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NATION-BUILDING AND REGIONAL INTEGRATION

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## NATION-BUILDING AND REGIONAL INTEGRATION

### Summary

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 objective, but often conflicting among themselves. This has given 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 further 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 permissibility of 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

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\*For a definition and the major characteristics of "economic nationalism", see page 16.

necessary compromises. The 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 the following pages, an attempt has been made to systematically study the nature of the constraints on economic nationalism which arise (I) from the competition among collateral objectives in (A) a closed economy, with no foreign trade sector, and in (B) an open economy, with foreign trade; (II) from determining permissible policy means in individual countries; and (III) from participation in a regional integration scheme, both as regards collateral objectives and permissible policy means.

### I. Competition Between Collateral Objectives

#### A. Closed Economy

Among the major economic goals, partial conflict arises between maximizing growth and (1) minimizing instability, (2) maximizing the rise in living standards, (3) achieving a more even income distribution, (4) minimizing unemployment, and (5) increasing "national status". In addition, causal interrelationships can also exist among these goals.

For instance, a rise in living standards may promote social cohesion, political stability, income redistribution, and national status improvement; economic stability itself may, by stabilizing prices, prevent deterioration in living standards; while economic growth itself may cause social and political tensions.

Growth versus Stability: Generally speaking, rapid economic growth brings about inflationary pressures. Less-developed economies (LDC's) are extremely sensitive to inflation due basically to inelasticity of supply and especially from projects in which the gestation period between investment and output is long and the marginal capital-output ratio is high. Matters can be aggravated if the mass of the people have a high marginal propensity to consume and little or no habit of voluntary savings. The lack of a custom of investing, poor rural banking, and underdeveloped money markets are generally inimical to a savings habit. On the other hand, people resist forced savings through heavy taxation because of the already low living standards; they have little capacity to be taxed. Inefficient enforcement machinery is an additional drain on tax revenues.

At the same time, an inadequate transportation and communication system, together with poor and badly distributed warehousing and storage facilities, create pockets of scarcity and of surpluses of foodstuffs and other necessities of life. Factor and product mobility is reduced because a substantial sector of the economy is non-monetized.

Hence, capital intensity, the inelasticity of output in the short-run, immobility of products and factors as a result of structural inadequacies, high propensity to consume, and inefficient administrative and enforcement machinery together render the growth process inflationary. This tends to make the economy unstable.

Growth versus Living Standards: An increasing number of theories

emphasize the importance of raising the rate of savings in order to sustain growth.<sup>1</sup> Assuming, therefore, that society's order of priorities needs to be changed, present consumption must be traded for future consumption. This lays bare the conflict inherent in the growth process between maximizing growth rates and raising present living standards, except where an increase in available consumer goods may provide more incentive, and hence faster economic growth.<sup>2</sup>

In this context, establishing an industrial base requires that low priorities be assigned to consumer goods industries, at least for some time, while greater efforts are made to mobilize resources, even through forced savings techniques such as higher sales and excise taxes and deferred wage payments. Raising living standards, on the other hand, would necessitate orientation towards consumer goods industries, lower sales and excise taxes, and higher money wages.

To the extent, therefore, that the determination of planning priorities is a political process;<sup>3</sup> to the extent that such a process reflects the planners' time preferences, rather than the market time preferences; and to the extent to which the execution of the former is politically and

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<sup>1</sup>W.A. Lewis, The Theory of Economic Growth (London, George Allen and Unwin Ltd., 1961). W.W. Rostow, The Stages of Economic Growth (Cambridge, University Press, 1964), pp.17-36. W. Leontief, "Theoretical Note on Time-Preference, Productivity of Capital, Stagnation and Economic Growth," AER Papers and Proceedings (March 1958), pp.105-11. H. Leibenstein, Economic Backwardness and Economic Growth (New York, John Wiley and Sons, Inc., 1963).

<sup>2</sup>Arthur Smithies, "Rising Expectations and Economic Development," American Economic Review (June 1961), pp.255-72.

<sup>3</sup>K. Arrow, Social Choice and Individual Values (New York, Cowles Commission Monograph 12, John Wiley and Sons, Inc.), pp.1-6. Duncan Black, "The Unity of Political and Economic Science," Economic Journal (September 1950), pp.506-14.

administratively feasible and operational; raising living standards in the immediate future creates certain limits to growth, however difficult to define.

Growth versus a More Even Income Distribution. Among the factors influencing planners, particularly in an overpopulated, underdeveloped, traditional society vulnerable to political instability or social disruption, that of reducing inequalities of income and wealth plays a significant role. The more "socialistically" oriented are the planners themselves, the stronger is its role (socialism, however, is not synonymous with equality). Nevertheless, if the lower strata of society is more consumption-minded than the upper; if the economy is prone to inflation, making imperative the need to control marginal increases in consumption; or if the rate of capital formation is closely related to the distribution of income, then equalitarian considerations may prove to be growth-inhibiting.<sup>4</sup>

Growth versus Full Employment. In an economy with a huge backlog of unemployed labor and a significant rate of increase of population, technological change which is capital-intensive and labor-saving might displace labor for an indefinite time, thus adding to the army of unemployed. There may be some indirect employment of labor in the capital-producing industries, which may partly reduce the unemployment incident to technological change or even wipe it out in the long run, but the long run might be too long to be socially acceptable or politically feasible.

It is not yet possible, with the analytical techniques available, to determine the extent of technological unemployment, as distinguished from that caused by other factors, such as the lack of effective demand, insti-

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<sup>4</sup>Robert Eisner, "Income Distribution, Investment and Growth," Indian Economic Journal (June 1961). Also note the doubt created in any such relationship by the equality of average and marginal propensity to consume implied in the Permanent Income Hypothesis of Milton Friedman.

tutional rigidities, and resource bottlenecks. Nevertheless, in a labor-surplus, capital-scarce, bottleneck-prone economy, the criterion of attaining full employment may place certain constraints on technological change for maximizing growth. The immediate social cost of such technological change might be very high in an economy in which the bulk of the people are already at subsistence levels; they cannot afford any further decline in absolute consumption rates. Factor-supply rigidities and product-supply inelasticities may render the real Keynesian multiplier inoperative while the money-income multiplier operates very effectively, thus generating inflation before full employment.<sup>5</sup>

Growth versus National Status. National prestige, military strategy, political survival, and the fact that some politicians possess built-in biases in favor of gigantic public works may be mentioned as some of the factors influencing policy decisions. Furthermore, "Gigantomania" may be an effective medium for hypnotizing the masses. Needless to say, resource allocation on this basis is likely to be less than optimal in most cases, for the opportunity cost of scarce resources is very high.

#### B. An Open Economy

Three additional collateral objectives may be introduced in the case of an open economy: (1) favorable trade balance; (2) a stable exchange rate; and (3) growth-promoting imports. The first and second goals can be considered together and regarded as being in conflict with the third. Achieving favorable terms of trade has not been treated as a distinct end

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<sup>5</sup>V.K.R.V. Rao, "Investment, Income, and the Multiplier in an Underdeveloped Economy," in Agarwala and Singh, eds., The Economics of Underdevelopment, Cambridge: (Oxford University Press, 1958), pp.205-18.

in itself, as in most cases, except those of monopoly or monopsony, global rather than internal conditions are more important in their determination.

Trade Balance. The trade balance can be made more favorable through promotion of exports or import substitution. Programs of export promotion may take the form of export subsidies (including dumping), quality improvement, or bilateral or intraregional trade treaties. All these measures, however, are subject to certain constraints, such as elasticity of foreign demand for the indigenous product, retaliation by the countries concerned (as in the case of dumping), or membership in international arrangements like the General Agreement on Tariffs and Trade. To the extent, however, that foreign trade provides a vent for the surplus resources of the economy, no such problems might arise, inasmuch as the surplus could be exported at the prevailing world price for that commodity. Even then, export earnings would depend on the elasticity of demand abroad.

Programs of import substitution, on the other hand, are mainly determined by technological feasibility and the state of technical know-how in relation to natural resource endowments. Besides, to the extent that they imply imposition of tariff barriers or exchange controls, these programs too may generate retaliation.

Exchange Rate Stability. An economy's ability to stabilize its exchange rate depends partly upon its balance of payments, as well as upon its exchange-pegging ability, whether from its own reserves of foreign currencies or from the short-term institutional credit available to it. However, it is by no means rare (and may in fact be frequently so) to come across cases of artificially high exchange rates, as reflected by a divergence between the open and black market rates in the international money market.

Over-valuation of currency is not very feasible as a long-run policy, however attractive it may seem; it might prove to be positively injurious,

insofar as it retards export prospects (except in the extreme case of absolute monopoly and complete inelasticity of demand in foreign markets). Also, the International Monetary Fund discourages a member country from having multiple exchange rates. Hence, there are both economic and institutional constraints on a country's ability to manipulate its exchange rate as a growth-promoting policy instrument.

Growth-promoting Imports. Here, the size of export earnings; foreign capital inflows, both equity and debenture, private and governmental; and foreign grants all act as limits, although a country is able to tide over temporary disequilibria in its trade balance through the use of accumulated reserves. Once again, however, the country's economic, political, and legal climates serve as constraints on the inflow of foreign capital. Fear of confiscation, of heavy taxation, and of a freeze on the repatriation of capital and the remission of profits may hinder the country's ability to attract foreign capital. Prospects may further be reduced, should the government limit the number or kind of fields into which foreign capital may be invested.

Three things emerge from the above discussion. First, the objective of nation-building, with its various collateral goals, is politically determined. Second, there is bound to be a "trade-off" among the collateral objectives; the development of a "goal index", after taking into account the marginal importance of each of the different goals, seems to be the only operational approach. Third, the preferences of the planners seem to take precedence over market preferences. This, however, is not so disturbing as it might seem, as even in free markets, it is not easy to determine the true preferences of the people. Arrow's "collective rationality" is not easy to attain, anyhow.<sup>6</sup>

## II. Determining Permissible Policy Means

If initiating and accelerating the process of economic growth requires "turning parameters into variables",<sup>7</sup> it is indeed difficult to set out an optimal range of policy means.

Nevertheless, the crucial test of whether a policy is appropriate is the extent to which it squarely meets the time lag inherent in the growth process. Bent Hansen distinguishes between the two types of lags.<sup>8</sup> The first is that between the moment when the disturbance occurs and the moment when the disturbance affects the end-variables: this interval might be called the disturbance time lag. The second is the policy time lag, which may be subdivided into the observation time lag, the administrative time lag, and the effect time lag. Further refinements could be

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<sup>6</sup> According to Arrow, the minimum conditions for collective rationality are:

1. Between three alternatives, the social-welfare function must give rise to a unique social ordering, no matter how individual members of the group choose to order the three alternatives.
2. The social ordering must correspond positively, or at least not negatively to changes in the ordering of any one individual.
3. The elimination of any one alternative shall not affect the ranking of the other alternatives in the social-welfare function.
4. Voters can choose freely among alternatives.

K. Arrow, Social Choice and Individual Values, Ch. 3.

Arrow defines a "social-welfare function" as "...a process or rule which, for each set of individual orderings  $R_1, \dots, R_n$  for alternative social states (one ordering for each individual), states a corresponding social ordering of alternative social states,  $R$ ." Ibid., p.23.

<sup>7</sup> Everett E. Hagen, "Turning Parameters into Variables in the Theory of Economic Growth," AER Papers and Proceedings (May 1960), pp.623-29.

<sup>8</sup> Bent Hansen, The Economic Theory of Fiscal Policy (Cambridge: Harvard University Press, 1958), pp.436-40.

developed, but the point is that policies must match the time lags.<sup>9</sup>

Further, the principle of "economy of means" should be observed. The planners should use as few means as possible, with the smallest possible variations in their types and magnitudes. In other words, here we have the very difficult problem of double minimization--of both the number and variety of means. And this is in addition to the political weighting, i.e., keeping in view political considerations involved. The selection of policy means should be made with a view to dealing directly and specifically with the source of the disturbance. Policy means can be listed in the order of their effectiveness in meeting a particular disturbance.<sup>10</sup>

The selection, the weighting, and the ordering of means, therefore, are the prime considerations for policy-making. Such selection, weighting, and ordering must be done with the following in view: expectations; price mechanisms; external economies; factor composition; and institutional factors.

Expectations. "All value", said Commons, "is expectancy".<sup>11</sup> "Use

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<sup>9</sup> Factors influencing these lags may be numerous and varied. For instance, the lag involved in the effectiveness of varying the money stock may depend partly on the components of the stock itself, such as high-powered money, the deposit-reserve ratio, and the currency-deposit ratio, and partly on the velocity of circulation of money. The latter, in turn, may depend upon factors like the type of bill markets in the country, the extent of the banking habit among the public, the magnitude of the non-monetized sector of the economy, and the importance of non-bank financial institutions. Similarly, the lag implicit in the bank rate policy may depend upon the liquidity position of the commercial banks, the state of expectations, and the importance of the unorganized money market. The lag in the policy of transfer payments may depend upon the coverage of social security measures, and so on.

<sup>10</sup> Bent Hansen, Op. Cit., p.399.

<sup>11</sup> J.R. Commons, Legal Foundations of Capitalism (Madison: University of Wisconsin Press, 1959), pp.25-28.

value", he continued, "is the expected behavior of things in man's activity of production and consumption. Exchange value is the expected behavior of people in buying and selling, lending, hiring, borrowing and paying debts." It is this very factor that made Hicks assign the central place, in matters of economic stability, to what he called "the elasticity of expectations". Only if the elasticity of price expectations, he said, is equal to or less than unity, will the market be stable.<sup>12</sup>

During the growth process, therefore, monetary and fiscal policies, as well as physical controls (if and wherever necessary), should aim at controlling the course of certain key prices, keeping in check the prices of those commodities, services, and factors that are likely to enter into production processes as inputs or into consumer budgets.

The Price Mechanism. Unrestrained price flexibility is no guarantee of full employment or of stability. Moreover, insofar as the price mechanism fails to provide "a signaling device to transmit information about present plans",<sup>13</sup> proper coordination of investment decisions becomes extremely difficult. In a formal sense, though, futures markets and futures prices could provide exactly such a signaling device, but "it is a moot point whether perfect futures markets for all goods can exist",<sup>14</sup> if for no other reason than that perfect foresight is impossible. Hence,

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<sup>12</sup>J.R. Hicks, Value and Capital (Oxford: Oxford University Press, 1962), p.205. Hicks defines "the elasticity of a particular person's expectations of the price of commodity X as the ratio of the proportional rise in expected future price of X to the proportional rise in its current price".

<sup>13</sup>Tibor Scitovsky, "Two Concepts of External Economies," Journal of Political Economy (April 1954), pp.143-151.

<sup>14</sup>P.N. Rosenstein-Rodan, "Notes on the Theory of the Big Push", in Morgan, Betz, and Choudhry, eds., Reading in Economic Development (San Francisco: Wadsworth, 1963), p. 144.

there is need either for centralized investment planning or for some additional communication system to supplement the pricing system. "Perspective planning", as an inter-temporal communication system, for instance, would hardly be possible in a free enterprise economy.

External Economies. Apart from the fact that, in a free market, there might be a divergence between "social marginal productivity" considerations and those of "private marginal productivity" on welfare grounds,<sup>15</sup> a strong case can be made for certain types of investments, in certain types of sectors, that have significant external economy effects during the growth process.

But some investments have more "linkages" than others; the "spread effects" differ from industry to industry.<sup>16</sup> During the growth process, unlike under general equilibrium conditions, it is the "pecuniary external economies" rather than the technological external economies which predominate.<sup>17</sup> Therefore, in a framework of inter-industry dependence, where distinction between inputs and outputs is hard to make, industries with strong linkage and spread effects must be strengthened. Means must be chosen, therefore, with a view toward maximizing the stock and flow of external economies,<sup>18</sup> regardless of whether the path chosen is one of "balanced" or "unbalanced" growth.

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<sup>15</sup>Hollis B. Chenery, "Comparative Advantage and Development Policy", AER Papers and Proceedings (March 1961), pp.18-51.

<sup>16</sup>Albert O. Hirschman, The Strategy of Economic Development (New Haven: Yale University Press, 1958), pp.76-83.

<sup>17</sup>Tibor Scitovsky, Op. Cit.

<sup>18</sup>Though "not all indivisibilities give rise to external economies and not all external economies are due to indivisibilities", yet is it possible to distinguish between three different kinds of indivisibilities and external economies: "(1) indivisibilities in the production function (lumpiness of capital), arising from indivisibilities of inputs, processes,

Factor Composition. The means of policy are also conditioned by the factor composition prevailing in the economy. Lack of availability of "cooperating factors" reduces the prospects of stable economic growth,<sup>19</sup> particularly when the production function happens to be such that production coefficients are rather fixed. Changing the factor composition therefore becomes an important prerequisite for stable growth.

Institutional Factors. The following points deserve special mention here. (a) Schumpeter's emphasis on the role of credit<sup>20</sup> needs to be reformulated to consider an economy in which the state itself acts as an entrepreneur, for the financial constraints under which the state must function are different from those of the Schumpeterian entrepreneur. Considerations of the financial needs of the whole economy, rather than the formal acceptability to commercial banks, is the real test here, although commercial acceptability still holds for the private sector. Yet, it should be emphasized, the lack of adequate investment banking catering to the specific needs of various functionaries in the economy may thwart many an effort worthy of support. The financial structure of the economy must therefore be made as flexible as possible to cope with the changing needs as the country develops.

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or outputs giving rise to increasing returns; (2) indivisibilities of demand (complementarity of demand), arising from the discontinuity in the complementarity of demand; and (3) indivisibility (kink) in the supply of savings, arising from a zero (or very low) price elasticity of the supply of saving and a high income elasticity of saving." P.N. Rosenstein-Rodan, Op. Cit.

<sup>19</sup> Richard S. Eckaus, "The Factor Proportions Problem in Underdeveloped Areas", American Economic Review (May 1960), pp.642-49.

<sup>20</sup> Joseph Schumpeter, The Theory of Economic Development (Cambridge: Harvard University Press, 1949), pp.95-128. Or in his Business Cycles (New York: McGraw Hill, 1939), pp. 109-123.

(b) When the state tries to assume too much upon itself, its administrative inefficiencies create diverse bottlenecks. Monolithic planning is not very operational, for under too much centralization, errors may be fewer, as Morgan points out,<sup>21</sup> but bigger. There is need, therefore, of some degree of what might be called "economic pluralism", to solicit and mobilize the cooperation of various agencies in the country, to take the plan to the people, and to induce them to participate actively in the process of planned economic transformation.

(c) With regard to social change, economic policy must perform a dual role. First, it must supplement the lagging entrepreneurial spirit of the private sector, wherever necessary. Second, it should promote a "universalistic-achievement" rather than "particularistic-ascriptive" pattern of social structure,<sup>22</sup> by creating conditions that will spread" ... the will ...to succeed for the sake, not of the fruits of success, but of success itself...for the joy of creating, of getting things done, or simply of exercising one's energy and ingenuity."<sup>23</sup>

(d) Claims of money owed must have legal sanction in order to be converted into assets. And if the essence of economic growth is the

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<sup>21</sup>Theodore Morgan, "The Theory of Error in Centrally-Directed Economic Systems", Quarterly Journal of Economics (August 1964), pp.395-419.

<sup>22</sup>Achievement-oriented roles are those which place the accent on the performances of the incumbent; ascribed roles, on his qualities or attributes independently of specific expected performances. Universalistic definitions of role-expectations are in terms of a universally valid moral precept, e.g., the obligation to fulfill contractual agreements; particularistic definitions run in terms of obligations to a kinsman, a neighbor, or the fellow member of any solidary group because of his membership as such. See Talcott Parsons, The Social System (New York: The Free Press of Glencoe, 1951), pp.60-62.

<sup>23</sup>Joseph Schumpeter, Op. Cit., pp.93-94.

maximization of the discounted value-stream of assets, both tangible and intangible, then the "rule of law" becomes the backbone of day-to-day transactions. Entrepreneurial initiative should not be expected to flourish in an environment wrought with uncertainty of the behavioral relations among the various components of society, particularly those between the state and the free enterprise sector of the economy, for the lure of confiscation, the drive for nationalization, and the insatiable desire to expand the sphere of the government sector are among the basic inhibitors of private entrepreneurship.

Does there exist, therefore, a composite of policy means that is optimal? Which of the possible sets is optimal in resource allocation--between the public and the private sectors, among industries, over time? How best could incentives be used: through tax rebates, tax holidays, subsidies, grants, tariffs, easy money? Which of the possible sets is optimal in resource mobilization: greater reliance on monetary policy, fiscal policy, debt management policy, or commercial policy? Should forced savings be resorted to at all? If so, should it be through inflationary finance, direct or indirect taxation, pricing policies of public enterprises, forced income deduction, deferred wage payments, or some combination thereof? Which of the sets is optimal in minimizing economic fluctuations: the bank rate policy, credit control, credit rationing, or capital issues control? Should greater emphasis be placed on taxes or on transfer payments as a means of economic stability? What changes, if any, should be brought about in the term structure of public debt, as an alternative to variation in the stock of money as a means of promoting growth with stability, and how best can such changes be timed? How best can disturbances created through changes in exogenous factors like productivity, wage rates, price levels, terms of

trade, or balance of trade be counteracted?

Evidently, these are empirical questions varying with each sector, country and period of time. The complexity involved in defining, even loosely, an optimal composite set of policy means, however, should be clear.

### III. Participation in Regional Integration Programs

Policies directed towards nation-building are always based on economic insulation, though not on economic isolation. Economic nationalism, defined as "a body of economic policies", aims "at the loosening of the organic links between economic processes taking place within the boundaries of a country and those taking place beyond these boundaries".<sup>24</sup> Furthermore, the new economic nationalism of developing countries is characterized by an emphasis on industrialization, a regard for certain industries as strategic, an almost universal preference for public over private enterprise, an emphasis on policies of substituting domestic production for imports, and a strong opposition to investment by foreign capital.<sup>25</sup>

Economic integration, on the other hand, may be regarded as a process or a state of affairs: "As a process it encompasses measures designed to abolish discrimination between economic units belonging to different national states; viewed as a state of affairs, it can be represented by the absence of various forms of discrimination between national economies."<sup>26</sup>

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<sup>24</sup>Michael A. Heilperin, Studies in Economic Nationalism (Geneva: Librairies E. Droz, 1962), p.27.

<sup>25</sup>Harry G. Johnson, "A Theoretical Model of Economic Nationalism in New and Developing States," Political Science Quarterly (June 1965), pp. 169-86.

<sup>26</sup>Bela Balassa, The Theory of Economic Integration (Homewood: Richard D. Irwin, 1961), p.1.

Regardless of the form it takes,<sup>27</sup> one thing is clear; autarky no longer remains the keynote of economic policy in any individual country, for an enhanced degree of economic interdependence implies national economic development through regional economic cooperation.

Whereas nation-building through economic nationalism is based upon economic self-sufficiency, industrialization, and economic insulation, the hallmarks of a drive towards regional integration may be stated as external economies, economies of scale, and resource complementarity. The first two are the direct outgrowth of the expansion in the size of the market, while the third results from the expansion in the resource-base. In addition, the process of economic integration gives rise to various economic spill-overs: it facilitates the exchange of technical know-how among the member countries; it enhances the viability of the region vis-a-vis the rest of the world; it paves the way for the establishment of certain institutions, such as regional banking, underwriting, and industrial insurance corporations; and it minimizes the economic vulnerability of the

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<sup>27</sup>"Economic integration can take several forms that represent varying degrees of integration. These are a free trade area, a customs union, a common market, an economic union, and complete economic integration. In a free trade area, tariffs (and quantitative restrictions) between the participating countries are abolished, but each country retains its own tariffs against non-members. Establishing a customs union involves, besides the suppression of discrimination in the field of commodity movements within the union, the equalization of tariffs in trade with non-member countries. A higher form of economic integration is attained in a common market, where not only trade restrictions but also restrictions on factor movements are abolished. An economic union, as distinct from a common market, combines the suppression of restrictions on commodity and factor movements with some degree of harmonization of national economic policies, in order to remove discrimination that was due to disparities in these policies. Finally, total economic integration presupposes the unification of monetary fiscal, social, and countercyclical policies and requires the setting-up of a supra-national authority whose decisions are binding for the member-states." Ibid., p.2.

member countries, both collectively and severally.

Participation in any regional grouping, however, implies a trade-off or compromise between national economic sovereignty and regional economic efficiency, for a relatively free multilateral trading system may come into conflict with the objective of full employment. It should not be a matter of surprise, therefore, to find individual economies not readily responding to the schemes of regional cooperation. Most, if not all, such countries feel that "in the successful attainment of the twin goals of full employment and the creation of a relatively free multilateral trading system, the former must certainly take precedence over the latter...(and furthermore) while countries can pursue full employment policies even without a multilateral trading system, the restoration of multilateralism without the attainment of internal economic stability in the trading countries is impossible."<sup>28</sup> The objections that have been leveled against the traditional gold standard also become pertinent with regard to regional free trade.

Insofar as it implies an unconditional unification of the monetary and fiscal policies of the member countries, of their currency systems and capital markets, and of their national development plans and investment patterns, full-blooded economic integration, in particular, really becomes an implausible proposition without the relinquishment of some national sovereignty. With regard to Europe, Schmitt states, "thus a customs union may create pressures to integrate not only commodity, but capital markets as well. An integration of capital markets in turn may necessitate currency unification for its effective functioning, and a unified currency

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<sup>28</sup>United Nations, National and International Measures for Full Employment (New York, 1949), para.65.

area finally may imply a pooling of sovereignties of the participating nation states."<sup>29</sup> That each successive step presupposes a change of national ideals is too obvious to need any elaboration.

Various attempts have been made to devise a practicable means of promoting economic cooperation in Southeast Asia. For instance, a United Nations Working Group of Experts suggested a sub-regional preferential arrangement for some of the ECAFE countries, as the best form of "a customs union limited to the goods which are at present produced or which it is planned to produce, in the countries of the sub-region",<sup>30</sup> the only feasible proposition under the circumstances.

But even attempts that aimed at sub-regional associations, such as the Association of Southeast Asia (ASA), have hardly been effective,<sup>31</sup> if for no other reason than that "the region is not a complete economic unit well suited to far-reaching measures of regional trade liberalization".<sup>32</sup> The problem is further compounded by the fact that the economies of this region fall into two broad categories: the inward-looking and the outward-

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<sup>29</sup>Hans O. Schmitt, "The Integration of Capital Markets in Europe-- A Step Towards Political Unifaction", Madison, June 9, 1965 (mimeo), p.1.

<sup>30</sup>United Nations, Regional Economic Cooperation in Asia and the Far East, Report of the Ministerial Conference on Asian Economic Cooperation (New York, 1964), p.70.

<sup>31</sup>Bernard K. Gordon, "Regional Cooperation in Southeast Asia: The Association of Southeast Asia: Politics and Prospects", Foreign Area Research Documentation Center, FAR-1004; External Research Staff, Bureau of Intelligence and Research, U.S. Department of State, November 1963 (mimeo).

<sup>32</sup>United Nations, Regional Economic Cooperation in Asia and the Far East, Op. cit., p.54.

looking,<sup>33</sup> and hence would find fewer meeting grounds than if they belonged to a homogeneous group. In addition, unlike Western Europe, where militant economic nationalism had already proved extremely costly historically, or Latin America, where most countries had gained their independence quite some time ago, economic nationalism in Southeast Asia is all the more militant because of its newly found independence.<sup>34</sup>

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<sup>33</sup>For instance, Burma, Ceylon, India, and Indonesia may be classified as belonging to the inward-looking group, while Malaya, the Philippines, and Thailand are members of the outward-looking group. The former exercise strict control over resource allocation through formal planning and strict trade and capital flow controls, and they show some disposition to nationalize foreign enterprise. The latter have these characteristics to only a mild degree or not at all. See Hla Myint, "The Inward-looking and the Outward-looking of Southeast Asia and the Economic Future of the Region", Kyoto, June 1965 (mimeo); also K.C. Sen, "The Inward-looking and the Outward-looking in Southeast Asia", Madison, January 6, 1965. Myint regards Burma and Indonesia as inward-looking and Malaya, the Philippines, and Thailand as outward-looking. Also see Douglas S. Paauw, "The State of Development Planning in the ECAFE Region", Center for Development Planning, November 1964 (mimeo). Paauw classifies these economies as belonging to (1) development planning leaders (India and Pakistan); (2) small effective planners (Malaysia and China-Taiwan); (3) free enterprise equivocators (the Philippines and Thailand); and (4) doctrinaire nationalists (Burma, Ceylon, and Indonesia).

<sup>34</sup>I am indebted to Professor Everett D. Hawkins for this point. The following classification by Morgan is interesting:

Influences on the Degree of Dominance of Nationalism  
and Single-Party Monopoly in Less Developed Areas

<u>A</u>		<u>B</u>
Factors maximizing their dominance		Factors minimizing their dominance
1. Domestic political insecurity of the regime, forcing it into short horizons and improvisation to keep itself in power.	vs	Security of the regime, enabling it to take the long view.
2. Recent independence, won through fighting.	vs	No past experience of colonial domination or rule; or independence peacefully achieved, or achieved in the distant past.
3. A strongly held, self-righteous orthodoxy, tradition of autocracy, and of violence as a road to power.	vs	Tradition of pluralism in ideas and tolerance of dissent; political democracy.

Besides the sub-regional preferential arrangement, several other suggestions concerning regional cooperation have been made. Agreed areas of specialization has been recommended, as a device to promote "joint industrial ventures at any location on the basis of some market-sharing agreements."<sup>35</sup> Also, a regional commodity exchange has been proposed, where "every country shall determine what it is capable of producing over and above what (could be) disposed of in traditional markets. This is to be reported to the regional commodity exchange. Similarly, the needs for those products which the different countries require should be reported. On the basis of this information, arrangements could be made through the use of commodity payment certificates if necessary and on the basis of triangular or multifateral arrangements and making use of future trading to bring about an expanded trade among Asian countries."<sup>36</sup>

In addition, a suggestion has been made to establish a common marketing organization, so that "countries producing the same goods may join together."<sup>37</sup>

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34 (continued)

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| 4. One or more conspicuous minority groups.   | vs | A homogeneous population.   |
| 5. Isolation, illiteracy; tradition of responsibility to self, family, and special group. | vs | Liberal education, literacy, sense of responsibility to national or world interest. |

Theodore Morgan, Economic Planning--Points of Success and Failure, Paper given at Conference on Economic Planning in Southeast Asia, February 1-5, 1965, Honolulu, Hawaii (mimeo).

<sup>35</sup>United Nations, "Approaches to Regional Harmonization of National Development Plans in Asia and the Far East", Economic Bulletin for Asia and the Far East (December 1964), p.38.

<sup>36</sup>Cornelio Balmaceda, "Regional Economic Cooperation of Asia", Asia Productivity Organization (February 1963), p.9.

<sup>37</sup>P.S. Lokanathan, Ibid., p.20, United Nations, "Approaches to Regional Harmonization...", Op. Cit.

Still another proposal is to promote vertical international division of labor among Asian countries, particularly in the manufacturing sectors, as a means of expanding the size of the market and of making economies of scale possible.<sup>38</sup> The establishment of institutions such as an Asian payments union and a regional development bank has been suggested, to pave the way for subsequent negotiations on a more meaningful regional arrangement.<sup>39</sup>

The regional approach to national economic development therefore requires the participants to trade-off (to equate marginal costs or gains) on both the ends and the means of policy. The burden of compromise will fall most heavily on the ends of economic self-sufficiency and the drive for all-around industrialization. For whether they follow the road of "agreed areas of specialization", or of "objective natural resource endowment" among the countries, or of "industrial potential" as revealed through various pre-investment studies and resource-potential surveys as might be conducted from time to time, the natural implication of the regional approach is that no country will be in a position to have all or even most of the industries it wants to have. The compromises or trade-offs on policy means will be far more significant, however, for there will tend to be a far-reaching reconditioning of all major instruments of economic policy--commercial policy, monetary policy, fiscal policy, debt-management policy. The degree of compromise or trade-off required of both ends and means will of course depend upon the form of regional integration.

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<sup>38</sup> Hla Myint, Op. Cit., p.15.

<sup>39</sup> Ajit N. Bhagat, "A Regional Payments Union for South and Southeast Asia," Madison, July, 1965. A.N. Bhagat, "An Asian Development Bank-- An Essay in Regional Institutionalization of Savings and Investment, October, 1965.

It is not hard to visualize the implications this will have for national planning. Each national planning body must take into account the blueprints of the other member countries before drawing up and finalizing its own. Furthermore, intra-regional economic conferences (which will become far more frequent with the passage of time) may tend to become exercises in "game theory". Whether and to what extent such conferences will fructify into something worthwhile is a separate question. The point here is that the very contours of the objective of nation-building will need to be redefined, for nation-building will now be subject to regional rather than national economic insulation. If it were not, the very purpose of regional integration--economies of scale, vertical division of labor, external economies -- would be defeated.

#### V. Conclusion

"Industrialism and Nationalism", observed Arnold Toynbee, "rather than Industrialism and Democracy, are the two forces which have exercised domination de facto over our Western Society in our age; and during the century that ended about A.D. 1875, the Industrial Revolution and the contemporary emergence of Nationalism in the Western World were working to build up 'great Powers' each of which claimed to be a universe in itself"<sup>40</sup> It is no historical accident, therefore, that the emerging nations of Asia are nationalistic in their approach to economic development. Rather, they are in tune with their times. "It may even be that nationalistic policies are the cheapest and most effective way to raise real income in

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<sup>40</sup>Arnold Toynbee, A Study of History, Vol. I (London, 1934), pp.9-10.

less developed countries; in some cases, one suspects, the prospects for genuine economic growth are so bleak that nationalism is the only possible means available for raising real income."<sup>41</sup> It is when we talk of regional integration, however, that nationalism--particularly of the militant type--becomes a divisive rather than a cohesive force.

Any approach to promoting the idea of regional integration, therefore, must appeal to the nationalistic spirit of the prospective members. This is not as unrealistic as it sounds. Two crucial factors emerge here: first, the demonstration of the success of similar experiments elsewhere in the world, and second, laying bare the hard facts of economic logic at various conferences held for the purpose. In the meantime, a start can be made by establishing institutions such as an Asian development bank or a regional commodity exchange, as the basic infrastructure of subsequent negotiations for a regional association. It takes time to transform societies.

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<sup>41</sup> Harry G. Johnson, Op. Cit., p.184.