# ECONOMIC AND SOCIAL SURVEY OF ASIA AND THE PACIFIC

1992

UNITED NATIONS

ECONOMIC AND SOCIAL COMMISSION FOR ASIA AND THE PACIFIC

# ECONOMIC AND SOCIAL SURVEY OF ASIA AND THE PACIFIC 1992

## PART ONE
## RECENT ECONOMIC AND SOCIAL DEVELOPMENTS

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# FOREWORD

This is the forty-sixth issue of the *Economic and Social Survey of Asia and the Pacific*. It is divided into two parts, as in previous years. Part one analyses recent economic and social developments in the region; part two deals with expansion of investment and intraregional trade as a vehicle for enhancing regional economic cooperation and development in Asia and the Pacific.

There has been a steep decline in the growth of world output and trade during the early years of the 1990s. This unfavourable development in the international environment has been a significant cause of some deceleration of economic growth in the region. Nevertheless, the increasing strength of the domestic market, the rapid expansion of intraregional trade and investment, and flexible domestic policies have enabled the region to sustain remarkably high growth rates, though with considerable variation among countries.

Economic growth does not automatically bring about a socially optimal pattern of development. The objective of establishing such a pattern should be to ensure an improvement in the living standards and quality of life of all groups of the population, while ensuring adequate protection of the environment and the natural resource base to make the process of growth and development sustainable. The issues that feature prominently in this context are: achieving growth with stability; the alleviation of poverty; improvement in literacy, education, health and nutrition; and the preservation of environmental quality. Accordingly, the *Survey* devotes considerable attention to analysis of performance and policies with regard to these issues. Health and nutrition are singled out for especially detailed treatment in consideration of their significance as major determinants of socio-economic well-being. In addition, the vast ESCAP region encompasses many economies with severe structural handicaps – the least developed, land-locked and island economies and economies in transition. The particular problems confronting them and the related policy choices are also dealt with at some length.

There is increasing recognition of the imperatives of regional cooperation in a wide range of activities as a means not only to provide a further boost to the economic and social development of the region as a whole but also to enable the lagging economies to become more active participants in that process. The focus in part two of the *Survey* is on trade and investment – the two most significant forms of cross-border transactions – as instruments of strengthening regional cooperation and development. The intensity of intraregional trade and investment flows is analysed with particular attention to the evolving interrelationships between them. The potential of greater benefits from the intraregional trade-investment nexus, in view of emerging complementarities among economies of the region, is examined; the constraints to a fuller realization of such potential are identified; and finally, policy options to overcome the constraints are suggested.

Owing to some unavoidable difficulties, part two could not be included in the present volume and will be published separately.

Like previous *Surveys*, this issue is published on the responsibility of the ESCAP secretariat and the views expressed do not necessarily reflect those of member and associate member Governments.

Rafeeuddin Ahmed
Executive Secretary

February 1993

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The term "ESCAP region" is used in the present issue of the *Survey* to include Afghanistan, Australia, Azerbaijan, Bangladesh, Bhutan, Brunei Darussalam, Cambodia, China, Commonwealth of the Northern Mariana Islands, Cook Islands, Democratic People's Republic of Korea, Fiji, French Polynesia, Guam, Hong Kong, India, Indonesia, Iran (the Islamic Republic of), Japan, Kazakhstan, Kiribati, Kyrgyzstan, Lao People's Democratic Republic, Macau, Malaysia, Maldives, Marshall Islands, Micronesia (Federated States of), Mongolia, Myanmar, Nauru, Nepal, New Caledonia, New Zealand, Niue, Pakistan, Papua New Guinea, Philippines, Republic of Korea, Republic of Palau, Samoa, Singapore, Solomon Islands, Sri Lanka, Tajikistan, Territory of American Samoa, Thailand, Tonga, Turkmenistan, Tuvalu, Uzbekistan, Vanuatu and Viet Nam. The term "developing ESCAP region" excludes Australia, Japan and New Zealand.

The term "the Asian republics" in this issue of the *Survey* refers to six of the successor States of the former Union of Soviet Socialist Republics: Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan.

The designations employed in this publication do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country or territory or of its authorities, or concerning the delimination of its frontiers.

Mention of any firm or licensed process does not imply endorsement by the United Nations.

The abbreviated title *Survey* in footnotes refers to *Economic and Social Survey of Asia and the Pacific* for the year indicated.

Many figures used in the *Survey* are on a fiscal year basis and are assigned to the calendar year which covers the major part or second half of the fiscal year.

Reference to "tons" indicates metric tons.

The term "billion" signifies a thousand million.

In the tables, three dots (...) indicate that data are not available or are not separately reported, a dash (–) indicates that the amount is nil or negligible, and a blank indicates that the item is not applicable.

In dates, a hyphen (-) is used to signify the full period involved, including the beginning and end years, and a stroke (/) indicates a crop year, a fiscal year or plan year. The fiscal years, currencies and 1992 exchange rates of the ESCAP economies are listed in the following table:

| *Country or area* | *Fiscal year* | *Currency and abbreviation* | *Mid-point rate of exchange for $1 as of June 1992* |
|---|---|---|---|
| Afghanistan | 21 March to 20 March | Afghani (Af) | 50.600 |
| Australia | 1 July to 30 June | Australian dollar ($A) | 1.344 |
| Azerbaijan | 1 January to 31 December | Russian Rouble (Rb)[a] | ... |
| Bangladesh | 1 July to 30 June | Taka (Tk) | 39.000 |
| Bhutan | 1 April to 31 March | Ngultrum (Nu) | 25.890 |
| Brunei Darussalam | 1 January to 31 December | Brunei dollar ($Br) | 1.60[b] |
| Cambodia | 1 January to 31 December | Riel (CR) | 1,000.000 |
| China | 1 January to 31 December | Yuan renminbi (YRMB) | 5.420 |
| Commonwealth of the Northern Mariana Islands | ... | United States dollar ($) | 1.000 |
| Cook Islands | 1 April to 31 March | New Zealand dollar ($NZ) | 1.834 |
| Democratic People's Republic of Korea | ... | North Korean Won (Won) | 0.940[c] |
| Fiji | 1 January to 31 December | Fijian dollar ($F) | 1.475 |
| Guam | 1 October to 30 September | United States dollar ($) | 1.000 |
| Hong Kong | 1 April to 31 March | Hong Kong dollar ($HK) | 7.735 |
| India | 1 April to 31 March | Rupee (Rs) | 25.890 |
| Indonesia | 1 April to 31 March | Rupiah (Rp) | 2,035.000 |
| Iran (Islamic Republic of) | 21 March to 20 March | Rial (Rls) | 63.823 |
| Japan | 1 April to 31 March | Yen (Y) | 127.200 |
| Kazakhstan | 1 January to 31 December | Russian Rouble (Rb) | 407.000[d] |
| Kiribati | 1 January to 31 December | Australian dollar ($A) | 1.344 |
| Kyrgyzstan | 1 January to 31 December | Russian Rouble (Rb) | 407.000[d] |
| Lao People's Democratic Republic | 1 July to 30 June | New kip (NK) | 717.000 |
| Macau | ... | Macau Pataca (MOP) | 7.963 |
| Malaysia | 1 January to 31 December | Ringgit ($M) | 2.502 |
| Maldives | 1 January to 31 December | Rufiyaa (Mal Rf) | 10.945 |
| Mongolia | 1 January to 31 December | Tughrik (Tug) | 40.000 |
| Micronesia (Federated States of) | ... | United States dollar ($) | 1.000 |
| Myanmar | 1 April to 31 March | Kyat (K) | 5.965 |
| Nauru | 1 July to 30 June | Australian dollar ($A) | 1.344 |
| Nepal | 16 July to 15 July | Rupee (NRs) | 42.700 |
| New Zealand | 1 April to 31 March | New Zealand dollar ($NZ) | 1.834 |
| Niue | 1 April to 31 March | New Zealand dollar ($NZ) | 1.834 |
| Pakistan | 1 July to 30 June | Rupee (PRs) | 25.130 |
| Papua New Guinea | 1 January to 31 December | Kina (K) | 0.959 |

| *Country or area* | *Fiscal year* | *Currency and abbreviation* | *Mid-point rate of exchange for $1 as of June 1992* |
|---|---|---|---|
| Philippines | 1 January to 31 December | Peso (P) | 24.910 |
| Republic of Korea | 1 January to 31 December | Won (W) | 788.100 |
| Republic of Palau | ... | United States dollar ($) | 1.000 |
| Samoa | 1 January to 31 December | Tala ($WS) | 2.443 |
| Singapore | 1 April to 31 March | Singapore dollar ($S) | 1.613 |
| Solomon Islands | 1 January to 31 December | Solomon Islands dollar ($SI) | 2.933 |
| Sri Lanka | 1 January to 31 December | Rupee (SLRs) | 44.080 |
| Tajikistan | 1 January to 31 December | Russian Rouble (Rb) | 407.000[d] |
| Thailand | 1 October to 30 September | Baht (B) | 25.310 |
| Tonga | 1 July to 30 June | Pa'anga (P) | 1.336 |
| Turkmenistan | 1 January to 31 December | Russian Rouble (Rb) | 407.000[d] |
| Tuvalu | 1 January to 31 December | Australian dollar ($A) | 1.344 |
| Uzbekistan | 1 January to 31 December | Russian Rouble (Rb) | 407.000[d] |
| Vanuatu | 1 January to 31 December | Vatu (VT) | 111.520 |
| Viet Nam | 1 January to 31 December | New dong | 10,875.000[c] |

***Sources:*** United Nations, *Monthly Bulletin of Statistics,* vol. XLVI, No. 12 (December 1992); and national sources.

[a] Azerbaijan also use Manat as an alternate currency. [b] August 1992. [c] September 1992. [d] November 1992.

## ABBREVIATIONS

| | |
|---|---|
| ACP | African, Caribbean and Pacific |
| ADB | Asian Development Bank |
| ASEAN | Association of South-East Asian Nations |
| CIS | Commonwealth of Independent States |
| CMEA | Council for Mutual Economic Assistance |
| CPI | consumer price index |
| EC | European Community |
| EIB | European Investment Bank |
| ERM | Exchange Rate Mechanism |
| EDF | European Development Fund |
| FAO | Food and Agriculture Organization of the United Nations |
| FDI | foreign direct investment |
| GATT | General Agreement on Tariffs and Trade |
| GDP | gross domestic product |
| GNP | gross national product |
| IDA | International Development Association |
| IMF | International Monetary Fund |
| NIEs | newly industrializing economies |
| NMP | net material product |
| OECD | Organisation for Economic Cooperation and Development |
| STABEX | system of stabilization of export earnings |
| UNDP | United Nations Development Programme |
| UNTAC | United Nations Authority in Cambodia |
| VAT | value added tax |
| WHO | World Health Organization |

# I. WORLD ECONOMIC DEVELOPMENTS AND PROSPECTS

## A. OUTPUT, EMPLOYMENT AND INFLATION

### 1. Output trends

The world economy was sluggish in 1992 and its future course uncertain. Recession, having first hit a number of industrialized countries in 1990, lingered on. While the North American economies stemmed the fall in output, the European economies became weaker. Output fell for the second year in the United Kingdom of Great Britain and Northern Ireland and grew slowly in France and Italy. The rate of growth in Germany was reduced to less than half of the 1990 rate of economic growth in west Germany. The smaller economies of Finland, Sweden and Switzerland remained in recession. In Japan also growth decelerated sharply. Thus, average output growth in the industrial countries, still a low 1.5 per cent, improved over the 0.7 per cent growth in 1991. In that year, aggregate world output had declined by 0.6 per cent, marking the first contraction in world output in the post-war era. The decline was caused by severe contraction of output in eastern Europe and the former Soviet Union, in conjunction with the less than 1 per cent growth in the industrialized countries. The average growth figure for the industrialized countries was boosted by Japan's 4.5 per cent rate of growth (table I.1).

An estimated 0.4 per cent world economic growth in 1992 reflected the weak growth impulse in the industrialized countries and continuing output contraction in eastern Europe and the successor States of the former Soviet Union. The year 1993 was projected to be better for the world economy with a 2 per cent growth. The latest projection revised downwards those made earlier, as economic recovery in the industrial countries appeared to be weak, a quick recovery of the economies in transition appeared less likely, and peace and stability in the world appeared less secure in the face of numerous and diverse conflicts persisting around the world contrary to expectations of a more peaceful world in the post-cold war era.

In 1992, Japanese output slowed down to an estimated 1.8 per cent. The positive effect of the reversal of output decline in North America was offset by the slow down in Japan. The slower rate of fall in output in the United Kingdom and slight growth in other European Community (EC) countries, enabled EC to achieve growth of 1.3 per cent, an improvement over the 0.6 per cent in 1991. However, in the successor States of the former Soviet Union the fall in output accelerated although it had slowed in eastern Europe. With the recovery from war-related set-backs in West Asian countries and continued strong growth in East and South-East Asia, the developing countries enhanced their rate of growth from 3.4 per cent in the previous year to 4.5 per cent. Nevertheless, in 1992 world economic growth, weighed down by slow growth in industrial countries and negative growth in eastern Europe and the successor States of the former Soviet Union, achieved only a low 0.4 per cent.

The volume of output in eastern European countries and the successor States declined by an estimated 18.4 per cent in 1992, following a 16 per cent fall in 1991. The situation was especially difficult in the successor States of the former Soviet Union, where output fell at an annual rate of 23 per cent in 1992, exceeding the 17 per cent estimated decline in the former Soviet Union in 1991. On the other hand, the rate of contraction of output was slowing in each of the eastern European economies in transition, especially Czechoslovakia, Hungary and Poland. These three countries had been in transition for a longer time and had achieved greater success in stabilizing prices, employment and output. Output decline also slowed in Bulgaria and Romania, although the rates of decline at 10.5 per cent in Bulgaria and 9.6 per cent in Romania were still high. The situation in the successor States of the former Soviet Union, was more unstable because of the sharp changes that had taken place in the early stages of their transition. In the Russian Federation, for example, consumer prices in June 1992 were estimated to be 13 times higher than in June 1991 and 10 times higher in the first half of 1992 than in the corresponding period of 1991, an outcome of extensive price reforms carried out in January 1992.

Growth in investment was estimated to be half the level of the year before. Exports fell by 35 per cent and imports by 24 per cent; the real income of an average household had declined by one third since 1991.

In the developing countries growth was more than a percentage point higher in 1992 than in 1991. Aggregate growth, however, was largely influenced by greatly accelerated growth in China and continued high growth in other East and South-East Asian economies. In Africa, which was suffering from a severe drought, the average rate of growth at 2.3 per cent in 1992 was only marginally better than the 2.1 per cent in 1991. The performance in the sub-Saharan African countries was much worse. Growth in Latin America and the Caribbean was expected to fall to 2 per cent in 1992 from a 2.9 per cent expansion in 1991. Chile, Argentina, Guatemala, Panama and Venezuela were among the faster-growing economies. Several countries in the region continued to correct the macroeconomic imbalances of the previous decade, thereby laying the foundation for long-term economic growth. Fiscal deficits were being reduced, inflation was slowing and privatization and liberalization policies were being implemented by most governments. The inflation and budget difficulties of Brazil, the largest economy of Latin America, however were an important exception. Several of the heavily indebted countries in the region were able to ease their debt situations considerably by reaching agreements for debt reduction with commercial bank creditors. The situation was also improved by the return of capital inflow in the form of both repatriation of flight capital and new foreign direct and portfolio investment resulting from improved business confidence.[1]

Towards the end of 1992, there were indications that the United States economy was strengthening. An estimated 3.9 per cent growth in the third quarter was the highest recorded in four years. However,

[1] This account draws on United Nations, "The world economy at the end of 1992: background for an international policy agenda", 16 December 1992; "The world economy in 1992: an update" (E/1992/INF/8), 22 October 1992; and *World Economic Survey 1992: Current Trends and Policies in the World Economy* (United Nations publication, Sales No. E.92.II.C.1).

**Table I.1. World output, 1989–1993**

*(Annual percentage change)*

| | *1989* | *1990* | *1991* | *1992*[a] | *1993*[b] |
|---|---|---|---|---|---|
| World | 3.3 | 1.7 | –0.6 | 0.4 | 2.0 |
| Industrial countries | 3.4 | 2.4 | 0.7 | 1.5 | 2.0 |
| Seven major countries | 3.4 | 2.4 | 0.6 | 1.6 | 2.0 |
| Canada | 2.3 | –0.5 | –1.7 | 1.3 | 2.5 |
| Japan | 4.8 | 5.2 | 4.5 | 1.8 | 2.3 |
| France | 4.1 | 2.3 | 1.2 | 1.8 | 1.6 |
| Germany[c] | 4.0 | 5.0 | –[d] | 2.1 | 0.8 |
| Italy | 3.1 | 2.0 | 1.6 | 1.2 | 0.5 |
| United Kingdom | 2.1 | 0.6 | –2.2 | –1.0 | 1.3 |
| United States | 2.5 | 0.8 | –1.2 | 1.8 | 2.6 |
| Other industrial countries | 3.6 | 2.4 | 0.7 | 1.1 | 1.8 |
| European Community | 3.6 | 2.8 | 0.6 | 1.3 | 1.2 |
| Developing countries | 3.5 | 3.4 | 3.4 | 4.5 | 5.0 |
| Latin America | 1.1 | 0.1 | 2.9 | 2.0 | 2.5 |
| Africa | 3.0 | 2.9 | 2.1 | 2.3 | 3.0 |
| West Asia | 3.2 | 1.9 | – | 5.0 | 5.5 |
| South and East Asia | 6.1 | 6.3 | 5.6 | 5.5 | 6.0 |
| China | 3.6 | 5.2 | 7.0 | 10.0 | 10.0 |
| Mediterranean | 0.3 | 2.0 | –7.9 | –5.4 | –5.0 |
| Economies in transition | 2.3 | –5.0 | –16.0 | –18.4 | –3.5 |

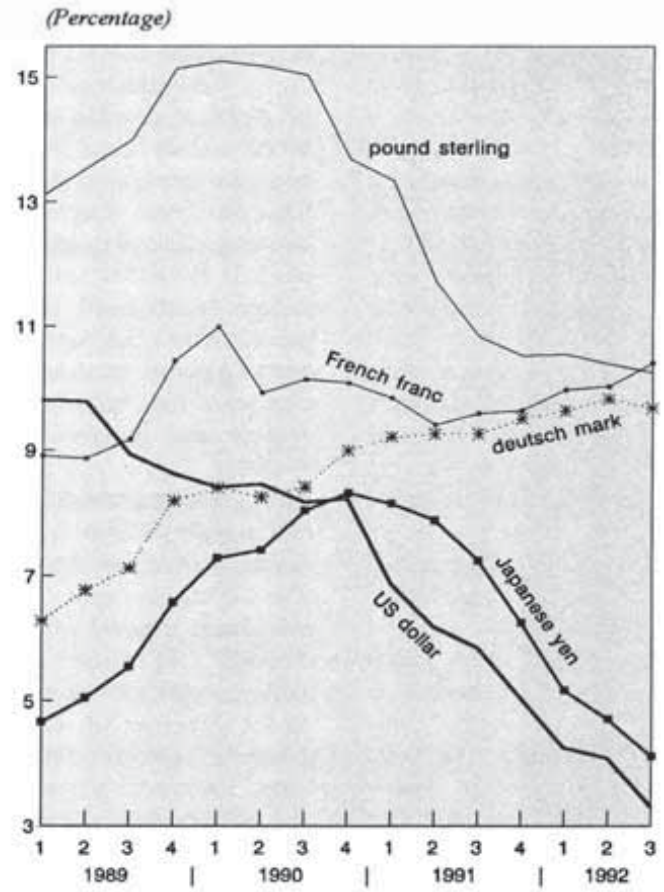
*Source:* United Nations, "The world economy at the end of 1992: background for an international policy agenda", 16 December 1992.

[a] Preliminary estimate. [b] Forecast. [c] Real gross national product. [d] Indicates discontinuity in the series: from 1991, Germany includes eastern Länder.

growth in Europe and Japan remained weak. Forecasters projected that the industrial economies would perform better in 1993, with a growth rate of 2 per cent. The recession was expected to bottom out, and direct government action in the form of packages of extra fiscal spending and tax cuts was expected to provide stimulus. In August 1992 the Japanese Government, for example, announced a spending package worth $86 billion to boost the economy. It was expected that Japan's economic growth would accelerate in 1993 as a result of that package as well as the increased confindence of households, investors and enterprises. In the United States, the new President-elect had promised a $220 billion public expenditure boost, which was expected to provide a confidence and an investment boost to the United States economy. These measures were envisaged as both the Japanese and the United States economies had displayed continued softness despite drastic decline in interest rates over the past two years (figure I.1).

Governments in Europe also were willing to boost their economies through additional spending, because monetary policies had been limited in effectiveness and had constrained manoeuvrability. This was reflected in the 12-nation EC negotiations in November-December 1992 to set up a new European Investment Fund within the European Investment Bank (EIB). It was envisaged that projects would receive 50 per cent private funding in collaboration with an EIB-centred public capital fund. This was expected to generate sufficient capital to finance infrastructural projects to stimulate the European economies. In addition, EC members agreed to reallocate, where possible, their budgetary spending to infrastructural projects, even though there might not be scope for additional spending.

**Figure I.1. International interest rates. London interbank three-month offer**




*Source:* International Monetary Fund, *International Financial Statistics*, December 1992.

## 2. The characteristic symptoms of the 1990-1991 recession

Since 1990 the industrial countries had succeeded in controlling inflation, perhaps at the expense of economic growth. The upward creep of inflation, which had started in 1987, had peaked by 1990 in all industrial countries except Germany. The acceleration of the German inflation rate since 1990 had dictated Germany's policies in 1991-1992 as discussed below. Unemployment rose in all industrial countries in 1991-1992 (figure I.2). In 1992, the average rate of unemployment in all industrial countries rose to 7.3 per cent: 9.2 per cent in EC, 7.4 per cent in the United States, and 9.7 per cent in other industrial countries. Stagnant economic growth and high rates of unemployment indicated the need to stimulate these economies by direct governmental intervention, as was being initiated in Japan, the United States and Europe. Continued large and rising budget deficits in many countries however remained a constraint on expansionary fiscal spending, as was the fear of rekindling inflation.

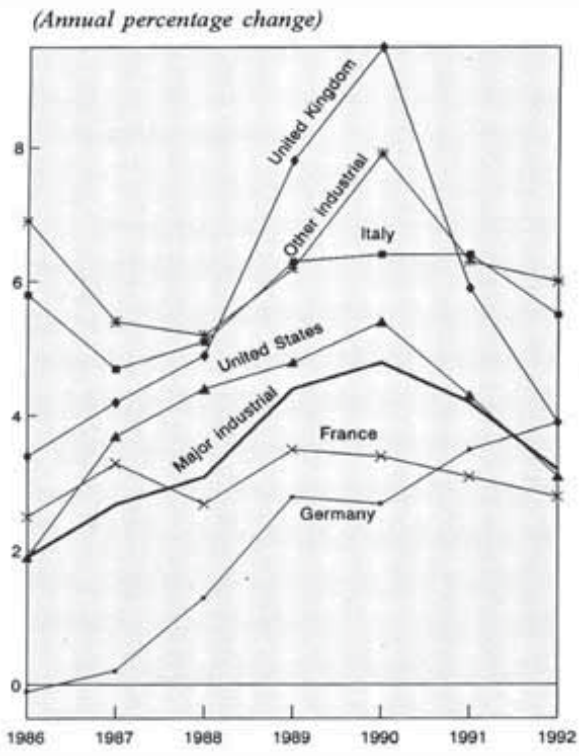
**Figure I.2. Unemployment and inflation rates**

**(a) Unemployment**

*(Percentage of total labour force)*


**(b) Consumer price inflation**

*(Annual percentage change)*




*Source:* United Nations, "The word economy at the end of 1992: an update", 6 October 1992.

The character of the 1990-1991 slow-down in the industrialized countries differed in important respects from the slow-downs of the 1970s and 1980s. Those earlier slow-downs were attributed mainly to disinflationary policies. The easing of monetary policies to soften the impact of the 1987 stock market crash had indeed been followed by tight monetary policies to stem rising inflation. However, the slow-down beginning in 1990 was more the result of "growth fatigue" than of disinflationary policies. The weakening demand in 1990-1991 reflected a loss of momentum after the long period of economic expansion since 1983. Demand was weakened by the cyclical deceleration in investment spending and the loss of consumer confidence. Both of these were conditioned by developments in the late 1980s.

Throughout the 1980s a major plank of policies and strategies in the industrialized countries had been the pursuit of price stability; that goal was largely achieved. However, following its steady decline in 1982-1986, inflation began to rise again, partly due to strain on capacity. Monetary policies were tightened to reduce inflationary pressures; in some countries, actions were delayed subsequently requiring greater and more sudden measures of adjustments. This further weakened the pace of economic activity in those countries. The failure in many countries to implement fiscal consolidation through the reduction of budget deficits kept real interest rates high to the detriment of investment and economic growth. At the same time, liberalized financial markets led to excessive private sector borrowing and unsustainable increases in asset prices. These prices later fell precipitously. Moreover, the persistent mismatch between skill composition of workforce and the requirements of

fast changing economic structures had kept unemployment rates high even during the period of sustained growth in the economies of Europe and North America.

These medium-term problems simultaneously facing all major countries exerted a drag on forces of recovery from the recent recession, which proved to be more protracted than had been foreseen. Households and enterprises played a major role in prolonging the recession through their efforts to improve balance sheets following sharp declines in the book value of financial assets and real estates. In addition, attempts by commercial banks to improve the quality of their assets led to a lower volume of lending than would have normally been associated with the decline in short-term interest rates in 1991-1992. Households continued to slow the rate of growth in consumer debt as unemployment rates increased and further increases were feared. Non-financial enterprises were burdened by debts acquired during a period of widespread mergers and acquisitions, most often financed by leveraged borrowing. Instead of making productivity-enhancing investments, these enterprises attempted to improve short-term cash flow by cutting costs through retrenchment.

In 1990-1992 the fear of unemployment was rising throughout Europe and North America, undermining consumer and business confidence. Consumer confidence surveys in the G-7 countries showed that the confidence index had dropped sharply since 1989. The drop in confidence deterred household spending and inhibited investment. The failure of economies to respond adequately to repeated doses of monetary easing in several countries reflected the prevalent crisis of confidence. Such was certainly the case in Australia, Canada, the United States, and Japan, where successive reductions had brought down interest rates to the lowest levels in many years.

Europe encountered an additional difficulty resulting from the unexpectedly large costs of German reunification. Early in 1991, as Germany was adjusting to the reunification process, annual inflation was recorded at approximately 4 per cent. That rate, considered too high by German standards, prompted the Bundesbank to tighten monetary policies. Owing to the high degree of financial integration between many other European economies and Germany, the resulting high European interest rates constrained growth throughout Europe.

In addition, EC countries as well as the applicants to EC membership, came under pressure to reduce fiscal deficits and meet other convergence criteria for participation in the economic and monetary union agreed on at Maastricht in December 1991. This also held back economic growth in the short run. Subsequent developments worsened the situation. In July 1992, the Bundesbank increased its discount rates to the highest level since 1931, reaffirming its determination to achieve the inflation target of 2 per cent a year. Other European countries had to follow suit, keeping their interest rates at a level higher than was justified by domestic economic conditions.

The German policy of maintaining high interest rates in order to achieve a lower level of inflation conflicted with the desire of other EC members to pursue a policy to overcome recession and economic stagnation. This policy conflict created tensions and turbulence within the European monetary system, anchored in the Exchange Rate Mechanism (ERM). Under the terms of the Maastricht treaty a European monetary union with a single European currency later in the decade was planned, which appeared to have come under strain as a result of the recent developments.

To ease tensions within ERM, in mid-September 1992 the Bundesbank lowered two key interest rates (the discount rate and the Lombard rate) by 0.5 and 0.25 percentage points. Austria, Belgium, the Netherlands and Switzerland followed suit by cutting their interest rates. However, the interest rate cuts were insufficient either to solve the ERM problems or to stimulate growth within Europe. Confidence in ERM eroded, resulting in a massive outflow of funds from countries with weaker currencies. This forced the British and the Italian Governments to suspend their ERM membership, letting their currencies float at least temporarily, and the Spanish Government to devalue the peseta by 5 per cent within ERM.

Since the Bundesbank concession was unable to usher in a general decline in European interest rates, the turmoil in the currency market was unabated. Late in November, the Swedish Central Bank was forced to stop linking the Swedish krona to the EC currency basket. The krona almost immediately lost 10 per cent of its value and 150 billion krona flowed out of the country within the period of a week. This occurred while the Swedish economy was in recession with a further decline in output anticipated for 1993. The floating of the krona exerted pressure on the Danish krone and the Norwegian krone, forcing both Denmark and Norway to raise interest rates to protect those currencies. The weaker Spanish and Portuguese currencies also came under pressure and both the peseta and the escudo were devalued.

Divergence in monetary policies thus provoked sharp changes in the exchange rates of the major

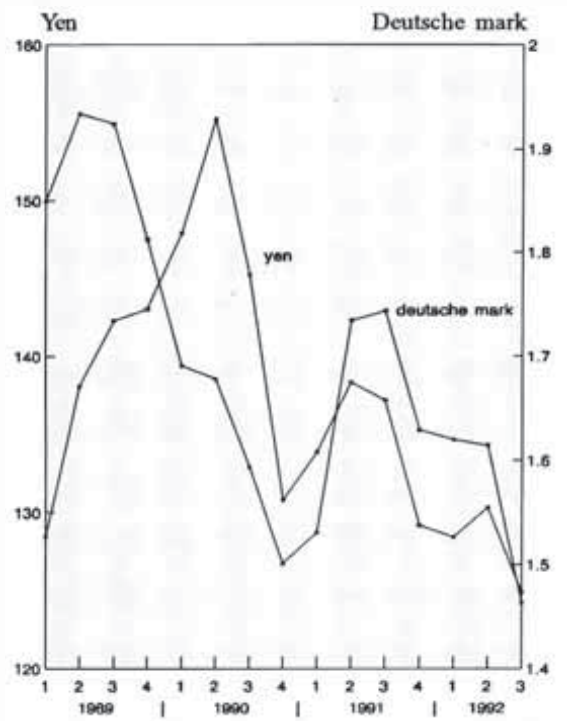
currencies in 1992 (figure I.3). By September, the dollar had fallen to a historic low against the deutsche mark and approached an all-time low against the yen. Repeated central bank interventions in the foreign exchange markets failed to stem the dollar's decline. However, with the instability in the European monetary system and the weakening of the Japanese and the German economies, the dollar started gaining later in the year. It also gathered strength from some indicators of better performance of the United States economy and in anticipation of a boost in the economy from the public investment package promised by the incoming United States Administration.

## B. INTERNATIONAL TRADE, BALANCE OF PAYMENTS AND FINANCIAL FLOWS

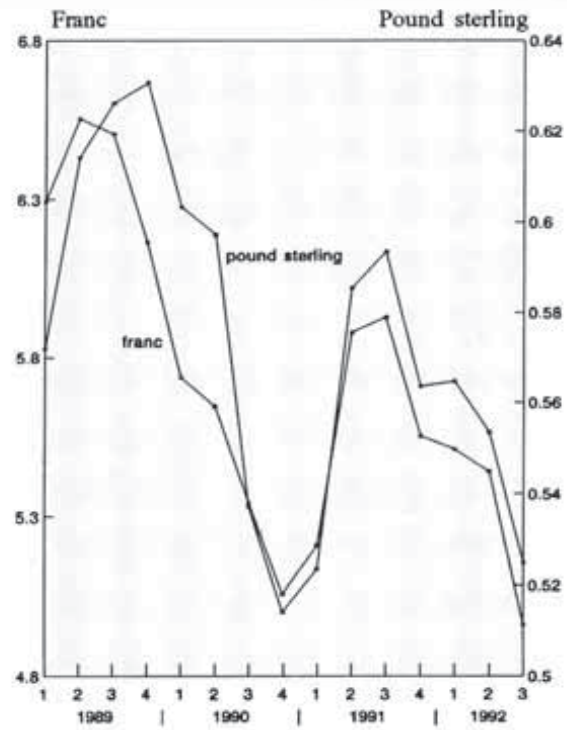
Growth in world trade decelerated sharply, from a volume growth of 7.7 per cent (average of exports and imports growth rates) in 1989 to 4.6 per cent in 1990 and 3.8 per cent in 1991. A relative improvement, 4.6 per cent growth was estimated in 1992. The pattern of growth in world trade reflected depressed demand for imports in the industrial countries owing to the recessionary conditions, and the collapse of trade among the former members of the Council for Mutual Economic Assistance (CMEA). Nevertheless, growth in world trade during 1990-1992 was still much faster than growth in world output. The developing countries experienced faster growth in their trade, with imports rising faster than exports. In 1991, their export volume grew at an average of 10.4 per cent and their import volume increased by 12.8 per cent. Rapid economic growth in East and South-East Asia resulted in increased demand for imports which, on average, had increased

**Figure I.3. Exchange rates. Selected major currencies**

*(Units of yen and deutsche mark per US dollar)*




*(Units of French franc and pound sterling per US dollar)*




*Source:* International Monetary Fund, *International Financial Statistics*, December 1992.

by 14.3 per cent. In Latin America also economic recovery led to a rapid increase of imports, by an estimated 15.5 per cent in 1991. In contrast, industrial country imports grew by a mere 2.9 per cent. This pattern was expected to continue in 1992. However, the imports of industrialized countries were expected to rise at a higher 3.7 per cent and those of the developing countries at a more moderate 9.5 per cent (table I.2).

Weak demand and the slow growth of imports in the industrial countries contributed to the continuing decline in the prices of primary commodities since 1989 (figure I.4). Non-fuel commodity prices fell by 4.5 per cent during the first half of 1992 over the same period of the previous year. This fall together with the continued increase in the prices of manufactured goods turned the terms of trade continuously against non-fuel-exporting developing countries since 1989. The oil-exporters' temporary gains during the height of the Persian Gulf crisis were also followed by losses as real oil prices came down to one of their lowest levels early in 1992 (figure I.4(b)).

**Table I.2. Summary indicators of changes in world trade, 1989–1992**

*(Annual percentage change)*

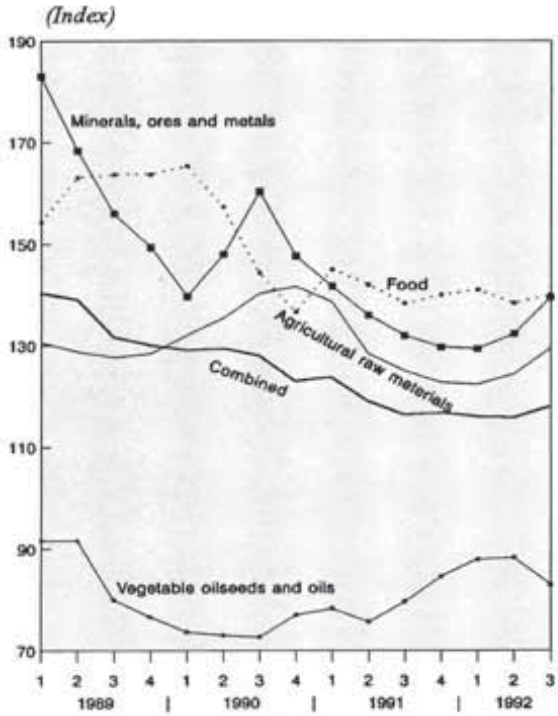
| | *1989* | *1990* | *1991* | *1992*[a] |
|---|---|---|---|---|
| Volume of exports | | | | |
| World | 7.5 | 4.8 | 3.7 | 4.5 |
| Developed market economies | 6.7 | 5.7 | 3.0 | 3.1 |
| North America | 8.3 | 7.8 | 6.0 | 5.3 |
| European Community | 6.8 | 6.8 | 2.0 | 3.0 |
| Japan | 3.8 | 5.5 | 2.3 | –0.2 |
| Other industrialized countries | 5.3 | 6.7 | 3.6 | 2.4 |
| Developing countries | 9.7 | 6.1 | 10.4 | 10.8 |
| Latin America | 6.8 | 3.1 | 4.1 | 7.3 |
| Africa | 5.7 | 9.2 | 2.3 | 3.9 |
| West Asia | 22.8 | 5.7 | –0.4 | 3.1 |
| South and East Asia | 10.5 | 7.4 | 15.3 | 15.8 |
| Mediterranean | 4.3 | 2.7 | 2.4 | –4.3 |
| China | 6.7 | 13.0 | 8.7 | 9.4 |
| Economies in transition | –0.9 | –10.7 | –20.8 | ... |
| Eastern Europe | –1.9 | –7.9 | –14.3 | ... |
| USSR | – | –13.1 | –25.0 | ... |
| Volume of imports | | | | |
| World | 7.9 | 4.4 | 4.0 | 4.7 |
| Developed market economies | 7.5 | 4.6 | 2.9 | 3.7 |
| North America | 5.9 | 2.9 | 0.7 | 4.0 |
| European Community | 7.9 | 7.3 | 4.6 | 3.9 |
| Japan | 7.5 | 5.5 | 2.9 | 0.3 |
| Other industrialized countries | 8.5 | 4.5 | 1.7 | 2.4 |
| Developing countries | 10.0 | 6.0 | 12.8 | 9.5 |
| Latin America | 5.8 | 5.1 | 15.5 | 11.1 |
| Africa | –1.0 | 7.9 | 2.0 | 4.9 |
| West Asia | 4.9 | –2.7 | 16.4 | 5.0 |
| South and East Asia | 15.6 | 10.8 | 14.3 | 11.5 |
| Mediterranean | 9.6 | 17.2 | –9.0 | –5.8 |
| China | 5.5 | –13.1 | 19.3 | 15.2 |
| Economies in transition | 5.0 | –5.2 | –31.4 | ... |
| Eastern Europe | 1.2 | –3.6 | –18.0 | ... |
| USSR | 9.2 | –1.4 | –30.9 | ... |

*Source:* United Nations, "The world economy at the end of 1992: background for an international policy agenda", 16 December 1992.

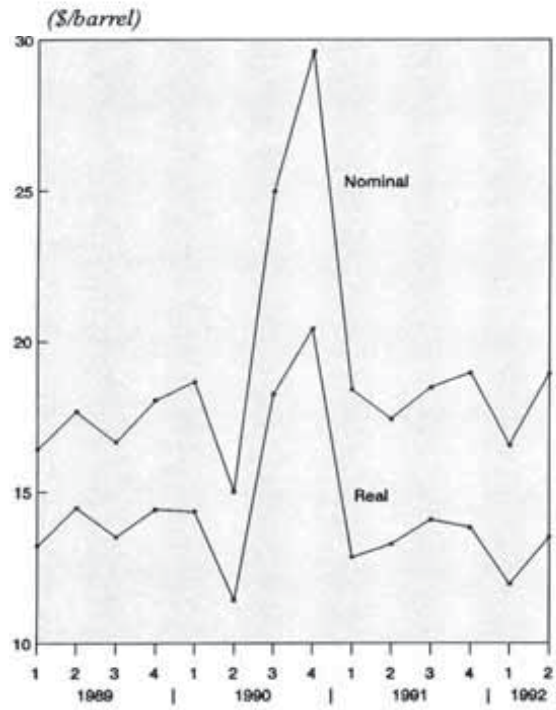
[a] Preliminary estimate.

**Figure I.4. Movements in commodity prices**

**(a) Non-oil commodities price indices (1985 = 100)**




**(b) Nominal and real prices of oil**




*Sources:* UNCTAD, *Monthly Commodity Price Bulletin,* vol. XII, No. 10, October 1992; International Monetary Fund, *International Financial Statistics,* December 1992; and United Nations, *Monthly Bulletin of Statistics,* October 1992.

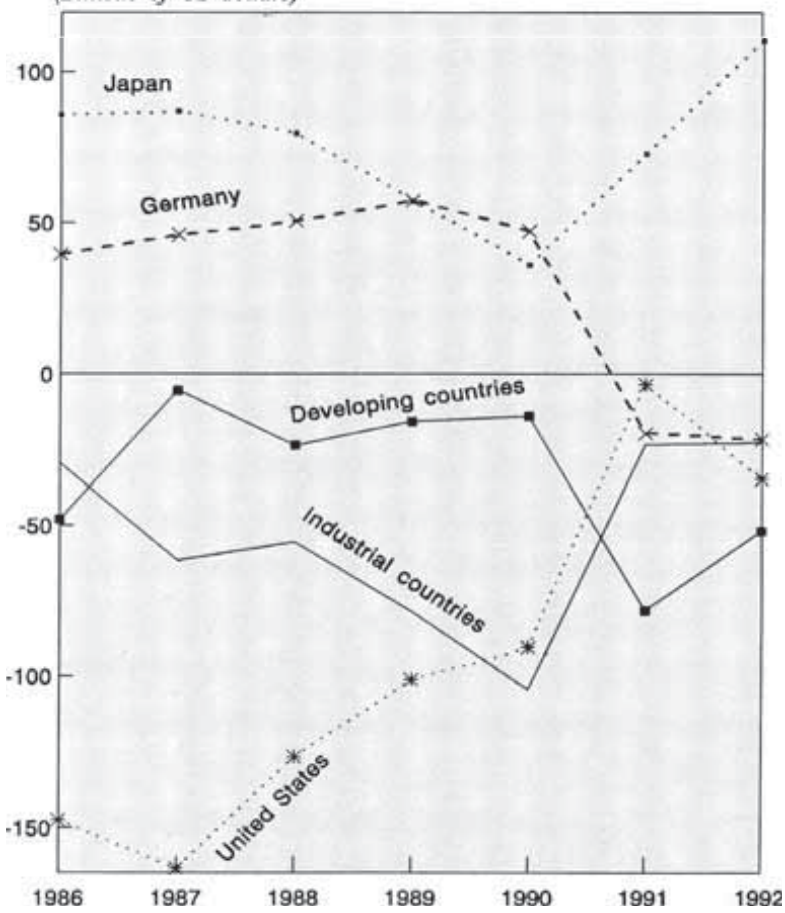
The imbalances in the current account balance of payments among industrial countries, for many years a source of contention among national policy makers, widened in 1992 after some improvement in 1990-1991. The current account deficits of the United States, having declined sharply in 1991 because of Persian Gulf war-related transfers, and the effects of the recession on imports, widened again in 1992 despite continued strong expansion in exports. Japan's current account surplus, having declined in 1989 and 1990, rose throughout 1991 and was expected to reach record level in 1992. In Germany, the current account shifted from surplus to deficit in 1991 after reunification, because imports increased and production was directed away from exports to meet domestic demand. In 1992 the deficit of Germany was expected to be around $20 billion, as in 1991 (figure I.5). For EC as a whole, a payment surplus was recorded until 1989; since then a deficit has been recorded, reaching $61 billion in 1991 and expected to widen to $71 billion in 1992.[2]

Reflecting the relative rates of growth in exports and imports, as noted above, the aggregate current account balance-of-payment deficits of the developing countries increased sharply from $14 billion in 1990 to $78 billion in 1991. A widening deficit was recorded by developing countries in all regions. Whereas widening deficits in 1991 in the West Asian region resulted primarily from the crisis in the Middle East, in Latin America and elsewhere in Asia they were largely due to the strong growth in imports resulting from growth in investment demand. The aggregate current account deficit of the de-

[2] International Monetary Fund, *World Economic Outlook: October 1992* (Washington, DC, 1992).

**Figure I.5. Current account balance of payments**

*(Billions of US dollars)*




*Source:* International Monetary Fund, *World Economic Outlook: October 1992* (Washington, DC, 1992).

veloping countries was projected to decline to $52 billion in 1992 when the rate of growth of imports was expected to decelerate.

The reversal in 1992 of the negative flow of developing country financial resources was a positive development in the international economy. The problem of the external debt of developing countries had been greatly alleviated. Net financial flows (official transfers, direct investment and external borrowing) to the developing countries, amounting to $101 billion in 1991, slightly lower than in 1990, were projected to average $153 billion in 1992-1993.[3] The increase in financial flows was projected for all regions except Africa. In eastern Europe, net financial flows were expected to increase from $2.5 billion in 1991 to $3.5 billion in 1992 and $6.0 billion in 1993. Net financial flows to the countries of the former Soviet Union, which were about $9 billion in 1991, were projected to rise to almost $21 billion in 1992. Official creditors would continue to account for the largest part of the inflow.

[3] International Monetary Fund, ibid., p. 20.

During the first half of 1992 several developing countries entered into debt-restructuring agreements with their commercial bank creditors. In addition, 12 developing countries concluded bilateral debt-restructuring agreements with official creditors. Several other countries, including those in eastern Europe, concluded debt-restructuring agreements under the aegis of the Paris Club. These agreements resulted in new flows of funds from official and private market sources to those countries.

This surge in financial inflows to the developing countries in 1992 was largely attributable to private sector flows. However, many low-income countries did not have significant access to such flows. Although constituting the largest proportion of the total flow, official flows tended to stagnate. New private flows consisted largely of short-term capital seeking better returns in high interest environments such as could be found in Latin America. Most of these funds were highly speculative and subject to sudden reversals in direction. However, corporate and sovereign-risk borrowers from developing countries, including borrowers from countries that had until recently been excluded from these markets because of their debt-servicing problems, were increasing their ability to tap medium-term funds in international bond and banking markets. In addition, large corporations from Argentina, Chile, India and Mexico had raised substantial amounts of equity capital on international markets, thereby setting a significant new trend. There was considerable international interest in foreign equity investment in China also through the purchase of publicly offered shares, and through the purchase of shares in mutual funds made up of equity in Chinese enterprises.

## C. POLICY CONCERNS

Reactivating world economic growth, and assisting developing economies and economies in transition in their development, should be the primary objectives of international policy. This would help create a more prosperous and balanced world economy. The higher growth rates achieved in developing countries despite the recent recession in most of the industrialized world may suggest that the developing economies have become less responsive to the cycles in the industrial world. However, that would be an oversimplification. The degree of interdependence between the developed and developing countries has reached the point at which hardly any individual economy in the world can remain unaffected by events and policies pursued elsewhere.

Recent policy changes in the developing countries and the economies in transition will further strengthen the links between these economies and the rest of the world. In many of these economies trade liberalization policy, for example, will increase the proportion of trade in their gross national product (GNP). Similarly, liberalization of financial and capital markets to forge closer links with an increasingly globalized capital market will exert considerable pressure on the entire range of their financial institutions, instruments and exchange mechanisms, and consequently on domestic fiscal and financial policy. All of these, in turn, will be affected by policies pursued by other countries, particularly the developed countries.

The increase in trade as a result of trade liberalization could foster productivity growth by enabling developing countries to benefit from specialization and economies of scale. That, however, would be possible only if trade protectionism were reduced worldwide. It was therefore crucial to conclude the Uruguay Round of multilateral trade negotiations successfully. The Round, which had already been extended two years beyond its original timetable, was brought to a stalemate by a disagreement, primarily between EC and the United States, over subsidized agricultural trade. The dispute over the subsidized production and sale of oil-seeds in EC, in particular, had threatened to break out into a trade war between EC and the United States. However, in November 1992, EC and the United States worked out an arrangement including proposals to reduce exports of EC-subsidized farm goods and the cultivation of oil-seeds. That arrangement considerably brightened the prospects for concluding the Uruguay Round successfully. Subsequently the Trade Negotiations Committee of the General Agreement on Tariffs and Trade (GATT) had accepted a proposal to reactivate substantive negotiations with a view to concluding the Uruguay Round.

Concerns remained that new regional trade arrangements, especially those involving the major economic areas would have a negative impact on the countries that had not been included in those arrangements. It was possible, however, that regional integration schemes that were compatible with multilateral trade rules could also contribute to the trade and economic growth of developing countries. Such regional trade arrangements should guarantee access and not become the basis for a new type of protectionism. Even within this frame, however, many developing countries, particularly in Asia and Africa, could stand to lose if the preferential trade treatment they were receiving was eroded as a result of the freeing of intra-bloc trade.

As indicated earlier, the industrial countries need to make adjustments to remove crucial imbalances in their economies to stimulate their own long-term growth rates, and thereby help stimulate those of others. There has been a shortage of savings worldwide, for which the fiscal deficits of the major industrial countries were largely responsible. The excess of government spending over income has drained away private sector savings, which had generally exceeded private investment. Therefore, fiscal adjustment has been a major strategic medium-term goal of policies to raise the savings rates sufficiently to finance needed investments. This goal has yet to be achieved in many countries. As a percentage of GNP, savings have fallen short of investment in the Organisation for Economic Cooperation and Development (OECD) group of countries since at least 1982; thus they became net importers of capital reversing their traditional role as a source of supply of capital to the world economy.

Without effective fiscal adjustments, the future rates of growth of savings in the OECD countries could continue to remain low and deprive the developing countries and the economies in transition of the necessary investments. The substantial increase in claims on global financial resources, such as the demand for support for the process of transition in eastern Europe and the former Soviet republics, the costs of German unification, and the requirement of net transfers to the developing countries to meet their need for structural adjustment, disaster relief, rehabilitation and reconstruction, come on top of a global decline in savings rates. A serious concern consequently arose about a short-term global capital shortage. It could be

## Box I.1. The liberalization and globalization of financial markets, and developing country participation

Since the mid-1970s, financial markets have become increasingly globalized. Progressive removal of exchange control on capital flows, removal of legal restrictions on interest rates and on the functional scope of financial institutions in developed countries have helped to bring this about. The process was further facilitated by the revolutionary developments in computer and telecommunication technologies for the speedy gathering, processing and transmission of information. International money centres have become so interlinked in the process that financial institutions are able to offer 24-hour services in areas such as sale and trading in debt and equity instruments.

This globalization has created several opportunities for all participants in the market. Overall, it has created a highly competitive environment, which in many ways works to the advantage of investors and borrowers. Innovations and the creation of new financial instruments in the market have widened the choice of instruments for savers, investors and borrowers. They can choose from a variety of instruments with different characteristics related to liquidity, risks and transaction costs. Opportunities have arisen for the so-called "securitization" of borrowings, whereby big borrowers can borrow directly from security markets, often at a cost lower than that of borrowing from banks. Opportunities for swap arrangements relating to currencies and/or interest rates have also emerged. All these have permitted lower borrowing costs, especially for the big borrowers, flexibility in debt management, and also higher net yields for the primary lenders or investors.

A progressive "institutional internationalization" of banks has taken place in this process of globalization and integration, and banks have played a growing role in international business. Banking institutions in many developed countries have rapidly increased their branches and representative offices abroad, and foreign banks have expanded their share of total business in many local or national markets.[a]

The developing countries have not taken a significant part in the international financial markets, either in terms of offering services or of taking advantage of the existing borrowing opportunities to meet their own financial needs. The lack of participation in terms of offering services relates mainly to the institutional weaknesses and the ability of the developing countries to offer financial services on a competitive basis, although some of the more advanced developing countries may already have the institutional, managerial, manpower and technological capability to participate effectively.

More importantly, the developing countries can take advantage of the market in respect of their borrowing needs. The developing countries have virtually had no share in the large surpluses of the world economy which were mobilized through the market during the 1980s, unlike in the 1970s when a substantial part of the oil surpluses were on-lent to the developing countries through the international banks. For the best part of the 1980s, the amount of inflow to the developing countries was more than offset by their debt-service obligations, resulting in a net outflow of the resources from the developing countries as a group. With the easing of the debt crisis, the trend is now reversing, as noted in the main text. Through greater participation in the market, the developing countries, particularly those that have maintained and/or are regaining creditworthiness, can more easily raise resources and better manage their debt as well as their international reserves. A liberal financial atmosphere could also facilitate the flow of foreign direct investment (FDI) in the economy and assist integration with the international market for financial services.[b]

To be able to participate effectively, the developing countries would need to bring about progressive integration of their domestic market with the international markets. That, in turn, would require, in addition to the strengthening of institutional, technological and manpower capabilities, considerable liberalization of their financial sectors from the administrative regimes to which they have often been subject. Banks may have to have freedom to diversify their operations, with the commercial banks, for example, undertaking merchant banking functions, housing finance and operation of mutual funds. The domestic interest rates may have to be closely related to interest rates in the major financial centres and therefore may require allowing the

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[a] V.V. Bhatt, "On participating in the international capital market", in *Services and Development Potential: the Indian Context* (UNCTAD/ITP/22) (United Nations, New York, 1989).

[b] Masumi Kishi, "Foreign capital and consolidation of Thai financial & capital market" paper presented at The First Conference on APEC: ASEAN/SAARC (Asia-Pacific Economic Cooperation: Association of South-East Asian Nations/ South Asian Association for Regional Cooperation) sponsored by the American Committee on Asian Economic Studies and Chulalongkorn University, Bangkok, 16-18 December 1992. Thailand, with its relatively liberal financial system, is found to have used the market opportunities to its advantage. The country has been progressively liberalizing its financial system at least since 1987 and has set a goal of becoming a regional financial centre.

*(Continued overleaf)*

*(Continued from preceding page)*

banks to determine interest rates freely on a competitive basis, without subjecting the rates to any administered structures. The introduction or expansion of the operations of foreign banks in the domestic market can be a useful catalyst in generating the competitive impulse in the domestic financial market.

Liberalization and promotion of competitive pressure in the domestic financial markets needs to be supported, however through the strategic and prudential regulation of the financial system to maintain an environment of financial stability. Progressive integration of the domestic market with the international market would make the domestic market vulnerable to the vicissitudes of the international market. Speculative capital flows can become a dominant causal factor, at least in the short term, in the determination of interest and exchange rates. This can lead to a misallocation of resources among various productive sectors.

To minimize the adverse effects of speculative capital flows, international coordination of macroeconomic policy becomes essential. Such coordination has worked reasonably well among small groups of developed countries since the mid-1970s, though not without occasional strain, which has been amply illustrated by the recent experience of the European countries. The pressure to which the weaker European economies were subjected as a result of some divergence in policy within a well-integrated European system can only serve to illustrate the vulnerability to which the developing countries can be exposed through an uncoordinated openness to a global system in which they can be at best minor players.

Financial services is an important area included in the Uruguay Round of multilateral trade negotiations on services. The developing countries had a great deal of hesitation in agreeing to include services as an area for negotiations under the Uruguay Round but had agreed to do so with the stipulation that the objective of the negotiations in services would be "promoting the economic growth of all trading partners and the development of developing countries". At the current stage of negotiations, broad agreements have reportedly been reached covering the basic principles of non-discrimination, market access and national treatment. With regard to financial services, however, it has been recognized that, notwithstanding other provisions, the parties will have the right to take prudential measures, including those for the protection of investors, deposit holders, policy holders (in the case of insurance), and to ensure the integrity and stability of the financial system.[c]

[c] General Agreement on Tariffs and Trade, "News of the Uruguay Round of multilateral trade negotiations" (NUR 055, 3 December 1992), p. 20.

wrong however to view the shortage as a purely short-term phenomenon.[4]

Many of the developing countries have embarked upon liberalization of their own financial and capital markets so that they can benefit from capital flows from a globalized private capital market. However, there may still be a need for caution and prudence to manage policies in order to avoid the misallocation of external financial flows, speculation, and the dangers of a financial crisis. Experience has shown that the globalization of the capital market and the banking industry has progressively made central bank controls on capital movement less effective. Nevertheless, it would appear to be necessary and possible to discourage short-term foreign capital flows through appropriate controls when macroeconomic conditions do not warrant such credit flows (see box I.1).

In view of the possible disruptive impact of such capital flows on domestic money supply and the exchange rate, it becomes necessary to rely more on fiscal policies for domestic stabilization and the sterilizing intervention of central banks to maintain short-term stability in exchange rates. Such efforts in developing countries can, however, be overwhelmed by developments in the rest of the world.

The process of reform and adjustment in the economies in transition must be sustained for their effective participation in the world economy. The timing and phasing of reform are crucial for successful adjustment. Changes that are too sudden or too large risk causing further disruption in economies that have little experience with functioning markets; however the right economic incentives will not be possible without a broad system of reforms. Price reforms and the dismantling of non-tariff barriers must occur rapidly in order to set in place the incentives for efficiencies. It may be prudent, on the other hand, to undertake financial liberalization, privatization, and credit liberalization in a phased manner.

Notwithstanding the revival of private capital flow to the developing countries, official credits remain important sources of funds for many countries, including the economies in transition. Many countries still need a substantial

[4] See the draft report of the Committee for Development Planning: Working Group on World Economic Outlook, held at Geneva from 29 September to 2 October 1992.

increase in official finance, especially of the concessional type. Eastern Europe and the countries of the former Soviet Union are in great need of external assistance for their transition to market economies. Much of that assistance will be in the form of official finance. It is therefore very important to strengthen the resources bases of the multilateral agencies such as the International Monetary Fund, the International Development Association of the World Bank and the regional banks such as the Asian Development Bank. Bilateral concessional finance will also continue to play a significant role in the development of certain developing countries, especially the least developed countries.

The United Nations Conference on Environment and Development, held at Rio de Janeiro, Brazil in 1992, greatly expanded the international agenda of action by adopting Agenda 21. The Agenda must be followed up by national and international action backed by adequate financial resources. The Agenda is a blueprint for "environmentally friendly" development, dealing with issues such as air and ocean pollution, hazardous waste, human health, poverty, and the advancement of women. The Rio Declaration, adopted as a non-binding statement of principles for guiding environmental policy, emphasized protecting the environment as part of economic development, safeguarding the ecological systems of other nations, and giving priority to the needs of developing countries, as these countries were the most environmentally vulnerable. Achieving a socially desirable rate of growth, alleviating poverty and maintaining the integrity of the environment will require additional resources to be mobilized and shared internationally.

# II. AN OVERVIEW OF DEVELOPMENT TRENDS AND ISSUES IN THE ESCAP REGION

## A. ECONOMIC GROWTH, INFLATION AND THE BALANCE OF PAYMENTS: AN ANALYTICAL REVIEW OF RECENT TRENDS

### 1. Developing economies

During the 1980s the average rate of economic growth in the ESCAP region was faster than in any other region of the world. During that decade, when growth faltered in all other developing regions, the developing ESCAP region accelerated its average growth rate from the 6.5 per cent achieved in the 1970s to 6.8 per cent. Rates of economic growth accelerated considerably during the second half of the 1980s for many countries in the region (figure II.1). Although the initial years of the 1990s have been marked by recession in the industrial countries, the region has succeeded in sustaining high growth performance based on the growing strength of domestic markets, intraregional trade and investment, and flexible domestic policies. Despite that achievement, a number of problems stand out, among them the problem of acute poverty and the accompanying problem of poor health, nutrition, access to education and housing, and the problem of pervasive environmental degradation.

How to maintain high and stable rates of economic growth and to accelerate such growth where it has been slow remains the basic economic issue for the ESCAP region. Economic growth is necessary for overcoming existing problems although, by itself, it is not sufficient. The fast-growing economies of the region have run into infrastructural and other constraints in recent years. They have initiated large-scale investments and other policy adjustments to overcome these constraints and to enable them to continue economic growth without unduly upsetting their macroeconomic stability.

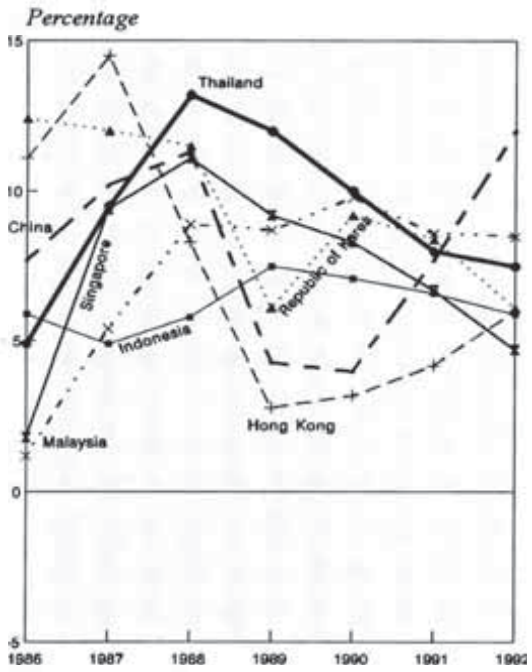
The period between 1983 and 1989 witnessed strong and sustained expansion in the economies of the industrialized countries. Their output and demand expansion provided a stimulus to expansion in international trade. This had a favourable impact on the external trade of the developing economies of the ESCAP region, stimulating exports, which, in turn, helped finance expanded volumes of imports and investment. A few other external factors also worked in favour of the good economic performance of countries in the ESCAP region especially in the later half of the 1980s. The realignment of the exchange rates of major world currencies by agreement in 1985 substantially depreciated the value of the United States dollar and appreciated other currencies, particularly the Japanese yen; this helped the domestic exports of the developing countries of the ESCAP region to become more competitive in the world market. The exports of some developing countries of the region also received a boost from an accelerated flow of foreign direct investment (FDI) to them, especially from Japan and the newly industrializing economies (NIEs) of East Asia.

Many labour-intensive industries, such as textiles and electronics, were losing competitiveness in their home-bases, especially in the NIEs in East Asia, owing to increase in domestic costs including wages. They were also finding it increasingly difficult to gain access to the industrialized country markets from their home-bases, owing to a variety of non-tariff barriers. Offshore bases offered better marketing opportunities. The exchange rate realignments gave impetus to this process of industrial relocation and FDI flows, which especially benefited countries such as China, Indonesia, Malaysia, Singapore and Thailand, the economies that had performed best and grown at the fastest rates since 1986. Although the precipitous fall in petroleum prices in 1985-1986 adversely affected a few of the region's oil exporters, it favourably affected the growth and development of most of the region's oil importers.

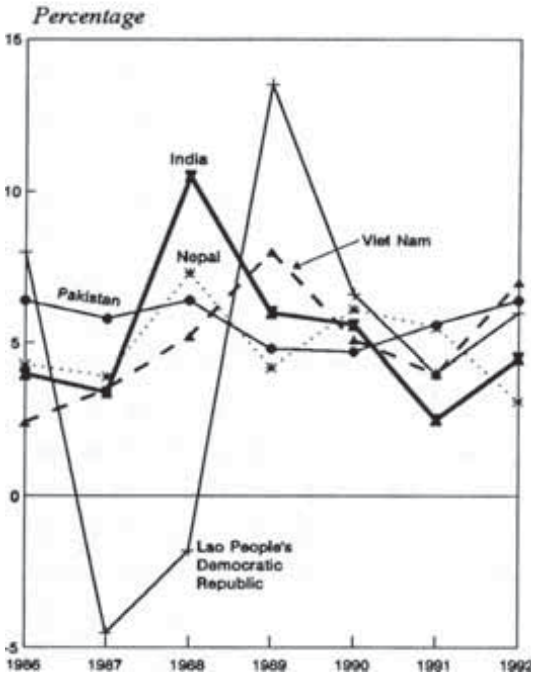
Other developing economies of the region displayed a diverse pattern of performance conditioned by a variety of factors. Although they encountered the same external environment as the more successful economies, they were able to benefit far less from the favourable factors in the international economy. The situation was not very advantageous with regard to certain factors, such as aid flows, on which the least developed among the developing countries of the region are particularly dependent. For these countries and many others, primary

**Figure II.1. Patterns of growth in the developing economies of the ESCAP region, 1986-1992**

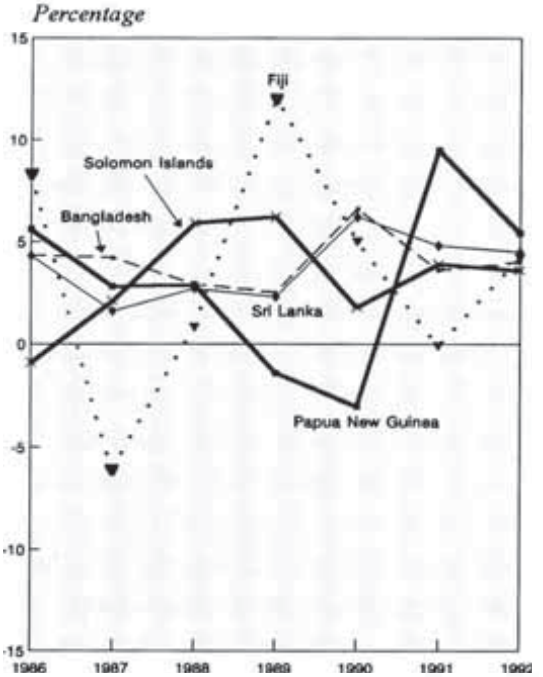
**Economies growing at >6 per cent annual average rate**



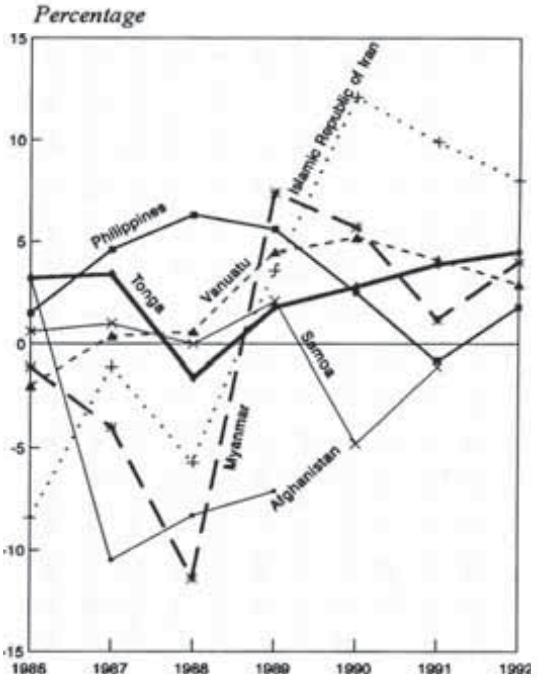

**Economies growing at >4 <6 per cent annual average rate**




**Economies growing at 3 <4 per cent annual average rate**




**Economies growing at <3 per cent annual average rate**




*Sources:* International Monetary Fund, *International Financial Statistics,* various issues; Asian Development Bank, *Key Indicators of Developing Asian and the Pacific Countries, 1992* and national sources.

commodities still constitute the bulk of exports, the prices of which have remained severely depressed at their 1985-1986 levels or deteriorated. A number of countries were experiencing political problems which were not conducive to the smooth functioning of their economies. The worst cases are those of Afghanistan and Cambodia. They had yet to initiate successfully their reconstruction and rehabilitation. The Islamic Republic of Iran, on the other hand, was able not only to reverse the trend of contractions of the economy during the war years up to 1988 but to move on to a substantially high growth path since then.

Domestic economic reforms and structural adjustments have also played a part in the region's economic performance. Almost all countries of the region have initiated a process of economic reform, readjustment and restructuring. However, the starting point and the extent and the speed of reform and restructuring have varied widely. Those countries which had started early and had carried out reforms speedily and to a greater extent, thereby boosting the confidence of investors, consumers and other participants in their economies, were able to reap greater benefits from the positive developments in the international economy in the 1980s. For example, the reform measures carried out by Indonesia, Malaysia and Thailand in the area of trade, investment, fiscal and financial policies stimulated greatly their growth and development.

Other countries started their reform processes under different circumstances. The Philippines, for example, initiated a reform process in 1986 when the Government changed. The reform process had initial good results and the economy had achieved 5-6 per cent growth in 1988 and 1989. However, a series of political problems and natural disasters caused set-backs, stalling the reform process. In South Asia, both India and Pakistan introduced reforms in the mid-1980s. However, the reforms did not go far enough and only recently has the reform process been accelerated. The economies of India and Pakistan maintained relatively high average growth rate without displaying signs of strong acceleration over time. Sri Lanka, on the other hand, initiated extensive reforms in its economy in 1977, which were followed up since then. However, the country suffered from an internal political conflict with damaging consequences for the economy and the economy maintained only a moderate pace of growth.

Bangladesh and Nepal, two least developed countries which achieved low growth rates, also initiated reform processes but the reforms have not had much of an impact, and the growth trend has not moved upward. Among other least developed countries, Myanmar seems to have arrested since 1988 the decline that its economy faced earlier, whereas the economies of Afghanistan and Samoa have suffered decline. With the exception of Solomon Islands and Vanuatu, most of the Pacific island economies seem to have a low and flat growth trends with strong year-to-year fluctuations.

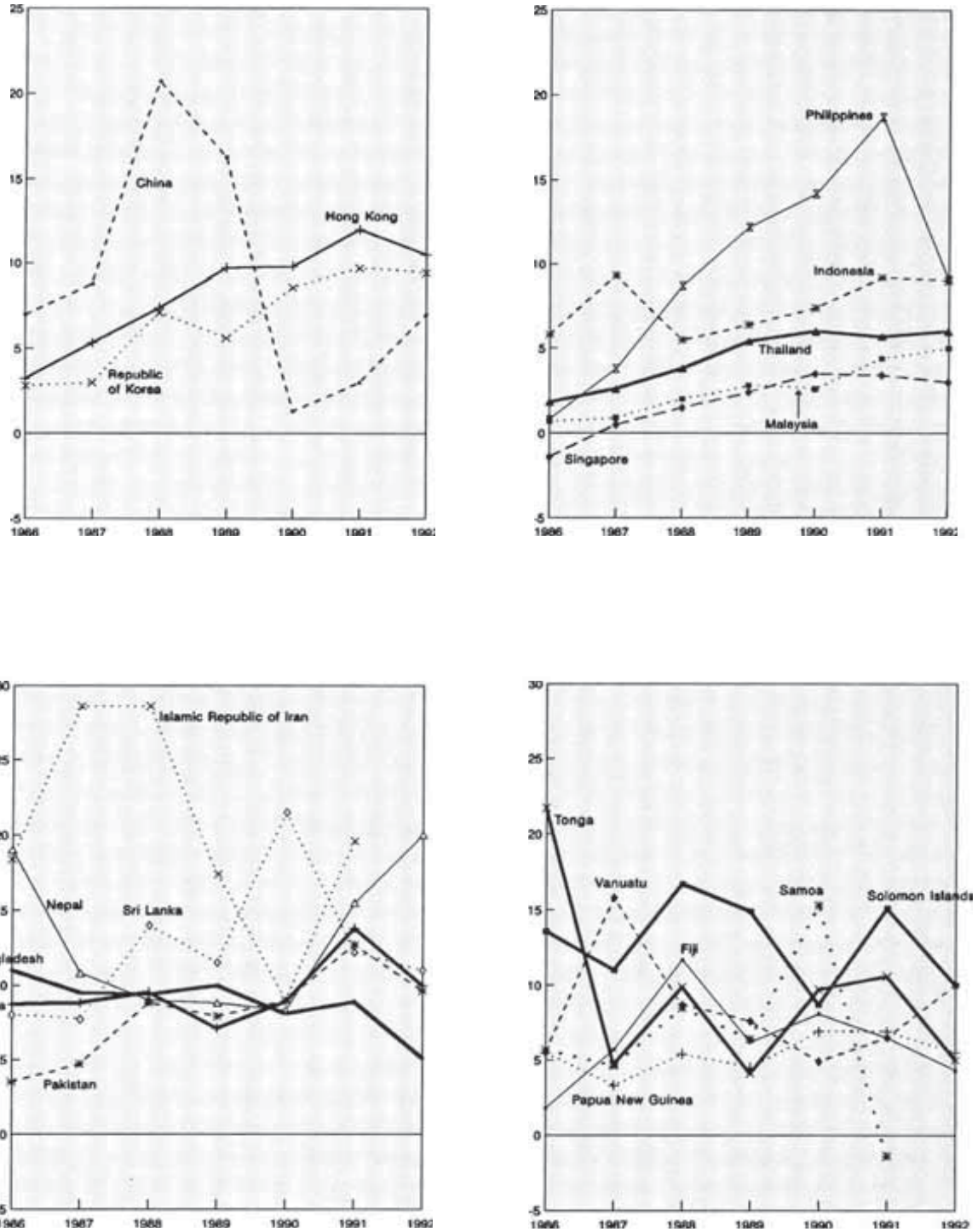
The Lao People's Democratic Republic, a least developed country, has initiated the reform and restructuring of its economy from a centrally planned to a more market responsive one, as have other planned economies such as Viet Nam and Mongolia. Viet Nam's reform process, initiated in the mid-1980s, has already produced positive results, the economy having moved on to an accelerated growth path. However, apart from the difficulties of integrating the two economies of the formerly divided country, which were run on totally opposite organizational and operational principles and practices, the country has faced severe difficulties due to economic boycotts by some countries and the sudden loss, more recently, of its links with the former Soviet Union and the eastern European countries. Mongolia's reform process, which was started after the collapse of the Soviet Union, has been implemented with considerable speed. However, it faces great difficulties in completing the transition from a centrally planned to a market-based system in a short period of time and has been suffering the dislocations that are inevitable in the initial period of transition.

During the period 1989-1992, growth rates slowed down to a level of 6-8 per cent in economies which achieved the double-digit rates in 1987 and 1988. The exceptionally high rates of growth could not have continued without exerting strain on those economies. Infrastructural problems, wage escalation and the inflationary threat, and even some social unrest, seemed to be undermining stable and continuing progress. The economies of the Republic of Korea and Hong Kong, two of the fastest-growing economies, experienced sharp slow-downs after the initial spurt of growth immediately following the 1985 agreement on exchange rate realignments. China recovered from the sudden plunge in growth experienced in 1989, with growth picking up to 12 per cent in 1992. Other countries were maintaining growth rates in the range of 6 to 8 per cent although there were indications of further downward pressure in 1992, at least in some cases (for details of current indicators see chapter III). Growth trends remained relatively weak in most other economies of the region, with considerable year-to-year variation in rates.

Macroeconomic stability, as signalled by the rates of inflation (see figure II.2) and the size of balance-of-payments deficits, which

**Figure II.2. Inflation in the developing economies of the ESCAP region, 1986-1992**

*(Percentage change in consumer price index)*




*Source:* Same as figure II.1.

have their roots in the rates of monetary growth and the budgetary deficits, has been a concern of most countries in the region. It is to the credit of countries such as Malaysia, Singapore and Thailand, that they could maintain high rates of economic growth with very stable prices. Even in these countries, however, signs of accelerated inflation appeared, with rates rising above 6 per cent in Thailand in 1990, and an estimated 4.5 per cent in Malaysia in 1992 from less than 3 per cent earlier. This has prompted these countries to apply restrictive monetary and budgetary policies which reflected their basic policy stance of maintaining price stability, a stance that could be partly responsible for the recent slow-down in the rates of economic growth.

Most other economies of the region have experienced high and sometimes accelerating rates of inflation, such as in China, Hong Kong and the Republic of Korea. These economies have all made efforts to contain inflation and ensure price stability, but only China appears to have been very successful. By using drastic measures, China was able to control the inflation that had exploded, with a rate of more than 20 per cent in 1988. That rate was brought down to 2 per cent in 1990, permitting the country to relax policies and resume speedy growth. Although inflation reappeared with the resumption of growth, it seems to have been contained within acceptable limits. Although the Republic of Korea and Hong Kong also contained inflation to one-digit levels, the recent inflation rates in those economies have been high by traditional standards. Most other countries of the region have experienced double-digit rates of inflation. Although they have sought to bring the rates down, this task has proved difficult in situations characterized by unstable growth, and large budgetary and balance-of-payment deficits affecting imports and domestic production.

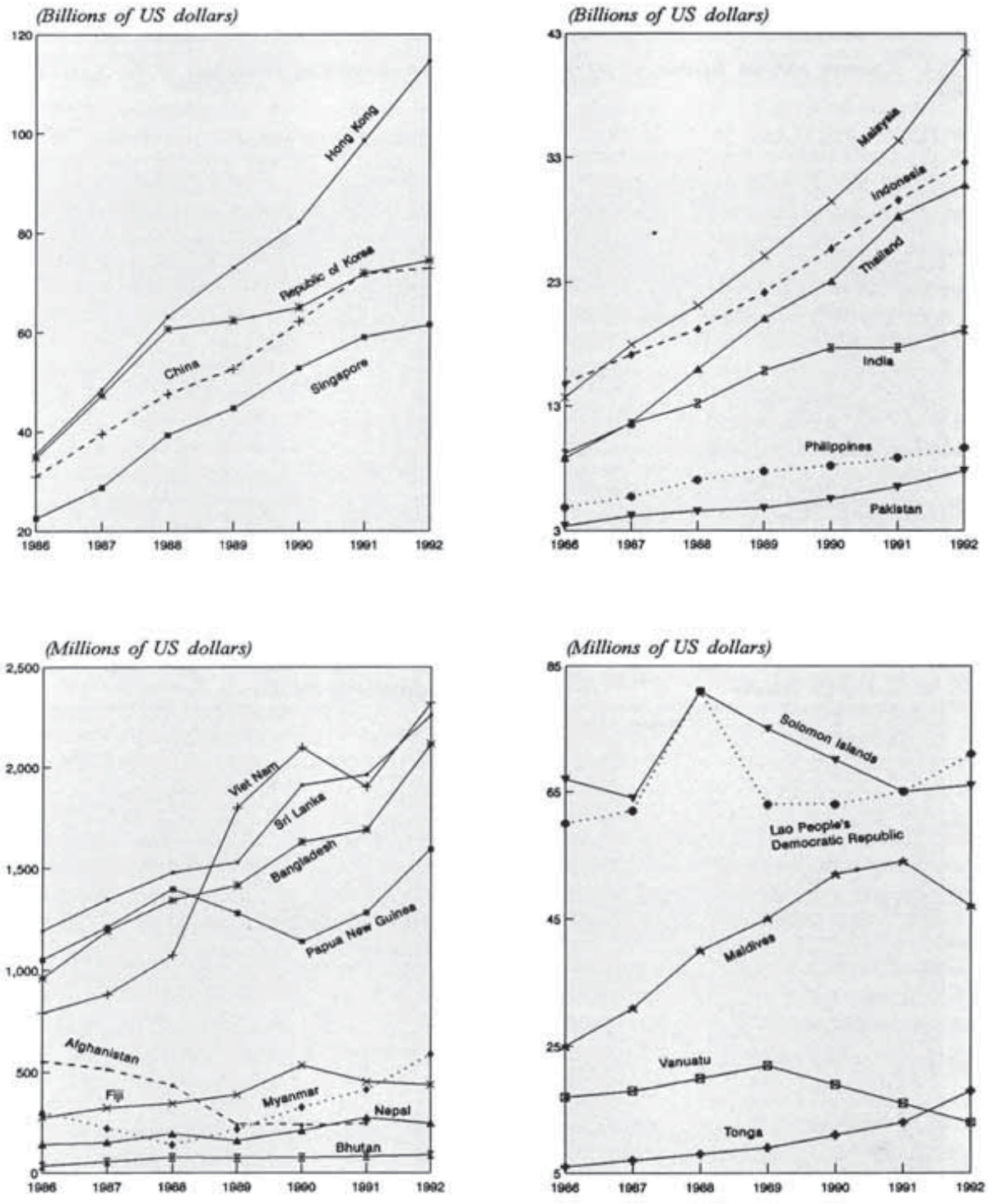
One aspect of macroeconomic stability that has been of prime concern is that of how to maintain sustainable external balance-of-payment deficits without running into critical levels of external indebtedness. As stated earlier, many countries in the region, especially in East and South-East Asia have achieved commendable success with their exports (figure II.3). That, however, has not prevented their current account balance-of-payments from deteriorating, even in countries such as Indonesia, Malaysia, the Republic of Korea and Thailand; fast growth has created larger demand for imports, causing both the trade and payments balances to deteriorate (figure II.4). Only China was able to reverse the deteriorating current account balance dramatically by means of its 1989 austerity measures, and to turn the payments balance from a deficit of more than $5 billion in 1989 to a surplus of $14 billion in 1991. For most other countries of the region the balance of payments remained structurally unbalanced, with large deficits throughout the entire period. Improving the external imbalance has been the aim of recent policy measures that constrain further the already relatively slow rates of economic growth, at least in the short term.

## 2. Developed economies

Among the three developed countries of the ESCAP region, Australia, Japan and New Zealand, both Australia and Japan achieved robust rates of economic growth during the 1980s. Starting from relatively low growth rates in 1986, both economies grew at rapid rates, averaging 3.3 per cent in Australia and 4.7 per cent in Japan during the period 1986-1990. Japan's economy was characterized by low rates of inflation and unemployment, and a large accumulation of balance-of-payments surpluses. Australia's, economy had relatively high rates of domestic inflation and an unfavourable balance-of-payments situation. New Zealand's economy had virtually stagnated, characterized by high rates of inflation, unemployment and rising balance-of-payments deficits. Whereas the Japanese economy had maintained strong growth performance up to 1991 both the Australian and the New Zealand economies had gone into recession. In 1991, output fell at 1.9 per cent in Australia and 2.1 per cent in New Zealand.

The Australian economy had entered a period of overheating in late 1987. It entered into recession in mid-1990, reflecting the lagged effects of tight monetary policy, the investment cycle and adverse terms of trade. High domestic demand in 1988-1989, with a large spillover into imports and the diversion of potential exports to domestic markets, was mainly the result of sharp improvement in the terms of trade as of 1986, an unexpected strong boost to investment from enhanced profits, positive effects on business and consumer confidence from fiscal consolidation (government budget deficits had shifted to surpluses as of 1988), and an easing of monetary policy in 1987. The progressive monetary tightening between April 1988 and June 1989 had negligible effects on domestic demand until mid-1989. Strong consumption growth resulting from improved terms of trade, and employment gains largely offset cutbacks in housing construction and machinery and in equity investment in response to high interest rates. Other factors contributing to the lagged response of aggregate demand were the interplay of

**Figure II.3. Exports of developing economies of the ESCAP region, 1986-1992**

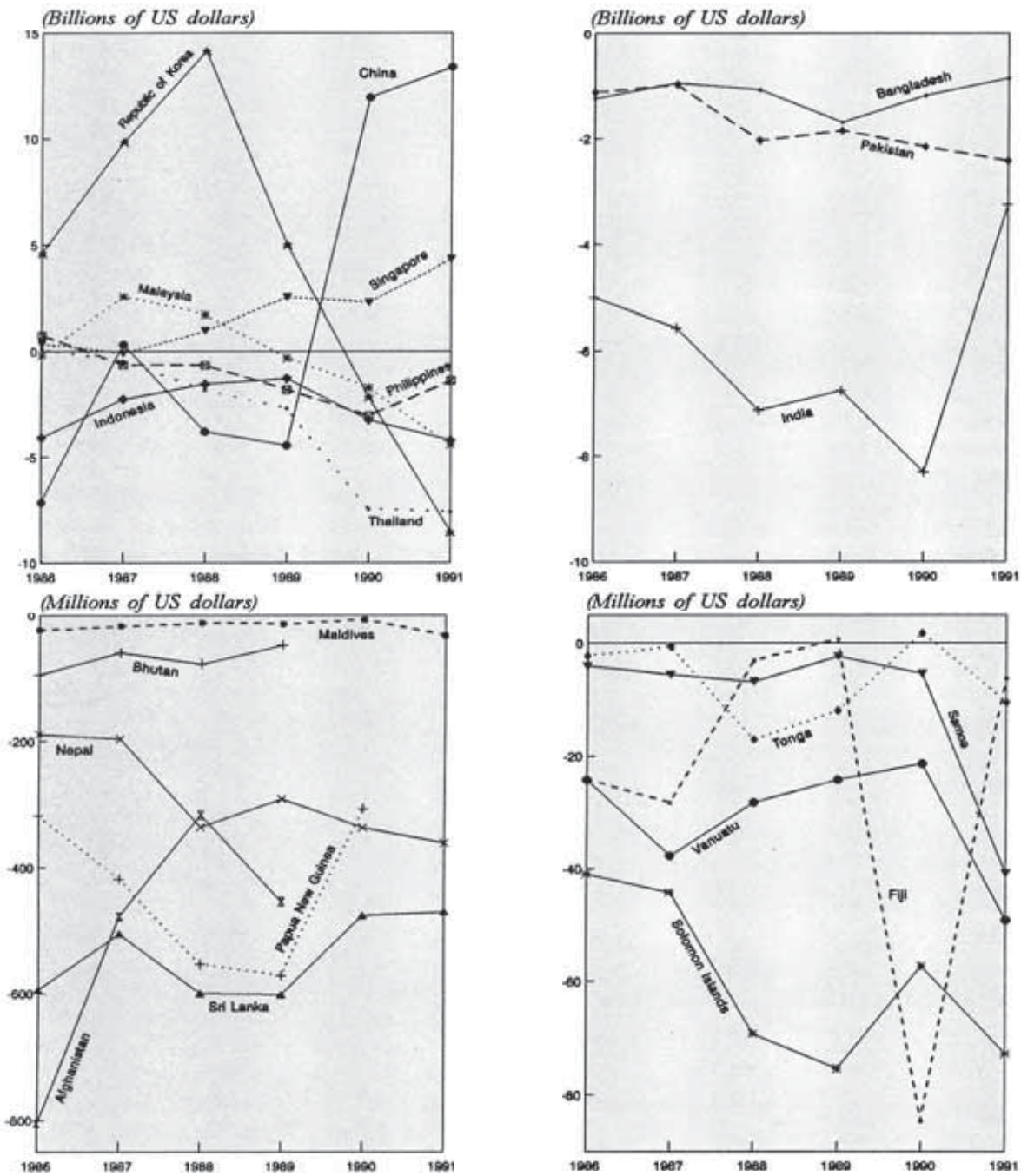



*Sources:* United Nations, *Monthly Bulletin of Statistics;* and International Monetary Fund, *International Financial Statistics,* various issues.

financial market liberalization, a synchronized asset price boom, rapid expansion of corporate borrowing, and long adjustment lags in commercial property prices.

While the tightening of monetary policy eventually had the effect of cooling down the overheated economy, halting the asset price boom, and decreasing the inflation rate, it also had the effect of slowing down the Australian economy's rate of growth from 4.4 per cent in 1989 to 1.7 per cent in 1990. In 1991, the economy went

**Figure II.4. Current account balance of payments[a] of selected developing economies of the ESCAP region, 1986-1991**




*Source:* International Monetary Fund, *International Financial Statistics*, various issues.

[a] Excluding official transfers.

into full recession and contracted by 1.9 per cent. The recession had a particularly strong effect on employment, breaking the 1983-1990 trend of a steady increase in employment. The aggregate rate of unemployment reached 10 per cent in April 1991 and continued to rise in 1992, exceeding 11 per cent. The weakness in the real economy and restraints in nominal wage growth resulted in a remarkable drop in inflation. The growth in the private consumption deflator, which had ranged between 5.2 and 15.9 per cent between 1981 and 1990, dropped to 3.5 and 2.8 per cent in 1991 and 1992 respectively.

Monetary policy began to be eased with the emergence of reduced demand and easing inflationary pressures. The overnight cash rates fell by 10.5 percentage points in the period January 1990-January 1992. The recovery however has so far been sluggish. The 1992 real GDP growth rate was estimated at 2.6 per cent, a considerable improvement compared with the negative growth in 1991 (1.9 per cent). Recovery of the gross fixed capital formation which declined by 5.5 per cent in 1990 and 11.2 per cent in 1991, remained weak in 1992, with 1.5 per cent growth partly as a result of high real interest rates. Unemployment, which continued to rise during 1992 reaching 11.1 per cent in June 1992, showed a slight decline in the second half of the year.

The recession that began in mid-1990 was thus more severe than had been anticipated. The fall in corporate investment was reinforced by a break in commercial property prices, a strong fall in terms of trade and destocking. The fall of commercial property prices together with the interaction of high corporate debt and high interest rates, strained the debt servicing capacity of corporations, depressed business confidence and put stress on financial institutions. Investment plans were cut and labour-saving measures pursued more vigorously, resulting in a sharp increase in unemployment. The cut-backs in the business sector, in turn, adversely affected consumer confidence and behaviour. Total domestic demand dropped by 5.8 per cent between March 1990 and September 1991, as exports grew rapidly and imports contracted. The recession affected all sectors of the economy, including construction, manufacturing, agriculture and mining, and the commercial services sector.

The current account deficit, having reached its peak in 1987 with a deficit of $A 17.33 billion (6.1 per cent of GDP), improved markedly and was expected to equal $A 9.6 billion in 1992. The main contributing factors included strong export performance since mid-1988 due to improvement in the relative export prices of manufactures, a drop in imports, and reduced net foreign interest payments as a result of falling domestic and foreign interest rates.

After several years of consecutive surpluses, the government budget deficit reached 4 per cent of GDP in 1992, as the Government continued efforts to lift the economy out of recession by increasing infrastructural expenditure, implementing tax revisions, and cutting interest rates further.

The Japanese economy slowed down in 1991 as GNP growth fell in the final quarter against the backdrop of decelerating domestic demand, falling industrial output and deteriorating business confidence. The tight monetary policy, implemented successfully after a period of extremely low interest rates to prevent increased labour demand and asset inflation from exerting inflationary pressure, resulted in a sharp slow-down in the growth of the money supply (M2) as of the first quarter of 1991, and its fall to the historic low of 1.7 per cent on an annual basis in the first four months of 1992. By the end of 1992, as a result of higher consumer borrowing costs and lower asset prices, domestic demand growth had slowed down to 1.6 per cent compared with 5.7 per cent at the end of the 1980s. GNP growth decelerated from 4.5 per cent in 1991 to an estimated 1.8 per cent in 1992, the lowest rate since 1980.

With the deflation of the speculative rise in land and share prices in 1990 and 1991, an end came to the abundance of capital that could be raised almost for free, and the economy entered a period of adjustment marked by restricted credit supply and domestic demand. The corporate sector, anticipating difficulties in capital investment and repayment of convertible bonds in 1992, reduced investment in plant and equipment considerably. Private residential investment declined by 7.9 and 2.4 per cent in 1991 and 1992 respectively. The impact of the sharp decrease in share values has been particularly serious in the financial sector, as bank assets were also threatened by the falling prices of land that had been used as collateral for loans. As a consequence banks widened their lending margins and also reduced their overseas assets by $190 billion in 1991 after a $150 billion increase in 1990. Investment overseas, which registered fast growth in the latter part of the 1980s, dropped from $48 billion in 1990 to just over $30 billion in 1991. An especially big drop in investment in financial services and real estate was recorded in the United States of America.

In order to reinforce business confidence and thus give impetus to corporate investment, the government raised public investments by 4.8 and 5.0 per cent respec-

tively in 1991 and 1992. Furthermore, monetary conditions were eased by a .50 point cut in the official discount rate by the end of December 1991, followed by a .75 point cut in April 1992.

The current account surplus more than doubled to $73 billion in 1991 (2.1 per cent of GDP), reversing a three-year downward trend. It was expected to increase to approximately 2.5 per cent of GDP in 1992, as a result of several factors, including the continued strong increase in exports and the stagnation in imports.

The easing of the monetary policy and fiscal conditions, low inflation of 2.5 per cent and strong growth of export markets, were expected to enable growth to return to 2.5 per cent by the end of 1992, compared with growth rates of 1.7 and 1.5 per cent for the second half of 1991 and the first half of 1992 respectively. However, in view of the sluggish recovery of personal consumption and corporate investment, it appeared unlikely that Japan's economy would soon return to the growth path it had entered in the mid-1980s.

New Zealand has directed efforts since 1984 towards establishing an efficient market-oriented economy and redressing macroeconomic imbalances. Previously, the economy had been highly regulated and protected and was characterized by slow growth of GDP, and full employment achieved through job creation in the public and protected sectors. The repercussions of structural reforms after decades of excessive government intervention were pronounced. Increased competition forced enterprises to restructure, and reductions in output and employment were widespread. The relatively poor economic performance of the early 1980s slipped further in 1985-1989, the period of rapid structural change with high inflation rates and considerable budgetary and balance-of-payments deficits.

In 1990, the economy made a hesitant recovery, with real GDP growth at 0.5 per cent compared with –0.7 per cent in 1989. In 1991 the economy plunged again into recession, when GDP fell by 2.1 per cent. As a result of budget cuts and the high level of real interest rates, domestic demand, which had recovered to 5.6 per cent growth in 1989 after an all time low of 0.2 per cent growth in 1988, fell by 6.6 per cent in 1991. Gross fixed capital formation plunged 16.1 per cent. Cuts in social transfers further reduced household real disposable income and private consumption dropped sharply. Housing construction also plunged, while business investment weakened as corporate profitability and confidence declined. Declining domestic demand caused imports to fall, while exports of goods and services continued to expand.

Slow output growth since 1986 had entailed a weakening in the demand for labour, while structural reforms and restructuring in the public and private sectors brought about widespread redundancies. Total unemployment increased steadily from 3.6 per cent in 1985 to 10.3 per cent in 1991.

As a result of the increasing slack in the product and labour markets, inflation dropped rapidly in 1991 to 2.8 per cent, compared with 6.4 per cent in 1990, well below the official target range. Projection for 1992 and 1993 indicated that the inflation rate could further decline to around 2.0 per cent. The rapid fall in inflation led the Central Bank to ease monetary policy since 1991.

Fiscal consolidation has, however, suffered a set-back as a result of the recession. For the fiscal year 1991/92 the deficit doubled over that of 1990/91 to almost 4.7 of GDP. The main contributing factors were the lower tax revenues resulting from poor profitability, tax incentives to foster business investment, and policy reforms in the areas of pension and health.

Over the period 1984-1988, the current account deficit fell steadily from 8.7 to 1.4 per cent of GDP, reflecting a reduction in imports owing to weak domestic demand and considerable improvement in the terms of trade. Furthermore, there was a sharp rise in agricultural exports between 1984 and 1988 because of the development of new markets and restriction on EC overproduction. The current account balance deteriorated in 1989 to 3.1 per cent of GDP owing to the fast growth of imports, at 14.4 per cent, and a slight deterioration of exports, mainly as a result of price developments in agricultural markets. The 1991 recession resulted in a decrease of imports by 6 per cent. Modest import growth rates, between 2.5 and 3 per cent, are expected in 1992.

## B. HIGHLIGHTS OF DEVELOPMENT ISSUES

### 1. Growth and stability

The basic economic issue facing the developing economies of the ESCAP region is how to maintain high and stable rates of economic growth, and to accelerate rates where they have been slow. The fast-growing economies of the region have initiated large-scale investments to overcome infrastructural constraints. As indicated above, this has not unduly upset their macroeconomic stability and may eventually ease the constraints on their future economic growth.

However, even for the fast-growing economies, some of the constraints, such as scarcity of energy resources and fresh-water

supply, will not easily be removed. Energy demand has been rising rapidly in most countries of the region and is expected to rise at accelerated rates in all countries as they seek to sustain or accelerate their rates of economic growth. The energy shortage has assumed critical proportions recently in the Philippines and has been a major weakness in countries of South Asia. However, even countries such as Malaysia and Thailand are experiencing growth in energy demand, which they will find difficult to meet from known sources of supply. Further energy exploration and production activities, including power generation and distribution, are being strengthened in many countries, even by inducing the private sector to enter, or to expand its role in this critical area which has traditionally been reserved for public sector enterprises. However, the potential demand and supply are almost certainly unbalanced as demand continues to grow while supply remains constrained by limitations of sources of supply, costs of development, and environmental concerns relating to the development of certain types of energy sources.

The task of strengthening the infrastructural base of the weaker economies of the region, including the production and distribution of energy, appears formidable, alongside the need to balance the economy by reducing the budgetary and balance-of-payments deficits, to contain inflation and to maintain a reasonable pace of economic growth. Given the limits on the ability to mobilize domestic resources, the success in restructuring and reforming these economies to achieve the desired level of infrastructural strength while removing the various imbalances, will depend critically on the external factors governing the flow of development finance and the trading environment.

The international economic environment has ceased to be as favourable as it was until two years ago. The recession and stagnation that had begun in some industrialized countries in 1990, had started to affect Germany and Japan, the two countries which had sustained the industrial countries' average growth in 1990 and 1991. The politico-economic map of the world has undergone some radical changes over the past two years; severing as a consequence, some traditional economic and trade links. This has adversely affected some developing countries of the region directly and immediately, for example Afghanistan, India, the Lao People's Democratic Republic, Mongolia and Viet Nam which had previously established trade and aid rapport with the former Soviet Union. Western trade, aid and financial flows have found an additional or expanded outlet in eastern Europe and the former Soviet republics. The continuing shortage of savings and investible resources in the world economy in the face of new demands raises the possibility of a squeeze of financial flows to the developing economies of the ESCAP region in terms of both private capital and development assistance.

The recent revival in the Latin American economies will intensify competition for Asian exports in their traditional markets in Europe and North America. The formation of giant trading blocs in both Europe and North America and the continued stalemate in the Uruguay Round of multilateral trade negotiations add other dimensions of uncertainty for the economies of the ESCAP region. Meanwhile some countries of the region are experiencing bilateral pressure to end certain trade practices and strengthen internal legislation and regulations governing intellectual property rights lest protective measures be imposed unilaterally against their exports. By not strictly adhering to conventions on intellectual property, some countries enjoy a competitive advantage in production and sales in the domestic and export markets. Export competitiveness will be further affected by rapid technological changes worldwide, with the increasing predominance of technology and skill-intensive goods and services requiring growth strategies to focus on technology and human resources development (see box II.1).

Countries such as those in South Asia as well as Mongolia, the Philippines, Viet Nam and many others, have been attempting to accelerate the pace of reforms, and expect to move on to higher growth paths. The situation, however, remains too uncertain to warrant any optimism about achieving an immediate breakthrough in their growth and development. Low levels of investment, poor infrastructure, low levels of human skills, and the paucity of both physical and financial resources in the least developed countries combine to prolong the low development levels of these countries. Strengthened external support together with improved internal management capabilities are urgently required for accelerated development in these countries.

## 2. Poverty and distributional equity

Economic growth is not an end in itself. It is a means to overcome poverty and provide a better life for people. When growth is not taking place or is taking place at a rate below that of population growth, the goal of achieving a better life cannot be reached. The population growth rate thus sets a lower limit on economic growth at any given period of time, since failing to

## Box II.1. New and emerging technologies and the developing economies of the ESCAP region

The ability to keep up with the rapid technological changes that are taking place in many parts of the world will be a decisive factor in industrial and trade competitiveness of producers in both domestic and international markets. Developing countries, with their inherent technological lag and persistent shortage of resources, research facilities and trained manpower, will find it specially difficult to cope with the changes. They may even lose some of their comparative advantage based on lower wages, as certain of the new and emerging technologies reduce the significance of labour costs in total costs or facilitate the development of substitutes for developing countries' traditional exports. The experience of producers of minerals and raw materials illustrates the latter point. Development of a wide range of substitute products and processes has cut-back the demand for minerals and other natural products substantially. Those producers who were able to change their production structure swiftly escaped some of the consequences of the demand shift away from natural products. Those who have been unable to do so will continue to experience difficulties.

The continued technological evolution will demand further changes in the structure and patterns of production, trade and investment in the developing countries of the ESCAP region in order for them to remain competitive. Most new and emerging technologies are transformational in nature. They change drastically the conditions under which industrial goods are produced; in their application they cut across many sectors of industry and services, making conventional classification of products and processes less meaningful or vague, as they tend to favour increased homogeneity of industrial production processes.

The emergence of new technologies has fortified entry barriers for new companies, especially for developing country producers. The barriers appear owing to the familiar problems of inaccessibility to or inability to operate the new technologies; lack of capital and research and development (R and D) capacity; and the inability to provide the marketing networks for product sales. These barriers are particularly stiff in the production of flexible automation equipment and information technologies.

It is inconceivable that the developing countries would be able to match the R and D expenditure and capacity of the developed countries in the foreseeable future. The developing countries in the ESCAP region spend less than 1 per cent of their gross national product (GNP) on R and D, compared with close to 3 per cent spent by many of the industrial countries. A large part of the R and D expenditure in the industrial countries is undertaken by the big transnational corporations (TNCs), which are also pioneers of new technologies. High risks and rising costs of new technologies, and the rapid obsolescence of new products owing to fast technological changes, have forced TNCs to form technology-related alliances to share development costs, acquire new technology and make better use of scarce skilled personnel. Such technological alliances can be viewed as a way of providing collective protection to technological advances among a few partners. Available evidence on the geographical and industry distribution of technological cooperation agreements among TNCs from Japan, western Europe and the United States indicates that, of the cumulative total number of such agreements up to 1989, only 5 per cent in biotechnology, 8 per cent in information technology, and 10 per cent in new materials were based outside of Japan, western Europe and the United States.[a] This indicates the difficulties that the developing countries encounter in gaining access to new technolo-

[a] *World Investment Report 1992: Transnational Corporations as Engines of Growth* (United Nations publication, Sales No. E.92.II.A.19), chap. VI.

achieve that minimum rate lowers the average standard of living. Beyond that it is almost impossible to define objectively what is a sufficient rate of economic growth.

Those countries having low growth rates possess archaic economic structures characterized by the domination of low productivity economic activities in agriculture and services, little progress in modern industrial development, poor infrastructure bases, and poor education, health and other standards of well-being. A very high proportion of the population in these countries falls below the minimal standard set by a national poverty line or threshold; thus these countries contain a large share of the region's estimated total of 830 million poor people.[1]

[1] For other estimates of incidence of poverty, see Asian Development Bank, "Rural poverty in Asia", *Asian Development Outlook 1992*, part III (Hong Kong, Oxford University Press for the Asian Development Bank, 1992).

How to eliminate or alleviate absolute poverty is a serious concern not only because of the sufferings that are caused to the hundreds of millions who are affected. Its persistence can also release destabilizing forces that could arrest the path to further progress.

Economic growth is a necessary but not a sufficient condition for the elimination of poverty. Poverty exists even in the richest countries of the world; however, in those countries poverty affects

gies even through the TNCs, which are looked upon as an important source of investment inflow and technology transfer by most developing countries in the ESCAP region.

The impact of new and emerging technologies will be very significant for developing countries in the ESCAP region. The initial effects could take the negative form of a further reduction in exports of minerals and commodities, and less competitiveness for manufactured products because of increased automation and technological efficiency in industrialized economies. It will be difficult for the developing countries in the region to set up industries based on or using new technologies because of infrastructure and other domestic constraints, besides the entry barriers mentioned above. A loss in employment and income may result because of the difficulty of adjusting speedily to the new competitive environment. Each new technology, therefore, presents a particular challenge, but perhaps also an opportunity for developing countries of the region.

For example, the impact of electronics and telemetrics is mainly on the efficiency, precision and capacity of industrial production which will influence international competitiveness. Developments in biotechnology and genetic engineering will play a vital role in the agricultural and health sectors. Both these developments can have an adverse impact on industrial and agricultural developments and employment and income in the developing countries by affecting their ability to compete.

No developing country in the region can ignore these challenges. To turn the challenges to opportunities, difficult though this may be, it is necessary to formulate and implement well-defined policies and programmes with respect to new technologies. That requires a substantial degree of technology planning, including the development of human resources and infrastructure. Technological information systems need to be set up and the capabilities for consultancy engineering and technological services need to be strengthened. Policies on foreign direct investment (FDI) and technology inflow will need to be suitably adjusted to ensure the adequate inflow, absorption and adaptation of new technologies. If new technologies are to be used effectively, it may also be necessary to undertake varying degrees of industrial restructuring in certain sectors. Technological assessment, monitoring and forecasting assume a new significance and dimension in this context. Research activities also have to be reoriented towards increased applied research and blending of new technologies with traditional processes.

only a residual margin of the population, unlike in the developing countries where poverty prevails on a mass scale. High rates of economic growth in some developing countries of the ESCAP region have apparently alleviated poverty in those countries to a large extent. Nevertheless, high percentages and large absolute numbers of people still live in conditions of absolute poverty.

It is estimated that poverty in Indonesia has been reduced from about 60 per cent of the total population or 70 million people in the 1970s, to around 15 per cent or 27 million people in the early 1990s. Similarly, in Malaysia it is estimated that poverty has been reduced from 20.7 per cent of the population in 1985 to 17.1 per cent in 1990. That left Malaysia with 619,400 poor households in 1990. Thailand also succeeded in reducing the percentage of the poor in the total population from about 30 per cent in the mid-1980s to 23 per cent, which still left 13 million people absolutely poor in 1990. These examples illustrate that high economic growth rates, even if they are sustained for a long period of time, do not guarantee the automatic eradication of poverty through the process of economic growth.[2]

Poverty is more concentrated in those countries of the region which have not achieved high rates of economic growth: the least developed countries, most of the South Asian countries and the Philippines, among others. In China, the percentage of the population living under the poverty threshold is one of the lowest in the region. Nevertheless, 87 million people were living below the official poverty line in 1991, of which 27 million remained absolutely poor.[3] China's achievement in reducing the percentage of the poor in the total population is, however, widely attributed not to economic growth *per se*, but to a wide variety of measures to improve the living conditions of the people. Sri Lanka and Viet Nam are two other countries which have achieved higher health, education and other welfare standards despite relatively low rates of economic growth.

The examples of the fast-growing countries in South-East

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2 For Indonesia, see *Address of the State by H.E. the President of Indonesia Soeharto Before the House of the People's Representatives on the Occasion of the 47th Independence Day, August 17th* (Jakarta, Department of Information, 1992); for Malaysia, see *Sixth Malaysia Plan 1991-1995* (Kuala Lumpur, National Printing Department, 1991); for Thailand, see *The Seventh National Economic and Social Development Plan (1992-1996)* (Bangkok, National Economic and Social Development Board, Office of the Prime Minister, 1992).

3 See Asian Development Bank, "Rural poverty....", in which it is estimated that there are 100 to 200 million poor in China.

Asia may suggest that while rapid growth is desirable, growth cannot be fully relied on to remove poverty within an acceptable timeframe. Growth, therefore, has to be more balanced and adjusted towards the specific goal of alleviating poverty and human misery even if, as a tradeoff, this involves a slow-down in the pace of growth. On the other hand, welfare standards achieved through deliberate actions and policies cannot be sustained without sufficient growth in the economy. Both growth-oriented macro and target-oriented micro approaches are necessary. In the latter approach the specific character of the target group should be fully analysed and programmes should be tailor-made to fit the target group's conditions and needs.

Poverty also has a relative dimension relating to the problem of distributional equity of the products of the economic system among the constituent population. Too much concentration of the product of society's collective enterprise in too few hands is morally indefensible and holds destabilizing potential. Empirical studies have established that up to a certain stage of growth and development, income distribution tends to become worse. Income distribution data in the region are insufficient to show whether such deterioration in distribution has taken place over time.

Estimates for recent years, however, indicate that the distribution pattern in the region has remained highly skewed. To cite a few examples: the lowest 20 per cent of income recipients in Hong Kong, Malaysia, the Philippines, Singapore and Sri Lanka received around 5 per cent of the total income, while the highest 20 per cent received 47 per cent in Hong Kong, 51 per cent in Malaysia, 48 per cent in the Philippines, 49 per cent in Singapore and 56 per cent in Sri Lanka. India, Indonesia, and Pakistan had a somewhat better distributional profile with the lowest 20 per cent of income recipients receiving around 8 per cent of the total income and the top 20 per cent receiving 41 per cent in India and Indonesia, and 46 per cent in Pakistan.[4] In Thailand, the lowest 20 per cent of income recipients received only 4.5 per cent of income while the richest 20 per cent received 55 per cent in 1988/89. This was a deterioration compared with 1975/76 when the share of the two groups was 6 and 49 per cent respectively.[5] Such deterioration is not unusual in the course of rapid economic growth and development.[6] Corrective action, however, ought to be taken before the imbalance can proceed beyond the limit of social acceptability or tolerance – a limit which varies from one society to the other.

### 3. The environment and development

As indicated in chapter I, the United Nations Conference on Environment and Development generated the most comprehensive account of the global environmental issues and concluded with the adoption of principles and an action agenda to promote a sustainable pace and pattern of development. The concerns, conclusions and recommendations of the Conference arose out of the realization that the historical patterns of economic development had absorbed large quantities of the renewable and non-renewable resources of the world through direct extraction of non-renewable natural resources, and the consumption of renewable resources at an unsustainable rate, and had generated wastes beyond the capacity of the environment to assimilate them. This was reflected in, among other things, a rapid loss of biodiversity, deforestation, the creation of holes in the ozone layer in the upper atmosphere, and the emergence of a serious threat of global warming. There has been growing awareness over the past two decades of the social costs associated with production processes and consumption patterns that harm the environment. Such harm is sometimes localized and affects not only the people who cause it, but more often it affects people living in other regions, or the prospects for future generations.[7] The costs, in terms of resource depletion and the gradual poisoning of the soil, the water and the air, may go even beyond the externalities allowed for in traditional economic or social cost accounting. The costs of economic growth and development therefore must be accounted for as accurately as possible and balanced against the benefits.

It has been argued that there are diverse sources of economic growth. Some sources of growth

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[4] These data, which refer to different years between 1980 and 1988, are reported in World Bank, *World Development Report 1992: Development and the Environment* (New York, Oxford University Press for the World Bank, 1992), statistical annex.

[5] Chalongphob Sussangkarn, "Towards balanced development: sectoral, spatial and other dimensions", paper presented at The 1992 Year-End Conference on Thailand's Economic Structure: Towards Balanced Development, 12-13 December 1992, Chon Buri, Thailand.

[6] Ashok Parikh and C.H. Shah, "Relationship between poverty and economic development: a quantitative analysis", *Economic Bulletin for Asia and the Pacific* (United Nations publication, Sales No. E.84.II.F.16).

[7] Economic and Social Council, "Report of the Committee for Development Planning on its twenty-eighth session, 18-22 April 1992" (E/1992/27), 12 June 1992.

might reach their limits or become too expensive. Growth *per se*, however, need not stop, nor does it have to be unsustainable in terms of the conservation of resources or the earth's physical environment. The technological means exist not only to arrest the deterioration of the environment but also to improve economic efficiency and productivity. It is possible to produce more with fewer inputs of resources by improving efficiency and productivity.

It has been argued also that the way to minimize costs is to reflect them fully in prices so that the producers or users of the products pay their true scarcity value. In that context suggestions are offered: to eliminate all direct and indirect subsidies and all other inefficient public interventions in the pricing process; to establish the institutions required for the emergence and efficient functioning of environmental and resource markets, for example, secure, enforceable and transferable property rights; to internalize externalities and mitigate the effects of any other market failures through a consistent structure of market-based economic incentives and disincentives rather than through bureaucratic command and control regulations that are less efficient; and to subject all public projects to rigorous scrutiny and eliminate those that promote environmental degradation or resource depletion.[8]

The imposition of such standards, apart from the difficulty in implementing them, could deprive countries, particularly the developing countries, of certain sources of growth. Improved efficiency and productivity might compensate the loss of these sources, but achieving a socially desirable rate of economic growth, while alleviating poverty and maintaining the integrity of the environment will not be easy.[9]

Moreover, in a situation characterized by a variety of market imperfections the possibility of extensive market failures cannot be ruled out, especially with regard to the discounting of the future that is most relevant from the point of view of conservation of resources. It was these perceptions that gave rise to subsidies, price-setting and other forms of public intervention to initiate, nurture and nourish development, which would otherwise be fragile or fail to come about. The measures were also intended to make growth and development more socially equitable. The controls, subsidies and other interventions instituted against the backdrop of these various perceptions on the development of developing countries, might have already served their historical purpose during the course of 40 years of development. Where they now appear to be inefficient and costly, they should be removed.

Nevertheless, the question of externalities is a matter of significant concern in the context of the environment and must be addressed. The use of the tax-subsidy mechanisms is considered to be a practical means of dealing with externalities. That however requires: knowing who is polluting and how much, in order to be able to invoke the Polluter Pays Principle, a principle that has been widely advocated; having the necessary tax instruments and/or institutions in place; and having the political will to act. None of these are easy to achieve. The problem is particularly difficult when national activities have an international or global environmental impact. The Polluter Pays Principle can be used internationally to share the costs of maintaining environmental integrity, but that would require international understanding and agreement.

At the micro level, the question has also been raised as to whether removing subsidies and getting the prices right will remove the problems of, for example, people who continue to farm lands that are already environmentally degraded because they have no other way to survive. Moving on from the micro to the macro level, the question of scale becomes central to the issue of whether growth is compatible with sustainability. In addition, there are questions with regard to the viability of alternative technologies. The nature of these problems can be illustrated with reference to energy needs for future development.

Historically, reliance has been placed so far on the burning of fossil fuels, first coal and then oil, as primary energy sources. With the possibility that these sources were becoming depleted, hopes were placed on the potential of atomic fission. Enthusiasm for that source of energy subsided somewhat after some of the frightening consequences of the use of atomic fission have become known. Harnessing energy directly from the sun appears to have unlimited prospects. However, in the past two decades, there has not been any major breakthrough in the technology for harnessing this energy.

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8 World Bank, *World Development Report 1992 ...;* and Lester Brown and Theodore Panayotou, "Roundtable discussion: is economic growth sustainable?" in Lawrence H. Summers and Shekhar Shah, eds., *Proceedings of the World Bank Annual Conference on Development Economics 1991* (Washington, DC, the World Bank, 1992), pp. 353-362.

9 Economic and Social Council, "Report of the Committee for Development Planning on its twenty-eighth session, 18-22 April 1992" (E/1992/27), 12 June 1992.

The possibilities for substituting for fossil fuel have remained limited, although a variety of so-called renewable sources of energy has been emphasized. Use of fossil fuels has been decried not only because such fuels may eventually be depleted but also because of their polluting effects. The limited experiments that have been conducted to find substitutes within the known range of possibilities have been beset by their own problems.

It is the unforeseen consequences of harnessing alternative energy sources that cause the most concern. Forty to fifty years ago, the pervasive environmental consequences of fossil fuel use were hardly foreseen, if at all. The required scale of future energy use is also cause for concern. For example, the Philippines' 6,000 MW current power-generating capacity is estimated to be about one fifth of that of the state of Virginia in the United States of America, where the population size is much smaller than in the Philippines. Thailand with a 9,000 MW generation capacity is currently better off than the Philippines. India with 69,000 MW current capacity has one of the lowest levels of per capita energy consumption in the world. If all developing countries were to reach even Thailand's current per capita energy use, the resulting totality of future needs and the attendant environmental implications can only be imagined.

The concerns about the environment that have arisen in the ESCAP region can be understood within the above general framework of analysis, but they must also be understood in their specific contexts.[10] The extent and intensity of the elements of environmental problems vary among subregions and among countries of the region. All of them, however, encounter the problem in one form or another with varying degrees of severity.

Broadly speaking, three types of critical environmental problems can be identified in the Asian and Pacific region. These are, first, land degradation and destruction of natural resources, including deforestation, soil erosion, soil fertility loss, waterlogging, salinization and toxification of soils, loss of biological diversity, damage to and destruction of coral reefs, mangroves, fisheries and other coastal and marine resources, and excessive extraction and associated problems relating to underground reservoirs of fresh water; secondly, pollution, including pollution of ambient air in cities, and household air in villages; pollution of lakes, rivers, underground reservoirs and marine water, with detrimental effects on mangroves and coral reefs; toxic waste dumping and environmental hazards emanating from industrial activities; thirdly, unsustainable environments in villages/human settlements caused by inadequate or inappropriate shelter, lack of water supplies, poor sanitation, shortage of cooking fuel, poor nutrition, excessive use of agrochemicals, and habitation of environmentally fragile and hazard-prone areas (see box II.2 for some statistical highlights).

In addition, there are predictions concerning the effects of greenhouse gases and the rise in sea level on subregions in Asia and the Pacific. These include more frequent storms, flooding, coastal erosion, negative impact on freshwater supply, changes in agricultural yields, loss of biodiversity, and possibly, loss of entire low-lying islands.

The causes of environmental degradation in the region may be attributed to both underdevelopment and development. In general, the region's huge population, which has doubled in the course of the past three decades and could double again in the next four decades at the current rate of growth, the consequent pressure on resources, especially with regard to food and agriculture, and the inefficient urban and industrial growth, are held principally responsible.

The requirement to expand both cash and food crop production in developing countries of the region is encouraging the abandonment of the traditional cropping system in favour of energy-intensive, very often monocultural cropping patterns that are dependent on irrigation expansion and which lead to increased waterlogging and salinity. Agricultural chemical residues pollute ground and surface waters, and soil fertility and natural pest resistance decline. Soil erosion and the consequent nutrient losses degrade the resource base further. This process is exacerbated by limited access to resources and technologies, such as to the green revolution technologies that only richer farmers can afford. In some cases as richer farmers prosper, small farmers are pauperized and driven to landlessness and eventually to already overcrowded urban areas or marginal lands that should never be cultivated, except possibly with long rotation periods.

While industrialization has brought some measure of economic prosperity to the region, it has also resulted in natural resource depletion, air, water and noise pollution and toxic and hazardous wastes accumulation, and it has increased the incidence of accidents. In most developing countries of the region, industrialization has not been accompanied

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[10] For more details of the environmental problem in the ESCAP region see ESCAP, *State of the Environment in Asia and the Pacific 1990* (ST/ESCAP/917).

## Box II.2. Statistical highlights of the environmental problems in the ESCAP region

*(a) Deforestation, and soil and other resource degradation*

Between 1975 and 1986, 1.8 million hectares of the region's closed forest cover were lost annually. At that rate, about 18 million hectares would have been lost by the year 2000. However, during the period 1986-1990 the rate of deforestation is estimated to have increased to 4.7 million hectares per year. Commercial logging, habitat encroachment and the collection of fuel wood are the principal causes of deforestation. By the year 2000, 1.4 billion people in rural areas of the region are likely to depend on fuel wood for their energy needs, compared with 700 million in the early 1980s. The denudation of the rainforests, in particular, poses a major threat to the region's biodiversity.

Mangroves are salt-tolerant, woody, seed bearing plants which generally grow in the intertidal areas of sheltered shores, estuaries, fringing reefs and salt marshes. In recent years, mangrove forests have been cleared to make way for ponds for the cultivation of fish and prawns. Mangroves in an area of 102 million hectares have been lost to aquaculture ponds. Mangrove forests have also been destroyed for fodder, timber and firewood, as well as for cultivation and land reclamation.

The majority of developing countries in the region have undergone extensive land degradation. The most seriously affected countries are China, India, Indonesia, the Lao People's Democratic Republic, Pakistan, the Philippines, Thailand and Viet Nam. Between 17 and 50 per cent of total land in these countries has suffered degradation (excluding desertification). Soil deterioration and losses are occurring in many ways. An evidence of this is that over 15 billion tons of sediment from soil are carried annually by the Asian rivers, compared with less than 2 billion tons by the North American and 1 billion tons by the South American rivers.

Threats to wetland, which forms the most productive ecosystems of inland waters, have increased substantially as a result of reclamation, pollution, over-exploitation and the degradation of watersheds. Eighty per cent of the wetlands in most countries of the region suffer from moderate or severe environmental degradation.

Desertification, a form of land degradation, has affected more than 860 million hectares of productive land, including degraded forest and woodland in the region. In terms of cultivated land, 85 million hectares have been lost. The estimated number of people directly affected by desertification in the region is close to 150 million, about half of the corresponding world total.

Biodiversity of the region, which includes the full complement of plants and animals, is being increasingly reduced. It is estimated that roughly 67 per cent of the original wildlife habitat area in the developing countries of the region has been lost, leading to the extinction of a number of species. Urban encroachment on prime agricultural land occurred apace, with a fourfold increase between 1950 and 1990 in the number of cities with more than 4 million people.

Excessive exploitation of groundwater has caused problems of land subsidence, salt-water intrusion and groundwater pollution in over one third of the countries of the region.

*(b) Pollution*

The use of solid (dirty) fuel had increased from 620 million tons in 1978 to 1,177 million tons in 1990 – an increase of about 90 per cent in twelve years. The use of such fuels has since continued unabated.

Industrial emission of carbon dioxide increased from 94 million tons in 1950 to 362 million tons in 1965, and 5.4 billion tons in 1989.

The use of agrochemicals has increased substantially. Fertilizer use in the developing countries of the region increased from 22 million tons in 1977 to 51 million tons in 1991. Pesticide consumption has been growing at the rate of 5-7 per cent per annum. Pesticide and toxic chemical concentrations in human bodies have been found to have increased.

Pollution from the flooding of rivers of the region is the highest in the world.

*(c) Health hazards*

Few countries of the ESCAP region can meet the WHO standard for safe drinking water, which calls for 95 per cent of the samples to be free from faecal coliform bacteria.

Eighty per cent of diseases are traceable directly to unsafe water and poor sanitation. Diarrhoeal diseases kill over 1.5 million children every year in just seven countries of the region.

Four out of every 10 people in rural areas of developing countries of the ESCAP region (excluding China) are still without access to safe drinking water.

Irrigation projects create conditions conducive to the spread of water related diseases such as malaria, dengue fever and schistosomiasis. Over 25 million people in the region have been infected with schistosomiasis.

Rural women in the household environment are exposed to almost 5,000 ppm of suspended particulate matter in some countries of the ESCAP region, whereas the maximum limit allowed for the occupational environment is only 290 ppm (see also chapter VI).

by adequate attention to technology planning that would emphasize low- or no-waste processes, highly efficient resource use, a high labour-capital ratio, and the use of indigenous knowledge and skills.

Inefficient use of both renewable and non-renewable natural resources, energy, water and raw materials in industrial processes is a common phenomenon in the region. Such practices result in increasing wastes and pollution. Increasing energy use coupled with a tendency to shift towards low-quality and low-cost solid fuels is responsible for a rise in atmospheric pollution. International trade and tourism, which have stimulated economic growth in many countries, have also been held responsible for environmental degradation through denuding natural resources including forests and damaging the physical ecology.

The set of policies prescribed to overcome environmental problems while sustaining the process of growth and development in the region are of the same types as those prescribed in the global context noted above. These policies can be translated into a series of action proposals, such as: to improve the access of the poor to natural resources and alleviate mass poverty; to limit population growth to the carrying capacities of ecosystems; to develop programmes that preserve or maintain vital ecosystem functions; to ensure provision for the needs of future generations in terms of resources and environmental quality, as well as technologies for meeting those needs; to preserve the diversity of genes, species, communities, habitats, and ecosystems; to use renewable natural resources on the basis of sustained yields; to minimize the impact of the exploitation of natural resources; to use clean technologies and waste-minimization techniques in industrial processes; to improve the efficiency of energy, water and land use; and to extend product life and guard against planned obsolescence.

However these actions would require that the mechanisms of their implementation, including strategies, instruments and institutions, take into account the precise nature of the environmental problems encountered in each country. Such problems would differ from one country to another, as would the capacity of each country to carry out the actions required to solve the problems. Besides solving problems of an international or global dimension in their origin and impact will require international cooperation. National governments will need to have international financial and technical support, particularly for tackling those problems which have international repercussions owing to the developing countries' limited financial and technical capabilities for solving such problems.

While rapid economic growth has often been blamed for environmental degradation, overall environmental problems are not necessarily worse in countries that have grown fast and achieved higher levels of development, nor do countries that have grown less rapidly necessarily enjoy a better environment. Moreover, it can also be argued that economic growth provides the means by which environmental problems can be solved effectively. After all, the richest countries enjoy the cleanest and best environment. However this argument is often carried to the extreme, as when growth first and clean-up later are advocated.

It may be found that certain risks of environmental degradation, such as risks of chemical poisoning and atmospheric pollution, are worse in countries with fast rates of economic growth. However, basic environmental sanitation and hygienic standards are much lower in countries with lower levels of development. While these differences are present, it is also true that some of the problems, such as deforestation and associated soil degradation, are quite common in the region. Countries at higher levels of industrialization and development could, therefore, pay more attention to the problems of atmospheric pollution while the lesser or the least developed countries could focus more on improving their sanitational and hygienic standards. The intensity of current actions should match the severity of current problems while at the same time seeking to avoid future deterioration.

# III. ECONOMIC PERFORMANCE OF THE DEVELOPING ECONOMIES OF THE ESCAP REGION: 1991-1992

In spite of the recession in the world economy, developing economies of the ESCAP region continued to be resilient, with an economic growth rate of 6.1 per cent in 1991. In 1992, the average GDP growth rate of the developing economies of the region is estimated to have accelerated to 6.9 per cent. The trend is expected to continue, with a 7 per cent rate of growth projected for 1993. The growing strength of domestic demand, continued efficiency and competitiveness of exports, the market for which was becoming progressively diversified both within the region and outside, and the cumulative effects of domestic economic reforms geared to maintaining or restoring macroeconomic balance and providing incentives for trade and investment activities, were the underlying factors contributing to the region's resilience.

However, the diverse characteristics of the developing economies of the ESCAP region have been reflected in their economic performance in recent years. Economic growth in 1991-1992 remained strong in a number of the East and South-East Asian economies. China achieved the highest rate of growth of 12 per cent in 1992, following a 7.7 per cent growth in 1991. Rates of economic growth in Hong Kong, the Republic of Korea and Taiwan Province of China in East Asia, and Indonesia, Malaysia, Singapore and Thailand in South-East Asia varied between 5 and 8 per cent in both 1991 and 1992. Viet Nam's economy also surged strongly during the two years. However, a number of countries in this very dynamic area, such as Cambodia, the Democratic People's Republic of Korea, the Lao People's Democratic Republic, Myanmar, Mongolia and the Philippines, did not fully share in the dynamism displayed by the other economies, owing to a variety of factors and circumstances. The rates of their economic growth were generally low.

The South Asian countries, with their huge populations and relatively low levels of development, have recently launched programmes of wide-ranging reforms with a view to accelerating the pace of their economic growth and development. India's economy dipped to a 2.5 per cent growth in 1991 in the face of a serious balance-of-payments crisis and enforced austerity aiming at stabilization and longer-term adjustments; its growth in 1992 was expected to pick up to slightly above 4 per cent. Pakistan has sustained growth rates at a respectable 5-6 per cent over the medium term through policy adjustments that started some years ago. Other countries in South Asia registered lower growth owing to basic structural weakness, although the rate in Sri Lanka was more attributable to short-term causes. Policy adjustments were being carried out in all South Asian countries to stimulate economic growth. Given the domestic resource constraints and the external factors governing their trade and investment financing opportunities, most of them have been slow to realize the hoped for breakthrough. The situation, as in the case of India, tended to worsen in the short term as the benefits from the reform and adjustment process were yet to be realized.

The six Asian Republics of the former Union of Soviet Socialist Republics were experiencing serious problems of transition from a long-lasting central planning regime to a market-oriented economic system, with losses of output, excessive inflation, and high and rising unemployment, which needed to be arrested and stabilized to set these countries on a course of steady growth and development.

The small island economies of the Pacific, with their small size, lack of resources and infrastructure, and a recent weakening of international support for their growth, development and welfare, are perhaps experiencing tightening rather than easing of the usual constraints on their growth and development. Some of the region's least developed countries have made determined efforts to improve their situation but their performance in most cases has remained lacklustre, with the exception of Maldives, which has registered double-digit average rate of economic growth in recent years.

The performance of these various groups of developing economies of the ESCAP region as regards output growth and inflation trends, together with other indicators in 1991-1992 (see tables III.1 and III.2), is discussed below.

## ECONOMIC GROWTH, INFLATION AND RELATED INDICATORS

### A. EAST ASIA

#### 1. Output growth

With the exception of the Democratic People's Republic of Korea and Mongolia, the economies of East Asia remained geared to a high performance in 1991 and 1992. The economies of China, Hong Kong and Taiwan Province of China, recovering from an earlier slow-down, experienced accelerated rates of growth. The Republic of Korea aimed to reduce its growth rate in 1992 as part of a plan to stabilize the economy, which had experienced high rates of inflation and a growing balance-of-payments deficit during 1990-1991.

China's gross national product (GNP) registered a 7.7 per cent increase in 1991, exceeding the planned target of 6 per cent. Growth thus accelerated from a rate of 4 per cent in 1990 despite the austerity measures, which had been imposed on the economy in late 1988, remaining in force. The austerity policy was officially ended in early 1992, and a new round of economic reforms and development was initiated. The resultant demand and investment boom pushed GNP growth to an estimated 12 per cent in 1992. With an increasing flow of investment and the improvement of infrastructure, the agricultural sector has shown growing resilience, with strong output expansion of both food and a variety of cash crops. Overall agricultural growth in 1991 was 3.7 per cent and is estimated to reach 4.5 per cent in 1992. Grain production at an estimated 440 million tons in 1992, reached the second best on record (after the 1990 figure of 445 million tons). Following a 14.6 per cent increase in 1991, industrial output grew at an estimated 16.7 per cent in 1992. Production, however, was increasing much more slowly in State-owned than in privately-owned enterprises.

Hong Kong's economic growth rate accelerated from 3.2 per cent in 1990 to 4.2 per cent in 1991 and an estimated 6 per cent in 1992. Rapid economic growth in China, with which the economy of Hong Kong has become increasingly linked boosted its exports, while enhanced labour productivity and an easing of the labour shortage through imports of foreign labour, provided the economy with a greater capacity for growth. While both the manufacturing and the service sectors expanded, the service sector was taking a lead role in the economy. Hong Kong's strategic location and well-developed transport and communications infrastructure enabled it to take advantage of not only the expanding entrepôt trade of the fast-growing Chinese economy but also the rapid rise in demand for financial, banking, business and other professional services resulting from the dynamic growth of the rest of the Asian and Pacific region.

Economic growth in Taiwan Province of China accelerated from 5 per cent in 1990 to 7.3 per cent in 1991 and was projected to reach 7 per cent in 1992. Robust exports, a rise in manufacturing investment, and increased spending to implement the new six-year development plan (1991-1997) were the underlying factors in the better performance. Industrial production increased by 6.4 per cent in 1991, against 1.3 per cent in 1990, and was projected to grow by 6.5 per cent in 1992. As in the case of other newly industrializing economies (NIEs), industry in Taiwan Province of China was geared more towards skill- and technology-intensive production as it was losing comparative advantage in labour-intensive products. Furthermore, the production structure was shifting rapidly towards service-oriented activity in the areas of finance, insurance and business services. The service sector expanded by 8.5 per cent in 1991 and was projected to expand by 8.6 per cent in 1992.

Located right in the dynamic hub comprising the territories of Hong Kong, and the southern Chinese provinces, the economy of another small territory, that of Macau, is expected soon to participate fully in the dynamism of its surrounding areas (See box III.1.).

The economy of the Democratic People's Republic of Korea grew at an estimated rate of 2-3 per cent per annum during the first three years of its current seven-year plan (1987-1993) and contracted in 1990-1991. Food production has remained a serious problem for the past few years owing to poor harvests. Raising agricultural production through irrigation and mechanization remained an important objective of the plan. A serious energy shortage reportedly caused industry to operate at only about 50 per cent of capacity. The industrial sector has an unbalanced structure owing to the fact that in the past priority for development has been accorded to the heavy and chemical industries. An increasing shortage of foreign exchange has recently inhibited imports of the advanced technology and machinery needed to modernize the industrial sector.

The fall in Mongolia's GDP in 1992 continued the trend of economic decline that began in 1990. GDP in real terms fell by 9.2 per cent in 1991 and a further decline of approximately 5 per cent was expected in 1992. There was a marked decline in both industrial and agricultural output, by 20 per cent and 7.4 per cent

## Box III.1. Macau: a small open economy in a dynamic hub

Macau is a small territory located within the dynamic growth hub encompassing the provinces of southern China and Hong Kong. Still under Portuguese administration, Macau is due to be returned to China in 1999. It had a total population of 351,700 in 1991, all of which is urban, in an area of 18 sq km. Although the natural rate of population growth was recorded at 1.57 per cent in 1991, the annual rate of population increase during the 1981 and 1991 census years was 3.77 per cent, indicating substantial immigration. With an 83 per cent share of trade in gross domestic product (GDP), Macau's economy is one of the most open in the region and will be increasingly drawn into the growth hub of southern China.

The major sectors of Macau's economy are trade, manufacturing and tourism. Macau's foreign trade grew from $2 billion in 1986 to $3.5 billion in 1991. Its major exports are textiles and garments, while its major imports are capital goods. So far, Macau's major export markets have been the United States of America, Hong Kong and Germany, while its imports have been mainly from Hong Kong, China and Japan.

Macau's economy has not so far grown as fast as the economies of its more dynamic neighbours, especially Hong Kong and south China, but its growth performance has not been unimpressive. In recent years its GDP has grown moderately, at an average of 4.5 per cent (see table). Since Macau is a small and very open economy, its growth depends very much on the global economic environment. Thus the recent slow-down in the major economies had a negative impact on the territory's exports. The slow-down in the United States demand for Macau's exports in 1990 was offset by buoyant sales to Germany; but the slow-down in the German economy in 1991-1992 has thus adversely affected Macau's growth.

However, relief came from the service sector which became the mainstay of GDP growth in 1992. A substantial increase was registered in tourism and related revenue. In the meantime, six new hotels were to open for business in 1992. Another boost will come from the infrastructural development programmes that are under way, especially the international airport, which is scheduled to be operational by 1995. The rate of growth in fixed capital formation decelerated from 16.3 per cent in 1990 to 11.0 per cent in 1992 but was still quite high for the economy's continuing growth over the longer run.

Export growth faltered in 1991, with a mere 0.2 per cent increase, but improved to 3 per cent growth in 1992. The future of Macau's exports will be influenced by the outcome of the Uruguay Round of multilatural trade negotiations. A successful conclusion of the Uruguay Round may give a boost to Macau's economy, although the liberalization in the international textile trade may have an adverse impact owing to competition from countries with lower wages.

A rather high domestic inflation rate was expected to moderate in 1992, the rate coming down to 7.9 per cent from 9.6 per cent in 1991. The slow-down of inflation in the territory reflected a depreciation in the Chinese currency and generally lower prices of imports. On the other hand, cost-push inflation stemming from the higher cost of electricity and transport contributed to the rise in the prices of locally produced goods and services.

Macau would greatly benefit in its future development from a closer integration of its economy with the neighbouring economies of southern China. The territory could assume the role of supplier of business networks and service technologies, and with its developed infrastructures serve as a platform for international transport and telecommunications. The signing of a cooperation agreement with the European Community in June 1992 may serve the territory well. It can make an important contribution to the modernization of the local industrial sector by promoting and facilitating coproduction for companies in the same line of business. Cooperation with financial institutions may develop Macau's financial services to serve the needs of the neighbouring economies. Under the agreement, Macau can join the list of countries and territories that are accorded preferential treatment by the European Investment Bank and therefore can submit to the Bank its own infrastructural projects for financing. This will enable the territory to further strengthen the links between Europe and the south China region.

**Macau: economic indicators**

*(Real growth rates)*

| | *1989* | *1990* | *1991* | *1992*[a] |
|---|---|---|---|---|
| Private consumption | 4.3 | 4.7 | 4.0 | 3.5 |
| Public consumption | 12.5 | 11.4 | –0.8 | 0.0 |
| Gross fixed capital formation | 3.6 | 16.3 | 12.3 | 11.0 |
| Exports of goods and services | 7.0 | 4.6 | 0.2 | 3.0 |
| Imports of goods and services | 7.2 | 0.4 | 7.2 | 5.0 |
| Gross domestic product | 4.9 | 7.7 | 3.1 | 4.0 |
| Consumer price (nominal index) | 8.8 | 8.0 | 9.6 | 7.9 |
| Trade balance (millions of US dollars) | 163.6 | 161.4 | –188.2 | ... |

***Source:*** Statistics and Census Department, Government of Macau.

[a] Estimates.

respectively, in 1991. This was due, in part, to the uncertainties resulting from the dismantling of the centrally planned system and the lag in replacing it with a functioning market-oriented system. Food and consumer goods production remained a matter of great concern. Following a poor harvest in the 1991 agricultural season, which resulted in panic buying and hoarding, rationing of basic foodstuffs and consumer goods was reimposed in 1991.

The economic performance of Mongolia is closely linked to its agricultural sector. Slow growth in agriculture results in slow growth rates in other sectors of the economy, especially in the light and food-processing industries. Despite the high priority accorded to agriculture and the privatization of State farms, agricultural performance has not been satisfactory. The need to expand agricultural output has resulted in a radical privatization programme. In January 1992, 90 per cent of the old agricultural cooperatives and 50 of the country's 70 State farms were privatized, covering around 4,000 individual farming enterprises. About 25 per cent of the country's livestock, the major component of agricultural production, is currently privately owned.

The value of gross industrial product in the first seven months of 1992 decreased by 20.4 per cent over the level attained in 1991. Lack of access to hard currency has left many industries short of critical spare parts and raw materials. Thus the decline in coal production in 1991 by 12 per cent was mainly due to the scarcity of spare parts and explosives. The poor condition of power plants has also resulted in a decrease of 5 per cent in electricity output.

The Republic of Korea's gross domestic product (GDP) grew by 8.4 per cent in 1991. A reduced rate of 7.3 per cent growth was achieved in 1992. The Government set a reduced growth target as part of the stabilization policies to reduce inflation and the balance-of-payments deficits. While the small agricultural sector of the economy was stagnating or contracting under certain structural impediments, the rapid expansion of activities in manufacturing and construction sustained economic growth. With the manufacturing sector growing by 8.5 per cent in 1991 and the construction sector by 11.3 per cent, the industrial sector expanded by 8.9 per cent and the service sector by 9.7 per cent. A growth rate of 7.4 per cent in the industrial sector and 8 per cent in the service sector was estimated for 1992. Growth in manufacturing was estimated at 8.2 per cent.

### 2. Inflation and other indicators of macroeconomic performance

The rate of inflation in the economy of China showed some signs of acceleration, with the retail price index rising by an estimated 6.0 per cent in 1992. Part of the acceleration from the low rates of inflation in 1990 and 1991 was the result of the extensive price reforms rather than any imbalance between supply and demand.

Since January 1992, economic reforms in China have accelerated. The reforms included more attractive policies towards both foreign and domestic investment, extensive price reforms, and the granting of more autonomy to State enterprises in production decisions. Under price reforms, about 80 per cent of the commodities were freed from control or regulations, 60-70 per cent of industrial production was targeted at market demand, and 70 per cent of raw materials were traded in the market. The upsurge in investment was reflected in the more than 13,000 wholly foreign-owned or joint-venture enterprises which came into being in the first eight months of 1992.

With rising income and wealth, domestic demand remained strong while people's savings potential also strengthened. One weakness in the Chinese economy was, however, the budget deficit that widened sharply in 1991-1992, much of which was attributed to subsidies given to debt-burdened State-owned enterprises. To remedy the situation, reliance has been placed on economic reforms and the market mechanism. Budgetary reform was also carried out which, for the first time in 1992, separated the operating budget from the capital budget, departing from the tradition of lumping them together.

Both consumption and investment expanded fast in Hong Kong. Gross domestic fixed capital formation was estimated to increase by 8 per cent in 1992. Investment was buoyed by the projected $HK 16 billion public spending on the new airport project, although there was some uncertainty owing to a lack of agreement with China concerning the implementation of the project. Investment in plant and equipment was particularly robust, rising by 18 per cent in 1991 with a 10 per cent growth forecast for 1992. Investment in the construction sector was also expected to accelerate to 7.6 per cent in 1992, from 1 per cent in 1991; increased private construction activity in residential, office and commercial development, as well as in infrastructural projects, together with the expected rise in public construction outlays, were to contribute to the sector's growth.

Inflation remained high, at 12 per cent, in 1991 but moderated to less than 10 per cent in 1992. The moderation was expected on

the basis of lower rates of imported inflation and reduced capacity constraints on domestic production. However, rising rents and high prices for consumer services, the huge public investment outlay and wage pressure in a tight labour market continued to provide strong inflationary pressures. In order to prevent the Hong Kong dollar from appreciating against the United States dollar, with which it has maintained a link, money supply in the economy was eased in response to an inflow of foreign funds into the local stock market. The government budget continued to produce surpluses, although the surplus has been projected to fall sharply to $HK 4 billion in fiscal 1992/93 compared with the $HK 14.1 billion surplus in 1991/92.

Gross fixed capital formation in Taiwan Province of China increased by 9 per cent in 1991 with increased spending on transport infrastructure, industrial technology, environmental protection, housing and health care under the six-year plan. Despite acceleration in money supply, the inflation rate remained relatively low, at 3.6 per cent in 1991, and was expected to stay at the same level in 1992. The financial sector was going through a process of liberalization and internationalization, which included the granting of licences to a number of new commercial banks, thereby introducing more competition in the domestic money market; allowing foreign institutional investors to invest directly in the security market; and removing restrictions on the establishment of new mutual funds and insurance companies.

In 1991-1992, a new set of reforms in price, trade and credit policy was introduced in Mongolia with the objective of reducing the budget deficit, which amounted to nearly 13 per cent of GNP in 1991. These reforms, however, resulted in a rapid increase in consumer prices. Tax revenues from trade dropped by 50 per cent in 1991. The budget deficit for 1992 was thus estimated at 20 per cent of GDP, which was, however, within the level recommended by the International Monetary Fund (IMF) for stabilizing the economy.

Mongolia has experienced high rates of inflation, price liberalization being a major cause; official estimates placed the rate at 46 per cent for 1991. The rate was probably higher in large urban centres such as Ulaanbaatar. The low growth of domestic output, a substantial curtailment of consumer goods imports and bottlenecks in infrastructure are among the factors making it difficult to contain inflationary pressures.

Rapid expansion in consumer demand and construction activity had caused the economy of the Republic of Korea to overheat in 1990 and 1991: inflation was registered at 9.7 per cent in 1991. Macroeconomic policy, therefore, gave priority to restoring price stability, and a variety of measures were adopted to achieve this aim, including the tightening of money supply, the dampening of construction activity, the curbing of property speculation and the launching of an anti-consumption campaign. As a rapid rise in wages has also been pushing up prices, the stabilization programme called for holding down wage increases to 5 per cent in 1992 compared with the 17 per cent rise in 1991. Inflation fell as a result, with only a 4.8 per cent increase in the consumer price index (CPI) during the first nine months of 1992. The annual inflation rate, however, could be still higher, at above 7 per cent.

Investment expenditure fell, in line with the major aim of macroeconomic policy to slow down the economy. In particular, the measures taken to control the construction boom reduced investment in that sector and the growth rate registered a sharp drop, from 27.9 per cent in 1990 to 12.3 per cent in 1991. At the same time, high interest rates and tight money supply dampened investment in machinery and equipment to reduce growth in those sectors to 12.5 per cent in 1991, from 18.4 per cent in 1990. Public investment in infrastructure was, however, maintained at a high level, and increased by 20 per cent in 1991. As a result of these changes, the rate of increase in real fixed investment was estimated to have declined to 12.4 per cent in 1991 from 23.4 per cent in 1990. With stabilization policies still in place, the downturn in the key areas of investment was to continue in 1992. As in the case of other NIEs, the Republic of Korea has been shifting its labour-intensive manufacturing activities to low-cost countries in order to maintain its competitive position, while gearing domestic production to high-technology- and skill-intensive products.

Growth in money supply (M2) was moderated to 18.6 per cent in 1991 from 21 per cent in 1990 and was targeted at about the same level in 1992. Liberal reforms in the financial sector in response to both external and domestic pressure were quickened. The restrictive market had started to obstruct the growth in investment required for upgrading production technology and for increasing the competitiveness of the products of the Republic of Korea in the international market. The liberalization programme, therefore, aimed to create an open and competitive financial system which would encompass market-determined interest rates, free foreign exchange flows, foreign access to domestic financial assets and equal treatment between foreign and local institutions.

The government budget in the Republic of Korea has traditionally shown a healthy balance between revenue and expenditure. However, a budget deficit appeared in 1990, amounting to 0.5 per cent of GDP, compared with a surplus of 0.2 per cent of GDP in 1989. The deficit widened to 1.1 per cent of GDP in 1991. Although revenue has expanded rapidly with high economic growth in recent years, expenditure has risen even faster, fuelled by high government spending on infrastructure and social welfare. The 1992 budget was projected to be 13 per cent higher than the revised 1991 budget.

## B. SOUTH-EAST ASIA

### 1. Output growth

Economic growth in 1992 has been sustained at slightly reduced rates compared with those of 1991 in most countries in South-East Asia. Only Singapore has experienced a substantial deceleration in its growth rate by 2 percentage points, while Viet Nam achieved a 3 percentage point acceleration over its rates of growth in 1991. The Philippines succeeded in reversing the contraction of its economy experienced in 1991; however, the growth rate remained low, at less than 2 per cent in 1992, and this will cause the average per capita income in the country to decline for the second year in a row.

Cambodia, the Lao People's Democratic Republic and Myanmar, the three least developed countries in South-East Asia, were characterized by relatively low levels of economic performance in 1991-1992. Cambodia's political and administrative systems were yet to be stabilized, for which efforts were under way on the initiative of the United Nations and its field mission, the United Nations Transitional Authority in Cambodia (UNTAC). Myanmar's economy had recovered in 1988-1989 from an earlier decline but the pace has slowed recently.

The efforts of the Lao People's Democratic Republic to stabilize the economy, however, have achieved a good measure of success. Its GDP growth rate slowed from 6.6 per cent in 1990 to 4 per cent in 1991, largely owing to a drought affecting agricultural production, which declined by 2.5 per cent during the year. A very rapid rate of growth in the industrial sector, 30 per cent, sustained GDP growth. In 1992, agricultural production was still suffering from drought, which also affected neighbouring Thailand. The industrial sector continued to grow rapidly, spurred by the liberal reforms covering investment, trade and prices that had been carried out for several years.

Myanmar's GDP reversed to a positive growth rate in 1989 and picked up to 3.7 per cent rate in 1990. The rate slowed to 2.7 per cent in 1991 and to 1.3 per cent in 1992. The slow-down was the result of the effect of adverse weather on agricultural production, which contributes about half of the GDP. Expansion of forestry output slowed after the initial high growth achieved in 1989-1990 with the introduction of private sector operations, including concessions granted to foreign companies. The industrial and service sectors maintained 1.5 and 1.3 per cent rates of growth respectively in 1992.

In Indonesia, the rate of GDP growth decelerated to 6.6 per cent in 1991, from 7.1 per cent in 1990. A further deceleration to 5.9 per cent was projected for 1992. The agricultural sector was seriously affected by a drought and decline in agricultural export prices. As a result, the rate of growth of the sector declined from 2.1 per cent in 1990 to 1.3 per cent in 1991. In spite of buoyant growth in manufacturing and the utility sectors (excluding oil and gas) growth in value added in the overall industrial sector declined to 10.6 per cent in 1991, from 13.0 per cent in 1990. The rate of growth of the service sector also slackened, from 8.3 per cent in 1990 to 6.9 per cent in 1991. In 1992, the agricultural sector's growth was expected to rise to 2.1 per cent, which should enable non-oil GDP to grow at a higher rate of 6.7 per cent compared with 6.2 per cent in 1991, despite projected lower growth rates in both the industrial and service sectors. GDP growth in the oil sector, with the loss of benefit of price increases experienced in 1991, was also expected to decelerate.

In Malaysia, the rate of economic growth in 1992 has been estimated at 8.5 per cent, compared with 8.6 per cent in 1991. In spite of a decline in production and unfavourable prices of rubber and cocoa, the agricultural sector's growth improved to 1.2 per cent in 1992 from near stagnation during the two previous years. Production of several other crops, including palm oil, increased. Industry and the service sectors grew by 9.9 and 9.7 per cent respectively, compared with a 10.5 per cent growth rate in both sectors in 1991. Within the industrial sector, manufacturing and construction maintained 13 and 13.5 per cent rates of growth, about a percentage point lower in both cases than in 1991.

The economy of the Philippines has been adversely affected by a number of factors during the past two years. These included damage inflicted by a series of natural calamities, the shocks inflicted by the rise in oil prices and the decline in workers' remittances consequent upon the Persian

Gulf war, domestic political uncertainties, and the imposition by the Government of short-term stabilization measures involving cuts in government spending, imports and consumption. The demand impulse in the economy remained seriously deficient in 1991. Weak demand, political uncertainties, and the trade measures, particularly the imposition of an import levy in January 1991, adversely affected the investment climate.

Apart from the weak demand feedback on the real economy, the long drought and other natural calamities, as well as the power shortage, partly due to drought-related water shortages, caused setbacks in production. The agricultural sector virtually stagnated. Industrial production suffered a decline, and the services also ceased to grow, with the result that overall GDP registered a decline of 0.9 per cent in 1991.

With the removal of uncertainties surrounding the political transition and the future of the United States bases in the Philippines, confidence was restored, and the new policy initiatives taken by the Government, such as the enactment of a foreign investment code, liberalization of the foreign exchange market, and trade and tariff reforms, improved the economy's prospects in 1992. However, with the continuation of the austerity measures still in force, the extent of the recovery remained limited. Real economic growth was expected to reach the level of 1.8 per cent, with 2.5 per cent growth in industry and 2 per cent in services, while the agricultural sector's growth was further reduced to 0.3 per cent from 0.7 per cent in 1991.

Thailand's economy went through a period of stress in 1991-1992. The underlying political uncertainty from February 1991 until the general election in September 1992, policy changes, including the introduction of the value-added tax on 1 January 1992, and the supply-side constraints which had emerged during the previous years of rapid growth, adversely affected both consumption and investment activities in the economy.

The overall rate of GDP growth, however, was estimated at 7.5 per cent in 1992, that is, about the same as in 1991. The agricultural sector's growth was reduced to 2.6 per cent in 1992 from 3 per cent in 1991 as a result of the drought prevailing during the 1992/93 crop season. The industrial sector recorded a growth rate of around 5 per cent during the first half of 1992 compared with 11.2 per cent during the same period of 1991, which reflected the political uncertainties culminating in the May 1992 disturbances. Construction activity slowed considerably as the sector appeared to have developed an oversupply in both housing and office units. However, manufacturing growth remained strong. Overall industrial growth during 1992 was expected to be slightly lower than the 11.2 per cent recorded in 1991. Growth in the service sector slowed to 8.3 per cent in 1991 and to 6.8 per cent in 1992 compared with 11.1 per cent growth recorded in 1989 and 10 per cent in 1990. The slowdown reflected a slackening off in the tourism industry.

The Singapore economy reflected the economic recession in the industrial countries more than any other. The rate of economic growth declined from 6.7 per cent in 1991 to 4.7 per cent in 1992. Growth in consumer demand slowed to a rate less than 3 per cent in 1992, although domestic sales were sustained by tourist spendings. The investment climate turned adverse, which was reflected in a downturn in gross domestic capital formation from the fourth quarter of 1991. This was confirmed by an adverse turn in general business expectations in the commercial, financial, business and real estate services. Growth in the manufacturing sector also slowed.

The economic performance of Viet Nam improved considerably in 1992. Real GDP was estimated to rise to 7 per cent in 1992, compared with 4 per cent in 1991. Success in balancing the trade account, effecting fiscal readjustment and stabilizing inflation, all reflected a healthy pattern. Agricultural growth, led by an upsurge in rice production since 1988 in response to the Government's decision to return inefficient farm cooperatives to private holders and to allow market forces to drive up the artificially low price of agricultural products, has been a major strong point in Viet Nam's recent economic performance. The manufacturing sector grew by 2 per cent during the first half of 1992, compared with a 5 per cent decline in the period 1989-1991. Private sector manufacturing industries were growing more rapidly in 1992 owing to policy liberalization which attracted both domestic and foreign investment.

## 2. Inflation and other indicators of macroeconomic performance

The Lao People's Democratic Republic has achieved considerable success in stabilizing its financial system with the establishment of the authority of a central bank, and institutionalizing the separate roles for the central bank and the commercial banks in the field of money and credit. The results of the reforms were reflected most significantly in a moderation of the inflation rate in the economy to 10.4 per cent in 1991 from an average rate of 49 per cent in 1989-1990, and were also reflected in a more stable exchange rate for

the national currency as well as an improvement in the balance-of-payments situation. With the introduction of tax and other fiscal reforms, government finances were also largely stabilized.

In Myanmar, the financial situation remained less than satisfactory, despite some efforts to introduce tax reforms and a consequent improvement in tax revenue. Government budgetary deficits remained large. Although the rate of growth in money supply decelerated from 43.5 per cent in 1990 to 12.6 per cent in 1991, inflation reached a rate of 32.3 per cent. The size of the government deficit, the growth in money supply and inflation rates were expected to remain high in 1992.

The growth slow-down in the Indonesian economy was partly the result of government policies seeking to reduce the demand pressure that could upset price stability. In mid-1990, the Government adopted a tight monetary policy which not only slowed the growth in money supply but also pushed the interest rates by several percentage points to their highest levels in recent years. Budgetary policy also was contractionary. The Budgetary Reserve for Development was created in 1991, which set aside Rp 1.5 trillion out of the windfall gains in oil and gas revenues during the Persian Gulf war as a "sterilization" measure and also as an insurance against future resource shortfalls.

Domestic demand decelerated owing to slow growth in both consumption and investment, the growth in domestic consumption falling from 8.8 per cent in 1990 to 7.5 per cent in 1991 in response to high interest rates and decline in consumer credit. Similarly, growth in investment slowed markedly, from 27.8 per cent in 1990 to 8.9 per cent in 1991. Thus, overall domestic demand slackened from 12.2 per cent growth in 1990 to 3.4 per cent growth in 1991. Monetary conditions were eased subsequently, with a decline in interest rates from the highest level reached in March 1991. Policies were targeted at further gradual relaxation in order to release the constraints on growth while ensuring that price stability was not unduly affected. The inflation rate accelerated slightly from 9.1 per cent in 1990 to 9.8 per cent in 1991, but has been projected to fall sharply to 4.7 per cent in 1992.

The slight moderation in the Malaysia's economic growth in 1991-1992 from the highest point of 9.8 per cent reached in 1990 was partly the result of policies of restraint adopted so as to prevent the economy from becoming heated. The inflation rate accelerated from around 3 per cent in 1990 to about 4 per cent in 1991, and is estimated to show 4.6 per cent for 1992. That raised concern in an economy used to low inflation rates, and in response the monetary policy was tightened to obviate possible further price escalations. Growth in money supply (M1) was slowed from 14 per cent in 1990 to 11 per cent in 1991 and to 9.4 per cent in 1992. Interest rates were raised across the board, the deposit rates more sharply than the lending rates, a move which reflected the strategy to control inflation while sustaining growth. Fiscal policy has moved along similar lines, as reflected in a fall in the Government's fiscal deficit from 5 per cent of GDP in 1990 to 3 per cent in 1992.

Malaysia's economic growth has been propelled by rapid expansion in domestic demand for both consumption and investment since 1989. However, demand growth was restrained in 1991-1992. Private consumption, after a 13-14 per cent growth in 1988-1989, grew at the rate of almost 12 per cent in 1991 but was projected to grow by only about 6 per cent in 1992. Public consumption, however, was growing faster, reflecting in part civil service salary increases. Growth in both public and private investment decelerated sharply, from 12 and 23 per cent in 1991 to 8 and 10 per cent respectively in 1992.

In the Philippines, while the growth of the economy was faltering, a notable success was achieved in moderating inflation, from a rate of 18.7 per cent in 1991 to 9.1 per cent in 1992. Restraints on the growth of money and credit and a reduction in government fiscal deficits constituted two major elements in the stabilization programme and marked success was achieved in both. Thus, growth in money supply (M1) was brought down from 31.5 per cent in 1989 to 13-14 per cent in 1990-1991. Interest rates which rose to 24 per cent (for secure loans) in 1990, however, started coming down and stood at an average of 20 per cent during the period January-July 1992, which reflected the liberal reforms introduced in the financial sector.

With severe restraints placed on the growth of government expenditure, the national budget deficits were also reduced, from 3.5 per cent of GNP in 1990 to 2.1 per cent in 1991 and to 1.2 per cent in 1992. Although the average rate of investment was estimated at around 20-21 per cent in 1991-1992, which was lower than the rate of 22.5 per cent in 1990, the resource gap between investment and available domestic savings was considerably reduced, from 6.1 per cent of GNP in 1990 to 2.4 per cent in 1992. That reflected a marked improvement in domestic savings rates, from 16.4 per cent in 1990 to an estimated 19.2 per cent in 1992, although it also partly reflected the lower rate of the investment.

**Table III.1. Selected developing economies of the ESCAP region. Growth and inflation, 1988-1992**

*(Percentage)*

| | | *Rates of growth* | | | | *Changes in consumer price index* |
|---|---|---|---|---|---|---|
| | | *Gross domestic product* | *Agriculture* | *Industry* | *Services* | |
| **East Asia** | | | | | | |
| China[a] | 1988 | 11.3 | 3.9 | 20.8 | 6.3 | 20.7 |
| | 1989 | 4.3 | 3.1 | 8.5 | -6.6 | 16.3 |
| | 1990 | 4.0 | 7.6 | 7.8 | 0.1 | 1.3 |
| | 1991 | 7.7 | 3.7 | 14.6 | 1.5 | 2.9 |
| | 1992 | 12.0 | 4.5 | 16.7 | 14.6 | 6.0 |
| Hong Kong | 1988 | 8.3 | ... | ... | ... | 7.4 |
| | 1989 | 2.8 | ... | ... | ... | 10.1 |
| | 1990 | 3.2 | ... | ... | ... | 9.7 |
| | 1991 | 4.2 | .. | ... | ... | 12.0 |
| | 1992 | 6.0 | ... | ... | ... | 9.9 |
| Republic of Korea | 1988 | 11.5 | 8.0 | 12.3 | 11.5 | 7.2 |
| | 1989 | 6.1 | -0.7 | 5.8 | 8.0 | 5.6 |
| | 1990 | 9.2 | -5.5 | 12.0 | 9.5 | 8.6 |
| | 1991 | 8.4 | -0.8 | 8.9 | 9.7 | 9.7 |
| | 1992 | 7.3 | 2.0 | 7.4 | 8.0 | 7.3 |
| **Soutn-East Asia** | | | | | | |
| Indonesia | 1988 | 5.8 | 4.9 | 5.2 | 6.8 | 8.0 |
| | 1989 | 7.5 | 3.3 | 7.8 | 9.3 | 6.5 |
| | 1990 | 7.1 | 2.0 | 9.7 | 7.3 | 9.1 |
| | 1991 | 6.6 | 1.3 | 9.9 | 5.8 | 9.8 |
| | 1992 | 5.9 | 2.1 | 8.1 | 4.3 | 4.7 |
| Lao People's Democratic Republic | 1988 | -1.8 | -4.2 | -2.4 | 4.1 | ... |
| | 1989 | 13.5 | 10.7 | 34.3 | 11.4 | 62.9 |
| | 1990 | 6.6 | 8.6 | 55.5 | -2.3 | 35.1 |
| | 1991 | 4.0 | -2.5 | 30.0 | 5.1 | 10.4 |
| | 1992 | 6.0 | ... | ... | ... | 9.5 |
| Malaysia | 1988 | 8.9 | 5.4 | 12.7 | 7.5 | 2.6 |
| | 1989 | 8.7 | 6.0 | 11.0 | 8.5 | 2.8 |
| | 1990 | 9.8 | 0.4 | 14.5 | 10.4 | 2.6 |
| | 1991 | 8.6 | 0.1 | 10.5 | 10.5 | 4.4 |
| | 1992 | 8.5 | 1.2 | 9.9 | 9.7 | 4.6 |
| Myanmar | 1988 | -4.0 | -8.2 | -5.2 | -2.6 | 16.1 |
| | 1989 | -11.4 | -12.5 | -16.8 | -8.2 | 27.2 |
| | 1990 | 3.7 | 4.4 | 15.4 | -0.4 | 17.6 |
| | 1991 | 2.7 | 2.0 | 4.2 | 3.2 | 32.3 |
| | 1992 | 1.3 | 1.3 | 1.5 | 1.3 | 27.0 |
| Philippines | 1988 | 6.3 | 3.7 | 8.5 | 6.3 | 8.7 |
| | 1989 | 5.6 | 4.3 | 6.9 | 5.7 | 12.2 |
| | 1990 | 2.5 | 2.1 | 2.3 | 3.3 | 14.2 |
| | 1991 | -0.9 | 0.7 | -3.3 | 0.0 | 18.7 |
| | 1992 | 1.8 | 0.3 | 2.5 | 2.0 | 9.1 |

*(Continued on next page)*

**Table III.1** *(continued)*

*(Percentage)*

| | | Rates of growth | | | | Changes in consumer price index |
|---|---|---|---|---|---|---|
| | | Gross domestic product | Agriculture | Industry | Services | |
| Singapore | 1988 | 11.1 | -12.2 | 13.2 | 8.7 | 1.5 |
| | 1989 | 9.2 | -6.6 | 8.3 | 10.5 | 2.4 |
| | 1990 | 8.3 | -7.6 | 9.1 | 9.7 | 3.5 |
| | 1991 | 6.7 | -9.4 | 7.7 | 6.4 | 3.4 |
| | 1992 | 4.7 | -6.2 | 4.9 | 4.8 | 3.3 |
| Thailand | 1988 | 13.2 | 10.2 | 17.4 | 11.6 | 3.8 |
| | 1989 | 12.0 | 6.6 | 16.2 | 11.1 | 5.4 |
| | 1990 | 10.0 | -1.8 | 15.6 | 10.0 | 6.0 |
| | 1991 | 8.0 | 3.0 | 11.2 | 8.3 | 5.7 |
| | 1992 | 7.5 | 2.6 | 10.7 | 6.8 | 5.0 |
| Viet Nam | 1988 | 5.2 | 4.0 | 2.3 | 8.9 | 393.8 |
| | 1989 | 8.0 | 6.9 | -2.8 | 17.3 | 34.4 |
| | 1990 | 5.1 | 1.5 | 2.9 | 10.3 | 67.5 |
| | 1991 | 4.0 | 0.5 | 4.3 | 7.5 | 67.0 |
| | 1992 | 7.0 | 4.5 | 12.0 | 6.6 | 18.0 |
| **South Asia** | | | | | | |
| Afghanistan | 1988 | -8.3 | -6.7 | -10.2 | -9.5 | 19.9 |
| | 1989 | -2.2 | -4.2 | -13.5 | -2.9 | 75.1 |
| | 1990 | ... | ... | ... | ... | 41.9 |
| | 1991 | ... | ... | ... | ... | 56.7 |
| Bangladesh | 1988 | 2.9 | -0.8 | 5.3 | 5.3 | 9.4 |
| | 1989 | 2.5 | -1.1 | 4.8 | 4.7 | 10.0 |
| | 1990 | 6.6 | 10.0 | 6.4 | 4.0 | 8.1 |
| | 1991 | 3.6 | 2.7 | 5.9 | 4.8 | 8.9 |
| | 1992 | 4.0 | 2.3 | 5.7 | 5.0 | 5.1 |
| Bhutan | 1988 | 1.0 | 1.5 | -4.8 | 5.8 | 10.1 |
| | 1989 | 5.0 | 2.5 | 6.6 | 7.9 | 8.5 |
| | 1990 | 3.1 | 2.7 | 4.9 | 2.1 | 9.4 |
| | 1991 | 3.5 | 3.5 | 4.0 | 3.0 | 12.0 |
| | 1992 | 4.0 | 4.0 | 4.5 | 3.5 | 11.0 |
| India | 1988 | 10.5 | 16.4 | 7.8 | 7.7 | 9.5 |
| | 1989 | 6.0 | 2.7 | 6.7 | 8.3 | 7.1 |
| | 1990 | 5.6 | 4.2 | 6.7 | 5.9 | 8.9 |
| | 1991 | 2.5 | -0.5 | 1.5 | 5.5 | 13.8 |
| | 1992 | 4.5 | 3.0 | 4.0 | 6.0 | 10.0 |
| Iran (Islamic Republic of) | 1988 | -5.7 | -12.9 | 1.0 | -6.9 | 28.6 |
| | 1989 | 3.6 | 3.8 | 5.4 | 2.1 | 17.4 |
| | 1990 | 12.1 | 8.1 | 16.5 | 9.0 | 9.0 |
| | 1991 | 9.9 | 5.1 | 14.3 | 5.1 | 19.6 |
| | 1992 | 8.0 | 7.1 | 11.5[b] | 9.0 | ... |
| Maldives | 1988 | 8.6 | 4.9 | 9.5 | 10.3 | ... |
| | 1989 | 9.3 | 5.4 | 10.0 | 10.9 | ... |
| | 1990 | 15.1 | 9.2 | 17.8 | 16.9 | ... |
| | 1991 | 8.0 | 5.8 | 9.3 | 8.5 | ... |

*(Continued on next page)*

**Table III.1** *(continued)*

*(Percentage)*

| | | Rates of growth | | | | Changes in consumer price index |
|---|---|---|---|---|---|---|
| | | Gross domestic product | Agriculture | Industry | Services | |
| Nepal[c] | 1988 | 7.3 | 8.1 | 6.0 | ... | 9.0 |
| | 1989 | 4.2 | 7.8 | -0.9 | ... | 8.8 |
| | 1990 | 6.1 | 7.4 | 4.1 | ... | 8.3 |
| | 1991 | 5.5 | 2.8 | 5.7 | ... | 15.5 |
| | 1992 | 3.1 | 0.5 | 7.0 | ... | 20.0 |
| Pakistan | 1988 | 6.4 | 2.7 | 9.8 | 6.8 | 8.8 |
| | 1989 | 4.8 | 6.9 | 4.7 | 3.8 | 7.9 |
| | 1990 | 4.7 | 2.7 | 6.3 | 4.8 | 9.0 |
| | 1991 | 5.6 | 5.1 | 6.2 | 5.5 | 12.7 |
| | 1992 | 6.4 | 6.4 | 7.3 | 5.9 | 9.6 |
| Sri Lanka | 1988 | 2.7 | 2.1 | 4.2 | 2.2 | 14.0 |
| | 1989 | 2.3 | -1.1 | 3.4 | 3.2 | 11.5 |
| | 1990 | 6.2 | 8.8 | 2.7 | 7.0 | 21.5 |
| | 1991 | 4.8 | 2.9 | 7.5 | 7.1 | 12.2 |
| | 1992 | 4.5 | -1.8 | 7.1 | 5.9 | 11.0 |
| **Pacific island economies** | | | | | | |
| Fiji | 1988 | 0.8 | -2.5 | -6.5 | 4.3 | 11.7 |
| | 1989 | 12.0 | 11.9 | 11.9 | 11.8 | 6.2 |
| | 1990 | 5.0 | -3.3 | 6.1 | 8.4 | 8.1 |
| | 1991 | -0.1 | -0.7 | 4.8 | -1.0 | 6.5 |
| | 1992 | 4.2 | 2.1 | 6.3 | 3.5 | 4.3 |
| Papua New Guinea | 1988 | 2.9 | 3.7 | -6.1 | -0.1 | 5.4 |
| | 1989 | -1.4 | 1.7 | -11.0 | 3.7 | 4.5 |
| | 1990 | -3.0 | -1.0 | -3.8 | -5.9 | 6.9 |
| | 1991 | 9.5 | 3.4 | 24.8 | 4.6 | 6.9 |
| | 1992 | 5.4 | 3.3 | 7.0 | 6.0 | 5.5 |
| Samoa | 1988 | 0.0 | ... | ... | ... | 8.5 |
| | 1989 | 2.1 | ... | ... | ... | 6.4 |
| | 1990 | -4.8 | ... | ... | ... | 15.3 |
| | 1991 | -1.0 | ... | ... | ... | -1.4 |
| Solomon Islands | 1988 | 5.9 | 10.1 | 14.9 | 1.7 | 16.7 |
| | 1989 | 6.2 | 13.6 | 6.4 | 3.7 | 14.9 |
| | 1990 | 1.8 | 2.4 | 1.3 | 1.5 | 8.8 |
| | 1991 | 3.9 | 2.1 | 0.0 | 5.7 | 15.1 |
| | 1992 | 3.6 | 4.3 | 5.5 | 2.5 | 10.0 |
| Tonga | 1988 | -1.6 | -9.7 | -0.4 | 2.5 | 10.0 |
| | 1989 | 1.8 | 5.6 | 4.8 | -0.7 | 4.1 |
| | 1990 | 2.8 | 4.0 | 1.0 | 1.5 | 10.9 |
| | 1991 | 3.9 | 7.4 | 1.0 | 2.0 | 9.4 |
| | 1992 | 4.5 | 9.0 | 1.0 | 2.0 | 5.0 |
| Vanuatu | 1988 | 0.6 | -9.9 | 14.9 | 1.5 | 8.7 |
| | 1989 | 4.5 | 9.4 | 10.4 | 1.9 | 7.8 |
| | 1990 | 5.2 | 16.8 | 8.1 | 0.9 | 4.7 |
| | 1991 | 4.1 | -1.3 | 9.3 | 4.9 | 6.5 |
| | 1992 | 2.9 | -11.4 | 10.7 | 6.0 | 10.0 |

***Sources:*** International Monetary Fund, *International Financial Statistics,* vol. XLV, No. 11 (November 1992); Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries, 1992* (Oxford University Press for Asian Development Bank, 1992) and *Asian Development Outlook 1992* (Oxford University Press for Asian Development Bank, 1992); and national sources.

[a] GNP. [b] Manufacturing only. [c] Industry includes services.

Overall investment declined by 13.6 per cent in 1991, led by a fall in private construction by 27.7 per cent and in durable equipment by 8.4 per cent. A 3 per cent fall in imports also reflected this unfavourable climate of consumption and investment in the economy. Public consumption grew by only 1 per cent in 1992, while private consumption expenditure was estimated to rise by 4 per cent. Investment growth was estimated at 8.3 per cent, led by a 10 per cent growth in investment in durable equipment.

Thailand was experiencing an investment slow-down after several years of rapid growth. The rate of growth in private investment was estimated at 6 per cent in 1992, compared with 15 per cent in 1991 and 22.3 per cent in 1990. The slow-down in investment was reflected in only marginal growth (1 per cent) of imports of capital goods and a decline in domestic sales of cement. The inflow of foreign direct investment (FDI) also slowed considerably which, as in other countries, also reflected a slow-down in Japan's overseas investment as a major source of FDI in the region.

Consumer price inflation decelerated from the annual rate of 6 per cent in 1990 to 5.7 per cent in 1991 and was estimated to decline further to 5.0 per cent in 1992. Monetary conditions were tightened with the emergence of strong inflationary forces in the economy in 1990, when the prime bank lending rates rose to a peak of 16 per cent. Growth in money supply (M1) was reduced from about 18 per cent in 1989 to about 12 per cent in 1990. Since then monetary conditions have been eased, interest rates have come down, and some acceleration in money supply growth has been allowed as reflected in a 15 per cent growth in money supply (M1) in 1992.

Since 1988, government fiscal operations have resulted in budgetary surpluses, which went up to a record 123 billion baht in 1991 from 104 billion baht in 1990. The surpluses partly reflected deliberate efforts to prevent the economy from overheating. With the gradual disappearance of the inflationary trend, budgetary spending has been accelerated with a planned increase in capital expenditure, partly to overcome some of the infrastructural bottlenecks. The increase in expenditure was also due to the relief provided for the damage caused by the drought and the political unrest of May 1992. As a result, the budget surplus was reduced to 82,000 million baht in 1992 and a deficit was projected in the 1993 budget, despite a healthy growth in revenue.

In Viet Nam, inflation, which averaged over 60 per cent in 1990 and 1991, fell to an estimated 18 per cent in 1992. Since December 1991, food prices have fallen in response to improved supply, but prices for manufactured products have risen fast. At the beginning of 1992 the Government adopted measures to further stabilize the national currency and the financial sector.

## C. SOUTH ASIA

### 1. Output growth

The five least developed countries in South Asia, Afghanistan, Bangladesh, Bhutan, Maldives and Nepal, have experienced more difficulties than the other three South Asian countries in their efforts to reform and readjust their economies and improve their performance. With the exception of Maldives, the performance level of the South Asian least developed countries remained low. While Afghanistan was seeking to stabilize its political situation, and the economy which had remained depressed for a number of years, there were signs of some resilience in 1992 in the economies of Bangladesh, Bhutan and Nepal. The economies of India and Pakistan also showed greater resilience in 1992, while that of Sri Lanka tended to falter due to both the effects of adverse weather on the economy and the continuing political problem in the country. In general, the South Asian countries have encountered political problems of various kinds which have not been conducive to the uninterrupted pursuit of economic growth and development. However, all South Asian countries are carrying out policy adjustments to liberalize their economies and stimulate growth (see box III.2.).

The Afghanistan economy suffered serious difficulties throughout the 1980s. The situation worsened in 1987 when GDP contracted by 10.3 per cent to be followed by an 8.3 per cent fall in 1988. The rate of decline in GDP slowed to 2.2 per cent in 1989. The limited available information showed no improvement in the performance of the economy in the subsequent years. The general index of agricultural production showed some improvement in 1990 as compared with 1989, but the value of the index was below that in 1987 and 1988. The index registered a further decline of 6 per cent in 1991 over the previous year.

The Bangladesh economy could improve marginally with a GDP growth rate of 4 per cent in 1992 against 3.6 per cent in 1991. The recovery from the effects of the cyclone in April 1991 and floods later in the year was slow. A large number of refugees on the country's eastern border added further problems to the hard-pressed economy. Agricultural and industrial growth rates, at 2.3 and 5.7 per cent respectively in 1992, were

## Box III.2. Privatization and investment deregulation in South Asian countries

In recent years, most of the South Asian countries have introduced major economic reforms in such important areas as industry, foreign trade, investment, public sector enterprises, and the foreign exchange, fiscal and financial systems. The reforms are aimed at liberalizing the economies in varying degrees.

Privatization and deregulation of investment are key components of economic reforms in most of these countries. Deregulation aims at removing unnecessary government controls over the private sector to enable it to concentrate more on increasing output and efficiency and less on complying with or circumventing government regulations. Privatization is considered beneficial for enhancing the efficiency of enterprises owned by government, encouraging private sector initiative, greater competition and better allocation of resources, and relieving the government budget from the financial burden of loss-making enterprises.

In India, licensing has been removed for all industries of any size except for 18 industries, which will be regulated for such reasons as security, chemical hazards, and overriding environmental or social concerns. The exemption is also applicable to expansion of the existing units. With the liberalization of the economy and the industrial sector, the Government also intends to restrict the role of the public sector to eight industries in the strategic and basic infrastructural sectors.

In July 1991, as part of a new industrial policy, it was announced that approval would be given for FDI with up to 51 per cent foreign equity in 34 high priority areas, provided that the foreign equity covered the import of capital goods fully , and outflows on account of dividend payments were balanced by export earnings over a period. Total foreign ownership is to be allowed in the power sector, fully export-oriented units and selected high-technology industries. Existing companies can also raise foreign equity up to 51 per cent, subject to certain prescribed guidelines. In the 1992/93 budget, foreign investment has been allowed in critical sectors such as oil and gas. Non-resident Indians and overseas corporate bodies owned by them are also permitted to invest up to 100 per cent in high-priority industries with full benefits of repatriation of capital invested and income accruing thereon.

The Government of Pakistan has quite a broad agenda on privatization that covers industries, telecommunications and other infrastructure, and the banks and development finance institutions. Some 115 industrial units were identified for divestiture in 1991. More than 22 units had already been transferred to the private sector and bids in respect of 32 units were at various stages of consideration. Out of four nationalized commercial banks, two have already been privatized. One of the banks has been divested to a management group formed by the workers of the bank. Before actual privatization, the Government negotiated an agreement with representatives of workers of public enterprises to safeguard their interests. The agreement removed any possible resistance from the workers and contributed to a smooth process of privatization. In the process of deregulation, the Government has abolished the requirement of prior sanction for all industries, except those on the specified list, which includes arms and ammunition, security printing, currency and mint, high explosives and radioactive substances.

Foreign investors are to be treated in the same way as local investors. Foreigners and overseas Pakistanis have been allowed to make new investments without having to obtain prior approval except in a few industries, for which domestic investors also require government approval. Foreign investors have been permitted to own up to 100 per cent of equity in a venture and to purchase equity in existing industrial companies on a repatriable basis. Remittances of dividends and disinvestment proceeds no longer require the Central Bank's permission. All controls on the operation of foreign currency accounts by foreign firms and individuals have been abolished. Access to borrowing by foreign companies has been greatly liberalized. Foreign firms have been permitted to borrow from the domestic market. In addition, the Government has opened to the private sector a number of areas for investment which used to be the monopoly of the public sector. These include banking, power generation, telecommunications, airlines, shipping, road construction and port operations.

In Bangladesh, industrial deregulation has been continued in the new industrial policy announced in 1991. The investment sanctioning process has been decentralized by allowing various agencies to sanction projects. The limit for projects which development finance institutions and nationalized commercial banks can accept for financing without prior government sanction has been raised to Tk 300 million. All projects with investment exceeding Tk 300 million require approval of the Government. No prior government sanction is required for investment in areas open to the private sector provided the industries are set up with the entrepreneur's own funds or with funds from private banks or private financial institutions. The sanctioning procedure for foreign investment has been simplified. Furthermore, no prior approval is needed for foreign investment in joint ventures in most cases.

*(Continued overleaf)*

*(Continued from preceding page)*

Thus far a large number of industrial and commercial enterprises, and two of the five nationalized commercial banks have already been privatized, besides permitting the establishment of a number of banks in the private sector. The Government has expressed firm determination to continue with the process of privatization and proceeded with a programme of sale of public enterprises through the floating of tenders. Bangladeshis working abroad will be encouraged to purchase these industrial units, or shares in them, in foreign currencies. However, resistance from workers of public enterprises has delayed the implementation of the privatization plan.

In Sri Lanka, a total of 21 public enterprises have been successfully privatized since 1989 and an additional 40 have been cleared for privatization. One important feature of the privatization programme in Sri Lanka is the emphasis placed on broadening the ownership base while ensuring continuity of the enterprise. In general, the method used is to sell 60 per cent of the shares to a prospective entrepreneur through a tender process, 30 per cent to the general public through the stock market, and 10 per cent given as gifts to the employees of the enterprise. An important achievement of the public enterprise reform programme was privatization of the management of most of the State-owned estates. Some 449 State-owned estates were regrouped into 22 independent regional plantation enterprises and their management was given to 22 private sector companies on a profit-sharing basis. This new arrangement brought 95,000 hectares of tea, 59,000 ha of rubber and 11,000 ha of coconut plantations under management contract.

As in many other areas, reforms have been introduced to deregulate industries and foreign investment. Foreign investment controls have been virtually eliminated, with the exception of only a few areas of activity reserved for local investors.

The new industrial policy of Nepal emphasizes deregulation. As a result, the licensing requirement for setting up industries has been largely abolished, except for a specified list of industries related to defence, public health and environment. Moreover, registration and licensing procedures have been simplified. A "one window" sanctioning procedure for industry has been established. To attract foreign investment, a simplified foreign investment approval system has been developed. The Government is committed to a privatization programme for public enterprises. Three manufacturing units were already in the process of privatization and another 60 were under examination for possible divestiture. Measures have also been taken to privatize five agricultural farms in the government sector.

marginally lower than those achieved by these sectors in the previous year. Bad weather and labour unrest were some of the factors keeping these growth rates lower. The energy sector grew at a fast rate of 13.3 per cent in 1992, against 4.4 per cent in 1991, as a result of the operationalization of new electricity generation plants. Construction works, public services and trading services expanded during 1992.

From an average of over 6 per cent during the 1980s, the rate of GDP growth in Bhutan fell to just over 3 per cent in 1990 and 1991. The decline in 1990 was due to slow growth in the public sector, while in 1991 it reflected the unsatisfactory performance of manufacturing. GDP growth in 1992 was estimated at 4 per cent, which was attributable to the improved performance of agriculture and industry. Although reliable agricultural statistics are difficult to obtain, estimates suggest that growth in agriculture slowed to an average of just over 3 per cent per annum in 1990-1991. This was an improvement on the previous two years, but it was well below the average of close to 6 per cent annual growth during the 1980s. The growth of the agricultural sector was estimated at about 4 per cent in 1992 with the continued exploitation of Bhutan's comparative advantage in horticulture, tree crops and other cash crops. The manufacturing sector, which was still quite small, was expected to grow by over 10 per cent in 1992, with an overall industrial growth of 4.5 per cent.

Under reforms initiated in 1989 and accelerated since then, greater participation of the private sector in industrial activities and improvement in industrial efficiency were envisaged. The Government identified a number of industrial and power projects to be undertaken with private sector participation, and liberalized the manufacturing licensing system which had created uncertainties for investors in the past. The recent liberalization of foreign exchange for imports should also help to stimulate the growth of private enterprise. In addition, the seventh five-year plan, which commenced in July 1992, focused on human resources and infrastructure development in order to create an environment conducive to private sector initiative. In the service sector also, all tourist activities, including the operation of hotels which had been handled by the Government, became privately operated.

The economy of Maldives performed exceptionally well during the 1980s. GDP growth during the decade averaged around 10

per cent per annum, sustained by growth in fisheries and tourism. GDP growth rates of 1990 and 1991 have been estimated at 15.1 and 8.0 per cent respectively. There is very little agriculture in Maldives. In terms of contribution to GDP, tourism overtook fisheries as the lead sector of the economy in 1985. Despite impressive gains in fishing, however, the contribution of primary sectors in GDP declined. The value of manufacturing output increased by 40 per cent between 1987 and 1990, as a result of the opening of several manufacturing enterprises. Major growth was recorded in the service sector, which included tourism and distribution and transport services.

Nepal's economic performance, after gaining some momentum in 1991, slackened in 1992. Compared with the revised GDP growth estimate of 5.5 per cent for 1991, GDP increased by only 3.1 per cent in 1992. Adverse weather conditions affecting agricultural production were mainly responsible for the set-back. Preliminary estimates suggested only 0.5 per cent growth in agriculture in 1992. Food grain production declined by 6.5 per cent. However, the non-agriculture sector, under the impetus of liberal reforms, was expected to grow at the rate of 7 per cent, compared with 5.7 per cent in 1991.

Despite the adverse effects of the Persian Gulf crisis, the growth rate of GDP in India was 5.6 per cent in 1990. There was a favourable monsoon and a bumper crop for the third consecutive year up to 1990. However, the Indian economy showed a distinct slowdown during 1991. The real GDP growth rate was reduced to 2.5 per cent, with growth rates of 1.5 per cent in industry and 5.5 per cent in the service sector, but a 0.5 per cent fall in the agricultural and allied activities sector. The sustained progress in agricultural production over the previous three years could not be maintained owing to the delayed and spatially unfavourable distribution of monsoon rainfall. In 1992, GDP was expected to grow by 4.5 per cent, industry by 4 per cent, the agricultural and allied activities sector by 3 per cent, and the service sector by 6 per cent in value-added terms.

The prospects for agricultural production were brighter in 1992 owing to a more favourable monsoon. The overall index of agricultural production was estimated to increase by 3 per cent in 1992 in contrast with a fall in 1991. Production of both food grain and commercial crops was expected to rise significantly. There was a distinct improvement in industrial production in 1992, attributable to trade liberalization measures such as the abolition of deposit requirements for imports, easier availability of imported raw materials, capital goods, spare parts and components. A fall in the rates of interest and inflation also contributed to the improvement of the economy. The performance of infrastructure industries such as power, coal, telecommunications, shipping and cement was encouraging.

The rates of growth of GDP in the Islamic Republic of Iran slowed from 12.1 per cent in 1990 to 9.9 per cent in 1991. However, the average annual growth rate of GDP during the period 1989-1991 was 8.3 per cent, higher than the target of 8 per cent set in the country's first five-year plan. The sectors contributing most to economic growth during this period were oil and manufacturing, which grew at the rates of 12.4 and 15 per cent respectively. The agricultural sector expanded by an annual average rate of 5.6 per cent, higher than the plan target of 5 per cent. The services sector's 5.5 per cent growth rate marginally lagged behind the plan target rate. The rate of growth of GDP was expected to be 8 per cent in 1992, with agriculture growing at 7.1 per cent, manufacturing at 11.5 per cent, oil at 4.5 per cent, and services at 9 per cent.

Pakistan's GDP grew at a faster rate, 6.4 per cent, in 1992, than the 5.6 per cent in 1991 and 4.7 per cent in 1990. The better performance was shared by both the commodity producing and service sectors. Agriculture and manufacturing registered growth rates of 6.4 and 7.7 per cent in 1992, compared with 5.1 and 6.3 per cent respectively in 1991. The improved performance of the agricultural sector was due to a bumper cotton crop, which went up by 33.2 per cent, resulting largely from higher productivity (25 per cent). The manufacturing sector registered a growth of 7.7 per cent in 1992 against 6.3 per cent in 1991. The performance of large-scale manufacturing improved substantially in 1992, with a 7.4 per cent growth rate, attributable to an upsurge in the rate of investment in the sector in recent years in response to reforms in the industrial and external sectors. The service sector grew at a relatively lower rate of 5.9 per cent in 1992, but marginally better than that in 1991. Prospects of a continuing good performance of the economy were seriously damaged by the devastating floods in September 1992.

The economic growth of Sri Lanka of 4.5 per cent in 1992 was lower than the 4.8 per cent in 1991 and 6.2 per cent in 1990. Lower growth in agriculture was a major cause of reduced GDP growth in both 1991 and 1992. Agriculture, which constitutes 25 per cent of the country's GDP, contracted by 1.8 per cent growth in 1992. A sharp drop in the production of tea owing to the severe

drought prevailing during the first half of the year contributed to a 5.6 per cent contraction in output in plantation agriculture. Non-plantation agriculture recorded a growth of 1.6 per cent, which was not enough to compensate for the loss in plantation agriculture. The overall growth of manufacturing in 1992 was expected to reach 7.5 per cent. The factory industry, which accounted for 75 per cent of manufacturing output, grew at an annual rate of over 9 per cent, offsetting, to a large extent, the poor performance of export processing industries. The service sector was expected to grow by 5.9 per cent as tourism picked up, showing a 26 per cent increase in tourist arrivals.

### 2. Inflation and other indicators of macroeconomic performance

A hyperinflationary situation has prevailed in Afghanistan in recent years. The average annual rate of inflation, as measured by CPI, was 48.0 per cent during 1988-1991. The rate of growth of money supply was 40 per cent in 1989 and 1990. Budgetary deficits are on the rise. In June 1992, the Secretary-General of the United Nations launched an appeal to mobilize emergency aid for Afghanistan, to cover expenditure for the rest of the year. The funds were needed for the repatriation of refugees, to help meet chronic food shortages and for the rehabilitation of infrastructure. That underscored the critical financial conditions that the country was experiencing.

In Bangladesh, the rate of inflation in 1992 was the lowest in the past few years. It declined to 5.1 per cent from 8.9 per cent in 1991. Relative stability in prices of food grain, constituting more than one half of average household expenditure, and other essential consumer goods, kept the inflation rate low in 1992.

Some progress was achieved in improving the economy's traditionally low savings ratio and narrowing the savings-investment gap; the investment rate, however, remained low. Thus, gross domestic savings picked up during the past two years from 2.1 per cent of GDP in 1990 to 4.4 per cent in 1991 and 6.1 per cent in 1992. Gross domestic investment increased only marginally, from 11 per cent in 1991 to 11.7 per cent in 1992. The savings-investment gap was thus narrowed from 6.6 per cent of GDP in 1991 to 5.6 per cent in 1992.

Fiscal policy in recent years was largely oriented towards macroeconomic stabilization and, in particular, the reduction of fiscal deficits. Both tax and non-tax revenues improved in 1991, but higher current expenditure, mainly occasioned by the repair of cyclone and flood damage and a salary increase for civil servants, kept budget deficits at about 7 per cent of GDP, the same level as in the previous year. A reduction by about one percentage point in 1992 was indicated.

Money supply increased by 14.6 per cent in 1992 against 13.1 per cent in 1991. The factors responsible for the higher growth were a surplus in the foreign sector, increase in credit to both public and private non-farm sectors, and expansion in agricultural credit. Under a financial sector reform programme, the Government was gradually moving from a comprehensive system of control on the level of interest rates to market-determined rates. Under the reformed procedure, the central bank would fix floor rates for savings and term deposits, taking into consideration the inflation rate. The commercial banks could then fix the rates of interest of their choosing above the floor. The banks were also free to fix their own lending rates, except for the categories of agriculture, exports, and small and cottage industries.

Bhutan's tight fiscal policies in 1990 resulted in a reduction in the overall budget deficit, which fell to 6.6 per cent of GDP from 10 per cent in 1989. The bulk of current revenue in 1990 came from profits on the sale of electricity to India. Current expenditure rose very little in real terms over that in previous years because of selective cut-backs in public expenditure.

Financial savings including bank deposits, provident fund and unit trust deposits increased at an average annual rate of 18 per cent between 1987 and 1989, but by only 6.5 per cent in 1990 and 1991. This fall in the rate of financial savings has been attributed to an increase in consumption expenditure and purchases by the public of shares of newly privatized government corporations.

The Royal Monetary Authority had limited ability to conduct monetary policy because of the close linkages with India and the lack of policy instruments. In the absence of suitable monetary instruments in Bhutan, monetary policy has fully accommodated the recent demand for credit of both the public and private sectors. Between 1989 and 1990, there was a rapid increase in the growth of domestic credit to the Government and the private sector, which led to an excess supply of ngultrum balances and contributed to the fall in rupee reserves observed in 1990.

The rate of inflation in Bhutan closely follows that in India because of the trade and monetary links with that country. After slowing to 8.5 per cent in 1989, inflation accelerated to 9.4 per cent in 1990 and to an estimated 12 per cent in 1991. The major factors behind these in-

creases were the strong growth in liquidity and the rise in prices of non-food items, including those of imports of intermediate goods, which reflected increased inflation in India. Inflation was estimated to be over 11 per cent in 1992.

There has been a rapid growth in investment in the economy of Maldives in recent years. Private sector investment increased by 72 per cent between 1987 and 1990. The Government's budget deficit, however, has increased since 1990, caused by a significant increase in expenditure on several large capital projects, on national security, and on public sector pay increases. The economy started to show signs of stress from demand pressure, and therefore, in September 1990, the Government moved to tighten both monetary and fiscal policy. A significant reduction in the rate of monetary and credit expansion was achieved later, which eased inflationary pressures.

During 1990-1991, the savings and investment ratios in Nepal declined, especially the savings ratio, owing to inflation, and the adverse effects of the Persian Gulf war and the impasse in trade and transit with India. The savings-investment gap widened, from 9.5 per cent of GDP in 1985 to 14.5 per cent in 1991. The Government directed its efforts to controlling its own spending with a view to improving macroeconomic balances. Despite the increase in debt servicing and salaries, and additional expenses for local elections, the budget deficit, estimated at 10.8 per cent of GDP in 1992, was prevented from escalating further. Improved tax administration and collections above targets made this possible.

For several years, money supply in Nepal has expanded rapidly, with a rate of about 24 per cent in 1991. This rapid increase was caused by a net increase in foreign assets and a rise in commercial bank lendings. To dampen growth in liquidity, the bank rate was raised by 2 percentage points, and the auctioning of treasury bills and papers was initiated. Commercial banks were required to invest 24 per cent of their deposit liability in Nepal Rastra Bank securities. The growth in broad money supply was thus reduced to 19.5 per cent by mid-April 1992. The substantial excess liquidity and the sharp devaluation of the Nepalese rupee by more than 40 per cent from the beginning of fiscal year 1991 fuelled inflation, which reached an annual rate of 22 per cent by mid-December 1991. The inflation rate for 1992 was estimated to be lower, at 20 per cent. The high rate of inflation is one of the most pressing macroeconomic problems faced by Nepal.

In India, the inflation rate as measured by the consumer price index registered a marked increase in 1991 to 13.8 per cent from 8.9 per cent in 1990. Thereafter, the rate of inflation declined steadily. However, in September 1992, the Government increased petroleum product prices on average by 18.9 per cent, partially decontrolled fertilizer prices and increased the issue prices of some commodities subject to price control as a part of fiscal adjustments. Consequently, the rate of inflation tended to accelerate later in the year and is estimated to average at about 10 per cent in 1992.

The basic factors responsible for the build-up of inflationary pressures in recent years were: persistent and large fiscal deficits and monetization of public debt, a liquidity overhang and the consequent excess effective demand; supply and demand imbalances in sensitive commodities, mainly due to a shortfall in domestic production and the inability to import desired quantities because of pressure on the balance of payments and shortage of foreign exchange; a wage-price spiral in many industries, adding an element of cost-push to inflation; and the built-in inflationary expectations in the economy.

In an effort to correct the fiscal imbalances, the main thrust of the budget for 1991 was to reduce the deficit from 8.5 per cent of GDP in 1990 to 6.5 per cent, through expenditure control and additional resource mobilization. Expenditure under the five-year plan was frozen in real terms, and subsidies on fertilizers, food and exports were reduced. The budget for 1992 envisaged a further reduction in the gross fiscal deficit to 5 per cent of GDP.

Savings-investment ratios have shown improvement since 1990. Gross domestic saving as a percentage of GDP at current market prices increased significantly, from 21.9 per cent in 1990 to 22.9 per cent in 1991 and an expected 23.7 per cent in 1992. Gross domestic investment declined marginally, from 24.6 per cent in 1990 to 24.1 per cent in 1991, but was estimated to reach 26.3 per cent of GDP in 1992.

Money supply (M3), grew on average by 17.4 per cent during 1986-1990, but at a decelerated rate of 14.9 per cent in 1990. Economic realities in 1991 and 1992 dictated the adoption of a more restrictive monetary policy. However, money supply recorded a higher growth of 18.5 per cent in 1991 than the target rate of 13 per cent, owing to the substantial build-up of foreign exchange reserves as imports slowed.

In the Islamic Republic of Iran, the relatively high growth of GDP during 1989-1991 was associated with the rapid growth of investment activity, at an average annual rate of 10.6 per cent. The gross domestic fixed

capital formation rose by 12 per cent in 1991. Gross investment as a ratio of GDP grew from 18.6 per cent in 1989 to 25.6 per cent in 1991. The share of the private and public sectors in total investment stood at 55.4 and 44.6 per cent respectively.

The financial situation of the Government improved considerably over the period 1989-1991. The ratio of government revenue to GDP increased from 9.6 per cent in 1988 to 15 per cent in 1991; that of government expenditure to GDP, on the other hand, declined from 19.4 to 17.4 per cent. The budget deficit thus declined from 9.7 per cent of GDP to 2.4 per cent. The share of development expenditure in total expenditure rose from 19.4 to 31.2 per cent over the same period.

Money supply (M2) grew by 24.6 per cent in 1991. The CPI rose by 19.6 per cent in 1991 against 9 per cent in 1990. The two most important groups in household expenditure, food and housing, contributed most to the rise in CPI in 1991, growing at the rate of 27.7 and 20.2 per cent respectively.

In Pakistan, total investment expenditure in nominal terms rose by 17.6 per cent in 1992, mainly owing to a rise in private investment. Since GDP in nominal terms also grew, at the rate of 17.6 per cent, the investment GDP ratio remained unchanged at 18.7 per cent. Private fixed investment increased by 24.8 per cent, while public fixed investment experienced a slower growth of 10.1 per cent. The rise in private investment reflected an improvement in the investment climate, attributable to the liberalization of policies to provide opportunities to private initiatives. Both domestic and foreign investors responded positively to the Government's policies of privatization, deregulation and incentives. The rate of growth of national savings decelerated from 17.1 per cent in 1991 to 13.5 per cent in 1992, lowering the savings GDP ratio from 13.9 to 12.8 per cent.

The size of the budgetary deficit continued to be unsustainably large. The fiscal deficit reached a high level of 8.7 per cent of GDP in 1991. The situation improved only marginally in 1992, when the deficit was estimated at 7.3 per cent of GDP. The overall deficit was financed from external resources (net) to the extent of 20.4 per cent and from domestic borrowing to the extent of 79.6 per cent. The large budgetary deficit and credit requirements of the private sector contributed to the 17.6 per cent growth in money supply in 1992, which was somewhat lower than the 20.1 per cent in 1991. Inflationary pressures, however, subsided somewhat, as CPI increased by 9.6 per cent in 1992 against 12.7 per cent in the previous year. Higher growth in GDP, larger imports, a relatively stable foreign exchange rate, and unchanged administered prices of some important items like natural gas and gasoline, helped to contain inflation to a lower level.

Gross investment in Sri Lanka in 1992 was expected to be about the same as in 1991, at around 23 per cent of GDP. Private investment was expected to increase marginally to 13 per cent from 12.8 per cent in the previous year, while public investment would drop to 10 per cent from 10.4 per cent. The drop in public investment resulted from a deliberate policy to restrict budgetary capital investment to 9 per cent of GDP, the balance being accounted for by parastatal organizations. Increase in private investment reflected the increased flow of foreign private capital. The opening of the Colombo Stock Market to foreign investors had attracted an increased flow of foreign private capital, while direct project-related investments had also increased. The increase in foreign private capital in 1992 was estimated at 30 per cent over the previous year.

Reduction of the budgetary deficit has been one of the major objectives of the Sri Lanka Government's structural adjustment programme. Budget deficits have been historically very high in Sri Lanka, averaging over 12 per cent of GDP during the past 10 years. In 1992, the budget deficit has been contained at 8.6 per cent of GDP, as envisaged in the structural adjustment programme, a significant reduction from the 1991 deficit of 11.6 per cent.

The rates of growth of the closely monitored monetary aggregates (M1) and (M2) should moderate in 1992 to around 13 per cent from 17.7 and 18.8 per cent respectively in 1991. Underpinning this squeeze in monetary growth was an improvement in the Government's fiscal performance, and a sharp contraction in the rate of growth of external bank asset holdings, projected to fall by around 80 per cent. The rate of growth of domestic credit could stabilize at the 1991 level as the rate of growth of net credit to government was likely to fall significantly. The fall in money supply growth during the year should help dampen residual demand pressure on the aggregate price level. Hence, the rate of price rise could slow down in spite of the supply side pressure brought about by the recent severe drought. Estimates put the end-year rate of inflation at around 11 per cent.

**Table III.2. Selected economies of the ESCAP region. Summary of macroeconomic indicators, 1986-1992**

*(Percentage)*

| | | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992[a] |
|---|---|---|---|---|---|---|---|---|
| **East Asia** | | | | | | | | |
| China | Savings/GDP | 34.7 | 34.1 | 34.5 | 33.8 | 32.8 | 31.9 | 36.7 |
| | Investment/GDP | 34.7 | 34.1 | 34.5 | 33.8 | 32.8 | 31.9 | 36.7 |
| | Current account balance/GDP | -2.9 | 0.1 | -1.2 | -1.2 | 4.0 | 4.5 | 2.9 |
| | Budgetary balance/GDP | -0.8 | -0.8 | -0.6 | -0.7 | -0.6 | -1.3 | -1.2 |
| | Money supply growth | 27.9 | 18.5 | 20.0 | 6.3 | 20.1 | 28.2 | 23.7 |
| Hong Kong | Savings/GDP | 29.4 | 33.8 | 35.0 | 35.7 | 33.4 | 31.6 | 31.8 |
| | Investment/GDP | 24.7 | 27.6 | 29.9 | 27.7 | 28.3 | 28.3 | 28.2 |
| | Current account balance/GDP | ... | ... | ... | ... | ... | ... | ... |
| | Budgetary balance/GDP | 1.3 | 3.2 | 3.9 | 0.9 | -0.0 | 2.2 | 1.0 |
| | Money supply growth | 23.9 | 46.0 | 8.5 | 6.8 | 13.3 | 19.5 | 17.7 |
| Republic of Korea | Savings/GDP | 34.0 | 36.6 | 38.3 | 35.6 | 36.2 | 36.4 | 35.6 |
| | Investment/GDP | 28.3 | 29.5 | 30.6 | 33.4 | 36.9 | 39.1 | 36.6 |
| | Current account balance/GDP | 4.3 | 7.5 | 8.1 | 2.4 | -0.9 | -3.0 | -1.1 |
| | Budgetary balance/GDP | -0.1 | 0.4 | 1.6 | 0.2 | -0.5 | -1.1 | -0.9 |
| | Money supply growth | 16.6 | 14.7 | 20.2 | 17.9 | 11.0 | 36.8 | ... |
| **South-East Asia** | | | | | | | | |
| Indonesia | Savings/GDP | 27.3 | 32.9 | 34.0 | 37.6 | 37.4 | 35.7 | 38.0 |
| | Investment/GDP | 28.3 | 31.4 | 31.5 | 35.2 | 36.5 | 35.1 | 37.7 |
| | Current account balance/GDP | -5.1 | -3.0 | -1.8 | -1.4 | -3.0 | -3.6 | -3.0 |
| | Budgetary balance/GDP | -5.7 | -4.9 | -7.0 | -5.6 | -5.7 | -4.7 | -3.8 |
| | Money supply growth | 14.9 | 9.2 | 13.3 | 42.9 | 15.9 | 12.1 | -0.8 |
| Lao People's | Savings/GDP | ... | ... | 2.2 | 1.1 | 0.8 | 2.0 | 3.5 |
| Democratic | Investment/GDP | ... | ... | 15.1 | 14.5 | 14.5 | 12.7 | 14.0 |
| Republic | Current account balance/GDP | -9.2 | -34.9 | -20.2 | -22.7 | -11.4 | -12.2 | -8.1 |
| | Budgetary balance/GDP | -6.5 | -5.8 | -20.4 | -16.5 | -13.5 | -9.5 | ... |
| | Money supply growth | 69.9 | 82.2 | 75.7 | 107.6 | 12.4 | 5.2 | ... |
| Malaysia | Savings/GDP | 32.1 | 37.3 | 36.3 | 33.9 | 32.3 | 30.2 | 46.8 |
| | Investment/GDP | 26.0 | 23.2 | 26.0 | 28.8 | 32.3 | 35.7 | 36.8 |
| | Current account balance/GDP | -0.6 | 8.1 | 5.0 | -0.8 | -4.1 | -9.5 | -8.4 |
| | Budgetary balance/GDP | -10.5 | -7.7 | -4.3 | -5.2 | -4.8 | -4.7 | -3.0 |
| | Money supply growth | 2.8 | 12.8 | 14.4 | 17.3 | 14.0 | 11.0 | 9.4 |
| Myanmar | Savings/GDP | 10.1 | 8.1 | 11.1 | 9.3 | 11.0 | 11.6 | 11.5 |
| | Investment/GDP | 12.7 | 11.6 | 12.8 | 9.8 | 13.6 | 12.5 | 12.0 |
| | Current account balance/GDP | -4.7 | -3.5 | ... | ... | -2.8[a] | -2.2[a] | -1.4 |
| | Budgetary balance/GDP | -2.5 | -2.2 | -3.0 | -4.4 | ... | ... | ... |
| | Money supply growth | 41.4 | -42.0 | 65.4 | 36.1 | 43.5 | 12.6 | ... |
| Philippines | Savings/GDP | 19.1 | 21.3 | 21.4 | 20.6 | 16.4 | 16.5 | 19.2 |
| | Investment/GDP | 16.0 | 18.0 | 18.4 | 21.8 | 22.5 | 20.1 | 21.6 |
| | Current account balance/GDP | 2.5 | -1.9 | -1.7 | -4.3 | -6.9 | -3.1 | 2.2 |
| | Budgetary balance/GDP | -5.0 | -2.4 | -2.9 | -2.1 | -3.5 | -2.1 | -1.2 |
| | Money supply growth | 17.4 | 24.6 | 13.7 | 31.5 | 13.4 | 13.9 | ... |
| Singapore | Savings/GDP | 39.3 | 40.0 | 42.5 | 44.2 | 45.4 | 46.1 | 46.3 |
| | Investment/GDP | 38.5 | 39.0 | 36.9 | 34.8 | 39.1 | 37.4 | 39.9 |
| | Current account balance/GDP | 1.9 | -0.5 | 3.9 | 8.8 | 6.5 | 10.5 | 7.5 |
| | Budgetary balance/GDP | 1.5 | -2.7 | 7.0 | 10.4 | ... | ... | ... |
| | Money supply growth | 11.8 | 12.3 | 8.4 | 14.9 | 11.0 | 7.7 | ... |

*(Continued on next page)*

**Table III.2** *(continued)*

*(Percentage)*

| | | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992[a] |
|---|---|---|---|---|---|---|---|---|
| Thailand | Savings/GDP | 22.4 | 24.8 | 29.8 | 31.1 | 32.3 | 33.4 | 30.4 |
| | Investment/GDP | 21.8 | 23.9 | 28.8 | 31.5 | 37.8 | 39.5 | 39.4 |
| | Current account balance/GDP | 0.2 | -1.0 | -3.1 | -3.9 | -9.2 | -8.1 | -7.9 |
| | Budgetary balance/GDP | -4.4 | -2.3 | 0.7 | 3.1 | 4.8 | 4.4 | 1.9 |
| | Money supply growth | 19.3 | 29.3 | 12.2 | 17.7 | 11.8 | 13.8 | 15.4 |
| Viet Nam | Savings/GDP | -2.4 | -2.1 | -0.2 | -0.2 | -0.0 | -1.3 | -7.0 |
| | Investment/GDP | 11.7 | 10.9 | 14.4 | 11.6 | 12.6 | 14.8 | 20.1 |
| | Current account balance/GDP[a] | ... | -3.8 | -4.6 | -7.7 | -3.1 | -5.6 | -5.3 |
| | Budgetary balance/GDP | -4.5 | -3.6 | -5.4 | -7.0 | -3.1 | -3.1 | -1.7 |
| | Money supply growth | ... | 301.8 | 426.5 | 109.5 | 31.4 | 58.6 | 42.5 |
| **South Asia** | | | | | | | | |
| Bangladesh | Savings/GDP | 3.2 | 2.8 | 2.2 | 2.5 | 2.1 | 4.4 | 6.1 |
| | Investment/GDP | 11.0 | 13.3 | 13.5 | 10.7 | 10.9 | 11.0 | 11.7 |
| | Current account balance/GDP | -8.1 | -5.5 | -5.7 | -8.3 | -5.5 | -3.9 | -2.8 |
| | Budgetary balance/GDP | -7.6 | -8.3 | -7.1 | -7.3 | -7.7 | -7.2 | ... |
| | Money supply growth | 8.8 | 2.0 | 4.2 | 12.9 | 9.6 | 13.1 | 14.6 |
| Bhutan | Savings/GDP | ... | ... | ... | ... | ... | ... | ... |
| | Investment/GDP | 40.5 | 30.2 | 38.6 | 32.2 | 35.2 | 35.6 | 35.7 |
| | Current account balance/GDP | -42.9 | -21.6 | -27.7 | -18.0 | -19.2[a] | -26.7[a] | -26.5 |
| | Budgetary balance/GDP | -3.5 | 0.0 | 0.8 | -9.9 | -6.6 | ... | ... |
| | Money supply growth | 5.8 | 14.4 | 30.1 | 32.6 | -1.2 | 38.9 | ... |
| India | Savings/GDP | 20.4 | 20.4 | 21.8 | 23.3 | 21.9 | 22.9 | 23.7 |
| | Investment/GDP | 23.0 | 22.7 | 23.9 | 23.1 | 24.6 | 24.1 | 26.3 |
| | Current account balance/GDP | -2.2 | -2.2 | -2.7 | -2.6 | -2.6 | -1.1 | -2.6 |
| | Budgetary balance/GDP | -9.3 | -8.4 | -8.1 | -8.2 | -7.0 | -8.4 | -6.2 |
| | Money supply growth | 16.1 | 13.5 | 16.5 | 18.0 | 14.3 | 21.7 | 10.5 |
| Iran (Islamic Republic of) | Savings/GDP | 29.3 | 29.8 | 23.5 | 23.1 | 22.9 | ... | ... |
| | Investment/GDP | 24.3 | 23.6 | 19.3 | 18.6 | 18.5 | 25.6 | ... |
| | Current account balance/GDP | -2.2 | -0.8 | -0.5 | ... | ... | ... | ... |
| | Budgetary balance/GDP | -7.5 | -6.7 | -9.7 | -3.8 | -1.8 | -2.4 | ... |
| | Money supply growth | ... | 17.3 | 19.4 | 15.8 | 13.3 | ... | ... |
| Maldives | Savings/GDP | 6.8 | 21.6 | 21.3 | 21.6 | 22.2 | ... | ... |
| | Investment/GDP | 36.5 | 60.5 | 57.4 | 65.5 | 64.8 | ... | ... |
| | Current account balance/GDP | -15.4 | -9.1 | -1.6 | 2.9 | 2.8 | ... | ... |
| | Budgetary balance/GDP | -12.1 | 1.5 | 5.7 | -4.2 | -12.4 | ... | ... |
| | Money supply growth | 12.4 | 5.7 | 12.7 | 17.5 | 17.8 | 26.9 | ... |
| Nepal | Savings/GDP | 11.7 | 12.4 | 11.0 | 9.9 | 6.1 | 6.5 | 6.8 |
| | Investment/GDP | 21.0 | 21.8 | 22.1 | 22.1 | 18.1 | 20.1 | 21.2 |
| | Current account balance/GDP | -8.0 | -7.2 | -11.7 | -10.2 | -10.9 | -12.8 | -10.3 |
| | Budgetary balance/GDP | -7.2 | -6.6 | -6.2 | -10.3 | -7.7 | -6.1 | -10.8 |
| | Money supply growth | 23.8 | 24.9 | 13.2 | 19.3 | 21.2 | 24.0 | ... |
| Pakistan | Savings/GDP | 10.9 | 13.9 | 12.4 | 12.6 | 13.2 | 13.9 | 12.8 |
| | Investment/GDP | 18.8 | 19.1 | 18.0 | 18.9 | 18.6 | 18.7 | 18.7 |
| | Current account balance/GDP | -3.6 | -3.0 | -5.4 | -4.9 | -5.4 | -5.7 | 5.2 |
| | Budgetary balance/GDP | -9.2 | -7.3 | -6.3 | -7.4 | -7.1 | -8.7 | -7.3 |
| | Money supply growth | 18.0 | 19.1 | 9.7 | 14.3 | 17.3 | 20.1 | 17.6 |
| Sri Lanka | Savings/GDP | 12.0 | 12.8 | 12.0 | 12.2 | 14.3 | 12.8 | 13.6 |
| | Investment/GDP | 23.7 | 23.3 | 22.8 | 21.7 | 22.2 | 23.0 | 23.3 |
| | Current account balance/GDP | -9.3 | -7.6 | -8.6 | -8.6 | -5.9 | -8.3 | -4.3 |
| | Budgetary balance/GDP | -10.1 | -8.7 | -12.7 | -8.6 | -7.8 | -11.6 | -8.6 |
| | Money supply growth | 12.8 | 18.3 | 29.1 | 9.1 | 12.8 | 17.7 | 13.3 |

*(Continued on next page)*

**Table III.2** *(continued)*

*(Percentage)*

| | | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992[a] |
|---|---|---|---|---|---|---|---|---|
| **Pacific island economies** | | | | | | | | |
| Fiji | Savings/GDP | 23.0 | 17.1 | 16.7 | 18.2 | 19.8 | 16.7 | 19.0 |
| | Investment/GDP | 18.2 | 16.0 | 14.8 | 14.7 | 19.3 | 17.3 | 17.2 |
| | Current account balance/GDP | -1.9 | -2.4 | -0.3 | 0.1 | -6.0 | -0.4 | 1.5 |
| | Budgetary balance/GDP | -4.8 | -5.0 | -0.7 | -2.9 | -2.2 | -0.1 | ... |
| | Money supply growth | 24.9 | -2.2 | 62.2 | -3.4 | 0.6 | 3.4 | ... |
| Papua New Guinea | Savings/GDP | 11.9 | 14.0 | 18.5 | 11.1 | 16.1 | 17.5 | 23.7 |
| | Investment/GDP | 19.7 | 20.5 | 27.2 | 23.2 | 24.4 | 27.4 | 33.0 |
| | Current account balance/GDP | -12.0 | -13.2 | -15.0 | -16.0 | -9.9 | -15.5 | -10.1 |
| | Budgetary balance/GDP | -3.0 | -1.8 | -0.9 | -1.2 | -3.3 | -1.2 | ... |
| | Money supply growth | 5.1 | 9.6 | 14.5 | 6.9 | -0.2 | 21.3 | ... |
| Samoa | Savings/GDP | -19.2 | -23.4 | -10.4 | -4.9 | -6.7 | -4.5 | ... |
| | Investment/GDP | 25.5 | 29.6 | 27.8 | 27.3 | 27.0 | 29.0 | ... |
| | Current account balance/GDP | -4.5 | -5.6 | -5.8 | -2.2 | 0.7[a] | -2.9[a] | ... |
| | Budgetary balance/GDP | -7.9 | -7.2 | -12.2 | -10.0 | ... | ... | ... |
| | Money supply growth | 8.4 | 32.6 | 5.2 | 9.8 | 42.6 | -9.2 | ... |
| Solomon Islands | Savings/GDP | -2.3 | -9.8 | -5.9 | -12.7 | ... | ... | ... |
| | Investment/GDP | 26.5 | 23.1 | 37.1 | 31.9 | 32.1 | 32.5 | 33.0 |
| | Current account balance/GDP | -28.6 | -30.2 | -40.4 | -44.9 | -14.3[a] | -14.1[a] | -13.6 |
| | Budgetary balance/GDP | -6.0 | -13.6 | -9.5 | -2.0 | -9.0 | -15.0 | ... |
| | Money supply growth | 7.2 | 22.5 | 31.7 | 3.8 | 26.6 | 23.4 | ... |
| Tonga | Savings/GDP | -5.5 | -6.5 | -8.0 | -5.4 | -4.5 | -3.5 | -3.5 |
| | Investment/GDP | 23.5 | 21.2 | 21.4 | 21.5 | 22.5 | 24.2 | 22.2 |
| | Current account balance/GDP | -3.3 | -0.8 | -19.5 | -12.4 | -14.3[a] | -14.1[a] | -13.6 |
| | Budgetary balance/GDP | -4.8 | -6.4 | 0.6 | -0.1 | -16.5 | -12.7 | ... |
| | Money supply growth | 21.6 | 14.3 | 3.2 | 9.5 | 29.8 | 15.2 | ... |
| Vanuatu | Savings/GDP | 1.4 | 4.9 | 3.2 | 5.7 | 8.8 | 7.6 | 7.8 |
| | Investment/GDP | 29.4 | 33.0 | 27.8 | 33.4 | 40.8 | 35.0 | 36.0 |
| | Current account balance/GDP | -21.0 | -30.9 | -19.6 | -17.1 | -13.9 | 2.1[a] | 3.4 |
| | Budgetary balance/GDP | -7.0 | 3.8 | -4.2 | -8.1 | 0.0 | 0.0 | ... |
| | Money supply growth | 6.4 | 50.1 | -16.7 | 24.3 | -10.9 | 12.4 | ... |

*Sources:* Same as table III.1.

*Note:* Money supply refers to M1.

[a] Current account balance includes official transfers, in other cases official tranfers are excluded.

## D. CENTRAL ASIA

### 1. Output growth

The economies of the six Asian republics of the former USSR suffered a series of shocks of increasing intensity beginning in 1990. The collapse of east European communist regimes, especially in Bulgaria, the former Czechoslovakia, east Germany and Romania, which led to the demise of the Council for Mutual Economic Assistance (CMEA) system, along with the increasing assertion of independence by the three Baltic States, caused a moderate drop of 2 per cent in the output of the former USSR. However, in 1990, out of the six Asian republics, output fell sharply only in Azerbaijan, largely due to the anti-alcohol drive by the then Soviet President (which adversely affected wine production) and the ethnic conflict in Nagorno-Karabakh. Kazakhstan suffered a decline in output of 1.5 per cent, and Tajikistan of only 0.6 per cent. Kyrgyzstan, Turkmenistan and Uzbekistan recorded GDP growth rates of 4.0, 1.5 and 4.3 per cent respectively.

These were considerably higher than the 0.4 per cent growth rate recorded by the Russian Federation, which was the only other republic with a positive GDP growth.

In 1991, the shock was much more severe as a result of serious disruption in the supplies following a breakdown of the centrally planned system. A sharp fall in the interrepublic trade, the collapse of trade with the CMEA countries, and balance-of-payments problems with the rest of the world led to serious shortfall in imports. Lower oil production and generally weak agricultural production exacerbated the shock. Even so, the six Asian economies, with the exception of Kazakhstan and Tajikistan, which recorded a decline in GDP of 9.6 and 8.7 per cent respectively, managed to limit the decline in their output to no more than 2.0 per cent in 1991, compared with a decline of 17.0 per cent for the former USSR as a whole (see table III.3).

The severest shock to the economies of the former USSR, including the six Asian republics, was provided by the total dissolution of the USSR towards the end of 1991 and the intensification of price liberalization measures by the Russian Federation. These measures were, by and large, followed by all the other republics, since they continued to belong to the rouble zone and no restrictions were placed on the movements of goods across the borders of the republics. However, the price liberalization measures differed considerably among the republics, in both scope and extent, largely due to the varying needs for providing subsidies to different industries and safety nets to protect the poorer sections of the population.

While firm data for 1992 are not available, estimates provided for the first nine months of 1992 indicate that the fall in output in the various republics is likely to be much steeper than in 1990 and 1991. The fall in the net material product (NMP) was estimated at 10-25 per cent over the corresponding months of 1991. Azerbaijan, Kazakhstan and Kyrgyzstan were to experience the most severe contraction of their economies up to a quarter of the NMP. The fall affected all sectors of the economy, but industry and construction, as well as investment and external trade, were particularly badly affected. Despite the governmental priorities for maintaining the output of agriculture and consumer goods, these also suffered substantial declines.

The price liberalization undertaken in the six republics was broadly in line with the liberalization measures announced by the Russian Federation in January 1992. However, there was considerable concern in most of the Republics about the effects of the major changes envisaged. While prices were liberalized for all commodities, they were regulated within certain ranges by the authorities in the republics with a view to minimizing their impact on the poor. At the same time, allocations for social safety nets such as pensions and unemployment benefits were raised. In spite of these measures, the rising prices generally outstripped the purchasing power of fixed income earners.

The liberalization of prices did not in general have favourable supply-side effects, as there was a

**Table III.3. Asian republics of the former USSR. Macroeconomic performance indicators**

| | *Percentage change* | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | *Real GDP* | | | *Consumer price* | | *Employment* | | *Current account*[a] *(in percentage of GDP)* | |
| | *1990* | *1991* | *1992*[b] | *1990* | *1991* | *1990* | *1991* | *1990* | *1991* |
| Former USSR | –2.4 | –17.0 | ... | 5.4 | 89.0 | –0.6 | –2.0 | –1.4[c] | –0.6[c] |
| Azerbaijan | –11.7 | –0.7[d] | –23.8[c] | 7.8 | 87.3 | ... | ... | 4.6 | 5.3 |
| Kazakhstan | –1.5 | –9.6[c] | –25.5[c] | 4.0 | 84.0 | ... | ... | –4.2 | –3.5 |
| Kyrgyzstan | 4.0 | –2.0[c] | –25.0[c] | 3.0 | 181.0 | –0.4 | –2.0 | –6.2 | 12.2 |
| Tajikistan | –0.6 | –8.7[c] | ... | 4.0 | 103.0 | 3.0 | 0.4 | 13.5[c] | 3.9[c] |
| Turkmenistan | 1.5 | –0.6[c] | –11.2[c] | 4.6 | 90.0 | 3.4 | 2.6 | –8.4 | 13.8 |
| Uzbekistan | 4.3 | –0.9[c] | ... | 3.1 | 82.2 | 2.8 | 0.4 | –15.0[c] | –1.1[c] |

***Source:*** International Monetary Fund, *Economic Review: Common Issues and Interrepublic Relations in the Former USSR* (April 1992).

[a] Current account in convertible and non-convertible currencies, including interrepublic trade. The percentages are the ratio of the combined current account to aggregate GDP/NMP. [b] First half of 1992. [c] Net material product. [d] Preliminary.

tendency among the monopolistic enterprises to restrict supplies and raise prices. Price liberalization has driven the economies into what may be called a "stagflation trap": the steep rise in prices curbed demand without increasing supplies and reducing inflationary pressure. Increasing costs decreased incomes further and deepened the recession.

The short-term prospects for growth in the six Asian economies for 1992-1993 were thus generally unfavourable and highly uncertain. The best scenario could be stemming the decline by early 1993 and achieving some positive growth by the end of 1993. The extent to which this scenario could approximate reality would depend on two important factors: the progress towards the transition to a market economy and the evolving nature of relationships within the Commonwealth of Independent States (CIS) and with the external world.

Over the longer run, the prospects of all six countries could be bright. Even those less well endowed with natural resources, Kyrgyzstan and Tajikistan, have the potential to generate hydroelectricity which could be exported to neighbouring countries (Kyrgyzstan has already signed a contract to export small quantities of electricity to Pakistan). The approaches to political and economic reform have already exhibited considerable variation. Kyrgyzstan was moving more rapidly than any of the others. Kazakhstan was also pursuing economic reform, but favoured a model of gradual reform. The other four Republics were pursuing more conservative economic and political strategies. Which of these approaches would be sustainable was not yet clear, but the pace of economic reform would affect long-run economic performance.

## 2. Other indicators of macroeconomic performance

Hyperinflation took hold in most of the Asian economies of the former USSR, with wholesale prices in September 1992 rising to between 10 and 20 times the level of 12 months earlier. Retail price increases had been somewhat smaller, from 6 to 10 times greater, but still in the realm of hyperinflation. The consequent collapse of living standards was indicated by the amount of retail sales at constant prices, which for the first nine months of 1992, as a percentage of that of the corresponding period of 1991, were as follows: Azerbaijan, 39.0 per cent, Kazakhstan, 58.5 per cent, Kyrgyzstan, 34.5 per cent, Tajikistan, 30.3 per cent, Turkmenistan, 62.0 per cent, and Uzbekistan, 63.1 per cent. These could, however, overstate the true fall in living standards as families became more self-sufficient in such areas as growing their own food and making and repairing clothing, or as barter transactions replaced monetary transactions. Nevertheless, a drop in retail sales of the reported magnitude must represent a sharp and substantial fall in living standards. The figures also indicated that the decline was much larger in Azerbaijan, Kyrgyzstan and Tajikistan than in the other three Asian republics.

In part, the severity of the decline in living standards reflected the delay in adjustment, compared with other Republics which went through early transition stages in 1991. The Asian republics were heavily oriented towards internal USSR trade, which was disrupted with unexpected suddenness during the second half of 1991. The republics which were selling products that had been underpriced within the USSR, especially energy products, were relatively less hit by this disruption, as these products could be sold at freer and higher prices. Hence the smaller decline in living standards in Kazakhstan, where coal and oil products accounted for half its 1992 exports, and in Turkmenistan and Uzbekistan, which are exporters of oil and natural gas. Even these countries were hampered, however, by the lack of infrastructure to diversify export markets (e.g. pipelines) and by the low world prices for the dominant cotton exports of Turkmenistan and Uzbekistan. The severity of the economic problems has been exacerbated in Azerbaijan and Tajikistan (and to a lesser extent in Kyrgyzstan) by political unrest.

Another sign of economic distress is growing unemployment. Reported unemployment rates in the former Soviet Union, have long been difficult to interpret, and job shortages appear to have been a source of discontent in some of the Asian republics for several years, despite low official rates of unemployment. Even in 1992 reported unemployment remained low; in Azerbaijan, the number of unemployed actually fell between April and September 1992 (from 7.9 to 6.2 thousand). In other republics, however, the number increased dramatically during 1992, for example by 5 times in Kazakhstan and by 11 times in Tajikistan. This was accompanied by the widespread and growing practice of granting workers additional "leave", partly paid or unpaid.

A major constraint on the macroeconomic management in the six Asian republics was the low degree of autonomy in matters of monetary policy arising from their continued membership of the rouble zone, with the Russian central bank having the sole authority to issue the currency and with weak infrastructures and mechanisms for coordination among the republics. Since these economies suffer from

structural difficulties which are quite different from those being experienced by the more industrially advanced republics, frequent policy differences and conflicts have arisen over the degree of fiscal and monetary expansion and the pricing of basic raw materials, especially energy products. In general, the six Asian republics have favoured a more expansionary monetary policy and more favourable terms of trade for energy exporters, as well as a slower pace of price liberalization for essential commodities.

## E. ISLAND ECONOMIES

### 1. Output growth

The small and highly open Pacific island economies, with their large degree of dependence on external trade, aid and investment, came under severe pressure from recessionary conditions prevailing in the industrialized countries in 1991-1992, especially in Australia and New Zealand. The problems for some of these economies, such as Guam, Samoa and Vanuatu, were further compounded by the extensive cyclone damage to their economies. The effects of these factors were most visible in Fiji and Samoa, both of which experienced a contraction in their economy in 1991. Many of the other island economies, however, maintained positive rates of growth in both 1991 and 1992, although the rates in 1992 could be reduced in a number of cases. Some of the small island economies, such as Guam, have achieved sustained progress, despite difficulties, by making use of the few advantages that are available (see box III.3).

## Box III.3. Guam: a flourishing small economy

Guam, an unincorporated territory of the United States of America, is the largest and southern-most island in the Marianas archipelago. It is one of the most affluent Pacific economies. Its income per capita of $8,781 in 1986 ranked third behind the Commonwealth of the Northern Mariana Islands and French Polynesias and exceeded that of Hong Kong and Singapore.

Guam has been a strategic United States military outpost since the end of the Second World War. Expenditure and activities related to the military have been the mainstay of the economy of Guam for a long time. However, tourism has become the dominant sector in more recent years: the military's contribution to the economy of Guam declined substantially from 75 per cent in 1960 to 35 per cent in 1990.[a]

Tourism has grown considerably since the first direct flights between Agana and Tokyo were inaugurated in 1967. Guam is now well served by air and sea routes, with about nine international airlines serving the territory. Tourist arrivals experienced a sharp increase in the 1980s, Japan being the major source. In 1991, 737,260 tourists visited Guam; this represented a 5 per cent decrease over 1990, and the first such decrease since 1978.

The economy of Guam is currently enjoying a boom, mainly as a result of the performance of tourism. The tourist-driven demand for new hotels and related businesses resulted in a construction boom. Permits for new hotels and hotel renovations amounted to $145 million in 1989 but declined to $98.7 million in 1991, while that for condominiums increased considerably from $14.8 million in 1990 to $175.9 million in 1991. The surge in the construction of condominiums reflects the increased demand by tourists for apartment-style accommodation as well as a long-standing need for housing by Guam residents. Retail sales in 1990, attributed mainly to tourism, were estimated at $1 billion.

In fact, 1991 was the seventh year of Guam's ongoing economic boom. This has increased employment opportunities, particularly in the construction industry. It has, however, also resulted in a higher rate of inflation. The Department of Labour reported that as of December 1991 a total of 66,390 persons were employed, of which 70 per cent were in the private sector.[b] The construction industry alone employed 12,060 persons, representing 18 per cent of total employment. The rate of inflation reached 14.4 per cent in 1991 and is the highest rate recorded since 1981.

An increase in business activities has resulted in higher revenues for the Government, reaching $655.3 million in 1991, an increase of 19 per cent over the figure for the fiscal year 1990. Government expenditure in 1991 totalled $526.8 million, giving rise to a surplus of $128.5 million for the year. This contrasts with that of many other Pacific island economies, which usually record large budget deficits.

Continued foreign investment and the growth of tourism are required to sustain the current economic boom. The Government of Guam has estimated that the requirement of foreign investment in the construction industry will exceed $3 billion to sustain the recent growth patterns. Guam has the finest deep-water harbour between Hawaii and the Philippines and, with its strategic location, it can be expected to assume growing importance in trade activities in the western Pacific.

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[a] T.R. Hughes, "Guam", *Asia and Pacific Review*, 1991/92 twelfth edition, pp. 149-150.

[b] Government of Guam, *Annual Economic Review, 1991*, p. 22.

Fiji recorded negative GDP growth in 1991, sharply reversing the strong recovery in 1989 and 1990. The world recession had a depressing effect on Fiji's non-traditional manufactures exports, and on tourism. Domestic industrial disputes also adversely affected output, particularly sugar and gold production. Earnings from tourism fell by 2 per cent, sugar by 1.5 per cent and gold by 32 per cent. The decline of 0.7 per cent in agricultural output in 1991 was the second consecutive decline of the sector. In 1992, the economy was expected to rebound with a 4.2 per cent growth, mainly due to improvement in commodity prices, and an expected increase in sugar production and tourist arrivals.

Papua New Guinea, with a 9.5 per cent growth in 1991, sharply reversed a cumulative contraction of its economy by more than 4.0 per cent during the previous two years, which was caused by the closure of the Bougainville mine coupled with a steep decline in the terms of trade. The stabilization measures introduced by the Government at the beginning of 1990 contributed to restoring financial stability in the country and to the strong recovery in 1991. The major impetus to growth came from developments related to mining and petroleum, particularly from the Pogera and Kutubu projects. The industry sector grew at the rate of almost 25 per cent in 1991 after a decline of 4 per cent in 1990. The agricultural sector grew by 3.4 per cent and the service sector by 5 per cent. The economy was expected to grow at a rate of over 5 per cent in 1992 despite the adverse effect of the recession in the industrialized countries.

Samoa was severely affected by two highly destructive cyclones which struck the country in 1990 and 1991. After contracting by about 5.0 per cent in 1990, the economy declined further by 1 per cent in 1991. With the support of external assistance, good progress was made with the restoration of the necessary infrastructure, such as power supplies, roads and telecommunication, from the damage caused by cyclone "Ofa" in 1990. In agriculture, domestic food production, mainly root crops, which were less affected by cyclone damage than tree crops, returned to normal levels, but the output of cocoa was negligible and copra production fell substantially. The reconstruction efforts resulted in the industrial sector remaining buoyant in 1991. However, weak export prices, coupled with a shortage of nuts for processing, led to a substantial fall in the production of coconut oil, and thus low-level activity in the manufacturing sector in 1991. Samoa was struck by a second cyclone, "Vai", at the end of 1991. The economy may record a negative growth in 1992 for the third year in succession, but the consequences of the damage wrought by the cyclones will be felt even longer.

Solomon Islands recorded an improvement in real GDP growth to 3.9 per cent in 1991 against 1.8 per cent in 1990. The 6 per cent growth of the service sector mainly reflected the rapidly expanding government operations. The agriculture sector also recorded a growth of 2.1 per cent. For 1992, growth in real GDP was projected to slow to 3.6 per cent, even though both the agriculture and the industry sectors are expected to record slight improvements in growth during the year.

Tonga recorded a 3.9 per cent GDP growth rate in 1991. This growth was largely attributed to an increase in agricultural output, particularly in the production of squash and vanilla for export, even though the output of other traditional agricultural products, such as copra, bananas and root crops, either declined or remained stagnant. The Tongan economy was projected to record a growth of over 4 per cent in 1992 mainly because the prospects for squash and, to a limited extent, vanilla, improved further.

Vanuatu recorded a GDP growth of over 4 per cent in 1991, which, however, was slower than in 1990. The reduced growth was attributed to a decline in total agricultural output by 1 per cent in 1991 after a 17 per cent rise in 1990. Both the industry and service sectors were projected to record further growth in 1992, but the agriculture sector was expected to contract by 11 per cent, mainly due to a fall in copra production as a result of lower export prices, and heavy damage inflicted by cyclones. The projected decline in the agricultural sector would slow the growth of the Vanuatu economy to 2.9 per cent in 1992.

## 2. Other indicators of macroeconomic performance

Governments of the island countries have made serious efforts to stabilize their economies, by improving their budgetary performance, which was adversely affected by a reduced flow of aid in recent years, and by pursuing appropriate monetary policies. Positive achievements have been made in a number of cases, with stronger rates of economic growth and slower rates of inflation. The records, however, present a mixed picture of performance by individual countries.

The rate of inflation in Fiji decelerated in 1991 to 6.5 per cent from 8.1 per cent in 1990. A dampening in food prices as well as lower rates of inflation in Australia and New Zealand, and a return of world oil prices to pre-Persian Gulf War level in 1991, had helped reduce the rate of in-

flation. The rate of inflation was further reduced to 4.3 per cent in 1992.

Fiji has managed to show improvement in its budgetary performance in recent years. After recording a budget deficit of about 5 per cent of GDP in 1986 and 1987, the budget was almost in balance in 1991. The 1992 budget made allowances for a deficit equal to 1 per cent of GDP. Higher revenue earning was to come from the value added tax (VAT), which was introduced in July 1992. The 1992 budget reinforced the Government's policy to model a dynamic, outward-looking, low-tax and high-growth economy in which private sector participation would continue to be encouraged and the government budget targeted at a zero net deficit. The key strategies in the 1992 budget included progressive deregulation, increased use of indirect taxes, reliance on labour market competition and encouragement of export industries. A consistent stance was maintained in the 1993 budget which was introduced on 6 November 1992. The Government proposed to continue to deregulate the economy, restrain government expenditure, and to alleviate poverty for which a $F 7 million capital fund was allocated.

Papua New Guinea was successful in keeping its inflation rate at the manageable level of 6.9 per cent in 1991. Keeping the value of the local currency high, coupled with austere measures of macroeconomic management, kept the inflation rate low. Even when the Government was forced to devalue the currency by 10 per cent in January 1990, the inflation rate was contained at 6.9 per cent with contractionary monetary measures and moderation of government expenditure. In addition, the flexibility introduced in the system of wage indexation in the country kept cost-push inflation low.

The authorities in Papua New Guinea have managed to keep the budget deficit in check since 1987, apart from 1990, when the budget deficit increased to just over 3 per cent of GDP. The deficit deteriorated in 1990 as a result of the closure of the Bougainville mine in 1989, but improved to around 1 per cent of GDP in 1991. The fiscal operations of the Government showed a deficit of K 48.6 million over the first half of 1992, when the increase in total revenue at 7.4 per cent was outpaced by the 12.3 per cent increase in total expenditure. The deficit was financed by net offshore concessional financing of K 40.5 million and by K 8.1 million from domestic sources. In its 1993 budget, the Government emphasized expenditure control. Nevertheless, a budget deficit equivalent to 3.3 per cent of GDP would be much higher than in the previous year. The Government planned to finance 66 per cent of the deficit through commercial overseas borrowings, while 24 per cent of the deficit was to be financed through concessional loans.

Samoa had recorded a negative inflation rate of 1.4 per cent in 1991 as against rates of 15.3 per cent in 1990 and 6.4 per cent in 1989. The damage to domestic food crops by cyclone "Ofa" in 1990 resulted in a sharp rise in prices in the first half of the year. Improved food supplies, low inflation in Australia and New Zealand, and a tight monetary policy led to a fall in consumer prices. The downward trend, however, was reversed following the destruction caused by cyclone "Vai". Inflation averaged 3.5 per cent per annum for the 12 months to the end of June 1992.

The Samoan Government has been pursuing measures to maintain a sound macroeconomic framework as the basis for accelerated economic growth since the mid-1980s. The budget deficit of the 1980s was turned into a surplus in 1990. The transitional budget of 1991 (as a result of the change from a fiscal year to a calendar year) provided for a small surplus. In the 1992-1993 budget, further cost-saving measures were introduced, including a small cut in non-salary expenditure and a freeze on the filling of public service vacancies.

Solomon Islands recorded both the sharpest increase and highest rate of inflation among the Pacific island countries. With a 15 per cent price increase, Solomon Islands was the only Pacific country that recorded a double-digit inflation rate in 1991. This was expected to moderate to 10 per cent in 1992. Solomon Islands has continued to experience large budget deficits in recent years, most of which were financed by domestic borrowing from the Central Bank. The significant monetization of the deficits contributed to high interest rates, put pressure on the balance of payments, and seriously crowded out the private sector, in addition to contributing significantly to the inflation rates.

Among the Pacific island countries, Solomon Islands has had great difficulty in containing its widening budget deficits. The deficit rose to almost 9 per cent of GDP in 1990 and to 15 per cent in 1991. The rise in the budget deficit was due to an increase in expenditure, while revenue remained relatively stable. The rise in expenditure was mainly attributed to an increase in recurrent expenditure at the rate of some 27 per cent in both 1990 and 1991, reflecting higher civil service salaries and allowances, transfers to provincial governments, losses by public enterprises and interest payments. The Government has continued to finance

most of its deficit from domestic sources in recent years. Monetary policy in Solomon Islands revolved around financing the government deficit, while defending domestic prices and external resources as best it could. Restraint on monetary expansion was sought through the use of required reserve ratios, the sale of new government securities, refinancing and discounting interest rates. The rate of inflation at 15 per cent in 1991 was high. The Government was, however, committed to reducing its budget deficit, which was expected to come down to around 7 per cent of GDP in 1992.

In Tonga, the inflation rate moderated to 9.4 per cent in 1991 from 10.9 per cent in the previous year and came down to an estimated 5.0 per cent in 1992. As in other Pacific island countries, the moderation in the inflation rate was due to a fall in prices of imported items as a result of lower inflation rates in Australia and New Zealand, which are the major sources of imports for Pacific island countries. Tonga's expansionary budgetary policy in 1990 and 1991 appeared to have reversed the improvements made since 1987. The budget deficit rose to 16.5 per cent of GDP in 1990 but declined to about 12.7 per cent in 1991. Over 76 per cent of the deficit was financed by foreign grants; and the rest by foreign and domestic borrowing. In 1991, 5 per cent of the deficit was financed from domestic sources.

The inflation rate in Vanuatu increased to 6.5 per cent in 1991 as against 4.7 per cent in 1990, mainly reflecting the general rise in prices in the first half of 1991. In the first quarter of 1992, the inflation rate dropped to an unprecedented -0.5 per cent, which was brought about by a decrease in the prices of water, fuel and electricity. The prices of food remained unchanged, while those of clothing, transport and communications fell slightly. Encouraged by the recent low inflation figures, the Government awarded 13-17 per cent increased allowances to public sector employees and this was likely to put pressure on the level of prices in the country in 1992.

Vanuatu has pursued sound economic management in recent years with considerable success. The budget for 1991 continued to reflect the Government's conservative approach to fiscal management, and current indications are that the budget was balanced in 1991. Nevertheless, current revenue still provided very little for development expenditure, which is mostly financed by external grants or loans. The Government extended the turnover tax to a few more areas besides hotel services in an effort to widen the tax base. The existing taxation system relies very heavily on the import trade, which accounts for about 70 per cent of total domestic revenue.

# IV. DEVELOPING ECONOMIES OF THE ESCAP REGION: INTERNATIONAL TRADE AND BALANCE OF PAYMENTS, 1991–1992

The international trade of the developing economies of the ESCAP region was buoyant in 1991-1992 (table IV.1), despite the recession and slow-down in world trade and economic activity. The strong performance of the trade sector was the result, in many cases, of improvement in production efficiency, the low rates of both domestic inflation and wage increases enabling productivity to rise faster than real wages, diversification of markets (see box IV.1), and expansion and consolidation of policy reforms involving trade and investment regimes.

Both the exports and imports of most of the East and South-East Asian economies grew strongly. Imports grew faster in most cases up to 1991, continuing a trend that had started several years earlier. The balance-of-payments deficits (table IV.2) of several countries widened sharply in the process and therefore macroeconomic policies were used to dampen the domestic demand pressure and the continuing rise in imports. The consequent slow growth in imports thus improved the current account balance of payments of countries such as Indonesia, Malaysia, the Republic of Korea and Thailand in 1992.

China and the Philippines were, however, registering accelerated rates of growth in imports in 1992 as their domestic economies gathered strength and some of the policy constraints on imports were eased or removed. The imports and exports of Viet Nam also grew strongly in 1991-1992 in spite of the continuing economic boycott of the country by some western countries, as it was able to increase its export production, particularly of rice, and find markets for its products, mainly within the ESCAP region. The pressure arising out of the economic boycott was also easing towards the end of 1992. The Democratic People's Republic of Korea, the Lao People's Democratic Republic, Mongolia and Myanmar, however, for different reasons, were experiencing difficulty with their foreign trade sector, although recent economic reforms have had favourable effects on the export growth of both the Lao People's Democratic Republic and Myanmar.

In South Asia, Pakistan's foreign trade sector showed steady expansion. That of Sri Lanka displayed some vulnerability owing to its continuing major dependence on exports of primary products such as tea, rubber and coconut. Growth in exports remained erratic, while imports showed steady growth, causing the balance-of-payments deficits to widen. India's foreign trade sector came under pressure in 1991 and 1992 from three major factors: the disruptive consequences of the Persian Gulf war on India's sizeable trade with the Middle East countries; the dislocation of trade with the former Soviet Union and eastern Europe; and the austere policy measures introduced by the Government aimed at halting the country's large and widening balance-of-payments deficit. In 1991, exports declined by about 2 per cent but imports fell by 14 per cent; this had a favourable effect on the balance of payments but at the cost of a slow-down in domestic economic activity. Export growth in 1992 was also expected to remain modest while imports were growing faster, thus widening the balance-of-payments deficit again compared with the dramatic improvement of 1991; however, the deficit was expected to remain within the limits of the policy target. With the exception of Afghanistan, the least developed countries in South Asia – Bangladesh, Bhutan, Maldives and Nepal – also showed a better trade and balance-of-payments performance in 1991-1992.

The foreign trade sector of the Pacific island economies, although crucial to their economies, remained vulnerable on account of their continued reliance on primary exports, the narrow commodity base of their exports, and the unfavourable price situations that their exports encountered in the world market. The gap between exports and imports remained wide in most cases, although the Governments of many countries continued to apply fiscal and monetary measures to reduce domestic demand pressure and the rise in imports while seeking to stimulate growth in exports.

## TRADE AND BALANCE OF PAYMENTS

### A. EAST ASIA

#### 1. Exports and imports

With the exception of the Democratic People's Republic of Korea and Mongolia, East Asian economies experienced strong growth in their external trade in

1991-1992. Much of this trade was intraregional, involving China, Hong Kong and Taiwan Province of China. The Republic of Korea was also taking an increasing part in such trade and had expanded its trade with the fast-growing economy of China while retaining its strong links with Hong Kong and Taiwan Province of China. The Democratic People's Republic of Korea was also taking part in the increased intraregional trade flows, as was evident from a sharp rise in inter-Korean trade.

Following the accelerated increase of 18.2 per cent in 1990 from 10.6 per cent in 1989, China sustained its export growth in 1991, at a high rate of 15.8 per cent. This strong performance was mainly attributed to growth in manufactures exports. Factors such as quality improvement of industrial products, and a strong policy package involving exchange rate depreciation, inflation control, and foreign trade reforms, which enhanced export efficiency and enabled a lowering of contributed to the good export performance. The composition of exports kept shifting in favour of manufactures. China also succeeded in diversifying its export markets, especially in the newly industrializing economies in the ESCAP region, while maintaining and expanding its trade with other developing countries. However, its trade with some of the developed countries remained strained owing to some trade-related and other issues. Nevertheless, exports continued to grow strongly, at an estimated 17.0 per cent in 1992. During January-September of that year, exports increased by 16.2 per cent over those of the same period in 1991. As a new export-promoting measure, the Bank of China, the country's major foreign exchange bank, has recently started to supply buyers' credits, giving a further boost to the country's export boom.

China expanded its imports considerably in 1991 by 19.6 per cent, following a 9.8 per cent decrease in 1990. Domestic policy actions were mainly responsible for the decrease in 1990. The major factor associated with the significant increase in imports in 1991 was the gradual liberalization of measures to meet the economy's postponed demands, particularly for the advanced technology and capital goods needed to expedite the process of economic reform and modernization. Imports thus soared also in 1992, at an estimated rate of 25 per cent. The actual increase during January-September was 21.4 per cent.

Hong Kong's visible exports, which grew by 20 per cent in 1991, amounted to $98.6 billion. Of this, 70 per cent consisted of re-exports, which have been growing rapidly in recent years. In 1991, they grew by 20 per cent and are projected to grow by 22 per cent in 1992. China headed the list among countries to which these exports were sent, accounting for 31 per cent of the total in the first half of 1992. The United States ranked second with a share of 21 per cent, followed by Germany and Japan, with 5 per cent each. China is not only the main market for re-exports, but also their main source. In the first half of 1992, 58 per cent of Hong Kong's re-exportables came from China; these consisted mostly of clothing, telecommunication and sound reproduction equipment, textile yarn and fabrics, and footwear. Domestic exports, however, did not perform well; they remained stagnant in 1991 and were projected to grow by only 2 per cent in 1992. Hong Kong's imports grew at a rate of just above 23 per cent, in both 1991 and 1992.

The merchandise exports of Taiwan Province of China rose by 13 per cent from $66.8 billion in 1990 to $75.5 billion in 1991, while imports rose by 15.3 per cent, from $51.9 billion to $59.8 billion. In 1992, exports were growing at a slower rate, 7.3 per cent, while imports were increasing by 12 per cent. The pattern reflected some loss of the export competitiveness of Taiwan Province of China in traditional exports, the slow-down in demand abroad as well as import liberalization to reduce its persistent trade and payment surpluses.

A major problem facing the Democratic People's Republic of Korea is the low level and narrow base of its foreign trade; until 1988, it had been expanding, albeit slowly, but subsequently started shrinking. The value of exports was $2 billion and of imports $2.6 billion in 1990. The weak foreign trade base was also reflected in the narrow composition of its exports and the number of its trading partners. Following a recent improvement in inter-State relations, inter-Korean trade received a considerable boost and totalled $124 million in the first eight months of 1992, rising from a bare $1 million in 1988. The Republic of Korea thus emerged as one of the major trading partners of the Democratic People's Republic of Korea.

In 1991, Mongolia's exports decreased by 51 per cent and its imports by 63 per cent in comparison with 1989. Thus, its foreign trade plummeted by 61 per cent in two years, from $1.7 billion in 1989 to $657 million in 1991. In the first seven months of 1992, trade turnover fell by 6.2 per cent against the same period of 1991. The Russian Federation remained the dominant trading partner and trade with the Commonwealth of Independent States (CIS) still accounted for about three quarters of the total. Most trade with the former USSR was conducted on a barter basis.

The Republic of Korea's export trade rebounded from slow growth in 1989-1990. Exports, on

## Box IV.1. Export market diversification for the developing countries: patterns and prospects

Market diversification reduces the instability of export earnings and promotes export growth. Many developing countries of the region have been pursuing the objective of market diversification in recent years in order to reduce dependence on traditional markets and achieve accelerated growth of their exports. The recent decline in the importance of traditional export markets, such as Japan and the United States of America, for many developing countries may reflect the result of these efforts.

The United States market has played an important role in boosting the exports of several developing countries of the region, but in recent years the dependence on that market has declined. The share of all developing country exports to the United States declined from 21.5 per cent in 1988 to 18.1 per cent in 1991 (see table). The share of the exports of East Asian economies declined from 23.7 per cent in 1988 to 19.5 per cent in 1991, owing to the declining importance of the United States market for exports from Hong Kong and the Republic of Korea. A higher share of China's exports has been absorbed by the United States. The share of the exports of South-East Asian countries to the United States has contracted, except for the Philippines and Thailand, where the share increased slightly. The share of South Asian countries has also declined, except for Bangladesh and Sri Lanka: larger exports of garments from these two countries to the United States have helped to increase their shares.

The market share of the European Community (EC) in developing country exports increased from 15.3 per cent in 1988 to 16.5 per cent in 1991. However, over a longer period the share of exports of developing countries to EC declined; in 1980, the share of EC in the exports of the developing economies of the ESCAP region was 17.1 per cent. The share of developing country exports to Japan also declined, from 21.9 per cent in 1980 to 15.5 per cent in 1988 and to 14.0 per cent in 1991.

The Persian Gulf war contributed to the diminished importance of the Middle East for exports from the developing countries of the ESCAP region. The share of East and South Asia's exports has declined, while that of South-East Asia registered marginal gains. Other than Thailand, countries in South-East Asia enhanced the share of their exports to the Middle East. In South Asia, Bangladesh, India and Sri Lanka saw a decline in the share of their exports to that area. However, developing countries of the region have been able to increase their exports to Latin America in recent years. The East Asian economies were most successful in that respect, particularly, Hong Kong and the Republic of Korea. Several other countries also have made marginal gains. The share of the exports of the developing countries of the ESCAP region to Latin America is still very small, but the lines of transport and communication with Latin America have been expanding, and this may be followed by expansion of trade. Similar possibility of trade expansion may exist with African countries, where the already small share of exports from the developing ESCAP region has further diminished in recent years.

The share of exports of developing countries to eastern Europe, including the former Soviet Union, declined marginally in 1991 compared with 1988. With the major political and economic changes of recent years, this region also offers potential for developing countries to increase their exports to them in future. Countries of the region such as Singapore and Thailand have been successful in directing a greater share of their exports to this region.

The exports of the developing countries of the ESCAP region have, however, risen considerably within the region itself. The share of intraregional exports in total exports of the developing countries rose from 46.7 per cent in 1988 to 49.9 per cent in 1991. This increase came entirely from higher exports to developing countries of the region, as the share of the three developed countries declined from 17.4 to 15.8 per cent over the same period. The growth of the market within the developing ESCAP region is broadly shared. East Asia's exports going to developing countries of the region increased from 31.0 per cent in 1988 to 38.4 per cent in 1991. The increase was largely due to China and the Republic of Korea. The increase in the share of South-East Asia was modest compared with that of East Asia. Indonesia, Malaysia and Singapore were able to increase the shares of their exports to markets in the region. The decline in Thailand's share in 1991 reflected a shrinking of the market for its rice exports in the region. In South Asia, Bangladesh, India and Pakistan sold a larger proportion of their exports to the markets in the region than before, while Nepal and Sri Lanka sold less. The growing trade links among countries of the ESCAP region augur well for forging enhanced regional economic cooperation.

**Destination of exports from the ESCAP region, 1988, 1991 and 1992[a]**

*(Percentage)*

| From \ To | ESCAP region | | | Developed economies of the region | | | Developing economies of the region | | | Middle East | | | Africa | | | Latin America | | | Eastern Europe[b] | | | United States of America | | | European Community | | | Japan | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1988 | 1991 | 1992 | 1988 | 1991 | 1992 | 1988 | 1991 | 1992 | 1988 | 1991 | 1992 | 1988 | 1991 | 1992 | 1988 | 1991 | 1992 | 1988 | 1991 | 1992 | 1988 | 1991 | 1992 | 1988 | 1991 | 1992 | 1988 | 1991 | 1992 |
| **Developing economies of the ESCAP region** | 46.7 | 49.9 | 48.1 | 17.4 | 15.8 | 14.3 | 29.3 | 34.1 | 33.8 | 3.3 | 2.6 | 2.8 | 2.0 | 1.6 | 1.7 | 1.2 | 1.8 | 1.7 | 2.6 | 2.1 | 2.0 | 21.5 | 18.1 | 18.3 | 15.3 | 16.5 | ... | 15.5 | 14.0 | 12.5 |
| **East Asia** | 46.4 | 51.4 | 49.6 | 15.4 | 12.9 | 11.6 | 31.0 | 38.4 | 38.0 | 3.2 | 2.2 | 2.3 | 2.1 | 1.7 | 2.0 | 1.5 | 2.2 | 2.1 | 1.7 | 1.3 | 0.9 | 23.7 | 19.5 | 19.7 | 13.3 | 14.1 | ... | 13.8 | 11.6 | 10.3 |
| China | 64.2 | 71.6 | 60.4 | 17.7 | 15.1 | 13.8 | 46.4 | 56.5 | 46.6 | 3.9 | 1.8 | 1.3 | 3.4 | 1.1 | 0.9 | 0.5 | 0.8 | 0.6 | 5.9 | 2.9 | 2.2 | 7.1 | 8.6 | 14.0 | 10.0 | 9.5 | ... | 16.9 | 14.3 | 12.8 |
| Hong Kong | 44.7 | 43.7 | 45.6 | 7.8 | 7.0 | 6.8 | 36.9 | 36.8 | 38.8 | 1.8 | 1.6 | 1.7 | 1.7 | 1.7 | 2.5 | 1.2 | 2.3 | 2.5 | 0.2 | 0.5 | 0.4 | 24.8 | 22.7 | 22.1 | 15.7 | 17.4 | ... | 5.8 | 5.4 | 5.2 |
| Republic of Korea | 34.2 | 41.2 | 42.6 | 21.4 | 19.2 | 16.8 | 12.8 | 22.0 | 25.8 | 4.2 | 3.3 | 4.3 | 1.3 | 2.4 | 2.5 | 2.5 | 3.4 | 3.3 | 0.0 | 0.7 | 0.0 | 35.4 | 26.4 | 22.8 | 13.4 | 14.2 | ... | 19.8 | 17.5 | 15.3 |
| **South-East Asia** | 52.4 | 53.2 | 51.9 | 21.0 | 20.0 | 18.3 | 31.4 | 33.2 | 33.6 | 2.8 | 3.0 | 3.3 | 1.6 | 1.3 | 1.4 | 0.9 | 1.2 | 1.1 | 0.7 | 0.9 | 1.2 | 21.3 | 19.0 | 18.8 | 14.5 | 15.4 | ... | 18.4 | 17.7 | 16.1 |
| Indonesia | 65.1 | 65.0 | 61.0 | 43.4 | 39.2 | 36.1 | 21.6 | 25.8 | 24.9 | 2.2 | 3.4 | 3.6 | 0.9 | 0.8 | 0.8 | 0.2 | 0.6 | 0.4 | 0.6 | 0.4 | 0.5 | 16.2 | 12.0 | 12.1 | 11.1 | 12.8 | ... | 41.7 | 36.9 | 33.4 |
| Malaysia | 58.6 | 60.9 | 57.7 | 19.6 | 17.8 | 15.7 | 39.0 | 43.1 | 42.0 | 2.3 | 2.1 | 2.5 | 0.6 | 0.5 | 0.4 | 0.8 | 1.1 | 1.3 | 1.1 | 0.5 | 0.2 | 17.4 | 16.9 | 17.4 | 14.4 | 14.8 | ... | 16.6 | 15.9 | 13.8 |
| Philippines | 38.7 | 37.5 | 38.3 | 21.8 | 21.3 | 22.5 | 16.9 | 16.2 | 15.8 | 1.3 | 1.7 | 1.6 | 0.2 | 0.2 | 0.2 | 0.7 | 1.1 | 0.7 | 0.3 | 0.3 | 0.2 | 35.7 | 35.7 | 36.1 | 17.7 | 18.6 | ... | 20.1 | 20.0 | 21.3 |
| Singapore | 49.2 | 50.7 | 48.5 | 11.7 | 11.5 | 7.6 | 37.5 | 39.2 | 40.9 | 2.5 | 2.8 | 3.4 | 2.0 | 2.0 | 2.5 | 1.5 | 1.6 | 1.7 | 0.7 | 1.1 | 2.0 | 23.8 | 19.7 | 18.9 | 13.0 | 14.0 | ... | 8.6 | 8.7 | 5.2 |
| Thailand | 42.6 | 41.4 | 45.2 | 18.0 | 20.1 | 19.7 | 24.5 | 21.2 | 25.6 | 5.5 | 4.4 | 4.6 | 3.3 | 2.0 | 1.6 | 0.6 | 1.0 | 0.7 | 0.7 | 2.0 | 2.4 | 20.1 | 21.8 | 21.6 | 20.8 | 20.8 | ... | 16.0 | 18.3 | 17.9 |
| **South Asia** | 25.7 | 27.5 | 26.4 | 11.8 | 9.7 | 9.3 | 13.9 | 17.8 | 17.1 | 8.1 | 6.0 | 5.8 | 2.5 | 2.3 | 2.0 | 0.4 | 0.6 | 0.5 | 11.7 | 11.3 | 9.9 | 18.4 | 16.0 | 16.8 | 26.7 | 27.4 | ... | 10.2 | 8.5 | 8.2 |
| Bangladesh | 21.4 | 17.7 | 15.0 | 8.6 | 4.5 | 3.3 | 12.9 | 13.2 | 11.7 | 4.3 | 3.2 | 2.7 | 3.8 | 1.8 | 1.9 | 1.2 | 1.1 | 1.6 | 6.7 | 3.5 | 1.4 | 26.0 | 26.6 | 35.8 | 28.5 | 40.1 | ... | 5.7 | 3.2 | 2.2 |
| India | 23.7 | 28.0 | 24.8 | 12.3 | 10.7 | 9.9 | 11.4 | 17.3 | 14.9 | 6.9 | 4.9 | 4.0 | 1.9 | 1.8 | 1.6 | 0.3 | 0.4 | 0.3 | 16.6 | 15.5 | 13.9 | 19.3 | 15.3 | 15.6 | 25.5 | 24.9 | ... | 10.9 | 9.6 | 8.9 |
| Nepal | 34.8 | 12.4 | ... | 1.0 | 0.8 | ... | 33.8 | 11.6 | ... | 0.1 | 0.0 | ... | 0.0 | 0.0 | ... | 0.0 | 0.1 | ... | 0.5 | 0.1 | ... | 23.7 | 23.6 | ... | 36.7 | 55.4 | ... | 0.9 | 0.6 | ... |
| Pakistan | 33.0 | 31.5 | 36.2 | 13.3 | 9.4 | 9.8 | 19.7 | 22.1 | 26.4 | 10.3 | 9.5 | 11.7 | 4.3 | 4.2 | 3.7 | 0.2 | 0.7 | 0.5 | 3.4 | 3.0 | 1.6 | 11.2 | 11.4 | 11.9 | 30.2 | 29.4 | ... | 11.4 | 8.0 | 8.4 |
| Sri Lanka | 23.2 | 20.9 | 19.3 | 7.3 | 6.9 | 7.1 | 16.0 | 13.9 | 12.3 | 15.9 | 7.9 | 6.1 | 1.4 | 1.3 | 0.8 | 1.8 | 1.6 | 0.8 | 0.7 | 3.4 | 4.3 | 25.1 | 27.1 | 30.3 | 23.4 | 30.7 | ... | 5.7 | 5.5 | 5.6 |

*Source:* International Monetary Fund, *Direction of Trade Statistics Yearbook, 1992* (Washington, DC, 1992).

[a] Data for 1992 are only for the first six months of the year. Exports are expressed as a percentage of total exports to the world. [b] Including the former Union of Soviet Socialist Republics.

a volume basis, exhibited a steady recovery, increasing by 9.8 per cent in 1991. The dollar value of exports rose by 10.6 per cent, compared with 4.2 per cent in 1990 and 2.8 per cent in 1989. This revival was brought about by efforts to advance into new markets in South-East Asia and Latin America, which enabled exporters to overcome the difficulties arising out of the weakened competitiveness of their products and the downturn in the world economy. Exports were projected to grow by 11.4 per cent in 1992. Among other things, the recovery reflected the won's sharp depreciation against both the United States dollar and the yen over the previous 18 months, which improved the price competitiveness of exports in overseas markets. Exports rose 9.6 per cent in January-June 1992.

The growth rate of imports accelerated to 16.8 per cent in 1991 from 13.6 per cent in 1990, as domestic demand continued its brisk expansion and caused imports of investment goods, construction materials and consumer goods to rise. In 1992, imports were projected to grow at the rate of only 1.2 per cent. Imports grew only 3.6 per cent in January-June. Lower oil prices and a slow-down in fixed investment, which caused a steep decline in machinery imports, kept the growth of overall imports low.

**Table IV.1. Total value and annual rates of change in dollar value of exports and imports, 1989-1992**

*(Value in millions of US dollars and annual change in percentage)*

| | *Exports* | | | | | | *Imports* | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | *Value* | *(Annual rates of changes)* | | | | | *Value* | *(Annual rates of changes)* | | | | |
| | *1991* | *1985-1990* | *1989* | *1990* | *1991* | *1992[a]* | *1991* | *1985-1990* | *1989* | *1990* | *1991* | *1992[a]* |
| **All developing economies of the ESCAP region** | 430 980.0 | 16.9 | 12.4 | 13.1 | 13.4 | ... | 466 156.0 | 15.6 | 14.9 | 14.2 | 14.2 | ... |
| **East Asia** | 242 423.0 | 19.0 | 9.7 | 11.3 | 15.8 | 16.8 | 246 888.0 | 14.8 | 12.7 | 6.7 | 20.0 | 16.9 |
| China | 71 910.0 | 17.8 | 10.6 | 18.2 | 15.8 | 17.0 | 63 791.0 | 4.8 | 7.0 | -9.8 | 19.6 | 25.0 |
| Hong Kong | 98 615.0 | 22.2 | 15.8 | 12.3 | 20.0 | 22.1 | 101 540.0 | 22.7 | 12.9 | 14.3 | 23.1 | 23.3 |
| Republic of Korea | 71 898.0 | 16.5 | 2.8 | 4.2 | 10.6 | 11.4 | 81 557.0 | 17.5 | 18.6 | 13.6 | 16.8 | 1.2 |
| **South-East Asia** | 162 180.0 | 15.1 | 17.1 | 16.4 | 14.5 | ... | 181 180.0 | 19.8 | 20.8 | 26.7 | 12.0 | ... |
| Indonesia | 29 143.0 | 6.7 | 14.6 | 16.6 | 13.5 | 10.9 | 26 182.0 | 16.4 | 20.2 | 37.7 | 19.4 | 26.3 |
| Lao People's Democratic Republic | 65.0 | 3.1 | -22.2 | 0.0 | 3.2 | ... | 209.0 | 7.1 | 3.7 | 10.1 | 13.0 | ... |
| Malaysia | 34 375.0 | 13.3 | 18.8 | 17.3 | 16.7 | 11.9 | 36 699.0 | 18.4 | 36.3 | 29.8 | 25.4 | 5.1 |
| Myanmar | 412.0 | -0.3 | 55.8 | 51.2 | 26.8 | ... | 616.0 | -1.6 | -21.7 | 36.6 | 136.0 | ... |
| Philippines | 8 840.0 | 12.1 | 10.1 | 5.7 | 8.0 | 9.2 | 12 051.0 | 19.1 | 22.9 | 21.5 | -7.6 | 14.7 |
| Singapore | 59 046.0 | 18.2 | 13.7 | 18.0 | 12.0 | 12.7 | 66 108.0 | 18.3 | 13.2 | 22.4 | 8.8 | 11.0 |
| Thailand | 28 395.0 | 26.5 | 25.7 | 15.0 | 23.1 | 17.8 | 37 188.0 | 29.3 | 27.0 | 29.5 | 11.4 | 13.0 |
| Viet Nam | 1 904.0 | 22.9 | 67.8 | 16.6 | -9.3 | ... | 2 127.0 | 20.0 | 3.2 | 9.0 | -25.8 | ... |
| **South Asia** | 24 605.0 | 13.6 | 13.2 | 13.6 | -9.8 | ... | 35 790.0 | 7.1 | 6.5 | 11.5 | -6.4 | ... |
| Afghanistan | 235.0 | -15.9 | -45.0 | -1.3 | ... | ... | 937.0 | -4.7 | -11.3 | 17.4 | ... | ... |
| Bangladesh | 1 693.0 | 12.0 | 5.4 | 15.1 | 3.8 | 23.8 | 3 408.0 | 10.6 | 19.8 | -1.4 | -5.5 | 5.9 |
| India | 14 149.0 | 15.2 | 20.2 | 11.9 | -1.9 | 5.1 | 19 931.0 | 8.4 | 6.9 | 15.0 | -14.4 | 18.0 |
| Maldives | 54.0 | 17.7 | 12.5 | 15.6 | 3.8 | ... | 151.0 | 19.5 | 16.7 | 22.9 | 17.1 | ... |
| Nepal | 273.0 | 5.5 | -17.2 | 31.4 | 30.6 | 32.5 | 790.0 | 8.7 | -14.6 | 18.1 | 15.2 | 1.0 |
| Pakistan | 6 471.0 | 15.2 | 5.6 | 15.5 | 17.2 | 14.2 | 8 427.0 | 4.5 | 7.5 | 3.3 | 14.6 | 21.0 |
| Sri Lanka | 1 965.0 | 8.4 | 3.2 | 25.0 | 2.8 | 7.6 | 3 083.0 | 8.1 | -5.6 | 26.1 | 17.0 | 4.6 |
| **Pacific** | 1 772.0 | 3.9 | -6.3 | -14.8 | -0.9 | ... | 2 298.0 | 5.2 | 17.3 | -11.2 | -3.7 | ... |
| Fiji | 451.0 | 17.7 | 12.5 | 38.1 | -15.4 | 6.0 | 652.0 | 11.0 | 39.4 | 17.5 | -12.4 | 6.8 |
| Kiribati | 2.8 | -6.6 | -10.5 | -44.2 | ... | ... | 26.6 | 12.2 | -6.0 | 17.5 | ... | ... |
| Papua New Guinea | 1 283.0 | 4.5 | -8.4 | -10.9 | 12.4 | 5.0 | 1 403.0 | 8.3 | 14.0 | -3.6 | 9.0 | 1.2 |
| Samoa | 8.0 | -9.7 | -13.3 | -30.8 | -11.1 | -5.0 | 99.0 | 8.0 | 1.3 | -2.6 | 32.0 | 5.0 |
| Solomon Islands | 70.0 | 0.0 | -7.4 | -6.7 | ... | 1.0 | 92.0 | 5.9 | 16.3 | -19.3 | ... | 4.0 |
| Tonga | 14.0 | 21.1 | 12.5 | 44.4 | 7.7 | 17.3 | 62.0 | 8.6 | -1.7 | 14.0 | -4.6 | 4.2 |
| Vanuatu | 16.0 | -9.3 | 10.0 | -13.6 | -15.8 | -5.7 | 82.0 | 6.7 | -1.4 | 38.6 | -15.5 | 6.0 |

*Sources:* United Nations, *Monthly Bulletin of Statistics,* vol. XLVI, No. 11, November 1992; International Monetary Fund, *International Financial Statistics,* vol. XLV, No. 11, November 1992; and national sources.

[a] Estimates/forecasts relate to the financial year. Data in other columns are on a calender year basis.

## 2. Balance of payments

Complete details of the balance of payments of the economies of East Asia, other than China, the Republic of Korea and Taiwan Province of China, are not available. China's balance of payments moved favourably for the second year in 1991. The current account showed a surplus of $13.4 billion, slightly higher than in 1990 when the trade deficit was converted into a large surplus, reversing the deficit trend which had prevailed since 1985. A much larger surplus on the services and income account was achieved. The surplus in the services balance increased rapidly as tourism became an expanded source of foreign exchange for China. In 1991, 33.4 million tourists visited the country, an increase of 21.5 per cent; income from the tourist industry increased by 28.3 per cent over 1990. There was also an increase in private transfers from overseas workers.

Direct investment inflow continued to show sustained large growth with the steady improvement in China's investment environment. China attracted a considerably larger volume of foreign direct investment (FDI) in 1991 and 1992 than in the previous years. The over 27,000 foreign-funded projects approved in the first nine months of 1992 represented a 237 per cent increase over the corresponding period in 1991; pledged foreign investment on these projects rose by 332 per cent to $30.7 billion. Portfolio investment became more significant in China as it pushed for financial reforms. A rapid increase was also seen in foreign loans. The foreign exchange reserve registered a record $42.6 billion at the end of 1991. The country's external debt was also growing fast, reaching $60.6 billion by the end of 1991. The annual repayment reached $10.0 billion in 1992 which, however, it was able to meet without much difficulties.

In 1991, there was a deficit of $HK 16 billion in Hong Kong's trade balance. However, this was more than offset by a surplus in the service sector, which is a substantial exchange earner for Hong Kong, so that there was a surplus of $HK 19 billion in the goods and services account. The merchandise trade deficit was projected to increase to $HK 21 billion in 1992, although there would still be a surplus of $HK 13 billion in the overall goods and services account.

The current account of the balance of payments of Taiwan Province of China has been in surplus for over a decade. The surplus in the balance of trade rose from $14.9 billion in 1990 to $15.9 billion in 1991. With a deficit in the service trade account of around $3.4 billion, the overall surplus in the current account increased to $12 billion in 1991 from $10.8 billion in 1990.

Since 1988, when a surplus of $14 billion was recorded, the current account balance of payments of the Republic of Korea has been deteriorating steadily. In 1990, the balance turned into a deficit of $2.2 billion and widened to $8.5 billion in 1991. The deficit arose out of export receipts not keeping up with rising imports. At the same time, a sharp increase in payments for travel and transport had resulted in a deficit in the invisible trade account as well, so that the current account deficit rose sharply in 1991. A $3.2 billion deficit was recorded in the first quarter of 1992. A lower deficit was expected for the year than in 1991 as export growth gathered strength and imports substantially slowed.

As part of its wider participation in international trade and investment, the Republic of Korea has been experiencing net outflow of financial resources, in the form of both contributions and direct investment. In 1991, a net outward transfer of $173 million and a net outward investment of $241 million were recorded. After the accelerated repayment of the foreign debts resulting in a $3-$4 billion net annual outflow in 1988-1989, net borrowings reversed to result in a positive inflow of borrowed capital of the order of $2.3 billion in both 1990 and 1991.

# B. SOUTH-EAST ASIA

## 1. Exports and imports

In spite of the slow-down in traditional export markets, the exports of the South-East Asian countries continued to grow strongly in 1991-1992. With a weakening of domestic demand, import growth, on the other hand, tended to decelerate, thus having a favourable effect on the balance of payments. Two of the least developed countries also reaped some of the benefits of their recent efforts to strengthen the trade sector as part of reforms to strengthen their economies.

Myanmar's exports grew at the rate of 27 per cent in 1991, following growth rates of over 50 per cent in 1989 and 1990. Exports of fishery and forestry products increased over those years. As a result of favourable government policies encouraging private sector participation, including the grant of fishing and logging rights to foreign entrepreneurs, there was a spurt in export activities. The opening up of foreign trade with neighbouring countries also helped. Border trade with China and Thailand was growing fast. The boom in exports was expected to continue in 1992.

After sharply declining in 1989 and stagnating in 1990, exports from the Lao People's

Democratic Republic grew modestly at 3 per cent in 1991. Exports to the non-convertible currency (rouble) area declined sharply in 1991, while those to the convertible currency area grew. A partial ban on logging imposed in 1991 also kept the growth of exports low, as timber and wood products constitute one of the two major exports, the other being electricity. Exports of electricity to Thailand were expected to rise with an increase in installed generating capacity. Resumption of more controlled logging would partly restore exports of timber and wood products. Total exports were expected to grow at a higher rate in 1992 than in 1991.

Indonesia's exports rose at the rate of 13.5 per cent in 1991, after growing by 16.6 per cent in 1990. Export growth was sustained, after the temporary oil boom in the wake of the Persian Gulf war had subsided, by the surge in non-oil exports which have been promoted by the Government since 1987 with a view to reducing the country's dependence on the exports of oil and natural gas. Even with a continuing slackening in oil prices and unfavourable prices of several agricultural commodities, export growth was expected to reach 11 per cent in 1992, sustained largely by manufactured goods, comprising mainly wood-based products, textiles and garments, and footwear. Imports, on the other hand, grew at a slower rate, 19.4 per cent, in 1991 in response to a slackening of domestic demand, after rising by 37.7 per cent in 1990. In 1992, imports were projected to rise again, by the high rate of 26 per cent.

Malaysia's exports were growing at the rate of 11.9 per cent in 1992, as against 16.7 per cent in 1991. Export growth was sustained largely by palm oil and manufactured goods, while earnings from rubber, crude petroleum and tin declined in both 1991 and 1992. Imports, however, were growing much more slowly, at the rate of 5 per cent, compared with 25.4 per cent in 1991. Manufactured goods and machinery and transport equipment registered the fastest growth in 1991, at 29 and 37 per cent respectively. A slowdown in both consumer and investment demand caused a slackening in import growth in 1992.

The exports of the Philippines were expected to increase at a higher rate, 9.2 per cent, in 1992 compared with 8.0 per cent in 1991. However, imports were expected to rise at a much faster rate, 14.7 per cent after a 7.6 per cent decline in 1991. Increased export revenues were derived from fruits and vegetables, shrimps and prawns, baby carriages, toys and sports gear, footwear, chemicals, electronics, and machinery and transport equipment. A decline in imports of consumer and capital goods, as well as mineral fuels, was recorded, while a slight increase was observed in the value of raw materials and intermediate goods imports in 1991.

Singapore's exports were adversely affected by the slow-down in markets in the United States and Europe. Total exports were still growing, at the rate of 12.7 per cent in 1992 as against 12.0 per cent in 1991. Imports were growing at the higher rate of 11 per cent compared with 8.8 per cent in 1991.

Thailand's exports, after growing at the rate of 23.1 per cent in 1991, were still growing strongly in 1992, at the rate of 17.8 per cent. Both agricultural and manufacturing exports were growing fast. Exports in the first eight months of 1992 were higher by 15 per cent than during the same period of 1991, despite the adverse effects of the events of May 1992. Agricultural exports rose by 10.3 per cent. The export of rice, tapioca products, rubber, frozen shrimps, frozen chicken and frozen squid expanded, while that of maize and mung beans dwindled, owing to lower output. Manufacturing exports, largely garments, computer sets and accessories, gems and jewellery, electrical circuit boards, spare parts, and radio and television sets and parts, surged by 9.5 per cent during the period. The export of food products, such as canned seafood, and steel pipes and cars declined. Exports to new markets, such as the Middle East and Australia, rose substantially, by 41.7 and 38.8 per cent respectively. Exports to the United States during the first eight months grew 23.9 per cent, to Japan 16.5 per cent and to the Association of South-East Asian Nations (ASEAN) 32.3 per cent, compared with the same period in 1991, while those to the European Community (EC) market rose by only 0.4 per cent, with lower exports of garments, gems and ornaments, computers and parts, and canned seafood.

The total export earnings of Viet Nam were estimated to increase by 19 per cent in 1992 to reach $2.5 billion. The largest increase was in oil exports, which rose 46 per cent in the first half of 1992. The major export earners in 1992 were crude oil, rice, coal, sea products, rubber, tin, coffee and tea. In contrast to the decrease in 1991, rice exports were expected to rise substantially to reach 1.6 to 1.9 million tons by the end of 1992. Industrial exports, which had been adversely affected by the dissolution of the Council for Mutual Economic Assistance (CMEA), were rising again. Export markets were becoming rapidly diversified, with Japan, followed by Singapore, Hong Kong, the Republic of Korea, Taiwan Province of China, France and Germany, emerging as

major trade partners. The share of the former Soviet Union in Vietnamese foreign trade, however, fell to 13 per cent in 1991. The foreign trade reforms introduced in Viet Nam in 1989-1991, including the abolition of most export and import quotas, the liberalization of export and import prices, and the adoption of a more realistic exchange rate based on market forces, were producing progressively good results in terms of export performance. In 1991, the Government also increased the number of companies allowed to engage in direct foreign trade, from 300 to 500. Viet Nam's imports, comprising capital equipment, and chemicals including fertilizer, were rising fast and exceeded the value of exports during most of 1992, although a trade surplus could result for the whole year.

## 2. Balance of payments

The balance of payments of most South-East Asian countries deteriorated in 1990-1991, despite fast growth in exports, as imports recorded phenomenal rates of growth. As noted earlier, buoyant domestic consumer and investment demand kept imports flowing in, particularly in Indonesia, Malaysia and Thailand, with a resulting increase in trade and current account balance-of-payments deficits. The Philippines showed improvement in its trade and current account balance owing to a recession in the domestic economy. Capital flows, however, permitted smooth financing and adjustment of the deficits in these countries, without any serious snag, even in the case of the Philippines, which had successfully negotiated substantial debt restructuring agreements with both its commercial and official creditors.

The surplus in Indonesia's balance of trade was reduced from $5.3 billion in 1990 to $4.8 billion in 1991, despite slower growth in imports. With an acceleration in import growth in 1992, the trade surplus was forecast to fall to around $1.5 billion, and consequently the current account deficit was to increase to $4.9 billion from $4.2 billion in 1991. The costs of servicing the country's external debt, which stood at about $60 billion in 1992, was still absorbing more than 25 per cent of its export earnings. The ratio of debt-service payments had come down from about 36 per cent in 1988. Despite higher earnings from tourism, the large outflows on income and services, mainly debt services and foreign investment-related payments, together with a reduced merchandise trade surplus, widened the balance-of-payments deficit in 1991. FDI flow and borrowings through the Aid Coordination Group on Indonesia have financed the deficit, with an occasional draw-down of reserves. But the size of the overall reserves has gone up since 1988, with the total almost doubling by March 1992.

As a result of a sharp deceleration in the growth of imports, Malaysia's trade balance was reverting to a surplus in 1992 from a small deficit in 1991. The deficit emerged, after a steady decline in 1989-1991, from the $5.5 billion surplus in 1988. Although the usual large deficits in the services and income account of Malaysia's balance of payments were to increase marginally in 1992, the deficit in the current account balance would be reduced by 37 per cent. The net flow of long-term capital was projected to be marginally lower in 1992, but the overall balance was projected to produce a larger surplus allowing a further accumulation of reserves, which stood at $10.4 billion at the end of 1991.

Owing to a contraction in imports, the Philippines had a reduced trade deficit of $3.2 billion in 1991 as against $4.0 billion in 1990. With a more than doubling of the inflows on account of non-merchandise transactions, which largely reflected the results of debt renegotiations, and some increase in net private transfers, the current account balance-of-payments deficit in 1991 was reduced to about $1.4 billion from $3.0 billion in 1990. In 1992, imports were rising faster than exports, thus widening the trade deficit from $3.2 billion to an anticipated $4.2 billion. As the non-merchandise transactions continued to improve, the current account balance-of-payments deficit was projected to be just above $1.1 billion in 1992. FDI showed a promising increase in both 1991 and 1992. However, increased net outpayments on account of debt servicing had forced the Philippines to find fresh finance from official and market sources to balance its external account and to replenish the reserves, which were running low in 1990.

Thailand experienced one of the fastest rates of growth in the region in imports from 1987 to 1990 and, despite a healthy surplus in the services account, experienced a very sharp deterioration in the current account balance of payments, the deficit almost trebling in 1990 over that in 1989. The growth of imports slackened in 1991 to a rate lower than that of growth in exports. The rate of growth of the deficit was therefore reduced to 4 per cent in 1991; the deficit actually started declining in 1992 and was estimated to have dropped by 31.5 per cent during the first eight months of the year. Imports were estimated to have increased by a mere 2.5 per cent during this period owing to a slow-down in private consumption and investment. After

some set-backs in mid-year owing to the political disturbances, tourism as a major foreign exchange earner for Thailand was reviving later in the year, and the balance-of-payments results for the year as a whole were expected to improve further. Thailand has operated with an official ceiling on annual external borrowings. Borrowings within the limit and FDI inflow have enabled the capital account to record surpluses, and the country's foreign exchange reserves, which have increased over the years, were currently capable of financing imports for five or six months.

## C. SOUTH ASIA

### 1. Exports and imports

The South Asian countries were effecting large adjustments in their economies, particularly in their trade and investment regimes, which were to have some destabilizing effects in the short term. Import growth slowed in 1991 under the influence of austere monetary, fiscal and trade policies, in efforts to reduce the large and persistent balance-of-payments deficits. In the case of most of the countries, exports rose in 1992. Imports were also growing fast, again in 1992, owing to the effects of policy liberalization as part of overall strategies to restructure the individual economies towards a longer-term balance with better growth prospects. The least developed countries of South Asia were also vigorously pursuing this process. Afghanistan, however, had yet to catch up in this regard.

After declining for several years, Afghanistan's exports increased by 3.4 per cent in 1991 as compared with the previous year. Fruits and nuts, carpets, wool, karakul skins and cotton are the major export items. The export of natural gas to the former Soviet Union had been an important source of foreign exchange earnings, but such export stopped in 1989.

After declining for several years, Afghanistan's imports grew by 17 per cent in 1990 but again declined in 1991, by 21 per cent. Its principal imports are capital goods, food, textiles, petroleum products, sugar and vegetable oil. Its imports are much larger than its exports. In 1991, only 33 per cent of the exports could be financed by exports. A decline in aid flows in recent years has aggravated the problem of balance of payments.

Bangladesh's exports grew at a much lower rate in 1991, 4 per cent, than the 15 per cent achieved in 1990, owing largely to the cyclone damage of April 1991. Non-traditional exports grew at a slower rate in 1991. Ready-made garments, currently accounting for over 50 per cent of total exports, recorded a 10 per cent growth in 1991 as against 30 per cent in 1990. Efforts were under way to diversify markets from the United States and EC, the two main buyers of Bangladesh garments, and to enter into new markets in Australia, Japan, the Middle East. The outlook for exports in 1992 was more promising, as evidenced by a 45.5 per cent growth of exports during the first five months of 1992. Four non-traditional types of products, toys, luggage and fashion goods, electronic items, and leather goods, were chosen to receive special incentives in the form of subsidized credit facilities and marketing assistance. These products have good export potential.

After growing sharply at 20 per cent in 1989, Bangladesh's imports declined by 1.4 per cent in 1990 and by 5.5 per cent in 1991. Besides the economic adjustments being carried out by the Government, the decline in imports partly reflected a slow-down in economic activity owing to the political uncertainties until the elections in 1991. Slow disbursement and utilization of foreign aid also kept imports in check. Imports of food grains, petroleum and petroleum products, chemicals and capital goods recorded a decline in 1991. Imports of fertilizers, edible oil, cement and imported inputs for the textile sector went up. Imports grew by 19.4 per cent during the first five months of 1992 but were projected to grow more moderately during the year. The Government continued its import liberalization policy with the removal of 59 entries from the import control list in 1991 in addition to the 68 that had been deleted in 1990. Most of the remaining items are to be replaced by tariffs over the next few years.

The external trade of Bhutan is dominated by transactions with India, which absorbs about 95 per cent of its exports. The trade deficit with India fell considerably from 1987 to 1989 because of the sharp rise in exports of cement, timber and electricity, but export growth slowed in 1990 and 1991 owing to India's economic slow-down. However, merchandise export growth was projected to increase by 8 per cent in 1992 as the effort towards diversification of export markets was having positive results and the effects of the devaluation of the domestic currency were taking hold. About 75 per cent of Bhutan's imports – mainly consumption and investment goods – are supplied by India. Imports of capital and consumer goods rose in 1990 and 1991, and a further growth of 8-9 per cent was projected for 1992.

Export earnings in Maldives had shown a rapid increase since 1986, fuelled by increases in fish catch and the international price of

fish. The value of marine exports increased by 131 per cent in the period 1987-1990. In 1990, the growth rate of exports was 15.6 per cent, which slowed considerably to 3.8 per cent in 1991 owing to recessionary conditions in the world economy.

Maldives, being an isolated scattered island economy devoid of any natural resources, depends on imports to satisfy all its needs for sustenance and development. Import growth surged to 22.9 per cent in 1990 but slowed to 17.1 per cent in 1991. In 1990, imports were dominated by consumer goods, which accounted for 53 per cent of all imports. The second largest category of imports was intermediate and capital goods, accounting for 30 per cent, followed by petroleum products, 17 per cent.

In Nepal, the liberal trade and industrial policy recently initiated increased both imports and exports. The release of the constraints resulting from the trade and transit impasse with India was also reflected in the rapid growth of exports since 1990. Exports to third countries increased by more than 100 per cent in 1992, a major increase being experienced in exports of carpets and garments. The devaluation of the Nepalese rupee towards the close of fiscal year 1991 increased the cost of imports paid in convertible currency, and the rate of growth of imports was expected to be much lower in 1992 than the 15.2 per cent in 1991.

India's export performance since 1985 has generally been quite impressive. However, its total merchandise exports fell by 1.9 per cent in 1991 mainly owning to disruption of trade with the former Soviet Union. While India's exports to rupee payments area declined by 42.5 per cent in dollar terms, exports to general currency areas registered an increase by 6.3 per cent. The stagnation of industrial output, the high rate of domestic inflation, the high costs of production and of export finance, and the recession in industrial countries also adversely affected India's exports. Exports of coffee, raw cotton, tea, iron ore, jute manufactures, ready-made garments and gems and jewellery declined in value terms in 1991. Exports in dollar terms were expected to increase by a modest 5.1 per cent in 1992.

The year 1990 was the most difficult for India's balance of payments, when the country incurred the largest ever deficit on current account. The stringent monetary restrictions on import financing and other import compression measures introduced by the Government contributed to a sharp fall in imports by 14.4 per cent in 1991. Lower prices of crude oil also helped in restraining imports. Imports, however, declined across the board. In 1992, imports in dollar terms were projected to increase by 18 per cent as measures of import liberalization gathered momentum.

The exports of the Islamic Republic of Iran declined by 5 per cent in 1991, as a result of a decline of about 15 per cent in the export value of oil and gas. Around 80 per cent of total exports are accounted for by exports of these items. Oil exports grew in terms of volume by 10.8 per cent, but lower international prices resulted in lower exports in value terms. Non-oil exports increased sharply, by 87.6 per cent. Exports of hand-made carpets, with about a 46 per cent share in total non-oil exports, rose sharply, at 127 per cent. Industrial exports, mainly of aluminium and copper dishes, metal ingots, textiles and shoes, recorded an increase of 187 per cent. The rate of growth of agricultural exports, 24 per cent, was also quite impressive.

The imports of the Islamic Republic of Iran recorded a fast growth rate of 22.8 per cent in 1991. Imports by the private sector grew by 24.7 per cent, and those by the public sector by 21.7 per cent. A negative growth of exports and acceleration in import growth resulted in a merchandise trade deficit in 1991 as opposed to the surplus in 1990.

Pakistan's exports continued to enjoy a boom in 1991, when total exports grew by 17.2 per cent, following 15.5 per cent growth in 1990. Higher exports of cotton-based manufactures, particularly of cotton yarn, helped to achieve the higher growth rate. Exports of primary products, such as cotton and rice, also increased. Export growth in 1992 was slower as a result of a sluggish world economy and the lowest international prices for raw cotton and cotton yarn in many years. Colossal damage caused to the cotton crop in September 1992 also will keep export growth lower. Total exports grew by 10.8 per cent during the first seven months of 1992.

Further opening of the external sector in Pakistan led to a sharp increase in imports in 1991, at 14.6 per cent, as against 3.3 per cent in 1990. A sharp increase in imports of machinery showed the positive response of investors to recent policy measures taken in the field of investment and foreign trade and payment regimes. Other items recording growth in imports were chemicals, synthetic fibre, silk yarn, iron and steel, wheat, palm oil and pulses. The major items recording a decline were crude oil, petroleum products, soybean oil and sugar. Imports were expected to grow at a higher rate in 1992 also, as evidenced by the 13 per cent growth rate during the first seven months of 1992.

The recovery of Sri Lanka's exports in 1992 from the low 2.8 per cent growth recorded in 1991 was largely due to a 16 per cent increase in industrial exports, the largest increase being registered in garments. It was estimated that garment exports would increase by 22 per cent over 1991 and total exports by 7.6 per cent, and that exports of agricultural products would decline by 9.2 per cent largely because of an 18.6 per cent fall in the export of tea. Although the share of industrial products in total exports has risen substantially over the years with garments alone currently accounting for 40 per cent of total exports, the stunting of export growth in 1991-1992 after a rapid 25 per cent growth in 1990, showed Sri Lanka's continuing vulnerability owing to a relatively large dependence on primary exports.

A 4.6 per cent rise in imports in 1992, declining sharply from a 17 per cent growth rate in 1991, was mainly due to a 4.5 per cent decline in capital goods imports after a 50 per cent rise in 1990. Imports of intermediate goods, such as textiles, imported mostly for the manufacture of garments, and petroleum products, registered increases of 10 and 39 per cent respectively. Imports of consumer goods, mainly wheat and rice, increased by 128 and 24 per cent respectively.

### 2. Balance of payments

Bangladesh's merchandise trade deficit narrowed to $1.4 billion in 1991, from about $1.6 billion in 1990. A reduction in debt-service payments and higher workers'remittances improved the non-merchandise balance. Workers' remittances picked up quickly after the end of the Persian Gulf crisis, as 30 per cent more workers went to work overseas in 1991 as compared with 1990. The balance of payments recorded an overall surplus in 1991, resulting in an increase in reserve assets by $592 million. Gross official reserves stood at $1,207 million by the end of 1991, as against $603 million in 1990, and were sufficient to finance imports for about five months (see table IV.2).

Bhutan's trade deficit with India fell considerably from 1987 to 1989 because of a sharp rise in exports, but increased in 1990 and 1991 as imports of consumer and capital goods rose and exports fell. The current account deficit was expected to increase slightly, to 20.2 per cent of gross domestic product (GDP) in 1992 from 19.8 per cent in 1991.

There was a distinct improvement in the balance of payments of India in 1991. The current account deficit was reduced to $3.2 billion in 1991 from $8.3 billion in 1990. The improvement was mainly due to a reduction in the trade deficit, from $7.7 billion in 1990 to $3.1 billion in 1991, as imports had declined by 14.4 per cent. Projections indicated that the deficit in the current account would increase sharply in 1992 to $7.1 billion more than double that of 1991. Although export growth was accelerating in 1992, imports were-increasing faster. There was also some deterioration in the balance on invisibles. Net capital inflows of $5.1 billion in 1991 were higher than in 1990. Foreign exchange reserves, which fell to $1.2 billion in 1990, went up to $3.6 billion in 1991.

The balance of payments of Maldives is normally characterized by a deficit on the trade account and surpluses on the services account. Revenue from services increased rapidly between 1987 and 1990: the net receipts from services more than doubled during the period. The trade deficit, however, increased sharply, from about $60 million in 1990 to about $83 million in 1991, leaving a deficit of $33 million in the current account.

In 1991, Nepal's deficit on the merchandise trade account increased and private transfers declined, while there was a rise in services income, mainly from tourism. In 1992, the trade deficit of Nepal with India increased while it declined with other countries. In 1991, rising official transfers and other capital inflows were more than adequate to offset the deficits on trade account and service transactions and added substantially to reserves.

Despite a narrowing of the merchandise trade deficit in 1991, the external payments situation of Pakistan continued to be fragile and vulnerable, mainly because of a widening deficit in services transactions and declining worker's remittances. The decline in remittances in 1991 partly reflected their diversion to foreign currency accounts in Pakistan which were allowed by the Government to all resident and non-resident Pakistanis. The current account deficit, which stood at $ 2.2 billion in 1990, rose to $ 2.4 billion in 1991, notwithstanding a reduction in the trade deficit from $2.7 billion to $2.2 billion. In view of the expected strong growth in imports and slower growth of exports, any improvement in the current account deficit in 1992 would be difficult to achieve. Total capital inflow, however, exceeded the current account deficit in 1991, resulting in an increase in reserves to $519 million from $295 million in 1990.

Sri Lanka's balance of payments deteriorated sharply in 1991 owing to an increase in the deficits in both trade and service transactions. Private transfers recorded some increase. Official transfers and other capital flows also increased, with FDI showing a significant rise. The balance of payments was estimated to

improve in 1992, mainly owing to a slow-down in import growth. While exports grew by 7.6 per cent, imports increased by only 4.6 per cent. The deficit in net factor incomes also declined marginally, mainly as the result of a drop in interest payments on foreign debt. Workers' remittances from the Middle East increased, as reflected in a 14.2 per cent increase in net private transfers.

**Table IV.2. The balance of payments: major components**

*(Value in millions of US dollars)*

| | | *Trade balance* | *Services and income balance* | *Private transfers* | *Current account balance* | *Official transfers* | *Long-term capital flows* | | *Foreign exchange reserves (end of period)* |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | *Direct investment* | *Other[a] capital flows* | |
| Afghanistan | 1988 | –278.0 | –38.6 | – | –316.6 | 342.8 | – | –4.1 | 241.8 |
| | 1989 | –371.2 | –83.0 | –1.2 | –455.4 | 312.1 | – | –59.6 | 226.7 |
| Bangladesh | 1988 | –1 443.5 | –461.4 | 827.2 | –1 077.7 | 804.4 | 1.8 | 396.8 | 961.9 |
| | 1989 | –1 995.3 | –500.2 | 806.8 | –1 688.7 | 589.1 | 0.2 | 831.3 | 469.0 |
| | 1990 | –1 587.0 | –424.5 | 828.3 | –1 183.2 | 785.8 | 3.2 | 694.3 | 602.9 |
| | 1991 | –1 400.0 | –357.7 | 901.8 | –855.9 | 905.6 | 1.4 | 428.6 | 1 206.9 |
| Bhutan | 1988 | –50.2 | –32.6 | 4.5 | –78.3 | 63.4 | – | 32.4 | 93.1 |
| | 1989 | –31.7 | –21.2 | 4.4 | –48.5 | 57.9 | – | 3.7 | 97.5 |
| China | 1988 | –5 315 | 1 094 | 416 | –3 805 | 3 | 2 344 | 3 996 | 17 548 |
| | 1989 | –5 620 | 922 | 238 | –4 460 | 143 | 2 613 | 1 289 | 17 022 |
| | 1990 | 9 165 | 2 559 | 222 | 11 946 | 52 | 2 659 | 5 787 | 28 594 |
| | 1991 | 8 743 | 4 191 | 444 | 13 378 | 387 | 3 453 | 4 344 | 42 664 |
| Fiji | 1988 | –49.7 | 50.2 | –3.6 | –3.1 | 33.7 | 48.6 | 16.3 | 202.5 |
| | 1989 | –95.8 | 109.7 | –13.1 | 0.8 | 28.4 | 41.2 | –39.3 | 180.3 |
| | 1990 | –172.1 | 110.8 | –23.3 | –84.6 | 24.9 | 100.2 | –17.5 | 227.2 |
| | 1991 | –118.4 | 137.0 | –24.9 | –6.3 | 25.3 | 33.8 | –31.3 | 248.5 |
| | 1992 i | –70.3 | 33.8 | –2.70 | –39.2 | 2.90 | 81.00 | –0.50 | 233.6 |
| India[b] | 1988 | –9 360 | –425 | 2 653 | –7 132 | 500 | 287 | 6 567 | 4 148 |
| | 1989 | –7 456 | –1 580 | 2 280 | –6 756 | 538 | 350 | 6 180 | 3 105 |
| | 1990 | –7 750 | –2 654 | 2 100 | –8 304 | 600 | 112 | 4 479 | 1 205 |
| | 1991 | –3 078 | –2 344 | 2 180 | –3 242 | 650 | 200 | 4 966 | 3 580 |
| | 1992[c] | –5 935 | –3 488 | 2 250 | –7 173 | 700 | 500 | 4 506 | 6 309 |
| Indonesia | 1988 | 5 678 | –7 329 | 99 | –1 552 | 155 | 576 | 1 739 | 4 948 |
| | 1989 | 6 664 | –8 111 | 167 | –1 280 | 172 | 682 | 2 409 | 5 357 |
| | 1990 | 5 352 | –8 758 | 166 | –3 240 | 252 | 1 093 | 3 495 | 7 353 |
| | 1991 | 4 804 | –9 146 | 130 | –4 212 | 132 | 1 482 | 4 656 | 9 151 |
| | 1992 i | 921 | –2 352 | 44 | –1 387 | 113 | 747 | 310 | 9 519 |
| Malaysia | 1988 | 5 546 | –3 888 | 70 | 1 728 | 81 | 719 | –2 608 | 6 134 |
| | 1989 | 3 913 | –4 205 | –17 | –309 | 97 | 1 668 | –17 | 7 393 |
| | 1990 | 1 924 | –3 673 | 16 | –1 733 | 61 | 2 514 | 259 | 9 327 |
| | 1991 | –263 | –4 224 | 52 | –4 435 | 74 | 3 454 | 1 203 | 10 421 |
| Maldives | 1988 | –39.7 | 31.5 | –5.0 | –13.2 | 11.5 | – | –4.6 | 21.6 |
| | 1989 | –56.3 | 46.4 | –5.1 | –15.0 | 18.3 | – | 8.0 | 24.7 |
| | 1990 | –58.9 | 58.5 | –7.4 | –7.8 | 11.2 | – | 2.3 | 24.4 |
| | 1991 | –82.6 | 66.2 | –16.6 | –33.0 | 18.0 | – | –0.8 | 23.4 |
| Myanmar | 1984 | –200.4 | –85.3 | 7.2 | –278.5 | 60.7 | – | 193.8 | 55.3 |
| | 1985 | –202.1 | –83.9 | 5.8 | –280.2 | 74.7 | – | 148.7 | 33.9 |
| | 1986 | –290.2 | –97.1 | 5.8 | –381.5 | 87.5 | – | 262.2 | 33.1 |
| Nepal | 1988 | –471.1 | 74.8 | 60.1 | –336.2 | 64.8 | – | 252.7 | 212.5 |
| | 1989 | –415.2 | 71.9 | 52.0 | –291.3 | 48.0 | – | 194.4 | 203.9 |
| | 1990 | –448.7 | 51.0 | 60.4 | –337.3 | 48.2 | – | 304.5 | 287.0 |
| | 1991 | –482.4 | 66.7 | 53.7 | –362.0 | 57.5 | – | 457.1 | 388.7 |

*(Continued on next page)*

**Table IV.2** *(continued)*

*(Value in millions of US dollars)*

| | | Trade balance | Services and income balance | Private transfers | Current account balance | Official transfers | Long-term capital flows: Direct investment | Long-term capital flows: Other[a] capital flows | Foreign exchange reserves (end of period) |
|---|---|---|---|---|---|---|---|---|---|
| Pakistan | 1988 | –2 692 | –1 446 | 2 101 | –2 037 | 615 | 173 | 1 248 | 388 |
| | 1989 | –2 570 | –1 485 | 2 207 | –1 848 | 513 | 167 | 957 | 519 |
| | 1990 | –2 714 | –1 719 | 2 276 | –2 157 | 504 | 242 | 843 | 295 |
| | 1991 | –2 247 | –1 966 | 1 797 | –2 416 | 487 | 261 | 546 | 519 |
| Papua New Guinea | 1988 | 90.8 | –520.4 | –124.6 | –554.2 | 217.7 | 119.7 | 125.4 | 380.1 |
| | 1989 | –22.8 | –419.1 | –130.7 | –572.6 | 217.3 | 221.3 | 43.7 | 371.7 |
| | 1990 i+ii | 27.1 | –198.3 | –81.7 | –307.1 | 170.9 | 177.7 | 108.8 | 416.0 |
| Philippines | 1988 | –1 085 | –80 | 500 | –665 | 275 | 936 | –415 | 951 |
| | 1989 | –2 598 | 312 | 473 | –1 813 | 357 | 563 | 511 | 1 365 |
| | 1990 | –4 020 | 611 | 357 | –3 052 | 357 | 530 | 1 577 | 868 |
| | 1991 | –3 211 | 1 350 | 473 | –1 388 | 354 | 544 | 2 275 | 3 186 |
| Republic of Korea | 1988 | 11 445 | 1 268 | 1 404 | 14 117 | 44 | 720 | –4 492 | 12 340 |
| | 1989 | 4 597 | 211 | 200 | 5 008 | 48 | 453 | –3 050 | 14 978 |
| | 1990 | –2 004 | –443 | 266 | –2 181 | 9 | –105 | 2 263 | 14 459 |
| | 1991 | –6 980 | –1 593 | 20 | –8 553 | –173 | –241 | 2 263 | 13 306 |
| | 1992 i | –2 637 | –624 | 30 | –3 231 | –9 | –215 | 1 713 | 14 054 |
| Samoa | 1988 | –53.40 | 11.11 | 35.47 | –6.82 | 14.54 | – | 0.49 | 45.90 |
| | 1989 | –55.63 | 15.13 | 38.15 | –2.35 | 14.60 | – | 0.48 | 54.12 |
| | 1990 | –64.31 | 19.16 | 39.72 | –5.43 | 12.68 | – | 9.40 | 64.82 |
| | 1991 | –74.93 | 3.17 | 31.00 | –40.76 | – | – | 0.46 | 64.06 |
| Singapore | 1988 | –2 345 | 3 533 | –209 | 979 | –90 | 3 538 | –2 256 | 16 861 |
| | 1989 | –2 448 | 5 255 | –254 | 2 553 | –125 | 2 317 | –1 013 | 20 136 |
| | 1990 | –5 119 | 7 693 | –270 | 2 304 | –134 | 3 368 | 2 787 | 27 535 |
| | 1991 | –4 129 | 8 816 | –339 | 4 348 | –141 | 2 883 | –8 | 33 931 |
| Solomon Islands | 1988 | –23.19 | –44.61 | –1.44 | –69.24 | 36.30 | 3.36 | 34.77 | 38.92 |
| | 1989 | –22.85 | –53.77 | 1.22 | –75.40 | 37.28 | 5.67 | 13.34 | 25.40 |
| | 1990 | –6.76 | –52.00 | 1.42 | –57.34 | 33.45 | 12.85 | 1.98 | 16.49 |
| | 1991 | –8.29 | –62.41 | –2.03 | –72.73 | 35.33 | 18.71 | 5.67 | 7.67 |
| Sri Lanka | 1988 | –540.4 | –380.0 | 320.0 | –600.4 | 206.1 | 43.6 | 212.4 | 222.0 |
| | 1989 | –550.0 | –382.9 | 330.7 | –602.2 | 188.6 | 17.7 | 559.3 | 231.0 |
| | 1990 | –472.6 | –366.8 | 362.4 | –477.0 | 178.1 | 42.5 | 435.6 | 422.0 |
| | 1991 | –735.5 | –412.4 | 394.5 | –753.4 | 196.7 | 101.6 | 610.0 | 685.0 |
| Thailand | 1988 | –2 075 | 184 | 47 | –1 844 | 189 | 1 081 | 2 228 | 5 997 |
| | 1989 | –2 916 | 172 | 47 | –2 697 | 199 | 1 726 | 3 387 | 9 461 |
| | 1990 | –6 750 | –744 | 26 | –7 468 | 187 | 2 303 | 6 833 | 13 247 |
| | 1991 | –5 986 | –1 840 | 216 | –7 610 | 45 | 1 847 | 9 993 | 17 287 |
| Tonga | 1988 | –37.64 | –0.68 | 21.28 | –17.04 | 5.67 | 0.06 | 4.82 | 29.41 |
| | 1989 | –38.20 | 1.35 | 24.87 | –11.98 | 10.00 | 0.11 | 3.21 | 23.72 |
| | 1990 | –40.45 | 11.72 | 30.53 | 1.80 | 10.47 | 0.10 | –0.03 | 30.04 |
| | 1991 | –40.85 | –0.23 | 30.61 | –10.47 | 6.34 | 0.20 | 4.90 | 30.17 |
| Vanuatu | 1988 | –42.50 | 4.57 | 9.78 | –28.15 | 30.83 | 10.81 | –0.87 | 38.10 |
| | 1989 | –44.18 | 15.42 | 4.60 | –24.16 | 20.70 | 9.17 | 15.02 | 32.44 |
| | 1990 | –65.85 | 37.82 | 6.69 | –21.34 | 29.36 | 13.19 | –8.92 | 34.69 |
| | 1991 | –59.15 | 29.11 | –19.07 | –49.11 | 32.05 | 18.45 | –77.64 | 36.69 |

***Sources:*** International Monetary Fund, *International Financial Statistics*, vol. XLV, No. 11, November 1992.

[a] Excluding portfolio investment. [b] National sources. [c] Projection.

## D. Pacific islands

The narrow commodity base of foreign trade of the Pacific island economies make them highly vulnerable to world commodity market developments. The scope for diversification of commodity exports remains limited in many of them. However, they can greatly benefit from the growth and modernization of the tourist industry in which they possess certain natural advantages (see box IV.2). The world recession in 1991 had an adverse impact on the external accounts of most Pacific island countries. For some, the problems were further compounded by natural disasters such as cyclone damage. As a result, the current account balance of payments of most island countries deteriorated.

In Fiji, the value of exports declined by 15.4 per cent in 1991, after recording an increase of 38.1 per cent in 1990. The decline in export earnings was the result of a significant fall in the volume of sugar, and gold exports because of domestic industrial disputes as well as low international gold prices. Molasses, coconut oil and timber exports also performed poorly in 1991. On the other hand, garments, which had become a major export item in recent years, recorded some increase. A growth rate of 6 per cent was projected for 1992.

The value of imports, which had been rising since 1987, declined by 12.4 per cent in 1991. While imports in most categories were lower, the major decline was in mineral fuels because of lower oil prices following the end of the Persian Gulf war. Imports had peaked in 1990, largely as a result of the purchase of an aircraft by the national airline. Growth of about 7 per cent was projected for 1992.

The current account balance-of-payments deficit, after peaking in 1990, improved in 1991. The developments in the current account mainly reflected trade performance. The trade deficit, which rose to $172 million in 1990, stayed at $118 million in 1991. Earnings from services improved steadily, while private transfers showed a marginally higher net outflow.

On capital account, FDI fell back after a promising increase in 1990. In 1991, FDI flow was almost offset by an outflow of other capital. However, official transfers and short-term capital inflow produced a surplus on the overall balance of payments. The indications were that 1992 would be a good year for Fiji's external account. The merchandise trade deficit for the nine months to September 1992 showed an improvement.

In Papua New Guinea, an improvement in the balance of payments in 1990 largely reflected the domestic recessionary situation following the Bougainville crisis in 1989. In 1990, imports in kina terms declined by 8 per cent and exports increased by 1 per cent. However, as economic activity, particularly that related to oil development in Kutubu, increased substantially, the level of imports increased by 7 per cent in 1991, and the trade surplus reverted back to a large deficit. Although official transfers outweighed private transfers, transfers as a whole were not sufficient to cover the deficit on service transactions. The current account remained in deficit during the entire 1989-1991 period, with a slight improvement in 1990. The deficit worsened in 1991. The balance of payments during the first half of 1992 recorded an overall surplus. Higher official transfers and higher surplus in the capital account more than offset a higher deficit in the trade and invisible account and contributed to the improvement.

In Solomon Islands, the deterioration in the trade account occurred despite an increase in total exports by 28 per cent in 1991. Fish exports more than doubled during the year accounting for 47 per cent of total exports, with the tuna industry recording exceptionally good catches in 1991, leading to doubling in both the value and volume of tuna exports. It was anticipated that canned tuna exports would record further growth in 1992 as a new cannery approached its designed production capacity. Other than cocoa the export value of which increased by 16 per cent in 1991, all agricultural products experienced a decline in both value and volume, with logs and timber declining in value by about 12 per cent. However, the total value of imports during 1991 increased by an estimated 28 per cent from the 1990 level. Much of this increase was attributed to a growth in plant and machinery imports, reflecting new investments in primary production and manufacturing, together with higher costs and increased volumes of fuel imports. The trade balance has remained in deficit since 1985. The deficit improved in 1990 but again deteriorated slightly in 1991. The increased investment inflow produced a larger surplus in capital account in 1991.

The export sector performed well in Tonga in 1990, with 44.4 per cent growth, mainly because of the rapid expansion of the export of squash, which had become the main export item. The value of imports also increased, by 14.0 per cent, reflecting higher cost of fuel imports. In 1991, exports grew by a moderate 7.7 per cent, but imports fell by 4.6 per cent, which had a favourable effect on the balance of payments.

Tonga's current account balance, which had recorded a small surplus in 1990 after two

## Box IV.2. Application of microprocessor-based information technology in tourism in the Pacific island economies

Tourism is a major source of foreign exchange earnings for the Pacific island economies. The beautiful beaches, exotic coral reefs, unpolluted surroundings and scenic overall beauty provide great attraction as tourist resorts. For some smaller islands, barring fishing and limited agriculture, tourism is virtually the only commercially productive sector and the principal earner of foreign exchange. The adoption of advanced technology in the tourism sector of the South Pacific is therefore important for improving productivity and increasing its share of the market in this important industry.[a]

With the availability of new technological devices and computerized reservation systems, there have been radical changes in the methods of marketing in the tourist industry, including publicity, transport and accommodation. Hoteliers have installed in-house property management software, which allows them to perform their housekeeping duties more effectively and in a more cost-efficient manner. Management information systems enable the managers to plan more accurately, and to access statistical information that is of great use in marketing programmes and strategies. Some systems are beginning to offer "direct" connection to the computerized reservation system on an on-line basis which allows the hotel computer to give an automatic answer to requests for reservations. Such applications of information technology are enabling hotels to make their accommodation available and facilities known to a very large number of travel agents, booking agencies and other clientele on a global basis.

The work and method of operation of outbound tour operators also changed with the introduction of new technology. It was in fact the replacement of the old wall-chart system with a computerized reservation system that enabled the large operators to grow in Europe, North America and Australia. The improved communications facilities of travel agents enabled them to access the tour operators' on-line computers, giving rise to the emergence of mega tour operators who enjoyed considerable economies of scale. No tour operator can function today without at least a fax or telex machine. The combination of computer and telecommunications technology in small inexpensive machines is becoming a tool that even the smallest operators will need to employ in order to remain in business in a highly competitive world environment.

With the introduction of computer terminals in travel agencies it has become possible for the individual agents to sell other services which were previously not easily accessible. In-house systems also assist them in processing the information-intensive requirements of the travel industry in a faster way and enable them to spend more time and resources in selling rather than administering. Thus the use of information technology has allowed a multitude of services relating to travel and tourism to be accessed by thousands of travel agents and airline offices, making it difficult for those who do not use such technology to compete.

The following information regarding the use of information technology in the tourist and travel industry in the Pacific island subregion was collected through a recent survey:

(i) 8.5 per cent of hotels used property management software in-house and a further 10 per cent were actively engaged in introducing a system.

(ii) No hotel had on-line connection to a chain, independent hotel reservation or airline computerized reservation system. Chain hotels whose head offices had such a system normally received their booking information via telex.

(iii) 93 per cent of the hotels had a fax machine and 47 per cent a telex.

(iv) Over 50 per cent of the bookings were done by fax, 36 per cent by telex and the rest by telephone and mail.

(v) 33 per cent of the hotels were contemplating the introduction of a computerized system at some future date.

(vi) 10 per cent of the hotels said that they did not need a computerized system.

(vii) 6 per cent of the sample stated specifically that they would benefit from a computerized system.

(viii) 100 per cent of the travel agents and operators were using a fax machine.

(ix) 75 per cent used a telex machine as well.

(x) 27 per cent of the agents/operators had a connection with an airline or head office system. Those agents handled 30 per cent of the traffic.

(xi) 70 per cent of the business of travel agents and tour operators with overseas clients was done by fax.

(xii) Spending on communications per passenger booking per annum ranged from $0.80 to $20.

The introduction of computerized reservation systems in the airlines also affects vitally the distribution route for tourism products to be chosen. The Association of South Pacific Airlines (ASPA) was contemplating a number of options available for connections and interconnections of the member airlines' product with mega airlines' systems. The difficulty often encountered by small airlines or associations is the cost of fee payments to the computerized reservation system which handles their traffic requirements. The capital cost of ownership or part ownership of a system, which could also allow them a share of its profits, is even greater.

It is apparent from the foregoing that the widespread use of information technology is of crucial importance in maximizing revenue and foreign exchange earnings in a competitive atmosphere. In the South Pacific a significant start has been made and the process is expected to gain momentum in the years to come.

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[a] The text in this box is drawn from Tourism Council of the South Pacific, *Information Technology Applications in Tourism in the South Pacific: A Preliminary Survey Report* (Suva, 1991).

consecutive years of deficit, again deteriorated to record a similar deficit in 1991. The deterioration was attributed to a decline in the net balance of invisibles. Tourist receipts increased by about 10 per cent, but remittances showed no improvement from the 1990 level. Tonga's overall balance in 1991 was in surplus, with some addition to reserves.

Most island countries would have encountered serious problems with their external accounts had it not been for generous foreign assistance, which comes in the form of official transfers. For some countries, such assistance included the utilization of funds for agriculture and fishery products through the system of stabilization of export earnings (STABEX) established under the Lomé Conventions. However, the rules under which STABEX grants are made available to African, Caribbean and Pacific (ACP) countries were changed under the Fourth Lomé Convention. The new procedures for the disbursement of STABEX funds will probably have implications for the annual balance-of-payments outcomes in future years as it is most likely that access to such funds will be delayed.

# V. ISSUES FACING THE ESPECIALLY DISADVANTAGED ECONOMIES OF THE ESCAP REGION

## AN OVERVIEW

A large number of the economies in the ESCAP region remain weak and fragile after decades of development effort, contrasting sharply with the region's general image as the most economically dynamic and robust in the world. They have neither shared in the dynamism of the region's more successful economies nor attained a base strong enough to be able to absorb successfully the exogenous shocks to which they are frequently subjected. Their problems are thus both short- and long-term in nature. As causal processes, the short- and long-term factors work to reinforce each other to keep these economies in a perpetual state of low performance and underdevelopment. Cyclone damage as a short-term exogenous shock, for example, can cause years of delay in implementing long-term development programmes. The absence of a viable resource and infrastructural base, in turn, not only intensifies such damage but also prolongs the restoration.

The nature of the problems faced by the disadvantaged countries of the region varies in both kind and intensity. Thirteen of the countries in the region are currently listed as least developed. By definition, they are the weakest both structurally and in their ability to perform and achieve. Four of these countries (Afghanistan, Bhutan, the Lao People's Democratic Republic and Nepal) suffer the additional disadvantage of being land-locked. Afghanistan, Cambodia and the Lao People's Democratic Republic are also in the process of transition from centralized planning to a market-oriented system and are facing the related economic and political problems. Afghanistan and Cambodia remain the most distressed, both economically and politically (see box V.1). Six of the least developed countries, including Maldives, are small islands, scattered over a vast span of the seas. Smallness, remoteness, and the fact that their economies are wide open to international market influences add to the other weaknesses which they share with the rest of the least developed countries. The particular difficulties mentioned are also shared with the other island economies in the Pacific.

The six Asian republics of the former USSR,[1] as they were seeking to effect changes in their economic system and expose their centrally planned and virtually closed economies to market forces, are facing difficulties that have surfaced recently in their most acute forms. The severance of the limited international links that they had traditionally maintained and the need to recast them on a completely new basis have made the task of adjustment difficult.

[1] The designation "the Asian republics" refers to the six successor States of the former Union of Soviet Socialist Republics, Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan.

## A. THE LEAST DEVELOPED COUNTRIES

### 1. The issues

The existing low level of per capita income and poor growth performance unambiguously point to the most urgent need for accelerating growth in the least developed countries, as indicated in section B of chapter II of this *Survey*. That would require, above all, much higher rates of productive investment than they have been able to achieve thus far. Meeting that requirement is not merely a question of the availability of financial, material and physical resources, but also of the efficient utilization and management of those resources through planning, programming and their implementation which, in turn, require a great deal of improvement in human resources.

There are constraints on both the supply of resources and their absorption. The supply of resources is constrained by the very low rates of domestic savings that failed to register any substantial and sustained improvement over time, making investment dependent mostly on foreign resources. This also has not exhibited any strong growth trend over time. In consequence, least developed countries have not been able to reach a minimum critical mass of investment. The lack of buoyancy in external resource flows to the least developed countries can be attributed to obstacles on the side of both the suppliers and the

## Box V.1. Afghanistan and Cambodia: the need for peaceful reconstruction

Afghanistan and Cambodia are seeking to recover from the trauma of long wars. Both the countries have suffered colossal losses in death, destruction and dislocation. According to some private estimates, over the past 14 years Afghanistan suffered close to three quarters of a million deaths, more than half a million injuries, the destitution of similar numbers of women and children, and the exodus of close to 6 million of its people to refugee camps in other countries. A significant part of the country's educated manpower has been lost through the war and the exodus. Almost one third of all villages were destroyed, vast parts of the terrain are strewn with mines, mostly unmapped. A large amount of land lies fallow because a high percentage of the rural population has moved to the cities for lack of security in the countryside. Two thirds of all paved roads are unusable.[a]

Afghanistan was a very poor country even before the war broke out. Large parts of the country's 625,000 square kilometres are range land that has been traditionally used for sheep and goat-herding by the nomadic pastoral population. The agricultural sector is the most important part of the economy, accounting for approximately 45 per cent of the gross national product (GNP). The principal crop is wheat, in which Afghanistan used to be self-sufficient. Recently about 250,000 tons per year had to be imported.[b] The country was relying on foreign sources for virtually all its food.

Fruits, vegetables, nuts, wool and skins are the major agricultural export items. But the exports have fallen drastically: in 1990/91, exports of fruits fell from $45 million in 1978 to $3 million and wool exports from $18 million to $1.5 million. According to statistics published by the Government of Afghanistan, production in the agricultural sector fell from Af 61.9 billion in 1978/79 to Af 47.3 billion in 1986/87. However, while exports, State revenue and production are on the decline, imports, money supply and the budget deficit are on the rise.

Defence spending, an increase in loan repayment obligations, and growing needs of government services caused an increase in government expenditure. The earnings from natural gas sales to the former Union of Soviet Socialist Republics, which had constituted a large source of income in the past, declined. This is also the main factor responsible for a fall in Afghanistan's exports to a total of $76.8 million in 1991, whereas imports totalled $215.9 million.[c] The budget deficit has been largely monetized and has, along with supply shortages, contributed to the high inflation rates, estimated at 48 per cent on average in 1988-1990.

Afghanistan's main problems lie in the development of its human resources and reconstruction of its infrastructure. In 1990, out of an estimated population of 16.6 million, only 29 per cent of the adults were literate. The Government has taken the first steps in rebuilding the education system, but much remains to be done. Life expectancy at birth, at only 42.5 years, is still one of the lowest, and the under-5 mortality rate (per thousand live births) was as high as 292 in 1990. In 1987-1989, only 28 per cent of the population had access to health services. The situation of public health services in rural areas deteriorated sharply, as 90 per cent of the health sub-centres are reported to have been destroyed by warfare.[d]

Afghanistan needs to rebuild its infrastructure and irrigation systems. The emphasis should be on the reconstruction of the road system for, there being no rail system, this is the country's only transport infrastructure. Irrigation systems are necessary for the cultivation of crops: Afghanistan cannot rely on the rains. However, all this is still hindered by the continuation of the civil strife.

With regard to Cambodia, continuous warfare over the last two decades accounts for most of its problems today. The deaths and displacement among Cambodia's small population of 8-9 million are well documented. By 1992, a total of above a quarter of a million people had sought shelter in neighbouring countries; more were displaced within the country itself. The country's economy is on the verge of collapse; its infrastructure is severely damaged; the population suffers from malnutrition; and the life expectancy is among the lowest in Asia.

One of the major problems is that the country lacks the basic prerequisites for economic development, such as infrastructure for transport and communications. According to some estimates, Cambodia has only 40-50 per cent of its pre-war transport capacity. The main highways are unusable owing to destruction resulting from warfare. Some 3,100 km of secondary roads and 2,800 km of tertiary roads are in an advanced state of deterioration, and some 4,100 bridges and culverts are in desperate need of reconstruction.[e] Owing to

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[a] Anthony Lake, *After the Wars: Reconstruction in Afghanistan, Indochina, Central America, Southern Africa and the Horn of Africa* (Washington, DC, 1990), pp. 45-46.

[b] Statement by the representative of Afghanistan at the Second United Nations Conference on the Least Developed Countries, held in Paris in September 1990.

[c] International Monetary Fund, *International Financial Statistics* (Washington, DC, 1992).

[d] United Nations Development Programme, *Human Development Report 1992* (New York, Oxford University Press, 1992).

[e] Figures from United Nations Development Programme, "Draft report of the Cambodia rural integration strategy mission, 29 January-3 March 1992", vol. I.

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the poor condition of the rail system, most trains can only run at a very low speed. The lack of spare parts and inadequate maintenance render transport vehicles inoperative. Rivers are clogged by years of undredged silt. With the arrival of the United Nations Transitional Authority in Cambodia (UNTAC) team, the process of restoration of the infrastructure has begun.

Cambodia is a rural country: 80 per cent of its population work in the area of agriculture, forestry or fishing, and only 15 per cent are employed in the service sector. Rice is the most important crop, and 93 per cent of the agricultural land is used for its cultivation. Agricultural output is still far below pre-war levels. This is partly because the effective availability of arable land is only 60 per cent owing to the danger of land-mines and lack of security.

Cambodia has no significant mineral wealth, apart from limited deposits of limestone, bauxite, tin, gold, silver and iron ore. Recent surveys attest to the fact that there are substantial deposits of natural gas and, to a lesser extent, oil, most of it offshore. In 1992, offshore concessions were given to foreign companies, some of which have already started exploration work. As soon as political stability is achieved international companies are expected to show increased interest.

Cambodia's industry is restricted to light industrial activity. Most of the outputs comprise cigarettes, textiles, chemicals and rubber products. Most plants operate at a very low capacity, caused by shortages of electricity, raw materials and spare parts, and management problems. In addition, the manufacturing sector is short of skilled workers.

Cambodia faces a severe financial situation. With the breakup of the Soviet Union, regular financial aid of the equivalent of $100 million a year to support the budget ceased, and the deficit has been growing steadily since. The liberalization of the market and privatization of enterprises caused significant shortages in government revenues. Despite the contraction in revenues, government spending kept rising and was twice as large as the total revenue in 1990-1991. Almost 50 per cent was spent on defence. The estimate of the inflation rate ranged from 130 to 200 per cent in 1992. UNTAC took over control of the National Bank of Cambodia (the central bank), in an effort to restrain the money supply. Fiscal and monetary measures were taken to restore confidence in the riel and to avoid further deterioration of the financial situation. Towards the end of 1992, the situation improved somewhat; prices, and the exchange rate of the riel against the dollar, remained more or less stable.[f]

The prospects for successful economic development appear rather problematic. Several steps must be taken before recovery can truly start. To attract financial aid from international donors to alleviate short-term deficits, Cambodia must assure the donors that the money will be used effectively. This requires the establishment of adequate institutions. Furthermore, the country has to clear $65 million in debt-servicing arrears with the International Monetary Fund (IMF). Failure to do so will make it difficult to obtain assistance from multilateral institutions. Once the infrastructure has improved, a slow build-up of the economy and expansion of the agrarian sector will be possible. Cambodia will have to rely mainly on agriculture and natural resources for economic growth. Foreign aid will be an essential requirement for effective utilization of the country's resources.

In the end, the success of the peace process will be one of the crucial factors determining the future of Cambodia's economy.

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[f] United Nations Transitional Authority in Cambodia, *"Economic indicators – December 1992"*, 25 January 1993.

recipients. On the supply side, private investment and lending tended to bypass the least developed countries owing to perceived or real lack of profitability of investment in these countries, and creditworthiness as borrowers. The disbursement of official resources has been much slower than commitments, as evidenced by long pipelines of undisbursed assistance in many cases.

The low level of per capita income and consumption, and the prevalence of distressing poverty sometimes made worse by natural disasters, are obvious limitations on the ability to generate more domestic resources. But the low-savings-investment-low-growth-low-income syndrome must be overcome and efforts to mobilize domestic resources must contribute more to the process than has been the case so far.

The counterpart of the domestic resources shortfall appears as a large deficit in the external balance of payments. Exports can generally finance less than 50 per cent of imports. The gap is perhaps potentially greater as import demands often remain suppressed for lack of foreign exchange. The large balance-of-payments deficits have been a persistent long-term phenomenon interspersed with short-term swings caused either by an adverse turn in the external situation (fall in export prices and/or rise in import prices) or failure in domestic production. The deficits are, however, basically a reflection of the economy's weak production base which is incapable of meeting domestic needs or generating exports to finance imports for meeting the supplementary

consumption and productive input needs of the economy.

All these economies share certain common structural problems. Agriculture constitutes the largest component of gross domestic product (GDP) and, in most cases, provides employment for more than three fourths of the workforce. Yet, the agricultural sector is extremely vulnerable to weather conditions, resulting in sharp fluctuations in agricultural output that are a potential food security threat and could necessitate large imports of food purchased from relatively limited foreign exchange resources. These imports notwithstanding, population growth and deficiencies in distribution have meant that many of these countries suffer from endemic malnutrition and worsening poverty for a part of the population.

While the vulnerability of agriculture warrants the diversification of economic activity, infrastructure is woefully inadequate and manufacturing reflects the dominance of agriculture in most of these economies. Manufacturing consists largely of units processing primary products and producing traditional and low-technology products. Food, beverages, tobacco and textiles account for two thirds of the total manufacturing activity in many of these economies. While the importance of the foreign trade sector varies substantially in these economies, merchandise exports generally consist of a narrow range of primary products that are subject to extreme volatility in terms of both volume and value. Only recently have ready-made garment exports shown promise. However, these exports also often encounter problems of market access under the restrictive Multifibre Arrangement regimes which have governed the international textile trade for many years.

The majority of the population in most of the countries concerned is still deprived of an adequate and internationally accepted minimum standard of living. In the 1980s, there were only marginal improvements in this area, and there has been a deterioration in certain social indicators in some least developed countries, as severe resource constraints forced Governments to limit social expenditure generally.

The average life expectancy at birth in the least developed countries of the ESCAP region improved during the past decade from 48 to 52 years, as compared with 58 years for all developing countries. Though the proportion of the population with access to safe water in rural areas increased from 34 per cent in 1980 to 60 per cent in 1988, largely reflecting the sinking of hand-pumped tubewells in villages; in the urban areas (where about one fifth of the population lives) access to safe water rose only marginally, from 40 to 41 per cent. Estimates for the period 1985-1988 showed that on average, only 35 per cent, of the rural population in the least developed countries of the ESCAP region had access to health services. Communicable diseases such as tuberculosis, malaria and diarrhoea were widespread, giving rise to high morbidity and mortality patterns (see chap. VI).

Progress in enhancing literacy and achieving universal primary education has also been unsatisfactory and uneven. The adult literacy rate in the least developed countries of the ESCAP region decreased from 51 to 43 per cent. However, primary school enrolment ratios increased from 66 to 72 per cent for children of primary age, with wide variations among countries.

Obviously improvements have been meagre in the overall quality of life of most least developed countries, leaving them still way behind many developing countries in that regard. The levels and trends in social indicators point to the urgent need for not merely higher growth in these countries but also policies aimed at addressing directly the problems of social development. Resources, however, remain a binding constraint.

Given the rather limited range of resources to which many of these countries have access, they may be forced to accelerate the pace of growth through more intensive and extensive use of natural resources, such as forest, hydroelectric and mineral resources. This could have extremely adverse environmental implications and render long-term development unsustainable. Confronted with a choice between immediate development that is destructive of the environment and a slower but more sustainable process of growth, the extremely low prevailing standards of living in these countries may prompt them to settle for immediate development.

## 2. Policy implications

Structural constraints, including geographical and other disadvantages need not cause an insurmountable bottleneck for development. Success, however, depends mainly on access to concessional foreign capital inflows commensurate with the nature and degree of the adjustment efforts required in individual cases. The causes of slow aid disbursements referred to earlier may be more complex and deep-rooted than is apparent, but bureaucratic red tape in both donor and recipient countries is often blamed. Adjustments on both sides are therefore needed to speed up aid disbursement. Part of the problem arises out of a different perception on the part of the donor and the recipient concerning the management and

utilization of aid resources. While there is evident justification for leaving the management and utilization of resources in the economy to the discretion of the recipient, with the donor being more flexible on that score, there is also need for improvement in the recipient's capacity to manage aid resources more efficiently in terms of planning, programming and effective implementation.

The role of technical assistance is very important in this context, given the shortage of trained and technical manpower, a handicap from which most of the least developed countries suffer. Technical assistance, which is often provided as part of an aid package, has, however, proved ineffective in many cases and has become an undue burden on resources in the form of high salaries, perquisites and privileges for expatriate personnel, and the use of expensive and often inappropriate technical equipment. This needs to be rectified.

As noted above, crucial to the development effort is a sustained increase in investment which requires, in turn, increased inflows of foreign aid and a substantially enhanced effort to mobilize domestic resources. A range of fiscal and financial policies can serve as an instrument in raising the rate of domestic savings. In that context, current efforts in several countries to reduce or eliminate fiscal deficits by strengthening the revenue system and pruning expenditure wherever feasible are moving in the right direction. The scope for manoeuvrability, however, remains limited, given the need for improvement in health and education and other aspects of the human condition to achieve a better quality of life and higher national productivity. Reforms in the financial and banking sectors are also under way in most of the countries and can be expected to stimulate private savings. Incentives for private investment are also being offered, but infrastructure and manpower developments must accompany those incentives. Financial and fiscal concessions alone are not likely to be effective in activating private enterprise on an adequate scale.

Raising the rate of domestic savings is crucial because the failure to do so aggravates the problem of external vulnerability reflected in the balance-of-payments disequilibrium. The remedy usually recommended for such disequilibrium, through domestic demand deflation (by using fiscal and credit policies) and exchange rate adjustments to reflect fully the underlying disequilibrium, has severe limitations in least developed countries. The demand deflationary measures tend to further dampen productive activities and intensify the distress associated with the usually low living standards. The extent of the adjustment in the exchange rate required to reflect equilibrium in the balance of payments may be too large and the shock may be too much for the economy to absorb. With the inelastic nature of the supply of exports and the demand for imports, devaluation tends to bring about little improvement in the balance of payments in the short term, but may fuel inflation. Nevertheless, the least developed countries in the ESCAP region have been moving in the direction of these adjustments over the last few years and this may be expected to produce better results over the longer term. It has, however, increased their need for external financial support to cope with the short-term costs.

The twin problems of inflation and balance-of-payments disequilibrium demand greater attention to the agricultural sector. Most of these economies need to undertake reforms in the agricultural sector since low productivity has been the cause of increased imports at different points in time and provides the basis for a potential or actual threat to food security. Efforts towards regional cooperation aimed at strengthening the agricultural sector can play a crucial role, given the experience with the green revolution in many developing countries of Asia and the Pacific.

The attempt to approximate food self-sufficiency needs to be accompanied by efforts to expand and diversify exports. Given the narrow export base of these countries and their relatively small contribution to world exports of the commodities concerned, international action to permit easier access to world markets for their commodities, and to compensate them for losses incurred as a result of the volatility in trade volumes and values, would help reduce vulnerability substantially. Such action in areas of traditional exports should be accompanied by efforts to diversify exports. This requires investment in new areas of potential comparative advantage in export markets. In the case of the land-locked countries, close relations with neighbours that both provide transit routes and serve as markets for exports and major sources of imports are obviously crucial. However, to avoid excessive dependence on one country, an effort to strengthen economic ties with other countries in Asia and the Pacific through an appropriate choice of products is essential. This would also require substantial investment in transport and communications.

The development process in these countries would, of course, require not merely the needed finance but a range of material and human resources. This calls for an effort to develop and build skills ranging from administrative to technical. Investing in people, in the

human capital which is recognized as an essential component of development, is therefore an imperative; and investing in people implies not only an effort at securing formal education but making the overall workforce productive, based on literacy, health and a minimum standard of living. As discussed in chapters II and VI, it is not enough to wait for growth to deal with quality-of-life issues; they must be tackled directly as part of a basic needs strategy. Such a strategy is not merely warranted on humanitarian grounds but is also a prerequisite for growth.

In the matter of environmental protection, foreign aid can play a supportive role that is beneficial to both donors and recipients. Regional cooperation efforts which benefit mostly adjacent neighbours, in terms of conserving resources and prevention of cross-border pollution, also recommend themselves. Such cooperation could reduce the pressure on the population to undertake activities damaging to the environment and help shape a more sustainable process of development.

## B. THE ISLAND ECONOMIES

### 1. The issues

The Pacific island economies, besides suffering from scarcity of domestic resources and a high degree of aid dependence, suffer from the additional disadvantages arising out of the small size of their populations and scale of activities as well as their remote and dispersed location. Their economies are also more open to international trade, with a high degree of import dependence and an export trade based on a narrow range of primary commodities which nevertheless account for a substantial part of their GDP. International economic developments usually have sharp repercussions on these economies. The trends towards long-term decline with short-term fluctuations in the prices of their primary commodity exports, for which they are price-takers being small suppliers in the world market, have more deleterious effects on these economies than on those which are larger in size and relatively well diversified.

Transport and communications is vital for island economies but a difficult area of development. The special geographic, economic and social characteristics of the developing Pacific island countries shape and constrain the development of transport and communications infrastructure and services. The remote and dispersed location of the islands, combined with the small size of their populations and scale of their economic activities, imply that transport services involve low volumes of traffic over relatively long distances; that is to say, the transport markets for freight and passenger movements are thin for both international and domestic transport. Such markets are more costly to serve, because economies of scale accruable to transport infrastructure and vehicles (for example, ships and aircraft) are unavailable. Moreover, the volume of traffic in such markets is low and in some cases, such as domestic transport services to isolated communities, may be so low that provision of the service is not commercially viable.

International shipping freight rates are also relatively high because of the difference in size and composition of imports and exports. For instance, imports comprise mainly containerized manufactured goods, while exports in most cases consist largely of bulk agricultural commodities or raw materials. Consequently, there is an imbalance in inward/outward vessel capacity which tends to increase transport costs.

Nevertheless, demand for transport, along with the supporting infrastructure, has in general, increased moderately. With the possible exception of Fiji, there are no significant capacity constraints, delays or congestion. Thus, major new investments in infrastructure do not appear to be needed, although replacement of some facilities may be required. Advances in transport technologies, especially in container vessels and wide-bodied aircraft, have influenced the design of transport infrastructure, particularly at international ports and airports. In some Pacific island countries, facilities have been introduced to accommodate these technologies. However, traffic volume, utilization and productivity have remained low. In domestic transport, traffic flows are modest, but in most cases the choice of transport technology is appropriate to the small volume. Inter-island or coastal shipping is very basic, but services are generally tailored to demand.

The demographic character of the island economies is rather complex. Most of them have small populations, some numbering only a few thousand people. Other than Fiji, Papua New Guinea and Solomon Islands, Pacific island countries have a population of less than 200,000 persons; eight have less than 50,000 people. The natural rate of population growth remains typically high, at above 2 per cent. The percentage of the dependent population is also high, especially in Papua New Guinea, Samoa, Solomon Islands, Tonga and Vanuatu. The slow pace of economic expansion has not permitted absorption of the addition to the labour force, with the result that high unemployment rates prevail, especially among young people. Lack of employment opportunity in traditional activities has encouraged migration from the countryside to

townships, creating a number of urban problems. It has also encouraged migration to other countries, particularly Australia and New Zealand. International migration has resulted in a net loss or a slow increase in population in the Cook Islands, Niue, Samoa and Tonga. Although remittances from such out-migration have helped the local economy, the out-migration has also created a local manpower shortage and an imbalance in the age and sex composition of the local population.

Human resources development, in which education plays a critical role, is of critical importance to the island developing economies. The usual indicators of educational achievement, such as the enrolment ratio at primary and secondary levels and adult literacy rates, place the island economies ahead of the average standard reached by the developing countries of the ESCAP region. However, the quality and relevance of the education received by the local population remain in question.

Absolute poverty, by and large, has not been a problem in the Pacific island economies, even in those with relatively low per capita income. With few exceptions, these are largely agriculture-based economies. The subsistence components of agriculture, fisheries and "gathering" provide most of the basic needs for rural dwellers, who typically account for up to 80 per cent of the population. As a general pattern, it would take between 12 and 20 hours per week to produce all of one's food, clothing and housing requirements; this has long been described in research literature as "subsistence affluence" in the Pacific.

The island ecology and the environment are, however, particularly delicate and extremely vulnerable. Extensive exploitation of natural resources has given rise to erosion or pollution of community assets such as soil, water, mangroves, coral reefs and rain forest in several islands. The frequent ravages by tropical cyclones contribute to longer-term environmental degradation, apart from the instant damage they cause. The predicted global warming poses another threat to be confronted by an already disadvantaged and hard-pressed group of economies.

## 2. Policy implications

The assistance received by many island economies under the system of stabilization of export earnings (STABEX) of the European Community (EC) has mitigated to a certain extent the problem arising out of low and fluctuating export earnings. A longer-term solution may, however, lie in developing a more diversified production structure with specializations on a subregional basis, for which understanding and cooperation among the island countries and with the neighbouring countries in the ESCAP region could be necessary and useful, given the small size and narrow resource base of individual economies.

The island economies have been more aid-dependent than other countries. Per capita aid receipts have been among the highest in the world in many of the countries. A large proportion of aid used to come as subventions from former colonial authorities, but these are being gradually reduced or withdrawn. Considering that the volume of assistance required is small in absolute terms, the island countries may not suffer from a dearth of aid availability.

There is an apparent need, however, for more effective management and utilization of aid resources. The consultative donor-recipient dialogues on policies and procedures being conducted under the auspices of the United Nations Development Programme (UNDP) country offices, the World Bank and the Forum Secretariat could be further strengthened to facilitate review of policies, procedures and performance in respect of external assistance. The policies being pursued by many island Governments to reduce or eliminate budget deficits, control inflation and liberalize trade and investment activities could help not only in overcoming problems connected with aid utilization but also in encouraging both domestic and foreign private investment.

Human resources development calls for better-quality education that is more relevant to local development needs. Much of the education system still reflects a bias towards the humanities. Graduates and diploma holders in the arts are finding it difficult to obtain jobs. Local demand for scientific and technical skills in sectors such as economics, financial services, engineering, communications and technologies, remains unsatisfied. Furthermore, there has been inadequate emphasis on vocational training for manual skills.

The shortage of appropriately trained and experienced people in both the public and the private sectors is a serious constraint on development efforts. A reallocation of resources within the educational budget and a restructuring of the current education system appear unavoidable. This challenge has to be met, with due consideration of population growth, the young age structure of the population and the severe constraints on government resources. A cooperative approach in this field can benefit especially the smaller Pacific island economies. There are already several training facilities of a Pacific-wide or intraregional nature at the tertiary level and in vocational skills.

The major challenges for the transport and communications sector facing the developing Pacific island countries include ensuring intrasectoral balance, efficient management of existing infrastructure and improving the efficiency of the domestic transport service. Development of this sector in the Pacific island countries has taken place in a somewhat arbitrary manner. The level of infrastructural investment has been high, and thus the need exists to assess the intersectoral balance. A key management issue that all Pacific island Governments are facing is how to obtain the best value from their existing transport infrastructure. The main issues that need to be addressed are weak maintenance management, lack of information to articulate priority maintenance needs, inadequate budget support for economically justified maintenance, limited delivery effectiveness and substitution of donor-financed rehabilitation for continuous maintenance.

Among other issues involved in improving the performance of domestic transport service operations are regulatory reform (especially in domestic/inter-island shipping), efficient provision of non-commercial transport services to remote communities, increasing the commercial autonomy of government-owned operators, and expanding opportunities for private sector involvement, for example, in domestic shipping.

Global warming and the rise in sea level are the most serious environmental threats to Pacific countries. This is because most of the islands are low-lying and atolls, and any increase in sea level would be disastrous. Unfortunately, island countries remain powerless in this regard, as global warming is a worldwide problem. Therefore, regional cooperation and international understanding in this regard are crucial. Recent moves to ban driftnet fishing and the cessation of nuclear testing prove some examples of such cooperation. Nevertheless, it is also important that the island countries raise awareness of this danger in their own countries so that they can play their part in conserving the environment. While all Governments of the region express strong commitment to environmentally sound development, for a variety of reasons these concerns are not always mirrored in the institutional framework, staffing levels and allocation of funds for environmental planning and administration. Some island Governments, such as those of the Cook Islands, Fiji, Samoa, Solomon Islands, the Federated States of Micronesia, the Marshall Islands and Tonga have, however, begun to prepare national environmental management strategies.

Pacific island economies, more than any other economies, would appear to be at a crossroads in respect of development and environmental conservation. While economic development, and by implication utilization of their natural resources, is seen as a necessary condition to improve living standards, this may come in conflict with the need to conserve the environment. In some island countries, destruction of the environment through mining has become a reality, while in others the fast destruction of forests is now being viewed with concern, not only by interest groups but also by the landowners themselves, as they begin to understand the issues involved. It is therefore crucial that the developed world should continue to provide the necessary assistance to island countries to support them in their efforts to strike a balance between shorter-term growth and sustainable development.

## C. THE ECONOMIES IN TRANSITION

### 1. Nature of the issues

The term "transition" has been used in recent years to describe those economies which are undergoing radical changes seeking a transformation from a centrally planned to a market-oriented economic system. Within the ESCAP region, the newly independent economies of the Asian republics of the former Soviet Union and the economies of Indo-China and Mongolia are in this sense in the transition process.

All their problems are, however, not transitional or transient as the term "transition" might suggest. Some of the problems are deeply structural in nature and can be overcome only over a period of time. At the same time, there are serious problems of short-term adjustments and macroeconomic management in using the instruments and institutions suited to market economies in place of the traditional mechanisms of command and control.

The shift from decades of managing the economy through centralized planning to managing it by using market-type instruments involves a sea change. The task is made more difficult by the nonexistence in most cases of the appropriate institutions and instruments with which to replace the command structure on which the economy had relied. It is necessary to create new institutions and instruments, and reform old ones, as well as to establish a set of relationships among them to work as a functioning mechanism. It is also necessary to ensure that the destabilizing forces released in the economy in the wake of first opening or liberalizing moves are held in check in order to prevent the whole economic and social fabric from falling apart. Faced

with this dilemma of how to effect large-scale change and at the same time maintain stability, the extent and speed of change with which these countries can cope within a given period of time becomes the essence of their problem.

*(a) Macroeconomic issues*

Among the economies in transition in the ESCAP region, the six Asian republics of the former Union of Soviet Socialist Republics received the severest shock from the total dissolution of the USSR towards the end of 1991. The intensification of price liberalization measures by the Russian Federation since January 1992, followed, to a greater or lesser extent, by the other former Soviet republics, gave a one-time boost to the price level, setting the economies concerned on a path to hyperinflation. Although the price liberalization measures in the Asian republics were taken cautiously in order to minimize their impact on the poor, the price rises caused real income, especially that of fixed income earners, to fall. However, price liberalization did not have the expected favourable supply-side effects, as there was a tendency among monopolistic enterprises to restrict supplies and raise prices. Price liberalization in fact drove the economies into what may be called a "stagflation trap": the steep rise in prices curbed demand without increasing supplies and reducing inflationary pressures.

Unlike Mongolia and Viet Nam, which could deal freely with their problems of macroeconomic instability by using their national monetary and fiscal instruments, the Asian republics faced a major constraint on macroeconomic management. This arose from their low degree of autonomy in matters of monetary policy and continued membership of the rouble zone, with the Russian central bank (Gosbank) having the sole authority to issue the currency. Following the dissolution of the USSR, the Russian Federation assumed jurisdiction over the Gosbank. The Russian Federation controlled the currency issue but, because all republics retained control over domestic credit creation and because there is no balancing mechanism for interrepublic trade transactions, no institution in the republics could exert effective monetary control. The result was an explosive increase in the money supply and hyperinflation.

From the perspective of individual republics seeking to pursue economic reform in the first half of 1992, membership of the rouble zone posed two serious problems. First, the multiplicity of credit-issuing institutions meant that even if the Russian Federation were committed to the stabilization of the rouble, its monetary policy could be undermined by the other republics. Credit expansion in the Russian Federation itself, however, remained strong, fuelling inflation that spilled over to other republics. Second, intrarepublic trade was being disrupted by delays in payments. More generally there was a shortage of cash, as the Gosbank could not print enough notes. Many republics reacted to the cash shortage by issuing "coupon" money or other money substitutes, adding to the monetary chaos.

Since the central Asian economies suffer from structural difficulties which are quite different from those being experienced by the other more industrially advanced republics of the former Soviet Union, frequent policy differences and conflicts have arisen over the degree of fiscal and monetary expansion and the pricing of basic raw materials, especially energy products. In general, the Asian republics have favoured a more expansionary monetary policy, more favourable terms of trade for energy exporters, and a slower pace of price liberalization for essential commodities. Thus, the Asian republics faced a more complicated task of achieving macroeconomic stabilization than, for example, the Lao People's Democratic Republic, Mongolia and Viet Nam, which had initiated reforms earlier and within fully established national structures.

Mongolia, nevertheless faced similar economic instability, involving rapid inflation, high unemployment, shortages of basic foods, and declining living standards, which have posed difficulties in implementing economic reform. The main issues facing the country's economic managers are to achieve equilibrium in the external sector at a reasonable social cost, to improve supplies of consumer staples in the market, and to reduce the budget deficit as much as possible.

Viet Nam faced similar macroeconomic imbalances and was confronted with structural adjustment costs associated with the ongoing process of economic reform. In particular, a substantial increase in the level of unemployment and underemployment and high inflation rates followed in the wake of liberalization moves which included price reforms and restraint on public expenditure and investment. Major changes in public finance policies were necessary to support the anti-inflation effort and achieve a more efficient allocation of resources that would preserve essential expenditure for infrastructure and social services. Reduction in the large budget deficit, freeing the financial sector, and stabilization of the chronic overvaluation of the currency, resulting in the loss of export competitiveness, are some of the issues that Viet Nam has sought to

tackle over the past several years. Restoring the confidence of the private sector is a basic aspect of efforts to spur renewed economic growth and generate employment in the country. Viet Nam has achieved a considerable measure of success over the years, especially in stimulating agricultural production, reducing inflation, stimulating private investment, including foreign direct investment (FDI), and balancing its external account.

*(b) Structural issues*

*(i) Institutional*

The Asian republics of the former Soviet Union, the Lao People's Democratic Republic, Mongolia and Viet Nam appear to have become irrevocably committed to transition to a market-oriented system, and to pursuing macroeconomic reforms to achieve that end. The pace and sequencing of policy reforms, however, vary considerably among them. Kyrgyzstan and Kazakhstan are the leaders among those seeking a quick transformation, following somewhat closely the example of the Russian Federation. The other countries, in general, have adopted a more cautious and less radical approach towards economic reforms.

The preference for a more gradualistic transition by most of the Asian republics arises from their specific conditions and structural problems. Their need for social protection of the population whose incomes are perceptibly lower than the average for the former Soviet republics, is greater. A precipitous decline in incomes could (as indeed happened in some cases) exacerbate social tension and political destabilization. The authorities in most Asian republics are also acutely aware of the risks of too slow a pace of transition, which could prolong suffering, increase uncertainties and cause both greater economic distress and social turmoil. They have therefore tried to speed up the process of legislative reform by either enacting the necessary laws or adopting presidential decrees in support of their economic and political reforms; such laws and decrees have included, almost invariably, the protection of foreign investments, regulations covering the banking system, privatization programmes, the liberalization of foreign trade and the regulation of joint ventures.

The difficulties with the privatization of land and large mining enterprises, which form the main public assets, caused by inadequate private capital and the lack of a legislative framework for the creation of statutory property rights, are the main obstacles to transition to a market economy system. The transition has also required the rationalization and restructuring of the administrative machinery, which in any event was inadequate to deal with the problems of independent economic management that had to be confronted after the break-up of the Soviet Union. Changes are being initiated to redefine the operational functions and substantive scope of executive ministries and agencies, appoint new personnel with knowledge and expertise of the functioning of the market economy – a skill which is in critically short supply in all the republics – and provide a new focus to the bureaucracy in handling the problems of transition.

However, many old structures and administrative modalities have remained intact and continue to survive. State orders still account for a large share in the output of enterprises and the role of central planning in many areas remains significantly unchanged. A comprehensive transformation of the old administrative system has yet to take place. "Gosplans" (planning committees) and "Gosnabs" (material supply agencies), along with various other economic organizations, were reduced in number or reorganized, but many such changes were cosmetic in nature rather than reflective of the need to have new institutions suited for the transition. Some new institutions, especially for dealing with privatization, and special banks and financial institutions have, however, been created in all the republics. Kyrgyzstan, which initiated the transition process much earlier than the other republics, has also carried out the most comprehensive reform, reducing by more than half the number of ministries and commissions, from 41 to 20, and merging the functions of the ministries of finance, planning and the economy into the single Ministry of Economy and Finance.

Among the issues relating to transition to a market economy system, the most intractable has been that of privatization. Schemes for privatization of land have consisted of various forms of land-leasing, rather than of land ownership. The main problem with land ownership relates to the maintenance and development of comprehensive systems of irrigation, which is the basis of their agricultural economy. There are also problems of evolving an equitable basis for the distribution of land among members of State and collective farms. Much of the privatization that has so far taken place in the Asian republics has been in trade and other services, handicrafts and cottage industries. Privatization of the larger industrial enterprises has usually taken the form of setting up joint stock companies, with shares being owned partly by employees and partly by public authorities. The process is likely to remain slow.

The transition of the Mongolian economy from a closed to an open economic system, integrated into the world and regional markets, is one of the principal goals of the new economic strategy under the Government's reform programme. The transition process has been conditioned by the changes in both the internal and external factors affecting Mongolia in the period of restructuring. The Government has introduced several of the necessary initial measures to privatize public and cooperative properties, develop different forms of property, transform the taxation and banking system, deregulate prices and tariffs, liberalize foreign economic cooperation activities, and establish a legal framework for company activities. The Government is thus moving with speed to implement a very comprehensive reform programme, but the short-term situation in the country remains complex.

The factors affecting the prospects for growth in the Vietnamese economy are broadly similar to those of other economies in transition: the ability of the economic base to create an investable surplus; the potential for supplementing this locally derived surplus through various forms of external assistance; and the efficiency with which the surplus is directed into productive investment. Viet Nam, by virtue of its earlier start and close interface with neighbouring countries, has achieved a larger measure of success in stabilizing and stimulating its economy than any of the other economies in transition.

### *(ii) Production, trade and investment*

In making the transition from a trade regime in a command economy to one in a liberal market economy, one must begin by redressing some of the basic problems created by central planning. These include the severe distortion of trade by government controls, with their impact not only on the composition but also the geographical distribution of trade. Partly as a consequence of orientation towards heavy industry and self-reliance under central planning, the export structure of the economies in transition is restricted and skewed towards the export of machinery and equipment. At the same time, trade is largely confined to the former Council for Mutual Economic Assistance (CMEA) area. Besides, under the command system of the past, very little attention was paid to the quality of products. In the past, the trade performance of the economies in transition was poor and suffered from the effects of centralization, regulation and heavy protection resulting in lack of competitiveness of their export products. Thus, one of the major challenges facing the economies in transition is to decentralize, liberalize and expand their trade relations and to enhance the competitiveness of their products.

Following the dissolution of CMEA, all the economies in transition will have to reorient their trading patterns and seek new trading partners outside the CMEA area. This applies in particular to the Asian republics. In the past, the largely closed nature of the Soviet economy not only distorted the comparative advantage of the Asian republics (see box V.2) but also forced them to divest their historically important economic ties with their natural trading partners to the east, west and south. Their land-locked state and the lack of transport and communications links with their neighbours no doubt also contributed to their economic isolation from the mainstream of Asian and Pacific trade. Thus, one of the problems facing the Asian republics of the former USSR is to break out of their isolation and establish trade and other economic links first and foremost with their neighbours if they are to realize their true comparative advantage.

Mongolia and the countries of Indo-China face a similar problem. The disruption of trade among the former CMEA countries, together with stagnation in the global economy, have added another burden to the critical economic situation in which these economies in transition are placed. For example, as a result of the collapse of preferential trade links with trading partners in eastern Europe and the former USSR, Viet Nam's agricultural exports have been adversely affected. At the same time, Viet Nam not only has to pay higher prices for its imports from these countries but it has to make the payments in convertible currency.

The reorientation of the trade and production structures can occur only over time. During the period of adjustment these countries need external financial assistance both to meet short-term adjustment costs and to undertake long-term investment. International response to their requirements for assistance has generally been favourable. However, these countries will have to compete for the available supply of resources in the world economy with the increased demand from many other countries of the world. The largest component of capital flows to the developing countries has generally been from official sources. These flows have not shown encouraging prospects for overall expansion in recent years. Private resource flows have mainly taken the form of FDI. In the past, centrally planned economies deliberately excluded FDI, for ideological reasons. Government policies often precluded or discouraged FDI through restrictive regulations, such as reserving

## Box V.2. Asian republics of the former Union of Soviet Socialist Republics: transition to open trading

The economy of the former Union of Soviet Socialist Republics was characterized by a high degree of self-sufficiency and a high degree of regional specialization within the Union. The effect was that the Asian republics used to trade mostly with other republics of the former Soviet Union. Thus, although the Asian republics traded approximately the same share of total output as did the Canadian provinces, for example, the proportion of their trade with other Soviet republics was much higher than the proportion of the trade of Canadian provinces within Canada. (see table).

During the final years of the USSR, interrepublic trade began to decline in line with the fall in overall economic activity, culminating in an estimated decline of 15 per cent in 1991. Trade with countries outside the USSR declined even more drastically; all of the Asian republics experienced a drop in exports of 35-40 per cent and in imports of 39-48 per cent.[a]

The collapse of interrepublic trade was exacerbated by the growth of export restrictions applied by the successor States of the former Soviet Union. The republics tried to conserve their national resources and to prevent arbitrage trade that could be encouraged by different level of subsidies or excessive tax cuts in neighbouring States. A further problem emerging in late 1991 was declining confidence in the rouble and in the payments mechanism, which led to doubts about when sales would be paid for and what the currency would be worth when payment was received.

A big challenge during the transition period is to cope with the major redirection in trading patterns with the minimum of short-run disruption. Temporary measures, such as a payments union and coordination of price and tax reform among the successor States of the former Soviet Union, as described in the text, may help in mitigating the problem. The process of opening up to the world market will be difficult, but returning to the pre-1992 situation is not an option in the interest of efficiency in the long run.

Moving towards an open economy linked to the global market rather than the former Soviet market will obviously be easier for Asian republics with readily exportable resources (for example, Turkmenistan and Uzbekistan) than for others (for example Kyrgyzstan and Tajikistan). For all of these countries there are constraints arising from the past development patterns and their landlocked status. Efficient export of oil or natural gas will require the construction of pipelines from the producing areas to the markets or to ports. Even if negotiations with neighbouring States reach a successful conclusion, it will be the middle of the decade before pipelines to any of the seaports could be completed. As land-locked economies, they sorely need improvements in transport links. This would require cooperation with neighbouring countries. Moreover, there is difficult terrain to negotiate, especially to reach seaports. The joining of the Asian republics in the Economic Cooperation Organization (ECO) with Afghanistan, the Islamic Republic of Iran, Pakistan and Turkey in late 1992 has opened up several possibilities, including the construction of railway lines and gas pipelines through neighbouring countries to seaports. Upgrading airports and communications systems is also a high priority and requires large funds.

**Comparison of trade flows: Asian republics of the former USSR and Canadian provinces**

| | *Average value of exports and imports as a percentage of GDP* | *"Domestic" trade as share of total trade* |
|---|---|---|
| **Asian republics of the former USSR (1988)** | | |
| Azerbaijan | 42.0 | 85.6 |
| Kazakhstan | 33.9 | 86.3 |
| Kyrgyzstan | 45.2 | 86.9 |
| Tajikistan | 41.6 | 86.3 |
| Turkmenistan | 39.3 | 89.1 |
| Uzbekistan | 39.5 | 85.8 |
| **Canadian provinces (1984)** | | |
| Alberta | 39.1 | 60.3 |
| British Columbia | 33.6 | 38.3 |
| Manitoba | 40.3 | 61.0 |
| New Brunswick | 61.5 | 51.5 |
| Newfoundland | 45.6 | 59.1 |
| Nova Scotia | 49.9 | 54.0 |
| Ontario | 49.5 | 33.9 |
| Prince Edward Island | 50.5 | 75.5 |
| Quebec | 42.2 | 48.0 |
| Saskatchewan | 51.4 | 52.2 |

*Source:* International Monetary Fund, *Economic Review: Common Issues and Interrepublic Relations in the Former USSR* (Washington, DC, 1992), p. 37.

[a] International Monetary Fund, *Economic Review: Common Issues and Interrepublic Relations in the Former USSR* (Washington, DC, 1992), pp. 7 and 53.

strategic or priority subsectors for State-owned enterprises or domestic investors; non-transparent licensing procedures; limits on capital and profit repatriation; and the possibility of nationalization or expropriation of private holdings. Most of the economies in transition have reversed their policies on FDI as part of their liberalization package, but many obstacles would still have to be overcome before such investments flowed on a significant scale.

*(c) Other issues*

Usual indicators of social development, such as those on health and education, indicate that most of the economies in transition had achieved a better standard than the average of the developing countries of the ESCAP region. This has been largely due to the welfare State policy followed by the Governments concerned for a long time. However, recent developments, characterized by falling income, rising inflation and high unemployment, indicate serious social distress in most of the economies in transition, particularly in the Asian republics and Mongolia. Those have served to intensify social dissension and create misgivings in the public mind towards the whole process of reform and restructuring, creating additional difficulties in implementing reform measures.

It is of critical significance for most of the economies in transition to rebuild, rehabilitate or expand their systems of transport and communications as a prerequisite to stimulate production, trade and investment activities. This is a formidable task for most of the economies in transition since they also suffer the disadvantage of being land-locked, thus lacking any immediate and direct link and access to international shipping routes (see section D below).

The countries, particularly the Asian republics, have also inherited severe environmental problems. They have been major producers or processors of raw materials. The irrigation and chemical-intensive agriculture, producing cotton and grain, entailed huge ecological and environmental costs in terms of soil erosion and water and air pollution. Their natural resources appear to have been over-exploited; the drying up of the Aral Sea for example, owing to excessive withdrawal of river water for irrigation purposes, provides some evidence of serious environmental and ecological degradation.

## 2. Policy issues

Price reform is central to the transition process. The artificial price structure inherited from the central planning regimes is not conducive to efficient resource allocation and improved productivity. Even if freeing prices had no immediate impact on output, it could lead to better utilization of existing output; for example, creating a housing market could allow better allocation of the existing housing stock with indirect benefits, such as aiding labour mobility. During the transition process, however, price changes and the accompanying change in the output mix will impose costs on some groups. Thus, Governments face political pressure to postpone increases in the prices of basic consumer goods or inputs, and yet to allow pensions, wages and other sources of income to increase, whether or not they are justified by the budget situation or by productivity. In sum, price liberalization is fundamental to the establishment of a market-based economy, but it is politically difficult to implement.

The questions which policy makers have to decide are: how to liberalize, how much to liberalize and how quickly. These questions have to be resolved against the backdrop of another constraint, brought about by the decision of the Russian Federation to eliminate the advantageous pricing of its raw material exports in the former CMEA area. The import-cost burden resulting from this could not have come at a worse time, since the economies in transition will have to confront this problem in addition to the massive problems associated with trade liberalization. Nevertheless, the Russian Federation's decision may be a blessing in disguise if part of its outcome is to accelerate realignment in the trade pattern of these economies in accordance with their comparative advantage.

By the time the Commonwealth of Independent States (CIS) was formed in December 1991, interrepublic trade was increasingly being carried out by government-to-government barter, with any imbalances to be met in hard currency or rouble payments at a negotiated rate.[2] The negotiations were often difficult and sometimes broke down; for example, trade between Turkmenistan and Ukraine came to a halt in March 1992 because of failure to agree on gas prices. Faced by critical shortages of food or oil, some republics turned to outside suppliers (for example, Kyrgyzstan to Canada and Australia for wheat). Such moves, however, encouraged the raw-material-exporting republics to insist on an even faster move towards world prices and immediate payment in hard currency, with adverse effects on intra-republic trade.

[2] In Azerbaijan, for example, the International Monetary Fund estimates that 90 per cent of trade in 1992 will be conducted on a barter basis; see International Monetary Fund, *Economic Review: Azerbaijan* (May 1992), p. 35.

The Asian republics in particular are poorly equipped for a rapid retreat into autarky, since their modern economic development has involved a high degree of specialization. Thus, an immediate issue facing these countries is how to halt the disruption of trade.

One recommendation is increased coordination among CIS members, in particular by forming a payments union. Such a union would permit multilateral clearing of intra-CIS payments and allow some short-term trade credits. The immediate concern is felt by potential creditor republics, which are afraid of not being paid, although this worry could be alleviated if international agencies would provide financial assistance for the establishment of the payments union. A longer-term concern is that such a union would perpetuate reliance on the "soft" internal markets and delay the eventual move to full convertibility and exposure to international markets.

A second coordination issue is for price liberalization and tax reform to move more or less in line across CIS members in order to prevent the emergence of arbitrage trade.[3] Again, there is a conflict between the immediate goal of preventing erosion of intraregional trade (because of high tax or subsidies) and the long-term goals of transition to a market-based system. Coordination of price liberalization and tax reform means either following the lead of the dominant economy (as happened in January 1992 when all CIS members had to follow the Russian Federation's price reforms), which may be an unacceptable challenge to some members, or moving at the pace of the slowest reformer.

An alternative approach is for individual republics to move more quickly towards the ultimate goal of incorporation in the world trading system. All of the Asian republics of the former Soviet Union are small economies, for which the appropriate set of relative prices is world prices. But it is not easy to conform to world prices in a situation of a high degree of macroeconomic instability the correction of which necessitates supporting reforms of macroeconomic policy and the financial sector. Thus, in order to move to convertibility on the current account, and thereby conform with world prices, it is desirable to ensure low inflation and a real exchange rate which makes exporting attractive, as well as a financial system which can arrange trade credit.

Too rapid an approach to trade reform will also involve large short-term adjustment costs, because existing output mixes based on intra-USSR specialization are very different from the output mix which would be appropriate at world prices. For countries which have already experienced large output losses in 1991-1992, the prospect of a further decline in output and an increase in unemployment may be politically unacceptable. The choice is not a pleasant one. The experience in eastern Europe is already showing that delaying the move to world prices in order to reduce adjustment costs prolongs economic inefficiency and in the long run is likely to be even more harmful.

In practice, trade reform progressed slowly in the Asian republics in 1991-1992. Export controls are common, surrender requirements for foreign exchange earnings tend to be high and exchange rates paid to exporters low. The immediate reasons for these measures are understandable, but they are not conducive to long-run export promotion. Imports have, for the most part, been liberalized, but they are subject to varying import duties. One obvious danger in the transition process is that Governments facing fiscal deficits will turn to high import taxes as an easy revenue source, especially if they are predisposed to arguments about the benefits of import-substituting industrialization. Perhaps more importantly, isolation from world markets may lead the newly independent Asian republics to repeat some of the policy mistakes made by the newly independent developing countries of the 1950s and 1960s.

Most of the economies in transition have a policy of encouraging FDI under newly drafted investment codes. Viet Nam had an early start and introduced a new Law on Foreign Investment in 1988 which superseded the Regulations on Foreign Investment of 1977 and substantially modified the previous regulations. The Law on Foreign Investment was further amended in 1990 and various regulations concerning FDI were issued in 1990-1992. These changes reflected a flexible and pragmatic approach by the Government aimed at facilitating and speeding up foreign investment inflows from developed as well as developing countries. The present FDI regime is quite liberal in permitting foreign ownership and management of enterprises up to 100 per cent.

However, competition for FDI worldwide will be keen. Experience has shown that among many determinants of FDI is a conducive investment climate with political and economic stability. As reforms take hold in the economies in transition, FDI is

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[3] Such trade between partially liberalized economies is already apparent across the China-Mongolia-Russian Federation and China-Kazakhstan borders, although the absolute value of this form of trade is limited by the state of transport facilities.

likely to increase in these countries. Infrastructure improvements, notably in telecommunications, through private investment, represent a potential area for FDI. Such investment in manufacturing, oriented towards domestic markets, is likely to be limited in the economies in transition with small population, such as the Lao People's Democratic Republic and Mongolia, but export-oriented manufacturing and service industries could be fruitful areas for FDI.

## D. THE LAND-LOCKED COUNTRIES

### 1. Nature of the issues

The land-locked disadvantaged countries include four of the region's least developed countries, Afghanistan, Bhutan, the Lao People's Democratic Republic and Nepal, the six Asian republics of the former Soviet Union, and Mongolia. Land-lockedness poses an additional hindrance not only to the short-term adjustment process which all of them are going through, but also to long-term development. The difficulty arises mainly in respect of transport and communications, especially that serving their international trade. High transport costs associated with remoteness and isolation from world markets accentuate the weaknesses of their international trade. Among land-locked countries of the region, Afghanistan and Mongolia face great distances in gaining access to the sea (see table V.1). All of them are dependent on transit-transport services in neighbouring countries, which are often inadequate. The hilly terrain of most of the land-locked countries also hinders the development of an internal transport network and easy movement within their own territories.

**Table V.1. Main access to the sea for some land-locked developing countries of the region**

| | *Distance to the sea*[a] *(km)* | *Means* |
|---|---|---|
| Afghanistan | 2 000 – 10 600 | Road and rail |
| Bhutan | 800 | Road and rail |
| Lao People's Democratic Republic | 670 | Road, water and rail |
| Mongolia | 1 600 – 6 450 | Road and rail |
| Nepal | 890 | Road and rail |

*Source: A Transport Strategy for Land-locked Developing Countries: Report of the Expert Group on the Transport Infrastructure for Land-locked Developing Countries* (TD/B/453/Add. l/Rev. 1) (United Nations publication, Sales No. E.74-11.D.5).

[a] Distance from principal town to main port. The figures show the shortest and longest routes used.

The neighbouring coastal States of land-locked developing countries are developing countries themselves and are thus limited in their capacity to allocate adequate resources for the improvement and development of transit facilities. In a developing transit country, the requirements for investment in transit-transport infrastructure may be treated marginally owing to the competition for scarce resources by other priority activities. Facilities in traditional transit corridors are not only poor and cost-inefficient but in some cases quite unreliable. Occasional disruptions of services on these traditional routes have thus meant that land-locked developing countries have been forced to use other even more expensive alternative land routes and to air freight.

Since the particular location of the individual land-locked countries confers a somewhat specific character on their problems, especially for the five countries included in table V.1, these individual cases are discussed below in some detail.

#### *(a) The least developed land-locked countries, and Mongolia*

The minimum distance to a port from Afghanistan is 2,000 kms. Owing to the political difficulties, and the inadequate infrastructure and services along the route to the sea, the country has faced serious problems in conducting its external trade. The severance of the close political and trade links with the former Soviet Union further aggravated the problem.

Over 90 per cent of Bhutan's external trade is with India. Its third-country exports, mainly fruit, are transported to Bangladesh. India provides quite generous transit facilities for Bhutan's trade with third countries. Under the India-Bhutan Agreement on Trade and Commerce for 1990-1995 of March 1990, the transit facilities which India provides to Bhutan include the specification of 13 exit/entry points to facilitate imports into and exports from Bhutan, and import/export procedures with respect to Bhutan's trade with third countries. The Agreement also refers to the favourable treatment of merchant ships sailing under the flag of Bhutan. Under the Agreement, bilateral trade between the two countries is free. All exports and imports of Bhutan to and from countries other than India are free from customs duties and trade restrictions. India also provides refunds of excise duties on goods of its own origin exported to Bhutan.

The two principal ports used by the Lao People's Democratic Republic for international trade are Bangkok (Thailand) and Da Nang (Viet Nam). Generally trade with the former CMEA countries passed through Da Nang and with other countries through Bangkok. With regard to cargo transiting through Bangkok, a significant improvement has been made as bilateral relations between the Lao People's Democratic Republic and Thailand have improved considerably in recent years. With the completion in 1994 of the bridge on the Mekong River, now under construction, the importance of the Lao transit trade through Thailand will further increase. Transit trade through Viet Nam has been difficult because of the poor road conditions. The movement of goods along the east-west route and through central and northern Lao People's Democratic Republic is still hampered by poor roads and also by the navigability of the river route, which is restricted to three to four months of the year.

An overwhelming proportion of Mongolia's external trade is with neighbouring China and the Russian Federation. Transit traffic is carried by rail through Ulan-Ude to the trans-Siberian line, where goods are moved eastward to the port of Nakhodka, a total distance of about 4,650 km, or westwards to the port of St. Petersburg, a total distance of 6,450 km. The alternative route is through China where the closest port, Tianjin is 1,600 km away. In 1991, Mongolia and China signed an agreement on the transit trade of Mongolia through Tianjin port. The countries also agreed to open eight border crossings and to promote road transport in the border areas, marking a rapid improvement in their bilateral relations.[4] Mongolia has a vast amount of arable land and great potential for mineral and hydrocarbon exploitation. However, the success of the development of these resources hinges on the country's ability to obtain the most efficient access to the sea.

The treaties of trade and transit between India and Nepal provide the framework for the regulation of the movement of the bulk of Nepal's transit cargo to and from third countries. Nepal experienced transit difficulties when the earlier trade and transit treaty expired in March 1989. However, in June 1990, the two Governments agreed to return to the status on 1 April 1987 with regard to the movement of goods in transit through India to and from Nepal, pending the finalization of new arrangements.

In December 1991, separate treaties on trade and transit, and an agreement for cooperation in controlling unauthorized border trade, were signed between Nepal and India. The trade treaty is valid for five years and can be renewed for another five. It provides for several new facilities and concessions for Nepal's exports to India, the most important being that the Nepali/Indian raw material content of Nepali manufactured goods to be exported to India was reduced from 65 to 55 per cent initially.[5] The transit treaty is valid for seven years, and introduces various simplifications in customs and other procedures to help Nepal's importers and exporters.

### *(b) The Asian republics of the former Soviet Union*

Covering a total area of 3,994,400 sq km and a population of less than 60 million, the Asian republics stretch nearly 5,000 km from west to east and 3,000 km from north to south. All the republics are land-locked countries, bounded in the north by the Russian Federation, in the east by China, in the south by Afghanistan and the Islamic Republic of Iran, and in the west by the Syrian Arab Republic and Turkey. The huge size of the territory and the spatial separation of resources and population have created the need for vast transport networks.

The existing transport system is quite extensive. It consists of more than 23,000 km of railways, and 333,200 km of roads, of which 75 per cent are hard-surfaced (table V.2). There are three international airports, but a number of airports serve domestic traffic. There is also a sizeable number of navigable inland waterways.

In general, transport infrastructure in the republics had been well developed when they were part of the former Soviet Union. However, transport networks have been developed in such a way that all the republics are well connected to Russia. Although connections to neighbouring countries, such as railway links from Azerbaijan to the Islamic Republic of Iran, from Turkmenistan to the Islamic Republic of Iran, from Kazakhstan to China, and a railway/road link from Uzbekistan to Afghanistan, have been constructed (or are under construction), the republics played very little part in these projects. This feature was a result of the extremely centralized socio-economic system of the former Soviet Union. Although the economic relations with the countries of CIS, first of all with the Russian Federation, would be most likely to remain the most important part of the external economic relations of the Asian republics, further attention needs to be paid to infrastructure development to strengthen the economic ties with neighbouring countries, particularly with China, the Islamic Republic of Iran, Pakistan and Turkey.

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[4] *Asian Recorder*, 19-25 August 1991.

[5] This was reduced to 50 per cent in October 1992.

**Table V.2. Public railways and road networks in the Asian republics of the former USSR, 1980-1988[a]**

*(Thousands of kilometres)*

| | Public railways network | | Road network | | | |
|---|---|---|---|---|---|---|
| | | | 1980 | | 1988 | |
| | 1980 | 1988 | Total | Hard surfaced | Total | Hard surfaced |
| Azerbaijan | 1.9 | 2.1 | 25.9 | 19.9 | 30.0 | 28.2 |
| Kazakhstan | 14.2 | 14.6 | 104.6 | 76.1 | 152.7 | 103.3 |
| Kyrgyzstan | 0.4 | 0.4 | 25.3 | 17.6 | 28.7 | 21.5 |
| Tajikistan | 0.5 | 0.5 | 17.0 | 13.9 | 29.6 | 18.3 |
| Turkmenistan | 2.1 | 2.1 | 16.4 | 11.4 | 21.4 | 17.1 |
| Uzbekistan | 3.4 | 3.5 | 62.9 | 52.1 | 70.8 | 59.7 |
| All Asian republics | 22.5 | 23.2 | 252.1 | 191.0 | 333.2 | 248.1 |
| Share of all the Asian republics in the former USSR (percentage) | 15.9 | 15.8 | 18.8 | 20.7 | 19.2 | 19.1 |

[a] International Monetary Fund, World Bank, Organisation for Economic Cooperation and Development, *A Study of the Soviet Economy*, vol. 3, February 1991, pp. 111 and 113.

## 2. Policy issues

The Programme of Action for the Least Developed Countries for the 1990s adopted by the Second United Naitons Conference on the Least Developed Countries, held in Paris in 1990, recognizes that the geographical handicap of land-lockedness adds to the structural deficiencies of the least developed countries by impairing their capacity to conduct and benefit from international trade. Improvement of the physical infrastructure, in particular transport and communications, is vital for the movement of goods and services within a country as well as for the expansion and development of the foreign trade sector. In order to alleviate this geographical handicap, it was recommended that the land-locked countries and their transit neighbours should continue to make concerted efforts, at bilateral and subregional levels, to simplify transit procedures and to improve international trade links in the 1990s, taking into account the relevant resolutions of the United Nations, in particular the Final Act of UNCTAD VII, and the needs and the means at the disposal of the countries concerned. The Programme of Action also called upon the international community to consider the possibility of assisting the land-locked countries in their efforts to finance their infrastructure projects, which are indispensable for their development.[6] Although the above recommendations relate to the least developed land-locked countries, the principles underlying them remain valid for other land-locked countries as well. UNCTAD VIII also endorsed such policy actions.

All the Governments of the Asian republics have emphasized the importance of transport infrastructure for the economic development of their countries, in view of their land-locked nature. The dissolution of the former Soviet Union has changed the trade pattern of the republics from its former orientation to individual and direct foreign economic relations. The traffic demand pattern with their neighbouring countries, and with other countries, will change as the direction of trade changes. The development of transport infrastructure in the republics will play a vital role in the strengthening of ties with East Asia, South Asia and Europe, and also assist the republics in overcoming the constraints they suffer as a result of being land-locked.

The dissolution of the former Soviet Union has caused serious problems for the development and maintenance of transport infrastructure in these republics. Railways had been totally managed by the former central government. All the functions, including factories and research institutes, are located in Moscow and some other large cities outside the Asian republics, which deprives them of the facilities they require for the development and maintenance of their railway network. Road

[6] See *Report of the Second United Nations Conference on the Least Developed Countries, Paris 3-14 September 1990* (A/CONF.147/18), part one, paras. 125 and 127.

construction and maintenance had been administrated by the former individual republics, but functions such as supply of equipment, survey and research, training activities etc. had been centralized in Moscow or some other large cities, which resulted in the same problems as those associated with the railway system. Furthermore, the Governments of the republics cannot afford the development and maintenance of transport infrastructure, owing to lack of resources. To enable the republics to play a larger role in the development of transport infrastructure, the establishment of research institutes and the development of an efficient and effective maintenance system, sufficient financing is needed.

International transport facilitation measures should be considered together with infrastructure development. Since the Asian republics in particular have been almost isolated from neighbouring Asian countries, they have not attended to international transport issues. For the time being, the issues are dealt with on the basis of international treaties/agreements ratified by the former Soviet Union. It is necessary for the Asian republics to recognize the issues and initiate appropriate action.

All the republics have their plans for the development of new international transport links to neighbouring countries, such as China, the Islamic Republic of Iran, Pakistan and Turkey. Most of the plans are for railway and road construction projects, while Caspian Sea transport could still be an important mode for some of the republics. Although some projects are expected to be completed within a few years, many of the planned projects face financing difficulties. All the republics could collaborate in an investment programme to strengthen international/regional transport links, based on an analysis of the current status and future projections. Equally important is the imperative of developing a modern communications network in these countries in order to facilitate trade and investment.

# VI. ASPECTS OF SOCIAL DEVELOPMENT: HEALTH AND NUTRITION

## A. SOCIO-ECONOMIC DIMENSIONS OF HEALTH AND NUTRITION

### 1. The concept of health and health care

The popular saying "Health is wealth" neatly summarizes the significance of health in human life. Good health is an integral component of socio-economic well-being. It is an essential requirement for the development and economic productivity of the individual, the community, the nation and ultimately, the global family. Poor health, on the other hand, constrains individual and societal development. By compromising the potential to lead a productive life, poor health perpetuates poverty and undermines human dignity.

The concept of good health cannot be defined precisely. The constitution of the World Health Organization (WHO) defines health as "a state of complete physical, mental and social well-being and not merely the absence of disease or infirmity". This definition embraces a more holistic concept of health than the bio-medical concept which limits its notion of health to the mere absence of disease. The holistic perspective also takes into account the social, ecological, cultural and behavioural dimensions of health. Such a perspective encompasses psychological and social pathologies, including alcoholism, drug abuse, violent crime, accidents, stress-related illnesses, and suicides, which are increasingly becoming major public health concerns for developed and developing countries alike.

Health-care systems based on the bio-medical model have been criticized as being costly and ineffective, and particularly inappropriate when applied to the developing world. The emphasis on curative care overlooks the fact that many illnesses can be prevented or alleviated simply through better nutrition and education, access to clean water and sanitation, family planning and improving the status of women. Their focus on sophisticated technology and hospital-based services leaves most people in developing countries without access to adequate health care.

This is not to discount the significance of modern advances in medicine. Applied appropriately, modern medicine and bio-medical research can yield tremendous public benefits, and even more so when combined with public health strategies. The invention of vaccines and contraceptives, to cite but two examples, has dramatically improved health and human welfare worldwide. Even before antibiotics and immunization techniques were introduced, however, the incidence of major infectious diseases in Europe and North America had already peaked and begun to decline in response to improvements in nutrition and living conditions.

The adoption of the concept of primary health care at the joint WHO/UNICEF International Conference on Primary Health Care held at Alma-Alta, Union of Soviet Socialist Republics, in 1978, and the adoption in 1981 of the Global Strategy for Health for All by the Year 2000, have provided the impetus and a move in the direction of holistic approach to health. Primary health care seeks to establish universal access to culturally appropriate and integrated health services. Health care incorporating primary health concepts represents the cornerstone of a worldwide movement to reduce the gap between the rich and the poor.

Notwithstanding this global effort to promote social equity, the minimum health needs of large sections of the population in the ESCAP region are still not being met. Undeniably, many more people than before are enjoying higher living standards, better education and improved social services. Nevertheless, ignorance, poverty and malnutrition still predominate in many parts of the region. Infectious and communicable diseases, many associated with substandard living conditions, continue to undermine social and economic productivity throughout the region. At the same time, social and economic inequities fuel the vicious circle leading from poverty to malnutrition and disease to loss of employment and productivity, thereby perpetuating poverty. Malnutrition and disease thus appear as both causes and effects of unemployment and poverty.

In more developed areas, cardiovascular diseases, cancer,

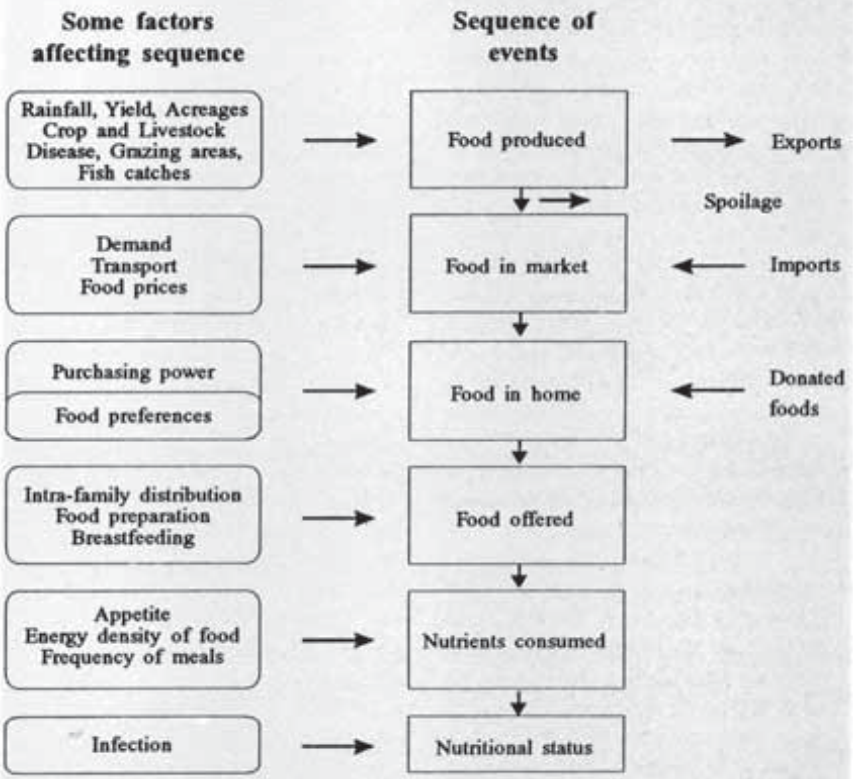
injuries and accidents, chronic obstructive lung diseases, diabetes and other non-communicable diseases linked to stress and environmental factors have become major public health problems. Drug addiction, which earlier existed in some Asian countries in a somewhat limited form, now threatens to acquire menacing new dimensions. Acquired immune deficiency syndrome (AIDS) and HIV (human immunodeficiency virus)-related infections are emerging as perhaps the foremost health challenge in the region, threatening not only to undermine the progress achieved in recent decades but also to devastate present and future generations.

## 2. The vicious circle of poverty, malnutrition and disease

Poverty lies at the root of malnutrition and illness because it keeps people from obtaining enough as well as the right kind of food. Millions of people in the world suffer from undernutrition and nutritional deficiencies, not so much for lack of food at the aggregate level but because their household incomes are too low to command access to sufficient or appropriate food to meet their nutritional needs. Inadequately nourished, they become more vulnerable to disease and risk further impoverishment owing to impaired productivity.

Food supply itself is a function of natural and market forces as well as household purchasing power. Figure VI.1 shows the complex and interrelated determinants that underlie food supply and have an impact on nutritional status. Apart from the deficiency of basic calories, micronutrient deficiencies present serious health problems in many parts of the world including the ESCAP region (see box VI.1)

**Figure VI.1. Model of causal sequence of nutritional status**




*Source:* Extracted from Department of Health, the Philippines, *Comprehensive Nutrition Programme 1992-1996* (October 1991).

A squalid living environment, insanitary disposal of human and household wastes, lack of access to clean water, education and basic services, and poor food processing and preparation further impinge on nutritional status by creating a fertile environment for the proliferation of disease.

Poverty and nutritional deficiencies affect the health of everyone, but women and children tend to suffer the most. Over 270 million children in Asia under the age of 5 are underweight[1] owing to acute or chronic protein-energy malnutrition.[2] In many societies, it is still the custom for adult women and young children to eat after the men have had their fill, leaving them less of the more nutritious foods. In countries where son preference is strong, girls are often given less protein-rich and iron-rich food than boys of the same age. In many cultures, pregnant women are discouraged from eating fruits, vegetables, milk, rice and other high-calorie foods, thus endangering the mother and unborn child

1 "Underweight" is defined as below two standard deviations of the WHO weight-for-age reference.

2 FAO/WHO/International Conference on Nutrition, "Final report, FAO/WHO Asia and Pacific Regional Meeting, 27-31 January 1992, Bangkok"; WHO, "Implementation of the Global Strategy for Health for All by the Year 2000, second evaluation; and eighth report on the world health situation" (A45/3), submitted to the Forty-fifth World Health Assembly, March 1992.

## Box VI.1. Micronutrient deficiency diseases: some highlights

Over 1,000 million people in more than 80 countries of the world live in areas where soils lack sufficient iodine. Two hundred million have goitre (enlarged thyroid gland), while 26 million, of which six million are cretins, suffer from mental defects owing to iodine deficiency. Lack of iodine during early childhood compromises disease resistance, leading to increased mortality. Iodine deficiency has also been shown to impair reproductive functions, leading to increased rates of abortion and still births. The majority of the people at risk are in Asia, including 300 million in China and 200 million in India.

Vitamin A deficiency, leading to night blindness and eventual blinding xerophthalmia, is a widespread problem among children. Every year, millions of children become blind, partially or totally, from vitamin A deficiency, and two thirds of these children die within a few months of going blind. Apart from these victims, 10-20 times more children are at risk because the deficiency impairs resistance to infection and stunts physical growth, thereby increasing mortality and morbidity rates. The problem is particularly serious in Asia, because the overall availability of vitamin A is less than that required and the unbalanced distribution of foods high in vitamin A within a population worsens the problem.

Iron deficiency, leading to anaemia, affects over 2 billion people across the globe, the highest incidence being in South Asia and Africa. The people most affected are women and children, of whom often more than 50 per cent are anaemic. Older children and men are also affected by anaemia. In infants and children, anaemia is associated with retarded physical growth and cognitive development and lowered resistance to infection. In adults, iron deficiency causes fatigue and reduces work capacity; it also seriously impairs reproductive functions. Pregnant women who are anaemic are at greater risk of fatal haemorrhaging during childbirth and are also more likely to give birth to low birth-weight babies. As many as 20 per cent of maternal deaths are principally due to iron deficiency.

Fluoride deficiency increases the incidence of dental caries. Excessive fluoride, on the other hand, can cause dental mottling and skeletal deformations. Vitamin B1 deficiency, leading to beriberi, is found among people whose main food is highly polished rice, and is sometimes associated with alcoholism in adults. Vitamin C (ascorbic acid) deficiency causes scurvy, and occurs especially among refugees, displaced persons dependent on food rations and others who lack access to fresh fruit or vegetables. Inadequate exposure to sunlight and lack of vitamin D can lead to rickets, especially in infants.[a]

Children are the group most vulnerable to a number of nutrient deficiency diseases, as noted above. It is, therefore, appropriate in this context to recall the goals adopted at the World Summit for Children, held in New York in September 1990, to which most countries in the ESCAP region subscribe. The relevant goals are: reduction in severe, as well as moderate malnutrition among under-5 children by half of the 1990 levels; reduction of the rate of low-birth weight (less than 2.5 kg) to less than 10 per cent; reduction of iron deficiency anaemia in women by one third of the 1990 levels; virtual elimination of iodine deficiency disorders; and virtual elimination of vitamin A deficiency and its consequences including blindness.[b] The goals are to be achieved by the year 2000. The need for concerted national, regional and international action with a view to realizing these goals can hardly be overstressed.

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[a] FAO/WHO/International Conference on Nutrition, "Final report, FAO/WHO Asia and Pacific Regional Meeting, 27-31 January 1992, Bangkok".

[b] United Nations Children's Fund, *First Call for Children* (New York, December 1990), p. 33.

(see figure VI.2). This tendency for girls and women to eat less food (or food with less nutritional value) is a factor that diminishes the usually longer life expectancy of infant girls at birth.

The repercussions of malnutrition are felt from one generation to the next. Malnourished women are sick more often, have smaller babies who are more susceptible to permanent damage from anaemia, iodine deficiency and other nutritional disorders, and die earlier. Malnutrition in mothers reduces their capacity to breast-feed, as well as the quality of their milk. Without this vital nourishment, their children face greater survival risks and are more likely to suffer from physical and mental stunting. Where infant and child mortality is high, birth rates are also high, increasing the stress on women's bodies and trapping them and their children into a perpetual cycle of ill health and poor nutrition.[3]

According to WHO, of the 140 million babies born worldwide each year, there are almost 4 million perinatal deaths, many related to poor maternal health, inadequate or absent prenatal care, unsanitary birth facilities and lack of trained personnel at the time of delivery. Approximately 95 per cent of these deaths occur in developing countries. In countries where the prevalence of infectious and parasitic disease is still high,

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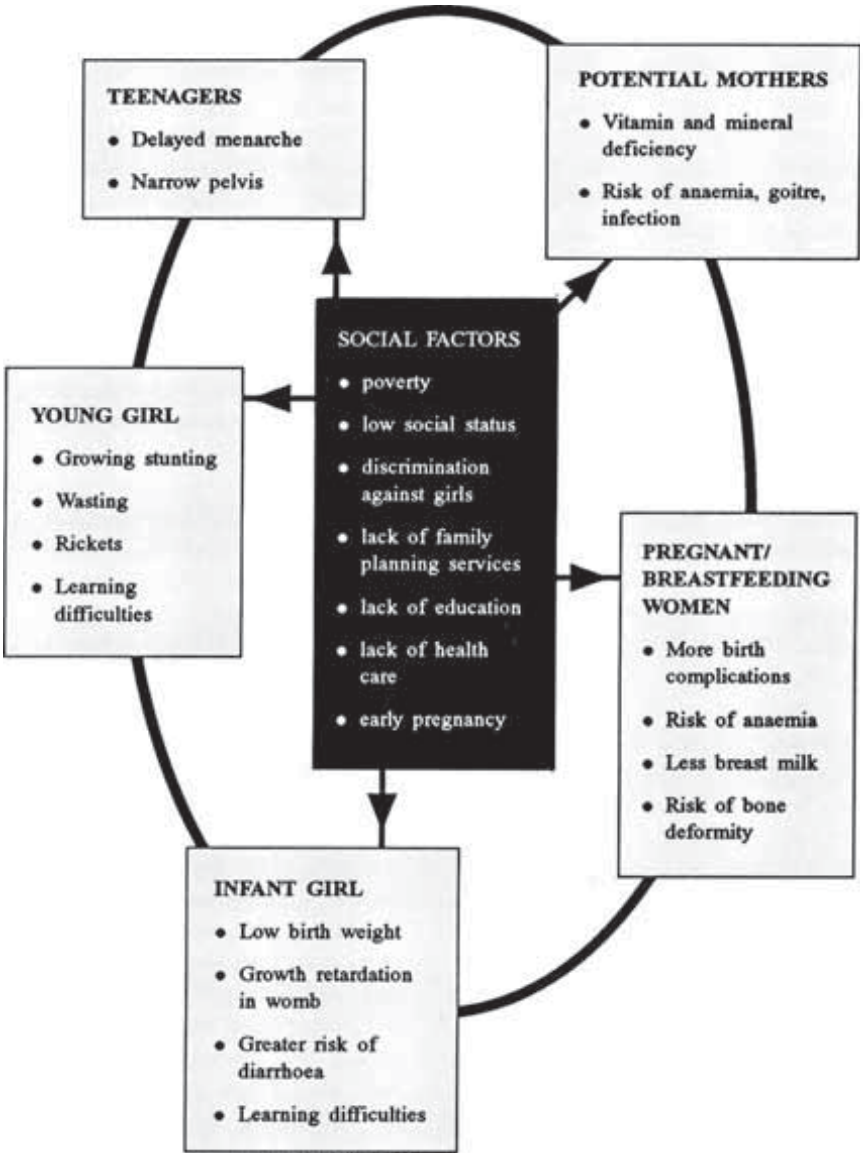
[3] *The World's Women 1970-1990: Trends and Statistics* (United Nations publication, Sales No. E.90.XVII.3).

**Figure VI.2. The vicious circle of malnutrition**




*Source:* United Nations Population Fund, *Investing in Women: The Focus of the '90s* (New York, 1989).

about half of all deaths typically occur before the age of 5.

Most of these deaths could be averted through immunization and improved water and sanitation. Mortality changes have been observed to occur within the context of an "epidemiological transition". Countries at the beginning of the transition have very high rates of infant and child death owing to infectious and parasitic diseases. As these diseases are brought under control, early mortality rates are reduced and life expectancy increases. Chronic and degenerative conditions, often related to changes in diet and lifestyle, become salient causes of morbidity and mortality in later phases of the transition.

Although increased life expectancy rates can indicate improvements in population health status, they belie quality differentials. Health conditions are by no means uniform across national populations, even when average life expectancy at birth is high. Pockets exist in the developed world where infant mortality rates rival those in the third world. As WHO notes, there are countries within countries, peoples within peoples, and even cities within cities.[4]

Women have certain inherent biological advantages that normally make their life-spans between 5 and 7 per cent longer than those of men; the difference is less in developing countries, averaging 3-4 per cent. However, the gender differentials in life expectancy mask many inequalities that hinder people's chances to live long, healthy and fulfilling lives. Furthermore, discriminatory treatment towards girls and women and the risks associated with childbearing can undermine the biological advantage. For example, in many South Asian countries, male life expectancy exceeds that of females, reflecting the harsh living conditions for women.

### 3. The environment and health

Environmental conditions and policies exert a major influence on health and nutrition. Rapid population growth poses a formidable challenge to sound environment. Increasing urbanization, soil degradation and erosion, deforestation, overgrazing and other unsuitable land-use practices all affect food production capacity and health conditions. Intensive use of chemical fertilizers to increase crop yields has caused deleterious

[4] WHO, "Implementation of the Global Strategy ..." (see note 2 above).

environmental changes and given rise to a new generation of health hazards, such as widespread pesticide poisoning and the emergence of resistant strains of crop killers and disease-transmitting insects. In some cases, warfare, causing massive population shifts, has destabilized the balance between humans and the eco-system, and rendered large areas of land uninhabitable because of mines.

Environmental cleanliness, including clean air, potable water, and safe waste disposal, is crucial for the promotion and maintenance of good health and the elimination of a wide variety of infectious diseases which cause high rates of mortality and morbidity. WHO estimates that water and sanitation-related diseases account for 80 per cent of all diseases in the developing world. Water-borne diseases are also a major cause of high infant mortality rates. An estimated 5 million children in the world die annually from diarrhoeal diseases, of which around one third are related to water. Water-related diseases also account for 15 per cent of all hospital deaths and cause the loss of millions of working days every year. This leads to increased medical costs and decreased productivity, thereby helping to perpetuate the vicious circle of poverty.

Solid waste disposal is becoming an increasingly serious problem in the wake of industrialization and escalating household consumption. In some communities, safe disposal of human faecal wastes is the major concern. With industrialization, however, the problem is multiplied as waste is created in the form of both direct discharge of effluents from industrial plants and as garbage from the residue of increased household consumption. Industrial pollutants pour into rivers, lakes and oceans resulting in severe pollution of the reservoirs, affecting drinking-water supplies and fisheries.

Industrialization, urbanization and other forms of development have given rise to a myriad other environmental and health hazards, among which acute and chronic exposure to chemicals from the production, storage, transport and use of chemicals is one of the most serious. Millions of people are exposed daily to toxic chemicals via food, drinking water, or air. This occurs through exposure at the workplace, the use of chemicals for agriculture or the use of pesticides for vector control. According to WHO estimates, agro-chemicals alone lead to about 4 million poisonings each year worldwide. Unprecedented increases in the number of road vehicles, coupled with high traffic congestion, poor road conditions and inadequate enforcement of traffic rules have led to a high toll of deaths and disabilities resulting from traffic accidents throughout the world. Noise pollution erodes hearing capabilities and can lead to psychological disabilities and nervous disorders. Depletion of the stratospheric ozone layer has been found to increase the risk of skin cancer and other diseases.

Urban air pollution affects the health of hundreds of millions of people across the globe. An estimated 600 million people live in cities where sulphur dioxide levels exceed WHO health guidelines, and 1,200 million people contend with an environment in which particulate matter in the air is at a hazardous level. Increasingly, children in major cities where automobile exhaust pollution is prevalent are being born with toxic levels of lead already in their blood. Indoor air pollution, mainly from cooking and heating with biomass fuels, affects an estimated 500 million people worldwide; the most important effects are acute respiratory infections, lung cancer and heart diseases.

Pathogen-contaminated drinking-water supply is a principal cause of diarrhoeal disease. Chronic poisoning caused by long-term exposure to chemicals present in the air, water and food, the spread of infection and parasitic diseases from hospital wastes, and sewage sludge are emerging as increasingly serious health hazards. The Bhopal and Chernobyl accidents of 1984 and 1986 dramatized the health risks associated with the accidental release of poisonous chemicals or ionized radiation.

## B. NUTRITIONAL AND HEALTH STATUS IN THE ESCAP REGION

### 1. The demographic dimension

The ESCAP region is home to over 3.1 billion people, accounting for 58 per cent of the world's total population. The region includes 12 of the world's 32 most populous countries and comprises complex and varied social and economic conditions. China, India and Indonesia alone contain 40.9 per cent of the total world population. The average annual growth rate of 1.7 per cent translates to an additional 53 million people each year in the region.

Notwithstanding national policies and programmes in many countries to promote birth-spacing and population control, high population growth rates prevail in much of the region. In India, Mongolia and the least developed countries in the region, the population grew at more than 2 per cent between 1985 and 1990. Maldives has an especially high rate, over 3 per cent. Indonesia, Sri Lanka and Thailand, with active family planning programmes, have countered this trend and achieved

growth rates of less than 2 per cent.

The total fertility rate for the region is 3.1 per cent in 1992, with notable variations among the subregions. Although this rate represents a decline from the rate of 3.3 per cent in 1990, it is still considerably higher than the average of 2.0 per cent for developed countries which have achieved population replacement levels leading to eventual population stabilization. Overall mortality rates in the ESCAP region, on the other hand, have declined in the last 30-40 years, though with considerable regional and country-to-country variation. As with fertility rates, the highest mortality rates are found in South Asia.

Past high fertility and falling mortality mean that women entering child-bearing age now constitute a large proportion of the total female population and this proportion will continue to increase up to the end of the century. In most countries of the region, the next generation of women will outnumber the previous one. Thus, even if the number of births per woman declines rapidly, the birth rates may stay high and the total number of births may be greater than before.

Although most countries conform to the demographic picture typical of developing countries, with a high proportion of the population under the age of 15, the more industrialized countries are beginning to assume a more mature profile, with increasing numbers of people in the older age groups. By the twenty-first century, more than 80 per cent of the world's elderly population in the developing world will be in the ESCAP region. Because of the implications of an increased number of elderly people for economic development and the demand for social services, the problems related to ageing are assuming growing importance on policy agenda across the region, particularly in East Asia (see box VI.2).

Despite generally rising per capita incomes, poverty remains a major problem in Asia (see chap. II). In 1990, more than 800 million people in the region were estimated to be below the poverty line as defined by their respective countries. In some countries, the percentage of the poor is estimated to be over 50 per cent of the national population. Even in China where the percentage is as low as 10 per cent, the number of the poor reaches a staggering 120 million.

Only about a third of the total population of the ESCAP region is urban, ranging from 5 per cent in Bhutan to 100 per cent in Singapore. Rising rural unemployment and pressure on agricultural lands, however, have stimulated increased migration from villages to towns and cities, leading to greater impoverishment and worsening health conditions in urban areas.

Population movements, whether in search of better economic opportunities or to escape from oppressive conditions, also facilitate the mobility of infectious agents and provide them with a more porous arena for circulation. For example, Thais venturing into mountainous areas of Cambodia to explore mining opportunities bring back with them drug-resistant strains of malaria. The thousands of refugees in constant flux in the region have made malaria control in some areas extremely difficult.

## 2. Health problems related to nutrition

Since the introduction of the green revolution technology in the region's agriculture, food production has increased and most food-deficit countries have reached the nominal threshold of food self-sufficiency, defined as a state where domestic production can satisfy the basic minimum food requirements of the population. Only in a few cases are imports still necessary to meet domestic requirements. The self-sufficiency in many cases is very thinly balanced, however, requiring imports in years of downward fluctuation in production, or in the event of natural disaster. Annual population growth may also outstrip production growth over the medium to long term.

The improvement in food supplies is reflected in the fact that the average daily calorie supply now fulfils 100 per cent of the per capita requirements in all but a few countries in the region (table VI.1). However, it is stipulated that supply at the national level must exceed the minimum nutritional needs by at least 20 per cent to enable "all people to have the purchasing capability to at least buy enough food",[5] in order to compensate for income disparities. As this is not yet the case in most of the region, in reality large sectors of the population are still deprived of access to sufficient food. Distortions in patterns of food grain production have contributed to the impairment of dietary protein quality, especially in poor households.[6] Changes in food prices often generate detrimental modifications in consumption

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5 FAO/WHO/International Conference on Nutrition, "Final report, FAO/WHO Asia and Pacific Regional Meeting, 27-31 January 1992, Bangkok".

6 UNICEF, *The State of the World's Children 1991* (New York, Oxford University Press, 1991).

## Box VI.2. Ageing of the population and its implications for health and health care

In the wake of declining birth and death rates, the numbers of elderly persons are growing in Asia and the Pacific, both in absolute terms and as a proportion of the total population. In Japan, in 1990, 17 per cent of the population were 60 years or older. That proportion is predicted to reach 20 per cent by the year 2000 and 25 per cent by 2020. In Australia and New Zealand, the elderly comprised 15 per cent of the population in 1990, and in Hong Kong, 13 per cent. The share of the elderly in the Republic of Korea is expected to pass the 10 per cent mark by the year 2000 and reach close to 18 per cent by 2020. By that time, China is predicted to be home to over a fifth of the world's elderly population. Even in the currently relatively young populations of Fiji, Sri Lanka and Thailand, the percentage of total population aged 60 and over will be 15.5, 14.6 and 13.1 respectively. By 2020, the Asian and Pacific region will be home to 55 per cent of the world's elderly population.

A longer life-span brings with it declining physical and mental functions. As people age, they become more susceptible to increased infirmities and disabilities. The rates of prevalence of such diseases and degenerative processes as diabetes, hypertension, chronic ischaemic heart disease, visual and auditory impairment, arthritis, osteoporosis, tooth decay and dementia tend to be higher among older cohorts.

Existing health-care delivery systems are not always appropriate for addressing the health needs of the elderly. Most of these systems comprise two broad categories: hospitalization in the case of severe illness, or out-patient care. Many of the elderly, however, suffer from health conditions that require nursing rather than hospital care, and long-term management of illness, disability, chronic conditions, impaired functional capacity and mobility.

Governments in developed countries have responded to the health and nutrition needs of the elderly at both the policy-making and service delivery levels by allocating resources for special services – for example, domiciliary health care, nursing care, day care, and geriatric centres – often at a subsidized cost. Although some developing countries have followed suit to some degree in terms of policy commitments and entitlement schemes, for the most part health services for the elderly remain inadequate. This is due not only to resource constraints and still nascent geriatric consciousness, but also to the perceptions that the elderly can always count on family support.

However, fertility decline, weakening of extended networks, migration and increased participation of women in the labour force have resulted in a smaller pool of potential caretakers for the growing number of the elderly. And even when family care and support are available, they are not always sufficient to meet the social and psychological as well as health needs of the elderly.

Primary health-care strategies incorporating community health workers provide some coverage for the population, but are still wanting in their ability to cope with the special health and nutrition problems of ageing. Positive developments in this regard include a growing interest in geriatric medicine, the inclusion of geriatric medicine in nursing and medical school curricula, the setting up of mobile health services, medical check-up camps, cataract operation camps, the opening of geriatric wards, units and special counters in hospitals, and earmarking special days in general hospitals for out-patient treatment of the elderly. Decentralized planning and activities to involve the elderly and their families to effect a better integration of services at the community level are gaining increasing attention. Another encouraging sign is the growing prevalence of media campaigns to provide health and nutrition education to the elderly and promote the message that old age need not be synonymous with decrepitude and disease.

The challenge of caring for the elderly is especially acute for older women, who constitute the majority of the elderly in virtually all countries in the ESCAP region outside of South Asia and Papua New Guinea. Because of women's greater longevity in most countries of the region and the tendency for men to marry women younger than themselves, many women are likely to end up as widows, thus leading to a serious gender asymmetry in the support and care of the elderly. Increased poverty and economic stress have eroded the traditional support for widows provided by the husband's family, thereby leaving older women increasingly vulnerable. Such trends have been observed in Bangladesh and Cambodia, for example, where elderly widows are often left to fend for themselves.

The problems confronting elderly women are, moreover, frequently compounded by the difficulties they face in obtaining sufficient income because of their limited access to pensions and other income generation opportunities, as well as rights to property. Older women are disproportionately highly represented among the elderly poor. Consequently, they are especially susceptible to gender-related illnesses and chronic conditions resulting from a lifetime of excessive physical exertion, frequent child-bearing and inadequate nutritional intake. Just the daily task of fetching and carrying water has been found to cause a wide range of physical disabilities in later life. The combination of economic and social disenfranchisement makes elderly women one of the most vulnerable groups in society, and their plight warrants special attention from planners and policy makers.

patterns. In the Asian republics of the former Union of Soviet Socialist Republics, for example, there have been significant dietary changes, even though spending on food items has remained relatively stable. Meat and dairy product (protein) consumption has declined dramatically in favour of bakery products and potatoes, which accounted for almost two thirds of caloric intake in 1992.

**Table VI.1. Daily per capita calorie availability as a percentage of average daily requirement and dietary "Q" scores for selected economies of the ESCAP region**

| | *(Percentage)* | | *Dietary "Q" scores* |
|---|---|---|---|
| | *1979-1981* | *1988-1990* | *1986-1989* |
| **Developing economies of the ESCAP region** | | | |
| **East Asia** | | | |
| China | 104.2 | 113.2 | 65 |
| Democratic People's Republic of Korea | 130.4 | 134.3 | 68 |
| Mongolia | 125.6 | 112.3 | 81 |
| Republic of Korea | 129.0 | 120.9 | 82 |
| **South-East Asia** | | | |
| Cambodia | ... | 93.4 | 51 |
| Indonesia | 109.8 | 123.6 | 57 |
| Lao People's Democratic Republic | ... | 115.4 | 63 |
| Malaysia | 113.7 | 121.5 | 78 |
| Myanmar | 112.0 | 116.6 | 59 |
| Philippines | 112.3 | 106.1 | 69 |
| Thailand | 105.1 | 103.5 | 71 |
| Viet Nam | ... | 102.4 | 57 |
| **South Asia** | | | |
| Bangladesh | 88.8 | 94.2 | 49 |
| India | 96.0 | 99.8 | 72 |
| Maldives | ... | 102.7 | 65 |
| Nepal | 87.8 | 92.9 | 55 |
| Pakistan | 105.0 | 105.1 | 78 |
| Sri Lanka | 104.9 | 106.8 | 63 |
| **Pacific** | | | |
| Fiji | 128.0 | 115.7 | 77 |
| Papua New Guinea | ... | 103.9 | 73 |
| Samoa | 101.2 | 102.0 | 84 |
| Solomon Islands | 93.3 | 100.0 | 75 |
| Tonga | 131.6 | 121.9 | 79 |
| Vanuatu | 97.6 | 116.3 | 80 |
| **Developed economies** | | | |
| Australia | 122.2 | 132.5 | 82 |
| Japan | 113.7 | 113.6 | 96 |
| New Zealand | 149.0 | 143.5 | 87 |

*Source:* FAO/WHO/International Conference on Nutrition, "Final report, FAO/WHO Asia and Pacific Regional Meeting, 27-31 January 1992, Bangkok".

It is also worth noting that the fulfilment of the average calorie or energy requirement fails to reveal the nutritive value of the food providing the given level of energy. Diets in the developing countries in the region are predominantly rich in cereals with low caloric density and are therefore consumed in bulk to attain the required levels of dietary energy. Other food items, ranging from fruits and vegetables and protein products, often feature insufficiently in the diet. The dietary quality index ("Q" score), which defines a desirable dietary pattern in terms of food groups rather than nutrients, reveals deficiencies across the region. Many of the developing countries in the ESCAP region have a score of less than 70 out of a maximum score of 100, suggesting that diets need considerable improvement.

Protein-energy malnutrition, and vitamin A, iron and iodine deficiency disorders and their related sequelae persist as major causes of morbidity and mortality in the ESCAP region (table VI.2). Low birth weights of children, and low weight for height and low height for age of children as well as adults lead to life-long disabilities. Low birth weights of children are indicative of maternal malnutrition and are closely linked with both neonatal and postnatal mortality. Nutritional anaemia affected more than 126 million women in 11 countries of the region[7] (59 per cent of all women of reproductive age) and contributed to high regional rates of low birth weights, particularly in

[7] Bangladesh, Bhutan, Democratic People's Republic of Korea, India, Indonesia, Maldives, Mongolia, Myanmar, Nepal, Sri Lanka and Thailand.

**Table VI.2. Magnitude of malnutrition in selected countries[a]**

| *Type of malnutrition* | *Indicator* | *Mean prevalence (percentage)* | *Estimate number affected (millions)* |
|---|---|---|---|
| **Protein energy malnutrition** | | | |
| Foetal malnutrition | Percentage of low birth weight births (2,500 g) | 29.4 | 10.2 |
| Acute "wasting" malnutrition | Percentage of under-5 children below standard weight for height | 16.3 | 27.0 |
| Chronic "stunting" malnutrition | Percentage of under-5 children below standard height for age | 49.2 | 81.5 |
| Moderate/severe malnutrition | Percentage of under-5 children below standard weight for age | 47.9 | 79.4 |
| **Iodine deficiency disorders (IDD)** | | | |
| Goitre | Percentage of population with goitre | 8.8 | 99.3 |
| Cretinism and other IDD handicaps | Percentage of population with cretinism and/or mental/motor handicap due to IDD | 1.6 | 17.5 |
| **Vitamin A deficiency** | | | |
| Xerophthalmia | Percentage of under-6 children with conjunctival/ corneal xerophthalmia | 6.7 | 10.0 |
| Nutritional blindness | Incidence of total blindness per year in under-6 children due to vitamin A deficiency | – | 0.1 |
| **Iron deficiency** | | | |
| Nutritional anaemia | Percentage of women aged 15-45 with anaemia | 59.0 | 126.0 |

*Source:* FAO/WHO/International Conference on Nutrition, "Final report, FAO/WHO Asia and Pacific Regional Meeting, 27-31 January 1992, Bangkok".

[a] Including Bangladesh, Bhutan, Democratic People's Republic of Korea, India, Indonesia, Maldives, Mongolia, Myanmar, Nepal, Sri Lanka and Thailand.

the South Asian countries. In Bangladesh, for example, 47 per cent of all babies born between 1980 and 1988 had a low birth weight.[8]

In South-East Asia, the percentage of low weight births varied from 9 per cent in Malaysia to 39 per cent in the Lao People's Democratic Republic, the high percentage which could be attributed in part to the practice of many women, particularly in South and South-East Asia, to restrict food intake during the third trimester of pregnancy, believing that the practice will keep the fetus small and thus easier to deliver. China, where priority is given to maternal and child health services, had one of the lowest rates of low birth weights in the region, only 9 per cent.

Micronutrient malnutrition continues to undermine the health of children in the region. Over 16 million children under the age of 6 in the South-East Asian region suffer from vision impairment, ranging from slight corneal damage to totally blinding corneal destruction, owing to vitamin A deficiency.[9] The disability does not stop there, because lack of vitamin A renders them more vulnerable to other debilitating diseases as well. In Viet Nam, vitamin A deficiency has been identified as the foremost cause of handicaps in children. Across the region, vitamin A deficiency is the single most frequent cause of blindness, leading even to death in 60-70

[8] UNICEF, *The State of the World's Children 1992* (New York, Oxford University Press, 1992).

[9] FAO/WHO/International Conference on Nutrition, "Final report, FAO/WHO Asia and Pacific Regional Meeting, 27-31 January 1992, Bangkok".

per cent of untreated cases. Iodine deficiency, another easily preventable nutrient disorder, resulted in 99.3 million people with goitre and 17.5 million born with cretinism and/or mental and/or motor dysfunction in South and South-East Asian countries. The incidence of malnutrition, particularly in children, tends to be higher from the end of the dry season to the beginning of the rainy season when diarrhoeal diseases and parasites also occur more frequently. Table VI.3 provides an overview of the estimated proportion of children in selected countries affected by undernutrition.

At the other end of the nutritional spectrum, the epidemiological transition has generated shifts in social and economic behaviour, which favour detrimental changes in dietary patterns that increase risk factors for chronic degenerative diseases. In the Pacific islands, for example, rapid urbanization has led to a change in food habits. Consumption preferences now favour processed and imported foods, which are often more accessible and convenient, as well as cheaper. Because the new diet contains more salt and animal fat than traditional staples, it has led to a sharp rise in obesity and other chronic diet-related disorders such as cardiovascular diseases and diabetes.

Similar trends are found in other parts of the region also, particularly in urban areas.

### 3. Overall health status

Life expectancy has increased significantly in most developing countries of the ESCAP region over the last three decades (table VI.4). In some countries it has reached almost the developed country levels – the so-called "final stage" of mortality transition. In many others, the levels are still 10-20 years below 70, considered the benchmark of the final stage of mortality transition. In the more advanced developing countries in East Asia, average life expectancy at birth has reached 70 years or more.

Infant mortality rates have declined in all countries but remain high relative to the rates in developed countries, and particularly in those countries where life expectancy is relatively low. Dramatic disparities exist within countries. In the Lao People's Democratic Republic, for example, infant mortality in urban areas is estimated to be as low as 83/1,000, while children in remote areas may have less than four chances in five of staying alive until their first birthday.[10] In Bangladesh, India and Indonesia, the infant mortality rate was lower for females than for males during the first month of life. In the post-natal period, from 29 days onwards, the trend was reversed, and the rate was higher for females. A socio-economic breakdown of this pattern in Bangladesh revealed what has been corroborated in many other countries, namely that the rate varied proportionately with the education and economic level of the mother, being highest in the illiterate and low-income groups.

**Table VI.3. Recent trends in prevalence of moderate/severe protein-energy malnutrition in children in selected countries of the ESCAP region**

| | *Year of survey* | *Percentage of prevalence of protein-energy malnutrition* |
|---|---|---|
| Bangladesh | 1975 | 78.8 |
| | 1989 | 54.2 |
| India | 1976 | 48.1 |
| | 1982 | 32.1 |
| Indonesia | 1988 | 10.8 |
| | 1993[a] | 9.5 |
| Myanmar | 1978 | 63.0 |
| | 1988 | 38.6 |
| Philippines | 1978 | 21.9 |
| | 1987 | 14.0 |
| Sri Lanka | 1976 | 42.0 |
| | 1982 | 27.8 |
| Thailand | 1979 | 15.1 |
| | 1990 | 0.8 |

***Sources:*** FAO/WHO/International Conference on Nutrition, "Final report, FAO/WHO Asia and Pacific Regional Meeting, 27-31 January 1992, Bangkok". Data for Indonesia and the Philippines are from national sources.

***Note:*** These figures are indicative but not strictly comparable.

[a] Target.

[10] UNICEF, *Children and Women in the Lao People's Democratic Republic* (Vientiane, 1992).

**Table VI.4. Key health indicators for selected economies of the ESCAP region**

| | *Babies with low birth weight (percentage)* | *Infant mortality (per 1,000 live births)* | | *Under-5 mortality rate* | | *Maternal mortality rate (per 100,000 live births)* | | *Crude death rate (per 1,000 population)* | | *Life expectancy at birth (years)* | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | *1980-1988* | *1960* | *1990* | *1960* | *1990* | *1980* | *1988* | *1960* | *1990* | *1960* | *1990* |
| **Developing economies of the ESCAP region** | | | | | | | | | | | |
| **East Asia** | | | | | | | | | | | |
| China | 9 | 31 | 29 | 203 | 42 | 44 | 130 | 19 | 7 | 63 | 70 |
| Democratic People's Republic of Korea | ... | 78 | 26 | 120 | 35 | 41 | 41 | 13 | 5 | 54 | 70 |
| Hong Kong | 5 | 38 | 7 | 64 | 7 | 4 | 6 | 7 | 6 | 67 | 78 |
| Mongolia | 10 | 109 | 62 | 185 | 84 | 140 | 250 | 18 | 8 | 52 | 63 |
| Republic of Korea | 9 | 78 | 17 | 120 | 30 | 34 | 80 | 14 | 6 | 54 | 71 |
| **South-East Asia** | | | | | | | | | | | |
| Brunei Darussalam | ... | ... | 9 | ... | ... | ... | ... | ... | 4 | ... | 76 |
| Cambodia | 8 | 150 | 117 | 218 | 193 | ... | 900 | 21 | 15 | 46 | 50 |
| Indonesia | 14 | 150 | 61 | 225 | 97 | 800 | 450 | 23 | 12 | 41 | 62 |
| Lao People's Democratic Republic | 39 | 155 | 103 | 233 | 152 | ... | 750 | 23 | 16 | 44 | 49 |
| Malaysia | 10 | 72 | 16 | 105 | 29 | 59 | 120 | 15 | 5 | 53 | 70 |
| Myanmar | 16 | 158 | 65 | 230 | 88 | 140 | 600 | 21 | 9 | 44 | 61 |
| Philippines | 18 | 106 | 41 | 134 | 69 | 80 | 250 | 15 | 7 | 53 | 64 |
| Singapore | 6 | 35 | 7 | 49 | 9 | 11 | 14 | 8 | 5 | 63 | 74 |
| Thailand | 12 | 103 | 27 | 149 | 34 | 270 | 50 | 15 | 7 | 52 | 66 |
| Viet Nam | 17 | 157 | 49 | 232 | 65 | 110 | 140 | 23 | 9 | 43 | 67 |
| **South Asia** | | | | | | | | | | | |
| Afghanistan | 20 | 230 | 167 | 381 | 292 | 640 | 1 000 | 30 | 23 | 33 | 42 |
| Bangladesh | 47 | 159 | 114 | 262 | 180 | 600 | 650 | 23 | 14 | 37 | 52 |
| Bhutan | ... | 195 | 122 | 298 | 189 | ... | 1 310 | 25 | 16 | 38 | 49 |
| India | 30 | 165 | 92 | 282 | 142 | 500 | 550 | 21 | 10 | 43 | 59 |
| Iran (Islamic Republic of) | 5 | 163 | 88 | 254 | 59 | ... | 250 | 21 | 9 | 50 | 63 |
| Maldives | 20 | 106 | 61 | ... | 85 | ... | 300 | ... | 12 | 47 | 62 |
| Nepal | ... | 195 | 121 | 298 | 189 | 850 | 850 | 26 | 14 | 38 | 52 |
| Pakistan | 25 | 162 | 103 | 276 | 158 | 600 | 600 | 24 | 11 | 43 | 56 |
| Sri Lanka | 25 | 71 | 19 | 114 | 35 | 90 | 60 | 9 | 6 | 62 | 71 |
| **Pacific** | | | | | | | | | | | |
| Fiji | 14 | 36 | 26 | 98 | 31 | ... | 150 | 10 | 7 | 65 | 65 |
| Kiribati | ... | 87 | 59 | ... | ... | ... | ... | ... | 11 | 54 | 55 |
| Papua New Guinea | 25 | 165 | 57 | 248 | 80 | 1 000 | 900 | 23 | 11 | 41 | 55 |
| Samoa | 3 | 19 | 46 | ... | 59 | ... | ... | ... | 7 | 61 | 66 |
| Solomon Islands | 9 | 52 | 30 | ... | ... | ... | ... | ... | 7 | 51 | 65 |
| Tonga | ... | 60 | 23 | ... | ... | ... | ... | ... | 6 | ... | 67 |
| Vanuatu | ... | ... | 71 | ... | ... | ... | ... | ... | 10 | ... | 65 |
| **Developed economies** | | | | | | | | | | | |
| Australia | 6 | 20 | 8 | 24 | 10 | 11 | ... | 9 | 7 | 71 | 77 |
| Japan | 5 | 31 | 5 | 39 | 6 | 15 | ... | 8 | 7 | 68 | 79 |
| New Zealand | 5 | 23 | 10 | 26 | 12 | 20 | ... | 9 | 7 | 72 | 75 |

*Sources:* UNDP, *Human Development Report 1992* (New York, Oxford University Press, 1992); World Bank, *World Development Report 1992: Development and the Environment* (New York, Oxford University Press, 1992); UNICEF, *The State of The World's Children 1992* (New York, Oxford University Press, 1992); ESCAP, *1991 ESCAP Population Data Sheet;* and WHO, *World Health Statistics Annual, 1990* (Geneva, Switzerland, 1991).

*Note:* In some cases data are for the nearest year indicated.

The under-5 mortality rate, considered by the United Nations Children's Fund (UNICEF) to be the most revealing indicator of the status of health and nutrition, varies widely across the region. Under-5 mortality reflects the cumulative outcome of a wide variety of inputs, including: the nutritional health and health knowledge of the mother; the level of immunization and oral rehydration therapy use (for treating diarrhoea); the availability of maternal and child health services; income and food availability in the family; the availability of clean water and safe sanitation; and the overall safety of the child's environment. The World Summit for Children held in 1990 has set targets, to which countries of the ESCAP region subscribe, for virtual elimination of the deficiencies in many of these areas by the year 2000.

War-torn Afghanistan and Cambodia recorded the most hostile environments, with under-5 mortality rates of 292 and 193 deaths per thousand live births respectively in 1990. Hong Kong and Singapore registered the lowest rates in the region. Among other developing countries in the region with the lowest under-5 mortality are Fiji, the Republic of Korea, Sri Lanka and Thailand, with rates ranging from 31 deaths per thousand live births in Fiji to 35 in Sri Lanka and 30 in the Republic of Korea.

Child morbidity in many countries tends to be underreported because children are often treated first at home or through other private sector channels and are only brought to the hospital when the home treatment fails, which unfortunately is frequently too late. As with infant mortality, child health and mortality are closely associated with maternal health and literacy levels.

Although women's health is receiving increasing attention globally, maternal mortality and morbidity continue to be major health problems in much of the ESCAP region. Maternal mortality is particularly high in areas where lack of family planning services, prenatal care and trained birth attendants gives rise to high rates of pregnancy and abortion-related complications, and in endemic malarial areas because the resultant anaemia increases the risk of fatal haemorrhaging during delivery. Child-bearing at a very young age, especially in many of the South Asian countries where early marriage is common, has been found to be a predisposing cause for maternal death. Frequent pregnancies and long lactational periods, coupled with endemic malnutrition and hard physical work, lead to the "maternal depletion syndrome", which affects women's health adversely and aggravates the risk of disease, disability and death both directly and indirectly. The dearth of trained female health workers creates a further obstacle for women in countries where access to outsiders is restricted. Finally, the growing AIDS pandemic has widespread implications for women throughout the region.

The available data on maternal mortality indicate that rates have been decreasing over time. Relative to the developed market economies as a whole, where the rate is about 34 maternal deaths per 100,000 live births, however, they remain inordinately high. For example, Bhutan recorded the worst maternal health conditions in the region, with 1,310 maternal deaths per 100,000 live births for the period 1980-1990,[11] which was possibly due in part to limited access to family planning and other health services. Other factors associated with poor maternal health are low female literacy rates and the low percentage of pregnant women immunized against tetanus. In the Asian republics of the former USSR, where family planning services are virtually non-existent and the frequency of abortions in many communities equals or exceeds the rate of live births, maternal mortality rates range from 40-120/100,000, higher than in many economically comparable countries.[12] In Sri Lanka and Thailand, where female literacy levels are relatively high and family planning services are widely available, maternal mortality rates have declined to 50 and 60 respectively.

Health indicators for the East Asian populations have improved substantially over time. Already in 1960, life expectancy in China and Hong Kong was 63 and 67 respectively, which has risen to 70 and 78 in the last 30 years. China's achievements stand out in the light of the fact that life expectancy in that country was only 35 years in 1949. By 1990, life expectancy in both the Democratic People's Republic of Korea and the Republic of Korea had increased to 70 and 71 years, from 54 years in 1960. During the same period, life expectancy in Mongolia advanced from 52 to 63 years. Fewer than 10 per cent of the babies are born with low birth weights in these countries, although infant mortality rates, at 62 per 1,000 live births in Mongolia and 29 and 26 in China and the Democratic People's Republic of Korea in 1990, are

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[11] UNICEF, *The State of the World's Children 1992* ...

[12] Lincoln C. Chen, Jon E. Rohde and Richard Jolly, "Health crisis in central Asian republics", in *Economic and Political Weekly*, vol. XXVII, No. 23, 6 June 1992.

still relatively high. The amelioration in health status reflects, among other things, an improvement in child health, a reduction in infant mortality rates and better nutrition. Improved health-care facilities and vigorous public health campaigns, especially in China, contributed to these trends.

With the exception of Cambodia and the Lao People's Democratic Republic, South-East Asian countries have made progress in raising the health status of their populations. Despite relatively low income levels in Myanmar and Viet Nam, the average life expectancy in those countries increased dramatically between 1960 and 1990, from 44 and 43 years to 61 and 64 years respectively. The infant mortality rate has dropped in Myanmar to 65 deaths per thousand live births, and to 49 in Viet Nam. In most other countries in the region, infant mortality rates have declined over time, but remain high by developed country standards, ranging from 117 in Cambodia to 41 in the Philippines and 27 in Thailand. Sri Lanka is the only country in South Asia where, by 1990, average life expectancy had reached 71, up from 62 years in 1960. Infant mortality rates in that country have declined from 71 per thousand live births in 1960 to 19 in 1990.

Life expectancy has improved dramatically in the Islamic Republic of Iran and Maldives, reaching an average of 63 and 62 respectively in 1990. Afghanistan's life expectancy of 42 years is the lowest in South Asia, followed by Bangladesh and Nepal, where average life expectancy at birth is estimated at 52 years. In Pakistan and India, life expectancy in 1990 stood at 56 and 59 respectively, up from 43 years for both countries in 1960.

Although progress has been achieved in improving child health, infant mortality rates in the least developed South Asian countries (Afghanistan, Bangladesh, Bhutan and Nepal) remain above 100 per thousand live births. Infant mortality rates of 92 in India, 88 in the Islamic Republic of Iran and 61 in Maldives are also relatively high.

On the basis of life expectancy and infant mortality, the health standards in the South Pacific are fairly high. The exception to this is Papua New Guinea, but the situation there has improved dramatically in the last 30 years. Life expectancy in 1990 was 55, up from 41 in 1960. During that time, infant mortality declined from 165 to 57. Papua New Guinea is much wealthier than most of the other islands, but has the poorest health conditions among them.[13]

With life expectancy rates ranging from the mid-60s to the high 60s for men to the low 70s for women, and infant mortality rates of 28-58 per thousand, the health situation in the Asian republics of the former USSR falls between that of the advanced industrialized countries and the less developed countries of the region.

## 4. Disease patterns: major causes of mortality and morbidity

### *(a) Infectious and communicable diseases*

Infectious and parasitic diseases, such as respiratory infections and pneumonia, diarrhoea, measles, malaria and tuberculosis, remain the leading causes of mortality and morbidity in the ESCAP region. Their incidence is closely related to the absence of safe drinking water, inadequate sanitation, overcrowded and badly ventilated housing, and the prevalence of air pollution, including smoke from wood fires.

Acute respiratory infections, particularly pneumonia, are the most common cause of death in children under the age of 5 in many of the developing countries of the ESCAP region. WHO figures indicate that 30-40 per cent of all infant mortality in Mongolia is due to acute respiratory infections. These are also widely prevalent in other countries of the region, where indoor pollution, emanating from wood fires and other biofuels, is high during the winter months. Prompt treatment with antibiotics can save many lives, but often the medicines are not available to those most in need. As low birth weight, malnutrition, overcrowding and urban air pollution are additional factors enhancing conditions for the transmission of acute respiratory infections, poverty alleviation measures hold the greatest hope for reducing unnecessary deaths.

Diarrhoeal diseases, often aggravated by parasitic infections and vice versa, continue to kill and maim young children as well as adults. In addition to contaminated water, inadequate hygiene and unhealthy food preparation practices, lack of breast-feeding and poor weaning practices have been identified as significant risk factors by contributing to impaired nutritional status. This in turn increases the

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[13] Suliana Siwatibau, "Some health issues in the South Pacific", *Pacific Economic Bulletin*, vol. 5, No. 2, December 1990 (National Centre for Development Studies, Australian National University).

severity, duration, and possibly even incidence of diarrhoeal disease. According to estimates for selected countries in the ESCAP region, children below the age of 5 suffer on average 2.3 episodes of diarrhoea per year in Bangladesh, 4.1 in Bhutan, 1.7 in India, 3.4 in Mongolia and 3.3 in Nepal.[14] Studies indicate that improved breast-feeding and weaning practices can reduce the incidence of diarrhoeal disease. More effective case management, principally through the promotion of oral rehydration salts and home-prepared fluids, has led to a decline in the case-fatality rate among children under 5. Nevertheless, diarrhoeal cases still account for a significant proportion of hospital admissions, where patients often receive expensive intravenous fluids, unnecessary antibiotics and anti-diarrhoeal drugs in lieu of oral rehydration salts, thereby placing an unnecessary burden on limited national health budgets, not to mention household incomes.

Vector-borne diseases such as malaria, dengue fever and Japanese encephalitis persist as serious public health problems in several countries of the region, because large percentages of the population live in areas where these diseases are endemic. Malaria, in particular, has been on the increase. Over 9 million cases of the disease occur in Asia each year, with the number of severe and complicated cases rising dramatically in many countries. Since 1987, the mortality rate attributed to malaria has increased by about 228 per cent in 1989 in Viet Nam and about 185 per cent in 1990 in Cambodia.[15] In Cambodia, Papua New Guinea, Solomon Islands and Viet Nam, malaria is the pre-eminent cause of child mortality; in many countries it also ranked first in terms of hospital bed occupancy. Human resistance to anti-malarials, vector resistance to insecticides, uncontrolled population movements, and intensified exploitation of natural resources yielding new reservoirs for the proliferation of mosquitoes, have made malaria control one of the foremost challenges of the region.

Vaccine-preventable diseases, particularly measles and whooping cough, remain major health threats to children under 5 in many countries despite global efforts to promote vaccination programmes. Child immunization coverage for 11 countries in Asia in 1990 was estimated at 86 per cent for diphtheria, pertussis (whooping cough) and tetanus, 87 per cent for poliomyelitis, 80 per cent for measles and 95 per cent for tuberculosis.[16] In the western Pacific, coverage was higher: 92 per cent for diptheria, pertussis and tetanus, 92 per cent for poliomyelitis, 91 per cent for measles and 93 per cent for tuberculosis.[17] Vaccination against hepatitis B for the newborn has been added to immunization programmes in 29 countries of the ESCAP region.

Official statistics attesting to broad coverage may, however, omit the fact that many people, particularly children, are only partially immunized. Often this is because mothers have not been forewarned about post-vaccine reactions, and are thus reluctant to bring their children back to complete the series.

The overall incidence of neonatal tetanus has declined in the region. However, protection against the disease remains problematic in areas with limited outreach services, where pregnant women receive prenatal care only by default in the course of seeking care for another ailment. A recent study carried out in Cambodia found that fewer than 10 per cent of women seen at a provincial hospital had been fully vaccinated against tetanus. In Bangladesh, tetanus still ranks as a pre-eminent cause of death.

Although reliable figures are lacking, it is estimated that the ESCAP region has at least one quarter of the world's tuberculosis cases. In some of the South Pacific islands, tuberculosis is responsible for close to 35 per cent of all reported deaths.[18] The number of cases in the region is rising due to problems relating to compliance with the requirements of treatment, the emergence of drug-resistant strains, and the spread of AIDS and HIV-related infections which make people more susceptible to virulent tuberculosis. Tuberculosis takes its heaviest toll on the economically most productive age groups (15-59), where it accounts for over a quarter of all deaths.

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14 WHO, "Programme for control of diarrhoeal diseases: eighth programme report, 1990-1991" (WHO/CDD/92.38).

15 WHO, "Malaria and malaria control in countries of the Western Pacific region" (July 1992).

16 This refers to the countries listed in note 7 above.

17 WHO, "Report of the Regional Director for the Western Pacific, 1 July 1991 to 30 June 1992". The countries concerned are Australia, Cambodia, China, Fiji, Japan, Kiribati, Lao People's Democratic Republic, Malaysia, New Zealand, Papua New Guinea, Philippines, Republic of Korea, Solomon Islands, Vanuatu and Viet Nam.

18 Suliana Siwatibau, loc.cit.

## Box VI.3. Socio-economic implications of AIDS in Asia

Since infection with the human immunodeficiency virus (HIV) was first identified in the region in 1984, acquired immune deficiency syndrome (AIDS) has assumed epidemic proportions in many countries and poses an unprecedented medical, social and economic threat to all countries. As of 30 October 1992, a total of 49,738 HIV-infected cases and 1,217 deaths were reported from a number of countries in the region. Most of the reported cases of infections and deaths were from three countries; whereas the numbers of infected persons were quite high in countries such as Thailand, India and Myanmar, other countries with a significant incidence of infections and deaths are Indonesia, Nepal and Sri Lanka.[a] Australia, Japan and New Zealand accounted for 92.4 per cent of the reported AIDS cases in the western Pacific region.[b]

The number of reported cases of infections and deaths may appear small in relation to the region's vast population. That also frequently generates complacency about the seriousness of the AIDS threat. The time-lag between infection and the appearance of symptoms, which extends up to 10 years, and the inadequacy of tests, detection and reporting in many countries, are likely to have kept the number of reported cases low. These cases may therefore represent only a fraction of the numbers of people that may already have been actually infected. More importantly, predictions about the future course based on the rapidity and the manner of the spread of infection raise the most serious concern about the future of the epidemic in the Asian and Pacific region. WHO projects that by the year 2000, globally a total of 30-40 million men, women and children will have been infected with HIV and nearly one fourth of them will be in Asia.[c]

Thus, despite the delayed onset of AIDS in Asia relative to Africa and the Western countries, the momentum of its subsequent spread has been extraordinary. In Thailand, for example, infection levels among intravenous drug users in Bangkok went up from zero to above 30 per cent in the first eight months of 1988. In 1989, 44 per cent of female prostitutes in the northern part of the country were found to be infected with HIV. In late 1991, over 15 per cent of a sample of army recruits from the northern province of Chiang Rai, considered representative of young men between 18 and 20 in the general population, were found to have been exposed to the HIV virus. Surveys carried out in mid-1992 found over 7 per cent seroprevalence among pregnant mothers seeking prenatal care; at least 200 babies born in Chiang Rai province tested positive for HIV. Seropositivity among voluntary blood donors countrywide jumped 73 per cent between June and December 1991. In the light of the above, current projections are that 2-4 million people in the country will be infected by the year 2000, assuming no significant behavioural changes.[d]

In India, where HIV infection is spiralling, 2-3 million persons are expected to be infected with the virus by the year 1996, and 179,000 persons with AIDS.[e] The number infected could rise to 5 million by the year 2000. Seroprevalence is multiplying among sex industry workers in Bombay and Tamil Nadu, and more than one third of those attending sexually transmitted disease clinics in Bombay are testing positive for HIV. In the north-eastern States bordering China and Myanmar, intravenous drug use is the principal mode of transmission; 50 per cent of the drug users tested have been found to be HIV infected. India has the added problem of depending heavily on "professional" blood donors to maintain national blood supplies. Many of these donors hail from indigent population groups found to have a high incidence of HIV. Efforts to ban them from donating blood have had a limited effect owing to the lack of control mechanisms, the continuing demand for blood and the willingness of the donor population to continue blood donation as a means of livelihood. Poor donor selection is only part of the problem; unsterile and improper collection and storage techniques further increase the probability of tainted blood supplies.

By October 1992, 4,246 people had tested positive for HIV in Myanmar, and thousands more are thought to be infected. The problem is most acute among intravenous drug users and sex industry workers.

Nobody is immune to AIDS and HIV infection but it tends to be inequitable in its impact and effects on different sectors of the population. The poor, for lack of other livelihood options, are more inclined to enter the commercial sex industry as well as to come into contact with the virus through unsterile health accessories. Poverty is also a frequent cause of migration and family fragmentation. It increases participation in occupations which entail long periods of separation of spouses and consequently, of extramarital liaisons. Women's dependency on men, and their generally lower levels of education, compromise their capacity to protect themselves against sexually transmitted infections.

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[a] World Health Organization, "AIDS – an update", paper presented at the forty-first meeting of the Regional Director with the WHO Representatives, New Delhi, November 1992 (SEA/WR41/6).

[b] See footnote 17 in the main text.

[c] World Health Organization, *AIDS in South-East Asia: No Time for Complacency* (New Delhi, 1992).

[d] Mechai Viravaidya, Stasia A. Obremskey and Dr. Charles Myers, "The economic impact of AIDS on Thailand", October 1991.

[e] World Health Organization, *AIDS in South-East Asia...*

The socio-economic costs of AIDS and HIV infection are devastating. Most important is the cost of sickness and ultimately death of large numbers of adults in the prime of life: the majority of HIV cases are found among men and women between the ages of 20 and 45. The loss of output from death or disability of this most productive population group can be serious in all sectors of the economy. The health care and social service costs of the disease coupled with the training costs to replace lost manpower, can impose significant burdens on government budgets. The direct annual costs of AIDS-related health and welfare services reportedly absorb $5 billion globally. The indirect costs of the epidemic worldwide through lost productivity, lost markets and cost of training new workers to replace those dead or disabled due the disease could be up to 10 times greater.

In the ESCAP region, the case of Thailand, which is the best researched and documented, provides some indication of the magnitude of the costs involved in individual cases. Over the 10-year period 1991-2000, the aggregate direct and indirect cost of AIDS to Thailand has been estimated at between $7.3 and $8.7 million. However, AIDS was likely to have a much broader impact through its adverse effects on, *inter alia*, tourism, foreign direct investment and remittances from workers abroad.[f]

Since no known effective cure of AIDS has been found so far, prevention is the only way to stop or reduce the toll that the disease is to take from the Asian and Pacific countries, as indeed the world.

The fact that there is often a long time-lag between exposure to the HIV virus and manifestation of the actual disease related to immune deficiency has created serious obstacles for preventive policies. In most Asian countries, only a handful of full-blown AIDS cases have been identified, at least publicly, relative to the potential infection, so that it is difficult to convince the average person that a very real problem exists and that risk-prone behaviour today can have implications for health status tomorrow. Concern about the impact of AIDS on the national image and on revenue-generating sectors such as tourism has impeded government response to the epidemic in some cases. Another problem is that because AIDS is as much a socio-behavioural problem as a medical one, an intersectoral approach to policy and prevention is required, and that is a very time-consuming, and often politically sensitive, process.

Increasingly, however, the urgency of addressing AIDS is being recognized in tandem with the development of innovative interventions both to promote prevention and to strengthen support systems to help those who are already infected and their families to cope with the disease. National AIDS control programmes under the auspices of the Ministry of Health are in place in many countries in the region. Thailand is one of the best examples of a country that has devised a multisectoral approach to AIDS.[g] Barring major affordable discoveries on the treatment front, massive public health education across the region remains the only means to stop the spread of the disease.

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[f] Mechai Viravaidya, Stasia A. Obremskey and Dr. Charles Myers, loc.cit.

[g] "Thailand National AIDS Prevention and Control Program" (AIDS Policy and Planning Coordination Bureau, Office of the Prime Minister, Bangkok); and "Final report – an external programme review of Thailand's National AIDS Programme: National Medium-term Programme for the Prevention and Control of AIDS in Thailand, 4-15 November 1991" (A joint review carried out by the Ministry of Public Health and WHO in collaboration with participating parties).

Leprosy continues to figure as a significant public health problem and cause of disability in South-East Asia, where almost three quarters of the total leprosy cases in the world are found. Adoption of the WHO multi-drug therapy strategy for leprosy has led to a steep decline in registered cases, from 3.7 million in 1985 to 2.7 million in 1990.[19] Many countries have made a concerted effort to integrate leprosy control into general health services. Raised awareness among the general population has led to increased self-reporting and early case detection, thereby reducing disability rates.

A high incidence of sexually transmitted diseases persists in some countries of the ESCAP region. Although such diseases rank among the top five diseases in adults who seek health care in many countries, inadequate recording and reporting systems and a widespread tendency to seek self-treatment outside of formal health channels understate the magnitude of the problem. The ramifications of these diseases also go underreported. Such diseases contribute to the incidence of blindness, brain damage, pelvic inflammation, spontaneous abortions, ectopic pregnancies and cervical cancer, and are a major cause of infertility in men as well as women. Children bear the brunt as well. Reproductive tract infections due to sexually transmitted diseases put the unborn child at risk of low birth weight, congenital abnormalities, blindness, pneumonia, retardation and even death.

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[19] WHO, "Review of second evaluation of regional strategies for health for all" (SEA/RC44/14), 22 July 1991. Data refer only to the WHO South-East Asia region.

The problem has assumed even greater dimensions in the light of the AIDS pandemic because the ulcerative conditions resulting from sexually transmitted diseases are associated with increased HIV transmission. Moreover, where prophylactic treatment with injections is common, opportunities for HIV transmission through the shared use of needles flourish. Abuse of over-the-counter antibiotics for both prophylactic and therapeutic purposes has also led to the emergence of drug-resistant strains of gonorrhoea, syphilis and other diseases. In some countries, particularly those with a high prevalence of HIV infection and prostitution, sexually transmitted diseases are on priority disease lists, often in conjunction with AIDS prevention efforts because of the crossover between transmission agents as well as target audiences.

AIDS and HIV infection have assumed epidemic proportions in India, Myanmar and Thailand and are gradually taking hold in other countries in the region. Sexual relations appear to be the major mode of HIV transmission, followed by fluid exchange through the use of unsterile needles and blood transfusions, and transmission by infected mothers to children during pregnancy or at birth. Infection was initially concentrated among prostitutes and their clients and intravenous drug users, but is now becoming increasingly entrenched among the general population in many countries (box VI.3).

*(b) Non-communicable diseases*

While the incidence of infectious diseases remains high in many countries of the region, non-communicable diseases, such as cardiovascular and chronic respiratory diseases, diabetes and cancer, which are major causes of death in the developed countries, are also emerging in the developing countries. Though more prevalent where infectious diseases are relatively well controlled and life expectancy is longer, they are rapidly gaining ground across the region, even where communicable diseases maintain a high profile, such as in the Asian republics. Diabetes is particularly prevalent in the Pacific islands. Some of these non-communicable illnesses are often described as "lifestyle" diseases because they are associated with particular behaviour that people have "selected" to engage in, even if not always wilfully. For example, while tobacco or alcohol use is a personal decision, working or living in a carcinogenic environment is not always a matter of choice. Table VI.5 lists major causes of mortality in some countries of the region, classified by rank.

The incidence of cancer in the region is increasing dramatically, much of it associated with tobacco use. The economic burden of smoking-related illnesses is now costing China more than the national tobacco industry is able to reap in profits. International tobacco companies have tried to compensate for declining tobacco use in their home countries by intensifying their promotional efforts in the developing world. Despite some national efforts to discourage tobacco use, the number of smokers, particularly among the young and women, appears to be increasing in many countries, such as Malaysia and Thailand.

*(c) Substance abuse*

Drug abuse rates in many countries of the ESCAP region have spiralled in recent years from usually low bases. In Malaysia, the number of identified drug abusers grew by a factor of more than 200 from 1970 to 1989, and by a factor of more than 11 from 1975 to 1989.[20] In Myanmar, registered heroin abusers grew by a factor of 8 between 1977 and 1987; this figure does not take into account heroin use among tribal groups in remote areas. Heroin abuse in Pakistan more than doubled from 1982 to 1986, and is surging rapidly in Thailand.[21] Drug abuse multiplies health risks ranging from tuberculosis and hepatitis to overdose deaths, HIV infection, violence and suicide.

Detailed data on alcohol abuse are scarce, but available evidence indicates that it is a significant and growing problem throughout much of the ESCAP region. Among the more salient alcohol-related causes of death are strokes, motor vehicle accidents, cirrhosis of the liver and cancer. The incidence of "alcohol dependency syndrome" rose in Sri Lanka from 4.6 to 44.0 per 100,000 persons above the age of 15 between 1975 and 1985.[22] In India, as many as 55.5 per cent of patients hospitalized for psychiatric reasons suffer from dependence on alcohol. Rapid socio-economic change has been associated with

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20 ESCAP, *Proceedings of the Meeting of Senior Officials on Drug Abuse Issues in Asia and the Pacific, Tokyo, 13-15 February 1991* (ST/ESCAP/987).

21 Ibid.

22 Ibid.

**Table VI.5. Leading causes of mortality in selected economies of the ESCAP region**

| *Country* | *Year* | *Leading causes of mortality in order of rank* |
|---|---|---|
| Bangladesh | 1985 | Diarrhoeal diseases; Respiratory diseases; Fevers; Asthma. |
| | 1991 | Tetanus; Pneumonia; Diarrhoeal diseases; Injury and poisoning; Asthma. |
| Brunei Darussalam | 1990 | Hypertensive diseases; Heart diseases; Malignant neoplasms; Cerebrovascular diseases. |
| Cambodia | 1980 | Malaria; Diarrhoeal diseases; Acute respiratory infections. |
| | 1988 | Acute respiratory infections; Malaria; Diarrhoeal diseases; Dengue haemorrhagic fever; Pregnancy-related complications. |
| China | 1989 | Diseases of the circulatory system; Diseases of the respiratory system; Neoplasms; Malignant neoplasms. |
| | 1990 | Bronchitis; Chronic and unspecified; Emphysema and Asthma. |
| Fiji | 1980 | Ischaemic heart diseases; Pneumonia; Hypertensive diseases; Malignant neoplasm of stomach. |
| | 1986 | Acute myocardial infarction; Hypertensive diseases; Malignant neoplasm of stomach. |
| Hong Kong | 1991 | Malignant neoplasms; Injury and poisoning. |
| India | 1985 | Senility; Respiratory diseases; Childhood communicable diseases; Circulatory system diseases; Unidentified fever. |
| | 1990 | Infectious and parasitic diseases; Diseases of the circulatory system; Respiratory diseases; Injury and poisoning; Diarrhoeal diseases. |
| Indonesia | 1985 | Respiratory diseases; Diarrhoeal diseases; Cardiovascular diseases; Tuberculosis; Tetanus. |
| | 1990 | Diarrhoeal diseases; Cardiovascular diseases; Tuberculosis; Measles; Respiratory diseases. |
| Lao People's Democratic Republic | 1982 | Malaria; Dysentery; Diarrhoea, Leprosy; Tuberculosis; Acute respiratory infections; Parasitic diseases. |
| | 1990 | Diarrhoeal diseases; Malaria; Acute respiratory infections. |
| Malaysia | 1989 | Acute myocardial infarction; Other ischaemic heart diseases; Cerebrovascular diseases; Septicaemia; Malignant neoplasms; Leukaemia; Motor vehicle traffic accidents. |
| Maldives | 1991 | Fevers; Diarrhoeal diseases; Abdominal pain; Tuberculosis; Pneumonia. |
| Myanmar | 1980 | Pneumonia; All other infectious and parasitic diseases; Fevers; Tuberculosis; Malignant neoplasms (all forms). |
| | 1990 | Malaria; Tuberculosis; Pneumonia; Diarrhoeal diseases; Cardiovascular diseases. |
| Nepal | 1980 | Infectious and parasitic diseases; Respiratory diseases; Nervous system diseases; Circulatory system diseases; Accidents. |
| | 1990 | Hepatitis; Tetanus; Gastroenteritis; Meningitis. |
| Philippines | 1980 | Pneumonia; Heart diseases; Tuberculosis (all forms); Diarrhoea. |
| | 1987 | Pneumonia; Heart diseases; Cerebrovascular diseases; Tuberculosis (all forms); Malignant neoplasms. |
| Singapore | 1980 | Heart diseases; Cancer; Cerebrovascular diseases; Pneumonia; Accidents. |
| | 1988 | Cancer; Heart diseases; Cerebrovascular diseases; Pneumonia; Accidents. |
| Thailand | 1980 | Poisonings and violence; Heart diseases; Malignant neoplasms (all forms); Respiratory diseases; Diarrhoeal diseases. |
| | 1988 | Heart diseases; Malignant neoplasms (all forms); Heart failure; Diseases of the digestive system; Diseases of the nervous system; Tuberculosis. |
| Viet Nam | 1978 | Malaria; Tuberculosis; Dysentery; Viral encephalitis; Tetanus. |
| | 1986 | Tuberculosis; Malaria; Food poisoning; Dengue fever; Viral encephalitis. |

***Sources:*** *Statistical Yearbook for Asia and the Pacific 1991* (United Nations publication, Sales No. E/F.92.II.F.1); Government of Nepal, *Statistical Year Book of Nepal 1991;* Robert J. Muscat, *Cambodia: Post-settlement Reconstruction and Development* (New York, East Asian Institute, Columbia University, 1990); UNDP, "Report of the Kampuchea needs assessment study" (August 1989); Government of the Lao People's Democratic Republic, "Report on the economic and social situation, development strategy, and assistance needs of Lao PDR" (vol. I), and "External assistance priorities and project profiles" (vol. II) (Geneva, May 1983); and UNDP, *Development Cooperation: Lao People's Democratic Republic, 1988 Report* (July 1989).

escalating rates of alcohol consumption and abuse across the region. In the Pacific Island countries, alcohol abuse is just one of a medley of psycho-social problems, including suicide, which are on the rise. In Malaysia, increasing alcoholism is posing serious social and health problems.[23] Alcohol and drug abuse not only take their toll on users but also seriously affect the lives of innocent people by contributing to the increased incidence of traffic fatalities and domestic violence.

In addition, the incidence of mental illness, vision and hearing impairment, and injuries and deaths resulting from accidents and disasters as well as from violence and suicide, are on the upswing. A wide variety of factors, including unsafe working conditions, inadequate housing, the widespread use of agricultural and other chemicals without proper precautions, air and noise pollution and other environmental factors are appearing as agents of additional diseases and deaths. Internal conflicts, industrialization, population pressure leading to migration and increased urbanization, and the fragmentation of family support networks, have contributed to social malaise and poor health.

## C. THE HEALTH CARE SYSTEM AND ACCESS TO SERVICES

### 1. Health policy orientation

"Health for all by the year 2000" continues to receive endorsement as policy at the highest level throughout most of the ESCAP region. Primary health care is widely recognized as the key to achieving this objective. The primary health care approach seeks to promote equity in ensuring that essential health and socio-economic needs for all groups of the population are met through integrated programmes, multisectoral collaboration and maximum community and individual participation. Most countries in the ESCAP region have demonstrated their commitment to this goal by incorporating health policies in their national development strategies, and making concerted efforts to reorient their health systems towards primary health care.

The majority of the national health-care systems in the ESCAP region have followed two main patterns. The first is a gradual extension of the hospital, with outpatient clinics, emergency medical care and general public health services supplemented by a sizeable private health sector. The second is the establishment of a countrywide network of health centres with limited ambulatory and home visiting services supported by a loose network of referral institutions.

In response to health for all goals, these national health-care organizations are being modified gradually to give greater precedence to primary health care. Steps have been taken to shift emphasis from the curative to the preventive aspects of health care, decentralize services and focus on reaching underserved and vulnerable populations, particularly in rural areas and urban slums.

Health development through community involvement is accepted as indispensable to social and economic development in Bhutan. In Indonesia, resources have been increased for primary health care and education despite calls for sectoral austerity measures in the national development plan. India and Sri Lanka have made primary health care an important component of their medium-term plans and investment programmes. Bangladesh has established a countrywide network of health complexes combined with an extensive domiciliary outreach programme to expand service to rural areas. Health development in Maldives counts on community self-reliance and self-development efforts to complement government activities. In the Democratic People's Republic of Korea, public health service is considered honourable work, and a system of universal free medical care that integrates traditional Korean medicine with modern scientific medicine is guaranteed under the national health policy. Although health services remain overly centralized in Pakistan, efforts are being made to decentralize to lower and local levels.

The practical implementation of the commitment to primary health care, however, has not been uniformly successful, owing to resource constraints and people's resistance to change. Not all political, professional and executive levels have completely accepted the primary health-care approach and its imperatives. Reorientation, leadership training and organizational and budgetary reforms remain challenging obstacles to be overcome.

Strategies for meaningful community involvement in organizing and maintaining local health care are yet to become well understood and implemented on a large scale, owing to their country-specific and culture-specific nature. For example, in countries where the status of women is low and their contribution to society undervalued, their role as health providers and their potential as community organizers is often overlooked.

[23] Ibid.

The proper role of the government sector in community involvement is also not always well defined. Health workers and volunteers deployed to the field often lack adequate training, supervision, support and remuneration. Many people with good will and leadership potential are shut out of the system because they cannot afford to divert themselves from the daily struggle to survive, and governments cannot or will not spare the additional resources to support them.

Many of the countries of the ESCAP region suffer from a lack of trained and motivated staff to extend services to the community level. Lack of supervision and transport for referral patients, even where higher-level referral facilities are available, are further constraints to reaching underserved areas. Moreover, health personnel policies and training strategies may operate in conflict with health for all goals. In many countries in the region, there is such a bias toward clinical training to the detriment of a balanced mix of health personnel that there are acute shortages of paramedics and nurses. Medical school curricula and training in most countries are still heavily biased towards teaching and research in modern bio-medical curative approaches and insufficient attention is given to preventive medicine.

Despite these caveats, progressive measures to reach rural areas and foster more equitable distribution of health personnel have been implemented throughout the region. Although doctors still face heavy patient loads, immunization coverage has increased, as has the availability of treatment facilities and hospital beds (table VI.6). Thailand has imposed compulsory rural service on doctors, dentists and pharmacists, who must serve a minimum of four years in the province of their recruitment. In a programme of retraining existing categories of health personnel, Indonesia is training 18,900 village-based midwives during its REPELITA V planning period (fifth five-year development plan, 1989/90-1993/94). Maldives introduced a new diploma-level nurse training programme in 1991. In Mongolia, male paramedics are being trained to serve nomads. Regional training centres for paramedic workers have been established in all five regions of Nepal. Sri Lanka is placing greater reliance on the use of auxiliaries. Pakistan has trained home visitors to promote diarrhoeal disease therapy and provide referrals. The Republic of Korea assigns newly qualified physicians to serve as public health doctors in lieu of their military obligations and subsidizes the salaries of community health practitioners.

There are many examples in the ESCAP region of countries which have spent a higher proportion of their resources on health than others at comparable levels of income. Achievements in improving the health status of populations are not, however, necessarily related to the amount or proportion of resources devoted to health care. Much can be achieved, and has already been achieved, in countries such as China, Sri Lanka and Viet Nam, by relatively inexpensive means. Preventive and promotional measures, including sanitation campaigns and improvements in food safety and personal hygiene, have proved to contribute more to ameliorating general health than expensive curative measures. Those countries with better health standards in the region have pursued these measures more vigorously and on a sustained basis over time than others whose achievements are relatively less impressive.

## 2. Health infrastructure and manpower

### *(a) East Asia*

China began with a very meagre base of health institutions and a very small cadre of highly trained doctors serving primarily the urban élite. The balance of the population relied on traditional Chinese medicine. From 1949 until the mid-1950s, small medical schools were consolidated, some schools were transferred to remote areas, curricula were standardized and some formal training programmes were introduced into traditional Chinese medicine. Medical curricula and education became much more rigid under the influence of the USSR model from the mid-1950s onwards. The Great Leap Forward and the Cultural Revolution disrupted formal training programmes, leading to the expansion of informal or short-term training programmes and the emergence of the "barefoot doctors" in the late 1960s. Medical cooperatives, funded by the collectives with some assistance from the Government, were established in the 1960s to respond to local needs. The number of medical institutions, hospital beds and medical personnel has expanded considerably since 1949. For example, ratio of population to the hospital bed was reduced from 6,600/1 in 1949 to 760/1 in 1970, and to 434/1 in 1989.

Health services in both urban and rural areas of China have improved rapidly since the late 1970s. Medical and health institutions of all kinds, ranging from hospitals and specialized clinics to maternity centres and drug inspection institutes, increased from 164,199 in 1977 to 208,734 in 1990. The number of hospital beds increased from 1,953,733 in 1977 to 2,925,390 in

1990: 20 per cent of these beds were allocated to patients being treated with traditional Chinese medicine. The number of medical personnel in the whole of China rose from 2.3 million in 1977 to 3.9 million in 1990. Better access to treatment and facilities has increased hospital cure rates and reduced mortality.

Maternal and child health, focusing on the promotion of prenatal care, safe birth practices and immunization campaigns as well as The "Four Periods" programme for women's reproductive health (menstruation, pregnancy, post-partum and breast-feeding) have received priority attention and yielded favourable results. During the period 1983-

**Table VI.6. Health-care coverage in the ESCAP region**

| | *Population per physician* | | *Population per bed* | | *Population per nurse* | | *One-year-olds immunized (percentage)* |
|---|---|---|---|---|---|---|---|
| | *1970* | *1990* | *1970* | *1990* | *1970* | *1990* | *1988-1990* |
| **Developing economies of the ESCAP region** | | | | | | | |
| **East Asia** | | | | | | | |
| China | ... | 1 077 | 760 | 434 | ... | 1 063 | 98 |
| Democratic People's Republic of Korea | ... | ... | ... | ... | ... | ... | 99 |
| Hong Kong | 1 520 | 927 | 240 | 229 | 2 246 | 202 | 81 |
| Mongolia | ... | 357 | 133 | 85 | 291 | 204 | 87 |
| Republic of Korea | 2 159 | 1 066 | 1 901 | 458 | 2 079 | 513 | 79 |
| **South-East Asia** | | | | | | | |
| Brunei Darussalam | 3 333 | 1 412 | 263 | 283 | 674 | 325 | ... |
| Cambodia | | | | | | | 42 |
| Indonesia | 26 510 | 7 372 | 1 650 | 1 513 | 7 960 | 2 665 | 89 |
| Lao People's Democratic Republic | 16 536 | ... | 1 176 | ... | 4 587 | 480 | 21 |
| Malaysia | 4 234 | 2 638 | 388 | 457 | 607 | 492 | 93 |
| Myanmar | 8 830 | 3 354 | 1 180 | 1 585 | 3 546 | 4 876 | 58 |
| Philippines | 1 170 | 6 413 | 917 | 683 | 948 | 5 245 | 90 |
| Singapore | 1 522 | 753 | 301 | 274 | 481 | 282 | 89 |
| Thailand | 6 726 | 4 843 | 892 | 533 | 2 364 | 788 | 91 |
| Viet Nam | 8 782 | 2 882 | 641 | 296 | ... | 844 | 88 |
| **South Asia** | | | | | | | |
| Afghanistan | 20 682 | 5 148 | 6 140 | ... | 35 237 | 7 129 | 25 |
| Bangladesh | 8 557 | 6 731 | 8 122 | 3 600 | 83 892 | 14 651 | 66 |
| Bhutan | ... | 9 740 | 1 940 | 1 500 | ... | 4 982 | 95 |
| India | 4 795 | 2 400 | 1 650 | 1 071 | 7 001 | 3 561 | 92 |
| Iran (Islamic Republic of) | 3 297 | 2 821 | ... | 689 | 3 234 | 5 837 | 91 |
| Maldives | 27 500 | 5 330 | 2 556 | 1 277 | 24 000 | 1 550 | 61 |
| Nepal | 51 086 | 20 978 | 5 762 | 4 260 | 70 932 | 29 933 | 80 |
| Pakistan | 4 658 | 2 127 | 2 061 | 1 535 | 14 700 | 6 611 | 97 |
| Sri Lanka | 5 950 | 7 255 | 341 | 358 | 2 259 | 2 040 | 88 |
| **Pacific** | | | | | | | |
| Fiji | 2 140 | 2 244 | 343 | 416 | 664 | 440 | 87 |
| Papua New Guinea | 10 644 | 10 083 | 149 | 238 | 1 616 | 1 123 | 74 |
| Samoa | 2 960 | 4 075 | 232 | 253 | 442 | 572 | 99 |
| Solomon Islands | 4 474 | 8 812 | 185 | 191 | 751 | 422 | 58 |
| Vanuatu | 3 310 | 8 344 | ... | 416 | ... | 482 | 55 |

*Sources:* UNDP, *Human Development Report 1992* (New York, Oxford University Press, 1992); World Bank, *World Development Report 1992: Development and the Environment* (New York, Oxford University Press, 1992); United Nations, *Statistical Yearbook for Asia and Pacific,* various issues; and national sources.

*Note:* In some cases data are for the nearest year indicated.

1989, 94 per cent of all births were attended by trained personnel. Maternal mortality dropped from an estimated 1,500/100,000 live births in 1949 to 44/100,000 for the period 1980-1988.[24] Owing to the active promotion of immunization campaigns, the vaccination coverage of children has reached over 98 per cent for the country. Death from neonatal tetanus has dropped to 2/100,000 in urban areas and 10/10,000 in rural areas. Regulations established in factories promote salutary working conditions for women to protect their health.

China's patriotic public health campaigns have played an outstanding role in improving the country's health and living standards. In response to burgeoning infectious diseases and unsatisfactory living conditions, the Government instituted a policy of "prevention first". Since the initiation of patriotic health campaigns in 1949, access to water supply and sanitation have improved considerably. At present, over 87 per cent of urban residents have access to running water, as compared with 10 per cent in 1949. The subsequent adoption of health laws and sanitation controls, and the monitoring of air, water and food quality, have greatly improved overall health and environmental conditions. In all parts of China, including the poorest areas, infectious diseases have decreased to a point where the chief causes of premature death and disability that remain are various chronic diseases.

A caveat worth noting, however, is that although China's health status has improved dramatically in the last 40 years, the Chinese health-care system is not well prepared for the transition from acute to chronic disease control. Many "public" health programmes have tended to concentrate the majority of their resources on the needs of those in early life, with the result that the health needs of the vast majority of the population are left to market forces. Furthermore, there is a need to reverse recent policy establishing separate organizations for traditional Chinese medicine and the Western approach to medicine. The vertical structuring has resulted in duplication of facilities and equipment and less than optimal distribution and training of personnel.

With the exception of Mongolia, most East Asian populations have satisfactory access to public health facilities. Although Mongolia has a well developed health-care infrastructure, curative services still take precedence over preventive health. The health system is heavily dependent on imports and the procurement of medical equipment and supplies has been hampered by the transitional difficulties currently facing the economy.

In the Republic of Korea, the private sector has assumed the dominant role in the provision of health services. In the mid-1980s, only about 38 per cent of the total available hospital beds and less than 20 per cent of the total of number of physicians were assigned to the public health systems. The country had a medical insurance scheme for workers in the organized sectors, and a medical programme which was specially geared to people under the poverty line or disabled persons. These two systems were targeted to cover 66 per cent of the population in 1986. A serious imbalance in the accessibility to health services remained between the urban and rural population as of the mid-1980s: 88 per cent of the doctors were located in urban areas and 89 per cent of the hospital beds were located in cities, which contained only about 54 per cent of the population. Greater demand for health care in the cities coupled with better opportunities for providers in urban areas contributed to this imbalance in resource allocation.

Despite the concentration of health resources in the private sector, the Government has made an effort since 1961 to provide public sector alternatives through the establishment of health centres and sub-centres throughout the country. With administrative and technical support from the Ministries of Home, Health and Social Affairs, 139 public health centres and 1,303 public health sub-centres had been set up by 1985 to provide comprehensive preventive and curative coverage to all counties and *myons* (townships). Recently, there has been a concerted effort to upgrade services to rural areas by subsidizing facilities and providing incentives to health personnel. Since 1989, the national health insurance scheme has covered the entire population.

*(b) South-East Asia*

Health facilities and human resources have expanded appreciably in most South-East Asian countries, although in 1990, in Indonesia, the Philippines and Thailand, one physician still had to serve between 5,000 and 7,000 people. Immunization and maternal health records indicate that impressive gains have been made in reaching those vulnerable populations. Most countries' health systems consist of a dual structure characterized by hospital-based curative services and rural/community-based health services devoted mainly to the promotive and preventive aspects of health.

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[24] UNICEF, *The State of the World's Children 1991*...

Health services are provided by both government and the private sector. The Government plays the major role in providing primary health care, especially in rural communities through a network of health centres and sub-centres.

Indonesia has an extensive network of government and private health facilities, ranging from specialized hospitals to mobile health centres, which extend from the central to the village level. The numbers of auxiliary and paramedic health personnel relative to qualified physicians are favourably balanced. Indonesia's rural health services have been strengthened considerably in recent years. Health centres at the sub-district level, *puskesma*, serve as the basic unit for the delivery of primary health care. By the end of the 1980s, the Government had established one such centre for every 29,000 people. Each health centre is supported by two or three sub-centres, the majority of which are headed by nurses. *Puskesmas* provide 16 basic health services and are generally equipped with appropriate transport vehicles to reach underserved populations in urban and remote rural areas. At the village level, the integrated family health post provides preventive and promotive services. Managed by the community with the assistance of health centre staff, it also serves as a recourse for village midwives.

The extension of services through the integrated family health post has been responsible for increasing immunization coverage, prenatal care and family planning acceptance significantly in Indonesia. Total vaccination coverage of children reached 90 per cent for the period 1988-1990. During the same period, 54 per cent of all women of reproductive age were immunized against tetanus toxoid, as compared with 25.5 per cent for the period 1986-1987. Forty-four per cent of the deliveries were attended by trained personnel and 62.3 per cent of the infants received post-natal care by trained personnel.

In Malaysia, health care is provided by both the private sector and the public sector. The role of the public sector far exceeds that of the private sector. None the less, about half of the registered practitioners in Malaysia are private practitioners, while the other half are government doctors. Unlike in Indonesia, the Philippines and Thailand, government doctors in Malaysia are full-time employees of the Government and do not practise privately.

Recent figures estimate that there is one doctor per 2,294 persons in Peninsular Malaysia. The ratio is notably higher in Sabah and Sarawak. Relative to doctors, paramedic personnel other than nurses are in short supply, with one per 12,996 persons. The nurse per population ratio stands at one to 1,510. Village aides, recruited from the community, provide preventive outreach services.

The health and medical system follows the pattern of the referral pyramid. At the base is a two-tiered network of primary facilities for out-patient and maternal and child health that extends to rural areas. In the middle are district hospitals providing primary (non-specialized) in-patient and out-patient care and supervision to the rural health units. State and national institutions providing both primary and specialized care are at the top of the pyramid. Mobile services are provided for those population groups that are without permanent health facilities or are in remote places. However, over half of the population in Sabah and Sarawak are still underserved (defined as being located beyond a 5-kilometre radius of a stationary health facility).

Malaysia has been able to achieve more than 90 per cent immunization coverage of children. Maternal mortality rates are estimated at 59 per 100,000, and more than 80 per cent of births are attended by trained personnel. Community participation in health activities, organized under the aegis of the Community Health Movement, has been encouraged by the Government.

Basic health facilities in the Philippines are unevenly distributed. There are 2,216 rural health units, 10,151 *Barangay* health stations and 1,733 hospitals of which 65 per cent are private. Most of these facilities are located in cities and other urban centres, and rural areas suffer from a severe lack of basic health facilities. As in many countries in the region, health personnel are either concentrated in the private sector in urban areas or have migrated overseas in search of better job opportunities. Maternal mortality is relatively high in depressed, rural and urban poor communities. The problem lies not so much in the lack of trained personnel, but in the inability of the population to pay for professional services. Despite public health efforts, communicable diseases remain a leading cause of morbidity and mortality, and chronic dietary energy deficiency persists as a major problem. In urban areas, the widespread availability of fast food and other processed foods with high fat and salt content has contributed to rising rates of obesity and chronic degenerative diseases. The current health plan of the Philippine Government includes a comprehensive nutrition programme (1992-1996) with the objective of improving the nation's nutritional well-being. The recently elected Government has also committed itself to improving maternal and child health services and promoting family planning.

Health services in Thailand are a complex mixture of the public and private sectors. In urban areas, private health services play an important role. For the large rural population, the primary source of health services is the Ministry of Health, operating through an extensive network of health and midwifery centres in sub-districts *(tambons)*, community hospitals at the district level, and general and regional hospitals at the provincial level. The public health system in Thailand has been expanded considerably in the last 15 years to provide primary health care to the entire population. In 1989, there was a ratio of 2.3 doctors and 12.4 nurses/midwives per 10,000 population.

The *tambon* facilities provide referrals and preventive health care, including pregnancy-related and post-partum services, child immunization, nutrition, family planning, and water supply and sanitation activities. Self-reliance has been encouraged to compensate for a concentration of resources at higher levels of care. Village health volunteers and communicators form the core of community organization and self-management activities. For example, drug cooperatives have been set up with the help of village-level cooperative revolving funds to overcome drug shortage problems.

In Viet Nam, health care is provided through a State-run network of health facilities, subject at each level to the authority of the political system. The health steering committees are part of the people's committees. The central level is responsible for policy and oversees medical training and specialized hospitals. Eighty-two general and 92 specialized hospitals provide health services at the provincial or city level, catering for an average of 350,000 inhabitants each. The district or ward health service comprises one or two hospitals with a polyclinic, laboratory and pharmacy, covering an average of 125,000 people.

Under the districts are the inter-commune polyclinics, each of which assists a group of about five communes on an out-patient basis. These polyclinics are a recent innovation in Viet Nam, set up in an effort to support primary health-care activities in large areas and compensate for the lack of hospital facilities in remote regions. The network has yet to be fully extended throughout the country. Commune health centres serving 5,000-7,000 people are responsible for primary health care activities and for the supervision of health workers at the production brigade level. Community involvement is particularly active at this level. According to 1988 data from the Ministry of Health, around 40 per cent of the total population are fully served by commune health centres, around 57 per cent are underserved and around 3 per cent are not served at all.[25] Medical staff distribution shows a ratio of 3.6 physicians and 7.5 assistant physicians per 10,000 inhabitants.

Since mid-1988, the private sector, which had previously existed informally, was officially recognized by the Government. The majority of those now in private practice are retired health personnel who have been allowed to open clinics, staff still employed by the Government who operate private clinics after their normal working hours, or private chemists. Essential drugs are produced at the national and provincial levels, but quality control remains uneven. Traditional medicine also plays a significant role in the Vietnamese health system. Traditional treatment is widely used domestically as well as recognized and practised internationally. Viet Nam's health policy delineates a commitment to support traditional medicine in addition to the tenets of primary health care. There are numerous traditional medicine training institutions and care facilities in existence.

In the Lao People's Democratic Republic, the number of medical personnel has been increasing steadily since 1976, although the number of health facilities in operation officially decreased in 1988. The number of doctors per 10,000 inhabitants (2.6 in 1989) is comparable with that (2.3) of medium human development countries as classified by the United Nations Development Programme (UNDP). However, these figures do not reflect the various imbalances or human resources inadequacies within the health system.

Like many other countries, the geographical distribution of the most qualified health personnel in the Lao People's Democratic Republic is weighted heavily in favour of urban areas. Two thirds of the doctors live in the Vientiane prefecture, where each serves 1,000 inhabitants, whereas in the three next most populated prefectures, the ratio rises as high as 17,000.[26]

Economic prosperity and socio-economic homogeneity have contributed to the salubrious conditions found in Brunei Darussalam and Singapore, which have the best health records in South-East Asia. Health indicators for Myanmar suggest that health conditions in that country have improved, despite relatively low levels of development. High

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25 UNICEF, "Viet Nam: the situation of children and women" (Hanoi, 1990).

26 UNICEF, *Children and Women in the Lao People's Democratic Republic* (Vientiane, 1992).

literacy rates relative to other countries in the region probably explain the achievement despite low per capita income levels. The health conditions in Cambodia and the Lao People's Democratic Republic, are among the worst in the region.

*(c) South Asia*

In general, health services and indicators in South Asia lag behind most other areas in the ESCAP region, owing to inadequate health infrastructure coupled with lower living standards, the subordinate status of women and generally low levels of female literacy. Attention is being given to extending service outreach to underserved populations and devising more effective strategies for reaching the poorest of the poor.

Despite government investment over the past decade, public health services in Afghanistan remain highly underdeveloped. Afghanistan's life expectancy of 42 years is one of the lowest in the world. Health facilities improved in urban areas between 1979 and 1987, while simultaneously deteriorating sharply in rural areas. The number of basic health centres declined by 33 per cent, from 147 in 1979 to 98 in 1987. Ninety per cent of the health sub-centres in rural areas are reported to have been destroyed by warfare. The security situation, lack of incentives to attract and retain capable staff, shortage of medical supplies and equipment and difficulties in transport have resulted in low operational efficiency and effectiveness of medical services in most areas of the country. Non-governmental organizations working with Afghan refugee populations in Pakistan have made an effort to train community health workers to provide basic primary health services to their compatriots when they repatriate.

In Bangladesh, 608 of the country's 875 hospitals are under government administration, as are 26,913 of the 33,376 hospital beds. Public health services are free in principle, but owing to inadequate supplies, patients must purchase drugs from private pharmacies. Most government providers operate private practices outside of their official duties. In 1990, Bangladesh had a ratio of 1.8 doctors and 1.5 nurses/ midwives/auxiliaries per 10,000 population. A net work of *thana* based health complexes and Union (the lowest level local government unit) based rural health centres form the lower level base of Bangladeshi's health infrastructure.

In changing the name of the National Population Council to that of National Health and Population Council in 1988, the Government of Bangladesh reaffirmed its commitment to countering exponential population growth through integrated health strategies. Efforts are being made to expand rural health services through *thana*-based health and family welfare centres. Non-governmental organizations, as well as the Government, have been active in training traditional birth attendants and community outreach workers. Worth noting in Bangladesh is the country's emphasis on self-reliance in technology. Local production of vaccines, and basic medical and surgical equipments receives high priority. Bangladesh was one of the first countries in the region to establish an essential drugs policy to reduce the incidence of the use of drugs with harmful side-effects, or ineffective in treatmemt. Recently, emphasis has also been given to the provision of health services and basic amenities to urban slums. Strategies have been developed to promote intersectoral coordination and community involvement in the development of basic infrastructure for primary health care in these slums.

In Bhutan, the organization of a modern health service system started with the establishment of the Department of Health Services in 1961. The country is administratively divided into zones, districts and blocks/villages. Decentralization is a central component of national health planning. Hospitals are located at the district level, with basic health units and dispensaries providing primary health services and village outreach at the block level, with the assistance of voluntary village health workers. Currently, Bhutan's health infrastructure comprises 28 modern and one indigenous hospital, 70 basic health units and 46 dispensaries. In 1989, the country had 157 doctors and 325 nurses, giving a ratio of 1 doctor and 2.1 nurses per 10,000 people. Approximately 900 village health volunteers represented the government health system in villages. Vaccination coverage in Bhutan has achieved acceptable levels and specialized programmes to control leprosy, tuberculosis and goitre have been initiated. However, shortage of trained personnel remains a critical factor in the efficient delivery of health services and programme expansion. The mountainous terrain, coupled with poor transport and communication networks, limits the accessibility of health services. Community involvement has been hampered by low literacy. Additional problems are poor intersectoral coordination and collaboration, despite the existence of multisectoral development committees to oversee health-related planning at the central and district levels.

India has a pyramidal health system with a very wide foundation of district-based services to reach its vast rural population. Currently, specific attention is being given

to strengthening the existing infrastructure, rather than expanding it. Strategies include improving outreach services, upgrading health management information systems, giving greater priority to safe motherhood, child survival and child health development, preventing environmental pollution, reducing regional imbalances and disparities, and promoting self-reliance through community involvement. In addition to allopathic medicine, there are other systems of indigenous medicine popular with the Indian people; efforts are being made to integrate these into the overall health system as well as to reorient the medical and health education systems to embrace holistic health approaches. Voluntary organizations and private institutions are being encouraged to take part in national health programmes. The private health sector comprises two parts, a commercial sector, which includes private practitioners and nursing homes located in cities and towns, and another sector which includes non-profit institutions. In addition, industries provide medical and health care to their employees individually or through the Employees' State Insurance Scheme. A central government health scheme provides comprehensive medical care to its employees. At the end of 1990, 365,000 doctors were registered, and at the end of 1989, 264,504 nurses and 141,191 auxiliary nurse-midwives were registered, indicating a ratio of 4.4 doctors and 3.2 nurses per 10,000 population. India also has extensive, and some of the most advanced, hospital facilities located mostly in the cities and other urban locations.

Despite the large health infrastructure in India, the demographic and health picture for the country remains a cause for concern. Pockets exist, such as the southern State of Kerala, where health conditions have improved dramatically owing to major investment in literacy and family planning programmes. For the most part, however, the status of health in India is less than satisfactory. Rapid population growth has adversely affected health and the quality of life. Child and maternal mortality is high. A high incidence of many communicable diseases persists. A very small proportion of the rural population has access to safe water and sanitation. Added to this is the rapidly growing problem of AIDS and HIV infection.

Maldives has made considerable progress in extending health-care facilities by establishing at least one primary health centre in each atoll to provide integrated and comprehensive care. At the island level, family health workers and trained *foolhumas* (traditional birth attendants) are the main providers of primary health care. Owing to the absence of regular inter-island transport and lack of basic laboratory services and blood transfusion facilities in the regional hospitals, most patients bypass them and seek treatment in Male.

The health system in Nepal comprises a series of hospitals at the national, regional and district levels with a string of health posts at the lowest level. In 1989, the country had 83 public and 40 private hospitals with a total of 4,717 beds, corresponding to a ratio of 2.5 beds per 10,000 population. The ratio of doctors and nurses/midwives was 0.5 and 1.6 per 10,000 population.

Health as a citizen's right was incorporated in the 1990 Constitution of Nepal. The national health policy is targeted at vulnerable groups and directed at achieving equity in the provision of health services and improved living standards. Low literacy levels, lack of infrastructure, scarcity of resources and a shortage as well as imbalance of appropriate health personnel are among the challenges that remain to be met if these goals are to be achieved. Despite the significant expansion of health facilities over the years, available health services are still inadequate relative to the size and needs of the population, and the mountainous terrain magnifies the problems of accessibility.

Pakistan's health services are also organized pyramidically, with a number of teaching hospitals at the top, followed by district and *tehsil*- (sub-district) level hospitals in the middle, and rural health centres and basic health units at the bottom. Most facilities offer diagnostic treatment. However, specialist treatment and surgical facilities are limited to national-level teaching hospitals and district hospitals. The rural health centres provide primary diagnostic and curative services coupled with maternal and child health facilities. Basic health units provide immunizations and basic treatment, and serve as a base for community outreach workers.

In principle, this structure should guarantee that health services are within the reach of local populations. In practice, however, numerous factors hamper effective service delivery. Although the district health officers are supposed to exercise substantial authority over district-level services, the reality of the situation is that they have very little administrative or planning power. Consequently, decision-making for health remains largely at the national level. Another constraint is the dearth of trained female personnel, which remains severe despite government and non-government efforts to stimulate training and recruitment.

Sri Lanka's long history of commitment to health care underlies the comparatively good health status of its population

today. Since independence in 1948, it has been the policy of successive Governments to provide health facilities to the entire society. The 1978 Constitution of Sri Lanka stipulates that access to health services is a fundamental right. The Government is committed to primary health-care concepts and reaching health for all targets by the year 2000.

Health services in Sri Lanka are rendered as a State welfare service and are available without charge through State-sponsored health service organizations and hospitals. In 1989, there were 502 government hospitals, with a total bed capacity of 46,620. Since 1978, the role of the private sector and non-governmental organizations has been increasing. Health policies are reviewed periodically to explore ways to strengthen mutually supportive operations by all participants in the provision of health services.

*(d) South Pacific*

Life expectancy in most of the Pacific island countries exceeds 65 years, at least for women. The exceptions are Papua New Guinea, the most populous country in the region, and Kiribati, where life expectancy at birth for men is below 55 years (it is 60 for women) and infant mortality remains high.

Papua New Guinea has been expanding its health services since 1973. A series of hospital facilities in city areas were developed during colonial times. After realizing that hospital services reach only limited groups of the population, the Government developed an extensive network of aid posts, health centres and sub-centres as main vehicles for health service delivery. Since the establishment of provincial governments in 1976, provincial authorities have been vested with the responsibility for health delivery in accordance with plans and policies formulated at the national level. The Government has endeavoured to strengthen capacity at the central level to provide more technical support for the lower levels of the system. Between 1973 and 1984, the provincial health divisions established 133 new health centres and an additional 6,884 aid posts. By 1986, reportedly 96 per cent of the population lived within two hours walk of the nearest health facility, compared with 86 per cent in 1973. Despite these expansion efforts, the health status of the population still lags far behind that of most of the other islands.

*(e) Asian republics of the former Soviet Union*

The central Asian republics have inherited a "command health care system" from the former Soviet Union. Health services are provided free to the population through a highly centralized medical bureaucracy with perhaps the highest number of providers per client of any system in the world today.[27] Health services are provided under a unified approach emphasizing both preventive and curative care. The four-tier system involves paramedic *(feldsher)* stations at the village level, district *(rayon)* and regional *(oblast)* level facilities; at the top is an assortment of advanced institutions at the national level. The well dispersed health systems function well despite chronic underfunding. Facilities are generally clean but run-down. Although most have electricity and heating, running water and sanitation facilities are not always adequate.

27 Lincoln C. Chen, Jon E. Rohde and Richard Jolly, "Health crisis in the central Asian republics", *Economic and Political Weekly*, vol. XXVII, No. 23, 6 June 1992.

### 3. Access to safe water supply and sanitation

Access to safe water and adequate disposal of excreta, waste and waste water figure prominently in determining the status of health, particularly of the most vulnerable groups. Excreta and water-related diseases are among the main causes of child morbidity and mortality and poor health. Consuming contaminated water causes, among other diseases, typhoid, cholera, dysentery and infectious hepatitis. Fetching and carrying water can consume up to 25 per cent of daytime human energy, with the burden falling primarily on women and young children, who are often the least nourished and least healthy members of the family. They are also the ones most at risk of being infected with diseases transmitted by insects which breed or bite near water, such as dengue haemorrhagic fever, malaria and guinea worm. Table VI.7 provides indicators of access to safe water and sanitation for selected economies of the ESCAP region.

Access to safe urban water varies from a low of 10 per cent in Cambodia to almost universal coverage in Brunei Darussalam, the Islamic Republic of Iran, Mongolia and some of the Pacific islands. The proportion of the rural population with access to safe water is notably lower, ranging from less than 2 per cent in Cambodia to 60-70 per cent in most other countries in the region. In the Asian republics of the former USSR, less than half of the rural population has access to safe water supplies. Even where coverage has officially increased, however, many people still lack access to reliable water sources, and must resort to private vendors who may charge the full market price for water that is often unsafe.

The proportion of the population with access to adequate sanitary facilities varies from less than 10 per cent in the rural areas of most of South Asia, Cambodia and Solomon Islands. Oddly, in the rural areas of Samoa, the population has better access to sanitation facilities than to safe water supply. The urban population of all countries has better access, upto 100 per cent in China, the Islamic Republic of Iran, Mongolia and Samoa, to sanitation facilities than those in rural areas, though coverage tends to decline with rapid urban growth.

Access to water and sanitation is only effective in improving the status of health when it is accompanied by education in water use and hygiene. Studies carried out recently in Cambodia found that while people used tube-well water for household tasks, they

**Table VI.7. Indicators of access to safe water and sanitation in 1987-1990**

| | *Percentage of population with access to* | | | | | |
|---|---|---|---|---|---|---|
| | *Safe water* | | | *Sanitation* | | |
| | *Rural* | *Urban* | *Total* | *Rural* | *Urban* | *Total* |
| **Developing economies of the ESCAP region** | | | | | | |
| **East Asia** | | | | | | |
| China | 68 | 87 | 71 | 81 | 100 | 85 |
| Hong Kong | 96 | 100 | 100 | 50 | 90 | 88 |
| Mongolia | 58 | 100 | 80 | 47 | 100 | 75 |
| Republic of Korea | 76 | 100 | 93 | 12 | 67 | 51 |
| **South-East Asia** | | | | | | |
| Brunei Darussalam[a] | 95 | 100 | ... | 98 | 100 | ... |
| Cambodia | ... | 10 | ... | ... | ... | ... |
| Indonesia | 32 | 19 | 28 | 45 | 40 | 43 |
| Lao People's Democratic Republic | 25 | 47 | 28 | 8 | 30 | 11 |
| Malaysia | 66 | 96 | 78 | 94 | 94 | 94 |
| Myanmar | 29 | 43 | 32 | 34 | 39 | 35 |
| Philippines | 72 | 93 | 81 | 63 | 79 | 70 |
| Singapore | ... | 100 | 100 | ... | 99 | 99 |
| Thailand | 85 | 67 | 81 | 86 | 84 | 86 |
| Viet Nam | 33 | 47 | 36 | 10 | 23 | 12 |
| **South Asia** | | | | | | |
| Afghanistan | 17 | 39 | 21 | ... | 20 | ... |
| Bangladesh | ... | 39 | 81 | 4 | 40 | 10 |
| Bhutan | 30 | 60 | 32 | 3 | 80 | 7 |
| India | 73 | 79 | 75 | 7 | 38 | ... |
| Iran (Islamic Republic of) | 75 | 100 | 89 | 35 | 100 | ... |
| Maldives | 68 | 76 | 70 | 4 | 95 | 31 |
| Nepal | 34 | 66 | 37 | 3 | 34 | 6 |
| Pakistan | 35 | 99 | 55 | 8 | 40 | 18 |
| Sri Lanka | 55 | 80 | 60 | 45 | 68 | 50 |
| **Pacific** | | | | | | |
| Fiji | 69 | 96 | 79 | 65 | 91 | 75 |
| Papua New Guinea | 20 | 94 | 33 | 56[a] | 57 | 56 |
| Samoa | 77 | 100 | 82 | 92 | 100 | 94 |
| Solomon Islands | 58 | 82 | 61 | 2 | 73 | 12 |
| Vanuatu | 64[a] | 84 | 72 | 46 | 97 | 43 |

*Sources:* World Health Organization, *International Drinking Water Supply and Sanitation Decade – End of Decade Review,* December 1990 (WHO/CWS/92.12); UNDP, *Human Development Report 1992* (New York, Oxford University Press, 1992); World Bank, *World Development Report 1992: Development and the Environment* (New York, Oxford University Press, 1992); and national sources.

[a] 1988 data.

still collected drinking water from contaminated sources because they preferred the taste. Water and sanitation programmes with a strong health education component incorporating specific roles for women have resulted in a significant drop in the incidence of diarrhoea in children under 5. Providing simple filtration and source protection has served to decrease the transmission of guinea worm disease in India and Pakistan.

Health for all by the year 2000 envisages safe water and hygienic sanitation for all by the same year, defined as safe water in the home or within 15 minutes walking distance, and adequate sanitary facilities in the home or immediate vicinity. Unfortunately, despite commitment to this goal and subsequent achievements of the International Drinking Water Supply and Sanitation Decade (1981-1990), the impact of population growth on the provision of water supply and sanitation services threatens its realization. In Asia and the Pacific, just to maintain the status quo 15.5 million additional urban residents a year had to be provided with water and 13.8 million with access to an appropriate means of excreta disposal.[28] In such mega-cities as Bangkok, Bombay, Dhaka, Delhi, Karachi, Madras and Manila, burgeoning populations are placing excessive demands on often already precarious water supplies and sanitation services. Although the proportion of population with sanitation coverage generally increased in the rural areas during the 1980s, the absolute number of rural people without adequate sanitation increased.[29]

Apart from population growth, efforts to extend water and sanitation services have confronted a number of other problems, among which are financial resource constraints, lack of intersectoral cooperation, lack of surveillance and control of the quality of drinking water, poor mobilization of community financing, and cost recovery. Great inequities of total expenditure for water and sanitation continue to exist between urban and rural areas. In spite of these many difficulties, significant progress has been achieved in expanding water and sanitation services within the ESCAP region.

## 4. Financial resources for health

Indicators of health status point to a positive association between health status and overall development levels as measured by per capita income. The richer a country the greater is its capacity to invest financial resources in health development and care. Whether this also implies equitable improvements in health status or not is a question of policy direction and resource allocation.

In general, the least developed countries have the lowest proportion of their government expenditure allocated to health care. The amount of the most developed countries' per capita expenditure on health is often three or four times greater than the total per capita income in the least developed countries. Not only can richer countries allocate more in absolute terms and as a proportion of their GNP than can the developing countries, they are also able to invest more resources in infrastructural improvements, education, food production and other sectors that have a bearing on health status. In many developed countries, government health expenditure amounts to 5 per cent of GNP or higher, compared with 1-2 per cent in the case of many developing countries.

Greater expenditure on health, however, is not necessarily indicative of better health status. Conversely, lower incomes coupled with lower health expenditure can still yield improved health. Sri Lanka has been able to bring life expectancy up to 70 with an income of about $470 a year, whereas in Indonesia life expectancy is still around 60 at an annual per capita income of $570. The State of Kerala in India, renowned for its improvements in health status and an average life expectancy of 70, has earmarked around 10 per cent of its total expenditure for health, despite a comparatively low per capita income.

Investment in health, however, is difficult to quantify and compare because most of the available data pertain only to central government expenditure on health services. State and local expenditures are often omitted, even when they account for a significant proportion of investment in service delivery, as in India and Pakistan. Detailed data on private expenditure on health including modern medicine, traditional remedies and self care, which often exceed public health expenditure, are rarely available. It has been estimated that private expenditure comprised more than 60 per cent of total 1987 health expenditure in India, Indonesia, Pakistan, the Philippines and

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[28] United Nations, "Achievements of the international drinking water supply and sanitation decade 1981-1990", Report of the Secretary-General to the General Assembly (A/45/327).

[29] WHO, *Bulletin of Regional Health Information* (New Delhi, 1992).

Thailand.[30] In China, self-paid medical services account for almost a quarter of total health expenditure. In evaluating total health costs, it is also difficult to isolate the impact of expenditure on related sectors that impinge on health.

In some countries, non-governmental organizations provide a significant proportion of health services, with expenditure frequently above that of the government. Often these organizations are financed externally, and it is difficult to assess their contribution. Nor is the nature of their interaction with the public sector always well understood. Cambodia represents an extreme case – international and non-governmental organizations have been the principal providers of health services, acting almost as proxies for government, because of the virtual annihilation of the national health infrastructure during the period 1975-1978 and subsequent isolation of the country until recently. In Bangladesh and India, the extensive free medical services provided by religious charities fall into a grey area between public and private expenditure.

Notwithstanding these caveats, the percentage of total government expenditure devoted to health services provides some indication of the relative priority accorded to health in relation to other sectors. Central government expenditure on health as a proportion of GNP has generally been very low for many of the developing economies of the ESCAP region – less than 1 per cent in a number of countries (table VI.8). Even in the more industrialized countries, such as the Republic of Korea, health expenditure as a proportion of GNP is minimal. The relatively high health standards in that country, in spite of the limited government expenditure suggest that the private sector has been effective in its dominant role in health service delivery. By 1989, total health expenditure in China had grown by 132.6 per cent (at constant prices) over that of 1980 and comprised slightly over 3 per cent of GNP.[31] In the Lao, People's Democratic Republic, the share of the national budget allocated to the health sector decreased from 9.4 per cent in 1986 to 4.9 per cent in 1988, and per capita expenditure from domestic sources from $3.60 in 1986 to $0.80 in 1989. Maldives, on the other hand, has made health a national priority and increased resource allocation to that sector.

The Pacific island economies tend to devote proportionately more resources to health than in other parts of the ESCAP region. However, impressive expenditure is often favoured over efficient expenditure, with a disproportionate amount spent on secondary and tertiary care expenditure and capital equipment over lower profile but more effective primary health inputs. It is estimated that in the Federated States of Micronesia, 2 per cent of the medical cases require tertiary care (specialist treatment), but receive 50 per cent of health expenditure – which is largely consumed by the cost of air transport to Hawaii.[32] Also, as is the case in many other countries of the ESCAP region, the urban bias in the distribution of health facilities and personnel has resulted in an inherent bias in health funding in favour of urban areas.

Many countries have taken account of the urban/rural inequities and made an effort to allocate more resources to local health services. In Bangladesh, rural health complexes and public health facilities in general receive the highest share of the development budget in the health sector. China has a policy of giving priority to decentralized funding strategies. Nepal increased the percentage of public sector health expenditure allocated to primary health care from 41.7 per cent in 1985 to 51.2 per cent in 1991.[33] In India, at least 50 per cent of public sector health resources are devoted to the rural sector. Thailand uses 27 per cent of its public sector health budget for first-level health and over 50 per cent for the rural areas of the country.

Economic growth trends have yielded a variety of experiences with government expenditure on health. In Papua New Guinea there was a drop in real per capita health spending, even though the Government increased the share of public resources committed to health. In Maldives, where the economy is currently thriving, the share of government expenditure allocated to health increased from 3.5 to 15.3 per cent between 1980 and 1990, with 100 per cent of that directed towards primary health care. In other cases,

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30 WHO, "Implementation of the Global Strategy..." (see note 2 above).

31 Liu Feng, "Effective local level delivery of human resources development related programmes: the case of China", paper prepared for the UNDP/ESCAP Seminar on Effective Local-level Delivery of Human Resources Development-related Programmes, Bangkok, March 1992.

32 Suliana Siwatibau, loc. cit.

33 WHO, "Review of second evaluation of regional strategies for health for all" (SEA/RC44/14), 22 July 1991.

retrenchment in public spending has occurred, thereby leading to a reduction in the government expenditure allocated to health, such as in Indonesia and the Philippines.[34] In China, the absolute amount allocated to health from the government budget increased between 1980 and 1989, while its proportion of the total expenditure decreased.

[34] WHO, "Implementation of the Global Strategy..." (see note 2 above).

Regardless of trends in national economic growth and the share of national income allocated to health, the combined effects of inflation and population growth have often resulted in declining real public spending for health per capita. Capital developments in the health sector, increasingly externally financed, invariably imply additional recurring costs to maintain the facilities and services developed. Yet, there has been an absolute decline in government spending in many countries, and a relative fall in government versus non-government spending in many more.

As it is the poor who are usually most dependent on public sector services, declining government health financing compromises equitable access to health care and exacerbates the already existing disparities in health status among different socio-economic groups within a country. In many cases, the equity issues arising from the

**Table VI.8. Central government expenditure on health in selected developing countries of the ESCAP region**

| | *Health expenditure as percentage of total government expenditure* | | | *Health expenditure as percentage of gross national product* | | | *Health expenditure per capita (US dollars)* | |
|---|---|---|---|---|---|---|---|---|
| | *1970* | *1980* | *1990* | *1970* | *1980* | *1990* | *1980-1982* | *1986-1987* |
| **East Asia** | | | | | | | | |
| Republic of Korea | 1.4 | 1.2 | 2.2 | 0.2 | 0.2 | 0.3 | 5 | 11 |
| **South-East Asia** | | | | | | | | |
| Indonesia | 1.4 | 2.5 | 2.0 | 0.2 | 0.6 | 0.4 | 3 | 2 |
| Lao People's Democratic Republic[a] | – | 9.4 | 4.9 | – | 1.5 | 1.2 | ... | 3.6 |
| Malaysia | 6.1 | 3.7 | 4.7 | 1.5 | 1.5 | 1.6 | ... | ... |
| Myanmar | 6.1 | 5.3 | 4.9 | 1.0 | 0.8 | 0.6 | ... | ... |
| Philippines | 3.0 | 3.9 | 3.1 | 0.4 | 0.6 | 0.7 | 5 | 4 |
| Singapore | 7.8 | 7.0 | 4.7 | 1.3 | 1.4 | 1.1 | 85 | 96 |
| Thailand | 3.7 | 4.1 | 6.8 | 0.6 | 0.8 | 1.0 | 8 | 10 |
| **South Asia** | | | | | | | | |
| Bangladesh | 5.0 | 6.4 | 5.4 | 0.5 | 0.6 | 0.9 | 1 | 1 |
| Bhutan | ... | 4.7 | 5.3 | ... | 1.7 | 2.3 | 2 | 3 |
| India | 1.5 | 1.6 | 2.5 | 0.2 | 0.2 | 0.5 | 1 | 1 |
| Iran (Islamic Republic of) | 3.6 | 6.4 | 8.5 | 1.1 | 2.3 | 1.4 | ... | ... |
| Maldives | ... | 3.5 | 15.3 | ... | 1.1 | 9.8 | ... | ... |
| Nepal | 4.7 | 3.9 | 4.8 | 0.4 | 0.5 | 1.0 | 1 | 1 |
| Pakistan | 1.1 | 1.5 | 0.7 | 0.2 | 0.2 | 0.2 | 1 | 1 |
| Sri Lanka | 7.6 | 4.9 | 5.4 | 2.1 | 2.0 | 1.5 | 4 | 7 |
| **Pacific** | | | | | | | | |
| Fiji | 13.3 | 8.1 | 11.8 | 3.4 | 2.3 | 1.5 | 45 | 38 |
| Papua New Guinea | 6.3 | 8.6 | 9.4 | 2.3 | 3.1 | 2.7 | 26 | 22 |
| Solomon Islands | 14.5 | 10.7 | 6.2 | 3.8 | 3.8 | 2.3 | 17 | 16 |
| Vanuatu | ... | 13.2 | 6.6 | ... | ... | 2.8 | ... | 37 |

*Sources:* International Monetary Fund, *Government Finance Statistics Yearbook*, vol. IV, 1980; vol. XIII, 1989; and vol. XIV, 1990; and *International Financial Statistics Yearbook*, vol. XLIV, 1991; Asian Development Bank, *Key Indicators of Developing Member Countries of ADB*, vol. XIV, April 1983, and *Key Indicators of Developing Asian and Pacific Countries, 1992*, vol. XXII, 1992; World Bank, *World Development Report*, 1984 and 1992; and World Health Organization, *World Health Statistics Annual, 1991* (Geneva, Switzerland, 1992).

*Note:* In some cases data are for the nearest year indicated, owing to the unavailability of data.

[a] Referring to 1986 and 1988.

surge in private sector activity, coupled with increasing public sector resource constraints, are compelling governments to reconsider both how to manage public-private sector relationships and how to restore competitiveness in the public sector. More and more countries are giving priority to devising ways and means of financing health services in different ways. Local health cooperatives, partial health insurance coverage, and public-private sharing of the cost of health care and user charges are emerging in response to the need for rationalizing health care financing.

## D. CONCLUSION

Declining infant mortality rates, rising life expectancy and improvements in maternal and under-5 mortality are evidence that progress towards health for all is being made on many fronts in the ESCAP region. Certainly one of the salient achievements of the health for all strategy thus far has been the universal policy endorsement given to this aim. Health for all has been acknowledged as a step in a search for social justice and equity. Health has been recognized as a fundamental human right in the Constitution of WHO, resolutions of the World Health Assembly and various international proclamations, and has assumed priority status on many national development agenda.

Nevertheless, much remains to be done. Achievements in primary health care have enabled more people, but still not enough, to have better health. And as they have better health and live longer, their health needs change, and curative care considerations often requiring more sophisticated technology and greater resources take higher precedence. Governments are increasingly hard pressed to respond to these changes and additional needs, particularly in the face of structural adjustment requirements and ensuing conflicting priorities.

In addition to resource allocation considerations, the critical role of population growth within the context of economic development and health for all goals demands even greater attention. It is well documented that population growth impinges on access to safe water and sanitation, a major factor in determining infant mortality and life expectancy at birth. Population growth also exerts pressure on agricultural lands, and the exodus to urban areas in search of better economic opportunities often has adverse consequences for health. Frequent child-bearing and short birth intervals leave women effete and unable to attend to the needs of their ever-increasing families. Water resources for human, agricultural and industrial use are diminishing in general, and cannot possibly meet the demands of ever growing populations. In summary, the detrimental consequences of population growth lie at the heart of many problems for health and human welfare.

Most countries in the ESCAP region have acknowledged the importance of this interaction and have taken steps to control their population growth through the promotion of integrated family planning and health programmes. But still not enough is being done, and integration efforts often leave much to be desired. For example, the implementation of separate vertical programmes for AIDS and family planning, as is the case in many countries, overlooks the intertwined nature of the issues and leads to duplication. In other cases, although priority may be given to family planning *per se*, in the absence of an adequately integrated approach it may be at the expense of other sectors that have an important bearing on fertility determinants, and ultimately on health and population growth.

It is estimated that, globally an additional $25 billion dollars will be required annually just to bring an end to malnutrition and preventable diseases. The additional cost of achieving the goals of the World Summit for children has been estimated at $20 billion. As committed as countries may be to realizing universal good health and social welfare, without adequate resources, the goal of achieving health for all will remain elusive. Vast additional amounts will be required to maintain an acceptable status quo, and even more to ensure subsequent improvements in global health status and well-being.

In spite of economic dynamism in the Asian and Pacific region, health indicators still leave much to be desired in the least developed countries, economies in transition, island nations and the very heavily populated countries of South Asia. The challenge of achieving health for all in many countries is sometimes compounded by conflicting priorities. Nevertheless, there is a strong case for augmenting resources for health care, through both national effort and international action.

Further to balancing sectoral priorities with available resources, efforts must continue to identify those vulnerable populations – among them, the urban and rural poor, women and children, the unemployed, the disabled and the elderly – who continue to suffer from restricted access to health care. Many of them are precisely those with the greatest health needs. As long as they are relegated to the periphery of the health care system, social equity will remain only a lofty ideal.

Since the 1957 issue, the *Economic and Social Survey of Asia and the Pacific* has, in addition to a review of the current situation of the region, contained a study of studies of some major aspect(s) or problem(s) of economies of Asia and the Pacific, as specified below:

1957: Postwar problems of economic development
1958: Review of postwar industrialization
1959: Foreign trade of ECAFE primary exporting countries
1960: Public finance in the postwar period
1961: Economic growth of ECAFE countries
1962: Asia's trade with western Europe
1963: Imports substitution and export diversification
1964: Economic development and the role of the agricultural sector
1965: Economic development and human resources
1966: Aspects of the finance of development
1967: Policies and planning for export
1968: Economic problems of export-dependent countries. Implications of economic controls and liberalization
1969: Strategies for agricultural development. Intra-regional trade as a growth strategy
1970: The role of foreign private investment in economic development and co-operation in the ECAFE region. Problems and prospects of the ECAFE region in the Second Development Decade
1971: Economic growth and social justice. Economic growth and employment. Economic growth and income distribution
1972: First biennial review of social and economic developments in ECAFE developing countries during the Second United Nations Development Dacade
1973: Education and employment
1974: Mid-term review and appraisal of the International Development Strategy for the Second United Nations Development Decade in the ESCAP region, 1974
1975: Rural development, the small farmer and institutional reform
1976: Biennial review and appraisal of the International Development Strategy at the regional level for the Second United Nations Development Decade in the ESCAP region, 1976
1977: The international economic crises and developing Asia and the Pacific
1978: Biennial review and appraisal at the regional level of the International Development Strategy for the Second United Nations Development Decade
1979: Regional development strategy for the 1980s
1980: Short-term economic policy aspects of the energy situation in the ESCAP region
1981: Recent economic developments in major subregions of the ESCAP region
1982: Fiscal policy for development in the ESCAP region
1983: Implementing the International Development Strategy: major issues facing the developing ESCAP region
1984: Financing development
1985: Trade, trade policies and development
1986: Human resources development in Asia and the Pacific: problems, policies and perspectives
1987: International trade in primary commodities
1988: Recent economic and social developments
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# ECONOMIC AND SOCIAL SURVEY OF ASIA AND THE PACIFIC

1992

UNITED NATIONS

ECONOMIC AND SOCIAL COMMISSION FOR ASIA AND THE PACIFIC

# ECONOMIC AND SOCIAL SURVEY OF ASIA AND THE PACIFIC 1992

## PART TWO
## EXPANSION OF INVESTMENT AND INTRAREGIONAL TRADE AS A VEHICLE FOR ENHANCING REGIONAL ECONOMIC COOPERATION AND DEVELOPMENT IN ASIA AND THE PACIFIC

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# FOREWORD

This is the forty-sixth issue of the *Economic and Social Survey of Asia and the Pacific.* It is divided into two parts, as in previous years. Part one analyses recent economic and social developments in the region; part two deals with expansion of investment and intraregional trade as a vehicle for enhancing regional economic cooperation and development in Asia and the Pacific.

There has been a steep decline in the growth of world output and trade during the early years of the 1990s. This unfavourable development in the international environment has been a significant cause of some deceleration of economic growth in the region. Nevertheless, the increasing strength of the domestic market, the rapid expansion of intraregional trade and investment, and flexible domestic policies have enabled the region to sustain remarkably high growth rates, though with considerable variation among countries.

Economic growth does not automatically bring about a socially optimal pattern of development. The objective of establishing such a pattern should be to ensure an improvement in the living standards and quality of life of all groups of the population, while ensuring adequate protection of the environment and the natural resource base to make the process of growth and development sustainable. The issues that feature prominently in this context are: achieving growth with stability; the alleviation of poverty; improvement in literacy, education, health and nutrition; and the preservation of environmental quality. Accordingly, the *Survey* devotes considerable attention to analysis of performance and policies with regard to these issues. Health and nutrition are singled out for especially detailed treatment in consideration of their significance as major determinants of socio-economic well-being. In addition, the vast ESCAP region encompasses many economies with severe structural handicaps – the least developed, land-locked and island economies and economies in transition. The particular problems confronting them and the related policy choices are also dealt with at some length.

There is increasing recognition of the imperatives of regional cooperation in a wide range of activities as a means not only to provide a further boost to the economic and social development of the region as a whole but also to enable the lagging economies to become more active participants in that process. The focus in part two of the *Survey* is on trade and investment – the two most significant forms of cross-border transactions – as instruments of strengthening regional cooperation and development. The intensity of intraregional trade and investment flows is analysed with particular attention to the evolving interrelationships between them. The potential of greater benefits from the intraregional trade-investment nexus, in view of emerging complementarities among economies of the region, is examined; the constraints on a fuller realization of such potential are identified; and finally, policy options to overcome the constraints are suggested.

Owing to some unavoidable difficulties, parts one and two have had to be published separately.

Like previous *Surveys,* this issue is published on the responsibility of the ESCAP secretariat and the views expressed do not necessarily reflect those of member and associate member Governments.

Rafeeuddin Ahmed
Executive Secretary

February 1993

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The term "ESCAP region" is used in the present issue of the *Survey* to include Afghanistan, Australia, Azerbaijan, Bangladesh, Bhutan, Brunei Darussalam, Cambodia, China, Cook Islands, Democratic People's Republic of Korea, Micronesia (Federated States of), Fiji, French Polynesia, Guam, Hong Kong, India, Indonesia, Iran (Islamic Republic of), Japan, Kazakhstan, Kiribati, Kyrgyzstan, Lao People's Democratic Republic, Macau, Malaysia, Maldives, Marshall Islands, Mongolia, Myanmar, Nauru, Nepal, New Caledonia, New Zealand, Niue, Northern Mariana Islands, Pakistan, Papua New Guinea, the Philippines, Republic of Korea, Republic of Palau, Samoa, Singapore, Solomon Islands, Sri Lanka, Tajikistan, Territory of American Samoa, Thailand, Tonga, Turkmenistan, Tuvalu, Uzbekistan, Vanuatu and Viet Nam. The term "developing ESCAP region" excludes Australia, Japan and New Zealand.

The term "the Asian republics" in this issue of the *Survey* refers to six of the successor States of the former Union of Soviet Socialist Republics: Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan.

The designations employed in this publication do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country or territory or of its authorities, or concerning the delimination of its frontiers.

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The abbreviated title *Survey* in footnotes refers to *Economic and Social Survey of Asia and the Pacific* for the year indicated.

Many figures used in the *Survey* are on a fiscal year basis and are assigned to the calendar year which covers the major part or second half of the fiscal year.

Reference to "tons" indicates metric tons.

The term "billion" signifies a thousand million.

In the tables, three dots (...) indicate that data are not available or are not separately reported, a dash (–) indicates that the amount is nil or negligible, and a blank indicates that the item is not applicable.

In dates, a hyphen (-) is used to signify the full period involved, including the beginning and end years, and a stroke (/) indicates a crop year, a fiscal year or plan year. The fiscal years, currencies and 1992 exchange rates of the ESCAP economies are listed in the following table:

| *Country or area* | *Fiscal year* | *Currency and abbreviation* | *Mid-point rate of exchange for $1 as of June 1992* |
|---|---|---|---|
| Afghanistan | 21 March to 20 March | Afghani (Af) | 50.600 |
| Australia | 1 July to 30 June | Australian dollar ($A) | 1.344 |
| Azerbaijan | 1 January to 31 December | Russian Rouble (Rb)[a] | ... |
| Bangladesh | 1 July to 30 June | Taka (Tk) | 39.000 |
| Bhutan | 1 April to 31 March | Ngultrum (Nu) | 25.890 |
| Brunei Darussalam | 1 January to 31 December | Brunei dollar ($Br) | 1.60[b] |
| Cambodia | 1 January to 31 December | Riel (CR) | 1,000.000 |
| China | 1 January to 31 December | Yuan renminbi (YRMB) | 5.420 |
| Commonwealth of the Northern Mariana Islands | ... | United States dollar ($) | 1.000 |
| Cook Islands | 1 April to 31 March | New Zealand dollar ($NZ) | 1.834 |
| Democratic People's Republic of Korea | ... | North Korean Won (Won) | 0.940[c] |
| Fiji | 1 January to 31 December | Fijian dollar ($F) | 1.475 |
| Guam | 1 October to 30 September | United States dollar ($) | 1.000 |
| Hong Kong | 1 April to 31 March | Hong Kong dollar ($HK) | 7.735 |
| India | 1 April to 31 March | Rupee (Rs) | 25.890 |
| Indonesia | 1 April to 31 March | Rupiah (Rp) | 2,035.000 |
| Iran (Islamic Republic of) | 21 March to 20 March | Rial (Rls) | 63.823 |
| Japan | 1 April to 31 March | Yen (Y) | 127.200 |
| Kazakhstan | 1 January to 31 December | Russian Rouble (Rb) | 407.000[d] |
| Kiribati | 1 January to 31 December | Australian dollar ($A) | 1.344 |
| Kyrgyzstan | 1 January to 31 December | Russian Rouble (Rb) | 407.000[d] |
| Lao People's Democratic Republic | 1 July to 30 June | New kip (NK) | 717.000 |
| Macau | ... | Macau Pataca (MOP) | 7.963 |
| Malaysia | 1 January to 31 December | Ringgit ($M) | 2.502 |
| Maldives | 1 January to 31 December | Rufiyaa (Mal Rf) | 10.945 |
| Mongolia | 1 January to 31 December | Tughrik (Tug) | 40.000 |
| Micronesia (Federated States of) | ... | United States dollar ($) | 1.000 |
| Myanmar | 1 April to 31 March | Kyat (K) | 5.965 |
| Nauru | 1 July to 30 June | Australian dollar ($A) | 1.344 |
| Nepal | 16 July to 15 July | Rupee (NRs) | 42.700 |
| New Zealand | 1 April to 31 March | New Zealand dollar ($NZ) | 1.834 |
| Niue | 1 April to 31 March | New Zealand dollar ($NZ) | 1.834 |
| Pakistan | 1 July to 30 June | Rupee (PRs) | 25.130 |
| Papua New Guinea | 1 January to 31 December | Kina (K) | 0.959 |

| *Country or area* | *Fiscal year* | *Currency and abbreviation* | *Mid-point rate of exchange for $1 as of June 1992* |
|---|---|---|---|
| Philippines | 1 January to 31 December | Peso (P) | 24.910 |
| Republic of Korea | 1 January to 31 December | Won (W) | 788.100 |
| Republic of Palau | ... | United States dollar ($) | 1.000 |
| Samoa | 1 January to 31 December | Tala ($WS) | 2.443 |
| Singapore | 1 April to 31 March | Singapore dollar ($S) | 1.613 |
| Solomon Islands | 1 January to 31 December | Solomon Islands dollar ($SI) | 2.933 |
| Sri Lanka | 1 January to 31 December | Rupee (SLRs) | 44.080 |
| Tajikistan | 1 January to 31 December | Russian Rouble (Rb) | 407.000[d] |
| Thailand | 1 October to 30 September | Baht (B) | 25.310 |
| Tonga | 1 July to 30 June | Pa'anga (P) | 1.336 |
| Turkmenistan | 1 January to 31 December | Russian Rouble (Rb) | 407.000[d] |
| Tuvalu | 1 January to 31 December | Australian dollar ($A) | 1.344 |
| Uzbekistan | 1 January to 31 December | Russian Rouble (Rb) | 407.000[d] |
| Vanuatu | 1 January to 31 December | Vatu (VT) | 111.520 |
| Viet Nam | 1 January to 31 December | New dong | 10,875.000[c] |

***Sources:*** United Nations, *Monthly Bulletin of Statistics*, vol. XLVI, No. 12 (December 1992); and national sources.

[a] Azerbaijan also use Manat as an alternate currency. [b] August 1992. [c] September 1992. [d] November 1992.

## ABBREVIATIONS

| | |
|---|---|
| ACU | Asian Clearing Union |
| ADB | Asian Development Bank |
| APEC | Asia-Pacific Economic Cooperation |
| ARC | Asian Reinsurance Corporation |
| ASEAN | Association of South-East Asian Nations |
| CMEA | Council for Mutual Economic Assistance |
| EC | European Community |
| ECO | Economic Cooperation Organization |
| EFTA | European Free Trade Association |
| FAO | Food and Agriculture Organization of the United Nations |
| FDI | foreign direct investment |
| GATT | General Agreement on Tariffs and Trade |
| GDP | gross domestic product |
| GNP | gross national product |
| IMF | International Monetary Fund |
| NAFTA | North American Free Trade Agreement |
| NIEs | newly industrializing economies |
| NMP | net material product |
| NTBs | non-tariff barriers |
| OECD | Organisation for Economic Cooperation and Development |
| ODA | official development assistance |
| RIIPS | regional investment information and promotion service |
| SAARC | South Asian Association for Regional Cooperation |
| SITC | Standard International Trade Classification |
| TRIMs | trade-related investment measures |
| UNCTAD | United Nations Conference on Trade and Development |
| UNDP | United Nations Development Programme |
| VERs | voluntary export restraints |

# I. BACKGROUND TO THE STUDY

The global economy presents a mixed picture of growing integration and cooperation, on the one hand, and isolationism and conflict, on the other. Integration has usually been in the nature of arrangements for formal consultations by a group of countries on issues of collective economic interest leading, at times, to the coordination of policies through consensus. While the motivation for most of the ongoing integration initiatives has stemmed generally from the desire to reduce barriers to trade and to defuse trade tensions, which is perceived to be easier to achieve on a regional than on a global basis, impatience with the slow and cumbersome process of multilateral negotiations has also been a major catalytic factor.

Two factors have, in addition, contributed significantly to the increase in international integration. One is the accelerated shift away from insular, import-substituting strategies during the 1980s, in part due to the conditionalities associated with structural adjustment finance and in part because of the voluntary acceptance of more liberal and open economic regimes in many developing countries. The second factor is the dismantling of the highly autarkic, command economy structures that characterized most former centrally planned economies that are now making the transition to a market economy system, with varying degrees of success. Along with these developments there has been a tendency towards greater regional cooperation across the globe, epitomized by the European Community (EC) and its struggle to forge a single, unified market and monetary system, but visible also in a range of less regimented formations, including, more prominently, the North American Free Trade Arrangement (NAFTA) and Asia Pacific Economic Cooperation (APEC).[1] It is, none the less, notable that all these schemes, which include preferential trade liberalization as a core component, have the professed objective of supplementing and strengthening multilateralism, rather than of establishing a narrower alternative.

However, these structural shifts in the world economic system do not imply an end to isolationism and conflict. Rather, in many instances, regional groupings have proved to be an intermediary level of relative isolation between national autarky and complete international integration. At the same time, while barriers between individual countries within the large number of regional groupings are being dismantled, there is a real threat of new and sometimes extremely restrictive barriers between regional groupings. The long delay in forging an agreement in the Uruguay Round of multilateral trade negotiations, the possibility of a trade conflict between the United States of America and EC over agricultural subsidies, and tension over protectionism in many developed countries, are all symptomatic of the potential for economic conflict in an otherwise more integrated world.

To a certain extent, these tendencies are inevitable. In a world system characterized by uneven development across countries, across sectors in each country and across the same sectors in different countries, and by imperfections, externalities and economies of scale, it is hard to achieve completely free multilateral flows of goods, services and financial resources. Even mainstream theory, in its more realistic versions, does not support such completely unfettered trade. After all, historical experience has made clear that much of world trade occurs between the developed countries whose resource endowments are more comparable with each other than with those of the less developed countries. The reason, of course, is that much of this trade is intra-industry (and, of course, intra-firm) trade of differentiated products. Such trade patterns, which do not quite fit into the conventional notions of comparative advantage, reflect, in fact,

[1] While NAFTA is an exclusive trading alliance between the United States of America, Canada and Mexico, APEC is a more open ended scheme which is intended to generate cooperation in various economic fields among its present and future members.

the increasingly important role of technological developments and innovation as a critical factor in the production process.

With the maturing of the world economic, social and political system, the excessive isolationism characteristic of the cold war years has given way to greater interaction for evolving cooperative action for development between even former adversaries. The present transition therefore appears to be towards an intermediate level of integration and interdependence, in which the extent of integration and policy coordination would be scaled up to break with the isolationism of the past, but would find an equilibrium well short of complete integration of a kind that substantially erodes the autonomy of the nation State. That is to say, regional cooperation, just as much as a greater degree of international coordination, would be an abiding characteristic of the international economic order that is currently being fashioned by autonomous processes and conscious intervention.

The significance of this assertion should be clear. The move towards greater regional and subregional cooperation in the Asian and Pacific region is not in any way a defensive response to efforts at regional integration elsewhere in the world, though it may occasionally appear to be so. Rather, it is part of the present process of restructuring the economic order of the post-war world that is now increasingly irrelevant. The study accordingly dwells on the theme of regional economic cooperation as an opportunity of which the Asian and Pacific economies, both developed and developing, have not made full use in the quest for growth characterized by a greater diffusion of its benefits across the region. Thus, any effort at facilitating that process of regional and subregional cooperation and integration is also intended to mitigate the impact of the otherwise painful process of transition to a new order. It is this perspective that underlies this study, which examines the role of expanding trade and foreign investment in enhancing economic cooperation and development among countries in the ESCAP region.

Emphasis is placed on trade and investment because these constitute the real, physical core of all integrative forces in the economy. Multilateral trade links up economies through the exchange of different or even differentiated products, implying the splicing of complementary segments of their economic structures. These differences in economic structure arise for a host of reasons, varying from resource endowments and levels of development to differences in the nature of human capital and socio-historical conditions. Exploiting these gives each trading partner the benefits that stem from partial specialization and economies of scale. But given the inequality of development even within regions and subregions, the benefits from such trade are unlikely to be distributed equitably. It is here that foreign investment and the effects that it can have on skill formation, technological capabilities and production patterns play a role. It could, if undertaken in an environment that does not encourage distorted investment decisions, help pull economies up in such a way that they reap a larger share of the benefits from trade. Needless to say, under circumstances that are by now well known, foreign investment can have adverse implications as well, in terms of accentuating the economic inequity among countries. Yet, in the kind of synergetic environment that is created through cooperation, the trade-investment nexus offers substantial benefits. But the success of that cooperation depends in the final analysis on the ability of individual countries in the cooperative forum to earn foreign exchange of a magnitude adequate to ensure that a liberal import regime does not result in an unsustainable current account deficit as well. The existence of that ability to restructure the economy to a level of greater operational efficiency, a suitable domestic environment and the international space to earn that volume of foreign exchange are therefore also essential for making the transition to a viable cooperative regime.

But that is not all. The prospects for the three emerging structural changes that have now become noticeable dominate discussions of the current conjuncture in the world economy. The first change is the shift from a deep and synchronized recession in the developed industrial economies to a situation where they recover at least some of the vibrancy which characterized the two decades after the Second World War. The rate of growth of output in the seven major industrial economies, which slowed from 3.4 per cent in 1989 to 2.4 per cent in 1990, fell to a marginal 0.6 per cent in 1991. It is estimated that growth rose to 1.6 per cent in 1992 and will increase to a more respectable, even if not very creditable, 2 per cent in 1993.[2] But actual

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[2] United Nations Department of Economic and Social Development, "The world economy at the end of 1992: background for an international policy agenda", Table A.II note of the Secretary-General for the Economic and Social Council, December 1992.

rates have been known to belie projections on these counts in the past and, particularly after a protracted slow period growth could be significantly higher than forecast. The second change is the reorientation of a number of developing countries from relatively insular to more open economic regimes; several developing countries of the Asian and Pacific region have opted for more open economic regimes over the last five years, and most have yet to complete the transition successfully in terms of rendering them sustainable. Third, the transition of the former centrally planned economies to a market economy system is also expected to influence the global economic scenario; these economies, which recorded a 5 per cent drop in output in 1990 and a further 16 per cent drop in 1991, are expected to record relatively high negative rates in 1992 and 1993 as well.[3]

These prevailing undercurrents in the world economy constitute the backdrop to this study of regional economic cooperation through trade and investment in Asia and the Pacific. These, in part, provide a rationale for such cooperation, in as much as a degree of coordination in periods of uncertainty is of some benefit, especially to the region's weaker economies. These trends, however, also define the difficult circumstances in which cooperation needs to be forged as formal arrangements themselves can achieve little if they are not strengthened by autonomous flows in trade and investment. At the same time, whether those flows are significant or not depends on the direction taken by the structural shifts currently under way in the world system.

In fact, the difficult circumstances in which a new international economic order is being forged has led to the argument that the immediate imperative for regional cooperation is defensive. The formation of major blocs such as the European Free Trade Association (EFTA) and NAFTA is seen to indicate the integration into blocs of regional groups of developed and developing countries the world over. These two blocs together are estimated to absorb 65 per cent of global imports and 47 per cent of developing country exports. Given the uncertainty surrounding growth in the developed countries, which reduces the economic space available for growth in the world economy, there is thus the view that the Asian and Pacific region needs to establish its own version of a regional understanding that takes advantage of the presence in the region of its own developed country group (Australia, Japan and New Zealand) and the set of successful industrializers in East Asia. It is contended that with its own creditable growth performance, which is more dispersed in terms of the number of economies that shore up that performance, the Asian and Pacific region would then be in a position to insulate itself from the destabilizing influences of the recession stemming in part from policy measures determined outside the region.

While the immediate objective of regional cooperation is the safeguard of the region's own interests, it cannot be denied that the long-term solution for regional, as well as global, prosperity lies in multilateralism and openness of economies. The study therefore also emphasizes the need to generate self-sustained growth poles in Asia and the Pacific and elsewhere, that can together pull the world economy out of the recession in which it is currently engulfed: any prolongation of the recessionary trends would threaten to intensify the forces of regional isolation. Given the lack of "world economic leadership" of the kind that the United Kingdom of Great Britain and Northern Ireland provided during the second half of the nineteenth century and the United States of America during a good part of this century, as an initial step, coordination of economic activities between decentralized units within individual poles of growth with the objective of strengthening their expansionary impulses is the most promising mechanism for fashioning sustainable recovery in the world system. Regional economic cooperation is thus the first stage of a two-tier movement towards global prosperity.

The study is divided into six chapters, including this introductory chapter. Chapter II examines recent overall trends in trade and investment in the Asian and Pacific region, and the consequent autonomous integration in the region. It is this process of autonomous integration that is sought to be strengthened by the formal regional and subregional arrangements which are surveyed. This analysis of global and regional links provides the setting to move on to an assessment of the nexus between trade and investment in the Asian and Pacific region in chapter III, and its actual and potential contribution to a process of industrial restructuring that could result in a virtuous circle of growth. Chapter IV describes in some detail why this synergy is not easily realized in some contexts. It

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[3] Figures from United Nations Department of Economic and Social Development, *"The world economy in 1992: an update"* (E/1992/INF/8).

examines situations where the virtuous circle has not only proved elusive but where the effort at approximating it has led to severe balance-of-payments difficulties. The chapter also looks at a range of issues, including endogenous factors such as the macro-economic environment, foreign exchange and investment regulations, infrastructural inadequacies, and some exogenous concerns that constrain the operation of the nexus. The analysis is extended in chapter V, which looks at the special problems prevailing in the Pacific islands, in the least developed countries in general and in the economies in transition in the region. The analysis in these chapters provides the basis for formulating, in chapter VI, an approach to regional cooperation and development and the specific direction that cooperation initiatives must take in the context of Asia and the Pacific.

# II. REGIONAL LINKS IN TRADE AND INVESTMENT

Among the stylized facts used by most analysts of the world economy is an observed shift in the focus of growth towards the Asian and Pacific region over the last two decades. This is reflected mainly in the persisting competitiveness of several of the region's developing economies, which have maintained both a high level of economic growth and a reasonably good trade performance. While part of the dynamism may be ascribed to close trade and investment linkages to Japan, which has performed well, much credit lies in the generally flexible production structures and responsive policy environment in these economies, which have enabled successful implementation of an export-led strategy of development. In fact, the robust growth of exports has effected a rise in the share of the developing ESCAP region in world trade from slightly under 9 per cent in 1980 to about 15.5 per cent in 1991.[1]

This remarkable performance is of critical importance as the central integrative economic force at the regional level is trade in goods and services, and, with a view to assessing its effectiveness, this chapter examines the trends in regional trade and focuses on the autonomous links that have developed in the Asian and Pacific region through intraregional trade, the ways in which they are related to global and intraregional trends in investment, and the relation of these trade and investment trends to the growth poles in Asia and the Pacific. However, inasmuch as regional economic cooperation in trade and investment offers the potential of strengthening the export capabilities of the developing Asian and Pacific region, the forces of market-driven integration require to be supplemented by formal cooperative arrangements at the regional and subregional levels. These deliberate policy-oriented operational interventions have a catalytic impact in nurturing the reinforcement of mutually acceptable and beneficial intraregional economic ties, and are therefore also surveyed to provide the basis for the more detailed examination in later chapters of the trade-investment nexus and its relation to growth in the region.

Accordingly, this chapter is divided into two sections. In section A, trends in the trade performance of the Asian and Pacific region are discussed with special reference to intraregional trade; this is followed by an examination of the trade performance by subregions, and a brief review of the evidence on the commodity composition of regional trade. Thereafter, trends in foreign investment in the region are assessed, with a view to establishing the backdrop for the analysis of the foreign trade and investment nexus which is the central theme of this study. Section B is devoted to a review of the formal agreements for economic cooperation within Asia and the Pacific in order to assess their efficacy in promoting economic ties within the region, particularly with regard to trade and investment.

## A. MAIN FEATURES OF REGIONAL TRADE AND INVESTMENT

### 1. Trends in regional trade

Despite the extremely unfavourable international environment, there are a number of factors that favour the growth of economic cooperation in the Asian and Pacific region through these means. To start with, the dynamism characteristic of the region is a well-documented fact. In the period 1986-1991, for example, when the rate of growth of world output averaged 2.6 per cent per annum, that of the developed ESCAP countries was 4.4 per cent and that in the developing ESCAP region averaged 6.7 per cent. Interestingly, barring the Pacific islands and the economies in transition, this relatively creditable rate of growth was more or less generalized across the ESCAP region, with the newly industrializing economies (NIEs) (Hong Kong, Republic of Korea, Singapore and Taiwan

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[1] Bank for International Settlements, *62nd Annual Report: 1st April 1991-31st March 1992* (Basle, 15 June 1992).

Province of China),[2] China, the "ASEAN-4" (Indonesia, Malaysia, the Philippines and Thailand) and South Asia (Bangladesh, India, Nepal, Pakistan and Sri Lanka) as groups having performed rather well. If this differential persists, by the turn of the century the Asian and Pacific region could constitute one of the world's largest and most dynamic markets.

Second, given the nexus between production and trade, exports from the region also grew much faster than in North America and Europe during the 1980s. Over the 16-year period 1975-1991, exports from the ESCAP region grew at the rate of 12.1 per cent per annum, while world exports expanded at the rate of 8.7 per cent per annum (table 2.1). As a result, the region's share of world exports rose from 15.3 per cent in 1975 to 25.3 per cent in 1991 (table 2.2).

Third, the ESCAP region has become its own most dynamic market. An inter-temporal analysis of the period 1975-1990 reveals three different phases in the growth of world and intraregional trade (table 2.3). The first period, 1975-1980, is one of rapid expansion of both intraregional and global trade, while the second, 1980-1985, coincides with the worldwide recession in the wake of the second oil shock, and is marked by a slow-down in both world and intraregional trade. The period 1985-1990 is, however, once again a period of growth. In each of these periods, exports by the ESCAP region to all countries in the region, which stood at 19.2, 5.0 and 15.5 per cent respectively, exceeded the exports by the ESCAP region to global markets (18.6, 4.8 and 13.2 per cent respectively). The net result was that the share of intra-ESCAP exports in the exports of countries of the ESCAP region to world markets rose from 33.3 per cent in 1975 to 45.3 per cent in 1991, indicating that there are growth stimuli internal to the region that can be exploited (table 2.2).

In spite of its recent upsurge, intraregional trade in Asia and the Pacific remains at a relatively modest level in relation to the share of intra-bloc trade to the total trade of the European Community (EC) or the combined trade of the United States of America and Canada, and there is still considerable scope for increasing its volume.[3] Even the current level is, to some extent, a misleading indicator of the interdependence among the economies of the region, as there are significant intraregional differences, and growth in all countries in the region has not been based on a rapid expansion

[2] In a sense, the use of the word "industrializing" when referring to these economies is perhaps a misnomer, in view of the fact that the industrialization process in these economies has continued for over two decades.

[3] See *World Economic Survey 1990* (United Nations publication, Sales No.E.90.II.C.I), table III.2.

**Table 2.1. Export performance of Asia and the Pacific, 1975-1991**

*(Percentage average annual compound growth rate)*

| From \ To | World | ESCAP region | Developed ESCAP region | South Asia | Newly industrializing economies | China | ASEAN-4 |
|---|---|---|---|---|---|---|---|
| World | 8.7 | 12.0 | | | | | |
| ESCAP region | 12.1 | 14.3 | | | | | |
| Developed ESCAP region | 9.7 | 11.9 | 6.8 | 8.9 | 16.2 | 10.7 | 11.4 |
| South Asia | 9.1 | 9.5 | 7.7 | 7.1 | 14.0 | 5.5 | 9.9 |
| NIEs | 17.5 | 19.5 | 17.3 | 20.9 | 22.9 | 45.5 | 17.1 |
| China | 15.7 | 18.1 | 13.9 | 18.3 | 21.1 | – | 11.5 |
| ASEAN-4 | 10.8 | 11.5 | 8.9 | 13.9 | 15.1 | 19.1 | 11.6 |

*Source:* Calculated from International Monetary Fund, *Direction of Trade Statistics Yearbook*, various issues.

*Note:*
ESCAP region: Developed ESCAP region, South Asia, NIEs, China and ASEAN-4
Developed ESCAP region: Japan, Australia and New Zealand
South Asia: Bangladesh, India, Pakistan and Sri Lanka
NIEs: Hong Kong, Republic of Korea, Singapore and Taiwan Province of China
ASEAN-4: Indonesia, Malaysia, Philippines and Thailand

of exports. In fact, there are a number of economies in the region which were not able to match the export trends characteristic of their neighbours, for example, some of the Pacific island countries (Samoa, Papua New Guinea, Solomon Islands and Vanuatu), Afghanistan, Brunei Darussalam, the Islamic Republic of Iran and Myanmar. There were also others, like India and the Philippines, which were unable to sustain the export growth rates needed to enable them to keep pace with the expansion of their imports.

The differential performance across subregions[4] and countries is all the more evident when a period long enough to cover both years of deceleration and years of growth are considered. On examining the export performance of subregions over the period 1975-1991, it is observed that the NIEs recorded a compound rate of growth of 17.5 per cent per annum and China of 15.7 per cent, whereas South Asia recorded

[4] In the text, the NIEs and the developed countries of the ESCAP region as a group have sometimes been referred to as subregions, but this is not strictly correct.

**Table 2.2. Intraregional export transactions in Asia and the Pacific, 1975 and 1991**

1991

| To / From | World | ESCAP region | Developed ESCAP region | South Asia | Newly industrializing economies | China | ASEAN-4 |
|---|---|---|---|---|---|---|---|
| | (millions of US dollars) | | (Percentage distribution) | | | | |
| World | 3 454 657 | 745 865 | | | | | |
| ESCAP region | 872 301 | 395 111 | | | | | |
| Developed ESCAP region | 366 520 | 143 642 | 17.12 | 2.99 | 52.97 | 6.92 | 20.00 |
| South Asia | 30 874 | 7 590 | 39.86 | 8.68 | 34.15 | 2.46 | 14.85 |
| NIEs | 302 972 | 137 794 | 27.68 | 3.12 | 28.25 | 20.25 | 20.70 |
| China | 71 986 | 50 357 | 21.62 | 2.11 | 72.09 | – | 4.19 |
| ASEAN-4 | 99 949 | 55 728 | 44.81 | 2.35 | 41.56 | 4.27 | 7.01 |

1975

| To / From | World | ESCAP region | Developed ESCAP region | South Asia | Newly industrializing economies | China | ASEAN-4 |
|---|---|---|---|---|---|---|---|
| | (millions of US dollars) | | (Percentage distribution) | | | | |
| World | 916 000 | 122 412 | | | | | |
| ESCAP region | 140 105 | 46 655 | | | | | |
| Developed ESCAP region | 83 271 | 23 626 | 36.23 | 4.64 | 29.35 | 8.27 | 21.51 |
| South Asia | 7 687 | 1 789 | 51.54 | 12.35 | 17.78 | 4.47 | 13.86 |
| NIEs | 22 827 | 7 988 | 49.76 | 2.58 | 18.04 | 0.86 | 28.76 |
| China | 6 943 | 3 495 | 38.97 | 2.06 | 48.38 | – | 10.59 |
| ASEAN-4 | 19 377 | 9 758 | 64.93 | 1.59 | 25.08 | 1.49 | 6.92 |

*Source:* Calculated from International Monetary Fund, *Direction of Trade Statistics Yearbook*, various issues.

*Note:*
ESCAP region: Developed ESCAP region, South Asia, NIEs, China and ASEAN-4
Developed ESCAP region: Japan, Australia and New Zealand
South Asia: Bangladesh, India, Pakistan and Sri Lanka
NIEs: Hong Kong, Republic of Korea, Singapore and Taiwan Province of China
ASEAN-4: Indonesia, Malaysia, Philippines and Thailand

## Table 2.3. Trade performance of the ESCAP region: growth rates

*(Average annual compound growth rate)*

| | Exports | | | | | | Imports | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | To World | | | To All ESCAP countries | | | From World | | | From All ESCAP countries | | |
| | 1975-80 | 1980-85 | 1985-90 | 1975-80 | 1980-85 | 1985-90 | 1975-80 | 1980-85 | 1985-90 | 1975-80 | 1980-85 | 1985-90 |
| **A. Developed ESCAP region** | 17.7 | 5.4 | 10.3 | 14.2 | 6.4 | 13.0 | 18.7 | -0.9 | 12.2 | 16.3 | 1.5 | 11.9 |
| Australia | 13.1 | 0.5 | 11.5 | 12.0 | 1.4 | 13.9 | 15.3 | 2.9 | 10.7 | 17.1 | 5.9 | 12.0 |
| Japan | 18.5 | 6.3 | 10.2 | 14.4 | 8.0 | 12.8 | 19.6 | -1.6 | 12.5 | 16.4 | 0.8 | 12.0 |
| New Zealand | 20.2 | 1.1 | 10.5 | 24.6 | 2.5 | 12.9 | 11.7 | 1.7 | 10.0 | 13.5 | 2.4 | 9.5 |
| **B. Newly industrializing economies** | 28.0 | 8.1 | 18.6 | 27.0 | 9.2 | 21.7 | 25.3 | 4.9 | 19.5 | 23.0 | 6.7 | 22.8 |
| Rep. of Korea | 28.0 | 11.7 | 14.8 | 24.3 | 9.0 | 22.3 | 24.8 | 7.1 | 17.1 | 21.3 | 7.2 | 20.1 |
| Hong Kong | 26.8 | 8.9 | 22.2 | 26.5 | 18.0 | 24.5 | 27.1 | 5.8 | 22.7 | 25.2 | 6.8 | 27.3 |
| Singapore | 29.2 | 3.3 | 18.3 | 28.9 | 3.0 | 17.7 | 24.2 | 1.8 | 18.4 | 21.9 | 6.2 | 17.7 |
| Taiwan Province of China | – | – | – | – | – | – | – | – | – | – | – | – |
| **C. ASEAN-4** | 25.1 | -0.6 | 13.5 | 26.1 | 0.5 | 12.6 | 20.9 | -0.2 | 21.4 | 19.9 | 0.5 | 24.4 |
| Indonesia | 25.3 | -3.3 | 6.7 | 28.4 | -3.8 | 8.3 | 17.8 | -1.2 | 16.5 | 18.0 | -4.6 | 21.9 |
| Malaysia | 27.8 | 3.5 | 13.8 | 31.2 | 6.5 | 12.7 | 25.1 | 2.6 | 18.9 | 23.4 | 4.4 | 20.1 |
| Philippines | 20.1 | -4.6 | 12.1 | 18.0 | -5.9 | 11.0 | 17.5 | -8.5 | 19.4 | 14.5 | -4.4 | 21.1 |
| Thailand | 24.1 | 1.8 | 26.2 | 15.7 | 1.4 | 25.5 | 23.6 | 0.1 | 29.5 | 23.3 | 4.2 | 32.5 |
| **D. Indo-China** | 13.0 | 12.3 | 32.3 | 6.9 | 18.8 | 32.9 | 8.9 | -8.0 | 10.6 | 11.4 | -0.7 | 6.3 |
| Cambodia | – | – | – | – | – | – | – | – | – | – | – | – |
| Lao People's Democratic Republic | 15.7 | -5.3 | 45.8 | 5.2 | +1.7 | 28.9 | 24.0 | -12.2 | 17.1 | 26.2 | -11.9 | 18.7 |
| Viet Nam | 12.7 | 14.0 | 31.4 | 7.2 | 20.6 | 33.2 | 7.6 | -7.5 | 9.9 | 9.1 | 1.3 | 4.3 |
| **E. South Asia** | 15.6 | 3.3 | 12.7 | 14.0 | 0.5 | 13.2 | 19.2 | 2.4 | 6.0 | 20.4 | 5.8 | 5.8 |
| Bangladesh | 19.3 | 4.8 | 10.9 | 45.7 | -0.1 | -1.1 | 15.4 | -0.7 | 7.7 | 24.8 | 4.0 | 12.5 |
| India | 14.1 | 3.6 | 12.6 | 9.1 | 2.8 | 15.1 | 19.1 | 3.4 | 5.8 | 23.1 | 6.1 | 2.0 |
| Maldives | – | 24.9 | 23.9 | – | 36.2 | 12.9 | – | 28.8 | 18.9 | – | 38.4 | 17.2 |
| Nepal | 11.1 | 16.6 | 13.5 | 3.1 | 7.5 | 5.6 | 15.0 | 6.0 | 13.2 | 15.2 | 6.0 | 12.3 |
| Pakistan | 20.0 | 0.9 | 15.3 | 25.3 | -4.7 | 13.4 | 20.2 | 1.9 | 4.6 | 13.4 | 6.9 | 5.9 |
| Sri Lanka | 16.1 | 4.0 | 8.4 | 6.2 | 0.2 | 9.3 | 24.3 | -2.1 | 7.5 | 20.0 | 2.8 | 12.0 |
| **F. Pacific islands** | 19.7 | -4.3 | 5.2 | 24.0 | -6.5 | 12.0 | 17.1 | -3.0 | 11.0 | 18.3 | -2.1 | 9.0 |
| Fiji | 15.9 | -8.5 | 9.1 | 23.8 | -8.8 | 12.7 | 15.8 | -4.6 | 10.6 | 16.6 | -3.8 | 12.1 |
| Papua New Guinea | 18.6 | -4.0 | 5.3 | 22.8 | -7.7 | 13.2 | 13.8 | -2.4 | 8.4 | 15.7 | -1.5 | 4.7 |
| Samoa | 19.1 | 16.3 | -20.4 | 21.1 | 14.8 | -9.7 | 12.0 | -2.9 | 9.4 | 13.1 | -0.6 | 0.8 |
| Solomon Islands | – | -1.0 | 1.6 | – | 13.8 | 2.1 | – | -1.8 | 6.0 | – | -0.2 | 4.4 |
| Tonga | – | -5.8 | 12.9 | – | -2.5 | 9.1 | – | 3.0 | 9.1 | – | 3.1 | 7.5 |
| Vanuatu | – | -0.3 | -6.9 | – | 23.3 | 7.7 | – | -2.9 | 36.3 | – | -4.9 | 43.3 |
| **G. China** | 25.8 | 8.5 | 20.5 | 23.3 | 11.0 | 20.9 | 25.0 | 16.9 | 6.6 | 20.6 | 23.3 | 5.4 |
| **H. Rest of developing ESCAP region** | 0.8 | -1.7 | 1.5 | 8.3 | -5.9 | -0.5 | 6.3 | -1.2 | 6.4 | 9.3 | -1.0 | 6.5 |
| Afghanistan | 34.1 | -1.7 | 4.1 | 15.0 | -2.7 | 8.2 | 14.1 | 9.9 | 11.2 | 1.5 | 11.9 | 4.4 |
| Brunei Darussalam | 34.6 | -8.6 | -5.6 | 34.4 | -9.2 | -5.1 | 16.2 | 1.1 | 23.2 | 16.8 | 2.2 | 19.8 |
| Iran, (Islamic Republic of) | -4.8 | -0.5 | 1.9 | 0.2 | -4.9 | 1.1 | 4.4 | -2.1 | 4.5 | 5.6 | -2.7 | 2.4 |
| Macau | 32.5 | 10.9 | 14.1 | 30.4 | 27.4 | 8.7 | 28.8 | 7.4 | 14.8 | 28.1 | 4.8 | 16.1 |
| Myanmar | 20.7 | 3.9 | -7.0 | 17.6 | 1.0 | -2.2 | 35.8 | -3.7 | -1.5 | 37.1 | -4.8 | 2.2 |
| **All ESCAP** | 18.6 | 4.8 | 13.2 | 19.2 | 5.0 | 15.5 | 19.6 | 1.9 | 14.0 | 18.5 | 4.8 | 15.9 |

*Source:* Calculated from International Monetary Fund, *Direction of Trade Statistics Yearbook*, various issues.

a figure of just 9.1 per cent and the ASEAN-4 only 10.8 per cent (table 2.1). Of course, part of the explanation for the relatively low rate observed for the ASEAN-4 is the weak performance by the Philippines in certain years. In fact, as will be seen later, the achievements of some of the individual economies within South Asia and the ASEAN-4 were rather unsatisfactory.

The implication of these trends should be clear: even though growth figures for the 1980s indicate that almost all components of the Asian and Pacific region, barring perhaps the Pacific islands, performed rather well, the evidence on export growth shows substantial variations, indicating that the process of growth based on exports is not generalized across the region. This renders some of these economies vulnerable as they make the transition to more open regimes, since inadequate export growth in the face of the inevitable post-liberalization increase in imports can lead to balance-of-payments difficulties. In fact, even without excessive liberalization, the effort to sustain higher output growth during the 1980s in economies which did not record substantial export expansion, as, for example, in India, generated macroeconomic imbalances that spilled over onto the balance of payments. What that experience indicated was that, given the limits to which the flow of imports through the sieve of intervention can be controlled, the ability to earn foreign exchange on a sustainable basis becomes a crucial determinant of the potential rate of growth of the system. The crux of that ability is, of course, the ability to raise exports.

The external vulnerability of some economies in the ESCAP region has been further aggravated with the inclusion in its fold of economies in transition the six Asian republics of the former Union of Soviet Socialist Republics, Azerbaijan, Kazakhstan, Kyrgyztan, Tajikistan, Turkmenistan and Uzbekistan. These economies, which were major producers or processors of raw materials in the former USSR, are characterized by severe structural deficiencies and a near absence of institutional and communications infrastructure. This reduces substantially the flexibility of their production structures in the short run, despite the rich resource potential of some of these economies. As these Asian republics now have to meet a substantial part of their consumption and investment requirements from the world market, they find themselves extremely vulnerable externally.

One response to this vulnerability (in fact, both within and outside the Asian and Pacific region) has been the widespread acceptance of structural adjustment strategies and trade liberalization measures as a means of correcting for the imbalance. Over the last five years, there have been major shifts in policy and a number of Asian and Pacific developing countries have announced far-reaching trade liberalization measures. The popularity of the "liberalization paradigm" in the developing world is explained to a substantial degree by the reaction to the fact that efforts to pursue relatively autarkic development strategies tend to fail in a double sense: they are unable to stem the flow of imports into these economies, except under extremely authoritarian economic structures, and they undermine the ability of these economies to export, by devaluing the significance of the international market relative to the domestic market; the underlying factor is generally that inward-oriented development, by sheltering domestic suppliers, breeds inefficient production, resulting in high cost and/or inferior quality of output.

Export growth therefore influences the development process in a twofold sense. For one thing, it matters to the extent that a trade surplus raises the rate of growth through mechanisms captured by the conventional foreign trade multiplier. For another, inasmuch as access to foreign exchange increases the manoeuvrability of the system in dealing with structural bottlenecks of one kind or another, high export growth stimulates the development process. Kalecki's seminal analysis of how the limits to the rate of non-inflationary growth set by the rate of growth of the production of necessities are eased by access to foreign exchange is a simple but telling illustration of this point.[5] In the event, most countries of the Asian and Pacific region have accepted as fact the need to expand exports for financing crucial imports as part of a growth strategy. There are, however, many forms that effort can take, varying from subjecting domestic firms to the cutting edge of international competition to using the State as a strategic coordinator.

In fact, increasingly, analysts of the successful nexus between trade and production in the more progressive East Asian economies have discounted the role of pure free market stimuli and directed attention to a large number of country-specific factors, including the rather special relationship between the State and private

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[5] M. Kalecki, "Problems of financing economic development in a mixed economy", reprinted in *Selected Essays on the Economic Growth of the Socialist and the Mixed Economy* (Cambridge, Cambridge University Press, 1972), pp. 145-161.

capital in many of these economies, which helps in the coordination of investment decisions. Such factors, rather than market signals, have also influenced the proximate determinants of success, that is, the extremely high degree of innovativeness of these economies with regard to products and processes, on the one hand, and organizational characteristics that ensure tight inventory and quality control, on the other. A corollary of that innovativeness has been the ability of their manufactured exports to retain a competitive edge in the world market as well as to dominate the regional economic scene.

The final picture of the regional economy that emerges, therefore, is a combination of overall above-average performance in production and trade, fuelled to a substantial extent by an intraregional stimulus, on the one hand, and disparities in performance and a high degree of external vulnerability of subregional blocs and individual countries, on the other.

## 2. Trade performance by subregions

The persistence of instances of external vulnerability has, however, been accompanied by the spread of the trade-production nexus in the region over time. The most striking feature of subregional trends over the period 1975-1991 is the widening of the geographical spread of exports of the countries of the ESCAP region to world and regional markets (table 2.2). In 1975, the developed ESCAP region accounted for 59 per cent of ESCAP region exports to the world, the NIEs and the ASEAN-4 for around 16 and 14 per cent, respectively, and South Asia and China for around 5 per cent each. By 1991, while the share of the developed ESCAP region in ESCAP region exports to world markets had fallen to 42 per cent, that of the NIEs had risen to 35 per cent and of China to 8 per cent. It is interesting to note that, while the ASEAN-4 had registered a decline to a 11.5 per cent share of the ESCAP region's world exports, that of South Asia actually fell from its already low level to just about 3.5 per cent.

A look at the contribution to intra-ESCAP exports by country groupings reveals shifts that are even more striking. In 1975, the developed ESCAP region accounted for about 51 per cent of these exports, the ASEAN-4 for 21 per cent, the NIEs for 17 per cent, China for around 7.5 per cent and South Asia for 3.8 per cent. By 1991, while the share of the developed ESCAP region had fallen to 36 per cent, that of the NIEs had risen to 35 per cent and of China to 13 per cent, while the share of the ASEAN-4 and South Asia had again fallen, to 14 and 2 per cent respectively.

There are a number of conclusions that emerge from these trends over the 16-year period 1975-1991. First, as is clear from table 2.1, the NIEs and China have been able to sustain higher rates of growth of their exports to both world and ESCAP markets (17.5 and 19.5 per cent per annum, and 15.7 and 18 per cent per annum, respectively) than the developed Asian and Pacific group (approximately 10 and 12 per cent per annum), the ASEAN-4 countries (around 11 per cent per annum in both markets), and South Asia (around 9 per cent per annum in both markets). In this period, the NIEs and China have therefore captured a portion of the share of the other major subregions in ESCAP region exports to world and regional markets. Second, the breakthrough of the NIEs and China has been more or less proportionate in both world and ESCAP markets in terms of increases in shares. Third, of the groups for which comparable data are available for both points in time (that is, all Asian and Pacific countries except the Pacific islands), the rate of growth of exports to markets in the ESCAP region is higher than that of its exports to world markets in all cases, although the difference is marginal in the case of South Asia.

The implications of this evidence need to be elaborated. While there has been an inevitable decline in the dominant role of the developed Asian and Pacific countries in the growth and trade of developing countries in the region, the benefits of the redressing of regional inequalities have gone more to the NIEs and China. While the ASEAN-4 as a group has had to struggle to hold its middle position (helped by a higher rate of expansion in regional markets), there is also evidence to suggest that there are some in that group, such as Thailand and Malaysia, which are performing rather well and others, like the Philippines, rather poorly. Thus, in 1991, Thailand and Malaysia accounted for 5.4 and 5.9 per cent respectively of ESCAP intraregional exports, as compared with 3.6 and 1.8 per cent in the case of Indonesia and the Philippines and 8.9, 9.6 and 7.8 per cent respectively in the case of the Republic of Korea, Singapore and Taiwan Province of China (table 2.4). What is disturbing, however, is that in the inevitable competition between the developing countries of the ESCAP region, several prominent subregions, South Asia and the ASEAN-4 (and, of course, the Pacific islands) are suffering significant losses in the regional market itself, which, as has been

**Table 2.4. Details of major intraregional export transactions in the ESCAP region, 1991**

*(Millions of US dollars)*

| From \ To | DEVELOPED | | | | ASEAN-4 | | | | NIEs | | | | | SOUTH ASIA | | | | CHINA | ESCAP region (Selected groups) | WORLD | Export to ESCAP region as percentage of exports to world |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Australia | Japan | New Zealand | | Indonesia | Malaysia | Philippines | Thailand | | Hong Kong | Republic of Korea | Singapore | Taiwan Province of China | | Bangladesh | India | Pakistan | Sri Lanka | | | 3 454 400 | |
| DEVELOPED | 24 591 | | | | 28 734 | | | | | 76 084 | | | | | 4 297 | | | | | 9 936 | 143 642 | 366 520 | 39.2% |
| Australia | | 0 | 11 661 | 2 009 | | 1 135 | 820 | 367 | 540 | | 1 488 | 2 655 | 2 250 | 1 816 | | 73 | 522 | 140 | 34 | | 1 173 | 26 683 | 42 044 | 63.5% |
| Japan | | 6 504 | 0 | 1 082 | | 5 618 | 7 649 | 2 662 | 9 446 | | 16 337 | 20 088 | 12 228 | 18 275 | | 242 | 1 525 | 1 362 | 292 | | 8 605 | 111 915 | 314 892 | 35.5% |
| New Zealand | | 1 812 | 1 523 | 0 | | 101 | 246 | 63 | 87 | | 158 | 417 | 152 | 221 | | 2 | 67 | 12 | 26 | | 158 | 5 044 | 9 584 | 62.6% |
| ASEAN-4 | 24 971 | | | | 3 909 | | | | | 23 158 | | | | | 1 310 | | | | | 2 380 | 55 728 | 99 949 | 55.8% |
| Indonesia | | 628 | 10 767 | 27 | | 0 | 342 | 168 | 267 | | 703 | 1 948 | 2 410 | 1 056 | | 66 | 56 | 68 | 30 | | 1 191 | 19 727 | 29 142 | 67.7% |
| Malaysia | | 587 | 5 458 | 70 | | 503 | 0 | 301 | 1 098 | | 1 152 | 1 514 | 8 020 | 932 | | 45 | 319 | 352 | 104 | | 639 | 20 194 | 34 405 | 61.2% |
| Philippines | | 104 | 1 771 | 10 | | 42 | 123 | 0 | 220 | | 392 | 228 | 229 | 210 | | 5 | 17 | 3 | 3 | | 128 | 3 485 | 8 840 | 39.4% |
| Thailand | | 463 | 5 038 | 48 | | 136 | 615 | 93 | 0 | | 1 281 | 468 | 2 139 | 476 | | 31 | 58 | 73 | 80 | | 422 | 11 421 | 27 562 | 41.3% |
| NIEs | 38 139 | | | | 28 518 | | | | | 38 932 | | | | | 4 304 | | | | | 27 901 | 137 794 | 302 972 | 45.5% |
| Hong Kong | | 1 386 | 5 307 | 164 | | 705 | 711 | 916 | 1 073 | | 0 | 2 111 | 2 688 | 3 967 | | 241 | 241 | 70 | 222 | | 26 736 | 46 538 | 98 579 | 47.2% |
| Republic of Korea | | 1 006 | 12 195 | 132 | | 1 048 | 1 117 | 632 | 1 350 | | 4 641 | 0 | 2 434 | 1 537 | | 218 | 471 | 322 | 193 | | 307 | 27 603 | 69 489 | 39.7% |
| Singapore | | 1 458 | 5 133 | 192 | | 1 698 | 8 800 | 681 | 3 706 | | 4 260 | 1 393 | 0 | 2 098 | | 364 | 1 004 | 263 | 232 | | 858 | 32 140 | 59 188 | 54.3% |
| Taiwan Province of China | | 1 451 | 9 488 | 227 | | 1 328 | 2 002 | 854 | 1 897 | | 9 600 | 1 492 | 2 711 | 0 | | .. | 265 | .. | 198 | | .. | 31 513 | 75 716 | 41.6% |
| SOUTH ASIA | 3 025 | | | | 1 127 | | | | | 2 592 | | | | | 659 | | | | | 187 | 7 590 | 30 874 | 24.6% |
| Bangladesh | | 20 | 53 | 3 | | 3 | 4 | 0 | 8 | | 24 | 2 | 33 | .. | | 0 | 23 | 39 | 6 | | 21 | 239 | 1 688 | 14.2% |
| India | | 199 | 1 960 | 25 | | 19 | 257 | 71 | 549 | | 657 | 387 | 388 | 211 | | 159 | 0 | 38 | 122 | | 101 | 5 143 | 20 492 | 25.1% |
| Pakistan | | 73 | 520 | 20 | | 48 | 32 | 23 | 81 | | 387 | 265 | 134 | .. | | 101 | 47 | 0 | 68 | | 61 | 1 860 | 6 494 | 28.6% |
| Sri Lanka | | 28 | 120 | 4 | | 2 | 9 | 2 | 19 | | 21 | 29 | 42 | 12 | | 4 | 21 | 31 | 0 | | 4 | 348 | 2 200 | 15.8% |
| China | 10 886 | | | | 2 108 | | | | | 36 300 | | | | | 1 063 | | | | | 0 | 50 357 | 71 986 | 70.0% |
| | | 555 | 10 265 | 66 | | 481 | 527 | 253 | 847 | | 32 110 | 2 177 | 2 013 | .. | | 204 | 144 | 597 | 118 | | 0 | 50 357 | 71 986 | 70.0% |
| ESCAP region (Selected groups) | 101 612 | | | | 64 396 | | | | | 177 066 | | | | | 11 633 | | | | | 40 404 | 395 111 | 872 301 | 45.3% |
| | | 16 274 | 81 259 | 4 079 | | 12 867 | 23 254 | 7 086 | 21 188 | | 73 211 | 35 174 | 37 871 | 30 811 | | 1 755 | 4 780 | 3 370 | 1 728 | | 40 404 | | | |

***Source:*** International Monetary Fund, Direction of Trade Statistics, Yearbook 1991, (Washington, 1992).

seen, is also the more dynamic segment of the world market. In fact, not only have ESCAP region markets been growing faster than world markets, but also the rate of increase in exports of all ESCAP subregions has been better in regional markets, or at least as good as in world markets.

The most striking developments in regional trade are reflected by the trends in relation to China, which has exhibited remarkable dynamism in trade in recent years, following the reform of its policies and the opening up of its economy. The rates of growth of exports to China from the NIEs and the ASEAN-4 are much higher than China's exports to them, whereas China's exports to the developed Asian and Pacific countries and South Asia have increased at a significantly higher rate than its imports from them. The rate of growth of NIE exports, in particular, to China has been spectacular (45.5 per cent per annum), which is indicative of the role that China plays as a final processing centre for their own exports. Clearly, China is attractive as a location for exports to third countries by the NIEs and even some of the dynamic ASEAN-4 economies. However, this would imply that the figures on trade (and even investment) for China would have to be treated with some caution, since including them in the overall export performance of the ESCAP region could imply a significant degree of double counting. China's trade performance, combined with rates of growth of intrasubregional trade, therefore, reflect a situation which is one of extremely high growth in the case of the NIEs, moderately high growth in the case of the ASEAN-4 and relatively poor growth in the case of the developed countries of Asia and the Pacific as well as South Asia. Such a scenario, in turn, indicates that the real growth poles in the developing ESCAP region are the NIEs and some of the ASEAN-4 countries. China, which has developed strong links with this group of countries, has also performed rather well, but the rest of the region, in particular South Asia and the Pacific island economies, has lagged behind.

In fact, in terms of regional integration, even the group of developed economies in the region hardly present themselves as a homogeneous entity. In 1991, out of the three countries in the developed Asian and Pacific subgroup, Japan alone accounted for 78 and 86 per cent respectively of the subgroup's exports to the ESCAP region and world markets. In fact, while regional markets have been extremely important for Australia and New Zealand, accounting for 63.5 and 52.6 per cent respectively of their global exports (as compared with 35.5 per cent in the case of Japan), these two developed countries of the region have not been significant markets for many of the subregions. With regard to the role of the developed countries of the region in absorbing intra-regional exports, Japan by itself accounted for 92 per cent of exports from the ASEAN-4, 94 per cent of China's exports, 84 per cent of the NIE exports and 88 per cent of South Asia's exports to that group (table 2.4).

Japan's integration through trade is greatest with the NIEs, and its participation in Asian and Pacific markets is dominated by manufactures and transport equipment. In the two-way flow, while China and the ASEAN-4 account for a little less than 10 per cent of Japanese exports, Japan accounts for a significant share of primary product exports from ASEAN and (lower level) manufactured goods from the NIEs. There is, however, a difference in terms of export and import dependence on Japan in the case of the ASEAN-4 and the NIEs. Japan is the destination for around 40 per cent of exports of primary products from the ASEAN-4, and the source of 35 per cent of its imports of manufactures. But while Japan supplies about 42 per cent of the NIE imports of machinery and transport equipment, it absorbs less than 10 per cent of their export of manufactures, the major market for which is the United States.

There is consequently a similarity in the relationship between Japan and the NIEs, and the NIEs and China, with the second element in each pair proving to be a destination for exports from the first element, financed by its own exports to third countries. It is this characteristic of autonomous Asian and Pacific integration that has come to be described by the "flying geese" pattern, where one set of countries takes the place of a more developed set in terms of exports based on imports of capital and technology from the more developed group and serving as the base for world-market-oriented production. This process occurs in a step-wise fashion with the developed economies pulling up the less developed segments. The developed countries, of course, move on to higher order exports, in the sense of being more technology-intensive in nature, more capital-intensive and, in some instances, less environmentally polluting. This, of course, could lead to the perpetuation of asymmetries and inequalities, unless the process results in a significant degree of development in indigenous export capabilities.

Indeed, there are signs that the asymmetry persists. Although

two-way trade between Japan and the NIEs remained the single largest component of intraregional trade, valued at US$ 99 billion in 1991, Japanese exports to NIEs rose by 18 per cent in that year, while its imports from them increased by only 5 per cent. This trend has taken Japan's trade surplus with these economies from US$ 19 billion in 1987 to US$ 35 billion in 1991.[6]

There is one other feature that emerges from an examination of the subregional trends in trade in the Asian and Pacific region, which is that intra-subregional exports as a proportion of total exports of each subregion are rather small in almost all cases excepting the NIEs and the developed countries of Asia and the Pacific (table 2.5). The dominance of inter-subregional trade over intra-subregional trade is also in keeping with the perception underlying the "flying geese" pattern.

The relatively small proportion of intra-South Asian exports is hardly surprising. Given the lack of strong complementarities and the existence of high trade barriers within the South Asian economies, the low volume of their intra-subregional trade is easily explained. The comparatively higher level of intra-NIE trade is also not remarkable, in view of the fact that two out of the four, Singapore and Hong Kong, are entrepôt centres for China and South-East Asia respectively. However, trade between Taiwan Province of China and the Republic of Korea is negligible, since their economies are far more competitive with each other than complementary. What is more interesting in this context is the small proportion of intra-ASEAN trade since the ASEAN economies are the only group in the region that extend trade preferences to each other.

Thus the trends in intra-subregional trade suggest that the dynamism of the Asian and Pacific region and its emergence as a growth pole in the world system is based on the dynamism of two subregions, the NIEs and the ASEAN-4, and the two major economies of Japan and China. Of these, the relationships between Japan and the NIEs and the NIEs and China, in particular, are in keeping with the "flying geese" pattern; however, to the extent that the "third country" importer in the pattern happens to be in the region itself, some economies could eventually be worse off. But, as the ASEAN-4 experience suggests, the overall dynamism that this process generates soon spills over in terms of expanding export opportunities in the region which other economies can exploit based on their own comparative advantage. There are, however, economies within South Asia and the ASEAN-4, as well as several least developed, geographically disadvantaged economies and economies in transition, which have yet to benefit from this regionwide virtuous circle. Conscious policy interventions and regionwide cooperative efforts to protect such economies from their high degree of external vulnerability will therefore be required.

**Table 2.5. Intra-subregional exports as a share of total exports**

*(Percentage)*

| | *1975* | *1990* |
|---|---|---|
| ASEAN-4 | 3.5 | 4.2 |
| China | .. | .. |
| Developed Asia and the Pacific | 10.3 | 7.0 |
| Newly industrializing economies | 6.3 | 12.3 |
| Pacific Rim | .. | .. |
| South Asia | 2.9 | 2.9 |

***Source:*** Calculated from a database developed for the ESCAP secretariat by the National Centre for Development Studies of the Australian National University, Canberra, in 1992.

***Note:*** Two dots [..] indicate that figures are negligible. For the Pacific Rim, even this negligible figure declined.

## 3. Commodity composition of regional trade

The evidence on the commodity composition of trade in Asia and the Pacific reveals that, for the region as a whole, exports of manufactured items such as textiles and clothing recorded very high growth rates and constituted the major source of buoyancy to the region's export performance. This was particularly true of exports destined for outside the region. Products such as metals, intermediates and semi-manufactures displayed the most dynamism among intraregional exports. A notable inference from the disaggregated analysis is that rapid expansion in the share of exports of manufactures and other industrial products in the commodity composition of regional trade has been at the expense of primary and agricultural-based commodities, whose share in the overall exports has declined,

[6] Merrill Lynch and Co., Singapore, *Asian Economic Commentary*, October 1992.

though partially it has also been induced by declining unit values of commodity exports.

Exports from sectors comprising non-ferrous metals, marine products, oil and natural gas are of emerging importance in the region, a trend that has been reinforced with the entry of China as a propelling force to the expansion of Asian and Pacific trade. Chemicals and the chemical products of the region have also displayed significant international competitiveness, but the performance by these industries has yet to attain the high growth demonstrated by electronics, which has been a mainstay of exports from Japan and the NIEs and now of, some ASEAN-4 economies.

Table 2.6 provides details of the growth in exports of commodity subgroups from different subregional groupings to the world and regional markets. What is striking is that in the case of the NIEs, between 1975 and 1989 all subgroups recorded relatively high rates of growth to all major markets, with manufactures dominating export performance in world markets. However, in the case of the ASEAN-4, the categories "Agri-based and traditionals" and "Manufactures" have shown better results, with success in some markets being better than in others. South Asia has done poorly with regard to manufactured exports in the regional markets,

**Table 2.6. Decomposition of subregional exports by commodity groups, 1975 and 1989**

| | *Newly industrializing economies* | | | *ASEAN-4* | | |
|---|---|---|---|---|---|---|
| | *1975* | *1989* | *Growth[a]* | *1975* | *1989* | *Growth[a]* |
| | *(thousands of US dollars)* | | *(percentage)* | *(thousands of US dollars)* | | *(percentage)* |
| **Total:** | | | | | | |
| ASEAN-4 | 459 026 | 12 469 196 | 26.60 | 351 616 | 1 237 344 | 9.40 |
| China | 47 215 | 6 737 020 | 42.52 | 92 643 | 568 131 | 13.83 |
| Developed ESCAP economies | 637 388 | 22 139 499 | 28.82 | 5 290 317 | 21 686 298 | 10.60 |
| NIEs | 814 629 | 9 509 981 | 19.19 | 2 080 187 | 15 247 900 | 15.29 |
| Pacific islands | 167 689 | 617 822 | 9.76 | 15 045 | 10 642 | -2.44 |
| South Asia | 160 186 | 3 113 843 | 23.61 | 222 934 | 178 789 | -1.56 |
| World | 59 571 | 135 614 419 | 73.70 | 15 355 049 | 73 428 063 | 11.83 |
| **Manufactures[b]** | | | | | | |
| ASEAN-4 | 260 169 | 9 340 650 | 29.15 | 58 218 | 363 581 | 13.98 |
| China | 3 716 | 5 496 324 | 68.43 | 24 | 66 480 | 76.15 |
| Developed ESCAP economies | 1 485 011 | 16 495 321 | 18.76 | 134 993 | 2 736 179 | 23.98 |
| NIEs | 402 700 | 7 441 104 | 23.16 | 240 161 | 6 243 394 | 26.20 |
| Pacific islands | 48 792 | 316 162 | 14.28 | 2 901 | 5 418 | 4.56 |
| South Asia | 86 817 | 2 290 414 | 26.33 | 7 599 | 25 614 | 9.07 |
| World | 2 520 609 | 116 601 374 | 31.51 | 1 001 343 | 22 379 611 | 24.85 |
| **Semi-processed[c]** | | | | | | |
| ASEAN-4 | 168 239 | 2 377 332 | 20.82 | 210 588 | 288 559 | 2.28 |
| China | 13 438 | 520 090 | 29.84 | 9 134 | 250 106 | 26.67 |
| Developed ESCAP economies | 662 065 | 3 150 966 | 11.79 | 3 228 426 | 10 404 478 | 8.72 |
| NIEs | 337 632 | 1 420 316 | 10.81 | 538 237 | 3 056 948 | 13.21 |
| Pacific islands | 114 765 | 254 687 | 5.86 | 6 854 | 1 351 | -10.95 |
| South Asia | 41 360 | 427 271 | 18.15 | 28 320 | 60 676 | 5.59 |
| World | 1 247 000 | 10 672 700 | 16.57 | 7 155 248 | 17 462 898 | 6.58 |
| **Agri-based and traditionals[d]** | | | | | | |
| ASEAN-4 | 30 604 | 727 714 | 25.40 | 66 825 | 487 721 | 15.25 |
| China | 30 061 | 720 606 | 25.47 | 83 481 | 250 868 | 8.18 |
| Developed ESCAP economies | 489 776 | 2 491 618 | 12.32 | 1 841 379 | 7 695 200 | 10.75 |
| NIEs | 73 505 | 647 524 | 16.81 | 1 247 827 | 4 849 353 | 10.18 |
| Pacific islands | 4 111 | 46 921 | 19.00 | 3 666 | 1 771 | -5.06 |
| South Asia | 31 406 | 393 620 | 19.79 | 182 019 | 77 992 | -5.87 |
| World | 2 284 420 | 8 303 418 | 9.66 | 6 640 200 | 24 879 914 | 9.89 |

*(Continued on next page)*

**Table 2.6.** *(continued)*

| | South Asia | | | Developed ESCAP economies | | |
|---|---|---|---|---|---|---|
| | *1975* | *1989* | *Growth[a]* | *1975* | *1989* | *Growth[a]* |
| | *(thousands of US dollars)* | | *(percentage)* | *(thousands of US dollars)* | | *(percentage)* |
| **Total:** | | | | | | |
| ASEAN-4 | 137 176 | 141 120 | 0.20 | 4 532 339 | 19 178 525 | 10.82 |
| China | 78 937 | ... | | 2 596 649 | 9 602 872 | 9.79 |
| Developed ESCAP economies | 652 159 | 3 114 478 | 11.82 | 6 780 645 | 23 008 034 | 9.12 |
| NIEs | 270 727 | 1 740 687 | 14.22 | 5 783 012 | 40 933 864 | 15.00 |
| Pacific islands | 4 318 | ... | | 628 252 | 1 991 474 | 8.59 |
| South Asia | 224 369 | ... | | 1 200 913 | 4 452 900 | 9.81 |
| World | 6 208 585 | 19 507 105 | 8.52 | 69 480 918 | 316 830 697 | 11.45 |
| **Manufactures[b]** | | | | | | |
| ASEAN-4 | 85 586 | 117 681 | 2.30 | 3 783 543 | 16 613 404 | 11.15 |
| China | 15 459 | 6 357 | –6.15 | 2 213 719 | 8 701 130 | 10.27 |
| Developed ESCAP economies | 194 221 | 1 295 282 | 14.51 | 3 035 770 | 13 602 943 | 11.31 |
| NIEs | 191 250 | 857 783 | 11.32 | 4 893 592 | 35 444 523 | 15.19 |
| Pacific islands | 123 317 | 136 508 | 0.73 | 324 573 | 1 316 764 | 10.52 |
| South Asia | 99 129 | ... | | 928 169 | 3 900 146 | 10.80 |
| World | 2 993 440 | 11 745 257 | 10.26 | 47 651 515 | 282 811 690 | 13.56 |
| **Semi-processed[c]** | | | | | | |
| ASEAN-4 | 3 897 | 7 829 | 5.11 | 228 917 | 1 207 198 | 12.61 |
| China | ... | ... | | 73 263 | 444 418 | 13.74 |
| Developed ESCAP economies | 260 120 | 1 353 932 | 12.51 | 2 215 376 | 5 926 676 | 7.28 |
| NIEs | 43 781 | 709 847 | 22.02 | 353 331 | 3 243 428 | 17.16 |
| Pacific islands | 32 | ... | | 51 025 | 239 554 | 11.68 |
| South Asia | 24 668 | ... | | 44 440 | 258 923 | 13.42 |
| World | 812 513 | 4 949 225 | 13.78 | 5 725 441 | 18 459 660 | 8.72 |
| **Agri-based and traditionals[d]** | | | | | | |
| ASEAN-4 | 47 323 | 13 866 | –8.39 | 494 293 | 1 357 784 | 7.48 |
| China | 65 387 | ... | | 305 119 | 457 322 | 2.93 |
| Developed ESCAP economies | 189 199 | 448 767 | 6.36 | 1 231 130 | 3 456 137 | 7.65 |
| NIEs | 25 818 | 150 856 | 13.44 | 495 598 | 1 823 431 | 9.75 |
| Pacific islands | 352 | ... | | 209 714 | 433 482 | 5.32 |
| South Asia | 99 664 | ... | | 223 979 | 293 805 | 1.96 |
| World | 2 340 978 | 2 670 687 | 0.95 | 7 069 526 | 15 522 945 | 5.78 |

*Source:* Calculated from a database developed for the ESCAP secretariat by the National Centre for Development Studies of the Australain National University, Canberra, in 1992.

*Notes:* [a] Average annual compound growth rate. [b] Including automotive components, chemicals, electronics, iron and steel, textiles and clothing, other manufacturing. [c] Including mining (excluding oil and natural gas), non-ferrous metals, non-metallic manufactures, oil and natural gas. [d] Including cereals and preparations, dairy products, fruits and vegetables, marine products, beverages and tobacco, forestry and forestry products, livestock and meat, sugar, other crops, other foods.

while in the case of the developed Asian and Pacific group of countries, exports of semi-processed goods have done better in regional markets and manufactures in world markets.

The implication appears to be that the top performers are those which have involved themselves in the intraregional trade in manufactures in which, judging from growth rates, the main commodities are electronics, chemicals, textiles and other manufacturing. In fact, electronics is the only category which ranks among the top three in terms of growth rates in the NIEs, the ASEAN-4 and China. On the other hand, growth in the region accompanied by shifting comparative advantage has helped some countries increase their exports of primary products and traditional manufactures within the region.

All of this appears to suggest a crude but perhaps meaningful

sequential story of trade and development in the region. Of the catalysts of growth in the region, Japan and the NIEs began their growth by making major forays into world markets, and provided a stimulus to the regional economy leading to an expansion of regional trade. In that process, many, though not all, of the NIEs relied on investment and technology from Japan. Given this development, some of the ASEAN-4 countries and, more recently, China could rely on both world and regional markets to sustain their growth process. The regional market is therefore emerging as the main channel for a foray into export markets, and the lesson for countries like those in South Asia, the Pacific islands and elsewhere in the region which have yet to benefit from the virtuous circle of trade and development is that it is necessary to exploit the growing regional and world markets as well as developing inter-subregional networks as part of a coordinated strategy of growth.

### 4. Trends in foreign investment

An interesting question is the extent to which the links that have been forged through trade are being strengthened by investment flows within the region. The available data on foreign direct investment (FDI) flows are not always consistent owing to differences in coverage, definitions and reporting methods. However, data from different sources tend to confirm that FDI flows to various regions of the world have grown rapidly over the last three decades; the rate of expansion has been particularly rapid since the mid-1980s. According to statistics compiled by the Secretariat of the United Nations, the nominal annual growth rate of FDI flows between 1985 and 1990 was 34 per cent, a rate which far exceeded that of merchandise exports (13 per cent) and nominal gross domestic product (GDP) (12 per cent).[7] This trend is explained by many factors, including the recovery of the world economy in the second half of the decade; the rapid increase in FDI outflows from Japan and the NIEs as a result of currency appreciation, and the adjustment of transnational corporations in these economies to changing economic forces; the drive to acquire technological advances and competitiveness in production; and the growing importance of transnational corporation investment in the service sector.

The bulk of FDI flows worldwide has been directed towards the developed countries, but FDI flows to developing countries have also increased at a rapid pace. The flows to developing economies as a whole reached one quarter of the world total in 1980-1985, but declined to 17 per cent between 1986 and 1990. However, the absolute volume of FDI flows to the developing countries doubled between the first and second half of the 1980s. A large proportion of the increased FDI flows has been channelled to the developing Asian and Pacific economies which, after 1986, overtook Latin America and the Caribbean as the largest regional recipient of FDI in the developing world, accounting for about half of global FDI flows (table 2.7).

There is, however, a marked variation in the size of FDI flows to various economies and subregions. Among the developing economies in the Asian and Pacific region, the bulk of FDI flows has been concentrated in nine countries in East and South-East Asia: the four NIEs, the ASEAN-4 and China. These nine countries accounted for over 90 per cent of FDI flows to all developing economies in the Asian and Pacific region in recent years. In fact, six of these economies, that is, Singapore, China, Hong Kong, Malaysia, Thailand and Taiwan Province of China, were among the 10 largest recipients of FDI flows in the developing world in the 1980s.[8]

Japan, the United States and EC have been the three most important sources of FDI stocks and flows worldwide. According to one estimate, these three sources account for some four fifths of total outward FDI stocks and flows.[9] The available evidence (table 2.8) indicates that Japan is the most important source of FDI flows in the Asian and Pacific region, although in some of the developing economies, the United States or EC has a more marked presence. Over the 1980s, outward FDI from Asian NIEs has also increased significantly and in some Asian and Pacific economies, notably China, the NIEs have even emerged as important sources of FDI flows.

As regards the distribution of FDI in the developing Asian and Pacific region, most has been channelled into manufacturing industries, although for some

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7 *World Investment Report, 1991: The Triad in Foreign Direct Investment* (United Nations publication, Sales No.E.91.II.A.12).

8 Singapore was ranked at the top in this list of 10, which included Argentina, Brazil, Egypt and Mexico. These 10 countries accounted for 68 per cent of total FDI flows to all developing economies in the 1980s. See *World Investment Report 1992: Transnational Corporations as Engines of Growth* (United Nations publication, Sales No.E.92.II.A.19), annex table 2, p.317.

9 *World Investment Report, 1991: The Triad ...* (see note 8 above).

**Table 2.7. Distribution of foreign direct investment inflows by region and economy, 1980-1990**

*(Millions of US dollars and percentage)*

| *Host region/economy* | *1980-1985 (Annual average)* | *1986* | *1987* | *1988* | *1989* | *1990* |
|---|---|---|---|---|---|---|
| **Developed regions/countries** | 37,179 | 64,083 | 107,916 | 128,556 | 165,385 | 151,970 |
| | (74.6) | (81.9) | (81.2) | (81.2) | (84.7) | (82.7) |
| **Western Europe** | 15,927 | 24,734 | 40,235 | 57,483 | 82,578 | 98,941 |
| | (32.0) | (31.6) | (30.3) | (36.3) | (42.3) | (53.8) |
| European Community | 14,690 | 20,013 | 36,406 | 54,278 | 75,492 | 88,871 |
| | (29.5) | (25.6) | (27.4) | (34.3) | (38.7) | (48.3) |
| Other western Europe | 1,237 | 4,721 | 3,829 | 3,205 | 7,086 | 10,070 |
| | (2.5) | (6.0) | (2.9) | (2.0) | (3.6) | (5.5) |
| **North America** | 18,453 | 35,297 | 62,338 | 63,207 | 74,841 | 43,133 |
| | (37) | (45.1) | (46.9) | (39.9) | (38.4) | (23.5) |
| Canada | -289 | 1,217 | 4,198 | 3,787 | 4,281 | 5,943 |
| | (-0.6) | (1.6) | (3.2) | (2.4) | (2.2) | (3.2) |
| United States of America | 18,742 | 34,080 | 58,140 | 59,420 | 70,560 | 37,190 |
| | (37.6) | (43.5) | (43.7) | (37.5) | (36.2) | (20.2) |
| **Other developed countries** | 2,800 | 4,052 | 5,343 | 7,866 | 7,967 | 9,896 |
| | (5.6) | (5.2) | (4.0) | (5.0) | (4.1) | (5.4) |
| Australia | 1,968 | 3,289 | 3,701 | 7,290 | 7,393 | 7,086 |
| | (3.9) | (4.2) | (2.8) | (4.6) | (3.8) | (3.9) |
| Japan | 325 | 230 | 1,170 | -520 | -1,060 | 1,760 |
| | (0.7) | (0.3) | (0.9) | (-0.3) | (-0.5) | (1.0) |
| Others | 508 | 533 | 472 | 1,096 | 1,634 | 1,050 |
| | (1.0) | (0.7) | (0.4) | (0.7) | (0.8) | (0.6) |
| **Developing regions/economies** | 12,634 | 14,184 | 25,021 | 29,718 | 29,756 | 31,776 |
| | (25.4) | (18.0) | (18.8) | (18.8) | (15.2) | (17.3) |
| Africa | 1,411 | 1,728 | 2,186 | 2,325 | 4,446 | 2,196 |
| | (2.8) | (2.2) | (1.6) | (1.5) | (2.3) | (1.2) |
| Latin America and the Caribbean | 6,035 | 5,353 | 10,826 | 11,443 | 8,363 | 10,055 |
| | (12.1) | (6.8) | (8.1) | (7.2) | (4.3) | (5.5) |
| Western Asia | 379 | 283 | 255 | 690 | 447 | 1,004 |
| | (0.8) | (0.4) | (0.2) | (0.4) | (0.2) | (0.5) |
| **East Asia** | | | | | | |
| China | 718 | 1,875 | 2,314 | 3,194 | 3,393 | 3,489 |
| | (1.4) | (2.4) | (1.7) | (2.1) | (1.7) | (1.9) |
| Asian newly industrializing economies | 2,155 | 3,467 | 7,450 | 8,152 | 7,650 | 7,636 |
| | (4.3) | (4.4) | (5.6) | (5.2) | (3.9) | (4.2) |
| ASEAN-4 | 1,584 | 1,137 | 1,467 | 3,336 | 4,690 | 6,772 |
| | (3.2) | (1.5) | (1.1) | (2.1) | (2.4) | (3.7) |
| **South Asia** | 179.1 | 256 | 405 | 326 | 482 | 412 |
| | (0.4) | (0.3) | (0.3) | (0.2) | (.02) | (0.2) |
| **Oceania** | 130 | 98 | 92 | 180 | 222 | 79 |
| | (0.3) | (0.1) | (0.07) | (0.1) | (0.1) | (0.04) |
| **Central and eastern Europe** | 17 | 16 | 12 | 15 | 11 | 89 |
| | (0.03) | (0.02) | (0.009) | (0.01) | (0.006) | (0.05) |
| **Others** | 36 | -6 | 27 | 63 | 61 | 114 |
| | (0.07) | (-0.008) | (0.02) | (0.04) | (0.03) | (0.06) |
| Total | 49,831 | 78,283 | 132,949 | 158,289 | 195,153 | 183,835 |
| | (100.0) | (100.0) | (100.0) | (100.0) | (100.0) | (100.0) |

*Source:* *World Investment Report 1992: Transnational Corporations as Engines of Growth* (United Nations publication, Sales No.E.92.II.A.19), annex table 1.

*Notes:* The figures in parentheses are percentages of the world total for inflows.

Data are estimates made by the Transnational Corporations and Management Division, United Nations Headquarters, based on data from the International Monetary Fund and OECD estimates; and *World Investment Directory 1992: Foreign Direct Investment, Legal Framework and Corporate Data,* vol. I, *Asia and the Pacific* (United Nations publication, Sales No.E.92.II.A.11).

economies FDI in certain service subsectors, such as finance and construction, is also important. In some resource-rich countries such as Indonesia, Malaysia and Papua New Guinea, there has also been substantial inward FDI in the extractive and primary sectors. Over time, however, there has been a decline in the share of FDI in the primary sector, while that in the manufacturing sector has increased. Moreover, as a result of changing comparative advantage, there has been a significant structural shift in the pattern of FDI within the manufacturing sector among countries and areas

**Table 2.8. Geographical distribution of FDI stock in the Asian and Pacific region, by source of investment**

*(Percentage)*

| *Country or area* | *Year* | *Source of FDI stock* | | | | | |
|---|---|---|---|---|---|---|---|
| | | *United States* | *European Community* | *Japan* | *Newly industrializing economies* | *ASEAN-4* | *Others* |
| **Newly industrializing economies** | | | | | | | |
| Hong Kong | 1984 | 53.7 | 12.4 | 21.0 | 2.9 | 3.2 | 6.7 |
| | 1989 | 31.4 | 14.7 | 29.9 | 2.2 | 2.3 | 19.5 |
| Republic of Korea | 1980 | 19.6 | 8.7 | 60.5 | 1.9 | – | 9.3 |
| | 1988 | 27.7 | 9.4 | 52.0 | 3.8 | 0.01 | 7.0 |
| Singapore | 1980 | 29.6 | 39.6 | 16.7 | ... | ... | 14.1[a] |
| | 1989 | 33.2 | 28.7 | 30.7 | ... | ... | 7.3[a] |
| Taiwan Province of China | 1980 | 35.0 | 9.7[b] | 18.6 | 21.3 | 5.0 | 10.4 |
| | 1988 | 32.1 | 13.4[b] | 26.8 | 14.8 | 2.4 | 10.5 |
| **ASEAN-4** | | | | | | | |
| Indonesia | 1980 | 4.3 | 8.3 | 33.7 | 11.6 | 0.7 | 41.4 |
| | 1988 | 5.8 | 12.1 | 18.4 | 10.8 | 0.3 | 52.5 |
| Malaysia | 1981 | 6.4 | 26.6 | 17.6 | 36.4 | 0.3 | 12.7 |
| | 1987 | 6.1 | 24.0 | 20.1 | 35.1 | 2.2 | 12.4 |
| Philippines | 1980 | 54.6 | 9.3 | 16.8 | 5.5 | 0.02 | 13.8 |
| | 1989 | 55.7 | 11.2 | 14.5 | 9.5 | 0.4 | 8.7 |
| Thailand | 1980 | 32.8 | 15.9 | 29.0 | 18.5 | 1.7 | 2.1 |
| | 1988 | 24.2 | 12.4 | 36.7 | 20.1 | 0.7 | 6.0 |
| **South Asia** | | | | | | | |
| Bangladesh | 1980 | 4.5 | 81.4 | 5.6 | 0.7 | – | 7.7 |
| | 1988 | 35.8 | 53.6 | 4.3 | 0.03 | – | 6.2 |
| India | 1975 | 22.6 | 63.6 | 0.4 | – | – | 13.4 |
| | 1980 | 21.0 | 62.3 | 0.5 | – | – | 16.2 |
| Pakistan | 1980 | 18.2 | 24.4 | 0.7 | 0.2 | – | 56.5 |
| | 1988 | 22.4 | 28.7 | 2.7 | 3.1 | 0.1 | 43.5 |
| Sri Lanka | 1980 | 16.0 | 18.8 | 8.3 | 9.7 | 1.0 | 46.2 |
| | 1987 | 10.4 | 24.0 | 10.0 | 23.5 | 1.2 | 30.9 |
| **Others** | | | | | | | |
| China | 1984 | 16.9 | 13.6 | 5.8 | 52.6 | 0.5 | 10.7 |
| | 1987 | 15.8 | 8.3 | 7.2 | 58.2 | 0.8 | 9.7 |
| Viet Nam | 1980 | – | – | – | – | – | – |
| | 1989 | 0.2 | 57.3 | 14.4 | 7.1 | 0.8 | 20.2 |

***Source:*** *World Investment Directory 1992: Foreign Direct Investment, Legal Framework and Corporate Data,* vol. 1, *Asia and the Pacific* (United Nations publication, Sales No.E.92.II.A.11). Original data are from individual countries and areas.

[a] Including FDI stock from NIEs and the ASEAN-4.
[b] FDI stock from western Europe, including EC.

of the region, and within an economy over time. For example, in most ASEAN countries, FDI flows have shifted from industries which serve the domestic market to export-oriented industries over the 1980s; over time there has also been a shift of FDI from labour-intensive industries such as textiles and clothing to more sophisticated products such as machinery, electronics and automotive parts and components.

A review of outward FDI flows by countries indicates that investments from Japan increased significantly in the 1980s, particularly in the second half of the decade, although there are signs of decline in 1990 and 1991. Furthermore, in what appears to be an effort to deal with rising protectionism in an integrated EC, the share of Japanese investments directed towards EC increased sharply, from 15.5 per cent in 1986 to 25.1 per cent in 1990. The setting up of automobile plants in Europe was a case in point. This implied a relative stagnation in shares directed towards Asia (table 2.9), despite an increase in absolute volumes.

**Table 2.9. Japanese direct investment by region and economy, 1981-1991[a]**

*(Millions of US dollars and percentage)*

| *Region/country or area* | *1981-1985 (Annual average)* | *1986* | *1987* | *1988* | *1989* | *1990* | *1991* |
|---|---|---|---|---|---|---|---|
| **North America** | 3,433.4 | 10,441 | 15,357 | 22,328 | 33,902 | 27,192 | 18,823 |
| | (36.4) | (46.8) | (46.0) | (47.5) | (50.2) | (47.8) | (45.3) |
| **Europe** | 1,306.2 | 3,469 | 6,576 | 9,116 | 14,808 | 14,294 | 9,371 |
| | (13.9) | (15.5) | (19.7) | (19.4) | (21.9) | (25.1) | (22.5) |
| **Asia** | 1,926.4 | 2,327 | 4,868 | 5,569 | 8,238 | 7,054 | 5,936 |
| | (20.4) | (10.4) | (14.6) | (11.8) | (12.2) | (12.4) | (14.3) |
| **Newly industrializing economies** | 820.8 | 1,531 | 2,580 | 3,264 | 4,900 | 3,355 | 2,203 |
| | (8.7) | (6.9) | (7.7) | (6.9) | (7.3) | (5.9) | (5.3) |
| Republic of Korea | 109.2 | 436 | 647 | 483 | 606 | 284 | 260 |
| | (1.2) | (2.0) | (1.9) | (1.0) | (0.9) | (0.5) | (0.6) |
| Taiwan Province of China | 78.2 | 291 | 367 | 372 | 494 | 446 | 405 |
| | (0.8) | (1.3) | (1.1) | (0.8) | (.07) | (0.8) | (1.0) |
| Hong Kong | 367 | 502 | 1,072 | 1,662 | 1,898 | 1,785 | 925 |
| | (3.9) | (2.2) | (3.2) | (3.5) | (2.8) | (3.1) | (2.2) |
| Singapore | 266.4 | 302 | 494 | 747 | 1,092 | 840 | 613 |
| | (2.8) | (1.4) | (1.5) | (1.6) | (2.8) | (1.5) | (1.5) |
| **ASEAN-4** | 1,023.4 | 553 | 1,030 | 1,966 | 2,782 | 3,242 | 3,083 |
| | (10.9) | (2.5) | (3.1) | (4.2) | (4.1) | (5.7) | (7.4) |
| Indonesia | 800 | 250 | 545 | 586 | 631 | 1,105 | 1,193 |
| | (8.5) | (1.1) | (1.6) | (1.2) | (0.9) | (1.9) | (2.9) |
| Malaysia | 95 | 158 | 163 | 387 | 673 | 725 | 880 |
| | (1.0) | (0.7) | (0.5) | (0.8) | (1.0) | (1.3) | (2.1) |
| Philippines | 55.6 | 21 | 72 | 134 | 202 | 258 | 203 |
| | (0.6) | (0.09) | (0.2) | (0.3) | (0.3) | (0.5) | (0.5) |
| Thailand | 72.8 | 124 | 250 | 859 | 1,276 | 1,154 | 807 |
| | (0.8) | (0.6) | (0.7) | (1.8) | (1.9) | (2.0) | (1.9) |
| **China** | 52.2 | 22.6 | 1,226 | 296 | 438 | 349 | 579 |
| | (0.6) | (0.1) | (3.7) | (0.6) | (0.6) | (0.6) | (1.4) |
| **South Asia** | 27.6 | 12 | 27 | 28 | 107 | 43 | 32 |
| | (0.3) | (0.05) | (0.08) | (0.06) | (0.2) | (0.07) | (0.07) |
| **Other Asia** | 2.4 | 5 | 5 | 15 | 11 | 65 | 39 |
| | (0.02) | (0.02) | (0.01) | (0.03) | (0.02) | (0.1) | (0.09) |
| **Others** | 2,764.2 | 6,083 | 6,563 | 10,009 | 10,592 | 8,371 | 7,454 |
| | (29.3) | (27.3) | (19.7) | (21.3) | (15.7) | (14.7) | (17.9) |
| **Total** | 9,430.2 | 32,320 | 33,364 | 47,022 | 67,540 | 56,911 | 41,584 |
| | (100.0) | (100.0) | (100.0) | (100.0) | (100.0) | (100.0) | (100.0) |

*Source:* Ministry of Finance, Japan.

[a] FDI outflows approved by the Ministry of Finance, Japan.

This increase reflected the establishment of production bases in the lower-cost Asian economies by Japanese manufacturers to survive the sharp revaluation of the yen in 1986-1987, a strategy that resulted not only in lower production costs (and therefore higher competitiveness) but also in reduced trade conflicts with the United States, since many of such products from the host countries are exported to that country. As regards the sectors into which Japanese FDI has flowed in the region, these have been determined mainly by the comparative advantage of the host countries, despite the view that post-1986 Japanese FDI has tended to be more export-oriented than in earlier years, when the objective was to expand and defend markets.[10] In this context, an interesting feature of Japanese FDI is the division of labour in different host countries for the same industry; in other words, manufacturing bases for different stages in the production process of an industry are dispersed across the region, depending on comparative advantage. Of greater relevance for this study is the fact that such an investment strategy also contributes to the expansion of intraregional trade. Despite a fall in the absolute volume of FDI to Asia from Japan in 1991, the share of Asia in the total actually rose, reflecting that the decline was less severe for this region in a year of all-round reduced outward investment. As regards the distribution of Japanese FDI flows within Asia, the main recipients have been the NIEs, Indonesia, Malaysia, Thailand and China, with South Asia receiving a minuscule 0.07 per cent.

Interestingly, United States investments, which for a long time have been displaced as the chief source of foreign investment in Asia, and which recorded a 38 per cent decline in that region in 1990, staged a sharp 36 per cent recovery in 1991, despite the fact that the recession in 1991 affected total United States investments abroad adversely, with the flow of such investments declining by 52 per cent (table 2.10). One plausible explanation for this increase in United States investment in the region is the renewed thrust in the development of energy and petrochemical facilities in Asia. The Persian Gulf War and rapid industrialization in recent years have prompted several economies to pursue the development of this sector and this is a field dominated by United States corporations. However, with the North American Free Trade Arrangement (NAFTA) likely to result in a rise in United States commitments in North America, the steady and positive increase in United States investments in Asia since 1987 (except for 1990) may not be sustained.

At the end of the 1980s in terms of share in the stock of FDI, the NIEs headed the list in Malaysia and were way ahead of the rest in China. The United States was the leader in Taiwan Province of China, Hong Kong and Singapore, although it was rapidly losing ground in those economies to Japan. Japan headed the list in Indonesia, the Republic of Korea and Thailand, but its presence in many of the other developing countries in the region is increasing rapidly. It is only in South Asia and Viet Nam that the EC is still the major source of FDI, indicating that traditional ties still hold sway in determining investment affiliations in those countries which have yet to benefit from the rapid trade-based growth that has enveloped the rest of Asia. But even in these relatively less dynamic economies, there are signs of the growing presence of regional investors from Japan and the NIEs.

**Table 2.10. United States direct investments in Asia**

*(Billions of US dollars)*

| | *1991* | *1990* | *Cumulative end-1991* |
|---|---|---|---|
| Asia | 2.29 | 1.68 | 25.18 |
| Hong Kong | 0.24 | 0.24 | 6.43 |
| Singapore | 0.93 | 1.07 | 4.31 |
| Republic of Korea | 0.21 | 0.32 | 2.39 |
| Taiwan, Province of China | 0.46 | 0.09 | 2.47 |
| Indonesia | 0.23 | -0.54 | 3.46 |
| Malaysia | 0.06 | 0.21 | 1.44 |
| Thailand | 0.20 | 0.31 | 1.79 |
| Philippines | 0.04 | -0.03 | 1.57 |
| India | 0.02 | -0.01 | 0.53 |
| Europe | 13.36 | 35.98 | 224.55 |
| Japan | 1.92 | 2.51 | 22.92 |
| World | 26.11 | 54.00 | 450.20 |

***Source:*** U.S. Department of Commerce, *Survey of Current Business*, cited in Merrill Lynch and Co., Singapore *Asian Economic Commentary A Monthly Review*, September 1992.

10 Edward K.Y. Chen, "Changing pattern of financial flows in the Asia-Pacific region and policy responses", *Asian Development Review*, vol. 10, No. 2, 1992.

The shape of FDI flows in the mediumterm to the developing Asian and Pacific region is, however, hard to forecast, as the outcome will be determined by the interplay of several forces and the path to be followed by industrialization in the region. As the relocation of lower- and medium-end manufacturing from Japan and the NIEs to the less industrialized ASEAN-4 economies that was spurred mainly by the exchange rate adjustments in 1986-1988 and rising labour costs is now largely complete, future foreign investment flows to the ASEAN-4 are likely to focus increasingly on areas like infrastructure, services and higher value-added industries. Since United States companies are as competitive as their Japanese counterparts in some service and infrastructure-related industries like banking and finance, computer software, insurance and telecommunications, United States investors could return in strength to the Asian and Pacific investment scene. At the same time, the long-term focus of Japanese investors will probably remain on tapping the region's low-cost labour, taking advantage of the availability of natural resources and targeting the increasingly affluent local markets with higher-priced consumer durables. If such is the eventual scenario, the developing Asian and Pacific region (particularly the NIEs and the ASEAN-4) could eventually stand to benefit from larger FDI flows from both the United States and Japan. The outlook for FDI flows into the region as a whole, given its diversity, will also be conditioned by a host of other factors, primarily the investing policies of transnational corporations. In this regard, much will depend on the region retaining its attractiveness in terms of offering a competitive production base; however, given the emerging trends of FDI in China, Viet Nam and some parts of South Asia, the prospects are indeed encouraging.

Turning to the NIEs, it can be clearly seen from tables 2.11-2.13 that outward investment from Hong Kong, the Republic of Korea and Taiwan Province of China has been rising substantially in recent years. In the future, these outflows are expected to intensify as investing elsewhere in the developing ESCAP region would serve to gain market access for the NIEs in Europe and North America by circumventing trade barriers and retention of the generalized system of preferences (GSP) benefits.

The Republic of Korea's foreign investment, which exceeded $100,000 in only two of the years between 1968 and 1985, rose sharply to $157,153 in 1986 (table 2.11), has since maintained a rising trend and was placed at $408,587 in the first six months of 1990 alone. Interestingly, the three sectors dominating that investment in 1990 were manufacturing (41 per cent), mining (22 per cent) and trade (17 per cent); the Republic of Korea has evidently been seeking locations for its manufacturing investment. Although much of this FDI was possibly linked to trade prospects, the major share of North America in the Republic of Korea's outward FDI reflects the desire to gain access to new technology developed in advanced countries. The prospects for a rapid increase in outward investment by firms from the Republic of Korea are positive, especially as many of its restrictions on international capital movements were removed in 1992.

A similar, post mid-1980s boom in foreign investment is visible in Hong Kong as well, with the approved volume of

**Table 2.11 (a). Republic of Korea: outward investment flows**

| *Year* | *Amount (thousands of US dollars)* | *Number of cases* |
|---|---|---|
| 1968-1971 | 13 364 | 19 |
| 1972-1976 | 43 173 | 81 |
| 1977-1981 | 117 065 | 221 |
| 1982 | 115 962 | 31 |
| 1983 | 103 819 | 49 |
| 1984 | 51 313 | 31 |
| 1985 | 31 492 | 11 |
| 1986 | 157 153 | 32 |
| 1987 | 332 715 | 59 |
| 1988 | 153 106 | 134 |
| 1989 | 324 982 | 231 |
| 1990 (January-June) | 408 587 | 172 |
| Total | 1 852 731 | 1 071 |

*Source:* Bank of Korea, The Status of Outward Foreign Investment, December 1990.

*Note:* Outward flows are based on realized investment (authorized investment less cancellations.)

**Table 2.11 (b). Republic of Korea: distribution of outward investment by industry[a]**

| | *Approved investment* | | | | *Realized investment* | | | |
|---|---|---|---|---|---|---|---|---|
| | *Case* | | *Amount* | | *Case* | | *Amount* | |
| | *nos.* | *per cent* | *'000 $* | *per cent* | *nos.* | *per cent* | *'000 $* | *per cent* |
| Mining | 23 | 1.7 | 640 432 | 20.2 | 17 | 1.6 | 399 810 | 21.6 |
| Forestry | 11 | 0.8 | 87 159 | 2.8 | 11 | 1.0 | 78 059 | 4.2 |
| Fisheries | 50 | 3.8 | 95 358 | 3.0 | 44 | 4.1 | 80 959 | 4.4 |
| Manufacturing | 555 | 41.9 | 1 501 416 | 47.4 | 388 | 36.2 | 759 226 | 41.0 |
| Construction | 61 | 4.6 | 66 330 | 2.1 | 60 | 5.6 | 50 596 | 2.7 |
| Transport and storage | 35 | 2.6 | 7 072 | 0.2 | 33 | 3.1 | 5 930 | 0.3 |
| Trade | 471 | 35.5 | 453 375 | 14.3 | 415 | 38.7 | 315 888 | 17.0 |
| Others | 103 | 7.8 | 280 717 | 8.9 | 87 | 8.1 | 128 501 | 6.9 |
| Real estate | 16 | 1.3 | 34 062 | 1.1 | 16 | 1.6 | 34 062 | 1.9 |
| Total | 1 325 | 100.0 | 3 165 921 | 100.0 | 1 071 | 100.0 | 1 852 731 | 100.0 |

*Source:* Bank of Korea, The Status of Outward Foreign Investment, June 1990.

[a] as of 30 June 1990

outward investment rising from a total of under $1.8 billion in 1986 to almost $4.7 billion in 1989 (table 2.12). China was the major recipient of such investment, whichis known to have entered labour-intensive manufacturing, but Indonesia and Thailand are also receiving significant volumes of investment from Hong Kong. Although initially Hong Kong became an external investor for the purpose of bypassing trade restrictions, subsequently the objective was looking for cheaper (land and labour) production bases.

Taiwan Province of China also entered the foreign investor stream in a substantial way in 1989, with 60 per cent of cumulative investments over the period 1959-1989 occurring in that one year (table 2.13). Interestingly, besides some of the ASEAN-4 countries that have received significant amounts, the major destination has been the United States, which accounts for 57 per cent of cumulative investments and 55 per cent of investments in 1989. This suggests that, faced with the threat of restrictions on its exports, Taiwan Province of China may in part be relocating production to what is its most important market, the United States. In a sense, such behaviour provides the empirical basis for the investment life cycle theory, in which an investing country, which initially generates the capability to export and then clamps down on what it considers disruptive imports, turns host to foreign investment aimed at jumping precisely those protectionist barriers.

Singapore's outward investment is not large compared with that of Hong Kong and Taiwan Province of China, but is clearly increasing.[11] Singapore-based firms which invest outside of the economy are mainly manufacturers and conglomerates involving a range of activities, including manufacturing, real estate and hotels. While large family concerns are also often actively involved, especially in service sector investment in neighbouring countries, investment flows to Malaysia are the most significant because of that country's geographical proximity and rich natural endowments.

Overall, therefore, the trends in investment flows to the Asian and Pacific region support the "flying geese" hypothesis that the trade figures have indicated. The NIEs and some of the ASEAN-4 countries are major hosts for investment from the developed countries, particularly the United States and Japan, with Japan showing some signs in recent years of taking the lead. The NIEs themselves and some of the more successful ASEAN-4 countries have, in turn, also become investors elsewhere in the region,

[11] See Linda Y.C. Lim and Pang Eng Fong, *Foreign Investment and Industrialization in Malaysia, Singapore, Taiwan and Thailand* (Paris, Development Centre of the Organization for Economic Cooperation and Development, 1991).

**Table 2.12. Direct outward investment of Hong Kong to major Asian countries**

*(Millions of US dollars)*

| *Year* | *China* | *Indonesia* | *Thailand* | *Taiwan Province of China* | *Republic of Korea* |
|---|---|---|---|---|---|
| 1986 | 1 449 | 10 | 127 | 76 | 13 |
| 1987 | 1 947 | 135 | 125 | 181 | 43 |
| 1988 | 3 466 | 240 | 451 | 157 | 14 |
| 1989 | 3 160 | 407 | 561 | 248 | 37 |
| Total (1980-1989) | 20 651 | 2 657 | 1 264 | 1 194 | 225 |

| *Year* | *Philippines* | *Malaysia* | *Japan* | *Total* |
|---|---|---|---|---|
| 1986 | 7 | 11 | 57 | 1 750 |
| 1987 | 28 | 11 | 36 | 2 506 |
| 1988 | 27 | 50 | 44 | 4 449 |
| 1989 | 133 | 42 | 63 | 4 651 |
| Total (1980-1989) | 214 | 163 | 453 | 26 821 |

*Source:* Compiled by the Hong Kong and Shanghai Banking Corporation Ltd. on the basis of official statistics of the recipient countries. Figures are based on approvals.

*Notes:* (1) Figures for Malaysia cover only manufacturing investment.
(2) Figure for Singapore are not available.
(3) Figures for Thailand, Malaysia and the Philippines were converted into US dollar terms by applying the average exchange rates in individual years.

**Table 2.13 (a). Outward investment of Taiwan Province of China by country and industry, 1959-1989**

*(Millions of US dollars)*

| | *Thailand* | *Malaysia* | *Singapore* | *Philippines* | *Indonesia* | *United States* | *Others* | *Total* |
|---|---|---|---|---|---|---|---|---|
| Food and beverages | 3.0 | – | 0.1 | 0.3 | 1.9 | 7.2 | 4.4 | 16.3 |
| Textiles | 1.9 | 30.1 | 3.7 | 5.7 | 7.5 | – | 4.1 | 53.0 |
| Pulp paper and products | 10.8 | – | – | 2.0 | 12.1 | 3.0 | – | 27.9 |
| Plastics and rubber products | 7.0 | 8.8 | 1.3 | 0.1 | 0.3 | 44.6 | 5.0 | 67.1 |
| Chemicals | 3.7 | 42.5 | 1.1 | 93.3 | 3.6 | 350.7 | 0.4 | 495.3 |
| Non-metallic minerals | 0.4 | 0.1 | 3.1 | 1.4 | 2.6 | 0.9 | 11.4 | 19.9 |
| Basic metals and metal products | 13.0 | 8.5 | 0.9 | 2.4 | 1.4 | 3.5 | 0.5 | 30.5 |
| Electronics and electric appliances | 28.3 | 64.8 | 3.0 | 6.0 | – | 180.9 | 9.2 | 293.8 |
| Construction | – | 6.7 | – | – | – | 5.0 | 23.0 | 34.7 |
| Trade | 3.5 | 0.8 | 1.2 | 1.9 | – | 20.6 | 17.8 | 45.8 |
| Banking and insurance | – | – | 5.0 | – | – | 113.1 | 74.5 | 192.7 |
| Services | 0.1 | 1.32 | 2.5 | – | 0.4 | 129.3 | 52.8 | 186.4 |
| Others | 11.9 | 10.9 | 1.0 | 2.3 | 1.1 | 6.3 | 28.0 | 60.5 |
| Total | 84.1 | 174.5 | 22.7 | 115.3 | 30.7 | 865.3 | 231.6 | 1524.3 |

*Source:* Investment Commission, Ministry of Economic Affairs, Taiwan Province of China.

**Table 2.13 (b). Outward investment of Taiwan Province of China by country and industry in 1989**

*(Millions of US dollars)*

| | *Thailand* | *Malaysia* | *Singapore* | *Philippines* | *United States* | *Others* | *Total* |
|---|---|---|---|---|---|---|---|
| Food and beverages | – | – | 0.1 | – | – | – | 0.1 |
| Textiles | 0.2 | 30.0 | – | 5.0 | – | 2.3 | 37.6 |
| Pulp paper and products | 2.6 | – | – | 2.0 | – | – | 4.6 |
| Plastics and rubber products | 2.8 | 6.8 | – | – | 31.0 | – | 40.6 |
| Chemicals | 1.9 | 42.5 | – | 56.5 | 314.0 | – | 414.9 |
| Non-metallic minerals | – | – | – | 1.3 | – | – | 1.3 |
| Basic metals and metal products | 12.0 | 5.3 | – | 0.4 | 2.8 | – | 20.4 |
| Electronics and electric appliances | 21.2 | 59.5 | – | 1.0 | 37.8 | 2.3 | 121.9 |
| Construction | – | 6.6 | – | – | – | 21.1 | 27.7 |
| Trade | 2.9 | 0.5 | 0.2 | 0.1 | 3.6 | 3.4 | 10.7 |
| Banking and insurance | – | – | 5.0 | – | 93.9 | 73.5 | 172.4 |
| Services | 2.1 | – | – | – | – | 7.9 | 9.9 |
| Others | 5.9 | 0.1 | – | – | 24.4 | 29.9 | 54.4 |
| Total | 51.6 | 158.6 | 5.2 | 66.3 | 508.7 | 140.5 | 916.5 |

***Source:*** Investment Commission, Ministry of Economic Affairs, Taiwan Province of China.

especially in other NIEs and the ASEAN-4, but also in a range of other countries, as for example, Thailand in Cambodia.

One significant issue of regional interest is, of course, the late 1980s timing of the NIE foreign investment boom. This was attributed to the exchange rate changes in 1986-1988, which forced Japan and the NIEs, whose currencies were appreciating relative to the dollar, to relocate their investments. The timing and resting of these investments in labour-intensive sectors of other developing economies of the ESCAP region and the entry of Taiwan Province of China investments into the United States all lend credence to this argument. However, there are two considerations that render the observed trend and the "flying geese" pattern that it is generating extremely tenuous in a twofold sense: first, with exchange rates volatile, it could make the observed post-1980s investment boom in some Asian economies short-lived; and, second, it could also imply a high degree of volatility in the direction of foreign investment.

There are, nevertheless, four significant conclusions that emerge from this discussion on the trends in FDI in the Asian and Pacific region. First, as in the case of trade, the dominant trend in investment is for intraregional flows to displace flows from and to the rest of the world, although this is less true in the case of the leading Asian and Pacific investor, Japan, which is strengthening its position in the United States and EC as well. Second, the major recipients of foreign investment from within and outside the region during the 1980s were the NIEs and the more successful of the ASEAN countries, indicating that economies which have a strong foothold in world markets, and offer a conducive environment for foreign investment looking for new sites for world market-oriented production, have an edge in attracting foreign investors. Third, as these economies benefit from foreign investment, they themselves have become significant sources of capital flows, willing to enter economies like Sri Lanka, for example, which are now creating an environment conducive to the new, as opposed to older, forms of foreign investment. As the other South Asian economies and those elsewhere in the Asian and Pacific region opt for similar strategies of growth, these prospects for a shift in the focus of intraregional foreign investment offer substantial opportunities for growth. Finally, there appears to be a nexus between trade and investment in the region, providing the basis for the "flying geese" pattern, a nexus which will be examined in detail in the next chapter.

## B. REVIEW OF AGREEMENTS FOR REGIONAL COOPERATION

### 1. Role of formal cooperation arrangements

It is readily apparent from the above review of trade and investment links in the region that the tendency for autonomous market forces to ensure a greater degree of economic integration between countries in the Asian and Pacific region is quite prevalent. This process of autonomous integration has also been accompanied by formal efforts at integration. Regional cooperation can, of course, take myriad forms, varying from enhanced trade, investment and technology flows to measures of integration varying from the creation of free trade areas to the establishment of customs unions, common markets or full-fledged economic unions.[12] But trade, investment and technology flows are also transactions that can occur independently of intervention. Thus, in a world characterized by segmented production processes, relatively low transport costs and highly developed communications networks, such interlinks between any two countries may be independent of the geographical distance that separates them. Therefore, in alluding to enhanced trade, investment and technology flows as means of enhancing regional economic cooperation, the catalytic role of measures that discriminate in favour of such transactions between economies in the region as compared with all economies in the world system is indirectly an acceptable proposition.

Needless to say, in a world where countries are constantly vying with each other for economic space, there are substantial difficulties involved in moving towards the high degree of integration that an economic union involves. In any case, envisaging even a free trade area in as large an economic space as the Asian and Pacific region is difficult. Hence, when the role of trade and investment as mechanisms for enhancing cooperation is emphasized, the objective is to facilitate what are in effect autonomous, "arms-length" transactions to an extent where the role of the Asian and Pacific region as a growth pole in the world economy is strengthened, keeping in mind the requirements of the less developed and less dynamic economies of the region as well. Stimulating the operation of such forces within the region implies, of course, the acceptance of the essential principles of integration: (1) the reduction of controls on economic interaction of various kinds between cooperating countries and restraint on discrimination among them; (2) the adoption of a policy of relative discrimination in favour of the region *vis-à-vis* the rest of the world when it comes to trade, technology transfer and investment flows; and (3) the conclusion of agreements aimed at strengthening the degree of economic interdependence between members of the group.

Unfortunately, in its analyses of free trade areas and customs unions mainstream theory has hitherto concentrated on the static welfare effects of trade cooperation alone. It considers customs unions to be superior to free trade agreements, which are seen to rely more on trade diversionary effects as member countries set their own separate tariffs on imports from the rest of the world, and an agreement includes rules of origin that confine intra-free trade area trade to products originating or mainly produced in the area, so as to restrain the distortionary impact of trade diversion.

However, even such diversion in the realm of trade, while adverse from the conventional welfare point of view, has a role to play in the context of an unequal international order. First, it could serve to turn the external terms of trade in favour of the countries forming the free trade area. Second, the production and employment enhancing effects of trade diversion can, through a Verdoorn's Law type process,[13] help exploit the benefit of economies of scale inherent in modern technologies and contribute to an increase in the rate of productivity change in the concerned economies. That is, trade cooperation is a means of exploiting more intensively and extensively (across the region) one of the main elements that has provided the internal growth stimuli in the Asian and Pacific region, namely, productivity increases.

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12 Free trade areas and customs unions involve the tariff-free movement of products within the area; but while a customs union is characterized by a common tariff *vis-à-vis* the external world for all countries in the union, members of a free trade area retain their own tariffs against the rest of the world. A common market is not only a customs union: it permits free mobility of labour and capital within the union, implying the integration of both product and factor markets. Finally, economic union involves going beyond the integration implicit in a customs union by unifying monetary, fiscal and other policies as well.

13 Verdoorn's Law relates to the positive relationship between the rate of increase in productivity and the rate of increase in employment and output. For further details, see N. Kaldor, "Causes of the slow growth of the United Kingdom", reprinted in *Collected Economic Essays*, vol.5, *Furthur Essays in Economic Theory* (London, Duckworth (Gerald) and Co. Ltd., 1978), pp. 100-138.

As is implicit in the discussion so far, the main objective of regional cooperation is an increase in the rate of growth of output of members by: (i) enhancing the flexibility of domestic production through technical cooperation, in the form of skill development and technology transfer, and greater flows of capital and scarce inputs that ease specific supply constraints; (ii) increasing efficiency by reallocating production and encouraging competition within the group; (iii) exploiting economies of scale; and (iv) improving the terms of trade of the group with the rest of the world. But the full benefits of all these factors can be exploited only when there are no supply constraints in the countries concerned.

The assumption of lack of supply constraints is, however, likely to be invalid in the case of many developing countries. Inadequate savings, lack of technological and managerial expertise and even entrepreneurship and infrastructural bottlenecks of various kinds result in structural rigidities that foreclose the flexibility needed to garner the benefits of regional trade integration. It is here that foreign capital inflows, and in particular foreign investment from within the region, could play a role. It could bring with it the finance, technology and expertise to ensure adequate supplies and ease infrastructural constraints, on the one hand, and induce the innovativeness to "push-out" exports on the other. It is this role of foreign capital from within the region easing supply constraints that allows trade and investment to be viewed as being the synergetic nexus that results in substantial gains from regional cooperation. And if the incentive structure in which it finds itself in the host country is neutral with respect to production for domestic use or for trade within the region or outside, such established capacity would be in keeping with the standards specified by the competitive edge of production in the region itself.

Foreign investment and other forms of foreign capital inflow are also crucial because they help ease the now inevitable transition to a more open economic regime, which, more often than not, is characterized by a widening of the deficit on the current account of the balance of payments. This could lead to crises of confidence and an outflow of capital that would not occur if the flow of foreign investment and capital flow from within the region were seen as a mechanism that builds capabilities to raise exports and earn the foreign exchange required to finance the future needs of the economy concerned. It is in these senses that cooperation in an unequal world is an alternative that is the optimal intermediate step between unacceptable isolationism and unfettered global interdependence.

The recent upsurge of interest in evolving modalities for the expansion of intra Asian and Pacific trade is therefore a response to the development needs of the region and, in a way, reflects particularly the difficulties that the region's developing economies are encountering in mobilizing resources for development as well as in expanding the exports of traditional and new products to their principal markets. In this regard, attention has coalesced around the proposal to liberalize trade and investment flows on a regional basis beyond the requirements of multilateral commitments. Developing countries of the region have thus often reiterated in several forums the need to pursue common approaches to evolve economic security interests which could shelter the region's smaller economies from external pressures while simultaneously serving as a useful complement to existing safeguards for multilateralism.

Indeed, there are features o the contemporary world economy that seem to suggest that going it alone may not be the most appropriate response by many countries. As the world economy has become multipolar and production has been internationalized, there are now more countries than ever before competing to push their exports, attract foreign investments, and to expand their production bases. The unequal strengths of the countries involved will mean that the stronger economies will reap considerably more gains than the weaker ones. In some instances, the weaker countries may even completely fail to take up available opportunities.

In the Asian and Pacific region, many developing countries, especially the least developed, land-locked and Pacific island economies, lack a sufficiently well-developed base, whether agricultural, industrial or services, or the technological sophistication, to mount substantial efforts at market penetration abroad. Their deficiency in infrastructure, among other things, may also restrict their ability to attract foreign investment. Their small size and their location, with limited accessibility from the centres, may add to the difficulty of benefiting from world economic changes without the cooperation of their neighbours. Operating within the framework of subregional cooperation has proved helpful to many of the region's developing countries in deriving benefits from trade and industrial complementation, but these benefits are as yet limited. It is therefore necessary that the benefits be expanded to maximize their favourable impact

on the member countries' economies; this requires not just the deepening of relations within each subregion but also the exploration of opportunities in neighbouring subregions.

Regional cooperation does not, however, preclude individual countries going it alone wherever they believe that it is in their best interests to do so, nor does it exclude cooperation in the subregional context. But in the Asian and Pacific context, in addition to allowing the achievement of gains and benefits from these two approaches, regional cooperation creates opportunities for the investigation and correction of intercountry problems within a broader yet manageable framework. It creates new opportunities among the countries to discover mutual complementarities and competitiveness, allowing them to respond positively to the changing pattern of comparative advantage in the region, and thus provides a strong stimulus for market expansion and increased intraregional trade and investment. Regional cooperation, no less than international trade itself, opens up avenues for overcoming the small size of the domestic market, permitting the developing countries to attain economies of scale in many economic and technological activities, and in the process enabling them to make fuller use of their underutilized human, technological and natural resources. In the long term, it also provides the basis for sustained growth and structural change.

The heterogeneity of the developing ESCAP region is well known and this factor may seem to make any successful regional economic cooperation difficult. However, the diversity can actually provide the basic complementarities and competitiveness that the countries need for the mutual stimulation of their economies. The region is made up of countries that are rich in human and natural resources and countries that are not. It also has its share of technology-intensive countries that are highly receptive to technology and technical change. Therefore, circumstances in the region offer the potential for regional members and associate members of ESCAP to cooperate more closely with each other to sustain the region's overall dynamism and promote a more even spread of its benefits. In the next subsection, some of the more formal cooperation agreements operating within the Asian and Pacific region are reviewed.

## 2. Experience in regional economic cooperation

No significant progress was made towards regional economic cooperation in the Asia and Pacific region until the mid-1960s. The effects of the cold war were so divisive that the movement for regional cooperation did not venture beyond rhetorical pronouncements and expressions of political solidarity. This may be explained by the desire among most of the countries in the region to consolidate and develop their newly independent economies after being subjected to decades of colonial domination. By the middle of the 1960s, however, many Asian and Pacific countries began to aspire towards greater economic interaction with their neighbours as their production base broadened and became more diversified.

From its inception, ESCAP has done much to promote economic cooperation in the Asian and Pacific region. It has launched and implemented some significant endeavours which to this day serve as landmarks in coordinated action among countries. Thus, it was in ESCAP that an integrated communications infrastructure for the Asian region was conceived. The Asian Highway network (initiated in 1960), the Trans-Asian Railway system, and the Asia-Pacific Telecommunity have since emerged as concrete demonstrations of economic cooperation. It may now be possible to envisage continuing with the Asian Highway project in view of the fact that the Government of Myanmar has recently indicated interest in participating in it. ESCAP has also promoted regional cooperation in shipping (see box II.1) and port management (see box II.2). The Asian and Pacific Centre for the Transfer of Technology, which is committed to the facilitation of technology transfer within the region is another regional project initiated by ESCAP, but the full potential of the Centre for the dissemination and transfer of technologies in the region has not yet been fully exploited. The Asian Development Bank, which was also established at the initiative of ESCAP, has, however, had a big impact on the region's developing economies, by supplying finance and technical assistance to individual countries.

With regard to foreign trade and investment, which is the main focus of this study, ESCAP in addition to assistance in the establishment of a number of commodity consultative mechanisms (such as in pepper, coconut, jute, silk, tropical timber and, most recently, coffee) has promoted two major cooperative initiatives to benefit the region's developing countries. The more important of these is the Bangkok Agreement (First Agreement on Trade Negotiations among Developing Member Countries of the Economic and Social Commission for Asia and the Pacific), which is primarily a preferential trading arrangement designed to liberalize

## Box II.1. Ship users' cooperation project

The decline of export earnings from primary commodities in the early 1970s, coupled with escalating ocean freight rates and inadequate shipping services, impeded the growth and economic development of countries in the Asian and Pacific region. At the same time, ship users or shippers of the region, disorganized and lacking in adequate knowledge of the operations and economics of the shipping industry as well as the technical terms used in maritime transport, were unable to negotiate on an equitable basis with the liner conferences. There was also a lack of awareness on the part of shippers of the benefits of active cooperation among themselves. Concern over these problems prompted many member Governments of the Economic and Social Commission for Asia and the Pacific (ESCAP) to request the secretariat to assist the region's shippers.

The ship users' cooperation project (SUCOP), which was implemented by the ESCAP secretariat between 1972 and 1990, was designed to rationalize transport services and thus contribute towards economic efficiency. It had the following objectives:

(a) To increase shippers' awareness of the benefits to be gained from cooperation among themselves and with the shipping industry;

(b) To impart technical knowledge about shipping to shippers to enable them to negotiate with the shipping industry and define transport requirements and solutions, thus contributing towards the rationalization of transport for the member countries of ESCAP;

(c) To upgrade the technical and managerial skills of shippers.

The programme of activities under the project comprised the following components:

(a) Promoting the establishment and strengthening of shippers' councils and organizations;

(b) Institutional support;

(c) Human resources development;

(d) Advisory services.

The promotional activities, of the project contributed to the more than fourfold increase in the number of shippers' councils and organizations in the region and helped to create a harmonious relationship between shippers' and shipowners' organizations in the region. Regular meetings of the chief executives of national shippers' organizations helped to formalize cooperation among shippers at the national, subregional and regional levels. In addition, joint meetings with port and customs authorities, concerned Government agencies, and freight forwarders' associations, as well as with shipowners, were organized because it was recognized that planning and implementing improvements and rationalizing maritime transport services could not be done effectively if only the shippers' viewpoints were taken into account. These meetings provided the secretariat with valuable information on emerging problems and activities that needed to undertaken to resolve them.

Most of the resources of SUCOP were allocated to human resources development activities. In this context, a series of regional and subregional workshops were organized covering important elements in the fields of shipping and port operations, transport economics, chartering and cargo-booking techniques, and legal and insurance matters as well as negotiating techniques, and legal and insurance matters as well as negotiating techniques. In support of these activities, the ESCAP secretariat published a set of training/reference material which included a handbook for shippers on models and tools for shipping analysis and decision-making and a publication on the use of maritime transport.

It was also recognized that, despite the relatively long duration of SUCOP, its efforts could not realistically be expected to produce lasting effects unless priority was accorded to the upgrading of the human resources development capability of shippers' organizations and established educational institutions in the region. In implementing project activity in this area, SUCOP provided assistance to the Shanghai Maritime Institute, the Merchant Marine Institute of the Chulalongkorn University of Bangkok, the Mahapola Training Institute of Colombo, and the Indian Institute of Foreign Trade at New Delhi.

The human resources development element of the project culminated in the development of a series of training-of-trainers courses through which 36 training managers from national shippers' councils were trained to organize and undertake training courses for shippers in their own countries.

In addition to the above, advisory services were provided to shippers' councils on specific problems and issues relating to institutional strengthening, freight booking centres, cargo consolidation and chartering.

Through these activities, the shippers of the Asian and Pacific region have now become more conversant with the operations and economies of the shipping industry and are better equipped to select efficient shipping and transport services as well as to propose, for example measures to streamline port and customs procedures to expedite the movement of goods, thereby contributing to the economic efficiency of their countries.

and expand trade in the ESCAP region progressively through tariff and non-tariff preferences, relaxation of trade barriers and other negotiating techniques. The Agreement became operative in July 1976 with its ratification by Bangladesh, India, the Lao People's Democratic Republic, Republic of Korea and Sri Lanka. Afghanistan and Papua New Guinea have also decided, in principle, to accede to the Agreement, and during the Second Round of Negotiations under the Bangkok Agreement held in 1985-1990 China, Indonesia, the Islamic Republic of Iran, Malaysia, Nepal,

## Box II.2. Port management tools assist in smoothing trade flows

In seeking ways to enhance the efficiency of transport so that it will better service trade, a growing number of countries in the ESCAP region are looking into the potential economic benefits of providing increased autonomy to the transport sector through commercialization and increased involvement of the private sector. For several years now, the ESCAP secretariat has been implementing a programme to strengthen port capabilities and prepare port managers to shoulder growing responsibilities.

PORTMIS (port management information project) can be considered the parent of the ESCAP/UNDP port development programme which has been implemented in more than 15 countries of the region to assist in upgrading the planning, management and operations of the region's trade gateways. Like other components of the programme, PORTMIS has followed a standard step-by-step approach to project implementation that provides practical benefits to recipient countries while maximizing opportunities for regional cooperation. The steps are as follows:

(i) Survey and detailed problem identification;

(ii) Development of a regional model solution;

(iii) Implementation and validation;

(iv) Regional training;

(v) Technical cooperation among developing countries.

Through this process it has been possible to develop models, guidelines and even software programmes tailored to country needs while at the same time providing a framework for regional cooperation.

PORTMIS is based on the formulation and quantification of management objectives to which information can be tailored. The PORTMIS model was first developed in 1981, following a survey of ports in the region to identify specific problems they were facing and to review solutions that had been applied in individual ports for potential incorporation in the model management system to be developed.

The PORTMIS system embodies commercial management principles that are specific to the port environment. Its objective is to create a management information system that encourages efficiency, pinpoints operational bottlenecks, stimulates the efficient use of existing facilities and assists investment decisions through the integration of operational and financial information. During the work at Port Kelang, Malaysia and more recent activities in 12 other countries, counterpart staff were provided with on-the-job training to improve national capabilities and develop the skills necessary to maintain the system after the withdrawal of project assistance.

The PORTMIS principles have stood the test of time; implementation has proved to be beneficial not only in developing countries, but as shown at a recent seminar in Australia, in developed countries as well.

At the time of the initial development of PORTMIS few ports had access to computer facilities. It was therefore designed as a conceptual framework embodying proven management techniques appropriate for ports with or without computers. In recent years, however, all ports of the region have invested in computer equipment. To accommodate this development the PORTMIS manual has been updated and a parallel project has been initiated on computerization to assist ports that are facing problems in the planning of computer systems and the writing of software. A PORTMIS audio-visual training package has been developed which includes introductory video programmes, overhead projection materials and a workbook developed in collaboration with the UNDP/UNCTAD TRAINMAR (training in maritime transport) programme. The package is now being distributed to ports in the region for in-house delivery; ESCAP assistance is being made available for the first presentation of the materials in each country.

The PORTMIS model approach to improved management has been adopted by a significant number of countries; however, much remains to be done both at the regional level and at the national level, particularly in the least developed countries which have been slow to adopt modern management principles.

The port computer project was initiated to assist member countries develop long-term computer plans and to provide them with the opportunity to exchange software and to transfer technology. The project also acts as a vehicle for the computerization of PORTMIS through the development of software packages. Within this project, in collaboration with the Port Authority of Thailand, the secretariat has developed a computerized asset register. The asset package provides a predefined library of reports for asset management and depreciation calculations or user specified output and analysis using the filters provided. The system includes the option of historic or current cost accounting.

Within the computer project a special study has been undertaken on the potential use of electronic data transfer between ports, and the use of EDI (electronic data interchange) in transport and trade facilitation. The report of the study is intended to create greater awareness of EDI in the region by providing the latest information on EDI developments and standards, as well as on role models for countries to emulate. A series of country-level training workshops based on the report have been held in eight locations around the region.

In addition to providing guidelines for the implementation of quantified management objectives and the integration of financial and operational information, PORTMIS has been instrumental in bringing a level of standardization to management reporting systems in the

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region. The model port tariff project was initiated to explore further the benefits of greater uniformity in port management systems and to provide an opportunity to develop more cost-effective systems through a regional approach. The project deals with tariff structure and the standardization of definitions of service rather than the pricing of individual services which is seen as an internal port policy isssue. The financial and cost information generated by PORTMIS is fundamental to these pricing issues. Several of the ports that have already adopted PORTMIS have, therefore, been well placed to adopt the model tafiff structure.

The tariff project was first proposed for ESCAP implementation by the ASEAN Port Authorities Association (APAA), whose members have remained closely involved in its work as have a large number of ports in the region through participation in the three expert group meetings convened to consider and refine the model at each step in its development, from regional survey, model drafting to validation and implementation in regional ports. The model was subsequently adopted at a meeting of chief executives of port authorities as the basis for future port tariff development in the ESCAP region as well as by APAA and the Association of Australian Port and Marine Authorities Incorporated. To date the model is being implemented by 13 ports in Australia, Malaysia, New Zealand, Sri Lanka and Thailand.

Each of these projects has been designed to create greater economic efficiency through the strengthening of port management, thereby upgrading port capacity to support the region's trade and growing economy effectively.

Pakistan, the Philippines and Thailand participated as observers.

The rules and regulations of the Bangkok Agreement are intended to ensure non-discriminatory and fair trade practices as well as to preserve the value of the preferences, including compensatory action where the value of the preference is reduced or abrogated. It also aims at cooperation in matters such as customs administration, standardization of procedures and formalities relating to mutual trade, adoption of a common nomenclature and harmonization of rules of origin and dumping. Moreover, the Agreement provides for any participating country to make a non-reciprocal concession to a participating least developed country, and for appropriate measures in a situation where its implementation results in a persistent disadvantage to any one of its members.

The Agreement, which has been approved by the General Agreement on Tariffs and Trade (GATT), is designed to expand mutual trade between its members through increased utilization of their trade potential. In relation to the present theme of increasing complementarities and intraregional trade, the Agreement can provide the mechanism through which greater opportunities for mutual exploitation of the trade potential of the developing countries of Asia and the Pacific may be harnessed through an increase in the number of participating countries. In fact, the original intention of the Bangkok Agreement was to establish a framework for the expansion of intra-Asia and Pacific trade.

Another trade-related facility initiated by ESCAP is the Asian Clearing Union (ACU), which commenced operations in 1975 and is essentially a regional payments arrangement to assist economies in the use of hard currencies in trade financing. Its membership, which is open to both developed and developing countries, includes the Central Banks of Bangladesh, India, the Islamic Republic of Iran, Myanmar, Nepal, Pakistan and Sri Lanka, and although it excludes bilateral trade between India and Nepal, ACU operations have also resulted in sizeable savings in commission and conversion charges over the years.

However, problems have emerged within ACU from asymmetries in the trading capacities of the respective members. For example, bringing payments for Iranian oil within the purview of the system enhanced the capacity of ACU: but for this arrangement to become more serviceable the Islamic Republic of Iran would be required to expand its imports from all member countries. Again, the introduction of a "swap" facility into ACU made it possible for Bangladesh (which was likely to remain in deficit until the country could realize an element of structural change to expand and diversify its exports) to convert some of its liabilities to particular creditors within ACU into short-term credits, but this arrangement only postponed the problem briefly. What countries encountering deficit balances need instead are measures to convert their payments liabilities within ACU into medium-term credits, and greater access to the markets of creditor countries. None the less, it is clear that as long as there are countries in the region that suffer from chronic problems with foreign exchange, ACU will be useful. Thus, while the benefits of ACU membership may be less

apparent to the ASEAN-4 and NIEs, it has visible benefits for countries wishing to cut down on the use of hard currencies; these include the region's least developed and island developing countries, the Asian republics, other economies in transition, and perhaps even China. The corollary is that a serviceable payments system will benefit the NIEs and the ASEAN-4 by offering some scope for enhancing the import capacity of the other developing countries of Asia and the Pacific for intraregional exports.

Insurance and reinsurance play an important role in the economic development process of the developing countries by providing protection against potential risks and by saving precious foreign exchange. The Asian Reinsurance Corporation (ARC), also established under ESCAP auspices, is aimed at reducing the foreign exchange outflow from the region arising from insurance and reinsurance payments by Asian and Pacific countries. Since its establishment, its broad membership has made extensive use of its facilities and it is today one of the best examples of economic cooperation among developing countries (ECDC) in the monetary field in the region. The Corporation has demonstrated its financial viability and ability to work with its own resources without requiring financial support. However, as the capability of ARC is linked in direct proportion to its capital base, increased membership would entail further saving of foreign exchange outflows for countries of the region.

Growing economic interdependence and globalization as well as the intensification of economic regionalism in other regions, particularly Europe, also prompted several Asian and Pacific countries to revitalize efforts for promoting economic cooperation within the region. However, notwithstanding the three ministerial conferences on Asian economic cooperation convened by ESCAP, which led to the formation of the Asian Council of Ministers for Asian Economic Cooperation and the landmark Kabul Declaration on Asian Economic Cooperation and Development of 1970, collective initiatives within the region in the 1950s and 1960s, both bilateral and multilateral, were focused more on fostering technical cooperation activities and exchange of experience than on forging cooperation arrangements among the countries to reap the benefits of economies of scale or differences in comparative advantage.[14]

The tardy pace of regional cooperation efforts, however, received a stimulus with a push towards subregional cooperation when Regional Cooperation for Development (RCD) was founded in 1964; RCD was reorganized and the name changed to the Economic Cooperation Organization (ECO) in 1985. The organization was originally a tripartite arrangement between the Islamic Republic of Iran, Pakistan and Turkey with the object of achieving closer economic, technical and cultural cooperation; it aims to cooperate in certain industrial projects and standards, trade, tourism, transport (including the building of road and rail links), communications and cultural affairs. The introduction of a preferential trade system was announced in July 1987, and the establishment of a joint reinsurance company was announced in September of the same year. The future of ECO was enhanced with the induction in November 1992 of Afghanistan and the Asian republics (except Kazakhstan) of the former USSR as full-fledged members. In this revitalized form, ECO is contemplating cooperation in various fields, but principally in trade.

Much more progress has been achieved with the Association of South-East Asian Nations (ASEAN), which was established with the signing of the Bangkok Declaration on 8 August 1967 by the Foreign Ministers of the member countries. Its major objectives were the following: to accelerate economic growth, social progress and cultural development in the region through cooperative endeavours; to promote regional peace and stability; to promote active collaboration and mutual assistance in matters of common interest; to provide assistance to each other in the form of training and research facilities; to maintain close and beneficial cooperation with existing international and regional organizations with similar aims and purposes; and to explore all avenues for even closer cooperation among themselves.

The Heads of State or Government of member countries are the highest authority in ASEAN, while the Secretary-General, who is located in Jakarta, is the chief executive of the ASEAN Secretariat. Apart from summit meetings and ministerial meetings, there is an ASEAN Standing Committee and a Committee on Trade and Tourism (COTT), on Industry, Minerals and Energy (COIME), on Food, Agriculture and Forestry (COFAF), on Finance and Banking (COFAB) on Transportation and Communications (COTAC), on Social Development (COSD), on Culture and Information (COCI) and a Budget Committee. In each member country, day-to-day work is coordinated by the ASEAN National Secretariat. At the governmental level, ASEAN has committees and subcommittees on various subjects.

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14 See *Survey 1983*, part two, chap. VIII.

In the private sector, it works through chambers of commerce and industry with a number of working groups, industrial clubs and commodity clubs. ASEAN has established several subsidiaries to pursue specialized activities, such as the ASEAN Insurance Council, the ASEAN Promotion Centre on Trade, Investment and Tourism and the ASEAN Council on Petroleum.[15]

Mention may also be made of ASEAN Industrial Complementation Scheme (AIC) and ASEAN Industrial Joint Ventures (AIJV) which are, in essence, programmes in industrial cooperation. While the aim of AIC is to allocate different stages of vertically integrated industries among different ASEAN countries to reap the benefits of specialization and economies of scale, the AIJV scheme was intended to promote intra-ASEAN investment by granting tariff preferences to AIJV products. However, owing to certain inherent shortcomings, both schemes have met with only limited success.[16]

Although ASEAN has generated an extensive interactive network of governmental and private sector agencies, ASEAN regional economic cooperation is still viewed in many quarters as not rapid enough, especially in the crucial areas of trade liberalization and industrial cooperation.[17] For example, in spite of the ASEAN Preferential Trading Arrangements and complementation scheme, intra-ASEAN trade has increased only marginally. Nevertheless, ASEAN is perhaps the most successful subregional cooperation group in Asia and the Pacific. The Association has been successful in speaking with one voice on major international trade and economic issues. It presented a joint stand at the Uruguay Round of multilateral trade negotiations on improving world trade rules, and it has worked out trade benefits jointly with EC, Japan and other major trading partners. ASEAN is now preparing to build on its success by setting up the ASEAN Free Trade Area (AFTA). Under the scheme proposed in 1991, ASEAN has decided on a 15-year time-frame to reduce tariffs on manufactured products to 5 per cent or less.[18]

In the Pacific, the first meeting of the South Pacific Forum, which is a gathering of Heads of Government of the independent and self-governing States of the South Pacific, was held in 1971. It meets annually and provides an opportunity for informal discussions on a wide range of common issues and problems. The Forum has no written constitution or international agreement covering its activities, nor any formal rules relating to its purpose, membership or the conduct of meetings. Decisions are always reached by consensus, it never having been found necessary or desirable to vote formally on issues.

The South Pacific Forum is served by the Forum Secretariat, which was established in 1973 and is located in Suva. The Secretariat's executive board is a committee which comprises representatives and senior officials from all member countries. It meets twice a year, immediately before the meetings of the Forum and at the end of the year, to discuss in detail the secretariat's work programme and annual budget. The Secretariat is headed by a director with an executive staff of 25 drawn from member countries, and coordinates regional action on trade promotion and marketing; industrialization; transport; energy; the law of the sea; and development planning. It assists in negotiating trade and commodity agreements and manages a disaster relief fund. The Secretariat also cooperates in the South Pacific Regional Environment Programme and has been instrumental in setting up the South Pacific Telecommunications Development Programme.[19]

The third initiative on subregional cooperation came with the formation of the South Asian Association for Regional Cooperation (SAARC) in 1985 by the leaders of seven South Asian countries (Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka) to improve regional cooperation, particularly in economic development. SAARC holds a meeting of Heads of

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15 For details, see Institute of Strategic and International Studies, *An Anthology on ASEAN Economic Cooperation* (Kuala Lumpur, 1987); see also Muthiah Alagappa, "ASEAN institutional framework and modus operandi: recommendations for change", in N. Sopiee and others, eds., *ASEAN at the Crossroads: Obstacles, Options and Opportunities in European Cooperation* (Kuala Lumpur, Institute of Strategic and International Studies, 1987).

16 For a detailed exposition, see "ASEAN trade and industrial cooperation" in ASEAN Secretariat, *ASEAN Economic Cooperation for the 1990s* (published jointly by the Philippine Institute for Development Studies, Manila, and the ASEAN Secretariat, Jakarta, 1992).

17 For details, see N. Sopiee and others, eds., op. cit.

18 See *ASEAN: The Tasks Ahead* (Singapore, Institute of Southeast Asian Studies, 1987).

19 For details, see H. Hughes, "Asian and Pacific developing economies: performance and issues", *Asian Development Review*, vol. 3, No. 1, 1985.

State or Government once a year, while the Council of Ministers (Foreign Ministers of member States) meets at least twice a year. The meetings review progress and take decisions on new areas of cooperation, additional mechanisms and other matters of general interest. A standing committee, comprising foreign secretaries, meets when necessary, provides overall monitoring and coordination, approves projects and programmes and their financing, determines priorities and mobilizes resources. The SAARC Secretariat comprises a Secretary-General, appointed by the Council of Ministers for a two-year term, which position rotates among member States; directors with three-year tenure; and general service staff. Technical committees, comprising representatives of member States, implement, coordinate and monitor programmes in their respective areas, while action committees are concerned with the implementation of projects involving some, but not all, member States.

The current areas of cooperation of SAARC relate to agriculture and forestry; health and population activities; meteorology; rural development; telecommunications; transport; science and technology; postal services; sports, arts and culture; women in development; and drug trafficking and abuse. Following a directive of the Second SAARC Summit held at Bangalore, India, in 1986, SAARC established the SAARC Documentation Centre, promoted organized tourism among member countries, instituted SAARC chairs, fellowships and scholarships, and launched an organized volunteers' programme.[20] Proposals for a SAARC preferential trading arrangement (SAPTA) have been voiced but a concrete plan of action for its establishment has yet to be evolved.

Partly as a result of the increasing dynamism of the East Asian countries and partly in response to the resurgence of regionalism in other parts of the world, several proposals emerged towards the end of the 1980s for more wide-ranging and effective forms of regional cooperation in the region. Some of these initiatives sought to establish links, primarily in the field of trade, among the economies around the Pacific Ocean rim.

One of the first efforts was the establishment of the Pacific Economic Cooperation Conference, whose name was subsequently changed to Pacific Economic Cooperation Council (PECC), as a non-governmental organization, for the promotion of economic cooperation among them. PECC was founded in September 1980 at the initiative of Australia and Japan. Its members are drawn from the government, business and academic sectors of 19 economies around the Pacific, each of which has established a national committee. A general meeting of the organization is held every 18 months. PECC also has a standing committee of 17 members, including members of ASEAN, Australia, Canada, China, Japan, New Zealand, the Pacific island countries, the Republic of Korea, Taiwan Province of China and the United States of America. However, apart from conducting studies and holding discussions on economic issues of common concern to its members, PECC has not initiated any significant schemes for regional economic cooperation.

In addition to these subregional arrangements, there are other country groupings with large regional participation, so that these mechanisms also provide ample scope for regional economic cooperation. The most prominent of such formations is Asia-Pacific Economic Cooperation (APEC), which shares many of the perceptions of PECC. It was established as an intergovernmental body in 1989 at the initiative of Australia, partially in response to the slow progress in the Uruguay Round. Its inaugural meeting was attended by ministers from 12 countries around the Pacific. The proposal to establish APEC arose from a recognition of the need for effective consultations among their decision makers to: (a) help strengthen the multilateral trading system and enhance the prospects for success in the Uruguay Round; (b) provide an opportunity to assess prospects for and obstacles to increased trade and investment flows within the Asian and Pacific region; and (c) identify the range of practical common economic interests.

Membership of APEC currently consists of Australia, Brunei Darussalam, Canada, Indonesia, Japan, Malaysia, New Zealand, the Philippines, the Republic of Korea, Singapore, Thailand and the United States. On the basis of its current membership, APEC is more of an interregional than a regional economic grouping, although its membership includes

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[20] For details, see Q.K. Ahmad, "SAARC: Some comments on the evaluation and some elements of a future agenda", in Ponna Wignaraja and Akmal Hussain, eds., *The Challenge in South Asia: Development Democracy and Regional Cooperation* (United Nations University, Tokyo, and Sage Publications, London, 1989); R. Kumar, "The coordination problem", in Asian Development Bank, *Towards Regional Cooperation in South Asia* (Manila, 1988); and S.H.N. Naqvi, "Possibilities of economic integration", in Bimal Prasad, ed., *Regional Cooperation in South Asia, Problems and Prospects* (New Delhi, Vikas Publishing House, 1989).

most of the dynamic economies of the region. Following its inception, APEC identified and implemented various projects relating to economic studies, trade liberalization, investment, technology transfer, human resources development and sectoral cooperation.

The most recent proposal, by Malaysia, for cooperation in the Asian and Pacific region is the East Asia Economic Group (EAEG). The proposed objective of EAEG is to defend the multilateral trading system, and the need for close consultation and cooperation among the countries of the region for the common good is emphasized. The following broad objectives have been proposed.

First, EAEG was intended to be a consultative forum in which member countries would consult, on an ongoing basis, on trade and economic issues of mutual interest. Initially, it would cooperate to ensure the success of the Uruguay Round but in time the consultative process would be strengthened to enhance economic cooperation in trade and investment. Second, EAEG was not intended to become a trade bloc or play a confrontational role *vis-à-vis* any other region, country or bloc. Third, EAEG would be consistent with GATT and contribute to the success of the Uruguay Round in its attempt to maintain and enhance the global trading system. Fourth, the aim of EAEG would be the generation of investment and trade and not trade diversion or the creation of unnecessary barriers to third country imports. Fifth, EAEG would not focus narrowly and concentrate on trade; instead it would explore all other areas of potentially productive cooperation across the whole spectrum of economic interrelationships. At the same time, EAEG would not indulge in the unproductive duplication of effort undertaken by other relevant organizations. Finally, it was proposed to include the ASEAN countries, China, Hong Kong, Myanmar, the Republic of Korea, Taiwan Province of China and Viet Nam among the founding members.

When EAEG was first proposed, it encountered such strong objections, particularly from the United States, that the proposal was diluted and the concept was renamed the East Asia Economic Caucus (EAEC), apparently to serve more as a discussion forum rather than the trade bloc which its opponents feared that it would turn out to be. Opposition to EAEC remains, so that the proposal is still without a formal organizational structure.

Mention should be made of other attempts at promoting regional economic cooperation. These include the "growth triangles", the Greater China Economic Zone and the Yellow Sea Economic Zone. While some of these attempts are even at the non-governmental level, others, such as the "growth triangles", are largely confined to areas rather than countries. The more successful examples of such efforts are the Johore/Singapore/Riau region and the area enclosed by Hong Kong, Taiwan Province of China and the southern China provinces of Guangdong and Fujian.[21] In its basic form, the complementarities between geographically contiguous areas of different countries are exploited to gain competitive edge in exports, and are facilitated by commercial investment, public sector infrastructural support, and the streamlining of procedures. Thus, the growth triangle concept as a vehicle of regional economic cooperation is valid not only in the context of trade but also with regard to extracting complementarities in labour, capital and infrastructural endowments.

Other arrangements similar to the various "zones" are still at the planning stage, although some of them may crystallize following recent developments. For example, the establishment of diplomatic ties between China and the Republic of Korea in September 1992 has improved prospects for turning the Yellow Sea Economic Zone into a reality. This development will set the stage for increased regional cooperation among the complementary economies of northern China, the Democratic People's Republic of Korea, the Republic of Korea, the eastern part of the Russian Federation and Japan, as these north-east Asian economies complement each other. In effect, China has an abundance of human resources, the far eastern region of the Russian Federation is rich in natural resources, while Japan and the Republic of Korea have the required capital and technology.

It would thus appear that after a hiatus of nearly four decades, the Asian and Pacific region is riding on a wave of constructive fraternalism among its economies which should enhance regional economic cooperation. While, in the interests of a more balanced spread of growth and development in the region, this thrust towards cooperative efforts must be realized, such conscious endeavours can only be hastened slowly in practice owing to some inherent constraints that have so far limited the success, even of inter-subregional cooperation.

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21 For details, see *Asian Development Bank, Asian Development Outlook 1992* (Manila, 1992), Box 1.7.

### 3. Status of inter-subregional cooperation

Although regional economic cooperation arrangements in Asia and the Pacific are being worked out at various levels, ranging from very restricted schemes such as the "growth triangles" to interregional schemes such as APEC, most of these schemes are evolving independently of each other and there is hardly any linkage or even dialogue among the various subregional or regional groups, with the exception of ASEAN and APEC. So far no formal mechanism or institution has been created to provide a forum to bring the subregional groups together to discuss or propose any scheme for inter-subregional cooperation. The lacuna renders it difficult to coordinate regional cooperation efforts or even manage them more systematically, although there may be several reasons for the lack of linkages among the subregional groups concerned with cooperation in Asia and the Pacific.

To start with, all the subregional groups, with the exception of ASEAN and the South Pacific Forum, were established less than a decade ago. Even ASEAN, the oldest subregional group in Asia and the Pacific, is barely 25 years old. It takes at least that much time to build up the confidence and trust required among the member countries before cooperation within the subregional group itself can provide a foundation for extending any form of cooperation outside the group.[22]

Second, cooperation within the subregional groups has been neither substantive nor successful. For example, in spite of preferential trading arrangements, intra-ASEAN trade in 1990 was estimated at only 18.5 per cent of the total exports, while in the case of ECO, the corresponding figure was 4.5 per cent. (By way of comparison, intra-EC trade is around 55 per cent, or nearly three times the volume of intra-ASEAN trade). Although AFTA may expand intra-ASEAN trade, it will take several years before it becomes fully operational and its effects can be observed.

Third, none of the subregional groups in Asia and the Pacific, except APEC and ASEAN, have any significant economic relations with each other. For example, it has been observed earlier that ASEAN economies have relatively little trade with SAARC countries; the SAARC subregion has even less trade with the Pacific island countries. In fact, the inter-subregional trade links are dominated by selected bilateral flows and India accounts for most of SAARC trade with ASEAN, while Singapore accounts for most of ASEAN trade with SAARC. As far as investment is concerned, among the SAARC countries it is mainly India which has invested in the ASEAN countries. Indian ventures can be found in all ASEAN countries, except Brunei Darussalam. Some of the ventures incorporate state-of-the-art techniques and are quite competitive internationally, while others are not well conceived and executed. As may be expected, their number, however, remains relatively small; furthermore, their share in the total foreign investment of the host countries is negligible.[23] Among the ASEAN countries, Singapore and Thailand have invested in several SAARC countries, including India, Bangladesh, Maldives and Sri Lanka, but the total volume of such investment has also remained small.[24]

Apart from ASEAN and SAARC, the other subregional groups in the developing Asian and Pacific region, ECO and the Forum countries, have hardly any trade or investment contacts with each other, although some trade and investment links exist between ASEAN and the Forum countries. The same applies to ECO and SAARC, although trade and investment may be expected to increase significantly once economic relations and infrastructural facilities are improved between the two subregional groups.

Thus, in an overall assessment of the prevailing trade and investment links in the region, although considerable advances have been made in setting up formal arrangements for cooperation, the evidence seems to suggest that it is the autonomous forces of trade and investment that have been more crucial in building the regional and subregional links that are operationally active in Asia and the Pacific, resulting in a virtuous circle of growth and development in some of these economies. An analysis of this trade-investment nexus is given in the following chapter.

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22 It should be noted that even the well-established regional groups in Asia and the Pacific, such as ASEAN and SAARC, are merely intergovernmental institutions and, unlike the EC, do not have any supranational authorities.

23 Thus, according to official but unpublished data, at the end of 1987, India's investment in Singapore were $S81.3 million, or 0.09 per cent of total foreign investment. India's share in some of the other ASEAN countries, such as Malaysia and Thailand, may be slightly higher (Mukul G. Asher, "Economic co-operation and linkages between SAARC, ASEAN and other subregions in the Asia-Pacific region", paper presented at the Conference on the Future of Asia Pacific Economies (FAPE IV), held at New Delhi in March 1991).

24 According to data supplied by the India Investment Centre, between 1981 and 1989 Singapore-based firms had 27 technical and 16 financial-cum-technical agreements with Indian firms, while its share in total foreign equity investment in India was 0.9 per cent.

# III. THE TRADE-INVESTMENT NEXUS: A REGIONAL ANALYSIS

It is generally believed that the openness of the newly industrializing economies (NIEs) and some of the ASEAN-4 countries has contributed to the overall efficiency and rapid growth of their economies. The trade orientation of these economies attracted a substantial amount of foreign investment which, in turn, although difficult to quantify precisely, partially fuelled their remarkable export dynamism. Thus, the combination of relatively open trade and investment policies had feedback effects which worked to enhance the economic performance of these countries.

More recently, China and several South Asian countries have also liberalized their economic regulations in an attempt to create a similar kind of virtuous cycle. In general, efforts have been made in these countries to streamline procedures for foreign investors and to provide a more attractive investment environment. This has, in turn, led to greater competition for foreign direct investment (FDI) among the developing economies of this region, as the emergence of the open- door policy in China in the 1980s induced a spurt in its growth through exports and, partly through its demonstration effect, has intensified the drive to mobilize FDI in several countries.

The objective in this chapter, which constitutes the crux of the study, is to examine the links between FDI flows and trade expansion in order to look briefly at some of the factors affecting this link. Accordingly, after a brief theoretical discussion of the relationship between trade and FDI, the evidence in the Asian and Pacific region on the ways in which foreign investment provides the basis for expansion of trade in general and intraregional trade in particular is examined. Thereafter, based on specific country experience, the contribution of this nexus to the process of industrial restructuring and growth in this region is analysed. The emphasis is on examining the rise to dominance of investment aimed at the world market, its effects in practice on intraregional trade, and, finally the degree to which it has spread, resulting in a combination of successes and failures from the point of view of the ability to exploit that nexus.

This chapter is, therefore, composed of three sections. In section A, the integration of FDI and trade flows is assessed, first in terms of the theory of the trade-investment nexus and then in terms of the evidence in Asia and the Pacific on the operation of this virtuous nexus. Section B reviews the role of foreign investment in the industrial restructuring process, and in that context examines the sectoral structure of FDI in the region. Section C traces some of the Asian developing country experience and sets the stage for discussion in the next chapter of the constraints on the spread of the trade-investment nexus.

## A. INTEGRATION OF FOREIGN DIRECT INVESTMENT AND TRADE FLOWS

Asymmetric trans-border movements of goods and services have at all times necessitated compensating financial flows. Accordingly, the mercantilist school of economic thought[1] assessed the gains from trade in terms of the resulting direction of flow of specie. However, subsequent experience has shown that there are different directions and forms that compensating financial flows can take, including aid, commercial loans and foreign investment. Of these, the one that is mainly aimed at physical production is FDI. However, the nature of even that flow has changed substantially over time, especially in terms of its relationship with trade.

In colonial times, FDI was closely linked with the needs of colonial trade, and was directed in the main into areas such as plantations, the extractive industries, shipping and insurance. Such investment only strengthened the "enforced bilateralism" in trade that colonialism implied, and the integrative effects of such trade and investment were limited. With the onset of decolonization and the adoption of protective, import-substituting strategies by independent post-colonial States

[1] Mercantilism refers to the school of economic theory in which money is the only form of wealth.

aiming to industrialize rapidly, foreign investment often became a substitute for trade. As tariff and non-tariff barriers restricted entry to many of their external markets, leading international firms found the need to jump those barriers by establishing production facilities in the importing country so that they could supply local markets. Given the prevailing objectives of national development, controls on such foreign investment were substantial, raising the costs and reducing the returns from such investment. In the inevitable calculations of costs and returns that followed, the volume and nature of foreign investment were determined by the extent of regulations, the size of local markets, taxation laws, and a host of non-economic concerns. In the event, though integrative on the surface, such investment was limited in quantity and reflected the dominant insularity of that period.

Matters have changed substantially since then. Not merely has the revolution in transport and communications, and the changes in technology that have segmented production processes, expanded world trade and capital flows over time, but over the last two decades or so there has been a rapid dismantling of protective regimes and relaxation of regulations on foreign investors across the globe. In fact, the Governments of many economies are competing with each other to provide infrastructural facilities, tax benefits and a friendly environment to foreign firms. This has naturally affected the character of foreign investment as well, since after allowing for national peculiarities and variations in political structures, any production site worldwide is becoming a potential site for production aimed at world markets. For the transnational firms, which over the years have come to view the world as their market, it offers the opportunity of locating in environments where certain advantages can be obtained. These include insulation from adverse macroeconomic and microeconomic trends and developments in their home countries which, in turn, may enhance their international competitiveness substantially.

More open trade regimes also mean that foreign investment can no longer be justified solely or even mainly by the need to retain a presence or expand in host country markets. With trade, including intra-firm trade, becoming increasingly global, foreign investment no longer reflects the "enforced bilateralism" of colonial times. These aspects of the current world conjuncture generate the synergetic nexus between trade and investment that is the central theme of this study.

## 1. Theory of the trade-investment nexus

Linking foreign investment and trade flows is not a simple matter. Much of the analysis to date has focused on the relationship between factor flows and commodity flows in the modified Heckscher-Ohlin model of international trade. When the movement of productive factors is allowed, it has generally been concluded under certain assumptions that capital flows can substitute for commodity trade. Factor-price equalization would occur with free factor movements and there would be no need for international trade; but allowing for complete specialization, imperfect competition or differences across economies in technologies and consumer preferences can reverse the result and create circumstances in which factor flows lead to greater trade volumes. This, therefore, leaves uncertain the probable effect of capital flows on trade.

The literature on immiserization, although it does not deal specifically with the relationship between trade and foreign investment, is also significant when one looks at the possible effects of foreign investment. It illustrates how, when recipient industries are protected, capital inflows can lead to sub-optimal welfare levels, and even reduce welfare below pre-flow levels.[2] In short, protection will result in investment decisions by foreign investors which cause a misallocation of resources, and the level of social welfare could easily be lower with foreign investment in a protected industry than without it.

The research on direct investment also provides some insight into the problem in its consideration of the potential for complementarity between trade and investment. For example, Kojima analysed the "trade-oriented" nature of Japanese FDI in resources and manufactures, demonstrating how trade-oriented FDI can generate higher levels of welfare than anti-trade-oriented FDI.[3] He argued that investment overseas is "macroeconomically" motivated, resulting in an orderly transfer of industries in which Japan is losing comparative advantage to those countries which still possess advantage in such industries. According to Kojima, this process made Japanese investment trade-oriented and also welfare-increasing for both

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2 R.A. Brecher and C.F. Diaz-Alejandro, "Tariffs, foreign capital and immiserizing growth", *Journal of International Economics*, vol. 7, No. 4 (November 1977).

3 K. Kojima, *Direct Foreign Investment: A Japanese Model of Multinational Business Operations* (London, Croom Helm Ltd., 1978).

investing and host countries, while FDI from some other countries had often been made in industries in which the investing companies had monopolistic advantages, and was therefore more likely to replace trade activities.

At a theoretical level, the main attempt to link foreign investment and trade within a dynamic framework came in the form of the product cycle literature.[4] In the model elaborated in that literature, products initially developed in the developed countries and exported to the less developed economies become standardized at later phases of their life. As the markets for these products increase in the less developed country, they are produced in that country through FDI for local sale. Over time, cost advantages in the less developed countries result in the closure of capacity for these products in the developed countries (which move on to new products) and, at the second stage of the process, are exported from the less developed to the developed. This "catching-up" process has important policy relevance. For the leading economies, the conclusions of the model bring out a concern that heavy foreign investment abroad will eventually lead to lower growth and less economic dynamism. Economists, however, generally agree that investing economies need not be affected adversely and, in fact, several studies have found that exports from the investing country actually tend to increase.[5] Yet, this hypothesis is much debated since, for the developing countries, the implication of the model that they will always be a rung below the developed economies on the product cycle ladder is somewhat hard to accept, despite the emphasis on the catching-up process in the model.

None the less, the model shows that technology, marketing know-how and the other intangible assets that the foreign firm introduces into the recipient economy can facilitate the production of a good in a developing country. The importance of FDI in technology transfer is a theme that is prevalent in FDI theory, and the benefits of such transfers accrue not only to recipient firms but also to competitors and input suppliers who may benefit from technological spillovers. The introduction of superior production technologies then works towards increasing the competitiveness of the host country's exports in the world market and, commensurately, the ability to take advantage of such opportunities.

There is also significant support for the "eclectic" view as to the necessary conditions under which a firm will undertake FDI.[6] Under this view, sometimes referred to as the OLI (ownership, location, internalization) paradigm, three conditions are necessary. First, the firm must have an ownership advantage, such as proprietary rights to a product or a production process that allows it to compete successfully with foreign companies. Second, the foreign country must have a location advantage for production, such as tariff or transport cost barriers to imports or low factor prices, that leads the transnational corporation to produce in that market rather than service it by exports. Third, there must be an internalization advantage that leads the transnational corporation to buy or create a foreign subsidiary rather than license production and/or distribution of a product to a foreign firm. Though there is some dissent to this view, the eclectic approach is useful in the present context as interest is focused mainly upon the two questions of whether a product is provided to a foreign market and whether it is provided by exports or by foreign production. The third issue is whether production in the host country is by a subsidiary or a licensee of the home firm, but this is of less relevance for the purposes of this study. The first two questions relate to the O (ownership) and L (location) of the Dunning paradigm, while the third relates to the I (internalization) of the paradigm that completes the triad.

In the scenario elucidated by these theories, where exports lead to investment and subsequent imports, the trade-investment nexus is one that does not correct for inequalizing trends but only raises the level of manufacturing production and export in the less developed countries. While this line of reasoning is relevant to an analysis of some forms of foreign investment, especially that characteristic of the "import-substituting" phase of developing country growth, the model fails to explain the shifting focus of growth, in even high-technology products, away from some of the leading manufacturing countries of the world.

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[4] In this connection, see R. Vernon, "International investment and international trade in the product cycle", *Quarterly Journal of Economics*, vol. LXXX, No. 2, May 1966; and K. Akamatsu, "A historical pattern of growth in developing countries", *The Developing Economies*, Preliminary Issue No. 1, March-August 1962.

[5] See, for example, R.E. Lipsey and M.Y. Weiss, "Foreign production and exports of individual firms", *Review of Economics and Statistics*, vol. LXVI, No. 2, May 1984.

[6] J.H. Dunning, "Trade, location of economic activity and the MNE: A search for an eclectic approach", in B.O. Hesselborn and P.M. Wijkman, eds., *The International Allocation of Economic Activity*, (New York, Holmes and Meiers Publishers, 1977).

Moreover, the model does not correspond exactly to the empirically observed trend for the shares in world manufactured exports of a particular developed country and of the transnational corporations originating in that country to diverge, even in high-technology areas. As Kravis and Lipsey have shown, while the share of the United States of America in world exports dropped from 17 per cent in 1966 to about 12 per cent in 1986-1988, the share of United States transnational corporations in world exports, which also stood at 17 per cent in 1966, fluctuated around that level through 1986 and was between 15 and 16 per cent in 1987 and 1988. "Within US multinational firms, there was a tendency for the shares of parents in world exports to decline, while the shares of affiliates drifted upwards. When the US firms' shares receded a bit from their 1985 peak during the next two years, both parent and affiliate shares declined, but the affiliate share fell by only a third as much. In 1986-1988, US multinationals were exporting more from their overseas affiliates than they were from the United States".[7] That is, United States transnational corporations have been supplying a rising proportion of their worldwide export markets from their foreign production bases. A similar trend has been noted in the case of Sweden and its transnational corporations.[8]

What is striking about the Kravis and Lipsey study, however, is the fact that when firms are classified into those operating in high-, medium- and low-technology sectors, "the export shares of U.S. multinationals, calculated classifying affiliates by the industry of their parents, were much higher than those of the United States for the high- and medium-technology groups". The authors therefore argue that even in these high-technology areas, while the competitiveness of United States transnational corporations rests on firm-specific assets not available to other United States firms but exploitable by them anywhere in the world, the competitiveness of countries rests on their factor endowments and macroeconomic policies. This, in a way, is clearly a conclusion that runs contrary to the conventional representation of the product-cycle theory, in which efficiency in production induced by intangibles such as technology transfers is a major determinant of trade patterns.

## 2. Evidence on the trade-investment nexus

Needless to say, there is no *a priori* reason for believing that developing countries in general, and those in Asia and the Pacific in particular, should be the beneficiaries of this trend in which transnational corporations produce a rising proportion of their worldwide supplies in foreign locations. Far from dominating the investment and production activities of host countries, foreign investors in the region have mainly supplemented domestic activities only. There is enough evidence, however, to indicate the significant role of foreign transnational corporations in exports from the most successful industrializing economies in the developing world. Host economy survey data (table 3.1) available for a limited number of economies show, for example, that in the Republic of Korea, the share of foreign firms in exports stood at around 35 per cent during the late 1970s but had advanced to almost 50 per cent by the mid-1980s, with Japanese firms accounting for a significant share of exports. In Singapore, these figures exceeded 70 per cent in the case of manufacturing exports, though United States firms were the dominant exporters. In Taiwan Province of China, where again Japanese firms dominated, the share of exports in production by foreign affiliates stood at over 50 per cent in the case of all exports, almost 60 per cent in the case of manufacturing and as high as 70 per cent in the case of electronics; however, garments, of which over 90 per cent were exported, headed the list. Though the degree of involvement in exports by foreign firms in Thailand was lower, with figures for selected years placing their shares (barring a solitary exception) within the range of about 10-50 per cent, there were some areas, such as the textile and food and beverage industries, where the role of foreign investment in exports was rather important.

Information on Japanese and majority-owned United States affiliates in Asia (table 3.2) provides a better view of the trade orientation of foreign transnational corporations in the region as a whole, albeit at the cost of ignoring transnational corporations from other economies.[9] Within the ASEAN-4, Japanese firms accounted for 6 per cent of the

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[7] Irving B. Kravis and Robert E. Lipsey, "Sources of competitiveness of the United States and of its multinational firms", *Review of Economics and Statistics*, vol. LXXIV, No. 2, May 1992.

[8] Magnus Blomstrom and Robert E. Lipsey, "The export performance of US and Swedish multinationals", *Review of Income and Wealth*, Series 35, No. 3, September 1989.

[9] It must be noted, however, that Japan and the United States accounted for over half of the FDI in those eight Asian economies for the period under consideration.

**Table 3.1. Export/sales ratios for foreign affiliates in selected host economies**

*(Export sales as a percentage of total sales)*

| *Host economy* | *Period* | *Industries covered* | *Domestic firms* | *All foreign affiliates* | *Japanese affiliates* | *United States affiliates* |
|---|---|---|---|---|---|---|
| Singapore | 1977-1980 | Manufacturing | 35.4 | 74.9 | 68.7 | 79.8 |
| | 1981-1985 | Manufacturing | 43.3 | 71.9 | 64.6 | 70.7 |
| Thailand | 1975[a] | Manufacturing | ... | ... | 9.7 | 74.3 |
| (Board of Investment, | | Food/beverages | 54.7 | 29.4 | 22.4 | 0.2 |
| promoted firms) | | Textiles/apparel | 7.3 | 28.6 | 17.2 | ... |
| | | Basic metals | 6.0 | 19.7 | ... | 98.8 |
| | | Electronics | 0.0 | 14.4 | 0.3 | 100.0 |
| | 1979 | Manufacturing | 20.9 | 31.5 | 17.6 | 41.7 |
| | | Food/beverages | 52.5 | 53.7 | ... | ... |
| | | Textiles/apparel | 15.9 | 41.8 | ... | ... |
| | | Basic metals | 3.4 | 9.8 | ... | ... |
| | | Electronics | 0.5 | 16.8 | ... | ... |
| | 1984 | Manufacturing | 39.0 | 33.0 | 21.0 | 35.0 |
| | | Food/beverages | 55.1 | 56.4 | ... | ... |
| | | Textiles/apparel | 47.3 | 49.4 | ... | ... |
| | | Basic metals | 6.7 | 2.8 | ... | ... |
| | | Electronics | 63.1 | 28.6 | ... | ... |
| Republic of Korea | 1974-1978 | All | ... | 35.0 | ... | ... |
| | | Manufacturing | 23.5 | 35.1 | 49.0 | 21.0 |
| | 1984-1986 | All | ... | 48.9 | 73.2 | 43.9 |
| Taiwan Province of China[b] | 1974-1979[c] | All | ... | 58.1 | ... | ... |
| | | Manufacturing | 33.9 | 58.9 | 58.2 | 63.4 |
| | | Textiles | 33.5 | 82.5 | 81.9 | 75.6 |
| | | Garments, etc. | 93.2 | 95.7 | 96.6 | 84.1 |
| | | Chemicals | 9.8 | 47.4 | 40.6 | 27.3 |
| | | Machinery | 25.8 | 32.1 | 69.2 | 26.3 |
| | | Electronics | 48.1 | 68.0 | 53.0 | 94.9 |
| | 1980-1985 | All | ... | 52.5 | ... | ... |
| | | Manufacturing | ... | 53.3 | ... | ... |
| | | Textiles | ... | 68.0 | ... | ... |
| | | Garments, etc. | ... | 93.6 | ... | ... |
| | | Chemicals | ... | 33.1 | ... | ... |
| | | Machinery | ... | 29.3 | ... | ... |
| | | Electronics | ... | 74.3 | ... | ... |

*Source:* Compiled by the ESCAP secretariat from various sources.

*Notes:* Three dots (...) indicate that data were not available, not disclosed or zero total sales.

[a] Manufacturing and sectoral data for Japanese and United States firms from Tambunlertchai (1977), other data from Sibunruang and Brimble (1987).

[b] The foreign total includes overseas Chinese firms.

[c] 1976 for domestic firms; 1979-1980 for Japanese firms; 1974-1978 for United States firms. Japanese and United States figures are averages of annual ratios; all other figures in the table are period averages calculated from export and sales figures.

total exports of Indonesia and about 9 per cent of its manufactured exports in 1987. Their best performance in the subregion was in Thailand in 1977-1979, when Japanese firms accounted for 15 per cent of total exports and over 8 per cent of total manufactured exports. In contrast, United States firms have consistently registered a larger share of the total exports in ASEAN countries: in 1989, it ranged from about 7 per cent for Thailand to almost 39 per cent for Malaysia. It must be noted that the data are not strictly comparable, as data for Japanese firms are not available for later years.

Japanese FDI data show that before 1979, Japanese investment

**Table 3.2. Share of Japanese and United States firm exports[a] in host economy exports**

| *Country or area* | | *Period* | *Total exports[b]* | | *Manufactured exports[c]* | |
|---|---|---|---|---|---|---|
| | | | *Millions US dollars* | *Percentage of total* | *Millions US dollars* | *Percentage of total* |
| **ASEAN-4** | | | | | | |
| Indonesia | Japanese | 1987 | 7 005 | 5.9 | 5 067 | 9.3 |
| | Japanese | 1972-1973 | 36 | 1.4 | 10 | 8.7 |
| | United States | 1977 | 4 426 | 40.5 | 107 | 27.8 |
| | United States | 1982-1985[d] | 7 592 | 36.4 | 47 | 2.2 |
| | United States | 1989 | 2 664 | 11.1 | | |
| Malaysia[e] | Japanese | 1972-1973 | 40 | 1.5 | 32 | 5.2 |
| | United States | 1977 | 508 | 7.4 | 339 | 21.1 |
| | United States | 1982-1985[d] | 2 346 | 13.9 | 1 400 | 33.6 |
| | United States | 1989 | 2 069 | 38.9 | 14 524 | 9.7[f] |
| Philippines[e] | Japanese | 1973 | 80 | 3.2 | 74 | 27.8 |
| | United States | 1977 | 355 | 8.4 | 260 | 45.1 |
| | United States | 1982-1985 | 600 | 7.5 | 488 | 35.7 |
| | United States | 1989 | 572 | 22.1 | | |
| Thailand | Japanese | 1972-1973 | 143 | 7.6 | 29 | 10.8 |
| | Japanese | 1972-1977 | ... | ... | 76 | 15.6 |
| | Japanese | 1977-1979 | 807 | 15.1 | 104 | 8.4 |
| | Japanese | 1981-1983 | 780 | 8.4 | 134 | 6.1 |
| | United States | 1977 | 104 | 2.4 | ... | ... |
| | United States | 1982-1985 | 460 | 4.7 | ... | ... |
| | United States | 1989 | 1 732 | 6.8 | | |
| **Newly industrializing economies** | | | | | | |
| Hong Kong | Japanese | 1972-1973 | 262 | 4.8 | 42 | 1.3 |
| | United State | 1977 | 3 822 | 31.2 | 600 | 8.3 |
| | United State | 1982-1985 | 5 119 | 16.6 | 880 | 6.0 |
| Republic of Korea[e] | Japanese | 1972-1973 | 138 | 4.3 | 137 | 6.7 |
| | United State | 1977 | 128 | 1.0 | 128 | 1.5 |
| | United State | 1982-1938[i] | 296 | 1.0 | 303 | 1.4 |
| | United State | 1989 | 542 | 24.8 | | |
| Singapore[g] | Japanese | 1972-1973 | 77 | 1.8 | 71 | 5.6 |
| | United States | 1977 | 1 423 | 12.7 | 822 | 23.2 |
| | United States | 1982-1985[h] | 10 914 | 35.5 | 2 224 | 20.6 |
| | United States | 1989 | 10 294 | 23.0 | | |
| Taiwan Province of China | Japanese | 1972-1973 | 339 | 7.9 | 339 | 11.2 |
| | United State | 1977 | 591 | 5.4 | 558 | 7.0 |
| | United State | 1982-1983 | 1 021 | 3.7 | 926 | 4.4 |
| | United State | 1989 | 2 215 | 3.0 | 2 142 | 3.5 |

*(Continued on next page)*

*Source:* Compiled by the ESCAP secretariat from various sources.

*Notes:* Three dots (...) indicate that data were not available or not disclosed.

[a] For United States firms, data refer to export sales of majority-owned non-bank affiliates of non-bank parents. Japanese firm data refer to the fiscal years ending 31 March of the following calendar year.

[b] Total exports defined as exports of goods and services as reported in the balance of payments, except where otherwise defined.

[c] Manufacturing exports defined as the sum of SITC 5-8. Note that industrial classifications used in sources of firm data do not correspond to the SITC (Standard International Trade Classification); hence these ratios are only rough approximations.

[d] 1982-1983 for manufacturing.

[e] Exports of goods only.

[f] Exports to United States parents only.

[g] Data for total exports of goods and services not available.

[h] Excluding 1984 for manufacturing.

[i] 1982 only for manufacturing.

in Asia was largely in the textile and apparel industry. Of the countries and areas included in table 3.2, it was only in the Philippines and Singapore that FDI from Japan went primarily to other industries. The grounds for their bypassing Singapore, where labour costs are relatively high and other business avenues more profitable, are apparent but the reasons in the case of the Philippines are less clear. Whatever the cause, however, the lack of foreign presence is cited as one of the factors explaining the relatively low productivity levels of the textile industry in the Philippines as compared with Thailand.

Table 3.2 also shows that in the 1970s, Japanese affiliates contributed less to exports than their United States counterparts. This is consistent with the findings of a survey that Japanese FDI in the ASEAN-4 was more geared towards penetrating the domestic market.[10] None the less, it is likely that more recent data would show larger shares, as Japanese firms have increasingly moved production into these countries in order to decrease production costs.

Export growth is not confined to host countries; investing country exports are often stimulated as well. This can be seen in the heavy involvement of transnational corporations in importing into host countries. Again, United States and Japanese data give added insight into the extent of foreign affiliate imports: intra-firm exports (from parent firms to affiliates) account for about 30 per cent of total exports and of manufactured exports of United States parent firms, as well as an equal share of total exports in the case of Japanese controlled firms (table 3.3). For Japanese manufactured exports, however, this ratio is surprisingly low, at less than 15 per cent, as Japanese affiliates in the ASEAN-4 have been known to rely heavily on parent firms as a source of intermediate and capital goods. This may therefore reflect the large share of FDI-promoted small- and medium-scale firms in manufacturing and the wide use of the joint-venture mechanism, especially in the technology-intensive or resource extraction industries.

In the United States, exports to affiliates were important in overall trade, but less important in trade to the region.[11] Although there were persistent surpluses in both the overall trade balance of parent firms and the intra-firm trade of these firms, particularly in manufacturing, United States parent firms generally had trade deficits with their affiliates in the Asian developing countries; this was particularly true in intra-firm trade. Intra-firm exports to the ASEAN-4 were large on average, especially in electronics, where they accounted for about 40 per cent of total United States electronics exports to these countries and, as would be expected, the share of intra-firm exports in total exports was especially important in Malaysia. Imports from affiliates by parent firms, however, were even larger than exports.

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[10] C.Y. Ng, R. Hirono and N. Akrasanee, *Industrial Restructuring in ASEAN and Japan: An Overview* (Singapore, Institute of Southeast Asian Studies, 1987).

[11] S. Naya, and E.D. Ramstetter, *"Foreign direct investment in Asia's developing countries and trade in the Asian and Pacific region"* ESCAP, *Development Papers*, No. 10: *Foreign Investment, Trade and Economic Cooperation in the Asian and Pacific Region* (United Nations publication, Sales No.E.91.II.F.19).

**Table 3.3. Intra-firm exports of Japan and the United States of America**

*(Millions of US dollars; the percentage shares of total exports are show in parentheses)*

| Sector | Japan[a] | | | United States of America[b] | | | |
|---|---|---|---|---|---|---|---|
| | 1973-1975 | 1977-1978 | 1979-1981 | 1977 | 1982-1983 | 1984-1985 | 1989 |
| All sectors | 17 844 (36.1) | 28 268 (31.7) | 36 650 (28.6) | 31 265 (26.5) | 48 186 (23.9) | 59 287 (28.3) | 58 648 (23.5) |
| Manufactures[c] | 6 694 (14.1) | 11 647 (13.4) | 14 274 (11.5) | 26 669 (28.5) | 42 533 26.9) | 54 119 (32.0) | 57 812 (21.2) |
| Textiles | 166 (4.5) | 90 (1.9) | 92 (1.5) | 186 (8.0) | 126 (4.4) | 122 (4.8) | n.a. n.a. |
| Chemicals | 206 (6.1) | 530 (11.2) | 585 (8.9) | 4 070 (38.2) | 6 196 (31.2) | 6 912 (31.4) | 6 581 (17.3) |
| Metals | 298 (2.7) | 350 (2.3) | 415 (2.0) | 1 071 (14.4) | 1 228 (9.9) | 1 366 (12.2) | 1 472 (12.1) |
| Machinery | 434 (7.7) | 689 (5.7) | 1 349 (7.3) | 5 279 (24.6) | 9 985 (27.7) | 12 995 (34.8) | 18 199 (17.3) |
| Electronics | 1 773 (27.6) | 3 879 (27.3) | 4 356 (19.0) | 2 629 (29.8) | 5 333 (29.5) | 6 229 (31.9) | |
| Transport equipment | 2 525 (20.3) | 3 742 (14.3) | 4 119 (12.2) | 9 159 48.5) | 13 446 (44.4) | 20 004 (57.0) | 23 782 (46.9) |

***Source:*** Japan, Ministry of International Trade and Industry, *Foreign Activities of National Firms,* Nos. 3-12; *White Paper on International Trade,* 1976-1984 issues (in Japanese). United States Department of Commerce, Bureau of the Census, *Statistical Abstract of the United States,* 1986-1992 issues. Ibid., Bureau of Economic Analysis, *U.S. Direct Investment Abroad; 1982 and 1989 Preliminary Estimates; U.S. Direct Investment Abroad; Operations of U.S. Parent Companies and Their Foreign Affiliates, Revised Estimates,* 1983, 1984, 1986 and 1988.

***Notes:*** [a] Data for Japanese parents refer to fiscal years but trade totals refer to calendar years.

[b] Data for United States parents refer to non-bank parents of non-bank affiliates; for 1982-1986, a large number of smaller firms included in the 1977 survey are excluded.

[c] Excluding petroleum and coal products for United States data.

The above review has demonstrated that transnational corporations, especially those from Japan and the United States, are heavily involved in the international trade of the ASEAN-4. Some insight into this question is given by the trade propensities of transnational firms as compared with those of other firms, most often defined as export-sales (export sales to total sales) and import-content (imported input to total input) ratios. Higher ratios for transnational firms than comparable ratios for other firms indicate that transnational firms in the industry are more likely to engage in trade. It is possible to infer from this that the expansion of transnational corporation sales leads to greater trade orientation. Of course, the indirect effects imparted through linkages can be very different from the direct effects; thus, the total effects may diverge somewhat from the direct effects measured by these ratios. None the less, such ratios can provide an important, albeit crude, first approximation of the relative trade impacts caused by different types of firms.

Export/sales ratios in the ASEAN-4 economies indicate that foreign transnational corporations often export more of their product than domestic firms (table 3.1). In Singapore, export/sales ratios were twice as high for foreign affiliates as for domestic firms until the 1980s. The differential closed slightly in the 1980s. The data for Thailand also show foreign affiliates as having larger export/sales ratios in most cases, though with a much smaller differential. Major exceptions are the food and beverage sector in 1975 (where foreign affiliates became more export-oriented in

later periods) and electronics. Data for investment in the Republic of Korea and Taiwan Province of China also indicate a strong tendency towards high export/sales ratios of foreign affiliates. This is highly consistent with the notion that one of the more important intangible assets possessed by transnational corporations is easy access to an extensive international marketing network, either internalized within the transnational corporations itself or through other trading firms.

It needs to be noted, however, that in many of these countries, over a period of time, the share of foreign firms in exports has been falling and that of domestic firms rising (table 3.4), suggesting that the involvement of foreign firms does not stifle or displace domestic export initiative but rather, by providing domestic experience in dealing with the international market, leads to a strengthening of domestic export capability. But that is not all: the investing country also benefits substantially from trade, inasmuch as investment leads to the sale of technology and capital equipment and intra-firm trade in intermediates and components. Thus, investment leads to exports not merely from the host country but from the investing country as well, enhancing trade flows in its wake (see box III.1).[12]

12 See Seiji Naya and Pearl Imada, "Trade and foreign investment linkages in ASEAN countries", in Soon Lee Ying, ed., *Foreign Direct Investment in ASEAN* (Kuala Lumpur, Malaysian Economic Association, 1990), p. 40.

**Table 3.4. Shares of transnational corporations in exports of manufactures from developing Asia, selected years**

*(Percentage)*

| *Host country or area* | *1966* | *1974* | *1976* | *1977* | *1982* | *1983* | *1984* | *1985* | *1986* |
|---|---|---|---|---|---|---|---|---|---|
| **Home country data**[a] | | | | | | | | | |
| *United States transnational corporations* | | | | | | | | | |
| Developing Asia | 3.8 | ... | ... | 6.2 | 6.4 | 6.2 | 6.7 | 6.5 | 5.7 |
| Hong Kong | ... | ... | ... | 8.1 | 6.5 | 5.6 | 5.7 | 5.6–6.4 | 4.5 |
| Republic of Korea | ... | ... | ... | 1.4 | 1.2 | 1.3 | 1.1–2.0 | 1.2–2.0 | 1.0 |
| Singapore | ... | ... | ... | 18.7 | 14.5 | 17.5 | 18.4–20.2 | 20.1 | 18.1 |
| Taiwan Province of China | ... | ... | ... | 6.2 | 4.2 | 4.0 | 3.7–6.3 | 4.1–5.7 | 3.4 |
| *Japanese transnational corporations* | | | | | | | | | |
| Developing Asia | ... | 6.2 | ... | 5.7 | ... | 6.9 | ... | ... | 7.1 |
| **Host country data** | | | | | | | | | |
| *All foreign firms* | | | | | | | | | |
| Republic of Korea | ... | 24.3 | 27.0 | 25.3 | ... | ... | 19.9 | 21.5 | 26.1 |
| Singapore | ... | ... | ... | 84.7 | 72.1 | 71.6 | 73.9 | 74.1 | ... |
| Taiwan Province of China | ... | 30.6 | 31.3 | 32.5 | 27.7 | 20.9 | 26.5 | 18.2 | 19.1 |
| *United States transnational corporations* | | | | | | | | | |
| Singapore | ... | ... | ... | 34.3 | 18.1 | 21.6 | 23.7 | 25.8 | ... |
| Taiwan Province of China | ... | 8.9 | 8.1 | 7.7 | 8.4 | 5.6 | 7.2 | 4.1 | 3.4 |
| *Japanese transnational corporations* | | | | | | | | | |
| Singapore | ... | ... | ... | 5.6 | 8.7 | 9.7 | 11.5 | 12.7 | ... |
| Taiwan Province of China | ... | 12.7 | 13.6 | 14.2 | 10.6 | 8.8 | 8.4 | 6.5 | 8.9 |

*Source:* Robert E. Lipsey, "Direct foreign investment and structural change in developing Asia, Japan, and the United States", in Eric D. Ramstetter, *ed., Direct Foreign Investment in Asia's Developing Economies and Structural Change in the Asia-Pacific Region,* (Boulder Colorado, Westview Press, 1991), table 10.3.

[a] Majority-owned affiliates.

## Box III.1. Transnational corporations and trade flows in the Asian and Pacific region

The importance of transnational corporations (TNCs) to world trade can be viewed, in the first instance, from their increasing contribution to the volume of global trade. From another viewpoint, the importance of TNCs to world trade can be discerned from the growing similarities between world-wide trade patterns, in terms of the composition and direction of exports and imports, and global patterns of foreign direct investment (FDI).[a] The growth of trade is most clearly evidenced by the external transactions of Japan, the United Kingdom of Great Britain and Northern Ireland and the United States of America, in which a substantial share takes the form of intra-firm transactions. In the United States in 1989, for instance, roughly 80 per cent of the country's external trade (exports plus imports) was attributed to the activities of TNCs[b], of which one third of exports and over two fifths of imports were estimated to be intra-firm transactions. Trade data for the United Kingdom and Japan during the early 1980s, indicate that about a third of the total value of the international trade for these countries took the form of intra-firm transactions.[c]

In host developing countries during the mid- and late 1980s, foreign affiliates of TNCs accounted for a significant proportion of exports, particularly from the manufacturing sector. During this period, the absolute value of manufactured exports by foreign affiliates in developing countries in Asia and the Pacific increased substantially. Despite the growth of exports by domestic firms in Asia in recent years, foreign affiliates of TNCs still dominate manufactured exports in some countries. In Malaysia, the Philippines and Sri Lanka, for example, foreign affiliates accounted for over 50 per cent of manufactured exports over the past decade; in Singapore, their share was almost 90 per cent. A recent survey of 777 firms in Thailand (which accounted for nearly one third of the country's total manufactured exports in 1990) found that nearly three fourths of their exports were undertaken by foreign affiliates and joint ventures.[d]

TNCs have been an important factor in generating shifts in the export composition of host countries towards more technologically advanced industries, primarily those producing electrical and electronic equipment. These shifts are evident for the affiliates of both United States and Japanese TNCs. In Asia and the Pacific, for instance, exports of electrical and electronic products from foreign affiliates of Japanese TNCs accounted for 61 per cent of total manufacturing exports from these countries in 1989, a significant rise from the share of 39.1 per cent in 1980. Concurrently, textile exports from foreign affiliates of Japanese TNCs experienced a sharp decline in their share of total manufacturing exports from 18.6 per cent in 1980 to 4.6 per cent in 1989.[e] The evidence suggests that under certain conditions foreign affiliates of TNCs can contribute to a change in the composition of exports in favour of more capital- and technology-intensive products. In Malaysia, the Republic of Korea, and Thailand, for example, data indicate that, between 1970 and the late 1980s, the increasing share of capital- and technology-intensive manufactured products in total manufactured exports was accompanied by a rising share of inward FDI in those industries.[f]

Underlying these changes in the composition of exports has been a significant shift in the sectoral destination of inward FDI by TNCs in the developing countries of the ESCAP region. In general, there has been a movement of TNCs away from the extraction and export of natural resources to the production and export of manufactured products. Several reasons account for this: nationalizations leading to the withdrawal of TNCs from directly-owned production activities; tariffs on processed products in export markets; the often incremental nature of investment in processing operations that favour existing sites; lack of appropriate infrastructure; and the growth of local entrepreneurial capabilities. Malaysia, for example, bought out foreign interests in virtually all foreign-owned rubber and oil palm estates during the 1970s and through a deliberate process privatized them during the 1980s.

TNCs also contribute to the growth of exports through a variety of non-equity arrangements between themselves and producers in developing countries in forms which provide vital links to final buyers. A major form of such non-equity

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[a] David Gold, Persephone Economou and Paz Estrella Tolentino, "Trade blocs and investment blocs: the triad in foreign direct investment and international trade," paper presented at the Annual Meeting of the Academy of International Business, Miami, Florida, 17-20 October 1991.

[b] Including parent companies in the United States, foreign affiliates of United States TNCs and United States affiliates of foreign TNCs.

[c] UNCTC, *World Investment Report 1991: The Triad in Foreign Direct Investment* (United Nations publications, Sales No. E.91.II.A.12), pp.67-74.

[d] UNCTC, *World Investment Report 1992: Transnational Corporations as Engines of Growth* (United Nations publications, Sales No. E.92.II.A.19), p.202.

[e] Ibid., p.203.

[f] Ibid., see, in particular, table VIII.4, p. 206.

*(Continued overleaf)*

*(Continued from preceding page)*

relationships is subcontracting. Several case-studies have indicated that subcontracting arrangements have been important in the export of garments from Hong Kong, Singapore, Taiwan Province of China and Thailand; and of bicycles and footwear from the Republic of Korea and Taiwan Province of China.[g] The initial stages of subcontracting arrangements usually concentrate on low value-added components of export products; in many cases, this leads to the production and export of relatively more sophisticated goods with greater value added. For instance, several local firms in the Philippines and the Republic of Korea undertake subcontracting work for TNCs in the semiconductor industry. Boeing, McDonnell Douglas and Short Brothers have subcontracting arrangements with firms in China for the export of aircraft components, while local companies in the Republic of Korea supply high quality aircraft components to TNCs.[h]

Case-studies of subcontracting in Singapore also provide evidence that the technology development of small- and medium-scale enterprises which are linked to TNCs can be very extensive; while direct technology transfer activities of TNCs appear to be of lesser importance, the extensive technological progress of the small- and medium-scale enterprises has been achieved mainly through various indirect processes such as learning facilitation, inducement and spillover.[i] The phenomenal success of garment exports from Bangladesh is a vivid illustration of the positive impact of learning through trade association with TNCs; the process in Bangladesh started with a non-equity arrangement with a developing country TNC, the Daewoo Corporation of the Republic of Korea.[j]

Subcontracting and other forms of non-equity arrangements are especially important for TNC trading companies which do not directly produce goods and services but rather organize a part of the exports of host economies. Just as there has been an observed shift in the sectoral concentration of TNC activities in many developing countries, the activities of trading TNCs have also declined in the primary sector and shifted largely to the manufacturing sector. These trading TNCs can help exports of manufactured products from developing countries by providing marketing services and access to international distribution networks since many developing countries lack a comparative advantage in marketing their products abroad. The activities of trading TNCs can enable developing countries to overcome marketing barriers in the form of product design, quality standards, packaging, presentation and access to consumers.[k]

Not all trading affiliates are established by trading TNCs; on a global basis, the majority of them are affiliates of industrial firms.[l] In developing countries, it has been observed that Japanese trading TNCs tend to establish more trading affiliates than their counterparts in manufacturing, suggesting that Japanese trading TNCs have a more important role in those countries. The Japanese trading TNCs are dominated by the *sogo shosha* which rank among the world's largest companies in terms of sales.[m] The nine largest *sogo shosha* had, in 1990, more than 3,000 foreign affiliates of which 55 per cent were located in developing countries. By March 1991, FDI by those firms amounted to $19 billion, accounting for 6 per cent of Japanese FDI, of which a large part was export-oriented in nature.[n] The activities of these *sogo shosha* can facilitate exports to Japan as well as third countries. For example, a *sogo shosha* operating in Indonesia is participating with Pertamina and two United States oil and gas companies to export 9 million tons of liquid natural gas (LNG) to Japan every year. This *sogo shosha* arranged project financing of $4 billion and organized the engineering, construction and equipment

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g Ibid., p.205.

h See UNCTC, *Transnational Corporations and the Electronic Industries of ASEAN Economies* (United Nations publication, Sales No.E.87.A.13); Michael Westlake, " Aviation and aerospace '88: China – Joint ventures and joint opportunities," *Far Eastern Economic Review*, (4 February 1988), pp.36-40.; and John D. Morocco, "Korean aerospace firms seek greater role in world market," *Aviation Week and Space Technology*, vol.130, No.24 (12 June 1989), pp.201-206.

i Wong Poh Kam, *Technological development through subcontracting linkages* (Asian Productivity Organization, 1991).

j In the initial five-year collaboration agreement, the TNC provided training for workers, assistance in start-up activities, including the installation of machinery, supervision of production, and marketing services. See Yung Whee Rhee, "The catalyst model of development: lessons from Bangladesh's success with garment exports," *World Development*, vol.18, No.2 (February 1990), pp.333-346.

k UNCTC, *World Investment Report 1992: Transnational Corporations as Engines of Growth* (United Nations publications, Sales No. E.92.II.A.19), p. 206.

l Ibid., p.207.

m The *sogo shosha* are highly sophisticated organizations involved in a broad spectrum of commercial activities world-wide. Through their large-scale communications networks, *sogo shosha* have access to and provide a wealth of information, expertise and contacts to their clients. In addition to assisting in marketing and distribution, those firms extend financial support by way of providing low interest-rate loans required for trade expansion, sometimes linking loan payments schedules to a plant's exports.

n UNCTC, *World Investment Report 1992: Transnational Corporations as Engines of Growth* (United Nations publications, Sales No. E.92.II.A.19), p. 208.

companies. It has been estimated that third-country transactions by *sogo shosha* accounted for about 5 to 6 per cent of world trade in 1988 ($144 billion).

In recent years, the role of TNCs and FDI in developing the export of services from host countries has gained increasing attention as perceptions in developing countries regarding the contribution of services to economic development have changed. This development has been fostered to a large extent by the growing awareness of the importance of services in terms of employment, output generation, and interlinkages with other activities, the experience of industrialized countries with service deregulation, as well as the impact of computer and communications technologies on a number of service industries. An increasing number of developing countries have become aware of the export potential of such services as tourism, labour services, harbour services, or transit-trade services, while recognizing the need to access efficient producer services as a requirement for the development of an efficient and competitive economy. Since services are non-tradable in nature, FDI is the predominant mode of delivering such services to foreign markets. Often, however, restrictions are placed on the entry of TNCs even when certain services are easily tradable. These restrictions are sometimes perceived as a contributory factor to the disruption of efficient production in manufacturing and, when applied too restrictively, can alter decisions on FDI in those particular countries. Very little information is currently available on the trade in services for the ESCAP region; it is expected that the volume and range of services exported and the contribution of TNCs may increase significantly in the near future because of breakthroughs in data and communications technologies that render more services more transportable.[o] The export of services is also expected to become more important as development gains pace especially in service industries such as engineering, financial services, and data input and software production.

TNCs also can influence imports of goods and services in important ways. Indeed, during the initial establishment of TNCs in certain industries in host countries, their imports may be more significant than at later stages of their operations. During the decade of the 1980s the imports of capital goods by the United States affiliates in the Asian and Pacific region rose from $3.1 billion in 1982 to $4.8 billion in 1989. These amounts represent about 5 per cent of the world share of the United States affiliates throughout the world in both years. Such imports of intermediate and capital goods by affiliates of TNCs can contribute to the growth of host countries. For example, in Hong Kong and Taiwan Province of China firms producing textiles and synthetic fibre have developed and sustained their technological competitiveness largely through the initial importation of technical components and machinery by TNCs. Supply bottlenecks may also be overcome through importation of services such as certain international banking services to domestic trading companies; the provision of certain insurance and re-insurance services to a wide range of local firms; and in air transport and shipping as well as in advanced data processing and telecommunications services, where TNC-related imports can enable domestic firms to reduce costs and gain access to world-wide networks of TNCs. The trend towards greater tradability of services, particularly information-intensive services implies that host countries may increasingly be able to use imports in addition to FDI to obtain the services they require.

In summary, the impact of TNCs on the linkages between trade and the growth of production can take place at three conceptual levels: At the macroeconomic level, the trade promoted by TNCs helps facilitate a higher growth rate by raising the demand for domestically produced goods through host-country exports, by easing supply constraints of both host and home economies through imports, and by facilitating a dynamic learning process. At the industry level, TNCs facilitate trade by fostering a deeper international division of labour which involves the location of production of components and final products across different countries. That process, in turn, facilitates a more efficient utilization of each country's resource and skill endowments, thus lowering production costs and promoting growth. At the company level, the organization of international networks of TNCs, including those of trading affiliates, can increase world trade and, in this manner, influence the growth and development of trading nations.[p]

The involvement of TNCs in the Asian and Pacific region has important implications for both FDI and trade policies. Yet, there is still scant information on their precise role in certain key areas of national and regional importance. In particular, there is room to improve understanding of the principal determinants of FDI by TNCs and the implications of such FDI to the development of important industries so that host countries will be better equipped to develop more effective and efficient FDI policies.[q]

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[o] UNCTC, *World Investment Report 1992: Transnational Corporations as Engines of Growth* (United Nations publications, Sales No. E.92.II.A.19), p. 209.

[p] Ibid., p. 216. The activities of TNCs may have important externalities for their host countries, including the development of forward and backward linkages. The ESCAP/TCMD Joint Unit on Transnational Corporations is currently undertaking a study of backward linkages in the electrical and electronics industry in six countries in the Asian and Pacific region.

[q] See Sachiko Kataoka, "A case study on the determinants of Japanese foreign direct investment in Thailand," ESCAP/TCMD Joint Unit on Transnational Corporations, 1992.

The foregoing analysis, therefore, indicates that FDI is likely to generate a good deal of trade. While FDI in primary commodities will create intra-firm trade since the basic objective is the sourcing of raw material, in the case of FDI directed at industrial activity most country exports are stimulated by the export-oriented nature of many foreign affiliates and the increasing competitiveness brought about by the new technologies and management skills of the foreign enterprise. At the same time, exports from the investing country are likely to expand to support production of the affiliate. Although there is the possibility of a reduction in exports of the good in question by the investing country, there is likely to be an offsetting increase in exports of raw materials, components and complementary items. Such exports can expand if the technology is disseminated and eventually imitated by local firms. In the case of production through FDI for exports aimed at gaining access to third-country markets, exports of raw materials and other complementary products from the host country are also likely to expand with internationalization of the manufacturing process.

There are a number of dangers, however, in choosing to exploit the trade-investment nexus. First, in certain contexts, either because of the nature of foreign investment operations or because of the failure of domestic policy, the initial high dependence on foreign investment to obtain and expand a foothold in world markets may not lead to the generation of domestic or indigenous export capability. Second, this failure can prove damaging if, in the search for low-cost locations for traditional or labour-intensive production operations, foreign investors relocate their capacities or install new capacities in competing sites that have now become more favourable. Such relocation of FDI could not only affect the expansion of exports at the margin but also induce further outflows of capital and start a process of deceleration, or even of decline, in exports. Third, excessive reliance on intra-firm trade could mean that the net foreign exchange earning from dependence on the investment-trade nexus could actually be low and even turn negative as the process of profit repatriation gathered momentum. This is an important concern where the foreign firms gain extra profits through the transfer price mechanism by which imports are overpriced and exports underpriced. Fourth, competition between countries to offer better terms to foreign investors can, if the above factors operate, lead to a situation where the linkages with the domestic economy are minimal. And, finally, if as part of the drive to exploit the trade-investment nexus, countries liberalize their trade regimes but fail to benefit from that nexus for reasons other than their trade or investment regime, liberalization can prove destabilizing.

To sum up, even though the evidence relates to a few of the developing countries of Asia and the Pacific, the existence of a nexus between foreign investment and trade in the region in recent years cannot be denied. The real issues, however, in the context of regional economic cooperation and development, are the degree to which this affects other countries, or can be generalized in the coming years, and the extent to which it could develop into a sustainable foreign exchange earning capacity – issues to which attention will be given in the discussion that follows.

## B. FOREIGN INVESTMENT AND INDUSTRIAL RESTRUCTURING

### 1. The role of foreign direct investment

In the current world environment, the process of industrial restructuring essentially involves the fashioning of an industrial base that is neutral with respect to production for domestic and export markets. Import-substituting industrialization, by substantially enhancing the size and diversifying the structure of the industrial base in many of the developing Asian and Pacific countries, helped them to insulate themselves from the adverse influences of international inequality. This was achieved in many ways: export substitution helped these countries to partially close their open production cycles and overcome their excessive (relative to their export capacities) dependence on imports from the world market of manufactured capital, intermediate and consumption goods; it facilitated breaking the barriers to the increasing productivity and income characteristic of predominantly agrarian economies; and it encouraged a learning-by-doing process which not merely created the capacity to deal with industrial technologies but also generated a significant scientific and technical manpower base.

However, as numerous studies have indicated, by favouring production directed at the protected and inevitably oligopolistic home market, rather than world markets in general, the import-substituting strategy fashioned an industrial structure which, in terms of costs, quality and the pace of innovation, lagged behind trends in the world economy. This not merely foreclosed the benefits being derived from changes that were

occurring in the international economic order, particularly the shift in the focus of growth away from its traditional centres, but also made it difficult to finance the growing domestic demand for foreign exchange, which could not be controlled, or contained within set limits, beyond a certain point. Even at the lower levels of import intensity of domestic production characteristic of import-substituting regimes, foreign exchange earnings proved inadequate to finance the imports that accompanied growth, necessitating periodic doses of deflation to stabilize the balance of payments. If external vulnerability was an important factor necessitating import-substituting strategies at one point in time, it now became the factor warranting a modification of that strategy.

A process of restructuring of the industrial sector in keeping with standards set by the world market, so as to be able to cater increasingly for those markets to achieve growth and higher foreign exchange earnings, has thus become inevitable since the 1970s in the developing Asian and Pacific region (see box III.2). Such restructuring can occur either through strategic coordination by the State of a flexible and largely privately led industrial sector (as was true in the Republic of Korea in the early phases of its rapid growth), or by subjecting atomistic private and public sector decision makers to the disciplining edge of international competition through a relatively open trade regime (as was true in many of the NIEs), or a combination of the two (as appears to be the case currently in China).

Whatever the environment within which industrial restructuring takes place, the involvement of foreign investment tends to be crucial for a number of reasons. To start with, the international market-place is not characterized by free, arm's-length transactions between independent buyers and sellers but is influenced by the presence of oligopolistic production, trading and retailing firms, resulting in a high volume of subcontracted or intra-firm trade that sets obstacles for the independent entrant. A degree of involvement of foreign firms is inevitable for any country and its individual producers to obtain an entry into that market. Second, as has been stressed repeatedly in the literature on FDI, entry into certain markets requires access not merely to marketing networks but also to technologies that permit the replication of frontline innovations, which are controlled by technological leaders through patents and other means. Access to technology often comes as part of a package that includes FDI in order to retain control over technology and facilitate intra-firm sales of capital goods, intermediates and components. Third, since the restructuring process, especially when it is fashioned through trade liberalization, often results in a widening of the current account deficit, FDI at times also helps finance the balance-of-payments gap. This is because even if foreign investment results in a net reverse flow in the medium or long term, its initial effect is to ensure an inflow of capital. Furthermore, foreign creditors have greater confidence in increasing their exposure in any particular country if that country is being selected by foreign investors as a site for world-market-oriented production, since it implies that the borrowing country, by virtue of its foreign affiliated investments, could generate the capability to earn the foreign exchange to meet its future debt-service obligations. Finally, in at least some of the developing countries of the Asian and Pacific region, where the process of import-substituting growth has not generated the managerial capabilities and skills to operate and oversee world market-oriented production, FDI brings with it the managerial expertise and the basic resources required to generate those skills in the domestic environment.

Past experience with transnational corporations indicates that, at times, their effects on domestic production capabilities and on the balance of payments can also be adverse. This is especially true in the case of those areas where patents and other means of control over product and process innovations give them an oligopolistic position in the world market. They could then write into technical collaboration agreements, and enforce through financial control, clauses that slow down the diffusion of competing product and process innovations and restrict the destination and volume of exports to protect the markets of their third-country subsidiaries. They could also resort to excessive and expensive purchases through intra-firm trade transactions and practices like "transfer pricing" of imported capital goods, intermediates and components that would make it difficult for host Governments to treat them on the same level as national firms, and increase the foreign exchange outflows on their account as well. The net effect could be adverse from the point of view of both the development of indigenous technological capability and the balance of payments. It is for this reason that strategic coordination by the State and some regulation by a regional authority is far preferable to the unfettered operation of market forces.

## Box III.2. Seoul Plan of Action for Promoting Industrial Restructuring in Asia and the Pacific

A draft plan of action for promoting industrial restructuring in Asia and the Pacific, evolving from the theme study, entitled "Industrial restructuring in Asia and the Pacific, in particular with a view to strengthening regional cooperation", was considered by the Economic and Social Commission for Asia and Pacific at its forty-seventh session, held at Seoul in April 1991. The Commission adopted resolution 47/2 of 10 April 1991 on the Seoul Plan of Action for Promoting Industrial Restructuring in Asia and the Pacific. In that resolution the Commission welcomed the plan of action as a comprehensive and constructive basis for further discussion. The Seoul Plan of Action was presented to the Meeting of Senior officials on the Seoul Plan of Action for Promoting Industrial Restructuring in Asia and the Pacific, held at Bangkok in November 1991. The purpose of the Meeting was to review the Plan with a view to establishing its priorities and modalities for promoting industrial restructuring in the ESCAP region.

The Seoul Plan of Action, with the suggested revisions and elaborations, was then presented to the Commission at its forty-eighth session, held at Beijing in April 1992. After extensive deliberations, the Commission adopted the Seoul Plan of Action for Promoting Industrial Restructuring in Asia and the Pacific, and noted that the secretariat should determine the specifics of the regional cooperation measures recommended therein, and assume the coordinating role. It emphasized the need to work closely with relevant international organizations and United Nations agencies and bodies, especially the United Nations Industrial Development Organization (UNIDO), in implementing the regional cooperation measures. In adopting the Seoul Plan of Action, the Commission endorsed the proposal that a regional forum for sustainable industrial development and restructuring. could be constituted to deal with key issues of regional concern in industrial development and restructuring. The forum is expected to bring together high-level government officials, representatives of the private sector and professional experts to work out the mechanisms for industrial restructuring. Its first meeting will be organized towards the end of 1993.

The Seoul Plan of Action has four major parts. The basic considerations and principles for promoting industrial restructuring in Asia and the Pacific are set out in part one. This is followed by detailed recommendations and proposals for action in part two. Part three sets out the measures for the monitoring and evaluation of the Plan. The implementation strategy for the Plan is spelled out in part four.

### Part one

### INTRODUCTION

The Seoul Plan of Action views industrial restructuring as a complex and dynamic process, involving shifts in the structure of production, ownership, size, and market orientation of industrial enterprises. The Seoul Plan of Action recognizes that the structural changes occurring in the manufacturing sector of the economies of the region are largely guided by factor prices, exchange rates, interest rates and credit policies, trade policies and technological capabilities.

The underlying considerations and principles embodied in the Plan of Action have been formulated in keeping with the dynamic performance of the region as a whole, as well as the perceptible tendencies towards greater integration and interdependence among the economies of the region. These tendencies have brought new opportunities as well as challenges for fostering regional cooperation to facilitate industrial restructuring . The Seoul Plan of Action is designed to utilize these opportunities, particularly those that have arisen in the areas of intraregional trade, foreign direct investment, new production technologies, relocation of industrial activities in line with changing comparative advantage, geographical sourcing of parts and equipment, region-wide subcontracting arrangements, and harmonization of industrial policies and programmes. The Plan of Action is predicated on the basic principle that the formulation and implementation of national strategies, policies, plans and programmes for industrial restructuring are the sovereign right and responsibility of each member and associate member of the Commission.

### Part two

### RECOMMENDATIONS AND PROPOSALS FOR ACTION

Part two contains 20 recommendations and 82 proposals for action. These recommendations and proposals for action are grouped under three functional headings: (a) national-level policy, planning, programming and institutional arrangements for promoting industrial restructuring; (b) regional cooperation measures and institutional arrangements in facilitating industrial restructuring; and (c) policy research, analysis and studies. As the principal focus of the Plan is on recommending measures to deal with critical issues and suggest specific actions of high priority to facilitate industrial restructuring in the region, the Plan urges the identification of focal points, target

groups and enabling institutions for the effective implementation of its various recommendations and proposals.

The distinguishing feature of the Seoul Plan of Action is its emphasis on the very important role of the private sector in the regional integration process. It draws attention to the rapidly increasing intra-regional trade, technology and investment flowsmostly undertaken by private firms which have made a significant contribution to the growing interdependence among economies of the region. The Plan therefore suggests several measures to strengthen the role of the private sector as an agent for fostering regional cooperation. At the national level, the Plan recommends that the private sector, in general, would have to assume a major role in the process of industrial restructuring as its speed and extent would be shaped by the requirements for creating on internationally competitive industrial sector with long-term growth in productivity and technological capability.

One of the major themes running throughout the recommendations and proposals for action is the objective of fostering productivity-enhancing (hence, income-enhancing) industrial restructuring through the adoption of higher value added and internationally competitive manufacturing processes. The Plan therefore lays down proposals for the prerequisites for effective industrial restructuring. Those proposals include human resources development, supportive financial institutions that function well, the upgrading of technology, the pursuit of appropriate macroeconomic policies, the maintenance of an open and fair international trading system and the provision of modern and efficient infrastructure, especially energy, and transport and communications facilities.

## Part three

## MONITORING AND EVALUATION

The Plan emphasizes the need to provide flexibility in policy matters, especially those related to trade, investment, technology, energy and human resources development. Monitoring at the national and regional levels is therefore considered essential as technology and trade patterns keep changing quickly. Furthermore, the composition of the labour and financial markets is also changing rapidly, with far-reaching implications for industrial restructuring. Therefore, part three of the Seoul Plan of Action points to the need for monitoring the key markets along with technological change and suggests appropriate arrangements to monitor and evaluate their impact on the industrial restructuring process. The Plan recommends that effective techniques, such as appropriate national focal points, should be devised to collect and disseminate information on technological changes, trends in specific key industries, and the impact of foreign direct investment flows on industrial restructuring. It is also essential to assess whether government investment promotion activities provide the needed incentives to foreign investors to transfer technology to and establish close technical links with local firms, especially suppliers and subcontractors. The Plan also advocates regular studies to monitor and evaluate the possible adverse social consequences of industrial restructuring, especially for the labour force, the informal sector, local communities, and the weaker sections of the society. The Plan recognizes that monitoring and evaluation of the industrial restructuring process is not an easy task. However, if countries of the region expect to improve the performance of their industrial sector, they would have to observe closely the key trends at the regional and global levels. For that purpose, arrangements would have to be made at the national level as well.

## Part four

## IMPLEMENTATION STRATEGY

In support of the national efforts suggested in the Seoul Plan of Action, the implementation strategy advocates the active participation of intergovernmental organizations, including United Nations bodies and agencies already involved in the field of industrial development – especially the United Nations Centre for Science and Technology for Development, the United Nations Development Programme, the United Nations Environment Programme, the International Labour Organisation and the United Nations Industrial Development Organization and UNIDO. Other organizations which possess valuable experience, such as the Asian Development Bank and the World Bank, should also be encouraged to assist the members and associate members in the implementation of various measures as outlined in the Plan. Within that general framework, the Plan suggests that it would be useful and desirable for a large regional organization like ESCAP to serve as the regional focal point for coordinating its implementation.

As the Seoul Plan of Action would require a time-frame covering a reasonable number of years to ensure its effective implementation, the Plan suggests a 10-year period as an appropriate time-frame.

## 2. Sectoral structure of foreign direct investment in the region

One way of assessing the role that FDI has played hitherto in the restructuring process in individual countries is to examine its sectoral structure, which indicates the degree to which it has moved out of traditional areas characteristic of the old type of foreign investment into areas of world-market-oriented production of the kind that generates dynamic comparative advantage. As can be seen from table 3.5, foreign investment in the Asian and Pacific region has undergone substantial changes in its sectoral structure, though the nature of that change varies across countries. In the more dynamic of the developing countries of the region, like the Republic of Korea and Singapore, where the primary sector is in any case small and accounts for only an insignificant share of FDI, the 1980s have seen a decrease in the share directed to the secondary sector and an increase in that directed to the tertiary sector. Others, such as Malaysia and Thailand, have seen a decline in the shares directed to the primary and tertiary sectors, and an increase in the share directed to the secondary sector. In China and India, while the share of the primary sector has declined, that of the tertiary sector has remained stable and that of the secondary sector has increased. Indonesia and the Philippines, on the other hand, have experienced an increase in FDI in the primary sector and a decline in the share directed to the secondary and tertiary sectors.

The overall situation, in fact, is one in which FDI flows to the Asian and Pacific region have undergone structural change in some broad directions over time. The importance of FDI in the primary and extractive industries has declined significantly, except for the petroleum industry in some oil-exporting countries and in countries where oil and natural gas have been discovered. At the same time, there have been increasing FDI flows into the manufacturing subsector, and the magnitude of FDI in manufacturing has been significant in almost all developing economies in the Asian and Pacific region. There have also been increasing FDI inflows into the service sector, especially trade, construction and finance, in many developing countries in the region.

Increased FDI in manufacturing activities, while following the worldwide trends in FDI flows, has mainly been the result of industrialization policies and specific policy measures adopted by the developing economies in the Asian and Pacific region to induce FDI into various manufacturing activities. These policy measures appear to be quite successful. Japanese direct investment, for example, has a much higher proportion in manufacturing activities in the Asian and Pacific region than in North America and Europe, where the investment flows from Japan have been spread over to finance, real estate and other service activities.[13] This higher concentration in manufacturing FDI from Japan in the Asian and Pacific region also reflects the stages of economic development and locational advantage of economies in the region as the host to manufacturing investment, as compared with high-income economies in the United States and Europe, where investment in services could be more profitable.

Within the manufacturing subsector, there has also been significant structural change in terms of industrial and product composition over time, as in most developing countries in the Asian and Pacific region FDI has played an important role at the stages of both import substitution and export expansion. Food processing, textiles, chemicals and some assembly-type industries such as automobiles, electronics and electrical products are among the important industries with significant FDI in the initial import-substituting stage. Later on, as industrialization proceeded, there was a movement towards more sophisticated industrial products; more important, to maintain further industrial growth, the promotion of manufactured exports was attempted. At this stage, as mentioned earlier, FDI inflows and participation by transnational corporations were also helpful for manufacturing products with acceptable quality and in gaining access to overseas markets.

The evidence thus suggests that although most of the FDI flows into Asia and the Pacific have been in the manufacturing sector, there are instances where investment still flows into traditional areas in large measure; but the nature of these flows, though possibly leading to increased exports, is not similar to the trade-investment nexus that underlies the successful cases of export-based growth. While from the point of view of the foreign investor such behaviour may be quite rational since the international demand for primary commodities, agricultural

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[13] Statistics from the Ministry of Finance of Japan show that in 1991, direct investment in manufacturing comprised 49.3 per cent of the amount of direct investment in Asia approved by the Ministry of Finance, as compared with 31.2 per cent for North America and 28.7 per cent for Europe, and the overall manufacturing share of 29.6 per cent of Japanese worldwide direct investment in the same year.

**Table 3.5. The sectoral distribution of foreign direct investment stock, various years[a]**

*(Percentage)*

| Country or area | | Inward stock | | | Outward stock | | |
|---|---|---|---|---|---|---|---|
| | | Primary | Secondary | Tertiary | Primary | Secondary | Tertiary |
| **Newly industrializing economies** | | | | | | | |
| Hong Kong | 1975 | ... | 60.4 | ... | ... | ... | ... |
| | 1980 | ... | 28.7 | ... | ... | ... | ... |
| | 1989 | ... | 25.9 | ... | ... | ... | ... |
| Republic of Korea | 1976 | 1.0 | 79.9 | 19.0 | 2.6 | 26.8 | 37.1 |
| | 1980 | 1.0 | 66.8 | 32.2 | 22.2 | 17.6 | 60.1 |
| | 1988 | 0.9 | 61.5 | 37.6 | 43.7 | 34.6 | 21.8 |
| Singapore | 1975 | 0.2 | 46.9 | 52.9 | ... | ... | ... |
| | 1980 | 0.2 | 54.6 | 45.2 | ... | ... | ... |
| | 1989 | 0.2 | 42.4 | 57.4 | ... | ... | ... |
| Taiwan Province of China | 1975 | ... | 90.6 | 0.9 | ... | ... | ... |
| | 1980 | ... | 93.6 | 6.4 | 4.2 | 85.8 | 10.0 |
| | 1988 | ... | 88.3 | 11.7 | 1.1 | 65.7 | 33.2 |
| **ASEAN-4** | | | | | | | |
| Indonesia | 1975 | 61.2 | 32.5 | 6.3 | ... | ... | ... |
| | 1980 | 70.4 | 25.4 | 4.2 | ... | ... | ... |
| | 1990 | 81.7 | 15.4 | 2.9 | ... | ... | ... |
| Malaysia | 1975 | 39.3 | 30.6 | 30.1 | b | b | b |
| | 1980 | 31.3 | 30.1 | 38.6 | b | b | b |
| | 1988 | 28.3 | 41.2 | 30.5 | b | b | b |
| Philippines | 1975 | 9.2 | 44.9 | 45.9 | ... | ... | ... |
| | 1980 | 18.8 | 50.4 | 30.7 | ... | ... | ... |
| | 1988 | 28.6 | 48.3 | 23.1 | ... | 19.8 | 80.2 |
| Thailand | 1975 | 15.1 | 29.9 | 55.0 | ... | ... | ... |
| | 1980 | 13.5 | 31.7 | 54.7 | 2.6 | 1.1 | 96.6 |
| | 1989 | 9.2 | 42.8 | 48.0 | 0.3 | 17.3 | 82.3 |
| **South Asia** | | | | | | | |
| India | 1975 | 26.3 | 70.4 | 3.2 | ... | ... | ... |
| | 1980 | 8.9 | 87.0 | 4.1 | ... | ... | ... |
| | 1988 | ... | ... | ... | 3.1 | 81.7 | 15.2 |
| Pakistan | 1975 | 6.9 | 48.1 | 45.0 | ... | ... | ... |
| | 1980 | 7.9 | 53.6 | 38.5 | ... | ... | ... |
| | 1988 | 11.5 | 38.7 | 49.8 | ... | ... | ... |
| **Pacific islands** | | | | | | | |
| Papua New Guinea | 1975 | 81.4 | 10.5 | 8.1 | ... | ... | ... |
| | 1980 | 73.7 | 16.4 | 9.8 | ... | ... | ... |
| | 1989 | 60.3 | 10.9 | 28.9 | ... | ... | ... |
| **Other Asia** | | | | | | | |
| China | 1983 | 66.9 | 20.4 | 12.7 | 2.0 | 12.2 | 85.7 |
| | 1985 | 15.0 | 36.2 | 48.8 | 37.0 | 20.3 | 42.7 |
| | 1988 | 8.2 | 49.7 | 42.2 | ... | ... | ... |
| Viet Nam | 1989 | 67.7 | 12.7 | 19.6 | ... | ... | ... |

*Source:* Country tables in part III of the *World Investment Directory 1992*, vol. I, *Asia and the Pacific* (United Nations publication, Sales No. E.92.II.A.11).

[a] *Foreign direct investment stock*

For associate and subsidiary enterprises, this is the value of the share of their capital and reserves (including retained profits) attributable to the parent enterprise (this is equal to total assets minus total liabilities), plus the net indebtedness of the associate or subsidiary to the parent firm.

For branches, this is the value of fixed assets and the value of current assets and investments, excluding amounts due from the parent, less liabilities to third parties.

Figures available but not comparable.

and mineral, is still substantial, from the point of view of the developing country the benefits are far more limited. Except for cases like petroleum exploration, the technology involved in these areas is easily purchased abroad and the managerial and marketing expertise and the skills required for operating such ventures exist in large measure within the countries concerned as a result of long years of production experience in these activities. The only positive benefit that could emerge from such FDI in primary activities is the inflow of foreign exchange. However, there is substantial evidence to indicate that besides the need to share revenues, foreign investment in these activities tends to have an adverse impact since the one-time inflow of investment into a venture, which is often small because of the concurrent use of local financial resources, is followed by rather large and persistent outflows on account of dividends. Even in instances where the share of foreign investment directed at the secondary sector is increasing, this may not be indicative of the operation of the trade-investment nexus, inasmuch as foreign investment may be directed at the domestic market. A closer look at individual experience is therefore warranted.

## C. INDIVIDUAL COUNTRY EXPERIENCE

### 1. Indonesia

Indonesia is one instance in which the primary sector is still a major recipient of foreign investment. As a result of the enforcement of a foreign investment law and the nationalization of some foreign assets, FDI inflows were reduced to a minimum in the late 1950s and early 1960s. Thus, between 1956 and 1965, cumulative investment amounted to just $84 million, much of which consisted of investments by foreign oil companies. Subsequently, under a restructured industrial regime starting in 1966, the foreign investment law was liberalized within the framework of an import-substituting strategy. Subsequently, in sectors excluding oil, insurance and banking, the cumulative value of investment over the period 1967-1985 was of the order of $15.4 billion. However, even in this period, petroleum received 70 per cent of cumulative foreign investment, with manufacturing receiving only 20 per cent.

Of the manufacturing investment, a substantial portion went into the metal and chemical industries, which were obviously stimulated by the import-substituting strategy. However, after 1985, when the foreign investment law was further liberalized, the emphasis on investment in the petroleum sector was further strengthened, and in 1990, for example, 80 per cent of all FDI was directed to that sector.[14] All this points to two trends: first, even though, relative to the colonial period when the bulk of the Netherlands FDI was directed to the plantation sector, there has been a greater emphasis on non-plantation investment, and extractive industries in the form of petroleum have consistently dominated foreign investment in Indonesia; second, as foreign investment laws were progressively liberalized it appeared that the petroleum sector benefited the most in terms of FDI. This indicates that, at least in the Indonesian context, foreign investment has played only a limited role so far as restructuring of the industrial sector is concerned.

There are, however, two features in table 3.6 particularly worth noting. First, while Japan dominated investments in sectors excluding oil, insurance and banking until about 1987, in the following two years there has been a substantial diversification of the origin of approved foreign investment to the country, with the Republic of Korea, Singapore and Taiwan Province of China playing a more significant role. In addition, these were the years which recorded a sharp increase in investment in manufacturing, indicating possibly the entry of the NIEs, and perhaps some of the ASEAN-4 countries, into that sector. That is, there are signs, though incipient, of a shift in the nature of foreign investment to that country. Furthermore, since 1987, manufactured export growth has become more broad-based owing to the contribution of companies with foreign equity participation in the export effort. In particular, FDI inflows into labour-intensive, export-oriented sectors such as textiles and electrical equipment have increased sharply in recent years.[15]

### 2. India

Unlike Indonesia, India is an example of a country where foreign investment, though occurring within the framework of an import-substituting strategy, has gone substantially to the

14 See Hal Hill, *Foreign Investment and Industrialization in Indonesia*, (Singapore, Oxford University Press, 1988).

15 Mari Pangestu, "Foreign firms and structural change in the Indonesian manufacturing sector" in Eric D. Ramstetter, ed., *Direct Foreign Investment in Asia's Developing Economies and Structural Change in the Asia-Pacific Region* (Boulder, Colorado, Westview Press, 1991).

**Table 3.6. Indonesia: approved inward foreign direct investment by country or area and industry**

*(Value in millions of US dollars)*

| *Country or area* | *Distribution by country or area* | | | | | *Industry* | *Allocation by industry* | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | *1967-1985* | *1986* | *1987* | *1988* | *1989* | | *1967-1985* | *1986* | *1987* | *1988* | *1989* |
| United States | 974 | 129 | –62 | 534 | 167 | Primary industries | 795 | 102 | 118 | 177 | 194 |
| Netherlands | 653 | 11 | 123 | 271 | 284 | Agriculture | 235 | 119 | 118 | 10 | 126 |
| Norway | 24 | – | – | 14 | 183 | Forestry | 409 | –3 | –14 | –10 | 18 |
| Federal Republic of Germany | 463 | 17 | 322 | 956 | 16 | Fisnery | 151 | –13 | 14 | 177 | 50 |
| United Kingdom | 417 | 46 | 16 | 89 | 162 | Mining and quarrying | 1 549 | 2 | 20 | 292 | 1 043 |
| Switzerland | 321 | 12 | –1 | 17 | 11 | Manufacturing | 11 639 | 591 | 703 | 3 468 | 4 265 |
| Japan | 5 009 | 325 | 512 | 225 | 920 | Construction | 333 | 42 | 24 | 3 | 25 |
| Republic of Korea | 113 | 22 | 16 | 209 | 481 | Trade, restaurants | | | | | |
| Hong Kong | 1 347 | –60 | 122 | 232 | 377 | and hotels | 380 | 19 | 143 | 319 | 207 |
| Taiwan Province of China | 123 | 17 | 8 | 923 | 190 | Transport and storage | 103 | 70 | 214 | 3 | 5 |
| Singapore | 164 | 105 | 13 | 255 | 183 | Finance and real estate | 428 | 49 | –5 | 80 | 67 |
| Australia | 193 | –7 | 21 | 357 | 157 | Services | 125 | 25 | 23 | 84 | 116 |
| Others | 5 047 | 185 | 150 | 344 | 2 789 | Others | 1 | –99 | – | – | –2 |
| Total | 15 353 | 801 | 1 240 | 4 426 | 5 920 | Total | 15 353 | 801 | 1 240 | 4 426 | 5 920 |

***Sources:*** 1) Central Bureau of Statistics, Indonesia, Monthly Statistical Bulletin.
2) Central Bureau of Statistics, Indonesia, Statistical Yearbook of Indonesia.

***Notes:*** i) Excluding the oil, insurance and banking sectors.
ii) The negative value is due to the reclassification of foreign investment as domestic investment.

manufacturing sector, including areas like electrical equipment, industrial machinery, transport equipment and chemicals. Although there were some signs of entry by the NIEs into India in 1991, in general the leading developed countries are still the dominant investors in India; of course, with inward FDI at only US$ 235 million in 1991, India receives an extremely small share of total world and regional FDI flows (table 3.7). Two factors are seen to explain this differential: first, the Government's own industrial and fiscal policy framework, which could influence the direction of FDI flows, and second, the size of the domestic market, since foreign investment within an import-substituting framework is essentially directed at that market. These features appear to influence not merely the commodity composition but also the source of FDI. That is, enhanced intraregional investment, while true as a general proposition for the developing Asian and Pacific region, does not appear to be true of countries that tend to restrict the operations of that investment and in which economic policies are still biased towards inward-oriented growth strategies.

It is, nevertheless, true that even when foreign investment enters within the framework of an import-substituting strategy, it helps diffuse skills, managerial expertise and technology, besides developing the capability for negotiating technology transfer contracts with foreign firms. The problem really lies in the fact that the extent to which a country benefits from FDI in industry within an import-substituting regime depends on the size of the domestic market. In addition, given the nexus between trade and investment, as the phase of world-market-oriented production is approached, the volume of foreign investment tends to be lower the more insular the economic regime in a country.

Interestingly, in the Indian case, in spite of recent efforts at

**Table 3.7. India: total inward foreign direct investment flows from major investing countries or areas, 1981-1991[a]**

*(Millions of US dollars)*

| Investment from | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Japan | 0.74 | 26.56 | 15.92 | 5.41 | 12.67 | 4.45 | 5.33 | 12.52 | 5.40 | 2.86 | 23.17 |
| United States | 2.60 | 5.32 | 13.76 | 7.88 | 32.28 | 23.29 | 22.77 | 69.80 | 38.22 | 19.69 | 81.71 |
| Canada | 0.07 | ... | 0.35 | 0.31 | 2.00 | 1.09 | 0.52 | 0.19 | 0.72 | 0.38 | 2.14 |
| European Community, of which | 8.06 | 12.81 | 19.35 | 6.48 | 23.46 | 34.23 | 24.38 | 64.29 | 111.67 | 23.28 | 79.25 |
| Netherlands | 0.10 | ... | 2.66 | ... | 0.32 | 5.76 | 0.78 | 0.76 | 1.42 | 2.15 | 24.59 |
| Federal Republic of Germany | 6.26 | 3.74 | 4.79 | 2.50 | 9.55 | 15.98 | 7.61 | 22.27 | 74.00 | 5.43 | 18.38 |
| United Kingdom | 0.82 | 1.75 | 9.71 | 1.60 | 3.00 | 6.12 | 6.52 | 9.99 | 20.58 | 5.18 | 14.11 |
| France | 0.72 | 2.73 | 0.79 | 1.07 | 1.90 | 1.62 | 4.13 | 8.46 | 5.20 | 5.05 | 8.50 |
| Other | 0.16 | 4.59 | 1.40 | 1.31 | 8.69 | 4.74 | 5.33 | 22.80 | 10.47 | 5.45 | 13.67 |
| Singapore | ... | ... | ... | 0.22 | 0.30 | 0.20 | 0.66 | 3.32 | 2.14 | ... | 0.60 |
| Hong Kong | ... | ... | 0.07 | 0.18 | 0.06 | 0.72 | 0.87 | 0.40 | 0.68 | 0.66 | 9.30 |
| Australia | ... | ... | 0.10 | ... | ... | 0.47 | 1.45 | 0.07 | 1.84 | 0.36 | 1.15 |
| Taiwan Province of China | ... | ... | ... | 0.02 | ... | 0.11 | 0.31 | 0.40 | ... | 0.37 | 0.20 |
| Republic of Korea | ... | 0.13 | ... | ... | ... | 0.05 | 0.11 | 0.32 | 0.21 | 4.03 | 2.71 |
| Other countries[b] | ... | 0.23 | ... | 0.37 | ... | 1.33 | 0.60 | 0.50 | 6.75 | 4.06 | 3.79 |
| TOTAL ALL COUNTRIES | 12.55 | 66.43 | 61.27 | 99.45 | 101.92 | 84.81 | 83.09 | 172.28 | 194.74 | 73.27 | 234.81 |

*Source:* (1) For the period 1981 to 1990, Government of India, Ministry of Industry, *Handbook of Industrial Statistics for 1988 and 1991.*
(2) For the year 1991, Government of India, Ministry of Industry, *Annual Report, 1991-1992.*
(3) Exchange rates have been taken from *Reserve Bank of India Bulletin,* various Issues.

*Notes:* [a] These data pertain only to approvals in a particular year. However, the actual inflow may be less as compared with these figures.
[b] (1) Bulgaria (2) Czechoslovakia (3) German Democratic Republic (4) Hungary (5) USSR.

resorting to a more liberalized trade and foreign investment environment, with substantial concessions to investors with regard to relaxation of limits to equity-holding, preferential treatment and relatively free passage for imports, the response has been rather disappointing. This suggests that factors other than the mere extent of openness of the foreign investment regime play a major role in influencing investment decisions, a fact suggested by other experiences in South Asia as well. In the context of India, infrastructural constraints, and the lack of a suitable "exit" policy in the event that a production unit becomes unviable, are major impediments to the unfettered inflows of foreign investment.

### 3. Republic of Korea

The experience of the Republic of Korea shows that involvement in trade need not always depend on FDI. Until the late 1960s, the total stock of FDI in the Republic of Korea was as low as $100 million in current prices and accounted for less than 4 per cent of the total capital inflow. The major channel of technology acquisition was through turnkey arrangements, which were also usually associated with foreign supplier credits and other forms of external borrowing. However, there are two points worth noting: first, even during the 1960s, when labour-intensive manufactures dominated the Republic of Korea's export profile, mass distributors and chain stores from the United States as well as Japanese trading companies played an important role through international subcontracting arrangements; second, starting from the late 1960s, even though foreign investment was not as dominant in total investments as elsewhere in East Asia, its role in exports from industries like the electronics sector was quite significant.

The sectoral distribution of FDI in the Republic of Korea illuminates its striking features (table 3.8). Between 1962 and 1989, out of a total of US$ 6.4 billion approved, US$ 2.2 billion (around 35 per cent) was in the service sector, with hotels accounting for almost three fourths of that investment. The other major area was, of course, manufacturing, involving investments of US$ 4.1 billion, in which chemicals and electronics dominated. The role of the Government in channelling investment to priority sectors was significant, and such deliberate controls enabled the efficient use of capital in line with government policy. Furthermore, because of the Government's role in channelling FDI, it could also ensure effective participation by domestic companies in local transnational corporation operations. By 1980, over 70 per cent of FDI was on a joint-venture basis, a large share of it relating to export-oriented production.

It is against this background that the recent trend towards the shifting of FDI to the tertiary sector has to be seen. Rapid development has induced high wage levels, a relatively stable currency and therefore declining competitiveness in traditional areas. This has resulted in a tendency for investors in the Republic of Korea to relocate certain manufacturing enterprises elsewhere in the region and the world, as well as for foreign investors to seek alternative sites for world market-oriented manufacturing production. It also explains the rise in the share of investment in the tertiary sector; however, owing to the nature of policy in the Republic of Korea, this move into the tertiary sector is not so much the result of investment in areas like finance and insurance, or for that matter the distributive trade, real estate or construction, but instead into the category "other services", dominated by hotels.

From the foregoing, it is thus clear that the progress of events in the Republic of Korea provides an excellent example of coordinated step-wise restructuring of the economy, based on a regulated use of the benefits of FDI. Restructuring in the economy was determined strategically and foreign investment merely followed the lead provided by trends in the domestic economy itself. In this effort, the country was substantially aided by access to foreign credits of substantial magnitude, in a period when international lending to the developing world was rather limited. But given the high exposure of the international financial system in most developing countries, it is unlikely that access to borrowed international liquidity of the magnitude that the Republic of Korea could ensure would be available to other developing countries for financing the transition to world market-oriented regimes. This only makes the dependence on FDI greater for the developing Asian and Pacific economies now embarking on the outward-oriented development strategy.

### 4. Singapore

The opposite example, of a largely market-determined reliance on FDI for restructuring purposes, is that of Singapore. In 1988, there was a total of 10,709 foreign affiliates in operation in Singapore, as compared with 2821 in the Republic of Korea; and in 1987 the ratio of FDI stock to gross domestic product (GDP) stood at 89.5 per cent in Singapore, as compared with just 2.3 per cent

**Table 3.8. Republic of Korea: approved inward foreign direct investment by country or area and sector**

*(Value in millions of US dollars)*

| *Country or area* | *Distribution by country or area* | | | | | *Sector* | *Allocation by sector* | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | *1962-1986* | *1987* | *1988* | *1989 (1-6)* | *1962-1989 (1-6)* | | *1962-1986* | *1987* | *1988* | *1989 (1-6)* | *1962-1989 (1-6)* |
| Japan | 1 902 | 494 | 696 | 170 | 3 263 | Agriculture and fishery | 20 | 3 | 10 | 2 | 35 |
| United States | 1 073 | 255 | 284 | 172 | 1 784 | Mining | 11 | 1 | 2 | – | 13 |
| Europe | 352 | 211 | 240 | 64 | 866 | Manufacturing | 2 321 | 779 | 738 | 306 | 4 144 |
| – Federal Republic of Germany | 64 | 42 | 74 | 13 | 193 | – Foodstuffs | 144 | 50 | 14 | 22 | 229 |
| – United Kingdom | 65 | 48 | 22 | 26 | 161 | – Textiles | 211 | 12 | 21 | 14 | 258 |
| – France | 44 | 11 | 47 | 5 | 108 | – Chemicals | 455 | 153 | 238 | 75 | 921 |
| – Netherlands | 53 | 46 | 49 | 3 | 151 | – Pharmaceutical | 96 | 34 | 43 | 8 | 180 |
| – Switzerland | 97 | 56 | 24 | 14 | 191 | – Petroleum | 90 | 55 | – | – | 145 |
| – Others | 29 | 8 | 23 | 2 | 62 | – Metals | 122 | 18 | 13 | 6 | 159 |
| Hong Kong | 131 | 46 | 14 | 22 | 213 | – Machinery | 173 | 88 | 65 | 33 | 359 |
| Others | 177 | 55 | 48 | 20 | 300 | – Electronics | 527 | 212 | 268 | 46 | 1 053 |
| | | | | | | – Transport | 338 | 120 | 43 | 92 | 592 |
| Total | 3 634 | 1 060 | 1 283 | 448 | 6 425 | – Others | 165 | 38 | 34 | 11 | 249 |
| | | | | | | Services | 1 282 | 277 | 533 | 140 | 2 233 |
| | | | | | | – Motels | 912 | 249 | 419 | 32 | 1 611 |
| | | | | | | – Finance | 171 | 16 | 90 | 39 | 316 |
| | | | | | | – Others | 200 | 12 | 24 | 70 | 306 |
| | | | | | | Total | 3 634 | 1 060 | 1 283 | 448 | 6 425 |

*Source:* Ministry of Finance, Republic of Korea.

in the Republic of Korea. This is largely explained by Singapore's open and outward-oriented economic regime that was adopted at the onset of its industrialization process. As has been argued elsewhere, unlike the Republic of Korea, whose early industrialization depended on import substitution based on a sizeable domestic market, Singapore had no such market in which to absorb entrepreneurial learning costs, and unlike Hong Kong, which received a core of entrepreneurs with interests in industrial development from mainland China during its early phase of industrialization, Singapore had no parallel pool of industrial entrepreneurs, since its traditional family-managed businesses were mainly in trading. For these and other reasons, industrialization in Singapore had to be export-oriented.

In launching its export-oriented industrialization strategy, Singapore found that it lacked the industrial experience needed either to obtain the capital, technology, and managerial and marketing expertise independently and efficiently, or to decompose a given investment requirement package. Thus, heavy dependence on transnational corporations was unavoidable.[16] FDI in manufacturing was limited in volume up to the early 1960s, but has since become increasingly important and dominant, following active government promotion. In fact, foreign investment accounted for nearly 25 per cent of its total investment in the 1980s, among the highest in the world. Initially, FDI in Singapore was concentrated in petroleum-refining and petroleum products (which accounted for more than half of such investment), followed by electrical, electronic, chemicals and chemical products, transport equipment and textile and garment industries. However, in the early 1980s the growth of foreign investment in the electronics and chemicals industries outpaced that in the petroleum-refining industry (table 3.9); other additional growth sectors during that period

16 Hafiz Mirza, *Multinationals and the Growth of the Singapore Economy*, (Beckenham, Kent, United Kingdom Croom Helm, 1986).

**Table 3.9(a). Foreign investment stock in Singapore by country or area, 1978-1988**

*(Millions of US dollars)*

| | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| United States | 633.6 | 895.6 | 1 191.6 | 1 532.1 | 1 995.9 | 2 379.4 | 2 442.7 | 2 804.3 | 3 322.1 | 4 036.1 | 4 134.0 |
| Japan | 344.8 | 493.5 | 663.5 | 811.1 | 982.7 | 1 066.1 | 1 371.7 | 1 482.3 | 1 732.2 | 2 246.2 | 3 302.5 |
| United Kingdom | 1 100.5 | 1 325.3 | 1 603.2 | 2 116.6 | 2 289.4 | 2 145.7 | 2 143.6 | 1 984.0 | 2 108.2 | 2 324.0 | 2 719.7 |
| Australia | 121.8 | 157.1 | 188.6 | 194.7 | 173.5 | 226.2 | 273.9 | 269.9 | 507.6 | 763.2 | 1 662.8 |
| ASEAN | 467.0 | 537.8 | 635.6 | 967.9 | 1 255.9 | 1 540.1 | 1 665.8 | 1 438.8 | 1 313.1 | 1 292.2 | 1 644.9 |
| Hong Kong | 441.1 | 523.1 | 797.2 | 1 035.4 | 1 237.0 | 1 293.0 | 1 303.5 | 1 069.4 | 974.5 | 1 251.8 | 1 434.2 |
| Federal Republic of Germany | 78.2 | 136.1 | 196.9 | 195.5 | 213.4 | 220.2 | 240.4 | 256.9 | 328.7 | 362.3 | 423.2 |
| Taiwan Province of China | 15.6 | 16.2 | 28.8 | 26.5 | 27.5 | 36.7 | 38.7 | 37.3 | 38.5 | 57.3 | 80.2 |
| Total | 3 662.6 | 4 663.1 | 6 072.5 | 7 895.8 | 9 511.8 | 10 468.2 | 11 626.8 | 11 591.1 | 13 127.6 | 16 400.9 | 20 511.2 |

**Table 3.9(b). Sectoral distribution of foreign investment stock in Singapore, 1978-1988**

*(Percentage)*

| | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Agriculture, fishing | 0.1 | 0.1 | 0.1 | 0.4 | 0.3 | 0.4 | 0.3 | 0.3 | 0.1 | 0.1 | 0.1 |
| Mining, quarrying | 0.1 | 0.1 | 0.1 | 0.1 | 0.0 | –0.0 | –0.1 | –0.2 | –0.2 | –0.1 | –0.1 |
| Manufacturing | 54.8 | 56.0 | 52.9 | 48.2 | 44.2 | 47.0 | 46.0 | 46.7 | 46.0 | 46.0 | 43.0 |
| Construction | 1.4 | 1.1 | 1.3 | 1.3 | 1.0 | 0.2 | 0.6 | 1.0 | 1.1 | 0.6 | 0.9 |
| Trade | 15.5 | 15.4 | 16.8 | 16.2 | 17.0 | 16.9 | 15.2 | 13.8 | 12.2 | 11.1 | 11.1 |
| Transport, storage | 2.8 | 3.5 | 3.4 | 3.3 | 2.9 | 2.2 | 1.5 | 0.4 | 0.7 | 1.5 | 2.1 |
| Financial, business services | 24.8 | 23.4 | 25.0 | 30.2 | 34.3 | 32.6 | 35.8 | 37.3 | 39.4 | 40.2 | 42.4 |
| Social, personal services | 0.5 | 0.4 | 0.3 | 0.4 | 0.3 | 0.7 | 0.6 | 0.7 | 0.7 | 0.6 | 0.5 |

*Source:* Calculated from the Singapore Ministry of Trade and Industry and Economic Development Bord data.

were machinery and transport equipment. Matters have changed further since then and, as in the Republic of Korea, there is increasing evidence of foreign investment being directed to the tertiary sector, particularly financial services, indicating that as a result of autonomous developments and conscious policy, Singapore is emerging as a major financial centre in the region. At present, about 43 per cent of the foreign investment stock in Singapore is in manufacturing and an almost equal amount in financial and business services.

Interestingly, these changes in the sectoral pattern of investment in Singapore over the 1980s have been accompanied by significant changes in the sources of foreign investment. The United States has the largest stock of foreign investment in Singapore (about 20 per cent of the total). Japan is a relative latecomer, but increased its share of Singapore's total FDI from about 10 per cent in the late 1970s and early 1980s to about 16 per cent in 1988. Investors from Hong Kong and from the other ASEAN economies account for 7 and 8 per cent respectively. Traditionally, Malaysia was the second largest investor in Singapore after the United Kingdom of Great Britain and Northern Ireland, but its share, along with that of the United Kingdom, has dropped with the large increases in flows from the United States and Japan in recent years. What these changes indicate is that as some sources either cut back on foreign investment (like the United Kingdom) or move to other locations (like the United States and Hong Kong), Singapore has been able to attract new investment from other countries, and thus keep total investment rising continuously over the years. That is, the emergence of competing locations has been dealt with through a combination of changing sectoral patterns and sources of investment.

Thus, over the years, the Republic of Korea and Singapore have both effected significant structural changes, with positive growth and balance-of-payments implications, but this has been achieved by following quite different routes. In both cases, however, the flexibility needed to restructure continually so as to keep pace with the changing nature of the international markets on which they were dependent made foreign investment crucial to the restructuring process. Singapore, in fact, continues to attract large inflows despite its relatively high wage costs and cost of living, owing to its reputation for having a highly productive workforce, minimal regulations, good infrastructure, well-developed capital and financial markets and socio-political stability. However, owing to the small size of its population and its strategic location, much of the output of foreign firms is aimed at export production as investors in Singapore tend to take a more regional view, looking at Singapore as a base for sales in the other countries of Asia and the Pacific rather than as a market in itself.

## 5. Hong Kong

In Hong Kong, despite the considerable sense uncertainty stemming from the change in sovereignty in 1997, foreign investment has continued to increase over time, with investment in the manufacturing industries (for which data are available) increasing from $HK 11,830 million at the end of 1985 to $HK 30,933 million at the end of 1990. Industries which very visibly dominate the profile of such investment are electronics and electrical products, followed by textiles and garments, chemical products and printing and publishing (table 3.10). In fact, a recent survey,[17] which identified 545 companies in Hong Kong and included investments from overseas in 1990, found that nearly half these companies (48 per cent), were involved in either the textile and clothing sector or the electronics/electrical industries. Other significant sectors were watches and clocks and chemical products. That is, labour-intensive investments aimed at an export market have constituted the main thrust of foreign investors.

With regard to the source of FDI, Japan was the largest investor, with 32 per cent of total investment, followed closely by the United States, with 31 per cent. China and the United Kingdom ranked third and fourth, accounting for 11 and 7 per cent respectively. Of the sales of $HK 73,192 million reported, 62 per cent was for the export markets and 38 per cent for the domestic market; in fact, exports of these companies accounted for about one fifth of Hong Kong's exports in 1990. The United States was the major overseas market, absorbing 21 per cent of total sales, with Japan (7 per cent), the then Federal Republic of Germany (5 per cent), China (5 per cent) and Taiwan Province of China (4 per cent) being the other important markets. What is interesting to note is that firms in the electronics, electrical and clothing industries exported the bulk of their products (84-91 per cent), whereas the output of companies in the food and beverages, printing and publishing, textiles, chemical products and watches and clock industries was

17 Government of Hong Kong, Industry Department, *1991 Survey of Overseas Investment in Hong Kong's Manufacturing Industries,* November 1991.

**Table 3.10. Hong Kong: foreign direct investment in manufacturing industries, by country and industry[a]**

*(Value in millions of Hong Kong dollars)*

| *Country or area* | *Distribution by country or area* | | | | | *Industry* | *Allocation by industry* | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | *1985* | *1986* | *1987* | *1988* | *1989* | | *1985* | *1986* | *1987* | *1988* | *1989* |
| United States | 6 314 | 8 053 | 7 695 | 8 907 | 9 290 | Electronics | 4 273 | 7 853 | 8 516 | 9 532 | 8 637 |
| Japan | 2 496 | 4 009 | 5 609 | 6 965 | 8 642 | Textiles & Garments | 1 205 | 1 437 | 2 031 | 2 741 | 2 789 |
| China | n.a. | 2 981 | 1 739 | 2 935 | 3 178 | Electrical Products | 913 | 1 084 | 1 814 | 2 336 | 3 446 |
| United Kingdom | 796 | 1 082 | 1 490 | 2 357 | 2 200 | Chemical Products | 804 | 1 355 | 1 624 | 2 189 | 2 316 |
| Australia | 191 | 263 | 261 | 831 | 1 020 | Printing & Publishing | 678 | 750 | 1 276 | 1 537 | 2 280 |
| Netherlands | 381 | 719 | 841 | 682 | 1 221 | Food & Beverage | 832 | 917 | 1 050 | 1 170 | 1 431 |
| Federal Republic of Germany | 124 | 237 | 398 | 535 | 583 | Watches & Clocks | 604 | 1 233 | 1 094 | 1 115 | 1 490 |
| Switzerland | 298 | 338 | 488 | 373 | 552 | Tobacco | n.a. | 652 | 700 | 910 | 1 052 |
| Singapore | 253 | 264 | 266 | 360 | 489 | Metal Products | 555 | 772 | 692 | 750 | 1 417 |
| Philippines | 303 | 342 | 356 | 355 | 439 | Toys | 112 | 279 | 208 | 478 | 484 |
| Others | 674 | 1 266 | 1 979 | 1 872 | 2 120 | Non-metallic Products | 873 | 1 962 | 212 | 436 | 405 |
| | | | | | | Others | 981 | 1 260 | 1 905 | 2 978 | 3 987 |
| Total | 11 830 | 19 554 | 21 122 | 26 172 | 29 734 | Total | 11 830 | 19 554 | 21 122 | 26 172 | 29 734 |

***Source:*** Industry Department, Government of Hong Kong.

***Note:*** Foreign investment is here defined as fixed assets at cost before depreciation plus working capital.

[a] Cumulative as at December 31.

oriented to the local market (61-85 per cent). Clearly, then, the basis of Hong Kong's success in attracting FDI lies in its relative advantage as a location for the labour-intensive phases of electronic goods and garment production geared to export markets.

### 6. Taiwan Province of China

The experience of Taiwan Province of China has many similarities with that of Hong Kong. In 1989, cumulative FDI in Taiwan Province of China amounted to $9,390 million (as compared with $6,500 million in the Republic of Korea). Around 80 per cent of cumulative approved investments between 1982 and 1986 came from the developed industrial countries; this ratio has since increased to about 90 per cent. The balance of the investments was mainly from overseas Chinese from different locations (table 3.11). The two industries accounting for the dominant part of this investment (40 per cent or more) were electronic and electrical products, and chemicals; however, there are a number of emerging trends worth noting. First, with Taiwan Province of China becoming a "capital-surplus economy", relative to its endowments of other resources the rate of growth of inward FDI has been slowing in recent years, and in fact Taiwan Province of China has lately become a net exporter of investment funds. Second, with the emergence of alternative centres for investment by overseas Chinese, their share in FDI in Taiwan Province of China has decreased while that of Japan and Europe has increased significantly. Third, this shift has been accompanied by a sharp decline in the relative importance of electronics and electrical goods and a significant increase in the share of chemicals, reflecting perhaps a shift to technology-intensive goods in line with shifting comparative advantage. Fourth, in the wake of the shift, Taiwan Province of China has been liberalizing its financial sector so that the share of FDI in banking and insurance increased from 1.1 per cent of total FDI in 1987 to 13 per cent in 1990. The trading sector has also seen a significant increase in its share of FDI, which rose from 2.9 to 14.6 per cent over these years. That is, like Singapore and the Republic of Korea, as alternative competitive locations for investment in the manufacturing sector emerge, the role of the financial sector in foreign investment tends to increase.

### 7. Malaysia

A typical example of an "alternative location" in the developing Asian and Pacific region for FDI in the manufacturing industry is Malaysia, where approvals of foreign investment rose sharply, from less than US$ 0.4 billion in 1985 to around US$ 1.8 billion in 1988 and to US$ 3.2 billion in 1989. In 1990, FDI inflows more than doubled over the 1989 level, to exceed US$ 6.5 billion (table 3.12). The three major investors in Malaysia are Taiwan Province of China, Japan and Singapore, which accounted for approximately 27, 26 and 8 per cent, respectively, of cumulative investments approved between 1985 and 1990. As regards the main areas of investment approvals, apart from mineral-based industries such as petroleum and base metals, FDI has flowed into electronics (26 per cent), which is a conventional labour-intensive investment area, and wood and wood products (12 per cent), which reflects the exploitation of a natural resource for export purposes.[18]

Malaysia emerged as a site for export-oriented foreign investment by offering an alternative location for labour-intensive exports as well as the benefit of a well-endowed natural resource base, which is usually hard to come by. Malaysia's example also reflects the increasing trend towards regional sourcing and networks in automotive parts and electronic components, although FDI in electronics in the country consists largely of final assembly with the bulk of the production being exported. Moreover, given its resource-rich economy, it is all but inevitable that FDI in metal products, chemicals and petroleum has also assumed importance.

### 8. China

China is following a similar trajectory of providing an alternative, and commercially more attractive, location. The Government has also played a very active and catalytic role in attracting FDI inflows through incentives, the streamlining of procedures and ensuring ready availability of the required infrastructural support. A two-pronged approach has been adopted in recent years, in which trade and foreign exchange controls have been relaxed and a policy conducive to FDI implemented. In giving effect to this strategy, China is benefiting from the rise in wage costs in the more developed NIEs and the need to relocate certain elements of the production process in low-cost sites elsewhere, a process that is enunciated in the "flying geese" hypothesis. Not only has this meant that China has to be

18 Linda Y.C. Lim and P.E. Fong, *Foreign Direct Investment and Industrialization in Malaysia, Singapore, Taiwan and Thailand* (Paris, Organisation for Economic Cooperation and Development, 1991).

**Table 3.11. Taiwan Province of China: approved foreign direct investment, by country or area and industry**

*(Value in millions of US dollars)*

| *Country or area* | *Distribution by country or area* | | | | | *Industry* | *Allocation by industry* | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | *1982-1986* | *1987* | *1988* | *1989* | *1990 (1-6)* | | *1982-1986* | *1987* | *1988* | *1989* | *1989 (1-6)* | *1990 (1-6)* |
| Overseas Chinese: | | | | | | Food and beverage | 146 | 77 | 57 | 219 | 148 | 66 |
| Hong Kong | 341 | 101 | 42 | 72 | 28 | Electronic and electronic products | 1 753 | 377 | 237 | 391 | 216 | 139 |
| Japan | 54 | 33 | 13 | 27 | 1 | Textiles | 173 | 21 | 30 | 58 | 42 | 6 |
| Philippines | 170 | 9 | 13 | 16 | 42 | Paper and paper products | 31 | 10 | 13 | 33 | 14 | 2 |
| United States | 221 | 32 | 26 | 38 | 27 | Chemicals | 1 085 | 247 | 162 | 604 | 266 | 358 |
| Others | 453 | 21 | 27 | 25 | 14 | Non-metallic mineral products | 371 | 48 | 35 | 33 | 15 | 26 |
| Subtotal | 1 240 | 196 | 121 | 177 | 112 | Basic metals and metal products | 396 | 121 | 68 | 176 | 54 | 71 |
| | | | | | | Machinery, equipment and instruments | 613 | 76 | 137 | 103 | 14 | 56 |
| Foreigners: | | | | | | Transportation | 106 | 43 | 64 | 65 | 24 | 25 |
| United States | 1 855 | 414 | 135 | 343 | 321 | Construction | 106 | 4 | 11 | 17 | 4 | 8 |
| Japan | 1 384 | 399 | 432 | 641 | 390 | Banking and insurance | 313 | 15 | 52 | 150 | 77 | 160 |
| Europe | 721 | 224 | 205 | 531 | 226 | Services | 641 | 311 | 177 | 312 | 123 | 98 |
| Others | 731 | 186 | 290 | 726 | 186 | Trade | 29 | 41 | 110 | 222 | 68 | 180 |
| Subtotal | 4 691 | 1 223 | 1 061 | 2 241 | 1 122 | Others | 169 | 28 | 30 | 35 | 10 | 39 |
| Total | 5 931 | 1 419 | 1 182 | 2 418 | 1 234 | Total | 5 930 | 1 419 | 1 183 | 2 418 | 1 135 | 1 234 |

*Sources:* 1) Domestic and Foreign Express Report of Economic Statistics Indicators.
2) Investment Commission, Ministry of Economic Affairs, Taiwan Province of China.

**Table 3.12. Inflow of foreign investment in approved Malaysian projects by country or area, 1980-1990**

*(Millions of US dollars)*

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 |
|---|---|---|---|---|---|---|
| Taiwan Province of China | 12.8 | 4.2 | 96.4 | 316.8 | 797.4 | 2 343.7 |
| Japan | 106.5 | 45.1 | 283.8 | 466.6 | 993.2 | 1 557.4 |
| Indonesia | 5.2 | ... | 0.6 | 8.9 | 38.9 | 400.5 |
| Singapore | 40.3 | 71.2 | 102.6 | 160.2 | 337.7 | 331.0 |
| United Kingdom | 10.8 | 19.2 | 30.5 | 75.0 | 282.1 | 320.6 |
| Republic of Korea | 10.1 | 1.5 | 1.4 | 16.0 | 69.8 | 240.5 |
| United States | 45.1 | 20.7 | 64.6 | 204.4 | 118.4 | 209.7 |
| Sweden | 7.0 | 0.5 | 1.0 | 0.5 | n.a. | 178.0 |
| Hong Kong | 11.4 | 21.7 | 35.3 | 113.9 | 130.0 | 138.6 |
| India | 480.9 | 16.3 | 31.7 | 34.0 | 276.9 | 82.0 |
| Federal Republic of Germany | 3.2 | 809.4 | 11.3 | 44.6 | 114.3 | 46.9 |
| Total | 386.3 | 653.9 | 817.6 | 1 851.2 | 3 194.3 | 6 521.3 |

***Source:*** Malaysian Industrial Development Authority.

export-oriented in nature but also that the FDI needed to help it in the restructuring process can come from the NIEs themselves. A typical instance of this is Hong Kong's investment in China. Thus, while Hong Kong received $HK 2,674 million of foreign investment inflows in 1989, approvals of outward investment from Hong Kong in that year amounted to US$ 4,588. While inward investment to Hong Kong came almost entirely from the United States, Japan and Europe, 69 per cent of Hong Kong's outward investment was directed at China. Furthermore, of the total of $10.8 billion of investment "implemented" in China between 1986 and 1989, 65 per cent originated in Hong Kong (table 3.13).

The recent experience in China has, in fact, shown that successful export promotion of manufactured products with the help of FDI is certainly possible, even for a country with a large domestic market. A recent study in the special economic zone of Shenzhen in southern China,[19] for example, reveals that most foreign-invested companies in the manufacturing subsector located in the zone were export-oriented, and that foreign firms had a higher export propensity as compared with domestic firms. Although the great majority of projects in Shenzhen were promoted by investors from Hong Kong, units with FDI from countries such as the United States and Japan were also engaged in exporting. Low labour costs in China, the availability of land and raw materials and the use of export quotas (as in the case of textiles and garments) were among the important factors inducing foreign firms to set up their investment in the zone. Thus, the relevance of shifting comparative advantage in inducing FDI to China is a rather visible outcome. Investors from Hong Kong, in addition, had advantages over others in terms of cultural and linguistic affinities, as well as geographical proximity and familiarity with the Chinese ways of doing business. Nevertheless, the ability of China in the coming years to sustain high FDI inflows and also spread the destination would be the real test of the "flying geese" pattern of development and, as such, will be viewed with considerable interest.

[19] Liu Dongyi, *An Analysis of Foreign Direct Investment in China's Special Economic Zone: A case study of Shenzhen*, M.A., Economics thesis, Thammasat University, Bangkok, May 1991.

### 9. Thailand

Foreign investment into Thailand increased from approximately 3.9 billion baht in 1980 to 64.7 billion baht in 1990, but the total fell to 51.4 billion baht in 1991. It reflected a decline of about 20 per cent, which was mainly due to a fall in the net surplus of equity investment and loans from Japanese affiliates. As shown in table 3.14(a), total Japanese FDI fell from 27.8 billion baht in 1990 to 15.6 billion baht in 1991, lowering the Japanese share to an amount from 45 to 31 per cent of the total net direct investment. Investment from Taiwan Province of China also declined sharply, from 7.2 billion baht in 1990 to 2.7 billion baht in 1991. Other significant investors in Thailand are Singapore and Hong Kong, whose absolute net investments actually increased in

**Table 3.13. China: foreign direct investment by country or area and industry**

*(Millions of US dollars)*

| *Country or area* | *Distribution by country or area* | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | *Contract basis* | | | | *Implementation* | | | |
| | *1986* | *1987* | *1988* | *1989* | *1986* | *1987* | *1988* | *1989* |
| Hong Kong | 1 449 | 1 947 | 3 467 | 3 160 | 1 329 | 1 598 | 2 067 | 2 036 |
| United States | 527 | 342 | 370 | 641 | 326 | 263 | 236 | 281 |
| Japan | 210 | 301 | 276 | 439 | 263 | 220 | 515 | 358 |
| Singapore | 137 | 70 | 137 | 111 | 13 | 22 | 28 | 84 |
| Canada | 88 | 26 | 40 | ... | – | 10 | 6 | ... |
| Italy | 56 | 6 | 11 | ... | 23 | 16 | 31 | ... |
| Federal Republic of Germany | 43 | 133 | 47 | 149 | 19 | 3 | 15 | 81 |
| United Kingdom | 43 | 25 | 42 | ... | 27 | 5 | 34 | ... |
| France | 5 | 64 | 23 | ... | 42 | 16 | 23 | ... |
| Others | 14 | 648 | 1 037 | 1 101 | 30 | 136 | 136 | 551** |
| Total | 2 834 | 3 709 | 5 297 | 5 600 | 1 875 | 2 314 | 3 194 | 3 393 |

| *Industry* | *Allocation by industry* | | | |
|---|---|---|---|---|
| | *1985* | *1986* | *1987* | *1988* |
| Agriculture | 13 | 62 | 125 | 209 |
| Industry | 2 384 | 785 | 1 776 | 4 021 |
| Building | 133 | 53 | 55 | 119 |
| Communications | 106 | 33 | 16 | 91 |
| Commerce | 527 | 100 | 29 | 64 |
| Public utilities | 2 271 | 1 617 | 1 471 | 530 |
| Social services | 52 | 16 | 12 | 5 |
| Culture | 4 | 41 | 14 | 44 |
| Science | 7 | – | 1 | 7 |
| Finance | 63 | ... | ... | 12 |
| Geology | 362 | ... | ... | 2 |
| Others | 411 | 127 | 210 | 192 |
| Total | 6 333 | 2 834 | 3 709 | 5 297 |

*Sources:* State Statistical Bureau of the People's Republic of China, *China Statistical Yearbook.* China Resources Advertising Co. Ltd. *Almanac of China's Foreign Economic Relations and Trade.*

*Notes:* * Investment from Macau is included in 1986 and 1987.
** Including foreign investment from Canada, France, Italy and the United Kingdom.

**Table 3.14(a). Net inflow of foreign direct investment in Thailand by home country or area[a]**

*(Millions of baht)*

| | 1980 | 1987 | 1988 | 1989 | 1990 | 1991 |
|---|---|---|---|---|---|---|
| Japan | 903 | 3 269 | 14 608 | 18 762 | 27 821 | 15 593 |
| Hong Kong | 1 114 | 796 | 2 795 | 5 716 | 75 508 | 11 566 |
| Singapore | 277 | (535)[b] | 1 572 | 2 748 | 5 909 | 6 469 |
| United States of America | 732 | 1 816 | 3 185 | 5 220 | 5 844 | 5 919 |
| Taiwan Province of China | 2 | 687 | 3 136 | 5 062 | 7 156 | 2 754 |
| Other countries or areas | 850 | 1 941 | 2 668 | 8 190 | 10 457 | 9 088 |
| Total | 3 878 | 9 044 | 27 964 | 45 698 | 64 695 | 51 389 |

[a] Including loans from affiliates which are classified as direct investment.
[b] Net outflow.

1991 relative to 1990. The three NIEs, therefore, now account for over one third of total FDI inflows to Thailand. Concerning the sectoral distribution of foreign investment, the fact that in the 1980s Thailand had emerged as a major alternative site for manufacturing FDI is reflected by the allocation of almost 50 per cent of FDI in 1987-1990 to the industrial sector, especially electrical appliances. This was followed by trade (17 per cent) and services (16 per cent, of which real estate and the hotel industry together absorbed about 12 per cent) (table 3.14(b)).

Though the evidence for a single year is no basis for judgement, a point to bear in mind is that with Thailand's gradually growing infrastructural constraints and rising wage rates, foreign investors in search of lucrative sites for manufacturing investment are also weighing the possibilities of shifting their attention to other countries in the region, especially China and Viet Nam, as part of the regionwide relocation process. If this assessment proves true on a medium-term basis, then the tenuousness of the special form that the "flying geese" trajectory is taking would give substantial cause for concern regarding the specific way in which the trade-investment nexus is operating. However, if the presence of trade-related FDI has helped develop indigenous capabilities that can now sustain Thailand's remarkable growth in manufacturing output and exports, then the "flying geese" trajectory would prove doubly positive.

**Table 3.14(b). Sectoral distribution of net flows of foreign direct investment in Thailand**

*(Percentage)*

| | *1980-1982* | *1983-1986* | *1987-1990* |
|---|---|---|---|
| Financial institutions | 0.14 | 1.45 | 6.68 |
| Trade | 13.19 | 22.10 | 16.91 |
| Construction | 19.12 | 15.84 | 7.17 |
| Mining and quarrying | 20.83 | 17.10 | 1.64 |
| 4.1 Oil exploration | 18.49 | 15.13 | 1.43 |
| 4.2 Others | 2.35 | 1.97 | 0.21 |
| Agriculture | 1.59 | 1.35 | 1.35 |
| Industry | 32.61 | 31.54 | 49.47 |
| 6.1 Food | (0.06)[a] | 3.44 | 3.72 |
| 6.2 Textiles | 2.65 | 2.09 | 3.14 |
| 6.3 Metal based and non-metallic | 2.19 | 3.26 | 5.56 |
| 6.4 Electrical appliances | 11.89 | 6.72 | 18.69 |
| 6.5 Machinery and transport equipment | 3.07 | 1.91 | 2.97 |
| 6.6 Chemicals | 3.40 | 5.50 | 7.52 |
| 6.7 Petroleum products | 7.66 | 3.23 | 0.32 |
| 6.8 Construction materials | 0.16 | 0.23 | 0.09 |
| 6.9 Others | 1.66 | 3.89 | 7.45 |
| Services | 12.51 | 10.62 | 16.08 |
| 7.1 Transportation and travel | 5.55 | 2.87 | 1.51 |
| 7.2 Housing and real estate | 1.10 | 1.84 | 7.61 |
| 7.3 Hotel and restaurant | 2.17 | 1.54 | 4.68 |
| 7.4 Others | 3.69 | 4.37 | 2.27 |
| Other | 0.00 | 0.00 | 0.70 |
| Total | 100.00 | 100.00 | 100.00 |

*Source:* Bank of Thailand.

*Note:* [a] Net outflow.

## 10. Summing-up of country experiences

What emerges from this diverse range of individual, but related developing country experiences in the Asian and Pacific region is the fact that foreign investment is not so much the leader of the industrial restructuring process but instead plays a catalytic, but critical, role and facilitates the restructuring that domestic policies seek to encourage. Such policies can lie within the extremes of strategic coordination by the State, as in the Republic of Korea, on the one hand, or in the relatively free play of market forces and government incentives, as in the case of Singapore initially, and many of the NIEs subsequently, on the other. The fact that China is restricting its utilization of foreign investment and export-oriented restructuring essentially to the special economic zones suggests that, thus far, it has successfully kept to a middle path.

The country experiences, however, also suggest that although in general all the developing countries of Asia and the Pacific have, at some stage, adopted (or at least professed to have adopted) outward-orientation growth strategies, in each country the process has been shaped to suit the individual country's specific requirements and endowments. No two cases have been identical, but based on the above review, traits of both unity and diversity can be distinguished in the applicability of the trade-investment nexus as part of a virtuous circle of growth and development.

The real problem lies in the region's developing countries which, having opted for market mechanisms as a means of attracting foreign investment, find themselves an unattractive site for foreign investment. While they have to secure the means to finance the increase in imports that follows a process of trade liberalization, they are unable to obtain the benefit of exports that flow from the trade-investment nexus. A typical example of that scenario is India in recent times, which has been faced with an increase in balance-of-payments vulnerability in the wake of policy reform for the restructuring of the economy. In the following chapter some of the factors that could explain such experiences are examined.

# IV. CONSTRAINTS ON INTRAREGIONAL TRADE AND INVESTMENT EXPANSION

The uneven spread of the incidence and the beneficial effects of the trade-investment nexus in the Asian and Pacific region that has emerged from the analysis in the previous chapters suggests that there are constraints to the exploitation of this nexus in several developing countries of the region. This chapter accordingly seeks to explain why the spread of the trade-investment nexus has not been greater than it actually has and the factors that could, at least in part, account for the instances of failure to exploit this interlinkage. It also seeks to explain situations where not only has the virtuous circle proved elusive but the effort at approximating it has led to severe balance-of-payments difficulties.

In general, the evidence on the operation of the trade-investment nexus in the Asian and Pacific region indicates that foreign investment has played an important role in the growth and diversification of exports of the region's more dynamic developing economies. Although foreign affiliates usually assisted in promoting the growth of exports from the host country, it should be recognized that factors other than foreign direct investment (FDI) inflows are also important determinants of the likely outcome of efforts at export expansion.

First, the way in which the investment is financed seems to affect the extent of the trade orientation of affiliates. One study found that the extent of foreign equity participation in manufacturing is positively related to export performance,[1] and that there was a positive correlation between local equity participation and domestic input sourcing, especially for inputs of raw materials. However, a study of Japanese investment in Indonesia which examined the factors contributing to large imports by affiliates found a negative correlation between the degree of in-kind financing (which means affiliate imports from the parent firm) and loan-equity ratios.[2] In other words, higher affiliate imports are linked to higher equity shares. It was explained that this finding in Indonesia's case was primarily due to policy variables obligating foreign firms to transfer their equity to local shareholders within a short period of time.

Second, the nature of the industry also affects the trade orientation of a firm. Investment in export-oriented industries will of course, correlate to high exports/sales ratios. In addition, it has been observed that in the case of export-oriented projects, like resource-extractive projects, it is more likely that inputs would be imported from the investing country. The critical input – cheap labour or raw material supplies – is from the host country, but other inputs are often imported from the investing country. Surveys of foreign affiliates have also pointed to poorer quality or unreliability of local supplies as major reasons for such imports.[3]

At the other extreme, high tariff barriers are likely to induce tariff-jumping on the part of multinational companies, with production geared to the protected domestic market. This type of investment may therefore not only have the negative welfare effects as suggested by the literature on immiserization but also have an adverse trade balance effect. Host country exports are unlikely to be stimulated since production is geared to the home market, but investing country exports may expand in complementary products.

The recent evidence and experience of the newly industrializing economies (NIEs) and the ASEAN-4 (Indonesia, Malaysia, the Philippines and Thailand) suggest that the benefits of FDI outweight both the real and perceived costs. Although there is no simple explanation of what policies attract FDI, the indicators generally point to the paramount importance of the policy environment of the host country and, in particular, to macroeconomic and exchange rate stability. Macroeconomic policies determine saving rates, and affect the capital

1 C.Y. Ng, R. Hirono and Narongchai Akrasanee, eds., *Industrial Restructuring in ASEAN and Japan: An Overview* (Singapore, Institute of Southeast Asian Studies, 1987).

2 R.J. Langhammer, "Financing of foreign direct investment and trade flows: the case of Indonesia", *Bulletin of Indonesian Economic Studies*, vol. 24, No. 1 (April 1988).

3 G.L. Reuber, *Private Foreign Investment in Development* (Oxford, Clarendon Press, 1973).

and foreign exchange availability in the host country, wage rates, and the overall economic environment. As will be seen later, these are the most important factors in determining whether or not foreign investment will take place in the country in question and will also have a role in determining the kinds of investment that are attracted.

There are two aspects to which host country policy towards FDI must accord attention in the context of stimulating the trade-investment nexus: one is inducing higher volumes of investment inflows, and the second is ensuring greater trade orientation of that inflow. The two are, however, interlinked as stipulations on contribution to exchange earnings may have an impact on the volume of FDI itself. With regard to the contribution of FDI to the export effort of the host country, performance requirements tend to limit the repatriation of profit and determine the allowable equity shareholdings of foreign affiliates. In conjunction with the availability of capital in the host country, these policies determine the loan-to-equity ratios of foreign investment. Policies regulating FDI inflows, especially those that may require transfer of equity to domestic concerns within a given period, also affect the amount of the investment that is financed in kind. Similarly, policies selecting preferred industries (or industrial targeting) and the degree of protection provided to that industry will have an effect on trade orientation by the very nature of the industry; but such directives may again have an impact on the quantum of FDI.

Furthermore, the importance of policies reflecting technology transfer and the availability of adequate infrastructural support (transport and communications facilities) cannot be overlooked, especially in the context of FDI through transnational corporations for developing specific industries with the objective of entering the world market. For that purpose, adequate domestic financing and external official resources would consequently have to be mobilized to help support the expansion of complementary infrastructure and social services that are essential to achieving increasingly higher levels of FDI.

Thus, in essence, constraints on the operation of the trade-investment nexus may be grouped, from the viewpoint of applicability to corrective policy, as being either endogenous or exogenous to the prevailing economic regime and circumstances in the host country. The endogenous obstacles stem mainly from three sources: the macroeconomic environment, the foreign investment regulatory regime and inadequate infrastructural support, which are within the purview of domestic policy. The exogenous obstructions, which are imposed by other countries and therefore beyond the scope of direct host country intervention, are mainly in the form of non-tariff barriers (NTBs), product standardization requirements imposed by importing countries and specific geopolitical peculiarities. While section A below relates to the endogenous factors, including the likely implications of TRIMs (trade-related investment measures) on developing countries as a group, section B reviews the impact of NTBs and standardization issues on intraregional trade and trade-linked investment prospects in the Asian and Pacific region.

## A. ENDOGENOUS CONSTRAINTS

### 1. Macroeconomic environment

It is clear from the experience of the NIEs and some of the ASEAN-4 countries that correct domestic policies are essential to the successful operation of the trade-investment nexus as the modality of implementing an export-led growth strategy. In this context, perhaps the most important factor influencing foreign investors has been the increasing emphasis on liberal, outward-oriented regimes in the ASEAN economies. Many countries in the region have moved to liberalize trade by reducing overall tariff rates and the dispersion of protection across industries, and this has contributed significantly to the establishment of strong export-competitiveness in comparative advantage industries. The NIEs and the ASEAN-4 countries were thus able to improve resource allocation and compete strongly in world markets, and FDI, which imparts essential intangible assets, was an important catalyst in the dynamism of the export sectors of their economies.

It is a commonly held view that central to host country approaches to attracting FDI on a sustained basis is the nature of the macro-policy environment within which foreign-affiliated firms are expected to operate. The familiar underlying theme is that the more successful and dynamic developing countries of the Asian and Pacific region have moved away from active support for an import-substituting approach to industrialization towards greater involvement in establishing export-generating industries based on the realization of a genuine local comparative advantage, which, in turn, stimulated the integration of the economy in the new evolving regionwide cross-border division of labour. Thus, trade orientation is understandably low in economies which promote import substitution to the extent that exports are penalized, either directly or indirectly. On the other hand, open economies have tended, *ceteris paribus*, to attract trade-oriented FDI.

While the synthesis of the experience of the region's major developing economies has focused on the strong influence of the stability and thrust of economic policies followed in the concerned country, it is also true that investment inflows are dependent on policies affecting related sectors. The strong desire to industrialize among the NIEs and the ASEAN-4 has led many of these countries to adopt relatively liberal policies towards FDI in manufacturing, as a result of which foreign firms have established affiliates when they have found it advantageous to do so. In contrast, the policy regime for FDI in services has been generally restrictive, and therefore FDI in services has also been limited. Again, in industries such as steel, where indigenous enterprise has also been promoted alongside foreign investment, FDI has remained limited despite the prevalence of scale economies.

At the same time, the emphasis on self-reliance in some of the Asian developing economies has resulted in policies that have restrained large inflows of FDI. This is particularly true of South Asia, China until the mid-1980s and Indo-China until recent times. Even in the Republic of Korea, a country with a relatively open trade regime since the 1970s, FDI inflows picked up only in the 1980s with the liberalization of industrialization and foreign investment policies. Similarly, the removal of restrictions on outward FDI was responsible for the increase in FDI from Japan in the 1970s and from Taiwan Province of China since 1987. In fact, to obtain the maximum benefits from FDI, the host country must implement policies to maximize the linkage effects created by foreign firms: this is to ensure full integration of local firms into the foreign investment sector in the course of time so as to prevent the formation of a foreign enclave leading to an increasing degree of external dependency. In countries where the public sector has a significant presence in production, effective policies for privatization will also be necessary (see box IV.1).

The importance of an appropriate and stable macroeconomic policy framework that ensures, at the margin, equal profitability of the traded and the non-traded goods sectors is also critical when viewed in terms of its efficacy in effecting economy-wide production efficiency which, in turn, induces internationally competitive production in at least some selected lines of output. This is evidenced by the fact that FDI flows to the region have concentrated in developing countries that possess either a large and growing internal market or substantive productive resources, or have geographical proximity to major developed country markets, but only when the prevailing host country policies and regulations favoured liberal flows of trade and investment. While freer imports induced competitive production, in several instances FDI was tied to export performance, so that the juxtapositioning of appropriate industrial, trade and investment policies with an efficient economic policy package was a significant factor in explaining the successful operation of the trade-investment nexus.

The macroeconomic environment also relates to the range of domestic fiscal and monetary policies and their impact as reflected in the behaviour of prices in the factor and goods market. These outcomes are crucial to the establishment of stability in major macroeconomic parameters, and the absence of such stability is reflected in the prevalence of imbalances that, in turn, could affect the rate of inflation and the balance of payments. There are three obvious reasons why such imbalances should matter. First, a macroeconomic imbalance that results in inflation, or a balance-of-payments crisis that forces measures of austerity, is known to be socially disruptive, leading to conflicts that affect the unfettered operations of investors who intend to compete in the world market. Second, inflation leads to uncertainties with respect not merely to wage levels but other elements of costs, resulting in reticence on the part of investors to choose an inflation-prone site for world market-oriented production. Third, macroeconomic imbalances could spill over onto the balance of payments to the extent that Governments may be forced to adopt emergency measures of a kind that lead to uncertainty with regard to the regime for imports, profit repatriation and taxation. In fact, the failure of a number of countries in South Asia to attract adequate inflows of foreign investment, despite relaxing regulations, appears to lie in the realm of an unfavourable macroeconomic environment, besides valid reaction to other inhibiting factors, such as lack of adequate infrastructure or of an "exit" policy for loss-making units that is essential in these countries.

Turning to investing economies, problems related to structural adjustment are crucial because FDI is often a result of changing locational comparative advantage patterns. The primary problems encountered relate to the immediate loss of jobs that may occur, the possible loss of export markets abroad, as well as loss of domestic market share to increased imports from foreign affiliates abroad. Yet, as has been seen earlier, there is clear evidence that FDI does not lead to loss of export markets abroad and some evidence that increased transnational trade does not appreciably worsen the home country trade balance. Hence the

## Box IV.1. Requirements of a privatization plan

Privatization, in the restricted sense of transfer by the Government of ownership and control of State-owned enterprises, has become a major concern for developing countries in the Asian and Pacific region. It is a process that helps shift the boundary between the public and private sectors so as to increase cost-effectiveness and enable resources to be used more efficiently in both government and business. Privatization can also open new opportunities for private investors, and free government resources and administrative skills for high-priority activities. However, in designing policies for privatization in this narrow sense, countries sometimes overlook the need to set complementary policies to stimulate private sector development. A privatization policy is an integral part of a private sector development policy. It is therefore necessary that the privatization policy of a country must complement and, in fact, flow from its overall policy for the development of the private sector. Consequently, the design of a privatization programme for a particular country must take into account the objectives of the overall national economic policy framework.

To have in place institutional support mechanisms is another basic requirement for implementing a successful privatization programme. A strong commitment to privatization cannot stand by itself; adequate technical and institutional capabilities are required to carry the privatization programme through. Thus, a country cannot undertake such a programme without an adequate framework of modern commercial laws nor can it proceed very far without sufficient institutional support in the financial sector. Hence, the establishment of at least a rudimentary legal framework of commercial laws and the reform of the financial sector should precede privatization in developing countries with a dominant public sector. In particular, the absence of financial institutions and instruments of financial intermediation can impede the progress of a privatization programme. Therefore, various financial sector reforms have to be promoted, such as the strengthening of financial institutions, the development of capital markets, the liberalization of interest rates and support for resource mobilization for private investment, as well as the introduction of competition in financial intermediation. These issues are sometimes ignored in developing countries, especially in economies where the pressure to put through privatization at any cost is high. Such haste can, however, defeat the very purpose of privatization, which is to create competitive conditions for greater efficiency.

Recent experience in privatization in the Asian and Pacific region shows that the procedural aspects of a privatization programme, namely, the appropriate modalities, are crucial to the success of the programme and need to be determined with reference to the local context. In former centrally planned economies seeking market orientation, these would differ from those in "mixed" economies with a heavy element of State intervention and indicative planning. Similarly, the modalities for privatization in a "mixed" economy would differ from those in a liberal market economy. Within each category of economies too, conditions differ widely. Each country, therefore, has to work out its own modalities with regard to the development of a private sector as also regarding the privatization programme. A uniform approach, even among groups of developing countries with several common characteristics, is neither possible nor desirable.

Therefore, models or precedents are of very little value in devising a privatization programme for a developing country. However, there are many lessons to be learned from the experience of countries in the region that have already embarked upon privatization programmes or have successfully completed a few of their proposals. Some important lessons from the experience of such countries are:

(a) It is essential to mobilize public opinion in support of privatization. One way to do this is to increase the number of stakeholders in privatization. The Republic of Korea, for example, was able to bring a large section of low income groups into the privatized equity segment, thereby softening opposition to subsequent divestments of majority Government holdings.

(b) Employee resistance to privatization of State-owned enterprises with excess manpower is inevitable. It is advisable to anticipate this resistance and devise a policy to overcome it. For example a suitable safety net would need to be devised for surplus employees who require to be rehabilitated. In this context, an employee stock ownership plan would be for an option; a liberal voluntary resignation or retirement scheme ("golden hand shake" provision) would be another.

(c) An institutional mechanism for privatization and a clear implementation plan can help in the systematic execution of the programme. While an institutional mechanism ensures greater transparency and objectivity in

*(Continued overleaf)*

*(Continued from preceding page)*

decision-making, a clear implementation plan helps in securing wider support for the programme.

(d) A strong dispute settlement framework reduces the scope for prolonged litigation that could accompany privatization, and such a framework must be put in place prior to launching the privatization programme to ensure that the programme is not aborted by vested interests.

(e) In view of the unanticipated problems that can crop up during the implementation of the programme in a developing country, the general public or persons affected by the programme should not be led to harbour unrealistic expectations about the gains to be derived from privatization. In fact, the privatization programme should be implemented in as low key a manner as possible.

problem is not so much loss of economic opportunity as the restructuring of that opportunity.

In this respect, it is crucial for investing economies to adopt policies which facilitate smooth adjustment, especially in the labour market. Japan has apparently been very successful in this regard, rationalizing large parts of the textile industry in the 1970s and the steel industry in the 1980s with comparatively little disruption in the labour market. While it is notable that such adjustment has apparently been somewhat easier in industries where FDI is relatively important (for example, electronics), it is also very important for investing economies to continue to promote an open world market. Structural adjustment in the investing countries is inevitable, and attempts to insulate economies will reduce the options available to deal with adjustment; restrictions on outward FDI are also to be avoided for the same reason.

### 2. Foreign investment regulations

It has been observed that beyond its role as a source of risk capital for investment, FDI can play an important role in development, by transferring new technology and business practice, stimulating innovation and investment in the host country through its linkage to domestic firms, and securing access to international goods and capital markets. In the NIEs, ASEAN-4 countries and now China, FDI has been a driving force in the expansion and diversification of manufactured exports. In that context, a non-distortionary incentive system (including transparent tax policies) and legal and regulatory reforms are important factors in inducing accelerated inflows of FDI.

Regulation of investment flows is therefore another element of intervention that adversely affects the operation of the trade-investment nexus, as foreign investors have to sift through a variety of regulations and incentives to arrive at a decision as to whether to locate production facilities there. These regulations are themselves motivated by a range of factors varying from the need to ensure that the domestic linkage effects of investment in a country are substantial and that its effects on domestic technological and production capabilities are significant, to the desire to prevent an adverse net foreign exchange flow in the medium or long term. To that end, Governments impose restrictions on the share of foreign investors in equity on firms registered locally, specify limits on royalty payments and dividend repatriation, introduce export clauses and frame direct tax laws. Such restrictions obviously limit the profitability of investment, threaten ready access to updated technological knowledge and may even lead to conflict of interest between the parent (foreign) investor, on the one hand, and the new collaborative venture, on the other. Furthermore, although foreign investors would like to have a degree of flexibility with regard to their operations in order to retain their relative competitiveness, developing countries with high unemployment and debilitating poverty, on the other hand, would like to place safeguards to ensure that foreign investment inflows do not take on characteristics similar to short-term "hot money" flows of financial capital.

To sum up, international trade and investment in the Asia and Pacific region have much in common; more important, both are market responses to opportunities provided by differences among countries in production possibilities. Since both serve the same purpose, to even out consumption possibilities in a world of different production capabilities, a central question that arises in regard to direct investment is why it takes place at all. While there are many theories on this, the nature of the investments that have taken place in the Asian and Pacific region would suggest three main determinants, each relating to an advantage of direct investment over alternative modes of serving the do-

mestic market and the external markets: the first is the ownership advantage, taking place through either equity participation or patent rights; the second is through locational advantage in serving either the host country's domestic market or its use as an export base; and the third is the internalization advantage that induces the foreign investor to choose FDI over more disparate forms such as production licensing.

The first wave of post-war direct investment in developing countries aiming at serving the host markets occurred in the 1950s and 1960s, largely in response to the adoption of import-substitution industrialization strategies by many of the developing countries in the Asian and Pacific region in terms of which trade barriers were set up and, in turn, provided the missing locational advantage to direct investment in developing countries; thus FDI became a way of circumventing trade restrictions. In recent years, however, foreign investment aimed at the domestic markets has been concentrated in the tertiary sector, in diverse branches such as banking, insurance and tourism. The third form of FDI is export-oriented investment, which has acquired special importance in East Asia since the 1970s. The locational advantage of such investment derives primarily from comparative advantage, in particular from a relative abundance of low-wage labour, and from policy-induced advantages, such as the establishment of export processing zones. This naturally suggests that where locational, ownership and internalization advantages exist, FDI inflows will follow, provided that the regulatory framework is conducive and barriers are not placed in the way.

A recent study[4] has, in fact, shown that the liberalization of restrictions on FDI can generate positive direct and indirect effects on income and welfare in the developing countries, since foreign capital inflows stimulate specialization and raise the productivity of the industry that uses them. The impact of foreign capital occurs through two mechanisms: a relative factor price effect and, to a certain extent, the market effect. In terms of relative factor prices, a capital inflow lowers the economy's rental rate, reducing the fixed cost of setting up and operating new services and stimulating the entry of firms into that sector. The extent of the market effect, on the other hand, indicates that, at given relative factor prices, capital inflows induce development of the service sector by augmenting industrial output. Both of these mechanisms act towards raising industrial productivity and therefore tend to raise incomes and welfare in the host country.

On the other hand, if FDI takes place in countries with high levels of effective protection, where economic rents accruing to producers are significant owing to the various distortions in the host country's economic policies, the net economic benefits are likely to be modest, insignificant or even negative, depending on the magnitude of distortions. In South Asian countries particularly, liberalization of policies towards FDI need to be accompanied by reduction in rates of effective protection and fostering of competition in domestic markets. Otherwise, the opening up of their economies to FDI by itself may not be sufficiently beneficial.

As the discussion on the trade-investment nexus has indicated, there has indeed been a perceived change in attitudes towards foreign investment in recent years, with most developing countries in the ESCAP region relaxing foreign investment regulations substantially. In fact, the evidence seems to suggest that in attempting to attract foreign investors, developing countries are competing with each other to an extent where even the minimal restraints needed to reduce, if not foreclose, the possible adverse fall-out of foreign investment are not being adhered to in many countries. Yet not all countries have been successful in attracting adequate volumes of investment, despite extremely competitive wage levels. This suggests that, increasingly, it is not the wage level or the regulation of foreign investment that is a deterrent to investment flows, but other aspects of the environment facing foreign capital, of which infrastructural constraints deserve a special review.

## 3. Infrastructural constraints

Besides shortcomings in the macro policy environment and foreign investment regulation framework that limit the expansion of intraregional trade and investment, a more tangible constraint on the expansion of trade and foreign investment is inadequate infrastructure. In fact, a review by the ESCAP secretariat of developments in transport and communications in the region has observed that the achievement of high rates of economic and trade growth by the ESCAP region and, in particular, by the developing Asian economies within the region is putting a strain on the region's transport and communications infrastructure.[5] In

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[4] F.L. Rivera-Batiz and L.A. Rivera-Batiz, "The effects of direct foreign investment in the presence of increasing returns due to specialization", *Journal of Development Economics* (Amsterdam), November 1990.

[5] ESCAP, *Review of Developments in Transport and Communications in the ESCAP Region 1990* (ST/ESCAP/980), p. 7.

certain developing countries of the region, notably Indonesia, the Philippines and Thailand, the capacity of seaports, telecommunications and hinterland transport has been placed under fairly severe pressure. Rapid growth of the region's trade has therefore made it necessary to improve and expand transport and communications links both between regions and within the region itself. While interregional trade would particularly benefit from the expansion of seaports, telecommunications and hinterland transport infrastructure, intraregional trade would benefit from these improvements coupled with the upgrading of regional shipping fleets and services.

Table 4.1 gives the rating of various aspects of infrastructure by a Japanese research institute which serves Japanese business interests. With respect to transport especially, as can be seen from the table, some or all aspects are rated as "fairly bad" or "poor" in all the South Asian countries and in Indonesia and the Philippines. The ESCAP study has found that the region's surface transport subsector, comprising (i) shipping, ports and inland waterways, (ii) roads and road transport and (iii) railways, have generally experienced high rates of traffic growth in the 1980s which have been the product of sustained economic and trade growth. As a consequence of this, some countries of the region face serious deficiencies of infrastructure, which must be rectified if they are to maintain such high rates of economic growth. At the same time, some of the region's transport operating agencies, consequent upon their drive towards modernization of their infrastructure, appear to have achieved significant gains in productivity, which may allow them to delay new investment in infrastructure without compromising their capacity to accommodate rapidly expanding traffic.

Developing economies of Asia and the Pacific have also experienced a dramatic growth in air transport activities during the last decade as a result of the emergence of this region as the fastest growing in the world in terms of economic performance and foreign trade. While air transport facilitates the conduct of public and private business and constitute a key factor in the development of tourism and foreign trade, particularly non-traditional exports and perishable commodities, the provision of adequate and efficient air services is of special importance to developing island and landlocked countries, whose economies are hampered by the geographical handicaps of distance compounded with lack of access to overland and/or sea transport. This also applies to developing areas within a country because of their often inadequate means of surface transport and remoteness from major market areas.

Transport policies have been subjected to extensive review and change in several countries in the Asian and Pacific region as a result of growing awareness among Governments of the linkages between transport and national development. Consequent upon its trade dynamism during the past decade, the region's seaports and airports have experienced an unprecedented expansion in goods traffic. In some cases, this has resulted in severe strain on the capacity of these facilities to cope efficiently with the receipt and despatch of trade consignments. Various solutions to this problem have been proposed and, in some instances, implemented. These solutions have included the extension of operating hours; the streamlining of customs and documentation procedures; the provision of additional container-handling berths and equipment at seaports; the removal of container stripping and/or stuffing activities to off-port loca-

**Table 4.1. Infrastructural standards in South and South-East Asia**

**South Asian countries**

| | *Bangladesh* | *India* | *Pakistan* | *Sri Lanka* |
|---|---|---|---|---|
| Infrastructure | | | | |
| Electricity | C | C | D | C |
| Industrial water | A | C | D | D |
| Telecommunication | A | C | D | A |
| Seaport | B | C | C | A |

**ASEAN countries**

| | *Indonesia* | *Malaysia* | *Philippines* | *Thailand* |
|---|---|---|---|---|
| Infrastructure | | | | |
| Electricity | C | B | C | B |
| Industrial water | C | A | C | B |
| Telecommunication | D | A | D | B |
| Seaport | B | A | B | C |

*Source:* Interviews conducted by Mitsui Taiyo Kobe Research Institute, Japan. (Extracted from S.P. Gupta and S. Tambunlertchai, *The Asia Pacific Economies: A Challenge to South Asia* (Delhi, Macmillian India Ltd., 1992), pp. 588-589.

*Notes:* Standard for infrastructure:
A: Excellent, B: Good, C: Fairly bad, D: Poor.

tions; and the development of small-scale private port facilities to accept the overflow of traffic from the major ports. Despite these efforts, in many cases port facilities have reached the limit of their potential for improvement of productivity, and expansion of the infrastructure, entailing substantial investment expenditure, is the only solution.

A notable feature of foreign investment in the Asian and Pacific region is its limited presence in the infrastructural area. While access to adequate infrastructure appears to be a requirement to facilitate foreign investment, foreign investing firms themselves have done little to build the infrastructural requirements needed for their own operations and for the process of industrial restructuring. One obvious reason is the large gestation period and massive outlays with the prospect of low returns initially, but government policy which generally restricts the role of FDI in the sector is no less important a reason.

Information on foreign investment in transport and communications infrastructure in countries of the ESCAP region is, again, very scanty, partly because data on FDI flows are collected primarily for balance-of-payments purposes, and are based on the exchange records of the central bank and therefore limited in terms of information on the detailed structure of such investment. In many cases, national data are not reported according to the International Standard Industrial Classification (ISIC) code, and industrial coverage of FDI is reported on a highly aggregate basis, involving broad economic categories. Furthermore, most Governments have reserved the infrastructural area, in particular transport and communications, as a State monopoly, or favour the involvement of only the domestic private sector. Although the process of liberalization of foreign investment regulations has affected this sector as well, such investment data are not always collected separately.

However, based on the limited information available, it is clear that the quantum of FDI flows into transport and communications infrastructure, crucial to any restructuring strategy, constitutes a relatively small share in most countries. In fact, in no case does it exceed 5.1 per cent of the total inflow of foreign investment received from the major investing (home) countries. The paucity of information and analysis on the role of FDI in infrastructural development suggests the need for a systematic analysis of the policy implications of the issue.

A related aspect in determining the intensity of the trade-investment nexus is the robustness of the human infrastructure in the host country. Since FDI depends heavily on the availability of skilled labour and the ability to adapt technology in a given economy, government support of education, research and development, and other measures spurring the development of technology, is likely to have a significant influence in stimulating foreign investment. The underlying reason is that investment in human capital is crucial in promoting the efficiency of the domestic economic sector and the absorptive capability of local firms for foreign technology and management skills. Countries with higher investment in human capital will accordingly be able to gain more from FDI.

Thus, whether in terms of its volume, its sectoral pattern or the sustainability of the growth it generates, domestic policy appears to be crucial in inducing FDI inflows. Since foreign investment can only be attracted with appropriate policy, it should be clear that that policy should be directed not merely towards benefiting in full from that investment but also towards developing the indigenous capability of sustaining trade once foreign investors decide to seek out alternative sites for production or operation. In this context, the emerging concern about trade-related investment measures (TRIMs) – currently a debatable issue with regard to its possible impact on FDI – could assume importance in the foreseeable future. The following subsection, therefore, alludes briefly to this contentious subject.

### 4. Trade-related investment measures

The term "trade-related investment measure" is very broad. The original discussion of TRIMs focused mainly on two broad categories of measures: investment incentives and performance requirements. Examples of investment incentives usually cited are subsidies, investment grants, priority access to credit, tax relief and other forms of fiscal, financial and commercial inducements for investments. Local content, trade-balancing and export requirements are the most frequently cited examples of performance requirements.[6]

Trade-related investment measures constitute one area of eco-

[6] The Uruguay Round discussions have produced a list of 14 TRIMs, intended not as a definitive catalogue but as illustrations of the types of measures that may warrant some form of multilateral discipline: investment incentives, local equity requirements, licensing requirements, remittance restrictions, foreign exchange restrictions, manufacturing limitations, transfer-of-technology requirements, domestic sales requirements, manufacturing requirements, product-mandating requirements, trade-balancing requirements, local content requirements, export requirements and import-substitution requirements.

nomic analysis in which theoretical considerations have crucial relevance. In the neoclassical paradigm, under assumptions of perfect competition, TRIMs are clearly distortionary to patterns of trade and development. The basic argument here is that TRIMs subtract from the welfare of all countries, including the host country which imposes them. Even export-performance TRIMs are deemed to worsen rather than improve the host country's trade balance. In contrast, recent investigations associated with strategic trade theory show that when there are increasing returns to scale and dynamic gains from learning, the distribution of international production and trade may no longer be what traditional trade theory would suggest: public policy-driven scale economy specialization could overlay comparative advantage. In these circumstances, when the cost of finding the optimal site is high in comparison with the operational cost differential, domestic content and export performance TRIMs may be the best option for the host country.

However, care should be taken not to confuse this cautious appraisal of the use of TRIMs as policy tools as an endorsement of trade protectionism. Even in industries with relatively few large players, trade liberalization is one of the most effective methods of stimulating competition; in contrast, trade protection is likely to solidify non-competitive behaviour.[7] It has also been observed that constraints on trade under conditions of imperfect competition lead to losses in efficiency two or three times as high as under perfect competition.[8] As a general proposition, therefore, trade liberalization still makes good sense.

An analysis of data on firm responses to TRIMs[9] has shown that changes in international corporate operations attributable to TRIM requirements are relatively small. Transnational corporate investors are not significantly influenced by TRIMs in their decisions, as argued by those concerned that such measures might pose a threat to the stability of the international trading system. Despite this finding, there is a strong contention among trade policy makers that TRIMs constitute a high-priority trade policy issue.

Focusing on the economic impact of TRIMs on the allocation of resources, two distinct outcomes may be discerned. On the one hand, TRIM failures are mainly associated with the sub-economic size of operation, subsidies to compensate investors for high-cost operations, and shelter from competition; on the other hand, TRIM successes are associated with economic size (full utilization of economies of scale), subsidies aimed at facilitating corporate exit and adjustment and compensating for initial risk and uncertainty, and subsequent exposure to competition in world markets. The divergent outcomes support the view that TRIMs, like other public sector interventions in imperfect markets, enhance resource allocation if they help all potentially comparable locales to utilize foreign investment to penetrate global markets, but detract if they merely insulate high-cost operations from competition.

It must be reiterated, however, that judgement on the use of TRIMs as a tool for development or trade policy depends centrally on assumptions about industry structure. In this context, the policy debate over TRIMs has lagged considerably behind advances in theory and evidence associated with the management of imperfectly competitive industries. For domestic content TRIMs, although the traditional justification is a variant of the standard infant-industry argument, namely that they provide the learning-curve experience necessary to nurture foreign subsidiaries into becoming world-class producers, the greatest potential benefit resides in situations where foreign subsidiaries producing final products exercise monopsonistic power to drive down the price received by competitive domestic input suppliers, with consequent under-consumption of local components. However, endorsement of domestic content TRIMs carries the threat that there could be a "contagion" of usage for import substitution reasons, which would hinder development efforts. Export-performance TRIMs (including trade-balancing requirements), in contrast, offer a broader array of development benefits if they serve to "fix" world-scale production within a host country's jurisdiction for an industry with increasing returns to scale. The result may be not only a shift of rents-cum-producer-surplus to the host economy but also the creation of "industrial complexes" with forward and backward linkages in non-traded intermediate goods which also enjoy increasing returns to scale. Nevertheless, it has been found that export-performance TRIMs are not as efficient as a straightforward production subsidy, which collects the inducement fee paid to the firm from taxpayers at large; an export-performance TRIM (offering access to a protected market, for

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7 Jagdish Bhagwati, *Protectionism* (Cambridge, Mass., The MIT Press, 1988).

8 J. David Richardson, "Empirical research on trade liberalization with imperfect competition: a survey", *OECD Economic Studies*, No. 12/ Spring 1989, pp. 8-50.

9 *The Impact of Trade-related Investment Measures on Trade and Development* (United Nations publication, Sales No.E.91.II.A.19).

example, in return for a target amount of exports) collects the inducement fee solely from local consumers of the product.

With respect to trade policy, the debate about whether TRIMs have a distortionary impact on trade flows is more complicated than conventional wisdom suggests. With developed and developing countries vying to establish world-scale production facilities on their territory and thereby influence trade patterns, the outcome is the result of a complex interaction between relevant policies. In this context, to single out one kind of locational policy (TRIMs) while leaving all other comparable policies in place would itself be distortionary: what is needed is a more balanced approach in which the regulation of public policy efforts aimed at influencing investment decisions is carried out in tandem with the regulation of policy designed to influence trade patterns. Therefore, the impact of TRIMs backed by trade protection will have to be compared with that of alternative policies for inducing relocation of productive facilities backed by fiscal incentives. There have been differing views on this, but, in general, to assert that such investment packages are not "trade-related" would hardly be accurate.

In the Uruguay Round, the negotiations have focused on efforts to control and reduce (and perhaps even prohibit) TRIMs. This effort is hardly consistent with a more broadly needed balanced approach to locational incentives. In seeking to proscribe the kind of investment packages most compatible with developing country circumstances, while leaving equivalent investment packages of the developed world intact, the Uruguay Round TRIMs effort could also in some sense, be regarded as distortionary in itself.[10] In fact, what is required is a comprehensive approach that addresses the interests of host countries as well as of home countries and transnational corporations within a balanced framework of rights and obligations, and offers greater possibilities for resolving conflicts over investment policies and investor behaviour. More beneficial would be an attempt to establish a multilateral framework of norms and standards on FDI, which would undoubtedly be a stabilizing force in the dynamic but volatile area of investor-government relations.

## B. EXOGENOUS FACTORS

### 1. Non-tariff barriers

#### *(a) Definition of non-tariff barriers*

Despite the fact that across the world there has been a substantial reduction in tariffs in the last few decades, many countries resort to a range of non-tariff measures that limit the volume or pace of expansion of imports, setting constraints on the operation of the trade-investment nexus. The large variety of NTBs that are currently in force render definitional clarity difficult, and range from quotas under the Multifibre Arrangement, which have now become an integral part of international trade in textiles, to a variety of extremely detailed discriminatory specifications on, say, packing, or colour schemes. Between these extremes there exist a range of measures such as tests and certification requirements, State trading or "canalization", local content requirements, standards, customs formalities, import authorizations, and the like, which render the concept of NTBs nebulous. The other problem in defining and categorizing NTBs arises from the mixed nature of some of these measures. Some voluntary export restraint arrangements (VERs) also include provisions for variable levies as countervailing measures; others, like tariff quotas, anti-dumping duties, countervailing actions and trigger price mechanisms, are quantitative in their content and application. These cross-border regulatory actions approximate to tariff rather than non-tariff measures.[11]

It is, therefore, more useful to try and categorize NTBs not by their functional form but on the basis of their intent or the objectives which the Government wishes to achieve by using them. Laird and Vossenaar distinguish between five categories of NTBs, depending on the "original intent" of the Governments which imposed them: (i) measures to control the volume of imports, involving quantity restrictions like prohibition, quotas or licences and export restraint arrangements like VERs, and bilateral framework agreements; (ii) measures to control the price of imported goods, which include instruments such as trigger price mechanisms, variable duties, anti-dumping levies and countervailing duties that prevent imports being priced artificially low and thereby protect domestic industries; (iii) direct and indirect subsidies on domestic production and on exports to third markets which make domestic goods and services competitive with exports;

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10 Ibid. A detailed exposition of the issues is given in appendix A.

11 However, some quotas remain unfulfilled, as is quite often the experience with those designated for least developed or small island economies. Overall quotas in some importing countries can also be larger than import demand and thereby remain unfulfilled. It is not clear in such cases if these quotas constitute a non-tariff barrier.

(iv) standards certification and quality approval measures, ostensibly enforced to ensure that imports conform to minimum standards applicable to domestically produced goods, which are often discriminatory, not always transparent and lead to disruption of imports; and (v) monitoring measures, used to detect early signs of market injury or disruption on account of imports, which are often a prelude to other measures.[12]

For the purpose of this discussion on the incidence of NTBs in the Asian and Pacific region, the categorization used by the United Nations Conference on Trade and Development (UNCTAD) has been followed. The UNCTAD database provides import coverage ratios which bring out the trade within a broader two-digit level category that is undertaken while being subject to some form of NTB. These import coverage ratios[13] thus indicate the potential loss in exports, with the assumption that exports affected by the NTBs would otherwise have attained growth rates and volumes comparable with other products in that group. The percentage of imports covered by NTBs for any particular country, on the other hand, reflects the extent to which the imports of a broad category are restrained by the use of NTBs.

The principal problem arises when NTBs are so strictly enforced that no imports can take place at all, or when the entire group of products are affected by NTBs. In the first case the trade coverage ratio may appear to be very low, which is the opposite of the actual situation; in the second case, the ratio may look unduly high because total imports of the group will have been adversely affected, thereby bringing down the value of the denominator in the above expression. In any case, the trade coverage ratio underestimates the actual impact of NTBs to the extent that any tightening of existing quotas is not taken into consideration. Such a contraction may occur on account of either reduction in the volumes permitted in the quota or a relative tightening as a result of capacity expansion in the exporting country and better fulfilment of existing quotas. It is also important to recognize that trade coverage ratios do not indicate the actual impact of the measures on exports: they merely describe or provide an indication of the number and volume of trade of items which are covered by such measures.

The brief quantitative analysis of the incidence and impact of NTBs on trade flows in the Asian and Pacific region that follows has three objectives: first, it describes the actual incidence of NTBs in the region and how they are spread across sectors and with respect to exports from within the region and outside, as well as from developed and developing countries; second, it compares the evidence presented in this chapter with that available for a broader group of developed and developing countries on the basis of UNCTAD data; and third, it assesses the impact of these NTBs on the potential export earnings of developing countries in the region on the basis of standard assumptions regarding their comparative advantage.

The source of information on the incidence of NTBs in the Asian and Pacific region is the UNCTAD database on trade control measures. This database lists individual trade control measures at each tariff line with respect to imports into each country from all its trading partners, and also estimates the trade coverage ratios. There were two major problems encountered while using this database for analysing their incidence and impact in the Asian and Pacific region: first, the data which were eventually made available in a usable form pertained to only nine countries within the region,[14] and thus the sample may underestimate the incidence and impact of NTBs in the region; second, the data available are only for 1990 and therefore cannot be used to assess the changes in NTBs, their incidence and import over time in the Asian and Pacific region.

The UNCTAD database on

12 This classification is taken from Laird and Vossenaar who have developed this almost exhaustive list on the basis of the UNCTAD database. See S. Laird and R. Vossenaar, "Why we should be worried about non-tariff measures", Special Issue on Non-tariff Measures (Madrid, Information Commercial Española, 1991).

13 The import coverage ratio measures the value of imports affected by selected NTBs as a ratio of all imports. The percentage of imports subject to NTBs for any specific importing country at the product group level is given by the following ratio:

$$C_{jt} = \frac{\sum_i (D_{it} \cdot V_{iT})}{\sum_i V_{iT}} * 100$$

where, if an importing country applies an NTB on a particular tariff line item 'i' the dummy variable '$D_i$' takes a value of one, being zero otherwise; '$V_i$' is the value of imports in that line item with 't' being the half year of measurement; and 'T' is the year in which the import weights are constructed with t = T if current year imports are being used as weights.

14 These nine countries or areas (Australia, Hong Kong, Indonesia, Japan, Malaysia, New Zealand, Republic of Korea, Singapore and Thailand) together accounted for 82 per cent of the total exports and 81 per cent of the total imports of the ESCAP region in 1990.

trade control measures makes it possible to distinguish between the incidence of various categories of NTBs. Although the database distinguishes nine different categories of NTBs, this study focuses on only four categories:

(i) The broad definition of NTBs, which is all-inclusive except for some customs valuation and health and sanitary standards;

(ii) The narrow definition of NTBs, which includes the "core" group of these measures and excludes quasi-NTB categories like tariff quotas, seasonal tariffs, preferential rates, special taxes, all types of indirect taxes which are levied on imports because corresponding taxes exist on domestic products, anti-dumping duties and variable levies. The core contains: the range of licensing and permit requirements; quotas, whether global, seasonal or in the nature of bans and prohibitions; voluntary export restraint agreements; quantity restrictions, applied as licences and included even if they allow unlimited imports while maintaining the provision for restrictions; price controls; trigger price mechanisms; voluntary control on prices; State monopoly of imports (also referred to as "canalization" provisions); additional custom formalities and certification requirements;

(iii) The voluntary export restraint agreements, which have only recently emerged as a non-tariff barrier and represent one of the most difficult measures to be tracked and monitored;

(iv) The set of quantitative restrictions, which include the range of licensing and permit requirements, quotas of all varieties, restrictions reported as occasionally applied through unspecified means and State monopoly of imports or exclusive importing rights for specific agencies. These represent what are commonly referred to as the "hard-core" NTBs and are representative of the quantitative restrictions (quotas)-based import-substituting regimes which are operative in some South Asian and South American economies.

*(b) Magnitude and pattern of non-tariff barriers*

It has been found that the most noteworthy characteristic about NTBs in the Asian and Pacific region is the almost complete absence of VERs as a trade or export restrictive measure. As can be noted from tables 4.2 to 4.4, which provide evidence on the incidence of VERs, except for Japan, no other country in the region resorted to such measures. Even for Japan, the incidence of VERs is marginal and in the case of exports from the Asian and Pacific region, only 0.26 per cent of total intraregional imports are affected (table 4.4). The marginal nature of VERs in the region testifies to the absence of strong bilateralism in trade relations and, in particular, reflects Japan's reluctance to use such bilateral measures to protect its industries, even in the case of exports from countries where it possesses dominant trading status.

The developed countries of the Asian and Pacific region, Australia, Japan and New Zealand, all of which are covered in the sample adopted for this study, imposed NTBs as broadly defined to the extent of covering, on a trade-weighted basis, 15.85 per cent of their imports from the world. For 1990, the "core group" of NTBs imposed by these three developed countries in the region covered 14.54 per cent of their imports, while quantitative restrictions had an incidence of 13.82 per cent. According to Laird and Vossanaar, in their study the group of 22 developed market economy countries covered 18.2 per cent of their total imports with NTBs as broadly defined. "Core" NTBs applied by these countries had an incidence of 12.0 per cent; quantitative restrictions covered 11 per cent of their imports. Thus, on an overall basis, in comparison with other developed market economy countries, the developed economies of Asia and the Pacific had less recourse to NTBs to protect their imports, though "core" NTBs reflected a slightly higher level of incidence. Moreover, as noted earlier, the developed economies of the ESCAP region imposed hardly any VERs, as compared with the incidence for developed market economy countries of 3.3 per cent of all imports.

The higher incidence of quantitative restrictions in the case of the developed economies of the region, as compared with other developed market economy countries, is accounted for by their predominance in Japan's trade regime. Quantitative restrictions are the most important border measures after health and safety regulations and technical standards in Japan. While these quotas have been contested by Japan's trading partners and have gradually been lifted, a number of quotas remain, especially for food imports.

The sectoral pattern of NTBs imposed by the developed economies of the ESCAP region is broadly similar to that imposed by other developed market economy countries. These countries in the ESCAP region imposed a large number of NTBs on their food imports, so that 48.8 per cent of total food imports were affected. Other such countries also took special care to ensure health and sanitary regulations in this sector and, in their case as well, this sector was the most widely affected by NTBs when broad sectoral groupings are considered. For the developed market economy country group, the UNCTAD database indicates that NTBs affected 38.0 per cent of all food imports.

**Table 4.2. Incidence of non-tariff barriers on imports from the world, by selected economies of the ESCAP region, 1990**

*(Value in thousands of US dollars; ratio in percentage)*

| *Countries or areas* | *Total imports* | *Broad definition* | | *Narrow definition* | | *Voluntary export restraints* | | *Quantitative restrictions* | |
|---|---|---|---|---|---|---|---|---|---|
| | | *Import coverage* | | *Import coverage* | | *Import coverage* | | *Import coverage* | |
| | | *Value* | *Ratio* | *Value* | *Ratio* | *Value* | *Ratio* | *Value* | *Ratio* |
| Australia | 31 877 563 | 2 326 897 | 7.30 | 1 026 347 | 3.22 | 0 | 0.00 | 226 | 0.00 |
| New Zealand | 7 287 52 | 223 984 | 3.07 | 205 387 | 2.82 | 0 | 0.00 | 205 387 | 2.82 |
| Japan | 180 836 292 | 32 324 211 | 17.87 | 30 748 481 | 17.00 | 129 006 | 0.07 | 30 201 974 | 16.70 |
| Hong Kong | 71 800 848 | 12 352 651 | 17.20 | 420 604 | 0.59 | 0 | 0.00 | 420 604 | 0.59 |
| Indonesia | 16 286 976 | 2 617 226 | 16.07 | 2 617 226 | 16.07 | 0 | 0.00 | 2 617 226 | 16.07 |
| Republic of Korea | 51 525 606 | 1 139 638 | 2.21 | 1 138 269 | 2.21 | 0 | 0.00 | 1 138 269 | 2.21 |
| Malaysia | 16 199 632 | 1 164 106 | 7.19 | 1 164 106 | 7.19 | 0 | 0.00 | 1 164 106 | 7.19 |
| Singapore | 48 648 431 | 1 575 868 | 3.24 | 1 575 868 | 3.24 | 0 | 0.00 | 141 925 | 0.29 |
| Thailand | 19 401 147 | 2 303 003 | 11.87 | 1 564 266 | 8.06 | 0 | 0.00 | 1 564 266 | 8.06 |
| Total | 443 863 997 | 56 027 584 | 12.62 | 40 460 554 | 0.09 | 129 006 | 0.00 | 37 453 983 | 8.44 |

***Source:*** Secretariat estimate, calculated from UNCTAD trade database, 1990.

**Table 4.3. Incidence of non-tariff barriers in selected economies of the ESCAP region on imports from developing countries or areas, including China**

*(Value in thousands of US dollars; ratio in percentage)*

| *Countries or areas* | *Total imports* | *Broad definition* | | *Narrow definition* | | *Voluntary export restraints* | | *Quantitative restrictions* | |
|---|---|---|---|---|---|---|---|---|---|
| | | *Import coverage* | | *Import coverage* | | *Import coverage* | | *Import coverage* | |
| | | *Value* | *Ratio* | *Value* | *Ratio* | *Value* | *Ratio* | *Value* | *Ratio* |
| Australia | 7 098 956 | 774 347 | 10.91 | 22 241 | 0.31 | 0 | 0.00 | 10 | 0.00 |
| New Zealand | 1 332 833 | 122 223 | 9.17 | 122 223 | 9.17 | 0 | 0.00 | 122 223 | 9.17 |
| Japan | 86 753 663 | 10 278 100 | 11.85 | 9 638 790 | 11.11 | 129 006 | 0.15 | 9 422 799 | 10.86 |
| Hong Kong | 41 871 023 | 9 798 232 | 23.40 | 268 128 | 0.64 | 0 | 0.00 | 268 128 | 0.64 |
| Indonesia | 5 643 206 | 799 983 | 14.18 | 799 983 | 14.18 | 0 | 0.00 | 799 983 | 14.18 |
| Republic of Korea | 9 921 302 | 194 644 | 1.96 | 194 644 | 1.96 | 0 | 0.00 | 194 644 | 1.96 |
| Malaysia | 5 905 765 | 222 849 | 3.77 | 222 849 | 3.77 | 0 | 0.00 | 222 849 | 3.77 |
| Singapore | 21 335 806 | 1 003 686 | 4.70 | 1 003 686 | 4.70 | 0 | 0.00 | 129 828 | 0.61 |
| Thailand | 6 606 686 | 845 184 | 12.79 | 317 832 | 4.81 | 0 | 0.00 | 317 832 | 4.81 |
| Total | 186 469 240 | 24 039 248 | 12.89 | 12 590 376 | 6.75 | 129 006 | 0.07 | 11 478 296 | 6.16 |

***Source:*** Secretariat estimate, calculated from UNCTAD trade database, 1990.

**Table 4.4. Incidence of non-tariff barriers in selected economies of the ESCAP region on intraregional imports, 1990**

*(Value in thousands of US dollars; ratio in percentage)*

| *Countries or areas* | *Total imports* | *Broad definition* | | *Narrow definition* | | *Voluntary export restraints* | | *Quantitative restrictions* | |
|---|---|---|---|---|---|---|---|---|---|
| | | *Import coverage* | | *Import coverage* | | *Import coverage* | | *Import coverage* | |
| | | *Value* | *Ratio* | *Value* | *Ratio* | *Value* | *Ratio* | *Value* | *Ratio* |
| Australia | 4 411 922 | 610 334 | 13.83 | 22 127 | 0.50 | 0 | 0.00 | 10 | 0.00 |
| New Zealand | 728 647 | 92 854 | 12.74 | 89 441 | 12.27 | 0 | 0.00 | 89 441 | 12.27 |
| Japan | 49 338 356 | 7 038 564 | 14.27 | 6 454 894 | 13.08 | 129 006 | 0.26 | 6 322 908 | 12.82 |
| Hong Kong | 33 905 079 | 8 679 255 | 25.60 | 206 570 | 0.61 | 0 | 0.00 | 206 570 | 0.61 |
| Indonesia | 3 369 311 | 603 567 | 17.91 | 603 567 | 17.91 | 0 | 0.00 | 603 567 | 17.91 |
| Republic of Korea | 4 321 691 | 129 805 | 3.00 | 129 805 | 3.00 | 0 | 0.00 | 129 805 | 3.00 |
| Malaysia | 4 475 600 | 143 049 | 3.20 | 143 049 | 3.20 | 0 | 0.00 | 143 049 | 3.20 |
| Singapore | 13 566 663 | 523 028 | 3.86 | 523 028 | 3.86 | 0 | 0.00 | 129 164 | 0.95 |
| Thailand | 4 307 918 | 706 306 | 16.40 | 189 754 | 4.40 | 0 | 0.00 | 189 754 | 4.40 |
| Total | 118 425 187 | 18 526 762 | 15.64 | 8 362 235 | 7.06 | 129 006 | 0.11 | 7 814 268 | 6.60 |

***Source:*** Secretariat estimate, calculated from UNCTAD trade database, 1990.

The higher incidence in the Asian and Pacific region is due to Japanese import restrictions, as Australia and New Zealand have imposed hardly any NTBs in this sector. Some 21.9 per cent of chemical imports; 14.7 per cent of fuel imports; 8.7 per cent of imports of manufactured products other than chemicals; and 4.6 per cent of agricultural raw material imports were affected by NTBs imposed by developed economies of the ESCAP region. There is some similarity in this pattern and that followed by other developed economies, where agricultural raw materials attracted the lowest incidence, at 4.6 per cent, followed by chemicals at 9.2 per cent, fuels 16.3 per cent and manufactures other than chemicals, at 17.8 per cent.

The major difference which perhaps needs explanation is the incidence of NTBs in manufactured products other than chemicals (SITC 6 + 7 + 8 - (67+68)). The incidence is low primarily because Japanese industry, being globally competitive in these sectors, did not require such protection. Japan, whose performance dominates the overall picture of the developed countries of the ESCAP region, did not even take part in the Multifibre Arrangement and had no VERs or quotas in industries such as vehicles, steel and leather footwear. The NTBs which do exist in Japan and affect 8.89 per cent of its imports in this sector (table 4.5) relate more to quality inspections, pre-shipment certification and some loosely applicable tariffs/quotas in the case of leather products.

To some extent, therefore, NTBs imposed by developed economies of the ESCAP region are not disproportionately imposed against exports of developing countries, as has been observed for the broad category of developed market economy countries. This conclusion emerges from two sets of facts. First, that the three developed countries of the ESCAP region impose lower levels of NTBs on SITC 6-8, where developing country manufactured exports are normally concentrated, as compared with NTBs on chemicals and fuels; in the last two sectors, non-oil exporting developing countries have a relatively marginal interest because they are generally uncompetitive in those sectors. Second, the absence of VERs and Multifibre Arrangement curbs signifies the lack of bilateral and individually discriminatory type of NTBs in this region which are generally applied against developing country exports. Thus, NTBs imposed by developed countries of the ESCAP region are not biased against specific trading partners and are applied more generally.

Of greater relevance to the theme of this study is the issue of the spread and impact of NTBs on intraregional trade. Table 4.4 gives the details of NTBs affecting imports from the Asian and Pacific region into the nine sample countries. The incidence of the "broad category" of NTBs on imports from the Asian and Pacific region is higher at 15.64 per cent than is the case (12.62 per cent) for imports from all parts of the world. However, imports affected by the "core group" of NTBs are smaller in the case of the Asian and Pacific region than imports from the world. Similarly, quantitative restrictions imposed against exports from the Asian and Pacific region covered 6.6 per cent of imports, as compared with 8.44 per cent in the case of exports from the world to countries of the ESCAP region (tables 4.2 and 4.4). As regards VERs, these are all concentrated on imports from this region. It is thus clear that exports in the region were faced with more specific and directed protectionist measures than were levied against exports generally. This may have had a more marked restrictive impact on export expansion because these specific and volume-restricting types of NTBs have been imposed on products and in sectors where countries of the region may have developed competitive advantage.

Japan, the major trading economy in the Asian and Pacific region, imposes consistently lower NTBs on imports from the region than it does on imports from the rest of the world. Trade coverage ratios for Japan's imports affected by NTBs were 17.9 and 14.3 per cent for the "broad category" of NTBs for imports from the world (table 4.2) and the Asian and Pacific region (table 4.4), respectively. The figures were 17 and 13 per cent for the core group of NTBs, and 16.7 and 12.8 per cent for imports affected by quantitative restrictions from the two regions. In contrast, New Zealand has consistently had markedly higher coverage ratios for imports from the Asian and Pacific region than it has for imports from the rest of the world. Australia also has a higher incidence of the broad group of NTBs but this declines substantially and becomes negligible when the coverage ratio for the "core group of NTBs" is considered. The developing countries display the same level of NTBs for imports from either in the Asian and Pacific region countries or the rest of the world. This is in line with the finding that developing countries apply their protectionist measures of a non-tariff variety in a more broad-based and general manner than is the case for developed economies.

*(c) Assessment of the impact of NTBs*

On the basis of the above analysis of the incidence and pattern of NTBs in the Asian and Pacific region, some assessment of

**Table 4.5. Incidence of non-tariff barriers by broad definition on imports from the world, by selected economies of the ESCAP region, 1990**

*(Value in thousands of US dollars; ratio in percentage)*

| Countries or areas | *Fuels (SITC 3)* | | | *All food items (SITC 0+1+22+4)* | | | *Agricultural raw materials (SITC 2-(22+27)* | | | *Chemicals (SITC 5)* | | | *Manufactures other than chemicals (SITC 6+7+8-(67+68))* | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | *Total imports* | *Import coverage* | | *Total imports* | *Import coverage* | | *Total imports* | *Import coverage* | | *Total imports* | *Import coverage* | | *Total imports* | *Import coverage* | |
| | | *Value* | *Ratio* | | *Value* | *Ratio* | | *Value* | *Ratio* | | *Value* | *Ratio* | | *Value* | *Ratio* |
| Australia | 1 349 624 | 0 | 0.00 | 1 673 622 | 72 934 | 4.36 | 879 824 | 0 | 0.00 | 3 683 407 | 64 465 | 1.75 | 23 070 453 | 2 099 975 | 9.10 |
| New Zealand | 402 121 | 0 | 0.00 | 548 555 | 8 981 | 1.64 | 99 571 | 0 | 0.00 | 957 530 | 0 | 0.00 | 4 703 132 | 204 304 | 4.34 |
| Japan | 38 902 799 | 5 979 938 | 15.37 | 31 233 225 | 16 243 699 | 52.01 | 16 326 367 | 800 639 | 4.90 | 14 190 988 | 4 064 078 | 28.64 | 56 266 996 | 5 003 166 | 8.89 |
| Hong Kong | 1 720 589 | 0 | 0.00 | 5 671 886 | 385 667 | 6.80 | 1 930 632 | 609 211 | 31.56 | 5 578 971 | 0 | 0.00 | 53 457 779 | 11 324 279 | 21.18 |
| Indonesia | 1 267 308 | 11 469 | 0.90 | 1 239 456 | 789 940 | 64.46 | 885 467 | 91 258 | 10.31 | 2 842 849 | 58 295 | 2.05 | 8 085 102 | 1 076 541 | 13.32 |
| Republic of Korea | 6 047 606 | 128 562 | 2.13 | 2 875 722 | 662 776 | 23.05 | 5 068 751 | 122 981 | 2.43 | 6 213 512 | 510 | 0.01 | 25 037 469 | 198 480 | 0.79 |
| Malaysia | 887 653 | 0 | 0.00 | 1 758 571 | 171 577 | 9.76 | 272 502 | 19 | 0.01 | 533 083 | 7 508 | 1.41 | 9 895 097 | 882 591 | 8.92 |
| Singapore | 6 873 709 | 965 329 | 14.04 | 3 252 772 | 541 104 | 16.64 | 1 045 758 | 65 790 | 6.29 | 3 782 639 | 3 645 | 0.10 | 30 883 919 | 0 | 0.00 |
| Thailand | 1 565 786 | 536 525 | 34.27 | 1 168 357 | 201 276 | 17.23 | 879 657 | 21 877 | 2.49 | 2 559 233 | 114 080 | 4.46 | 10 500 676 | 1 110 344 | 10.57 |
| Total | 59 017 185 | 7 621 823 | 12.70 | 49 422 166 | 19 086 954 | 38.62 | 27 388 529 | 1 711 775 | 6.25 | 40 342 212 | 4 312 581 | 10.69 | 221 900 623 | 21 899 680 | 9.87 |

***Source:*** Secretariat estimate, calculated from UNCTAD trade database, 1990.

their impact can be made, though the sample is somewhat biased in favour of countries in the region with more open economic regimes. First, it is clear that, as in the case of NTBs all over the world, those in the region are also targeted disproportionately against sectors which are of export interest to developing countries. Thus, an elimination or rolling back of these NTBs in the Asian and Pacific region would clearly be beneficial to the developing economies. The importance of lowering these NTBs is higher today because of the structural reforms being attempted by developing countries and their dependence on export expansion for achieving success.

Second, it was observed that countries in the Asian and Pacific region face higher and more specific types of NTBs in other countries within the region as compared with exporters from outside the region. This is perhaps partly responsible for the relatively slower growth in intra-ESCAP region trade than is warranted by the growth rates in trade flows achieved by countries in this region. These NTBs reinforce the existing bias in favour of trade relationships between developing countries of the region and developed economies of Europe and the United States of America. Intra-developing country trade within the region is also adversely affected because of the presence of NTBs in the developing countries themselves. The situation is mitigated to some extent by Japan showing a consistently lower level of NTBs for imports from countries of the Asian and Pacific region than its NTBs on imports from other regions, though the absolute levels of incidence warrant further reduction. In the case of Japan, too, food imports and imports of manufactured goods other than chemicals face fairly extensive NTBs. Their elimination would thus contribute significantly to the development of the Asian and Pacific region into an even more trade-oriented and open economic region.

Third, the developed economies of the region are observed to be less protective than their counterparts in Europe and the United States, though their protectionist measures are biased against intraregional trade and should be altered. The developed economies of the ESCAP region also do not choose VERs to impose individually discriminatory and covert restrictions on exports from partner countries. This is a feature which should be further strengthened, as it demonstrates that developed economies in the region do not protect uncompetitive industries and have continuously restructured their industries in line with their emerging and dynamic comparative advantage. It is hoped that this trend will also extend to the food and agricultural sectors and will be further strengthened in New Zealand, which is imposing higher than average NTBs on imports from the ESCAP region.

Finally, developing economies in the region are less protective than developed market economy countries. This is in contrast to the experience in the rest of the world, where developing countries are seen as imposing more extensive but less discriminatory NTBs on their imports and, in a way, reflects the competitive strength of the region. With more developing countries now in the midst of structural reforms, that characteristic may be further reinforced.

## 2. Technical barriers to trade

In view of the fact that most developing countries in the region are exerting greater effort to expand their foreign exchange earnings through diversification of exports and by moving from commodity exports (whose terms of trade are declining) to value-added goods, such processed and manufactured goods for external markets must meet international standards in terms of quality, design and finish. Thus, over the past few years, certification arrangements have been increasingly used in international trade to confirm that a product conforms to the quality prescribed by standards, regulations and specifications in the importing country. In this context, technical barriers to trade are caused by a variety of technical requirements specified in importing countries for ensuring the standardization of products procured from different countries. These requirements relate to quality parameters, dimensions, safety criteria, methods of sampling and the like. Of late, developed countries have also increasingly been imposing health safety and sanitary standards on imports.

Since developing countries of the region are increasingly exposed to the direct influence of the international market, where the competitiveness of a nation's economy and products are objectively appraised and verified through a relentless struggle for the best possible market position, strategic considerations have prompted several of the developing economies of the Asian and Pacific region to accord greater attention to qualitative factors of production in order to induce a rise in productive efficiency as well as improvement in the quality of output. This has been especially important for the NIEs and some of the ASEAN-4 economies which have, in recent years, carved out significant domestic and international market niches in diverse product groups ranging from processed foods and leather goods to automobiles, electrical appliances and textiles.

At present, developing econo-

mies of the ESCAP region may be grouped into three categories in relation to the development of arrangements for standardization and quality control. The first group consists mainly of the NIEs, particularly the Republic of Korea and Singapore with their sophisticated and institutionalized systems, as in these countries adequate quality certification measures are essential to maintain the reputation of products and to effect improvements in the quality of its products. The second group consists of countries such as India, Indonesia, Malaysia, the Philippines and Thailand, which have moderately developed capabilities. The third category is made up of other developing and least developed countries which have either not developed, or have only recently developed, activities in the field of standardization.

As regards the operational modalities, countries of the region have adopted strategies and instituted measures of varying kinds, including modifications of institutional and policy infrastructure, to maintain and strengthen product competitiveness overseas. These approaches have ranged from the attainment of international standards through the improvement of local quality through incentives, to the integration of standards established by the government agencies of other countries into national quality benchmarks. However, applicable standards between countries vary considerably, reflecting, in a way, the element of occasional arbitariness in domestic standards arising out of protectionist pressures emanating from non-economic considerations.[15]

Furthermore, though there have been impressive achievements by some countries (in a qualitative as well as quantitative sense), a large number of problems are still being encountered by a majority of the region's developing countries. These include lack of trained manpower, dearth of financial resources, non-existent or inadequate testing facilities, absence of quality consciousness, inappropriate industrial and technology policies and institutions, as well as other problems associated with the effective and efficient implementation of standards. Significant among these problems is that confronting small-scale manufacturers seeking certification marks or marks of conformity with relevant national standards, who in many cases neither possess the requisite testing facilities nor have access to such facilities.

It is, therefore, a matter of importance that effective cooperation and coordination of trade efficiency activities, including measures for standardization and quality control, be established among the countries of the ESCAP region, as well as also their trading partners from the developed economies, with the objective of establishing generally accepted norms of quality in regional production. The evolution of such international standards would promote intra-regional trade since they are intended, by concept and design, to eliminate the technical barriers resulting from the lack of, or conflict in, national standards through the establishment of predetermined quality levels for manufactured products targeted for export markets. As the ultimate goal of such an effort would be to achieve international accord on all technical questions which are related to the exchange of goods and services between one country and another, it is of strategic importance that developing countries of the ESCAP region if they aspire to better trade performance and a greater market share, adhere to international standards as much as possible. Of course, international standards should be determined on an equitable basis and reflect the concerns and requirements of developing countries which, on occasion, feel that these standards have become technical barriers to entry rather than measures that maintain product quality for facilitating international trade.

A major drawback in this context is that international product standards are geared towards performance specifications rather than design specifications, because they permit a variety of approaches in the attainment of fitness for use of the product. It is believed that performance-oriented standards allow the necessary flexibility in fitting standards to the varying conditions for manufacturing throughout the world. There is a view, however, that for developing countries, international standards should contain both performance and design specifications (which are necessary for, say, spare parts and maintenance), so that interchangeability of machine parts and equipment are guaranteed to the developing countries. Neglect of this fact has thus led to the incompatibility of the standards needs of the developing countries with those of the developed economies, particularly as international standards are established in consultation mainly with the developed countries.

Besides standards and other regulations, the existing certification and laboratory accreditation systems in ESCAP members and associate members also act as barriers to trade. Since these systems, depending on national cir-

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15 One possible method of overcoming this problem is by having the laboratory accreditation systems of different countries standardized or based upon substantially identical fundamental criteria, since this will facilitate acceptance of test results produced by accredited laboratories; however, this will be a time-consuming process and difficult to achieve.

## Box IV.2. Trade and environment

The relationship between trade and environmental policies has recently emerged as a major topic of international attention and debate. There is increasing concern that in the short and medium term, measures adopted for environmental reasons may have adverse impacts on trade and impede the economic growth of developing countries. There is also concern that as a result of unfavourable world economic conditions some developing countries may feel obliged to maintain export patterns leading to an over-exploitation of natural resources, whereas existing protectionism in developed countries may also lead to distortions in international trade which are incompatible with sustainable development.

Policy initiatives, both at the national and regional levels, will therefore be required to ensure that environmental policies and the relevant rules of the international trading system are mutually supportive with a view to achieving sustainable development. Technology transfer issues and national policies aimed at the development of environmentally sound technologies in developing countries will also need to be addressed in the analysis of possible ways to reconcile environmental and trade policies. The focus here is on issues which need to be addressed to assist the region's developing countries in framing their domestic policies in the context of the trade-related concerns of major external markets, taking into account the constraints in their own countries.

A large number of international agreements and instruments relate to the environment.[a] This is partly a reflection of the fact that there are many environmental problems that are beyond the power of individual nations to control. However, not all international agreements obtain universal participation, nor do they cover all matters of relevance to international trade. As such, friction and trade distortions arise when a country attempts to enforce its rules and standards in a way that affects the trading interest of other countries whose rules and standards may be different or non-existent. This may be the case even when the country applies its rules and standards equally to domestic production and to exports.

Thus, some measures ostensibly taken for health, safety or environmental reasons, particularly technical standards, can act as disguised trade barriers. Therefore, efforts in the General Agreement on Tariffs and Trade (GATT) have been made to restrict the use of standards as non-tariff barriers. The Tokyo Round Standards Code, as well as the current Uruguay Round of multilateral trade negotiations to modify and extend it, obliges signatories to make use of international norms when possible. Deviations are permitted for various reasons, including environmental protection, provided they are transparent and have a scientific basis.

Standards harmonization entails potential benefits and costs. It may reduce inefficient differences and permit increased trade, yet allowances must be made for differing standards when they reflect, for example, more stringent national risk tolerances. In the case of environmental protection standards, different countries may be capable of the same levels of abatement using different standards, thus making harmonization inefficient. Furthermore, purely local environmental problems would be most efficiently handled through national policies, whereas regional problems may require cooperative solutions entailing some standards harmonization.

Another issue involves the effects on "competitivenes" of differing costs of environmental protection with regard to traded goods. Pollution-intensive industries in countries with costly abatement policies may claim to suffer from the "unfair" trade advantages of countries with lower costs. For this reason, it has been suggested that imports from countries with low abatement costs be considered unfairly subsidized and that they be subject to countervailing duties. However, countries may be capable of achieving similar levels of environmental quality at different costs. For example, a country levying countervailing duties against products from a country with lower abatement costs could be protecting an inefficient domestic industry. Furthermore, when environmental effects are local and standards and abatement costs differ, such measures may be seen as encroaching on national sovereignty.

Clearly, the protection of the environment and promotion of intraregional trade need a set of rules that are generally acceptable to the region, especially the developing countries in the region. However, the global implication of these rules cannot be overlooked because most of the region's trade is still outside of Asia and the Pacific. Moreover, complications arise with regard to internalization of environmental costs and international competitiveness. Some countries, especially those with low levels of income, place a greater premium on growth than on the environment. National environmental standards thus vary greatly. Consequently, particular industries in some countries might include environmental costs in their cost calculations more completely than their competitors in other countries, giving the latter a competitive advantage.[b]

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[a] The United Nations Environment Programme lists 152 such agreements, many of which concern international trade, but for the most part indirectly. See GATT, *Trade and Environment* (L/6896), 18 September 1991.

[b] Doubts have, however, been expressed about the size of cost differences, owing to variations in environmental standards. See GATT, *International Trade 90-91*, vol. 1 (Geneva, 1992).

*(Continued overleaf)*

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These questions can be resolved only by regional consensus. But they also lead to the broader issues of development priorities in a region known for its diversity, where nations are at very different levels of development, and production and consumption patterns vary greatly among countries. While protection of the environment is a legitimate concern of any nation, it can also be used as a cover for trade protection. This is one of the major dangers to intraregional trade expansion unless countries cooperate to achieve an appropriate balance between the legitimate environmental interests of a country and the need for trade expansion in a manner that benefits the entire region.

cumstances, are often different in a practical, economic, legal or technical sense, it becomes necessary to harmonize the fundamental criteria on which they are based from the viewpoint of facilitating trade expansion. While the harmonization of such criteria on the basis of internationally recognized standards and guidelines will allow for the removal of or reduction in trade barriers, active cooperation among the developing economies of Asia and the Pacific will help them to better organize and improve their trade efficiency efforts. Pitted against other countries, particularly the developed economies which place product quality high on their list of priorities, developing countries of the region cannot be complacent over the quality control issue. The general level of inadequate facilities for ensuring product quality in these countries therefore highlights the crucial need for greater mutual support and interaction, especially as new concerns such as trade and environment are likely to impose additional technical barriers to trade expansion (see box IV.2).

# V. SPECIFIC PROBLEMS OF THE PACIFIC ISLANDS, LEAST DEVELOPED COUNTRIES AND THE ECONOMIES IN TRANSITION

If foreign investment is not the leading but merely a facilitating force in generating a virtuous circle of growth based on the nexus between foreign trade and investment, internal structures and domestic policies must play a key role in ensuring such growth. This means that in practice there could be countries where the specific structural features with which the economy has been endowed, rather than those it has created by policy, inhibit exploitation of that virtuous nexus. In this chapter, three sets of countries within the Asian and Pacific region with such specific problems, which render them special cases in the overall scenario of the spread of growth based on the trade-investment nexus, are focused upon: the Pacific islands, the non-island least developed countries and the economies in transition. It may be noted, however, that in the discussion only those structural handicaps that are amenable to economic solutions and policy are highlighted. Therefore, the need for guaranteed trade and transit facilities to land-locked countries, although of paramount importance to the countries concerned, is recognized but not analysed.

As will become evident in the chapter, for each of the three sets of countries the role of the foreign trade and investment nexus has divergent implications. The Pacific island economies and the non-island least developed countries, even after years of development effort, have made only limited progress in their search for sustained growth. While in part this is due to the small size of their economies, which precludes the derivation of economies of scale, much of the reason for this limited progress may also be their narrow resource base and poor infrastructural facilities. In this context, the critical and catalytic role of continued official development assistance (ODA) from external sources cannot be relegated to relative neglect, as investments to overcome infrastructural constraints will be a precondition for inducing the private investor. In the foreseeable future, foreign aid will therefore continue to be the mainstay in these two categories of countries, although domestic policies to attract foreign direct investment (FDI) will certainly have to be pursued to complement governmental efforts.

In the case of the group of economies in transition, structural deficiencies in their economic systems and infrastructural problems are the overwhelming constraint. Substantial official external assistance will thus be required to ease these bottlenecks, especially their limited transport and communication availability. However, as the resource base of these economies is generally adequate, it may be expected that, with appropriate policy backup, FDI flows can be attracted in sizeable magnitudes, so as to set these countries on the path to sustained growth within a foreseeable time-frame. The operation of the virtuous foreign trade and investment nexus is therefore likely to operate for this group with greater intensity once the basic problems created in the past by central planning have been redressed.[1]

## A. THE PACIFIC ISLANDS

### 1. Foreign trade structure

Nearly all the Pacific island economies have a long history of commerce with the East and the West, and since the end of the Second World War have maintained a relatively open trading stance with each other and with the rest of the world. These economic ties are attenuated by distance, limited infrastructure facilities and, with a few exceptions, insufficient economies of scale. In recent years, most of the economies in this subregion, as a result of low prices for export commodities, have experienced a slow-down in economic growth. Except for Papua New Guinea, all these economies record substantial trade deficits; and all

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1 For a detailed discussion of the issue, see ESCAP, "An action programme for regional economic cooperation in trade and investment: selected issues and policy options for economic development in Asia and the Pacific", (ESCAP/SREC/INF.1), background paper prepared for the Steering Group of the Committee for Regional Economic Cooperation, held at New Delhi from 24 to 27 November 1992, Chapter V.

of them, including Papua New Guinea, register substantial current account deficits on their balance of payments.

A study of the structure of trade in some of the Pacific islands has estimated a strong relationship between export growtand the trends in world trade. For all the countries for which data were available, including Fiji, Papua New Guinea, Solomon Islands and Tonga, the estimated elasticity of export growth with respect to the value of world trade was greater than one, and to the volume of world trade, of the order of three to four.[2] This extreme sensitivity to the trends in world trade is in part the result of the dependence of these economies on a narrow range of exports which, in turn, are afflicted by volatility within the prevailing structure of international trade. Furthermore, the dominant markets for these exports still reflect the links with former colonial powers.

The high dependence of these economies on the exports of a few commodities is well illustrated in table 5.1. On average, over the 1980s food and live animals accounted for 63 per cent of exports from Fiji and around 40 per cent of those from Kiribati, Samoa and Tonga. The share of this category (SITC-0) was also high in the case of the Papua New Guinea, Solomon Islands and Vanuatu. Similarly, the category of crude materials, excluding fuels (SITC-2), accounted on average for 68 per cent of exports from Vanuatu, 63 per cent from Papua New Guinea, 55 per cent from Solomon Islands, 47 per cent from

**Table 5.1. Distribution of exports in the Pacific islands by SITC category**

*(Summary statistics for proportion of total trade in 1980s, percentage)*

| *Country or area* | *Minimum* | *Maximum* | *Mean* | *Standard deviation* |
|---|---|---|---|---|
| **0 Food and live animals** | | | | |
| Fiji | 55.25 | 70.97 | 63.20 | 4.89 |
| Kiribati | 17.38 | 71.98 | 39.54 | 23.45 |
| Papua New Guinea | 15.65 | 36.29 | 25.77 | 6.41 |
| Samoa | 33.96 | 48.88 | 40.25 | 6.25 |
| Solomon Islands | 1.32 | 53.38 | 33.64 | 18.67 |
| Tonga | 26.79 | 53.60 | 38.53 | 9.38 |
| Vanuatu | 21.03 | 46.72 | 27.09 | 9.84 |
| **1 Beverages and tobacco** | | | | |
| Fiji | 0.05 | 0.64 | 0.20 | 0.18 |
| Papua New Guinea | 0.00 | 0.01 | 0.01 | 0.00 |
| Tonga | 7.21 | 7.73 | 7.47 | 0.26 |
| **2 Crude materials except fuels** | | | | |
| Fiji | 1.04 | 3.93 | 2.10 | 0.84 |
| Kiribati | 19.51 | 77.90 | 47.23 | 23.93 |
| Papua New Guinea | 55.48 | 75.42 | 62.98 | 7.81 |
| Samoa | 9.89 | 57.87 | 37.79 | 17.41 |
| Solomon Islands | 38.42 | 94.15 | 55.35 | 20.32 |
| Tonga | 0.87 | 37.45 | 11.95 | 14.56 |
| Vanuatu | 51.78 | 78.28 | 68.33 | 9.42 |
| **3 Mineral fuels etc** | | | | |
| Fiji | 10.30 | 21.70 | 17.16 | 4.16 |
| Papua New Guinea | 0.05 | 0.62 | 0.27 | 0.20 |
| Samoa | 0.31 | 0.81 | 0.57 | 0.21 |
| Tonga | 0.05 | 0.07 | 0.06 | 0.01 |
| **4 Animal and vegetable oils, fat** | | | | |
| Fiji | 0.91 | 8.70 | 3.57 | 2.61 |
| Papua New Guinea | 0.33 | 1.56 | 0.86 | 0.51 |
| Samoa | 0.59 | 41.07 | 14.09 | 19.08 |
| Solomon Islands | 2.78 | 4.77 | 3.78 | 1.00 |
| Tonga | 0.07 | 13.25 | 4.54 | 6.16 |
| Vanuatu | 0.04 | 8.51 | 2.18 | 3.66 |
| **5 Chemicals** | | | | |
| Fiji | 0.40 | 1.07 | 0.73 | 0.27 |
| Papua New Guinea | 0.05 | 0.24 | 0.09 | 0.07 |
| Samoa | 0.06 | 0.65 | 0.36 | 0.27 |
| Tonga | 0.05 | 0.13 | 0.08 | 0.03 |
| Vanuatu | 0.19 | 0.19 | 0.19 | 0.00 |
| **6 Basic manufactures** | | | | |
| Fiji | 2.32 | 5.63 | 4.20 | 1.17 |
| Papua New Guinea | 0.83 | 1.25 | 1.03 | 0.16 |
| Samoa | 0.32 | 2.21 | 1.27 | 0.85 |
| Tonga | 0.66 | 8.49 | 2.87 | 2.88 |

*(Continued on next page)*

[2] A.P. Thirlwall, *The Performance and Prospects of the Pacific Island Economies in the World Economy*, Research Report Series No. 14, (Honolulu, East-West Center, Pacific Islands Development Program, 1991).

**Table 5.1.** *(continued)*

*(Summary statistics for proportion of total trade in 1980s, percentage)*

| Country or area | Minimum | Maximum | Mean | Standard deviation |
|---|---|---|---|---|
| **7 Machines, transport equipment** | | | | |
| Fiji | 2.23 | 7.39 | 4.29 | 1.49 |
| Papua New Guinea | 0.47 | 2.70 | 1.24 | 0.73 |
| Samoa | 0.19 | 5.78 | 2.44 | 2.11 |
| Tonga | 0.62 | 4.40 | 3.02 | 1.42 |
| Vanuatu | 0.17 | 1.43 | 0.80 | 0.63 |
| **8 Miscellaneous manufactured goods** | | | | |
| Fiji | 0.95 | 4.26 | 2.49 | 1.06 |
| Kiribati | 0.74 | 0.95 | 0.87 | 0.09 |
| Papua New Guinea | 0.06 | 0.33 | 0.14 | 0.09 |
| Samoa | 0.49 | 1.25 | 0.87 | 0.31 |
| Tonga | 4.05 | 15.79 | 9.46 | 4.44 |
| Vanuatu | 0.07 | 0.61 | 0.28 | 0.19 |
| **9 Goods not classified by kind** | | | | |
| Fiji | 1.24 | 3.92 | 2.06 | 0.83 |
| Kiribati | 3.98 | 25.51 | 12.36 | 9.41 |
| Papua New Guinea | 0.00 | 4.78 | 2.39 | 2.39 |
| Samoa | 0.17 | 5.18 | 1.86 | 2.04 |
| Solomon Islands | 2.73 | 4.42 | 3.25 | 0.60 |
| Tonga | 1.27 | 7.72 | 3.63 | 2.38 |
| Vanuatu | 0.01 | 10.68 | 2.74 | 4.58 |

*Source:* United Nations trade statistics database; calculations by the ESCAP secretariat.

Kiribati and 38 per cent from Samoa. Thus, not merely did these commodities represent a high share of exports but they were also items which involved a minimum degree of domestic processing. Though these export items also constituted the dominant determinant of income in the Pacific islands, exports in general did not reflect a significant amount of value added.

This commodity composition of the exports of the island economies renders them highly vulnerable to world price fluctuations. One indicator of the volatility is the rather sharp variation in the share of SITC groups 0 and 2 in the total exports of these economies over the 1980s. For example, during the 1980s, the share of SITC 2 in the export earnings of Kiribati varied from a minimum of 19.5 per cent to a maximum of 77.9 per cent. While, in a few instances, the differences reflected the growing importance of a particular export item, such instability usually played havoc with individual economies, leading in many cases to stagflationary trends.

Besides the fact that adverse export performance has a direct impact on growth, it also renders them dependent on remittances and aid to finance crucial imports. Three sets of commodities dominate the import profile of the Pacific islands: food, mineral fuels and manufactures (including consumption goods and machinery); that is to say, the structure of these economies makes them dependent on a rather wide range of imports that need to be financed with earnings from a narrow export base. Unfortunately, subregional trade has not helped reduce the dependence of these economies on outside markets for such imports. As emerges from tables 5.2 and 5.3, subregional exports amounted to just 2.9 per cent of exports from the Pacific islands, and subregional imports for just 1.1 per cent of the imports of these economies.

When seen in the light of more disaggregated data, the factor responsible for this small share of subregional trade is twofold: first, the sheer physical difficulties in ensuring subregional trade; and second, the fact that endowments are such that the exports of most of these islands are competitive, while imports are largely of commodities not in surplus anywhere in the subregion. There are, in fact, four basic obstacles to more rapid development of subregional trade.[3] The first barrier is the "tyranny of distance"; some 6,000 kilometres separate Papua New Guinea from French Polynesia, while some island countries are much closer to Australia and New Zealand. The second hurdle is small production volumes and infrequent shipping schedules, which make for high per unit transport costs. The third constraint is the persistence of colonial economic relations. This means, among other things, that international shipping is geared to taking raw materials from the islands and bringing manufactured goods back, rather than providing links between one island country and another. The fourth factor is the heavy reliance on foreign aid, which often requires recipient

3 Te'o I. Fairbairn, *Island Economies: Studies from the South Pacific* (Suva, University of the South Pacific, 1985).

**Table 5.2. Geographical distribution of total exports of Pacific island economies, 1990**

*(Percentage)*

| | *Exports of:* | | | | | | |
|---|---|---|---|---|---|---|---|
| | *Fiji* | *Papua New Guinea* | *Samoa* | *Solomon Islands* | *Tonga* | *Vanuatu* | *Total Pacific islands* |
| **To:** | | | | | | | |
| Fiji | – | 0.03 | 2.39 | 3.61 | 1.76 | 0.20 | 0.27 |
| Papua New Guinea | 0.38 | – | – | 0.72 | – | 0.04 | 0.14 |
| Solomon Islands | 0.26 | 0.16 | – | – | – | 0.44 | 0.23 |
| Territory of American Samoa | 1.72 | – | 8.01 | – | 4.40 | – | 0.57 |
| Samoa | 1.34 | – | – | – | 0.14 | – | 0.36 |
| Vanuatu | 1.25 | – | – | 0.40 | – | – | 0.36 |
| Tonga | 2.51 | – | 0.09 | – | – | – | 0.68 |
| Tuvalu | 0.52 | – | – | – | – | – | 0.14 |
| Kiribati | 0.59 | – | – | – | – | – | 0.16 |
| All Pacific islands | 8.57 | 0.19 | 10.49 | 4.73 | 6.30 | 0.68 | 2.91 |
| United Kingdom | 30.62 | 4.17 | 3.67 | 11.55 | 0.23 | 0.32 | 12.73 |
| Australia/New Zealand | 23.41 | 18.32 | 48.34 | 5.48 | 41.78 | 7.77 | 24.15 |
| United States/Canada | 7.22 | 1.98 | 6.56 | 3.76 | 15.90 | 3.72 | 4.22 |
| Germany | 0.37 | 19.78 | – | 4.09 | 0.09 | 29.05 | 18.82 |
| Japan | 6.07 | 33.04 | 0.51 | 41.27 | 35.45 | 20.75 | 34.64 |
| Republic of Korea | 0.02 | 7.15 | – | 4.78 | – | 2.67 | 6.81 |
| China | 2.03 | 0.14 | – | – | – | 0.04 | 0.68 |
| Taiwan Province of China | 2.39 | 0.30 | – | 1.11 | 0.04 | – | 0.98 |
| Malaysia | 8.96 | 0.13 | – | 0.04 | – | – | 2.53 |
| Philippines | 0.01 | 5.51 | – | – | – | – | 5.00 |
| Rest of Asia | 11.84 | 2.03 | 23.02 | 21.12 | 6.44 | 6.35 | 6.61 |

***Source:*** United Nations trade statistics database; calculations by the ESCAP secretariat.

countries to order equipment and supplies from donor countries. This is exacerbated by the fact that trade agreements, which provide for favourable access to donor country markets of recipient country products, have often accompanied aid packages.

The major markets for the exports of these economies are Japan, Australia/New Zealand, Germany and the United Kingdom of Great Britain and Northern Ireland, in that order; and the main sources of imports are Australia/New Zealand, Japan and the rest of Asia. In fact, the rise of Japan as the single most important destination for exports from the Pacific islands is recent; in 1990, Japan absorbed $456 million, or 34.6 per cent, of the exports of those economies for which data are available. Moreover, exports to Japan have been rising over time, at the rate of 6-7 per cent a year over the period 1984-1990, in contrast with the stagnation or even decline in exports to many other destinations. Not surprisingly, Japan has also emerged as the single most important supplier of imports after Australia and New Zealand.

Three conclusions emerge from this brief review. First, an effort to enhance intra-regional trade within the Pacific islands is necessary so that the subregion can meet at least some of its essential requirements from among these island economies. Second, appropriate measures are required to change the structure and direction of trade in a manner that would enhance the benefits to be derived from integration with the Asian and Pacific region as a whole, especially the new growth poles among the NIEs, the ASEAN-4 and China. To a certain extent this is already occurring, especially in the case of Papua New Guinea. The Republic of Korea, Taiwan Province of China, Malaysia and the Philippines have become important new export destinations. In 1990, the Republic of Korea absorbed 6.8 per cent of the exports of the

**Table 5.3. Geographical distribution of imports of Pacific island economies, 1990**

*(Percentage)*

| | *Imports of:* | | | | | | |
|---|---|---|---|---|---|---|---|
| | *Fiji* | *Papua New Guinea* | *Samoa* | *Solomon Islands* | *Tonga* | *Vanuatu* | *Total Pacific islands* |
| **From:** | | | | | | | |
| Fiji | – | 0.08 | 3.35 | 1.03 | 11.05 | 5.60 | 0.73 |
| Papua New Guinea | 0.05 | – | – | 2.25 | 0.06 | 0.03 | 0.11 |
| Solomon Islands | 0.30 | 0.02 | – | – | – | 0.39 | 0.12 |
| Territory of American Samoa | 0.00 | – | 0.05 | – | 0.24 | – | 0.01 |
| Samoa | 0.02 | – | – | – | 0.12 | – | 0.01 |
| Vanuatu | 0.01 | – | – | – | – | – | 0.00 |
| Tonga | 0.02 | – | – | – | – | – | 0.00 |
| Tuvalu | 0.01 | – | – | – | – | – | 0.00 |
| Kiribati | 0.21 | – | – | – | 0.00 | – | 0.07 |
| All Pacific islands | 0.62 | 0.10 | 3.40 | 3.28 | 11.47 | 6.02 | 1.05 |
| United Kingdom | 3.26 | 2.16 | 1.57 | 0.09 | 3.47 | 3.89 | 2.51 |
| Australia/New Zealand | 47.80 | 42.39 | 41.33 | 39.92 | 52.33 | 37.54 | 44.07 |
| United States/Canada | 5.36 | 8.30 | 9.64 | 6.90 | 11.87 | 7.44 | 7.41 |
| Germany | 1.04 | 1.61 | 4.90 | 0.89 | 0.77 | 0.24 | 1.44 |
| Japan | 11.62 | 13.31 | 8.55 | 20.19 | 6.25 | 84.73 | 15.41 |
| Republic of Korea | 1.89 | 0.80 | – | 2.00 | 0.56 | 0.76 | 1.16 |
| China | 2.47 | 1.58 | 1.97 | 1.89 | 1.20 | 1.80 | 1.89 |
| Taiwan Province of China | 4.06 | 1.02 | 1.84 | 0.83 | 1.11 | 0.24 | 1.99 |
| Malaysia | 0.40 | 0.43 | 0.12 | 0.20 | 0.02 | 0.08 | 0.37 |
| Philippines | 0.17 | 0.35 | – | – | 0.04 | 0.03 | 0.25 |
| Rest of Asia | 17.65 | 13.17 | 27.11 | 21.00 | 19.27 | 11.39 | 15.54 |

***Source:*** United Nations trade statistics database; calculations by the ESCAP secretariat.

economies for which data are available. In the light of past experience, it can be said that the re-emergence of China's trading relationship can be discerned from the numbers, with Fiji taking the lead in this linkage. Third, given the narrow production structure, the scenic attractions of the Pacific island economies must be used to augment foreign exchange earnings through tourism. To a certain extent, this policy is already being followed (see box V.1).

Thus, while signs of a process of diversification are discernible, the economies are characterized by endowments and locational and structural problems, which need to be specifically addressed when working towards greater regional cooperation so as to find alternatives to foreign aid to overcome the extreme vulnerability of these economies in the wake of fluctuations in world trade. Foreign investment can in fact play a significant role in this respect.

## 2. Foreign investment patterns

For a number of historical reasons, foreign investment already plays a significant role in some of the Pacific islands, though transnational corporation involvement has varied from one economy to another in terms of scale and sector. FDI in Fiji has been concentrated on the development of the tourism industry, whereas petroleum exploration and mining development have dominated investments in Papua New Guinea. Transnational corporations also have a strong presence in large-scale agricultural production in Papua New Guinea, and it has been estimated that transnational corporations in that country accounted for the bulk of tea and rubber production, one half of copra, and about one third of cocoa, coffee and palm oil. Transnational corporation involvement in fisheries, especially tuna fishing and processing has been significant in Fiji, Papua New Guinea, Solomon Islands and the Territory of American Samoa. In

## Box V.1. Tourism in the Pacific island subregion

Countries of the Pacific island subregion have been suffering from economic stagnation in the past few years. Severe limits on their import capacity are seriously constraining their development efforts. The range of commodities exported is extremely narrow and in recent years even these limited exports have been adversely affected by falling commodity prices and limited access to external markets. Owing to low rates of savings and capital formation, economic growth rates have been slow and sometimes negative as a result of natural disasters. Under these circumstances, tourism is expected to play an even more important role in the socio-economic development of many of the countries in the Pacific subregion.

These countries have experienced varying rates of growth in tourism. In some, tourism has become the leading economic sector, while in others, tourism represents one of the few areas with growth potential in terms of economic development. Tourism has been recognized by nearly all Pacific island Governments as an important means of expanding their country's economic base, increasing foreign exchange earnings, providing employment, and enhancing the standard of living.

According to statistics compiled by the Tourism Council of the South Pacific, tourist arrivals in 12 Pacific island countries and areas Cook Islands, Fiji, French Polynesia, Kiribati, Niue, Papua New Guinea, Samoa, Solomon Islands, Territory of American Samoa, Tonga, Tuvalu and Vanuatu increased at an average annual rate of 3.5 per cent, from 547,896 in 1985 to 650,759 in 1990.

Tourist arrivals increased at a rate higher than 3.5 per cent in Tonga (8.1 per cent), Vanuatu (7.4 per cent), Papua New Guinea (6 per cent), American Samoa (4.2 per cent) and Fiji (4.1 per cent). In three countries – Niue, Solomon Islands and Tuvalu – tourist arrivals recorded negative growth.

Of the 12 countries and areas mentioned above Fiji and French Polynesia received the largest number of tourists, accounting for 63.2 per cent of arrivals. Between 5 and 7 per cent of arrivals were received by Territory of American Samoa (7.3 per cent), Samoa (7.3 per cent), Papua New Guinea (6.3 per cent), Vanuatu (5.4 per cent) and Cook Islands (5.2 per cent). The remaining five countries received a share of less than 5 per cent.

The principal source markets for tourism to the Pacific island countries and areas are Australia, New Zealand and the United States of America, which together accounted for 54 per cent of the tourist arrivals recorded in the region in 1990; however, this was a decline from the 61.8 per cent share recorded in 1985. In recent years, Western Europe and Japan have emerged as important source markets for tourism to these countries and areas. The share of the European markets increased from 11.3 per cent in 1985 to 18.1 per cent in 1990, while the share of the Japanese market increased from 3.3 to 6.2 per cent during the same period. These two market sources also recorded the highest average annual growth rates for tourism to the Pacific island countries and areas, 13.9 and 17.1 per cent, respectively. The traditional source markets of Australia and New Zealand recorded much lower average annual growth rates for tourism to these destinations, 2.9 and 3.9 per cent respectively, while the United States of America and Canada recorded negative average annual

**Table 1. Tourist arrivals in Pacific island countries and areas, 1985-1990**

*(number of tourists)*

| *Year* / *Country/Area* | *1985* | *1986* | *1987* | *1988* | *1989* | *1990* | *Average annual growth rate 1985-1990 (percentage)* |
|---|---|---|---|---|---|---|---|
| Cook Islands | 28 782 | 31 245 | 32 112 | 33 886 | 32 907 | 33 882 | 3.4 |
| Fiji | 228 175 | 257 824 | 189 866 | 208 155 | 250 565 | 278 996 | 4.1 |
| French Polynesia | 122 086 | 161 238 | 143 547 | 135 387 | 139 705 | 132 361 | 1.6 |
| Kiribati | 3 028 | 3 350 | 3 905 | 3 465 | 3 009 | 3 332 | 1.9 |
| Niue | 1 495 | 1 788 | 1 623 | 1 231 | 580 | 640 | –18.5 |
| Papua New Guinea | 30 391 | 31 900 | 34 970 | 40 529 | 48 918 | 40 742 | 6.0 |
| Samoa | 43 919 | 49 710 | 48 665 | 49 088 | 53 994 | 47 642 | 1.6 |
| Solomon Islands | 11 974 | 11 630 | 12 555 | 10 679 | 9 860 | 9 195 | –5.4 |
| Territory of American Samoa | 38 625 | 36 546 | 38 449 | 38 513 | 47 188 | 47 337 | 4.2 |
| Tonga | 14 216 | 16 088 | 17 239 | 19 456 | 21 029 | 20 919 | 8.1 |
| Tuvalu | 684 | 732 | 530 | 674 | 567 | 671 | –0.4 |
| Vanuatu | 24 521 | 17 515 | 14 624 | 17 544 | 23 865 | 35 042 | 7.4 |
| Total | 547 896 | 619 566 | 538 085 | 558 607 | 632 187 | 650 759 | 3.5 |

***Source:*** Tourism Council of the South Pacific, *South Pacific Regional Tourism Statistics 1985-1990* (Suva, 1991).

**Table 2. Tourist arrivals in Pacific island countries and areas, 1990**

*(by major markets)*

| Country/Area \ Market | Australia | New Zealand | United States | Canada | Japan | Other Asia | United Kingdom | Other Europe | Pacific islands | Other countries | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Cook Islands | 4 843 | 10 757 | 4 373 | 2 381 | [a] | [a] | [b] | 6 003 | 3 662 | 1 863 | 33 882 |
| Fiji | 103 535 | 29 432 | 36 928 | 18 438 | 21 619 | 6 255 | 16 773 | 27 211 | 17 528 | 1 277 | 278 996 |
| French Polynesia | 8 934 | 6 061 | 43 251 | 4 124 | 14 060 | 1 019 | 4 265 | 42 344 | 3 618 | 4 685 | 132 361 |
| Kiribati | 381 | 158 | 642 | [a] | 252 | [a] | 10 | [a] | 1 470 | 419 | 3 332 |
| Niue | 55 | 465 | 9 | – | 1 | 3 | – | 4 | 103 | – | 640 |
| Papua New Guinea | 18 845 | 1 882 | 4 332 | 758 | 1 830 | 4 500 | 3 101 | 4 396 | 741 | 357 | 40 742 |
| Samoa | 5 029 | 8 224 | 4 121 | 565 | 481 | [a] | 2 870 | 3 066 | 20 626 | 2 660 | 47 642 |
| Solomon Islands | 3 403 | 1 269 | 758 | 70 | 537 | 187 | 506 | 285 | 1 720 | 460 | 9 195 |
| Territory of American Samoa | 1 589 | 3 334 | 10 142 | 481 | 162 | 713 | 607 | 724 | 29 426 | 159 | 47 337 |
| Tonga | 3 519 | 4 840 | 4 540 | 341 | 542 | 1 868 | 755 | 2 420 | 2 063 | 31 | 20 919 |
| Tuvalu | 94 | 69 | 69 | 7 | 30 | 8 | 51 | 78 | 232 | 33 | 671 |
| Vanuatu | 17 667 | 6 291 | 904 | 190 | 751 | [a] | 697 | 1 342 | 5 603 | 1 597 | 35 042 |
| Total | 167 894 | 72 782 | 110 069 | 27 355 | 40 265 | 14 553 | 29 635 | 87 873 | 86 792 | 13 541 | 650 759 |

***Source:*** Tourism Council of the South Pacific, *South Pacific Regional Tourism Statistics 1985-1990* (Suva, 1991).

***Notes:*** [a] included under Other countries.
[b] included under Other Europe.

growth rates of tourism to these destinations of -3.9 per cent and -0.8 per cent respectively.

The tourism industry contributed significantly to the economic growth and modernization of a large part of the Pacific island subregion in the last decade. In Fiji, foreign exchange earnings from tourism in 1990 were estimated at F$ 335.9 million (or US$ 227 million), making tourism Fiji's largest foreign exchange earner. Tonga's tourism earnings in 1989 were estimated at T$ 11.5 million (or US$ 8.8 million), which was equivalent to 91 per cent of the merchandise export earnings; earnings from tourism were much higher than those from the principal items of merchandise exports, such as coconut products (T$ 1.6 million), fish (T$ 1.4 million), root crops (T$ 2.0 million) and manufactured goods (T$ 2.1 million). In Samoa, tourism earned WS$ 47.1 million (or US$ 20.5 million) in 1990; this was 2.3 times higher than the total merchandise export earnings of WS$ 20.5 million. In Vanuatu, earnings from tourism in 1989 were estimated at VT 1,988 million (or US$ 17 million); earnings from tourism as a proportion of the total merchandise export earnings of VT 2,563 million were as high as 78 per cent.

While the substantial economic contribution of tourism to Pacific island economies is becoming increasingly evident, to harness the tourism potential fully the island countries will need to pursue the development of their tourism sectors in a comprehensive and well-planned manner. This involves the proper development of key industry components, including accommodation, air transport, manpower training and appropriate marketing strategies.

An extremely important factor in ensuring the sound growth of tourism is the integration of environmental considerations into tourism planning. More than any other type of development, tourism requires an unspoiled environment in which to operate. This is especially true in the Pacific, where the region's major marketing strategy extols the beauty and tranquillity of the coastal areas. It is therefore essential that tourism in the region be developed and managed in such a way as to protect natural assets. The extent to which tourism development is planned and controlled in an orderly and coordinated manner will affect the long-term quality of the tourism product and ultimately the success of the industry.

To attain the level of economic benefits desired from tourism, Pacific island Governments will need to tackle the following major issues: (a) the lack of the necessary infrastructure; (b) the lack of clearly defined tourism policies; (c) the limited availability and infrequency of a convenient and economical air services; (d) the considerable leakage of tourism income through outside purchases of goods and services not readily available in island countries; (e) the lack of a comprehensive perception of the sociocultural, environmental and economic impact of tourism; (f) the lack of adequate expertise and facilities for manpower training; (g) insufficient marketing; (h) the distance from major markets; and (i) data deficiencies. These issues can be tackled more effectively through closer cooperation among the countries of the subregion. The development of a consistent tourism framework for the Pacific subregion could achieve a higher degree of success both for each individual country and for the subregion than would the adoption and prosecution of individually constructed policies.

addition, there are signs of such investment in some manufacturing activities, including apparel for export in Fiji and other islands. For most other island economies, direct investment flows are minuscule in comparison with official development inflows and remittances from citizens living abroad. It is therefore evident that foreign investment has largely entered sectors linked to the primary product exports of these economies. To a certain extent, this is understandable, but what needs to be ensured is that FDI involvement results in an increase in productivity in these sectors as well as allowing for significant value addition within the domestic economy.

An examination of average annual foreign investment flows on a net balance-of-payments basis for the periods 1976-1980, 1981-1985 and 1986-1989 (table 5.4) shows that average annual net inflows increased from $53 million per year in the late 1970s to $138 million in the first half of the 1980s, and to $151 million in the second half of the 1980s. This, of course, is far below the FDI inflows to the NIEs, the ASEAN-4 and China. However, as a proportion of domestic investment, FDI plays a much more significant role in the Pacific islands than in the other economies of the Asian and Pacific region. Evidence on the ratio of net FDI to gross domestic capital formation indicates that for the period 1976-1979, FDI represented 7 per cent of Fiji's capital formation in Fiji and 15 per cent of that in Papua New Guinea, in contrast to, say, only 4 per cent for Thailand.

An analysis of the direction of new FDI is, however, less encouraging. Papua New Guinea, where mineral and oil exploration received a boost, was the main beneficiary of the increase, while Fiji actually suffered a sizeable reduction in average annual flows. That is, precisely in those economies where foreign investment appeared to be contributing to a diversification in the structure of exports, the inflow of foreign investment has fallen. This suggests that the contribution of foreign investment to help these economies overcome their extreme external vulnerability is as yet inadequate, necessitating special measures to deal with the problem. Of these, ODA retains its critical and complementary role.

**Table 5.4. Destination of foreign direct investment**

*(Based on balance-of-payments outward flows)*

| *Host economy* | *Value (Millions of US dollars)* | | |
|---|---|---|---|
| | *Average 1976-1980* | *Average 1981-1985* | *Average 1986-1989* |
| Total world flows | 32 440 | 53 081 | 130 110 |
| All developing economies, of which: | 6 103 | 17 103 | 17 221 |
| Asian and Pacific region* of which: | 1 794 | 4 371 | 10 150 |
| Pacific islands | 53 | 138 | 151 |
| Fiji | 9 | 30 | 5 |
| Papua New Guinea | 40 | 102 | 135 |
| Solomon Islands | 4 | 1 | 4 |
| Vanuatu | 0 | 5 | 7 |

*Source:* Calculations by the ESCAP secretariat

* Excluding Australia, Japan and New Zealand.

## B. LEAST DEVELOPED COUNTRIES

The second group of countries in the Asian and Pacific region that are characterized by rather specific developmental problems are the least developed countries – a category which includes a number of the Pacific island economies. These specific problems stem from a combination of the following characteristic features: low per capita income, which restricts the size of the domestic market for most commodities; poor infrastructure facilities, in particular transport, which results in a fragmented market and economy; a high degree of vulnerability when faced with natural calamities; inadequate diversification of the economic structure; and low savings rates, which render economic and social transformation dependent on substantial inflows of foreign assistance. In this section, the implications of these particular features for the possibility of using trade and investment to expand cooperation are examined, with particular reference to two of the Asian least developed countries, Bangladesh and Nepal.

### 1. Bangladesh

Among the Asian least developed countries, Bangladesh has the greatest potential for growth. Yet, the expansion in national income occurs in a context where Bangladesh has not

been able to raise the domestic savings rate to satisfactory levels: the rate never exceeded 3 per cent during the 1980s. At the same time, investment rates have hovered around 10 and 13 per cent of gross domestic product (GDP), resulting in a substantial financing gap, the effects of which spilled over onto the balance of payments. There are three factors, in the main, which explain this phenomenon. First, in order to hold inflation in an economy that is faced with an agricultural bottleneck, the Government has consistently resorted to imports of food and related items which have traditionally accounted for 25-30 per cent of Bangladesh's import bill. Second, the structure of domestic production is such that increases in income inevitably lead to increased imports of manufactures, whose share in imports remained above 50 per cent throughout this period. Finally, dependence on fuel imports adds a third inevitable component.

Put simply, domestic structures are such that any effort to raise rates of growth in the economy inevitably implies a sharp increase in the import bill. Hence, growth must be accompanied by an increase in exports, in part to provide markets for such growth but also to finance the inevitable increase in imports. In this context, it must be said to the credit of Bangladesh that, faced with declining demand for its traditional export, jute and jute goods, the country has successfully entered the area of garment exports, which is now its leading export item. However, the fact that garments accounted for about 47 per cent of the total exports of Bangladesh in 1991 indicates that, while diversification away from jute exports has been successfully ensured, the country's export base remains narrow.

Given the high dependence on imports of manufactured capital goods, intermediates and components, Bangladesh's breakthrough in the garment industry is an inadequate basis for raising the rate of growth, which warrants higher and more diversified export growth and a degree of adjustment of domestic structures that reduces reliance on food imports, for example. In this context, the trade policy framework must also identify a few sectors, such as leather products, as thrust areas for export promotion, maintain a flexible exchange rate regime, and perhaps provide specific incentives for export production in special economic zones. It is in support of these efforts that greater regional cooperation through trade and investment can help. Since Asian developing countries absorbed just 13.5 per cent of the exports of Bangladesh, while contributing 26.7 per cent of its imports, the possibility of expanding trade with developing countries in the Asian and Pacific region is high.

It is against this background that the role of FDI as an option to expand manufactured exports from Bangladesh needs to be assessed. However, FDI stood annually at just $2.1 million on average over the period 1986-1989 and was small not only in itself but also relative to the annual average of total long-term capital inflows of $708.1 million; this is so in spite of the fact that in recent years Bangladesh has attempted to liberalize its economy and relax constraints on the operation of foreign capital through the Foreign Private Investment (Promotion and Protection) Act promulgated in 1986, which marked the beginning of an open-door policy. Several initiatives have followed, relating to liberalization of trade, simplification of customs procedures, tariff reforms and reduction of quantitative restrictions.

Clearly, there is considerable scope and need for trade-linked foreign investment in Bangladesh. But the same factors which, to a degree, constrain the pace of expansion of the economy, including inadequate infrastructure and a small and segmented domestic market, appear to militate against foreign investors choosing Bangladesh as a site for world market-oriented production. Measures to correct for this vicious circle have begun, but need to be enhanced as part of a strategy of using trade and investment as vehicles for enhancing regional cooperation and development.

## 2. Nepal

Nepal is a predominantly agricultural economy, with the agriculture sector accounting for 60 per cent of GDP and, until recently, a significant share of merchandise exports. More recently, however, the contribution of agriculture to exports has declined sharply, partly because of declining exportable surpluses and partly because of a sharp increase in the exports of carpets and garments. Despite the reduced dependence on agriculture, this sector remains extremely vulnerable. Inadequate extension services, increased cultivation of marginal lands, inadequate irrigation facilities, inadequate transport infrastructure and a system of absentee landownership and share-cropping are the most important factors in the dismal performance of agriculture. The difficulties faced by the agriculture sector therefore call not only for efforts to resolve them but also for a process of diversification of the economy that will yield economic opportunities and earn the foreign exchange needed to finance development.

Accordingly, under the New Industrial Policy launched in 1992, licensing requirements for industrial establishments other than those concerned with national security or which affect public health and the environment have been abolished. Foreign investments are now allowed into the country with no restrictions on the repatriation of profits and dividends. This initiative, however, has yet to show results, as besides the limited size of the domestic market and the paucity of investible funds, infrastructure, in particular electricity, is also a major constraint on industrialization, despite the country's substantial potential for the generation of hydroelectric power.

Backward agriculture and a stunted industry have thus set limits on Nepal's trade performance. In spite of these handicaps, in terms of commodity composition there was a dramatic diversification in Nepal's exports in the 1980s. While in 1980 primary products accounted for 92 per cent of exports, in 1990 they accounted for just 17 per cent. On the other hand, the share of manufactured goods in total exports rose from 30.5 to 82.6 per cent, but the number conceals the still rather narrow base of such manufactured exports, which are dominated by woollen carpets and garments: their shares in total exports in 1990 were 50 and 31 per cent, respectively.

A persistent trade deficit is characteristic of Nepal's trade, but what is striking about the direction of trade figures is the fact that in 1989, 69 per cent of Nepal's exports went to the industrialized countries, which accounted for only 32.2 per cent of Nepal's imports. Most of Nepal's imports (66.9 per cent) came from developing countries in the Asian and Pacific region, with a significant share coming from non-SAARC countries (30.7 per cent). Countries in the Asian and Pacific region, however, absorbed only 6.4 per cent of Nepal's exports, so that while Nepal contributed to intraregional imports it did not benefit as much from intraregional exports. Redressing this is accordingly a pertinent issue for attention.

The increased availability of aid from developed country sources and multilateral agencies has helped absorb Nepal's trade deficit, and official foreign assistance rose from $163.1 million in 1980 to $428.8 million in 1990. As a result, foreign aid accounted for over 50 per cent of Nepal's development outlay during the 1980s and assumed a dominant position with regard to capital inflows. FDI has played a negligible role and short-term capital flows have been extremely volatile, making these an undependable source of finance. Thus, the trade-investment nexus seems to be hardly operative in Nepal.

The prospects for inducing FDI to step up exports in labour intensive manufactures like carpets and garments are nevertheless good, making this least developed country another example of a country which can benefit from using the trade-investment nexus as the basis for regional cooperation. Such cooperation should also aim to strengthen the agriculture sector in the Nepalese economy, reducing its dependence on external markets for food and easing the constraint set by the balance of payments on growth. In addition, to overcome the constraints on a land-locked economy with mountainous terrain, aid-financed investment in transport and communications would also have to be supported as part of the regional cooperation effort.

## C. ECONOMIES IN TRANSITION

The economies in transition in the Asian and Pacific region are struggling to transform their earlier centrally planned system to a market economy system. Nevertheless, despite this common objective of transition to a market economy, which justifies their inclusion in a broad economic category of economies in transition, their specific historical situations and existing economic structures are very different. The general problem of their transition and its impact on the operation of the trade-investment nexus must be analysed, therefore, in the specific historical context of each economy or country grouping. These economies can be broadly classified into two categories.

The first group would include the six Asian republics of the former Union of Soviet Socialist Republics, Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan,[4] all of which have the common characteristic of being land-locked. Until recently, none of them were "sovereign" economies or modern nation States, and instead were part of the wider production and economic structure of the former USSR. Consequently, all these six economies face some typical common problems during the transition stage. First, these economies have been severely disrupted from both the demand and supply sides. On the demand side, they have suddenly lost significant market and trade links. Their supply lines have been disrupted equally abruptly, since in several important branches of production the output constituted merely parts of the integrated supply system and the

[4] Hereinafter referred to as the "Asian republics".

regional division of labour characterizing the overall production structure of the former USSR. Second, these severe negative shocks afflicting both the demand and supply sides in these economies have occurred at a time when their economic administration structures were exceptionally vulnerable, for as newly emergent States they have still to develop a fully independent legal and administrative structure for economic management, such as an autonomous central banking system to look after matters relating to national currencies and debt obligations of the government. Third, they have not yet had the time to develop an adequate statistical information base for economic management that can provide, for example, satisfactory national income or foreign trade statistics. In short, the creation of "sovereign" economic and administrative structures compatible with the role of the modern nation State is an integral part as well as a special problem facing the transitional process in these six Asian republics.

The economies in transition in the Asian region also include Cambodia, Mongolia, the Lao People's Democratic Republic and Viet Nam. However, while these economies share with the six Asian republics the common objective of changing to market economy system, they differ at least in one significant respect: in terms of their recent history, they have been "nation-States" with a sovereign economic and administrative structure of varying capabilities. At the same time, they have shared with the Asian republics the common shock of disruption in the source of supply caused by the disintegration of the former USSR. But while the Asian republics suffered mostly from a sudden disruption in the integrated supply system dependent on the regional division of labour in the former USSR, the economies of Mongolia, the Lao People's Democratic Republic and Viet Nam suffered especially from a disruption in Soviet aid and technical assistance. For instance, until recently Viet Nam received substantial non-convertible assistance from the former Council for Mutual Economic Assistance (CMEA), estimated at approximately US$ 1 billion per year until 1989. The flow has dwindled since then, and the one-year agreement with the former Soviet Union in January 1991 amounted to grants worth only US$ 10 million, with a US$ 100 million credit line. Thus, the earlier centrally planned economies linked closely to the former USSR face the formidable task of making the transition to a market economy system, while their flexibility for economic adjustment from the supply side has been reduced drastically by a sharp decline in foreign capital and technical assistance inflow from the former USSR – a decline estimated conservatively at somewhere between one tenth to one twentieth of the average earlier annual flow of assistance.[5]

The role of intraregional trade and investment in these economies in transition therefore needs to be set in this exceptional historical context: their major source of foreign assistance in terms of financial aid and technical assistance has more or less dried up. In addition, most of these economies are now subject to severe economic constraints in so far as their traditional international markets suddenly collapsed, and in many cases their traditional supply lines were simultaneously cut. Intraregional trade and investment flows in the Asian and Pacific region therefore have to assume an absolutely critical role in these changed and difficult circumstances, if these economies are to make a successful transition to a market economy system.

## 1. The Asian republics of the former USSR

The economic situations inherited by the policy makers in many of the economies in transition of Asia are exceptionally poor. According to official statistics, in 1991 aggregate Soviet gross national product (GNP) fell by 17 per cent, while inflation soared to 140 per cent (90 per cent, according to the consumer price index). On 29 October 1991, the foreign trade and payments bank of the then USSR was forced to stop payments on even guaranteed letters of credit, and requested the rescheduling of the external debt of the USSR which it could no longer service. Furthermore, it defaulted towards domestic holders of hard currency accounts (which totalled about US$ 5.4 billion), setting in motion unprecedented capital flight. The acute erosion of monetary confidence was evident even in the official Moscow interbank foreign exchange auction market, where the rouble lost 86 per cent of its value against the dollar during the year 1991 alone.[6] Set against this overall dismal background, it is worth noting that the Asian

[5] Based on calculations by the ESCAP secretariat from various issues of the *Survey;* from Organisation for Economic Cooperation and Development, *Development Cooperation*, various issues; and from the Asian Development Bank, *Asian Development Outlook*, various issues.

[6] For further details, see, *Economic Review: The Economy of the former USSR in 1991*, (Washington D.C., International Monetary Fund, 1992).

republics, in relation to other constituent republics in the former USSR, suffered relatively less in terms of output and employment decline, probably owing to their more insular economic structure, even though their inflation rate was comparable with the national experience.

Nevertheless, it must be noted that the Asian republics had relatively little impact on and low statistical weight in the economy of the former USSR as none of them contributed more than 5 per cent to the total net material product (NMP) of the USSR (Azerbaijan, 1.7 per cent, Kazakhstan, 0.8 per cent, Tajikistan, 0.8 per cent, Turkmenistan, 0.7 per cent, and Uzbekistan, 3.3 per cent). At the same time, they were relatively poor economies in terms of income measured by per capita NMP. Typically, per capita NMP in the Asian republics was around half the USSR average, except for Azerbaijan and Kazakhstan, which approached three fourths of the national average. Therefore, to sum up, the (negative) output and employment shock in the Asian republics at the time of the disintegration of the former USSR was less pronounced, but their inflation rate was comparable to the USSR national average (even higher in some cases).

A common characteristic shared by the Asian republics and typical of the then prevalent division of labour in the Soviet Union was a much higher proportion of inter-republic trade in comparison with trade with the outside world. Inter-republic exports amounted to a figure as high as 46 per cent (unweighted average) of the value added by material production. Inter-republic imports, on the other hand, amounted to a distinctly lower (unweighted average) figure of about 13 per cent of the value added of the material product. A special feature of the Asian republics seems to be their role as net exporters in the inter-republic trade in the sphere of non-services material product.[7] This also suggests, as a first approximation, that with the sharp decline in later years in inter-republic trade the negative shock may have been transmitted more sharply in quantitative terms from the demand (export) side than from the supply (import) side, at least in so far as the Asian republics were concerned. This also calls for greater caution in these economies in the application of conventional stabilization policies which aim to achieve a relatively sharp contraction in demand during the stabilization phase.

The picture, however, looks somewhat different when international, rather than interregional, trade is considered for the six Asian republics in the context of the former USSR. The (unweighted average) figure of exorts as a proportion of material product value added for these economies was around just 4.4 per cent, in contrast to an import figure of 6.6 per cent.[8]

The foregoing implies an interesting pattern of trade openness for the Asian republics which were net exporters in inter-republic trade, but net importers in international trade, in so far as non-services material products are concerned. Perhaps part of the explanation for this pattern of trade lies in the relative difference in economic structures, that is, the predominantly primary sector-oriented output composition of the Asian republics which made them net exporters of various relatively unprocessed products in inter-regional or inter-republic trade, but importers of relatively processed products in international trade. Available evidence on the contribution of different sectors to NMP indicates the relatively greater importance of the agriculture sector in the Asian republics and their relatively lower importance with respect to industry, compared with the national average of the former USSR.[9]

The broad similarity in the economic structures of the Asian republics at this very aggregative level suggests two preliminary hypotheses worthy of further investigation. First, the possibility of expanding trade strictly among themselves on the basis of complementarities may be somewhat limited. Consequently, these countries will need to be involved in a wider trade network if they are to benefit adequately from the gains of international trade. It is in this context that the land-locked nature of their economies may prove to be a serious impediment, unless new arrangements are made urgently to promote long-distance trade by creating new transport routes and facilities. Second, the considerable degree of similarity in their economic structures suggests that comparative advantages in economic and social infrastructures, including political stability (in addition to wage and labour productivity differentials), may exert a significant influence

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7 Available data for 1989 estimated by the Economist Intelligence Unit (London) suggests that the Asian States maintained a surplus on visible inter-republic trade while they were usually in deficit on invisible inter-republic trade (mostly services). See also International Monetary Fund data in *The Economy of the Former USSR*, (see footnote 6), (tables 1-5), which present a similar picture.

8 See previous footnote for source of information.

9 Derived from data for 1989 from the Economist Intelligence Unit.

on the pattern of FDI inflows into this region. However, without policy coordination and conscious decision-making in terms of favoured production structures in each of the Asian republics, these economies are more likely to be competitive rather than complementary in terms of attracting foreign investments; of course, this is hard to achieve in practice.

Both the earlier inter-republic and international (that is, outside the former USSR) trade of the Asian republics has been undergoing sharp, even dramatic declines, particularly since 1989. As interregional trade has traditionally played by far the dominant quantitative role, this also means that trade with the rest of the world (outside the former USSR) has hardly offset the decline in interregional trade. One of the major economic challenges facing these economies, therefore, is either to recapture the level of former interregional trade in a way which is fully compatible with their political sovereignty and international economic competitiveness or to find alternative outlets for trade. Table 5.5 gives a picture of the importance of interregional trade (within the former USSR) until 1990 and the sharp decline in external trade by about 40 per cent which took place within one year, that is, by the end of 1991. Unless these trends are arrested immediately, the Asian republics may become trapped in a situation of low-level incomes and near self-sufficiency in trade, from which autarkic trap they would have neither the requisite production structure nor the required financial framework to escape for a long time. To avoid such a disaster is probably the main challenge facing the Asian republics with respect to trade and investment policy in the context of regional and/or subregional cooperation.

Table 5.6 provides a more disaggregated view of the decline in total trade (inter-republic as well as external), separated on the export and import side in 1991 over 1990. It will be noticed that exports and imports tend to decline more or less by the same orders of magnitude in percentage terms in all the Asian republics. Except for Turkmenistan, the percentage decline in exports was somewhat less than that in imports in all the other cases. However, since in 1990 the value of exports was invariably considerably less in all the Asian republics than the value of imports, in most cases this resulted in a narrowing of the external trade gap in 1991 compared with 1990.[10] The table also shows explicitly the absolute amounts of the trade deficit in million rouble units, which was consistently lower by over 45 per cent in 1991 compared with 1990 for each of the Asian republics. However, this narrowing of the trade gap shows the ill health rather than the well-being of these economies in transition. Deprived of any significant foreign assistance and/or net foreign reserve, the contraction of the

[10] If $E_t$ and $M_t$ stand for export and import in year t and, $r_e$ and $r_m$ are proportional (per cent) declines in export and import over the base year 1990) with $M_{90} = k.E_{90}$, $k>1$, then:

$(M_{91}-E_{91}) = [(1-r_m)k-(1-r_e)]\ E_{90}$,

and $(M_{90}-E_{90}) = (k-1)\ E_{90}$.

In follows that the import surplus (i.e. trade deficit) of 1991 is less than that of 1990 if $k>(r_e/r_m)$, a condition satisfied for all the Asian States, where $r_e$ and $r_m$ had similar magnitudes, making the ratio close to unity, but k tended to be much larger than unity in all cases.

**Table 5.5. Composition of trade by destination (i.e. within and outside the former USSR) and decline in trade (1990-1991)**

| | *Total trade[a] (as percentage of GDP)* | *Interrepublic trade (as a percentage of total trade)* | *Percentage decline in foreign trade in 1991[b]* |
|---|---|---|---|
| Azerbaijan | 42.0 | 85.6 | -42.1 |
| Kazakhstan | 33.9 | 86.3 | -39.1 |
| Kyrgyzstan | 45.2 | 86.9 | -42.4 |
| Taijikistan | 41.6 | 86.3 | -43.6 |
| Turkmenistan | 39.0 | 89.1 | -37.1 |
| Uzbekistan | 39.5 | 85.8 | -39.8 |
| Average of the former USSR | 29.4 | 71.8 | n.a. |

*Source:* International Monetary Fund data on the former USSR (not always compatible with data published in *Economic Review* papers on individual republics).

*Notes:* [a] Average of exports and imports of goods. [b] Exports plus imports of goods.

**Table 5.6. Estimated foreign trade of the Asian Republics of the former USSR**

| | *Exports* | | | *Imports* | | | *Trade deficit* | | |
|---|---|---|---|---|---|---|---|---|---|
| | *1990* | *1991* | *Change in 1991 compared with 1990 (percentage)* | *1990* | *1991* | *Change in 1991 compared with 1990 (percentage)* | *1990* | *1991* | *Change in 1991 compared with 1990 (percentage)* |
| | *(Millions of roubles)* | | | *(Millions of roubles)* | | | *(Millions of roubles)* | | |
| Azerbaijan | 898.7 | 557.7 | -38.9 | 2 500.4 | 1 410.0 | -43.6 | 1 601.7 | 852.3 | 53.2 |
| Kazakhstan | 2 199.5 | 1 354.4 | -38.4 | 4 747.0 | 2 877.0 | -39.4 | 2 547.5 | 1 522.6 | 59.8 |
| Kyrgyzstan | 130.1 | 79.7 | -48.7 | 1 700.8 | 975.6 | -42.6 | 1 570.7 | 895.9 | 57.0 |
| Tajikistan | 816.0 | 486.0 | -40.4 | 1 459.6 | 797.5 | -48.4 | 643.6 | 311.5 | 48.4 |
| Turkmenistan | 272.0 | 167.3 | -38.3 | 1 104.3 | 697.9 | -36.8 | 832.3 | 530.6 | 63.8 |
| Uzbekistan | 1 726.5 | 1 131.3 | -34.5 | 3 998.2 | 2 314.3 | -42.1 | 2 271.7 | 1 183.0 | 52.1 |

*Source:* The Statistical Committee of the Commonwealth of Independent States, compiled by the International Monetary Fand, *The Economy of the Former USSR in 1991* (Washington, IMF, 1992).

trade deficit was brought about by strong, negative macroeconomic adjustments involving a fall in output (real GDP) in 1991, which was also associated with a high comparative rate of inflation. Both these macroeconomic factors suggest that export performance might diminish even further, owing to both the increasing lack of domestic availability of exportable goods (as output falls) and erosion of price competitiveness (as the inflation rate remains high). It also seems plausible to argue that the drastic disruption on the supply side may have led to a fall in supply which has exceeded the negative shock of reduced demand in these economies, so that the aggregate excess demand gap may even have widened to fuel further the process of inflation.

In order to obtain a better idea of the evolving structures of export and import by commodity composition in the Asian republics over the last few years (since 1987), table 5.7 provides a view of the dominant export and import items in the trade of each of the Asian republics. It should be remembered that, because of the predominance of inter-republican trade in relation to that of international trade (which has been indicated statistically in table 5.5) the major export and import items refer mostly to former inter-republic trade. However, this may change rather drastically if the relative quantitative importance of former inter-republic trade diminishes rapidly, as some preliminary data for 1992, as well as projections for 1992/93, appear to suggest.

It may also be observed from table 5.7 that inter-republic trade largely determined trade in manufacturing for the Asian republics, which very often imported and exported in inter-republican trade the same or a similar category of manufactured products, that is, they traded in "goods-in-process" at different stages of production in machine building, metal works and light industry. This, in turn, implied that the structure of production in manufacturing has been highly interdependent, especially for Azerbaijan, Kyrgyzstan and Turkmenistan. Therefore, unless the inter-republic trade of the earlier period can be revived in some form, at least in the short run, the manufacturing sector of the Asian republics would be subject to very severe demand as well as supply shocks through inter-industrial linkages, in addition to the impact of final demand contraction.[11] The immediate need is to devise policies and ways of reviving and maintaining the former interregional trade, particularly in manufacturing, until these economies become gradually more integrated with the outside world.

Trade with the outside world (outside the former USSR) presents an even bleaker picture, as the Asian republics seem to depend on imported items of food and light consumer goods. Since many of them are potentially agrarian economies with rich potential, the policy should be to attempt to attract FDI in agro-based industries on especially favourable terms: this appears to be one area in which these economies may be able to develop comparative advantage in the near future, as well as provide an immediate domestic market, thus making FDI worthwhile for outside investors in various forms, including joint ventures. Progress towards a near vertically integrated and sophisticated food industry would thus seem to be an important component of the strategy for economic development worth considering in many of the Asian republics.

11 Inter-industrial linkages in the sense of Leontief input-output analysis (in the flow, rather than the stock, matrix); these include both forward and backward linkages.

**Table 5.7. Most significant trading commodities of the Asian republics of the former USSR: 1987/88 to 1991/92[a]**

| | *Dominant items of trade* | | | |
|---|---|---|---|---|
| | *Imports* | | *Exports* | |
| | *Interrepublic* | *Rest of the world* | *Interrepublic* | *Rest of the world* |
| Azerbaijan[b] | Machine metal work, initially about 40% now about 20% Food (now nearly 20%) | Food items now nearly 60% | Textiles, gradually decreasing from 20% Food increasing from 20% to nearly 40% Machine metalwork | Textiles |
| Kazakhstan[c] | ... | ... | ... | Agricultural and mineral products (40%) |
| Kyrgyzstan[d] | Machine-building and metal-working (20%) and light industry mostly (20%) | Food items, now nearly 50% | Machine building and metal-works (30%), light plus food industry (50%) | Non-ferrous metal-lurgy (over 50%) |
| Tajikistan | ... | ... | ... | ... |
| Turkmenistan[e] | Machine-building (accounting for about 30%) | Light industry (over 20%) and food items (nearly 20%) | Light industry (40%). Oil and gas, second biggest item (20%) | Light industry (nearly 50%) |
| Uzbekistan[f] | Consumers' goods | Food items (nearly 40%); other consumer goods | Cotton | Cotton (nearly 80%) |

*Notes:*
[a] The percentage figures are indicative of importance, rather than exact quantitative magnitudes.
[b] International Monetary Fund, *Economic Review: Azerbaijan* (Washington, D.C., 1992); *Azerbaijan Goskomstat* and *USSR Vestnik Statiski.*
[c] Based on 1992 projections by Ministry of Foreign Economic Affairs, Kazakhstan.
[d] International Monetary Fund, *Economic Review: Kyrgyzstan* (Washington, D.C., 1992); Goskomstat.
[e] Ibid., *Economic Review: Turkmenistan* (Washington, D.C., 1992); *Gosplan and Gossnab.*
[f] Ibid., *Economic Review: Uzbekistan* (Washington, D.C., 1992); Uzbekistan Ministry of Foreign Economic Relations and Goskomstat (figures relate to 1989 to 1991 only). The figures are inadequate to enable a distruction to be made between inter-republican and outside (former USSR) trade.

## 2. Cambodia, Lao People's Democratic Republic, Mongolia and Viet Nam

The other economies in transition of Asia and the Pacific, Cambodia, the Lao People's Democratic Republic, Mongolia and Viet Nam, differ from the Asian republics of the former USSR in at least one important respect. From the political, legal and administrative points of view, they enjoyed the status of sovereign nation-States well before their transition to a market economy system commenced, although, particularly in the case of Cambodia, their administrative machinery has been ruined over the years on account of non-economic disturbances. Therefore, unlike in the Asian republics the process of building the economic administration of the nation States is more evident in the above group of economies in transition to a market economy system.

In another important respect, however, these other economies in transition of Asia share a similar problem with the Asian republics. While the Asian republics formed integral parts of the former economic structure of the USSR and therefore experienced severe demand and supply shocks upon the disintegration of the USSR, these other economies in transition which were also heavily dependent on economic and technical assistance from, as well as trade

connections with, the former USSR, also experienced negative demand and, more particularly, supply shocks in varying degrees as a result of this dissolution. Although direct information is not available on the amounts of military and non-military assistance received from the former USSR and other former socialist countries of Europe and related trade volumes, for these other economies in transition of Asia, the existing data from the former CMEA give some idea of the orders of magnitude involved. Table 5.8 provides some evidence on the trade patterns of the former USSR, by region, up to 1990, from which it may be inferred that the cessation of CMEA in its traditional form in 1990 had resulted in severe demand and supply shocks for the economies in transition of Asia, especially Mongolia and Viet Nam, which had traditionally been large recipients of assistance and had traded mostly within the CMEA region.

In fact, since the late 1970s, many of the centrally planned economies of Asia increasingly felt the need to adopt a more market-friendly approach to economic management. From primarily an intellectual or ideological debate in the early years, mirroring the debates in the former USSR, economic attempts at reducing the scope of their centrally planned structures began to take shape after the mid-1980s, especially in the Lao People's Democratic Republic and Viet Nam, and a little later in Mongolia. The process of economic reform in Viet Nam, after a halting start, was accelerated dramatically during the late 1980s, with the deregulation of most prices as well as extensive deregulation of trading and commercial activities in 1989. At the same time, the unification of multiple exchange rates in external trade in March 1989 led to a massive devaluation of the Vietnamese currency: the dong went down from 225 to the United States dollar in 1987 to 4,500 in 1989, followed by a further devaluation to 11,000 dong to the US dollar in 1991. Such massive devaluation, comparable only to the devaluation by Poland in 1990 during stabilization, entailed: (a) a sharp increase in the profitability of exports compared with production for the domestic market, (b) the enhanced attractiveness of FDI in Viet Nam, and finally (c) a narrowing of the gap between the official and the parallel exchange rate to only 10 per cent.

The practical import of these various effects, following upon the devaluation of the dong and complemented by one of the most liberal codes for foreign investment, is easy to discern. Convertible currency export earnings, which had averaged less than $1 billion until 1988, increased to $1.3 billion in 1989, while exports in non-convertible, transferable roubles also increased substantially. By 1990, FDI in Viet Nam exceeded the figure of US$ 1 billion and the gross, cumulative value of FDI is estimated to have

**Table 5.8. Evolution of the regional trade pattern of the former USSR, 1980-1990**

*(Billions of foreign-exchange roubles, at current prices)*

| | | *1980* | *1985* | *1988* | *1989* | *1990* |
|---|---|---|---|---|---|---|
| Total trade | Exports | 49.6 | 72.7 | 67.1 | 68.7 | 60.9 |
| | Imports | 44.5 | 69.4 | 65.0 | 72.1 | 70.7 |
| Trade with socialist countries[a] | Exports | 26.9 | 44.5 | 42.9 | 42.2 | 34.5 |
| | Imports | 23.6 | 42.5 | 43.4 | 44.7 | 43.2 |
| Trade with CMEA member countries[b] | Exports | 24.3 | 40.2 | 39.0 | 38.0 | 30.3 |
| | Imports | 21.4 | 39.9 | 39.8 | 40.6 | 38.7 |
| Trade with Mongolia and Viet Nam[c] | | ... | 1.4 | 1.6 | ... | ... |
| Trade with the Lao People's Democratic Republic[d] | | 0.4 | 1.1 | 0.8 | 0.7 | ... |

***Source:*** *COMECON Data, 1990* edited by the Vienna Institute for Comparative Economic Studies (London, 1991). Macmillan, (also *COMECON Data,* 1988 and 1989 in the same series and A. Bhaduri, "The role of interregional trade and investment in the growth process of the transitional economies of Asia", 1992.)

***Notes:***

a Including the former centrally planned economies of Europe *plus* Albania, Cuba, Mongolia and Viet Nam (i.e. non-European CMEA (Council for Mutual Economic Assistance) members), plus China, Lao People's Democratic Republic, and Yugoslavia.

b European and non-European members of CMEA; see note (a) above.

c Tentative estimate based on CMEA and country data; average of exports and imports.

d Tentative estimate; average of exports and imports.

been about US$ 2.7 billion at the beginning of 1988. There are also reports that, with the decline in importance of the parallel currency market, the dong is now able to function better as a "store of value" and a "medium of exchange", which are the requisites of a functioning monetary system.

Nevertheless, the experience of Viet Nam since 1989 also indicates why orthodox remedies of relying on the price mechanism for deregulation and devaluation may not be sufficient for promoting trade and economic growth through regional cooperation in the long run. First, FDI in Viet Nam has increasingly shown a short-term speculative bias in favour of real estate, trading and primary resource-extractive activities, and only around one tenth of the cumulative foreign investment has been directed to the manufacturing or processing industries. At the same time, the required international financial support through the multilateral agencies has failed to materialize, despite Viet Nam's explicit market-oriented strategy in recent years. Much of the financial inflow is reported to be from overseas Vietnamese, which shows that deregulation has helped, but not so much by setting prices right between tradables and non-tradables for foreign investment. These limits to devaluation and deregulation point to the necessity of following a well-articulated industrial strategy supported by regional cooperation to promote sustained economic growth.

The experience of the Lao People's Democratic Republic in the transition process mirrors that of Viet Nam, not only in terms of geographical proximity but also in other important respects. With per capita income at $180, which was somewhat lower than that of Viet Nam at $200 in 1989,[12] and a predominantly non-industrial production structure, the Lao People's Democratic Republic, like Viet Nam, increased its merchandise export earnings between 1980 and 1990 considerably. From a negligible base of $5 million, exports had increased to $63 million by 1990 for the Lao People's Democratic Republic, while for Viet Nam exports had increased during the same period from $537 million to $2,100 million. In both economies, the structure of exports remained oriented towards primary commodities, with nearly half being accounted for by primary commodity exports.[13] Despite rapid growth in merchandise exports, imports grew even faster, and during the years 1987 to 1989 the Lao People's Democratic Republic experienced high current account deficits, so that external debt rose rapidly and consumed nearly 15 per cent of export earnings by 1989. However, the Lao People's Democratic Republic seems somewhat different from Viet Nam in one significant respect: it maintained a much higher average rate of investment during the 1980s, at about 25 per cent of GDP compared with less than 10 per cent in the case of Viet Nam. This was financed not only by external flows but also by budgetary deficits of the Government. However, despite the higher investment rate, external assistance increased only moderately, and the excess of investment over domestic savings was financed increasingly by budget deficits which were later monetized by the central bank. Such credit expansion inflamed inflationary pressures and, along with poor agricultural production and drought conditions, brought to the surface the extreme vulnerability of the Laotian economy. The country had little option but to enter an IMF-sponsored three-year stabilization and adjustment phase, which has entailed a somewhat increased flow of external resources but severe demand restraint to control inflation.

The other economies in transition in Asia, Cambodia and Mongolia, tend to exhibit similar structural characteristics in varying degrees to those of the Lao People's Democratic Republic and Viet Nam, in so far as their economic vulnerability is accentuated by their dependence on primary commodity exports on the one hand, and persistent lack of adequate and assured inflow of foreign capital on the other.

It is in this context that an integrated approach to trade and investment flows through regional cooperation could play a critical role. Greater value added, even from the production of primary commodities, and greater domestic retention of that value added through trade, require both improved technology and the creation of new trading channels and markets. The economies in transition of the Asian and Pacific region seem incapable in the short run of meeting this challenge in isolation, especially because they have been largely cut off from international markets in the past. Foreign investment, particularly on the basis of regional cooperation, could combine the critical dual roles of carrying new technology and of creating new trading channels and markets, for example through intra-firm trade, especially in manufacturing. The present structure and composition of the

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12 Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries*, vol. XXII, July 1991.

13 Figures from United Nations, *International Trade Statistics Yearbook*, various issues; International Monetary Fund, *International Financial Statistics*, various issues.

primary product-based exports of these economies could perhaps change significantly in the short term only if foreign investment also encouraged ancillary manufacturing intra-firm trade, and regional cooperation played an effective role. At the same time, this also requires to be supplemented by large expansion and updating of the socio-economic infrastructures in human and physical capital which, in turn, requires exceedingly capital-intensive investment with long gestation periods. Therefore, at least in this respect, the role of ODA and domestic resource mobilization should not be minimized. Sustainable high growth designed to effect transition to a market economy can be achieved only through a synergy of these various factors, in which FDI in the context of regional cooperation, development assistance, and domestic resource mobilization and its effective uses, each play a complementary role. Such a synergetic process would seem to constitute the essence of any successful transition for these economies.

# VI. POLICY OPTIONS FOR ENHANCING COOPERATION AND DEVELOPMENT IN THE REGION

This final chapter brings together some of the more important observations made earlier in the study and the issues raised therein, in order to assess the range and directions of policy options available to developing countries for intensifying regional economic cooperation and promoting development. One broad result that emerged despite the heterogeneity among the developing economies of the Asian and Pacific region is that a large part of the region's general dynamism may be attributed to the complementary nature of the interrelationship between intraregional trade and investment expansion. While the foregoing analysis of the previous chapters has demonstrated that the synergetic nexus between the two has had a catalytic impact on growth based on trade, it is also observed that the autonomous impulses emanating from the trade-investment nexus in itself have been more successful than formal arrangements in linking the economies of the region. In this setting, given the constraints on the spread of this virtuous growth propellant in several developing economies of the region, this chapter also considers operational mechanisms which may stimulate intraregional trade and investment expansion as vehicles for enhancing economic cooperation and development within the Asian and Pacific region.

This chapter is divided into five sections: section A reviews the major lessons to be learned from the regional experience in investment and intraregional trade; section B discusses the prospects for the region, and the policy implications thereof, with regard to the spread of the trade-investment nexus; section C, in the context of regional economic cooperation, analyses the policy options, giving special emphasis to issues related to the lowering of trade barriers, investment cooperation, macroeconomic coordination and infrastructural development; section D reflects on some suggestions for regional arrangements that could possibly have a catalytic effect in enhancing economic cooperation and development in the context of expansion of investment and intraregional trade among ESCAP members and associate members, and is followed by the conclusion in section E.

## A. LESSONS TO BE LEARNED FROM THE REGIONAL EXPERIENCE

From the discussion in the foregoing chapters, it is evident that the rapid growth in intra-Asian and Pacific trade during the last few years has been accompanied by a phenomenal increase in intra-Asian capital flows. Strong investment flows from Japan and the NIEs are, in fact, likely to reshape the regional structure of production over the next decade and sustain economic growth in the 1990s in terms of a major impact on the pace of industrialization and export potential of the recipient countries. This is particularly so because, apart from providing investment capital to the host countries, much of the foreign investment is in the light manufactures industry, which has a low gestation period and high export potential.

It would, of course, be simplistic on the part of the less dynamic developing countries of the region to regard FDI as the panacea for sluggish growth, for the reason that efficient use of this foreign investment, as well as its intersectoral allocation, will play a major role in determining the success of the growth process. It is therefore important to realize that the role of foreign investment in stimulating outward-oriented development revolves not only around the volume of such investment and the trade linkages that it generates; the intersectoral allocations of that investment, and the demand and supply elasticities of outputs are also relevant factors. This relationship is no doubt complex, and sustainable restructuring requires matching not only of aggregate demand and supply but also of the composition of the demand and supply parameters, and the maintenance of equilibrium through foreign trade.

It is thus clear that the role of the external sector goes far beyond that of an mechanism to ensure equilibrium between aggregate demand and supply. The external sector is, in fact, capable of generating a self-sustaining cycle of export and investment-led growth. At an aggregate level, exports provide a market on the demand side, enforce cost discipline and, more particularly, create an environment for investment. This interaction between the export multiplier and the domestic output structure thus provides a good framework for determining the intersectoral investment strategy and for the flow of foreign capital. In this way, the external sector provides a macroeconomic impetus to growth through the expansion of the markets, under the condition that exports expand faster than imports. However, given the nature of the gestation lags of investment, the situation may be reversed, especially in the process of industrial restructuring. The deficit on the current account, which in national accounting terms corresponds to the investment-savings gap, would then need to be financed by foreign capital flows.

In the ideal world of perfect arbitrage, developing countries would have easy and fair access to foreign capital flows. This, however, is rarely the case in practice. As has been observed in this study, a certain amount of selectivity is imposed by the investor and FDI flows are determined by factors influencing the profitability of operations, such as the stability of the macroeconomic environment, possibilities of non-competing production and the availability of adequate infrastructure – all factors in which most developing countries of the Asian and Pacific region, aside from the NIEs and the ASEAN-4 have not scored too well. For example, the economic performance of the countries of South Asia, individually as well as collectively, has not been such as to inspire large-scale foreign investment of a magnitude comparable with that in East and South-East Asia. The prospects for large FDI flows to the least developed and the Pacific island economies could be viewed in a similar perspective.

Past experience has also indicated that the vigorous operation of the trade-FDI nexus leading to rapid growth of output in the developing Asian and Pacific region is the result of a catching-up process involving the region's most dynamic economies. Following the exceptional growth and industrialization of the NIEs in the 1970s and 1980s, the ASEAN-4 have been able to emulate the outward-looking development strategy of the NIEs sufficiently to speed up the pace of their growth in the 1980s. At the same time, China, or at least several regions of China, has followed its neighbouring developing countries to join the catching-up process of development.

Not surprisingly, the considerable success of export-oriented integration in certain economies in the Asian and Pacific region has, in turn, led many other developing countries of the region to emulate it. It provides them with the hope of achieving high growth rates by using their most abundant resource, labour, and overcoming the major constraint of foreign exchange that has so far stood in the way of rapid industrialization. FDI, along with transfer of technology and access to export markets, has greatly increased the possibility of rapid economic development for many developing countries in the region. However, besides the problem of meeting the requisite initial conditions faced by individual countries, there are problems which the region as a whole faces in pursuing the FDI-led export growth strategy.

First, Japan's unassailable lead in technology-intensive industries will continue to augment its growing trade surpluses. This will not only result in balance-of-trade deficits in the case of NIEs *vis-à-vis* Japan and of the ASEAN-4 *vis-à-vis* NIEs, and so on, but will also tend to create larger overall trade surpluses of NIEs and the ASEAN-4 *vis-à-vis* the United States of America and EC to offset the intraregional trade imbalances. Although FDI can contribute to an amelioration of the scenario, the dangers that are inherent in pursuing this course for exacerbating trade friction and protectionist trends cannot be overstated. It therefore seems necessary for policies to be adopted to diversify the destinations of trade flows from the region, particularly by intensifying intraregional trade among them.

In a similar way, the NIEs have begun to play the role of middle-level economies in the trade linkage among the countries in the Asian and Pacific region, opening their markets to imports from, and expanding their direct investment and technology transfer throughout, South-East Asia and China. However, this middle-level role has not contributed to the NIE trade with the ASEAN-4 to the extent originally expected. In fact, NIE exports to the ASEAN-4 as a percentage of their total exports fell to 6 per cent in 1989 from over 10 per cent a decade earlier.[1]

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[1] ESCAP, "Increasing complementarities and intraregional trade" (E/ESCAP(XLVIII)/INF.3), background study submitted to the Commission at its forty-eighth session held at Beijing in April 1992.

Lack of adequate success in expanding exports to the ASEAN-4 and the continued large imbalance in trade with Japan, have, in turn, induced the NIEs to place discriminatory restrictions on Japanese imports and to substitute them with imports from the United States and EC in an effort to reduce their trade surplus with the United States and EC. Both the Republic of Korea and Taiwan Province of China and, to a lesser extent, the ASEAN-4, have also encountered pressure to switch their sources of imports from Japan to the North American and European countries, which provide a much larger market for their exports.

The impenetrability of the Japanese market, however, is often greatly exaggerated. In recent years, as a result of higher incomes as well as the opening up of Japan's economy owing to pressure to reduce its large external trade surplus, there has been a big upsurge in domestic demand, translating it into a huge home market. This emerging domestic demand in post-industrial affluent Japan is, however, the strongest in sophisticated and quality products. Japanese consumers are also highly discriminating and are forcing its industry and retail distributors to scour the world for new ideas for product development. This, in fact, provides a great challenge and opportunity for Asian developing economies to innovate and improve the quality of their products for export to the large Japanese market. Product development can often be encouraged by the large chains of Japanese department stores in various parts of Asia, which serve as a conduit and testing ground for exports to the Japanese market. The emergence of a large, sophisticated domestic market in Japan is also facilitating the basis for intra-industry trade and investment in manufactures, as Japanese firms increasingly resort to global sourcing of their output.

Along with the development of a sophisticated and buoyant internal market, Japanese industry is becoming more efficient and technologically advanced through the intensive application of computer-aided techniques and robots, as well as the practical use of industrial lasers. The growth and sophistication of internal demand have also provided Japanese industry with the capacity to dispense with the dependence on external markets for exploiting the economies of scale and development of new products.[2] Furthermore, it has enabled Japanese industry to shed low-end manufacturing through direct overseas operations without worrying about the possibility of eroding its domestic industrial base. Such continuing technological advancement and restructuring of Japanese industry, accompanied by buoyant domestic demand, thus provides ever-increasing opportunities for industrial transformation in the developing Asian and Pacific region through the growth of intra-industry trade with Japan and the development of a vertical division of labour under which Japanese industry continues to retain, and further strengthen, its comparative advantage in higher value-added, more sophisticated components.

In spite of these favourable developments in Japan, there are dangers that should be avoided in regional cooperation among countries of the Asian and Pacific region. With highly unequal degrees of industrialization, liberalization of trade among them could force many developing countries to specialize in low-learning and low-technology industries for ever. To avoid this it is necessary to allow industrial policy to play a role in enabling these countries to take advantage of the changing division of labour through skill development and technological upgrading. To this end, modalities for easier transfer of technology and sharing of research and development (R and D) activities would be necessary.

The emergence of trade and current account surpluses, especially in the case of Japan and the NIEs, should not in itself be considered an undesirable development in the world economy. These surpluses reflect the higher productivity and higher propensity to save in the leading industrial economies of the Asian and Pacific region. At a time when there is an increasing shortage of capital in the world to meet the growing demands of reconstruction, renewal and restructuring, these surpluses should be welcomed rather than viewed as causes of concern. However, in order to avoid these surpluses becoming the target of attack by, and the cause of trade conflicts with, other regions, it is essential that they should be deployed to assist the development of the poorer and less dynamic parts of the region. This will not only lead to a more balanced and more integrated economic development of the region but, by raising substantially the low incomes of the large population of Asia, will also provide a sizeable export market for capital goods, intermediates and consumer goods manufactures of the more dynamic economies of the Asian and Pacific region.

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[2] See Terutomo Ozawa, "Japan in a new phase of multinationalism and industrial upgrading: functional integration of trade, growth and FDI", *Journal of World Trade*, vol. 25, No. 1 (February 1991).

## B. PROSPECTS AND POLICY IMPLICATIONS

### 1. Outlook for investment and intraregional trade

It is therefore evident that the prospects for increased flows of intraregional trade and investment in the Asian and Pacific region are mixed. While the focal point of growth in world trade has definitely shifted to this region, it is clear that not all countries in the region have been able to take advantage of the export-led growth process. Structural differences, competing specializations, and external payments imbalances in several of the region's developing economies will limit the growth potential offered by the expansion of world trade in the 1990s. Furthermore, the immediate future is likely to witness radical changes in the world economic system that may further compound the already existing problems. Regional groupings and increasing bilateralism outside this region will also restrict the advantages that the multilateral trading system has to offer.

In this setting, regional cooperation drawing upon the participative synergy of the ESCAP members and associate members in the region is one possible option. The Asian and Pacific region represents a rich diversity of natural resources and production capabilities, and intercountry competition can only limit the benefits from the growth process. In contrast, coordinated regional strategies based on trade-led growth would imply increasing complementarities in the production process as well as intersectoral allocation of resources based on efficient capital use (for goods in the domestic market) and export multipliers (for goods destined to be non-competing exports). The distribution of regionwide investment flows on the principle of maximizing benefits from realization of comparative advantage is, in this context, a major guidline for defining effective regional cooperation strategies. This is because specializations based on regional complementarities would encourage more efficient use of capital, expand both intraregional and interregional markets, and encourage capital flows within the region. It is important to note that despite the delicate external balances of many countries, the Asian and Pacific region is a net exporter of capital and this factor must be used for its benefit. While no doubt capital flows will be determined by stability, profitability and market sustainability, the region's developing countries could well adopt restructuring and development policies that would enable them to meet this criterion. The large technological gaps that characterize the production process can also be narrowed by successful implementation of these policies.

Although a certain amount of caution is still exercised in considering the liberalization of foreign investment-inducing regimes, economists and policy makers in the developing economies of the Asian and Pacific region generally hold the view that FDI inflows to the region, on balance, have had a positive impact on the implementation of an outward-oriented strategy of development by bringing with them capital, inflows of technology and access to international marketing channels. There has also been much discussion on the "flying geese" pattern of sequential industrial development across the region, involving the spread of industrialization from Japan to the NIEs and then to the ASEAN-4, and now possibly to China and South Asia and Indo-China as well. International trade and investment within the Asian and Pacific region has, in this context, so far served as a facilitator for the export-led pattern of development, and industrialization in the different economies has accelerated over the last decade as a result of more intensive trade and investment relationships.

But can increasing volumes in intraregional flows of trade and investment in the Asian and Pacific region be sustained in the future? Will it be possible for the trade-investment nexus to operate as effectively in the 1990s as it did in the 1980s? Moreover, given the marked variation in the magnitude of FDI inflows among the economies in the region, how can the Pacific island economies, the least developed countries and South Asia be brought to join the mainstream of dynamism in the ESCAP region?

As has been observed, the increase in FDI flows to the region from Japan and the NIEs in the second half of the 1980s was unprecedented and was prompted by several factors acting in conjunction. As regards the first half of the 1990s, the outlook is that, although Japan and Taiwan Province of China should continue to have a surplus on current account in their balance of payments, and their outward FDI may remain substantial, it is highly unlikely that their investment outflows will increase at a rate comparable to that experienced in the late 1980s. In fact, there has already been a noticeable slowing down of Japanese outward investment over the last two years, partly due to lower growth in Japan and partly to the drop in Tokyo stock values (since capital gains from the pre-1989 boom had facilitated a large part of the Japanese outward FDI).

There are other factors which could work to reduce the net inflows of FDI to the Asian and Pacific region. There has been much concern in the region that some recent developments in the world economy, including the formation of the NAFTA and the ongoing reforms towards a market economy system in eastern Europe and in the republics of the former Union of Soviet Socialist Republics, could divert some of the FDI flows which would otherwise be directed to the Asian and Pacific region. The stronger integration of the EC markets and between EC and the EFTA would also induce major investors of FDI in Europe, such as those in Germany and the United Kingdom of Great Britain and Northern Ireland, to turn their attention inward towards Europe instead of investing more in Asia and the Pacific. Whether or not these concerns would become reality remains to be seen, but countries in the region should be prepared to meet the challenge of more intense competition for FDI flows, particularly those from its three traditionally largest sources, Japan, the United States and the EC.

In addition, one major effect of the growing tendency towards regional cooperation or preferences elsewhere in the world and the implicit (or even explicit) protectionism is that the pattern of FDI is also expected to change. Japan and the NIEs, with their surplus on the current account and appreciating currency, may try to pre-empt a loss of markets by shifting the geographical location of their investments. This may take the form of a direct shift of industrial activities and investment which will be located increasingly within various trade blocs: for instance, light industrial producers of the Republic of Korea or Taiwan Province of China may relocate some of the investment into the European or Latin American countries. This would represent an increasing outflow of capital from the region and therefore the strategy for intensifying investment flows within the region must be reinforced. In fact, available data, though rudimentary, suggest that such geographical relocation is already taking place to some extent. Defensive bilateralism and protectionism may therefore create distortions in the geographical relocation of industrial activities such that in some cases they move against the international pattern of comparative costs. For the developing Asian and Pacific region, these trends do not bode well.

Furthermore, competition among the region's developing economies for intraregional FDI flows will intensify, as countries which have hitherto received relatively small amounts of FDI inflows, such as those in South Asia and Indo-China, have also recently stepped up their efforts to attract foreign investment. Countries with a good record of economic growth, such as the ASEAN-4 (excluding the Philippines) and China, could be in a better position, although FDI flows to these countries could also slow down significantly in the 1990s. There are a variety of explanations for this possibility. One explanation is that China will itself provide strong competition to the ASEAN-4 in terms of ability to attract FDI. In addition, as a result of the rapid increase in FDI inflows and several years of economic boom, the problem of infrastructural bottlenecks has become increasingly severe in most of the ASEAN-4 countries. There has also been the problem of shortage of skilled manpower in Indonesia, Malaysia and Thailand in recent years. As these constraints are likely to prevail for some years, a slowing down of FDI inflows in the short run could give the ASEAN-4 economies some "breathing space" to build up their infrastructure and manpower base, as well as prompt the fine-tuning that is required in economic and industrial policies within the group. In particular, it should be stressed that the ASEAN-4 may need to base their long-term industrialization strategies on the one factor that clearly distinguishes them from the NIEs, that is, a vast supply of natural resources.

A new feature of intraregional FDI is the emerging outflow from the ASEAN-4 to neighbouring Indo-China as well as, in more limited amounts, to China and South Asia. While this may reflect in part new-found prosperity, particularly of Malaysia and Thailand, it is also due to some extent to the result of gradually increasing wage rates in the ASEAN-4 economies. In this context, it is useful to note that evidence of limited FDI inflows from India into the ASEAN-4 can also be seen, but this is not an entirely new phenomenon.

With slower economic growth, and comparatively less attention from transnational corporations, countries in South Asia would have more difficulty in attracting a significant amount of FDI inflows. The experience of China after its opening up to international trade and investment over the last decade should, however, provide a good lesson for the large countries in South Asia, such as India. In fact, South Asian countries possess a number of comparative advantages over most other developing economies

in the Asian and Pacific region:[3] large domestic markets, ample supply of low-wage labour, availability of ample skilled and educated manpower, and high level of technological competence in some essential branches of industries which are important locational advantages for attracting foreign firms, especially in human capital-intensive industries such as computer software.[4] The problems of South Asian countries are mainly excessive government control and a relative lack of effectiveness in pursuing an outward-looking industrialization policy, but of late there has been a significant shift in economic policy towards economic liberalization and deregulation in South Asia. If this trend towards economic reform could be continued, it would not be impossible for the South Asian countries to attract larger FDI inflows in the future. In this regard, the possibility of establishing "special economic zones" along coastal areas, as in China, could be explored with a view to establishing growth poles in a similar format.

None the less, these countries, particularly India, still need to overcome some serious obstacles to ensure adequate FDI inflows. First, infrastructural constraints pose a major hurdle, as the inadequate availability or unreliability of power, transport and communication services is a fairly widespread phenomenon; second, the lack of a suitable "exit" policy for loss-making units to close down, as well as of labour legislation that allows employers reasonable flexibility in altering their workforce requirements, is also a deterrant to the foreign investor. In addition, for a large country like India, decentralization of the decision-making process with regard to FDI to the level of State governments is desirable to facilitate more direct interaction between investors and host country policy makers. Moreover, obtaining the required procedural approvals is occasionally a time-consuming affair.

To sum up, reorienting industrial policies, improving infrastructure, easing manpower constraints and further liberalizing investment and trade laws in the Asian and Pacific region will take time. But as these changes unfold in the coming years, there is likely to be a gradual shift in the specific types and flows of intraregional investments. At one end of the spectrum, some of the ASEAN-4 (especially Malaysia and Thailand) are likely to move increasingly towards low labour-intensive and yet high resource-intensive industries. Investors, both foreign and local, will probably focus much more on this segment of industry. At the other end of the spectrum are likely to be the region's larger economies, China, India and Indonesia, which have the resources to establish a whole gamut of industries, especially as all three are now in the midst of major liberalization and deregulation efforts. The impressive growth of foreign investment in China in 1991 reflects this to some degree. Thus, increasingly, intraregional investment is likely to be characterized on the one hand by continuing flows from Japan and the NIEs to these three large regional economies, and on the other by more selective investments in the smaller developing economies of the Asian and Pacific region. This new pattern of FDI is likely to reflect increasingly the future course of industrial development of the region. Without the aberrations created by exchange rate realignments or other unexpected changes, the growth of intra-regional FDI flows is also anticipated to plateau at a more steady and sustainable pace.

## 2. Policy implications of the trade-investment nexus

As regards the role of FDI in trade promotion, there are major implications for policy in the developing Asian and Pacific region. First, if there are restrictions on inward investment in conjunction with an emphasis on exports, the influence of foreign investors on the relationship between trade and growth may be more indirect, taking the form of licensing and contractual agreements in place of actual investment. This has been the case in Japan and the Republic of Korea, where the role of transnational corporations in fostering trade and growth has been significant, but not so much through FDI *per se*. However, economies such as Hong Kong and Singapore have grown with open policies towards FDI as well as emphasis on exports. Such contrasting experiences suggest that various approaches may be pursued by different countries in relation to foreign investment, trade and growth. It should be noted, however, that factors such as the high degree of cooperation between government and the domestic private sector, the adequate level of entrepreneurial and human resources development, and the overall macroeconomic policy framework which provided a strong stimulus to domestic

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[3] Ishrat Hussain and Kwang W. Jun, "Capital flows in South Asian and ASEAN countries: Trends, determinants, and policy implications", in S.P. Gupta and Somsak Tambunlertchai, eds., *The Asia Pacific Economies: A Challenge to South Asia* (Delhi, Macmillan India Limited, 1992).

[4] John H. Dunning, *Explaining International Production* (London, Unwin Hyman Ltd., 1988).

growth, are among the unique features of the experiences of Japan and the Republic of Korea that may not be easily replicable in other developing countries. In addition, the economic growth of those countries took place when world trade was expanding rapidly, a performance that may not necessarily be sustained with the same intensity. Furthermore, the trend towards internalization of technologies by foreign firms, particularly in high-technology industries with greater trade and growth potential, would limit the scope for a host country to maintain restrictive policies towards FDI while simultaneously pursuing an export-oriented growth strategy. These arguments underscore the need to give attention to improved coordination between trade and FDI policies.

Second, given that the central concern of trade policies in the region's developing countries is evidently to increase exports, it has been observed that FDI can contribute to these efforts in terms of an increase in the export propensity of foreign affiliates in the recipient country. While the recipient country, in turn, is significantly influenced by the structure of incentives of the host country's trade regime in addition to the behaviour of other macroeconomic variables, such as inflation and exchange rates, it is also crucially important that the developing countries do not face protectionist barriers in their export markets. Developing countries of the Asian and Pacific region therefore need to pursue liberalized trade policies to stimulate the growth of trade and trade-related FDI in the region.

Another issue of special importance for developing countries of the region that currently specialize in labour-intensive processes and component production is that further export growth of those products may be threatened by shifts of production to more competitive foreign locations or to alternative subcontractors. In such cases, trade and FDI policies should be aimed at increasing the competitiveness of existing exports to the extent possible, and at providing incentives to both domestic and foreign firms to develop new areas of comparative advantage.

In addition, the beneficial externalities of FDI in the trade of host countries can be enhanced and spread to the extent that the capacity of domestic enterprises to learn, imitate and adapt the practices of transnational corporations can be increased. In this context, since domestic policies, including trade and FDI policies, that foster the growth of entrepreneurship and competitive spirit play a crucial role, a policy regime that offers prolonged protection against imports or subsidies to exports would tend to reduce incentives to compete and, as a corollary, reduce the scope of potential externalities. Therefore, in so far as the import propensities are dependent on cost and quality considerations, government policies need to encourage linkages between foreign affiliates and domestic firms, with a view to developing efficient local industries.

Finally, an overarching policy question concerns a host country's use of strategic trade and FDI policies to foster growth. More specifically, the issue is whether FDI can make a contribution to selective import substitution and export augmentation, particularly through a combination of incentives and performance requirements. This is a difficult option, even for those developing countries with large domestic markets and other specific locational advantages (such as the availability of low-cost skilled labour relative to productivity and high-quality infrastructure) that confer strong bargaining leverage. Broadly speaking, there may be justification for the highly selective use of a combination of investment incentives and performance requirements in only a limited number of activities which promise strong positive externalities and possibilities of net long-term gain, for example, by opening new markets or introducing new technologies. As a general rule, however, smaller and poorer developing countries will find it difficult to offer such an investment incentive/performance requirement package that will attract FDI.

However, in assessing the impact of FDI on trade expansion for the Asian and Pacific region, it should be borne in mind that the impact is likely to vary according to the stage of development of the host country. In particular, the impact may be greater for the more advanced developing countries than for the less developed countries at early stages of development. This is the case not only because the less developed countries receive relatively low amounts of FDI; it is also a result of the fact that growth in these developing countries (in the Asian and Pacific region, this group would include the least developed, land-locked and Pacific island economies) depends significantly on processes that tend to be marginal to the interests of foreign investors, that is, the raising of productivity in the agriculture sector, improvement of basic infrastructure, and raising the educational and nutritional standards of the population. Those areas in which FDI can make the greatest contribution, such as introducing modern technologies and production methods, increasing exports of manufactured goods and improving the performance of service industries, are

more important in countries that have already reached a more advanced level of economic development. Not surprisingly, therefore, at very early stages of their development, countries would have to rely more heavily on official aid than on FDI to raise living standards. While FDI can make a positive contribution to the economic growth and trade performance of low-income countries, it is likely that its greatest impact will be in countries that can absorb most effectively the investment, technology, training and trade opportunities that transnational corporations offer. Thus, it is probably necessary that a threshold level of domestic economic development should exist in order to enable a developing country to benefit most from the operation of the trade-FDI nexus. Perhaps this is the essential explanation for its limited influence in the region beyond East and South-East Asia.

## C. REGIONAL ECONOMIC COOPERATION AND POLICY OPTIONS

The process of reform that has distinguished economic policy in the region in recent years is expected to continue well into the 1990s. Several developing countries of the Asian and Pacific region with relatively low trade exposure have initiated reforms relating to exchange rate policy, industrial licensing and budgetary measures that are expected to provide a renewed impetus to growth. Most of the NIEs and South-East Asian countries have striven to improve competitiveness in their industrial structure by fostering competition in their domestic markets, maintaining open policies with respect to foreign investment and trade, and implementing various other measures to spur growth in productivity and output.

In countries of South Asia, and to a lesser extent China, where inward-looking policies have been dominant, often with large investments in State-owned enterprises, industrial growth has tended to be slower: this has been further hampered by the constraint on foreign exchange, poor infrastructure, and excessive regulation and licensing, that have limited production efficiency. In most of these countries, therefore, ongoing reforms have stressed reduction of controls, higher productivity, replacement of quantitative restrictions by tariffs, and freeing of investors from licensing requirements.

For the Pacific island economies and the group of least developed, land-locked countries, as well as the economies in transition, the success of the growth process depends crucially on the speed with which the prevailing structural constraints are overcome. These relate mainly to infrastructural bottlenecks, dependence on a narrow range of products and the geographical handicap of adverse location. In the context of this group of countries, the catalytic role of ODA in their development process cannot be underestimated.

Consequently, there are a number of levels to which the policy effort should be directed. To start with, it must remove or ease the constraints on the free flow of goods, services and investment in the region. Second, it must ensure access to information about markets, technologies and investment opportunities to decision makers and the business community so that neither the lack of information nor asymmetries in access constrain the level or spread of gains from trade and investment. Third, it must attempt to ensure that foreign investment is increasingly directed at regional and world markets, rather than host country domestic markets, so that the positive balance-of-payments effects of the new kind of foreign investment outweigh the possible negative effects of the old kind of investment. Fourth, it should be ensured that attempts to exploit the trade-investment nexus lead to enhanced export capacity in the domestic private sectors of host countries so as to render the development path sustainable. Fifth, to the extent that countries making the transition to a regime that exploits the trade-investment nexus are losers in the asymmetric distribution of gains from trade, mechanisms such as payments arrangements and capital flows must be worked out which ensure that the traverse to a regime of growth based on the trade-investment nexus is not subverted by balance-of-payments disequilibrium. Finally, the policy effort must ensure that the specific problems of the Pacific islands, the least developed countries and the economies in transition are dealt with through cooperative endeavours, so that they are not left behind by the virtuous circle of growth in the rest of the region.

These elements of the policy effort require not merely regional initiatives but also a range of national initiatives. Following from the analysis of constraints on the operation of the trade-investment nexus in the region's developing countries, the main elements of possible national initiatives are the reduction of tariffs and non-tariff barriers to the movements of goods and services at regional and subregional levels, the dismantling of investment regulations that deter foreign investors and, above all, the creation of a relatively stable macroeconomic environment conducive to foreign investment.

Once that framework is in place, attention can be diverted to resolving other limits to the free flows of tradeable goods and services and investment funds, including infrastructural bottlenecks and the obstacles created by technical barriers to trade. These constraints need to be addressed through joint efforts on the part of national Governments in host and investor countries, potential foreign investors themselves, and perhaps a concerned regional intergovernmental organization. It is in this setting that regional economic cooperation can be viewed as a means of modifying the constraints imposed by the circumstances in which the developing economies of the Asian and Pacific region now find themselves.

As mentioned at the outset, regional economic cooperation is viewed in this study as an opportunity of which economies of the region could avail themselves to complement the individual country efforts for their own and world development, in an environment in which several fresh developments in global negotiations could alter the current trading alignments in the 1990s to a significant extent. Thus, greater economic cooperation within the Asian and Pacific region can enhance the region's relatively greater dynamism and also induce a wider dispersion of its benefits. With far-reaching domestic reform programmes being implemented in almost all developing countries of the region and the movement towards more liberal private sector-oriented economies, prospects for economic cooperation are now brighter than before. In particular, with greater diversification of production in the developing economies of the region and increasing industrialization levels, the almost universal positive response to the call for reduction of barriers to trade and investment is facilitating greater economic interlinkages. Although progress in economic cooperation in the region has been slow, given the diversity in terms of size, income, culture, peoples and national interests ESCAP members and associate members in the region, the step-by-step procedure has, in a sense, laid the foundation for the success of future efforts to widen the areas of cooperation as well as increase its pace. For the successful operation and spread of the trade-investment nexus, this is of critical importance, as greater interaction within the region will stimulate the confidence of both traders and investors.

The time has therefore come for a bold and innovative approach to regional economic cooperation, a concept whose importance and potential have been recognized and accepted by all Governments in the region. But what should be its essential characteristics and directions? In the remaining part of this section, the policy aspects are discussed, and reflections on possible operational mechanisms of regional economic cooperation for the expansion of intraregional trade and investment are presented in the next section. As regards the main directions of policy, a distinction may be drawn between border and non-border concerns. The border concerns would include issues related to the lowering of barriers to trade and intensification of investment cooperation, while macroeconomic coordination and infrastructure development could be classified as part of the non-border concerns.

### 1. Lowering of barriers to trade

Since trade is of the utmost importance for the economic growth of the region, cooperative action in the region should accord high importance to the lowering of barriers to trade, as well as to the strengthening of supportive institutions. It is pertinent to note that the elimination or even preferential treatment to the lowering of barriers only to intraregional trade expansion is not being suggested; rather, growth of intraregional trade should be part of the entire process of greater trade orientation of the region. Within the region, less severe border controls in the form of reduced tariff levels, would induce trade expansion and provide the scope for eliciting economies of scale in production as well as increased process efficiency; of course, in view of the region's great diversity, the uniform lowering of trade barriers will be a long process and will naturally be conditioned by prevailing national circumstances.

The two areas where cooperative action is likely to generate significant results in terms of facilitating increased intraregional trade are the simplification of documentation requirements and determining the rules of fair competition in regional trade. While ESCAP has contributed significantly to the propagation of trade facilitation measures, especially to the least developed countries of the region, the region as a whole has a long way to go in terms of adopting a common set of documentation and harmonized customs procedures for the shipment of tradables. As regards fair competition, the main issues relate to the establishment of a regional understanding on the level of export duties and drawback, government support or subisidies, and dumping. From the viewpoint of Governments, several of the duty drawbacks and selective subsidies could be viewed as consistent with the free flow of trade, but as a general rule such interventions influence the trade outcomes directly.

Special attention will, in this context, also have to be accorded to the reduction of non-tariff barriers, which will increasingly become the major impediment to a rise in trade levels within the region, consequent upon a progressive decline in tariff rates. A regional schedule for the gradual removal of quantitative restrictions may be compiled and coordinated, if possible, with agreed phasing of removal or reduction in tariffs. On the issue of technical barriers to trade, the cooperative endeavour should be focused on the harmonization and standardization of differing national requirements or specifications. For that purpose, it may be useful to identify, through consultation, the areas where harmonization is required and assess how differences in national standards may hamper intraregional trade. In addition, it would be worthwhile to explore cooperative efforts for the reciprocal recognition of tests, inspection procedures and certification of products in the region, for which the existing international harmonization efforts of recognized institutions and bodies could be used as the base.

### 2. Intensification of investment cooperation

Since the nexus in the region between foreign investment and trade expansion has been broadly established, industrial cooperation should be expanded and linked more closely to trade liberalization efforts. Given the generally higher degree of trade orientation for foreign firms, stronger intra-firm and intra-industry trade will be a key element of the eventual self-sustainability of intraregional trade in the Asian and Pacific region. In this regard, the regional attempt to foster industrial cooperation could initially take the form of exchange of experience between policy makers and the business community on deregulation of FDI controls, and consultations on how to improve FDI regimes by effectively reducing barriers to investment inflows from abroad. This is important, as a country with more stringent requirements would not attract much foreign investment unless the economic and social conditions in that country were superior to those in others. However, a certain amount of caution will need to be exercised, as competition between the region's developing countries in extending facilities and incentives to foreign investors may prove to be a costly exercise.

The cooperation programme may also encourage the establishment of new cross-border "growth triangles" in the region which offer distinct possibilities of stimulating intraregional trade and investment flows; support at the policy level for such pockets of growth may thus be desirable. In order to promote intraregional investment, fiscal incentives and investment promotion packages exclusive to investors from within the region may have to be provided initially on a preferential basis.

Moreover, for strengthening cooperation in investment promotion, following the establishment of the proposed regional investment information and promotion service (RIIPS) which will fulfill many of the catalytic functions required of a regional organization in terms of information dissemination and provision of technical services, close collaboration between RIIPS and the national investment boards and chambers of commerce and industry in the region will be essential. This would be particularly useful for the mobilization of funds, technical support in identifying suitable locations for proposed manufacturing facilities, preparing feasibility studies, and ensuring coordination between different national or regional bodies.

A major policy concern for the region is that with the move towards higher levels of intraregional trade and investment, traditional small and medium enterprises which have made a significant contribution to trade and output growth in the Asian and Pacific region, would face more intense competition, as inflows of investment from transnational corporations in similar product lines would bring with them superior technology, better management capability and access to more rigorous marketing channels. At the same time, increased trade may introduce competing products to the small and medium enterprise markets. While such competition from different sources would lead to more efficient resource allocation in the long run, regional cooperation for assisting small and medium enterprises in forging linkages with large industries will have a big role in establishing the viability of these enterprises; this is especially important for an export-oriented strategy in which these enterprises produce ancillaries and components under a subcontracting system. In this context, the cooperative action could also be addressed to the establishment of a suitable technology transfer mechanism for small and medium enterprises to enable a wider dispersion of technological advancements, as that would have additional spin-off effects. The issue of evolving, through regional action, an appropriate framework for strengthening the trade and

investment information flows for these enterprises is also of critical importance.[5]

## 3. Macroeconomic cooperation

Increasing intraregional economic linkages in trade and investment emphasize the need for greater macroeconomic consultation, cooperation and synchronization, especially on monetary, fiscal and external commercial issues. As most of the region's developing economies are liberalizing their production structures unilaterally in order to render their economies more efficient and competititive, all future accords to promote regional economic cooperation should ensure that the process retains continuity. In fact, cooperative action should be used to speed up the external sector liberalization process in the region so that unfettered operation of the trade-investment nexus is made possible.

Domestic macroeconomic (especially fiscal and monetary) policies, such as those affecting interest rates, inflation and the balance-of-payments position of the developing countries of the Asian and Pacific region, have important ramifications for trade and investments flows in the region. Owing to the close interdependence of financial, industrial and commercial policies in an ever-liberalizing framework of growing trade and investment linkages between economies in the region, coordination of policy would be desirable to stimulate the operation of the trade-investment nexus as well as stability and growth in the Asian and Pacific region. For example, divergent monetary policies will result in different rates of changes in the structure of prices and, in turn, are likely to affect exchange rate parities. Subsequently, trade and investment flows will, of course, be affected. It may therefore be useful to consider the establishment of an arrangement for consultations on macroeconomic policy issues to be held at periodic intervals.

Regional cooperation may also extend to the finance and banking sectors, under which enlarged use of existing facilities such as the Asian Clearing Union (ACU) and the Asian Reinsurance Corporation (ARC) may be considered.[6] Furthermore, given the growing importance of trade in financial services, cooperative endeavours leading to the deregulation of banking services in the form of more liberal mutual insurance of licences, will be important for increased facilitation of financial flows in the region. With the establishment in several developing countries of the Asian and Pacific region of stock exchanges permitting even foreign investors, financial transactions in the region are expanding rapidly and, as these will become more substantial in the future, cooperation in training facilities and the sharing of experience may also yield rich dividends at this embryonic stage of capital market and financial services development.

## 4. Infrastructure development

Cooperation in transport and communications, which constitutes a critical service in facilitating economic integration, is an important but often neglected topic in discussions on economic cooperation in the region. Communication, especially telecommunication, has become a key input into the development process, and transport is an important prerequisite for trade. The move towards trade liberalization in Asia and the Pacific will therefore require the coordination of efforts to strengthen the regional transport and communications infrastructure. It will also imply regional cooperation for the removal of hindrances so as to facilitate the movement of goods and people within a country as well as across its borders. In a way, trade infrastructure really relates to the upgrading of domestic infrastructure; and factors that have hindered the development of domestic infrastructure have been mainly the lack of funds, as well as lack of the requisite manpower, or of a sense of urgency, or changing priorities in the country concerned.

Inadequate infrastructure is a serious problem in both the faster growing East and South-East Asian countries and the slower growing economies of South Asia or the region's least developed, land-locked and Pacific island economies. In the first category, rapid growth is exerting strains on infrastructure requirements such as transport, housing and telecommunication. In the slower growing economies, lack of adequate infrastructure is one of the major deterrents to FDI inflows. In addition to the high social costs arising out of infrastructural bottlenecks, the lack of sufficient capacity to service the demand for infrastructural facilities results

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5 For a detailed review of the role of regional economic cooperation in the development of small and medium enterprises, see ESCAP, "An action programme for regional economic cooperation in trade and investment: selected issues and policy options for economic development in Asia and the Pacific" (ESCAP/SREC/INF.1), background paper prepared for the Steering Group of the Committee for Regional Economic Cooperation, held at New Delhi from 24 to 27 November 1992, pp. 41-50.

6 For a discussion on ACU and ARC, see chap. II, sect. B above.

in delayed deliveries and failure to effect maximum efficiency in production: in the context of trade based on international competitiveness, this is a serious failing.

Infrastructure development in the economies of the Asian and Pacific region has a long-term focus, although spending on infrastructure in the past has occasionally been motivated by various factors, such as the provision of employment or as a counter-cyclical measure. Thus, most infrastructure projects are geared primarily to meet individual country demands, although attempts in the past at fostering cooperation in transport and communications have achieved some progress in the areas of shipping, air transport and telecommunication. Cooperation in land transport has been somewhat less, despite projects such as the Asian Highway and programmes related to safety standards for road vehicles.

The regional cooperation programme should therefore address the important areas of infrastructure development in a coordinated manner to facilitate the movements by road, rail and sea; the harmonization of port charges; and measures for facilitating cross-border movements of traffic. As a starting-point, the strengths and weaknesses within each of the transport sectors may be assessed in a regional perspective, and thereafter, investments which complement and enhance the economic growth of ESCAP members and associate members of the region could be considered (see box VI.1). While regional consultations on policy would be useful, the basic tenets should be to reduce journey time in transport, minimize restrictive regulations and improve the availability and quality of infrastructural services. The regional effort could also extend to

## Box VI.1. Investment in the transport sector for regional economic development

The unparalleled economic growth and trade expansion in the region has created an enormous demand for investment in transport infrastructure and services, particularly for containerized cargoes. Unfortunately, in undertaking investment and project planning, many of the countries have had to rely on outside expertise and consultancy services.

To assist members and associate members in leading and controlling the process of planning and financial/economic evaluation of projects more effectively, the ESCAP secretariat has been active in developing computer software models, for regional distribution, with the objective of strengthening national capabilities. The approach has been to provide tools to undertake prefeasibility/feasibility studies and more effectively control the work of consultants. The models consist of user friendly software packages and manuals which provide a continuous logic from cargo projections to the physical requirements, including infrastructure, equipment procurement and replacement, operating costs and revenues throughout the life of the project and the financial and economic feasibility analysis. Presented in a simple spreadsheet format, the model provides the benefit of speedily calculating the impact of alternate operating configurations and optional financing arrangements. Included in each of the modules are sets of preliminary planning factors, including budgetary costs and typical productivities that can be applied in initial project screening and evaluation without pre-feasibility studies.

Specially designed modules are available for evaluation of container terminals, bulk handling facilities, inland container depots (ICD) and new rail line developments. Each of the modules is self-contained and provides the essential framework for a multi-disciplinary team to undertake the planning, engineering, financial and economic components of project implementation.

With the massive growth of containerization and demand for new investment in this area, it is not surprising that the greatest demand for implementation assistance from the secretariat has been for the container terminal and ICD modules. These modules have been validated and implemented in five countries of the region in which multi-million dollar projects are being planned or implemented. The container terminal module has the flexibility to evaluate facilities with or without gantry cranes, thereby responding to the needs of both the large and small ports of the region. The inland container depot module has the benefit of a transport cost comparison element which allows planners to evaluate the potential cost of alternate modes of transport being used to move containers/cargo overland and thereby provide indications of possible modal split.

Extensive training activities have already been undertaken through regional and country-level workshops supplemented by on-the-job training based on actual projects being implemented in individual countries. Multidisciplinary teams of planners have already begun to use the models to plan transport facilities in the region more effectively, leading to greater economic efficiency in the transport and trade sector. Advisory services are available from the secretariat to assist countries in the implementation of the individual modules and to train counterpart staff in its usage.

discussions to evolve an agreed common policy in which, apart from coordination of projects and programmes for infrastructural development in the region, an attempt would be made to establish guidelines for infrastructure services pricing, as well as a reporting system for capacity utilization.

## D. MEASURES FOR ENHANCING REGIONAL ECONOMIC COOPERATION

While market forces and structural change in the region's developing economies are the main propellants for expanding intraregional trade and investment in the Asian and Pacific region, policies and institutions are required to exploit the opportunities which these generate. Without them the emerging regional trade and investment possibilities will not be optimally utilized. Regional economic cooperation endeavours should accordingly incorporate interlocking elements which generate an overall catalytic impact to speed up the process of trade-led economic growth. While the broad directions of policy support for enhancing regional economic cooperation have been discussed in the previous section, the paragraphs which follow contain suggestions for some specific measures that may be considered for follow-up action within the sphere of economic cooperation in the Asian and Pacific region. The measures, which are intended to strengthen the operation of the trade-investment nexus in the region as well as ensure the spread of its beneficial impact to the less dynamic parts of the developing Asian and Pacific region, also endorse the validity of the action programme for regional economic cooperation in trade and investment that was considered by the Steering Group of the ESCAP Committee for Regional Economic Cooperation.[7]

### 1. Dissemination of regional trade information

Alongside the effort at easing constraints on the flow of goods and services, measures to facilitate such flows should be undertaken. At the base of that effort would be increased access to information about market opportunities that could enhance the volume of trade transactions as well as induce a wider spread of the gains from trade. This could include a mechanism to monitor and analyse trade trends in the region, as well as the related policy changes, so as to provide readily to member Governments, whenever necessary, the information required to contribute to this cooperative effort. However, at present there are no easily accessible, detailed and consistent trade data sets on which Governments and business communities of the region can depend, and country-specific information on trade possibilities and regimes varies considerably in both content and timeliness. This warrants the creation of a data bank which would include disaggregated data and qualitative information on the changing patterns of trade, especially in manufactures and services. In this context, the Regional Trade Information Network (TISNET) of ESCAP could be strengthened in two ways: (a) through the more active participation of members and associate members; and (b) through strengthening its data collection and delivery capabilities to enable it to provide speedier and updated information on trade opportunities to countries of the region (see box VI.2).

These efforts may be further strengthened by the active participation of the national chambers of commerce and industry of countries of the Asian and Pacific region in a regional programme to ensure the dissemination of trade-related information at regular intervals. The proposed programme may have three elements: (i) information could be collated and transferred to the regional data bank so that exporters and importers can respond effectively to the intense volatility of the world economy; (ii) international trade fairs could be organized, as these are proved and effective modes of developing trade through the exhibition of products and the promotion of business negotiations; and (iii) overseas missions could be organized to introduce products with market potential to host countries and to develop business relationships: this would also lead to first-hand knowledge of actual market conditions in the host countries.

### 2. Network of trade-related research institutions

An appropriate initiative related to the above network would be the strengthening of informal and formal systems for collaboration among institutions in trade-related research at the regional level. This would enhance substantially the quality of strategic studies based on an analysis of data of the kind collated in the regional data bank. Some preliminary work has already been initiated by ESCAP in this direction, and the active support of member Governments would facilitate the process. The proposed network is expected to work towards the common goal of

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[7] ESCAP, "An action programme for regional economic cooperation in trade and investment: selected issues and policy options for economic development in Asia and the Pacific" (E/ESCAP/SREC/1).

## Box VI.2. The Regional Trade Information Network (TISNET)

The Regional Trade Information Network (TISNET) was constituted in 1980 in pursuance of a decision of the Ministerial Conference on Cooperation in Trade for Asia and the Pacific, held at New Delhi in 1978, linking national trade information services in the countries in the ESCAP region with the ESCAP Trade Information Service (ESCAP/TIS), the regional focal point. The major objective of TISNET is to organize a system through which it would be possible to ensure a regular flow of information in order to assist the participating countries in their efforts to expand their trade. TISNET is based upon two principles:

1. The participating countries have national focal points for collection and supply of information to ESCAP/TIS. National focal points arrange dissemination of information received from the regional focal point.

2. ESCAP/TIS arranges for the acquisition, storage, retrieval and dissemination of the information on the basis of predetermined priorities and work programmes set by the countries participating in annual Commission sessions and Meetings of Senior Trade Officials on TISNET which are held periodically. It is also responsible for liaison with United Nations agencies and other international organizations to supplement information input and to avoid duplication of efforts.

### Dissemination of information

The regional focal point, ESCAP/TIS, disseminates trade information to TISNET members through an enquiry/reply service, computerized databases and the following recurrent publications:

*TISNET Trade Information Sheet.* This semi-monthly publication has been issued since May 1982 and distributed free of charge to approximately 200 public and private sector trade-related organizations, including national focal points within and outside the region. Through an arrangement with a commercial publisher it is also available on subscription to individuals. It provides information on changes in trade regulations and customs tariffs, trade fairs held in the region, trade meetings and training events, business opportunities, trade publications and other trade-related information.

*Prices of Selected Asia/Pacific Products.* This monthly publication is distributed to approximately 260 public and private sector organizations and companies. It provides price indications including the monthly highest/lowest prices of over 70 exportable products from the region.

*Directory of Trade Promotion/Development Organizations of Developing Countries and Areas in Asia and the Pacific.* First published in 1983, the *Directory* has been updated biennially with the cooperation of the national focal points of TISNET. The latest edition (1991) covers over 300 national as well as regional organizations in developing countries and areas in the ESCAP region and provides addresses as well as information on functions, activities and publications.

*Trade Profiles.* This publication, which provides information on the trade regimes of developing countries in the ESCAP region, was first issued in 1982. The format has recently been revised in order to include more detailed information and it is being computerized using software developed by the International Trade Centre UNCTAD/GATT for use in networking.

Information from the above-mentioned publications is further disseminated by national focal points to their business communities through their own publications as well as other communication media.

strengthening research capabilities for analysing and forecasting trade- and investment-related policy changes. In this context, a commonly defined work programme could be evolved and include; among other things, areas in which gaps in research exist, and the exchange of researchers between the participating national institutions in the region. The academic perspective on policy that such studies would provide would obviously increase the efficacy of the regional cooperation process.

Improvement of information on and understanding of trade issues in the region could also help address trade disputes and friction, as and when they occur, and ensure that they are resolved in an open and non-discriminatory manner. Furthermore, looking beyond the current Uruguay Round of multilateral trade negotiations, the establishment of a reliable information base could prove to be an important first step towards discussions of trade liberalization issues from a regional perspective, and help to ensure that regional priorities are effectively taken into account in setting the agenda and direction of any future multilateral trade negotiations.

### 3. Regional programme on quality assurance

A major development that is expected to influence the pattern of trade in the world is the adoption of the ISO 9000 series

### TISNET Market Information System (TISNET-MIS)

To provide the developing countries of the region with basic information required for formulating trade policies and trade promotion strategies, ESCAP/TIS has built up in collaboration with other United Nations agencies a collection of import/export and other trade-related data of the ESCAP members and associate members and major market countries in machine-readable form constituting the *TISNET Market Information System (TISNET-MIS).* TISNET-MIS comprises the following:

*(a) Trade and trade-related data in machine-readable form:*

(i) *Trade data in United Nations format* covering ESCAP members and associate members as well as non-ESCAP members obtained from the United Nations Statistical Division;

(ii) *Trade data in national format* provided by member countries and the European Community;

(iii) *Trade-related data* including industrial and agricultural production statistics, and financial statistics from the Food and Agriculture Organization of the United Nations, the International Monetary Fund and the World Bank.

*(b) TISNET-BIS* (Bibliographic Information Sources Database), providing bibliographic information on trade and trade-related publications and other materials;

*(c) TISNET-DIS* (Trade Information Sources Directory), providing address information on publishers and trade-related institutions.

ESCAP/TIS also has direct access to the following computerized databases developed by other United Nations organizations:

*1. COMTRADE* (International Commodity Trade Data Base), which covers export and import data. (Source: United Nations Statistical Division).

*2. PACKDATA,* which has about 3,000 records of information concerned with various aspects of packaging with particular reference to products of export interest to developing countries. These records refer to hard copy material which is also housed in ESCAP/TIS. (Source: ITC).

*3. TRADERS,* which contains about 19,000 profiles of exporters and importers of selected products worldwide. For each company traders provides contact information and a set of data to facilitate the selection of approximate partners, including data on bank references, employees and products imported and exported. The data available in ESCAP/TIS are on importers. (Source: ITC).

*4. TCM* (Trade Control Measures), which covers developed and developing countries and provides detailed information on tariffs and additional charges on imports including some preferential rates as well as non-tariff measures. The basic software allows for information on trade control measures to be combined with trade data from the COMTRADE database for selected products and markets. (Source: United Nations Conference on Trade and Development).

### Technical assistance

To develop and strengthen trade information services, advisory services and training have been provided to officials of national focal points under a series of UNDP (United Nations Development Programme) financed projects implemented by ITC in cooperation with ESCAP since 1975, as well as under a regional project funded by the Government of Japan. In addition, in-service training has been provided at ESCAP/TIS for officials of the developing countries of the ESCAP region under national projects as well as through arrangements under ECDC/TCDC (economic and technical cooperation among developing countries).

which reflects the quality dimension of the manufacturing process. ESCAP members and associate members of the region will therefore have to make a concerted effort to evolve a harmonious system that will help not only in identifying trading patterns but also in establishing quality standards according to the process used in production. Research organizations or government administrative departments will have to take the initial responsibility in this regard. But a regional programme of concerted action for strengthening national capabilities in standardization and quality certification processes would make it easier, especially for the region's small and medium enterprises, as well as some of the less technologically advanced ESCAP members and associate members, in keeping pace with global developments related to quality control of export products. The essential objective, in this context, would be to motivate manufacturers of tradeable products to adopt internationally accepted quality standards.

## 4. Possibilities for regional cooperation in trade in services

Cooperation in promoting trade in services is another issue of significant common interest to the region's developing countries. Since cooperation in the Asian and Pacific region on enhancement of intraregional trade in services is still at a rudimentary stage, preliminary initiatives may be

based on the experience in such cooperation in other subregions. One area of potential benefit to intraregional trade is service facilitation. This form of cooperation would include action to achieve coordination and harmonization of rules and regulations affecting service activities in order to facilitate the provision of the service itself or to facilitate trade in goods. It has considerable potential, especially in the areas of transport in the context of programmes for facilitating greater economic integration, and tourism, to facilitate the flows of visitors among countries.

In the field of transport, cooperative efforts can yield rich dividends in: (i) the integration of transport infrastructure with a view to increasing intraregional trade, and (ii) the removal of material and non-material obstacles to the provision of transport services within the region with a view to facilitating the movement of goods and people. The harmonization and simplification of custom policies and transport documentation, and decisions granting the "right of transit" to the means of transport of ESCAP members and associate members, are examples of such cooperation. The establishment, through regional cooperation, of guidelines on transit trade facilities, especially for the land-locked countries of the region, is also an issue that deserves serious consideration.

Cooperation in tourism could focus on two areas: (i) cooperation in promotion and marketing through the execution of joint advertising campaigns and the establishment of package travel programmes which include visits to member countries of the grouping; and (ii) measures that seek to reduce travel barriers and promote intraregional flows of tourism. In this context, while conceding a nation's right to impose the requirements that it deems necessary for its national interests, the possibility of establishing a regional protocol for facilitating tourism flows between countries of the Asian and Pacific region, could be examined, perhaps as an expansion of the bilateral travel facilitating agreements that exist between some countries of this region. The encouragement, through cooperative endeavours, of "tourism growth triangles" could also have interesting prospects.

Furthermore, service exports to countries outside the region could be promoted through joint corporate mechanisms; for example, consultancy and engineering consortia have proved a successful means of gaining access to highly competitive international markets. By pooling their resources, developing countries of the region could also enter into distribution networks for services and goods in developed countries. Lastly, joint approaches, or even common regulatory structures, could assist countries of the region (i) in negotiating more effectively with foreign service suppliers, including transnational corporations, to seek improved terms of market access in developed countries, through access to downstream services as well; and (ii) in maximizing the possibilities of transfer of technology.

## 5. Issues relating to flows of foreign direct investment

Given the close nexus between trade and investment, enhancing cooperation to facilitate regional trade expansion should be accompanied by efforts to promote intraregional investment flows. One possibility is to develop a framework for cooperation between organizations of business and industry in individual countries, so that each party may have adequate appreciation of the needs and objectives of the other. Currently, business delegations organized in an ad hoc manner and directed at the more developed host and investing countries undertake this task, but a regional programme of action, would allow middle- and lower-income developing countries of the Asian and Pacific region to participate in the process. The main objective would be to identify potentially viable opportunities, formulate project proposals and search for suitable partners.

In this regard, the proposed United Nations supported regional investment information and promotion service (RIIPS) seeks to identify and match private investment initiatives and opportunities between capital and technology exporting and importing countries of the region. The need to establish such a service was recognized by the Commission at its forty-seventh session;[8] it is proposed to establish the service in the Republic of Korea through the collaborative efforts of ESCAP, the United Nations Conference on Trade and Development (UNCTAD), the United Nations Development Programme (UNDP) and the Export-Import Bank of Korea. Subject to its sustainability and commercial viability being assured, RIIPS would help enterprises in the region, particularly the small and medium enterprises, to engage in industrial cooperation, including joint ventures, through the pooling of information on complementary investment opportunities. On the basis of an extensive business information database, now being developed by the sponsoring

8 Report of the Commission on its forty-seventh session *(Official Records of the Economic and Social Council, 1991, Supplement No. 14)* (E/1991/35-E/ESCAP/822), para. 452.

organizations, the service could perform these functions using a computerized system which would enable it to single out the most complementary parties among the interested enterprises in the region. RIIPS could also assist with the financial viability assessment of a project, as well as provide on-line information related to investment conditions in the region on both a firm-specific as well as a country-specific basis. However, to make the service effective, the unequivocal support and cooperation of Governments in the region would be required.

## 6. Development of small and medium enterprises

Special attention should be directed to small and medium enterprises in the effort to enhance regional economic cooperation. This should not be difficult, given the experience with these enterprises in Japan and the Asian NIEs, which began by supplying low-cost labour-intensive products but have now reached an advanced stage of development through exposure to international trade and institutional support. These enterprises continue to play a critical role in the export of manufactured products from Japan and the NIEs, and their presence in technology- and skill-intensive industries, such as computers and software, is increasing, with many of them becoming important suppliers of specialized parts and components.

However, small and medium enterprises from other developing countries of the region may have to rely more on intraregional trade, at least in the short to medium term, to carve out niches in export markets, which, in turn, would lead to the upgrading of their technological base. In addition, information gaps, difficulties with access to capital and trade barriers also pose special problems. Therefore, technical and financial assistance, improved supply and marketing arrangements, and training of personnel are some areas in which regional schemes may be formulated to foster the growth of efficient export-oriented small and medium enterprises. Cooperation in the development of such enterprises through a subcontracting system would further help their entry into export markets and promote closer interdependence across the region between large enterprises and small and medium enterprises. The establishment of suitable technology transfer mechanisms to assist the enterprises of the region in acquiring efficient technology is also of vital importance; in this context, technical cooperation among developing countries (TCDC) arrangements and cooperation between the region's technical as well as scientific and industrial research institutions may be fostered. The services offered by the Asia and Pacific Centre for Transfer of Technology (APCTT), established by ESCAP, could also be geared to satisfy the specific technology requirements of small and medium enterprises.

## 7. Harmonization of customs procedures

There are other useful and practical forms of trade-related cooperation. One possibility, for example, might be for Governments to review the prospects for the harmonization of customs regulations and procedures in the region. While this is an issue of global dimensions, a regional initiative to harmonize border transaction procedures would certainly be of benefit to the economies of the Asian and Pacific region. Customs administrations are facing increasing demands to apply new technology to customs processing. The demands come not only from Governments seeking productivity gains but also from the client companies whose work practices and profits rely on automated processing. Differences among countries of the region in this area can add unnecessarily to the cost of transactions, in terms of both resources and time delays. Governments of the region may therefore see value in cooperating in this area, particularly through the Regional Trade Facilitation Network which has been established under the auspices of ESCAP. In this context, regional initiatives in the global effort towards harmonization of international trade laws could also be considered.

## 8. Human resources development

A large share of the human resources in the Asia and Pacific region are underdeveloped, and therefore underutilized. This poses a challenge to make the region's huge population more productive in an era of rapid technological change. Consequently, human resources development is also an increasingly important focus of technical assistance and cooperation programmes. It encompasses the development and utilization of skills through training, education, research, information and scholastic exchange. For this purpose ESCAP is implementing the Jakarta Plan of Action on Human Resources Development in the ESCAP region adopted by the Commission in resolution 274 (XLIV) of 20 April 1988. Human resources development is also a means of coping with the introduction of labour-saving technologies and is integral to the diffusion and successful absorption of technology; human resources development and training will

therefore constitute an important input into regional cooperation efforts. Training in the field of trade-related skills, among others, can assist in appreciating the advantages of intraregional trade and investment expansion. In this context, cooperative action would be required for providing training facilities to personnel, especially from the region's least developed countries and the economies in transition, to enable them to manage trade promotion efforts effectively during the process of reform.

### 9. Special assistance to economies in transition

The economic isolation of the economies in transition of the region from world markets until recent years necessitates their placing high priority on the development of new trade links through trade liberalization and trade diversification with emphasis on export promotion. In this context, the land-locked nature of most economies in transition makes it essential for such economies to redesign and strengthen their transport and communications infrastructure for the purpose of forging links with the rest of the region. Moreover, the widespread controls on currency highlight the urgent need for financial sector reforms and for developing expertise in macroeconomic policy management to underpin the implementation of stabilization policies. Under these circumstances, the major focus of regional technical assistance would be on the development of policies that introduce competition in the economy, namely, programmes for privatization, and the design and implementation of anti-monopoly legislation, which constitute the foundation of a market economy. Very little substantive progress has been made on these issues in most economies in transition in the region.

In addition, assistance from the region for the outward-oriented development of the transport and communications sector of all these land-locked economies would play a vital role in achieving their faster integration of these with the rest of the world. It would also help in reducing transaction costs and in attracting FDI particularly in the Asian republics of the former USSR. While each country has its own plans for strengthening transport and telecommunication infrastructure, and some plans are also being developed by neighbouring countries for the Asian republics, there is need for much greater coordination. For example, the formulation of a master plan for transport and communications infrastructure development covering the whole of central Asia, including Mongolia, could be seriously considered with a view to achieving integrated development of the area.

### 10. Assistance to the least developed countries

A special advantage for the least developed countries is that under the generalized system of preferences (GSP), restrictive conditions which are occasionally imposed on certain items exported by developing countries to protect domestic producers in the developed countries are not applied to the least developed countries. A regional programme to assist these countries in availing themselves of those GSP benefits which interest them and are offered by the region's developed countries would have two impacts. First, in the short term it would enable the least developed countries to expand their exports of such tradables; and second, in the medium and long term it may even induce investment flows into these countries, especially from neighbouring developing countries that may wish to overcome their own inability to expand exports from their home base by shifting such export-oriented production facilities to the least developed countries.

## E. CONCLUSION

In conclusion, it must be reiterated that although the focal point of expansion in world trade and economic growth has shifted to the Asian and Pacific region, not all countries of the region are able to take advantage of these favourable developments. Structural differences and precarious external imbalances in several of the region's developing economies threaten the continuation into the next century of the economic expansion of the developing Asian and Pacific region, which had been the hallmark of the 1980s. In order to meet this challenge, regional economic cooperation is imperative, both to sustain growth in the region and to ensure the operation of the trade-investment nexus along with a wider spread of its benefits across the developing ESCAP region.

In realizing the wealth of bounty from regional cooperation, the constraints are not imposed by the lack of understanding of what is to be done or how to go about it; rather, they arise from the reluctance of participating members and lack of their persistent endeavours to eradicate the divisive biases that form the stumbling-block. International cooperation is a two-way street where diverging internal interests have to be settled and a small internal loss may have to be borne for a bigger external gain. Thus, even with sound prescriptions for promoting regional cooperation, the process of

realizing its benefits is, at times, extremely difficult.

In the ultimate analysis, the economy of the region as a whole can only be as strong as the countries constituting it. Far-reaching decisions are, therefore, needed to induce the Governments, concerned United Nations agencies and related organizations to work jointly on a blueprint envisaging benefits to both the fast and the slow growing countries of the region and involving an agenda for action admitting trade, capital and technology flows along with market reforms. If the Asian and Pacific region is to enjoy the benefits of regional cooperation fully, the barriers to such intraregional flows must be dismantled, but without subverting any country's chosen path of development. This is a difficult task, but it is not insurmountable, if only for the reason that all, including the better-off economies of the region, stand to gain from such an initiative. All that is required is that Governments in the region work together to provide the required impetus for a growth process stimulated by sustained expansion of investment and intra-regional trade which would have a well-balanced developmental impact on the Asian and Pacific region, instead of polarizing it into rich and poor segments.

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