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THE INWARD AND THE OUTWARD LOOKING COUNTRIES OF SOUTHEAST ASIA AND THE ECONOMIC FUTURE OF THE REGION

by

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6	H.O. Schmitt	"The Integration of Capital Markets in Europe: A Step Towards Political Unification" (January, 1966)
7	H. Myint	"The Inward and the Outward Looking Countries of Southeast Asia and the Economic Future of the Region" (February, 1966)

The Inward and the Outward Looking Countries of Southeast Asia and the Economic Future of the Region

1. In this paper, I shall discuss the two different patterns of economic development which have taken place in Burma and Indonesia on the one hand, and in Malaya, Thailand and the Philippines on the other, in the post-war period. (1) I shall then consider some of the implications of these different patterns of development for the economic future of Southeast Asia and the role of Japan in promoting economic development in the region.

2. The Southeast Asian countries have two broad economic characteristics which distinguish them from their neighbours, India and China. First, they do not so far suffer from overpopulation in any serious way. With the exception of Java and parts of Vietnam, the region as a whole possesses a considerable amount of under-utilised land and natural resources offering possibilities of further economic expansion. Second, their relatively small size and population are not favourable for the creation of domestic markets large enough for the setting up of heavy capital goods industries requiring the economies of scale. Even Indonesia, which is much larger than the others, is too widely spread out for the building up of a large cohesive internal market.

3. These two conditions, taken together, suggest that the type of economic development policy appropriate for the Southeast Asian countries will be different from those adopted in India or in China. In these big overpopulated countries, the basic economic problem is the sheer physical problem of combating food shortage and the pressure of population on very limited land. Here, heroic measures have to be adopted to control present consumption and raise saving and investment so that in the future, the rate of economic growth may be sufficient to cope with the population explosion. To enforce these heroic measures it may be necessary to exercise a rigid and detailed control over the use of scarce resources through a system of central planning. In contrast, the basic economic problem in Southeast Asia is how to create a favourable economic environment and economic institutions which will lead to a more effective and fuller use of the relatively abundant and under-utilised resources. Given their comfortable surplus production of food above

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(1) Mainly during the period 1946-1960. It is difficult to obtain information about some of these countries beyond 1960.

subsistence requirements, the Southeast Asian countries are in a position to experiment with positive economic incentives instead of relying on rigid economic controls, and the rapid economic expansion promised by the under-utilised natural resources may be used as a spring board for further economic growth. Again, India or China may attempt an inward-looking autarchic approach to economic development, with an emphasis on heavy capital goods industries and orientated towards their potentially immense domestic markets. But such an autarchic type of development policy is not likely to succeed in the South-east Asian countries with their relatively small internal markets. The most promising thing for them is to adopt an outward-looking development policy, making a more effective use of their existing opportunities for international trade and ultimately to seek to widen the size of their markets by some form of regional co-operation.

4. In spite of these broad prima facie considerations, only Malaya, Thailand and the Philippines have followed such an outward-looking type of economic development policy. Burma and Indonesia, after some vacillations, have tended to follow an increasingly inward-looking path of economic development. The reasons why Burma and Indonesia have chosen this path are deeply rooted in the political and psychological attitudes in these countries and these in their turn are moulded by their experiences, not only during the war and the subsequent transfer of power, but also stretching far back into their colonial days. In particular, the great depression of the 1930's seems to have had a profound influence, sometimes subconsciously, on the outlook of the political leaders. In the post-war years these political and psychological attitudes and the economic policies interacted and re-enforced each other and with each round of disappointment and failure, the countries seem to have been driven deeper into their inward-looking path. I shall not attempt to trace this complex history in detail. Nor shall I presume to judge whether these political and psychological attitudes are ultimately right or wrong for the countries concerned. What I shall however do is to take the various economic reasons which have been put forward to justify these inward-looking policies and consider how far they are appropriate for the economic development of these countries and how far they have fulfilled their stated economic objectives.

5. It should be remembered that at the end of the war and on the eve of their independence, all the Southeast Asian countries shared a common reaction against "the colonial economic pattern" and the belief in the need for direct government action to change this pattern and accelerate their rates of economic growth. Thus, in the early postwar years Burma's rice marketing board was matched by the Thai government monopoly of the rice export trade and the Philippines pursued the policy of setting up government-owned factories more vigorously than Burma. Moreover, they all agreed that economic development, apart from increasing national income, should also fulfill two important objectives: (i) to change their status as agricultural countries and reduce their dependence on a few primary exports vulnerable to world market fluctuations and to set up a sizeable domestic manufacturing sector; (ii) to transfer a growing share of the incomes, economic activities and economic power from the foreigners to their own people by changing the pre-war economic pyramid dominated by big Western enterprises at the top and by the Chinese and Indians in the middle levels.

6. Starting from this common reaction against the "colonial economic pattern" countries like the Philippines (1), Malaya or Thailand seem to have sensed early that it would be easier and quicker to change the economic structure and the pattern of distribution of incomes and economic activities if the total volume of national output were expanding rapidly than in a situation of economic stagnation or slow growth. They also seem to have realised that, given the basic conditions of their economies, the key to expanding their total national product was to be found in expanding the volume of their exports. Since a large share of these exports was produced by the foreign-owned mines and plantations, the governments of these countries took care to guarantee the security of foreign property and freedom to remit profits and generally created a favourable economic environment which encouraged the foreign enterprises not only to continue their existing production but also to undertake new investments, to strike out into new lines of exports and to introduce new methods of production and organization. Countries like the Philippines

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(1) For a fuller account of the Filipino economic nationalism see F.H. Golay, The Philippines: Public Policy and National Economic Development, Cornell University Press, 1961, Ch. XIV.

and Thailand made no secret of their aspiration that a progressively larger share of these enterprises would be taken over by their nationals. But the foreign investors had confidence that such a transfer, when it took place, would be through the ordinary process of buying and selling of shares at the prevailing market prices rather than through arbitrary expropriations.

7. Countries like Thailand or the Philippines also came to realise that in order to have a rapid economic expansion, they must use positive economic incentives not only on the foreign enterprises but also on their own nationals. Thus, the Thai Government, after a few years of experiment with government monopoly, liberalised the rice trade and, through using economic incentives, encouraged the peasant producers not only to expand rice production but also to adapt to changing world market conditions and produce new export crops, such as maize, all the time making a fuller use of the available supply of land. The Philippines government, disillusioned by the inefficiency and corruption in government-owned factories, sold them back to Filipino entrepreneurs. Thereafter, it switched over to an indirect method of industrialization, providing differential economic incentives and advantages to the Filipino entrepreneurs, through the overvaluation of currency, protection, foreign exchange allocation, etc. In the peasant agricultural sector also the provision of economic incentives led to a rapid expansion in agricultural output mainly through bringing under cultivation new land in the outlying islands.

8. In contrast, countries like Burma and Indonesia were obsessed by the fear that once the foreign enterprises were allowed to re-establish themselves in the export industries, they would regain their old "strangle-hold" on the economy so they felt that the right policy was to take advantage of the war-time breakdown in production to discourage them from renewing their activities. Throughout, these countries were more interested in getting a larger share of the cake irrespective almost of what was happening to the size of the total output. Moreover, there was a certain ambivalence in their attitude towards the value of primary export production for economic development. On the one hand, the governments of these countries carried out extensive nationalisation of foreign companies on the grounds that the exploitation of natural resources was too valuable and important to be left in the hands of foreigners. On the other, once the governments had obtained control of the

mines and plantations and other export enterprises, no great effort was made to expand production. At this point the governments seem to have switched over to the feeling that it was not important to carry on with this "colonial economic pattern" and diverted their attention and resources to the industrialization program in the form of building a few more state-owned factories, and, in the case of Burma, to big and costly social overhead projects in transport and electricity. In the earlier period, Burma did explore the possibilities of forming "Joint Ventures" with Western enterprises, particularly in the field of manufacturing. But apart from the Burma Oil Company (since completely nationalised) nothing much came out of this as the country did not afford adequate security or incentives to the private investors. From then on Burma came to adopt an increasingly negative attitude towards foreign enterprises, both Western and Indian and Chinese. Burma's exports in the mining and forest sectors never recovered their pre-war level. The same pattern may be observed in Indonesia with the exception of the new foreign oil companies which were allowed to be set up in the post-war years.

9. Burma and Indonesia were unwilling to employ positive economic incentives to expand export production, not only for the foreigners, but also for their own nationals. Thus, the slow recovery of Burma's rice exports must be attributed, apart from the breakdown of law and order, to the inefficiency of the State Agricultural Marketing Board in almost all its operations, from the collection of crop from the peasants to the sale of rice to foreign buyers and above all, in its pricing policies. These amounted to charging zero transport and storage costs and, moreover, kept the prices paid to the peasant fixed at the same level over a decade, in the face of the rising prices of everything else. Thus, the Burmese peasants, in spite of initial benefits from the expropriation of land from foreign landlords and from having to pay little or no land revenue, became increasingly cut off from the economic incentives of the world market and were not able to expand production or strike out into new export crops as in Thailand. (1)

10. Under the shelter of import controls, some small scale domestic manufacturing industries sprang up in Burma, in some cases owned and run by Burmese entrepreneurs, who apparently were able to obtain capital from the windfall

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(1) By 1954-55, Burma's index of production of all agricultural commodoties (on a 1934-38 base equal to 100) was 88 compared to 152 for Thailand, 137 for the Philippines, 131 for Malaya and 122 for Indonesia (ECAFE, Economic Survey for Asia and the Far East, 1955, p. 195). But there is general agreement that the value of agricultural output is underestimated in Burmese national accounts.

profits arising out of the allocation of import lisenses. But unlike in the Philippines, these infant Burmese enterprises never gained strength for a number of reasons. First, there was the misguided policy of wholesale import liberalisation in the early 1950's which frittered away the foreign exchange reserves accumulated during the Korean boom. Next, reimposed import controls heavily handicapped the import of machinery and materials by the private entrepreneurs as a larger part of the scarce foreign exchange was diverted to capital intensive projects in the state sector. (1) Finally, there was the continual threat and the progressive carrying out of a nationalization policy from large foreign-owned enterprises down to small Burmese owned enterprises.

11. The general dimensions of economic development in the Philippines, Thailand and Malaya on the one hand and Burma and Indonesia on the other can be illustrated by the following table showing the percentage growth in their volume of exports and in real national product in the late 1950's compared with their respective pre-war level (2).

	1958-60 Export Volumes as % of 1937 level	1960 level of Aggregate Real National Product as % of the pre-war level
The Philippines	163	201
Thailand	149	191
Malaya	167	164
Indonesia	121	111
Burma	48	111

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(1) Burma's public investment is estimated to have been about 47% of total fixed investment during the late 1950s (compared to 28% in the Philippines and 24% in Thailand) ECAFE, Economic Survey for Asia and the Far East, 1961, p. 27 and p. 36. The Survey goes on to state: "In the eight-year (1953-60) plan of Burma, for instance transport, communications and power were to have absorbed 43 percent of total government expenditure or 77 percent of public investment. This has been considered excessive in an economy which has barely recovered pre-war levels of production especially in agriculture, and where more attention needs to be given to augmenting direction production".

(2) These calculations are reproduced from Douglass S. Paauw's excellent article on "Economic Progress of Southeast Asia", Journal of Asian Studies, November 1963. Professor Paauw's calculations strengthen and support the general view of those acquainted with the post-war economic conditions in Southeast Asia. For my own assessment of the situation see "Problems of Economic Development in South-East Asia", Royal Central Asian Journal, July/October 1963.

12. These figures comparing the post-war period 1946-60 with the pre-war levels give a better picture of the relative economic performance of the two groups of South-east Asian countries than the usual method comparing the average annual growth rates in Aggregate real product starting only from 1950. For instance, taking the period 1950-59, the ECAFE Economic Survey of Asia and the Far East 1961, p. 11 gives the following annual growth rates: Burma, 5.1%; Indonesia, 3.6%; Thailand, 5%, and the Philippines, 6%. But these calculations do not bring out the fact that Malaya, Thailand and the Philippines very rapidly recovered their pre-war levels of aggregate real national product by 1947 or 1948, whereas Burma did not regain her pre-war level of aggregate real product until 1957 and Indonesia, not until 1953. Thus, in terms of annual growth rates in aggregate real products, the Philppines is estimated to have grown at 50% during 1946 - 47, and Thailand at 30% during 1946-47 and at 15.3% during 1947-50. (1) The high rates were possible during the rehabilitation period as these countries were merely making good the war-time interruption or damage to production and were merely retracing their pre-war paths of production on the basis of pre-existing land and labour and methods of production. All this took place before the ECAFE figures started. On the other hand, the ECAFE figures include 7 years of Burma's and 3 years of Indonesia's rehabilitation period when the rate of expansion in national output could have been much higher than the growth rates for the Philippines and Thailand which represented genuinely new economic growth over and above their pre-war production.

13. What then are the causes of slow rates of economic recovery in Burma and Indonesia and the rapid rates of recovery and new economic growth in Malaya, Thailand and the Philippines? There are, of course, special circumstances and extra-economic factors which may partly account for these differences. Thus, war-time damage to material capital was very severe in Burma but then it was equally severe in the Philippines. The breakdown in law and order and the long-drawn insurgencies in Burma have admittedly been a running sore in Burma's economy. But then Malaya had to cope with her "Emergency" and the Philippines with the Huk rebellion. But even when we have made allowances for the special circumstances, it is difficult to avoid the conclusion that a large part of the explanation for the poor economic performance of Burma and Indonesia must be found in the economic policies they pursued, in parti-

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(1) Cf. Paauw, loc cit., pp. 70-75 and pp. 82-83.

cular the inward-looking attitude which failed to appreciate the vital importance of export expansion for economic growth and preferred centralised economic planning and controls based on direct state activity to the use of positive economic incentives to encourage both the foreign and indigenous pro ducers to expand economic activity. The post-war breakdown of production and law and order emphasised the need for using economic incentives to hasten economic recovery. But instead, the governments of these countries preferred cumberous and complex methods of planning and control which were beyond the decision-making capacity of their politicians and the administrative capacity of their civil servants. Burma, in particular, was distracted by high expectations from her development plans from pressing forward with th vital tasks of re-establishing law and order and physical reconstruction, particularly in the areas which produced her mineral and timber exports. The hope of some of her politicians that insurgency would automatically die as the fruits of the economic development plans became available showed a complete failure to understand that the fruits of development, even if they were to be realised, would be much too slow for the urgencies created by armed rebellion. They might as well have tried to cure a case of acute appendicitis by giving vitamin pills.

14. Granted that the outward looking countries of the Philippines, Thailand and Malaya have been able to expand both their exports and their national incomes faster than the inward looking countries of Burma and Indonesia, how far do they succeed in attaining the two further objectives (i) of expanding domestic manufacturing industry and reducing their dependence on a few export commodities and (ii) of redistributing incomes and economic activities in favor of their own people?

15. In the Southeast Asian economic setting, it is not possible to sustain the expansion of the domestic manufacturing industry unless exports are also expanding rapidly at the same time. This is so because, given their present stage of economic development, the Southeast Asian countries have to import from abroad much of the capital equipment, skilled personnel and frequently much of the semi-processed materials. Thus, while the process of industrialisation is likely to be held up by frequent balance of payments crises in countries like Burma and Indonesia because of insufficient foreign exchange earnings, it is likely to proceed further and more smoothly in the other countries which can command an expanding supply of foreign exchange through

exports of further inflow of foreign investment. Further, countries like Burma and Indonesia by insisting on state ownership and control for the new industries, may also be held back by the limited supplies of civil servants who are competent to run and manage these enterprises. Whereas countries like the Philippines and Thailand by encouraging private enterprise of their own nationals may be able to create and draw on an expanding supply of private entrepreneurs who have gained experience through the assistance of their governments. This is in line with the statistical evidence provided by Professor Paauw who has measured changes in the contributions of Agriculture, Industry in the broad sense (including mining, manufacturing, construction, electricity, gas and water) and Manufacturing in the narrower sense in Burma, Indonesia, Philippines and Thailand during the 1950-60 decade, (He uses current prices for lack of suitable data at constant prices for Burma and Indonesia and takes three-yearly averages to smooth out short-run fluctuations.) His results show that the fastest rate of structural change has taken place in the Philippines where the share of agriculture in national output was reduced to 34% by 1958-60, compared to 37% for Thailand, though the rate of decline for Thailand was somewhat greater. The rise in the share of manufacturing in the narrower sense was also most rapid in the Philippines, roughly doubling from 9 to 18%. Industry as a whole expanded at the same rate for the Philippines and Thailand, at a rate much faster than for Burma. While Burma showed some expansion in manufacturing in the narrower sense, the share of agriculture in her national output remained much higher than in the Philippines and Thailand. There was hardly any change in the relative shares of agriculture and industry in Indonesia during the decade. (1)

16. What about the objective of reducing dependence on a few export commodities? Here also the outward looking countries have achieved a little more success, although all the Southeast Asian countries are still highly dependent on a few exports. The rapid expansion of exports from the Philippines, Thailand and Malaya was achieved not only through the expansion of the older exports but also through the addition of new export commodities. For instance, Thailand compensated for the declining Japanese demand for her rice by the expansion of maize exports. The Malayan Government encouraged not only the replanting of the new high-yielding rubber trees, but also the expansion of new crops such as palm oil. The post-war development of iron mining in the

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(1) Paauw, loc cit, pp. 83-89 and Figure II.

East coast of Malaya promises not only to contribute to economic diversification but also to longer run economic development. In contrast, given the drastic reduction in the exports of petroleum, timber and minerals which formed about half of her total in pre-war days, Burma is now more dependent than ever on her rice exports. Similarly, the quantum index of Indonesian exports cover only her four major exports, petroleum, rubber, tin and copra and does not reflect the reduced volumes in a wide variety of minor exports which she has suffered in the post-war period.

17. The picture is not appreciably different when we look at this matter more broadly in terms of the ratio of exports to total national products in these countries. From the figures given in para. 11, we should expect the ratio of export to total national product to be declining in all countries except Malaya, though for somewhat different reasons. In the Philippines and Thailand, the ratio would be declining because the rapid expansion in exports has been accompanied by an even more rapid expansion of total national product. In Burma, it would be declining because of an absolute decline in the volume of exports with very little growth in total national product. This seems to be borne out by the direct estimates of the ratio of exports to national income given by Professor Paauw. According to him, comparing 1938 with the average for 1957-59, the Philippines has reduced the ratio of exports to GNP from 20% to 9%; Thailand has reduced the ratio of exports to her Gross Geographical Product from 19% to 16%; Burma has reduced the ratio of exports to her GDP from 33% to 19%; and Indonesia from 24% to 5%. These figures have to be interpreted cautiously. First, the concept of the national product used in calculating the ratio varies: GNP (Gross National Product), GDP (Gross Domestic Product) and GGP (Gross Geographical Product). Second, and more significant, there were varying degrees of overvaluation of currency, particularly in Indonesia and in the Philippines (before the devaluation of the peso in 1962). Taking this into account Professor Paauw suggests that the ratio of export to national products in both countries was around 17% in the late 1950's. (1) Taking it by and large, we may conclude that countries like the Philippines and Thailand have not increased but have reduced to some extent the ratio of export

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(1) Paauw, loc cit, p. 80.

to national product through a vigorous policy of export expansion and they cannot be said to be more dependent on exports than Burma and Indonesia. (2)

18. Granted that, without increasing their dependence on exports, the Philippines and Thailand have beenmore successful in increasing the share of industry and in reducing the share of agriculture in their economies than Burma and Indonesia, how far are they successful in achieving the further objective of increasing the share of their nationals in the incomes and economic activities of their countries? Here, since Burma and Indonesia pursued this goal of economic nationalism through direct take-overs by the state and the Philippines and Thailand pursued this objective indirectly by encouraging the private enterprise of their nationals, it is difficult to make a meaningful comparison. Although statistics are not available, one would guess that through progressive nationalization of foreign enterprises the governments of Burma and Indonesia would by now control a larger share of the total economic activities of their countries than do the governments of the Philippines and Thailand and their private nationals taken together. But as we have seen, while Burma and Indonesia are getting a larger share of a smaller or a less rapidly growing cake, the Philippines and Thailand are increasing the relative shares of their nationals in a setting of rapid economic expansion, progressively acquiring experience and knowledge to better their position further. Most impartial observers in the Philippines and Thailand would agree that the relatively open policy towards foreign enterprise adopted in these countries has not led to foreign economic domination and the re-establishment of the foreign "stranglehold" in the way feared by Burma and Indonesia. Moreover, the governments of the Philippines and Thailand have not followed policies of _laissez-faire_ which might have handicapped their nationals, but a judicious system of government support to improve the competitive position of their private entrepreneurs. Here again, the Philippines seem to have

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(2) The ratio of exports to GDP remains high for the Federation of Malaya at about 90% but she has been able to achieve a considerable degree of stability due to export taxes and other factors. Cf. C.H. Harvie, "Export Multiplier and the Stability of the Federation of Malaya's Economy", _Malayan Economic Review_, April 1964, pp. 80-89.

achieved the most striking success. As a leading authority on the Philippines Economy has said recently:

> "Equally remarkable has been the rapid Filipinization of all major economic sectors. Export production, with the major exception of mining in which foreign capital and management is still prominent, has been rapidly transferred to Filipino ownership and management. Commerce, both foreign and domestic, with the exception of the ubiquitous international oil distributing firms, and a few large export-import firms, is now dominated by Filipino ownership and management and heavy nationalist pressures are being maintained on the remaining Chinese and Western interests.
>
> Similarly, public utility services, including transport and communications, are virtually one hundred per-cent Filipino owned and managed. Finally, the post-war period has seen the emergence with government encouragement of a sophisticated structure of money and capital market institutions essentially owned and controlled by Filipinos". (1)

19. What are the implications of these two different patterns of economic development which we have described for the economic future of Southeast Asia? Much will, of course, depend on the outcome of the situation in Vietnam and the Indonesian threat to Malaysia. Assuming that these crises can be settled or contained without widening the area of conflict, we may try to outline the type of economic problems which the Southeast Asian countries may have to face in future.

20. The Philippines, Thailand and Malaya may be able to carry on for some time with their present pattern of economic development based on the expansion of primary exports and industrialization through progressive import substitution. But, sooner or later, they may encounter difficulties both in export expansion and import substitution. First, the world demand factors, such as the substitution of synthetic for natural rubber, may turn against some of their major export commodities. Second, as their rapid population growth and export expansion press against the limits of their natural resources, they are likely to encounter increasing difficulties on the supply side of export expansion. Third, as they extend their process of import-substitution from the simpler types of consumers goods to the more complex types of consumers' durables and capital goods, they may increasingly feel the limitations of the smallness of their domestic markets.

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(1) F.H. Golay, "Aspects of Filipino Entrepreneurship", paper given April, 1965, to the San Francisco meeting of the Association for Asian studies, See also his book <u>The Philippines</u>: cited above, Ch. XIV.

21. Burma and Indonesia have still to solve the primary problem of making a more effective use of their natural resources and their opportunities for international trade. Since their inward-looking economic policies spring ultimately from deep-seated political and psychological attitudes, their problem is essentially a political one which cannot be dealt with purely in terms of economic analysis. Thus, it is not the function of a mere economist like myself to urge them to relax some of their prevailing attitudes for the sake of expanding their exports. Ultimately, they must make their own decision about the correct balance between political and economic objectives. What I can however do is to clarify some of the points relevant to this decision. First, the more outward looking policy toward international trade need not affect their "neutralist" position in foreign policy. Indeed, the most advantageous trade policy for them would be a strictly neutralist attempt to trade with whatever country that offers the most favourable trading terms. To shift trading relationships from one country or bloc of countries to another is merely a "diversion" of trade. To "create" trade, these countries should increase the number of their trading partners. They must diversify not only their exports but also the direction of exports. Second, it should be pointed out that population is increasing almost as rapidly in Burma and Indonesia as in the other Southeast Asian countries. We have seen that these two countries increased their aggregate national product by a mere 11% above the pre-war level by 1960. Allowing for the population growth the two decades from 1940 to 1960 it is very doubtful that whether these countries have so far regained their pre-war level of per capita national output. So long as total output cannot be expanded through the expansion of exports, the pressure on standards of living must continue. In Indonesia particularly, population pressure is serious not only because it reduces the standard of living but also because it tends to divert land from cash export crops to subsistence agriculture, thus aggravating the foreign exchange shortage. Finally, even if the governments of Burma and Indonesia are unwilling or unable to admit direct private foreign investment, they could take more vigorous action to expand exports from the mining and plantation sector, either through state enterprise or joint enterprises with suitable foreign partners. With the resulting increase in foreign exchange earnings, they could expand output of domestic consumers' goods thus alleviating the present austerities created

by heavy import restrictions. While it might be possible to adopt direct state production methods in the mining and plantation exports, I feel that they would still have to make a greater use of the indirect economic incentive methods in stimulating output from the peasant export sector. In Burma particularly, where the peasants have suffered from the fixed prices paid by the State Agricultural Marketing Board, a more vigorous and flexible use of positive economic incentives should not only expand production but also help to diversify peasant exports to meet new trends in the world market demand.

22. Proposals for regional Economic Unions and Common Markets are very popular nowadays and it is therefore natural to ask whether a closer regional co-operation among the Southeast Asian countries might not offer a promising way of widening their markets and perhaps bringing about a more outward looking frame of mind in Burma and Indonesia. While I am keenly aware of the long-term advantages of closer regional economic co-operation in Southeast Asia, I cannot help feeling that, at the moment, the more ambitious types of proposal, such as a Common Market or a Regional Investment Planning Authority, are somewhat premature. Without attempting to go systematically into the pros and cons of these proposals, I may draw three implications from my previous analysis which indicate a cautious attitude towards wide-sweeping proposals for regional economic co-operation.

23. To begin with, there are the hardening patterns of the inward and outward-looking economic attitudes in Burma and Indonesia on the one hand and Malaysia, Thailand and the Philippines on the other. It is difficult enough to suppress nationalism among the newly independent countries even when they have the same type of approach to economic development. Thus ASA which is made up of the three outward-looking Southeast Asian countries has so far achieved very little in economic co-operation. The problems are considerably increased when we are trying to combine two groups of countries with very different outlooks on economic development. If the proposed Customs Union or Common Market is to be worked on a more or less free enterprise basis, the Burmese and Indonesians would merely dismiss it as a device by which the foreign capitalists, whether Southeast Asian or others, were attempting to obtain the old "stranglehold" on their economies. If

the Economic Union is to be on the basis of Regional Planning, co-ordinating investment plans to avoid duplicating productive capacity, insuperable difficulties and jealousies would arise over the geographical allocation of what are considered to be the more desirable types of industry. For instance, which country is to get "the Steel Mill"? Apart from these subjective obstacles, the different patterns of economic development which have taken place in the last two decades in the two groups of countries are bound to create genuinely serious structural problems for regional integration. To take one obvious example, consider the difficulties of a Payments Union between the strong and stable currencies of the outward-looking countries with those of the inward-looking countries are deeply rooted in their slow rate of export expansion and their policies which have resulted in a chronic state of suppressed capital flight, it is difficult to see how the rates of exchange of these currencies can be brought into line with the others without radical changes in their economic policies.

24. I have said that the process of import-substitution in the outward-looking countries may increasingly feel the limitations of the smallness of their domestic markets. Most people jump too readily from this to the conclusion that therefore the only remedy is to have a wider Common Market. There is also another path which deserves to be explored. It is frequently forgotten that while a small country may have a small domestic market, the size is not necessarily fixed once and for all. It can in fact be increased appreciably even within a relatively short period both by the growth of population and by the growth of per capita income. Thus, if the outward-looking Southeast Asian countries can continue to expand their exports by increasing productivity in their existing lines of primary exports and by creating a favourable economic environment which might, with luck, enable them to strike into new lines of primary exports, they may be able to expand the size of their domestic markets quickly enough to keep on adding further stages of import substitution, without being held back by a foreign exchange shortage. If they can maintain this process for some time, their domestic industrial base may become strong enough to enable them to supplement their primary exports with further exports of manufactured and semi-processed goods.

Without this possibility, it is difficult to see how the smaller European countries, such as the Scandanavian countries, have managed to launch themselves into economic development in the past without the benefits of large regional common markets or colonies. Of course, this escape route may be increasingly difficult for the "late comers" like Southeast Asia who have also to contend with the competition from countries like Hong Kong, India and Pakistan in the export market for the simpler types of manufacture. But, perhaps international trade in manufactures may look more promising if we take into account not only finished products but also the possibility of trading in semi-processed goods simpler capital goods affording opportunities for a "vertical" international division of labour among Asian Countries. When this possibility is supplemented by internal economic measures such as expansion of domestic food production, improvements in internal transport and marketing facilities, a more equal distribution of incomes between the towns and the countryside, etc., the initial smallness of the domestic market need not necessarily prove to be a fatal handicap for economic development. It is worth stressing this point, because an underdeveloped country may easily fall into the danger of not pressing forward urgently enough with its own economic reforms because it is distracted by the great expectations held out to it by the proposals for a regional economic union.

25. Another favourite argument in support of a regional economic association is that it may enable a greater amount of outside economic aid to be funnelled into the region, say, through a Regional Economic Development Bank. The Southeast Asian countries can, of course, use more economic and technical aid of the right type. But, as we have seen, the basic reason for the slow economic growth of Burma and Indonesia is to be found, not in the shortage of material resources but in the deep-seated political attitudes which have prevented them from creating a favourable economic environment for making a more effective use of their own existing resources. For these two countries at least the primary problem still remains how to stimulate the expansion of trade and a mere increase in the amount of aid (even if a country like Burma were willing to accept more aid) may not have much effect unless the fundamental attitudes governing economic policy can be shifted in a more outward-looking direction.

26. What then is the role of Japan in the economic future of Southeast Asia? Given Japan's position as the most industrially developed Asian country, with a high degree of complementarity of resources with Southeast Asia and a high and growing proportion of both her trade and funds for economic co-operation devoted to the region, Japan is bound to play a crucial role in the economic future of Southeast Asia. If we envisage the immediate possibility of far-reaching forms of regional economic association, Japan must be looked upon, either on her own or jointly with other developed countries, or ECAFE as one of the main pillars on which such a regional economic structure may be built. But Japan's importance is even greater if we adopt,as I would prefer to do, a more realistic approach, starting from the economic conditions in Southeast Asia as they exist now and assuming a minimum change of attitudes, particularly on the part of Burma and Indonesia.

27. Given her friendly relations with these two countries, Japan is currently in a more effective position to help them than any other advanced country; and given that the regional economic prosperity of Southeast Asia may be jeopardised by the increasing gap in economic development between these two countries and their neighbours, Japan may find it in her long run interest to make special efforts to help them. Take for instance the declining Japanese demand for Southeast Asian rice. While Thailand has been able to compensate for it by expansion in exports of maize the structure of Burma's agriculture has been more rigid and she still depends principally on her rice exports. It would be interesting to explore how far Japan might be able to modify internal agricultural policies to admit more rice from Burma. (1) This, however, should be looked upon as a "pump-priming" operation to use Japanese capital and technical aid to assist Burma in the expansion of her other non-peasant exports and her import-substituting industries. The Japanese experts are said to have shown a particular flair in analysing the prospects of investment projects in Asian conditions and in

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(1) See particularly the suggestive paper by Katsu Yanaihara on "Problems of the Rice Trade Between Burma and Japan - A Case Study on Exports of Primary Products in Underdeveloped Countries", The Developing Economies, March 1964.

suggesting new industries under conditions of limited markets and their assistance should be particularly valuable in Burma. (1)

28. Apart from these special efforts directed towards the inward-looking countries, I should like to suggest that Japan's role is not merely to expand trade along existing lines but also make flexible adjustments to enable the Southeast Asian countries to make their crucial transition from the export of primary products to the exports of manufactured goods and to extend the scope of their manufacturing industries from this domestic to the world market. The Southeast Asian countries can learn much from Japan's policies adopted during her own transition period. But they will be further assisted if Japan (together with other advanced countries) were to adopt a policy of progressive withdrawal from the exports of simpler manufactures to make room for the exports from the underdeveloped countries and to turn progressively towards the export of the more complex and capital and skill-intensive products in which her comparative advantages are increasing. (2)

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(1) I speak here purely as an outside economist who has no connections with the Government of Burma.

(2) Cf. Kiyoshi Kojima, "The Pattern of Triangular Trade among the U.S.A., Japan and Southeast Asia", The Developing Economies, March-August, 1962 and also Toshiaki Yoshihara, "Japan's Trade with Developing Countries" in the same issue of the Journal for further discussion of the adjustments which may be made in the Commodity composition of Japan's trade with Southeast Asia.