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RESEARCH PROGRAM ON ECONOMIC  
INTERDEPENDENCE IN SOUTHEAST ASIA

DEPARTMENT OF ECONOMICS  
SOCIAL SCIENCE BUILDING

May 20, 1967 PD-AAP-681

Mr. Dan B. Blake  
Office of Program Coordination  
Agency for International Development  
Department of State  
Washington, D.C. 20523

Dear Mr. Blake:

I am sending you a draft of the "User Summary" that you requested and abstracts of our first sixteen research papers. I have tried to follow the format of the sample summaries that you sent to Professor Morgan and in so doing have prepared a new list of our research products (the Appendix to the summary). However, I believe the changes and additions to our list dated November, 1966, are clear. If we can be of further assistance in supplying information, please let me know.

On the conference manuscript: we are still working on an introduction and the summary chapter. Last week was unexpectedly hectic, but we hope to send a draft off to you soon.

*only 15 rec'd*

Sincerely yours,

Nyle Spoelstra  
Assistant to the Director

**"Economic Interdependence in Southeast Asia"****USER SUMMARY**

1. Description: -- The purpose of this research project is to study systematically the nature and amount of benefits that might result from increased economic cooperation and coordination among various possible groupings of South, East and Southeast Asian countries. The general area with which the research is concerned is the developing ECAFE region, and more particularly a central group of countries, their selection justified by existing and prospective economic relationships. Japan, Australia and China are considered as they impinge on the region.

Major research areas are: (1) the theory and experience of economic growth with particular application to Southeast Asia; (2) the theory and experience of economic cooperation for economic growth; (3) the nature and extent of existing economic interdependence in Southeast Asia; (4) the probable impact of closer cooperation for individual countries on the production of individual commodities, on exports and imports, on governmental revenues, and on national economic plans; (5) the role of national and regional institutions and programs in promoting economic growth in Southeast Asia; (6) an assessment of non-economic factors affecting national and regional growth in Southeast Asia; and (7) alternative strategies on the part of Asian governments, the United States and other developed countries, and private organizations, which would accelerate economic growth in the region.

The research program is organized around a staff of economists working in the United States at the University of Wisconsin. Experts on economic development in Southeast Asia have filled short-term research appointments

at the University. In addition, the research program draws on consultants and lecturers specializing in other disciplines and regions that are related to the research program.

In January, 1967, a conference of leading Asian economists was held in Bangkok at which 11 papers relating to Asian economic development and economic cooperation were discussed. The papers and the proceedings of the conference will be published by the University of Wisconsin Press.

2. Findings to Date: -- The results of the research are contained in a series of published and unpublished research papers, working papers and miscellaneous manuscripts which are listed in the Appendix. Abstracts and complete versions of the various papers are available from AID/Washington.

These documents deal with various aspects of several working hypotheses:

(1) The case for economic integration to accelerate economic growth and improve economic welfare in less-developed countries is not self-evident, either in terms of economic theory or of actual experience. National mixed objectives and constraints with respect to economic growth, distribution of income effects, the position of national interest groups, and other factors besides, are bases for conflict over the division of the gains from economic cooperation. Indeed, there are at least as many cases of significant disintegration as of integration among the less-developed countries.

(2) There are many types of regional cooperation, ranging from informal, occasional meetings and exchanges of persons and ideas, to progressively more and more formal arrangements that require, at the limit, abdications of national sovereignty and commitments by nations to reallocate economic resources. There is an inverse relationship between the ease with which an economic cooperation venture can be established, and its probable short and moderate-run impact on economic change.

(3) The variety among Asian nations in historical background, economic structures, recent performances and probable future policies is considerable. These facts suggest that relatively simple and partial kinds of economic cooperation, and sectoral plans in which all cooperating nations clearly gain, are most likely to succeed. In spite of their public announcements, Asian governments are not likely to accept either the implications of an unqualified traditional trade liberalization scheme, or the "program for agreed specialization" or "harmonization of national development Plans" that has been outlined by ECAFE.

(4) Economic regionalism is one among various complementary and alternative development strategies. Because of inherent obstacles, significant steps toward economic cooperation could be furthered by substantial material and moral support from the developed countries. Therefore, economic regionalism should be assessed not only on its specific merits and applicability for Southeast Asia, but also on its merits relative to additional and alternative policies (such as trade preferences) which the developed countries might follow.

Publications:

P.T. Ellsworth, "Import Substitution in Pakistan--A Comment," Pakistan Development Review (Autumn, 1966). *RP # 9*

E.D. Hawkins, "Job Inflation in Indonesia," Asian Survey (May, 1966). *RP # 4*

A.C. Kelley and J.G. Williamson, "The Prospects for Regional Economic Cooperation and the Rate of Household Savings in the LDC's [Indonesia]," Economic Development and Cultural Change (forthcoming). *RP # 15*

T. Morgan, "Economic Planning--Points of Success and Failure," Philippine Economic Journal (Second Semester, 1965). *RP # 5*

T. Morgan, "Theory of Error in Centrally-Directed Economic Systems," Quarterly Journal of Economics (August, 1964). *RP # 2*

H. Myint, "The Inward and the Outward Looking Countries of Southeast Asia and the Economic Future of the Region," Japan's Future in Southeast Asia: Symposium Series 2, Center for Southeast Asian Studies, Kyoto University, 1966. *RP # 7*

S. Naya, "The Commodity Pattern and Performance of Southeast Asia's Exports to the Developed Areas," Economic Development and Cultural Change (forthcoming). *RP # 10*

S. Naya, "Natural Resources, Factor Mix, and Factor Reversal in International Trade [U.S., Japan, India, and Canada]," American Economic Review, Papers and Proceedings (May, 1967). *RP # 17*

K.C. Sen, "Economic Growth and the Price Level--An Analysis of Some Asian Data, 1950-1963," Philippine Economic Journal (forthcoming). *RP # 13*

T. Morgan and N. Spoelstra, eds., Economic Interdependence in Southeast Asia: Proceedings of the Bangkok Conference (University of Wisconsin Press, forthcoming).

Contents

Wu Ta-yeh, "Problems and Prospects of Economic Cooperation in Southeast Asia".

Hiroshi Kitamura and A.N. Bhagat, "Aspects of Regional Harmonization of National Development Plans".

Nurul Islam, "Tariff Protection, Comparative Costs and Industrialization".

I-Shuan Sun, "Trade Policies and Economic Development in Taiwan".

Suparb Yossundara and Yune Hunkratoon, "Some Salient Aspects of Thailand's Trade During 1955-1964".

K.R. Chou, "Hong Kong's Changing Pattern of Trade and Economic Interdependence in Southeast Asia."

Amado A. Castro, "Philippine Export Development, 1950-1965".

Lim Chong Yah, "West Malaysian External Trade, 1947-1965".

D.T. Lakdawala and R.H. Patil, "Prospects of India's Foreign Trade with ECAFE Countries".

H.N.S. Karunatilake, "Trade Agreements on Trade and Production in Ceylon".

D.V. Ramana and Ken'ichi Odawara, "Deficit Financing and Import Substitution India, 1951-1965".

J. Panglaykim and Ken Thomas, "Trade, Production and Inflation in Indonesia."

Discussants and Commentators: E.D. Hawkins, R.J. Lampman, D.S. Paauw, J.H. Power, G. Sicat, and A. Tang

### Unpublished Research Papers

P.F. Bell, "A Quantitative Study of Entrepreneurship and Socio-economic Determinants of Development in Asia" (February, 1967; RP #14)

P.F. Bell, "Small Industry: Socio-economic Aspects of Its Promotion in Asia" (March, 1967; RP #16.)

J.C. Leith, "The Specification of Nominal Tariff Rates in Effective Protection Estimates" (October, 1966; RP #12)

T. Morgan, "Investment versus Economic Growth" (August, 1966; RP #11)

T. Morgan, "Preferences Revisited" (May, 1967; RP #18)

H Myint, "Economic Theory and the Underdeveloped Countries" (March, 1965; RP #5)

H.O. Schmitt, "The Integration of Capital Markets in Europe: A Step Towards Political Unification" (January, 1966; RP #6)

K.C. Sen, "Convergence in Planned Economies" (June, 1965; RP #1)

K.C. Sen, "Nation-Building and Regional Integration" (May, 1966; RP #8)

### Working Papers

B. Abrahamsson, "Developing Nations and Ocean Transportation -- With Special Reference to Southeast Asia" (May, 1967)

R.E. Baldwin, "The Case Against the Infant Industry Argument" (October, 1966)

B. Higgins, "Trade versus Aid in the Reconstruction of the Development of Southeast Asia" (March, 1967)

H. Hinrichs, "A Regional Industrial Bank: A New Approach to Economic Integration in Southeast Asia" (May, 1967)

A.C. Kelley, "Regional Integration, Demographic Change and Patterns of Industrial Growth" (May, 1967)

A.C. Kelley and J.C. Knowles, "Regional Integration and National Economic Development: The Case of Southeast Asia" (April, 1967)

S. Naya, "The Accuracy of Southeast Asian Trade Statistics" (May, 1967)

K.C. Sen, "Foreign Exchange Constraint, Import Substitution and Regional Development" (May, 1967)

Miscellaneous Manuscripts

Staff Report

"Economic Interdependence in Southeast Asia" prepared for the SEADAG Meeting, Honolulu, March, 1967

Background Papers

D. Alwan, "Development Criteria in the IBRD Survey Mission Reports"

A. Bilkey, "A Brief Analysis of the Intraregional Trade of the Central American Common Market Countries"

J.C. Leith, "Tariff Structures and Protection"

S. Naya, "Some Comments on Trade Projections for Developing Asian Countries"

I.J. Singh, "The Role of Agriculture in Economic Development"

Essays

A.N. Bhagat, "A Regional Payments Union for South and Southeast Asia"

A.N. Bhagat, "Asian Development -- An Essay in Regional Institutionalization of Savings and Development"

D.J. Devoretz, "P.L. 480 and Southeast Asian Trade"

K.L. Huang, "Factors Discouraging Savings in Asia"

K.L. Huang, "Capital Flight in Southeast Asia"

K.L. Huang, "A Nucleus for Developing A Common Market in Southeast Asia."

Research Paper #1: K.C. Sen, "Convergence in Planned Economies"  
Abstract

It is the thesis of this paper that, regardless of the ideological commitments of the planners or the degree of plan comprehensiveness, certain basic tendencies to converge emerge in all forms of economic planning. Five such areas have been isolated and illustrations presented from the experience with widely different types of planning in a number of countries-- Yugoslavia, China, the U.S.S.R., Czechoslovakia, Mexico, France, Scandanavia, and the ECAFE countries. There is increasing recognition of the roles played in the process of economic growth by: (1) the price mechanism, interest rates, cost-profit relationships, and productivity, with a view toward improving allocative efficiency, minimizing waste, and rationalizing the cost structure; (2) material incentives, in order to foster work effort; (3) economic pluralism, to mobilize public participation and support; (4) functional banking, with a view toward catering to and increasing the financial viability of firms; and (5) flexibility in planning, in order to provide against administrative bottlenecks.

Hence: (1) If not the market rate of interest, then at least some kind of rate-of-return-equalization criterion must be applied by the planners, in order to avoid misallocation of resources. (2) "Enterprises" must be operated not merely on the basis of "output maximization." (3) "Average-cost-plus" policy does not necessarily lead to maximization of returns from investment, as the cost structure itself may not be optimal. (4) "Financial

responsibility " requires that "enterprises" be subjected to various forms of charges, like depreciation and amortization charges. (5) To arouse active enthusiasm among workers towards increased efficiency, aid must be sought from "differential wage" payments, non-economic incentives being insufficient. (6) It is necessary to have many centers of decision-making and implementation of policy (though within the over-all framework of plan strategy), and some sort of "economic pluralism" is essential in bringing the plan to the people. (7) Both the strategy and the implementation of planning must be flexible in order to lend resilience to the plan. (8) "Functional banking" is a potent factor of accelerated growth rates, (9) Once the economy gets going and the dimensions of various economic issues get unwieldy, central or monolithic management leads to definite errors; the state must consider a phased and graduated withdrawal through delegation of authority; "target planning" or "indicative planning" with guidelines of policy, rather than crippling the market through multifarious controls, is desirable. (10) Though the empirical evidence is not conclusive, the tendency towards decentralization is associated with fewer bottlenecks, greater efficiency, and higher growth rates.

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Research Paper#2: Theodore Morgan  
"The Theory of Error in Centrally-Directed Economic Systems"

Abstract

The article analyzes the nature and sources of consistent administrative error in centrally-directed economic systems. The division is not between government and private economic units, but between large and small ones.

There is reason to be (A) a tendency toward fewer-but-bigger errors than in decentralized systems. Bookkeeping and other checkable mistakes-- that is, little mistakes-- can be avoided; but there will be drift toward kinds of errors not readily checked for three reasons.

(B) There are tendencies toward delay, excessive optimism, and multiplication of controls. Delay and excessive optimism derive from the normal psychology of the chief and his estimate of his own policies, coupled with political pressures on him, the tact of subordinates, and the nature of bureaucratic work. Well-documented military catastrophies of World War II suggest a dependable pattern of bureaucratic error originating in wish-fulfillment bias and a tendency to pay attention to information that supports current expectations. Then, when something goes wrong, the normal administrative reaction is to impose laws and regulations and/or extend them.

(C) Adequate incentives to the top leaders contrast with modest incentives or the treadmill for the many. Central authorities, in their quest for general approbation, tend to

rely on what their communities regard as the highest motives; but work gets done best when reliance is on the strongest motives.

(D) The divergence between highest motives and strongest motives, and between public policies and private interests, leads to hypocrisy and on to avoidance, evasion, and corruption. Hypocrisy is plainly a social loss but the latter resorts can at times be socially useful, offering the only way that wooden-headed or unlucky policies can be made consistent with economic survival or progress.

Some implications for policy are drawn.

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Economic Interdependence in Southeast Asia

Research Paper #3: Hla Myint  
"Economic Theory and the Underdeveloped Countries"

Abstract

There is no reason to suppose that economic policies considered appropriate for the advanced countries will prove to be equally appropriate to the underdeveloped countries. But this "realistic" objection to generalizations should apply not only to the laissez-faire but also to the planning policies in the underdeveloped countries. Further, given the wide differences which exist among the underdeveloped countries themselves with respect, say, to the degree of population pressure, the overall size of the economy, the general level of administrative efficiency and the coherence of the institutional framework, etc., it is highly unlikely that any single standard model of development planning will be appropriate for all of them.

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"Economic Interdependence in Southeast Asia"

Research Paper #4: E.D. Hawkins, "Job Inflation in Indonesia"

Abstract

Inflation has forced Indonesians to adopt many methods to increase family incomes: (1) working longer hours to secure overtime pay; (2) having additional members of the family work; (3) securing an extra job (moonlighting) or, in Indonesia, several individual jobs; (4) asking for wage increases or, if they are frozen, promotions to get more money; (5) engaging in self-employment such as buying and selling; and (6) performing certain services for fees outside the legal channels. The most important of these is to hold multiple jobs. If only a few people take on multiple jobs, they will bring in more income to their families, and such a small increase in income relative to aggregate income of all Indonesians would have so little effect on prices, no matter what their additional output, that they would gain relatively by this move. As more and more engage in multiple jobs, the individual gains in income may be more and more offset by new price rises, especially if the net increase in output demanded is low relative to added earnings.

Price inflation has encouraged job inflation as a means of avoiding lowered real income, but the widespread extension of job inflation is probably leading to further price inflation, which may encourage more job inflation. Other methods are needed to halt the spiral of inflation. The 1963 stabilization efforts were abortive, largely because the government failed to consider the political implications of the measures and as a result did not receive the support of any of the major power groups. Any new attempt should have a more solid political base.

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Economic Interdependence in Southeast Asia

Research Paper #5: Theodore Morgan  
"Success and Failure in Economic Planning"

Abstract

Failures of economic planning originate both in (a) government instability, with its context of maneuvering for political power and shifts of persons and policies, and in (b) the nationalist and one-party policies that governing groups use to keep themselves in power. They originate also in (c) centralized large organizations that attempt to control economic life in detail, with their tendencies to substitute ideology for reality; to alienate the people of the villages and farms for whom the planning is done; and to delay and to be rigid.

Successes of planning, actual and potential, originate in (a) influencing the economic environment in which private individuals make their decisions, and in trying to supplement those decisions; (b) in evoking expression of felt wants for improvement from the people in the villages and fields, and hence stimulating their ideas and energy, which the government can then assist. Finally, planning is in our time a popular word like democracy: Hypocrisy being the homage vice pays to virtue, dictatorships proclaim they are democracies, and governments that have no intention of serious planning go through the motions. Even so planning(c) keeps alive the hope of economic advance, which makes more likely its eventual reality.

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Research Paper #6: Hans O. Schmitt  
"The Integration of Capital Markets in Europe"  
A Step Towards Political Unification

Abstract

The expectation that a customs union in Europe will ultimately lead to political unification is based on the so-called "spill-over" effect. This effect operates whenever any step towards integration creates new needs and fresh demands to proceed further in the same direction. Thus a customs union may create pressures to integrate not only commodity, but capital markets as well. An integration of capital markets turn may necessitate currency unification for its effective functioning, and a unified currency area finally may imply a pooling of sovereignties sufficiently complete to destroy the separate identities of the participating nation states.

This paper argues that a sequence of that sort is in fact one of the mechanisms at work in the European integration process. Trade integration is not likely to prove acceptable except within a context of full-scale economic integration. For freer trade will strengthen tendencies towards factor price equalization. As the distribution of income shifts against capital in the poorer regions, the propensity to save will decline there, and the growth rate fall if financial stability is maintained. Thus "core areas"-- where capital and technology are already plentiful-- would gain at the expense of the periphery. Entrepreneurs and workers at the periphery cannot

rationally accept this consequence unless they are themselves free to move to the center to participate in its gains. One of the requirements would be an integrated capital market.

A close intermingling of claims and liabilities in a single capital market requires a single currency to eliminate exchange risks. The political significance of money derives from the fact that it cannot exist without a set of individual producers accepting a collective identity. For if each producer issues his own currency, in terms of which he prices his product, the distinction between a currency depreciation and an individual price fall disappears. Money itself would then have given way to barter. But once several producers have joined in a single currency arrangement, they may, by a depreciation of the exchange rate, respond collectively to a fall in the external demand for any one of their products.

The option of such a collective response to economic adversity would be destroyed by a common currency. Producers would henceforth have to meet in the Common Market as individuals only, assuming a national identity only toward third countries. If in fact this fusion of national identities is not intended, the customs union must also be called in question. For by itself, it clearly creates tensions that cannot be resolved except by moving forward in the direction of political union-- or else by giving up the enterprise altogether. For no inevitability can be ascribed to the "spill-over" process. Precisely at the point where the creation of a common currency comes to threaten the foundations of sovereignty, the impulse to withdraw



may well be strongest.

\* \* \* \* \*

A prefatory section to this paper explores the implications of the European experience for prospects for economic cooperation in Southeast Asia. Any discussion must first make clear to whom such cooperation is likely to yield political advantages. Arguments based on economic welfare-- even if they can be consistently formulated-- are not likely to carry decisive weight in actual decision making.

The major interest groups, that just now might have a political stake in regional solidarity, are business communities in the various countries under consideration. Hard pressed as they are in Burma and Indonesia as well as in Vietnam, they would do well to cooperate for the mutual strengthening throughout the region.

The closest form of cooperation would be in a currency union. A common currency in Southeast Asia, if one is to develop, must be based on business communities indigenous to the region. Is it realistic to expect them to draw together on the European pattern?

Economic integration is a "nuclear process" in the sense that larger communities tend to crystallize around "core areas" where capital and technology are plentiful. In Europe, this process currently centers on the Ruhr. What core area could fulfill a similar function in Southeast Asia? Singapore as a commercial, financial, and also progressively industrial center, seemed for a while to be a candidate. In fact, it

could have been argued that the Malaysian Federation was the first visible evidence that a "nuclear process" focussed on Singapore had begun. The Indonesian "confrontation" campaign can still be seen as a defensive reaction to that possibility.

But was the Malaysian Federation ever viable, independent of the British presence? The fact that the "entrepreneurial" elite on which it was based is ethnically mainly Chinese, makes this a questionable proposition for an otherwise predominantly Malay region.

Abandoning any hope for an agglomerative process in Southeast Asia, then, is it perhaps still possible to advocate a widening of Southeast Asian markets through lowered barriers to regional commodity trade? Though restrictions on capital account would continue, such an arrangement could still aim to realize economies of scale that would otherwise create barriers to investment even on a national basis.

But unfortunately, as argued above, trade "integration" is not likely to prove acceptable except within a context of full scale economic integration.

Neither a "free trade area" nor a common market, therefore, let alone a common currency, seem likely prospects in Southeast Asia. There remains a last possibility, something on the pattern of the O.E.E.C. in Europe, similarly based on large-scale foreign aid from abroad. The organizational form such aid should take must be carefully adapted to the posited goal of strengthening business communities in the region. Most worth investigating perhaps is the creation of a regional development bank on the pattern of the International Finance Corporation

rather than of the World Bank itself. The I.F.C. grants loans and participates in the capital specifically of private enterprises, without so much as a government guarantee.

We have defined four possible ways of organizing cooperation in Southeast Asia: a common currency, a common market characterized by a free flow of resources, a free trade arrangement with continuing barriers on capital account, and a regional development bank. The problems encountered in Europe in the effort of moving from the last of these to the first suggest that at this stage only the last offers sufficient hope of success to be seriously considered in Southeast Asia. But that is only a hypothesis to be investigated at this stage, not a conclusion based on a completed investigation.

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Economic Interdependence in Southeast Asia

Research Paper #8: K.C. Sen  
"Nation-building and Regional Integration"

Abstract

The central objective of all economic policy-making in emerging nations of Southeast Asia seems to be nation-building or "national coherence" through economic nationalism or autarkical policies. Accordingly, their planning documents include a multiplicity of collateral objectives, each designed to promote the central objectives, but often conflicting among themselves. This gives rise to what may be called a "goal index"-- a composite of economic goals which is the closest possible approximation of the central objective, with a marginal trade-off among the goals. In addition, the permissible means of policy are chosen within the range of the "goal index".

If these nations participate in a regional integration program, there is implied a compromise on the central objective itself. The burden of adjustment is likely to fall most heavily on two collateral objectives, economic self-sufficiency and diversified industrialization. Also, both the certainty and the range of permissible policy means are further reduced, especially when the particular advantage of this or that group within countries needs to be explicitly emphasized.

The success of any regional integration program among emerging nations depends, therefore, upon the effectiveness with which the economic benefits resulting from participation can offset the losses arising from the necessary compromises. The

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task will be easier the less sudden or drastic the compromise called for and the more cogent and compelling the case for economic integration. Expert pre-investment and feasibility studies and resource-potential surveys will be required, as well as expert advice on the prospects for joint industrial enterprises and marketing systems. The benefits accruing from economies of scale, external economies, vertical division of labor within the region, and the establishment of institutions such as a regional development bank or a payments union must be emphasized. In fact, economic nationalism itself can be used to promote regional integration, after these studies have been made, since many bottlenecks-- for example, those arising from the small size of a market and the lack of resource-complementarity-- may now be overcome. Moreover, the economic viability of the region vis-a-vis the rest of the world may be increased.

In this study an attempt has been made to study systematically the nature of the constraints on economic nationalism which arise (1) from the competition among collateral objectives in (a) a closed economy, with foreign trade; (2) from determining permissible policy means in individual countries; and (3) from participation in a regional integration scheme, both as regards collateral objectives and permissible policy means.

AID-University of Wisconsin Research Contract csd 355  
Economic Interdependence in Southeast Asia

Research Paper #9: P.T.Ellsworth  
"Import Substitution in Pakistan--A Comment"

Abstract

The methodology and the results of a paper published in the Pakistan Development Review (Summer 1965) by Soligo & Stern are stated briefly. The authors, using a simplified input-output model, examined 48 industries in Pakistan and found that in 23 of them, value added (at world prices for inputs and outputs) was negative-- that is, the value of inter-industry inputs alone exceeded the total value of output when world prices were used. Attribution of this striking result to the respective industries' being either (a) premature, or operating at too early a stage of their increasing return phase, or (b) over-expanded, or operating beyond the minimum cost point, is criticized as resting on inaccurate diagrammatic argument. It is contended instead that the results can be interpreted as reflecting wasteful use of inputs, factor price distortions, or methodological difficulties due to improper assumptions about price relations, or to improper weighting. Further, it is suggested that the "investment" industries shown by Soligo and Stern to have a comparative advantage are not investment industries in the usual sense of producing heavy industrial goods, but rather the producers of light manufactured goods almost exclusively.

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AID-University of Wisconsin Research Contract csd 355  
Economic Interdependence in Southeast Asia

Research Paper #10: Seiji Naya  
"The Commodity Pattern and Performance of Southeast Asia's Exports  
to the Developed Areas"

Abstract

As an analysis of the export performance of Southeast Asia, this report aims to find those commodities responsible for the region's slow expansion of exports to the developed areas. The exports of 15 Asian countries to 20 developed nations are compared with the latter's imports from the world for two periods, the averages of 1956 and 1957 (Period I) and 1962 and 1963 (Period II). The comparison is made in terms of nine commodity groups, five of primary and four of manufactured goods, which are re-arranged from the three-digit Standard International Trade Classification.

Although the export trade of Southeast Asia to the developed countries (DC's) increased 13.89% (from \$4 billion in Period I to \$4.5 billion in Period II), the total imports of the DC's from the world rose 39.77%, a difference of -25.88%. Of this total difference, -17.99% is explained by the import pattern of the DC's which moved against the region's export commodity composition (compositional effect). The remaining -7.89% is due to the region's inability to maintain its share in the exports of individual commodity groups (competitive effect). In other words, the export lag has been considerably affected by the region's poor performance even in exporting primary products, as compared to the rest of the world.

In contrast to the stagnant exports of primary products, manufactured exports have grown rapidly, even faster than the import growth of similar products in the DC's. Within the manufactured exports, however, only Light Industrial Goods can be singled out for its export contribution. This is the only manufactured group which has a relatively large share in total exports and constitutes a relatively large proportion of the DC's imports (5.8% in Period I and 7.7% in Period II). The increase in exports of this group alone accounts for more than 90% of the region's over-all increase, the export share of other manufactured groups being too small to affect appreciably the region's total exports.

The four major DC areas, the U.S., the U.K., the E.E.C., and Japan absorbed approximately 90% of the region's exports to the 20 DC's while the remaining 10% is accounted for by exports to Australia, Canada, and Other Europe. The exports to the four major areas grew far less than the import growth rate of these areas, especially with respect to the E.E.C. and Japan. Although an unfavorable compositional effect is shown for all four areas, a weakened competitive effect is found to explain a large part of the region's export lag with the U.K., the E.E.C., and Japan.

Although this paper considers Southeast Asia as a group, much variation is found in the export performance of individual Asian countries. Hong Kong, Formosa, Thailand, and the Philippines increased their exports very rapidly, compared to the relative export stagnation of Indonesia, Vietnam-Cambodia-Laos, Pakistan,

India, and Ceylon. It is not clearly evident that those countries with a high export concentration in primary products always performed poorly. Thailand and the Philippines, for example, have done well even with a high degree of specialization in primary exports. Examination of specific commodity items reveals that these countries were able to offset the decline of some primary exports with increases in other primary goods, such as maize (Thailand) and copra (Philippines).

It is likely that the region's exports will continue to be concentrated in primary goods in the near future, implying that the export lag is also likely to persist. As indicated above, however, the performance of some Asian countries suggests that the gap can be narrowed. Manufactured exports should be encouraged in order to reduce the export lag by lessening the unfavorable compositional effect.

AID-University of Wisconsin Research Contract csd 355  
Economic Interdependence in Southeast Asia

Research Paper #11: T. Morgan  
"Investment versus Economic Growth"

Abstract

Often investment in a national income accounting sense is identified with those resource uses that add future potential income. The identification is fallacious. Human resource development and non-material capital formation, often served by resource uses normally labelled "consumption" are significant contributors to growth. The empirical marginal-capital-output-ratio, often used to measure the effect of capital input, is in fact a conglomerate whose main significance is that of being an inverse measure of the rate of growth. Economic growth is a complex phenomenon which may be correlated with a rise or decline in the quantity of capital, and is frequently associated with the need for increased consumption.

The policy implication is that in Southeast Asia as in other areas the international flow of investment goods should be much less a preoccupation of AID and domestic developers than it has been. The evaluation of resource uses directed toward improving human productivity and organization is a candidate for regional cooperative activity.

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AID-University of Wisconsin Research Contract csd/355  
Economic Interdependence in Southeast Asia

Research Paper #12: J.C. Leith, "The Specification of Nominal Tariff Rates  
in Effective Protection Estimates"

Abstract

A number of economists have called attention to the significance of a tariff structure that distinguishes between intermediate inputs and final goods. Estimates of effective rates of protection can be useful guides to policy makers concerned with the impact of national protective structure on domestic resource allocation. However, this paper shows that estimates of protection are sensitive to any misstatement of nominal tariff rates. Furthermore, obtaining more accurate specification of nominal tariff rates may be very difficult. Problems include converting rates from specific to ad valorem basis and from an f.o.b. to c.i.f. valuation. Because the detail of tariff rates is much greater than the available information on the industries involved, there is also a problem of weighting individual tariff rates. Finally, the nominal tariff rate may not in fact reflect accurately the divergence between world and domestic prices.

Although the analysis of effective rates may provide considerable insight into the process of economic growth, users should realize that the analysis rests on certain restrictive assumptions and that the estimates are sensitive to errors in the specification of actual nominal tariff rates. The sources of potential error in nominal tariff data are numerous and important, and, data necessary for adequate adjustment are not ordinarily available.

AID-University of Wisconsin Research Contract csd/355  
"Economic Interdependence in Southeast Asia"

Research Paper #13: K.C. Sen, "Economic Growth and the Price Level--An  
Analysis of Some Asian Data, 1950-1963"

Abstract

This paper deals with the question of the relationship between economic growth and the price level in Asian countries. The format of the paper is as follows: (1) A survey of the important studies in the field of the relationship between economic growth and the price level; (2) discussion and evaluation of three interpretations of the causes of inflation, namely, the "monetary fundamentalists", the "structural fundamentalists", and the "behaviorists"; (3) analysis of data between 1952 and 1962 in relation to the behavior of prices in some Asian countries; and (4) policy implications.

In whatever way inflation may be defined--as a sustained rise in the general level of prices, or as a state of generalized excess demand where too much money chases too few goods, or in some other way--the phenomenon does not lead itself to a simple explanation. The juxtaposition of the relevant variables--monetary, structural, and behavioral--differs from time to time and from country to country. It is essential to keep in mind the heterogeneity of situations and the interdependence of the factors involved.

It is even hard to say whether inflation is an inescapable cost of economic growth at all. The empirical evidence--in Europe, the U.S., Latin America, and elsewhere--does not indicate any necessary or causal relationship between the rate of economic growth and the price level.

The analysis of part 3 attempts to explain the behavior of prices in some Asian countries through the rates of change in the aggregate real gross national product, money supply, wage rates, terms of trade, and past price

behavior. Since the number of years for which the necessary data on each individual country are available is not sufficient to give us the necessary degrees of freedom, we have employed a temporal cross-section approach. The countries covered are Ceylon, India, Indonesia, Japan, Pakistan, and the Philippines for the period 1952-62. There are variations between countries in the number of years covered, but all these countries have observations in all the variables.

The analysis gives some insight into the phenomenon of price-change. There is considerable variety of experience among countries, but the magnitudes of the coefficients are sensitive to the specification of the model. No single-variable approach to an explanation of the behavior of prices is sufficient. Thus, whereas money supply is a very significant variable for some countries in explaining the course of prices, in others it is less so. Whereas improvements in the terms of trade do exert a downward pressure on prices in certain countries, in others they do not. Whereas a rise in money wages tends to be price-stimulating in general, the impact is greater in certain countries than in others. It is possible to say broadly what the course of prices will be in certain countries by extrapolating from the past behavior of prices, while in others this approach is too hazardous.

To have economic growth without inflation we need a composite policy. In the LDC's particularly, where precise estimation of the relative magnitudes of the relevant variables is not possible, the need for certain rules of thumb becomes imperative. For that matter, even in the DC's, governments do follow the so called "guidelines" of policy. In the LDC's, where a substantial chunk of the economy is non-monetized and several structural bottlenecks (for example, in transport) reduce factor and product mobility, there is greater reason to formulate such rules of thumb.



Another serious problem arises from the lack of integration and coordination among various policies--monetary, fiscal, and commercial. For instance, whereas stringent controls on the banking sector might be exercised, on the one hand, it is not infrequent to find huge budget deficits side by side. Similarly, the drive for self-sufficiency of the economy might lead the country into trade and tariff policies that are essentially inflationary.

Part of the problem may be of the LDC's own making. Defective tariff-rate structures, over-valued exchange rates, excessive zeal for attaining economic self-sufficiency impatience and the tendency to shift the responsibility to the outsiders (e.g., the DC's) are greatly responsible for the inflationary impact of LDC growth policies. This is not to deny that there are certain real bottlenecks in these economies, e.g., lack of savings and skills and a very thin base of infra-structure.

One of the ways in which cost structures and investment patterns could be rationalized is through intra-regional economic cooperation. With resulting economies of scale, richer resource availability, greater factor and product mobility, and less autarky in trade and tariff policies, it may be possible to minimize the cost of economic growth in terms of inflation.

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Economic Interdependence in Southeast Asia

Research Paper #14: Peter F. Bell  
"A Quantitative Study of Entrepreneurship and  
Socio-Economic Determinants of Development in Asia"

Abstract

Development theory and development policy presume relationships among economic and social variables that have, in many cases, not been subjected to any quantitative tests. Such tests would help to clarify some of the areas of dispute between theorists-- for example the response of the private sector to economic disequilibria.

The theory of entrepreneurship is composed of a multitude of widely differing generalizations, nearly all of which lack empirical support. This pilot study uses the technique of factor analysis to attempt to shed some light on the systematic relationships which have been assumed to exist between the supply of entrepreneurs and certain social and economic characteristics.

Two groups of countries were chosen for study. The first group, selected on the basis of reliability and availability of data, were countries in Southeast and South Asia: Pakistan, India, Burma, Thailand, Japan, and the Philippines. The second group comprised countries for which sample studies of entrepreneurship have already been completed (two countries which fall into this category are duplicated from group I); these are: Pakistan, the Philippines, Turkey, Lebanon, Greece, and Puerto Rico. The decade of the 1950's was the period chosen for study, 1170

Although some figures used refer to slightly later dates.

The analysis suggested the following tentative results:

(i) a large entrepreneurial class appears to be associated with some of the generally accepted characteristics of developing countries, namely, a decreasing agricultural sector, increasing urbanization, literacy and contact with the outside world, and a slowing down in the rate of population growth; (ii) the growth of such a group might be related to a development pattern which favors capital formation, an expanding government sector, stability of exports and of internal prices coupled with improvements in wages; (iii) a vigorous group of entrepreneurs may also be affected by an expanding export sector, and export-orientated economy ("outward-looking"), with a degree of dependence in foreign trade. In spite of the great heterogeneity between the two groups of countries, and between the countries in each group, the results displayed a remarkable degree of consistency and "significance" when judged by the standard tests. Although the results are heuristic and tentative, the semi-quantitative insights provided suggest useful hypotheses and delineate the areas to which more detailed studies might be directed. More thorough-going studies of the inter-relations between social and economic variables would increase our understanding of the mechanisms by which growth may be promoted-- both nationally and regionally--and would assist in the selection of policies which would more rapidly achieve this goal.

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"Economic Interdependence in Southeast Asia"

Research Paper #15: A.C. Kelley & J.G. Williamson, "Household Savings Behavior in the Developing Economies: The Indonesian Case"

Abstract

One of the principal obstacles to international economic integration, whether it takes the form of trade expansion, factor market integration, or a combination of the two, is the danger that some members of the union will enjoy, as a result of the integration process, more rapid growth than others.

The theme is a simple one. Differential growth rates arising out of the integration process are based in part on the behavior of factor prices in the face of trade expansion, as well as on the possibility of adverse capital flows resulting from a liberalization of factor movements. Even partial factor price equalization will result in a lower rate of return to capital in those countries which are the relatively capital-poor members of a union. It is reasonable to expect that a lower rate of return in these countries will exert a downward force on the rate of return in the capital stock. If, in addition, trade expansion is coupled with the development of integrated factor markets, and if this latter aspect of integration gives rise to adverse capital flows, the supply of capital in capital-poor members will be seriously curtailed.

Capital may flow to those countries which already enjoy a concentration of capital and technology in order to take advantage of what Hans Schmitt has called, "economies of agglomeration" (see, "The Integration of Capital Markets in Europe: A Step Towards Political Unification," AID Research Paper #6, University of Wisconsin, 1966). Or alternatively, as Kelley and Knowles argue, (in a forthcoming study, "Regional Integration and National Economic Development: The Case of Southeast Asia") differences between real rates of

return as derived from production functions, and those actually received by owners of capital when appropriately discounted for such factors as risk of confiscation, taxes, and exchange rate fluctuations, may also result in adverse capital movements.

The supply of savings and the demand for investable resources thus become crucial factors in the degree of success experienced by any integration scheme. An inquiry into the determinants of the supply of savings constitutes the subject of the present study, which attempts to identify the determinants of household savings behavior in the Daerah Istimewa Jogjakarta Region of Indonesia. The data consist of a 1959 household survey of 490 families. While several non-linear models are explored, the analysis and findings relate to linear per capita functions. The variables considered include income, occupation (farmer, trader and craftsman, owner of business, government employee, other wage earner), degree of asset ownership, education, location (urban, rural), and age.

Two models of savings behavior are explored. The first examines the influence of source of income and occupation. We conclude that the development hypotheses which stress source of income (e.g., Lewis model) might better be formulated by stressing the ownership of earning assets. This approach was found very useful in interpreting differential savings behavior by income source. Access to an efficient capital market may emerge as a significant element in determining average household savings levels, given household income.

The second model is a straight forward representation of the life-cycle hypothesis. The empirical results, constrained by the relatively small sample size, are somewhat neutral regarding the applicability of life-cycle formulations in Indonesia.

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Research Paper #16: P.F. Bell, "Small Industry: Socio-Economic Aspects of its Promotion in Asia"

Abstract

Policies for economic development in Asia continue to stress the importance of promoting small business enterprises for a variety of reasons-- economic, political and social. The economic rationale of this promotion is based on an assumption of their economic advantage in terms of capital-saving and labor-intensity. Available statistical evidence, however, suggests that these policies cannot be supported on economic grounds. There is, moreover, a conflict between the various objectives of promotion which may invalidate some or all of them.

There is a need for more extensive studies of the operating conditions of small units and an examination of the non-economic benefits which are alleged to accrue from their promotion. It is also necessary that the role which small units are to play in the overall development strategy be decided upon and that their promotion, rather than be isolated into a separate category, be integrated into the overall development plan. Efforts to arrive at an overall optimum size of firm which includes all aspects bearing on firm size are unlikely to be successful--the statement of the factors bearing on this optimum provide, however, a useful theoretical frame.

It may be that development policy should stress "disability-removing" rather than direct protection of small industry. Both in terms of individual country plans and the need for an overall regional view, small industry promotion must be based on sounder theoretical premises than hitherto.