority especially for countries with high population growth rates.

The region's urban population is also growing disproportionately, from 21 percent in 1960 to an estimated 36 percent of total population in 2000. The number of urban poor is probably growing even faster. Therefore, while a shift in resources from urban to rural is desirable, attention must also be paid to the urban poor.

The disparity between the rich and the poor in the countries of the region has important policy implications. Even in countries which have registered successes in human development, such as Malaysia, the distribution of income is becoming increasingly unequal over time. This disparity is often reinforced by the greater access that the rich have to social services. In the Philippines in the early 1980s, for example, annual subsidies to private hospitals catering to upper-income families exceeded the resources allocated to mass programs (including malaria eradication and schistosomiasis) and to primary health care. A shift in focus from rich to poor could therefore free considerable resources. One possible route
would be to introduce discriminatory user fees which could raise resources to improve social services while ensuring that the poor pay no more than nominal fees.

International assistance can make a substantial difference to the outcome of this effort. Currently, Asia receives the largest amount of official development assistance (ODA) received by developing regions, US$13,200 million in 1987 (Figure 7). However, on a per capita basis Asia receives the lowest amount at US$4.8 per person which is far below that of the Middle East (US$23.8), Africa (US$22.1), and Latin America (US$10.3). A larger commitment coupled with a clearer channelling of international resources to human development assistance can provide the necessary impetus to these programs.

CONCLUDING REMARKS

In order to give the necessary urgency to some of the policy measures discussed above and to promote more systematic human development planning and monitoring, efforts have to be made in
improving social statistics as well as in raising the awareness and understanding of policy makers and development professionals, as well as people at large, about what the human development record to date is, what are "doable" strategies, what are "realistic" goals in terms of the cost, and where the needed financial and other resources could come from. Investment in social statistics is an important precondition for accelerated future human development.

Another prerequisite is to include human development balance sheets and strategies in national development plans. Establishing priorities which are ranked according to the people’s preferences and then translating these priorities into specific achievable goals are essential steps in the planning of human development. Although it has not been a priority concern, a lot of practical experience exists in the region. Several countries have demonstrated that rapid progress in human development is achievable. Examining the successful experiences of other countries can provide planners with a range of alternative and doable strategies for their own use.

While in the past a lot of attention has been devoted to strategies (including participatory approaches, targeted meso policies and social sector programs), less attention has been paid to the issues of financing human development: What does education or health-for-all cost? Where do the resources come from? What budgetary restructuring would be necessary?

The UNDP intercountry program for Asia and the Pacific could be a vehicle for promoting further progress in the human development area by providing a forum for policy dialogue and exchange of experiences among governments of the region on such issues as improving social statistics by making human development planning more systematic and by mobilizing resources for human development.
Note

1. Policies addressed to the intermediate level between "macro" and "micro" level policies.
Reference

Social trends affecting natural resources management in upland areas of Asia and the Pacific

A. Terry Rambo with Lawrence S. Hamilton

In the upland areas of the Asia-Pacific developing countries, relationships between society and natural resources are undergoing rapid change. Three key trends have been identified: (1) increasing dependency on institutions, (2) increasing differentiation in access to resources, and (3) increasing intensity in resource use.

All of these trends have important implications for choosing appropriate resource management strategies in the future. Technical solutions formulated in ignorance of these trends are likely to be unsuccessful. For example, village water supply problems will not be solved by simply building bigger ponds for multipurpose use unless effective social mechanisms to manage such common property water resources can be established; attempting to stop deforestation by proclaiming total bans on logging may be politically satisfying but will not actually protect the forest unless alternative ways are found for poor landless farmers to obtain access to needed resources without continued encroachment on forest reserves; and prohibiting shifting cultivation in upland areas cannot be enforced unless viable systems of permanent cultivation can be placed in those areas.

Thus, any discussion of natural resources, and of improved strategies for their management, cannot and should not be separated from discussion of the social context in which resource management strategies must be implemented. This paper which discusses the critical trends in the relationship between society and resources in the upland areas of Asia-Pacific developing countries represents a preliminary attempt to show some of the ways in which social factors and the management of natural resources are interrelated.

The conventional approach to natural resource management is to organize discussions in terms of key sectoral categories (e.g., forests, water, agriculture). Focusing on these sectoral resources is understandable, perhaps unavoidable, because they reflect the way in which government resource management agencies are structured. But exclusive use of these sectoral categories often has the unfortunate consequence of channeling discussion into technical areas in which critical social, cultural,
and economic factors are ignored. In addition, the use of sectoral categories aggravates the tendency to focus on a narrow range of solutions to the perceived problems. For instance, if deforestation is seen as a critical problem, then it is natural to look for solutions within the forestry sector (e.g., decreeing new laws to regulate tree cutting, hiring more forest guards, or organizing ambitious tree-planting projects). However, if deforestation is occurring because land-hungry peasants from the overcrowded lowlands are clearing new upland areas to raise crops, then the solution may not lie within the forestry sector at all. Instead, reform of tenurial arrangements in the lowlands, intensification of production on existing agricultural lands, or creation of new employment opportunities in the industrial sector may offer the most effective solutions to the problems of deforestation.

As the preceding example illustrates, resource problems are as much social as they are technical. In seeking solutions, we need to pay attention to the interplay between key sectoral categories of resources (forests, agriculture, and water) and the social trends and processes that influence human use and management of resources. Such an approach is based on the explicit recognition that resources are human appraisals of the usefulness or value of pieces of the natural world. That is, resources are not natural phenomena but are, instead, aspects of the social construction of reality. As the economic geographer Zimmerman stated long ago, resources are simply components of the environment that have been put into the service of humanity.

RESOURCES AS A HUMAN INVENTION

Petroleum offers the classic example of the way in which resources are created by changing social needs. Oil seeped from the desert sands of Arabia for thousands of years, but oil was not a resource until the invention of the internal combustion engine created a market for gasoline. Suddenly, Saudi Arabia escalated from one of the countries with the poorest resource endowments to one of the wealthiest. Nothing in the natural environment had changed, but the cultural assignment of value to one of its components had radically altered.

That resources are a human invention, rather than an intrinsic aspect of nature, is further illustrated by the case of salt in northeastern Thailand. Agriculturalists do not view salt as a resource but as a threat to production. Salinization was rapidly spreading in northeastern Thailand with consequent decreases in rice yields and even abandonment of lands. A few
years ago, however, the boom in construction of prawn ponds in coastal Thailand resulted in a steep decline in salt production with consequent shortages and a price increase of this essential commodity. As a result, some farmers in the northeastern part of Thailand have begun to produce salt as a cash "crop." In this case, an environmental hazard became a valuable resource.

The changeable character of resources should caution us against accepting conventional sectoral labels for them. Labels such as water, agriculture, and forests suggest a certain fixity or permanency in defining resources; but because resources are socially defined, there is no such fixity. The definition of what constitutes a resource varies from society to society and even from generation to generation within the same society. Uranium was merely a scientific curiosity in our ancestors' time; now it is the ultimate strategic resource. Today, we speak of forests as a valuable natural resource. In doing so we are actually lumping together a number of rather different concepts of the forest as a resource: forests as a source of timber, forests as watershed protection, forests as a place of recreation, forests as a reserve for biological diversity. Our modern-day concept of the forest as a multipurpose resource is very different from the perception of a member of a hunting-and-gathering tribe; to him, the forest itself is not seen as a resource but is valued only as a place where he can find wild game and fruit. A shifting cultivator from a hill tribe has yet a different definition of the forest as a resource; to him, the forest is simply a storehouse of energy and nutrients that can be converted by use of fire into a swidden agroecosystem. And to lowland Southeast Asian wet rice farmers of 30 years ago who were searching for new land to convert into paddy fields, the forest was not a resource at all; it was something to be cut down to make space available for growing rice. That the forest was not highly valued in Malaysia, the Philippines, and the outer islands of Indonesia is hardly surprising because most of the surface of these areas were tree-covered until the late 1940s. Today, now that there is almost no forest left, the forest is prized as a valuable resource in these areas.

SOCIAL ASPECTS OF RESOURCE MANAGEMENT

Because resources are defined in terms of human values and needs, improving the management of resources involves more than just the solution of technical questions, but also involves asking and answering questions about the social aspects of resource use. In particular, it is important and necessary to understand the social factors and processes that influence the ways in which resources are perceived, used, and
managed by people. For example, specialists on water resources now recognize that achieving high efficiency in irrigation systems is not simply a problem in hydraulic engineering. More important is the development of effective water management, which is also a social problem, the solution of which involves the creation of a management system linking the farmer-users to the officials charged with the formal responsibility for operation of the irrigation system.

A number of fundamental change processes are currently evident in the upland areas of the developing countries of Asia and the Pacific. These include rapid growth in the human population, a shift from a subsistence orientation to a cash orientation, rapid technological changes that have had especially dramatic impacts on communications and transportation, a shift from traditional local cultural values and beliefs to more universalistic patterns, and a shift from a feudalistic to a bureaucratic system of governance. As a consequence of these and other change processes, a number of trends in natural resource management are becoming evident. These trends have profound implications in our attempts to formulate improved strategies for resource management.

Three major trends can be identified as especially significant in the changing social situation of resource management in the developing countries of Asia and the Pacific today. These relate to increases in (1) the dependency on external institutions and forces, (2) the differentiation in access to resources, and (3) the intensification of resource use.

Dependency

Imagine a time machine that allows us to travel backwards in time to observe the everyday life in a typical Asian upland peasant village fifty years ago. In fact, we actually already have such a “time machine” in the form of the marvelous Thai autobiographical novel, Luc Isan [Child of the northeast], in which Kampoon Boontawee presents a picture of life as it was lived by the poor peasants on the Khorat Plateau in northeastern Thailand around 1940. At that time, village existence was largely autonomous with little dependence on the larger world for goods or information. Agriculture was almost totally subsistence-oriented with only a few cattle raised for trade purposes. Cattle were the only feasible commercial product because, being self-propelled, they could take themselves to market over the rough trails that provided the only link between the village and the outside world. Although the villagers purchased small quantities of manufactured goods such as steel tools, matches, and school uniforms
(in the novel, the young hero wants, more than anything else in the world, an official boy scout belt), such cash expenditures represented only a tiny fraction of the household budget. Almost everything that a family needed to survive was produced by the family itself using locally available resources. Decision making about resource management was almost entirely in the hands of the villagers themselves. Direct intervention by government agencies, other than to collect taxes, was practically unknown. The flow of information was highly localized. It was a special occasion when travelers from another village would pass by in their ox carts or when a storyteller or singer from another province would perform at a village festival. Medical care was in the hands of local ritual specialists who, while able to successfully treat some forms of sickness, enjoyed notable lack of success with other ailments such as malaria.

Now compare the almost total autonomy of the villagers fifty years ago with their situation today. Rice is still primarily raised for subsistence use, but the fields are plowed with an "iron buffalo" that is imported from Bangkok or Japan, and eats gasoline from Malaysia or Saudi Arabia rather than grass from the local pasture. Expenditure on manufactured consumer goods is now a significant share of the household budget, and earning sufficient cash income to cover these expenditures is a major preoccupation of the farmers. In addition to raising cassava for export to the countries of the European Community (EC), many families now export themselves as wage laborers to Bangkok or even to the Middle East. Decision making about resource management is no longer a purely local affair. Land use is regulated by a multitude of government agencies. The villagers often have little voice in making decisions that deeply affect their ability to use resources. The flow of information is expanded in quantity and extended in space. Radio, television, and VCRs link the villagers directly to the global information economy. Instead of traditional self-produced entertainment, television shows from Bangkok or movies like Rambo are now avidly consumed. Village children attend schools that follow the national curriculum and, at least occasionally, may even succeed in gaining admittance to colleges and universities where they are exposed to the latest ideas of modern science. Villagers suffering from many formerly untreatable illnesses can now obtain medical advice and effective medicines from hospitals and clinics.

The process described here of decreasing local autonomy and increasing dependency on extralocal institutions and forces is evident everywhere in the uplands of Asia and the Pacific. This process is profoundly changing the relationship between upland farmers and natural
resources. For example, forestlands, which traditionally were a common property resource used for hunting, collecting wild products, and grazing livestock, are everywhere being transformed into private property that is used for production of cash crops, or are being gazetted by governments as forest reserves and national parks. Deforestation, soil erosion, loss of wild species, and overgrazing of remaining "wild" areas are all resource management consequences of the incorporation of formerly highly autonomous subsistence farmers into a larger social and economic system.

As is the case with most kinds of social change, the trend toward increased dependency of upland people on outside institutions and forces tends to be discussed in highly value-laden and emotive terms. Some social theorists (e.g., Andre Gunder Frank and the proponents of the dependencia school of development theory) have presented the process of increasing dependency as inherently bad. They see it as producing a permanently impoverished and powerless mass of rural poor in the peripheral countries whose natural resources and cheap labor are ruthlessly exploited for the benefit of the wealthy capitalist core countries. Other development theorists attribute positive social consequences to increased dependency, seeing it as part of a process of creating larger and more tightly integrated national and global social systems. From the Durkheimian perspective, for example, the process ultimately leads to enhanced social integration as growing specialization and division of labor produce an "organic" type of solidarity between individuals. Rather than Asian countries being weak feudal states composed of almost wholly autonomous villages, they are becoming strong nation-states composed of highly interdependent citizens, each dependent on many others for even the most basic survival needs. From the latter point of view, reduction in local autonomy is seen as necessary in order to strengthen national integration. Upland areas, which are often part of the frontier and are neighbors to countries that are not necessarily friendly or trusted, are seen as especially critical in this regard. This is all the more true in areas inhabited by ethnic minorities whose loyalty to the new nation-state is questionable.

The main point to be made, of course, is that increasing dependency itself is inherently neither good nor bad; it is simply a consequence of social and technological change. The judgment of good or bad depends on the values and social objectives of the observer. Ultimately, decisions about the positive or negative value of dependency are political ones. They involve very complex trade-offs between the rights of individuals and
local communities to self-determination and the desire of national elites to solidify state power. In any case, increasing dependency is a fundamental fact of life for virtually all upland Asian farmers. The question we now face is: How can resource management practices be adapted to take this fact into account?

That the issue of dependency is more than an academic concern is indicated by the hostile response of some Asian villagers to government-sponsored reforestation projects. Reforestation of degraded uplands may be seen as desirable by those who seek to reduce soil erosion in reservoir watersheds. It is also seen as desirable in terms of the national policy of increasing the total area of the country under forest cover. However, it is very threatening to those villagers who require cash income from growing upland crops to maintain their ability to purchase the manufactured goods on which they are now heavily dependent. It can also cut off poor landless villagers from free sources of firewood and fodder. It is no secret that even poorly managed upland farms can support more persons per hectare than can well-managed forests that are dedicated to production of timber or pulpwood. Unless ways can be found to combine reforestation with other means of income generation, farmer resistance is inevitable. This does not mean, as some officials appear to believe, that small farmers continue to encroach on forests because they are exceptionally greedy or pigheadedly opposed to national policy. It means that their situation of increased dependency offers them few or no alternatives unless they are willing to accept a drastic reduction in what they have come to see as an acceptable standard of living. To continue to have the cash to purchase aspirin to treat a child’s fever, gasoline for the iron buffalo or motorcycle, and perhaps a television set or cassette recorder for the better-off farmers—items that many of their urban-dwelling critics would likely consider to be necessities—the villagers can be expected to continue to exploit natural resources in ways that scientists consider to be ecologically unsound. From this perspective, it will be necessary to offer viable alternatives to present practices.

Finding such alternatives is not an easy task. Development of cropping systems that improve soil organic matter content and that restore fertility can reduce dependence on expensive chemical inputs and thus increase the profitability of farming. Finding practical ways to stabilize shifting cultivation is especially urgent. Unfortunately, thus far, most attempts to convert shifting cultivation to permanent types of agriculture have involved such heavy reliance on externally supplied inputs as to be impractical on a large-scale basis. Development of new crops that grow
well under difficult soil and climatic conditions of upland areas can also boost farm incomes and help reduce pressure on forest resources. Developing small-scale water resources in the villages can provide alternative sources of food and income by means of fish culture. Forestlands can be managed to provide for some of the subsistence needs of the villagers while still yielding desired timber and watershed protection. Better organization of the nonwood forest products trade (the so-called minor forest products such as rattan, medicinal plants, and wild game) could result in greater income at the local level. Tourism to national parks and nature reserves can also be organized to provide employment to local populations.

Differentiation in Access to Resources

Let us again imagine ourselves going back in time to observe life in a traditional upland village. We would observe that most families enjoy about the same standard of living. Some might have slightly larger or better-built houses, others might eat more or better-quality food, and some may wear newer clothing. In this village, the differences in the standard of living generally reflect the stage of each household in the family life cycle. Younger families with many dependent children and few adult workers would be somewhat poorer than those families where the labor of the parents is supplemented by that of unmarried teenage sons or recently acquired sons-in-law. Households in which the adults enjoy good health and possess superior skills and initiative would be more prosperous than those where illness or lack of ambition lower productive capacity. A few families with members that possess superior business skills or that have political connections might accumulate considerable capital reserves. None, however, could attribute their relative wealth or poverty to differential access to natural resources. In the frontier situation that characterized most of the upland areas of Asia fifty years ago, free land was available to anyone willing and able to clear the forest and construct paddy fields. If crops failed, as they did all too often, the forest and rivers offered a wide range of resources to sustain people until the next harvest.

Today, the situation is very different. Observable differences in standard of living between the best-off and the poorest households are dramatically evident. One-room thatched houses stand only meters away from two-story concrete structures festooned with TV antennas. Some villagers drive trucks or motorcycles while their neighbors walk barefooted. Many children must drop out of school after the primary grades while a few go on to attend a university. Such social differentiation is linked to a
pronounced increase in the extent of differentiation in an individual’s access to resources. Land is becoming increasingly concentrated in the hands of a few large landholders while there is an overall decrease in average farm size. Outright landlessness is increasingly common. In villages, common property resources such as woodlots and pasture have undergone enclosure for private raising of upland cash crops or have been degraded by unrestricted exploitation. Little forest remains in which to settle, and that frontier is rapidly closing as government policy against forest encroachment becomes firmer. Remaining wild resources are either inaccessible or unable to sustain the demands of a much larger population. Migration to urban areas remains the last frontier but one that requires much greater financial resources and personal capabilities to conquer than did the traditional forest.

As in the case of rising dependency on institutions, one can argue about whether the process of differentiation in access to resources is good or bad. Again, the answer to the question depends on the values and social objectives of the observer. Many development economists assert that such differentiation in access to resources, particularly as expressed in the form of “privatization” of natural resources, is a prerequisite to the efficient management of resources. They point to the “tragedy of the commons” as the ultimate consequence of allowing free access to natural resources. The recent experiences of China and Viet Nam in turning control over communal farmlands back to individual households support the view that privatizing management of small-scale agricultural resources can result in higher productivity.

The assumption that privatization has benign environmental results when it involves giving control of large areas into the hands of big landlords, individual or corporate, is certainly questionable. Indeed, it is already well established that absentee owners frequently mismanage their land, whether we are speaking of the traditional latifundistas of Latin America or the modern American corporate owners of wheat farms in the Palouse region of Washington State. Unfortunately some development assistance agencies have made ideologically-based prejudgments in favor of privatization without fully considering the ecological and social consequences of the resulting differentiation in people’s access to resources. Doubly unfortunate, at least in part as a consequence of the advice given by such agencies, is that many Asian countries are moving more rapidly and less cautiously to privatize resources than might have otherwise been the case. There is considerable irony in the fact that at a time when the United States, where private ownership of resources is a
national dogma, is moving to exclude private businesses from its national parks, powerful forces in Thailand are advocating privatization of parks.

The question we face is, how do we take increasing differentiation into account in our attempts to formulate improved strategies for resource management? Recognition that many upland farmers no longer have access to wild resources in the forest might direct our attention to development of agroforestry methods that will recreate some of these resources within the bounds of a small farm plot. Recognition that agricultural technology is not scale-neutral might lead us to focus research on technology having potential value to resource-poor small farmers. Recognition that village ponds are an important source of food for poor households might cause us to try maintaining year-round fish productivity rather than permitting only one or two harvests each year, even if the latter strategy gives higher net returns.

Intensification of Resource Use

Anthropologists distinguish between societies that employ ecologically-specialized adaptive strategies that are based on exploiting one or a few resources intensively, and societies that exploit a broad spectrum of resources. Traditionally, Asian small-scale subsistence farmers belonged to the broad spectrum type of adaptation. For example, farmers in northeastern Thailand relied on what David Thomas has labeled a "diversified portfolio" of resources for their survival. Raising of rice was certainly a central feature of their adaptive strategy, but it was only one of many alternative means they employed to make their living. In years of drought or flood when no crop could be grown, and in the dry season in all years, people readily turned to other activities—including hunting, fishing, and collecting of wild products, handicraft industry, off-farm wage labor, and seasonal migration to cities—to ensure their survival. Such a broad-spectrum strategy is linked to an extensive pattern of resource use that tends to be relatively sustainable. As the population has grown and demand for cash to purchase commodities has increased, however, there has been a noticeable trend toward greater specialization and more intensive exploitation of rural resources.

Intensification is evident in many forms. Conversion of upland forests into fields for raising cassava, sugarcane, or soybeans is one common form of intensification. Instead of a small but steady flow of minor forest products, cash crops are harvested in large quantities every year, at least until the soil fertility is destroyed. Commercially oriented planting of trees,
Social trends affecting natural resources management in upland areas

such as monocultural rubber, oil palm, tea, or timber and pulp trees such as eucalyptus or pine, is another common form of intensification of upland land use. Development of water resources has permitted irrigation of some lower areas where farmers now grow two crops a year on land that formerly supported only a single harvest.

Such intensification in resource use has many social and environmental consequences. Its effects on sustainability have received much attention. Year-round cultivation, for example, both depletes soil nutrients and allows the build-up of large pest populations. Solutions to these problems in the form of application of chemical fertilizers and pesticides create new problems of pollution, ecosystem disruption, and evolution of resistant pest varieties.

Intensification can also lead to increased competition between users of multipurpose resources. A village pond is simultaneously used as a source of water for livestock, a bathing place for people, and a fish pond. If someone uses it for retting kenaf, its value to other users is reduced or destroyed. Natural forests provide villagers with many different resources such as medicinal plants, wild game, fruit, firewood, and fodder for livestock. In contrast, monocultural tree plantations offer few such assets, especially when they are composed of alien species such as eucalyptus or oil palm.

It is fruitless to debate the issue of whether intensification of resource use is good or bad. Given the rapid growth of population in rural Asia and the Pacific, further intensification is inevitable, even in the unlikely case that there is no further increase in consumption expectations. The question that faces us is: How can we devise strategies for intensified resource use that will meet the broadest range of needs of the greatest number of people in the most sustainable way? Particular attention needs to be paid to increasing the productivity of existing agricultural land to reduce pressures to clear or otherwise exploit remaining forestland. Agroforestry, which combines the simultaneous production of wood and crops on a single piece of land, is one attempt to meet this objective. Interplanting of different annual crops in polycultural cropping systems may be another way to increase yields without using more land. Such multispecies systems may also have greater resistance to pests. Solving problems of village water supply to allow small-scale vegetable production and raising of fish in the dry season may also be a useful approach. In remaining forest areas, careful exploitation of nonwood forest products may produce
greater returns with less ecological disruption than commercial logging every 40 to 50 years.

CONCLUDING REMARKS

Changes in the management of natural resources in the uplands of Asia and the Pacific reflect the influence of powerful social factors. We have suggested that the most important of these factors are increased dependency on outside forces, differentiation in access to resources, and intensification in exploitation of resources. Two additional social factors affecting management of upland resources that merit consideration are the false perception of uplands as underutilized habitats and the "colonial" status of the upland population in most of the countries of the region.

False Perception of Uplands as Underutilized Habitats

In many Asian countries, there is a sharp demographic division between the densely settled lowlands and the much more sparsely inhabited uplands. In Viet Nam, for example, densities in parts of the Red River Delta exceed 1,000 persons per km$^2$ while in the Central Highlands there are fewer than 50 persons per km$^2$. Many upland areas are still covered with forest; from the vantage point of the planner's helicopter, these areas appear to offer vast empty spaces of fertile land for agricultural colonization. The unknowing observer in the helicopter would ask, "Why not open up these underutilized uplands for resettlement of landless farmers from the lowlands?"

In some cases, the areas which do contain underutilized resources are unhealthy or otherwise unsafe for human occupation. For example, large tracts in Burma and Cambodia are rendered virtually uninhabitable by particularly dangerous strains of malaria. Other areas in Laos, Viet Nam, and Cambodia are made hazardous by unexploded mines and bombs.

More importantly, most upland areas, empty as they may appear, are in fact already heavily utilized. These areas which may appear to be underutilized are actually already overexploited in terms of the carrying capacity of their ecosystems. For example, in a paper by French tropical geographer Pierre Gourou that was entitled "China's Unused Uplands," it was observed that Chinese settlement was entirely concentrated in valleys and that there did not seem to be any systematic economic exploitation of hill lands. He suggested that there was an unutilized niche for raising
livestock in the hills as is common practice in European uplands. However, what Gourou failed to recognize was that the upland ecosystems in China were already badly overexploited. Virtually all of the biomass produced within these systems was collected to provide fuel, fodder, and green manure to maintain the productivity of the lowland agricultural systems. This continued down-slope migration of nutrients had steadily degraded the soil of the uplands and lowered its capacity to support vegetation. If access to the hills were cut off, however, the yields of lowland fields would decrease dramatically. A trade-off had been made between maximizing grain production in the valleys and using the uplands for economic production, where the uplands had basically been written off as productive assets in their own right.

Uplands as Internal Colonies

Most upland areas in the Asia and Pacific countries enjoy the status of "internal colonies" within the sovereign nations of the region. They are managed not for the benefit of their existing inhabitants but to achieve larger national goals. Indeed, the decision-making power for upland resource management is rarely or never held by the residents of the uplands. Decisions about development of the Cordillera in the Philippines, for example, are made in Manila, not Baguio. Similarly, decisions about developing the Central Highlands of Viet Nam are made in Hanoi, not Kontum.

That this should be true does not suggest evil intent by national governments, but is a reflection of the small populations of the uplands. The uplands inhabitants simply do not have a sufficient number of "votes" to exert more control. The situation is, of course, often worsened by the existence of ethnic differences between upland populations and the lowlanders who generally dominate decision-making positions within many national governments.

The consequence of the lack of political influence by upland residents is that plans for upland development tend to be made by lowland planners. Many of these planners have a lowland perspective on the world and lack adequate understanding of upland ecology, and many costly mistakes in development projects have resulted. There is a real need to deal with development of upland regions in their own human ecological terms and not simply to exploit upland resources as a cheap and expedient way to achieve immediate objectives of concern in the lowlands.
In all parts of the world, purely technical solutions to resource management problems have rarely proved effective in achieving their stated objectives. Nowhere is this more true than in the uplands of Asia and the Pacific. The landscape in this region is littered with the remains of ambitious resource management projects that failed to consider social factors. How many thousands of kilometers of bench terraces have been abandoned in Thailand, Laos, and the Philippines because upland swidden farmers could not obtain the inputs needed to maintain continuous production on their poor, depleted soils? How many millions of trees planted in China's vast reforestation campaigns have died because no institutional mechanisms existed to ensure that the young trees were cared for after the mass effort was completed? How many soil conservation and forest restoration projects have been put in place in Nepal (and on the mistaken premise that such projects would significantly reduce flooding in the lower Ganges and Brahmaputra) with little to show for the effort that was not of local origin anyway? If such misallocation of limited development resources is to be avoided in the future, project planners need to transcend sectoral and disciplinary boundaries in thinking about problems of managing natural resources. Planning for development of upland natural resources must pay increased attention to their unique social context.
Notes

1. Of necessity, new words such as "agroforestry" have been coined to describe systems of mixed tree and annual crop raising. Such mixed systems, which are common in upland areas of Asia and the Pacific, do not fit within conventional Western categorization of resources in which "forests" and "farms" are seen as mutually exclusive concepts.

2. As social scientists are perhaps all too fond of pointing out, social processes are complex and difficult to understand. In particular, the causes of social and economic change are poorly understood. The nature of change processes is a matter of continuing acrimonious debate among social scientists. Exploring these issues in detail will hardly be illuminating for our present purposes.

3. The effects of privatization on soil and water conservation measures formerly implemented at the communal level have often been less beneficial. Local communities are no longer able to mobilize sufficient labor to build hillside terraces, maintain communal irrigation systems, or reforest denuded hilltops.
References


Part III:
Regional and country papers
Regional economic cooperation in South Asia

Abulmaal A. Muhith

INTRODUCTION

Regional cooperation is a measure of advance in civilization. Civilized nations not only live in peace but also work together to promote the welfare of their citizens. Functional cooperation between nations began as far back as the nineteenth century when time and space were formidable obstacles to interaction of nations. The International Telecommunication Union (established in 1865) and the Universal Postal Union (established in 1875) bear testimony to such cooperative efforts and underlines the fact that telecommunication facilities function better and more economically when undertaken on a regional basis.

The virtues of economic integration in the promotion of human welfare are best demonstrated by North American history. Partly because of its isolation from the rest of the world, partly because of the colonial background that helped knit the continent together, and partly because of the spirit of the immigrants who were united by a devotion to freedom and prosperity, the United States of America demonstrated the attractions of economic integration. A large market not only provided demand stimulus, but also helped investment planning on a grand scale and resource exploitation on an efficient and economic basis.

After World War II, tired of conflict and devastation, western Europe commenced the process of economic integration with the establishment of the Council of Europe in 1948 and the Coal and Steel Community in 1951. Since 1957, more confident strides were made towards economic integration and the prospect of completing the internal market by the end of 1992 now beckons. Furthermore, recent developments in eastern Europe suggest the possibility of a larger European economic union before the turn of the century.

In the developing countries, efforts at economic integration began in Latin America and the Caribbean region in 1960 with the establishment of the Latin American Free Trade Association (LAFTA) and the Central American Common Market (CACM). In Africa, a monetary union called the Franc Zone was functioning from colonial days, i.e., 1958. Other economic cooperation efforts include a customs union known as UDEAC
(Customs and Economic Union of Central Africa) that was formed in 1964, the Association of South East Asian Nations (ASEAN) in Asia which was formed in 1967, and the South Asian Association for Regional Cooperation (SAARC) coming as late as 1985. Although there has not been any dearth of efforts, these integration or even cooperation moves have not as yet achieved much success.

Accompanying these initiatives, the literature on economic cooperation or integration has been plentiful in the postwar period. Jacob Viner (1950) opened the debate, and authoritative texts have been produced by economists and planners on region-specific or global issues on the subject.

In practice, regional economic cooperation initiatives have come about under different circumstances including as a response to the perception of a collective strategic threat or simply as a step towards strengthening the economic bargaining capacity of a regional group. Whatever the initial motivation, economic integration has always been considered to be beneficial for the growth and development of participating countries. In this perception, trade cooperation has been the point of departure leading subsequently to investment and monetary cooperation. In addition, functional cooperation, as manifested by more technical forms of exchange, has provided impetus for broader economic cooperation.

The South Asian region was a latecomer to regional cooperation for reasons that are not difficult to understand. Prior to 1947, the three largest countries of the region (Bangladesh, India, and Pakistan) were a single colony of the British Empire. The other five nations (Bhutan, Burma, Maldives, Nepal, and Sri Lanka) were also under British domination and shared many facilities and services in common. But as a result of a complex process of economic deprivation of some regions, communal animosities, and political differences, the cohesion of the region disintegrated. India and Pakistan emerged as antagonists and fought a war soon after their independence. Almost ironically, the prospects for regional cooperation brightened with the emergence of Bangladesh in 1971 as communal and religious animosities could no longer be used to justify the political differences between states. Despite the thaw in Indo-Pakistan relations in the wake of the Simla Accord of 1972, however, the progress towards regional economic cooperation was again minimal until the late 1970s.
It was under the auspices of the Marga Institute that a study on regional cooperation was commissioned in 1978 with the participation of development research institutions from India, Iran, Bangladesh, Pakistan, and Nepal. The Committee for Studies on Development Cooperation (CSDC) undertook important work on resource assessment, regional development, and trade promotion. In 1978, the government of Bangladesh commissioned a study on South Asian Customs Union. Then in 1980, Bangladesh President Ziaur Rahman invited the heads of state of all seven countries to consider regional economic cooperation. The working paper prepared by the Bangladesh government in November 1980 laid down the raison d'être for regional cooperation and identified possible areas of cooperation. In the eleven identified areas, items like free trade, joint investment planning, and joint management of natural resources—an important issue in an ecologically and historically integrated region such as South Asia—were deliberately left out because they were, or had the potential to be, contentious issues and were hence considered to be matters for bilateral negotiations.

In South Asia, it was not the perception of external threat to the region that inspired regional cooperation as was in part the case for ASEAN. Rather, it was the acceleration of the pace of economic and social development of the countries and the promotion of individual and collective self-reliance that motivated the move. As Mrs. Gandhi, Prime Minister of India, inaugurating the first meeting of Foreign Ministers of SAARC in New Delhi in August 1983 correctly stated, "We had our political differences in the past, and have even now, but economic cooperation will give strong impetus to closer friendship and greater stability in South Asia."

Given the history of suspicion and tension between some of the countries of the region, the progress since 1980 has been surprising. The first summit was held in Dhaka on December 7–8, 1985, and the South Asian Association for Regional Cooperation was launched with the Dhaka Declaration. The second summit in Bangalore in November 1986 set up a small permanent secretariat headquartered in Kathmandu. The fifth summit scheduled in 1989 at Colombo could not be held because of tension between India and Sri Lanka, but two summits are planned in 1990 in Colombo and Male (Maldives).
ECONOMIC REALITIES OF THE SAARC COUNTRIES

The countries of SAARC—Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka—are inhabited by the largest numbers of the world’s poor. The total population below the poverty line in these countries is more than 400 million (larger than the population of Africa). In this region about 21 percent of the world’s population survive on 3.5 percent of the world’s land area, only half of which is arable and which produces less than 2 percent of the world’s output. The ratio of number of persons to land and natural resources in this region are among the highest in the world. Exports from the region are only 1 percent of world exports and imports account for 1.2 percent of world imports. The three attached tables provide economic and social indicators for the SAARC economies.

Population growth is a serious problem in the region and is a matter of concern for all SAARC countries, except in Sri Lanka (Table 1). Although the highest population growth rate is in Maldives and Pakistan, the most serious problem is in Bangladesh and Nepal where natural resources are being severely strained by population pressure. Urbanization is at a low level in all countries but the rate of growth is very high in Bangladesh and Nepal, and quite high in Pakistan and India. In the last twenty-five years, the crude death rate has fallen dramatically in all countries, but the birth rate has fallen only in India. With the exception of Pakistan, there is little religious opposition to population control in any of the countries.

In the provision of basic education, the performance of all the SAARC countries except Sri Lanka has been poor. Even in India, which has the third largest stock of high-level scientific manpower in the world next only to the United States and the USSR, progress has been slow in the last quarter of a century. Literacy rates in all of these countries vary between 10 percent and 35 percent, and are among the lowest in Asia and indeed the developing world. Investment in education in these countries, except Sri Lanka, has been low, although in India and Nepal enrollment at the primary level has been expanding at a fast pace in recent years.

The structure of production and employment has been changing to a varying degree in SAARC (Table 2). In 1965, for example, agriculture accounted for 47 percent of Indian GDP and 40 percent of Pakistan GDP. However, both countries have successfully brought about the green revolution, and the share of agriculture has declined substantially to 30
## Table 1: Basic Social Indicators of the SAARC Countries and China

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n.a. = Not available.

Table 2 Economic Indicators of the SAARC Countries and China, 1987

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<th>Country</th>
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<th>Growth Rate, 1980–1987 (%)</th>
<th>Per Capita Income (US$)</th>
<th>Distribution of GDP (%)</th>
<th>Commercial Energy Consumption</th>
<th>Gross Domestic Investment Rate</th>
<th>Domestic Saving</th>
<th>Total Expenditure</th>
<th>Defense Expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangladesh</td>
<td>17.60</td>
<td>3.7</td>
<td>160</td>
<td>47</td>
<td>13</td>
<td>40</td>
<td>7</td>
<td>47</td>
<td>8.1</td>
</tr>
<tr>
<td>Bhutan</td>
<td>0.25</td>
<td>5.0</td>
<td>150</td>
<td>51</td>
<td>16</td>
<td>33</td>
<td>4</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>India</td>
<td>241.30</td>
<td>4.8</td>
<td>300</td>
<td>30</td>
<td>30</td>
<td>40</td>
<td>20</td>
<td>208</td>
<td>6.0</td>
</tr>
<tr>
<td>Maldives</td>
<td>0.06</td>
<td>6.8</td>
<td>300</td>
<td>38</td>
<td>14</td>
<td>48</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Nepal</td>
<td>2.80</td>
<td>4.7</td>
<td>160</td>
<td>57</td>
<td>14</td>
<td>29</td>
<td>5</td>
<td>23</td>
<td>10.3</td>
</tr>
<tr>
<td>Pakistan</td>
<td>36.20</td>
<td>6.6</td>
<td>350</td>
<td>23</td>
<td>28</td>
<td>49</td>
<td>17</td>
<td>207</td>
<td>6.5</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>6.50</td>
<td>3.7</td>
<td>390</td>
<td>27</td>
<td>27</td>
<td>46</td>
<td>16</td>
<td>160</td>
<td>3.9</td>
</tr>
<tr>
<td>China</td>
<td>319.70</td>
<td>10.4</td>
<td>300</td>
<td>31</td>
<td>49</td>
<td>20</td>
<td>34</td>
<td>525</td>
<td>4.4</td>
</tr>
</tbody>
</table>

n.a. = Not available.

percent and 23 percent, respectively, over a period of twenty years; the gains have been distributed equally between the industry and service sectors. In Sri Lanka, the share of agriculture in 1965 was 28 percent and it has dipped marginally since then, but industry has expanded from 21 percent to 28 percent at the expense of the service sector. In Bangladesh and Nepal, the change has been very limited. Agriculture still absorbs more than two-thirds of the labor force in all countries except Sri Lanka and Pakistan where it absorbs a little above 50 percent. The service sector accounts for a disproportionately high share of GDP in all countries and employment in the service sector has grown rapidly since 1965 except in India and Sri Lanka. This means that employment at wages below subsistence level is very high. Unemployment and underemployment are very high in all countries and Bangladesh has one of the highest rates at over 30 percent.

Industrialization has made some headway in India, Sri Lanka, and Pakistan, but the share of manufacturing is still low at 20 percent, 16 percent, and 17 percent, respectively, as of 1987 (Table 2). In the other four countries, the productive capacity, as measured by the consumption of commercial energy, is extremely low. Only India has a heavy industrial sector, while Pakistan's engineering industry is beginning to move into the production of some heavy machinery including armaments.

All of the South Asian countries, except Bhutan and Maldives, have been preparing medium-term development plans for nearly thirty years or more, and all have been economies managed through regulation and active public intervention. India has been the most regulated and for a while Pakistan was the least regulated among these countries. But winds of change have been blowing in South Asia since at least the second half of the 1970s, and trade liberalization, expansion of the private sector, and deregulation are now espoused by all countries. India remains the most regulated of all.

Investment in all SAARC countries except Bangladesh is at a reasonably satisfactory level. However, with the exception of India, the countries are all heavily dependent on external assistance for their investment program. The domestic savings rate as of 1987 was quite low in all of the countries except India, and governments in all countries spend more than they raise in revenue.

Trade is a small element in the GDP of all SAARC countries except Maldives (table 3). In recent times, even Sri Lanka has expanded trade.
Table 3  Major External Economic Indicators of the SAARC Countries and China, 1987

<table>
<thead>
<tr>
<th>Country</th>
<th>Exports</th>
<th>Structure of Exports (%)</th>
<th>Imports</th>
<th>Structure of Imports (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>As a Percentage of GDP</td>
<td>Foods</td>
<td>As a Percentage of GDP</td>
</tr>
<tr>
<td></td>
<td>(US$ m)</td>
<td>Fuels &amp; Metals</td>
<td>Primary Commodities</td>
<td>Manufactures</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>1,074</td>
<td>6.1</td>
<td>16</td>
<td>33</td>
</tr>
<tr>
<td>Bhutan</td>
<td>25</td>
<td>1.0</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>India</td>
<td>12,548</td>
<td>5.2</td>
<td>9</td>
<td>22</td>
</tr>
<tr>
<td>Maldives</td>
<td>33</td>
<td>55.0</td>
<td>0</td>
<td>67</td>
</tr>
<tr>
<td>Nepal</td>
<td>151</td>
<td>5.4</td>
<td>2</td>
<td>26</td>
</tr>
<tr>
<td>Pakistan</td>
<td>4,172</td>
<td>11.5</td>
<td>1</td>
<td>32</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>1,393</td>
<td>21.5</td>
<td>8</td>
<td>52</td>
</tr>
<tr>
<td>China</td>
<td>39,542</td>
<td>12.3</td>
<td>14</td>
<td>16</td>
</tr>
</tbody>
</table>

n.a. = Not available.

Nevertheless, all of the South Asian countries have adverse balances of trade which are covered by external assistance. In the 1980s, manufacturing exports grew in all the countries with textile and clothing accounting for a large part of the expansion. All of the countries are large energy importers, and in all cases, machinery and transport imports account for over one-quarter of foreign payments. The food import bill is also quite large in these countries, although foodgrains are no longer imported by India and Pakistan. The South Asian countries have only recently begun to make efforts to expand exports, and trade and industrial policy reforms are on the agenda of all of them. Sri Lanka abandoned an import-substitution strategy and began an outward-oriented strategy in the late 1970s. In other countries, the change is still being made and is slowest in India which has a very large domestic market and a developed, if not yet a competitive, industrial sector.

As mentioned above, however, what distinguishes the SAARC region most is the level of its poverty. In Bangladesh, at least 75 percent of the people live below the poverty line, and in India it is in the neighborhood of 40 percent. Only in Sri Lanka and Maldives are poverty levels less acute. Poverty is prevalent in spite of the fact that India and Pakistan achieved self-sufficiency in foodgrains production several years ago. In reality, the potential for agricultural growth has not been fully exploited in any of these countries (except Maldives where there is no agricultural potential). Realizing this potential means better irrigation management, improved husbandry practices, research and extension, improved land systems, and above all diversification. But the most serious crisis of all is the lack of access to assets and employment by the large and growing numbers of rural people.

The lowest quintile of the population command about the same share of GDP in all the countries, between 6 and 7 percent, while the highest quintile command 45 to 50 percent of GDP. While these figures do not compare unfavorably with other countries, because of the very low level of output per capita in the South Asian countries, the data imply a high incidence of poverty which is made worse by limited public investment in social services.

Economically and geopolitically, the most important feature of the SAARC region is the dominant position of India. India borders all of the other six countries, no two of which are themselves contiguous. In terms of natural resource endowment, foodgrains surplus, industrial structure, and scientific and technological know-how, the advantage is again with
India which has been very much the command economy of the region until recently. Given the current political climate, this Indocentric position may be considered a liability rather than an asset.

Another feature of the SAARC region, partly related to the size of India and the political climate and which has an extremely unfavorable impact on the member economies, is the monstrous burden of wasteful defense expenditure. For Pakistan to spend nearly 7 percent of GDP on defense is as reprehensible as for Nepal to devote 1 percent or Bangladesh to devote 1.5 percent of GDP to this futile pursuit. Besides diverting resources, it has created in several countries of the region an antidevelopment and antipeople ethos among the ruling elite.

Intra-SAARC trade constitutes a very small part of the international trade of these countries. Moreover, intra-SAARC trade has been declining (Table 4). The four larger countries have very little trade between them and only about 10 percent of their total trade is within the SAARC region. Traditional trade links are with the industrialized countries and this pattern is underscored by aid flows. In addition, the SAARC countries manifest a preference for supplies from developed countries. Moreover, the complementarity of production processes is very limited. India could supply capital goods to its neighbors but the financing of such trade would stand in the way of greater mutual exchange. For some exportable goods, efforts at coordinating marketing and negotiating access to markets have been considered on many occasions but without positive results.

PRESENT COOPERATIVE INITIATIVES

The first meeting of the foreign secretaries was held in Colombo in April 1981 and led to the establishment of working groups in five areas with a coordinator from one of the member countries to identify the modalities of cooperation and develop sectoral action programs. Three additional working groups were established at the next meeting in Kathmandu in November 1982, and a ninth group was added by the third meeting in Islamabad in August 1983. Thus, before the SAARC was formally launched, regional cooperation efforts were underway in nine sectors: agriculture, rural development, telecommunication, meteorology, health and population, transport, postal services, scientific and technical cooperation, and sports and culture. The activities consisted of meetings of experts, seminars on specific items of common interest, training courses, joint festivals, and arrangements for exchange of information. A number of proposals for the establishment of regional institutions were discussed.
Table 4 Direction of Trade of the SAARC Countries (Percentage of total trade)

<table>
<thead>
<tr>
<th>Destination Country</th>
<th>Market Economies</th>
<th>East European Planned Economies</th>
<th>Developing Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exports</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bangladesh</td>
<td>33.9</td>
<td>65.8</td>
<td>7.2</td>
</tr>
<tr>
<td>India</td>
<td>42.4</td>
<td>59.3</td>
<td>25.1</td>
</tr>
<tr>
<td>Maldives</td>
<td>44.2</td>
<td>18.1</td>
<td>n.a.</td>
</tr>
<tr>
<td>Nepal</td>
<td>25.2</td>
<td>65.3</td>
<td>n.a.</td>
</tr>
<tr>
<td>Pakistan</td>
<td>35.0</td>
<td>58.6</td>
<td>2.8</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>40.9</td>
<td>63.5</td>
<td>3.0</td>
</tr>
<tr>
<td>South Asia</td>
<td>39.7</td>
<td>59.8</td>
<td>16.2</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Country of Origin</th>
<th>Market Economies</th>
<th>East European Planned Economies</th>
<th>Developing Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Imports</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bangladesh</td>
<td>38.5</td>
<td>44.8</td>
<td>2.4</td>
</tr>
<tr>
<td>India</td>
<td>43.1</td>
<td>60.8</td>
<td>10.8</td>
</tr>
<tr>
<td>Maldives</td>
<td>28.4</td>
<td>26.1</td>
<td>n.a.</td>
</tr>
<tr>
<td>Nepal</td>
<td>35.6</td>
<td>50.4</td>
<td>n.a.</td>
</tr>
<tr>
<td>Pakistan</td>
<td>47.5</td>
<td>58.3</td>
<td>1.6</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>42.6</td>
<td>43.3</td>
<td>0.4</td>
</tr>
<tr>
<td>South Asia</td>
<td>43.5</td>
<td>57.6</td>
<td>7.0</td>
</tr>
</tbody>
</table>

n.a. = Not available.
The 1985 summit expanded the institutional structure; SAARC, with technical committees on all subject matters, was subsequently augmented to twelve subjects (with the additional items of drugs, women in development, and education). These committees carry out what is called the Integrated Program of Action. The activities are not very different from the previously established functions except that management of the regional institutions has now been added. The summit, which is the highest decision-making regional authority, meet once a year and the Council of Ministers meets twice a year. A small secretariat carries out the mandate given by the summit, services the Council of Ministers and the technical committees, and organizes other activities.

Three regional centers have been established: the Agricultural Information Center in Bangladesh, the Meteorological Research Center in India, and the Documentation Center in India. A fourth institution, the Human Resource Development Center, is to be set up in Pakistan. There are a number of other proposals for additional regional centers on which the Council of Foreign Ministers has yet to make any recommendation.

The programs so far begun are the following:

1. Audio-visual exchange program under which television and radio programs of member countries are shown or aired in the other countries

2. Chairs and fellowships program for exchange of scholars and researchers

3. Organized tourism providing for concessional airfare and limited currency convertibility which will hopefully leading to easier visa issuance

4. Youth volunteers program for service by nationals of the region in all countries

5. Food reserve scheme under which emergency stocks of 200,000 tons have been built up in member countries

Under the aegis of the Bangkok Agreement, the Asian Clearing Union was established in 1975 encompassing Iran and Afghanistan and the four SAARC members—Pakistan, India, Bangladesh, and Nepal. In 1976, transactions worth SDR 22 million were dealt with under this arrangement
Regional economic cooperation in South Asia

and by 1985 the volume had increased to SDR 596 million. This arrange-
ment specifically excludes some transactions but the settlement period
under it is very short, i.e., only two months. However, it excludes three
countries of the SAARC and cannot be considered a program of the
region, although it could help to enhance intraregional trade expansion.

The first summit took up the issue of terrorism and a Convention on
Terrorism that covered cross-border terrorism was adopted in the second
summit. This was indeed a milestone inasmuch as it dealt with a
contentious political issue involving the infringement of national sovereign-
ty.

The third summit took an important initiative on environmental
concerns. Destruction of forests, natural disasters such as floods and
landslides, and global warming and its impact on the rise in sea level were
drawn to the attention of the leaders. The study commissioned in
pursuance of the summit directive is being finalized in 1990 in order to
present an action plan to the sixth summit. In the area of natural resource
management, regional cooperation is both difficult as well as rewarding.
Scholars from within the region as well as from outside have been
emphasizing the gravity of ecological improvement or the use of Himalayan
resources (Lall 1989, Agrawal 1988). It is to the credit of the first summit
that Nepal was co-opted into the discussions on the Joint River Commis-
sion between India and Bangladesh. The movement towards consideration
of regional ecological problems is a significant advance in regional
cooperation, leading to the possibility of joint exploitation of natural
resources of the region.

The fourth summit authorized a study on cooperation in trade,
manufacture, and services that was recommended earlier by the second
annual meeting of planners in Islamabad in October 1987. Country studies
in pursuance of the summit decision have already been prepared; the
studies identify areas of complementarity and propose modalities of trade
expansion. The fifth summit is expected to reconsider the subject,
although no technical committee was established for trade expansion as
it was considered too contentious a subject. However, the broaching of
this area by the summit is a welcome move in an area which calls for
careful and gradual measures and concomitant investment cooperation.

The third annual meeting of planners held in Kathmandu in November
1988 recommended the launching of SAARC 2000, a program for human
resource development and basic needs in the region. The fourth summit
authorized preliminary work on such a program. Various realizable social targets for 2000 or, more appropriately, for 2015 are to be drawn up. Joint pursuit of objectives such as literacy, safe water supply, and immunization of children is an area where regional cooperation could be both successful and highly beneficial (Syeduzzaman 1989).

EVALUATION OF PERFORMANCE AND FUTURE PROSPECTS

The progress towards greater cooperation in South Asia, compared with the pessimistic forecast and the cautious beginning, is not discouraging. The exclusion of trade and natural resource development from the primary areas of cooperation has rightfully raised doubts about the possibility of worthwhile cooperation (Bhuiya 1987, Fernando 1988), but notwithstanding the difficulties there has been some initiative in this area.

The currently low and declining levels of intraregional trade (Table 4) coupled with the relative absence of production complementarities are impediments to trade cooperation (Naqvi 1987). In a dynamic trade context, complementarities could be built up, but the South Asian countries, as noted earlier, remain dependent on concessional aid for meeting their trade gap and the lack of independent financing could impede intraregional trade expansion. Taxes on trade are also quite high in South Asia and since they provide a large part of public revenues in all of the countries, the freeing of trade from fiscal constraints will be resisted. Some trade and industrial reforms have nevertheless succeeded in reducing tariff rates in the region.

It has also been said that the structure of the economies of South Asia, and the prevalence of poverty, inhibit cooperation (Hirono 1989) although there is no experience from other cooperative endeavors which offer lessons for South Asia. The reasonably uniform ecosystems of the region and its historical and cultural linkages perhaps suggest the possibility of applying common development problems which essentially derive from inequitable output growth in the face of adverse land/person and land/resource ratios.

The greatest pessimism, however, springs from the political realities of the region. The absence of compatible political systems and the differing perceptions of foreign policy and security interests by the countries of the region do not augur well for cooperation. There are some problems between neighbors which have defied solution for years: for instance, the Kashmir dispute between India and Pakistan, the Ganges
water dispute between India and Bangladesh, the Tamil minority problem between India and Sri Lanka, and the trade and transit rights dispute between India and Nepal. Because of such problems, some observers have gone to the extent of judging that SAARC is nonviable (Ayoob 1985). Another school of thought maintains that the character of the ruling elite in the region is not susceptible to developing cooperative arrangements for the benefit of the people. Moreover, this group considers the gradualistic approach towards marginal cooperation as not being worth the trouble (Rahman 1986). Even the protagonists of regional cooperation grant that a reduction in military and political hostilities must precede any progress in cooperation (Sobhan and Rahman 1987).

There is no denying the fact that progress towards real democratization in the countries of the region will help the spirit of cooperation even if it is no guarantee of good relations between countries. The current brink-of-war situation between India and Pakistan proves the point. It is, indeed, the worst threat to regional peace in twenty years and even overshadows the Sri Lankan crisis which threatened both the second and third summits and delayed the fifth. It is ironic that while in 1989 the goodwill of the fourth summit brought about the first reduction in the military budgets of India and Pakistan, both countries have subsequently increased them again.

Tension in the region is likely to continue. Problems between India and Nepal, India and Bangladesh, and India and Sri Lanka, in particular, will continue and there may be periods of goodwill alternated by periods of difficulty. The problem between India and Pakistan, however, is of a different kind. Accepting this reality, two developments will have to be pursued. First, the arms race should be halted because armed conflict will never resolve any issue and will only jeopardize both economic and social stability. Second, ways should be found to establish an economic community. A commonwealth of South Asia may be a distant dream but functional as well as trade and investment cooperation cannot wait for complete political harmony.

A number of suggestions have been made to promote South Asian regional cooperation in a meaningful way and for existing cooperation in the region to move beyond marginal activities. Considering these suggestions and recognizing the unique problems of the region (confidence gap, resource gap, and wealth gap), the following ideas are illustrations of unorthodox but potentially effective regional cooperation measures.
Functional Cooperation. Kappagoda (1988) has suggested joint programs in areas as varied as agricultural research, investment codes, and tourism promotion. In these sectors, consideration should be given to joint management of programs and facilities. Despite the desire to set up new regional institutions, it may be more economic and efficient to set up a network of national institutes in a specific field and manage them jointly. For example, a regional agricultural research council could supervise the programs of all institutes on agricultural research in all the countries of SAARC and could develop the individual specializations of some of them to serve regional needs. In tourism, all national facilities could be pooled and regional tour programs for both regional as well as extraregional visitors could be organized. There could be regional standards to be maintained by various classes of facilities and programs. In light of current reforms on trade and industrial policy in all the countries of the region, consideration should be given to devising a uniform investment code for the region as a whole. Harmonization might not prove very difficult since national policies are not very different now.

The second session of the Standing Committee (as the Council of Foreign Ministers used to be called before SAARC was formally launched) in Male in July 1984 considered some bold and imaginative proposals in the field of civil aviation. There was to be an inventory of all aircraft, infrastructure facilities for civil aviation, and repair and maintenance facilities for aircraft. Consideration was also given to joint negotiation of traffic rights and tariffs, common standards for repair facilities, common practices for airport management, and common airworthiness certification (SAARC Secretariat 1988). Such proposals, if considered seriously, will inevitably lead to pooling, if not unification, of all national air services in the region. These are the kinds of functional cooperation (or more strictly integration) which deserve to be considered. For railways, telecommunication, postal services, shipping, and meteorology, integration of facilities and services should be the objective of a medium-term action plan.

Planning Coordination. Yamaguchi (1989) has suggested that SAARC should be a channel for external resource flows to the region. This would naturally lead to a measure of joint regional trade and investment planning, with consideration of national development programs by a SAARC mechanism. Individual countries would draw up their programs and quantify both trade and investment gaps. In a regional forum, these would be considered so that they were consistent with regional resource use, trade opportunities, and investment proposals. Only then would it be possible to distribute external assistance to the countries. This proposal
assumes that donors would be disposed to provide a given amount of aid to the region, perhaps on the basis of their assessment of collective needs. Such an assumption is doubtful for all resource flows to the region, but it could be true for aid allocations to specific programs of regional cooperation such as hydropower generation, river basin development, watershed management, or regional industrial projects. A SAARC mechanism would assist in determining the sharing and utilization of such aid.

Trade between the countries of the region could expand if the difficulty of financing trade deficits can be overcome. India, and to some extent Pakistan, could supply a large proportion of the imports which other countries of the region currently purchase from developed countries with aid money. Sobhan and Rahman (1987) have suggested that regional trade could be expanded if India would invest its trade surplus with the deficit countries of the region in production capacities that would produce exports to India. They have cited in this context an earlier proposal for urea capacity in Bangladesh for meeting Indian demand. Trade expansion is thus related to investment planning. Sir Roy Harrod, as early as 1962, had also recommended coordination of investment planning in the region, suggesting a regional planning board and joint licensing and evaluation of investment proposals (Harrod 1962).

The action programs now being prepared for two major undertakings in SAARC only highlight the need for joint planning. The plan for environmental protection and upgradation, and the program for cooperation in trade, manufactures, and services, demand the establishment of a planning apparatus. A regional planning board may be established as an apex body for the national planning authorities. In the first instance, such a body would only scrutinize national program proposals to ensure that they were consistent with regional development objectives in the pattern of the Commission of the European Community.

A planning board of this nature has become all the more necessary for finalizing the SAARC 2000 Program. As mentioned earlier, the program should ideally have a twenty-five-year time span and could better be SAARC 2015. It should focus on a few objectives like literacy, immunization, drinking water supply, primary health care, and population control, and could be a promising foundation for human development in the region. Resource planning for such a program should take into account not only intensification of domestic resource mobilization but, more importantly, reduction of wasteful expenditure, including that on defense expenditures.
which, as already noted, is at an obscene level in all the South Asian countries and barely justifiable in the poorer ones.

In all the countries of the region, public expenditure is an area of special attention. Government expenditure programs for both current and development expenditure are at high levels compared with revenue raising. The tax system and budgetary practices are very similar among the South Asian countries. The pressure for current expenditure is strong, while the allocation for maintenance and operation is miserly and the development budget is large. The coordination between public finance and management of money and banking (where the public sector is quite dominant) is lax or nonexistent. Public expenditure priorities are crucial to the provision of basic needs and South Asian economies should carefully orient their public expenditure programs with human development goals in mind. Here, regional guidance could be very useful and might be considered an item of first priority for the regional planning board.
Notes

1. Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay, and Venezuela formed LAFTA. This was replaced in 1980 by the Latin American Integration Association (LAIA).

2. The CACM is composed of Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua.

3. The France Zone covered Benin, Burkina Faso, Cameroon, Central African Republic, Chad, Comoros, Congo, Equatorial Guinea, Gabon, Ivory Coast, Mali, Niger, Senegal, Togo, Guinea, Tunisia, Morocco, Algeria, Mauritania, and Madagascar, and was linked to France by agreement.

4. Cameroon, Central African Republic, Congo, Equatorial Guinea, Gabon, and Chad formed UDEAC in 1964 as a customs union. In 1984, they decided to extend the membership to other countries including Burundi, Zaire, Rwanda, Angola and Sao Tome, and Principe.

5. ASEAN is currently composed of Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand.


7. Some of the notable publications are Gunatilleke (1979), David et al. (1979), Quereshi (1981), Agrawal (1984), and Mukherjee et al. (1985).


9. The working paper listed the following areas for possible cooperation: (1) telecommunication; (2) meteorology; (3) road and rail transport; (4) shipping; (5) agriculture rural sector; (6) joint ventures; (7) market promotion for common items of export like jute, tea, or cotton; (8) scientific and technical cooperation; (9) educational and technical training; and (10) cultural cooperation (SAARC Secretariat 1988).

10. The SAARC Charter says:
4. Convinced that regional cooperation among countries of South Asia is mutually beneficial, desirable and necessary for promoting the welfare and improving the quality of life of the peoples of the region.

5. Convinced further that economic, social and technical cooperation among the countries of South Asia would contribute significantly to national and collective self-reliance.

11. In Sri Lanka, however, crude birth and death rates were already low in 1965 at 33 and 8, respectively, which is lower than the current rates in India.
References


An ASEAN perspective on regional cooperation issues in Asia and the Pacific

Florian A. Albuø

INTRODUCTION

This paper presents an ASEAN perspective on a number of emerging issues on regional cooperation in Asia and the Pacific. Without meaning to be exhaustive, the perspective presented is a means to identify areas where ASEAN could be supported in addressing those issues.

In the next section, existing ASEAN cooperation, especially economic cooperation, is outlined. In addition, the more recent cooperation agreements following the 1987 ASEAN Summit are briefly reviewed. Following this, the paper looks at the changes in the global environment that have a bearing on ASEAN and the broad needs for regional cooperation. A more detailed elaboration of the emerging concerns in ASEAN cooperation follows. Finally, some of the potential needs of support for ASEAN in addressing these cooperation issues are discussed in the concluding section.

This paper argues that while cooperation "in the small and in the large" will improve the development environment (e.g., trade and investment, incentives harmonization, exchange flows, business regulations, etc.), ASEAN will need to build its collective and individual capacities to respond productively. These capacities revolve around institutional machineries, regional and national infrastructure, and skills development.

ASEAN ECONOMIC COOPERATION: REVIEW

ASEAN has not been lacking in indications of economic cooperation. The ASEAN governments have a food security reserve system providing for emergency reserves of rice, joint programs for eradication of foot and mouth disease, and a training institute in the field of agriculture. There is an ASEAN Swap Arrangement that provides for US$200 million standby credit for members with balance-of-payments problems. ASEAN also expresses a common stance on international economic issues in negotiations in GATT, with the European Community (EC), and other international commodity agreements.
In industrial cooperation, the ASEAN governments are not short of mechanisms for resource pooling or market sharing. Several upstream projects were agreed upon and in some cases the projects were started up (such as the fertilizer project in Indonesia, the rock salt-soda ash project in Thailand, and the superphosphate project in the Philippines). Apart from the visible hand of government in the implementation of these projects, several problems arose and these examples of industrial cooperation accomplished little. In the ASEAN Industrial Complementation (AIC) program, past efforts have also left much to be desired. The original package for complementation in the automotive industry met difficulties in product identification and country allocation because of the cumbersome institutional machinery involving multigovernment–private sector consultation on locational decisions (Chng 1985).

It is perhaps in the area of trade liberalization, or in influencing trade direction, that we see the potential of economic integration. The ASEAN governments have gone through the motions of reducing each others’ tariff rates through preferences. From original margins of 20–25 percent, tariff cuts have been deepened to 50 percent. Within the Preferential Trading Arrangements (PTA), trade preferences were originally voluntary offers whereby each country extended preferences on a product-by-product basis. This was later expanded to an across-the-board approach whereby automatic preferences were given for certain level of import values (initially in 1980 for items with an import value below US$50,000; by 1982, the ceiling was progressively raised to US$10 million).

Despite what appears to be an important vehicle for pushing private trade into regional interaction, the PTA suffered from a host of problems. First, because of the voluntary nature of the items offered for tariff preferences, the products initially listed under the PTA were of no consequence to ASEAN trade. There was no correspondence between the increasing number of items listed under the PTA and the value of trade taking place. Second, the acceptance of across-the-board items for preferences, or the switch to increased ceiling value, was effectively nullified by allowing member countries to put up an exclusion list for "sensitive" product imports. In fact, the number of items excluded ranged from 2 percent of all items for Singapore to 63 percent of all items for Thailand. Finally, associated with the institution of the PTA is a rules-of-origin requirement which also effectively limits the scope for intra-ASEAN trade with margins of preferences (Ooi 1981, Chng 1985).
In general, the past experiences of ASEAN seem to have failed to fully capture what theory argues to be the potential benefits of integration. For one, the institution of the PTA, while meaningful, was not systemic in nature and was not drawn up jointly among all members. For another, there was no clear long-term scenario envisioned for the ASEAN economic front. Finally, even the explicit economic cooperation efforts were dominated by government intervention and did not actively promote private sector contribution.

This does not mean, however, that there were no real achievements to speak of. If anything, work among ASEAN economic committees and exchange among bureaucrats served to break down barriers to mutual interest. Indeed, this experience paved the way for bold initiatives and a more dynamic vision for ASEAN.

The new initiatives considered at the ASEAN summit meeting were drawn from various alternatives considered by ASEAN's ministers, and clearly recognized the realities of differences in the individual countries' policies, cultures, and levels of development. In addition, the initiatives took into account what is feasible and what can be achieved, with minimum disturbance to the ASEAN institutional structure.

ASEAN’s thrust does not seem to be in the abstract notion of integration or trade preferences, i.e., where general trade barriers are removed and market forces are allowed to determine net trade effects. Rather, the Summit proposal is anchored on strengthening the PTA system through which integration will be realized. Specifically the proposal entails the following:

1. The goal of increasing the share of trade covered by the PTA (in terms of volume and value) by the year 2000. This objective, while not cast in quantitative terms, reflects a schedule and a timetable, and when viewed in the context of other features is equally contemplative as a pronouncement for the year 2000.

2. The proposal envisions a reduction in the exclusion list to 10 percent of traded items (using a standard intra-ASEAN trade classification scheme and aggregation), and 50 percent of intra-ASEAN trade value. At the same time, the countries will harmonize their exclusion lists.
3. Margins of preferences (MOPs) are to be deepened from its present minimum of 25 percent to 50 percent for those enjoying some tariff reduction under the existing PTA.

4. Allowances will be made for a different treatment for some countries in the enhancement of the PTA. A longer time frame for both Indonesia and the Philippines to achieve the targets has been accepted by ASEAN.

5. ASEAN is committed to a standstill in the imposition of further trade barriers and a rollback in terms of nontariff barriers.

Apart from strengthening the PTA, the Summit also approved other supplementary schemes such as strengthening the ASEAN Industrial Joint Ventures (AIJV) through specific proposals (e.g., automatic list, MOP on ASEAN-sourced inputs, 90 percent MOP for AIJV products among participating countries, etc.), and improvement of economic machineries and other programs.

A seriously pursued and strengthened PTA along the line of the Summit's economic proposal will definitely expand the scope of intra-ASEAN trade. A harmonized and limited exclusion list to the PTA guarantees that exemptions would not be fragmented even though their identification and determination are subject to negotiations. An agreed-upon depth in MOP will certainly induce efficiencies in import substitution.

The fact that the PTA improvements are based on a five-year schedule will rationalize the incremental phasing-in process. The review process will allow adjustments to details of the PTA. In addition, because the implementation of the PTA is spread over time, it can allow for differential speeds of improvement for such countries as Indonesia and the Philippines.

In short, increasing MOPs exercised through PTAs are close substitutes to a purely free trade area. They become even closer substitutes the greater is the share of intra-ASEAN trade covered by the PTA. This is different from a collective declaration of all six countries as a free trade area or eventually a union. Indeed, progressive declines in trade barriers among ASEAN countries (through the PTA) will similarly achieve integration potentials.
A CHANGING ENVIRONMENT

This section examines how changes in ASEAN economic cooperation fits in the context of the changing world economy. Some of the more important global changes are summarized first before discussion of the role of ASEAN’s initiatives.

It has been said that the world economy has already changed structurally and quite irreversibly towards an “uncoupling” of the primary-product economy from the industrial economy, the “uncoupling” of the latter’s production from employment, and the primacy of capital movements in driving the world economy. Comparative costs have dramatically shifted from labor to knowledge and research, and there has been a decline in unit inputs of primary products in industry (Drucker 1986).

These broad structural changes in the world economy were factors leading to the initiation of the Uruguay Round of Multilateral Trade Negotiations (URMTN) in 1986. Other factors were the need to define new trade rules for services and intellectual property rights, the inadequacy of the Tokyo Round, the increasing protectionism of trading nations, and a need to reexamine GATT codes and a desire to bring into its ambit trade in agriculture.

Despite the supposed decline in tariffs among traded products, nontariff barriers, such as quantitative restrictions, voluntary export restraints, and other nontransparent measures, had proliferated since the Tokyo Round. The worst part of the protectionism was that the measures were erected to correct errors in the fiscal management of the economies. The failure of the United States, for example, to narrow its budget deficit and correct its trade imbalances led to political moves towards protectionism (Alburo 1989b).

One example of this protectionism is the trend to engage in bilateral trade negotiations for specific products that have an impact on domestic industries. Thus bilateralism was reborn and more distortions in the trading system resulted. Growing protectionism, attention to specific products or countries, and bilateral agreements multiplied across a number of countries in recent periods threatening a broader trading framework—this is now a characteristic of global trade.

Yet to those who view the changes occurring in the world economy as inevitable, the retreat to protectionism seems a refusal to recognize the
root causes of these changes and the need to redefine trade rules to accommodate them fairly. Thus, there are varying perceptions on the importance of the new areas in the URMTN.

Although there are a number of issues in the URMTN that ASEAN, individually or collectively, would rather not consider (e.g., intellectual property rights and services), the Uruguay Round is considered to be a superior alternative to contending with bilateral country arrangements where much depends on the strength of each country at the negotiating table. The alignment of ASEAN with the Cairns Group to improve agricultural trade is an indication of the serious desire for and importance of fair competition to the ASEAN countries even though not all of the ASEAN members have a direct stake in agricultural trade. A main point made by ASEAN's support of the Cairns Group is their intention to seek out multilateral mechanisms to counter individual protectionism.

A further major global issue with impact on ASEAN and other developing countries is the international debt crisis. After seven years and without any concrete and comprehensive solution in sight, the debt crisis has taken its toll not only in the form of huge negative net transfers of resources but also in the form of trade reduction arising from slowdown in growth among the indebted countries. Even more important is that the debt crisis has led to adjustments that are not necessarily conducive to global or intraregional trade.

Arriving at a solution to the debt problem would benefit the creditor countries by expanding their markets and trade, while conversely, cutbacks in growth would deprive the same countries of markets. Thus, without a lasting solution, the debt problem carries with it the danger of stimulating the formation of subregional groupings, of polarizing North and South countries, and of contracting international trade. The ad hoc approaches thus far have not signalled a strong global commitment to solve the debt problem. The way out of the debt crisis will surely require structural adjustments that necessitate maintaining openness and promoting freer trade. Through such adjustments, there will be mutually reinforcing feedback between debtors and creditors.

Another issue of concern to the Asia-Pacific region is the agreement among the twelve European nations toward a united Europe in 1992. As freer trade takes place in Europe and as economic policies become more harmonized, some trade will diminish between the European countries and their present trading partners. Already, trade, investment, and location
decisions are being influenced by the shape of Europe in 1992. While some heavy adjustments will need to take place among the European countries as there exists significant distortions between them, what is noticeable are the growing instances of industrial alignments, mergers, or consolidations in anticipation of the removal of bureaucratic barriers to the free flow of goods and factors. There is also the likelihood that the European Common Agricultural Policy may be further entrenched.

Nevertheless, despite claims that a united Europe will not reduce the individual countries' commitments to a multilateral trading system, it cannot be denied that intraregional trade will be facilitated. An economic union in Europe will be a leverage to reckon with in any negotiations under GATT auspices. While some forces may lead to further trade in the Pacific Rim or with the United States (for example, industries where economies of scale exceed the market absorption of Europe), the net impact of Europe 1992 has yet to be fully considered (Shimano 1989).

As if to highlight the trend towards bilateralism, the move towards free trade areas (FTAs) has gained new ground. Prominent among these is the U.S.–Canada Free Trade Agreement. Another smaller example of FTAs is the U.S.–Mexico trade agreement. The concept of the FTA has been pursued more on the basis of historical ties between the countries involved than on the basis of purely economic benefits. Nevertheless, the growing prominence and interest in FTAs seems to imply that the existing barriers that are imposed on a most-favored-nation basis have not been forging full trade potentials; hence the interest in a FTA. One immediate effect of an FTA, even if implemented in a specified time frame (as in the U.S.–Canada case), is to change the flow of investments such that the configuration is a more homogeneous market. This, in turn, has been reshaping global movements of investments.⁶

A perception implied by the formation of FTAs is that they worsen the scale of protectionism; although they promote free trade among the countries in the FTA, the members of the FTA continue to maintain their individual barriers against the rest of the world. Furthermore, a united Europe and the formation of FTAs have also stimulated proposals for other arrangements such as a Pacific Area and an ASEAN–U.S. Initiative which are subglobal in nature (Naya et al. 1989).

Aside from these external parameters that have rapidly changed, there are a number of individual developments with far-reaching consequences. There is the continuing importance of policies pursued individually by the
United States and Japan, and the need for greater coordination with the rest of the developed countries. There is the emergence of the newly industrializing economies (NIEs) and their implications on global trade relations. There is the distortion caused by currency rigidities and the effects of realignments on patterns of trade and investments. There is the new openness among countries that have traditionally been closed (e.g., Soviet Union and Viet Nam).

All of these global developments have different impacts on various regions and regional groupings of countries. Some are more imperative than others. In turn, they change the context of existing regional arrangements such as the cooperation in ASEAN. Indeed, regional initiatives may have to be reassessed in light of the contextual change. To be sure, the response of countries individually or collectively will depend on the strength of these imperatives.

The upshot of the changing international economic environment is clearly in the direction of a world that is, in economic terms, more integrated than ever before. This has brought about global and ASEAN initiatives that go different ways.

Capitalizing on the initial political cohesiveness of the group, ASEAN has embarked on economic cooperation which, while cautious, subscribes to freer and more open trade. The various schemes, described in the previous section, aim to temporally capture the benefits of openness among members without resistance to greater global outward orientation. On the other hand, to the extent that adjustments do not take place or that some countries, for economic or political reasons, choose to avoid making adjustments or accommodative measures, the ASEAN members look towards cooperation with its neighboring countries as an interim mechanism for maintaining a global commitment.

The fact remains however that the Asia-Pacific region is the locomotive to global expansion. The region accounts for more than 50 percent of world GNP and within the region, ASEAN constitutes one of the more dynamic group of countries (Akazawa 1989). Growth in ASEAN has been characterized by openness, adherence to international competition, and quick adjustments to changing parameters. ASEAN cooperation therefore, which has been marked by removal of trade barriers, suggests a continuing participation in the global economic environment. The recent ASEAN initiatives even more strongly indicate that support.
EMERGING CONCERNS IN COOPERATION

The events that have taken place in the international environment define the scope for ASEAN cooperation initiatives. They likewise result in separate initiatives or outcomes which bear on ASEAN itself.

First, the dynamism of the Pacific area and the varying competitive participation among countries in the region have highlighted the uneven performance within ASEAN. While there is general robustness in ASEAN, intra-ASEAN disparities are now more prominent and these disparities raise the question of whether more concerted efforts at cooperation might alleviate some of the disparities.

The differences in growth performance within ASEAN may signal the decline of ASEAN as a regional bloc or it may create a challenging opportunity for ASEAN to seek more balanced regional development. The recent and significant moves of Indonesia, for example, towards greater outward orientation may augur well for a consolidated regional group or may cause a potential drag to narrowing of intercountry disparities. Given the consensus nature of decision making in ASEAN, how to keep the regional bloc intact is one emerging concern.

The convening of twelve Asia-Pacific countries in Canberra in November 1989 under a broad notion of an Asia-Pacific Economic Cooperation (APEC) ushered in a potential additional arrangement for economic cooperation that is extra-ASEAN. Although APEC was not claimed as analogous to the Organisation for Economic Co-operation and Development (OECD), the timing of its proposal (initiated by Australia's Prime Minister Hawke) coincided with the prominence of and preparations for (by the public and private sectors) the coming of Europe 1992.

After careful review and consultation among member countries, the ASEAN nations stressed that it continues to view ASEAN as the core organization for promoting regional cooperation within the context of existing fora, such as its Post-Ministerial Conference (PMC). Furthermore, ASEAN's understanding of APEC and its first Ministerial meeting is that it is exploratory in nature and does not supplant formal bodies. True enough, the joint statement of the ASEAN Ministers upon the conclusion of the APEC meeting highlighted ASEAN's reservations. Yet in the same vein it opened the avenue for further ministerial meetings, in fact with a specific country (Singapore) hosting the next meeting.
The convening of APEC, no matter how informal its structure is envisioned, diminishes the lead of ASEAN in the wider Pacific region. APEC is perceived by some as cooperation that is being orchestrated by developed countries which could degenerate into a meaningless North-South dichotomy. The role of ASEAN and even the traditional PMC will be major concerns if succeeding APEC Ministerial meetings are called.

The recent political breakthroughs in Eastern Europe plus economic reforms, liberalization, and market orientation may, at first, seem to be too distant to have an appreciable impact on ASEAN. However, closer scrutiny reveals that the changes occurring in Eastern Europe may in fact influence cooperation in the Asia-Pacific region. For example, the possibility of new trade routes which can be arranged collectively as a body or unilaterally by individual ASEAN countries is enhanced. In addition, the development needs of the Eastern European countries will necessitate official development assistance (ODA) that will displace what would otherwise be flows into the Pacific region. Thus both trade and aid are affected. An emerging concern for ASEAN is not only to be able to cope with this development, but also to understand how its own priorities will be reshaped. As the East European economies become integrated with the rest of the world, their interactions with ASEAN will become permanent dimensions.

With the developments in the international economic environment, ASEAN is at a crossroads: either ASEAN cooperation can decline or ASEAN can take advantage of the greater opportunities for mutual benefits for member countries. Although the global direction is definitely towards liberalization and greater competition, the parallel trend towards subgrouping or regional blocs imply that there is a role for ASEAN as a productive mechanism for significantly improving welfare or for reducing growth disparities. These emerging concerns of cooperation need to be responded to individually and collectively in the context of the recent economic developments.

No mention has been made here of the continuing need for collective effort and vigilance in the political front in the neighboring areas of South Asia, Cambodia, and Viet Nam. However, if taken in the light of the overall trends in the global sphere, there is no doubt of the trend towards democratization, and greater trade liberalization and openness of countries. What is needed is to capture these opportunities for ASEAN.
POTENTIAL NEEDS TO SUPPORT COOPERATION

There is no doubt that ASEAN has remained a stable organization for more than two decades. Its original directions stemmed from the geopolitical environment of the global "cold war" era. However, the recent political developments and the changed economic environment suggest that the modalities for ASEAN cooperation will need to change in order for ASEAN to maintain its viability and to face up to the challenges that are being posed.

The new initiative, exemplified by the 1987 Summit Declaration, focused on economic priorities. To the extent that ASEAN forges ahead in this area without closing its boundaries, it shall have entered a new era. Because of this shift in emphasis of ASEAN cooperation, there is a need to improve ASEAN's support systems to foster the moves towards increasing cooperation.

First, there is a need for ASEAN to have a deeper appreciation and understanding of a regional view of development. This means a realization that the benefits of cooperation are never uniform across member countries but that in the long term, cooperation makes every country better off. Past political cooperation did not have this pronounced differential benefits as would economic cooperation.

Second, there is a need to strengthen the ASEAN Secretariat both as the spokesman of the regional organization and as the transmitter of a regional view of cooperation. Whether or not it is desirable to empower the Secretariat with the same level of authority as the EC Commission is not the critical question; what is really important is that there is a strong conviction to regional cooperation by all member countries. Not only should the Secretary-General of the Secretariat be an activist, but the economic officers (while being seconded by individual countries) must have a regional perspective as well.

Third, the various ASEAN machineries appear to be institutionally cumbersome in terms of decision making and organizational structure. For example, the ASEAN Standing Committee (ASC), the individual country ASEAN desks, and other various committees perform parallel work. At the same time, the overlapping of duties and functions also serve to dilute the function of the Secretariat and the regional interests. Indeed the structures do not support, but, in fact, compete with each other. Further, because individual countries continue to prefer chairing particular committees for
parochial motives, the machinery is stalled from becoming a regional mechanism.

Fourth, there is a continuing need to sustain ASEAN's commitment to openness beyond mere rhetoric. Even with the new initiatives surrounding the PTA, there are indications that openness is being postponed as far as possible. The accommodation to the Philippines and Indonesia to spread their liberalization over a longer time frame of seven years, as compared to five years for the rest of ASEAN, is one example. It is important for openness and liberalization to be a matter of choice rather than a matter of default due to the country's trade and industrial structure. As a matter of choice, openness becomes an integral part of a systemic view of the economy in the context of its economic relations with the rest of the world.

Fifth, it now seems that Indonesia is seriously pursuing broad reforms towards greater outward orientation, openness, and trade liberalization that were not anticipated at the Summit initiatives. On the other hand, it now also seems that the Philippines is retreating towards greater protectionism and resistance to openness and liberalization. Where in the past Indonesia expressed caution about the speed of ASEAN's cooperation in openness, it would now appear that a new call for caution would be coming from the Philippines. If the decision-by-consensus approach remains to be followed by ASEAN, this would simply mean that openness will continue to drag with the roles for Indonesia and the Philippines having been switched.

Finally, ASEAN will definitely require support as it explores new trade opportunities with the coming of Europe 1992, the opening of markets in Eastern Europe and the Soviet Union, the common U.S. and Canadian markets, and the dynamism of the Pacific region. For ASEAN to take full advantage of these opportunities, it is important for ASEAN to increase its capacities: The analytical capacities of ASEAN must be improved along with a regional perspective and a long-term perspective. These can either be broadly provided to the ASEAN Secretariat or the ASEAN desks in each individual country. Such analytical capacities must also be capable of advocacy programs to increase understanding of the region.

There is also the uneven, if not weak, magnitude of technology transfer to the ASEAN countries from the United States, Europe, and Japan. If ASEAN is to cope with the fast pace of international developments, its technological environment must expand as well (Lindsey 1986). ASEAN support is not needed for a technological "leapfrog"; rather,
assistance is needed to widen the spectrum for technology changes in the region to keep pace with global developments.

As the trade opportunities widen, ASEAN will require improved evaluation skills and capacities for identifying trade opportunities. Such skills can again emanate from the ASEAN Secretariat or individual countries. What is important is to appreciate specialization, and identify each country's role in the international division of production and comparative advantage.

Continuous promotion of openness and reforms in an international setting is key to ASEAN's success in cooperation. A sustained commitment to an outward orientation will require support to ASEAN leaders and its bureaucracy. There must be development of institutions that can permanently spread the regional perspective and internationalism.

Finally, the Philippine situation needs special attention not because of political instability (though that is not far-fetched), but because of a deterioration in this country's outlook towards greater protection, bilateralism, and distance from cooperation. If these trends in the Philippines are ignored, the rest of ASEAN may suffer. The country needs to strengthen and expand its constituency of those who advocate openness, fair trade and competition, and liberalization. Special attention must be given to developing a consensus, widening the information base, broadening the analytical capacities, and developing a regional perspective. In any form of cooperation, the deterioration of one will threaten the rest.

In summary, it is important to nurture ASEAN's support systems in order for ASEAN to capture the potential of the changing international environment and emerge as a strong group in the Asia-Pacific region.
Notes

1. This section draws extensively from Alburo (1988).


3. The United States has been the prime example of this strategy. Section 301 of the U.S. Omnibus Trade Act of 1988 lists countries as "unfair traders" or as failing to protect U.S. intellectual property rights among others.

4. Strictly speaking, only Thailand has a major interest in world agricultural trade (e.g., grains); yet ASEAN exhibited solidarity in identifying with the Cairns Group.

5. These range from differences in monetary policies and fiscal systems, to customs regulation and protective structure.

6. Investments into Europe from the United States and Japan have been mostly in anticipation of overcoming common external walls from nonmember countries.

7. See the 21st ASEAN Economic Ministers (AEM) Meeting: Joint Press Statement, 30 November–1 December 1989.

8. See the Joint Statement of the Asia Pacific Economic Cooperation Meeting in Canberra, Australia in November 1989.

9. This is evidenced by an examination of country products scheduled for liberalization (Alburo 1989a).
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The South Pacific countries and regionalism

Savenaca Siwatibau

ECONOMIC ENVIRONMENT

The tempo of change appears to be steadily accelerating as we reach the end of the 20th century. Developments and "shocks" beyond and around the rim of the Pacific impact directly and immediately upon the economies and peoples of the island countries of the Pacific.

The wave of political, social, constitutional, and economic changes which now engulf Eastern Europe and which seem to be steadily spreading outward could have major impacts on the South Pacific. The European industrial countries, Japan, and the United States are now marshalling support; the support should be in place quickly to ensure that stability is maintained while the countries of Eastern Europe including the Soviet Union go through a difficult period of transition and painful economic and social adjustment. Large amounts of public sector aid, commercial bank loans, private sector investments, and technical and management know-how are now urgently needed and will be diverted to Eastern Europe from the Western countries. For example, an East European Bank of Reconstruction and Development is to be established and is expected to be a powerful vehicle for channelling development funds from West to East. The preoccupation with Eastern Europe by the industrial countries could have repercussions upon future capital injections into the International Monetary Fund, the World Bank, the International Development Association, the International Finance Corporation, and possibly the Asian Development Bank, as well as upon the future volume of bilateral assistance and multilateral lending to the Pacific countries.

Furthermore, the program of liberalization in the European Community (EC) countries, culminating in the abolition of internal borders and the creation of a single market in 1992, could have a significant impact on the privileged position which the African, Caribbean and Pacific (ACP) partners of the EC now enjoy. Restrictions on imports by EC members from third countries will not be enforceable, standards will be harmonized and mutually recognized, capital controls will be removed, and labor mobility will be enhanced. The current round of GATT negotiations could also have similar repercussions. Under the review of the Common Agricultural Policy proposed at the Uruguay Round, the benefits under the Sugar Protocol of
the Lomé Convention may have to be discounted over time. The EC has also declared that it is unable to guarantee the margin of protection which the ACP countries enjoyed under their trading relations during the previous Lomé Conventions. It is very likely that similar experiences will be met in the New Zealand and Australian markets as liberalization progressively takes place. The margins of favored entry under the South Pacific Regional Trade and Economic Agreement (SPARTECA) are likely to erode gradually over time. The message seems to come through clearly: increasingly, developing countries in the Pacific will need to produce goods which people want to buy and will need to transport these goods at costs that are competitive with goods from other countries.

Although the South Pacific countries, because of their historical connections with the European metropolitan powers, enjoy substantial advantages under the provisions of successive Lomé Conventions, their future growth and development depends upon its political, trading, financial, economic, and strategic relations within and around the Pacific Basin. The center of gravity of the world economy is steadily shifting into the Pacific Basin in the wake of rapid economic growth in Japan, the newly industrialized countries (NICs) of Asia, and other East and Southeast Asian countries.

Japan is the most dynamic economy today. Its high savings rate, disciplined labor force, increasing productivity, management strength, and high investments in research and development will ensure that it continues to strengthen its position into the 21st century. With the liberalization of its financial markets, Japan is becoming the largest banker to the capital-importing countries, particularly the United States. The yen has become an important reserve currency and is playing a growing role in international trade and finance. In addition, Japan is becoming, as it already has in Southeast Asia and other countries, the most important external source of private and public capital in the Pacific.

The NICs of Asia have achieved very high rates of economic growth while maintaining financial stability. Their outward-looking economic and trading policies have served them well. They have steadily increased their share of world output and trade, have accumulated substantial current account surpluses, and have become important capital exporters.

China was until June 1989 going through a period of reform which involved opening up its economy and resetting its priorities. The country’s leaders hoped to achieve a more rapid pace of development through freer
economic relations both domestically and with the rest of the world. Chinese policymakers were beginning to realize that market forces and profit motives are essential for economic restructuring and long-term growth, but the country needs capital, know-how, and technology from the West. Once the process of reform is resumed, the economy should begin to recover from its current difficulties, and, given continuing economic and political reforms, China will become a large and dynamic economy in the 21st century.

The Association of Southeast Asian Nations (ASEAN) comprises four resource-rich countries (Malaysia, Indonesia, Brunei, and the Philippines), a newly industrialized country (Singapore), and Thailand which has had and continues to have rapid economic growth rates. While intra-ASEAN trade is still comparatively small, the volume of ASEAN transactions with North America and Northeast Asia has been increasing rapidly. Apart from the Philippines, which continues to labor under the weight of external debt, the ASEAN countries show healthy prospects for steady economic growth into the 21st century.

Australia and New Zealand see the Pacific Rim as their principal and most dynamic market. Demand for their primary products within the western rim countries is expected to continue growing rapidly and the prospects for increased reciprocal trade are good, particularly with the current trend towards increased liberalization.

In all of these Pacific Rim countries, technology, private investment, tourism, and trade are contributing to the fast pace of economic activity with much of the impetus coming from Japan. Trade between North America and the western Pacific Rim countries has overtaken and is growing faster than trans-Atlantic trade, and trade among the western Pacific Rim countries is growing faster than their trade with North America.

The Pacific Basin Economic Council (PBEC), a body whose members are businessmen, academics, and individuals from the Pacific Rim countries, has been in existence for some time. The council organizes discussions on all aspects of development within the Pacific Basin. In addition, in a meeting last November in Canberra, government ministers of the Pacific Rim countries agreed to meet in the future as the Asia-Pacific Economic Cooperation Council (APEC). Whether this grouping will develop into a more formal regional bloc depends upon the current trend towards large regional groupings which appear to be evolving at the expense of globalism.
The changes in Eastern Europe may also have ramifications for the strategic interests of the world powers in the Pacific. Is the Soviet Union, with its preoccupation with economic and social changes at home, withdrawing progressively from the Pacific Basin? Will the United States also move eastward leaving an economic vacuum to be filled by Japan and perhaps Korea and China? Will France take a more conciliatory position on nuclear testing in French Polynesia? Will China and Taiwan continue to follow each other around the Pacific in search of firm commitments for support from the small island countries at various international fora? Will Australia and New Zealand be the only countries to show direct interest in the political and economic stability of the South Pacific countries over the short- to medium-term? How will all these changing equations affect the future flow of aid, private capital, and expertise into the region?

These questions and the fluid world economic environment which surrounds the Pacific countries should exercise the minds of leaders in the region. There are uncertainties but there are also bright prospects. The projected rapid economic growth around the Pacific Rim furnishes growing opportunities for trade and capital inflows, and for the development of mineral deposits (on land and offshore), fisheries, forestry, tourism, and manufacturing. The South Pacific countries will need to organize themselves individually and as a group to capitalize on these opportunities; at the same time, they will have to ensure that appropriate and supportive domestic policies are firmly put in place.

ECONOMIC OVERVIEW OF THE SOUTH PACIFIC COUNTRIES

The island countries of the South Pacific are dispersed over millions of square kilometers of ocean. Most of them are fragmented into numerous island groups extending over great distances. The "tyranny of distance" and the difficulty and expense of transportation both internally and externally are difficult hurdles which the Pacific Island economies have in common.

But while there are similarities, contrasts abound (Table 1). For example, Papua New Guinea (PNG) is comparatively very large with a population of 3.5 million on a topographically rugged land area of 462,243 km$^2$. The country is endowed with rich mineral deposits and, in more recent times, its enclave copper and gold mining sector has come to dominate the economy. The fiscal position of the government, the balance of payments, foreign reserves, and the gross domestic product have come to be determined to a very large extent by the fortunes of these sectors.
Table 1  Principal Physical and Economic Features of the Pacific Island Countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Land Area (km²)</th>
<th>Sea Area (’000 km²)</th>
<th>Total (Persons/km²)</th>
<th>Density 1982-1987 (Persons/km²)</th>
<th>Annual Growth Rate (%)</th>
<th>Per Capita (A$)</th>
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n.a. = Not available.
PNG has rich soil, forests, and abundant living and nonliving resources within its exclusive economic zone (EEZ). Besides gold and copper, the country exports coffee, timber, palm oil, copra, coconut oil, and fish. The potential for future development in PNG is extremely good, but its realization will be a function of many factors including appropriate domestic policies, a supportive international environment, and a social and political evolution that is able to contain centrifugal tendencies and foster strong national feelings of identity and belonging.

Vanuatu, the Solomon Islands, and Fiji consist, like PNG, of large, rugged mainly volcanic islands which are relatively rich in natural resources. They have fertile land and abundant timber and mineral resources. Gold and sugar are important exports for Fiji. Gold deposits have been reported in the Solomon Islands and in Vanuatu. All three countries also have abundant nonliving and living resources within their exclusive economic zones.

The Pacific Island countries such as these are capable of achieving financial and economic independence. For them, steady economic growth without the continuing injection of substantial grant aid would be feasible provided appropriate domestic policies are firmly put in place. These policies include:

1. The exposure of their domestic economies to outside competition aimed at improving domestic efficiencies

2. Allowing the price mechanism to determine resource allocation

3. The containment of the public sector's role in the production of goods and services and allowing the private sector to play a greater role in economic activities

4. Freeing the financial sector so that savers would save more as returns to them increase, thus supporting investments which yield the highest returns to the economy

5. The employment of macroeconomic policies (including fiscal, monetary, income, and exchange rate policies) which assure financial stability at all times.

At the other extreme is Tuvalu with a population of only 8,500 persons and an area of only 26 km². Its soil is very saline and poor and the
environment is fragile. Most of the land area over the nine atolls which make up Tuvalu is below five meters above sea level; hence, the predictions of the sea level rising in the wake of rising world atmospheric temperatures are of acute concern in Tuvalu. The trade balance and the current account of the balance of payments accumulate substantial deficits annually. Aid, which finances all development expenditure, accounts for the surpluses in the annual overall account of the balance of payments and for the comfortable level of foreign reserves (over 12 months of imports) in recent years.

Micronesia and Polynesia are made up of groups of smaller islands. Some of these islands, such as Tonga and Western Samoa, have rich soil, but in general, the islands are small isolated atolls with poor soil. Forestry is important only in Samoa but the seas of Polynesia and Micronesia are well-endowed with living resources. Tonga and Western Samoa export a range of agricultural products but run substantial trade deficits which are financed through aid and remittances (Table 2). In Tonga, remittances are as much as three times the value of exports and about one-half that of imports. Similar orders of magnitude for remittances exist in Western Samoa. Tourism has great potential for further development in these two countries. The population growth rates in these two countries have been low due to the high levels of emigration over the past years. The bulk of development expenditures are financed through aid. While Tonga and Western Samoa are capable of achieving economic viability in the long term, it may require the adoption of domestic policies that could lead to lower standards of living.

The other island countries comprising Niue, Tuvalu, Kiribati, the Cook Islands, and the Marshall Islands are relatively small in area. Except for Niue and the Cook Islands whose people have free access to New Zealand, these Pacific Island countries have relatively high population growth rates. Land is poor and limited in area. Except for the living resources of the seas, natural resources are severely limited. The economies and environment of this group of countries are extremely fragile. Substantial trade deficits which cannot be sustained except with ongoing large inflows of aid are experienced every year. Remittances are very important for these countries and the high levels of consumption and welfare are underwritten by aid.

The other sources of foreign exchange for these countries are copra and other minor agricultural produce, rent on fishing rights granted to the vessels of other nations, and artifacts. Earnings from commemorative
Table 2: Key Economic Indicators of the Pacific Island Countries

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<td>n.a.</td>
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n.a. = Not available.

a. C.i.f. basis.
The South Pacific countries and regionalism

stamps were once important in Tuvalu and the Cook Islands. Their public sectors, the activities of which are to a large extent supported by aid, dominate the economies. The small private sectors depend heavily on the goods and services which they supply to the governments. Economic growth, government revenue, the national import bill, and movements in external accounts are highly sensitive to public sector expenditures. Long-term financial and economic independence is likely to be an elusive target for this group of countries. Sharpened skills in rent-seeking, emigration arrangements with metropolitan countries, or closer association with other countries are some of the strategies that may have to be pursued.

In summary, the physical and economic structures of the Pacific Island countries range over a wide spectrum. However, quite a number of common characteristics are discernible including:

1. Large distances from external markets and very high costs of transportation

2. High degree of fragmentation of domestic markets

3. Exposure to natural disasters, particularly hurricanes

4. Very open economies with heavy dependence on international trade and finance but narrow export bases. The economies are subject to frequent shocks emanating from external and domestic factors which give rise to fluctuations in exports, external account balances, GDP, and revenue; developments which make national, financial, and economic management somewhat difficult. The fragility of these economies' external sectors and their vulnerability to shocks necessitate the holding of relatively large external reserves.

5. The limited role of monetary policies due to open economies, fixed exchange rates, and the relative ease of capital inflows and outflows. Fiscal policies which call for unsustainable inflationary financing from the central bank or active credit policies aimed at boosting economic growth invariably result in high inflation rates, weak external sector positions, and, in some cases, mounting external debt.

6. Overregulation and control of economies and dominant public sectors. Private sectors do not receive encouragement and
have not played the enhanced role necessary for the achievement of the ambitious objectives outlined in all the development plans of the island countries. Public sectors have generally taken the lead in wage settlements and in many cases these rates were above those necessary to maintain competitiveness.

7. Generally high population growth rates which, while declining steadily, are still generally high except for a limited number of countries such as Western Samoa, Tonga, Niue, and the Cook Islands where steady emigration has taken place over the years.

8. Continuing scarcity of technical and management skills.

9. Low average economic growth rates over the last 10 years.

10. Domestic savings levels that are below domestic investment as manifested in large current account deficits. It is probably a moot point as to whether the bulk of these foreign savings which come in through the public sectors do in fact contribute to improved efficiency and enhanced productive capacities of the island countries. A lot of flexibility exists for increasing domestic resource mobilization if the financial sectors were less repressed than at present.

11. High levels of aid per capita that allows difficult adjustment measures to be postponed or avoided and relatively easy procurement of development finance. The main constraints appear to be in the generation of bankable projects in the public and private sectors. Too often projects and programs that do not contribute to the enhancement of the productive capacity of a country have attracted and received external aid support.

12. Difficult land tenure systems which impede development in the agricultural and other sectors, particularly in parts of Melanesia.

13. Inability to assimilate unavoidable changes in value systems which follow in the wake of economic changes and which are themselves necessary for economic development. Instead of
managing changes in ways that facilitate economic and social development, there is still much official ambivalence and hesitancy.

KEY DEVELOPMENT ISSUES

Fragile ecosystems. Development of fragile ecosystems in some Pacific Island countries has been associated with uncontrolled exploitation of natural resources. In the absence of environmental standards, there has in some cases been irreparable harm to the fragile ecosystems. An integral component of sound economic growth in the long term is the careful management of the environment on a sustainable basis. This requires an appreciation of the delicate balance which surround the life-support systems such as air, soil, and water, as well as the natural ecosystems of rainforests, mangroves, coral reefs, and deep-sea marine life. The threats that development activities pose for the long-term viability of these natural communities have become a matter of increasing concern in recent years.

The current deforestation—whether it was done to expand human settlements, for agriculture, or for timber extraction—may, without sound management, not only lead to increased soil erosion but also to the loss of a whole range of species comprising the forest ecosystem. In the Pacific Islands, this loss may be especially tragic since many of the native species are found nowhere else outside these island countries. It is said that the Pacific region has one of the highest species extraction rates in the world. The loss of many rare species of plants and animals will rob the world of important economic organisms which are potential future sources of food and medicine.

A sustainable development path for the island countries based on a stable physical and biological environment may not, in the long term, be achievable without the willing cooperation of countries outside the region. For example, drift-net fishing threatens the ocean resources on which the Pacific Island economies heavily depend; global warming could necessitate, according to pessimists, the wholesale relocation of the populations of small nations such as Kiribati, Tuvalu, Tokelau, and the Marshall Islands; and radioactive pollution, though perhaps localized in its impact on various communities, could have secondary impacts through the food chain of which the long-term damages are perhaps still not fully understood.
Foreign aid. Australia, New Zealand, the United Kingdom, Japan, France, the United States, and the European Community provide substantial aid to the Pacific countries. French aid flows mainly to New Caledonia and French Polynesia, while assistance from the United States is centered on its former Trust Territories in Micronesia and American Samoa (Tables 3 and 4).

The impact of aid on the balance of payments and the government budgets of the Pacific Island countries are significant, although there are doubts about its efficacy. Aid which finances projects and programs that are carefully evaluated, that are economically and financially viable, and that are likely to improve productive capacity is preferable. Aid outside this category is likely to add to pressures on recurrent budgets and to contribute to growing aid dependence over time. Aid flows have, in a number of island countries, allowed relatively higher wages and salaries to be maintained and supported in the public sector, contributing to upward pressures on wages and salaries throughout the economy. For example, higher levels of wages and salaries induced by aid appear to have had adverse effects on agriculture in Tonga, Samoa, and the Cook Islands, where agricultural wages are already high and it is increasingly difficult to secure agricultural labor. This situation is compounded by rural emigration to the towns and overseas.

Large aid inflows have also had a secondary negative impact upon the tradeable goods sector, including agriculture. Aid cushions countries for long periods against currency adjustments which are necessary for long-term growth. The combination of wage levels and relatively strong currencies supported by aid have tended to erode the competitiveness of the economies in the South Pacific.

The International Monetary Fund (IMF) attaches conditions to the financial assistance it provides to countries and the World Bank, and more recently the Asian Development Bank, have taken more interest in the macroeconomic policies of countries to which they lend. Indeed, macro- and microeconomic policy changes have increasingly become part of the requirements of World Bank loans. The European Community now requires discussions on policies and priorities with the African, Caribbean, and Pacific (ACP) countries to which it provides aid. Some developing countries have found the exchange of views with multilateral organizations beneficial, but a similar dialogue with bilateral donors has not, to date, been forthcoming.
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— = Insignificant or zero.
The sensitivity with which bilateral donors have viewed this kind of interaction is perhaps understandable. However, such a procedure needs encouragement in the Pacific. Donors could identify approved projects and programs which meet minimum criteria for funding thereby limiting the possibility of national priority distortions by the donor or by the recipient in the pursuit of objectives which may be at variance with national goals.

A number of country meetings with donors have been held and have proved useful, with background documents generally covering policies and priorities which are subject to detailed discussions.

**Remittances.** Remittances are particularly significant in five of the South Pacific countries—Tonga, Western Samoa, Kiribati, the Cook Islands, and Niue. In these countries, the impact of remittances on GDP, employment, revenue, wages and salaries, the current account, and foreign reserves are as important as those of aid receipts. By helping to induce high labor costs and by enabling the maintenance of overvalued currencies, large remittances have had negative repercussions on the tradeable goods sector. If applied mainly for increased consumption, remittances will, over time, steadily transform the structure of an economy to one of increasing dependence.

Remittances are likely to increase as more individuals emigrate. So long as emigration into developed countries is allowed without restraint, as in the cases of the people of the Cook Islands and Niue to New Zealand, real growth in remittances will continue. Countries which do not enjoy similar arrangements should build more conservative assumptions about remittances into their long-term economic strategies, taking into account the fact that the level of remittances is likely to be inversely related to the length of residency overseas.

**Financial policies.** Since the economies of the South Pacific countries are very open with free flows of capital in and out, national income, revenue, and the balance of payments fluctuate with goods and services and aid receipts. The maintenance of stable and sustainable balance-of-payments positions and comfortable levels of external reserves are preconditions to steady growth. In the majority of countries, external financial stability has been underwritten by aid and, in a number of cases, remittances.

The Pacific Island countries have fixed exchange rate regimes. Kiribati and Tuvalu use the Australian dollar, while Niue and the Cook Islands are pegged to the New Zealand currency. Tonga's currency,
paanga, is still tied to the Australian dollar, but the reserve bank is reported to be in the process of establishing a currency basket. The Solomon Islands, PNG, Fiji, Vanuatu, and Western Samoa each peg their currencies to baskets of currencies based on their external commercial relations.

Fixed exchange rate regimes are adopted by countries with small open economies in order to ensure relative stability in the movements of their currencies. Their narrow foreign exchange markets and concentration of exports and financial institutions imply that relatively small speculative transactions would result in wide fluctuations in their currencies if they were freely floating.

However, fixed exchange rates, economic openness, and high mobility of capital makes active monetary policy relatively ineffective. Liberal credit policies aimed at promoting growth are not likely to work since aggregate demand will increase, prices will rise, labor costs will increase, the balance-of-payments deficit will rise, net capital outflow will increase, reserves will fall, and the external debt position is likely to deteriorate quickly. Gains in output through such policies are likely to be short-lived as adjustment policies will become unavoidable in the interest of reestablishing national financial stability.

External price and exchange rate changes influence domestic prices in small open economies more immediately than they do in larger and less open ones. Exchange rate devaluations quickly increase the prices of domestically produced tradeable goods, and through cost of living adjustments, wages and salaries rapidly adjust to maintain their levels in real terms. To the extent that prices of nontradeable goods keep pace, devaluation will therefore rapidly manifest itself in price increases throughout the economy. Unless wages and salaries are determined so that they do not automatically maintain their levels in real terms, a devaluation which aims at giving momentum to growth will not succeed but will certainly result in increased inflation. The Pacific Island countries should ensure through fiscal, exchange rate, monetary, and income policies that the real effective exchange rate of their currencies move in directions which increase the competitiveness of their economies.

The link between budget deficits and the balance of payments is particularly direct in small open economies. Budgetary excesses result in increased credit by the banking system and inflationary financing by the central bank. Under such conditions the private sector finds itself crowded out of the credit market to the detriment of private sector investments.
Since the Pacific Islands are subject to sudden internal and external economic shocks, it is important for external reserves to be maintained at relatively high levels because adjustments to such shocks are economically and socially painful if financing through owned or borrowed reserves cannot be readily obtained. Ready access to borrowed reserves is itself a function of a country's good credit standing which is in turn a function of sound national financial management. Investments by the private sector are likely to be encouraged if national financial stability looks assured.

The IMF already provides advice and financial assistance to six Pacific Island member countries. Although the IMF has not been popular with some of the developing countries receiving conditional assistance, the record of IMF activity should be of interest to the region.

Many countries allow financial discipline to slide and allow appropriate policy changes to be delayed in the face of political constraints. In some cases, external financial stability is disturbed through external shocks, but external imbalances always require both adjustment and financing.

The experiences of one country in the region which recently implemented an IMF program is of general interest. To support the pace of development in the 1970s and early 1980s, the country pursued expansionary fiscal policies. Credit increased quickly, the rate of inflation rose, the balance of payments deteriorated, and external indebtedness increased. The world recession of the early 1980s which was partly triggered off by the second escalation in oil prices made things more difficult. The terms of trade fell sharply as the price of imports, particularly oil, rose while export prices declined. The country's budget and balance-of-payments deficits deteriorated sharply and inflation worsened. An IMF program that involved the usual stabilization measures was put in place in 1983; the currency was devalued, the deficit of the public sector was cut back, and credit was tightly contained. Supported by favorable external developments after 1983, the program appears to have succeeded. Inflation rates have fallen, reserves have increased significantly, and external arrears have been paid for. Now that financial stability has been achieved, the country is again able to focus on economic growth.

The IMF preaches and imposes the kind of financial and economic discipline which island countries should note and put in place themselves without the need for pressures from outside bodies. There cannot be any
long-term growth and development without external and internal financial stability.

THE PROSPECTS FOR PACIFIC ISLAND COUNTRIES

Minerals. PNG has rich deposits of two minerals, gold and copper, which have become the largest sources of foreign exchange and revenue for the country. Fiji has a gold mine which is doing well at present and more gold deposits have been found. Deposits of copper ore were found in the 1970s but their commercial development awaits further improvements in market prices. The potential for gold mining in Vanuatu and the Solomon Islands is also good.

The geological mapping and exploration of areas under the sea have been in progress in the South Pacific for some time. The sophisticated technology, know-how, and capital that are required for commercial development of minerals under the EEZs imply that reliance will have to be placed on large multinationals. Close cooperation between private capital and governments will be needed.

Agriculture and fishing. This sector supports the bulk of the population in the region. It is the sector upon which sound economic development and economic independence will continue to be based. There are good prospects for diversification and deepening of commercial agricultural activities, particularly in the larger island countries.

In Tonga, vanilla, a high-value, low-volume product, has become the largest export earner ahead of copra. Other nontraditional export crops which are being tried or are under consideration by departments of agriculture in the region include avocado, pear, pawpaw, mango, spices (pepper, clove, chili), pumpkin, medicinal plants, orchids, flowers, and other tropical ornaments. Possibilities exist in the field of mariculture including seaweeds, shellfish, crustaceans, eels, pearls, bêche-de-mer, and black and pink corals. Development of these new items will require technical and marketing research so as to establish niches in the market place. Increased reliance should be placed on the private sector, with the public sector playing at most a supporting role.

Offshore fishing in the EEZs of the region has a lot of potential, but technology, capital, and know-how will need to be imported. Tuna fishing and deep-sea fishing for high-priced fish such as deep-sea snapper have become possible with overseas capital, technology, and know-how. Some
countries such as the Cook Islands, Vanuatu, and Kiribati have offered licenses (at a fee) to overseas fishing organizations. This arrangement presents additional sources of income in the short term. The possibility of increased local private capital involvement in this important sector should improve over time.

Tourism. Tourism is already a major industry in Fiji, Vanuatu, and the Cook Islands, and is growing in importance in Tonga, Western Samoa, and the Solomon Islands. Other countries in the region are also actively encouraging its growth.

Heavy investments in tourist infrastructure have been undertaken and more are proposed. These include the building and extension of airfields and airport facilities, electricity supply, roads, water supply, telecommunication, and sewage systems. These projects all involve large public sector outlays that are supported through bilateral and multilateral aid.

The tourist industry is a ready market for agricultural and aquacultural produce, artifacts, and a wide range of domestic services. Although leakages out of the tourist industry are still substantial, increased domestic supply of food such as fruit, vegetables, fish, and root crops should improve on this situation.

Tourism will become more important to the economies of the region in the future and its growth is seen as a necessary diversification of the Pacific Islands' economic base. It will supplement, but not supplant, agriculture and fishing in the South Pacific countries.

Financial centers. Establishment of financial centers have encouraging prospects in some of the smaller countries of the region. Vanuatu established its center in the early 1970s and the industry has grown steadily contributing an estimated US$1.5 million annually in direct revenue from licenses and registration fees, and employing 200 locals and 148 expatriates. The total overseas assets of exempt banks and other financial institutions registered in Vanuatu hover around US$2 billion, while the annual net foreign exchange earnings generated by the industry is estimated at about US$3 million.

A number of smaller countries including Nauru, the Cook Islands, and Tonga are trying to develop their own financial centers, but this industry is very mobile with domestic investments limited to telex machines and other office equipment, and training. The total volume of business that
is likely to be generated in the region is limited and participating countries will need to work together to maximize returns from this industry without poaching from each other. The prospects for modest growth, however, look good.

Private sector development. Because the level of domestic savings in the region falls short of required domestic investments, overseas investments have an important role to play in the future development of the region. It is no surprise then to find that the Pacific Island countries are now promoting private sector investments. Private investments are likely to be attracted by (1) political stability, a factor which has been subject to a degree of uncertainty in recent years; (2) expectations of steady economic growth, of internal and external financial stability based on past records, and the effectiveness of economic management; (3) the freedom with which profits and capital may be repatriated overseas; (4) stable cost structures, rising productivity of the labor force, and a stable industrial relations climate; (5) a deregulated business and financial environment; (6) a land tenure system which allows security and ready access to land for the investor; (7) expanding domestic and export markets; and (8) an efficient deregulated domestic capital market and easy access to the overseas capital markets.

Deregulation of the business environment is slowly gaining acceptance and a number of countries have started cautiously along this path. Corporatization followed by progressive sales of shares to members of the public has been tried in a number of island countries. Similar experiments are likely to be pursued in the coming years.

REGIONAL COOPERATION IN THE SOUTH PACIFIC

Regional cooperation is sometimes an appropriate vehicle by which countries can pursue their economic, political, and social objectives. Such cooperation need not necessarily be pursued through formal regional bodies but often is. Benefits which accrue from regional cooperation include gains from economies of scale, gains from the increased collective weight necessary for securing concessions in trade and aid negotiations, and gains from ensuring that the views of countries are at least listened to in the various world economic or political forums. However, regional cooperation implies the need for individual countries to surrender part of their sovereignty to a supranational body in the interest of the group and the members, a situation which calls for a great deal of political will.
The areas of regional cooperation in the pursuit of national and group objectives have to be chosen carefully. In the South Pacific, these have included transportation, civil aviation, higher education, telecommunication, tourism, agriculture, trade, energy, exploration within the EEZs, the environment, regional economic issues, nuclear testing and pollution, regional security, and political developments. The remainder of this paper describes the main cooperative initiatives that have been undertaken in the region.

**South Pacific Commission (SPC).** The SPC is the oldest regional organization in the South Pacific. It was established on February 6, 1947 when the colonial powers in the Pacific—Australia, France, New Zealand, the United States, the United Kingdom, and the Netherlands—signed the Canberra Agreement. The preamble to this Agreement says that the signatories wanted to "encourage and strengthen international cooperation in promoting the economic and social welfare and advancement of the peoples of the non-self-governing territories in the South Pacific region administered by them." The Netherlands left the SPC when Dutch New Guinea was absorbed into Indonesia in 1962.

The mandate of the SPC is nonpolitical. It is a technical assistance organization which provides advice to member countries upon request. It undertakes training and disseminates economic, social, and technical information. Its areas of strength have been statistics, demography, agriculture, fisheries, mariculture, and development issues for women. Under the South Pacific Regional Environment Program (SPREP) Convention, the SPC is effectively the secretariat responsible for implementing the programs formulated by the signatory governments.

From the outset, political discussions were proscribed at South Pacific Council meetings. Later the South Pacific Conference was established as an advisory body to the Council. The Conference, which met triennially, allowed the island people to discuss issues of common interest and enabled participants from the island countries to comment on the proposed work programs of the South Pacific Commission.

The SPC performs well in its fields of expertise. It serves twenty-two independent and dependent member countries. Its annual work program is determined by a committee of senior officials from the member countries called the Committee of Representatives of Governments and Administrations (CRGA). The bulk of the annual funding is borne by the metropolitan member countries, though it receives substantial ongoing financial support
from metropolitan countries which are not members of the South Pacific Forum. Part of this would probably not be available to the region if the concept of a single regional organization were to be implemented. The SPC will therefore continue to be a useful vehicle for regional cooperation in a number of technical fields for many years to come.

**South Pacific Forum.** Discussion among Pacific islanders which started at the SPC conferences developed into informal meetings of leaders of self-governing Pacific countries outside of Noumea. Out of these informal meetings, the first of which was held in Wellington in August 1971, the South Pacific Forum came into being.

The meetings of the Forum are informal and are attended by heads of governments or foreign affairs ministers. All self-governing Pacific countries, including Australia and New Zealand, are members. The Forum is not a formal organization in as much as it has no charter which formalizes its existence and the mode with which it runs its affairs. It deliberates on political, economic, social, security, and constitutional issues that affect the membership. It has made pronouncements upon and representations to governments and world bodies on nuclear testing, dumping of nuclear wastes and decolonization—political and environmental issues which are of particular interest to governments in the Pacific region. The Forum has on a number of occasions also attempted to resolve difficult political and constitutional issues within member countries.

The South Pacific Bureau of Economic Cooperation (SPEC) was later established under a formal agreement of the member countries whose leaders attend the Forum meetings. It acts as the secretariat of the Forum and it is charged with facilitating continuing cooperation and consultation between members on trade, economic development, tourism, transport, and other related areas.

The current 10-year Corporate Plan of SPEC, now renamed the Forum Secretariat (FS), broadly defines the role of this organization as follows: "(i) to provide administrative support, legal advice, consultative machinery and secretariat services to the Forum itself; (ii) to maintain conference support services for regional and subregional meetings and training activities; (iii) to collect, analyze and disseminate data on social and economic change, trade, aid, investment, and financial flows in the region, providing a regional framework of economic analysis for use in national development planning, and in the mobilization and management of aid flows and private investment; (iv) to monitor and analyze political
and strategic developments, develop ideas and initiatives that strengthen regional cooperation in economic and political activity, projecting and representing South Pacific regional identity and interests to the outside world; (v) to initiate and undertake projects and programs of regional or subregional significance, including mobilization of the necessary resources, leading in due course to the completion, permanent operation by SPEC, transfer to another institution or spin-off of such activities to autonomous status; (vi) to assist in mobilizing and coordinating the flow of appropriate forms of external assistance and private capital into the region; (vii) to arrange technical assistance to member states and other South Pacific territories, from Forum Island Countries, regional and international sources; (viii) to maintain competent, accountable and comprehensive corporate services to high technical and professional standards.

The Economic Section of the FS is required to: (1) respond to island government requests for assistance with economic analysis and development planning, (2) help prepare feasibility studies for member countries, (3) prepare economic briefing papers for the Forum and the various committee of officials, (4) accumulate social and economic statistical information upon the member countries, and (5) monitor and analyze regional and subregional economic issues which may call for decision or intervention by the Forum.

The Forum Secretariat has concerned itself with the important subject of aid coordination, and has established a special section within its Economic Division. This special section is charged with: (1) surveying the various alternative sources of aid to the region. These alternatives are required to be evaluated and graded in terms of grant elements; (2) advising member countries on appropriate funding sources and working with them to secure enhanced flows of preferred aid; and (3) advising members on the optimum mechanism for aid coordination which South Pacific countries may wish to adopt and, in cooperation with bilateral and multilateral donors, providing secretariat support to member countries in aid coordination and negotiation.

The Economic Division may need to extend its role and advise members on restructuring and macroeconomic policies necessary for ensuring financial stability and long-term development and growth. This is a sensitive area as it will involve frank discussions at the highest level on policies and priorities. Much will depend on the style and delicacy with which the advice is given. It will be particularly important for the nonmem-
ber countries of the IMF, IBRD, and ADB which do not have had the benefit of this kind of interaction.

Cooperation in the area of trade, both intraregionally and between the island member countries and metropolitan countries, is an important focus for the FS. Through its Trade Division it is required to:

1. Monitor and negotiate improvements to the SPARTECA Agreement

2. Assist Forum island countries (FICs) in the negotiation and implementation of other trade agreements

3. Collect and collate information regarding existing trade arrangements and the conditions and restrictions applying to trade access to countries outside the region

4. Set up and maintain, in collaboration with the SPC, a database of trade information, conditions and statistics, and distribute this information to FICs and interested trading partners on a regular basis

5. Undertake market research and promotion for FIC products, including existing and potential agricultural exports (in collaboration with the SPC), and provide regular information regarding the potential size of markets, prices, relevant transport schedules and costs, and about institutions that are able to assist

6. Give special support and attention to industry development, and especially to the development of small and import-replacement industries

7. Explore opportunities for intraregional trade, and maintain up-to-date record of conditions and restrictions in FICs affecting such trade

8. Give support to the private sector through product development, training of exporters, information, and promotional activities. This includes encouragement of the development of the South Pacific Association of Chambers of Commerce
and other regional organizations of relevance to the trade and industry development of FICs.

The programs which the FS oversees in the important areas of transportation, telecommunication, energy, and tourism are substantial in terms of funding. These programs have been allowed varying degrees of discretion in the way they are administered. The tourism, transportation, and telecommunication programs have committees of government officials which guide their activities, but they all work under the broad guidance of the FS. These programs are funded through extrabudgetary support from bilateral and multilateral donors. The transport program promotes regional maritime training, assists in the formulation of a maritime code for the South Pacific, keeps close contact with the Pacific Forum Line and assesses its operation, administers regional aid in transportation, provides technical assistance to island countries, and assists in the formulation of regional aviation policy. Similar activities are pursued under the telecommunication and energy programs.

Tourism is seen as a sector where regional cooperation can yield increased returns to the Pacific countries. The EC has given substantial financial support to the Tourism Council of the South Pacific (TCSP) which, under the umbrella of the FS, is (1) promoting a regional approach to tourism by the authorities in the region; (2) helping member countries prepare their tourist sector development plans (incorporating measures which enhance linkages between the tourist sector and other sectors within an economy); (3) advising countries on the interaction between tourism growth and local cultures and traditions, and on measures which might be adopted in order to ensure that such interactions are mutually supportive; (4) advising governments on the required transportation developments in support of the future growth of tourism in the region; (5) advising governments on appropriate marketing policies and strategies; (6) developing a database of regional tourism statistics for use by all members as input into their own planning, and for the preparation and review of regional marketing strategies; (7) assisting member countries in the training of all categories of operatives within the tourism industry; and (8) promoting public awareness of the tourist industry and of the benefits and the costs which accrue to each country through tourism development.

Besides the regular meetings of heads of governments and the senior officials who sit as decision makers in the SPEC Committee, numerous meetings of officials such as development planners, security officers, chiefs of police, and agriculturists are regularly organized at the
FS head office. These allow exchange of views on all aspects of developments in the region and at varying levels.

The Forum has been concerned about the need for close coordination among the South Pacific regional bodies. To ensure that overlaps of their activities were minimized and cooperation was maximized in the interest of the member countries, the South Pacific Organizations Coordinating Committee (SPOCC) was established. The members of SPOCC are the Forum Secretariat, CCOP/SOPAC, the Forum Fisheries Agency (FFA), the Pacific Island Development Program (PIDP), the South Pacific Commission (SPC), and the University of the South Pacific (USP).

Another Forum initiative which is expected to have far-reaching, long-term impacts is the establishment of the process of dialogue with partners. The dialogue partners are Canada, France, Japan, China, the United Kingdom, the United States, EC, SPC, and UNDP. The dialogue in which the collective views of the island countries are projected follows the annual meetings of the South Pacific Forum.

The arrangements under which the Forum and the Forum Secretariat are able to take initiatives in regional cooperation are flexible and well-suited to the needs of the region. The Forum Fisheries Agency, a body with specialized technical functions, was spawned off by the Forum and allowed substantial autonomy. It was set up under a separate charter with common membership with that of the Forum Secretariat. Its annual reports are submitted for information to the Forum by the Chairman of the Forum Fisheries Committee, its governing body made up of government officials. The Pacific Forum Line, another Forum initiative, was established as a private company and required to operate as a commercial venture.

The SPARTECA Agreement was an initiative developed within the Forum. The Forum Secretariat has also played an important supportive role to the island countries in the negotiation of the Lomé Conventions. A similar catalytic role in new initiatives, the opportunities for which are many, could be undertaken by the Forum in the future. There have been constraints in the technical capacity of the organization but the Secretariat has begun to address this problem.

South Pacific Regional Trade and Economic Agreement (SPARTECA). This Agreement between governments of the island member countries of the Forum on the one hand and the governments of Australia and New
Zealand on the other was an important initiative pursued and executed through the Forum. The objectives of SPARTECA are to:

1. Allow duty-free and unrestricted access for exports from the islands to Australia and New Zealand
2. Accelerate economic development in the island economies through increased exportation
3. Reduce tariff barriers against island products in Australia and New Zealand
4. Promote cooperation in commercial, industrial, agricultural and technical activities among the Forum member countries

The Agreement provides for and encourages cooperation between private sector entities, training for island people, and marketing and promotional support in Australia and New Zealand. Provisions for special treatment of the smaller island states are made and the two metropolitan Forum members may allow more favorable treatment in special and deserving cases.

A number of labor-intensive goods are subject to quotas. Conditions for access of goods into the Australian and New Zealand markets are provided in the Agreement. These require that goods originate in the island countries. Manufactured goods must (1) have the last stage of manufacturing performed in an island country and (2) have not less that 50 percent of the factory or work costs made up of the value of labor and/or materials. Such costs must have been expended in any one or more of the Forum island countries including Australia and New Zealand. In instances where costs incurred in Australia or New Zealand are to be taken into account in establishing origin in the islands, at least 25 percent of the factory or work costs must be represented by the value of materials and/or labor in one or more island countries and the material included in the computation must be freely traded between Australia and New Zealand.

A Regional Committee on Trade, whose members are senior trade officials from the Forum countries, regularly reviews the provisions of SPARTECA and makes proposals for changes to the Forum through the Secretary-General of the Forum Secretariat.
SPARTECA is a nonreciprocal trading arrangement which has been of great assistance, particularly to the larger, more developed island countries. One constraint for these countries is in the quantum of the quota. More generally, however, the more important hurdle lies within the island countries in organizing the production of goods which the market wants at competitive costs.

The recent experiences of Fiji may be illustrative. In 1987, the Fiji currency was devalued by 35 percent. Wages and salaries had been declining in real terms since 1984. Despite the more than average rates of inflation in 1987 and 1988, the real effective exchange rate of the Fiji currency declined substantially and Fiji's competitiveness improved markedly. Exports, including garments exports, became very competitive and profitable. Indeed Fiji's manufacturing exports are now competing effectively in the United States, Australia, and New Zealand.

As already observed, the favored position of island goods is likely to be eroded over time with the increasing trend of economic liberalization. This will mean, more and more, that the island countries must rely on new initiatives and on prudent and enlightened domestic policies which will allow them to be strongly competitive.

Forum Fisheries (FFA). The island countries have seen the immense potential of the resources within their EEZs following the ratification of the UN Convention of the Law of the Sea. They have realized that cooperation among themselves in the conservation and better management of such resources would maximize returns to them. Out of this concern they decided to establish the FFA which among other things is required to "(1) secure and promote the conservation, management and optimum utilization of living resources including the migratory species within the EEZs of member countries and in the high seas of the region; (2) promote the cooperation of member countries and of the fishing nations operating within the EEZs of member countries and the high seas of the region; (3) promote intraregional coordination among member countries in the following fields: harmonization of policies with respect to fisheries management; cooperation with respect to relations with Distant Water Fishing Nations (DWFNs); cooperation in surveillance and enforcement; cooperation in onshore fish processing; cooperation in marketing; cooperation in access to EEZs by other parties; and cooperation in conservation; (4) facilitate the collection, analysis, evaluation, and dissemination of scientific, technological and economic information about the living marine resources of the region with particular focus on the highly
migratory species; (5) advise the developing member countries on scientific, technical, commercial, legal and academic aspects of marine resources thereby enabling them to maximize the contribution from such resources to their economic and social development efforts; (6) establish and improve on working arrangements, including the rationalization of services with relevant regional and international organizations, including the SPC."

Regional cooperation under the FFA umbrella has already proved very effective and beneficial. The signing of the Multilateral Fisheries Treaty by the United States and possibly other major fishing countries and the developments leading to the banning of drift-net fishing in the region betoken the benefits of regional cooperation by small states.

It is likely that over time the FFA through the Forum Fisheries Committee (FFC) may have to be endowed with discretionary powers to make decisions on behalf of members. Such decisions may include the licensing of fishermen, fishery vessels of DWFNs and equipment, the level of fees by fishing vessels and their mode of payment, the seasons and approved areas of fishing, the size of fish that may be caught, and enforcement procedures.

The FFA is, with other regional cooperative institutions, in a delicate financial position. About 90 percent of its recurrent budget, including the programs which it administers, is financed by aid from bilateral and multilateral donors.

**University of the South Pacific (USP).** Individually the eleven member countries of the USP were considered to be too small to support a university and establishment of USP was expected to result in the advantages of scale accruing to member countries. However, this concept, which implied the concentration of institutions into one geographical area, has given rise to some dissatisfaction over the last 21 years. The financial and economic benefits of having a university, such as the revenue and GDP generated through capital and recurrent expenditures, were seen by many as accruing mainly to Fiji. To counteract this sentiment, the policy of geographically dispersing various activities of the university over the region has been adopted over time. This policy is a necessary trade-off which must be accepted in this kind of cooperative arrangement.

The university attempts to respond to the needs of the member countries. It teaches most traditional university courses except for such
subjects as architecture, engineering, and medicine. In its attempt to be fully responsive, it has included technical training, extension, and preuniversity year courses in its teaching programs.

Aid finances all the capital expenditures and 10 percent of the operating expenditures of the university. The balance of its operating expenditures is shared among the eleven member countries under a formula which reflects the average proportion of national students and the benefits that accrue to each member country through having part of the university operation located within such a country.

The university is a good example of regional cooperation in the important field of human resources development. While it will continue to have financial difficulties, its contribution to the region since its establishment in the 1960s has been valuable. Most of the senior officials and private sector executives, and some heads of governments in the eleven member countries are USP alumni.

There will be future expansion of the activities of the USP despite the centrifugal pressures with which it is familiar. The enormous costs involved, the likely reluctance by donors to support other similar institutions in the region, and the growing pressure from universities in Australia and New Zealand will ensure that the USP will survive and grow into the next century.

Committee for Coordination of Joint Prospecting for Mineral Resources in South Pacific Offshore Areas (CCOP/SOPAC). The CCOP/SOPAC is a separate regional entity with specific technical functions. The members of the committee, the governing body of the organization, are senior officials of the member countries. CCOP/SOPAC promotes the interest of the membership by (1) undertaking geographical, geophysical, and energy studies, and advising governments on how they may be developed into investments which promote national interests; (2) helping in the finalization of requests for technical assistance from international organizations which are involved in natural resource research and development; (3) assisting in the interpretation and evaluation of technical data and information relating to minerals, energy, and other natural resources within the coastal and offshore areas of member countries; (4) coordinating the sharing of technical facilities and information among the member countries; and (5) promoting and facilitating the training of personnel involved in minerals, energy and other natural resources.
The organization has devoted, and will continue to devote, its energies to accumulating knowledge about the nonliving resources within the EEZs of the South Pacific island countries. The results of its findings and those of large multinationals which show increasing interest in this field could be decisive in the course of future economic and social development in the region. CCOP/SOPAC has attracted substantial support from donors and is very likely to continue to do so in the coming years.

Air Pacific, the regional airline. Air Pacific is an experiment in regional cooperation which has not succeeded as intended. A number of island governments and three large airlines took up equity in Air Pacific, which was constituted as a private company.

The airline, in the interest of regionalism, felt obliged to service a number of regional routes which ran consistent losses. Unhappiness also surfaced about what was conceived to be the inequitable distribution of benefits from foreign exchange receipts and the employment of nationals of shareholder governments. There was also the growing feeling in individual countries that owning and operating an airline was an important national symbol with significant nonfinancial benefits.

The airline ran up losses for a number of years and accumulated debts in the process. However, it began an impressive turnaround after 1988. Only two countries, Tonga and Fiji, now sit on the Board and a number of original shareholders now run their own airlines.

Operating an airlines in the Pacific where distances are immense, where the market is very thin, and where choosing the wrong equipment can be disastrous, is generally a precarious enterprise. The concept of regional cooperation through a regional airline is something which probably needs to be reexamined with the hope that the wisdom of hindsight may be of assistance for the future.

Pacific Forum Line (PFL). The Forum acted as a catalyst in the formation of this shipping company which is jointly owned by a number of governments in the region. It survives with heavy subsidies particularly from the EC, Australia, and New Zealand, though the financial results of the company are reported to have improved recently.

PFL recently started monthly service through Fiji to Tuvalu, Kiribati, and the Marshalls. If it is able to break even on this route, PFL would play an important role in the future development of these three atoll island
The company hopes ultimately to be financially viable and to furnish returns to its shareholders. Perhaps when that point is reached, consideration could be given to making PFL a public company with shares progressively sold by governments to their nationals.

**Regional development bank.** The idea of a regional development bank serving the Pacific Island countries was proposed in the mid-1970s. Although a number of smaller island countries favored the proposal since they considered the ADB and IBRD too large to serve their needs effectively, some of the larger Pacific countries were less enthusiastic. The larger island countries were of the view that the capital needs of all the island countries were adequately satisfied through the various sources that already existed and that the establishment of the proposed institution would not lead to additional capital inflows into the Pacific region but would impose substantial and unnecessary overheads.

As a result of these concerns, a more modest arrangement, a regional development fund, was examined. This fund was to be capitalized by metropolitan and island countries and its resources supplemented by issuing bonds in the region. The Fund was to extend relatively large development loans at less than commercial rates to the island governments. As the staffing was to be small, it was hoped that the overhead would be contained at modest levels. However, this proposal also did not meet with enthusiastic support.

It is of some interest that the proposal for the establishment of a regional development bank generated some concern at the ADB in Manila, which decided to change its policy and establish a regional office in Port Vila, its only regional office. The concept of a regional development bank will probably not now see the light of day since the ADB treats the needs of the smaller and larger island countries with equal attention.

**Regional cooperation against dubious investors.** There have been a number of unfortunate experiences with individuals or other entities presenting themselves as investors with substantial resources but whose aims have been quick enrichment through devious or illegal means. Generally, such operators move from country to country and the potential damage that flows from such activities is substantial.

The central banks of the Forum island countries have established a data bank to which details of all dubious investors in the region are fed. Cooperation with the Comptroller of the Currency in Washington and the
police in metropolitan countries will need to be strengthened. Authorities are supposed to feed into the data bank details which they come across and may call upon the data bank to check on promoters of proposals which appear to need thorough scrutiny. These procedures could be supplemented by inquiries with the Dunn and Bradsheet organization and with international banking contacts which central banks have worldwide.

Unfortunately only six island countries have central banks. In the other countries, the Ministries of Finance or commercial banks which perform the role of central banks could participate in this cooperative arrangement.

Cooperation among central banks. The central banks of the Forum countries, including Australia and New Zealand, meet once a year to discuss the banking industry in the region and various avenues of cooperation among themselves.

A cooperative payment system for trade within the Forum countries has been considered. Under the scheme, central banks of net exporting countries (such as Australia, New Zealand, and Fiji) to Pacific Island countries will allow credit to, or swap arrangements with, those of net importing ones. These facilities would be made available on commercial terms and settlements could be made every three or six months. For countries which may experience persistent but reversible balance-of-payments difficulties, the benefit under this scheme would be substantial provided that their imports from other Forum countries including Australia and New Zealand are relatively large. The importance of this arrangement will be a function of the future trend in intraregional trade in the Pacific.

Regional cooperation on environmental protection. The South Pacific countries have adopted an Action Plan for managing the natural resources and environment of the region. Under the Action Plan, the Pacific Island countries intend to (1) preserve their natural heritage; (2) ensure that hydrological, geological, marine and ecological characteristics are not damaged or destroyed in the process of development; (3) inculcate the principles of sustained resource management; (4) foster cooperation among themselves and with other regional, subregional, and international organizations in the pursuit of coordinated and controlled natural resources development; and (5) eradicate marine pollution and control environmental degradation.
A Convention for the Protection of the Natural Resources and Environment of the South Pacific Region (SPREP Convention) has been agreed to and signed by the island countries which make up the island membership of the South Pacific Commission including Australia and New Zealand. About ten of these countries have gone through the procedure of ratification and a few more ratifications are required before the Convention comes into effect.

The area covered under the Convention is wide, encompassing 200 nautical mile zones of the signatories and of East Australia. The designated "organization" or Secretariat under the Convention is the South Pacific Commission. A small team within the SPC exclusively administers the programs agreed to by the signatory countries.

Reflecting their importance, environmental programs tend to attract funding with relative ease. The activities envisaged within the framework of the Convention are therefore expected to grow in importance during the coming years.

Cooperation against nuclear testing and dumping of radioactive wastes. The South Pacific Nuclear Free Zone Treaty adopted at Rarotonga in August 1985 spells out the collective position of the island countries against nuclear testing and radioactive waste.

The Treaty defines the South Pacific Nuclear Free Zone and the obligations of the signatories within it. It discourages the stationing and testing of nuclear devices and the dumping of radioactive wastes in the zone, but the discretion to allow ships or aircraft into ports and airfields or through air-space or territorial waters rests with each signatory country.

Although a number of Pacific powers have signed and ratified the Treaty, the Treaty has not been ratified by some of the major powers because of its controversial nature. However, the Treaty has shown how close cooperation can achieve much of what cannot be done when small countries act individually.

Other cooperative arrangements. Regional cooperation is not confined to cooperation at government levels, and nongovernmental organizations, such as the churches, also work closely with one another in the region. The private sector, through arrangements such as the Pacific Islands Association of Chambers of Commerce (PIACC), is also beginning to work together for the common good. The development bankers of the Pacific
meet regularly and tourism authorities have now formalized their frequent meetings under the umbrella of the Tourism Council of the South Pacific.

Closer cooperation with other bodies around the Pacific Rim and beyond will need to be forged. A Pacific country already sits as an observer in ASEAN. The Forum should probably seek observer status in the same body and at the Asia-Pacific Economic Cooperation Council (APECC) on behalf of the Pacific countries. More private sector representatives at the PBEC would yield returns in terms of more investment inflows and trade with the Pacific Rim countries. The FS will also need to closely monitor developments of the current round of GATT negotiations and advise the island member countries of the Forum.
The political economy of China

Anthony M. Tang

INTRODUCTION

The year 1989 was the anniversary of several highly significant Chinese events. These events include the start of the Opium War 150 years ago, the May Fourth student movement in 1919 which was a protest of the ignoble Versailles Treaty, the founding of the People's Republic of China in 1949, the last Sino-Soviet summit in 1959 which marked the end of the fraternal bilateral relations and the beginning of a long period of dangerous hostility, the introduction of the celebrated reforms of senior leader Deng Xiaoping 10 years ago, and the Sino-British Joint Declaration in 1984 which set Hong Kong's future governance under Chinese sovereignty starting July 1, 1997. Furthermore, for the leaders and people of China, 1989 was a year to take stock and reflect, as Deng's bold reforms, which were first entrusted to Hu Yaobang and later to Zhao Ziyang, had fallen on hard times.

The new openness and reformist atmosphere in China were to bring Gorbachev to Beijing for the first Sino-Soviet summit in 30 years and the Asian Development Bank to Beijing for its Annual Meeting to be attended by an official delegation from Taiwan led by the Minister of Finance and the Central Bank Governor. Suddenly there was excitement in the air. The death of Hu Yaobang on April 15, an event of great symbolic value, led to masses of students and civilians congregating in Tiananmen Square and staying there for the next month and a half. The students' demands, which were modest by the standards of the more recent East Bloc protesters, included dialogues on democracy (this was not so much a negation of the Communist Party power as much as a demand for greater political openness and accountability), a stop to corruption by high-level officials and abuse of power and privilege, and a stop to inflation. The object of mass discontent was, thus, the negative effects of Deng's economic reforms as much as anything else. The widespread support for the students alarmed the party leaders, but the party and state decision-making machinery were paralyzed by the intraparty factional polarization and the titanic power struggle which was in the process of sorting itself out. The fall of reformist Zhao and the June 4th crackdown to clear the Tiananmen Square are history.
Whether an individual agrees with Henry Kissinger that no government can tolerate such a prolonged occupation of the heart of the capital city and thus views the crackdown with regret mixed with sympathy, or whether an individual condemns the crackdown outright, is a subjective choice. What is important, however, is that inordinate force was employed in the incident rather than flexibility and substantive dialogue. This use of force gave rise to consequences whose gravity is difficult to exaggerate. Whereas the Chinese Communist Party (CCP) and the government it controlled used to enjoy broad-based popular support and trust through most of the 1950s, their leaders now seem to fear their own people. This fear has affected Beijing’s dealings with Hong Kong, while not so subtle warnings have been issued against Taiwan’s burgeoning separatist movement. It is, thus, useful to analyze China’s economic reforms and the country’s future prospects against the backdrop of the country’s political economy. A few remarks about the possible roles the United Nations Development Programme (UNDP) can play is also offered in the conclusion.

This paper draws mainly on my accumulated knowledge and past writings. It presents some new arguments about the relationship between separability of a value-dictated command system and socialist ownership of the means of production; about the limitations of the command system in a nation-building context; about the need for price-directed mobilization scheme for long-term nation-building; about economic pluralism (in Kissinger's terms) as the cause of "chaos"; about the need for legal and political reforms for decentralization to work; and about China’s special problem of spatial disequilibrium owing to its size, geographical layout, population distribution and ethnic mix, and migration policy.

CHINA’S LEGACIES

As a result of its early liberation from feudalism some 2,000 years ago, China has long enjoyed early leads in economic development (not the least of which in agriculture); in institutions conducive to growth (such as family farming as opposed to the feudal manorial system, civil service, national examination system, and abolition of hereditary titles in the promotion of vertical mobility); in market growth unhampered by feudal barriers to movements of goods, people, and ideas; in premodern technology; in the development of a workable monetary and transportation system; and in literacy, numeracy, and public administration which was aided by China’s advancements in printing technology very early on. However, because of its rapid population growth in the premodern era,
China was ultimately forced into a "low (income) level equilibrium trap" characterized by highly fragmented, one-hectare subsistence-size farms, a low level of agricultural surplus (which could be mobilized by a purposeful modern state to support the development of a modern sector), and near-exhaustion of the stock of premodern technologies.¹

Unlike China, Europe and Japan did not abolish feudalism until much later in their development. While feudal restraints held back their development, they also served to (1) keep population growth in check during the crucial 500-year period preceding the dawning of the Industrial Revolution in England;² (2) allow the countries to accumulate a huge backlog of unexploited premodern technologies in agriculture; and (3) preserve a large agricultural surplus, through its skewed distribution of income and wealth—a surplus used prior to the modern era for the patronage of the arts, literature, science, navigation, adventure, and exploration whose flowering helped to usher in the modern era. The formation of nation-states in Europe and Japan enabled the capture of the agricultural surplus for purposeful development and led to a sudden release of the pent up growth potential. The resulting surges in per capita incomes and the perception that these gains were permanent altered the demographic behavior of these industrializing societies. Thus the economic and demographic processes became mutually reinforcing, paving the way for Kuznets' "modern economic growth."

In China, on the other hand, the gradual ascendancy of the Chinese imperial system ultimately led to Confucian orthodoxy and an intolerant attitude towards new and diverse ideas and technologies. The imperial examination system came to focus on Confucian classics only and the emphasis on knowledge-seeking shifted from "what is" to "what ought to be." Education lost its substance and integrity; yet the power of its attraction continued to grow. In principle, any farm boy in China, however humble his background, could one day become the Prime Minister of the vast empire if he commanded a superior mastery of the classics over all others. There is little wonder, therefore, that mathematics, spinning and weaving technology, and many other fields in which the Chinese sought to excel (as catalogued by Joseph Needham of Cambridge) began to wither. It is interesting to note that there are observers who claim to discern the same mandarin-autocrat world view and mode of thinking in China's leaders today.

It is likely that Karl Marx would have been terribly embarrassed if he had been around when the Bolshevik Revolution succeeded in 1917 in
Russia, or when the Chinese revolution came to fruition in 1949. At that time, neither Russia nor China was a mature capitalist country where revolution by the proletariat class was supposed to happen. It should come as no surprise that it took the Soviets nearly 10 years to come up with a plan that gave the party leaders acceptable articulations of their values in displacement of those of the people. In this context, the Communist Party regards itself as the sole repository of truths, and the values of its leaders are aptly summarized in a metaphor attributed to Abram Bergson: "To the Party leadership, bread is an intermediate product; steel is the final good." Although Bergson's metaphor was in reference to the Stalinist strategy of economic development, the same strategy was embraced by Beijing's leaders when they assumed power in 1949.

A thoughtful reading of Marx—together with the unlikely settings (in 1917 for Russia and in 1949 for China) for the ascendancy of his revolution, the Communist Party pronouncements, and the revealed party economic priorities—would plausibly support the following list of shared values and goal imperatives for the party leaderships at the inception of their respective First Five-Year Plans. These values or goals are as follows:

1. To elevate the "material base" of the economy and to "legitimize" the revolution
2. To demonstrate system superiority in a modern power context
3. To negotiate the transitional socialist phase with a view to reaching the communist millennium as speedily as possible
4. To follow an essentially self-reliant path of development in recognition of the hostile capitalist environment
5. Maximum effort and highest priority are given to the development tasks consistent with the articulation of the above imperatives

The power-oriented value and goal imperatives, together with the clear sense of urgency attached to their attainment, dictated a development strategy that can be best described as "maximum-speed selective growth under austerity." This strategy required a command economic system to ensure total resource mobilization which was necessary for the strategy to succeed. Selectivity is associated with the development of modern heavy
industrial sector whose absolute size is the preponderant determinant of national power in geopolitical terms; the command system eschews markets and prices in important ways, preferring to allocate critical resources administratively.

Unlike the Soviet Union, China found its pace of industrialization constrained by agriculture owing to its meager initial conditions. With agriculture as the binding constraint, the Chinese planners were faced with the task of first developing the sector by emphasizing mobilization of indigenous resources of low or no opportunity cost, exploiting traditional production possibilities, and eventually exhausting them. In this scenario, the development program takes on additional complexities and the planners must pay attention to the conflicting dual-policy requirements (output growth and maximum extraction) that are imposed on agriculture. The clash in time preference between the household and the planner becomes more immediate; the bureaucracy and the command structure grow accordingly. Even more so than before, direct quantitative controls such as rationing of basic consumer goods (a Chinese practice since 1955) are preferred.

In an attempt to deal with these problems, or "contradictions" in Marxian lexicon, efforts are made to find nonmaterial substitutes for incentives to raise output without incurring increased consumption (viewed as a cost by the planner). Because of China's unfavorable initial conditions, the country's industrialization was agriculture-constrained; this is clear from my earlier empirical studies and from Beijing's recent own reckoning. China's preoccupation under Mao with "radical experiment"—a predilection responsible for Beijing's policy cycles—is thus quite understandable. So was Mao's singular concern with the problems of government and party bureaucracies, as symbolized by his concept of "permanent revolution" to keep the governing apparatus "renewed." At the opposite end from these radical courses of action, Beijing has shown a willingness to compromise high principles of socialism and nationalism. In the singular case of Hong Kong and Macao (where Beijing virtually insisted that Britain and Portugal retain, for some time, the two territories as colonies), the bending of these principles is very clear. The overriding importance attached to technology transfers and the multibillion dollar foreign exchange earnings netted annually by Beijing through trade, remittances, and its banking and commercial operations in these two Western colonies, attests at once to the preeminence of growth-related values vis-à-vis the competing ideological and nationalistic considerations which, like consumption, will assert themselves one day. Thus, within the
relevant time horizon, they are best treated as constraints rather than as arguments in the objective functions. Theoretically, the Hong Kong–related policies serve to raise the transformation curve through more efficient conversion of China's agricultural surplus into capital goods and technology for industry than can be achieved without the markets and services of these colonies. There are, however, limits to such policies; these limits are clear from Beijing's decision to recover the territories in 1997–1999. Similarly, there is a threshold that CCP leaders will not want to cross in reinstituting capitalist practices.

The virtue of the command system lies in its recognized efficacy in mobilizing resources for the attainment of some single-minded social objective. Efficiency and finesse in using the resources thus mobilized are not among its strong points. When total mobilization is required, as it was during World War II, the command system coupled with rationing and price controls can achieve more complete and more sharply focused allocation of critical resources while maintaining equity and price stability during the emergency. The clash between the household and the planner (in time preference) is minimized if the imperatives of the proceedings are understood and shared by the people. Popular perception of leadership performance and the time frame of the proceedings is critical. When these aspects begin to be seen in a negative light, the cost and effectiveness of the system begin to suffer.

While the command system would seem to command itself well under the value/goal imperatives of the Communist Party leadership, it is placed at risk by the protracted nature of the required proceedings of nation-building in accordance with the Stalinist blueprint. As the economy grows in size and sophistication, and as the consumption standard is raised in deference to the periodic duration-required concessions to incentive considerations, the cost of the system in terms of efficiency loss and administrative cost tends to rise exponentially. The latter in turn reinforces the negative perceptions of the people and there is a feedback loop.

These problems have been compounded in China by the further requirement of the Marxist legacy that the means of production be nationalized. In principle, the command system need not be accompanied by state ownership of enterprises. The United States which is the foremost capitalist country, fought and won the second World War with the help of the command system (with the War Production Board as the command center) without nationalizing a single war contractor. The extensive literature on socialism makes it clear that even without the compounding
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Effect of the command system, market or liberal socialism for consumer welfare maximization is beset with operational difficulties in three key areas: (1) administrative determination of distortion-free scarcity prices for all inputs and outputs, (2) provision of an efficient incentive structure to secure the same level of performance from workers and state enterprise managers as achieved in private enterprise market economies, and (3) provision of incentives for Schumpeterian innovations for which microeconomic risk-taking entrepreneurship is essential. The linking of the command imperative with socialism gave rise to a command socialist system, as ordained by the Stalinist development strategy, that brought about problems far more intractable than those under market socialism in two respects: by eschewing prices and markets, and by setting up severe clashes between the household and the planner. To the latter, one can add the further insight that the more unfavorable the initial conditions, the more severe is the clash.

It is important to remember that the basic afflictions of the system are found in meeting the varied demands of consumers (and producers such as farmers) for mass-produced, mass-distributed goods (and inputs) in terms of time, place, and assortment. However, for such sectors as machine-making, defense, and space technology, which are of special importance to the Stalinist strategy, the systemic handicaps of the Soviet and Chinese economies lose much substance. The process by which innovations—whether it be in the form of new spacecraft, new launch systems, or new weapons systems—start from a concept and then proceed through the various stages of specifications, blueprinting, R&D, testing, and production are basically not all that different between the economic systems. Broadly defined as the modern heavy industrial sector, this sector and its growth performance are what matters to Chinese and Soviet leaders.

In these power-oriented terms, the Soviets have done exceedingly well. The Soviet Union has become a superpower equal to that of the United States in a short time span of 70 years and despite heavy wartime losses and destruction. However, leaving aside its "power" sector, one can reasonably characterize the Soviet economy as Third World. Overall measures such as growth of per capita income and total output are quite irrelevant in this power context. For example, Switzerland may have a higher per capita income than the United States but it is not a superpower.
In contrast, China which started out some 30 years after the Soviet Union with a poorer set of initial conditions can be fairly described as having attained great power status, despite the low-keyed self-characterization of China by its leaders as a backward Third World economy (with a per capita GNP of under US$400). Notwithstanding its relatively low per capita income, China's power status derives from its annual output of steel of 60 mmt (million metric tons), crude oil production of 150 mmt (of which 30 mmt are exported), grain production of 400+ mmt (China is only marginally dependent on grain imports), a capability to produce and export a full array of armaments of improving quality, a nuclear and missile launching capability that clearly marks it as a great power, and its recent commercial satellite-launching capability. It is in these terms that the so-called hardline conservative octogenarians are inclined to view the worth of the command socialist system, which they espouse in unflinching opposition to the reformist schemes. The hardline conservatives blame the reformist for having laid waste to the state investment plan and for undermining the "commanding heights," while bringing in other problems such as mounting budget deficits, erosion of central control over revenues (an outcome of decentralization), inflation, corruption, and a return of unacceptable class differences between the rich and the dispossessed. The conservatives could have well added that the rich (who were to be glorified in the wide-open reform days) were getting rich not so much by hard work and sound business investment but through rent-seeking whose opportunities mushroomed as a result of the reforms.

The Stalinist development model is a "catch-up" model, and its validity is gone once the party leaders declare that the task of catching-up (once headily described as equaling the United States and burying capitalism) has been accomplished. This juncture seems to have arrived in the Soviet Union. Gorbachev is busily dealing with the difficult problems associated with the transition from command socialism to market socialism, to be preceded by legal and political reforms, in an order that is seemingly opposite to China's. In China, the interplay between the meager initial conditions and the imperatives of the development strategy have made a retreat from command socialism inevitable, as the Maoist approach had basically exhausted further growth possibilities. Further insight into this argument is given in the next section, where the Chinese growth record is analyzed in some detail in terms of trends and developments in the key agricultural sector.
AGRICULTURAL DEVELOPMENT AND THE GROWTH RECORD UNDER MAO, 1952–1977

The period 1952–1977 reveals agricultural trends under the policy influence of Mao, who died on September 9, 1976. Starting with an output of 164 mmt in 1952, total grain output (including soybeans) in China reached 283 mmt in 1977. This is an increase of 73 percent or 2.3 percent a year, compared with an average population growth rate of 2.1 percent. Leaving aside the question of material and human costs occasioned by experimentation with radical programs, this increase in per capita grain output may be viewed as credible. In addition, in value terms (all in constant 1952 prices), the gross value of agricultural output (GVAO) rose from 40.05 to 79.87 billion yuan, an increase of 99 percent during 1952–1977, or 2.9 percent per year. However, the high GVAO growth rate is biased upward to the extent that the GVAO concept allows multiple counting of output. Because multiple counting increases more than proportionally with output as a sector undergoes growth and modernization, gross output rises more rapidly than net output. Moreover, the growth in GVAO was associated with even greater increases in total real resource cost. Between 1952 and 1977, the aggregate input index increased by 129 percent. Setting the output index against the aggregate input index to form the total factor productivity index, we see a decline of 13 percent in Chinese agricultural productivity over the period 1952–1977, or 0.6 percent per year. In more technical terms, China witnessed downward shifts in its agricultural production function.

Thus, in productivity terms, the Chinese historical record under Mao was not impressive. We note that the large-scale stepping up of resource use in securing output growth was based primarily on inputs purchased from the nonagricultural sector. These inputs, which included power equipment and machinery, fuel and electric power, seeds, chemicals for disease and insect control, and especially, chemical fertilizers, enabled Chinese agriculture to grow at a sufficiently rapid pace to deliver the end product in quantities large enough to meet the elementary needs of the country's expanding population. This was achieved not through improved productivity as such, but mainly through massive injections of resources external to the sector. This stands in sharp contrast against the notable productivity gains enjoyed by agriculture in the neighboring economies of Japan, Korea, and Taiwan.

The agricultural sector's capacity to generate value added was also limited. Value added by agriculture (VABA) rose from 36.83 billion yuan
in 1952 to 55.07 billion in 1977, an increase of only 42 percent (as compared with 99 percent in GVAO) or an annual rate of 1.7 percent. The modest rate of increase has meant a stagnant or slightly declining value added per worker. From about 220 yuan in 1952–1953, agricultural value added per worker declined to 215 yuan in 1976–1977 in 1952 prices. In 1952, Chinese agriculture was almost completely self-contained. Inputs purchased from outside (including cake fertilizers) amounted to just under 1 billion yuan, or 2.5 percent of gross output (net of self-supplied feed and seed for consistency). By 1977, purchased inputs reached an estimated 21.11 billion yuan, or 27.7 percent of output. Against a relatively constant marketing ratio of 25 percent of gross output, the explosive increase in the industry sector's contribution to agricultural output is highly significant, and signifies adverse changes in intersectoral resource flows. In 1952, agriculture was a large net contributor to industrialization but by 1977, industry basically paid for what it got from agriculture, notwithstanding requirements of the Mao development strategy. That is, industry was no longer able to grow on the backs of the peasant primarily because of agriculture’s dismal productivity record.

Further statistical calculations using 1957 as a base period bring out more sharply the adverse development in intersectoral resource flows under the country's collectivization program. Since 1952 was a precollectivization year, the year 1957 might be a more satisfactory starting point for comparisons against 1977. The value of purchased inputs in 1957 came to 2.3 billion yuan, or 4.9 percent of output. The latter figure is to be compared against the 1977 percentage of 27.7 percent. The decline in value added per agricultural worker was from an estimated 254 yuan in 1957 to 210 yuan in 1977, a substantial drop of 17.3 percent. The significance of these computations is seen in the effects of official agricultural output and input price adjustments on farm levels of living. Thus in 1979, the year which saw a major price reform in favor of agriculture, value added per worker at 218 yuan was only marginally better than in 1977.5

In sum, it is reasonable to conclude that the 1979 farm price reform was made inevitable by the unsatisfactory currents underlying Chinese agricultural development under Mao's stewardship and that the relative price changes (i.e., a partial closing of the "price scissors") did not do much more than restore real farm incomes to their 1950s level. However, rural household incomes did improve considerably in the 1980s with enactment of far-reaching organizational reforms, in particular introduction of the household responsibility system beginning in 1981.6
A CRITICAL ASSESSMENT OF POST-MAO REFORMS

With the 1979 price reform closing at least part of the "price scissors" and the gradual return to family farming under the household responsibility system, Chinese agricultural output expanded vigorously in the reform period of 1979–1985 at an average rate of 9 percent per year. According to Johnson (1988), about one-half of the output growth (1978–1984) was due to increases in productivity (in sharp contrast to the decline under Mao) and the other half to increased use of inputs. However, while the rate is unprecedented, it is important to note that the high growth is somewhat exaggerated because of (1) the multiple counting embedded in the aggregate with the degree of overstatement rising over time, and (2) GVAO's inclusion of the nonagricultural output of the most rapidly growing sector of the rural economy, the "village industries sector," which grew at 30 percent a year during 1980–1985. In 1985, these village industries accounted for 24.8 percent of GVAO. Grain and other crop output grew at a more modest 5 percent a year during 1979–1985.

All of this is a testament to Deng's insightful policy-making and serves to reconfirm his and the economist's long-held premise that the Chinese peasant is an "economic man" despite Mao's attempt to reconstruct him into the "Communist man." The growth in productivity also confirms the efficacy of the family farm. Long recognized elsewhere by agricultural development economists, family farming provides more flexibility and greater incentives to seize economic opportunities; family farming obviates the need for monitoring labor effort on the part of family workers who are all unpaid residual claimants of the family income and wealth pool. In contrast, effective monitoring is costly on collective farms.

The analysis suggests several factors which are critical in assessing the future prospects of China. To an important degree, the realized growth represents the sort of spurt that one would expect from the freeing of a long-repressed sector. It is basically a one-time-only type of growth although the recovery may be spread out over several years. In China's case, this has been sustained by continued massive injections of modern inputs, especially chemical fertilizers which showed a 63.5 percent rise in consumption in 1985 from an already high base fertilization rate in 1979, or an average annual increase of 9 percent. Nonetheless, the output growth since 1979 represented a "cheap" growth in resource terms. To generate future growth, even if that growth is at much lower and sustainable rates, modern inputs will have to carry the load; this implies that costly investment lies ahead. The role of modern inputs will be even more
important because of Beijing's neglect of agricultural investment during the reform period. This is not to say that reform has not been costly to Beijing. In fact, when prices of meats and many other subsidiary foods were freed in the spring of 1985, cash grants were simultaneously given to urban households to help offset the large price increases (in some cases prices rose as high as 50 percent). Not only do basic urban foods remain highly subsidized, but transport, medical care, pensions, and energy continue to be subsidized in the cities. Grain subsidies, which reached 12.2 billion yuan in 1981, were no doubt higher in 1984–1985 because procurement levels were higher and more output was purchased at higher "negotiated" prices (Far Eastern Economic Review 1986, 133). The 1981 grain subsidies amounted to 11 percent of total state revenues in that year, while total subsidies on food, energy, transport; and housing are estimated to have reached a staggering 25 percent of total government spending. According to Lardy's estimates, urban subsidies rose so much under Deng's reform that by 1982 their imputed value per urban worker actually exceeded the average wage (Johnson 1988). Within the urban sector, subsidies do not go to those engaged in private activities. In more explicit forms, workers in state enterprises received 300 yuan per capita in 1982 for annual subsidies while subsidies to peasants were 10 yuan.

It is one of the ironies that in an economic system that claims to be egalitarian, numerous and large subsidies have gone not to the least well-off but to the individuals that are best-off. The continued bias towards "urban-industries, large-scale state enterprises" of China's development plan is clear.

It may be said that China's preoccupation with the cities leaves little room in the state budget to look after the needs in the countryside where reform, unlike in the cities, has really paid off. When reforms were first announced, state investment in agriculture was supposed to rise from 11 percent to more than 18 percent of total state investment. Budgetary allocations to agriculture (including forestry, water conservation; and meteorological services), however, declined from a high of 16.8 billion yuan in 1979, to 11.3 billion in 1982, and to 9.4 billion in 1985 or 6 percent of total state investment.

Meanwhile, Deng's rural reforms have indeed gone far, though not without undesirable side effects. Chen Yun, the veteran planner under Mao, is the loudest and one of the more persistent critics. Clearly, there is a threshold beyond which the system becomes more capitalist than socialist, and among his numerous complaints, Chen strongly feels that
Deng's appeal to markets and the profit motive may have already gone too far. Chen argues that the party is rapidly losing its discipline, its image, and its own sense of purpose as well as its command over China's destiny; that the individuals who have been faithful to the party and those who have served the people through the long lean years are being cast aside like so many rags; that the key link, grain, is being neglected; that the Party is losing control over what Lenin called "the commanding heights"; and that the classless society is once again burdened with contending classes—the rich vs. the poor, the elite vs. the masses, privileged state enterprises vs. private cooperative enterprises, and the city vs. the countryside. One wonders how many political leaders still cling to Chen Yun's haunting metaphor that "it is better for several Chinese to share one pair of pants than for their country to be without the atom bomb."

In the cities, successful reform will require comprehensive political and legal reforms. To some extent, Deng laid the groundwork for basic political reform at the special party conference in September 1985, when sixty-four aging Central Committee members, including 10 members of the Politburo, resigned. But the reforms were hampered by corruption, influence-peddling by highly placed officials, and widespread profiteering. Scarce goods and materials became commodities sold under the counter for huge profits. Even some central departments were found to be involved in the spreading corruption; as someone so aptly put it, "Fish begins to stink at the head."

As graft and corruption become more institutionalized, the road to further urban reforms will not be easy, nor should it be if Chen has his way. Outraged by student demonstrations in December 1986 and January 1987 and seizing the banner of antibourgeois liberalism, Peng Zhen has picked up the battle cry to roll back political reforms and, with them, economic reforms as well. That urban reform does not have an urban counterpart to the family farm to fall back on makes the task inherently more difficult. State-owned factories cannot be cut up into numerous family enterprises without doing fundamental violence to socialism, and without destroying the enterprise entities. They are not divisible in the same way that production teams are divisible into family units.

In agriculture, reform has proceeded only to the extent that farmers have the right to either use the land or rent it to another family. As a result, there are once again large farming units under the name of "specialized" farms. While this allows for greater efficiency in the factor markets, it raises distributive and equity questions from which socialism,
in particular, cannot turn away. Meanwhile, there is apparently no substantive, systematic national land tax to siphon off the land rent that under socialism is best regarded as a return to all people and that gives the state the means with which to undertake needed investment in agriculture. There are scattered references to rents being specified in the team-household contracts, but these are evidently local provisions.

The investment needs are many. Whereas under the old days of collective farming there may have been quite a lot of hunger in the poorer regions—to a large extent the result of a policy of binding people to their villages—there is evidence that there has been substantial improvement in the general environment in which the rural people live. Declining infant mortality, longer life expectancy, and increased school attendance rates attest to an improvement in the various forms of "collective consumption" that are provided by the state through its collective arm. Ironically, Deng’s reform is undermining provision of these services. As Johnson noted, with the abolition of the communes there also went the principal source of financing for medical and hospital facilities, schools, centers for the caring of the old and young, maintenance of irrigation and flood control facilities, and the provision for processing and marketing facilities (Johnson 1988). The vacuum does not appear to have been filled by the township and other local entities (mainly loose cooperatives for small-scale rural industries). With migration to cities (sanctioned by household registration) still all but forbidden, the failure of the state to maintain the existing rural infrastructure (or to make provisions for local replacement of the old communes) and to improve the generally inadequate infrastructure system raises serious questions about agriculture’s ability to create more jobs for the (trapped) growing labor force.

In terms of infrastructure, Chinese roads are probably the weakest link. Road access is probably the single most important factor determining the development prospects of the individual villages and their ability to provide employment in the future. Yet, total highway road mileage measures only 750,000 km, or about one-tenth the total road mileage of the United States. Only one-fourth of the Chinese highways are classified as "first class" (probably meaning asphalted) or "near-first class."

The historical sections of the paper support the following arguments.

1. The value and goal imperatives of the Chinese Communist Party required adoption of a Soviet-style command economic system
in order to accommodate the implementation of the underlying economic development strategy.

2. The model may be said to "maximize selective growth under austerity," where selectivity is in favor of Lenin's "commanding heights," or the modern heavy industrial sector. Bergson's bread-and-steel metaphor is a useful reminder.

3. The degree of austerity to be imposed on the nation's households depends on the interaction of the initial, mainly agricultural, conditions with the requirements of the Mao development model.

4. The degree of difficulty implementing the reforms and the cumulative cost of the reformed system depends on that interaction and the duration of the planning period under the strategy.

5. China's extraordinarily meager initial conditions, as compared with the Soviet Union's, have given rise to (a) more severe and conflicting requirements for agriculture; (b) a more immediate and intractable clash between the household and the planner in time preference; (c) virtually stationary incomes, at basically the subsistence level, for the farm household for prolonged periods; (d) low and, almost certainly, declining total factor productivity in agriculture; (e) even worse performance in net output or value added by agriculture, a term of reference pertinent to intersectoral resource flows between agriculture and priority industry; (f) even less reliance on prices and markets and a greater dependence on administrative controls and allocation than in the Soviet Union; (g) more balanced growth, at the expense of the priority "commanding heights"; and (h) substitution of radical coercive campaigns for material incentive and greater stress on egalitarianism, making the system vulnerable to policy cycles.

It appeared that toward the end of the Maoist era, the sources of agricultural growth that had been tapped in China were nearly exhausted. The mounting costs and rising scarcities made inevitable the reforms that came later under the post-Mao leadership. Reforms were introduced first in agriculture by attacking the two pillars of socialist agriculture under the command system—collectivization and the price scissors. Unlike in industry, farming can be returned to the household by turning collective
land to private use, subject to contractual quota deliveries to the state at newly reformed prices that relaxed the price scissors against agriculture. The household responsibility system removed the gap between performance and reward, while price (and quota) reform restored economic incentive. The resulting output and productivity growth in 1979–1984 was electrifying. Removal of collective restraint, together with market opening, allowed farm households to engage in individual and cooperative rural industries. The resulting explosive growth of village (and by extension, township) industries is perhaps the most notable achievement arising from Deng’s reform agenda. The reforms answered a long-suppressed demand of rural households for the output of these rudimentary industries. By addressing the consumption bundle through these diversely composed small-scale rural industries and within the context of local markets, the development comes close to lending full substance to Say's law of markets which says that supply creates its own demand. These rural industries have been growing at some 30 percent a year, employing in 1988 some 90 million workers and contributing US$130 billion gross output (Asian Wall Street Journal 1989).

But the “commanding heights,” or the centrally-controlled heavy industrial sector remains unyielding against all the reformist currents which have since 1985 been extended to the urban-industrial sector. The state's control of the modern heavy industries represents the irreducible minimum of the value and goal imperatives of the CCP leadership; is the basis for Deng’s repeated proclamation that the Communist Party and socialism must remain supreme though all else may be expendable under reform; explains why urban-industrial reform cannot be as comprehensive as agricultural reform centering on the return to family farming; is responsible for the multilayered pricing system, which is a major reason for the corrupt practices in pursuit of rent-seeking; and requires the support of low and stable wages which in turn make it necessary for the state to grant enormous subsidies on all the urban necessities including food, housing, and transport. As a result, budget deficits mounted even as commitments to agriculture were increasingly neglected. Failure to revise state purchase prices upward in step with the rising costs (which occurred as a result of increasing input prices and labor's opportunity cost) has eroded producer incentives, and has resulted in declining output of critical grains since the record levels of 1984. Deng’s long-promised increase in state investment in agriculture has been contradicted, i.e., declines in state-budgeted investment occurred both in absolute terms and relative to total state investment. At the same time, irrigation, other infrastructure, and rural
services that had been looked after by the communes and lower collective bodies have been neglected.

In Soviet-type economies, consumer sovereignty is sacrificed in the name of the "commanding heights," and steel, not bread, is the final good. This doctrinaire allegiance to the "commanding heights" is central to an understanding of the Chinese dilemma. It explains why Deng's reforms have been partial and cannot be complete unless he is willing to dismantle the very foundation on which his two "irreducibles"—supremacy of the Party and socialism—rest. Under partial reforms, prices are not rationalized but are in fact full of distortions, markets cannot impose discipline, and the resulting decentralization of responsibilities and decision leads to chaos that now threatens China's reform. The list of afflictions is long—double-digit inflation, crippling bottlenecks in key areas such as power and transport, widespread shortages of basic consumer goods, widespread and rising corruption, social tension fed by a rapidly worsening income distribution, "localization" phenomena, reemergence of agricultural problems, and, most important, an erosion of central control over the "commanding heights."

It is not clear if anyone understands what is meant by what Beijing's reformers call a "planned socialist commodity economy," supposedly the end result of their strategy. A reasonable guess is that it is a market economy built around a centrally planned core that is best identified with the "commanding heights." However, students of comparative systems know that for a socialist market economy, it is not sufficient to have a set of rational scarcity prices in place; there remains the issue of incentives. Because cost minimization or output maximization entails much effort and detailed managerial attention, efficient managers must be willing to work hard. Where reward bears little or no relationship to performance—a problem compounded by the near impossibility of measuring performance under socialism where certain components such as rents and quasirents may be missing—lack of incentive to respond rationally to prices becomes an intractable issue. The central authority cannot decree state enterprise managers to behave as price-taking profit maximizers, and Leibenstein's "X-inefficiency" would loom large. More important still, innovations, the Schumpeterian engine of growth, would suffer.

It is, thus, difficult to avoid Milton Friedman's policy advice to Beijing's leaders to privatize China's state enterprises, i.e., to dismantle the "commanding heights." Only by doing so will China be able to reform its economy totally and to push on with the other two complementary
reforms, the political and legal reforms. Without a clear separation of party from administration and without a "rule-of-law" context for government and party, economic reform cannot go far.

In an economy where markets are allowed full scope, there is no such thing as chaos. In fact, the market is a harsh disciplinarian; it tolerates no nonsense, and it does so in an impersonal way. Personal connections lose their importance, rent-seeking opportunities disappear, and depersonalization means economic democracy where full membership is open to anyone through hard work, investment, and entrepreneurship. With economic democracy, political democracy is not likely to be far behind, since political and administrative authoritarianism, in a systemic sense as opposed to personal power aggrandizement, has no raison d'être in a system where consumers are sovereign.

To say that this is a daunting task for the reformers to contemplate is an understatement for it requires the stripping away of power and privileges from those who now enjoy and benefit from them. Many, if not most, will oppose the reform movement to protect their vested interests while others will do so out of ideological convictions. Moreover, the power-holders for the most part are the very ones who will be called upon to carry out the work of the reformers. The history of the East bloc is full of ill-fated economic reforms. It is as if Marxist predeterminism had laid down an iron law of irreversible economic systemic evolution. While the PRC has a strong incentive to continue successfully down the reformist road in order to narrow the economic and systemic differences between the mainland, on the one hand, and Hong Kong and Taiwan, on the other, a sober assessment would suggest that the future of Chinese reform is clouded with uncertainty.

MAKING THE "PLANNED SOCIALIST COMMODITY ECONOMY" WORK

If the reform is to allow the markets to impose discipline and to provide incentives for performance and initiative, there is no escaping Friedman's advice to privatize the state enterprises. However, given Beijing's twin "irreducibles" of the supremacy of the Communist Party and socialism, reforms in China will be limited by the confines of its "planned Socialist commodity economy" or PSCE. To flesh out the slogan with an operational interpretation, the scheme amounts to building a market economy around a centralized planned "core." The 1984 urban enterprise reform, which extended the responsibility system to the urban state enterprise sector, resorted to a contract system as a further parallel to the
rural reform. However, I believe that the PSCE is best implemented not by an enterprise contract system, but by retaining the centralized "material balance" command approach for the core production plan while allowing state enterprises to produce for the commodity economy and according to market resources in the open market. To see the force of the argument, one need only to reflect on what would have happened to prices and what "chaos" in Chen Yun's terms would have ensued if the U.S. War Production Board had proceeded with total mobilization using a contract system during World War II under which the contractors had to bid for the required inputs in the open market, instead of being supplied with the wherewithals by direct administrative allocation by the War Production Board under fixed prices. In addition, not to be overlooked is the distinction in effectiveness and equity between prohibiting civilian new car production by decree, for instance, and rationing out its production by prices.

Price reform looms as another intractable issue. A major reason for the rising state budget deficit has been the widening gap between prices paid to producers and prices received from consumers for basic commodities. Consumer price reform is not feasible without compensatory wage reform (coupled with income transfers where desired) if subsistence security is to be protected. Reform in this critical area will take several years at a minimum. Meanwhile, an interim approach would be to limit incentive producer price increases to "new" output. Beijing does not always remember that what matters in economics is the marginal concept. The 1979 agricultural price reform applied not only to new output, i.e., output above the quota level, but also applied to the old quota output as well. The resulting budget burden could have been negated by a compensatory lump sum tax (which was not applied). It should be clear that it would have been "cleaner" to apply the price increase to the new output only without losing the intended incentive effect. The 1979 price reform was a policy error avoidable for future reform.

Possible Roles for UNDP

Given China's sensitivity in bilateral relations in matters seen as impinging on its sovereignty or verging on outside interference in its internal affairs, the UNDP may have a special role to play in assisting in China's development. There are three areas worthy of consideration. As a disclaimer, I claim no special knowledge about the issues involves; rather these ideas are presented here for possible discussion.
1. In a country of China's size it makes sense to decentralize administrative responsibilities to the provincial and local levels. However, in many cases the arrangement had greatly aggravated the local-emperor phenomenon (tuhuangti), and there has been local abuse of power and neglect of local infrastructure. Rule of law and local frame of accountability are ways in which the problem can be handled. To do this will require legal and political reforms, the latter requiring (within the constraint recognized earlier) one-party, multicandidate local elections to give articulation to the concept of local accountability.

2. It is commonplace to say that a self-serving, ossified, obstructionist bureaucracy can lay waste to the best conceived plan. Taiwan's former Joint (Sino-U.S.) Commission for Rural Reconstruction may serve as a model in addressing the critical problem of forming a purposeful and efficient action agency capable of rising above the usual bureaucratic constraints. A joint commission with a UN development agency may provide a formula for an umbrella superagency for Chinese development that is acceptable to Beijing. Such a superagency would command a supersalary structure to secure a trained professional staff, lines of authority cutting across ministerial divisions, direct access and reporting to the top, and priority command over resources.

3. If one draws a line roughly along the Kunming-Chengdu-Lanzhou axis, dissecting the vast country into two more-or-less equal parts, the eastern half would contain some 90 percent of the population consisting of almost all Han Chinese (complemented by the Mongols, the best integrated ethnic minority in China), while the western half takes up the rest of the population with a decided majority consisting of ethnic minorities. Because of this acute spatial problem of distribution, it is difficult to conceive of balanced spatial development for all of China. However, priority development of special economic zones and the larger coastal regions has given rise to severe spatial disequilibrium, with vast hinterland regions almost completely bypassed by development and with pockets of severe and continued poverty. To help rationalize a scheme that supports spatial differentiation without politically destabilizing disequilibrium—a problem exacerbated by recent developments in Soviet Central Asia and in Outer Mongolia—it may be useful to think
of the coastal regions as being built up to attract private foreign investment (including the dominant investment from Taiwan and Hong Kong) which will then sustain their development, while hinterland development with its huge infrastructural requirements may be seen as a natural domain for bilateral and multilateral ODA programs. Here, UNDP may have a niche as the lead or coordinating agency. Spatial labor mobility—an important variable in any spatial equation, and which was hitherto hampered in China by official household registration requirements—may best be promoted within a UNDP-related development planning context.

4. UNDP is in a good position to undertake, commission, or sponsor studies in relatively sensitive areas such as poverty, income distribution, health and demography, and pollution and environment. Ignorance of the causes and magnitude of the problems in these sensitive areas have made development planning thus far less than thoughtful.
Notes

1. The strikingly high crop yields attained in China on the eve of the "modern economic growth" era (in Simon Kuznets' terms) were derived from the effective exploitation by China's efficient family farms.

2. The Chinese population, starting from a higher density base, more than quadrupled in the same time span that the European population barely doubled.

3. In production function terminology, the aggregate input index is also a theoretical index of output in the absence of any "technical change" and under certain assumptions about the markets and technical properties of the function.

4. VABA is gross of depreciation charges on farm machinery and transport, equipment, and service buildings. Thus, in net terms, the pace of increase in sector contribution to the Chinese national product would be slower still.

5. In one of my earlier studies, the value of output and inputs were recalculated in current prices for 1957 and 1979 (price adjustment reflected) to see how the resulting value added or net income per worker would compare against the constant price calculations discussed earlier. Net of the agricultural tax (which, when expressed as a proportion, changed from 10 percent of gross output for 1957 to 5 percent for 1979, and was in itself a supplementary adjustment reinforcing relative price reform) and with the 1979 value deflated by a rural retail price index, we ended up with a per worker net real income of 233 yuan for 1957 and 273 yuan for 1979, an increase of 40 yuan or 17 percent over a span of 22 years (0.75 percent per year). This is to be compared against Perkins' calculation from official statistics of an increase of 10 percent between 1952–1978 in 1978 constant prices.

There are two points worth noting. First, net income as calculated is not net of depreciation of purchased machinery and equipment. Second, it is problematical whether home consumption should be revalued at the revised 1979 state procurement prices, as was done here, or be left in 1952 prices. Since it is doubtful that the rural retail price index employed as a deflator reflected the higher procurement
prices, our 1979 estimated real net income probably erred on the high side.

6. One final point here is that of the two basic methods of calculating value added net of inflation used here, each has its appropriate use and interpretation. The first method uses constant 1952 prices on both inputs and outputs and implies constant barter terms of trade between agriculture and industry. It is useful for inferring intersectoral real resource flows (not adjusted for productivity changes). The second method uses current input and output prices and deflates the value added difference by a price index on farmers' purchases. The changing terms of trade reflect policy change and relative productivity-scarcity changes between the sectors. These calculations measure agriculture's welfare and income status.
References


INTRODUCTION

During the 1980s, the governments of Cambodia, the Lao People’s Democratic Republic (hereafter referred to as Laos), and the Socialist Republic of Viet Nam (hereafter referred to as Viet Nam) have embarked on radical programs aimed at transforming their centrally planned socialist economies into market-oriented systems. The most radical policy changes have been implemented since 1987 and are aimed at achieving a more decentralized system of economic management, market-determined pricing, and an outward-looking trade regime. These changes have greatly enhanced the economic environment for the successful implementation of both public and private sector investment, and have considerably improved the scope for regional economic cooperation. These developments provide the potential for a marked acceleration in the rate of economic development in these countries during the 1990s through improved allocation of domestic resources as well as greater gains from international cooperation including trade and foreign investment.

Despite recent improvements in the economic environment, major challenges remain if the economic development potential of these countries is to be realized. The substantial adjustment costs associated with recent reforms are reflected in inflation, increased unemployment, increased budget and external deficits, and acute foreign exchange shortages. Poorly developed infrastructure and limited market-oriented management skills continue to be the major constraints to the successful implementation of public and private sector investments. Government agencies have had little experience in planning, evaluating, and implementing development projects which have economic efficiency as a major criterion. External assistance, both financial and technical, could play a very important role in mitigating these adjustment costs and in realizing the beneficial effects of the ongoing policy reforms in Indochina. It should be emphasized, however, that effective coordination and cooperation among development agencies will be especially important in the provision of development assistance to these countries. The appropriate quantum of external aid will need to be carefully evaluated and will need to take account of the absorptive capacity and external debt situation of these countries.
Coordination of aid agencies is also crucial in ensuring the appropriateness and mutual consistency of recommended policy reforms as well as their timing and sequencing.

The objective of this paper is to briefly describe the major features and impacts of the recent reforms, to assess the implications of these reforms for the activities of development agencies in the region, and to analyze the actual and potential impacts of the reforms for regional development. In the following section, a brief review of the major recent reforms and the major constraints encountered in the reform process, and a preliminary assessment of the impact of these reforms are given. The paper then reviews the scope for and the major constraints to the effective provision of development assistance in Indochina. In the final section, the paper concludes with an assessment of the implications these reforms have for regional development, including potential implications for trade and investment flows.

RECENT ECONOMIC AND POLICY DEVELOPMENTS

The Socialist Republic of Viet Nam

Viet Nam is endowed with limited but fertile agricultural land, rich natural resources including oil and coal, substantial hydroelectricity potential, extensive forest areas, and considerable fishery resources. Its population is better educated and has a higher life expectancy than the populations of most countries that have a similar per capita income. However, Viet Nam's economic performance has not matched its potential and the country has one of the lowest per capita incomes in the world. Recently, the Viet Nam government has recognized that centralized decision making has been a major constraint to economic development, and has moved towards a more decentralized system of economic management.

Initial moves towards decentralization of economic decision making began after the Sixth Plenum of the Party Central Committee in August 1979. Reforms implemented during 1979 and the early 1980s were largely in response to an increase in unplanned (or unofficial) commercial activities in both agriculture and industry. Policy reforms were characterized by attempts to accommodate these practices, which had been initiated at the local level, within the framework of a centrally planned economy. Under the policy concessions made during this period, the legality of unplanned activities was not clearly established and there were periodic clampdowns
on the unofficial market. In contrast, policy reforms implemented since the Sixth Party Congress (December 1986) have been mostly "top down" initiatives aimed at the decentralization of economic decision making.

The limited economic liberalization during the early 1980s led to an initial improvement in economic performance, but the economy was faltering by the end of the Third Five Year Plan (1981–1985). In per capita terms, real growth fell from almost 6 percent per annum in 1981–1984 to 3.5 percent in 1985 and a meager 1.3 percent in 1986. Poorly conceived reforms introduced during 1985 worsened the situation by increasing budget and external deficits, and the rate of inflation soared to almost 500 percent in 1986. The failure of the Viet Nam government to achieve macroeconomic stability led to considerable disenchantment with the centrally planned economic system and to pressures for the radical reorientation of economic policies following the Sixth Party Congress.

During the Sixth Party Congress, agreement was reached on the need to have strong economic growth and macroeconomic stability as important objectives of development planning, and on a program of policy reforms required to achieve these objectives. Guidelines agreed upon included the need to abolish centralized management, subsidies, and price control in favor of production systems that are more closely linked to the market. Recognition was given to the need for enterprises to earn profits, to have incentives related to profits, and to generally develop a more market-oriented economy as a means to increase economic efficiency and income levels.

As a result of the accelerated pace of implementation of reforms during 1988 and 1989, the system of economic management has changed drastically; there is now substantial decentralization of economic decision making and a shift towards a more market-oriented pricing system. Following successive devaluations in the official exchange rate during 1988, a single market-determined exchange rate was established in early 1989. At the same time, interest rates were increased to provide positive real returns. By early 1989 the prices of most goods and services had been unified at the market rate. However, controls remain on the prices of transport, petroleum products, electricity, and other public utilities.

In addition to price reforms, there have been major reforms in the structure of production. In the agricultural sector, production targets and compulsory membership of cooperatives have been abolished; farmers are now given medium- to long-term leases on agricultural land; and farmers
can now sell surplus production on the open market. Financial and managerial autonomy for state enterprises has been phased in since November 1987, and state intervention in production, financial, marketing, and personnel management decisions has been abolished in most enterprises. In early 1988, private sector enterprises were guaranteed rights to property, inheritance, and income. Family and private enterprises are now allowed to engage in almost all kinds of economic activity, including commercial and other activities that were previously monopolized by the state sector.

Other institutional reforms to be introduced include the ongoing restructuring of the banking system, including the separation of commercial banking responsibilities from the State Bank in 1988. New foreign exchange regulations have been introduced to provide greater incentives to use the formal banking system for foreign exchange transactions and deposits. A liberal foreign investment law was introduced in late 1987 to attract foreign investment. Restrictions on external trade have been progressively reduced.

These reforms have been implemented at the same time that the Viet Nam government has adopted restrictive monetary and fiscal policies in order to reduce inflation. The adjustment costs have been substantial and major macroeconomic imbalances, including large budget and external deficits, remain. Difficulties in adjusting to "self-financing" requirements and increased import competition have resulted in state enterprises reducing their work force, thus aggravating unemployment problems. The trade-off between price stability and inflation remains a major issue. State enterprise autonomy, price and trade liberalization, and agricultural and industrial sector reforms have had a negative effect on government revenue and contributed to an increase in the budget deficit. Opportunities for reductions in expenditure are limited given the minimal investment expenditure in recent years and urgent investment requirements. Substantive improvements in revenue will only be achieved in the longer term. The government's policy alternatives in mitigating the inflationary impact of deficit financing continues to be limited by low domestic savings, a weak export base, and difficulties in mobilizing foreign savings.

Despite these constraints there are strong indications of the positive impact of recent reforms. Inflation has been greatly reduced, the exchange rate has stabilized, and the level of deposits in the formal banking system has increased markedly. Price and other reforms have reduced the domestic terms of trade bias against the agriculture sector, providing
incentives for strong increases in agriculture production and reductions in postharvest losses that allowed Viet Nam to export 1.4 million tons of rice in 1989. Total exports grew by 30 percent in 1989, compared with growth in imports of 9 percent. The reduction in restrictions on internal trade has improved the domestic supply situation. Total economic output increased by about 5.8 percent in 1988 and 3.2 percent in 1989. The relatively modest performance in 1989 was largely due to the poor performance of many state enterprises, which experienced difficulties in adjusting to the "self-financing" system and to increased competition from imports and the private sector.

Many of the most difficult decisions concerning economic restructuring have already been taken. Further reforms are required in international trade, long-distance domestic transport, increased allocations of investment resources to agriculture and light industry, and cost recovery in the provision of public utilities. Viet Nam has a considerable amount of underutilized resources and, provided that the shift towards a more market-oriented economy can be sustained and foreign exchange constraints can be reduced, the potential for substantial economic growth appears promising. However, in order to facilitate economic development a number of constraints need to be tackled as a matter of priority. These constraints include (1) the lack of foreign and domestic financial resources for investment, (2) poorly developed and maintained infrastructure, (3) poorly developed systems for mobilization and allocation of domestic resources, (4) a narrow taxation base, and (5) the structural adjustment costs, including macroeconomic instability, that are associated with the reform process. There is considerable scope for external development agencies to assist in alleviating these constraints, but coordination of efforts will be essential given the limited experience on the part of the local bureaucracy in dealing with donor agencies/countries from the nonsocialist bloc.

The uniqueness of Viet Nam's economic reform lies in the fact that it has been implemented with very limited assistance from major non-COMECON donors. It is highly commendable in this light that the country has succeeded in containing hyperinflation and maintaining a moderate growth rate during the course of major policy changes. However, further reforms (e.g., financial, fiscal and trade reforms) will involve substantial institutional building, major organizational changes, and the development of more human resources, which would require a longer gestation period than previous reforms in agriculture and industry.
There has also been a major restructuring of the system of economic management in Laos. The decision to restructure the system of economic management was made following the Fourth Party Congress in November 1986 (one month before similar decisions were made in Viet Nam). Implementation of the program of reforms, known collectively as the New Economic Mechanism (NEM), began in 1987. A catalog of major policy developments since the removal of state control over the price of most goods and services (other than public utilities and minerals) include the abolition of fertilizer and other subsidies, the liberalization of private sector economic activity including foreign investment, the decentralization of economic planning, increased financial and management autonomy for state enterprises, the abolition of centrally determined production targets, reforms in the taxation system, restructuring of the monetary and banking system, increases in interest rates and the use of economic efficiency criteria in the allocation of credit, the adoption of a market-related exchange rate, and the liberalization of domestic and external trade.

The impact of the reforms in Laos has not been as widespread as was the case in Viet Nam, primarily because the majority of the population live in isolated rural areas and depend largely on subsistence agricultural production, predominantly glutinous rice, for their livelihood. In contrast to Viet Nam, the impact of formal collectivization was minimal in Laos as most farmers continued to produce crops under traditional systems with usufructuary rights to land. Thus even prior to the reforms, most agricultural output was produced by individual farm families. The impact of recent reforms have been more pronounced in Vientiane and other regional centers.

Indeed, the policy reforms have contributed to an increase in macroeconomic instability, with a sharp increase in the government deficit and an acceleration in the rate of inflation. The adjustment costs were aggravated by exceptionally poor climatic conditions which contributed to marked reductions in agriculture and hydroelectric output. In particular, poor supply conditions aggravated inflationary pressures resulting from the abolition of most controls on prices. Agriculture has been the dominant contributor to GDP (about 62 percent), while electricity was the major source of export earnings until the recent decline. These problems aggravated the pressures faced by the Lao government in implementing the reforms, which makes it even more remarkable that the reform process has continued with no major reversals.
During the last year, economic prospects in Laos have improved considerably. Improved prices and access to markets, combined with a recovery from two years of drought conditions, contributed to a marked increase in agriculture production. Growth in agricultural output in 1989 is provisionally estimated at 14 to 15 percent. Improved supply conditions have also contributed to a reduction in inflation during the latter part of 1989 and the first quarter of 1990. While subsistence agriculture remains a major feature of the economy in many rural areas, the level of monetization in the economy has increased markedly in recent years. A visible indicator of the impact of the recent reforms is the marked increase in the number of small private commercial enterprises operating in Vientiane and the major regional centers of Savannakhet, Champassack, and Luang Prabang. Local enterprises are now supplying vehicles, machinery and equipment, computer equipment, and spare parts which previously had to be imported from Thailand. Other enterprises are providing agricultural, engineering, trade, and financial consulting services.

While recent reforms have improved the prospects for increased returns from investments in economic development, some important potential constraints need to be addressed. The Lao government is almost entirely dependent on foreign aid for development expenditure, since domestic revenue barely covers current expenditure. Laos also faces a major trade deficit, with the total value of exports accounting for only about one-third of imports. The financing gap has been met mostly through bilateral clearing arrangements and long-term loans, and has resulted in a rapid increase in the country’s debt. It is important that the remaining constraints to developing a more diversified export base be removed, and that the government continues to encourage increased mobilization and more efficient utilization of resources so as to avoid a situation of unmanageable external debt.

Cambodia

Less information is available on the reform process in Cambodia. The circumstances in this country are considerably different from Viet Nam and Laos because of the extreme policies of the previous rulers, the Khmer Rouge. Since the Heng Semrin administration gained power over most of the country in 1979, there has been a gradual move towards economic liberalization in Cambodia. The role of the market and the importance of trade were explicitly recognized by the new administration. For example, attempts were made to eliminate obstructions to internal movements of goods and a domestic currency was reintroduced in 1980. Recognition
of the rights to private property and to inherit rights to land, but not to trade in land, were included in Cambodia's new constitution which was approved by the National Assembly in June 1981. The legitimate role of the private sector in economic activities was recognized in the Five-Year Program (1986–1990) which was adopted by the Fifth Party Congress in 1985. More recent reforms have included the restoration of private land ownership, the promotion of foreign investment, requirements that state enterprises be self-financing, and private investment in state enterprises.

It is especially difficult to make a reliable assessment of the impact of the economic reforms because of the paucity of data, the massive disruptions prior to the reforms, and the continuing internal conflicts. However, official data indicate that there have been strong and fairly consistent increases in agricultural production since 1981. The marked increases in private commercial activity and improved availability of consumer goods that followed the economic reforms in Viet Nam and Laos has also been reported in Cambodia.

The challenges facing the major donors and development agencies, when they resume assistance to Cambodia, will be enormous. Assistance requirements will be extensive, but institutional capacity will be very limited. The clear definition of priorities by the Cambodian government and individual development agencies will be especially critical in Cambodia.

COOPERATION IN DEVELOPMENT ASSISTANCE

The need for cooperation among donors and development agencies in coordinating development activities has become something of a cliche but, while everyone agrees with the principle, the lack of effective coordination has oftentimes been quite conspicuous. Special efforts to coordinate and achieve more effective integration of donor assistance is especially critical in the Indochina region because of the enormous investment requirements, and the limited absorptive capacity and institutional experience in preparing, evaluating, and implementing development projects which have economic efficiency as a major criterion. This is not to say that the donor community should establish a cartel to limit the scope for governments to choose between alternatives offered by different agencies. However, it is important to ensure that competition to provide assistance does not contribute to the wasteful use of resources to the detriment of economic development in the region. This should be achieved by concerned donors focusing their respective strategies for development assistance on areas in which they have a demonstrated
comparative advantage. In this regard, it may well be argued that attempts by single agencies to provide assistance across all areas of development assistance can only be to the detriment of the recipient governments. Furthermore, close coordination among donor agencies is necessitated by the fact that the Indochina countries are in the process of radical economic restructuring. Appropriate timing and sequencing of policy changes is critical for the success of the ongoing liberalization efforts. Aid agencies will have to ensure the appropriateness and consistency of their recommendations for additional reforms, as well as on the timing and sequencing of such reforms.

The limited recent experience in the region has provided examples of the potential benefits from cooperation. In Laos, there has been excellent cooperation between the Asian Development Bank (ADB) and the World Bank in policy-based lending, as well as with the International Monetary Fund (IMF) in the ongoing restructuring of the monetary and banking system. The efforts of the United Nations Development Programme (UNDP) in facilitating the coordination of development activities in Laos have been greatly appreciated by the ADB and other development agencies. The UNDP has also played an important role in coordinating the activities of development agencies in undertaking economic and sector studies in Viet Nam, and this has contributed to a most useful sharing of information amongst the agencies concerned. It is important that this cooperation in Viet Nam continues as the donor community continues to develop, and hopefully begins to implement, strategies for the provision of development assistance. Such cooperation is, and will continue to be, essential in avoiding wasteful duplication of effort. In Cambodia, it is imperative that the donor community consult closely with the major umbrella groups for the nongovernment organizations (NGOs), who have provided most of the non-COMECON assistance in recent years, as well as the UN agencies providing humanitarian assistance. The importance of the services rendered by the UNDP is undoubtedly even greater in Cambodia where the UNDP is de facto the sole representative of the entire aid community.

The question then is how to avoid duplication of effort? There are no easy answers; personal rapport between the individuals concerned is very often an important factor. However, there are some concrete steps that can be taken to facilitate improved coordination. Regular formal donor coordination meetings are important, as are formal and informal contacts concerning interlinked development activities and sharing of documentation. Development agencies can also encourage governments to establish
a central agency to be responsible for overall coordination of development assistance; this is an issue which may be particularly germane with respect to the Indochina countries. In addition, as demonstrated in a number of projects in Laos, formal cooperation in projects which can best be implemented with the combined specialist expertise of different agencies provide additional long-term benefits in improving informal links between agencies.

REGIONAL COOPERATION IN ECONOMIC DEVELOPMENT

Differences in the relative endowment of resources in Laos, Cambodia, and Viet Nam provide ideal opportunities for economic cooperation through trade and investment. Viet Nam faces much greater land pressures than both Cambodia and Laos, but has a relatively better developed industrial base and pool of skilled labor. As a consequence, there is potential for further development of economic cooperation between these countries. In addition to the division of labor based on relative comparative advantage, there may be a number of other sources for enhanced economic cooperation among the countries in Indochina. Also, because Laos is landlocked, it is especially important for the country to develop closer links with its neighboring countries. The fact that the further development of the Mekong Delta as a major irrigation system would be more efficiently undertaken with collaboration of the other riparian countries is a further example of the need for cooperation. The scope for economic cooperation with other countries in the region is potentially even more important. The rapid growth and consequent increases in wage costs in the newly industrialized economies (NIES), Thailand, Malaysia, and Indonesia, provide opportunities for labor-intensive industries to relocate to Viet Nam, Cambodia, and Laos where labor remains relatively inexpensive.

Recent reforms have reflected an export-oriented focus which will be important in servicing the relatively large external debts owed by these countries. The commitment of the governments of Laos, Cambodia, and Viet Nam to a trade-oriented development strategy is likely to result in marked changes in the pattern of regional trade flows over the next decade. There are already indications that recent trade liberalization has contributed to strong growth in textile, garment, handicraft, marine products, and even rice exports from Viet Nam, and exports of livestock and forest products from Laos. Cambodia continues to export rubber, timber, and other agricultural products but has yet to resume rice exports. A marked increase in the contribution of these countries to regional trade
in labor-intensive manufactured goods can be expected as the other countries in the region move into the production of more capital-intensive and higher-technology goods.

Exports of timber, wood products, gemstones, and other resource-based products have also registered strong growth; but there are also growing concerns about possible exploitation from foreign investors and how to best manage resources that are not, or not easily, renewable. Increased competition from imports has exacerbated difficulties faced by state enterprises in adjusting to self-financing requirements, with adverse consequences for employment, and this has led to discussion about the most appropriate phasing of trade liberalization. There is a danger that the increasing adjustment costs, concerns about foreign exploitation, and delayed realization of the benefits from reform could lead to a sociopolitical backlash against economic reform. It is not sufficient for the government to simply state that market liberalization will be a panacea for all economic problems. There is scope for an increased role for external agencies to assist in evaluating alternative policies to address market failures and to ameliorate the adjustment costs associated with economic liberalization. Financial assistance could also play an important role in mitigating the adjustment costs and enhancing benefits arising from economic liberalization, and thereby reduce the likelihood of pressures for a return to increased state intervention.

There will also be considerable scope for neighboring countries to benefit from increased cooperation with the Indochina countries. Many of the technologies adapted by the NIEs and the Southeast Asian nations could be successfully applied in the Indochina countries. Similarly, there is scope for a transfer of service industry skills. It is anticipated that neighboring countries have the potential to play an important role in, and benefit from, the economic development of Indochina through increased exports of capital and consumer goods and services. The activities of development agencies should be aimed at facilitating increased economic cooperation for the mutual benefit of the parties concerned.
Participants of the Symposium on Cooperation in Asia and the Pacific

Dr. Florian Alburo
University of the Philippines

Professor Le Quy An
State Committee for Science & Technology, Vietnam

Professor Cheng Bifan
Chinese Academy of Social Sciences

Mr. Stephen Browne
United Nations Development Programme

Dr. Larry Hamilton
East-West Center

Professor Ryokichi Hirono
Seikei University

Mr. Arthur Holcombe
United Nations Development Programme

Dr. Pearl Imada
East-West Center

Dr. Bruce Koppel
East-West Center

Dr. Keun Lee
East-West Center

Ms. Caroll Long
United Nations Development Programme

Mr. Turhan Mangun
United Nations Development Programme
Participants

Dr. Shelley M. Mark  
East-West Center

Dr. Robert McCleery  
East-West Center

Mr. Roy Morey  
United Nations Development Programme

Dr. Abulmaal A. Muhith  
UNDP Consultant

Dr. Seiji Naya  
East-West Center

Dr. Filologo Pante, Jr.  
Philippine Institute for Development Studies

Mr. Eul Yong Park  
Korea Development Institute

Dr. Michael Plummer  
East-West Center

Dr. Terry Rambo  
East-West Center

Mr. Nigel Ringrose  
United Nations Development Programme

Dr. Emil Salim  
Minister of State for Population and Environment

Mr. Victor Santiapillai  
UNDP Consultant

Mr. N.A. Sarma  
Indian Council for Research on International Economic Relations

Mr. Dato Ajit Singh  
Ministry of Foreign Affairs
Mr. Krishan Singh
United Nations Development Programme

Mr. Savenaca Siwatibau
UN ESCAP

Professor Augustine H.H. Tan
National University of Singapore

Mr. Ricardo Tan
Asian Development Bank

Professor Anthony Tang
The Chinese University of Hong Kong

Professor Jahara Yahaya
University of Malaya

Mr. Sebastian Zacharia
United Nations Development Programme