Economic Analysis and Survey Branch

Economic Survey of Asia and the Far East 1970

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Beginning with the ninth volume (1958/59), the *Economic Bulletin for Asia and the Far East* has been issued quarterly, in March, June, September and December. The March issue is the annual *Economic Survey of Asia and the Far East*, the June and September issues contain articles and notes on subjects related to the Asian economy, and the December issue features special studies and reports relating to economic development and planning.

The Bulletin is prepared by the secretariat of the Economic Commission for Asia and the Far East and is published entirely on the responsibility of that secretariat. 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 delimitation of the frontiers of any country or territory.

Since the 1957 issue, the *Economic Survey of Asia and the Far East* has, in addition to a review of the current situation of the region, contained a study or studies of some major aspect(s) or problem(s) of Asian economy, 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: Import 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 exports
1968: Economic problems of export-dependent countries Implications of economic control 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

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PREFACE

The present *Survey* is the twenty-fourth in a series of reports prepared annually by the secretariat of the Economic Commission for Asia and the Far East. A major object of these *Surveys*, and of the quarterly *Economic Bulletin,* is the analysis of recent economic developments in the countries of Asia and the Far East, and of international developments that affect them. Particular attention is paid to the analysis of economic policy and policy issues.

Since 1957, in addition to review and analysis of developments in individual countries of the region, it has been the practice of these annual *Surveys* to examine specific problems concerning the economies of the region in order to study long-term trends and their implications for national policies. In keeping with this practice, Part One of the present *Survey* contains a study on the role of foreign private investment in economic development and co-operation in the ECAFE region. Part Two, in addition to individual current surveys of twenty-one countries of the region, contains two special studies, the first on problems and prospects of the ECAFE region in the Second Development Decade and the second on broad features of development in the ECAFE region in 1969/70 and their implications for 1971.

The Survey is published on the sole responsibility of the ECAFE secretariat; the views expressed should not be attributed to the Commission or to the Governments of member countries.

Bangkok, March 1971.

EXPLANATORY NOTE

The term "ECAFE region" is used in the present issue of the *Survey* to include Afghanistan, Australia, Brunei, Burma, Ceylon, China (Taiwan), Fiji, Hong Kong, India, Indonesia, Iran, Japan, Khmer Republic, the Republic of Korea, Laos, Malaysia, Nepal, New Zealand, Pakistan, Papua and New Guinea, the Philippines, Singapore, Thailand, the Republic of Viet-Nam and Western Samoa. Unless otherwise specified or made clear in the text, it excludes China (mainland), Mongolia, North Korea and North Viet-Nam, all of which are centrally-planned economies for which adequate information or comparable statistics are not available. Malaysia includes the territories of West Malaysia (the former States of Malaya) and East Malaysia (Sabah and Sarawak), and statistics relating to previous years often have to be given separately for the two parts of the country. There are also cases where national figures of previous years are combined to compare with those of later years. The term "developing ECAFE region" excludes Australia, Japan and New Zealand.

Unless otherwise stated, all statistical tables are compiled by the ECAFE secretariat on the basis of data published by Governments and the United Nations and its specialized agencies.

Reference to "tons" indicates metric tons, and to "dollars", United States dollars, unless otherwise stated.

The term "billion" signifies a thousand million.

Three dots (. . .) indicate that data are not available or are not separately reported.

A dash (—) indicates that the amount is nil or negligible.

A blank in a table indicates that the item is not applicable.

A hyphen (-) between dates representing years, e.g. 1950-1960, is used to signify the full period involved, including the beginning and end years.

A stroke (/) indicates a crop year, fiscal year or plan year, e.g. 1960/70.

The plan years of the ECAFE countries coincide with their fiscal years as given in the table below, except in the case of China (Taiwan), where the plan year coincides with the calendar year.

In respect of information given, the countries listed below have generally been included, subject to limitation of data.

Country	*Fiscal year*	*Currency and abbreviation*	*Official rate of exchange for one United States dollar as of 16 February 1971 except as otherwise indicated*
Afghanistan	21 March to 20 March since 1963/64	Afghanistan (Af)	45.00
Australia	July to June	Australian dollar (A$)	0.89
Brunei	January to December	Brunei dollar (B$)	3.06
Burma	October to September	Kyat (K)	4.76
Ceylon	October to September	Rupee (Rs)	5.95
China (mainland)	January to December	Yuan	2.46[a]
China (Taiwan)	July to June	New Taiwan dollar (NT$)	40.00
Hong Kong	April to March	Hong Kong (HK$)	6.06
India	April to March	Rupee (Rs)	7.50
Indonesia	January to December	Rupiah (Rp)	340.14[b]
Iran	21 March to 20 March	Rial	75.76
Japan	April to March	Yen (¥)	359.71
Khmer Republic	January to December	Riel (Ri)	55.56[c]
Korea, Republic of	January to December	Won	316.46[d]
Laos	July to June	Kip (Kp)	239.81[e]
Malaysia	January to December	Malaysian dollar (M$)	3.06
Nepal	16 July to 15 July	Rupee (Rs)	10.12
New Zealand	April to March	New Zealand dollar (NZ$)	0.89
Pakistan	July to June	Rupee (Rs)	4.76
Papua and New Guinea	July to June	Australian dollar (A$)	0.89
Philippines	July to June	Peso (P)	3.90[f]
Singapore	April to March since 1969/70	Singapore dollar (S$)	3.06
Thailand	October to September since 1961/62	Baht	20.80
Viet-Nam, Republic of	January to December	Piastre (Pr)	118.06[g]
Western Samoa	April to March	Samoan tala (WS$)	0.71

[a] June 1, 1968.
[b] Major export rate at the end of 1970.
[c] End of October 1970.
[d] End of 1970.
[e] End of October 1970.
[f] Floating rate since 21 February 1970.
[g] End of 1970.

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INTRODUCTION

The First Development Decade

The record of the developing ECAFE region during the First Development Decade is a mixed one. Measured purely in terms of aggregate growth in production, the First Development Decade witnessed success in most of the developing ECAFE countries. The target growth rate of 5 per cent, set by the United Nations General Assembly at the beginning of the decade, appears to have been achieved by a large number of countries in the region, and quite a few have recorded growth rates considerably in excess of the target. The better performance of the agricultural sector was an important factor in improving the growth performance of a number of developing ECAFE countries during the 1960s.

The rise in *per capita* income in most countries is, however, far less impressive on account of the fast growth in population. Moreover, the gains from development have not been equitably distributed. The increase in inequalities of income and wealth, and the lack of any pronounced improvement in the living conditions of the lower income strata in many countries, have led to social discontent and to calls for a major reorientation of policies in the Second Development Decade.

The average annual rise in *per capita* income in the developing ECAFE region between 1960 and 1968 amounted to no more than 1.9 per cent. Even this rate cannot be taken as a good indicator of progress, however, because direct and indirect evidence points to an aggravation of income inequalities in most countries of the region. Large segments of population in a number of countries continue to suffer from varying degrees of malnutrition as a direct effect of low incomes, and the unemployment situation remains acute in most countries. On account of the inequitable sharing of gains from development, a number of developing ECAFE countries experienced social discontent of varying intensity during the First Development Decade.

Major policy issues in the Second Development Decade

The major policy issue which confronts the developing ECAFE countries in the Second Development Decade is how to bring about a better blend between economic growth and social justice. A considerable acceleration in the rate of growth of *per capita* income will be necessary in order to tackle the socio-economic problems of the region effectively. The slowness with which living conditions improved in the First Development Decade in the developing ECAFE region is in large part a reflection of the fact that, at the beginning of the 1960s, Asia was the poorest of the world's regions in terms of *per capita* income, and it remains so today.

It is encouraging, however, to find a number of factors which promise more rapid economic growth in the Second Development Decade. By far the most important of these is the breakthrough in agriculture. It is particularly satisfying to note that progress in the adoption of new high-yielding varieties of seeds and greater use of fertilizers has been most rapid in the densely-populated and food-deficit countries of the region, such as India, Pakistan and the Philippines. This is of great significance because the new strategy, being land saving, necessitates a large amount of working capital per unit of land to fulfil the new varieties' requirements for very large inputs of fertilizers and pesticides, technically superior water supplies and precision of cultivation. To enable the small farmer to share in the benefits of the new high-yielding varieties, a substantial extension of bank credit and other assistance seems essential.

In general, with the building up of a more adequate physical infrastructure, the "development potential" of most developing ECAFE countries has increased, and the development process in future should gain by "external economies" associated with it. The process of industrialization, which was fairly rapid in a number of countries, has imparted greater strength to their economies. Some countries, such as India, the Republic of Korea and China (Taiwan), have progressed beyond the first phase of industrialization and have made significant headway in more sophisticated lines of industrial production. This change in the internal structure of industry is likely to have beneficial "spread" effects in the future, if other circumstances are favourable. The savings and investment effort of the developing ECAFE countries during the First Development Decade was also substantial; in a number of countries the marginal rate of savings was as high as 20 per cent or more. The fact that, in the case of almost all developing ECAFE countries, the marginal rate of savings has been higher than the average rate of savings gives cause for hope that gross domestic savings as a proportion of gross domestic product will rise further in future. Viewed against the background of the numerous impediments in the way of export expansion, the export performance of the developing ECAFE countries during the First Development Decade was also encouraging.

Acceleration in economic growth will require the removal of a number of impediments which held back faster progress in the First Development Decade. A slowing down in the rate of population growth is essential if significant improvements in living conditions are to be attained. It will also be necessary to remove such institutional impediments to progress as inequitable land tenure systems. Steps need be taken to achieve greater allocative efficiency. The development strategy pursued in the 1960s involved certain imbalances in both intersectoral and intrasectoral resource allocation. These need to be remedied. In this connexion, exchange rate and interest rate policies, in particular, need re-examination in a number of countries. At the same time, achievement of a higher growth rate will require increased domestic resource mobilization and vigorous export expansion. Apart from self-financing, there are two fundamental methods of resource mobilization: budgetary surpluses and the channelling of private savings to development-oriented financial institutions. Budgetary surpluses over current expenditure will have to play a much more important role in domestic resource mobilization in the Second Development Decade on account of the need to maintain monetary stability, the clearly discernible rising trend in a number of countries in the ratio of public investment to total investment and GNP, and the expected rise in social sector capital expenditures. A major effort will be needed, therefore, to increase government revenues. Rising *per capita* incomes, the decline of the subsistence sector and the greater diversification of the economies in the ECAFE region mean that particular attention will have to be given to the development of financial institutions to streamline and quicken the process of resource mobilization. The desired acceleration in the rate of economic growth will require a steady increase in foreign exchange earnings and this, in turn, will require measures on a broad front, such as improvement in quality and reduction in the cost of production of export products, development of new export markets, and a relative shift towards the production and export of those commodities whose world demand is expected to grow at a faster pace in the future.

These measures need to be supplemented by more active regional co-operation and greater assistance on the part of the international community in matters of trade and aid. Measures of trade liberalization among the developing countries, together with commodity agreement and harmonization of development plans, can significantly aid the development effort of individual countries by overcoming the problem of smallness of domestic markets and by increasing productive efficiency through greater specialization and achievement of economies of scale. Considerable headway has been made in the study of the problems of regional co-operation in the First Development Decade, and more tangible results can be expected in the Second Development Decade. Developed countries' tariff and non-tariff barriers to imports from developing countries are impeding a faster rise in the developing countries' export earnings. It is hoped that developed countries will allow increased access to their markets in the Second Development Decade and thereby assist the export drive of developing countries. An increase in the flow of foreign assistance and a softening of the terms of all types of foreign assistance are also needed if the "trade gap" of developing countries is not to interfere seriously with their efforts to speed up economic growth.

A number of measures are required to ensure that the benefits of economic growth are widely distributed. Fiscal policy needs to play a more active role in bringing about a better pattern of income distribution. It is necessary to stabilize the cost of living and guard against the emergence of undue inflationary pressures which result in regressive changes in income distribution. Vigorous efforts are needed to expand employment opportunities. Finally, it is necessary to give more attention to social sectors and to modify the institutional and policy framework so that all strata of society have ample opportunities for rapid economic and social advancement.

The current economic situation

Economic developments within ECAFE developing economies were affected by developments in the international economic community. In 1969 and 1970, the world economy suffered strong inflationary pressures. These occurred because of excess demand conditions which manifested themselves in a marked expansion in the value of world output and trade. As a result of this high level of economic activity in the developed industrial nations, record rates of growth in output and trade were experienced by developing economies. The continuing effects of the "green revolution" in agriculture also assisted materially in expanding output in a number of countries.

Although there were some exceptions, the developing economies of the ECAFE region, as a whole, recorded impressive increase in the level of real gross national products in 1969, and, from preliminary evidence available, it is obvious that these increases continued in 1970. Increases in gross national product in China (Taiwan) and the Republic of Korea were a result of the rapid expansion of demand in the developed industrial nations, and, in the remainder of the region, they were the result of the continued expansion in agricultural output.

As the individual country chapters indicate, the developed economies of the region also sustained impressive economic development. Rates of growth

in gross national product are given in table 1 for a number of selected developing countries in the ECAFE region. Three points are worth noting. First, although some of the estimates for 1970 are not yet to hand, it is evident that, in 1969 and 1970, most countries in the region either attained or exceeded, in some cases considerably, the 5.0 per cent rate of growth in gross national product set for the First Development Decade. Secondly, there is encouraging evidence that, in India and Indonesia, the long-term rate of growth in real gross national product is rising and will continue to rise. Pakistan is maintaining its growth momentum. Because of the large size of these countries, this is of particular importance in assessing the prospects for the region in the coming development decade. Thirdly, in 1969, most of the countries achieved increases in real gross national product in excess of the targets laid down in their development plans (where these existed). In the Republic of Korea, in particular, the growth rate of 15.9 per cent considerably exceeded the plan target of 10.0 per cent.

Table 1. Selected developing countries of the ECAFE region: Growth rates of gross national products at constant prices

Country	Annual average		Change from the previous year		
	1960-1965	1965-1969	1968	1969	1970
Ceylon	3.9	6.1	8.3	5.7	5.3[a]
China (Taiwan)	10.1	9.9	10.1	8.7	n.a.
India[b]	3.3	4.4	9.7	2.2	5.5[a]
Indonesia	1.8	3.5	6.9	6.3[a]	n.a.
Iran[c]	6.6	9.3	11.8	10.2	11.4
Korea, Republic of	6.8	12.8	13.3	15.9	11.6[a]
Malaysia, West	5.9	6.9	5.8	9.0	n.a.
Pakistan[d]	5.5	6.0	7.8	5.0	5.8
Philippines[d]	5.6	6.3	6.2	6.5	5.0
Thailand	7.3	9.1	9.1	9.4	5.4[a]

Sources: International Monetary Fund, *Annual Report, 1970*, p. 104; country reports included in this *Survey*; and various official publications.

[a] Estimate only.
[b] Year ending 31 March.
[c] Year ending 20 March.
[d] Year ending 20 June.

Recently released FAO information indicates that total production in the agricultural sector of the ECAFE region increased by 3.3 per cent in 1970. This solid achievement in the agricultural sector indicates that the effects of new agricultural techniques, known as the "green revolution", are continuing, except where particularly adverse climatic or other conditions have appeared. In some nations, increased output is also the result of policies directed towards agricultural self-sufficiency. This increase in agricultural output has given rise to new problems. First, the export prospects of traditionally food-exporting nations, such as Thailand, have been adversely affected. In so far as these new techniques are responsible for a genuine shift in comparative advantage there is little such countries can do except to adopt policies which will offset the adverse balance of payments effects and diversify agricultural production.

Secondly, because of the nature of the new agricultural techniques, the disparity in income distribution in the agricultural sector has tended to increase. Generally speaking, it is the larger-scale economic unit, which has access to capital, which has benefited most. As stated before, it is necessary to extend substantial bank credit and other types of assistance to small cultivators to enable them to share in the benefits of the new high-yielding varieties.

For the region as a whole, there has been a continued expansion in industrial activity. The expansion in demand in the developed industrial economies in 1968, 1969 and 1970 has been biased towards manufactured commodities and has benefited most the exports of those commodities.

It is well-known that, at least until intermediate and capital goods industries commence operation, large-scale industrial development will require heavy imports of capital equipments and semi-processed products. It is essential to realize, however, that, in small developing countries, the development of key industries, such as petro-chemicals, iron and steel, aluminium, and machinery, will face severe difficulties and lead to uneconomical use of scarce resources if based on a single country's market. For this reason, it is important that recent proposals concerning intra-regional trade among developing countries be proceeded with as soon as possible.

The recent export performances of countries in the region is a mixed one. On the one hand, estimates for 1968, 1969 and 1970 indicate that the Republic of Korea, China (Taiwan), Iran, Malaysia, India and Indonesia have improved considerably on their performances in the earlier years of the decade. Indeed, with the exception of India, the exports of these countries are currently growing at a rate in excess of 10 per cent per annum. On the other hand, countries such as Thailand, the Philippines, Pakistan and Ceylon have encountered difficulties in sustaining the rate of expansion of their exports.

Those countries in which export development has been particularly strong, such as the Republic of Korea, China (Taiwan), Singapore and Hong Kong, have been influenced by the excess demand conditions in the developed industrial nations and by the bias of the import demand of these countries in favour of manufactured goods. Iran and Malaysia have

benefited from buoyant demand conditions for their traditional exports, and Indonesia is reaping the benefits of policies, such as exchange rate alterations, which sought to improve the efficiency of their export sectors.

Adverse balance of payments influences have also been operative. Rice exports from Thailand have fallen as a result of the increases in agricultural output elsewhere in the region. In Pakistan, the failure to sustain export growth is partly due to reduced foreign aid which has curtailed the flow of imported raw material to the manufacturing sector and thereby reduced the export of manufactured goods.

The rate of growth of imports in a number of countries of the region reflects several basic influences. In the case of the Republic of Korea and China (Taiwan), the strong export-led development of the domestic economy has given rise to a rapid expansion of import demand. In the former country, economic development has also been augmented by foreign capital inflow, with the result that it has secured the highest rates of increase of import demand recorded since 1968. In a number of other countries, such as Pakistan, India and Ceylon, import demand has been adversely affected by the stagnation of foreign aid. Import demand has also been strongly influenced by a tendency for certain economies, such as the Philippines and Iran, to expand aggregate demand, including demand for fixed-capital formation, beyond the availability of domestically produced goods and services, and to finance this excess of expenditure over income by large short-term borrowing from abroad. In each of these cases, the subsequent short-term debt-servicing problem has required the adoption of unpalatable monetary, fiscal and external policies to bring the balance of payments to order.

The prospects for 1971

For a variety of reasons, it is likely that developments in the international economy will adversely affect the balance of payments situation of a number of countries in the region and thereby give further emphasis to the need to mobilize domestic savings if the level of investment in relation to gross national products is to be sustained.

First, the rate of growth in output of the industrial countries can be expected to decline in 1971 as these countries adopt more effective anti-inflationary measures. The level of industrial activity in the developed economies strongly influences the exports of ECAFE developing economies, and countries such as the Republic of Korea, China (Taiwan) and Singapore, in particular, will probably be adversely affected. Secondly, while the more pessimistic fears about a revival of protectionist philosophy in the United States are unlikely to materialize fully, there is no doubt that, at a time of excessive unemployment and of balance of payments difficulties, the arguments of protection groups are influential.

For the most part, of course, it is the very success which many developing nations have had in competing in the markets of the developed countries which has prompted the unfortunate and short-sighted adoption of protectionist policies. It is pleasing to note, however, that, in the recently held meetings of the UNCTAD Committee on Preferences, the developed countries indicated their willingness to take measures by 1971 to accord non-discriminatory and non-reciprocal preferences to developing countries.

Thirdly, the observed decline in the absolute value of capital flows of a genuinely concessionary nature is a matter of deep concern. Indeed, the decline is more pronounced if real and not current values are used. Moreover, while the flow of long- and short-term capital of a non-concessionary type has tended to offset this decline in foreign assistance, the changed composition of the over-all capital flow to harder commercial terms, and the increased share of short-term capital in the over-all total, have increased the debt-servicing commitments of many ECAFE developing countries.

As a result mainly of the decline in foreign assistance and rising debt-service obligations, investment and particularly public sector investment has tended to stagnate in a number of countries in the region. This situation could be aggravated in 1971 unless the developed economies plan their anti-inflation policies in such a way that the export prospects of the developing economies are not seriously jeopardized and unless the developing economies pursue their attempts to mobilize domestic savings and promote exports with renewed vigour.

Finally, if recent growth rates of gross national products within the region are to be maintained and increased, it is imperative that the progress in agricultural activity should be sustained. This will require a concentrated effort to extend the technological basis of the "green revolution" to crops and farm products other than cereals and to improve agricultural extension activities and credit facilities so that the results of improved technology not only reach but can be used by the entire farming community.

ECONOMIC SURVEY OF ASIA AND THE FAR EAST, 1970

PART ONE

THE ROLE OF FOREIGN PRIVATE INVESTMENT IN ECONOMIC DEVELOPMENT AND CO-OPERATION IN THE ECAFE REGION

THE ROLE OF FOREIGN PRIVATE INVESTMENT IN ECONOMIC DEVELOPMENT AND CO-OPERATION IN THE ECAFE REGION

Chapter I

INTRODUCTION

Foreign private investment has long played a profound role in the development of the ECAFE region; it has helped to introduce new technologies, explore for mineral resources, cultivate plantations, and build factories, railways and financial institutions. During the 1960s, the flow of private capital to the developing ECAFE countries expanded rapidly, to more than $900 million in 1968.

The share of private investment in total net financial flows to this region increased from about 8 per cent in 1960 to 17 per cent in 1967, while multilateral flows increased from about 3 per cent to 9 per cent, and the share of official bilateral aid declined from 89 per cent to 74 per cent.[1] The growth in the flow of private capital to the developing ECAFE region is expected to continue during the 1970s. It has been estimated that, by 1975, for example, Japan will have increased its annual flow of direct investments and export credit to all developing countries to $2,170 million, 2.5 times the 1969 level of $827 million.[2] There are good reasons to believe that developing ECAFE countries will share fully in these increased flows from Japan, and from other capital-supplying countries. The share of private investment in total flows is still low, compared to other regions; new interest is being shown in oil exploration along the continental shelf from the Republic of Korea to Indonesia and across to India and Pakistan; labour shortages in many developed countries have intensified, while large reserves of relatively low-cost manpower can be tapped in most developing ECAFE countries; severe problems of overcrowding and pollution in advanced countries are exerting pressure on several types of industry to move to available plant sites close to raw material sources in the developing countries.

Needless to say, official aid and multilateral flows to the developing ECAFE region will continue to play essential roles in development of this region. Each of the three major types of flow makes its own unique contribution. Direct private investment has the potential to (*a*) contribute indirectly to the savings and foreign exchange gaps by contributing to tax revenue; (*b*) help in the transfer of technology and skills; (*c*) provide management and training of local managers; (*d*) help in training workers and creating indigenous skills in administrative, marketing, and other business techniques; (*e*) contribute to the growth of local entrepreneurship; (*f*) increase competition by changing the market structure; (*g*) establish contacts with overseas banks, capital markets, factor and product markets, and sales organizations; (*h*) create employment opportunities directly and indirectly; and (*i*) raise domestic wages or improve the terms of trade.[3]

However, the cost of foreign private investment may include remittances of dividends, interest, royalties, technical fees and other related payments. In addition, there may be indirect costs, such as loss of government revenue from promotional tax concessions and subsidies, the effects of special tariffs which may be required to protect new investments, and the waste caused by redundant imports of technology. If national policies are not properly devised, foreign capital may also have stultifying effects on indigeonous enterprise and domestic research activities.[4] Thus, evaluation of the actual net contribution of foreign investment within the context of developing ECAFE countries requires careful cost-benefit analysis based on more adequate data than are now available. Systematic and continuing studies are needed to support this type of analysis.

Effective policies by both investing and host countries can help to maximize the actual benefits of direct investments for both investors and host countries. The International Development Strategy for the Second United Nations Development Decade calls on developing countries to "adopt appropriate measures for investing, stimulating and making effective use of foreign private capital, taking into account the areas in which such capital should be sought and

[1] See table I-2-6 in Chapter II.

[2] Based on projections contained in Japan's "New Economic and Social Development Plan" of 1970 and the Japanese commitment to meet the one per cent of GNP target for transfers of financial resources to developing countries by 1975. *The Japan Economic Journal*, 12 January 1971, p. 7.

[3] Streeton, Paul, "The Flow of Financial Resources", UNCTAD document TD/B/C.3/79/Add.1 dated 21 May 1970.

[4] For a recent discussion of the benefits and costs of foreign private investment in some of the ECAFE countries, see the collected papers presented to the Third Pacific Trade and Development Conference, Sydney, August 1970.

bearing in mind the importance for its attraction of conditions conducive to sustained investment". At the same time, "foreign private investors in developing countries should endeavour to provide for an increase in the local share in management and administration, employment and training of local labour, including personnel at the managerial and technical levels, participation of local capital and reinvestment of profits". The Governments of developed countries are urged to adopt "further measures to encourage the flow of private capital to developing countries" and "assist developing countries in identifying technologies which are appropriate for their circumstances and in avoiding the utilization of scarce resources for inappropriate technologies".[5]

In order to bring together some of the background data and analysis required to assess and co-ordinate policies of the countries of this region toward foreign private investment, a joint study has been initiated by the ECAFE secretariat and the United Nations Asian Institute for Economic Development and Planning. The objective of the study is to increase the volume and to improve the utilization of private capital flows into regional countries by identifying some of the problems faced by foreign investors and host countries, and promoting mutual understanding and co-operation among the investment partners. The following chapters are an interim report on the first phase of this project.

[5] United Nations, *International Development Strategy, Action Programme of the General Assembly for the Second United Nations Development Decade* (ST/ECA/139), 1970 (Sales No: E.71.II.A.2), paras. 50 and 63, pp. 11, 16.

Chapter II summarizes the published data, mostly aggregate, on foreign private capital in this region in the pre-war period and during the 1960s. The trends discussed in this chapter are elaborated in chapter III by taking illustrations of direct investments from two important investing countries, namely the United States and Japan. Chapter IV presents data collected from regional host countries. This chapter is divided into two sections. The first section gives a survey of recent experience in nine ECAFE countries: China (Taiwan), Indonesia, Iran, Malaysia, Pakistan, the Philippines, the Republic of Korea, Singapore, and Thailand. The second section discusses the pattern of investment and selected policy issues in India, where more complete data were available. The growing importance of export credit flows to finance investment in the ECAFE region and the issues related to these flows are discussed in chapter V.

Chapters VI and VII are devoted to two important subjects which influence the climate for foreign investment in the host countries, namely taxation and capital markets. The specific aspects examined are the tax incentives provided by the host countries, the structure of the capital markets, and financial resources extended by different constituents of the markets.

The concluding chapter summarizes the findings of the study and makes recommendations for regional co-operation with regard to certain aspects of intra-regional investment and foreign private investment from outside the region.

Chapter II

TRENDS IN FOREIGN PRIVATE INVESTMENT IN THE DEVELOPING ECAFE REGION

For an understanding of the changes that have been occurring in the pattern of foreign investment during the postwar decades, it is useful to have a picture of the nature and extent of foreign capital on the eve of the Second World War. In section A, estimates of the stock of foreign private capital outstanding at the end of the 1930s are presented for most countries of the region. It has also been possible to compile these pre-war data by country of origin of investment and by major sector of industry.

The postwar data presented in section B mostly relate to flows during the 1960s. Data on the outstanding stock of foreign private investment in the postwar period are not yet available for most of the host countries of this region. The distribution of foreign investments in individual host countries by national origins and industry sectors is discussed in chapter IV. The purpose of this chapter is to show the relative importance of different investing countries for this region and the relative share of individual host countries in total foreign investment in the region. Recent trends in the flows of foreign capital into the ECAFE region are also discussed in this chapter.

Section A

Pre-war foreign investment in south and southeast Asia

The data on foreign private investment in south and southeast Asia on the eve of the Second World War are presented in the first three tables in this chapter. The main source utilized for the various countries, except for the subcontinent which now consists of India, Pakistan and Ceylon, is the study by Helmut G. Callis.[1] For the subcontinent, the source is the first Indian census of foreign assets and liabilities carried out by the Reserve Bank of India.[2]

The estimates in table I-2-1 broadly indicate the orders of magnitude involved and the relative position of different countries. The total of foreign investment outstanding at the end of the 1930s is roughly placed at $9.4 billion.

Table I-2-1. Estimates of foreign private capital in south and southeast Asia on the eve of the Second World War

(in million dollars)

Country	*Reference year of the estimate*	*Amount*	*Share of portfolio (in percentage of total)*
Netherlands Indies	1937	2,264	37.7
British Malaya	1937	455	18.2
Thailand	1938	124	27.4
Philippines	1935	376	16.2
Burma	1939	233	3.4
French Indo-China	1938	384	21.4
Formosa (Taiwan)	1939	200	25.0
Sub-total		4,036	29.0[b]
India, including[a] Pakistan and Ceylon	1936/1938	5,385[a]	40.0[a]
Total	Eve of the Second World War	9.4 billion dollars approximately	35.0[b] approximately

Sources: Compiled from Callis, H. G., *Foreign Capital In Southeast Asia* (International Secretariat, Institute of Pacific Relations, New York, 1942), appendix, p. 108, for all countries except India;

Report on the Census of India's Foreign Liabilities and Assets, Reserve Bank of India, Bombay, 1950, appendix I, p. 158, for the estimate of British capital of which the original source is the British financial journal, *The Statist*, 1939;

United States Department of Commerce, *Survey of Current Business*, December 1952, for the estimate of United States direct investment in India (1936).

Note: Approximate exchange rates used for conversion into dollars:

1 guilder = 40 cents
1 pound = 5 dollars
1 yen = 27.5 cents.

[a] The estimate for India relates to British investments (1938) and United States direct investments (1936) only.

[b] Some of Callis' estimates of "portfolio" investments seem to be on the low side.

[1] Callis, Helmut G., *Foreign Capital in South Asia*, I.P.R. International Research Series (International Secretariat, Institute of Pacific Relations, New York, 1942). Callis uses the categories, "entrepreneur" and "rentier" investments, instead of the usual "direct" and "portfolio" concepts. "Entrepreneur" investments are deemed to cover a wider field than "direct" investments in that they include estimates of investments in both incorporated and unincorporated enterprises, including family enterprises. "Rentier" investments, on the other hand, are broadly conterminous with portfolio, and include private investments in bonds, debentures, etc. of Government and public bodies. However, except for the very rough estimates of overseas Chinese investments, Callis' data mostly refer to corporate direct investments and portfolio investments in public issues.

[2] *Report on the Census of India's Foreign Liabilities and Assets*, 1948, Reserve Bank of India, Bombay 1950, appendix 1, pp. 151-159.

Table I-2-2. Foreign investment from different capital-exporting countries to the countries of south and southeast Asia on the eve of the Second World War

From metropolitan countries / To host countries	Philippines 1936 (million dollars)	Netherlands-Indies 1937 (million dollars)	Formosa (Taiwan) 1939 (million yen)	British Malaya 1937 (million dollars)	Thailand 1938 (million dollars)	French Indo-China 1938 (million dollars)	Burma 1939 (million pounds)	India 1939 (million pounds)
United States								
Entrepreneur	(151)[a] 163 (258)[b]	95		23.7[c]				(29.7)[d1] (41.3)[d2]
Rentier	36.3 (37.5)[e]							
United Kingdom								(700)[i]
Entrepreneur	35	200		261[f]	90[g]		47.2 (236)[h]	651[i] (3,255)[j]
Rentier					34[k]		2.8 (14)[i]	420[i] (2,100)[j]
France								
Entrepreneur		35				302[m]		
Rentier						82.2[n]		
Netherlands								
Entrepreneur		1,040[o]						
Rentier								
Belgium								
Entrepreneur		9						
Rentier								
Spain								
Entrepreneur	90							
Rentier								
Japan								
Entrepreneur	27	12	320 +200[p]					
Rentier			94.2[q] + 79.0[q]					
Germany								
Entrepreneur		10						
Rentier								
Italy								
Entrepreneur		10						
Rentier								
Overseas Chinese	100	150[r]		200[s]	100[t]	80		
Total								
Entrepreneur	315[u]	1,411	520	372	90	302[v]	47.2[w] (236)[h]	(3,284.7)[x] (3,541.3)[y]
Rentier	61	852.5[z]	173.2	82.5	34	82.2	2.8 (14)[h]	420 (2,100)[j]
Grand total	376	2,263.5	693.2[aa]	454.5[bb]	124[cc]	384.2	50 (250)[h]	(5,384.7)[dd]

Notes: (1) The years are approximate.

(2) Except for Indian data, figures not in parentheses are those accepted by Callis (*op. cit.*). The figures for British Investments in India refer to the subcontinent of India (including Pakistan and Ceylon) and were estimated by the British financial journal, *The Statist*, 1939. This figure is also cited approvingly in the *Report on the Census of India's Foreign Liabilities and Assets, op. cit.* The figures for United States investments in India also refer to the subcontinent, inclusive of Pakistan and Ceylon, and are as estimated by the Department of Commerce, *Survey of Current Business, op. cit.* Column data do not necessarily add up to totals because of inadequate coverage of the countrywise analysis.

[a] Estimate for 1935, United States Department of Commerce.
[b] Estimate for 1935, Bureau of Insular Affairs.
[c] United States Department of Commerce estimate (1936) of the holdings of 17 companies.
[d1] United States Department of Commerce estimate for 1936. Direct investment only, in million dollars.
[d2] United States Department of Commerce estimate for 1943. Direct investment only, in million dollars.
[e] United States Department of Commerce estimate as on 31 December 1939.
[f] Estimated as 70 per cent of total foreign entrepreneur investments, excluding Chinese investments.
[g] This is the total for non-Chinese foreign entrepreneur investment, of which 70-80 per cent was held in the United Kingdom and Australia; the rest was in the hands of Danish, United States, Swiss, Japanese and French investors.
[h] Estimates in pound sterling, converted to dollars at £1 = $5.
[i] The total estimate is a range: £1,071 million to £1,120 million. The figure for rentier investment covers bonds etc. of Government, local bodies and railways only.
[j] Estimated in million $ at £1 = $5.
[k] Public loans largely held by British investors.
[l] United States Department of Commerce estimate for 1943. Direct investment only, in million dollars.
[m] 95-97 per cent French, only 3-5 per cent all other non-Chinese foreign investment.
[n] Public bonds etc., entirely held by French $4.2 million industrial bonds.
[o] Include Chinese investments estimated at $150 million, inseparable from Netherlands holdings.
[p] Japanese investments in government enterprises. The 520 million yen of total Japanese investments in enterprises = $143 million at the 1937 exchange rate.
[q] Government debt and industrial bonds respectively.
[r] Chinese investments are inseparable from Netherlands holdings and are included in the figure for Netherlands investments.
[s] Rough estimate not included in total.
[t] Rough estimates: 100-120 million dollars, not included in total.
[u] Excludes Chinese investments.
[v] Excluding Chinese investments.
[w] More than 90 per cent British.
[x] In million dollars. 1936 estimate for United States investments added to lower estimate for British investments (£1,071 million).
[y] In million dollars. 1943 estimate for United States investments added to higher estimate for British investments (£1,120 million).
[z] Mainly government and public bonds.
[aa] Inclusive of Japanese investments in government enterprises. In 1939, the share of Japanese investments in total native and foreign private corporate capital in Formosa was 78.4 per cent.
[bb] Total does not tally as breakdown incomplete.
[cc] Excluding Chinese investments.
[dd] In million dollars. Sum of the lower estimates only.

Table I-2-3. Sectoral composition of foreign investments of the dominant metropolitan country in each host country on the eve of the Second World War

(percentage shares)

Country	Sector				
	Extractive		Infrastructure Finance, commerce, transport, power and public utilities	Manufacturing	Total
	Mining, including oil	Other extractive, including forestry and plantations			
Philippines (United States: 1935)	23.2	32.9[a]	34.2	9.7[b]	100
Indonesia (Netherlands: 1937)	19.4[c]	45.6[a]	33.1	1.9	100
India (United Kingdom: 1948)	4.6	28.0[d]	48.0	19.4[e]	100
Burma (United Kingdom: 1948)	56.5	21.0	16.7[f]	5.8[g]	100
Malaya (United Kingdom: 1936)	17.5[h]	70.2[i]	12.3[j]	[k]	100
French Indochina[l] (France: 1924-1938)	15.8	32.3	36.0[m]	15.9[n]	100
Korea (Japan: 1938)	17.8	6.8[o]	53.0[p]	22.4	100
Formosa (Taiwan) (Japan: 1939)	12.0	8.6[q] (45)[r]	13.2	66.2 (30)[r]	100

Notes: The classification is only very roughly comparable between countries. Countries and years in parentheses indicate the metropolitan country and the year to which the sectoral classifications of investment refer. The proportions have been culled from tables presented in the country-surveys in H. G. Callis, *op. cit.* For Malaya, the proportions refer to total foreign investments of which at least 70 per cent was British. The proportions for India have been derived from data given in the *Report on the Census of India's Foreign Liabilities and Assets, op. cit.*

[a] Includes sugar centrals in the case of the Philippines; sugar plantations, explicitly, and sugar-processing also, presumably, in the case of Indonesia.

[b] Includes miscellaneous and embroidery.

[c] Includes private tin mining only and oil.

[d] This is the share of the "miscellaneous" sector in the Indian census data, the bulk of which is plantation investment.

[e] Includes sugar and raw jute primary processing in both of which the share of British capital was quite small.

[f] Includes miscellaneous manufactures, with inconsiderable amounts of British investments. The only large textile unit was Indian.

[g] Rice mills only, which accounted for nearly half of total "factory" employment.

[h] Tin mining only.

[i] Rubber only.

[j] Includes a few smelting, brewery and colliery units, but excludes the substantial investments in banks and finance companies.

[k] No estimates available for the solitary British-owned large factory (the United Engineers' Foundry and Works).

[l] The figures cited in Callis' country-survey of Indochina cover cumulated value of new issues over the period 1924-1938. The percentages have been derived from these new-issues data. Includes some public issues.

[m] Includes real estate.

[n] Includes forestry-based units such as saw mills, and sugar factories.

[o] Includes fisheries.

[p] Electricity 22.2 per cent of total.

[q] Includes fisheries and marine products.

[r] Food processing is likely to have accounted for nearly two-thirds of total capital invested in "industry" according to Callis. And, sugar industry, including by-products, accounted for 90 per cent of the total value of production of the food-stuffs industry in 1936. If sugar is taken out of "manufacturing", the share of manufacturing would possibly be around 30 per cent instead of 66.2 per cent, and the share of the "other extractive" sector would go up to around 45 per cent when sugar is included in the latter sector as has been done for the Philippines and Indonesia.

The Indian subcontinent accounted for more than half of the total foreign investment in the region and the Netherlands Indies for about a quarter.

The features of foreign private investment which emerge from these data (tables I-2-1 to I-2-3) are summarized below. First, British investment occupied a pre-eminent position in the Far East, followed by investments from the Netherlands, France, the United States and Japan. C. F. Remer's estimates[3] put the British holdings in mainland China (excluding Hong Kong) about the year 1931 at nearly $1,200 million, followed by Japan (about $1,150 million), with the United States investment less than $200 million. In Japan, by 1930, the United States investments have been estimated at 92 million pounds sterling and British investments at 63 million pounds sterling according to data cited by Allen and Donnithorne.[4] Callis' estimates show that, by 1936, total United States investment in the Far East was in the neighbourhood of $800 million, which was, perhaps, not more than 10-15 per cent of total British investments in the Far East.[5]

The second feature of foreign private investment in the pre-war period was that most of it flowed into the infrastructure (including finance and commerce) and extractive sectors. Manufacturing accounted for a relatively small proportion of the total in all countries, except Formosa (Taiwan), which at that time was part of the Japanese empire (see table I-2-3).

The third feature was the fact that an overwhelming part (from 60 per cent to 90 per cent) of foreign investment in any given host country was generally accounted for by the metropolitan country.

The fourth feature was the significant share of portfolio investments in total foreign investment. These were largely in the form of subscriptions by investors of the metropolitan country to the issues of governments, public bodies and railways of the host countries. This feature was, however, less prominent for United States investments in the Philippines. With the end of the colonial system, with its security and guarantee practices, the share of such portfolio investments sharply declined. In particular, United States investments, which have predominated in the postwar period, have been mostly in the form of direct investment rather than portfolio investment. This was also true even for the pre-war pattern of United States investments, not only in the Philippines where they were 50 to 60 per cent of all foreign private investment, but also in mainland China where they were only about 6 per cent of total foreign investments in the early 1930s.

[3] Remer, C. F., *Foreign Investments in China* (MacMillan, New York, 1933) as cited in Allen G. C., and Donnithorne, A. G., *Western Enterprise in Far Eastern Economic Development* (George Allen and Unwin, London, 1954), p. 262.

[4] Allen and Donnithorne, *op. cit.*, p. 264. The amounts would be equivalent to $460 million and $315 million, respectively.

[5] Cleona Lewis' figures confirm this estimate: See Lewis, C., *America's Stake in International Investments*, The Brookings Institution, Washington D.C., 1938, appendix D, section XI, table II. She gives the total United States investments in Asia to be $915 million in 1935.

Section B

Post-war trends in foreign investment

Total direct foreign investment in the world was estimated at nearly $90 billion in 1966, and of this, the developing countries received about $30 billion. The share of the major investing countries in this total is estimated as follows:

Table I-2-4. Direct foreign investment: Accumulated assets, end of 1966 (book value)

Investing country	*Amount (million dollars)*	*Percentage of total*	*Share of investment in developing countries (percentage)*
World	89,583	100.0	33.5
United States	54,562	60.9	30.9
United Kingdom	16,002	17.9	38.6
France	4,000[a]	4.5	52.5
Germany, Fed. Rep. of	2,500	2.8	33.8
Canada	3,238	3.6	16.5
Japan	1,000	1.1	60.5
Others	8,281	9.2	...

Source: Compiled from OECD-DAC data by Sydney E. Rolfe, and published in *The International Corporation*, International Chamber of Commerce, Paris, 1969, and reprinted in *Multinational Corporation*, Headline Series, American Foreign Policy Association, New York, 1970.

[a] Estimate.

Out of the total of $90 billion, United States investment abroad amounted to $54.6 billion. The share of United States investment that went to developing countries was about one-third of this amount. The major part of Japanese foreign investment on the other hand was in developing countries (60 per cent). France's overseas investment was shared about equally between the developed and the developing countries. From all other investing countries, the major part went to the developed countries. Even from the United Kingdom, which has had trade and investment relations with many developing countries for several centuries, the major part (61 per cent) of investment went to the developed countries.

Recent flows into the developing ECAFE region

The data presented in table I-2-5 below show that the flows of financial resources from the developed countries which are members of the Development Assistance Committee of OECD to the developing countries has been increasing since 1960. The total net resource flow increased from $8.1 billion in 1960 to $13.6 billion in 1969. The growth in the private flow was faster than for the public flow, so that the share of the private flow increased from 39 per cent in 1960 to 46 per cent in 1969.

Table I-2-5. Net resource flow from developed (DAC) countries to developing countries, 1960-1969

(in million dollars)

Year	Total flow	Public flow[a]	Private flow[b]	Percentage of private flow to total flow
1960 . . .	8,115	4,965	3,150	38.8
1961 . . .	9,249	6,143	3,106	33.6
1962 . . .	8,487	6,034	2,453	28.9
1963 . . .	8,633	6,076	2,557	29.6
1964 . . .	9,142	5,942	3,200	35.0
1965 . . .	10,420	6,238	4,182	40.1
1966 . . .	10,347	6,537	3,810	36.8
1967 . . .	11,309	7,101	4,208	37.2
1968 . . .	13,113	7,150	5,963	45.5
1969 . . .	13,567	7,287	6,280	46.3
	102,384	63,473	38,909	38.0

Source: OCED, *Development Assistance, 1970.*

[a] Includes public flows through multilateral institutions.

[b] Includes direct investments, bilateral/multilateral portfolio investments and export credits, i.e. guaranteed credits including unguaranteed portions. Excludes credits which are not guaranteed in the donor country. Net flow is measured, by some countries, as change in outstanding amounts due on disbursed credits. Interest is included in the sums recorded as outstanding.

The pattern of net flow of financial resources from the DAC countries to the developing ECAFE region is presented in table I-2-6. Subject to some fluctuations, all three major types of flow increased steadily throughout the period 1960 to 1967/68. Both multilateral flows from international institutions and private investment flows grew considerably faster than official bilateral aid. The share of private investment, including export credits, rose from 7.7 per cent to 17.2 per cent, while the share of multilateral flows rose from 3.4 per cent to 8.7 per cent. However, it should be noted that the contribution of private sources to the total resource flow into developing ECAFE countries during the period 1960-1967 was only 12.7 per cent, much less than their part in the total flow to all developing countries (35 per cent for 1960-1967).

Table I-2-7 shows the total inflows on official account (including grants and long-term capital of all sorts) and the private long-term capital inflows for major developing ECAFE countries during the period 1960-1968. These data were compiled by the Centre for Development Planning, Projection and Policies, United Nations Headquarters, from the IMF *Balance of Payments Yearbook.*

Private capital flow plays an important role in the total capital flow in seven countries of the region, namely Malaysia and Singapore (76 per cent), Thailand (57 per cent), China (Taiwan) (48 per cent), Iran (41.5 per cent), the Republic of Korea (41 per cent) and the Philippines (31 per cent). In Pakistan, private capital formed about 12 per cent of the total capital flow. In India and Indonesia, the public flow has been much more important. In Ceylon and the Republic of Viet-Nam, the private flow was negative during the period.

Direct and portfolio investment

The comparison of direct versus portfolio investment is important from the point of view of the flexibility enjoyed by the host country in allocating the resources and the effect of the return flows on the balance of payments. In the initial stages, when the country is industrially undeveloped, greater reliance may be placed on direct investment and official aid, but as industrial progress takes place, entrepreneurial and technical skills develop, and the domestic capital market expands, the proportion of portfolio investment could be increased.

From the point of view of the balance of payments, portfolio investments which take the form of loans have the advantage that the commitment is known beforehand and the repayment of the principal and the interest charges can be planned. The defect, however, is that portfolio investment can lead to some inflexible situations, and, if the trade position deteriorates in an unforeseen manner and the reserve position of the country is also weak, the commitments on account of portfolio investments can result in balance of payments difficulties. The outflows of profits and dividends, and the repatriation of capital in the case of the equity portions of direct investments, generally follow the economic weather, so that the outflows may tend to be large when the country can afford to pay more, and less when it cannot. Moreover, if a direct investment is not profitable, no return flow is required on the equity component. However, balance-of-payments effect is only one of the several considerations in investment choice; other factors such as the effect on *per capita* income of the host country must also be taken into account.

Table I-2-6. Net flows of long-term financial resources to developing ECAFE countries, 1960-1968

(in million dollars)

Year	Total	Official bilateral[a]	Multilateral[a]	Private[b]	Percentage shares: Private	Multilateral	Official
1960	2,154	1,916	73	165	88.9	3.4	7.7
1961	2,086	1,867	88	131	89.5	4.2	6.3
1962	2,421	1,971	137	313	81.4	5.7	12.9
1963	2,760	2,311	153	296	83.7	5.6	10.7
1964	2,885	2,421	163	301	83.9	5.7	10.4
1965	3,447	2,540	341	566	73.7	9.9	16.4
1966	3,409	2,638	295	476	77.3	8.7	14.0
1967	4,187	3,100	365	722	74.1	8.7	17.2
1968	—	—	—	914	—	—	—
Total 1960-1967	23,347	18,764	1,615	2,970	80.4	6.9	12.7
Total 1960-1968				3,884			

Sources: "Official bilateral" and "Multilateral": OECD, *Geographical Distribution of Financial Flows to Less Developed Countries*, 1960-64; 1965 and 1966-67. "Private": IMF, *Balance of Payments Yearbook*, vols. 17 and 21.

[a] Includes south Asia and Far East regional totals plus Iran. Official bilateral flows are limited to those originating from the OECD/DAC countries.

[b] Direct investment and long-term loans, including export credits, received by Burma, Ceylon, China (Taiwan), Iran, India, Indonesia, Khmer Republic, Republic of Korea, Malaysia, Pakistan, Philippines, Singapore, Thailand and Republic of Viet-Nam.

Table I-2-7. Net inflow of long-term capital and official donations to ECAFE countries, 1960-1968

(in million dollars)

Country	Official receipts[a]	Private receipts[b]	Total	Private receipts as per cent of total
Burma	174	12	186	6.5
Ceylon	214	—8	206	—3.9
China (Taiwan)	394	367	761	48.2
India	7,959	76	8,035	0.9
Indonesia	1,672	32	1,704	1.9
Iran	745	528	1,273	41.5
Malaysia and Singapore	210	639	849	75.3
(Singapore[c])	(3)	(51)	(54)	(94.4)
Pakistan	3,191	449	3,640	12.3
Philippines	461	203	664	30.6
Republic of Korea	1,404	985	2,389	41.2
Republic of Viet-Nam	1,766	—1	1,765	—0.1
Thailand	388	513	901	56.9
Total	18,581	3,846	22,427	17.1

Source: Compiled from various issues of *The External Financing of Economic Development: International Flow of Long-term Capital and Official Donations*, published by the United Nations.

[a] Includes grants and long-term public loans.

[b] Includes direct investments, long-term private loans and export credits.

[c] 1965-1968 only.

During the pre-war era, while considerable direct investment was made in plantations and mining, large inflows of loan capital were invested in the infrastructure. These portfolio investments, in most cases, were made by the investors of the metropolitan countries, as mentioned in Section A. During the postwar years, the role of pre-war private bilateral portfolio investments has been taken over by multilateral loans and official aid. The flow of loan capital during the 1960s remained large as shown in table I-2-8, and was about two and a half times the flow of direct investment; but its nature and function have completely changed. The private loan capital that now comes into the developing countries is rarely of the old portfolio type, that is, raised by Governments or private companies in the international capital market and used by them according to their own needs. Private loan capital today is often closely associated with private direct investment or consists of export credits which are tied to imports from abroad. Thus, increasing magnitude and role of loan capital and export credits can be viewed as part of the increasing international competition for market shares among multinational corporations,[6] and/or as the result of national export promotion policies in the more developed countries (see the related discussions in chapters III, IV and V).

[6] See for example, Hymer, S., and Rowthorn, R., *Multinational Corporations and International Oligopoly: The Non-American Challenge*, Centre paper No. 149, Yale University Growth Centre, New Haven, 1970, and also printed in C. P. Kindleberger, ed. *The International Corporation* (Cambridge, The MIT Press, 1970).

Table I-2-8. Private foreign investment in and long-term loans to selected ECAFE countries 1960-1969
(in million dollars)

Country	Direct investment	Long-term loans[a]	Total	Share of loans in total (percentage)
Ceylon	2.05	1.10	3.15	34.92
China (Taiwan)	184.60	448.30	632.90	70.83
Iran	592.30	70.90	663.20	10.69
Korea, Republic of	66.60	1,188.30	1,254.90	94.69
Pakistan	159.17	356.66	515.83	69.14
Philippines	33.10	637.30	670.40	95.06
Thailand	278.50	819.90	1,098.40	74.64
Viet-Nam, Republic of	18.24	14.10	32.34	43.59
Total	1,334.56	3,536.56	4,871.12	72.60

Source: Compiled from the IMF, *Balance of Payments Yearbook*, vols. 17, 21 and 22 (provisional data for 1969).

[a] Private loans of all types with maturity of one year or more, including export credits.

Foreign investment flow by country of origin

The data in table I-2-9 show that the United States is the largest investor in Asia, accounting in recent years for over 67 per cent of the total foreign private investment, excluding most United Kingdom investments (see the note to the table). Japan occupied the second position, supplying 13 per cent of the total during the period. The Federal Republic of Germany, however, moved into second place for the year 1967 with a remarkable expansion which raised its investment in Asia from $18 million in 1966 to $134 million in 1967. Other data show that the Japanese direct investment flow to Asia, excluding the Middle East, increased from $51 million in 1967 to $199 million in 1969, on approval basis.[7]

A major defect of the data in this table (table I-2-9) is that it does not include the British investment in Asia, except for one year, 1966, and consequently the share of other countries is over-stated. Since the British investment has been lumped together into the "unallocated" category, it has been excluded from this table. Data on British investments, excluding oil investments, obtained from the *Board of Trade Journal* show that there was a considerable rise in British investment in the ECAFE countries: from £530.5 million in 1962 to £627.4 million in 1968 (see table I-2-10). Rough calculations suggest that, including oil investments, the United States and British direct investments in the Far East were about the same in 1965, that is, in the neighbourhood of $2 billion.[8] However, the growth rate of British investments has not been as high as that of the United States, Japan or the other European countries.

There are several reasons for the increase in foreign private investment flows to the developing ECAFE region during the 1960s. The flow into Europe and Latin America has been showing a deceleration in recent years. For example, the flow of United States investment showed a major shift during

[7] Japan, Ministry of International Trade and Industry, *Keizai Kyoryoku no Genjo to Mondaiten* (Tokyo, M.I.T.I., 1970), p. 511.

[8] Data in Reddaway, W. B., *Effects of United Kingdom Direct Investments Overseas, Interim Report*, chapter VIII (Cambridge University Press, 1967); Penrose, Edith, *The Large International Firm in Developing Countries*, chapter IV, George Allen and Unwin, London, 1968, and United Kingdom Board of Trade, *Board of Trade Journal*, 26 January 1968, have been utilized to establish the order of total United Kingdom investments in the Far East. United States data have been taken from United States Department of Commerce, *Survey of Current Business*, September 1966 and October 1969.

Table I-2-9. Direct investment and other private capital flows (net) from OECD countries to developing Asia[a]
(in million dollars)

Year	Total Asia	United States	United Kingdom[b]	France	Federal Republic of Germany	Italy	Japan	Others
1960	320	175	...	5	3	5	60	72
1961	292	147	...	5	9	7	82	42
1962	103	45	...	1	3	9	44	1
1963	271	212	...	6	10	—8	51	—
1964	301	254	...	5	—	4	37	1
1965	884	702	...	82	24	14	52	10
1966	462	264	34	69	18	18	58.5	4
1967	858	556	...	77	134	15	72	4
Total	3,491	2,355	34	250	201	61	456	134
Percentage[c]	100	67.3	1.0	7.2	5.8	1.8	13.1	3.8

Source: OECD, *Geographical Distribution of Financial Flows to Less Developed Countries*, 1960-1964, 1965 and 1966-1967.

[a] As far as possible, the data include estimates for re-invested earnings. The data exclude guaranteed private export credits and unallocated investments.

[b] The British investment abroad, as shown in the OECD table, was most probably included in the unallocated class. This table therefore gives an underestimate of British foreign investment.

[c] Since this table excludes British investment for most years, the percentage shares of other countries are correspondingly overestimated.

1960-1968. The data presented in table I-2-11 indicate that there was a definite deceleration in United States investment in Europe, while the growth rate in Latin America was also becoming sluggish. In Canada and Asia, on the other hand, the acceleration gathered considerable momentum during 1964-1968. It has been estimated that, in Europe, United States subsidiaries are facing the problem of overcapacity, since their capacity utilization was 90 per cent in 1964, 87 per cent in 1965 and 81 per cent in 1967.[9]

Table I-2-10. Book values of net assets of British direct investments in developing ECAFE countries, 1962-1968

(in million pounds sterling)

Region/country	1962	1968
Sterling area		
Burma	5.8	...
Ceylon	45.9	48.2
Hong Kong	20.3	39.1
India	259.7	277.2
Malaysia	126.7	172.6
Pakistan	32.5	52.4
Singapore	6.0	7.6
Non-sterling area		
Burma	...	3.9
Iran	1.3	4.8
Thailand	3.8	11.6
Far East, n.s.d. and unallocated	28.5	10.0
Total	530.5	627.4

Source: United Kingdom Board of Trade, *Journal*, vol. 199, No. 3836, 23 September 1970, table 1.
Note: Oil investments are excluded.

Table I-2-11. Increase in book value of United States direct investment abroad, 1960-1964 and 1964-1968

Region/country	Percentage increase		
	1960-1964	1964-1968	Difference
Canada	23.9	74.3	50.4
Japan	35.4	75.2	39.8
Far East (excluding Japan)	31.6	55.9	24.3
Asia (excluding Japan)	23.4	45.0	21.6
Australia	72.3	79.3	7.0
Latin America	22.6	26.7	4.1
South Africa	63.3	48.2	—15.1
Europe	81.3	59.8	—21.4
All areas	39.6	45.6	6.0

Source: Compiled from various issues of *Survey of Current Business*, published by the United States Department of Commerce.

The sluggishness of the flow of United States investment in Latin America and Europe and its expansion in Asia and Canada can also be seen from table I-2-12. This table shows the number of United States companies operating at least one foreign subsidiary in different parts of the world. By 1967, the number of United States companies operating subsidiaries in Asia and Africa had already reached the same number as that in Latin America in 1957, though the amount of capital inflow was still less than half of the investment in Latin America in 1957.

Table I-2-12. Number of United States companies operating a foreign subsidiary

Region	Number		Percentage increase
	1957	1967	
Canada	167	174	4.19
Latin America	155	182	17.41
Europe	160	185	15.62
Asia and Africa (excluding South Africa)	83	158	90.36

Source: Vaupel, J. W. and Curhan, J. P., *The making of Multinational Enterprise* (Harvard University, Boston), p. 69. Quoted in Stephen Hymer; paper presented to Third Pacific Trade and Development Conference, Sydney, 1970, *op. cit.*, Appendix.

What has been true of United States investment also applies to investment from European countries and Japan. Total private foreign investment into the developing countries of Asia increased by 83 per cent during 1960-1964, and accelerated further to 203 per cent during 1964-1968. The volume of foreign private capital flows into developing Asia is likely to continue to expand in the 1970s if the tempo of international economic activity and the development of this region can be sustained. This expansion, if realized, may put the developing countries of Asia in a better bargaining position. The policy objectives of the developing countries of the region for the coming decade, therefore, should be framed in such a manner as to obtain greater benefits from foreign investment and to utilize it more effectively for securing even faster rates of growth.

Return flows of investment earnings

This discussion of recent trends in private foreign investment would be incomplete without mention of the return flow of investment income, which provides one measure of the cost to the host country of such investment. The outflow of investment income, according to standard balance of payments definitions, consists of two streams: interest on debt (official bilateral, multilateral, private portfolio and direct investment loans, and export credits) and dividends, or profits, remitted from earnings on private foreign investment.[10] Unfortunately, because many developing countries do not distinguish clearly between interest outflows and profit remittances, it is not possible to measure adequately the foreign exchange costs of private direct investments.

[9] Rolfe, S., *op. cit.*, p. 34.

[10] See IMF, *Balance of Payments Manual* (Washington, D.C., Third Edition, reprinted 1966), pp. 86-88, 96-100. Royalties, management and technical fees, and other payments directly related to foreign private investment also may be considered to be forms of investment income, but since they are included together with "other services" in standardized balance of payments accounts, these data are not easily available.

Sixty-seven developing countries have reported total payments of foreign investment income of $6 billion in 1967 and $6.8 billion in 1968, as compared with repayments of loans and repatriatian of capital of between $2 and $3 billion. Based on data collected from 55 developing countries, the United Nations has estimated that 20 per cent of these outflows consisted of interest payments.[11] Thus, about $4.8 billion in 1967 and $5.4 billion in 1968 would be the values of remitted profits on equity investments. For 1967, this figure would be equivalent to a 16 per cent rate of return on the $30 billion value of outstanding direct investments in the developing countries estimated by Rolfe.[12] Of these total profit outflows, about $3 billion and $3.5 billion, in 1967 and 1968 respectively, were remitted by eight petroleum exporting countries. Therefore, it can be estimated that the investment income outflows from other developing countries amounted to approximately $1.8 billion in profits and $1.2 billion interest for 1967, and about $1.9 billion in profits and $1.4 billion interest for 1968.[13]

The return flows of investment income from 12 south and east Asian countries increased from $344 million in 1960 to $878 million in 1968, compared to a slightly slower increase in similar return flows for petroleum-exporting Iran from $296 million to $688 million over the same period.[14] Since the ratio of private investment to official long-term loans is smaller for the south and east Asian countries than for all developing countries, it may be assumed that the income return flows from the developing ECAFE countries were more equally divided between interest and profits than indicated in the preceding paragraph.

Specific data on net direct investment inflows and remittances of investment income related to direct investment are presented in table I-2-13 for four ECAFE countries. Direct investments in Ceylon and the Philippines may be characterized as being relatively mature, since in most years disinvestment has exceeded new private capital inflows resulting in negative inflows, before allowing for reinvested earnings. For these countries the primary balance of payments effects have been negative. On the other hand, direct investments in China (Taiwan) and Thailand appear to be relatively new with larger and increasing net inflows of capital and small, but increasing, return flows of remitted profits. These countries have experienced positive results from the primary effects of foreign investments on the balance of payments. It must be emphasized that the secondary balance of payments effects, including import substitution, export promotion and demonstration effects may be much more important than the primary effects.

It appears that dividend and other profit remittances are subject to considerable fluctuation from year to year because of the various factors which influence the decision to reinvest or remit profits, as well as because of cyclical and short-term variations in profit realization. The need is evident for more adequate data concerning the questions suggested in this section.

[11] See United Nations, *The External Financing of Economic Development, International Flow of Long-term Capital and Official Donations, 1964-1968*, New York, 1970, pp. 85-93.

[12] See table I-2-4 above.

[13] Based on United Nations, *op. cit.*, pp. 88, 93.

[14] United Nations, *op. cit.*, table 32, pp. 86-87. The twelve countries included are Burma, Ceylon, China (Taiwan), India, Indonesia, Malaysia, Pakistan, the Philippines, Republic of Korea, Republic of Viet-Nam (1960 only), Singapore (1968 only), Thailand.

Table I-2-13. Direct investment: Net inflows and related investment income remittances[a] for four ECAFE countries, 1960-1968
(in million dollars)

Year	Ceylon		China (Taiwan)		Philippines		Thailand	
	Net inflow[b]	Investment income[b]	Net inflow[c]	Investment income[d]	Net inflow[e]	Investment income[e]	Net inflow[f]	Investment income
1960	— 1	12	6	0	28	73	2	8
1961	— 1	10	10	0	—57[g]	36	6	9
1962	0	10	9	0	— 3	16	8	9
1963	1	10	18	0	— 3	17	17	8
1964	— 1	6	16	0	— 3	13	17	9
1965	0	1	11	5	— 9	17	29	9
1966	— 3	5	10	3	—12	26	25	14
1967	— 1	7	28	6	— 8	55	36	14
1968	— 2	4	28	15	— 5	79	48	10

Source: IMF, *Balance of Payments Yearbooks*, vols. 17 and 21.

Note: These data are not directly comparable with data in table I-2-7 and those for individual countries in chapter IV, because of differences in coverage.

[a] Reinvested profits are excluded except where noted.

[b] Includes reinvested profits during 1960-1964. Rupee values for 1960-1962 have been converted using $1 = 4.77 Rs.

[c] Includes investments by Chinese living abroad.

[d] Coverage is believed to be more comprehensive after 1965.

[e] Includes reinvested profits during 1960.

[f] Excludes drawings and repayments on loans for the Export-Import Bank of the United States.

[g] Includes debit of $47 million for purchase price of Manila Railroad and Electric Company.

Chapter III

DIRECT INVESTMENT FROM TWO CAPITAL-EXPORTING COUNTRIES: UNITED STATES AND JAPAN

The general pattern of foreign private investment, discussed in the preceding chapter, needs elaboration of the features of investment from different countries. This chapter focuses on direct investment flows from two of the important investing countries, namely, the United States and Japan. The following aspects of foreign investment are discussed: geographical distribution among major regions, particularly the ECAFE region, distribution by sectors of economic activity, and earnings of investment.

The section on Japan includes analysis of the number of projects and average investment volumes; investment in individual countries of the ECAFE region; and classification by different types of investment, such as equity, loan and export credit. A description of the motivation of Japanese investors is also presented. This sets the pattern for the type of data to be collected for further studies of other countries.

Section A
United States Direct Investments

The data on United States direct investments are drawn from the annual surveys of foreign investments published by the United States Department of Commerce in the *Survey of Current Business*. Supplementary information from other published sources is also utilized.

The definition of direct investment, as given by the Department of Commerce,[1] is reproduced in Appendix A to this section. Private long-term foreign investments are normally divided into two principal classes—direct investments in which there is evidence of intention to control, and portfolio investments, in which the intention of the investor is to realize income or capital gains but not to exercise control over management.

The basic magnitudes and composition of United States direct investment abroad

Total international investments, it appears, have grown twice as fast as the world GNP in the last twenty years. The share of United States corporations in this phenomenal movement of capital has grown even more rapidly.[2] The foreign assets of United States based corporations (i.e., direct investments only) during the period 1950-1968 rose from $12 billion to an estimated $65 billion.[3]

Rough calculations by Judd Polk of the United States Council of the International Chamber of Commerce suggest that "on average, $1 of direct investment at book value generates about $2 of foreign output each year".[4] This indicates that, by 1966, the total output of foreign affiliates of United States corporations was already roughly equal to the GNP of the Federal Republic of Germany, or of the United Kingdom in that year. United States direct investments abroad accounted for more than three-fifths of all such investments in the world by the end of the 1960s.

Geographical distribution

Table I-3-1 gives a picture of the phenomenal growth of United States direct investments abroad by major regions.

The change between 1929 and 1950 actually measures the change between 1946 and 1950; for between 1929 and 1946 there was practically no change in the over-all magnitudes. United States prices approximately doubled between the 1920s and the 1960s; hence, if the figure for 1968 is correspondingly halved, the real book value would still appear to have risen about four and a half times.

Of the United States $53 billion of additional book value created abroad between 1950 and 1968, nearly $38 billion has been absorbed by Europe, the developed areas of European settlement, and Japan (subtotal II, table I-3-1). During the same period, developing economies received about $13 billion. While the total book value in the developed countries increased somewhat less than eight times (subtotal II) over the period 1950-1968, it has increased about three times in the developing economies (subtotal III).

However, there is some evidence to the effect that the rate of growth of the total book value of

[1] See Pizer, Samuel and Cutler, Frederick, *United States Business Investments in Foreign Countries, A supplement to the Survey of Current Business* (Office of Business Economics, United States Department of Commerce, Washington D.C., 1960), pp. 76-82.

[2] See The Economist Intelligence Unit, *The Growth and Spread of Multinational Companies, Quarterly Economic Review*, Special No. 5, October 1969.

[3] Derived from various issues of the *Survey of Current Business*, published by the United States Department of Commerce.

[4] Economist Intelligence Unit, *op. cit.*, p. 10.

United States direct investments was decelerating in Europe and accelerating in the Far East (excluding Japan) and the Middle East toward the second half of the 1960s as compared with the first half (discussed in the preceding chapter). This trend is expected to continue in the 1970s.

Table I-3-1. Outstanding book values of United States direct investment abroad by region/country: Selected years

(in billion dollars)

Region	1929	1946	1950	1959	1968
I. World total	7.5	7.2	11.8	29.7	64.8
(1) Canada	2.0	2.5	3.6	10.2	19.5
(2) Europe[a]	1.4	1.0	1.7	5.3	19.4
(3) Oceania, Japan and South Africa	0.3	0.2	0.4	1.4	4.5
II. Sub-total of (1), (2) & (3)	3.7	3.7	5.7	16.9	43.4
(4) Latin America[b]	3.5	3.0	4.6	9.0	13.0
(5) Middle East[c]	0.01	0.2	0.7	1.2	1.8
(6) Asia (excluding Japan and Middle East)	0.3	0.2	0.3	0.8	1.8
(7) Africa (excluding South Africa)	0.03	0.1	0.15	0.5	2.0
III. Sub-total of (4), (5), (6) & (7)	3.8	3.5	5.8	11.5	18.6
(8) International[d]	...	...	0.35	1.3	2.8

Sources: United States Department of Commerce: *U.S. Business Investments in Foreign Countries, 1960,* and *Balance of Payments Statistical Supplement, 1958,* as cited in Mikesell, R. F., ed. *U.S. Private and Government Investment Abroad,* University of Oregon, 1962, p. 55, for 1929, 1950 and 1959; and United States Department of Commerce, *Survey of Current Business,* vol. 49, No. 10, October 1969, p. 28, for preliminary estimates for 1968.

Notes: The magnitude of gross non-residential capital stock in the United States at constant dollar values (1958 prices) increased from 291 billion in 1929 to 434 billion in 1968. See United States Department of Commerce, *Survey of Current Business,* April 1970, table 2, col. 1 (All industries), p. 24. United States prices approximately doubled between the 1920s and and the 1960s.

[a] Includes Turkey.

[b] Includes Latin American republics and western hemisphere dependencies, etc.

[c] Includes countries east of Suez, up to and including Iran, but excluding Turkey.

[d] Shipping enterprises registered in Liberia and Panama but operating world wide.

The rate of growth of United States direct investments appears to be positively associated with the rates of growth of a number of European economies. Moreover, United States direct investments tend to be higher in the relatively high growth-rate industries within the countries taken severally.[5] Without further investigation, such evidence does not indicate which factor is the cause, and which the effect. However, to the extent that the modern high-growth industries tend to be concentrated in the high-income countries, this trend seems to have accentuated the inherited disparities in income levels and growth rates between the high- and low-income areas.

Sectoral composition

The sectoral composition of United States direct investment outstanding at the end of 1968 is shown in table I-3-2. In the relatively advanced economies of Canada, Europe, Japan, South Africa and Australia, the share of the manufacturing sector in the total book value of United States direct investments outstanding at the end of 1968 was in the range of 44 per cent to 56 per cent, while in the developing areas of the Far East (excluding Japan) the share was about 30 per cent. In the Middle East and Africa, excluding South Africa, the share of the manufacturing sector was less than 4 per cent, petroleum absorbing the bulk of United States direct investments.

India stands out in the developing world of the Far East, followed by the Philippines, with the manufacturing sector accounting for nearly 47 per cent and 36 per cent, respectively, of the total outstanding book value of United States direct investments in these two countries. The share in India compares favourably with that in the advanced economies. It appears that, in the case of India, this high share of the manufacturing sector is a consequence of certain deliberate policy choices undertaken by that country.

Table I-3-3 shows the sectoral composition of the addition to total book value of United States investments over the period 1957-1968. The share of the manufacturing sector in the developing region of the Far East (excluding Japan) is 48 per cent of these recent net investments. The corresponding share of the manufacturing sector in India and the Philippines, about 56 and 54 per cent, compares favourably with that for the developed areas of Canada, Europe, Australia and Japan (in the range of 45 to 56 per cent).

[5] See, for example, the evidence summarized in Behrman, Jack N., *Some Patterns in the Rise of the Multinational Enterprise,* Research Paper 18, Graduate School of Business Administration, University of North Carolina, 1969, pp. 42-43. See also Dunning, J. H., "Technology, U.S. Investment and European Economic Growth", in Kindleberger, C. P., ed. *The International Corporation,* The M.I.T. Press, Cambridge (Mass.), 1970. Results of tests with first difference data are however inconclusive: See Bandera, V. N., and Whyte, J. T., "U.S. Direct Investments and Domestic Markets in Europe", *Economia Internazionala,* vol. 21, February 1968.

Table I-3-2. Sectoral composition of outstanding United States direct investment by region/country/geographical areas: End of 1968[a]

(Percentage shares)

Region/area/country	Total	Manufacture	Non-manufacture			
			Petroleum	Mining, smelting	Others	Total
All areas	100	40.70	29.09	8.29	21.92	59.30
Of which:						
1. *Canada*	100	43.85	20.98	13.52	21.65	56.15
2. *Europe*	100	55.59	23.93	0.32	20.16	44.41
3. *Latin America*	100	18.56	36.74	14.41	30.29	81.44
4. *Other areas*	100	23.59	50.14	6.19	20.08	76.41
Of which:						
A. *Asia*	100	24.24	59.65	0.94	15.17	75.76
(i) Middle East	100	3.49	91.74	0.17	4.60	96.51
(ii) Far East	100	37.17	39.63	1.45	21.75	62.83
(iii) Far East, excluding Japan	100	30.04	...	2.28	67.68[b]	69.96
(iv) Japan	100	49.71	...	—	...	50.29
(v) India	100	46.79	...	...	...	53.21
(vi) Philippines	100	35.53	...	...	...	64.47
(vii) Other Far East[c]	100	20.69	...	...	...	79.31
B. *Africa*	100	14.96	58.62	14.48	11.94	85.04
(i) South Africa	100	48.05	21.27	11.29	19.39	51.95
(ii) Other Africa	100	3.43	71.65	15.59	9.39	96.57
C. *Oceania*	100	53.30	22.91	13.01	10.78	46.70
(i) Australia	100	53.59	...	13.79	32.62[b]	46.41
(ii) Other Oceania	100	48.85	...	1.15	50.00	51.15

Source: Compiled from various issues of the *Survey of Current Business.*

[a] Preliminary estimates.

[b] Including petroleum.

[c] Far East, excluding Japan, India and Philippines.

Table I-3-3. Sectoral composition of additions to book value of United States direct investments by region/country: 1957-1968

(percentage shares)

Region/area/country	Total	Manufacturing	Petroleum	All non-manufacture
All areas	100	46.67	24.94	53.33
Of which:				
1. *Canada*	100	45.12	17.33	54.88
2. *Europe*	100	56.52	22.45	43.48
3. *Latin America*	100	59.40	7.55	40.60
4. *Other areas*	100	26.50	45.61	73.50
Of which:				
A. *Asia*	100	39.87	44.19	60.13
(i) Middle East	100	4.70	86.87	95.30
(ii) Far East	100	52.12	29.26	47.88
(iii) Far East, excluding Japan	100	48.23	...	51.77[a]
(iv) Japan	100	56.20	...	43.80[a]
(v) India	100	56.55	...	43.45[a]
(vi) Philippines	100	53.87	...	46.13[a]
(vii) Other Far East[b]	100	23.50	...	76.50[a]
B. *Africa*				
(i) South Africa	100	57.44	23.08	42.56
(ii) Other Africa	100	3.09	75.54	96.91
C. *Australia*	100	54.10	...	45.90

Source: Derived from data in various issues of the *Survey of Current Business.*

[a] Including petroleum.

[b] Far East, excluding Japan, India and Philippines.

Table I-3-4. Average rates of return on United States direct investments by region/country: Selected periods
(percentage of book value)

Region/country	Average rate of return on book value over the period		
	1950-1959	1957-1968	1960-1968
All areas	13.50	10.11	10.89
Of which:			
1. *Canada*	8.31	7.19	7.27
2. *Europe*	13.90	8.82	8.30
3. *Latin America*	12.93	11.90	11.98
4. *Other areas* (A, B, C below)	27.06	20.26	19.48
Of which:			
A. *Asia*	...	34.27	34.17
(i) Middle East	...	59.36	61.21
(ii) Far East	...	13.56	13.17
(iii) Far East, excluding Japan	...	14.12	13.44
(iv) Japan	11.36	12.29	12.58
B. *Africa*	...	15.62	16.56
(i) South Africa	...	18.33	18.92
(ii) Other Africa	...	14.46	15.63
C. *Oceania*	...	8.98	8.40
(i) Australia	13.42	8.78	8.09
(ii) Other Oceania	...	10.84	11.68

Source: Compiled from various issues of the *Survey of Current Business.*

Earnings on investment

Table I-3-4 gives a measure of the average rate of return on United States direct investments over the specified periods.[6] It is given as a ratio of the sum of net earnings[7] on direct investments to the sum of book values. This ratio may have been understated for currencies which have tended to depreciate over the periods.[8]

In the period 1957-1968, average rates of return thus defined ranged from 7.19 per cent for Canada, 8.82 per cent for Europe and 8.78 per cent for Australia, to 12.29 per cent for Japan. In contrast, the rates of return were 11.90 per cent for Latin America, 14.12 per cent for the Far East (excluding Japan), 14.46 per cent for Africa (excluding South Africa) and 59.36 per cent for the Middle East. Thus, even if the returns on the Middle East oil investments are set aside as constituting a class by themselves, it would still appear that the developing areas exhibit higher rates of return than those for most of the developed areas. However, during the period 1960-1968, as compared with the period 1957-1968, the ratio for the developing areas of the Far East slightly declined from 14.12 per cent to 13.44 per cent.

International investors may be expecting higher rates of return in less developed countries because investments in these countries are often perceived to be more risky, and future growth potentials are considered to be less assured than in developed countries. Furthermore, the application of oligopoly theory to the behaviour of multinational companies has revealed a picture of international investments being made to gain, enlarge or defend positions in markets with attractive growth potentials, almost in disregard of short-term profit expectations.[9] Thus,

[6] "These rates of return may be compared with earnings after U.S. taxes of leading U.S. corporations as a per cent of book net assets". Mikesell, R. F., "U.S. Postwar Investment Abroad: A Statistical Analysis"; in Mikesell, R. F., ed. *U.S. Private and Government Investment Abroad*, University of Oregon, 1962, p. 65.

[7] Earnings as defined by the United States Department of Commerce are: "the proportionate equity of U.S. holders of common stock in the earnings of the foreign subsidiaries attributable to common stock holders, as well as earnings of branches or other non-corporate forms". As far as possible the figures derived directly from profit and loss statements are "stated before charging or crediting unrealised exchange losses or gains". The total of "earnings" is, then, the sum of the United States share in net earnings (or losses) of foreign corporations and branch profits after foreign taxes but before United States taxes.

[8] For the purpose of deriving the dollar values, current assets and liabilities were converted at rates current at the date of the report and fixed assets were converted at the rate current at the time the assets were acquired. Depreciation reserves were converted at the same rates used in converting the value of the related assets. Capital stock accounts were ordinarily converted at the rate current at the time the stock was acquired or issued, but sometimes at the rate current as of the date of the report. From the point of view of the host countries, this method of valuation used by the United States Department of Commerce would generally result in overvaluation of fixed assets for currencies which have tended to depreciate vis-à-vis the dollar. On the other hand, since depreciation of assets has been reckoned at historial costs of related assets, there would be a corresponding undervaluation of profits in dollar values. Thus, from this point of view, the rates of return on book value would then be subject to a twofold underestimation—undervaluation of the numerator and overvaluation of the denominator—in the case of currencies which tend to depreciate vis-à-vis the dollar.

[9] See, for example, Johnson, Harry G., "The Role of Foreign Investment in Asian-Pacific Economic Development, A Survey of the Issues", paper presented at the Third Pacific Trade and Development Conference, Sydney, August 1970; Kindleberger, C. P., *American Business Abroad* (Yale University Press, 1969), chapter 1; Galbraith, J. K., *The New Industrial State* (Boston, Houghton Mifflin, 1967), chapter 15.

"in some industries, differences in the size of the market among possible host countries will dominate differences in capitalization rates".[10] So far as these explanations of the differences in rates of return are valid, concerted regional action should be expected to lower the cost of foreign direct investments, and at the same time, increase inflows. The key components of such a regional approach would include improved guarantees against expropriation or excessive restrictions of foreign capital, effective development planning (and implementation) to promote rapid growth within each country, regional or subregional co-operation to expand market size, and effective communication of these actions to potential foreign investors. (Discussed further in chapters VI, VII and VIII).

Appendix (Section A)

Definition of direct investment as given by the Department of Commerce, United States[11]

Direct investment includes the United States share in "all those foreign business enterprises in which a United States resident, person, organization, or affiliated group, owned a 25 per cent interest, either in the voting stock of a foreign corporation, or an equivalent ownership in a non-incorporated foreign enterprise". In particular, "direct investments include the United States *equity* in the following types of enterprises:

(*i*) Foreign corporations, the voting securities of which were owned to the extent of 25 per cent or more by persons, or groups of affiliated persons, ordinarily resident in the United States, and analogous interests in partnerships and other organizations.

(*ii*) Foreign corporations, the voting stock of which was publicly held within the United States to an aggregate extent of 50 per cent or more, but distributed among stockholders so that no one investor or group of affiliated investors, owned as much as 25 per cent.

(*iii*) Sole proprietorships, partnerships or real property (other than property held for the personal use of the owner) held abroad by residents of the United States.

(*iv*) Foreign branches of United States corporations: 'Foreign branches' are defined as the foreign assets of any person, natural or juridical, allocated to or held for the purposes of conducting the person's business in a foreign country. The selling of merchandise by an independent agent does not, of itself, constitute a branch operation".

The term "affiliates" is defined to "include any group of United States persons that ordinarily exercises voting rights in a foreign organization as a unit".

"In addition to the ownership interest of the reporter, or parent, and affiliates, the term 'direct investments' includes all the equity or ownership of non-affiliated United States persons in the stock, surplus, long-term debt, or other liabilities of the foreign enterprise. Ordinary bank loans to and commercial claims on the foreign enterprise, or financing by United States government agencies, are not included as direct investments in that particular enterprise but elsewhere in the statements of international investments".

The basis of valuation is "the value of the reporter's interest in the stock, surplus, and liabilities, plus other United States interest in the securities and surplus of foreign allied organizations, or home office accounts of foreign branches of United States incorporated enterprises, as shown on the books of the foreign organizations, usually converted into dollars in accordance with standard accounting practices". The term 'surplus' "includes capital surplus as well as earned surplus and surplus reserves and would include, for example, reserves for retirement of preferred stock, reserves for plant expansion, reserves for contingencies, and other types of voluntary reserves". For the purpose of deriving the dollar values, "current assets and liabilities were converted at rates current at the date of the report and fixed assets were converted at the rate current at the time the assets were acquired. Depreciation reserves were converted at the same rates used in converting the value of the related assets. Capital stock accounts were ordinarily converted at the rate current at the time the stock was acquired or issued, but sometimes at the rate current as of the date of the report".

Private long-term foreign investments are normally divided into two principal classes — direct investments in which there is evidence of substantial managerial interest, and portfolio investments, in which the intention of the investor is to realize income or capital gains but not to exercise control over management.

Between these two classes, however, there has always been a range of ownership, say 10-25 per cent, in which the United States parent company does not exercise effective control, but is a participant in

[10] Aliber, Robert Z., "A Theory of Direct Foreign Investment", *The International Corporation*, Kindleberger, C. P., ed. (Cambridge, M.I.T. Press, 1970), p. 32.

[11] See Pizer, Samuel and Cutler, Frederick, *U.S. Business Investments in Foreign Countries, A Supplement to the Survey of Current Business* (Office of Business Economics, United States Department of Commerce, Washington D.C. 1960), pp. 76-82.

at least some phases of management.[12] Depending upon the terms of participation, such investment could be more in the nature of direct investments than portfolio. However, these investments have generally been excluded from the category of "direct" investment, though the census report[13] published in 1960 revealed separate estimates for investments in such "associated foreign enterprises" also.[14]

Section B

Japanese Direct Investments

Rapid economic growth and balance of payments strength over the last decade have been reflected in a dramatic expansion of Japanese direct overseas investments (see table I-3-5). Japan's capacity to generate capital and to channel it into overseas investments had been previously demonstrated in the inter-war period.[15] However, at the end of the Second World War, in 1945, all Japanese foreign assets were forfeited, and during the postwar reconstruction and military occupation no foreign investment was undertaken. In 1951, the year when the peace treaty was signed and also the year when industrial production regained the pre-war (1934-1936) level, the first postwar overseas investment was initiated. By 1956, the level of foreign direct investment outflows overtook direct investment inflows, and, in 1960, the cumulative gross total of direct investments abroad passed the cumulative total of direct investment received in the postwar period from other countries.[16] Japan shifted from an over-all external debtor position to become a net international creditor in 1967.[17] By 1969, the outflow of direct investment to all countries had increased to $668 million and the cumulative total had reached $2.683 billion.[18] While Japan still ranked behind the United States, France, the United Kingdom, the Federal Republic of Germany and the Netherlands in 1969 flows of direct investment to developing countries,[19] Japan has become one of the most important investors in the ECAFE region, and the first or second most important source of direct investments for China (Taiwan), the Republic of Korea, Malaysia, Singapore and Thailand.[20]

Table I-3-5. Japanese direct investment outflows to all countries: Fiscal years 1951-1969, approval basis (excluding reinvested earnings)

Fiscal year	*Investment projects (number)*	*Volume of investments (million dollars)*	*Average volume per project (thousand dollars)*
1951–1957	367	78	210
1958	78	65	830
1959	123	53	430
1960	151	93	620
1961	133	165	1,240
1962	179	99	550
1963	223	126	570
1964	193	120	620
1965	209	157	750
1966	253	227	900
1967	306	275	900
1968	384	557	1,440
1969	568	668	1,170
Cumulative total	3,167	2,683	850

Source: Foreign Department, Bank of Japan.

Note: The Japanese fiscal year is 1 April to 31 March, so that the fiscal year 1969 ended on 31 March 1970.

Statistical data on official approvals of investment outflow statistics are published by the Bank of Japan, the Ministry of Finance and the Ministry of International Trade and Industry (MITI). The most comprehensive source is *Keizai Kyoryoku no Genjo to Mondaiten* (Economic Co-operation—Present Status and Problems) published annually by MITI. Several problems are evident in the data published. First, there is a time lag, as well as some attrition between approval of a project and the actual transfer of capital, which creates disparities between approval statistics and the balance of payments data. Second,

[12] There seems to be general agreement among the IMF, the OECD and the United States Department of Commerce on the principles of classification. See IMF, *Balance of Payments Manual*, 1961, pp. 118-120; and OECD, *Resources for the Developing World 1962-1968*, annex III.

[13] *U.S. Business Investments in Foreign Countries*, Office of Business Economics, United States Department of Commerce, 1960.

[14] From 1967, however, it appears that the *Survey of Current Business* has been using a definition of "direct" investments which includes investments in the "associated foreign enterprises". Thus, "at the end of 1967, nearly half of all U.S. investments abroad were direct investments, defined as U.S. ownership interest in foreign enterprises of *at least 10 per cent*". *Survey of Current Business*, October 1968, p. 21 (emphasis ours).

[15] During the First World War, Japan became a net international creditor. Lockwood has estimated the value of Japanese long-term foreign investments, mostly in China (especially Manchuria), as of the end of 1934, at 3.0 billion yen (1.0 billion dollars), and the value of holdings in its overseas empire (Korea, Formosa, Sakhlin, and the Mandated Islands) at 1.8 to 2.0 billion yen (0.6 to 0.7 billion dollars), giving total overseas investments of 4.8 to 5.0 billion yen (1.6 to 1.7 billion dollars). To convert yen to US dollars, the average exchange rate for 1930-1936 of one yen to 34.1 cents has been used. Lockwood, William W., *The Economic Development of Japan, Growth and Structural Change, 1868-1938* (Princeton, Princeton University Press, 1954), pp. 257, 258-261. Compare Remer, C. F., *Foreign Investments in China* (New York, Council for Pacific Relations, 1933), pp. 448, 548. It has been estimated that, in 1935, Japan invested about 3 per cent of her national income in her overseas colonies and sphere of influence: Saburo Okita, *Causes and Problems of Rapid Growth in Postwar Japan and Their Implications for Newly Developing Economies* (Tokyo, Japan Economic Research Center, 1967), pp. 11.

[16] Based on balance of payments concept of direct investment: IMF, *Balance of Payments Yearbook*, vols. 8, 12, 15, 18 and 21.

[17] *OECD Economic Surveys: Japan* (Paris, OECD, 1970), p. 43.

[18] Approval basis; all values are given in United States dollars, unless otherwise indicated.

[19] OECD/DAC, *Development Assistance, 1970 Review* (Paris, OECD, 1970), annex table 6, pp. 176-177. This ranking is based on the OECD/DAC definition of direct investment which is more restrictive than the concept which will be adopted in this section.

[20] For rankings of sources of foreign investment for Asian countries, see Shigekazu Matsumoto, "Tonan Ajia ni Okeru Keizai Kyoryoku to Minkan Toshi" (Economic Cooperation and Private Investment in Southeast Asia), *Sekai Keizai Hyoron*, October 1970, p. 60.

data on liquidation of foreign investments and reinvestment of earnings, neither of which are subject to approval, generally have not been considered important enough to warrant publication. Obviously, with cumulative direct investments now exceeding $2.5 billion, reinvestment of earnings can be assumed to be quite significant. Repatriation of capital also could become important in the future. Third, perhaps because of the newness of most Japanese private foreign investments, relatively little has been done in the way of publishing official systematic follow-up survey findings concerning the present values, earnings and operations of these investments. Several agencies, such as the Export-Import Bank of Japan, the Japan Economic Research Institute, the Institute of Developing Economies (formerly the Asian Economic Research Institute), and several independent scholars have made surveys of Japanese private foreign investments, some of which will be referred to below, but the need for further research is apparent.

Some clarification is in order concerning the concept of "direct investment" in the context of this section. While there is no official Japanese definition of direct investment, the prevailing understanding would seem to agree with the description in the OECD Code of Liberalization of Capital Movements which reads:

> "Investment for the purpose of establishing lasting economic relations with an undertaking such as, in particular, investments which give the possibility of exercising an effective influence on the management thereof:
>
> (1) Creation or extension of a wholly-owned enterprise, subsidiary or branch, acquisition of full ownership of an existing enterprise;
>
> (2) Participation in a new or existing enterprise;
>
> (3) A long-term loan (five years and longer)."[21]

The Bank of Japan, in a "Classification of Foreign Exchange Transactions", divides direct investment into:

(1) Branches
(2) Subsidiaries
  (*a*) Creditor capital
  (*b*) Portfolio securities.[22]

Here the term "portfolio securities" apparently does not carry the conventional meaning of absence of control, but rather can be taken to mean shares or other securities issued by subsidiaries incorporated in foreign countries. Likewise, it is evident that "loans" or "creditor capital" are treated as direct investments when undertaken to establish "lasting economic relations" with some degree of influence on management, and subject to the same approval system as other types of direct investment. These loans are made (1) when necessary for operation of a branch, subsidiary or joint venture, and (2) when host country laws prohibit direct acquisition of shares of an enterprise. In the latter case, a loan may be made to a national of the host country who acquires shares in the enterprise, which belong indirectly to the Japanese investors.[23] The Government, through the Export-Import Bank and the Organization for Economic Co-operation Fund, extends loans to Japanese enterprises to help them finance direct investments overseas. Also, various government subsidies are granted to support pre-investment surveys, technical assistance, foreign investment liaison and other services for Japanese investors. Because of this type of government-business collaboration, as well as official guidance, it is difficult to differentiate between the private and public elements in Japanese direct investments. Consequently, direct investment will be conceived in this chapter to include any equity, loan or real property investment overseas in which profit motivation and some degree of influence on management are present, whether the original source of capital is private or official. Thus, the cumulative total of Japanese gross investments overseas (as listed in table I-3-5), virtually all of which should be considered direct investment, is composed of:

	projects	*million $*
Loans,	521	1,283
Shares and other securities,	2,245	1,035
Branch establishments,	352	26
Other property,	49	339
Total	3,167	2,683[24]

Distribution among major regions and individual ECAFE countries

The geographical distribution among major regions of Japanese cumulative direct investments[25] through the 1969 fiscal year is shown in table I-3-6. South and East Asia (which closely corresponds to

[21] OECD, *Code of Liberalization of Capital Movements* (Paris, OECD, 1969), annex A, I/B, p. 43.
[22] Foreign Department, Bank of Japan, *Foreign Exchange Statistics Monthly.*
[23] *Kaigai Toshi Kankei Tetsuzuki no Kaisetsu* (Explanation of Procedures Relating to Overseas Investments), (Tokyo, Kokusai Gijutsu Kyoryoku Kyokai, 1970 revised edition), pp. 13-14.
[24] MITI, *Keizai Kyoryoku no Genjo to Mondaiten,* 1970, pp. 512-513.
[25] Approval basis: using the concept discussed above, with both reinvested earnings and disinvestments excluded, i.e. only the originally approved outflows are cumulated.

the developing ECAFE countries)[26] ranked first in number of investment projects, 43.5 per cent, but second in investment volume, 22.5 per cent. The disparity between the region's position in number of projects and volume has been persistent. In 1959 and 1964, Asia ranked first in projects, with 35.5 per cent and 38.1 per cent respectively, but third in volume, with 18.5 per cent and 20.9 per cent respectively. This continuing disparity reflects Asia's low average investment volume per project ($440,000) which is little more than half the over-all average of $850,000 at the end of the 1969 fiscal year and much less than any other region.

Table I-3-6. Geographical distribution of Japanese direct investment outflows: Fiscal years 1951-1969, approval basis (excluding reinvested earnings)

Region	Investment projects (number)	Investment projects (percentage)	Volume of investment (million $)	Volume of investment (percentage)	Average volume per project (thousand $)
South and East Asia*	1,379	43.5	604	22.5	440
North America	739	23.3	720	26.8	970
Latin America	529	16.7	513	19.2	980
Europe	291	9.2	303	11.3	1,040
Oceania	127	4.0	158	5.9	1,240
Africa	75	2.4	79	2.9	950
Middle East	27	0.9	306	11.4	11,300
Total	3,167	100.0	2,683	100.0	850

Source: Foreign Department, Bank of Japan.

* See table I-3-7 for list of countries included in South and East Asia.

The distribution of investment projects and investment volumes among individual countries within South and East Asia (see table I-3-7) again show wide disparities, as dictated by differing conditions among the countries. Brunei and Indonesia, with large proportions of investments in the primary sectors,[27] have high average volumes per project. On the other hand, Hong Kong has a low average investment per project, reflecting a large proportion of investment in light manufacturing and the trade sector. Major recipients of Japanese investments in terms of project numbers have been China (Taiwan), Thailand and Hong Kong, in that order, which between them account for 56.8 per cent of projects in the region. The three leading recipients by volume of investment, on the other hand, have been Indonesia, Brunei and Thailand, which together have received 59.1 per cent of investment volume.

Table I-3-7. Country distribution of Japanese direct investment outflows to South and East Asia: Fiscal years 1951-1969, approval basis (excluding reinvested earnings)

Country*	Investment projects (number)	Investment projects (percentage)	Volume of investments (million $)	Volume of investments (percentage)	Average volume per project (thousand $)
Brunei	9	0.7	86.31	14.3	9,589
Burma	8	0.6	0.44	0.1	55
Ceylon	15	1.1	1.86	0.3	124
Khmer Republic	3	0.2	0.75	0.1	250
China (Taiwan)	358	25.9	60.28	10.0	168
Hong Kong	212	15.4	19.65	3.3	93
India	63	4.6	16.87	2.8	268
Indonesia	46	3.3	192.83	31.9	4,192
Korea, Republic of	34	2.5	15.02	2.5	442
Laos	7	0.5	1.25	0.2	179
Malaysia	86	6.3	35.91	5.9	418
Nepal	1	0.1	0.15	0.1	150
Pakistan	25	1.8	5.40	0.9	216
Philippines	62	4.5	44.70	7.4	721
Ryukyu Islands	153	11.1	20.00	3.3	131
Singapore	78	5.5	23.71	3.9	304
Thailand	214	15.5	78.21	12.9	365
Viet-Nam, Republic of	5	0.4	0.68	0.1	136
All Asia	1,379	100.0	604.02	100.0	439

Source: Japan, Ministry of International Trade and Industry, *Keizai Kyoryoku no Genjo to Mondaiten* (Economic Cooperation — Present Status and Problems), 1970.

* Iran is not included in this tabulation (see table I-3-8); Ryukyu Islands are included even though they will be reunited with Japan under agreement with the United States.

The question can be posed whether number of projects or volume of investment is the better measure of impact from foreign investment. If transfers of technical and managerial skills, demonstration effects, and other non-tangible items are considered to be the unique contributions of direct investment, then a good argument can be presented that number of investment projects is the better indicator of impact, or of benefit received. This argument would need to assume that transfer of skills is not necessarily proportional to volume of capital, and that even small investment projects entail some transfer of managerial and technical skills. The validity of these assumptions for direct investments in the ECAFE region should be investigated.

Some details of the flows of Japanese private capital to twelve ECAFE countries for the five latest years available and for the whole period 1951-1969 are tabulated in table I-3-8, along with a comparison of net receipts of Japanese export credits. Iran is

[26] Iran is classified as Middle East instead of South and East Asia. The Ryukyu Islands are included even though they will revert to Japan in 1972 under agreement with the United States.

[27] Japanese investments in Brunei are dominated by the Shell/Mitsubishi joint ventures for export of liquefied natural gas to Japan, which involves a $480 million investment in liquefaction plant and other facilities in Brunei, special ocean tankers, and distribution facilities in Japan. See OECD/DAC, *op. cit.*, p. 79.

Table I-3-8. Japanese direct investment and export credit flows to twelve developing ECAFE countries, approval basis

(in million dollars)

Country/type	Fiscal year 1965	1966	1967	1968	1969	Cumulative 1951-1969
Brunei —						
Branch equity	—	—	—	—	—	—
Other equity	—	—	—	—	13.67	14.21
Loans	—	—	—	—	72.08	72.10
Gross investment	—	—	—	—	85.75	86.31
Net investment	×	×	×	×	×	86.31
Export credits	—	—	—	—	0.78	×
Total	—	—	—	—	86.53	×
China (Taiwan) —						
Branch equity	0.05	0.10	0.09	0.04	0.27	0.95
Other equity	0.94	2.88	10.04	12.78	18.84	51.98
Loans	0.28	0.15	3.00	0.82	1.50	7.27
Gross investment	1.27	3.13	13.13	13.64	20.61	60.20
Net investment	×	×	×	×	×	57.89
Export credits	6.94	20.82	63.37	99.53	24.49	×
Total	8.21	23.95	76.50	113.17	45.10	×
Hong Kong —						
Branch equity	0.03	0.02	0.03	0.10	0.61	2.05
Other equity	1.20	2.28	1.13	0.89	3.78	16.06
Loans	0.39	0.15	—	—	0.42	1.28
Gross investment	1.62	2.45	1.16	0.99	4.81	19.39
Net investment	×	×	×	×	×	16.62
Export credits	4.00	11.00	—	...	65.10	×
Total	5.62	13.45	1.16	...	69.91	×
India —						
Branch equity	0.05	0.08	—	0.17	—	0.82
Other equity	0.13	2.61	2.00	0.73	—	11.28
Loans	—	—	0.08	—	—	0.17
Gross investment	0.18	2.69	2.08	0.90	—	12.27
Net investment	×	×	×	×	×	11.57
Export credits	43.00	26.86	79.92	1.79	−1.87	×
Total	43.18	29.55	82.00	2.69	−1.87	×
Indonesia —						
Branch equity	—	—	—	0.50	—	0.51
Other equity	—	—	—	3.36	12.76	16.98
Loans	16.15	5.55	52.04	37.71	30.07	175.34
Gross investment	16.15	5.55	52.04	41.57	42.83	192.83
Net investment	×	×	×	×	×	150.50
Export credits	122.00	8.00	17.87	2.81	−10.93	×
Total	138.15	13.55	69.91	44.38	31.90	×

Table I-3-8 *(Cont'd)*

(in million dollars)

Country/type	Fiscal year 1965	1966	1967	1968	1969	Cumulative 1951-1969
Iran —						
Branch equity	—	—	—	—	—	—
Other equity	—	0.27	0.08	0.39	1.61	3.08
Loans	—	—	—	—	—	—
Gross investment	—	0.27	0.08	0.39	1.61	3.08
Net investment	×	×	×	×	×	2.92
Export credits	—	0.69	64.16	28.24	11.86	×
Total	—	0.96	64.24	28.63	13.47	×
Korea, Republic of —						
Branch equity	—	—	1.27	—	—	1.27
Other equity	—	—	0.31	0.49	9.68	10.48
Loans	—	2.50	—	0.10	0.67	3.27
Gross investment	—	2.50	1.58	0.59	10.35	15.02
Net investment	×	×	×	×	×	12.13
Export credits	23.50	110.09	184.60	127.37	72.03	×
Total	23.50	112.59	186.18	127.96	82.38	×
Malaysia —						
Branch equity	—	—	—	0.03	—	0.43
Other equity	5.08	5.41	1.06	11.37	4.63	22.91
Loans	0.12	0.32	2.98	0.78	0.66	12.36
Gross investment	5.20	5.73	4.04	2.18	5.29	35.70
Net investment	×	×	×	×	×	24.70
Export credits	2.00	17.00	5.35	7.12	1.25	×
Total	7.20	22.73	9.39	9.30	6.54	×
Pakistan —						
Branch equity	—	—	—	0.10	—	0.23
Other equity	2.19	0.02	—	1.20	0.28	5.06
Loans	—	—	—	—	—	—
Gross investment	2.19	0.02	—	1.30	0.28	5.29
Net investment	×	×	×	×	×	5.01
Export credits	3.11	—	20.36	24.94	4.67	×
Total	5.30	0.02	20.36	26.24	4.95	×
Philippines —						
Branch equity	—	—	0.90	0.01	0.02	0.89
Other equity	0.13	0.12	3.41	3.04	1.66	10.03
Loans	0.30	2.33	4.90	2.00	2.05	33.73
Gross investment	0.43	2.45	9.21	5.05	3.73	44.65
Net investment	×	×	×	×	×	18.12
Export credits	62.30	45.97	142.93	120.05	17.75	×
Total	62.73	48.42	152.14	125.10	21.48	×

Table I-3-8. *(Cont'd)*

(in million dollars)

Country/type	Fiscal year 1965	1966	1967	1968	1969	Cumulative 1951-1969
Singapore —						
Branch equity	—	—	0.04	—	—	1.59
Other equity	1.90	0.37	0.98	0.87	3.46	15.78
Loans	—	0.99	—	0.10	0.16	6.25
Gross investment	1.90	1.36	1.02	0.97	3.62	23.62
Net investment	×	×	×	×	×	14.80
Export credits	12.00	5.27	12.31	14.93	18.18	×
Total	13.90	6.63	13.33	15.90	21.80	×
Thailand —						
Branch equity	0.05	0.21	—	—	0.11	2.62
Other equity	4.36	1.76	4.06	8.14	12.08	49.89
Loans	1.52	0.43	4.29	2.10	6.51	25.52
Gross investment	5.93	2.40	8.35	10.24	18.70	78.03
Net investment	×	×	×	×	×	68.91
Export credits	36.17	46.34	77.57	89.97	18.79	×
Total	42.10	48.74	85.92	100.21	37.49	×

Sources: Japan, Ministry of International Trade and Industry, *Keizai Kyoryoku no Genjo to Mondaiten* (Economic Co-operation — Present Status and Problems), 1966-1970.
Japan, Overseas Economic Co-operation Fund, *Kaigai Keizai Kyoryoku Binran* (Handbook on Foreign Economic Co-operation), 1969-1971.

Notes: (1) Reinvested earnings are not included.
(2) "×" indicates not tabulated.
(3) Export credits are given net of repayments.

included here, although it is not part of South and East Asia as defined in the official statistics. During the short period tabulated, rising trends in investment volume approved can be fairly clearly identified for China (Taiwan), Indonesia, Iran and Thailand. The investment flows to Malaysia appear to be relatively steady, although there are substantial fluctuations in composition by type of investment. For the other seven countries, no clear-cut trend emerged over the five years.

The role of loans has been prominent in Brunei, Indonesia and the Philippines and has been important for Malaysia and Thailand. Since all five of these countries are important sources of raw materials, there seems to be a pattern of financing resource development projects with a combination of equity and loan capital. The large flows of loans to Brunei, Indonesia and the Philippines have brought the regional loan composition to 57.6 per cent (see table I-3-10), compared with 48 per cent loans in total investments to all countries. However, the level of loans is low for the other nine countries tabulated. The volume of investment in branches is important only in Hong Kong and Singapore, the two pivotal trading centres.

Table I-3-8 presents data on net investment of all types outstanding, as of 31 March 1970, the end of the 1969 fiscal year. The difference between net investment and the cumulative total gross investment should be a measure of disinvestment during the period 1951 through 1969. Total disinvestment calculated in this way is $107 million, or 18.6 per cent of the gross investment of $576 million. Most of the disinvestment has apparently taken the form of repayment of loans. However, country-by-country comparisons of disinvestment with cumulative loan totals show that minor amounts of equity capital have been repatriated from Hong Kong, India, Iran, Pakistan and Singapore.

For comparative purposes, net export credit flows to the twelve countries are also tabulated in table I-3-8. Export credits have been a more important source of funds than direct investments in most of these countries (see Chapter V).

Sectoral distribution

The sectoral distributions of cumulative Japanese direct investments in all countries and in South and East Asia are compared in table I-3-9. Through 1969, the global distribution of investment projects was led by trade (31.4 per cent), other services (15.0 per cent), other manufacturing (7.7 per cent)[28] and textile manufacture (7.6 per cent); while the Asian frequency leaders were other manufacturing (15.4 per cent), trade (13.4 per cent), textiles (12.5 per cent) and electrical/electronics (9.7 per cent), closely followed by chemical manufacturing (8.8 per cent). Of course, distribution has varied widely between individual countries. Prominent sectors in the following five countries have been:

China (Taiwan) — electrical/electronic, textiles, other manuafcturing;

Hong Kong—trade, textiles, other manufacturing;

India—metals/metal products, other manufacturing, trade;

Malaysia—mining, wood and pulp products, other manufacturing;

Thailand—trade, textiles, electrical/electronic.[29]

Nearly half of the global projects were in the tertiary sectors (50.2 per cent), while Asian projects were concentrated in the secondary sectors (66.0 per cent).

The global distribution of investment volume was dominated by mining, including petroleum (33.6 per cent), and the tertiary sectors (together 36.7 per cent). Mining also led the Asian volume distribution with 38.5 per cent, followed by textile manufacture (12.0 per cent), finance and insurance (11.0 per cent) and agriculture, forestry and fishing (6.6 per cent). Volume of global direct investments to all countries was balanced between primary sectors (36.1 per cent), secondary (27.2 per cent) and tertiary (36.7 per cent), but, in Asia, investment in the primary (45.1 per cent) and secondary (39.5 per cent) sectors outweighed tertiary investments (15.4 per cent).

[28] "Other manufacturing" includes generally light, labour-intensive, sundry products.

[29] *Kaigai Toshi to Gijutsu Yushutsu Yoran* (Japan's Overseas Investment and Technology Exports), (Tokyo, Jukagaku Kogyo Tsushinsha, 1970), chapter 6.

Table I-3-9. Distribution by sector of Japanese direct investments, World and South and East Asia: Fiscal years 1951-1969, approval basis (excluding reinvested earnings)

Sector	All countries					South and East Asia	
	Investment projects		Volume of investments		Average volume	Projects	Volume
	(number)	(percentage)	(million $)	(percentage)	(thousand $)	%	%
Agriculture, forestry, fisheries	156	5.5	67	2.5	430	5.4	6.6
Mining	157	5.6	892	33.6	5,700	5.1	38.5
Primary sectors	313	11.1	959	36.1	3,060	10.5	45.1
Food-stuffs	105	3.7	45	1.7	430	6.1	4.6
Textiles	213	7.6	140	5.3	660	12.5	12.0
Wood and pulp	30	1.1	133	5.0	4,420	1.3	0.9
Chemicals	135	4.8	34	1.3	250	8.8	2.6
Metal products	86	3.1	129	4.9	1,500	5.5	5.3
Electrical machinery	163	5.7	49	1.9	300	9.7	5.1
Transport equipment	39	1.2	100	3.6	2,560	1.6	2.1
Other machinery	101	3.6	51	2.0	500	5.1	1.6
Other manufactures	215	7.7	40	1.5	180	15.4	5.3
Secondary sectors	1,087	38.5	721	27.2	660	66.0	39.5
Trade	887	31.4	322	12.1	370	13.4	1.9
Finance, insurance	85	3.0	230	8.7	2,700	2.2	11.0
Construction	22	0.8	3.3	1.2	1,490	1.4	0.3
Other services	421	15.0	391	14.7	930	6.5	2.2
Tertiary sectors	1,415	50.2	976	36.7	680	23.5	15.4
Total, excluding branches	2,815	100.0	2,656	100.0	950	100.0	100.0
Branches	352		27		80		
Total	3,167		2,683		850		

Source: Japan, Ministry of International Trade and Industry, *Keizai Kyoryoku no Genjo to Mondaiten* (Economic Cooperation — Present Status and Problems), 1970.

Notes: (1) See table I-3-7 for countries included in South and East Asia.

(2) Branch investments are not included in the sectoral distribution.

Average volumes per project in each sector are listed in tables I-3-9 and I-3-10. The global averages were led by mining ($5.7 million), wood and pulp manufacturing ($4.4 million) finance and insurance ($2.7 million) transport equipment ($2.6 million), and metals/metal products ($1.5 million), while chemical manufacturing averaged only $250,000 per project and other manufacturing only $180,000. Asian average volumes per project, though smaller, were also led by mining ($3.7 million), followed by finance and insurance ($2.5 million), agriculture and forestry ($850,000, or $620,000, if combined with fisheries) and transport equipment $650,000), and ranged downward to only $72,000 for trade.

The classification of types of investment in each sector is given for the Asian countries in table I-3-10. Unfortunately, however, the classification for investments in branches is not available. Loan investments were made in all sectors, but are especially important (on the basis of investment volume) in the primary sectors, particularly in mining and agriculture/forestry, and the tertiary sectors, particularly in finance and insurance. Some direct investments in real property took place in the trade and other services sectors, presumably concentrated in warehouse, shipping, airline and similar facilities. Compared with the global composition, loan and branch investments were more important in Asia (57.6 per cent, compared with 47.8 per cent, and 2.5 per cent, compared with 1.0 per cent), equity investments in shares and other securities were about the same (39.6 per cent, compared with 38.6 per cent), and investments in real property were significantly lower (0.4 per cent, compared with 12.6 per cent) than the world figure which included large investments in leases and other property of oil exploration ventures not incorporated in the host countries.

Table I-3-10. Distribution by sector and type of Japanese direct investments in South and East Asia: Fiscal years 1951-1969, approval basis (excluding reinvested earnings)

Sector	Investment projects (number)	Volume of investments (million $)	Average volume per project (thousand $)	Type of investment (excluding branches)			
				Equity (%)	Loans (%)	Real prop. (%)	Branch (%)
Agriculture and forestry	41	35.03	854	15.6	84.2	0.2	×
Fishery	22	4.30	196	68.9	31.1	—	×
Mining	61	226.54	3,714	10.2	89.8	—	×
Primary sectors	124	265.87	2,144	11.9	88.1	—	×
Food-stuffs	72	27.19	378	58.4	41.6	—	×
Textiles	148	70.60	477	78.1	21.9	—	×
Wood and pulp	15	5.66	377	46.0	54.0	—	×
Chemicals	101	15.08	149	84.4	15.6	—	×
Metal products	65	31.47	484	90.3	9.7	—	×
Electrical machinery	115	29.99	261	93.9	6.1	—	×
Transport equipment	19	12.37	651	71.8	28.2	—	×
Other machinery	61	8.84	145	89.8	10.2	—	×
Other manufacturing	180	31.48	175	75.9	24.1	—	×
Secondary sectors	776	232.68	300	79.1	20.9	—	×
Trade	158	11.31	72	87.2	8.5	4.3	×
Finance and insurance	26	64.54	2,482	7.3	92.7	—	×
Construction	17	1.86	104	94.8	5.2	—	×
Other services	76	12.95	171	57.8	29.9	12.3	×
Tertiary sectors	277	90.56	327	26.2	71.5	2.3	×
Total, excluding branches	1,177	589.11	501	×	×	×	×
Branches	202	14.91	74	×	×	×	2.5
Total	1,379	604.02	438	39.6	57.6	0.4	2.5

Source: Japan, Ministry of International Trade and Industry, *Keizai Kyoryoku no Genjo to Mondaiten* (Economic Cooperation — Present Status and Problems), 1970.

Notes: (1) See table I-3-7 for countries included in South and East Asia.

(2) Branch investments are not included in the sectoral distribution.

(3) "×" indicates not tabulated.

Table I-3-11. 1968 survey[a] findings on profitability of Japanese direct investments by sector and region (percentages of firms replying)

Sector	Result during latest accounting period			Cumulated profit or loss			Firms Replying
	Profit (%)	Even (%)	Loss (%)	Profit (%)	Even (%)	Loss (%)	(number)
Agriculture and forestry	33	—	67	17	—	83	6
Fishery	48	13	39	39	—	61	23
Mining	57	—	43	43	—	57	21
Food-stuffs	40	—	60	35	—	65	40
Textiles	73	4	23	63	1	36	70
Chemical	72	—	28	47	11	42	36
Ceramic	61	8	31	54	—	46	13
Metals	60	5	35	48	5	48	40
Electrical machinery	61	16	23	57	—	43	44
Other machinery	47	3	50	37	3	60	30
Other	64	3	33	64	—	36	36
Total, including Ryukyu Islands	60	5	35	50	2	48	359
Region							
East Asia	70	1	29	58	1	41	79
Southeast Asia	60	3	37	51	2	47	118
West Asia	100	—	—	100	—	—	1
Latin America	51	11	38	41	4	55	66
Africa	74	10	16	74	—	26	19
Developing regions	62	5	33	52	2	46	283
North America, Europe and Oceania	67	—	33	50	—	50	36
Total, excluding Ryukyu Islands	62	4	34	52	2	46	319

Source: *Yugin Joho* (Quarterly News from the Export-Import Bank of Japan), March 1969.

Note: East Asia includes China (Taiwan), and the Republic of Korea; Southeast Asia includes Burma, Cambodia, Ceylon, India, Indonesia, Laos, Malaysia, Pakistan, Philippines, Singapore, Thailand, and the Republic of Viet-Nam; West Asia includes Iran and the Middle East.

[a] Conducted by the Export-Import Bank of Japan.

Earnings and motivation

Data on the earnings of Japanese direct investments, comparable with the United States data given earlier, are not available. However, the Export-Import Bank of Japan has published a valuable survey of the motivation and profitability of Japanese direct investments abroad. Questionnaires were sent out in July 1968 to firms with direct investments, asking, among other questions, whether they had made a profit or loss, or had broken even, during the previous accounting period, and whether they had a cumulative profit or loss.[30] The results are shown in table I-3-11. The record for investments in southeast Asia (from India and Pakistan through Indonesia and the Philippines) was in line with all countries, while results in east Asia (China (Taiwan) and the Republic of Korea, but excluding the Ryukyu Islands) were a little better than average. By sectoral classification, textiles, electrical/electronic, and other manufacturing (sundries) had done better than average. However, only 62 per cent of all firms replying to the survey, excluding those in the Ryukyu Islands, showed profits in the latest period, and only 52 per cent had a cumulative profit. Only about half of the latter, or 29 per cent of the total, had commenced dividend payments to parent companies. The apparent low level of profitability is partially explained by the large portion of Japanese direct investment which was too new to have matured to full earning power. This characteristic had been accentuated by the rapid growth in direct investment since the 1950s, as shown in table I-3-5. Other main reasons for unfavourable results obtained by the survey were insufficient sales and/or low sales prices due to (*a*) competition from imports, (*b*) competition from other firms in the host country, and (*c*) miscalculation of local demand. Also mentioned were high cost of raw materials, low productivity of labour, unstable economic environment, and slow and inefficient government procedures and administration in host countries.[31] These findings raise questions about the relative cost performance and pre-investment planning of Japanese foreign ventures.

[30] *Yugin Joho* (Quarterly News from the Export-Import Bank of Japan), March 1969, quoted in *Shihon Jiyuka to Kaigai Kigyo Shinshutsu, Kokusai Shihon Ido Kenkyu Iinkai Hokokusho* (Capital Liberalization and Advancement of Overseas Firms, a report by a committee on international capital movements), (Tokyo, Ministry of Finance Printing Office, 1969), pp. 150-166, and Koichi Hamada, "Role of Foreign Investment in Asian-Pacific Development: Japanese Investment Abroad", paper presented at the third Pacific Trade and Development Conference, August 1970, pp. 10-21. Generally, accounting periods of Japanese companies are six months and start in various months.

[31] *Ibid.*

Another, and probably a more basic, explanation for the apparently low profitability of Japanese direct investments is the importance which business and Government have placed on the promotion of exports and development of sources of raw materials. According to the survey, foreign ventures in agriculture and forestry, fisheries, and mining, while reporting below-average profitability, succeeded in meeting or exceeding originally scheduled deliveries of primary products to Japan in 60 per cent of the answering firms. These firms were judged successful in terms of supplying needed raw materials, regardless of reported profits or losses. It was observed that, in this case, the profit of subsidiaries and joint ventures abroad is not necessarily a good indicator of economic performance. The profit in the consolidated accounts of the firm abroad and the parent firm at home would be relevant for judging actual performance.[32] Of course, this applied more or less to all direct investments, not just to those in the primary sectors. It is possible that, in some cases, intrafirm pricing policies of parent and subsidiary companies actually underpriced host country exports to Japan and/or overpriced imports of Japanese capital goods, components and materials to host countries. Under relatively free market conditions in the host countries, the ability to so distort international prices would be greatly restricted by the competitive pressures of other investors and traders, both local and from third countries. Apparently, influence on prices has not been nearly so important a motivation as simple access to promising export markets and to dependable supplies of the raw materials which are in critically limited supply in Japan. The OECD Committee for Invisible Transactions has noted that Japanese direct investments have often been made for purposes of long-term trade development and commercial contacts, rather than for immediate profit.[33]

The Export-Import Bank survey findings on motivation confirm the low importance attached to immediate rate of return by Japanese foreign investors. Only 3 per cent of the 410 responding firms in the manufacturing (secondary) sectors listed "earning a dividend" as their investment motive, while 77 per cent listed motives related to promotion of Japanese exports (developing foreign market 26 per cent, defending foreign market 23 per cent, export of materials or semi-finished goods from Japan 21 per cent, and export of machinery and equipment from Japan 7 per cent), and 16 per cent listed motives related to trade based on host country supplies of low-cost labour or other factors in short supply in Japan (export of product to other countries 9 per cent and export of product to Japan 7 per cent). Of 78 primary sector firms engaged in developing foreign natural resources, 55 per cent listed "more stable supply" as their investment motive, 31 per cent "low price", and 14 per cent "better quality" or other reasons. Compared with an earlier survey in 1965, the motive related to low-cost labour had increased in importance in 1968. It has been reported that wage rates in China (Taiwan) are about one-quarter of those in Japan, and, in the Republic of Korea, about one-fifth to one-sixth.[34] This has been reflected in the increase of investments in Asian countries to manufacture textiles, electrical/electronic products, sundries, and other labour-intensive goods for export to Japan or other countries. As the labour shortage in Japan has become more severe, foreign investment has served as an alternative to the immigration of labour from neighbouring labour-surplus countries. OECD/DAC has observed that "it is in many ways better for both parties that components be imported rather than transient people".[35] Such factor-oriented investments have been promoted by the development of special duty-free industrial areas in China (Taiwan), the Republic of Korea and other countries. Anticipation of favourable duties on products manufactured in developing countries under the general preferential tariff scheme has also stimulated long-run development of export-oriented investments in labour-intensive industries.[36]

Likewise, as overcrowding in Japanese cities and pollution of air and water by industrial wastes have become more serious, industrialists have sought favourable plant sites available in nearby countries. Dr. Saburo Okita has predicted that:

> One of the new features of the 1970s will be rapidly expanding investment from Japan to develop natural resources overseas and, as the exporting countries will increasingly demand the processing of raw materials in their own countries, there will be many cases of Japanese investment in processing industries of those countries.[37]

In summary, there are a variety of motives for Japanese direct investments in the developing ECAFE countries. Access to markets and supplies of raw materials and fuels can be expected to remain important. The growing labour shortage and scarcity of plant sites in Japan should continue to promote further private capital outflows in the future.

[32] *Ibid.*

[33] *Liberalization of International Capital Movements: Japan* (Paris, OECD, 1968), pp. 22-23.

[34] Clark, Gregory, "Wanted — Cheap Labor", *Far Eastern Economic Review*, 30 October 1970, pp. 42-43.

[35] OECD/DAC, *Development Assistance, 1970 Review*, p. 81.

[36] Hamada, *op. cit.*, p. 14; Saburo Okita, "A Centre of Dynamism in the World Economy", *Nihon Keizai Shimbun*, International Weekly Edition, 5 January 1971, p. 3.

[37] Okita, *ibid.*

Chapter IV
RECENT FEATURES OF FOREIGN INVESTMENT IN SELECTED ECAFE COUNTRIES

This chapter brings together foreign private investment data collected from regional host country sources, many virtually for the first time. Much of the data relates to approval values of foreign investment projects promoted, or registered, by the agencies responsible for the administration of national laws and regulations concerning foreign capital. No attempt has been made to reconcile approval-basis data with balance of payments data. While differing from actual inflows realized over a given time period, approvals are valuable because they indicate (*a*) magnitudes, types, sources and allocations of planned investments, (*b*) investors' intentions, without distortion by such exogenous factors as construction delays and other lags or lapses caused by problems of implementation, and (*c*) the directions in which host countries seek to channel foreign investment. However, approvals, or even registrations, do not generally reflect the entire picture of foreign investments because of the limited scope of investment promotion programmes and the difficulty of monitoring medium- and small-size non-corporate capital inflows. Furthermore, reinvestments of unremitted earnings and investments in branches of foreign companies are often not included. Because of non-compatibility in the definitions underlying the available data, each country is taken up separately, and no regional tabulations are attempted.

This chapter is divided into two sections. Section A presents a brief survey of the foreign investment in nine developing ECAFE countries, China (Taiwan), Indonesia, Iran, Malaysia, Pakistan, the Philippines, the Republic of Korea, Singapore and Thailand. These countries represent a wide range of resource endowments, population densities, historical and cultural backgrounds, and stages of development. Section B is devoted to a descriptive discussion of foreign private capital in India, where somewhat more complete data are available.

Section A

China (Taiwan)

While average rate of growth of the GNP in China (Taiwan) over the period 1951-1966 has been about 8.3 per cent per annum, a recent study reveals that, without the massive inflow of foreign resources, the rate of growth would have been no more than 3.9 per cent.[1] Foreign private investments have been an important component of these foreign resources in recent years. Available data mostly relate to approvals of foreign private investments under the promotion laws and regulations. The following table I-4-1 presents what seems to be the most complete set of data available for foreign and overseas Chinese direct investments over the period 1960 to 1969. The United States accounts for more than half, and Japan for nearly a fourth, of total direct investment undertaken over the period 1962 to 1968.

Table I-4-1. China (Taiwan): Foreign and overseas Chinese direct investment, by source

(in million dollars)

Year	United States	Japan	Asia (except Japan)	Others	Total
1960 . .	...	...	...	...	5.77
1961 . .	...	...	...	...	9.46
1962 . .	3.37	3.83	0.89	0.90	8.99
1963 . .	13.52	2.78	1.17	0.81	18.28
1964 . .	7.63	1.71	0.31	5.92	15.57
1965 . .	7.13	1.88	0.68	0.82	10.51
1966 . .	2.19	1.68	1.68	2.86	8.41
1967 . .	13.43	9.39	3.73	1.32	27.87
1968 . .	17.56	6.41	3.35	0.56	27.88
1969 . .	...	...	...	...	50.62
Total . .	64.83[a]	27.68[a]	11.81[a]	13.19[a]	183.36
Percentage share of total[b]	(55.2)	(23.6)	(10.0)	(11.2)	(100)

Source: Balance of payments statistics compiled by the Economic Research Department of the Central Bank of China.

Note: Reinvested profits are not included.

[a] Total for the period 1962-1968 for which the data are available by country of origin. Total investments for the period 1962-1968 are $117.51 million.

[b] Figures in parentheses represent percentage shares of each country with respect to the total for the period 1962-1968.

Table I-4-2 shows a sharp acceleration in foreign private investment approvals over the three periods 1952-1959, 1960-1964 and 1965-1969. In the eight years of the 1950s, the total of approvals amounted to only 5.8 per cent of the total number of projects and 4.5 per cent of the total amount of investments over the period 1952-1969; in the first half of the 1960s, the proportions rose to 14 per cent and 17.5 per cent, and in the second half to 80.2 per cent and 78.0 per cent respectively. United States and Japanese investments have, together, accounted for almost 56 per cent of total investments, including overseas

[1] See Kowie Chang , ed., *Economic Development in Taiwan, Taipei*, 1968, p. 10.

Chinese investments, which have been somewhat less than a third of all foreign investment over the period. Excluding overseas Chinese investment, the share of the United States and Japan together comes to more than 80 per cent of total foreign investments.

These approvals have been distributed over the different sectors as shown in table I-4-3. As these data are restricted to approvals of promoted investments, the coverage for non-manufacturing investments is likely to be incomplete. Consequently, the division of total investment approvals between manufacturing and non-manufacturing is not particularly meaningful. However, the manufacturing sector appears to be adequately covered. Both United States and Japanese investments have tended to be concentrated in chemicals, and electronics and electronic appliances. These two industry groups together account for as much as 77.2 per cent and 54.6 per cent of United States and Japanese investments, respectively. Another striking feature is the wide disparity in the scale of investment between the United States and Japan. Thus, while the average amount of investment per project (i.e. per approved "case") is $548,000 for all non-Chinese investments, the corresponding averages for United States and Japanese investments are $1.22 million and $179,000, respectively. In fact, the Japanese average is even lower than the overseas Chinese average ($213,000).

Three questions require further probing: (*a*) How far is the United States and Japanese concentration of investments in chemicals and electronics indicative of full-scale technology transfer; (*b*) How far is the strikingly small average value of Japanese capital indicative of the fact that the Japanese technology imported into Taiwan is specifically adapted to the present state of factor endowments in Taiwan; and (*c*) How far can scale economies be incorporated into small-scale investment projects.

Table I-4-2. China (Taiwan): Foreign private investment approvals by country source and year, 1952-1969

(in thousand dollars)

Year \ Country	Foreign investments								Overseas Chinese[a] investments		Grand total	
	United States		Japan		Others		Total					
	No. of cases	Amount	No. of cases	Amount	No. of cases	Amount	No. of cases	Amount	No. of cases	Amount	No. of cases	Amount
1952	...	...	...	...	...	...	...	...	5	1,067	...	...
1953	1	1,881	1	160	—	—	2	2,041	12	1,654	14	3,695
1954	3	2,028	1	14	1	50	5	2,092	3	128	8	2,220
1955	2	4,423	—	—	—	—	2	4,423	3	176	5	4,599
1956	2	1,009	—	—	—	—	2	1,009	13	2,484	15	3,493
1957	1	11	3	37	—	—	4	48	10	1,574	14	1,622
1958	—	—	3	1,116	—	—	3	1,116	6	1,402	9	2,518
1959	1	100	1	45	—	—	2	145	—	820	2	965
Sub-total	10	9,452	9	1,372	1	50	20	10,874	52	9,305	67	19,112
% share to total (1953-1959)	7.0	5.4	2.7	2.3	2.4	0.1	3.8	3.8	8.2	6.9	5.8	4.5
1960	5	14,029	3	309	—	—	8	14,338	7	1,299	15	15,637
1961	1	4,288	3	1,301	1	375	5	5,964	24	8,340	29	14,304
1962	8	738	16	2,664	3	639	27	4,041	10	1,660	37	5,701
1963	9	8,734	6	1,397	1	216	16	10,347	22	7,703	38	18,050
1964	8	10,223	2	728	4	916	14	11,867	28	8,007	42	19,874
Sub-total	31	38,012	30	6,399	9	2,146	70	46,557	91	27,009	161	73,566
% share to total (1960-1964)	21.7	21.8	8.8	10.5	21.4	4.1	13.3	16.2	14.4	20.1	14.0	17.5
1965	17	31,104	14	2,081	5	1,955	36	35,140	31	6,486	67	41,626
1966	15	17,711	35	2,447	2	746	52	20,904	53	8,496	105	29,400
1967	19	15,726	77	15,957	13	7,005	109	38,688	108	18,455	217	57,143
1968	20	34,555	96	14,855	6	4,035	122	53,445	206	37,129	328	90,574
1969	31	27,882	79	17,642	6	36,697	116	82,221	91	27,551	207	109,772
Sub-total	102	126,978	301	52,982	32	50,438	435	230,398	489	98,117	924	328,515
% share to total (1965-1969)	71.3	72.8	88.5	87.2	76.2	95.8	82.9	80.0	77.4	73.0	80.2	78.0
Grand total	143	174,442	340	60,753	42	52,634	525	287,829	632	134,431	1,152	421,193
Percentage share of total foreign private investment	—	41.4	—	14.4	—	12.5	—	68.3	—	31.7[b]	—	100.0

Source: Overseas Chinese and Foreign Investment Commission, Republic of China, Taiwan.

[a] Includes investments of overseas Chinese investors from Hong Kong, Japan and "other" areas.

[b] 1952 data for overseas Chinese investments not included.

Table I-4-3. China (Taiwan): Distribution of total foreign investment approvals by sources and industry over the period 1952-1969[a]

(in thousand dollars)

Industry	Foreign investments																Overseas Chinese[b] investments			
	United States				Japan				Others				Total							
	No. of cases	Amount	Average amount	% to total amount	No. of cases	Amount	Average amount	% to total amount	No. of cases	Amount	Average amount	% to total amount	No. of cases	Amount	Average amount	% to total amount	No. of cases	Amount	Average amount	% to total amount
Agriculture and forestry	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	8	1,119	139.9	0.8
Fishery and animal husbandry industry	3	420	140.0	0.2	—	—	—	—	1	1,000	1,000	1.9	4	1,428	357.0	0.5	13	2,850	219.2	2.1
Mining	—	—	—	—	1	73	73.0	0.1	—	—	—	—	1	73	73.0	0.03	1	310	310.0	0.3
Food and beverage processing	14	4,534	323.9	2.6	9	1,526	169.6	2.5	4	990	247.5	1.9	27	7,050	261.1	2.5	51	13,832	271.2	10.3
Textiles	1	1,743	1,743.0	1.0	17	4,510	265.3	7.4	—	—	—	—	18	6,253	347.4	2.2	33	12,280	372.1	9.1
Garment and footwear	7	888	126.9	0.5	28	2,779	99.3	4.6	8	3,192	399.0	6.0	43	6,859	159.5	2.4	66	8,576	129.9	6.4
Lumber and bamboo products	3	160	53.3	0.1	7	245	35.0	0.4	—	—	—	—	10	405	40.5	0.1	20	2,401	120.1	1.8
Pulp paper and products	1	311	311.0	0.2	7	915	130.7	1.5	—	—	—	—	8	1,226	153.3	0.4	13	2,376	182.8	1.8
Leather and fur products	3	384	128.0	0.2	7	277	39.6	0.5	—	—	—	—	10	661	66.1	0.2	10	680	68.0	0.5
Plastic and rubber products	6	1,748	291.3	1.0	33	4,283	129.8	7.0	5	214	42.8	0.4	44	6,245	141.9	2.2	49	4,485	91.5	3.3
Chemicals	20	47,642	2,382.1	27.3	43	15,226	354.1	25.1	8	3,947	493.4	7.5	71	66,815	941.1	23.2	40	4,004	100.1	3.0
Non-metallic minerals	6	309	51.5	0.2	12	2,178	181.5	3.6	2	233	116.5	0.4	20	2,720	136.0	1.0	46	7,035	152.9	5.2
Basic metals and metal products	10	5,755	575.5	3.3	53	4,625	87.3	7.6	5	884	176.8	1.7	68	11,264	165.6	3.9	30	2,708	90.3	2.0
Machinery equipment and instruments	9	2,900	322.2	1.7	19	3,081	162.2	5.1	3	3,455	1,151.7	6.6	31	9,436	304.4	3.3	11	3,138	285.3	2.3
Electronics and electronic appliances	30	86,983	2,899.4	49.9	76	17,916	235.7	29.5	4	38,322	9,580.5	72.8	110	143,221	1,302.0	49.8	24	4,196	174.8	3.1
Construction	3	8,240	2,746.7	4.7	2	249	124.5	0.4	1	297	297.0	0.6	6	8,786	1,464.3	3.0	61	13,416	219.9	10.0
Trade	2	570	285.0	0.3	—	—	—	—	—	—	—	—	2	570	285.0	0.2	20	1,538	76.9	1.2
Banking and insurance	3	811	270.3	0.5	—	—	—	—	—	—	—	—	3	811	270.3	0.3	6	7,624	1,270.7	5.7
Transportation	3	3,272	1,090.7	1.9	1	325	325.0	0.5	—	—	—	—	4	3,597	899.3	1.2	18	6,740	374.4	5.0
Services	10	5,784	578.4	3.3	2	475	237.5	0.8	—	—	—	—	12	6,259	521.6	2.2	33	27,407	830.5	20.4
Others	9	1,980	220.0	1.1	23	2,070	90.0	3.4	1	100	100.0	0.2	33	4,150	125.8	1.4	79	7,716	97.7	5.7
Total	143	174,434	1,219.8	100.0	340	60,753	178.7	100.0	42	52,634	1,253.2	100.0	525	287,829	548.2	100.0	632	134,431	212.7	100.0

Source: Overseas Chinese and Foreign Investment Commission, Republic of China: Taiwan.

[a] The data on non-Chinese foreign investments cover the period 1953-1969.

[b] Includes investments of overseas Chinese investors from Hong Kong, Japan and "other" areas.

Table I-4-4. China (Taiwan): Foreign loans from foreign business firms

(in million dollars)

Year	Public enterprises			Private sector			Total
	Credit	Debit	Balance	Credit	Debit	Balance	
1960	4.79	3.72	1.07	21.65	6.68	14.97	16.04
1961	22.42	14.36	8.06	28.52	22.91	5.61	13.67
1962	7.80	10.61	—2.81	5.43	17.01	—11.58	—14.39
1963	9.69	12.31	—2.62	12.59	15.78	—3.19	—5.81
1964	7.47	10.05	—2.58	5.14	8.21	—3.07	—5.65
Sub-total	52.17	51.05	1.12	73.33	70.59	2.74	3.86
1965	11.72	8.24	3.48	6.94	10.08	—3.14	0.34
1966	20.05	8.79	11.26	7.12	4.64	2.48	13.74
1967	15.40	21.18	—5.78	42.53	6.51	36.02	30.24
1968 (2)	6.51	2.27	4.24	24.28	12.56	11.72	15.96
1969 (2)	—	0.24	—0.24	67.33	15.73	51.60	51.36
Sub-total	53.68	40.72	12.96	148.20	49.52	98.62	111.64
Grand total	105.85	91.77	14.08	221.53	120.11	101.42	115.50

Source: Balance of payments statstics compiled by the Economic Research Department of the Central Bank of China.

Notes: (1) Minus sign represents net outflow.

(2) Includes only long-term foreign loans.

Loans, particularly suppliers' credits, have been an important feature of foreign investments in Taiwan. Table I-4-4 presents the relevant data. The private sector has been the major recipient, though public enterprises have also received quite substantial amounts from foreign business firms.

The data do not permit any assessment of the *net* effects of foreign private investments on the country's economy. However, the following table I-4-5 brings together some of the available data on relative inflows and outflows over the period 1967-1969. The coverage is incomplete, nor can the categories be properly matched. Assuming, however, that investment service payments, reimbursement of loans, and royalties and licence fees cover the bulk of the outflows (there may be some double counting), and direct investments and foreign loans (credit entries only) cover the bulk of the inflows (again, there may be some double counting), the ratio of total outflows to total inflows over the period works out at about 42 per cent.

As for over-all effects, it has been estimated that the contribution of foreign and overseas Chinese investment to current national income moved up from 0.2 per cent in 1959 to 7.4 per cent in 1969. Over the period 1960-1967, foreign and overseas Chinese enterprises have contributed about 21 per cent of total exports, but the corresponding import-content of the output of these enterprises is not known. Generally speaking, the foreign and overseas Chinese enterprises may pay higher wages. A recent survey, however, indicates that 62 per cent of the technical personnel and 30 per cent of the skilled workers in foreign enterprises have been drawn away from the labour forces of existing domestic units. This has had some tendency to discourage local entrepreneurs from training their labour force.

Table I-4-5. China (Taiwan): Inflows and outflows on account of foreign investment, 1967, 1968 and 1969

(in million dollars)

	1967	1968	1969	Total
Actual foreign and overseas Chinese direct investment.	27.87	27.88	50.62	106.37
Foreign loans from business firms:				
(a) Public enterprises				
Credit	15.40	6.51	—	21.91
Debit	21.18	2.27	0.24	23.69
Net	—5.78	4.24	—0.24	—1.78
(b) Private enterprises				
Credit	42.53	24.28	67.33	134.14
Debit	6.51	12.56	15.73	34.80
Net	36.02	11.72	51.60	99.34
Total loan credits	57.93	30.79	67.33	156.05
Investment service payments (principal + interest)	6.02	9.74	9.99	25.75
Reimbursement of loans	13.22	21.51	39.19	73.92
Royalty and licence fees	2.47	3.69	3.53	9.69

Source: Overseas Chinese and Foreign Investment Commission, Republic of China, Taiwan.

Table I-4-6. Indonesia: Approved foreign investment projects,[a] 1967-1970 (June), by sector and country
(in million dollars)

Sector	Total	United States	Philippines	Japan	Canada	Singapore and Malaysia	Korea, Rep. of	Other
Agriculture	422.4	29.7	260.0	24.6	—	28.0	48.5	31.6
Plantations[b]	30.6	20.5	—	4.7	—	—	—	5.4
Forestry	378.4	9.2	258.5	9.0	—	28.0	48.5	25.2
Fisheries	13.4	—	1.5	10.9	—	—	—	1.0
Mining	535.5	376.1	—	75.9	76.5	—	—	7.0
Manufacturing	205.6	55.2	0.5	45.4	0.8	26.9	—	76.8
Light industry[c]	78.1	7.4	—	6.6	0.8	22.4	—	40.9
Textiles	52.2	20.0	—	28.5	—	—	—	3.7
Chemical, pharmaceutical	39.7	20.4	0.5	1.5	—	1.5	—	15.8
Basic industry[d]	35.6	7.3	—	8.8	—	3.0	—	16.5
Construction[e]	21.2	7.7	1.0	0.6	—	5.1	—	6.8
Transport and communications	8.2	6.4	—	—	—	0.5	—	1.3
Trade	7.8	0.8	—	2.1	—	2.3	—	2.6
Hotels	10.5	0.5	—	—	—	0.4	—	9.6
Other[f]	6.2	2.1	—	—	—	—	0.9	3.2
Total	1,217.3	478.4	261.5	148.6	77.3	63.3	49.4	138.8
Share of each country (%)	100.0	39.3	21.5	12.2	6.4	5.2	4.1	11.4
Sectoral distribution (%)								
Agriculture	34.7	6.2	99.4	16.6	—	44.3	98.2	22.8
Plantations[b]	2.5	4.3	—	3.2	—	—	—	3.9
Forestry	31.1	1.9	98.8	6.1	—	44.3	98.2	18.1
Fisheries	1.1	—	0.6	7.3	—	—	—	0.7
Mining	44.0	78.6	—	51.1	99.0	—	—	5.0
Manufacturing	16.9	11.5	0.2	30.6	1.0	42.6	—	55.3
Light[c]	6.4	1.6	—	4.4	1.0	35.4	—	29.4
Textiles	4.3	4.2	—	19.2	—	—	—	2.7
Chemical, pharmaceutical	3.3	4.3	0.2	1.0	—	2.4	—	11.4
Basic[d]	2.9	1.5	—	5.9	—	4.8	—	11.9
Construction[e]	1.7	1.6	0.4	0.4	—	8.1	—	4.9
Transport and communications	0.7	1.3	—	—	—	0.8	—	0.9
Trade	0.6	0.2	—	1.4	—	3.6	—	1.9
Hotels	0.9	0.1	—	—	—	0.6	—	6.9
Other[f]	0.5	0.4	—	—	—	—	1.8	2.3
Total[g]	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Foreign Investment Board, *Statistical Data on Foreign Investment in Indonesia*, July 1970.

[a] Excluding petroleum sector and banks.

[b] Including other agriculture.

[c] Mainly foodstuffs and other consumer goods.

[d] Chiefly rubber, mineral, industrial chemical, metal products, machinery (incl. electrical) and transport equipment.

[e] Including housing development and some recreational services constructions.

[f] Listed as "infrastructure", including general contracting, dredging, consultant engineering and an assembly plant for electrical transformers.

[g] Excluding value of withdrawn projects.

Indonesia

A revision of official policies toward foreign private capital has led, since 1967, to increasing capital inflows in Indonesia. Data are available only by approvals. There is some evidence to suggest that the pace of actual realization of proposed and approved investments has not been according to expectations. The Foreign Investment Board has estimated $160 million as the realized total of foreign investment over the period 1967 to August 1970. The annual rate of implementation of the "approvals" is generally 9 per cent of the total projected investment in an approved project, with a lower average (7 per cent) for the first year of any project. The rate of implementation is expected to increase with the restoration of normal infrastructure facilities and the development of the proposed industrial estates.

Table I-4-6 gives the classification of approved foreign investment projects, 1967-1970 (June) by sector and country of origin. Approved investments cover virtually the entire organized sector of agriculture (plantations and forestry), mining, manufacturing, and services. The United States is the chief investing country, followed by the Philippines, Japan and Canada. Substantial amounts of investments have come from the Republic of Korea, Singapore and Malaysia. However, in the absence of detailed information regarding the subsidiaries of multinational companies investing in Indonesia, it is not possible to say how much of the capital from the Philippines, the Republic of Korea, Singapore and Malaysia ultimately originated from developed countries.

An outstanding feature of foreign investment is its concentration in the rich raw material resources of Indonesia. About 75 per cent of total approved investments is in forestry and mining. Forests (31 per cent of total investment) are of interest to the capital coming from the Philippines, Singapore, the Republic of Korea and some European countries, notably Italy. In mining (44 per cent of total investment) there seems to be keen competition among United States, Canadian and Japanese companies for copper, nickel, manganese and other minerals. Bauxite mining is also being investigated.

A recent set of estimates regarding foreign investment approvals over the period 1967 to 1970 (November) gives the following data on the size distribution of the non-oil investments (Table I-4-7). More than two-fifths of the total number of projects are in the smallest class. On the other hand, about one-fifth of the total number of firms in the largest class account for 84 per cent of total capital. The degree of concentration is considerable.

Table I-4-7. Indonesia: Size distribution of approved foreign investment projects, 1967-1970 (November)

Size class (amount of capital)	*Number*	*Percentage of total number*	*Amount of capital (million dollars)*	*Percentage of total capital*
$ 2½ million or more	65	20.6	1,101.17	84.1
Between $1 million and $2½ million	118	37.5	158.32	12.1
Less than $1 million	132	41.9	50.21	3.8
Total	315	100.0	1,309.70	100.0

Table I-4-8 gives the number of projects, amount of capital and average capital per project by sectors. The mining projects seem to be altogether in a different category, their average size being several times greater than the next largest (forestry). Forestry, chemicals and textiles, in that order, have the next largest scales of investment per project. Table I-4-9 gives the shares of different ownership types in the total number of projects and in the total amount of capital approved. It appears that fully foreign-owned projects account for somewhat more than one-fourth of the total number of projects, but about one-third of the total capital. Mining contracts also relate to foreign applicants. The average amount of capital per project is noticeably larger in the fully foreign-owned enterprises (nearly $5 million) than in the joint enterprises (about $1.6 million). There are also interesting inter-country variations in the average investment per project, as shown in table I-4-10.

Table I-4-8. Indonesia: Average size of approved foreign investment projects by sectors, 1967-1970 (November)

Sector	*Number*	*Amount of capital (million dollars)*	*Average capital per project (million dollars)*
Mining	9	535.50	59.50
Manufacturing			
Basic industry	33	50.40	1.53
Light industry	91	90.59	1.00
Textiles	12	53.95	4.50
Chemicals	7	43.24	6.18
Pharmaceuticals	36	29.16	0.81
Forestry	48	381.35	7.94
Fishery	9	13.36	1.48
Transport/communications	7	8.17	1.17
Trade*	10	7.75	0.78
Real estate, construction, housing development	16	30.34	1.90
Infrastructure development	12	7.12	0.59
Hotel business	5	10.49	2.10
Estates, agrobusiness	30	48.19	1.61
Total	325	1,309.61	4.16

Source: Foreign Investment Board, Indonesia.
* Includes crumb rubber projects.

Table I-4-9. Indonesia: Share of different ownership types in approved foreign investment, 1967-1970 (November)

	Total number	Percentage of total number	Amount of capital (million dollars)	Percentage of total capital
Fully foreign-owned	86	27.3	432.90	33.1
Joint enterprise	220	69.8	341.30	26.1
Mining contracts	9	2.9	535.50	40.8
Total	315	100.0	1,309.70	100.0

Source: Foreign Investment Board, Indonesia.

Table I-4-10. Indonesia: Number of projects, amount of investment and average investment per approved project by country of origin, 1967-1970 (November)

Country	Number	Amount (million dollars)	Average (million dollars)
United States	55	517.64	9.41
Japan	52	156.22	3.00
Hong Kong	42	45.71	1.09
Singapore	25	39.08	1.56
Malaysia	18	26.44	1.47
Germany, Fed. Rep. of	17	19.31	1.14
Netherlands	16	31.15	1.95
United Kingdom	15	12.74	0.85
Philippines	13	261.50	20.12
Belgium	11	8.25	0.75
Switzerland	10	12.86	1.29
Australia	8	4.56	0.57
France	7	13.39	1.91
Thailand	6	6.10	1.02
Denmark	4	5.00	1.25
Korea, Rep. of	4	53.30	13.33
Canada	3	77.32	25.77
Panama	3	12.00	4.00
Norway	3	4.23	1.41
Sweden	1	1.20	1.20
Liberia	1	1.00	1.00
India	1	0.64	0.64
Total	315	1,309.64	4.16

Source: Foreign Investment Board, Indonesia.

Iran

The country's vast wealth of oil and gas reserves are of key importance to the economy of Iran. Since investments in petroleum exploration and extraction are not included in promoted foreign private investments,[2] the sectoral distribution in table I-4-11 is misleading. However, the amounts of investment in oil refining and petrochemicals, other chemicals, mining, and metals and metal products indicate the important role of petroleum and other mineral resources in Iran's economic development. While production of other chemicals has received a steady stream of medium-size investments since 1963, the promotion of local processing of oil and gas has shown dramatic results since 1966, with especially large investment volume in 1969/70.

Since 1964/65, promoted direct investments have shown rapid growth and increased concentration in the manufacturing sectors. The absence of promoted investment in textiles and wood and paper products, plus the small amounts invested in food and beverages, transportation equipment, and electric and electronic equipment is significant. Evidently, import substitution in consumer products is not the priority development strategy.

Table I-4-12 demonstrates the striking domination by the United States and nine Western European countries of foreign investment in Iran (95.9 per cent of the 1956-1970 cumulation). The small role of Asian investors would appear to reflect the location of Iran at the extreme western edge of the ECAFE region and the emphasis placed on development of capital-intensive basic industries.

Malaysia

A recent study[3] gives the sectoral classification of investment in fixed assets in Malaysia at the end of 1968 for limited companies, local and foreign controlled, and branches of foreign companies (see table I-4-13). Figures of investment in fixed assets particularly underestimate the total capital operating in the financial and commercial sectors, which are of considerable magnitude and importance in an export economy like Malaysia's. The weightage of the non-manufacturing sector would probably be higher than this table shows, but even going by the book value of fixed assets, the share of non-manufacturing, though lower than the pre-war share, continues to be as high as nearly three-fourths of the total book value of fixed assets. Apparently, branches of foreign companies continue to show a marked preference for non-manufacturing investments: only 4 per cent of their total book value is in the manufacturing sector. About 70 per cent of tin mining was under foreign control in pre-war Malaya, and the share remains more than 60 per cent. More than 80 per cent of the book value of fixed assets in "other mining" and about 75 per cent of that in rubber are under foreign control. It appears that foreign capital continues to occupy a dominant position in the corporate sector as a whole.

[2] Data since 1950 on direct investment flows, investment income, and exports and imports related to the oil sector in Iran are easily available in the IMF, *Balance of Payments Yearbook*, various volumes.

[3] Kanapathy, V., "Foreign Investment in Malaysia: Experience and Prospects", *UMBC Economic Review, vol. VI*, No. 2, 1970.

Table I-4-11. Iran: Sectoral distribution of promoted foreign private investment inflows through September 1970

(million rials)

Sector	1963/64	1964/65	1965/66	1966/67	1967/68	1968/69	1969/70	Cumulation 1956-1970
Food and beverages	3	0	50	2	7	19	32	140
Rubber products	0	52	376	256	70	502	118	1,571
Oil refining and petrochemical	0	0	0	164	60	97	2,107	2,426
Other chemical and drugs	87	64	126	203	204	223	274	1,253
Metals and metal products	15	18	28	95	66	128	283	723
Electric and electronic	32	63	34	78	60	153	176	601
Transportation equipment	19	5	19	17	35	86	77	337
Total manufacturing	156	202	633	815	462	1,208	3,067	7,051
Mining	64	27	146	113	159	274	103	1,113
Construction	37	40	29	0	47	38	64	586
Hotels	0	0	0	0	0	50	30	80
Other	0	11	0	30	0	13	0	49
Total for all sectors	257	280	808	958	668	1,583	3,264	8,879
Sectoral shares								
Food and beverages	1.2%	0%	6.2%	0.2%	1.1%	1.2%	1.0%	1.6%
Rubber products	0	18.6	46.5	26.7	10.5	31.7	3.6	17.7
Oil refining and petrochemical	0	0	0	17.1	9.0	6.1	64.5	27.3
Other chemical and drugs	33.8	22.9	15.6	21.2	30.5	14.1	8.4	14.1
Metals and metal products	5.8	6.4	3.5	9.9	9.9	8.1	8.7	8.1
Electric and electronic	12.5	22.5	4.2	8.2	3.0	9.7	5.4	6.8
Transportation equipment	7.4	1.8	2.3	1.8	5.2	5.4	2.4	3.8
Total manufacturing	60.7	72.2	78.3	85.1	69.2	76.3	94.0	79.4
Mining	24.9	9.6	18.1	11.8	23.8	17.3	3.1	12.5
Construction	14.4	14.3	3.6	0	7.0	2.4	2.0	6.6
Hotels	0	0	0	0	0	3.2	0.9	0.9
Other	0	3.9	0	3.1	0	0.8	0	0.6
Total for all sectors	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Center for the Attraction and Protection of Foreign Investments, Bank Markazi Iran.

Table I-4-12. Iran: Promoted foreign private investment inflows by country of origin

Country	1968/69		1969/70		Cumulation 1956/1970	
	million rls.	per cent	million rls.	per cent	million rls.	per cent
United Kingdom	855	54.1	2,696	82.7	5,615	63.3
United States	242	15.3	118	834	834	9.4
Germany, Federal Republic of	178	11.2	125	3.8	577	6.5
France	67	4.2	99	3.0	471	5.3
Other Western Europe[a]	198	12.5	76	2.3	1,010	11.4
Other	43	2.7	150	4.6	372	4.1
Total	1,583	100.0	3,264	100.0	8,879	100.0

Source: Center for the Attraction and Protection of Foreign Investments, Bank Markazi Iran.

[a] Netherlands, Belgium, Switzerland, Italy, Denmark, and Sweden.

Table I-4-13. Malaysia: Book values of company fixed assets, 1968

(value in million Malaysian dollars)

Item	Rubber		Other agriculture		Tin mining		Other mining		Manufacturing		Construction		Wholesale trade		Retail trade		Other industry		All industries	
	Amount	% of total	Amount	% of total	Amount	% of total	Amount	% of total	Amount	% of total	Amount	% of total	Amount	% of total	Amounts	% of total	Amount	% of total	Amount	% of total
Limited companies incorporated in Malaysia:																				
Locally controlled . . .	265	25.41	107	46.32	119	39.27	23	15.54	489	50.83	32	71.11	120	34.29	45	68.18	428	71.93	1,628.0	43.49
	(16.28)		(6.57)		(7.31)		(1.41)		(30.04)		(1.97)		(7.37)		(2.76)		(26.29)		(100.00)	
Limited companies incorporated in Malaysia:																				
Foreign controlled . . .	203	19.46	54	23.38	70	23.10	105	70.95	426	44.28	4.5	10.00	75	21.43	20	30.30	84	14.12	1,041.5	27.83
	(19.49)		(5.18)		(6.72)		(10.08)		(40.90)		(0.43)		(7.20)		(1.92)		(8.07)		(100.00)	
Malaysian branches of foreign companies	575	55.13	70	30.30	114	37.62	20	13.51	47	4.89	8.5	18.89	155	44.28	1	1.52	83	13.95	1,073.5	28.68
	(53.56)		(6.52)		(10.62)		(1.86)		(4.38)		(0.79)		(14.44)		(0.09)		(7.73)		(100.00)	
Total	1,043	100.00	231	100.00	303	100.00	148	100.00	962	100.00	45.0	100.00	350	100.00	66	100.00	595	100.00	3,743.0	100.00
	(27.87)		(6.17)		(8.10)		(3.95)		(25.70)		(1.20)		(9.35)		(1.76)		(15.90)		(100.00)	

Source: *Report on the Financial Survey of Limited Companies in Malaysia*, 1969, and other official sources. Figures represent book values of net assets. "Book values are not a particularly good measure of the net worth of foreign direct investments. Rubber, which is yet the single largest investment, is a good example. Taking a conservative estimate of M$1,000 per acre, investment in West Malaysia's 4.3 million acres alone works out at about M$4,300 million. The book value for rubber amounts to only M$1,043 million " (V. Kanapathy, "Foreign Investment in Malaysia: Experience and Prospects", *UMBC Economic Review*, vol. VI, No. 2, 1970).

Note: "Foreign" excludes resident Chinese. Figures in parentheses represent percentages of horizontal totals.

Table I-4-14. West Malaysia: "Pioneer" firms, called-up capital, by sector and country of origin 1962[a]

(in million Malaysian dollars)

Industry	*Total*	*Domestic*	*Singapore*	*United Kingdom*[b]	*United States*	*Hong Kong*	*Other foreign*	*Other*[c]
Food, beverages	18.3	0.3	9.1	5.0	1.6	—	0.5	1.8
Textiles, garments	4.0	—	1.2	—	—	2.8	—	—
Wood, furniture	0.3	—	0.3	—	—	—	—	—
Paper, printing	2.0	—	—	—	—	—	2.0	—
Leather, rubber	12.0	—	—	7.4	—	—	—	4.6
Chemicals	16.2	3.3	1.7	6.0	—	1.4	2.3	1.5
Petroleum	30.6	0.4	0.1	—	—	—	22.6	7.5
Mineral	2.4	0.3	1.8	—	—	—	0.3	—
Metals, metal products	5.7	0.6	3.0	0.2	—	—	1.5	0.4
Machinery, transport equipment	0.9	—	0.5	—	—	—	0.4	—
Electrical machinery	5.6	0.3	0.3	2.5	1.9	—	0.4	0.2
Miscellaneous	1.0	0.6	0.1	—	—	—	—	0.3
Unidentified[d]	—	7.2	1.6	—	—	—	—	(—8.8)
Total	99.0	13.0	19.7	21.1	3.5	4.2	30.0	7.5
Ownership shares (%)	100.0	13.1	19.8	21.2	3.6	4.4	30.3	7.6
Industry distribution (%)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	
Food, beverages	18.6	2.3	46.2	23.7	45.7	—	1.7	
Textiles, garments	4.0	—	6.1	—	—	66.7	—	
Wood, furniture	0.3	—	1.5	—	—	—	—	
Paper, printing	2.0	—	—	—	—	—	6.7	
Leather, rubber	12.1	—	—	35.1	—	—	—	
Chemicals	16.5	25.4	8.6	28.4	—	33.3	7.7	
Petroleum	30.9	3.1	0.5	—	—	—	75.3	
Mineral	2.4	2.3	9.1	—	—	—	1.0	
Metals, metal product	5.7	4.6	15.2	1.0	—	—	5.0	
Machinery, transport equipment	0.9	—	2.6	—	—	—	1.3	
Electrical machinery	5.5	2.3	1.5	11.8	54.3	—	1.3	
Miscellaneous	1.0	4.6	0.5	—	—	—	—	
Unidentified[d]	—	55.4	8.1	—	—	—	—	

Source: Ministry of Commerce and Industry and Registrar of Companies, in Wheelwright, *Industrialization in Malaysia* (1965), pp. 47-54.

Note: Minor discrepancies due to rounding.

[a] June 1962, except for M$30 million in petroleum refining, October 1962. (Shell Company).

[b] Includes Bahamas, M$5 million in foods.

[c] Mainly residuals.

[d] Unidentified by industry; included in other.

In the manufacturing group alone, one-half of the sectoral book value of fixed assets is accounted for by limited companies under local control. It is noteworthy, however, that manufacturing accounts for nearly 41 per cent of the fixed assets of the foreign-controlled companies, but only 30 per cent of the fixed assets of the locally-controlled companies.

Supplementary information on the banking and insurance group shows that the share of total banking deposits held with foreign banks amounted to 63.6 per cent at the end of 1969, 22 of the 38 commercial banks being foreign. Foreign-owned companies supply (in value terms) well over 70 per cent of the manufactured goods in Malaysia. Of M$678 million of total company profits before tax in Malaysia in 1968, foreign companies accounted for M$455 million.[4]

Data for different industries of the manufacturing group are available for "pioneer" firms in West Malaysia alone. These data are available for two time points, 1962 and 1969, as presented in tables I-4-14 and I-4-15, but separate data are not available for Japanese investments in 1962. The largest share in 1962 was that of the unclassified "other foreign" category (30 per cent), followed by the United

[4] The data in this paragraph are taken from V. Kanapathy, *op. cit.*, pp. 6-7. According to Reddaway, the post-tax profitability rate of United Kingdom investments in Malaysia was 18.8 per cent, as against 8.2 per cent in India and 8.8 per cent on the average for the fifteen countries covered by him. See W. B. Reddaway, *op. cit.*

Kingdom and Singapore. Some of the Singapore capital might have been British. In sectoral composition, petroleum led, followed by food and beverages, chemicals, and leather and rubber. Food and beverages, leather and rubber, and petroleum together accounted for more than 60 per cent of all investments in "pioneer" firms, domestic and foreign in 1962; chemicals for another 16.5 per cent.

The picture (table I-4-15) changes somewhat in 1969. The United Kingdom's share has shrunk from 21 per cent to 17 per cent, while the share of domestic capital has increased from 13 per cent to 38 per cent. The United States' share of capital has gone up to nearly 11 per cent from less than 4 per cent. Japan has emerged as a significant investor, while the shares of Singapore and Hong Kong have shown relatively little change. Among the various industries, textiles and basic metals have registered gains, but leather and rubber have registered noticeable declines. Food and beverages, and petroleum, together, continue to account for about 41 per cent of total investments in all "pioneer" firms in 1969, as against about 50 per cent in 1962. The share of chemicals was 13.5 per cent in 1969, against 16.5 per cent in 1962. Machinery and transport equipment have not yet become of significant importance in the industrial structure of Malaysia.

Table I-4-15. West Malaysia: "Pioneer" firms, called-up capital, 1969[a] by sector

(in million Malaysian dollars)

Industry	*Total*	*Domestic*	*Singapore*	*United Kingdom*[b]	*United States*	*Japan*	*Hong Kong*	*Other*
Food, beverages	101.7	38.6	25.4	12.6	4.0	8.1	9.9	3.1
Textiles, garments	45.5	26.2	6.8	0.7	—	3.5	6.5	1.8
Wood, furniture	23.4	20.5	1.1	—	—	0.4	—	1.4
Paper, printing	6.1	4.1	2.0	—	—	—	—	—
Leather, rubber	21.9	6.0	3.7	12.2	—	—	—	—
Chemicals	63.7	16.4	8.7	25.4	—	0.4	11.4	1.7
Petroleum	92.8	17.8	12.9	22.7	39.2	—	0.1	0.1
Mineral	19.7	6.6	6.7	1.8	—	1.4	0.1	3.1
Metals, basic	53.7	29.7	0.5	—	3.7	15.2	0.3	4.3
Metal products	12.8	3.0	8.2	—	—	0.5	0.9	0.2
Machinery, transport equipment	7.0	2.4	2.4	1.1	1.1	—	—	—
Electrical machinery	18.3	5.7	1.1	3.1	2.9	2.4	1.6	1.5
Miscellaneous	4.9	4.0	0.5	0.1	—	0.3	—	—
Total	471.6	181.0	80.0	79.7	50.9	31.9	30.8	17.2
Ownership shares (%)	100.0	38.4	17.0	16.9	10.8	6.7	6.6	3.6
Industry distribution (%)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	
Food, beverages	21.6	21.3	31.8	15.8	7.9	25.4	32.1	
Textiles, garments	9.6	14.5	8.5	0.9	—	11.0	21.1	
Wood, furniture	5.0	11.3	1.4	—	—	1.3	—	
Paper, printing	1.3	2.3	2.5	—	—	—	—	
Leather, rubber	4.7	3.3	4.6	15.3	—	—	—	
Chemicals	13.5	9.1	10.9	31.9	—	0.3	37.0	
Petroleum	19.7	9.8	16.1	28.5	77.0	—	0.3	
Mineral	4.2	3.6	8.4	2.3	—	4.4	0.3	
Metals, basic	11.4	16.4	0.6	—	7.3	47.7	1.0	
Metal products	2.7	1.7	10.2	—	—	1.6	2.9	
Machinery, transport equipment	1.5	1.3	3.0	1.4	2.2	—	—	
Electrical machinery	3.9	3.2	1.4	3.9	5.7	7.5	5.2	
Miscellaneous	1.0	2.2	0.6	0.1	—	0.9	—	

Source: Federal Industrial Development Authority.

Note: Minor discrepancies due to rounding.

[a] At 31 December 1969.

[b] Includes Bahamas, M$7 million in foods.

Pakistan

While the annual flows of foreign private investment into Pakistan did not grow during the period 1964 through 1968,[5] there was a marked shift from the primary and tertiary sectors toward manufacturing projects, which absorbed five-sixths of 1968 investment, compared with one-third at the beginning of the period(table I-4-16). Unfortunately, data were not available on the division of investments between the various manufacturing sectors, so the full significance of the shift is not clear. However, the over-all decline in flows to commerce (which includes banking, insurance and trading) and transportation, storage and communication would indicate a reduced role for foreign private investors in infrastructure services. Since processing of agricultural, forestry and fishery products is included in the agriculture sector, which received a decreasing share after 1965, it is also possible to infer that some shift in foreign investment has occurred toward heavier industries. With regard to the over-all importance of foreign private capital in the Pakistan economy, it has been estimated that the proportion of total corporate business owned by foreigners fell from about 30 per cent in 1962 to about 15 per cent in 1967.[6]

The United Kingdom has been the largest source of private capital for Pakistan, although its share of foreign investment fell from 50 per cent in 1960 to 36 per cent in 1967, when the United States share was 17 per cent. Other important sources of private capital have included the Federal Republic of Germany, Japan, France, Switzerland and India. Annual inflows by countries are shown in table I-4-17. United Kingdom investments declined between 1964 and 1968, but there were only small fluctuations in the intervening years. On the other hand, both United States and "other" countries' investments fell sharply in 1965 and 1966, but then recovered to levels in 1968 higher than four years before. Even though the data cover a very short period, these diverse patterns would appear to reflect a large volume of reinvestment by established British enterprises.

Reinvested earnings fluctuated between 22.6 per cent and 45.5 per cent of total inflows from 1964 to 1968. Table I-4-18 displays the average compositions of foreign private capital flows to Pakistan for three-year periods, 1960-1968. Actual transfers of foreign exchange declined from 20 per cent in 1960-1962 to 10 per cent in 1966-1968, while direct exports of capital goods by the investor increased from 33 per cent to 56 per cent. These trends, if valid in other countries, would indicate an increasing connexion between export promotion and foreign investment. While remittances by foreign investment enterprises for royalties, trade marks and technical fees were sharply curtailed in 1965 and recovered only slowly, dividend remittances increased sharply over the period, as recorded in table I-4-17. Outflows of these two types of remittances exceeded actual foreign capital inflows each year. The net outflow related to foreign investment was especially large in 1966 and 1967, but was improved in 1968. It should be emphasized that a simple comparison of the net balance of payments effects of foreign private investment may be quite misleading. Evaluation of the secondary effects on export promotion, import substitution, and changes generated by the demonstration effects of foreign investment is needed before the value of foreign investments can be judged.

[5] Inflows had reached a historic high in 1964.

[6] Chaudhry, Shahid Amjad, "Private Foreign Investment in Pakistan", *Pakistan Development Review*, Spring 1970, p. 101.

Table I-4-16. Pakistan: Sectoral distribution of foreign private investment inflows, including reinvested earnings

Sector	*Value (million dollars)*					*Shares (per cent)*				
	1964	*1965*	*1966*	*1967*	*1968*	*1964*	*1965*	*1966*	*1967*	*1968*
Agriculture	1.0	2.5	1.0	0.2	0.2	3.6	13.7	8.9	1.3	0.8
Mining	2.7	1.2	1.1	1.7	1.7	9.6	6.6	9.7	11.5	6.8
Manufacturing	9.3	6.6	6.3	8.8	20.9	33.1	36.3	55.8	59.9	83.6
Construction	7.9	1.2	—0.3	1.1	0.4	28.1	6.6	—2.7	7.5	1.6
Transportation, storage and communication	2.4	5.1	0.1	0.1	0.1	8.5	28.0	0.9	0.7	0.4
Commerce	4.7	1.5	3.1	1.2	1.6	16.7	8.2	27.4	8.2	6.4
Other	0.1	0.1	0	1.6	0.1	0.4	0.6	0	10.9	0.4
Total for all sectors	28.1	18.2	11.3	14.7	25.0	100.0	100.0	100.0	100.0	100.0

Source: State Bank of Pakistan, *Foreign Liabilities and Assets and Private Foreign Investments in Pakistan*, 1964-66, 1966-68 issues.

Table I-4-17. Pakistan: Foreign private investment inflows by country of origin and related outflows by type

	Value (million dollars)					*Shares (per cent)*				
	1964	*1965*	*1966*	*1967*	*1968*	*1964*	*1965*	*1966*	*1967*	*1968*
Inflows:										
United Kingdom	11.4	10.0	8.1	8.5	6.3	40.6	55.0	72.3	58.2	25.3
United States	9.3	3.5	0.9	0.7	10.6	33.1	19.2	8.0	4.8	42.6
Other	7.4	4.7	2.2	5.4	8.0	26.3	25.8	19.7	37.0	32.1
Total	28.1	18.2	11.2	14.6	24.9	100.0	100.0	100.0	100.0	100.0
Less reinvested earnings	7.7	5.5	5.1	3.3	6.9	27.4	30.2	45.5	22.6	27.7
Actual inflows	20.4	12.7	6.1	11.3	18.0	72.6	69.8	54.5	77.4	72.3
Outflows:										
Dividend remittances	6.4	6.8	10.2	11.9	11.2	29.8	43.6	49.5	54.8	50.7
Payments for royalties, trademarks technical fees[a]	15.1	8.8	10.4	9.8	10.9	70.2	56.4	50.5	45.2	49.3
Total outflows of earnings (excluding interest remittances)	21.5	15.6	20.6	21.7	22.1	100.0	100.0	100.0	100.0	100.0

Sources: Department of Investment Promotion and Supplies; State Bank of Pakistan.
[a] Remittances made by foreign investment enterprises.

Table I-4-18. Pakistan: Composition of foreign private investment

(average annual shares in percentage)

Composition	*1960-1962*	*1963-1965*	*1966-1968*	*1960-1968*
Foreign exchange brought in	20	17	10	16
Capital equipment brought in	33	53	56	47
Reinvested earnings	47	30	34	37
Total	100	100	100	100

Source: State Bank of Pakistan, *Foreign Liabilities and Assets and Private Foreign Investments in Pakistan*, various issues.

The Philippines

In contrast with other countries, detailed data are available from the Philippines on foreign investments in the primary and tertiary sectors, but not for the distribution among different types of manufacturing. Table I-4-19 presents the country sources and sectoral distribution of non-financial corporate capital in the Philippines as of 1965. Almost one-third of the stock of capital was foreign owned, with foreign capital especially important in manufacturing, commerce and public utilities. About 70 of the 100 largest corporations are said to be foreign-owned. Among foreign investors United States firms clearly dominated with 67 per cent of foreign capital, or 21 per cent of total Philippines non-financial corporate capital, reflecting the 70 year old special relationship between the two countries, which has been continued since Philippine independence under the Bell Act and the Laurel-Langley Agreement. Japanese investment has been comparatively small in the Philippines because the treaty of commerce and navigation between the two countries has not yet been ratified.

The Investment Incentives Act of 1967 has required that all enterprises in non-pioneering industries must be controlled by Filipinos to the extent of 60 per cent of the voting stock. Pioneering industries, which require heavy capital investment and modern technology, can be established with up to 100 per cent foreign ownership. However, after ten years steps must be initiated to reduce foreign equity in such industries, with 60 per cent Filipino ownership required by the twentieth year (this time limit may be extended to a maximum of forty years by the Board of Investment). Since enactment of this legislation, the inflow of foreign capital has been small, as shown in table I-4-20. Annual average inflows of new foreign investment fell to 9.5 million pesos, or 2.3 per cent of total new investment, during 1967-1969, compared with an annual average of 18.9 million pesos, or 5.4 per cent of the total, from 1962 through 1966. The United States continued to predominate, with 45 per cent of foreign investment during 1967-1969, but this was only 1.0 per cent of the total new investment in the period. Furthermore, only 14 per cent of recent United States investment went to the manufacturing sector, compared with 52 per cent of the United States capital outstanding in 1965. Filipino investment in manufacturing fell off somewhat less, to 17.5 per cent in 1967-1969. In comparison, almost 35 per cent of other foreign investment was allocated to manufacturing. The nature of, and reason for, the large United States investment in real estate since 1967 is not clear, but may be related to the scheduled termination in 1974

Table I-4-19. Philippines: Distribution of total non-financial corporate equity and long-term debt by sector and country of ownership, 1965
(in million pesos)

Sector	Grand total	Filipino[a]	Total foreign	United States	United Kingdom	Spain	Other
Agriculture, forestry, fishery	275	232	43	35	—	6	2
Mining	657	373	284	169	17	5	93
Manufacturing	3,792	2,500	1,292	958	77	84	173
Construction	93	75	18	18	—	—	—
Real estate	526	502	24	18	3	1	2
Utility, transportation	1,397	969	428	203	3	13	209
Commerce	1,008	524	484	346	59	12	67
Other services	810	663	147	85	1	60	1
All sectors	8,558	5,838	2,720	1,832	160	181	547
Share: All sectors	100%	68.2%	31.8%	21.4%	1.9%	2.1%	6.4%
Share: Foreign	—	—	100	67.3	5.9	6.7	20.1
Share: Manufacturing	100	65.9	34.1	25.3	2.0	2.2	4.6
Sectoral shares							
Agriculture, forestry and fishery	3.2%	4.0%	1.6%	1.9%	—%	3.3%	0.4%
Mining	7.7	6.4	10.4	9.2	10.6	2.8	17.0
Manufacturing	44.3	42.8	47.5	52.3	48.1	46.4	31.6
Construction	1.1	1.3	0.7	1.0	—	—	—
Real estate	6.1	8.6	0.9	1.0	1.9	0.6	0.4
Utility, transportation	16.3	16.6	15.7	11.1	1.9	7.2	38.2
Commerce	11.8	9.0	17.8	18.9	36.9	6.6	12.2
Other services	9.5	11.3	5.4	4.6	0.6	33.1	0.2
All sectors	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Based on Poblador, Niceto S., "Foreign Investment in the Major Non-financial Corporate Sector of the Philippines, 1964 and 1965", School of Economics, University of the Philippines, discussion paper No. 69-23, appendix tables.
[a] Including Chinese residing in the Philippines.

Table I-4-20. Philippines: Annual average investment flows to newly-registered non-financial businesses by sector and country of ownership, 1967-1969
(in million pesos)

Sector	Grand total	Filipino[a]	Total foreign	United States	Other
Agriculture, forestry, fishery	29.3	28.9	0.4	0.2	0.2
Mining	14.8	14.3	0.5	0.4	0.1
Manufacturing	72.0	69.6	2.4	0.6	1.8
Construction	19.6	19.2	0.4	0.3	0.1
Real estate	51.8	50.1	1.7	1.6	0.1
Utility, transportation	30.8	30.6	0.2	0.1	0.1
Commerce	140.5	137.3	3.2	0.7	2.5
Other services	48.3	47.6	0.7	0.4	0.3
All sectors	407.1	397.6	9.5	4.3	5.2
Share: All sectors	100%	97.7%	2.3%	1.0%	1.3%
Share: Foreign	—	—	100	45.3	54.7
Share: Manufacturing	100	96.7	3.3	0.8	2.5
Sectoral shares					
Agriculture, forestry, fishery	7.2%	7.3%	4.2%	4.6%	3.9%
Mining	3.6	3.6	5.2	9.3	1.9
Manufacturing	17.7	17.5	25.3	14.0	34.6
Construction	4.8	4.8	4.2	7.0	1.9
Real estate	12.7	12.6	17.9	37.2	1.9
Utility, transportation	7.6	7.7	2.1	2.3	1.9
Commerce	34.5	34.5	33.7	16.3	48.1
Other services	11.9	12.0	7.4	9.3	5.8
All sectors	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Based on Virata, Cesar, "Foreign Investments by Advanced Countries in the Philippines", paper presented to Third Pacific Trade and Development Conference, Sydney, August 1970.
[a] Includes Chinese residing in the Philippines.

Table I-4-21. Republic of Korea: Foreign investments and investment income payments, 1959/62-1970

(in million dollars)

Year	Total	Public loan[a]						Commercial loan[a]							Direct or joint investment[a]				Investment income payment[b]
		Sub-total	United States	Japan	Germany, Fed. Rep. of	IBRD-ADB	Others	Sub-total	United States	Japan	Germany, Fed. Rep. of	France	United Kingdom	Others	Sub-total	United States	Japan	Others	
1959/1962	77.5	73.5	49.9	—	9.6	—	14.0	1.9	—	—	1.4	—	0.5	—	2.1	2.1	—	—	0.123
1963	69.8	9.1	9.1	—	—	—	—	55.3	33.8	—	16.6	2.5	—	2.4	5.4	5.4	—	—	0.170
1964	99.5	35.4	29.8	—	4.4	—	1.2	63.3	6.3	0.4	16.4	20.5	—	19.7	0.8	0.4	—	0.4	1.785
1965	176.6	76.7	71.5	—	5.2	—	—	78.1	3.3	70.8	—	—	—	4.0	21.8	21.0	0.7	0.1	2.011
1966	260.6	153.5	95.0	44.9	13.6	—	—	105.1	3.4	67.1	22.7	11.2	0.7	—	2.0	1.9	—	0.1	3.251
1967	250.1	73.8	32.0	29.9	—	—	11.9	155.4	21.0	36.2	39.5	12.5	1.8	44.4	20.9	18.5	1.7	0.7	10.807
1968	577.8	61.9	28.0	18.6	—	11.8	3.5	483.9	153.5	110.0	48.6	29.3	53.5	89.0	32.0	17.0	8.5	6.5	17.469
1969	904.7	233.2	114.9	11.3	—	89.5	17.5	622.8	217.3	71.9	48.1	129.0	56.2	100.3	48.7	15.1	26.7	6.9	41.518
1970	310.4	116.9	60.5	—	—	40.0	16.4	145.2	54.9	34.6	1.0	0.4	42.9	11.4	48.3	36.4	9.5	2.4	39.997
Total	2,727.0	834.0	490.7	104.7	32.8	141.3	64.5	1,711.0	493.5	391.0	194.3	205.4	155.6	271.2	182.0	117.8	47.1	17.1	117.221

Source: Economic Planning Board, *Major Economic Indicators 1959-1970*, Seoul, 1970, table 13-14, pp. 80-81.

[a] 1970: Total of first seven months of the year.

[b] 1970: Total of first six months of the year.

of the privileged status accorded to Americans under the Laurel-Langley Agreement. It should be emphasized that three years is not a long enough period to evaluate the long-run effects of the new foreign investment regulations. Nevertheless, the apparent initial dampening effect of the Investment Incentive Act on foreign capital inflows would appear to be indicative of the delicacy with which this type of regulation must be approached.

Republic of Korea

In the Republic of Korea, at the end of October 1970, there were 230 projects on the active list for approval, amounting to $183 million. Of these, 37 cases with a total investment of $32 million were wholly foreign owned. United States investment was involved in 86 cases amounting to $116 million, and Japanese investment in 84 cases amounting to $29 million. Thus, United States investments amount to 37.4 per cent of the total number of projects and 63.2 per cent of the total value of investment. The corresponding Japanese shares are 36.5 per cent and 16 per cent, indicating the relative smallness of the Japanese projects. However, it is not clear how foreign "investment" is defined in these data.[7]

[7] These data are taken from Yoonsae Yang, *Foreign Investment in Korea*, Office of Investment Promotion, Seoul, 1970. From the context it appears that total foreign "investment" consists of equity shares and long-term loans ("Equity Type B"). As of the end of 1969, Korean residents in Japan had invested $21.3 million in 37 projects (reported in *Korean Business Review*, March 1970).

The characteristic feature of foreign investments in the Republic of Korea is the preponderance of loan capital. Table I-4-21 gives the analysis of foreign investments by type and country of origin over the period 1959/1962 to 1970. The United States and Japan predominate, in that order, in all the three categories. Commercial loans account for more than 60 per cent of all foreign investments, public or private. These loans seem to have carried rather easy terms, as the low magnitude of investment income payments suggests. It is possible, however, that the return flows have just started, which is likely in view of the fact that the rate of acceleration in the return flows has been rather high.

As for direct investments,[8] the data collected in the course of the present survey (table I-4-22) shows that United States affiliates account for 65 per cent of total foreign direct investments, followed by Japanese affiliates whose share is about 27 per cent. The 50-100 per cent ownership category accounts for 70 per cent of all direct investments.

Among the various categories of private loan capital, export credits predominate. The total export credits of more than three-year duration disbursed as of 30 September 1970 are distributed as follows among the various countries (table I-4-23).

[8] The country sources have included the 0-25 per cent foreign-owned firms in the category of direct investment.

Table I-4-22. Republic of Korea: Direct foreign investments classified by country sources and type of control, as at the year ending 31 October 1970

(in thousand dollars)

Country	Type of control: 100% foreign-owned		50-100% foreign-owned		25-50% foreign-owned		0-25% foreign-owned		Total	
	Amount	% share to total	Amount	% share to total	Amount	% share to total	Amount	% share to total	Amount	% share to total
Japan	6,462	13.2 (20.2)	32,736	66.9 (25.4)	9,608	19.7 (51.1)	100	0.2 (2.7)	48,906	100.0 (26.7)
United States	25,464	21.8 (79.8)	87,049	74.4 (67.6)	4,324	3.7 (23.0)	148	0.1 (4.0)	116,985	100.0 (63.8)
United Kingdom	—	—	60	100.0 (0.05)	—	—	—	—	60	100.0 (0.1)
Other Western Europe[a]	—	—	6,741	93.6 (5.2)	416	5.8 (2.2)	44	0.6 (1.2)	7,201	100.0 (3.9)
Other ECAFE[b]	—	—	200	10.7 (0.2)	1,663	89.3 (8.8)	—	—	1,863	100.0 (1.0)
Other[c]	—	—	2,050	24.8 (1.6)	2,802	34.0 (14.9)	3,400	41.2 (92.1)	8,252	100.0 (4.5)
Total	31,926	17.4 (100.0)	128,836	70.3 (100.0)	18,813	10.3 (100.0)	3,692	2.0 (100.0)	183,267	100.0 (100.0)

Source: Office of Investment Promotion, Republic of Korea.

Note: Figures in parenthesis are the percentage shares of the vertical totals.

[a] Federal Republic of Germany, Italy, Netherlands.

[b] Hong Kong, China (Taiwan).

[c] Panama, IFC.

Table I-4-23. Republic of Korea: Export credits of more than three-year duration by source, as of 30 September 1970

Source country	Amount (million dollars)	Percentage share of total
United States	514.1	29.4
Japan	397.5	22.7
United Kingdom	156.6	9.0
Germany, Federal Republic of	196.9	11.3
France	209.9	12.0
Italy	86.0	4.9
Switzerland	20.0	1.2
Others	166.6	9.5
Total	1,748.2	100.0

The United States and Japan together account for 52 per cent of all export credits to the Republic of Korea, followed by France, the Federal Republic of Germany and the United Kingdom, in that order, which together account for about one-third of the total.

A relatively comprehensive sectoral breakup of the direct investments is available for the Republic of Korea. Table I-4-24 gives the data by sectors and country of origin. About one-third of all foreign direct investments are in the non-manufacturing sectors, of which somewhat less than two-thirds is accounted for by oil and gas, almost entirely under United States affiliates. More than two-fifths of all direct investments are in two categories of manufacturing: chemicals and drugs, and electrical machinery and equipment. Those two sectors account for nearly 33 per cent of all Japanese, and 45 per cent of all United States direct investments. Japanese investments are substantial also in textiles and apparel (66.2 per cent of all foreign investments in this industry) and in metals (99 per cent). On the other hand, United States investments predominate in electrical machinery and equipment (67 per cent of all foreign investments in this industry). Of total foreign direct investment in the manufacturing sector, about one-third is Japanese and one-half United States.

In the absence of data on other related indicators, it is difficult to assess the implications of such sectoral composition for technology transfer. About 15 per cent of the total exports of the Republic of Korea came from foreign direct investment enterprises in 1969. Without data on the import content of the output of foreign investment enterprises, it is not possible to assess the *net* effect on the balance of payments.

Singapore

Some data are available for Singapore for the year 1966. The performance of "pioneer" firms reflected in these data largely represents the situation obtaining in these firms as a result of their evolution prior to the separation of Singapore and Malaysia.

Table I-4-25 gives values of raw materials used (both imported and local), value added, and classification of sales by destination. It is noteworthy that: (*a*) the percentage share of imported raw materials was 91 per cent for "pioneer" firms with foreign participation, and 61 per cent for firms totally Singapore-owned; (*b*) value added locally per unit of materials imported was about 0.31 for the firms with foreign participation, and 1.0 for firms totally Singapore-owned; and (*c*) the ratio of the value of imported raw materials to total exports was about 2.1 for firms with foreign participation, and 0.7 for firms totally Singapore-owned.

Though imports here include imports from Malaysia (as do exports), it would appear that "pioneer" firms with foreign participation operating in Singapore in 1966 did not have a favourable impact on the balance of payments to the extent that these firms generally were importing much more than they were exporting. In particular, the fully Singapore-owned firms seem to have had a better impact on the balance of payments. The study[9] from which the above table is derived gives an analysis of foreign investments in Singapore till 1966. Not much can be added. Since then, however, another set of data has become available on the sectoral composition of the outstanding foreign share capital in "pioneer" firms as of 31 December 1967. These data are presented in table I-4-26.

Basic metals and engineering, petroleum and petroleum products, and food and beverages, in that order, followed by textiles, chemicals, and rubber and leather, account for the largest shares of total foreign and local investments. Taken separately, they are broadly similar, except that petroleum and rubber account for larger shares of foreign investments than of local investments; the ratio of foreign investments to local investments is also noticeably higher in these two sectors (85.1 per cent and 85.5 per cent respectively). The over-all ratio of foreign investments to local investments is 50 per cent.

[9] Helen Hughes and You Poh Seng, ed., *Foreign Investment and Industrialization in Singapore* (Australian National University Press, Canberra, 1969).

Table I-4-24. Republic of Korea: Direct foreign investments by sectors and sources, outstanding at the year end 31 October 1970

(in thousand dollars)

Sector \ Sources	Japan		United States		Other W. European countries		Other ECAFE countries		Other countries		Total	
	Amount	% share to total	Amount	% share to total	Amount	% share to total	Amount	% share to total	Amount	% share to total	Amount	% share to total
Manufacturing:												
Food and beverages	279	0.6 (18.3)	1,203	1.0 (78.7)	—	—	—	—	46	0.6 (3.0)	1,528	0.8 (100.0)
Textiles and apparel	12,633	25.8 (66.2)	4,716	4.0 (24.7)	35	0.5 (0.2)	1,400	75.2 (7.3)	307	3.7 (1.6)	19,091	10.4 (100.0)
Wood and pulp products	—	—	1,283	1.1 (100.0)	—	—	—	—	—	—	1,283	0.7 (100.0)
Chemicals and drugs	3,055	6.3 (8.2)	25,962	22.2 (69.4)	6,969	96.8 (18.7)	—	—	1,400	17.0 (3.7)	37,386	20.4 (100.0)
Metals	8,728	17.9 (99.0)	—	—	89	1.2 (1.0)	—	—	—	—	8,817	4.8 (100.0)
Electrical machinery and equipment	12,835	26.2 (32.7)	26,430	22.6 (67.3)	—	—	—	—	—	—	39,265	21.4 (100.0)
Transport equipment	289	0.6 (27.8)	750	0.6 (72.2)	—	—	—	—	—	—	1,039	0.6 (100.0)
Other machinery	3,773	7.7 (64.1)	1,851	1.6 (31.4)	—	—	263	14.1 (4.5)	—	—	5,887	3.2 (100.0)
Other manufacturing	2,338	4.8 (25.9)	2,559	2.2 (28.3)	—	—	—	—	4,134	50.1 (45.8)	9,031	4.9 (100.0)
Sub-total	43,930	89.9 (35.6)	64,754	55.3 (52.5)	7,093	98.5 (5.8)	1,663	89.3 (1.3)	5,887	71.4 (4.8)	123,327	67.3 (100.0)
Non-manufacturing:												
Agriculture	197	0.4 (24.1)	517	0.5 (63.4)	—	—	—	—	102	1.2 (12.5)	816	0.4 (100.0)
Forestry and fishery	612	1.2 (94.2)	—	—	—	—	—	—	38	0.5 (5.8)	650	0.3 (100.0)
Oil and gas	—	—	36,282	31.0 (99.7)	108	1.5 (0.3)	—	—	—	—	36,390	19.8 (100.0)
Mining	312	0.6 (100.0)	—	—	—	—	—	—	—	—	312	0.2 (100.0)
Banking and other financial	—	—	1,700	1.5 (46.9)	—	—	—	—	1,925	23.3 (53.1)	3,625	2.0 (100.0)
Commerce: Wholesale and retail	—	—	—	—	—	—	—	—	—	—	—	—
Other non-manufacturing	3,855	7.9 (21.3)	13,732	11.7 (75.9)	—	—	200	10.7 (1.1)	300	3.6 (1.7)	18,087	10.0 (100.0)
Sub-total	4,976	10.1 (8.3)	52,231	44.7 (87.2)	108	1.5 (0.2)	200	10.7 (0.3)	2,365	28.6 (4.0)	59,880	32.7 (100.0)
Grand total	48,906	100.0 (26.7)	116,985	100.0 (63.9)	7,201	100.0 (3.9)	1,863	100.0 (1.0)	8,252	100.0 (4.5)	183,207	100.0 (100.0)

Source: Office of Investment Promotion, Republic of Korea.
Note: Figures in parenthesis are the percentage shares of the horizontal totals.

Total investments per establishment are highest in petroleum and rubber, being $2,792,600 and $1,270,200 respectively, as against an over-all average of $468,400 only. The continued preference of foreign capital for the natural resource-based and light consumer goods sectors is apparent, and seems to be "leading" the preference pattern of local capital too, although the natural resource base of Singapore is very limited. These sectors would depend, very largely, on raw material imports from Malaysia and Indonesia. The relative imports and exports of firms with foreign participation have a particularly significant role in an economy such as that of Singapore because of the country's limited resource base.

Table I-4-25. Singapore: Performance of "pioneer" firms for the year 1966 by nationality of foreign participation

(all values in thousand Singapore dollars)

Nationality of foreign participation	*Value of raw materials used*			*Value added*	*Value of sales*				*Total sales*	*Percentage of raw materials imported*	*Value added per unit of materials input*	*Percentage of total sales exported*	*Ratio of value of imported raw material to total exports*	*Value added per unit of materials imported*
	Total	*Local*	*Imported*		*Singapore*	*Exports to Malaysia*	*Exports to rest of the world*	*Total exports*						
Australia	11,206	1,899	9,307	1,605	10,951	2,649	1,179	3,828	14,779	83	.1432	26	2.4313	.1725
Hong Kong	46,918	2,329	44,589	7,696	24,548	9,817	25,477	35,294	59,842	85	.1640	59	1.2634	.1726
Japan	32,232	3,672	28,560	22,548	32,447	5,567	19,895	25,462	57,909	89	.6996	44	1.1217	.7895
Malaysia	18,172	1,021	17,151	1,404	15,686	3,927	941	4,868	20,554	94	.0773	24	3.5232	.0819
China (Taiwan)	9,545	774	8,771	4,026	7,108	476	8,671	9,147	16,255	92	.4218	56	.9589	.4590
United Kingdom	25,671	1,443	24,228	6,815	38,741	2,850	7,303	10,153	48,894	94	.2655	21	2.3863	.2813
United States	48,119	2,662	45,457	10,678	27,770	2,267	29,876	32,143	59,913	94	.2219	54	1.4142	.2349
Other	112,632	14,252	98,380	30,045	132,449	12,602	69	12,671	150,120	87	.2668	8	7.7642	.3054
Firms with foreign participation	304,495	28,052	276,443	84,817	294,700	40,155	93,411	133,566	428,266	91	.2785	31	2.0697	.3068
Firms totally Singapore-owned	56,654	22,199	34,455	34,582	43,590	10,901	40,743	51,644	95,234	61	.6104	54	.6672	1.0037
Total "pioneer" firms	361,149	50,251	310,898	119,399	338,290	51,056	134,154	185,210	523,500	86	.3306	35	1.6786	.3840

Source: Derived from Helen Hughes and You Poh Seng, *Foreign Investment and Industrialization in Singapore* (Australian National University Press, Canberra, 1969), pp. 216-217 and p. 219.

Table I-4-26. Singapore: The stock of direct foreign investment[a] in "pioneer" enterprises by industry sector,[b] at 31 December 1967

Industry	No. of establishments	Foreign investment ($'000)	Local investment ($'000)	Total investment ($'000)	Foreign investment per establishment ($'000)	Total investment per establishment ($'000)	Foreign investment as percentage of local investment	Sectoral percentage shares		
								Foreign investment	Local investment	Total investment
Food and beverages	29	4,213	12,329	16,542	145.28	570.41	34.2	11.5	16.9	15.1
Textiles and garments	32	2,635	6,935	9,570	82.34	299.06	38.0	7.2	9.5	8.7
Wood and paper products	11	1,001	4,079	5,080	91.00	461.82	24.5	2.7	5.6	4.6
Rubber and leather products	6	3,513	4,108	7,621	585.50	1,270.17	85.5	9.6	5.6	7.0
Chemical and chemical products	38	2,872	5,528	8,400	75.58	221.05	51.9	7.9	7.6	7.7
Petroleum and petroleum products	8	10,272	12,069	22,341	1,284.00	2,792.63	85.1	28.1	16.5	20.4
Non-metallic mineral products	10	1,173	2,866	4,039	117.30	403.90	40.9	3.2	3.9	3.7
Basic metals and engineering	48	7,571	17,012	24,583	157.73	512.14	44.5	20.7	23.3	22.4
Electrical products	18	1,741	4,070	5,811	96.72	322.83	42.8	4.8	5.6	5.3
Plastic products	11	282	1,045	1,327	25.64	120.64	27.0	0.8	1.4	1.2
Miscellaneous[c]	23	1,263	3,024	4,287	54.91	186.39	41.8	3.5	4.1	3.9
Total	234	36,535	73,065	109,600	156.13	468.38	50.0	100.0	100.0	100.0

Source: Derived from data obtained from Economic Development Board, *Annual Report 1967*, p. 82 as cited in Helen Hughes, "The Assessment of Policies Towards Foreign Investment in the Asian-Pacific Region", Third Pacific Trade and Development Conference, University of New South Wales, Sydney, August 1970.

[a] Paid-up capital in Singapore dollars.

[b] Includes enterprises in production and in course of construction.

[c] Tourist enterprises are included under "miscellaneous".

Thailand

The data collected for Thailand represent capital of registered firms, but exclude branches of foreign firms. Over the period 1959-1969, United States direct investment firms (with 25 per cent or more of equity held in the United States) accounted for about 26 per cent and Japanese direct investment firms accounted for about 37 per cent of total registered foreign capital in direct investment enterprises (table I-4-27).

The table also reveals interesting variations between countries as regards the type of control. Thus, while Japanese direct investment firms accounted for 37 per cent of the total registered capital of direct investment firms, they controlled nearly three-quarters of all such registered capital in 100 per cent foreign-owned subsidiaries. The comparable United States share is about one-tenth. Japanese investors seem to have preferred 100 per cent control more than the investors from other areas. However, the general concentration of investment from all countries is in the 50-100 per cent foreign-owned category which accounts for three-quarters of all registered capital in foreign direct investment firms.

There seems to be an awareness among Japanese investors about the desirability of reducing the weightage of Japanese ownership in general, and 100 per cent foreign-owned subsidiaries in particular. A recent survey undertaken by the Japanese Chamber of Commerce in Thailand[10] has contributed data on the trend of Japanese investments between 1966-1969 shown in table I-4-28. While total paid-up share capital in Japanese affiliates in Thailand doubled between 1966 and 1969, the capital of 100 per cent Japanese-owned firms registered a significant decline. Although the share of Japanese ownership in the total paid-up capital of Japanese subsidiaries was as high as 71 per cent[11] in 1969, a tendency toward reduction of that share is indicated by the fact that it had declined from 75 per cent in 1966. It is noteworthy also that the Japanese share is higher in the foodstuff industry than in more technology-intensive industries, such as automobiles or metals, although a higher level of technology transfer might imply a relatively larger amount of capital transfer, and vice versa. It is possible, however, that relative profitability expectations are such that more local capital is forthcoming for investment in automobiles and metals than in food-stuffs. Table I-4-28 also gives the sectoral composition of Japanese investments. Textiles account for 55 per cent of all investments. The share of textiles and food-stuffs, together, is nearly three-fifths of all Japanese investments.

[10] See *The Investor*, Bangkok, August 1970, pp. 816-817.

[11] The United States share in total equities of United States affiliates covered in a current survey undertaken by USOM in Thailand is 60 per cent. See Marsden, Donald C., *American Business Investments in Thailand*, United States Operation Mission, Agency for International Development, Bangkok, 1970.

Table I-4-27. Thailand: Registered capital of foreign direct investment firms in operations promoted over the period 1959-1969, by nationality of ownership and type of control

(in million dollars)

Country	Type of control							
	100% foreign-owned		50-100% foreign-owned		25-50% foreign-owned		Total	
	Amount	% share of total	Amount	% share of total	Amount	% share of total	Amount	% share of total
Japan	6.75	26.2 (72.9)	17.21	66.9 (32.7)	1.77	6.9 (21.2)	25.73	100.0 (36.6)
United States	0.86	4.6 (9.3)	14.44	77.4 (27.4)	3.35	18.0 (40.1)	18.65	100.0 (26.5)
United Kingdom	0.44	13.2 (4.8)	2.37	71.4 (4.5)	0.51	15.4 (6.1)	3.32	100.0 (4.7)
Other Western Europe	0.96	11.5 (10.4)	7.31	87.3 (13.9)	0.10	1.2 (1.2)	8.37	100.0 (11.9)
Australia	—	—	0.66	98.5 (1.2)	0.01	1.5 (0.1)	0.67	100.0 (1.0)
Other ECAFE	—	—	7.85	75.2 (14.9)	2.59	24.8 (31.0)	10.44	100.0 (4.9)
Other	0.24	7.7 (2.6)	2.84	91.3 (5.4)	0.03	1.0 (0.3)	3.11	100.0 (4.4)
Total	9.25	13.2 (100.0)	52.68	74.9 (100.0)	8.36	11.9 (100.0)	70.29	100.0 (100.0)

Source: Board of Investment, Thailand.

Note: Figures in parenthesis are the percentage shares of the vertical totals.

Table I-4-28. Thailand: Capital of Japanese industrial enterprises in 1966 and 1969

(in thousand baht)

Year	Type of industry	Total paid-up capital	Japanese capital			Share of Japanese investment %
			Total	Joint ventures	100 per cent Japanese investment	
1966	Textile	209,850	157,765	97,765	60,000	75
	Automobile	104,894	82,416	35,987	46,429	78
	Metal	39,500	20,510	20,510	—	52
	Food-stuff	58,500	52,950	30,450	22,500	90
	Other	62,000	40,700	36,700	4,000	65
	Total	474,744	354,341	221,412	132,929	75
1969	Textile	520,350	375,120	355,120	20,000	72
	Automobile	175,899	124,361	77,932	46,429	71
	Metal	91,500	56,550	56,550	—	62
	Food-stuff	68,500	62,250	39,750	22,500	91
	Other	100,500	60,275	54,275	6,000	60
	Total	956,749	678,556	583,627	94,929	71

Source: *The Investor*, Bangkok, August 1970, p. 817.

Table I-4-29. Thailand: Registered capital of foreign firms in operation promoted over the period 1959/1969, by sector and country of origin

(in million dollars)

Sector \ Country of origin	Japan		United States		United Kingdom		Other W. European countries		Australia		Other ECAFE countries		Other countries		Total	
	Amount	% share of total	Amount	% share of total	Amount	% share of total	Amount	% share of total	Amount	% share of total	Amount	% share of total	Amount	% share of total	Amount	% share of total
Manufacture:																
Food and beverages	1.74	6.76	5.61	30.08	0.28	8.43	3.85	45.94	0.62	93.94	1.60	15.34	0.59	19.03	14.29	20.33
Textiles and apparel	11.22	43.57	0.59	3.17	0.60	18.07	0.93	11.10	—	—	1.25	11.99	0.26	8.39	14.85	21.13
Wood and pulp products	—	—	2.04	10.94	—	—	0.03	0.36	—	—	0.18	1.73	0.01	0.32	2.26	3.22
Chemicals and drugs	1.24	4.82	1.01	5.42	0.98	39.52	2.54	30.31	—	—	0.96	9.20	—	—	6.73	9.58
Metals	3.50	13.59	2.36	12.66	0.09	2.71	0.09	1.07	—	—	2.42	23.20	—	—	8.46	12.04
Electrical machinery and equipment	0.59	2.29	0.44	2.36	—	—	0.09	1.07	0.01	1.52	0.16	1.53	—	—	1.29	1.84
Transport equipment	5.85	22.72	3.32	17.81	0.48	14.46	0.09	1.07	0.01	1.52	0.24	2.30	—	—	9.99	14.22
Other manufacturing	1.61	6.24	2.22	11.91	0.87	26.21	0.68	8.12	0.02	3.03	3.06	29.34	2.10	67.74	10.56	15.03
Sub-total	25.75	100.00	17.59	94.37	3.30	99.40	8.30	99.05	0.66	100.00	9.87	94.63	2.96	95.48	68.43	97.37
Non-manufacture:																
Mining	—	—	—	—	—	—	—	—	—	—	0.06	0.58	—	—	0.06	0.09
Hotels and services	—	—	1.05	5.63	0.02	0.60	0.08	0.95	—	—	0.50	4.79	0.14	4.52	1.79	2.55
Sub-total	—	—	1.05	5.63	0.02	0.60	0.08	0.95	—	—	0.56	5.37	0.14	4.52	1.85	2.63
Grand total	25.75	100.00	18.64	100.00	3.32	100.00	8.38	100.00	0.66	100.00	10.43	100.00	3.10	100.00	70.28	100.00

Source: Board of Investment, Thailand.

Table I-4-29 brings together the data on sectoral composition by country/area of origin, collected through questionnaires sent out in the course of the present survey. Since branches of foreign firms are excluded, most foreign banks, financial and insurance organizations, and distributing agencies are not taken into account. To that extent, the division of total capital between the manufacturing and the non-manufacturing sectors is distorted. Moreover, promotional regulations relate mostly to the manufacturing sector, and the data here relate to promoted foreign affiliates only. Hence, the data on the division of the manufacturing sector are relatively more comprehensive. Food, beverages and textiles account for half of the total promoted non-branch capital in Japanese subsidiaries, nearly one-third in United States subsidiaries, somewhat more than one-fourth in United Kingdom subsidiaries as well as in the subsidiaries of "other ECAFE" countries and "other" countries. Australian and "other West European" investments are also concentrated in these two categories (94 per cent and 57 per cent respectively). Transport equipment, mostly assembly plants, occupies the next most important place, accounting for 23 per cent, 18 per cent and 14 per cent of the capital of Japanese, United States and United Kingdom subsidiaries respectively. For the United Kingdom and "other West European" countries, however, investments in chemicals and drugs also feature prominently.[12]

In the absence of more detailed information, it is difficult to assess the significance of these investments for Thailand's economy. However, a Board of Investment survey of 221 major companies showed a net rate of profit (after deduction of lossess suffered by concerns at their initial teething phase) of 14 per cent of equity, 6.5 per cent of total assets, and 5.9 per cent of total sales.[13] Considering the fact that most of these concerns are "green-field" ventures, a 14 per cent rate of return on equity is rather high, and confirms Reddaway's findings about the relatively higher profitability of "green-field" ventures in the developing economies compared with that in the developed economies.[14]

[12] The USOM survey states that about 60 per cent of United States investments in Thailand are in the manufacturing sector, and 40 per cent in non-manufacture. There are 200 United States firms with significant investments in Thailand. By early 1970, the total assets of United States sponsored business investments in Thailand were approximately $250 million, and accounted for between one-fourth and one-third of all foreign-sponsored investments in Thailand. There are 31 United States firms with total assets of $1 million or more each. Of these, 9 have investments in companies with total assets of $5 million or more each. See Donald C. Marsden, *op. cit.*

[13] See *The Investor*, Bangkok, May 1970, p. 463.

[14] Reddaway, W. B., *Effects of U.K. Direct Investments Overseas, Final Report*, Cambridge University Press, 1968, table XVII. 5, p. 226.

The Japanese affiliates have tended to raise wage levels in Thai industry as the following table I-4-30 shows. Presumably, this is also true for other foreign enterprises, although data have not been readily available.

Table I-4-30. Thailand: *Per capita* monthly average wages of Thai employees by sector

(in baht)

Type of industry	*Japanese manufacturing enterprises*		*All manufacturing enterprises*[a]
	1969	1968	1968
Textile	613	540	449
Automobile	1,040	960	782
Metal	1,363	877	813
Food-stuff	721	858	608
Other	983	1,007	540
Average	812	718	638

Source: *The Investor*, Bangkok, August 1970, p. 817.

[a] Survey conducted by the Ministry of Industry, Thailand.

If both rates of return and wage levels are relatively high, it would be correct to infer that over-all productivity levels are also correspondingly high. However, the extent to which this higher productivity of foreign investment has a positive impact on Thailand's balance of payments is rather doubtful. The following table I-4-31 gives the total sales of Japanese industrial enterprises over the period 1966 to 1969; figures in parentheses represent exports. The share of exports in total sales is, as yet, quite negligible (2 per cent or less), with no tendency to rise over the four-year period. Undoubtedly, there is significant import-substitution of the final goods that would have to be imported in the absence of these foreign investments. However, this effect will

Table I-4-31. Thailand: Total sales and exports of Japanese enterprises, 1966-1969

(in thousand baht)

	1966	1967	1968	1969
Textiles	415,067 (11,574)	556,659 (7,586)	664,885 (8,814)	840,406 (6,803)
Automobiles	385,134 (—)	737,523 (747)	1,002,795 (—)	1,253,714 (—)
Metal products	393,088 (1,606)	530,458 (6,169)	720,385 (5,300)	874,837 (13,544)
Food-stuffs	150,082 (4,950)	170,632 (—)	205,581 (—)	273,083 (5,908)
Others	140,110 (10,696)	196,484 (7,405)	224,361 (5,619)	307,002 (25,068)
Total	1,483,481 (28,826)	2,191,756 (21,907)	2,818,007 (19,733)	3,549,042 (51,323)

Source: *The Investor*, Bangkok, August 1970, p. 817.

be reduced if the import-content of the foreign companies' production is high. It should also be noted that such foreign investments may not only substitute for imports, but the associated demonstration effects may also generate new demands for imports. In any event, there is a *prima facie* case for further probing of the *net* balance-of-payments effects of such foreign investments which produce goods mainly for domestic consumption.

The sharp acceleration in foreign capital inflows in recent years has helped to maintain positive net direct effects of foreign investment on Thailand's balance of payments for the time being. Table I-4-32 below gives the annual foreign exchange inflows and outflows directly accruing from foreign investments. The data show that there has been a sharp acceleration of foreign investment inflows, including long-term suppliers' (export) credits, into Thailand over the last decade. The three ratios also show that, while the proportion of equity inflow to total inflow has had a tendency to decline from the average of 38.2 per cent for 1961-1964 to 34.5 per cent for 1965-1969, the ratio of net to gross inflow has registered a sharp increase from the average of 19.5 per cent (1961-1964) to 62 per cent (1965-1969), with a corresponding reduction in the ratio of gross outflow to gross inflow. However, since most of the enterprises are "green-field" ventures, the pressure of the cumulative effect of the return flows on the balance of payments will be making itself felt in the course of the next few years.

Table I-4-32. Thailand: Inflows and outflows on account of foreign private investment, 1961-1969

(in million baht)

Year	*Annual inflow of foreign equity capital*	*Total inflow of foreign investment*	*Total outflow (profit, etc.)*	*Net investment*
1961	32.4	120.9	204.9	—84.0
1962	43.7	156.7	204.7	—48.0
1963	152.1	348.2	194.5	153.7
1964	153.8	373.3	201.6	172.7
Sub-total	382.0	999.1	805.7	194.4
1965	112.4	603.7	205.0	398.7
1966	198.5	587.7	345.6	242.1
1967	400.4	869.5	377.4	492.1
1968	598.2	1,312.5	339.0	972.5
1969	230.2	1,090.0	420.3	669.7
Sub-total	1,539.7	4,463.4	1,687.3	2,775.1
Total	1,921.7	5,462.5	2,493.0	2,969.5

Ratio of:	*1961-1964*	*1965-1969*	*1961-1969*
(1) Net to gross inflow (%)	19.46	62.17	54.36
(2) Gross outflow to gross inflow (%)	80.64	37.80	45.64
(3) Equity inflow to total inflow (%)	38.23	34.50	35.18

Source: Bank of Thailand.

Summary remarks

The foregoing brief survey of foreign private investment in the ECAFE region has presented several common features, as well as some points of difference, in the experiences of nine host countries. Inflows of private capital have grown rapidly during the 1960s in most of the countries surveyed. Furthermore, the share of foreign investment in total capital stock appears to be significant, perhaps 15 to 30 per cent, where data are available. However, private capital inflows appear to be subject to frequent fluctuations and to be sensitive to such adverse factors as international confrontations, political unrest, and what is considered by investors to be excessive regulation.

The role of the United States as a source of private capital is important in all nine countries, with United States investments tending to be large and to be concentrated in oil or mineral development, or technologically advanced fields, such as electric/electronic manufacturing and chemicals. Japanese and United Kingdom investments are large in east and south Asian countries, respectively, with the exception of the Philippines in which Japanese investment is small. In particular, Japanese investments tend to be smaller and to be directed to lighter industries, such as textiles and electric/electronic equipment, although Japanese mining and metal manufacturing investments are important in Indonesia and Malaysia. Other Western European investors are active in most of the countries. Recent intraregional investment flows from other developing countries (approvals or registrations as reported in the country tables in this chapter) have also been significant in several countries, such as Indonesia (more than US$430 million); China (Taiwan) ($130 million-from overseas Chinese); Malaysia (M$700 million); and Thailand ($10 million). On the other hand, investments in Iran from other Asian countries have been very small. Little is known about these intraregional flows except that they appear to be invested primarily in textiles, food and beverages, and other light manufacturing and service industries. With institutional steps to promote and improve regional capital markets, it may be supposed that these intraregional flows could be expanded and guided into more significant areas of investment in line with national development policies.

A large and increasing share of promoted foreign investments has been distributed to manufacturing industries. However, some countries have evidently encouraged large investments in textiles, food and beverages, and transportation equipment (mostly automobiles), while other countries have guided foreign capital into heavier and, perhaps, more basic industries, such as chemicals/petrochemicals, metals and metal products. Of course, the differing resource endowments of the countries have also played an important role in the allocation of foreign capital. A comprehensive evaluation of foreign investment promotion policies and the actual contribution of foreign investors must await the collection of more complete and systematic data, especially with regard to indirect balance of payments effects, transfers of technology, and linkage effects. Regional standardization of the statistical classifications and concepts applying to foreign private investment and its effects, as well as co-ordination and encouragement of wider data collection, are urgently needed in order to facilitate further study and regional cooperation in national policies toward foreign private investment.

Section B

India

Over-all trends

In mid-1948, and at the end of 1953, outstanding foreign investments in India's private sector amounted to $800 million and $834 million, respectively (table I-4-33). During this period, though foreign investments in rupee terms increased by about 50 per cent, in terms of dollars they increased only by about 4 per cent.[15] Similarly, between 1948 and 1967, foreign investments expressed in domestic currency increased by about 4.6 times, but in dollar terms they increased only by about 1.5 times. These figures no doubt reflect fortuitous accounting gains to the country, but, in view of valuation changes, foreign investment figures for India, when expressed in *dollar terms*, underestimate the growth rate of that part of foreign investment which comes primarily in the form of risk capital.

In 1948, slightly over one-fourth of the outstanding foreign investment was in the manufacturing sector, with plantations, mining and services together accounting for about two-thirds of the total. Services was the biggest sector, absorbing almost 40 per cent of the total foreign investments, and, within the services sector, trading alone accounted for about 40 per cent. Even in the manufacturing sector, less sophisticated industries, such as food and beverages and textile products, were the dominant ones, as a little more than one-half of the foreign capital in this sector was engaged in these industries.

Though the planning era in India was initiated in 1951/52, the process of industrialization gathered momentum only with the launching of the second five-year plan in April 1956; thus, for a discussion on changes in pattern of foreign investment during the period of relatively rapid industrialization, foreign investment figures for 1956 could be conveniently used for comparison. It is interesting to note that, even during the eight-year period prior to 1956, there were important shifts in the pattern of foreign investment. Between 1948 and 1956, outstanding foreign investment increased by one-fourth and crossed the $1 million mark (table I-4-33). During this period, foreign investment in plantations increased by about $27 million to $184 million, but its relative share in the total remained unchanged. Foreign capital in mining and services declined by about $87 million to $273 million, and their share in the total declined from 45 per cent to 27 per cent. Foreign investment in the petroleum industry rose steeply from $67 million in 1948 to $244 million in 1956, and, during this period, the relative share of the petroleum industry in the total increased almost threefold.

The ten-year period from the end of 1956 to March 1966 covers the second and the third five-year plan periods during which outstanding foreign investment in India increased by 123 per cent to $2,247 million. This period was characterized by an impressive growth of foreign investment in the manufacturing sector, from $303 million in 1956 to $1,126 million in 1966. During this decade, investment in plantations increased by slightly over one-fourth to $236 million; in mining it remained stagnant, but in services it almost doubled. In the services sector, foreign investment in trading increased from $61 million in 1956 to $77 million in 1966, but its share in the total of services declined from about one-fourth to one-seventh; the share of construction, utilities and transport in services more than doubled. Although foreign investment in services increased so as to keep its share in the total foreign investment in the country almost unchanged, it was accompanied by a perceptible decline in trading and a notable increase in construction and utilities.

A significant feature of the growth of foreign investment in the manufacturing sector between 1956 and 1966 related to relative changes in the importance of different industries. Relative rates of growth of foreign investment in both textile products and foods and beverages were much lower during this period in comparison with the growth in transport equipment, machinery and machine tools, metals and metal

[15] Compare rupee values table I-4-33a with dollar values in table I-4-33. As figures for 1948 and 1953 include the liabilities of insurance companies ($26.6 million and $10.7 million respectively), they are not strictly comparable with those given for the other years in these tables.

Table I-4-33. India: Outstanding foreign business investments[a] by industry

(in million dollars)

Industry/group	As at the end of June 1948	As at the end of December									As at the end of March				
		1953	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967
Plantations	157.8	150.2	183.2	184.4	181.7	199.7	197.8	207.9	215.0	234.4	219.9	228.9	239.6	235.6	171.6
Mining	34.8	17.6	19.5	22.3	20.0	24.8	26.0	26.7	26.0	27.3	33.4	28.8	24.8	20.6	15.3
Petroleum	67.4	161.9	218.4	244.4	281.6	248.6	251.0	313.3	320.3	323.4	356.4	351.5	384.3	373.0	275.5
Manufacturing	213.7	260.6	271.2	302.8	379.6	451.3	483.4	516.6	619.5	683.3	790.1	898.9	1,007.9	1,126.1	984.0
Food, beverages, etc.	30.5	65.7	60.9	62.4	63.2	63.8	65.7	71.4	75.8	83.0	71.0	73.1	75.8	80.4	55.3
Textile products	84.6	52.9	45.8	46.0	44.3	44.3	46.0	46.4	44.9	43.7	79.6	90.7	96.6	97.9	94.7
Transport equipment	3.0	11.3	7.6	9.5	10.3	12.0	14.9	16.6	27.3	32.6	37.2	68.7	89.3	104.0	100.3
Machinery and machine tools	3.6	5.7	10.5	11.3	11.8	12.4	14.9	21.2	29.4	50.0	41.6	50.0	58.4	71.0	52.5
Metals and metal products	24.2	17.9	23.3	42.8	108.2	159.6	172.6	173.5	199.7	192.4	206.4	207.3	220.3	233.3	205.2
Electrical goods and machinery	14.5	25.2	30.7	33.2	34.7	35.9	37.4	38.9	31.1	35.5	50.4	57.5	71.8	87.8	78.3
Chemical and allied products	24.2	39.7	42.6	46.4	48.1	54.4	63.2	72.5	113.6	136.5	148.3	171.6	207.7	262.1	268.0
Miscellaneous	29.1	42.2	49.8	51.2	59.0	68.9	68.7	76.2	97.7	109.6	155.6	180.0	188.0	189.6	129.7
Services	326.1	243.7	236.9	250.8	254.4	256.9	265.0	268.5	246.7	271.6	293.3	358.7	433.1	491.7	530.1
Trading	130.0	58.2	56.3	60.9	56.7	62.2	58.4	61.7	61.5	65.1	68.5	68.0	80.4	76.7	78.8
Construction, utilities and transport	95.2	85.7	89.7	102.9	112.1	108.8	114.2	110.9	118.7	127.9	142.2	186.9	225.8	262.1	301.3
Financial	47.5	41.6	36.5	35.3	34.4	34.9	39.7	42.4	26.0	37.4	41.6	60.3	80.9	107.3	121.6
Miscellaneous	53.4	58.2	54.4	51.7	51.2	51.0	52.7	53.5	40.5	41.2	41.0	43.5	46.0	45.6	28.4
Total	799.8	834.0	929.2	1,004.7	1,117.3	1,181.3	1,223.2	1,333.0	1,427.5	1,540.0	1,693.1	1,866.8	2,089.7	2,247.0	1,976.5

Source: "India's international investment position in 1965/66 and 1966/67", *Reserve Bank of India Bulletin*, August 1969, p. 1,150.

Notes: (1) Figures adjusted to exclude from computation inflows of foreign investments due to changes in valuation, accounting practices, etc.

(2) Figures for banking and insurance are excluded.

(3) Totals may not add up due to rounding.

[a] Book value of investments.

Table I-4-33a. India: Outstanding foreign business investments[a] by industry

(in million rupees)

Industry/group	As at the end of June 1948	As at the end of December									As at the end of March				
		1953	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967
Plantations	522	715	872	878	865	951	942	990	1,024	1,116	1,047	1,090	1,141	1,122	1,287
Mining	115	84	93	106	95	118	124	127	124	130	159	137	118	98	115
Petroleum	223	771	1,040	1,164	1,341	1,184	1,195	1,492	1,525	1,540	1,697	1,674	1,830	1,776	2,066
Manufacturing	707	1,241	1,291	1,442	1,807	2,149	2,302	2,460	2,950	3,254	3,762	4,280	4,799	5,362	7,380
Food, beverages, etc.	101	313	290	297	301	304	313	340	361	395	338	348	361	383	415
Textile products	280	252	218	219	211	211	219	221	214	208	379	432	460	466	710
Transport equipment	10	54	36	45	49	57	71	79	130	155	177	327	425	495	752
Machinery and machine tools	12	27	50	54	56	59	71	101	140	238	198	238	278	338	394
Metals and metal products	80	85	111	204	515	760	822	826	951	916	983	987	1,049	1,111	1,539
Electrical goods and machinery	48	120	146	158	165	171	178	185	148	169	240	274	342	418	587
Chemical and allied products	80	189	203	221	229	259	301	345	541	650	706	817	989	1,248	2,010
Miscellaneous	96	201	237	244	281	328	327	363	465	522	741	857	895	903	973
Services	1,079	1,160	1,128	1,194	1,212	1,223	1,262	1,278	1,175	1,293	1,396	1,708	2,062	2,341	3,976
Trading	430	277	268	290	270	296	278	294	293	310	326	324	383	365	591
Construction, utilities and transport	315	408	427	490	534	518	544	528	565	609	677	890	1,075	1,248	2,260
Financial	157	198	174	168	164	166	189	202	124	178	198	287	385	511	912
Miscellaneous	177	277	259	246	244	243	251	254	193	196	195	207	219	217	213
Total	2,646	3,971	4,424	4,784	5,320	5,625	5,825	6,347	6,798	7,333	8,061	8,889	9,950	10,699	14,824

Source: "India's international investment position in 1965/66 and 1966/67", *Reserve Bank of India Bulletin*, August 1969, p. 1,150.

Notes: (1) Figures adjusted to exclude from computation inflows of foreign investments due to changes in valuation, accounting practices, etc.

(2) Figures for banking and insurance are excluded.

[a] Book value of investments.

products, and chemicals and allied products. There was a more than tenfold increase in foreign investment in transport equipment, from about $10 million in 1956 to $104 million in 1966. Similarly, there was a sixfold rise in machinery and machine tools, and a more than fivefold rise in both metals and metal products and chemicals and allied products. The relative share of these industries in the total of foreign investment in the manufacturing sector increased from about one-third to more than 50 per cent.

Despite a net inflow of foreign capital of $243 million during 1966/67, outstanding foreign investment in 1967, at $1,976 million, was $271 million lower than that of the previous year as a result of the exchange rate adjustment in June 1966. Excluding the effect of the devaluation, there was a net outflow of capital from petroleum of about $19 million and a larger net inflow in manufacturing and services to the extent of $143 million and $120 million, respectively.[16] A relatively larger impact of the exchange rate adjustment, resulting in deflation of investments, was borne by plantations and petroleum, in which direct investments as proportions of total foreign investment were 97 per cent and 78 per cent respectively in 1966 (table I-4-34). In the services sector, however, as direct investment formed only one-third of its total foreign investment, deflation of foreign investment in this sector was relatively smaller than in the manufacturing sector in which direct investment to its total foreign investment was slightly over one-half during 1966.

The United Kingdom continued to be the largest investing country between 1948 and 1967, though its share in the total declined from 80 per cent to 44 per cent over the period (table I-4-35). Foreign investment originating from the United States increased very sharply, from $34 million in 1948 to $501 million in 1967. Japanese foreign investment also increased sharply, but, the base being small, it continued to be a relatively small investor, with investment accounting for less than 5 per cent of the total in 1967.

[16] "India's international investment position in 1965/66 and 1966/67", *Reserve Bank of India Bulletin*, August 1969, p. 1,131.

Table I-4-34. India: Outstanding foreign business investments by types
(in million dollars)

Industry	End 1953			End 1961			End March 1966			End March 1967		
	Direct	Portfolio	Total	Direct	Portfolio	Total	Direct	Portfolio	Total	Direct	Portfolio	Total
Plantations	134.6	15.5	150.2	208.1	6.9	215.0	229.1	6.5	235.6	166.0	5.6	171.6
	(89.7)	(10.3)	(100.0)	(96.8)	(3.2)	(100.0)	(97.2)	(2.8)	(100.0)	(96.7)	(3.3)	(100.0)
Mining	13.0	4.6	17.6	22.9	3.1	26.0	8.2	12.4	20.6	5.9	9.4	15.3
	(73.9)	(26.1)	(100.0)	(88.1)	(11.9)	(100.0)	(39.8)	(60.2)	(100.0)	(38.6)	(61.4)	(100.0)
Petroleum	161.3	0.6	161.9	311.0	9.2	320.3	291.7	81.3	373.0	196.9	78.5	275.5
	(99.6)	(0.4)	(100.0)	(97.1)	(2.9)	(100.0)	(78.2)	(21.8)	(100.0)	(71.5)	(28.5)	(100.0)
Manufacturing	199.5	61.1	260.6	392.3	227.2	619.5	620.7	505.3	1,126.0	438.5	545.5	984.0
	(76.6)	(23.4)	(100.0)	(63.3)	(36.7)	(100.0)	(55.1)	(44.9)	(100.0)	(44.6)	(55.4)	(100.0)
Services	176.8	56.1	232.9	172.8	73.9	246.7	179.8	311.8	491.6	126.7	403.4	530.1
	(75.9)	(24.1)	(100.0)	(70.0)	(30.0)	(100.0)	(36.6)	(63.4)	(100.0)	(23.9)	(76.1)	(100.0)
Total	685.2	137.9	823.2	1,107.1	320.4	1,427.6	1,329.5	917.3	2,246.8	934.0	1,042.5	1,976.5
	(83.2)	(16.8)	(100.0)	(77.5)	(22.5)	(100.0)	(59.2)	(40.8)	(100.0)	(47.3)	(52.7)	(100.0)

Sources: *India's Foreign Liabilities and Assets 1961, Survey Report, op. cit.*, p. 75;
"India's international investment position in 1965/66 and 1966/67", *op. cit.*, p. 1149.

Notes: (1) Figures for 1953 are inclusive of liabilities of insurance companies, which are not included in the figures for other years.
(2) Totals may not add up due to rounding.

Table I-4-35. India: Outstanding foreign business investments by country
(in million dollars)

Country	Mid 1948	End 1953	End 1955	End 1961	As at end March 1963	1964	1965	1966	1967
United Kingdom	622.6	685.4	768.4	937.0	1,035.7	1,066.0	1,131.9	1,156.7	873.9
United States	33.9	63.0	83.2	201.4	251.6	341.5	451.1	520.2	501.1
Other Western Europe	16.3	12.8	17.0	59.9	151.8	171.8	205.8	240.9	270.7
Japan	0.6	0.2	0.4	6.7	31.9	63.2	78.3	88.6	92.2
Others	99.7	61.7	60.1	222.6	221.8	224.3	222.4	240.4	238.6
Total	773.2	823.2	929.0	1,427.6	1,692.8	1,866.7	2,089.5	2,246.8	1,976.5

Sources: *India's Foreign Liabilities and Assets 1961, Survey Report, op. cit.*, pp. 74-75;
"India's international investment position in 1965/66 and 1966/67", *op. cit.*, pp. 1148-1149.

Notes: (1) Figures for 1948 and 1953 are inclusive of liabilities of insurance companies.
(2) Totals may not add up due to rounding.

Between 1955 and 1966, the pattern of investment from the United Kingdom into plantations, petroleum, manufacturing and services did not change appreciably. While the United States investments in petroleum increased twofold at $111 million in 1966, they increased nearly fifteenfold in manufacturing at $326 million, and accounted for three-fifths of its total investments in 1966. Growth of Japanese investments in India was much faster in the services than in the manufacturing sector during this period. In 1966, about two-thirds of Japanese investments were in services with manufacturing accounting for less than one-third of the total.

During 1966, direct investment, at $83 million, from "other Western Europe" was around one-third of the total investment from this region. Though manufacturing continued to occupy the largest proportion of this region's total investment in India, its proportion declined from over four-fifths in 1963 to slightly above one-half in 1967, primarily because investment in services increased rapidly.

Changes in types of investments[17]

The equity type of foreign capital invested in India increased between 1955 and 1966 by over three-fifths to $1,450 million (table I-4-36). (The data relate to net position of branches and equity value, i.e., paid-up equity capital plus proportionate free reserves and surplus). In view of the exchange rate adjustments, the equity value was lower at $1,013 million in 1967. Thus, between 1955 and 1967, net liability of the country on account of direct foreign investment increased by only $122 million. In respect of creditor capital, India's liabilities to foreign investors increased during this period from $35 million to $958 million.[18]

[17] It would be appropriate to indicate briefly the system of classification of foreign investment adopted in the Reserve Bank of India's studies on *India's Foreign Liabilities and Assets*. A subsidiary is defined to be a company which (i) "is a member of a foreign company which controls the composition of the Board of Directors of the Indian company or (ii) the foreign company holds more than half of the Indian company's equity share capital or (iii) the Indian company is a subsidiary of a foreign company." Indian companies in which 40 per cent or more equity shares are held in a foreign country or 25 per cent or more of the ordinary shares are held by another company which is a foreign company or a foreign-controlled company is defined to be a foreign-controlled rupee company. In India, the term "direct investment" connotes "net assets of branches and proportionate share of foreign investors in the net assets of the foreign-controlled rupee companies." Portfolio investments are defined to be those foreign investments that do not have controlling interest in the Indian company. Portfolio investments comprise subscription to equity stock without controlling interest, preference shares and debentures and loans and suppliers' credits. Portfolio investments are classified into two categories, viz. "official portfolio" and "private portfolio", depending on the sources from which they are obtained. *India's Foreign Liabilities and Assets 1961 — Survey Report*, Reserve Bank of India, Bombay, 1964, p. 7.

[18] Compare the changes in rupee values, as shown in table I-4-36a.

Table I-4-36. India: Outstanding direct and portfolio foreign business investments, 1955-1967
(in million dollars)

	End 1955	End 1961	End March 1966	End March 1967
Direct investments[a] .	811.6	1,107.1	1,329.5	934.0
Branches . . .	510.5	567.6	526.7	387.5
Subsidiaries . .	250.7	434.5	605.2	410.4
Other controlled .	50.4	105.0	197.6	136.1
Portfolio investments	117.4	320.5	917.3	1,042.5
Equity[b] . . .	82.3	93.0	119.7	84.3
Creditor capital[c] .	35.1	227.4	797.6	958.2
Grand total . . .	929.0	1,427.6	2,246.8	1,976.5

Source: *India's Foreign Liabilities and Assets 1961: Survey Report, op. cit.*, p. 25.
"Foreign investments in India: 1962", *Reserve Bank of India Bulletin*, April 1966, p. 368;
"India's international investment position in 1965/66 and 1966/67", *op. cit.*, p. 1,125.

Note: Totals may not add up due to rounding.

[a] Cover (i) net assets in India of branches, representing the net claims on them by non-residents and (ii) the equity holdings of investors in the country of control and their proportionate share in the free reserves of the foreign-controlled rupee companies.

[b] Represent ordinary shares to the extent that these are held by the investors in countries other than the country of control.

[c] Represent non-resident holdings of preference shares and debentures of the rupee companies and suppliers' credits for imports.

Table I-4-36a. India: Outstanding direct and portfolio foreign business investments, 1955-1967
(in million rupees)

	End 1955	End 1961	End March 1966	End March 1967
Direct investments[a] .	3,865	5,272	6,331	7,005
(a) Branches . .	2,431	2,703	2,508	2,906
(b) Subsidiaries .	1,194	2,069	2,882	3,078
(c) Other controlled	240	500	941	1,021
Portfolio investments	559	1,526	4,368	7,819
(a) Equity[b] . .	392	443	570	632
(b) Creditor capital[c]	167	1,083	3,798	7,187
Grand total . . .	4,424	6,798	10,699	14,824

Source: *India's Foreign Liabilities and Assets 1961: Survey Report, op. cit.*, p. 25.
"Foreign investments in India: 1962", *Reserve Bank of India Bulletin*, April 1966, p. 368;
"India's international investment position in 1965/66 and 1966/67", *op. cit.*, p. 1,125.

Note: Totals may not add up due to rounding.

[a] Cover (i) net assets in India of branches, representing the net claims on them by non-residents and (ii) the equity holdings of investors in the country of control and their proportionate share in the free reserves of the foreign-controlled rupee companies.

[b] Represent ordinary shares to the extent that these are held by the investors in countries other than the country of control.

[c] Represent non-resident holdings of preference shares and debentures of the rupee companies and suppliers' credits for imports.

Between 1955 and 1961, branch investment increased marginally by $57 million to $567 million, but, between 1961 and 1966, it declined by $41 million. In contrast to this near stagnant trend in branch investment between 1955 and 1966, direct investment in foreign-controlled companies increased substantially from $301 million to $803 million. Among the foreign-controlled companies, direct investment in subsidiaries rose by 140 per cent, from $250 million to $605 million, between 1955 and 1966, whereas growth of investment in other controlled companies increased almost fourfold, from $50 million to $197 million. During the same period, foreign investment in the form of portfolio equity increased by less than one-half to $120 million.

Out of the total direct investments and portfolio equity investments of $1,018 million in 1967, branches accounted for $387 million, foreign-controlled companies for $546 million and portfolio equity for $84 million. Between 1955 and 1967, while investments in branches as a proportion of total direct and portfolio equity investments declined from three-fifths to two-fifths, those in foreign-controlled companies increased from one-third to over one-half.

A significant feature of the growth of foreign investment in India was the growth of portfolio investments in the form of creditor capital. Between 1955 and 1966, such creditor capital increased from $35 million to $798 million (table I-4-36). Creditor capital almost doubled from $227 million to $452 million during 1961-1963, and thereafter it increased steadily. Among the three items of creditor capital, viz. securities, loans and suppliers' credits, while investments in securities remained insignificant between 1963 and 1967, loans continued to form over two-thirds of the total creditor capital and more than doubled, from $304 million to $625 million. Though suppliers' credits increased at a faster rate than loans, their share in the total creditor capital only increased marginally, from 28 per cent to 33 per cent.

If foreign investment data for 1967 are analysed, two features stand out prominently. First, foreign investment in the form of creditor capital was around the same level as the risk capital (direct investments plus portfolio equity). Secondly, of the total risk capital, portfolio equity constituted less than 10 per cent, investments in branches were about 40 per cent, and subsidiaries and other controlled companies about 50 per cent.

Policy issues

(*a*) *Majority control.* The 'Majority Indian Control' principle has been one of the basic tenets of Indian foreign investment policy, yet it has been used with considerable flexibility. The areas where foreign investment is permitted have been flexibly implemented, the two major relaxations being the special concessions given to the foreign sector in oil in the 1950s and fertilizers in the 1960s. The general policy has been to limit fresh investment in branches and reduce the percentage foreign holding in subsidiaries as much as possible. Branch investment at the end of March 1967 was $387 million out of a total direct investment of $934 million, the balance of $547 million being accounted for by subsidiaries and other foreign-controlled companies. During the 1960s, branch investment did not show any growth. While 90 per cent of branch investment is accounted for by plantations, oil and services, the subsidiaries have been the dynamic sector of foreign investment, with investment mainly in manufacturing, and this sector has therefore been the focal point of foreign investment policy. There were 224 subsidiaries as of 31 March 1964, and over one-half of these were wholly foreign-owned; nearly three-fourths of these wholly foreign-owned subsidiaries were incorporated by the end of 1947. In the post-Independence years, there was a perceptible tendency towards setting up subsidiaries with some Indian capital participation, and a little over two-thirds of the subsidiaries incorporated during 1956-1964 had less than 74 per cent foreign capital participation, which was in consonance with the government policy of enabling the Indian partner to have a say in changes in the articles of incorporation. The above analysis indicates that, while the Government has been enforcing the Indian majority principle with progressive stringency, there is flexibility in the policy to allow for exceptions on the merits of the individual case.

(*b*) *Pattern of agreements for foreign collaboration.* An important feature of the foreign sector in the post-Independence era was the growth of technical collaboration agreements. Between 1948 and March 1964, about 2,200 agreements were approved, and, between April 1964 and March 1970, nearly 1,300 approvals were granted. *The Survey of Foreign Collaboration in Indian Industry* conducted by the Reserve Bank of India brought out the fact that, as of March 1964, there were only about 1,050 agreements in force.[19] The *Survey* showed an interesting alignment of industries depending on the company group. Machinery and machine tools, and electrical goods and chemicals together accounted for 55 per cent of agreements. Pure technical collaboration was relatively more important in textiles, machinery and machine tools, and metals and metal products, while subsidiaries and minority participation companies dominated in petroleum, transport equipment, electrical goods and chemicals.

[19] Excluding minor agreements of individuals and partnerships.

(c) *Over-import of technology.* One of the questions raised regarding foreign technical collaboration is whether there has been an over-import of technology either into sectors where it was not necessary or into sectors where adequate amounts of technology were already imported.[20] Although agreements in the early post-Independence period were concentrated in consumer goods industries, the industry mix of agreements currently in force shows that the bulk of agreements are in fairly sophisticated sectors of industry, though it could be argued that the broad industry groups cover a wide range of consumer goods, for instance, some of the firms in medicines and pharmaceuticals also produce toiletries.

While technical collaboration in consumer goods and services is sometimes claimed to be unwarranted, the basic reasons for these agreements need to be examined. First, the import of technology has to be related to the time perspective of a development process; the technology which may be indispensable at the stage of its import may be dispensable in the future, i.e. the import of a certain technology itself may make future imports of that technology unnecessary. Thus, inter-temporal comparisons need to be undertaken with caution. Secondly, foreign collaboration in the production of consumer goods is an adjunct of the programme of progressive import substitution. The process of import substitution is related not merely to the steel-heavy engineering complex but to the entire gamut of consumer goods, and, to the extent that domestic "know-how" is deficient in the production of consumer goods, resort to foreign collaboration is unavoidable. Although foreign collaboration may seem unnecessary in certain sectors, in that substitute products with indigenous technology are available, the reason for permitting foreign collaboration may be the possibilities of developing an export market, though such cases are limited. Thirdly, there may be a decided advantage in permitting technical collaboration, with or without minority equity capital participation, especially when an industry consists largely of foreign subsidiaries, since this strengthens the competitiveness of the Indian company and also acts as a lever to facilitate the Government's policy to reduce the share of foreign equity in subsidiaries. Fourthly, in a dynamic context of changing technology, a country which is not a technological leader is faced with the prospect of importing technology on a continuing basis as the type of technology changes over time. In a period of rapid technological advance, a developing country which does not import technology for the production of consumer, intermediate and capital goods will inevitably find itself cut off from the mainstream of industrial development in the international economy. There is also the problem of a country reacting to the argument of an over-import of technology by importing less technology than is warranted by the level and pattern of industrial activity and the corresponding domestic technological base. The main difficulty is not so much the over-import of technology as its timely adaptation to the conditions of the country.[21] However, the often discussed point that the type of technology imported should be chosen with discrimination is unexceptionable.

The *repetitive* import of technology, in the sense of two or more companies importing the same "know-how", though seemingly a waste of foreign exchange resources, is sometimes necessary. It is not always possible to eliminate duplication of technology imports unless there is a drastic change in the pattern of inter-company transactions both in the host and transmitting country.

The Reserve Bank's *Survey of Foreign Collaboration in Indian Industry* has shown that over 70 per cent of agreements had a specific clause assuring exclusive rights to the licensee. Most of the agreements which do not specifically grant exclusive rights operate on the basis of an understanding that tacit exclusivity will be granted unless the working of the agreement is found to be unsatisfactory.

An UNCTAD paper refers to the "positive experience" of Japan in utilizing the world market for licences and "know-how" and the "somewhat less positive experience" of India.[22] However, other studies show that even Japan has been faced with problems of repetitive import of technology. In 1961/62, the share of new techniques to total technology introductions was more than 70 per cent, but, in 1965/66, the share dropped to 43 per cent, with the greater part of introduction either identified with the techniques already imported or similar thereto. This tendency was noted mainly in the fields of engineering, chemicals and textiles. In the petrochemical industry, for example, more than 10 agreements related to polyethylene. In respect of 73 technical collaboration agreements in the electrical engineering industry, it was noted that, if they were to be classified according to similarity of techniques, they could be reduced to 35 types. This indicates that 38 out of the 73 technical collaboration agreements involved repetitive imports of technology.[23]

[20] Kidron, M., *Foreign Investments in India*, Oxford University Press, 1965, p. 302.

[21] To the extent that there is a problem of over-import of technology, the problem is equally relevant for intermediate and capital goods as for consumer goods. Yet illustrations of over-import are generally identified with consumer goods.

[22] Oldham, C. H. G., Freeman, C., and Turken, E. (Science Policy Research Unit of the University of Sussex), *The Transfer of Technology to Developing Countries with Special Reference to Licensing and Know-how Agreements*, UNCTAD, TD/28/Supp. 1, 1967, p. 14.

[23] Patil, R. H., "Foreign Collaboration in Japanese Industry", *Reserve Bank of India Bulletin*, February 1970, p. 207.

An interesting feature of technology transfers in India is that virtually all inter-company transfers are between foreign collaborators and Indian companies; similar transfers between Indian companies are rare, even though they could play a vital role in the development of indigenous technology.

The inter-firm transmission of technology under foreign collaboration agreements is invariably on an exclusive basis, i.e. the Indian party is precluded from transmitting "know-how" to other companies. The reason for this is that the foreign collaborator's patented and unpatented "know-how" is protected, while the Indian party has the assurance that other Indian parties are unable to utilize the "know-how". This results in a multiplicity of agreements for the import of "know-how" for the same process/product. With a view to facilitating the transfer of "know-how" among Indian firms, and to reducing the multiplicity of agreements, the Government has recently insisted on incorporating a "no secrecy clause" in some agreements and stipulating that the Indian firm should be free to sub-license the technical "know-how"/product of design/engineering design under the agreement to another party; the terms of sub-licensing, however, would be mutually agreed to by all the parties and be subject to government approval.

The freer flow of technology among Indian firms is unlikely to impair the competitive position of the licensor firm for two reasons. First, the licensor firm is likely to have a "head start" and advance its own technology, and, therefore, be willing to transmit technology to firms that need such assistance. Secondly, among firms of equal technological strength, a healthy system of cross-licensing could develop.

With a view to promoting such inter-company transfers of "know-how", the Finance Act of 1969 allows Indian companies a deduction of 40 per cent of income if such income is received by way of royalties, technical service fees or for providing technical "know-how" or rendering technical services to any person carrying on business in India. To be eligible, the agreement should be entered into after 1 April 1969 and approved by the Government.

(*d*) *Duration of agreements and royalty rates.* The duration of agreements and the rate of royalty payments are the main points in the general evaluation of foreign technical collaboration. A little over 13 per cent of agreements in the Indian *Survey* had a duration of over ten years. Comparable data for other countries regarding the duration of agreements is not readily available, and, in view of variations in administrative procedures regarding classification and content of agreements, the utility of comparisons is somewhat limited. The experience of Japan indicates that 20 per cent of contracts in that country had a duration of fifteen years.[24] Though no definite conclusions can be drawn from the duration pattern of the two countries, it appears that Indian industry is not unduly saddled with excessively long duration agreements.

An examination of the rates of royalty linked to value of sales/production, shows that only 12 per cent of cases in the Indian *Survey* had rates over 5 per cent. No definite conclusions regarding the efficacy of foreign collaboration policy can be drawn from an examination of the rates of royalty. Other things being equal, an agreement with a higher rate of royalty may appear to be less favourable than an agreement with a lower rate of royalty, but, it is conceivable that, in the latter case, the technical fees may outweigh the advantages of a lower royalty. When sanctioning collaboration agreements, the Government attempts an *ex ante* assessment, on the available data, of all the alternative collaboration terms submitted for approval, and, by comparing similar proposals in an industry, has operated as a moderator aiding the Indian party. Preoccupation with rates of royalty can sometimes result in misleading conclusions regarding the role of the Indian Government. For instance, the fact that a larger proportion of 1956-1965 subsidiary agreements had royalty rates over 3 per cent than those agreements which were approved prior to 1955 does not necessarily mean that the Government was less successful in obtaining favourable royalty terms, since much depends on the content of the agreements. It is quite conceivable that the earlier agreements involved rudimentary technology, while, with an increase in industrial activity, the latter agreements involved the transmission of more sophisticated "know-how". Thus, an inter-temporal comparison of royalty rates needs to be made with some caution.

(*e*) *Export restrictions.* The Indian *Survey* shows that 43 per cent of agreements had export restrictions (table I-4-37). Once again, only a very small amount of comparable data is available regarding the prevalence of export restrictions in the collaboration agreements of countries other than Japan. A study of Japanese agreements reveals that well over one-half of all agreements had such clauses,[25] which *prima facie* indicates that the Indian experience has not been particularly unfavourable.

[24] UNCTAD paper, *op. cit.*, p. 25.

[25] UNCTAD paper, *op. cit.*, p. 25.

However, the mere enumeration of export clauses in agreements does not indicate the relative severity of export restrictions in the agreements of the two countries, because the intensity of restriction varies from agreement to agreement. Moreover, the absence of export restrictions may not be a sufficient condition for spurring an export effort, since the agreements, which may be free of export restriction, could relate to companies which have little or no export prospects.

(f) Concluding observations. While the Government, in actual practice, has not specified rigorous terms, broad norms have developed over time, such as the spheres in which collaboration is permitted, the 51 per cent rule, the 5 per cent royalty ceiling, the ten years' duration for agreements and the ceiling of 10 per cent on "free shares". The Government's policy appears to be flexible to accomodate individual proposals as special cases within a broad framework.

Table I-4-37. India: Types of restrictive clauses

Type of restrictive clause	*Number of agreements with restrictive clauses*			
	Subsidiaries	*Minority capital participation*	*Pure technical collaboration*	*Total*
Export clauses	56	230	169	455
of which:				
Permission of collaborators for exports	32	80	37	149
Exports permitted only to certain countries	16	101	80	197
Exports prohibited to certain countries	3	17	22	42
Exports prohibited	3	15	18	36
Exports restricted to certain types of products	1	2	1	4
Exports restricted only to collaborator's agents/distributors	1	13	6	20
Restriction on the annual value of exports	—	2	—	2
Restriction on use of trademarks for exports	—	—	5	5
Sources of supply of raw materials and plant and machinery	14	46	94	154
Restrictions on production pattern	2	36	27	65
Payment of minimum royalty	1	14	40	55
Restrictions on sales procedure	6	7	5	18
Stipulation on earning minimum profit	—	1	—	1
Restrictions on termination of agreement	1	—	1	2
Total number of agreements with restrictive clauses[a]	63	251	213	527
Total number of agreements	144	445	462	1,051

Source: *Foreign Collaboration in Indian Industry: Survey Report, op. cit.*, p. 106.

[a] The total number of agreements with restrictive clauses would be less than the total number of restrictive clauses since one agreement may have more than one restrictive clause.

Chapter V

EXPORT CREDIT FLOWS TO THE ECAFE REGION

From the recipient countries' view-point, export credits can be considered to resemble direct investments as a source of private long-term capital. However, four important distinctions should be made between export credit and direct investment. First, export credits like portfolio investments are free from the foreign control which is associated with direct investment, with the result that allocation and management are in the host country's hands. Second, at the same time, export credits do not promote the transfer of foreign technology and managerial "know-how" to the same degree as direct investments. Third, the repayment of export credits is rigidly fixed, whereas the equity component of direct investments carries no fixed repayment terms. Fourth, while interest on export credits is fixed and mandatory, earnings on equity investments are not limited, but are determined entirely by the success of the investment project. Furthermore, such earnings may be either reinvested without foreign exchange cost to the host country, or remitted as dividends to the foreign investor, depending upon future developments.

Growth of export credit flows

Since the early 1950s, private exports credits (or suppliers' credits) as a means to finance exports of capital goods and other manufactures to developing countries have grown increasingly important. These credits, together with official aid flows, have substantially replaced the traditional financing in the form of portfolio investments, i.e. bond floatations on the international market. Export credit financing has in fact grown on such a scale that, for some countries, they represent the largest portion of outstanding external public debt.

Table I-5-1 shows the growing importance of export credit flows to all developing countries over the last decade. From an annual average of only $559.5 million in 1960/61, export credit flows have grown to $1,809.5 million in 1968/69, at an annual rate of 15.8 per cent. Official flows during the same period grew by only 3.3 per cent and total flows by 5.5 per cent. The estimate of export credits excludes part of the funds classified as official flows which are in fact export credits granted by public institutions in developed countries such as the United States and Japanese Export Banks and the German Kreditanstalt fur Wideraufbau.

The cumulative net changes in private insured export credits granted to the developing countries by the DAC countries between 1956 and 1968 show credits with maturities up to five years totalling $4,347.3 million, and those with maturities extending beyond five years amounting to $5,651.6 million.[1]

[1] *Source:* OECD, *The Flow of Financial Resources to Less-Developed Countries, Development Assistance, 1969.*

Table I-5-1. Net flows of financial resources to developing countries, 1960-1969[a]

Average of years	Total	Private flows			Total	Private flows		
		Official flows	Export credits[b]	Others[c]		Official flows	Export credits	Others
	(in million dollars)				(in percentages)			
1960–61 . . .	8,682.0	5,554.0	559.5	2,568.5	100	64.0	6.4	29.6
1962–63 . . .	8,559.5	6,055.0	616.0	1,889.0	100	70.7	7.2	22.1
1964–65 . . .	9,777.5	6,090.0	805.0	2,882.0	100	62.3	8.2	29.5
1966–67 . . .	10,829.0	6,819.0	1,047.5	2,962.5	100	62.9	9.7	27.4
1968–69 . . .	13,342.0	7,218.5	1,809.5	4,312.0	100	54.1	13.6	32.3
Annual rate of growth 1960/61 to 1968/69 in percentages .	5.5	3.3	15.8	6.6				

Source: Based on data from OECD, *Development Assistance, 1970.*

[a] From DAC countries only. Gross disbursement minus amortization receipts on earlier lending on credits of one year and over.

[b] Publicly guaranteed export credits only. Public export credits, i.e., those provided by public financial institutions in DAC countries, are included under official flows.

[c] Bilateral portfolio, multilateral portfolio and private direct investment.

The share of the United States in the total private insured credits of both types above is small, amounting to only 2.8 per cent of the total, whereas Japan accounts for the major share in the total, at 20.1 per cent. The United States insurance system is of relatively recent origin. Exporters in that country, when selling capital goods on credit, could rely on the Export Import Bank, a credit institution specially established for the purpose. In Europe, on the other hand, while the specialized credit institutions have been established relatively recently, export credit insurance institutions in most of them date as far back as the period between the two world wars. In more recent years, there has been a move from financing by specialized institutions towards insurance-backed credits in the United States, whereas, in Europe, the move has been towards a greater utilization of specialized financing institutions.

As a percentage of total financial resources flows to developing countries, private export credits have grown from 6.4 per cent in 1960/61 to 13.6 per cent in 1968/69, while official flows declined in importance from 64 per cent to 54.1 per cent. This broadly indicates a hardening of terms for the developing countries, since export credits are commercial loans which generally carry commercial terms as against the concessionary aid flows which make up the bulk of official flows.[2]

Table I-5-2 shows, for selected ECAFE countries, the composition of total external public debt outstanding at the end of 1968. With the exception of India, for which data on export credits are not available, the export credits shown include those contracted by the Governments in the recipient countries and guaranteed by them. The table shows that the importance of export credits varies from 67.6 per cent for the Republic of Korea to 1.5 per cent for Singapore. Malaysia, Thailand and Singapore seem to have been the main beneficiaries of international loans, whereas India and Indonesia are the main recipients of loans from Governments on a bilateral basis. Malaysia's 14.4 per cent of "other private debts" consists mainly of bond floatations on the international market.

A review of net export credits granted by DAC countries between 1960 and 1968 on a global basis shows that such flows have been unevenly distributed. Six Asian countries account for 32.4 per cent of flows to all developing countries of the world, three countries in Europe for 12.7 per cent, six countries in Latin America for 26.7 per cent and six countries in Africa for 18.6 per cent. Thus, the twenty-one countries above account for 90.5 per cent of all flows during 1960-1968. Available data on the geographical distribution of the destinations of export credit exceeding five years also show an excessive degree of concentration, with fifteen selected countries accounting for 71 per cent of the total of such credits.[3]

Table I-5-3 shows the trend of net inflow of export credits provided by DAC members to ECAFE countries. Table I-5-2 and I-5-3 are not strictly comparable. Table I-5-2 shows data on outstanding debt supplied by recipient countries and excludes export credits to the private sector unless such credits are guaranteed by the Governments in recipient countries. Table I-5-3 is based on data supplied by creditor countries and excludes export credits which are not insured or guaranteed by the Governments in the creditor countries themselves.

In the aggregate, the ECAFE region has been receiving an increasing percentage of total flows to all developing countries, from 4.2 per cent in 1960 to 40.1 per cent of the total in 1968. It must be borne in mind that the data in table I-5-3 refer to net flows and the low proportion of regional to total flows in the years 1960-1962 was mainly caused by a substantial net outflow from India.

Based on data in table I-5-3, table I-5-4 presents the average annual rates of increase of net export credits inflows obtained by using least square trends.[4] The trend is insignificant for the five countries showing negative rates of increase, as is borne out by the low coefficient of determination. In Indonesia, net inflows were large until the payments crisis of 1965, when a moratorium was put on export credit inflows, resulting in a negative flow. The trend is also insignificant for Malaysia, Singapore and Hong Kong. For the remaining countries, which have used export credits significantly, the positive trend is quite significant.

Terms and conditions of repayment

Export credits have been criticised as being an expensive form of finance because exporters allegedly put up the price on such credits and because interest rates, while nominally low, are often calculated on the basis of the original amount, rather than on outstanding balances. Whether or not this criticism is justified, the short maturities involved in export credits tend to lead to an accumulation of short-term borrowings for the finance of long-term investments which may lead to balance of payment problems.

[2] Under the Supplementary Terms Recommendation adopted by DAC in February 1969, official flows are separated into two categories: (a) Official development assistance, which comprises concessionary aid flows, and (b) other official flows, which include mainly export credits by official institutions in donor countries.

[3] OECD and estimates quoted from: IMF, "The Use of Commercial Credits by Developing Countries for Financing Imports of Capital Goods", *Staff Papers*, vol. XVII, No. 1, March 1970.

"All flows" means "all insured credits including uninsured portions of insured credits granted by DAC member countries only".

[4] See explanation of method in notes to table I-5-4.

Table I-5-2. External public debt outstanding by categories at 31 December 1968: Selected ECAFE countries

(in million dollars)

Country	Total debt outstanding		Export credits		Other private debts		Loans from international organizations		Loans from Governments	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Afghanistan	648.9	100	—	—	—	—	3.5	—	645.4	—
China (Taiwan)	842.1	100	131.4	15.6	—	—	167.9	19.9	542.9	64.5
Ceylon	336.7	100	62.5	18.6	7.3	2.2	46.2	13.7	220.6	65.5
India[a]	7,733.5	100	115.1	1.5	3.9	—	1,639.0	21.2	5,975.5	77.3
Indonesia[b]	2,984.8	100	262.8	8.8	195.3	6.5	67.0	2.2	2,459.7	82.4
Iran	1,932.3	100	672.8	34.8	—	—	223.1	11.6	1,036.4	53.6
Khmer Republic[b]	49.0	100	15.8	32.2	—	—	—	—	33.3	67.9
Korea, Republic of	1,597.8	100	1,080.9	67.6	—	—	40.3	2.5	476.5	29.8
Malaysia	460.3	100	12.1	2.6	66.2	14.4	202.4	44.0	179.6	39.0
Pakistan	3,261.1	100	270.6	8.3	—	—	778.2	23.9	2,212.3	67.8
Philippines	493.2	100	200.8	40.7	12.6	2.5	131.1	26.6	148.7	30.1
Singapore	80.0	100	1.2	1.2	—	—	75.9	94.9	2.8	3.5
Thailand	311.3	100	20.5	6.6	—	—	201.5	64.7	89.4	28.7

Source: IBRD, Annual Report 1970.

Notes: Export credits include such debts of Governments or government agencies in debtor countries and privately-held debt guaranteed by them.

Other privately-placed debts are those obtained from financial institutions in creditor countries or internationally-placed bonds.

[a] Excludes suuppliers' credit.

[b] As of 31 December 1969.

Table I-5-3. Net inflow of export credits into the ECAFE region

(in million dollars)

Country	Net inflow of export credits										Total 1960/69
	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	
Afghanistan	2.71	—3.70	—1.07	0.11	—0.04	3.20	1.76	0.24	9.02	—1.58	10.65
Burma	0.65	0.33	2.43	—1.74	—0.39	3.05	—0.15	13.22	9.20	1.30	27.90
Ceylon	0.93	3.39	—2.26	—1.12	6.56	2.32	0.90	34.38	18.29	3.11	66.50
China (Taiwan)	3.21	8.16	1.59	—5.41	0.12	9.31	5.86	29.98	49.71	52.90	155.43
Hong Kong	0.53	6.03	4.39	27.43	—2.86	3.26	26.02	20.42	0.80	—2.31	83.71
India	—66.24	—86.37	—24.19	5.92	104.26	49.72	107.09	40.83	81.85	36.25	249.12
Indonesia	25.30	60.45	18.72	17.64	117.37	138.49	—5.47	—67.68	—12.32	—53.91	238.59
Iran	23.64	—12.86	—15.43	45.28	—107.50	—11.85	34.09	179.21	129.40	379.04	643.02
Khmer Republic	—	0.42	—0.21	—0.03	0.57	2.49	8.75	3.31	3.54	1.48	20.32
Korea, Republic of	—1.28	12.34	6.04	21.02	—8.22	22.93	87.56	92.36	126.29	161.55	520.59
Laos	—	—0.05	—0.08	1.06	1.49	0.10	—0.04	—0.08	—0.13	—0.03	2.24
Malaysia	0.24	4.18	1.90	4.27	14.60	11.16	9.19	—6.55	3.42	0.91	43.32
Nepal	—	0.10	0.01	1.00	1.82	—0.65	—0.07	1.47	—3.21	—0.39	0.08
Pakistan	—8.73	17.12	28.20	—23.58	2.99	15.39	24.97	39.14	61.89	62.62	220.01
Philippines	31.74	24.20	0.70	—2.11	14.81	20.96	29.70	83.72	64.66	69.06	337.44
Singapore	1.66	—0.54	2.94	—2.56	—0.62	0.48	2.92	—0.25	5.71	2.45	12.19
Thailand	10.25	27.86	13.05	40.65	36.92	11.57	4.43	—18.20	33.79	53.02	213.34
Viet-Nam, Republic of	—1.73	1.39	6.94	9.92	4.22	—1.99	—4.51	—7.81	—6.01	—1.07	—0.65
Unallocated	—	—	—0.01	23.17	1.00	—0.01	7.91	—1.80	1.00	—0.08	31.18
Total ECAFE	22.88	62.45	43.66	160.92	187.10	279.93	340.91	435.91	576.90	764.32	2,874.98
Total to developing countries	546.00	573.00	572.00	660.00	860.00	750.00	1,214.78	1,052.55	1,441.34	1,905.51	—
ECAFE as a proportion of the total (in per cent)	4.2	10.9	7.6	24.4	21.8	37.3	28.1	41.4	40.0	40.1	

Source: OECD, *Geographical Distribution of Financial Flows to Less-Developed Countries*, various issues;
OECD, *Development Assistance*, 1969, 1970.

Table I-5-4. Annual rate of increase in the net inflow of export credits: ECAFE countries

(in million dollars)

Country	Annual rate of increase B[a]	SE[a]	Coefficient of determination (R^2)
India	21.80	5.54	0.83
Iran	19.10	9.86	0.59
Korea, Republic of	18.20	4.51	0.84
Philippines	8.21	3.32	0.68
Pakistan	6.28	2.49	0.68
China (Taiwan)	5.71	2.20	0.70
Ceylon	2.87	1.24	0.66
Burma	1.55	0.58	0.71
Hong Kong	0.96	1.59	0.22
Khmer Republic	0.80	0.37	0.66
Afghanistan	0.76	0.39	0.59
Singapore	0.43	0.36	0.42
Malaysia	0.04	0.87	0.02
Laos	—0.07	0.10	0.27
Nepal	—0.25	0.24	0.04
Thailand	—1.64	2.49	0.24
Viet-Nam, Republic of	—1.32	0.66	0.60
Indonesia	—8.15	8.42	0.34
Unallocated	—	—	—
Total ECAFE[b]	52.0%	—	—
Total flow to developing countries[b]	13.2%	—	—

Source: Based on table I-5-3, 1960 to 1968 annual data.

[a] Rates of annual increase were determined by regressions of annual inflows on time; $Y = a + Bx$ where Y = net inflows of export credits and x = calendar years, 1960 = 1, etc., B, the regression coefficient measures the annual rate of increase in US$ millions and SE is the standard error of the regression coefficient.

[b] Annual rate of growth of terminal values, based on compounded rate of increase.

Through the twin measures of providing export-credit insurance and facilitating export-credit financing itself by granting concessionary interest rates or rediscounting facilities, Governments in developed nations have encouraged their exporters to sell aggressively on credit to destinations which, under normal commercial practices, would not have been possible. Some of the facilities provided may include an element of subsidy.

The establishment of export credit insurance facilities in virtually all developed countries has greatly facilitated the lengthening of maturities of export-credit financing, as, the longer the repayment period, the greater the political and commercial risks involved and therefore the greater the need for export-credit insurance.

Under existing export-credit insurance schemes, an exporter selling on credit may insure part of the value of his exports (between 80 and 90 per cent) against commercial and non-commercial risks, with a government-operated or government-backed export-credit insurance system in his country. Since such government-backed or government-owned export-credit insurance schemes were established primarily to promote exports on credit, not for the purpose of making profits, they may be only secondarily concerned about the creditworthiness of debtor countries, even though they usually do grade countries according to the potential risks involved. These insurance facilities are therefore partly responsible for the excessive accumulations of export credit debts which in some recipient countries have led to debt crises and renegotiation.

With regard to the allegation that overpricing may lead to excess cost, it is argued that export credits, being funds tied to a specific purchase, can be likened to tied aid, and are therefore subject to the possible excess pricing which has been shown to be the characteristic of tied aid.

A pioneering study dealing with quantitative data for Pakistan showed that the weighted average price for twenty projects which were financed by tied aid was 51 per cent higher than the lowest international bids on these projects, and that the tying of foreign credits raises the average procurement prices for Pakistan by about 12 per cent.[5] Other studies have also come to similar conclusions.[6]

Critics of export credits allege that this form of finance constitutes the ultimate form of tied aid because such credits are tied to a specific commodity purchase, as well as to a specific source. Consequently, these critics believe that export credits carry a high component of excess cost over world price, estimated in some cases to exceed 100 per cent.[7]

Compared with cash imports, export credits indeed carry a certain element of tiedness in that the particular credit will not be forthcoming unless the purchase is made. Therefore, purchase decisions will be influenced by availability of financing.

The objections to export credit are largely based on the fact that it can create a monopolistic product differentiation for the exporter, and that he can charge a higher price if successful. On the other hand, when several countries try to create similar product differentiation, an oligopolistic situation is generated in which the buyer, if sufficiently alert, can derive certain bargaining advantages by utilizing the oligopolistic competition among the suppliers.

[5] The estimate of weighted average was obtained by comparing bids, rather than actual prices paid, with the lowest price available, and therefore represents a range of "potential cost" rather than actual cost. Mahbub Ul Haq, "Tied Credits — A Quantitative Analysis", in Adler, John H. and Kuznets, Simon, ed., *Capital Movements and Economic Development*, Proceedings of a Conference held by the International Economic Association (New York, St. Martin's Press, 1967).

[6] UNCTAD, Second Session, vol. IV, *Problems and Policies of Financing*, 1968.

[7] Pearson Commission, *Report*, p. 119.

However, institutional arrangements in developing countries are often such that they only approach one supplier and are, therefore, not in a position to obtain the best price available in the world market. This drawback exists in regard to their cash imports as well where importers do not necessarily succeed in obtaining the best quality and the cheapest price. Perfect competition and perfect market knowledge are always harder to approximate in the international than in the domestic markets.

Diversification of import sources is, of course, a very important consideration for the developing countries, not only in order to obtain better terms for export credits, but also with a view to minimizing the harmful effects of tied aid. It has been observed in Iran, for instance, that, by obtaining aid from several countries, while generally enjoying a relatively easy foreign-exchange position, the country has been in a position to limit the cost of tying by switching sources of imports and giving wide circulation to project tenders. It has also been observed that, as Pakistan managed to diversify its sources of credits, it succeeded in obtaining supplies at more competitive rates in the world market.[8]

Diversification of suppliers in export-credit financing is the stated policy of the Republic of Korea which deliberately uses the policy of inducement of export credits to minimize its dependence on a single country. In 1968, imports utilizing export credits came from Japan ($129.3 million), the United States ($73.7 million), the Federal Republic of Germany ($41.3 million), and Italy ($15.8 million). This indicates that the Republic of Korea has been relatively successful in achieving its objective.[9]

Turning now to the problems of interest rates and maturities, table I-5-5 shows the comparison of future service payments on the various types of outstanding debt for a selected group of ECAFE countries. Two interesting points emerge from this exercise. Firstly, the table shows that amortization payments for export credits will be almost entirely completed within the period under consideration. For other classes of debt, lower proportions of amortization payments will be completed. This shows that, despite the increasing number of export credits of five years and over, export credits in general carry far shorter maturities than other types of loans, especially those emanating from international organizations which are definitely long-term in character. It seems clear, therefore, that a country which accumulates large amounts of export credits, especially those of the short-term variety, should be more careful in managing its balance of payments problems.

[8] Country study on Iran in UNCTAD, *op. cit.*, and Mahbub Ul Haq, *op. cit.*

[9] Information supplied by the Bank of Korea.

Table I-5-5. Estimated future debt service payments for each type of debt as proportions of total debt outstanding of that type[a]—Selected group of ECAFE countries 1968-1977

(in percentages)

	Amortization	*Interest*	*Total payments*
Total external debt	48.3	20.3	68.6
Privately-held export credits .	98.7	18.9	117.6
Other privately-held debt[b] . .	82.8	25.8	108.6
Loans from international organizations	36.2	24.4	60.6
Loans from Governments . .	46.3	19.4	65.7

Source: Based on data from national and international sources.

Note: The selected group of ECAFE countries includes China (Taiwan), Ceylon, India, Indonesia, Iran the Republic of Korea, Malaysia, Pakistan, the Philippines, Singapore, Thailand.

[a] Estimated service payments are annual payments during the period stated on debt outstanding, including undisbursed, at the inception of the period. Total service payments for the whole period are then divided by debt outstanding to obtain the ratios for each category of debt. They are not forecasts of the service payments which are expected, because new debts may be contracted and terms and composition of existing debts may be changed.

[b] Includes loans from financial institutions and publicly issued bonds.

There is an optimum combination of different types of foreign loans, taking into consideration not only the interest rate and the period of maturity, but also the expected trade balance, net capital flows and the reserve position of the country. Any type of loan in excess of this optimum creates balance of payments problems. When kept at the optimum level, different types of loans can contribute a great deal to development.

Secondly, when it comes to interest payments, however, it is not clear that export credits carry a heavier interest burden than other types of loans. In fact, table I-5-5 shows that, during the same period under study, interest payments on export credits as a percentage of such debts outstanding are lower than interest payments as a percentage of loans in the other categories, i.e. government loans and loans from international organizations, which appear to be the most expensive. The explanation lies partly in the fact elaborated earlier that (*a*) export credits are competitive credits and (*b*) developed countries are competing with each other to promote their exports giving attractive interest rates to their export credit sector. In the case of international financial institutions, on the other hand, the increasing cost of money on the international markets has tended to increase their lending costs also. Interest rates on export credits have stabilized under competitive conditions and have become almost uniform throughout the

Table I-5-6. Commercial credits exceeding five years extended to developing countries by members of the Group on Export Credits and Credit Guarantees, by purpose, 1963-1968

(in million dollars)

Purpose	*1963*	*1964*	*1965*	*1966*	*1967*	*1968[a]*
Complete plants (including extensions)	449	614	665	520	1,457	1,900
Power	116	204	163	125	299	650
Chemicals and fertilizers	153	119	100	158	235	400
Steel and metal products	122	135	65	68	393	470
Wood pulp and paper	8	26	75	56	8	5
Cement	14	13	69	41	83	25
Mining	—	—	81	26	40	30
Sugar	10	27	48	17	108	80
Textiles	7	24	33	18	55	60
Other	19	66	31	11	236	180
Machinery motors and plant equipment[b]	76	145	120	218	273	265
Ships[c]	172	236	367	403	713	1,050
Aircraft[c]	24	59	105	140	301	240
Locomotives[c]	47	25	46	80	57	75
Road vehicles[c]	1	5	14	27	12	10
Road, railway, and port equipment	86	61	60	63	79	135
Telecommunications and electrical equipment	38	76	49	72	158	120
Other (unspecified and multi-purpose)	65	264	186	156	147	165
Total	958	1,485	1,612	1,679	3,197	3,960

Source: OECD, Trade Committee, Group on Export Credits and Credit Guarantees, quoted in IMF, *Staff Papers, op. cit.*

[a] Preliminary data.

[b] Power plant and transmission equipment included under heading "Power".

[c] Including components and spare parts.

developed countries, averaging around 6 per cent. By comparison, interest rates on World Bank loans granted during fiscal year 1969/70 all carried interest rates of 6.5 or 7 per cent.[10]

It should be noted however that, in the case of export credits, the interest charges have meaning only in relation to the price charged for the product. This is because the supplier has the option of charging a higher price and lower interest rate, or vice versa, depending on his assessment of the customer's liquidity position.

Uses of export-credit financing

Table I-5-6 shows the utilization of export credits exceeding five years granted by members of the OECD Group on Export Credits and Credit Guarantees. The table shows that complete plants occupy a domineering position in the total and that the three most important categories falling under this heading are power, chemicals and fertilizers, and steel and metal products. The financing of sugar and textile mills is also becoming important. Among the rest, ships (predominantly to sail under the flags of Liberia and Panama) occupy the largest percentage, with machinery and aircraft also becoming important.

More detailed statistics on utilization of export credits in the recipient country are available for the Republic of Korea. During 1968/69, official aid imports were used mainly for foodstuffs and crude materials, except fuels, (SITC 0 and 1), accounting for 78.4 per cent of such imports. Export credits, on the other hand, were used mainly for the importation of machinery and transport equipment (SITC 7), which accounted for 75 per cent of imports financed by export credits.[11]

Export credit inflows and economic development

The tied nature of aid, the delays in processing, and its limited quantity in relation to the needs leave large gaps in foreign resource flows which may be partially filled by export credits.

[10] World Bank, *Annual Report 1970.* Interest rates on export credits: United Nations, *Export Credits and Development Financing*; Part I, *Current Practices and Problems* (1966), p. 11 and Part II, *National Export Credit Systems* (1969), p. 2.

[11] Bank of Korea, *Statistical Yearbook.* SITC 7 also includes consumer durables and passenger cars, and a further breakdown is needed to know the exact utilization of export credits for productive capital goods. (SITC = Standard International Trade Classification).

Immediately after the Second World War, the shortage of all kinds of goods presented no need for specific export promotion. This situation has changed drastically as more and more countries are building up their industrial capacities and trying to export increasingly larger amounts of virtually every commodity traded in the international market. An abundant supply situation has created intense competition amongst suppliers, who attempt to maintain their shares of given export markets or tap new markets. Export-credit financing has become a standard practice in international trade, especially for the financing of capital goods.

The important problem for developing countries is not how to restrict such credit inflows, but how to make the best use of them by allocating them to projects which will contribute to economic development. This entails studies on the best proportional combination of export credits and official development assistance.

Developing countries are often denied access to lucrative markets for the export of their growing production of various manufactures on account of their inability to provide the same credit facilities as those extended by developed countries. Co-operation among developing countries would be very helpful in this field.

In the present situation, export-credit facilities, somewhat like private direct investment flows, frequently include technical "know-how" supplied by the manufacturers of equipment who have a direct stake in the repayment possibilities of their credits. Nowadays, it is quite common, in export-credit financing, to have manufacturers design complete plants and make recommendations on the selection of technical personnel to help the local managers and engineers during the plant's initial period of operation.

On the other hand, export credits are different from private direct investment in that the foreign suppliers never obtain a stake in the undertaking itself. In this respect, such credits more closely resemble official aid credits. In addition, export credits can be obtained by the public sector in developing countries, or be guaranteed by the public sector. Compared with private direct investment, they can be geared more towards development priorities. It seems that export credits, if used judiciously, can combine the advantages of aid flows and private foreign investment, and, thus, may provide a necessary complement to other capital inflows.

Nevertheless, the inherent dangers in the excessive use of export credits should be recognized by the developing countries concerned. As such credits involve future repayment in foreign exchange, the Governments of the countries receiving such credits should exercise greater control over the inflow and use of export credits by the private sector. One criterion may be that export credits should be used to finance the import of equipment for projects which will generate foreign currency income at least equivalent to the yearly loan repayment figures. Foreign exchange income should here be interpreted broadly to mean direct earnings or indirect earnings if the industry established is of the import-substituting variety. There is no reason why Governments should not carefully include export-credit financing in their foreign exchange budget and carefully plan the repayments of export credits.

At present, most developing countries have investment boards for the control of direct foreign investments, and the inflow of private export credits should be similarly controlled and regulated to prevent their use for unproductive imports beyond the means of the country.

One effective way to reduce excess cost would be to require importers to submit at least three different quotations from suppliers of credit for any project to be financed by export credits. India has already introduced this stipulation. Another is to limit the approval of export credits to those with maturities exceeding a certain number of years to be used for the finance of long-term capital goods imports. The Republic of Korea is imposing limitations on export credits of below ten years' maturity.

Finally, the combining of credits from public funds with private export credits may be used more extensively. An important innovation is the combining of private export-credit financing with World Bank or Asian Development Bank funds. Since 1965, IBRD has done this on several occasions. In 1968, four projects in Latin America were financed partly by IBRD funds and partly by export credits with maturities of ten years. The advantages are many. The export contracts under this programme were negotiated under IBRD guidelines for procurement, including fully competitive bidding. Moreover, IBRD, in co-operation with IMF and OECD, has, in the past few years, considerably improved the debt and debt servicing statistics of developing countries and is therefore in a better position to judge the creditworthiness of recipient countries than private exporters. Governments in recipient countries can help themselves by improving their statistics on debt and debt servicing, so that debt crises can be avoided.

In conclusion, it must be emphasized that the test of usefulness of export credits, as with the case of other external capital inflows, is not only that such capital will contribute to the economic growth of the country, but that it should include considerations on how such capital inflows will influence the goals of self-reliant national development.

Chapter VI

INCENTIVES FOR FOREIGN INVESTMENT IN THE DEVELOPING ECAFE COUNTRIES

Most developing countries of the ECAFE region have established regulations for the entry and operations of foreign private investment. They also offer incentives to attract foreign investment. The discussion of regulations and incentives in this chapter is based mostly on information relating to nine selected countries, namely China (Taiwan), India, Iran, Malaysia, Pakistan, the Philippines, the Republic of Korea, Singapore and Thailand. As most of the findings based on the analysis of this information are of a general nature, they should be of interest to other countries as well.

Administrative procedures

One of the common complaints of foreign investors has been the bureaucratic procedures and administrative delays involved in processing their applications for investment in developing countries. In recent years, most countries have simplified their procedures for granting approval of entry and for sanctioning various facilities. One method that has been introduced to avoid delays is the centralization of the decision-making process. For example, in the Republic of Korea, representatives of the government departments concerned are posted in the Office of Investment Promotion (OIP). In China (Taiwan), the Industrial Development and Investment Centre (IDIC) constitutes the central authority.

Other countries have established contact centres for potential investors, which also assist the local and foreign investors in negotiating terms of collaboration. The Federal Industrial Development Authority (FIDA) in Malaysia, besides performing its wider function of industrial promotion in the country, registers both local and foreign investors, to provide them with the necessary facilities. The Centre for Attraction and Protection of Foreign Investments in Iran (ACPFI), the Board of Investment in Thailand (BOI), the Board of Investments of the Philippines and the Department of Investment Promotion and Supplies in Pakistan perform similar functions. In India, the Government has set up the Indian Investment Centre to assist and promote joint ventures and technical collaboration. The Government has also delegated powers to a newly-established Foreign Investment Board which deals with all cases involving total investment exceeding Rs 20 million of equity capital and where the foreign investment exceeds 40 per cent of the issued equity capital. The Economic Development Board of Singapore (EDB) supplies all the information required by potential investors, and renders all necessary assistance.

Most countries do not impose any formal restrictions on the fields for foreign investment. Foreign investors can apply for entry into all types of activities which are open to domestic investors. However, some Governments declare lists of industries in which investment is invited. Most often these industries entitle the investor to claim various incentives under the national investment promotion programme. They are called "promotable" industries in Thailand, "pioneer status" industries in Malaysia and Singapore and "preferred areas of investment" in the Philippines.

The Republic of Korea has recommended specific industries to foreign investors, notably machinery for export. India has published three illustrative lists: (*a*) where foreign investment may be permitted; (*b*) where only foreign technical collaboration may be permitted; (*c*) where no foreign collaboration (financial or technical) is considered necessary. In the Philippines, the constitution provides that "disposition, exploitation, development and utilization of the natural resources of the country shall be exclusively reserved to the Philippine citizens or to corporations or associations at least 60 per cent of the capital of which is owned by such citizens".

In practice, most countries encourage foreign investment in the fields where it can help resolve the balance-of-payments problems by developing import-replacing or export-oriented industries. In several countries, the emphasis so far has been on import-substitution but recently interest has developed in export promotion. Foreign corporations are particularly invited to those fields where their technology and resources can be utilized for manufacturing exportable products.

There is an increasing interest in most countries that foreign investment should come into industries which have the maximum linkage effects in the economy and contribute to a self-sustaining growth process. Many countries expect foreign enterprises to gradually substitute foreign personnel by local employees in order to spread the technical "know-how" in the country.

Most countries of the region do not have any legal restrictions against wholly-owned foreign enterprises. However, in India, the industrial policy enunciated soon after independence stated that, as a rule, the major interest in ownership, and effective control, should always be in Indian hands. But, in practice, the Government has sanctioned majority participation of foreign investment in the light of the needs of foreign technology or capital in particular industries.

There are also countries, such as Singapore, where many foreign investments are wholly-owned foreign subsidiaries. China (Taiwan) and the Republic of Korea also have liberal policies in regard to permitting foreign ownership.

In some countries, although there is no statutory provision for it, an attempt is made to persuade foreign investors at the time of approval of application to take local participation. The general trend is towards encouragement of joint ventures rather than foreign branches or wholly-owned subsidiaries. However, generally no such condition is imposed by the host countries.

Risks and investment guarantee schemes

Most developing ECAFE countries have been liberal in allowing full remittance of earnings, although some restrictions are imposed on the repatriation of capital. This restriction is only in terms of the proportion of capital that may be repatriated annually: the right to repatriate the full amount is honoured. However, foreign investors often feel that, in situations of balance-of-payments crisis, there still is a risk of their profits and capital becoming inconvertible. Other risks which are of concern to foreign investors include: expropriation of their assets and the uncertainties of war and revolution. Some developing countries have given specific assurances against expropriation. For example, China (Taiwan) has committed itself to a statutory guarantee against expropriation or requisition for a period of at least twenty years. Most countries have declared in their policy statements that foreign investors enjoy the same rights as domestic enterprises. Should nationalization be deemed necessary, because of changed circumstances or in the public interest, just and fair compensation would be paid. Nevertheless, the foreign investor usually continues to rely mainly on the investment-guarantee programme of his home country.

A list of investing countries and the year in which they established an investment insurance programme is given below.[1]

United States	1948
Japan	1956
Germany, Fed. Rep. of	1960
Norway	1964
Australia	1966
Denmark	1966
Sweden	1968
Canada	1969
Netherlands	1969
Switzerland	1970

The types of risks covered by the insurance schemes are expropriation, war and transfer. The geographical coverage of the schemes varies. In the United States and the Federal Republic of Germany, the insurance schemes cover only those countries that have signed bilateral agreements, but, in Japan, the insurance has a world-wide coverage. The investment-guarantee programme of all the countries fully cover the initial investment, but the coverage of reinvested earnings and remitted earnings varies from one investing country to another. The duration of the coverage also varies, from fifteen to twenty years. The main features of the guarantee schemes of three capital-exporting countries, which are important for this region, are summarized in table I-6-1.

An OECD report gives the following comments on the results of investment insurance schemes: "From the insurer's point of view, the outstanding fact about the record to date is the small number and value of claims made against investment insurers. While only the United States, the Federal Republic of Germany and Japan have any very substantial operational experience, it is notable that indemnified claims against both the United States and the Federal Republic of Germany amount to only about one-tenth of one per cent of the value of insurance cover contracted. Japan has suffered no losses.

From these results it might be concluded that the risk inherent in investing in developing countries has been much exaggerated in the minds of the business community. The risks would in particular seem to be less for new investments, the bulk of nationalizations appearing to hit long-standing investments which have strong associations with earlier periods in the eyes of local politicians. The relative immunity of new investments may also have some substantial basis, in that the modern investor in developing countries has on the whole learnt to show flexibility in adapting his business methods to the particular sensitivities of developing countries (e.g. through joint venture arrangements and agreements on the employment of local labour, etc.). The results of investment insurance schemes may reflect these factors to the extent that coverage is available only for new investment.

[1] OECD, *Investing in Developing Countries*, 1970, pp. 14-15.

Table I-6-1. Summary of guarantee schemes for overseas direct investment

Country and name of executive agency or department	Geographic coverage a) World-wide b) Developing countries only c) Countries having signed bilateral agreement only	Coverage of principal and earnings[a] a) Initial investment b) Reinvested earnings c) Remitted earnings (per cent of original investment)	Coverage in case of loss: Indemnities paid as a percentage of recognized loss	Coverage in case of loss: Reductions in coverage
United States[b] Overseas Private Investment Corporation (OPIC). Until 1970, Agency for International Development (AID)	c) (to date some 92 countries)	a) 100 per cent b) 100 per cent of principal c)	99 per cent	Per net worth in financial statements
Federal Republic of Germany Deutsche Revisions — und — Treuhand AG and Interministerial Board	c) and some other countries	a) 100 per cent b) 50 per cent c) 8 per cent per annum for up to 3 years	Up to 95 per cent	Going concern value not exceeding capital brought in
Japan Ministry of International Trade and Industry (MITI)	a)	a) 100 per cent b) 100 per cent c) 10 per cent per annum	Up to 90 per cent	Reduction based on book value

Country and name of executive agency or department	Annual premium rates (percentage of outstanding amounts except if otherwise shown)	Duration of coverage	Accumulated guarantees outstanding
United States[b] Overseas Private Investment Corporation (OPIC). Until 1970, Agency for International Development (AID)	a) 0.25 per cent (convertibility) b) 0.50 per cent (expropriation) c) 0.50 per cent (war) b) and c) combined: 0.875 per cent plus 0.1 per cent on standby amount	Equity = maximum 20 years; Loan = duration of the loan	December 1969: $7.3 billion (December 1965: less than $2 billion)
Federal Republic of Germany Deutsche Revisions — und — Treuhand AG and Interministerial Board	0.5 per cent of current amount for the three risks together	Normally = up to 15 years; exceptionally = up to 20 years	Mid-1969: $280 million
Japan Ministry of International Trade and Industry (MITI)	0.55 per cent for the three risks together	Normally = up to 15 years	December 1969: $59.5 million

Source: OECD, *Investing in Developing Countries, 1970.*

[a] This column shows the coverage of principal and earnings for equity investments only. As regards loan investments, the schemes wholly cover outstanding principal and interest.

[b] The table gives only a presentation of the Specific Risk Guaranty Programme (the new name of this programme, now under the administration of OPIC, is Investment Insurance). The Extended Risk Guaranty Programme (also now under the administration of OPIC, under the heading of Investment Guaranty) has not been inserted in the table.

Notes: (1) These three countries insure against the risks of expropriation, war and transfer.

(2) These countries cover several types of investment. Investments can be in the form of (i) equity and loan participation and (ii) advances, the consideration for which may be cash, machinery, goods, "know-how" and services.

Even under the United States scheme, in operation since 1948, the bulk of new investments have taken place in the past few years."[2]

Tax incentives

The foreign investor is concerned mainly with two aspects of taxation in host countries: (*a*) the tax rates applicable to his investment income and (*b*) the tax incentives that reduce the tax rate or the tax base. In the developing ECAFE countries, the effective tax rate on corporate profits is usually much lower than the statutory or standard rate because of liberal tax incentives provided for investment.

The statutory rates vary markedly among the countries. In India, a company in priority industries is subject to an income tax rate of 50.6 per cent.[3] In Pakistan, the combined rate of income tax and super tax on companies in which the public are substantially interested comes to 55 per cent.[4] The tax rate in Malaysia is 45 per cent and it is 40 per cent in Singapore.

[2] "Foreign investment in developing countries: A pattern of increasing support from the Governments of the capital-exporting countries", *The OECD Observer*, No. 47, August 1970, pp. 4-5.

[3] This rate is applicable to a widely-held domestic company (including a wholly-owned subsidiary of such a company), if the total income exceeds Rs 50,000. There would be virtually no company below this level of business profits: at such low levels, it would be better not to form a company because the tax liability as an individual would be less. Therefore 50.6 per cent may be taken as the typical income tax rate on companies in priority industries. The rate of income tax on widely-held domestic companies in other industries is 55 per cent.

[4] The rebate on profits distributed as dividends is withdrawn in the 1971-72 budget.

Both India and Pakistan impose a higher rate of tax on the income of foreign branches which have not made the prescribed arrangements for the declaration and payment of dividends within the country. (70 per cent in India and 60 per cent in Pakistan.) The higher rate has been justified on the grounds that, in the case of a foreign company, the rate includes an element of the personal tax leviable on the foreign (non-resident) shareholders who later receive the distributed profits. This is a convenient method of collecting the tax on shareholders of foreign companies which cannot be realized directly from them.

In Thailand, the corporate income tax rate varies from 15 per cent on the first 500,000 baht of net profits to 25 per cent on profits in excess of one million baht. In China (Taiwan), the maximum rate of income tax for any profit-seeking enterprise, either local or foreign corporations, is 18 per cent. In the Republic of Korea, the tax rate on an open corporation ranges from 16.5 to 27.5 per cent. The Philippines levies on income tax of 35 per cent on the taxable income of domestic corporations exceeding 100,000 Pesos, the rate for corporate income below this amount being 25 per cent. For non-resident foreign corporations the rate is a fixed 35 per cent on gross income derived locally.

In most developing ECAFE countries, these rates, as such,[5] are lower than the standard rates of the corporate tax in several investing countries, such as the United States, the United Kingdom and the Federal Republic of Germany where they range from 42 to 50 per cent. In Japan, the tax rate on undistributed profits is about 35 per cent.

However, a comparison of the standard income-tax rates on corporations is not valid for showing the relative tax burden on investment income. The main reason is that the system of corporate taxation differs among the countries. Some treat the corporation as a separate entity which has a taxable capacity of its own, independent of the tax liability of its shareholders. Others give credit to the shareholders for the tax paid by their company, as if it had been paid on their behalf. Moreover, some countries provide different rates for undistributed and distributed profits. The rates also vary for different types of industries or different sectors of the economy, such as manufacturing, mining, public utilities, banking and insurance.

What really matters to the investor is the effective rate which he actually pays after adjustments for various exemptions, reliefs and deductions. The actual tax burden can be found only by analysing the financial results of the working of companies in different countries, but most developing countries have not carried out such studies.

However, an indication of the difference between effective tax rates and standard rates on corporate profits can be brought out through a discussion of the various tax concessions provided in these countries.

All the ECAFE countries have established investment promotion programmes, and tax incentives constitute a part of these programmes. In addition to a variety of incentives for promoting both domestic and foreign investment, some special concessions are offered to foreign investors. The developed countries from which foreign investment flows have also taken some measures to encourage their corporations to invest in developing countries,[6] but only the incentives provided by the host countries will be discussed here.

The major incentives can be classified as follows: (*i*) Tax holiday for enterprises; (*ii*) Accelerated depreciation allowance; (*iii*) Development rebate or investment allowance; (*iv*) Carry-forward of losses; (*v*) Income-tax exemption for foreign technicians and other foreign experts; (*vi*) Concessions on import duties.

Tax holiday Most ECAFE countries grant a tax holiday to enterprises for a specified period. Generally, the tax exemption is given in respect of income tax only, but there are special features of this provision in each country.

In Iran, the eligibility for, and the period of, tax exemption depends upon the location of the enterprise. The concession is not given to enterprises located within 120 kilometres of Tehran. It is available for only 50 per cent of the taxable income and for five years to enterprises within 50 kilometres of Isfahan. Complete exemption from income tax is given to undertakings in the border regions, where the concession can be extended from five to ten years. The list of industries eligible for exemption is revised every three years.

India grants a tax holiday for five years to new industrial undertakings, hotels and ships. The amount of income-tax exemption is limited to 6 per cent of the capital employed. Under certain conditions, the exemption can also be given for substantial expansion of existing undertakings.

[5] In some countries, there is also a tax on dividends to non-resident companies (i.e. inter-corporate dividends), which adds to the tax burden on foreign investment income.

[6] Discussed in the following publications: OECD, *Fiscal Incentives for Private Investment in Developing Countries*, 1965; United Nations, *United States Income Taxation of Private Investments in Developing Countries*, 1970; OECD, *Investing in Developing Countries*, 1970.

In Pakistan, the tax holiday for industrial undertakings set up between 1 July 1970 and 30 June 1975 varies from three to six years, depending on the area of the country in which the enterprise is located. The areas have been divided into three categories eligible for tax exemption for three, four and six years. Developed areas, such as Karachi, are excluded from the purview of the tax holiday provision during the fourth plan period (1970-1975). Further conditions are specified for a company to be eligible for tax exemption. Its paid-up and authorized capital must be more than $10,000. It must set apart 40 per cent of its profits and distribute the remaining 60 per cent or pay a dividend of 10 per cent, whichever is less.

Thailand grants "promotion certificates" to enterprises by which they can claim exemption from corporate income tax for a period of five years. The tax benefit is available only to new enterprises and is not given for the expansion of existing enterprises.

Singapore gives this tax privilege to "pioneer" enterprises, defined as those manufacturing commodities which are not being produced in the country or are not produced in sufficient quantities to meet local requirements. The period of tax exemption varies from two to five years depending on the amount of capital investment; two years where the fixed capital is less than S$250,000, three years where the investment is between S$250,000 and S$500,000, four years for that between S$500,000 and S$1 million, and five years for enterprises with fixed capital exceeding S$1 million. Exports enjoy an additional concession. Even after the five-year full tax holiday from income tax, a low rate of only 4 per cent (i.e. only one-tenth of the corporate income tax rate of 40 per cent) is levied for an additional period of ten years. Exports of even non-pioneer enterprises can enjoy this tax concession of 4 per cent for a period of fifteen years.

In Malaysia also, the tax relief is given to companies which have been granted "pioneer" status. The tax exemption is initially given for a period of two years to all pioneer companies, but it can be extended by another period of three years on the basis of the amount of capital invested; an extension of one year for companies which have incurred fixed-capital expenditure of not less than M$250,000 by the end of the third year of production, of two years for those with expenditure of not less than M$500,000 by the end of the fourth year, and of three years if the expenditure is not less than M$1 million by the end of the fifth year. In addition to the five-year tax holiday mentioned above, a further extension of one year can be given to companies on the basis of each of the following criteria designed to promote balanced development: (*a*) development areas declared by the Government; (*b*) specified priority industries; (*c*) specified proportion of domestic materials used. The total period of tax holiday can thus be eight years.

China (Taiwan) grants a five-year tax holiday to "productive enterprises" that conform with the encouragement criteria prescribed by the Government. The Statute for Encouragement of Investment specifies the types of activities which are considered to be productive.

In the Republic of Korea, tax exemption is given for property tax in addition to corporate income tax. Besides the full exemption for five years, a concession of 50 per cent of the tax can be given for a further period of three years. These incentives are granted to foreign enterprises under the Foreign Capital Inducement Law. Dividends paid to foreign nationals who have obtained an authorization at the time of making the investment are completely exempted from income tax for the first five years of the enterprise and a concession of 50 per cent of the income tax is given for a further period of three years.

The Philippines has specified certain "preferred" areas of investment which are divided into "pioneer" and "non-pioneer" areas. An Investment Priorities Plan is prepared annually to specify the activities in agriculture, mining and manufacturing which are to be accorded preferred status and thereby enjoy the incentives under the Investment Incentives Act. "A preferred pioneer area is one which, besides being important to national economic development, involves the manufacture or production of commodities or raw materials that are not being produced on a commercial scale in the Philippines, or which uses a new and untried design, formula or process for producing or transforming raw materials into finished goods."[7] The tax exemption is granted only to pioneer enterprises. Unlike the tax holiday provision in other ECAFE countries, the exemption covers all taxes other than income tax. Moreover, the scale of tax concession declines gradually over the specified period, from 100 per cent up to 31 December 1972, to 10 per cent during the years 31 December 1979 — 31 December 1981.

This review has brought out several variations of the tax holiday provision in different countries. The period varies from two to ten years. There are various criteria on which the concession is based, e.g. location of the enterprise, amount of investment involved, new enterprise or an item of manufacture which is new to the country, and exports. The tax benefit generally pertains to the full amount of income-tax liability of the enterprise, but there are variations in India, the Republic of Korea and the Philippines.

[7] Sycip, Gorres Velayo and Co., *Doing Business in the Philippines*, Makati, Philippines, April 1970, p. 22.

Accelerated depreciation. Accelerated depreciation is permitted in various forms, in addition to the normal rate. India gives an additional allowance of 50 per cent if plant and machinery are used on a double shift and 100 per cent on a triple shift. Pakistan provides an initial depreciation of 25 per cent in the first year of the installation of plant and machinery, in addition to the normal depreciation. Singapore allows full depreciation of the fixed assets (i.e. up to 100 per cent of the cost) in the very first year. There are special provisions for accelerated depreciation in some other countries also. For example, Malaysia allows depreciation of 40 per cent, instead of 10 per cent, to enterprises which export more than 20 per cent of their total production. In China (Taiwan), when a productive enterprise renovates its machinery or equipment, it can reduce the period of depreciation of the asset by one-third the number of years prescribed in the Income Tax Law.

The depreciation allowances are cumulative, and they cannot exceed the cost of the asset. An enterprise is able to postpone a certain amount of tax liability and thus to increase its liquid resources in the early years of undertaking the investment; thereby the risk of investment is also reduced.

Development rebate. The development rebate, which is usually given in the year of acquisition of an asset, constitutes an outright subsidy on investment. Since it is given in addition to depreciation allowances, the rebate ultimately allows the enterprise to deduct more than 100 per cent of capital expenditure on an asset from its income before taxes. All these allowances increase the prospective profitability of investment.

India has a specific provision for development rebate. There are four rates for different activities: 40 per cent for ships, 35 per cent for selected export-oriented industries, 25 per cent for specified priority industries and for hotels, and 15 per cent for other industries. In Malaysia, 25 per cent of capital expenditure incurred on the expansion of a factory, plant or machinery is exempted from income tax.

The development rebate is given in a different form in some other countries. In Singapore, for example, a manufacturing enterprise which expands through the increase of investment is granted tax exemption on the increased income for a period of up to five years, provided that the value of the productive equipment after expansion is at least 30 per cent greater than that of the original equipment.

Accelerated depreciation, development rebate and other concessions related to fixed investment are likely to encourage capital-intensive methods rather than labour-intensive methods. Even if economic criteria justify a greater use of labour, capital equipment would be preferred if it qualifies for a development rebate that confers greater benefit. Thus, this type of incentive could create a tendency towards less efficient use of capital resources. To remove this bias of the development rebate towards capital-intensive techniques, some economists have suggested other bases for granting the investment allowance: the benefit might be related to turnover[8] instead of investment in fixed capital, or it might be based on the rate of increase of turnover.[9]

Carry-forward of losses. A provision to offset net losses against subsequent profits allows enterprises to utilize fully the tax concession of depreciation, development rebate and tax holiday. In the early years of operation, corporate profits may not be large enough to absorb all these concessions, unless there are carry-forward provisions for them. Special provisions to this effect are made in the tax laws of some countries, for example, India, Pakistan, and the Philippines. In India, the depreciation allowance can be carried forward indefinitely, the carry-forward of unused tax exemption due to deficiency of profits during the tax holiday is limited to three years, while that of loss sustained under any head of income is allowed for eight years. Pakistan allows carry-over of losses for six years, but they can be set off only against income from the same business, profession or vocation. The unabsorbed depreciation can, however, be carried forward for an indefinite period. In the Philippines, the net operating loss in any of the first ten years of a business can be carried forward for six years following the year of such losses. In Malaysia, losses incurred every year throughout the tax relief period can be aggregated for deduction in a later period.

Other incentives

In some countries, the dividends paid to companies, local or foreign, enjoy a concessional rate of tax, compared with the standard tax rate on corporate profits. Royalty and interest payments to foreign companies are also subject to a concessional tax rate. In several countries, payments of interest on approved foreign loans are exempted from income tax.

Although most foreign investment comes from corporations abroad and it is corporate taxes that are generally relevant to such investment decisions, under

[8] Ackley, G. and Dini, L., made this suggestion for the development of southern Italy in "Tax and credit aids to industrial development in southern Italy", *Quarterly Review, Banca Nazionale del Lavoro*, December 1959.

[9] Knorr, K. J., and Baumol, W. J., *What Price Economic Growth?* (Prentice-Hall, 1961).

certain circumstances, personal taxes also impinge upon foreign investment. Direct investment is likely to be accompanied by some foreign technicians and managerial personnel. To provide an incentive for specialists to serve abroad, some countries have made provisions for tax relief for foreign personnel. India and Pakistan completely exempt foreign technicians from income tax on their remuneration for three years. The technician can enjoy the benefit for a further period of five years if the tax on his salary is paid by his employer. In the Republic of Korea, foreign personnel employed in foreign enterprises are exempted completely from personal income-tax liability.

Several countries grant exemption from customs duties on equipment, machinery and raw materials required for approved industrial activities. In some industries, these duties form a substantial part of the cost of production. The tax exemption therefore provides an important incentive for investment. The Republic of Korea grants permanent exemption from import duties. In Thailand, "promoted" enterprises are granted "exemption from import duties on the machinery, component parts and accessories which are required for the industrial activity. This shall include prefabricated factory structures to be installed for carrying on the industrial activity or such other materials and equipment for the construction thereof as may be approved by the Board of Investment under such conditions as it deems fit, provided that similar materials approximately equal in price and quality, are not being produced within the country in sufficient quantity".[10] Apart from this tax exemption for machinery etc., Thailand gives concession on import duty for raw materials. The Philippines permits imports on a tax-free basis for seven years from the date of registration of the enterprise. China (Taiwan) allows customs duties on machinery and equipment to be paid in instalments, payable from the first day of the second year after commencing production. The length of the period for paying the instalments can be extended up to five years.

Protection of selected industries by imposing high tariffs or quantitative restrictions on competing imports appears to have acted as an effective incentive for attracting and holding foreign private investment in many developing countries. The question of the extent of protectionist policies that should be pursued to foster domestic enterprise, or to encourage foreign investment, is controversial. The effect of such policies on the cost-price structure of the country in particular has been debated at length. But the opinion is widespread that these policies have been more powerful than the tax incentives in attracting foreign investment.

[10] *Promotion of Industrial Investment Act B.E. 2505 (1962)*, Board of Investment, Bangkok, p. 4.

Another type of effort to promote both domestic and foreign investment has been the improvement of infrastructure facilities. One of the effective approaches has been the establishment of industrial estates and free trade zones for export industries, such as Jurong Estate in Singapore and the Kaohsiung Export Processing Zone in Taiwan.

Concluding remarks

The above review of tax incentive programmes of different countries indicates that there is increasing competition among the countries, which may have led to revenue losses without corresponding gains in attracting foreign investment. These tax concessions are granted mostly to the expanding sectors of the economy, and, if the incidence of taxation on such sectors is markedly reduced through revenue losses, the income elasticity of the entire tax system will be affected.

There is a need to harmonize fiscal incentives among the developing ECAFE countries. A scale of tax benefits may be formed in relation to the actual performance of the enterprise. A United Nations report on the harmonization of fiscal incentives suggests the criterion of local value added to secure increasing linkage effects for the region.[11] The tax benefit would be related to local value added as a percentage of total value of output sold by the enterprise during the year. Enclave industries are treated as a separate group. The scale of incentives suggested in the report takes into account the needs of special areas within countries and of less developed countries within the region. However, the criterion is designed mainly to encourage the use of regional manpower and material resources. A special study is required to formulate the bases for a harmonization of fiscal incentives which would be most beneficial to the ECAFE countries.

Tax concessions given by host countries will have only limited usefulness as incentives to foreign enterprise if there is no tax treaty with the investing country for the avoidance of double taxation. The treaty must include a method to provide full benefit of the concession to the foreign enterprise which is not "frustrated" by taxation in his home country. The United Nations document on *Tax Treaties between Developed and Developing Countries* has already raised this issue and discussed several methods to obtain this objective.[12]

[11] United Nations Economic Commission for Latin America (ECLA) Office for the Caribbean, *Report of the United Nations Expert Team on Harmonization of Fiscal Incentives to Industries in the Caribbean Free Trade Area, 1969* (E/CN.12/845). Also see, ECLA's Report of 2 November 1970 (ECLA/POS.70/16).

[12] United Nations: *Tax Treaties between Developed and Developing Countries*, 1969. (Sales No.: E.69.XVI.2).

Chapter VII

CAPITAL MARKETS OF SELECTED ECAFE COUNTRIES

The capital markets of the host countries are of great importance for the promotion of joint ventures, which require both equity and loan capital from the local sources. This chapter discusses the various constituents of the capital markets in selected ECAFE countries and the nature and extent of the financial resources provided by them. Suggestions are made for the extension of these markets to help promote intraregional investments as well as foreign investments from outside the region.

In this discussion, the concept of capital market covers all those financial instruments and institutions which collect funds of savers and distribute them among investors on a long-term basis; it is not confined to the security markets narrowly construed. The money market in the sense of dealings in short-term funds is excluded as it is not germane to this subject which relates to investments of a long-term nature. This does not imply that the money market and the capital market so conceived are rigidly separate from each other. It is recognized that there are interconnexions between the two, some funds move from one to the other and several institutions are common to both. From the viewpoint of the enterprise also, when the finances have been raised, there is no rigid earmarking of funds for working capital and fixed investment. They form a common pool from which drawings are made, as required, for one purpose or another. However, for the analytical purpose here, it is useful to distinguish between the sources of short-term and long-term funds and concentrate upon the long-term capital markets.

The scope of the capital market can be indicated in terms of the types of financial assets which are traded such as corporate shares, bonds, debentures and other debt instruments, as against the short-term treasury bills, bills of exchange and other commercial paper which are dealt with in the money market. Thus, the financial institutions relevant to our subject are the commercial bank in its capacity as a supplier of medium and long-term credit, the development bank, the new issue market and the stock exchange.

These constituents of the capital markets of investment-receiving countries play an important role in the promotion of foreign collaborations and portfolio investments, although they do not have the same significance for foreign branches and wholly-owned subsidiaries. The latter may not be interested in seeking equity capital from the host countries, but they do need local credit for financing current assets; otherwise such assets would have to be financed by the companies with their foreign exchange resources.[1] In fact, foreign investors have often mentioned difficulties in raising local capital as a deterrent to investment.[2]

The subject of the adequacy of the capital market in relation to foreign investment will assume increasing importance because of the increasing emphasis on joint ventures recently expressed in national policy statements on foreign investment. The need to expand the scope for portfolio investments, discussed later in this chapter, also can be expected to increase the role of the capital market.

The size of the capital market depends on the volume as well as pattern of domestic savings, that is, the relative share of different sources of savings and the composition of household savings. The savings of corporations generally do not channel through the capital market nor do most of the government savings. Of the household savings, the relevant part is those in financial forms.

In most developing countries of the region, households, including private non-profit institutions and unincorporated enterprises, account for one-half to two-thirds of gross domestic savings.[3] The forms to which households allocate their savings are mostly non-financial physical assets, such as commodity stocks, land, residential dwellings and non-corporate business structures. The estimates for selected ECAFE countries for the period 1955-1959 indicate that households in most countries accumulated one-half to three-fourths of their gross savings in the form of

[1] This would also increase the foreign exchange liabilities of the host countries.

[2] The National Industrial Conference Board, *Obstacles and Incentives to Private Foreign Investment, 1967-1968*, vol. I: Obstacles (Studies in Business Policy, No. 130), New York, p. 8 and pp. 70-71, 87, 100, 109.

[3] United Nations, *Economic Bulletin for Asia and the Far East*, vol. XIII, December 1962. More recent data for countries indicate this proportion as follows: 70.5 per cent in China (Taiwan) (1965-1969); 71.1 per cent in the Philippines (1965-1969); 60.2 per cent in Malaysia (1962-1966). Source: *United Nations Yearbook of National Accounts Statistics, 1969*, vol. 1: Individual country data, and source for China (Taiwan): *National Income of the Republic of China*, prepared by the Director-General of Budgets, Accounts and Statistics, Executive Yuan, October 1969. In Pakistan, savings of households and unincorporated enterprises formed 87.2 per cent of gross domestic savings in 1963. (Source: Asbjorn Bergan, "Personal Income Distribution and Personal Savings in Pakistan, 1963-64", *Pakistan Development Review*, vol. VII, No. 2). In India, the fourth five-year plan, April 1969 to March 1974, envisages household and co-operative saving at 61.0 per cent of total domestic saving.

non-financial assets. In fact, as the ECAFE Bulletin of December 1962 pointed out: "It would not be surprising if household saving in the form of tangible assets accounted for three-fourths or more of total net household saving for many of the less developed countries of the region."[4]

Such comparative data on the composition of household savings in different countries of the region are not available for recent years, but the preferences do not appear to have significantly changed. For example, in India, non-financial assets during 1955-1958 formed 54.9 per cent of net household saving and even recent estimates place them at roughly one-half of the household saving.[5]

Besides the small volume of savings, the existing pattern of savings imposes a limitation on the size of capital markets in the developing ECAFE countries. The size of these markets should ideally be studied by analysing the sectoral flow-of-funds accounts, but such data are not available for most countries. The discussion on size, therefore, has to be in a descriptive and qualitative manner.

Information on the functions and performance of different constituents is available and it will be used for analysis. Attention is focused on selected institutions, namely commercial banks, development banks, new issue markets and stock exchanges. Other constituents, such as agricultural credit banks, co-operative credit societies, and mortgage and housing finance institutions, are not covered.

Commercial banks

Commercial banks form the most important constituent of the capital market in most developing countries of the region. Although traditionally they confined their credit to working capital, during recent years the commercial banks have been giving substantial amounts of medium-term finance and even long-term loans to industry. This is usually done by repeatedly "rolling over" short-term advances. To well-established and regular customers, the banks have also extended "term" loans straightaway. For example, in Pakistan a recent survey conducted by the State Bank showed that about 35 per cent of the total advances of commercial banks displayed the "character" of long-term loans. In the Republic of Korea, loans for financing equipment formed about 32 per cent of the total increase in bank credit during 1968. In Ceylon, 27 per cent of the total commercial banks' credit at the end of 1968 was long term and another 34 per cent comprised maturities ranging from six to thirty months, while the remaining 39 per cent was for a short term of less than six months. The four-year plan of the Philippines (1970/71-1973/74), envisages that, out of the total credit to be extended by commercial banks to manufacturing and mining, 10 per cent will be used for capital formation. In India, an *ad hoc* survey in 1962 revealed that medium-term loans formed only 8 per cent of the total commercial bank credit, but, since then, the banks have been increasingly involved in term-lending.

However, the enterprise is concerned with the total requirements for gross asset formation consisting of both working and fixed capital. In this total picture of finances of companies, commercial banks constitute an important source of funds. In Pakistan, bank credit formed 19.7 per cent of the flow of funds in the corporate sector during 1969/70.[6] An Indian study shows that, in 1966/67, banks provided 20.3 per cent of the finances for gross asset formation of public limited companies.[7]

Table I-7-1 gives the amounts and proportions of credit extended by commercial banks to different sectors of the economy in nine selected ECAFE countries. During the period 1960 to 1969, there was generally a marked shift from trade to industry, in line with the structural changes in these economies. At the end of 1969, the manufacturing sector was the most important recipient of bank credit in four countries, namely China (Taiwan), India, the Republic of Korea, and Pakistan, accounting for 40 to 68 per cent of the total bank credit. In Ceylon, Malaysia, the Philippines, Singapore and Thailand, 'commerce', including foreign trade, got the largest proportion of bank credit. Even in these countries, where foreign trade accounts for a substantial part of the gross national product, the share of the commerce sector generally declined, while that of manufacturing increased markedly; the only exception being the Philippines.

Facilities for commercial bank credit have expanded strikingly during the last decade or so. This is evident from table I-7-2, which gives the proportion of bank credit to gross domestic product in 1960 and 1969. This proportion in 1969 ranged from 10 per cent in India to 35 per cent in Singapore, having more than doubled in five countries and increased by 50 per cent in two other countries during a nine-year period.

[4] United Nations, *Economic Bulletin for Asia and the Far East*, XIII, December 1962, p. 5. This is in sharp contrast to the developed countries where financial savings form a major proportion of total savings of households. Net financial saving as a percentage of net saving of households in certain countries during the period 1960-1965 were as follows: Japan 77.3; France 69.5; Federal Republic of Germany 67.4; United Kingdom 56.0; United States 52.6 per cent. Source: OECD, *Capital Markets Study-General Report*, 1967, p. 93.

[5] *Reserve Bank of India Bulletin*, July 1970, p. 1101.

[6] Large-scale industries only. *Fourth Annual Report of the Investment Corporation of Pakistan*, 1970, p. 6.

[7] *Reserve Bank of India Bulletin*, August 1969, pp. 1175-1178.

Table I-7-1. Distribution of commercial banks' credit to various sectors (outstandings)

(in million units of national currency)

Country	Currency	Total for all sectors		Agriculture		Mining and quarrying		Manufacturing		Construction		Commerce		Public utilities[a]		Personal consumption		Others	
		1960	1969	1960	1969	1960	1969	1960	1969	1960	1969	1960	1969	1960	1969	1960	1969	1960	1969
Ceylon	Rs	548.6[b]	1,513.4	10.6	176.6			24.0	387.3			379.2	668.7			32.7	98.8	102.1	182.0
	%	(100.0)	(100.0)	(1.9)	(11.7)			(4.4)	(25.6)			(69.1)	(44.2)			(6.0)	(6.5)	(18.6)	(12.0)
China (Taiwan)	NT$	9,275	57,504	1,716	7,522			4,075	25,294			1,900	13,635	586	3,886			998	7,167
	%	(100.0)	(100.0)	(18.5)	(13.1)			(43.9)	(44.0)			(20.5)	(23.7)	(6.3)	(6.7)			(10.8)	(12.5)
India[c]	Rs	13,062[d]	30,644[e]	405	671			6,638	20,675			3,732	5,877			879	1,134	1,408	2,287
	%	(100.0)	(100.0)	(3.1)	(2.2)			(50.)	(67.5)			(28.6)	(19.2)			(6.7)	(3.7)	(10.8)	(7.5)
Korea, Republic of	Won	12,778[b]	325,783	443	6,921	289	8,834	7,222	181,944	508	17,390	2,435	70,609	371	15,910			1,510	24,175
	%	(100.0)	(100.0)	(3.5)	(2.1)	(2.3)	(2.7)	(56.5)	(55.8)	(4.0)	(5.3)	(19.1)	(21.7)	(2.9)	(4.9)			(11.8)	(7.4)
Malaysia (West)	M$	510.3	1,998.9	37.0	193.1	8.1	51.5	53.2	345.6	19.1	178.9	215.0	729.8			94.6	325.5	83.2	174.5
	%	(100.0)	(100.0)	(7.3)	(9.7)	(1.6)	(2.6)	(10.4)	(17.3)	(3.7)	(8.9)	(42.1)	(36.5)			(18.5)	(16.3)	(16.3)	(8.7)
Pakistan[c]	Rs	2,043.8	10,383.3	132.2	905.8	14.6	49.1	615.8	4,196.2	14.8	201.7	980.3	3,434.2	48.9	326.4			237.2	1,269.9
	%	(100.0)	(100.0)	(6.5)	(8.7)	(0.7)	(0.5)	(30.1)	(40.4)	(0.7)	(1.9)	(48.0)	(33.1)	(2.4)	(3.1)			(11.6)	(12.2)
Philippines	Peso	1,684.6	5,896.4[f]	450.1	1,462.6	21.7	35.0	547.2	1,473.3	20.2	112.6	407.1	1,858.3	41.4	167.1	60.8	207.4	136.1	580.1
	%	(100.0)	(100.0)	(26.7)	(24.8)	(1.3)	(0.6)	(32.5)	(25.0)	(1.2)	(1.9)	(24.2)	(31.5)	(2.5)	(2.8)	(3.6)	(3.5)	(8.1)	(9.8)
Singapore	S$	731.2[g]	1,727.2	39.0	16.4	10.8	11.9	93.5	447.5	19.2	48.1	377.1	629.7					191.6	573.6
	%	(100.0)	(100.0)	(5.3)	(0.9)	(1.5)	(0.7)	(12.8)	(25.9)	(2.6)	(2.8)	(51.6)	(36.5)					(26.2)	(33.2)
Thailand[h]	Baht	3,809.3	17,776.6	115.9	615.0	36.6	252.6	402.6	2,808.4	296.1[i]	2,744.0[i]	2,060.3	7,869.8	29.3	245.5			868.5	3,241.3
	%	(100.0)	(100.0)	(3.0)	(3.5)	(1.0)	(1.4)	(10.6)	(15.8)	(7.8)	(15.4)	(54.1)	(44.3)	(0.8)	(1.4)			(22.8)	(18.2)

Source: Ceylon: Central Bank of Ceylon, *Annual Report of the Ministry Board to the Minister of Finance.*
China (Taiwan): Council for International Economic Co-operation and Development, *Taiwan Statistical Data Book 1970*, p. 102.
India: Reserve Bank of India, *Reserve Bank of India Bulletin*, May 1970, p. 833.
Korea, Republic of: Bank of Korea, *Economic Statistics Yearbook*, 1968 and 1970 issues, pp. 122-123 and p. 117 respectively.
Malaysia: Bank Negara Malaysia, *Annual Report and Statement of Accounts*, 1961 and 1969 issues, p. 15 and p. 29 respectively.
Pakistan: Government of Pakistan, *Pakistan Economic Survey*, 1962 and 1970 issues, p. 132 and table 17, p. 36 respectively.
Philippines: Central Bank of the Philippines, *Statistical Bulletin*, vol. XXI, No. 4, statistical appendix to the *Twenty-First Annual Report 1969*, pp. 67-72.
Singapore: Department of Statistics, *Singapore Yearbook of Statistics*, 1969, p. 102.
Thailand: Bank of Thailand, *Annual Economic Report*, 1962 and 1969 issues, p. 64 and p. 113 respectively.

Note: There are gaps under certain sectors of some countries. National sources of data have not indicated the figures for these separately and have presumably included them under 'others'.

[a] "Includes "Transport and Communication".
[b] Figure as at the end of December 1961.
[c] Scheduled banks only.
[d] Figure as at the end of April 1961.
[e] Figure as at the end of March 1968.
[f] Figure as at the end of December 1968.
[g] Figure as at the end of 1962.
[h] Includes inter-commercial bank transactions.
[i] Includes "Real Estate".

Table I-7-2. Commercial banks' credit (outstanding) as percentage of gross domestic product

(in million units of national currency)

Country	Currency	Bank credit (outstanding)		Gross domestic product at current market prices		Bank credit as percentage of GDP	
		1960	1969	1960	1969	1960	1969
Ceylon	Rs	548.6[a]	1,513.5	6,686[a]	11,765	8.21	12.86
China (Taiwan)	NT$	9,275	57,504	62,566	191,019	14.82	30.10
India	Rs	13,062[b]	30,644[c]	141,010[b]	304,900[c]	9.26	10.05
Korea, Rep. of	Won	12,778[a]	325,783	294,040[a]	2,005,600	4.35	16.24
Malaysia	M$	510.3	1,998.9	6,019	10,370	8.48	19.28
Pakistan	Rs	2,043.8	10,383.3	31,472[d]	68,300[e]	6.49	15.20
Philippines	Peso	1,684.6	5,896.4[f]	13,390	29,843[f]	12.58	19.76
Singapore	S$	731.2[g]	1,727.2	2,371.4[g]	4,833	30.83	35.74
Thailand	Baht	3,809.3	17,776	53,984	130,613	7.06	13.61

Sources of GDP data:

Ceylon: Government of Ceylon, Department of Census and Statistics.

China (Taiwan): Directorate-General of Budgets, Accounts and Statistics, *National Income of the Republic of China*, 1970, p. 87.

India: Government of India, *Estimates of National Product 1960/61 to 1968/69*, August 1970, table 4, p. 6.

Korea, Rep. of: Bank of Korea, *Economic Statistics Yearbook 1970*, table 6, pp. 10-11.

Malaysia: Bank Negara Malaysia, *10th Anniversary Commemorative Issue*, March 1969 and *Annual Report*, 1969, table 23, p. 5.

Pakistan: Government of Pakistan, *Pakistan Economic Survey 1969/70*, Statistical Section, table 2, pp. 4-5.

Philippines: Philippines National Economic Council, *The Statistical Reporter*, January-March 1969 and April-June 1970 issues, table 1, pp. 2-3, and table 1, p. 17, respectively.

Singapore: United Nations Monthly Bulletin of Statistics, February 1971.

Thailand: National Economic Development Board, *National Income of Thailand*, Revised Estimates, 1960-1969.

Notes on fiscal year: Ceylon, January-December; China (Taiwan), July-June; India, April-March; Korea, January-December; Malaysia, January-December; Pakistan, July-June; Philippines, January-December; Singapore, January-December; Thailand, January-December.

[a] 1961 figure.
[b] 1960/61 gross domestic product at current factor cost.
[c] 1967/68 gross domestic product at current factor cost.
[d] 1959/60 gross domestic product at current factor cost.
[e] 1968/69 gross domestic product at current factor cost.
[f] 1968 figure.
[g] 1962 figure.

However, in view of the nature of their demand liabilities, the commercial banks have to maintain a certain proportion of liquidity, and they cannot, therefore, go far in extending long-term credit. There must be some other institutions which specialize in meeting the needs of long-term loans.

Development banks

Almost all countries of the region have now established development banks to fill a major gap of long-term finance in the structure of industrial financing. Although the banks were generally sponsored by Governments, the management and control in most countries is private. In some countries, both private and government-managed banks operate. The Pakistan Industrial Credit and Investment Corporation Limited (PICIC) and the Industrial Credit and Investment Corporation of India (ICICI) are private development corporations, while the Industrial Development Banks, IDBP and IDBI, are run by the Government in each country. In the Philippines, in addition to the government-owned Development Bank of the Philippines (DBP), there are four private investment banks and development corporations.

The development banks render a variety of financial and promotional assistance, such as direct loans to industry, underwriting of and subscription to new issues of companies, refinancing of loans extended by other agencies, guarantee of deferred payments in respect of foreign loans, and managerial and technical service to private enterprise.

The total financial assistance disbursed by development banks showed a remarkable expansion during the period 1960-1969 (see table I-7-3). The rate of increase of assistance per annum (compound rate) is not comparable among the countries as some of the banks had extended a very small amount in the base year 1960, but total disbursement as a percentage of value added by manufacturing also showed a tremendous rise in most countries, as much as four to seven times. The only exception is the Republic of Korea, where foreign loans constitute a large part of the total borrowing.

Table I-7-3. Total assistance disbursed by selected development finance institutions to the private sector

(in million units of national currency)

Country	Financial institution	Currency	Amount at the end of 1960			Amount at the end of 1969			Compound rate of change (% p.a.)	Value added by the manufacturing sector		Total disbursement as percentage of value added by manufacturing	
			Total	Loans	Investments	Total	Loans	Investments		1960	1969	1960	1969
Ceylon	DFCC	Rs	17.0	14.4	2.7	62.7	54.9	7.8	15.6	711.7	1,274.3	2.39	4.92
China (Taiwan)	CDC	NT$	146.3	146.3	—	2,769.5	2,576.5	193.0	38.6	8,488	34,946	1.72	7.93
India	IDBI	Rs	120.4[a]	120.4	—	2,080.0	1,944.0[b]	136.0[c]	36.8				
	IFCI		507.3	507.3	—	2,661.2	2,391.4	269.8	20.8	19,940	42,660	2.54[e]	6.24[f]
	ICICI		297.0[d]	255.2	41.8	1,454.1	1,389.3	64.8	19.3				
Korea, Rep. of	KDB	Won	15,852.0	15,852.0	—	130,586.0	96,104.0	34,482.0	26.4	33,500	410,540	47.32	31.81
Malaysia	MIDF	M$	3.9[d]	3.9	—	68.9[g]	68.9	—	37.6	472	974[h]	0.83	7.07
Pakistan	IDBP	Rs	125.3	125.3	—	1,532.4	1,524.7	7.7	32.8	2,930	7,489	9.50[i]	47.51[i]
	PICIC		153.0	146.8	6.2	2,025.9	2,006.9	19.0	33.3				
Philippines	DBP and private banks	Pesos	508.4	485.5	22.9	2,297.4	2,019.0	278.4	18.2	2,141[j]	4,648[j]	23.75	49.43
Singapore	DBS	S$	9.9[k]	7.3	2.6	135.5[l]	94.3	41.2	33.7	246.8[k]	827.0[m]	4.01	16.38
Thailand	IFCT	Baht	2.0	2.0	—	440.9	440.9	—	82.1	5,883.0	19,074.2	0.03	2.31

Sources of disbursement data

Ceylon: Central Bank of Ceylon, *Annual Report 1969*, appendix II, table 26.

China (Taiwan): Based on data from national and international sources.

India: (1) For IDBI: *IDBI Annual Report*, 1964/65 and 1968/69 issues, table 5, p. 24 and table 1, p. 7 respectively.

(2) For IFCI: *IFCI Annual Report*, 1960, p. 6, and the 1970 issue.

(3) For ICICI: Based on data from national and international sources.

Korea, Rep. of: Bank of Korea, *Economic Statistics Yearbook 1970*, table 55, pp. 130-131.

Malaysia: MIDF, *Annual Report*, 1960/61, 1961/62 and 1967 issues, p. 10, 12, and 28 respectively.

Pakistan: (1) For IDBP: Based on data from national and international sources.

(2) For PICIC: *PICIC at Work 1963* and *PICIC Annual Report 1969*.

Philippines: Central Bank of the Philippines, *Statistical Bulletin*, December 1969, table 42, p. 90.

Singapore: Based on data from national and international sources.

Thailand: IFCT, *IFCT 1969*, appendix E-3, p. 42.

Sources of data on value added by the manufacturing sector

Ceylon: Central Bank of Ceylon, *Annual Report*, 1969, appendix II, table 4.

China (Taiwan): Council for International Economic Co-operation and Development, *Taiwan Statistical Data Book 1970*, table 3.6, p. 12.

India: Government of India, *Estimates of National Product 1960/61 to 1968/69*, August 1970, table 4, p. 6.

Korea, Rep. of: Bank of Korea, *Economic Statistics Yearbook 1970*, table 7, pp. 14-15.

Malaysia: *Yearbook of National Accounts Statistics 1969*, p. 456, and Bank Negara Malaysia, *Annual Report 1969*, pp. 58-59.

Pakistan: Government of Pakistan, *Pakistan Economic Survey 1969/70*, statistical section, table 2, pp. 4-5.

Philippines: Philippines National Economic Council, *The Statistical Reporter*, January-March and April-June issues, supporting table 1, pp. 6-7 and supporting table 1, p. 22 respectively.

Singapore: Singapore Department of Statistics, *Yearbook of Statistics Singapore*, 1970, table 13.5, p. 136.

Thailand: Bank of Thailand, *Annual Report*, 1964 and 1969 issues, table 29, p. 86 and table 1, p. 85 respectively.

Notes:

DFCC — Development Finance Corporation of Ceylon Limited.
CDC — China Development Corporation.
IDBI — Industrial Development Bank of India.
IFCI — Industrial Finance Corporation of India Limited.
ICICI — Industrial Credit and Investment Corporation of India Limited.
KDB — Korean Development Bank.
MIDF — Malaysian Industrial Development Finance Limited.
IDBP — Industrial Development Bank of Pakistan.
PICIC — Pakistan Industrial Credit and Investment Corporation Limited.
DBP — Development Bank of the Philippines.
DBS — Development Bank of Singapore Limited.
IFCT — Industrial Finance Corporation of Thailand Limited.

[a] Figure as at the end of 1963/64.
[b] Includes refinance of industrial loans and rediscounting of bills.
[c] Includes underwriting of and subscription to debentures.
[d] Figure as at the end of 1961/62.
[e] IFCI only.
[f] Total of all the three institutions.
[g] Figure as at the end of March 1968.
[h] Estimated figure for 1968.
[i] Total of the two institutions.
[j] Value at factor cost.
[k] Figure as at the end of 1962.
[l] Figure as at the end of August 1968.
[m] Includes quarrying.

Most development banks provide loans in foreign currency also. In some cases, the foreign exchange formed a large proportion of the total disbursements made up to the end of 1969: 75-80 per cent in Pakistan (PICIC—76 per cent, IDBP—80 per cent), 58 per cent in China (Taiwan) and 40 per cent in Thailand.

Some banks have made substantial investments in the equities of private enterprise and thereby helped the expansion of security markets. The investments of development banks in China (Taiwan), India, and the Philippines formed 7 to 12 per cent of their total disbursements. In the Republic of Korea and Singapore, these proportions were as high as 26 and 30 per cent respectively (table I-7-3).

New issue markets

New issues provide a small proportion of funds required by the corporate sector, but relevant data are available for only a few countries. In India, new issues in 1966/67 represented only 4 per cent of the total funds used for asset formation by the corporate sector.[8] In Pakistan, the contribution of institutions and the general public to new issues accounted for 7.6 per cent of the financing of gross investment in the corporate sector during the third plan (1965-1970).[9]

The new issue market is not one identifiable institution of finance with a separate geographical existence. It is an organization of several institutions: (*a*) issuing houses[10] (investment bankers in the United States and syndicates of banks in Europe); (*b*) underwriters and sub-underwriters; and (*c*) stock-brokers. An active stock exchange is necessary to establish an efficient new issue market.

The development banks and other specialized financing institutions now provide increasing facilities for underwriting. Some other institutions, such as commercial banks, insurance companies and pension (provident) funds, also participate in this market. However, an organized and integrated new issue market has not yet grown in most developing ECAFE countries.

Stock exchanges

Most developing countries of the region have now established a stock exchange or stock exchanges, but the size of this secondary market for trading in 'already-existing' securities is yet very small. Table I-7-4 gives information regarding the year of establishment, number of companies listed and market value of the total capital of listed companies on the stock exchanges of seven countries of the region. By comparison, although exactly comparable magnitudes are not available, the number of security issues listed as against number of companies and the market value of listed securities as compared with the total capital of listed companies in the capital markets of five developed countries are shown in table I-7-5. The ratios of market values to gross national product in the two tables indicate the comparatively small size of the markets of developing countries. The ratio for the United States is 12 to 15 times that of the largest markets (in relation to GNP) in the ECAFE region, namely the stock exchanges of India and the joint stock exchange of Malaysia and Singapore.

Most of the stock exchanges of ECAFE countries are yet very young (except for those of India and the Philippines), having been started in the 1960s. These countries are making special efforts to build up their security markets. At least three countries, Pakistan, Singapore and Thailand, have recently carried out special studies, with the assistance of United States experts[11] who had had experience of capital markets in the developed countries.

Extension of capital markets

This discussion of the capital markets of the ECAFE region shows that the developing countries have established most of the institutional structure necessary for the promotion of foreign collaborations. The commercial banks and specialized development banks for long-term loans have been well developed. During the last decade, these institutions displayed a remarkable expansion of facilities for loan capital.

There are some difficulties in raising equity capital in the security markets. This problem should be examined in terms of both supply of and demand for securities. On the supply side, foreign investment itself has an important role to play by coming in the form of joint ventures. Even those foreign companies which decide to retain full control could sell a small part of their shares to the public and

[8] *Reserve Bank of India Bulletin*, August 1969, pp. 1175-1178.

[9] *Fourth Annual Report of the Investment Corporation of Pakistan*, 1970, p. 6.

[10] The issuing house advises its clients (companies) on various aspects of making the new issue. But in its capacity as an intermediary between the issuing company and the investors, it has a responsibility to the public. "The fact that a long-established issuing house will sponsor an issue helps to enlist the confidence of the investor, who has the assurance that it has been the subject of expert examination and is being made on reasonable terms and under reputable auspices." *Report of the Committee on the Working of the Monetary System* (The Radcliffe Committee), Her Majesty's Stationery Office, London, 1964, p. 78.

[11] Pakistan: Allan R. Roth, Rutgers, The State University, New Jersey. Singapore: George M. Ferris Jr., Governor, New York Stock Exchange. Thailand: Prof. Sidney M. Robbins of Columbia University.

Table I-7-4. Stock exchanges in selected ECAFE countries

Country and name of stock exchange	Unit of currency	Year established	Period observed	Number of companies listed	Market value of total capital of listed companies: National Currency	Market value of total capital of listed companies: US$	Ratio of capital of listed companies to GNP
			(at year end)		(million)		
China (Taiwan)							
Taiwan stock exchange	NT$	1962	1968	40	6,937[a]	173	0.04[a]
India							
Bombay stock exchange	Rs	1875	1965	502	8,410	1,761	
Calcutta stock exchange		1908	1965	652	6,290	1,317	
Madras stock exchange		1937	1965	329	2,910	609	
Ahmedabad stock exchange		1894	1965	128	2,040	427	
Delhi stock exchange		1947	1965	133	2,140	448	
Hyderabad stock exchange		1943	1965	32	330	69	
Indore stock exchange		1930	1965	16	190	39	
Bangalore stock exchange		1957	1965	45	210	44	
Total India			1965	1,837	22,520[b]	4,716	0.10[b]
Malaysia and Singapore							
Stock exchange of Malaysia and Singapore[g]	M$	1960	30 June 1969	226	2,435.5[c]	788.2	0.16[c]
Pakistan							
Karachi stock exchange	Rs	1949	1969	...	4,969.3[d]	1,037.2	0.07[d]
Philippines							
Manila stock exchange	Pesos	1927	30 June 1963	88	1,346.9[e]	383.7	0.07[e]
Thailand							
Bangkok stock exchange	Baht	1962	1968	33	2,292.5[f]	109.2	0.02[f]

Sources: China (Taiwan): First National City Bank New York, *Republic China (Taiwan), A Guide for Investors*, p. 22.
India: Bombay stock exchange, *The Stock Market in India*, 1970, tables I and III.
Malaysia and Singapore: Based on data from national and international sources.
Pakistan: Government of Pakistan, *Pakistan Economic Survey, 1969-1970*, p. 86.
Philippines: Roxas, Antonio V., "The Stock Exchanges of the Philippines" in D. E. Spray (ed.), *op. cit.*, p. 293.
Thailand: *Thai Investment Review*, 1969 edition, pp. 9-11.

[a] Total capital of listed companies.
[b] Market value of total capital including debentures.
[c] Total issued and paid-up capital of listed companies.
[d] Aggregate market value of shares traded on the stock exchange.
[e] Total market value of listed shares.
[f] Total market value of the share capital of quoted companies.
[g] Originally named the Malaysian Stock Exchange.

Table I-7-5. Stock exchanges in selected developed countries as of 31 December 1965

Country	Number of security issues traded	Market value of outstanding securities: Total	Shares of domestic companies	Bonds of domestic companies	Issues of rest of the world	Ratio of value of securities to GNP
		(in billion dollars)				
France	3,384[a]	21.3	18.9	2.4	—	0.21
Germany, Fed. Rep. of	3,903[b]	27.4	11.2	15.5	0.7	0.23
Japan	1,986[c]	31.0[d]	29.0	2.0	—	0.34
United Kingdom	9,431[e]	172.5	161.3	7.0	4.2	1.63
United States	4,398[f]	882.6	742.8	130.7	9.1	1.86

Sources: OECD, *Functioning of Capital Markets*, Capital Markets Study III, 1968, table 35, p. 104. For Japan, OECD Committee for Invisible Transactions, *General Report*, Capital Markets Study, 1967, tables 35 and 36, pp. 197-198.

[a] Paris stock exchange.
[b] All official markets.
[c] All markets.
[d] 1966 figure.
[e] London stock exchange.
[f] All markets.

thereby help to develop the security markets. Foreign companies with an international reputation and impressive operating history often have greater appeal to the common investor than new local entrepreneurs. In recent years, there have been several instances of new issues of foreign companies being heavily oversubscribed. However, there is much more scope for foreign investors to play a special role in increasing the supply of securities. They can also use their experience of the developed capital markets in their home countries to help nurture various agencies of the security markets in the host countries and to encourage the participation of the public.

The developing countries have initiated some measures to stimulate the demand for securities, but further efforts are required. It is essential for the development of the security market that the over-all rate of return on financial assets (including both income yield and change in the capital value of the asset) should be attractive when compared with that on physical assets, such as real estate and commodity stocks. In several countries, the returns on physical assets are much higher. This may be due to inflationary conditions and undesirable speculative activities in such holdings.

Special measures need to be designed to control the unduly high returns from socially unproductive speculation in physical assets. For example, among the fiscal measures the following may be considered; capital gains from real estate can be heavily taxed to discourage speculation and re-direct such funds to the security markets. On the other hand, the supply of securities can be stimulated by allowing companies to treat dividends on new issues in the same manner as interest on bonds, which is deductible from taxable profits (an incentive which could be given for a specified period after a new issue is made[12]). Such measures, together with incentives for savings in financial forms (discussed below), would extend the scope of the capital market and increase its efficiency in the allocation of funds among competing uses.

Several countries encourage household financial savings as a matter of public policy, particularly in the form of those financial assets which can be channelled to finance investment. In some countries, this policy is also derived from the social objective of spreading the ownership of productive wealth. Among these assets, special provision can be made for corporate securities.

India provides a tax exemption for income up to Rs 3,000 from specified forms of financial savings, including shares in Indian companies. Pakistan exempts from income tax dividends up to Rs 3,000 and an additional Rs 2,000 of dividends paid by companies listed on the stock exchange. In addition to this full exemption to benefit the small shareholder, Pakistan grants exemption to "an amount equal to 10 per cent of the dividend income in excess of Rs 30,000, or Rs 50,000, as the case may be".[13] This provision is designed to attract savings of the higher-income groups into corporate securities.

Another method to promote financial savings is to grant tax relief on the flows of savings into specified financial forms, such as life insurance premiums, contributions to provident funds and time deposits in post offices. Both India and Pakistan provide this type of tax incentive also, but Pakistan has specified a wider range of financial forms, including shares of approved companies and unit trust certificates. Several other countries also provide this tax incentive for selected forms of financial savings.

An additional effort for the promotion of financial savings, particularly in securities, has been the development of intermediaries, such as the unit trusts (known as mutual funds in the United States). The unit trust provides the small saver with the benefits of professional management and reduces the risks by diversifying the investments.

The people generally prefer to keep their savings in liquid forms, such as currency and bank deposits,[14] which can be easily shifted into physical assets, such as gold and real estate: the traditional forms of hedging against inflation. Under inflationary conditions, the unit trust provides the small saver with some protection against the erosion of the capital value of his savings, and, thereby, attracts funds into the security markets.

India and Pakistan have each established a unit trust (Unit Trust of India "UTI" and National Investment (Unit) Trust "NIT") sponsored and regulated by the Government under specific legislation. The Investment Corporation of Pakistan (ICP), which provides professional advice, credit facilities and other services for portfolio investments,[15] has

[12] EEC Commission, *The Development of a European Capital Market*, November 1966.

[13] Government of Pakistan, Ministry of Finance, *The Budget in Brief, 1969/70*, p. 70.

[14] Data on the composition of household financial savings are available for India and Pakistan. In India, currency and bank deposits formed 62.2 per cent of gross savings of the household sector in financial assets during 1965/66. In Pakistan, their proportion was 76.0 per cent. Sources: (i) *Report on Currency and Finance for the Year 1968/69*, Reserve Bank of India, 1969; (ii) Abdul Ghafar, "Financial Asset Accumulation by the Non-corporate Private Sector in Pakistan, *Pakistan Development Review*, vol. IV, No. 1.

[15] This is in addition to its function as a specialized investment bank, designed to assist in the floatation of shares and debentures for public subscription. ICP has been set up by the Government under a statute 'to encourage and broaden the base of investments and develop the capital market in Pakistan'. Its functions are :(i) to underwrite and distribute new issues; (ii) to open and maintain investors' accounts; (iii) to provide investment counsel for issuers and investors.

sponsored four "closed-end" mutual funds. The difference between a unit trust ("open-ended" type) and "closed-end" mutual fund (or investment trust) is that, while the former offers new "units" for sale and is always ready to redeem the existing ones, the latter has no such responsibility. However, the "closed" type, which usually takes the form of a company, issues its own shares (Fund certificates in Pakistan), which can be traded on the stock exchange.

There are also private mutual funds regulated through legislation in some countries, for example, the Philippines, and apparently without any special legislation in some others, such as Thailand.

To encourage the public to invest in securities, there is a need to develop the unit trust in countries which do not have this type of institution. Even those which already have such an institution need to encourage the growth of a larger number of them to create competition for the funds of the small savers.

The experience of the United States, where the number of shareholders has increased to about 25 million from 6.5 million in 1952, shows that "the shares are sold rather than bought". This was the conclusion of a study of mutual funds conducted by the Securities Exchange Commission. Its implication is that aggressive salemanship is necessary to motivate individuals to buy shares. The unit trust is the right type of institution to organize a public relations programme for this purpose and assist individuals in managing their private investments.

The distrust of potential investors can be removed by improving institutional and legislative controls over the security markets. The objective should be disclosure of adequate information to the investor regarding the operations of companies and safeguards to assure him that "insiders" will not be able to exploit their position. In most countries, the annual reports and accounts of companies and the speeches of chairmen do not disclose all the facts that the investor wants to know before making his investment decision.

The stock exchange has also a responsibility in this matter. It can enforce certain rules for the disclosure of data by the companies that seek listing on the exchange. The stock exchange should help the small investor by analysing the data on the performance of different companies and making such findings available to the public.

The promotion of institutional savings in securities is also necessary to develop the capital market. In recent years, the markets of developed countries have expanded mostly on the flow of pension and life insurance funds. In some developing countries (for example, Pakistan and India) there are statutory restrictions on the investments which such institutions can make in corporate securities. This is considered necessary to ensure the full security of such funds. However, in the light of the experience of developed countries, it appears that there is a case for relaxing such restrictions, so as to increase the flow of institutional funds to the markets for corporate securities.

There is another aspect of the capital markets which has so far been neglected in this region. At present, the national markets are insulated from one another for several reasons. First, there is the need for strict control over foreign exchange for balance-of-payments problems. Second, the level of interest rates should be controlled as an instrument of domestic monetary policy. Third, investible funds require to be directed to selected uses in line with the country's plan for economic development.

The proposed programme of regional co-operation in trade will require the promotion of intraregional investments, and, for this objective, there is a need to establish certain links among the national capital markets of the region which will not affect the autonomy of the monetary policy of individual countries. A special study should be carried out, with the collaboration of financial institutions of the various countries, to analyse the existing links between the markets and examine the scope for establishing new ones.

There is also a need to examine the scope for bond issues of ECAFE countries on the international capital markets, which, in the era preceding the "Great Depression" of the 1930s, constituted the main channel for foreign private investment. The Pearson Commission has recommended that the developed countries remove the legal and other restrictions on the issues of developing countries. The ECAFE countries should study what they can do in the way of adopting a regional approach for the promotion of such portfolio investments.

Such a study would also reveal the scope for increasing other types of portfolio investment by individuals from foreign countries. At present, most foreign investment flows from companies incorporated in foreign countries, but the lack of interest of individuals is partly due to the ignorance of potential investors, and partly due to their scepticism of investment opportunities in the developing countries. In the developed countries, individuals still hold a major proportion of the securities on stock exchanges. In the New York stock exchange, this proportion was as high as 80 per cent in 1965. In the United

Kingdom, it fell from 66 per cent in 1957 to 54 per cent in 1963, but a large proportion of outstanding securities continued to be held by individuals.[16] There is evidence that small investors in developed countries have resources to invest abroad.

Japan has introduced several measures to stimulate the interest of foreign portfolio investors in Japanese securities traded on the Tokyo stock exchange. In addition to brochures and periodical market reviews for potential foreign investors, a system of "depository receipts" has been introduced to remove procedural difficulties and reduce certain expenses of trading. These are known as "American Depository Receipts" (A.D.R.), "European Depository Receipts" (E.D.R.) and "London Depository Receipts" (L.D.R.). Foreign banks supply these depository receipts to foreign subscribers against shares which are deposited with the Japanese banks, and the receipts are traded in the foreign markets. The holder of a receipt can withdraw the underlying shares in order to sell them on the Tokyo Stock Exchange. The value of A.D.Rs and E.D.Rs issued during the period June 1961 to March 1964 came to $83.5 million and £4.6 million respectively.[17]

It would be useful to study possible ways of stimulating the interest of individual foreign investors in investments within the developing ECAFE countries.

[16] OECD, *Capital Markets Study, Functioning of Capital Markets*, 1968, pp. 77-79.

[17] OECD, Committee for Invisible Transactions, *Liberalization of International Capital Movements, Japan*, 1968, pp. 90-91.

Concluding remarks

The national capital markets of the developing ECAFE countries mostly provide the institutional structure required for the promotion of foreign investment. The institutions for loan capital, both commercial banks and development banks, have expanded their services remarkably during the last decade. This is revealed by the marked rise in the proportion of commercial bank credit to GDP and that of development bank loans to value added by manufacturing.

The markets for equity capital should be further developed. The preference of households for physical assets, such as land and commodity stocks, imposes a limitation on the size of these markets. Two types of efforts are required to divert the flow of savings into financial assets, particularly into industrial securities. First, taxation may be used as a device to discourage the choice of unproductive assets, such as speculative dealings in real estate. The flow of savings into financial forms may be accorded liberal tax concessions. Secondly, financial intermediaries, such as unit trusts, should be developed to mobilize small savings which are now scattered in unproductive forms.

A detailed study is required to examine the possibilities of establishing certain links among the national capital markets which will assist in the promotion of intraregional investments. The proposed study could be extended to explore further sources of private funds within the region, as well as outside, and to suggest ways of mobilizing such resources for private investments.

Chapter VIII

CONCLUSIONS: ISSUES AND POLICIES

This concluding chapter summarizes the major findings of the preceding chapters and suggests further research to provide data useful in formulating policies of the developing ECAFE countries toward foreign private investment. It also brings out the need and scope for regional co-operation in reducing the costs of foreign investment and increasing its contributions to the economic development of regional countries.

Summary of major findings

The flow of foreign private investment into the developing ECAFE region, as a whole, has shown a marked increase during the 1960s, as was shown in chapter II. This is also true for most individual countries of the region. During 1960-1968 private flows formed a large proportion of the total financial resource flows (higher than 30 per cent) into seven countries of the region, namely China (Taiwan), Iran, Malaysia, the Philippines, the Republic of Korea, Singapore and Thailand.

The presence of favourable opportunities for investment in many of the countries of this region is one reason for the expansion of foreign private capital inflows. ECAFE countries provide expanding local markets, raw material supplies for investing countries, and relatively low-cost labour (as discussed with reference to Japan in chapter III). The rates of return on direct investment have been higher than, or at least equal to, those in other regions, with the exception of the Middle East with its unique oil reserves (as shown for United States investments in chapter III).

However, the volume of direct private investments in the ECAFE region remains relatively small, compared with investment flows to Europe, North America and Latin America. International investors may expect higher rates of returns in ECAFE and other developing countries because investments in these countries are generally considered to entail wider ranges of risks than in developed countries. Furthermore, some multinational corporations may view the future sales growth of their products in the developing ECAFE countries to be less certain than in more developed regions. In as much as this is a valid explanation of the differences in rates of return on foreign investment in this region and the more developed regions, regional co-operation in such forms as investment guarantees and expansion of markets, discussed later in this chapter, could lower the cost of foreign investment, and at the same time increase flows of capital.

The flow of private export credit has recently expanded as a new method of financing investment in capital goods. This represents a shift from the traditional form of foreign portfolio investments in the pre-war era. In terms of their proportion to total external public debt outstanding, export credits are particularly important for Ceylon, China (Taiwan), Iran, the Khmer Republic, the Philippines and the Republic of Korea. The terms and conditions of such credits were discussed in chapter V, and several suggestions were made for improving their contribution to development.

Other features of foreign private investment that emerge from analysis of the data on ten developing countries of the region (chapter IV) may be summarized as follows. The share of foreign investment in the total stock of capital is significant (15 to 30 per cent) in the countries for which such data are available. However, the inflows of private investment appear to be subject to fluctuations. Further study is required of the factors responsible for such fluctuations in the flows to this region.

Although private investments from the United States, Japan, the United Kingdom and other Western European countries are generally dominant, intraregional investments from developing countries have been significant in several countries. Unfortunately, it is not possible to separate completely those investments which are made by subsidiaries of multinational companies, and, thus, are actually capital from the developed countries outside the region. Intraregional investments appear to be concentrated in such fields as textiles, food and beverages, and other light manufacturing and service industries. Further data need to be collected to obtain a clear picture of such investments, but the available information suggests that intraregional investments can be expanded and diversified into strategic sectors if appropriate investment promotion policies are instituted.

There is an increasing trend in the general flow of foreign investment to manufacturing industries. Within the broad category of manufacturing, the emphasis varies among the countries: consumer goods in some countries, low-cost labour oriented industries in others, and natural resource oriented industries in still others. These variations in the distribution of foreign investment depend upon the local resource

endowments, and the priorities set by national development programmes and investment promotion policies.

Foreign investment carries certain costs as well as benefits. One aspect of these costs is the associated outflows of investment income, such as dividends, interest and royalties. Data on return flows of investment income in relation to net investment inflows are available only for a few countries. These have been presented in chapters II and IV. However, these data do not adequately measure the balance of payments effect of foreign investment. Several other factors must be taken into account, such as export expansion and import saving. There is urgent need for co-ordination of efforts to collect the data required to evaluate properly the economic costs and benefits of foreign investment.

The volume of foreign private capital flows into developing countries is likely to continue to expand in the 1970s if the tempo of economic development in the region is maintained. At present the countries of the ECAFE region generally make individual efforts to attract further foreign investment, as described in chapter VI. Most of them have either enacted specific legislation or established official policies relating to foreign investment, and have set up special boards or councils to administer these policies. In recent years, several countries have taken steps to streamline their procedures for processing proposals of foreign investment. Some countries have centralized authority to take decisions on such proposals in order to reduce procedural delays. Many countries are becoming more selective in granting approvals to the entry of investment. There is an increasing desire that foreign investors should assist in the promotion of the exports of host countries. In several countries, the emphasis so far has been on import substitution, but recently interest has developed in export promotion. Moreover, foreign enterprises are expected to generate external economies through the transfer of modern technology and business practices, and to create linkage effects within the economy. The developing countries are also interested in promoting local research facilities with the assistance of foreign enterprises. These contributions are desired for the long-term objective of self-sustained growth.

Some countries have introduced restrictions on the inflow of capital with 100 per cent foreign control. The trend is towards encouragement of joint ventures between foreign and domestic investors. However, these conditions are not imposed but negotiated with foreign investors. In fact, some foreign investors themselves have shown preference for joint ventures. The local partner facilitates access to the distribution channels of the country, local labour and sources of raw materials. His collaboration in sharing the risks "represents an additional safety factor for the investment".[1]

There have recently been attempts to introduce procedures to facilitate transfer of some part of equity ownership from foreign to local investors when national enterprise is ready to take over. These procedures should be designed so as to encourage foreign investors to move into new fields where technological advancement is required. The questions relating to industrial fields open to foreign investment, employment of foreign personnel, and the desirable degree of foreign ownership and control will continue to be matters of national policies. The size and form of foreign investment must also conform with the national plan of the country. Decisions on such questions must be taken in the context of the development programme of each country.

Scope for regional co-operation

There are certain other aspects of foreign investment which require a regional approach. For example, the fear of non-commercial risks of investment in developing countries still continues to be a deterrent to foreign investment.[2] The ECAFE countries may wish to examine the possibility of developing a regional plan for insurance of foreign investment against different types of risks. This could involve both investing and host countries and thereby lower premiums for the insurance. The discussion of tax provisions in different countries (chapter VI) also points out the need for regional harmonization of tax incentives. There is a danger of wasteful competition among the unco-ordinated investment incentive programmes of individual ECAFE countries, which can lead to large revenue losses without corresponding gains in attracting additional investment into the region. There is need for a systematic appraisal of the impact of such concessions on the inflow of private capital for developing a regional incentive policy. Such a policy could give due weight to the objective of accelerating the growth of relatively less developed countries of the region.

The promotion of intraregional investment requires the establishment of certain links among the national capital markets. For this purpose, a comprehensive study of the working of the national markets should be undertaken to explore potential sources of funds both within the region and outside.

Analysis of the available data on national capital markets in chapter VII shows that while sources of loan capital have been developed in several ECAFE

[1] Schreiber, Jordan C., *U.S. Corporate Investment in Taiwan* (University Press of Cambridge, Massachusetts, 1970), p. 45.

[2] National Industrial Conference Board, *Obstacles and Incentives to Private Foreign Investment 1967-1968*, New York, 1969.

countries, the equity markets are still underdeveloped in most countries. The further development and co-ordination of the capital markets is another field in which regional co-operation can be beneficial.

This discussion has brought out the need for several types of regional co-operation in the promotion of intraregional investment and investment from outside the region. It is suggested that to establish such co-operation on a continuing basis, a regional agency, which could be named the "Asian Investment Centre", might be set up. Possible functions of the proposed centre are summarized as follows:

(*a*) Analysis of the experience of different countries relating to the benefits and costs of different forms of foreign private investment in the various fields of economic development, exchange of information among the countries of the region and advice to Governments on policies for maximizing net gains from such investments.

(*b*) Harmonization of national investment promotion policies, especially the use of fiscal and other incentives, which, if not co-ordinated, are likely to lead to wasteful competition among the individual countries.

(*c*) Continuing analysis of the capital markets to explore sources of private funds within the region, as well as outside, to establish links among the regional markets, and to assist in the mobilization of such resources for private investments.

(*d*) Examination of the scope for promoting the issue of bonds by Asian countries on the international capital markets and for stimulating other forms of portfolio investments.

(*e*) Study of the various laws and regulations affecting foreign investment to reveal any deterrents which might be removed without sacrificing important interests of the investment-receiving countries.

(*f*) On the request of Governments and private parties seeking foreign participation, provision of advisory services relating to the terms and conditions of proposals and agreements for foreign collaboration.

(*g*) Special assistance to the smaller and relatively underdeveloped countries of the region to promote foreign investment.

Other issues for further studies

Some other issues that need further research studies are transfer of technology, restrictions in foreign collaboration agreements, and the role of multinational corporations. An UNCTAD study has classified issues relating to the transfer of technology under the following headings: (*a*) main channels used in the transfer of technology, (*b*) costs of the transfer, (*c*) access to technology, (*d*) trade and transfer of technology, (*e*) substitution of domestic for imported technology, and (*f*) choice of technology.[3] These issues need to be studied in the context of the special problems of the developing ECAFE countries. For example, the question of over-import of technology has been discussed for one country, India (chapter IV).

Certain restrictions are often imposed by foreign investors on the scope of operation of joint ventures and local companies receiving the use of foreign technology or other proprietary rights. One form of such restrictions is the limitation of exports, as discussed in the case of India (chapter IV). There is no single pattern of these restrictions, but they need to be examined in the light of the data for each country.

The issues raised by the emergence of multinational corporations have been discussed at length in recent literature, but mostly on a theoretical basis in terms of competition for market shares among oligopolists, or of the economics of new product development.[4] There is a need to study these aspects in the context of the ECAFE region since the theoretical conclusions advanced so far may not be relevant to this region.

The various questions raised in this *Survey* could be taken into account in further studies that might be undertaken by the secretariat.

[3] UNCTAD document TD/B/310 dated 1 July 1970.

[4] See for example: Hymer, S. H., "The International Operations of National Firms", *A Study of Direct Investment* (M.I.T. doctoral dissertation, Cambridge, Mass., 1960); Vernon, Raymond, "International Investment and International Trade in the Product Cycle", *Quarterly Journal of Economics*, vol. 80, No. 2, May 1966, pp. 190-207; and *The International Corporation*, A symposium edited by Charles P. Kindelberger (M.I.T. Press, Cambridge, Mass., 1970).

ECONOMIC SURVEY OF ASIA AND THE FAR EAST, 1970

PART TWO

CURRENT ECONOMIC DEVELOPMENTS

Chapter I

PROBLEMS AND PROSPECTS OF THE ECAFE REGION IN THE SECOND DEVELOPMENT DECADE

Introduction

The ECAFE region enters the Second United Nations Development Decade on a mixed note of hope and anxiety. The First Development Decade witnessed a number of encouraging developments in the region which give cause for optimism about its prospects in the future. At the same time, there were certain disquieting trends, generating a feeling of uncertainty and apprehension. Among the bright features, perhaps the foremost in significance was the breakthrough in agriculture in a number of developing ECAFE countries. This was not only the major factor in improving their growth performance but also helped the over-all development effort in a number of ways. The developing ECAFE countries were also able to bring about an appreciable rise in the level of savings and investment and financed a greater proportion of their development expenditures from their own resources. The process of industrialization was carried a stage further and this imparted greater strength to their economies. Simultaneously, there was considerable strengthening of the basic infrastructure which should facilitate growth in future years. The administrative capacity of the Governments to implement planned programmes of development recorded noticeable qualitative improvement and the commitment to planning as an organized method of economic management gained further respectability.

As against these gains, the First Development Decade also witnessed some disappointments. Though the gross domestic product of the developing ECAFE countries rose somewhat faster in the 1960s than in the 1950s, a good part of the increase was offset by the rapid growth in population so that the rise in *per capita* income was just about 2 per cent per annum. At the same time, the pattern of development was such that certain segments of population did not derive commensurate benefits from the growth process. The accentuation of income inequalities, lack of sufficient employment opportunities, poor living conditions and inadequate social amenities caused some social discontent in a number of countries.

The stagnation in foreign aid flows at a time when the need for additional resources was becoming much more acute to tackle these social problems gave rise to serious concern. The continuation of the war in Viet-Nam and the enlargement of the area of hostilities involving neighbouring countries posed further problems for the region.

The Second Development Decade thus poses a real challenge for the countries of the ECAFE region. In a recent address the Secretary-General of the United Nations emphasized the crucial importance of the next ten years:

> "I do not wish to seem overdramatic, but I can only conclude from the information that is available to me as Secretary-General that the Members of the United Nations have perhaps ten years left in which to subordinate their ancient quarrels and launch a global partnership to curb the arms race, to improve the human environment, to defuse the population explosion, and to supply the required momentum to world development efforts. If such a global partnership is not forged within the next decade, then I very much fear that the problems I have mentioned will have reached such staggering proportions that they will be beyond our capacity to control".[1]

The object of this chapter is to analyse the problems and prospects of the developing ECAFE region during the Second Development Decade. To provide a proper perspective for such a discussion, the first part of the chapter attempts a critical evaluation of the performance of the developing ECAFE countries during the First Development Decade. The second part deals with the objectives and targets of the Second Development Decade, with particular reference to prospects of their being achieved in the developing ECAFE region. The third part is concerned with the major policy issues confronting the developing ECAFE countries. It also seeks to delineate, in broad terms, the main elements of a development strategy to resolve these policy issues and help achieve the targets of the Second Development Decade.

I. Review of the past decade

Objectives of the First Development Decade

On 19 December 1961, the General Assembly of the United Nations designated the years up to 1970 as "the United Nations Development Decade, in which Member States and their peoples will intensify their efforts to mobilize and to sustain support for the measures required on the part of both developed and

[1] "The Second United Nations Development Decade: A Blueprint for Action", Proceedings of a seminar convened by the Institute on Man and Science, Rensselaerville, New York, May 1969.

developing countries to accelerate progress towards self-sustaining growth of the economy of the individual nations and their social advancement so as to attain in each underdeveloped country a substantial increase in the rate of growth, with each country setting its own target, taking as the objective a minimum annual rate of growth of aggregate national income of 5 per cent at the end of the Decade". In adopting this target, the United Nations explicitly recognized that its achievement was a matter of international as well as national concern. Earlier in 1960, the General Assembly of the United Nations had already adopted a resolution to the effect that "the flow of international assistance and capital should be increased substantially so as to reach as soon as possible approximately 1 per cent of the combined national incomes of the economically advanced countries".

The adequacy of these targets has been frequently called into question, not only as to the magnitudes chosen,[1] but also the manner in which they were denominated and "their simple but ambiguous arithmetic."[2] It has been said, for example, that "The resource transfer target is too aggregative and too donor-centred to provide a means of assessing the value or effectiveness of the transfers actually made. The growth target is too absolute and too simplistic to be used for appraising achievements in the complicated process of development".[3] In effect, however, attempts have been made over the years to give a more concrete expression to these targets. Thus, the report of the Secretary-General of the United Nations entitled "Proposals for Action"[4] issued in 1962 elaborated the concept of development and placed special stress on the social aspects of development. It warned that "one of the greatest dangers in development policy lies in the tendency to give the more material aspects of growth an overriding and disproportionate emphasis."[5] It emphasized that, for development to be meaningful, the acceleration in the rate of growth of incomes should go hand in hand with improvements in internal income distribution. The General Assembly resolution also referred specifically to social advancement, social development, land reform, the elimination of illiteracy, hunger and disease, improvements in education and similar measures of social progress.[6]

Similarly, in the context of the aggregative 1 per cent target of foreign assistance, efforts have been made to take the quality of resource transfers into account. In 1965, the Development Assistance Committee of the Organization for Economic Co-operation and Development (OECD) recommended two subsidiary targets for the terms of official lending, one on interest rates, grace periods and maturities, and the other on progressive reduction in the degree of tying of loans to specific commodities or country of supply.[7] To ensure a more steady flow of foreign resources at terms which are not onerous, the desirability of setting a specific target for the official component of resource transfers within the over-all 1 per cent target was discussed at the second session of UNCTAD in 1968 and specifically recommended by the Pearson Commission in its report presented in September 1969.[8]

Growth performance of the developing countries

It will be seen from Table II-1-1 that the developing countries as a group achieved an average growth rate of 4.7 per cent per annum in the period 1960-1968.[9] According to preliminary indications, the growth rate appears to have improved perceptibly in the subsequent two years. Thus, if the 5 per cent growth target of the First Development Decade is interpreted in a global sense, it may well be achieved. The average, however, conceals marked differences in the growth performance of individual countries and various regions. The Middle East had the highest average annual growth rate of 6.5 per cent in 1960-1968, due mainly to the buoyancy of the oil-producing economies. Latin America came next with an average growth rate or 4.9 per cent per annum. Africa had the lowest growth rate among developing regions, averaging 4.2 per cent per annum in this period. East and southeast Asia, roughly corresponding to the developing ECAFE region, achieved an average growth rate of 4.4 per cent per annum. It is noteworthy that, excepting east and southeast Asia, the growth rate suffered a retardation in all the developing regions in 1960-1968 compared with the 1950s.

While the growth rate of gross domestic product in all developing countries taken together was almost unchanged in 1960-1968 compared with the 1950s,

[1] See, for example, the proceedings of the first and second sessions of UNCTAD held in 1964 and 1968, where a number of delegates representing the developing countries expressed dissatisfaction with the 5 per cent growth target as also the fact that the target was laid down in aggregative rather than in *per capita* terms.

[2] Cf., "The Problems and Policies of Economic Development: An Appraisal of Recent Experience" in the United Nations' *World Economic Survey*, 1967, p. 2.

[3] *Ibid.*

[4] United Nations, *The United Nations Development Decade: Proposals for Action*, Report of the Secretary-General, 1962.

[5] *Ibid.*, pp. 10-11.

[6] *Ibid.*, p. 9.

[7] These targets were reviewed further in 1968, and, as a result, certain changes were effected in 1969. For details, see OECD, *Development Assistance, Efforts and Policies of the Members of the Development Assistance Committee*, 1969 Review, pp. 267-270.

[8] *Partners in Development*, Report of the Commission on International Development (Lester B. Pearson, Chairman), 1969.

[9] The growth performance of the developing countries is first analysed in this chapter on the basis of data relating to the aggregate and *per capita* gross domestic product. In view of the fact, however, that development cannot be satisfactorily interpreted simply as a process of growth of production, the analysis goes on to cover such aspects as changes in the pattern of income distribution and levels of living in the case of developing ECAFE countries.

Table II-1-1. Growth rates of real gross domestic product, population, and gross domestic product *per capita*, 1950-1968

	1950-1960	1960-1965	1960-1968
1. *World*[a]			
GDP	4.0	5.2	5.2
Population	1.9	2.0	2.1
GDP *per capita*	2.1	3.1	3.0
2. *Developed regions*[b]			
GDP	3.9	5.3	5.3
Population	1.2	1.2	1.1
GDP *per capita*	2.7	4.1	4.2
3. *Developing regions*[c]			
GDP	4.8	4.6	4.7
Population	2.2	2.3	2.5
GDP *per capita*	2.5	2.2	2.1
East and southeast Asia[d]			
GDP	4.0	4.3	4.4
Population	2.1	2.5	2.5
GDP *per capita*	1.9	1.8	1.9
Africa[e]			
GDP	4.9	4.2	4.2
Population	2.1	2.4	2.5
GDP *per capita*	2.7	1.8	1.7
Caribbean and Latin America			
GDP	5.5	4.8	4.9
Population	2.8	2.9	2.9
GDP *per capita*	2.6	1.8	1.9
Middle East[f]			
GDP	6.9	6.6	6.5
Population	2.7	2.4	2.4
GDP *per capita*	4.1	4.1	4.0

Source: Statistical Office, United Nations.

[a] Excludes centrally planned economies.

[b] Excludes centrally planned economies; includes all countries in Western Europe, North America and Oceania, together with Japan, South Africa and Israel.

[c] Includes all the countries included in the regional groupings under this heading, i.e. all countries of east and southeast Asia except Japan and centrally planned economies, all African countries except South Africa, all Caribbean and Latin America, and the Middle East except Israel.

[d] Excludes Japan and centrally planned economies. Roughly corresponds to developing ECAFE region.

[e] Excludes South Africa.

[f] Excludes Israel.

the rate of growth in *per capita* income actually showed a decline. This was the consequence of accelerated population growth. The countries of east and southeast Asia and Africa recorded the fastest acceleration in population growth, the rate going up from 2.1 per cent in the 1950s to 2.5 per cent per annum in the 1960s. It was on account of the rapid growth in population that, notwithstanding the acceleration in the rate of growth of aggregate domestic product in 1960-1968, the growth rate of *per capita* GDP remained unchanged at 1.9 per cent in east and southeast Asia. In Africa, the notable fall in the rate of growth of *per capita* GDP from 2.7 per cent per annum in the 1950s to 1.7 per cent in 1960-1968 was the result of both deceleration in the rate of growth of aggregate GDP and acceleration in the rate of growth of population. The main reason for the decline in the rate of growth of *per capita* GDP in the case of Latin America was the retardation in the rate of growth of real gross domestic product, though the rate of population growth also went up marginally. The Middle East was the only developing region where the rate of population growth showed a decline in the 1960s compared with the 1950s; this helped to sustain the rate of growth in *per capita* GDP, despite a fall in the rate of growth of aggregate domestic product.

The population growth rate has stabilized around 1.2 per cent per annum in the advanced countries. With the acceleration in the rate of growth of their gross domestic product from 3.9 per cent per annum in the 1950s to 5.3 per cent per annum in 1960-1968, the rate of growth in their *per capita* GDP went up from 2.7 per cent to 4.2 per cent per annum in this period. As the rise in *per capita* GDP in the developing countries averaged no more than 2.1 per cent per annum in 1960-1968, the disparity in the *per capita* income between the developing and the developed countries increased further over this period.[10]

The average rise of about 2 per cent per annum in the *per capita* income of developing countries in the First Development Decade appears to be extremely modest when viewed in the context of their poverty.[11] However, viewed in the historical perspective of the growth of nations, the developing countries seem to be making a heroic effort to improve their economic well-being. Statistical information about the rates of growth achieved by the presently developed countries in the early stages of their growth is rather scanty. However, on the basis of data available, it seems clear that economic growth in many developing countries is proceeding at a higher rate than that achieved by presently developed countries in similar stages of their economic growth. Table II-1-2 gives the data assembled by Kuznets on historical rates of growth in the presently developed countries. These

[10] It is one of the aims of international development policy to reduce the disparity in the *per capita* incomes of developed and developing countries. The widening of the disparity is therefore a cause for disappointment. It is clearly understood, however, that a reduction in this disparity has to be brought about by accelerating the rise in the *per capita* income of developing countries rather than a deceleration in the growth rate of *per capita* income in developed countries. In fact, on account of the great dependence of the developing countries on developed countries, both in trade and aid, a steady growth in developed countries is a prerequisite for accelerated development of the developing countries.

[11] The *per capita* income of developing countries in Asia in 1968 at 1964 factor cost was US$105. A 2 per cent rate of growth in *per capita* income means that, during 1960-1968, the rise in *per capita* income of developing Asian countries was only about US$2 a year.

show that in the United Kingdom, Switzerland and Sweden, the average annual rate of growth of real aggregate product was around 2.5 per cent in the early stages of modern economic growth. Countries like Germany, Japan, Italy and the United States, which enjoyed certain advantages on account of their being latecomers, achieved higher rates of growth, but in none of these did the rate of growth exceed 5 per cent per annum, the likely average for the developing countries in the First Development Decade. Even the *per capita* growth rate was not significantly higher, and, in some cases, it was even lower than that achieved by the developing countries in the 1960s, though they did not experience a "population explosion" of the type these countries are presently faced with. The historical experience of the growth of nations, therefore, should serve as an encouragement to the developing countries rather than dampen their development effort.

Table II-1-2. Growth rates of advanced countries in early stages of growth

Country	Period	Annual percentage rate of growth: Total	Annual percentage rate of growth: Per capita
United Kingdom	1860–1899	2.6	1.5
France	1840–1899	1.7	1.5
Germany	1860–1899	3.8	2.8
Italy	1861–1900	3.3	2.6
Switzerland	1890–1929	2.6	1.9
Denmark	1870–1909	3.1	2.0
Sweden	1861–1890	2.5	1.8
United States	1869–1908	4.3	2.2
Canada	1870–1910	3.8	2.3
Japan	1878–1907	4.6	3.4

Source: Kuznets, S., "Population, Income and Capital" in *Economic Progress* (ed. L. H. Dupriez), pp. 43-44.

It is also pertinent to remember that economic growth is a long and arduous process in which the first steps are always the most difficult. The objective of development effort in the developing countries is not so much to catch up with the developed countries as to bring about appreciable improvement in their living standards within a reasonable period of time. In this connexion, one should not ignore the compounded effect over time of a sustained growth in *per capita* income. Thus, if the developing ECAFE region maintains a modest average growth rate of even 2 per cent per annum in *per capita* income, it would mean a doubling of *per capita* income in 35 years and a quadrupling in 70 years. The sights should, of course, be set much higher and efforts made to realize the maximum feasible rates of growth compatible with other national objectives, to bring about speedy amelioration in the living standards.

Economic growth in the ECAFE region

The developing ECAFE region enjoys a distinctive position in the developing world in several respects. It contains about 40 per cent of the entire world population and nearly two thirds of the population of the developing world. However, it accounts for only 11 per cent of the total land area of the world and 17 per cent of the land area of developing regions, and is the most densely populated developing region in the world. Its share of world gross product by industrial origin is some 28 per cent in agriculture, less than 4 per cent in manufacturing, and some 5 per cent in construction, transport and communication and services. Of the total gross domestic product of the developing world, the share of the developing ECAFE region is about one half, but, on account of the heavy population pressure, its *per capita* income is the lowest amongst the developing regions. In many ways, Asia is also perhaps the most critical region.

The gross domestic product of the developing ECAFE region as a whole is estimated to have risen by 4.4 per cent per annum during 1960-1968. This is an improvement on the 4 per cent of the preceding decade, but, till 1968, it fell short of the 5 per cent target set for the First Development Decade. From preliminary reports, it appears that a marked improvement in the growth performance of the developing ECAFE region took place in 1969, and, if this was maintained in 1970, the 5 per cent target would have been achieved by the close of the First Development Decade. It will be seen from Table II-1-3 that all countries of the region increased the level of their gross domestic product during the 1960s but the growth rates differed considerably from country to country. The most rapidly expanding economies during the period 1960-1968 were those of China (Taiwan), the Republic of Korea, Iran and Thailand, which grew at average annual rates of 10 per cent, 8.4 per cent, 8 per cent and 7.8 per cent respectively.

Other countries which achieved rates of growth higher than the regional average were Malaysia (5.9 per cent), Pakistan (5.6 per cent), Ceylon (4.8 per cent) and the Philippines (4.6 per cent). The growth rates achieved by India, Burma and Indonesia were below the regional average. It is also seen from the table that, with the exception of India, Burma, Indonesia, and the Philippines, all countries of the region were able to accelerate their rates of growth during 1960-1968 compared with the 1950s.

The better performance of the agricultural sector was an important factor in improving the growth performance of a number of developing ECAFE countries during the 1960s. Table II-1-4 compares the annual rates of growth of GDP, agriculture and

Table II-1-3. Developing ECAFE countries: Annual growth rates of real gross domestic product, population, and gross domestic product *per capita*, 1950-1968

Country	Annual compound: per cent		
	1950-1960	1960-1965	1960-1968
Burma			
GDP[a]	6.3	2.7	1.3[b]
Population	1.9	2.0	2.1[b]
GDP *per capita*	4.3	0.7	—0.7[b]
Ceylon			
GDP[a]	3.0	3.9	4.8
Population	2.5	2.5	2.4
GDP *per capita*	0.5	1.4	2.4
China (Taiwan)			
GDP[a]	7.6[c]	10.1	10.0
Population	3.7[c]	3.2	3.1
GDP *per capita*	3.8[c]	6.7	6.8
India			
GDP[d]	3.5	3.3	3.3
Population	1.9	2.5	2.5
GDP *per capita*	1.6	0.8	0.8
Indonesia			
GDP[a]	3.3[c]	1.8	2.6
Population	2.1[c]	2.3	2.4
GDP *per capita*	1.2	—0.5	0.2
Iran			
GDP[a]	...	6.6	8.0
Population	...	2.7	2.9
GDP *per capita*	...	3.8	4.9
Korea, Rep. of			
GDP[a]	5.2[e]	6.8	8.4
Population	2.6[e]	2.9	2.7
GDP *per capita*	2.5[e]	3.8	5.6
Malaysia, West			
GDP[a]	4.0[f]	5.9	5.9[g]
Population	3.1[f]	3.1	3.1[g]
GDP *per capita*	0.9[f]	2.8	2.7[g]
Pakistan			
GDP[h]	2.5	5.5	5.6
Population	2.1	2.1	2.1
GDP *per capita*	0.4	3.3	3.4
Philippines			
GDP[a]	6.9	4.8	4.6
Population	3.1	3.4	3.5
GDP *per capita*	3.7	1.4	1.1
Thailand			
GDP[a]	6.4[e]	7.2	7.8
Population	3.8[e]	3.1	3.1
GDP *per capita*	2.5[e]	4.0	4.6
Developing ECAFE countries			
GDP	4.0	4.3	4.4
Population	2.1	2.5	2.5
GDP *per capita*	1.9	1.8	1.9

Source: United Nations, *Yearbook of National Accounts Statistics*, 1969; United Nations, *Monthly Bulletin of Statistics* and national official publications.

[a] At market prices.
[b] 1960-1967.
[c] 1951-1960.
[d] NDP at factor cost.
[e] 1953-1960.
[f] 1955-1960.
[g] 1960-1966.
[h] At factor cost.

manufacturing in some of these countries in the 1950s and the 1960s. The agricultural growth rate more than doubled in the cases of Pakistan and Ceylon and was fairly high in the cases of Malaysia and the Republic of Korea. In the cases of India and Indonesia, there was a deceleration in the rate of agricultural growth in 1960-1968, but the position improved subsequently. Production in the manufacturing sector expanded at a faster rate in the 1960s in all countries except the Philippines.

The fast growth in population neutralized a good part of the increase in gross domestic product in a number of developing ECAFE countries. The *per capita* income in the developing ECAFE region rose at an average annual rate of just 1.9 per cent during 1960-1968 which was below the average of 2.1 per cent for the developing countries as a whole. However, some countries of the region, particularly China (Taiwan), Iran, the Republic of Korea and Thailand, achieved average growths in *per capita* income substantially above the average for the developing countries as a whole. These were also the countries which showed a pronounced acceleration in the rate of growth of *per capita* income in 1960-1968 compared with the 1950s.

Changes in the levels of living

Increase in *per capita* income is not the sole concern of development effort nor is it a comprehensive measure of increase in human welfare. Identical rates of growth in *per capita* income can conceal substantive differences in changes in the levels of living and standards of material well-being. This is because a simple statistical measure like *per capita* income growth tells us nothing about changes in the pattern of income distribution and the qualitative changes in the levels of living of different classes of a country's population. For determining the impact of the development process on the living standards of various groups of population, it is necessary therefore to have some idea about changes in the pattern of income distribution during the time period under study.

The level of living is also affected by the environmental conditions and the type of social services[12] available in an economy. Social services provide benefits in kind for which people would have otherwise spent or needed cash. They also enable people to improve their productive efficiency and make life enjoyable. Social welfare is not an automatic consequence of growth in national income, and living standards can remain static or even regress notwithstanding a rise in national or *per capita* income.

[12] Social services include educational facilities, care of health, low-cost housing and a whole host of other items designed to improve the living conditions of the people.

Table II-1-4. Developing ECAFE countries: Annual rates of growth of gross domestic product, agriculture and manufacturing, 1950-1960 and 1960-1968

	Gross domestic product		*Agriculture*		*Manufacturing*	
	1950-1960	*1960-1968*	*1950-1960*	*1960-1968*	*1950-1960*	*1960-1968*
Ceylon	3.0	4.8	1.2	2.6	5.2	13.5
China (Taiwan)	7.6[a]	10.0	6.7[a]	5.8	10.8[a]	13.8
India	3.5	3.3	3.1	1.2	3.3	5.1
Indonesia	3.3[a]	2.6	4.8[a]	2.0	—0.3[a]	2.8
Korea, Rep. of	5.2[b]	8.4	2.6[b]	3.9	13.6[b]	15.9
Malaysia, West	4.0[c]	5.9[d]	2.9[c]	4.7[d]	4.9[c]	11.0[d]
Pakistan	2.5	5.6	1.4	3.7	7.8	8.3
Philippines	6.9	4.6	5.0	5.1	9.8	4.7
Thailand	6.4[a]	7.8	4.3[a]	4.8	6.8[a]	10.8

Source: United Nations, *Yearbook of National Accounts Statistics*, 1969, and national sources.

[a] 1951-1960. [c] 1955-1960.

[b] 1953-1960. [d] 1960-1966.

Information on changes in *per capita* income has therefore to be supplemented by information on other indices of social change to determine changes in human welfare (the ultimate aim of all development effort). The United Nations Statistical Commission has suggested nine major components of a satisfactory index of levels of living: (*a*) health; (*b*) food consumption and nutrition; (*c*) education; (*d*) employment and conditions of work; (*e*) housing; (*f*) social security; (*g*) clothing; (*h*) recreation and (*i*) human freedoms. The Commission recommended that consideration also be given to population and labour force, income and expenditure, and communications and transportation, to obtain a comprehensive picture of the levels of living.

Evaluation of progress in the developing ECAFE region in the First Development Decade thus requires a review of not only the trends in gross domestic product and its distribution amongst the various income groups but also an assessment of achievements and failures in a number of other fields. Unfortunately, adequate information is not available for a comprehensive evaluation of this type. However, an attempt is made below to delineate at least the broad trends in respect of changes in income distribution and the levels of living in the developing ECAFE countries in the First Development Decade. This should serve to focus attention on some of the major policy issues with which these countries are likely to be faced in the Second Development Decade.

Trends in income distribution

Adequate statistics are not available to form a comprehensive picture about the trends in income distribution in the developing ECAFE countries in the recent past. Attempts have been made in some countries to study the pattern of income distribution with the help of fragmentary data based on income tax returns and household sample surveys,[13] but these studies usually relate to a point of time and do not furnish information about trends in income distribution over time. In the absence of sufficient data on the subject, any judgement on the trends in income distribution in the developing ECAFE region has to rely a good deal on indirect inference.

Among the developing ECAFE countries, the Philippines and Ceylon are the only ones which have data on income distribution permitting some comparison over time. The data relating to the Philippines reveal an increase in income inequalities between 1956 and 1961.[14] The share of the top decile in personal incomes is estimated to have increased from 39.3 per cent in 1956 to 40.7 per cent in 1961, while the share of the five lowest deciles declined from 18.5 to 17.9 per cent. The over-all concentration ratio is estimated to have risen from 0.492 to 0.515 during this period. The sectoral analysis of income distribution showed that income disparities were wider in urban than in rural areas and income inequalities appeared to be rising faster in urban than in rural areas. In Ceylon, the extent of income inequalities is estimated to have declined slightly between 1953 and 1963.[15] The share of the top decile in personal incomes declined appreciably from 40.6 per cent in 1953 to 36.8 per cent in 1963, but the share of the five lowest deciles did not rise; in fact, it declined from 20.9 to 19.93 per cent. It was the share of upper middle-income groups which improved percep-

[13] For the limitations of such data and the caution that is needed in using them in income distribution studies, see Titmus, R. M., *Income Distribution and Social Change* (London, Allen and Unwin, 1962) and Kuznets, S., *Modern Economic Growth* (Yale University Press, 1966), pp. 195-206.

[14] Reyes, P. S. and Chan, T. L., Family Income Distribution in the Philippines", *Statistical Reporter*, Vol. IX, No. 2, 1965, pp. 31-32.

[15] Central Bank of Ceylon, *Survey of Ceylon's Consumer Finances*, 1963, p. 66.

tibly in this period and this, along with the decline in the share of the top decile, led to a slight decline in the over-all concentration ratio from 0.46 in 1953 to 0.45 in 1963.

Information about trends in income distribution in other developing countries of the ECAFE region is very scanty. A study on income distribution in India relating to the period 1953/54 to 1956/57 found that the top decile in the urban areas had 37 per cent of personal income while the top decile in the rural areas had 25 per cent.[16] On the other hand, the share of the five lowest deciles in urban areas was 25 per cent, while the share of corresponding deciles in the rural areas was 30 per cent. The concentration ratio worked out at 0.40 for urban areas, 0.31 for rural areas and 0.34 for the country as a whole. Comparable information for the subsequent period is not available, but, according to the Indian Planning Commission: "Available information does not indicate any trend towards reduction in the concentration of income and wealth. Nor is there any indication that there has been any lessening of disparity in the standards of living of various classes".[17]

A rough estimate of income distribution in Pakistan for 1959/60 revealed wide disparities between the lowest and highest income groups, particularly in the urban areas.[18] A study relating to 1963/64 also indicated wide-ranging income inequalities.[19] The only study which attempted an inter-temporal comparison of trends in income distribution in Pakistan was based on income tax returns and hence covered only 0.1 per cent of the total population and about 1 per cent of the urban population in the country.[20] Moreover, it covered the period up to 1960/61 only. This study reached the conclusion that, whereas the pattern of income distribution amongst the tax-paying population in Pakistan was highly skewed,[21] there was a modest decline in income concentration in that population group between 1950 and 1960. It recognized, however, that indirect checks had revealed that the inequality of incomes between the tax-paying population (representing the upper-income brackets) and the rest of the economy, had been increasing over time. Sectoral income studies also corroborate the trend towards increasing inequalities. In one of these studies, for example, it was found that the real income of Pakistan's rural population declined from 1949/50 onwards till the early 1960s, after which it recovered, but the 1964/65 level was about the same as in 1949/50.[22] Another study indicated a decline in the real income level of the poorest stratum of rural population in East Pakistan in the 1950s, and no significant rise in the 1960s for the period covered up to 1966.[23] The trend in real wages in the manufacturing sector in Pakistan was investigated in another study which concluded that, in the period 1954-1964, real wages had "failed to rise and almost certainly declined somewhat" so that, with *per capita* income rising, it could be inferred that the pattern of income distribution had become more unequal, particularly in the urban areas.[24]

Information on the income distribution pattern in China (Taiwan) is available only for one point of time. According to a survey carried out in 1964, the top decile of households received about 26 per cent of all family income as against approximately 28 per cent for the five lowest deciles.[25] The data show that, unlike the position in most other developing ECAFE countries, there was no significant difference between rural and urban incomes in China (Taiwan).

Information on changes in the pattern of income distribution in other developing ECAFE countries is lacking but there are reasons to believe that inequalities of income have probably increased in most of these countries in recent years. Though there has been a structural change away from agriculture to industry and other occupations where the value of product per worker is higher, the favourable effects of these intersectoral shifts on the pattern of income distribution seem to have been more than neutralized by intrasectoral changes in income differentials. It appears that a number of institutional and other factors have militated against an equitable sharing of the gains in productivity, both in the agricultural and non-agricultural sectors, and have often aggravated income inequalities.[26] There is evidence that even the recent "agricultural revolution" is tending to

[16] Bhatt, V. V. and Ojha, P. D., "Pattern of Income Distribution in an Underdeveloped Economy: A Case Study of India", *American Economic Review*, September 1964. For some earlier estimates see *Report of the Committee on Distribution of Income and Levels of Living*, Part I (Planning Commission, Government of India, 1966), pp. 14-15.

[17] *Fourth Five-Year Plan* (draft), Planning Commission, Government of India, 1969, p. 8.

[18] Government of Pakistan, *The Third Five-Year Plan*, p. 29.

[19] Bergan, A., "Personal Income Distribution and Personal Savings in Pakistan, 1963/64", *Pakistan Development Review*, Summer 1967.

[20] Khadija Haq, "A Measurement of Inequality in Urban Personal Income Distribution in Pakistan", *Pakistan Development Review*, Winter 1964, pp. 623-664.

[21] In 1960/61, the top decile of the tax-paying population accounted for 35.4 per cent of total incomes while the lowest five deciles had only 23.5 per cent of total incomes.

[22] Griffin, K. B., "Financing Development Plans in Pakistan", *Pakistan Development Review*, Winter 1965.

[23] Bose, S. R., "Trend of Real Income of the Rural Poor in East Pakistan, 1949-60", *Pakistan Development Review*, Autumn 1968.

[24] Khan, A. R., "What has been happening to real wages in Pakistan", *Pakistan Development Review*, Autumn 1967.

[25] Government of the Republic of China, Directorate General of Budgets, Accounts and Statistics, *Report on the Survey of Family Income and Expenditure and Study of Personal Income Distribution in Taiwan*, cited in ECAFE: "Review of the Social Situation in the ECAFE region", February 1970 (E/CN/11/L.250), p. 16.

[26] How this has happened is discussed at some length in the section on Major Policy Issues.

increase, rather than decrease, income inequalities, and these inequalities may become more serious unless suitable policy measures are taken.[27]

Apart from pronounced interpersonal income inequalities, some of the developing ECAFE countries have a sizable problem of significant interregional disparities in income. In Pakistan, for example, the eastern part of the country has lagged considerably behind the western part in the matter of economic development, and imbalance in regional income distribution has accentuated.[28] There is evidence of considerable regional disparities in the case of India also. According to a recent plan-evaluation study, the percentage of households living below the "poverty line" (defined as monthly expenditure of Rs 100 per month) varied from 33 per cent in certain States to as high as 73 per cent in others.[29] In the Philippines, interregional income disparities are reported to have become more pronounced over time, while the same has probably happened in the case of Thailand, the Republic of Korea and other developing ECAFE countries.[30]

Living standards and environmental conditions

The improvement brought about by economic growth in the living standards of the people in the developing ECAFE region during the First Development Decade is not easy to quantify. In the developing countries, where large masses of population still suffer from varying degrees of malnutrition, quantitative and qualitative changes in food consumption are one of the most important indicators of changes in the levels of living. Nutritional quantity is usually measured by caloric content while the quality of diet is judged with reference to its protein content. Table II-1-5 illustrates the nutritional situation in the developing ECAFE countries and also provides a comparison with certain developed countries. It will be seen that there is a wide disparity in the caloric and protein content of *per capita* food supply between the developing ECAFE countries and the advanced countries. The progress in the direction of improving the nutritional levels appears to have been quite slow in a number of countries, at least till 1967, the latest year for which such figures are available. The minimum daily requirement of calorie intake for Asian countries is placed at 2,300 units by the Food and Agriculture Organization. It will be seen that, of the listed countries, only three, namely China (Taiwan), the Republic of Korea and Malaysia, had average daily intakes above this level, while others had yet to reach this level. The total protein intake, especially animal protein, was far below the level of advanced countries and had not risen much in recent years. In fact, in quite a few countries, the protein intake had gone down, and, in India and Pakistan, the two most heavily populated countries, the protein intake was even lower than in the pre-war period.

The above-cited national averages of calorie and protein intake do not portray the full magnitude of malnutrition prevalent in some of the developing ECAFE countries. Available evidence suggests that there are pronounced disparities in the consumption levels and dietary composition of various groups of population in these countries, particularly in respect of protein intake. For example, it is estimated that, in India, between a quarter and a third of the total households do not receive enough protein.[31] Even in regard to cereals, the staple diet, there appear to be wide variations in consumption between the richer and the poorer families, and, according to a detailed survey of consumption trends in the Indian economy, the poorest sections of the population were living even below the subsistence level.[32] Some groups of population in Indonesia also were reported to be suffering from under-nourishment and malnutrition.[33] According to FAO estimates, more than half of the total population of the developing ECAFE region does not have the amount of food necessary to lead a healthy, active life.[34]

The widespread malnutrition in most of the developing ECAFE countries is attributable to the low levels of *per capita* income and slow growth in the production of foodgrains and non-cereal food items. The average income of a large number of households is not enough to provide even two square meals a day. According to an Indian study, "the low level of consumption of cereals of the poorest section was almost certainly due to lack of purchasing capacity"[35] and year-to-year variations in cereal consumption showed that "the poorest section of the population, except for the period of very low prices, could not afford to consume as much cereals as they would have desired".[36] The position is worse in

[27] Cf., "Strategies for Agricultural Development", *Economic Survey of Asia and the Far East*, 1969, Part I, pp. 42-43, and *Report of the Joint FAO/ECAFE/ILO Seminar on Land Reform Implementation in Asia and the Far East*, Rome, 1969, p. 4.

[28] Government of Pakistan, *The Fourth Five-Year Plan*, p. 1.

[29] Government of India, Planning Commission, *Regional Variations in Social Development and Levels of Living* (New Delhi, 1967), Vol. I, p. 49.

[30] ECAFE, "Review of the Social Situation in the ECAFE Region", February 1970, *op. cit.*, pp. 18-19.

[31] United Nations, *Report on the World Social Situation*, 1967, p. 40.

[32] *Report of the Committee on Distribution of Income and Levels of Living* (India), Part II, *op. cit.*, p. 18.

[33] Napitrpulu, B., "Hunger in Indonesia", *Bulletin of Indonesian Economic Studies*, No. 9, February 1968, pp. 60-70.

[34] Cf., United Nations, *Report on the World Social Situation*, 1967, *op. cit.*, pp. 37-39.

[35] *Report of the Committee on Distribution of Income and Levels of Living* (India), Part II, *op. cit.*, p. 18.

[36] *Ibid.*, p. 32.

Table II-1-5. Estimated calorie and protein content of *per capita* food supply in selected developed and developing countries

	Calories				Total protein				Animal protein			
	Pre-war	1960-1962	1966	1967	Pre-war	1960-1962	1966	1967	Pre-war	1960-1962	1966	1967
	Number per day				Grammes per day							
Developing ECAFE countries												
Afghanistan	...	2,040[a]	1,950	...	...	62.5[a]	56.4	...	...	7.8[a]	7.7	...
Ceylon	...	2,080	2,180	2,170	...	46.1	44.5	48.0	...	7.9	10.3	8.3
China (Taiwan)	1,870	2,350	2,400	2,520	45.1	58.5	62.2	68.2	15.5	15.3	19.3	23.9
India[b]	1,950[c]	2,020	1,810[d]	...	52.2[c]	49.6	45.4[d]	...	8.2[c]	5.6	5.4[d]	...
Indonesia[b]	...	1,980[e]	...	...	...	38.2[e]	...	...	...	4.5[e]	...	...
Iran	...	2,050[f]	1,890	...	...	59.6[f]	49.8	...	...	13.4[f]	11.5	...
Korea, Rep. of	...	2,240[g]	2,390	...	...	72.6[g]	70.5	...	...	11.4[g]	11.5	...
Malaysia (West) — Singapore	...	2,400[e]	...	...	...	54.3[e]	...	...	...	16.3[e]	...	...
Pakistan[b]	1,950[c]	2,090	2,230	...	52.2[c]	49.0	51.5	...	8.2[c]	11.1	11.2	...
Philippines	...	1,880	2,070	2,000	...	48.0	48.6	50.5	...	17.7	18.2	18.7
Selected developed countries												
Australia	3,300	3,140[i]	3,120[j]	...	103.3	89.8[i]	90.5[j]	...	66.6	59.7[i]	60.6[j]	...
France	2,880	3,080	3,100	...	94.9	99.2	100.7	...	40.9	53.4	59.9	...
Germany, Fed. Rep. of	3,040[h]	2,990[i]	2,879[j]	2,960[k]	84.8	81.1[i]	79.9[j]	80.9[k]	42.5	49.8[i]	51.5[j]	52.0[k]
United Kingdom	3,110	3,270[i]	3,220[j]	3,150[k]	80.2	89.0[i]	88.9[j]	87.5[k]	43.9	53.4[i]	53.3[j]	53.8[k]
United States	3,280	3,120	3,160[j]	3,200[k]	86.3	92.4	93.8	95.6[k]	51.7	64.3	65.1[j]	68.6[k]

Source: FAO, *The State of Food and Agriculture*, 1969.

[a] 1961/62.
[b] Split years.
[c] India and Pakistan.
[d] 1965/66.
[e] 1961-1963.
[f] 1960.
[g] 1962.
[h] From 1959/60 onward including the Saar.
[i] 1960/61–1962–63.
[j] 1966/67.
[k] 1967/68.

respect of more nutrient types of food which are generally outside the reach of the mass of the population. Apart from the low level of income, the inability of the people to have sufficient food and a balanced diet is also related to inadequate growth in the agricultural sector. In quite a few countries, production of foodgrains till recently did not keep pace with the increased demand resulting from population growth and rise in *per capita* income, and, consequently, the prices of foodgrains rose and the consumption levels of poorer sections of society were depressed.[37] The production of more nutrient types of food has risen even more slowly and resulted in a steady rise in their prices. The prices of meat, eggs, milk and butter, the main sources of animal protein, have shown a pronounced rise over the years, and the inability of large masses of population to afford them at these prices is an important factor in the prevalent widespread malnutrition.

Social services provided by the Government are considered an important means of raising the living standard of the people. A recent survey[38] conducted by ECAFE disclosed that government financial allocations for social services[39] have shown an appreciable rise over the years in most of the developing ECAFE countries. Table II-1-6 summarizes this information.[40] It will be seen that government expenditures on social services have not only recorded a rise in absolute terms but have also risen relatively to other government expenditures. In the smaller countries, the proportion of government expenditure devoted to social services was in almost all cases more than 25 per cent, and, in some cases, exceeded one-third of central government expenditure for all purposes. The proportion was much lower in the relatively more heavily populated countries, such as India and Pakistan.

The distribution of government expenditure on social services is also shown in Table II-1-6. It will be seen that, in almost all cases, more than 50 per cent of government expenditure on social services was on education. In most countries, also, education is the social service which has shown the largest

[37] Food-deficit countries have sought to correct the imbalance between the demand for and supply of foodgrains by means of imports, but, in most cases, this has not prevented prices from rising.

[38] The results of this survey have been published in *The Planning and Financing of Social Development in the ECAFE Region*, ECAFE Social Development Series, No. 1, 1969.

[39] Social services were defined to include three major activities, namely education, health and social security (plus social welfare and miscellaneous social services, such as housing and recreation).

[40] This information is based on replies received to an ECAFE questionnaire and is subject to a number of limitations detailed in the publication mentioned in 38 above.

Table II-1-6. Developing ECAFE countries: Percentage distribution of government expenditure by functional classification

Country	Year	Social services					Other government services	All government services
		Total	Education	Health	Social security and special welfare services	Other social services		
Whole government								
Hong Kong	1956	31.6	14.0	8.3	1.0	8.3	68.4	100.0
	1961	37.8	15.7	10.4	1.1	10.6	62.2	100.0
	1966	37.7	15.1	9.1	1.0	12.5	62.3	100.0
India	1954	17.7	7.9	4.0	4.9	0.9	82.3	100.0
	1955	n.a.	8.3[a]	3.9[b]	n.a.	n.a.	n.a.	100.0
	1960	n.a.	9.3[a]	4.5[b]	n.a.	n.a.	n.a.	100.0
	1965	n.a.	8.7[a]	3.8[b]	n.a.	n.a.	n.a.	100.0
Korea, Republic of	1957	2.1	0.4	0.9	0.7	0.1	97.9	100.0
	1961	20.8	14.1	1.2	3.6	1.9	79.2	100.0
	1966	36.7	27.9	2.1	4.3	2.4	63.3	100.0
Malaysia, West	1960	17.3	10.1	4.5	1.5	1.2	82.7	100.0
	1965	20.8	13.4	5.0	0.4	2.0	79.2	100.0
Pakistan[c]	1956	9.6	6.4	n.a.	0.1	3.1	n.a.	100.0
	1961	7.8	5.2	n.a.	0.2	2.4	n.a.	100.0
	1966	9.6	5.7	n.a.	0.2	3.7	n.a.	100.0
Singapore	1956	37.4	18.3	11.9	3.9	3.3	62.6	100.0
	1961	30.9	14.8	10.1	2.7	3.3	69.1	100.0
	1966	35.6	19.1	9.8	1.7	5.0	64.4	100.0
Central government								
Afghanistan	1961	17.1	9.9	3.7	—	3.5	82.9	100.0
	1966	19.5	12.9	2.8	—	3.8	80.5	100.0
Ceylon	1956	35.4	14.3	9.4	11.7		64.6	100.0
	1961	38.8	15.1	7.8	15.9		61.2	100.0
	1966	37.9	15.1	7.1	15.7		62.1	100.0
India	1966	6.5	1.9	1.3	3.3		93.5	100.0
Korea, Republic of	1957	1.1	0.4	0.5	0.2	0.1	98.9	100.0
	1961	20.3	13.4	1.0	4.3	1.6	79.7	100.0
	1966	26.1	17.9	1.5	5.6	1.1	73.9	100.0
Malaysia, West	1960	17.7	10.8	4.8	1.4	0.7	82.3	100.0
	1965	21.2	15.1	5.5	0.4	0.2	78.8	100.0
Philippines	1956	31.7	23.9	6.1	1.7		68.3	100.0
	1961	36.9	26.7	7.5	2.7		63.1	100.0
	1966	39.2	32.0	5.8	1.4		60.8	100.0
Thailand	1959	26.4	19.5	2.9	3.2	0.8	73.6	100.0
	1961[d]	24.7	16.6	2.7	4.0	1.4	15.3	100.0
	1966	27.3	16.5	3.6	3.8	3.4	72.7	100.0

Source: United Nations, *The Planning and Financing of Social Development in the ECAFE Region*, ECAFE Social Development Series No. 1, 1969, pp. 33-34.

[a] Capital expenditures are not included.

[b] Capital expenditures are partially included.

[c] Development expenditure only. Social services total does not include expenditures on health.

[d] Nine-month period ending 30 September.

acceleration in expenditure. It is noteworthy that expenditure on health has not increased to any great extent in any of the countries for which data are available; in fact, in some countries, the proportion spent on health services has actually registered a decline. Expenditure on other social services, which include subsidized housing for the poor and other programmes aimed at improving the general living and environmental conditions, have shown an even smaller progression, particularly in the case of more heavily populated countries.

The trends in the ratio of government expenditures on social services to gross domestic product in the developing ECAFE countries, as shown in Table II-1-7, demonstrate that, in most of these countries, government expenditure on social services as a proportion of GDP has risen over the years, but, except in the case of a few of the smaller countries, the rise is not very notable. It is particularly noticeable that expenditure on social services other than education has formed a very small proportion of total gross domestic product in most of these countries, and expenditure on "other social services" which include certain items of the greatest relevance for the living conditions of the poorest sections of the population is a minute proportion of the total gross domestic product.

Table II-1-7. Developing ECAFE countries: Percentage ratio of government expenditures on social services to gross domestic product (or gross national product)

Country	*Year*	*Total*	*Education*	*Health*	*Social security and special welfare services*	*Other social services*
Whole government						
China (Taiwan)	1966	3.6	2.7	0.2	0.7	0.0
Hong Kong	1961	6.8	2.8	1.9	0.2	1.9[a]
India[b]	1954	2.2	1.0	0.5	0.6	0.1
	1960	n.a.	1.6[c]	0.8[d]	n.a.	n.a.
	1965	n.a.	2.0[c]	0.9[d]	n.a.	n.a.
Iran[b]	1966	4.6	2.7	1.1	0.5[e]	0.3
Korea, Rep. of	1957	0.4	0.1	0.2	0.1[e]	0.0
	1961	4.9	3.3	0.3	0.8[e]	0.5
	1966	9.0	6.9	0.5	1.0[e]	0.6
Malaysia, West	1960	6.1	3.6	1.6	0.5	0.4
	1965	7.6	4.9	1.8	0.2	0.7
Singapore	1961	6.1	2.9	2.0	0.6	0.6
	1966	7.5	4.0	2.1	0.3	1.1
Central government						
Ceylon	1956	8.3	3.4	2.2	2.7	
	1961	11.5	4.5	2.3	4.7	
	1966	11.0	4.4	2.1	4.5	
China (Taiwan)	1966	0.8	0.5	0.0	0.3	0.0
India[b]	1954	1.0	0.2	0.1	0.6	0.1
	1966	1.1	0.3	0.2	0.6	
Iran[b]	1966	4.2	2.7	0.9	0.4[e]	0.2
Korea, Rep. of	1957	0.2	0.1	0.1	0.0[e]	0.0
	1961	4.0	2.6	0.2	0.9[e]	0.3
	1966	3.9	2.7	0.2	0.8[e]	0.2
Malaysia, West	1960	5.7	3.5	1.5	0.5	0.2
	1965	6.8	4.8	1.8	0.1	0.1
Philippines	1966	3.8	3.1	0.6	0.1[f]	
Thailand	1959	3.6	2.7	0.4	0.4	0.1
	1966	4.3	2.6	0.6	0.6	0.5

Source: *The Planning and Financing of Social Development in the ECAFE Region*, ECAFE Social Development Series No. 1, 1969, p. 38.

[a] Urban services and resettlement.

[b] Percentage of GNP.

[c] Excluding capital expenditures.

[d] Capital expenditures are only partially included.

[e] Social security.

[f] Labour and welfare.

Apart from government expenditure on social services, certain expenditures in the private sector also directly affect the well-being of the people, such as amounts spent on workers' housing and private hospitals. However, such expenditures are believed to be of insignificant magnitudes. Comprehensive information is not available regarding the impact of expenditure on social sectors on the actual living conditions of the people in the First Development Decade. However, fragmentary evidence suggests that, whereas notable gains have been achieved in the field of education, conditions in other sectors have not shown much of an improvement and, in certain cases, have even deteriorated.

The First Development Decade has witnessed a remarkable improvement in the field of education in almost all the developing ECAFE countries. There has been a rapid expansion in educational facilities at all levels of schooling from primary to tertiary, with pupil enrolments outpacing the rate of growth of the corresponding school age groups. A rough picture of the achievements in the field of education is set out in Table II-1-8. Though figures of school enrolments are presently available only for the period up to 1963/64, they are sufficiently indicative of the all-round progress that was being made in this field in the 1960s. The largest numerical increase in enrolments has taken place at the primary level. It is reported that, in at least seven developing ECAFE countries, namely Ceylon, China (Taiwan), Mongolia, the Philippines, Singapore, the Republic of Korea and Thailand, 90 per cent or more of the primary school age groups were actually enrolled.[41] The rate of growth in enrolments has been generally higher at the secondary level and, in some countries, highest of all at the tertiary level. These high growth rates, however, reflect the extremely low base levels, and, in absolute terms, educational facilities at higher levels

[41] United Nations, *Report on the World Social Situation*, 1967, *op. cit.*, p. 118.

Table II-1-8 Developing ECAFE countries: Percentage of population aged 5-14 years and 15-19 years enrolled at first and second levels of education in 1950, 1960 and 1963, and numbers of students per 100,000 population enrolled at third level of education in 1950, 1960 and 1964

	First level (5-14 years of age)			*Second level (15-19 years of age)*			*Third level*		
	1950	*1960*	*1963*	*1950*	*1960*	*1963*	*1950*	*1960*	*1963*
	(Percentage of age group)			*(Percentage of age group)*			*(No. of students per 100,000)*		
Afghanistan	3	5	9	0.5	1	3	3	12	23
Brunei	30	71	86	—	21	29	...	...	...
Burma	9[a]	31	34[b]	3[a]	13	23[b]	18[e]	66[e]	...
Ceylon	54	64	64	...	...	...	54	68	114[f]
China (Taiwan)	48	67	67	15	37	52	87	330	530
Fiji	71	78	79	6	15	17	...	109	111[e]
Hong Kong	26	57	67	17	38	70	43[g]	276	276
India	21	34	38[c]	14	35	31[c]	118	154	284[h]
Indonesia	29	42	...	3	9	...	8	48[i]	...
Iran	16	28	37[b]	5	14	19[b]	34	98	108
Khmer Republic	13[a]	44	45	0.4[a]	5[a]	14	5	17	77
Korea, Rep. of	53	60	69	20	32	38	177	401	516
Laos	11	20	27	0.5[a]	2[a]	3[a]	—	6	7
Malaysia: West	45	58	54	7	26	33	5	37	113
East: Sabah	24	42	55	2	9	15	...	...	...
Sarawak	...	52	53	...	13	22	...	...	19
Mongolia	...	40	...	...	7	...	160	259	756[h]
Nepal	...	8	14[b]	...	7	7[b]	...	50	66
Pakistan	16	22	25	15	16	22	93	161	222[h]
Philippines	74	56	60[e]	22	25	26[e]	900	978	1,144[h]
Singapore	51	66	65	11	47	57	181	629	892
Thailand	52	59	60	7	13	14	150	173	199[h]
Viet-Nam, Rep. of	16	50	61	2	15	19	...	85	138[h]
Western Samoa[d]	103	99	94	4	6	54	242	125	79

Source: United Nations, *Compendium of Social Statistics, 1967, Statistical Papers*, Series K, No. 3, New York, 1968.

[a] Public education only.
[b] 1964.
[c] 1962.
[d] During the period under review, criteria for the classification of education as primary and secondary level were modified.
[e] University of Rangoon only.
[f] Universities only.
[g] Incomplete data.
[h] 1963.
[i] Universities and degree-granting institutions only.

are still far below those found in advanced countries. Moreover, progress in education cannot be judged merely by the rate of growth of enrolments. The high rate of drop-outs in developing countries, particularly at the primary and secondary levels, means that a large number of pupils who enrol at schools do not complete their education.[42] The educational programmes have also been characterized by certain imbalances which need special attention in the Second Department Decade.[43]

The housing situation appears to have deteriorated in most of the developing ECAFE countries during the First Development Decade. At the beginning of the decade, it was estimated that over 1,000 million people in Africa, Asia and Latin America (about half of the total population of these countries) were "homeless or live in housing which is a health hazard and an affront to human dignity".[44] Available evidence suggests that housing output has steadily lagged behind needs during the First Development Decade. It is reported, for example, that the estimated requirement of ten new dwelling units per 1,000 inhabitants per year has been met only in a few advanced countries of the world, whereas, in many of the developing countries, it has not been higher than two or three units per 1,000 inhabitants.[45] Moreover, much of the investment in housing in developing countries has gone into private luxury residential construction, while progress in low-cost housing has been disappointing. As a result, the housing situation for the poorer sections of society has continued to deteriorate. The housing shortage in India is reported to have increased by nearly 50 per cent during the 1960s, and, in Pakistan, by approximately 100 per cent.[46] The situation is particularly acute in the urban areas, on account of the fast pace of urbanization, and is rapidly assuming the proportions of a first-rate crisis. The slum population of Calcutta in India and of metropolitan Manila in the Philippines is reported to account for one half and one quarter respectively of the population of these two cities.[47]

In the field of health and sanitation, the record is a mixed one. There appears to have been a considerable advance in the eradication of certain diseases which were previously mass killers, and this has resulted in significantly reducing the mortality rates and raising the average life expectancy. The progress in respect of general medical services and health care has, however, been slow and uneven, as can be seen from Table II-1-9 which gives data relating to population per hospital bed and population per physician in the developing ECAFE countries. Moreover, improvement in the hospital bed/population ratio is not a comprehensive indicator of over-all progress in medical facilities in these countries because such facilities have generally "tended to coagulate in and around urban areas, leaving large segments of the rural population with little access to skilled medical help."[48]

The environmental conditions in which large masses of population live in developing ECAFE countries are appalling. Even such an elementary facility as a safe, piped water supply is not accessible to the large majority of the population. According to a survey by the World Health Organization (WHO), only 11 per cent of the population surveyed in developing regions had a good or fair water supply; supplies for the remaining 89 per cent were unsatisfactory or grossly unsatisfactory.[49] These figures are corroborated by some of the individual country studies. In Pakistan, for example, it is officially stated that "hardly 10 per cent of the total population has access to drinkable water, and, in the large urban areas, not more than 30 per cent of the population has access to piped water.[50] The over-all sanitary conditions, particularly in respect of sewerage and garbage disposal, are highly unsatisfactory, and, in large areas, virtually non-existent. Urban transport facilities have also failed to grow in line with requirements.

A very important determinant of the level of living in a country is the state of employment. It is not possible to make any precise assessment of the trends in employment or unemployment in the developing ECAFE countries during the First Development Decade. The greatest difficulty in any such assessment arises from the fact that unemployment in less developed countries often takes the form of chronic under-employment which is usually termed "disguised unemployment". The measurement of the degree of under-employment or "disguised unemployment" raises several difficulties and is usually subject to considerable margins or error.[51] Statistics relating

[42] In some of the developing ECAFE countries, drop-out rates in the first four years of primary school education are as high as 80 per cent or more of original enrolments and rates of more than 50 per cent are quite common. See the *Bulletin of the UNESCO Regional Office for Education in Asia*, Vol. 1, No. 2, 1967.

[43] For a discussion of these aspects, see pp. 78 and 82 below.

[44] United Nations, *The United Nations Development Decade, Proposals for Action, op. cit.*, p. 59.

[45] United Nations, *Report on the World Social Situation*, 1967, *op. cit.*, p. 49.

[46] ECAFE, "Review of the Social Situation in the ECAFE Region", February 1970, *op. cit.*, p. 9.

[47] *Ibid.*, p. 7.

[48] United Nations, *Report on the World Social Situation*, 1967, *op. cit.*, p. 118.

[49] *Ibid.*, p. 30.

[50] Government of Pakistan, *The Fourth Five-Year Plan*, p. 465.

[51] For a discussion of difficulties involved in such measurement, see the paper by Louis J. Ducoff and Margaret T. Hagood in *The Measurement and Behaviour of Unemployment*, National Bureau of Economic Research (Princeton, 1957) and Chiang Hsieh, "Underemployment in Asia: Nature and Extent", *International Labour Review*, Vol. LXV, No. 6.

Table II-1-9. Developing ECAFE countries: Population per hospital bed and population per physician, 1960 and 1965-1968

	Population per hospital bed					Population per physician				
	1960	1965	1966	1967	1968	1960	1965	1966	1967	1968
Afghanistan	...	5,760	5,810	...	...	31,000[a]	...	21,360	...	...
Brunei	...	250	...	260	...	4,400[b]	4,590	3,470	3,090	...
Burma	1,400	...	1,030	1,190	...	11,000	11,900	9,580	...	...
Ceylon	330	290	...	320	...	4,500	5,820	4,180	4,060	...
China (Taiwan)	...	...	1,040	...	...	1,564	2,470	2,330	2,540	...
Fiji	...	270	...	320	...	2,000	2,370	...	2,400	...
Hong Kong	...	...	280	270	...	2,900[a]	2,660[c]	2,320	2,390	...
India	2,200[d]	1,670	...	...	...	5,800[b]	5,780[a]	4,830	...	...
Indonesia	1,300	1,450	...	...	1,470	48,000	34,820[c]	29,480	27,560	...
Iran	...	...	900	960	...	3,800	3,880	3,670	3,820	...
Khmer Rep.	...	1,320	...	...	...	29,727	22,500	...	...	...
Korea, Rep. of	...	...	1,250	...	...	2,900[a]	2,710	2,540	...	2,360
Laos	...	...	1,650	1,570	...	58,250	20,000	24,550	23,380	...
Malaysia: West	...	...	250	...	...	6,500[b]	5,890	5,320	4,750	...
East: Sabah	...	...	420	...	...	12,000[a]	9,740	11,340	...	...
Sarawak	...	...	380	400	...	14,000[a]	...	12,870	...	11,130
Mongolia	...	110	...	...	...	950[b]	730	...	...	...
Nepal	...	...	6,950	5,110	...	72,000	45,090	41,180	39,780	...
Pakistan	13,000	...	2,820	3,560	...	11,000	6,200	5,980	9,890	...
Philippines	...	...	730	720	...	3,949	1,330	1,370	1,390	...
Singapore	...	...	250	280	...	2,400	2,020[c]	1,790	1,780	...
Thailand	1,200	...	1,090	1,160	...	7,500	8,820	7,110	8,550	...
Viet-Nam, Rep. of	...	610	590	...	...	29,000	19,960[a]	37,430	...	...
Western Samoa	...	250	240	...	...	2,265	...	2,710	...	2,980

Source: United Nations, *Compendium of Social Statistics*, 1963, and United Nations, *Statistical Yearbook* (various issues).

[a] 1962.
[b] 1961.
[c] 1964.
[d] 1957-1959.

to "open" unemployment in developing countries are also far from comprehensive and are often based on registration of applications for work which substantially understate the extent of unemployment. The available estimates of under-employment and unemployment in the developing ECAFE countries are therefore subject to a number of reservations; but, even taken as a rough indication, reveal a situation which is clearly disturbing. Estimates made for seven Asian countries in the early 1960s gave unemployment rates ranging from 5 to 12 per cent and showed that the incidence of under-employment varied between 7.5 to 37 per cent.[52]

It is a notable feature of the unemployment situation in the developing ECAFE countries that its incidence is most severe amongst the younger people. In Ceylon, for example, it was estimated a few years back that about 80 per cent of the rural unemployed and 65 per cent of the urban unemployed were under 25 years of age; in the Philippines, about 56 per cent of the unemployed were in the age group of 10-24 years and, in Indonesia, half of the urban unemployed were in the age group of 15-24 years.[53] Another disquieting feature is the high rate of unemployment among the educated people. In Malaysia, for example, a survey carried out in 1962 showed that unemployment rates were smallest for illiterates or those with only primary school education on the one hand, and for persons with higher school certificates on the other, while they were greatest for the group in between.[54] The problem of educated unemployed appears to have assumed serious proportions in India and Pakistan, two of the most heavily populated countries of the ECAFE region. A number of studies in regard to the unemployment situation in India reveal that an increasing percentage of graduates are unable to find employment, and it is taking longer, on the average, to secure a job after getting a degree.[55]

[52] Cf., United Nations, *Report on the World Social Situation*, 1967, *op. cit.*, p. 116.

[53] Cf., "Review of the social situation in the ECAFE region", *Economic Bulletin for Asia and the Far East*, June 1965, p. 34.

[54] Cf., "Progress and problems of social development in the ECAFE region", *Economic Bulletin for Asia and the Far East*, June 1967, p. 52.

[55] Ilchman, Warren F., "People in plenty: Educated unemployment in India", *Asian Survey*, October 1969, pp. 786-788.

In a number of advanced countries, the hardships of the less privileged and more vulnerable sections of society, such as the old and the sick and the unemployed, are alleviated by well-designed programmes of social welfare and social security. In the developing countries, however, Governments lack the resources to mount social welfare programmes of any significant dimensions and voluntary philanthropic effort in the field is neither well organized nor substantial.

Social discontent

A number of developing ECAFE countries experienced social discontent of varying intensity during the First Development Decade. The underlying causes of social discontent are by no means uniform and are related to a complex set of economic factors peculiar to each country. Lack of any pronounced improvement in the living standards of the vast majority of the population appears, however, to be an important element in social discontent in most of these countries. Social discontent has been most in evidence in countries which gained their independence after the Second World War. It seems that people had expected appreciable improvement in their living conditions after the attainment of national sovereignty. As "colonial exploitation" was believed to be the major factor in people's poverty, there was a "revolution of rising expectations" after independence. The first decade or so in most of these countries was a period of remarkable political and social stability as people waited for the fruits of development to appear. Gradually, however, as the years go by, a sense of frustration seems to overtake them as they see very little improvement in their living conditions. This frustration has been heightened by the increase in inequalities of income and wealth and glaring contrasts between the living conditions of the rich and the poor. The uneven development of various regions within a country has also given rise to tensions in a number of developing ECAFE countries.

The social tensions are more apparent in urban areas than in the rural areas, even though *per capita* income in the urban areas is in most cases much higher than in the rural areas. It appears that, notwithstanding this difference in *per capita* income, the lot of the low-income groups in urban areas is no better than in rural areas and may in fact be worse. As the pattern of income distribution is more skewed in the urban areas than in the rural areas, rural-urban differentials in the actual income accruing to low-income groups are not so prominent as they appear from a simple comparison of *per capita* incomes. Moreover, the cost of living has been rising much more sharply in the urban areas than in the rural areas, so that *per capita* income figures, which are usually not fully adjusted to take care of all price differentials, do not accurately reflect the purchasing power of income received. The prices of the basic necessities of life, especially of food items which constitute the major component of family budgets of low-income groups both in rural and urban areas, are generally lower in rural areas than in urban areas simply because most of these products originate from the agricultural sector. Housing is a much costlier item in the urban areas, and people in those areas have to incur higher expenditures on services which are either free or much cheaper in rural areas. Finally, as the environmental conditions in which different sections of population live and work show much greater contrasts in cities than in rural areas, class distinctions are more sharply drawn and the sense of dissatisfaction is greater in urban areas.

The encouraging features

While there is much in the ECAFE region which gives cause for concern, there are a number of hopeful signs that, given appropriate policies, most of these stresses and strains can be overcome. The basic problems of developing ECAFE countries arise from the low level of *per capita* income, inadequate rate of growth and inequitable distribution of gains from development. It is encouraging to note that the rate of economic growth in some of the developing ECAFE countries showed a marked acceleration in the second half of the First Development Decade and the trend is likely to continue. At the same time, considerable rethinking is taking place in regard to social aspects of development and it is expected that future policies will represent a better blend between economic growth and social justice and lead to greater social stability.

The recent acceleration in the rate of economic growth represents a tremendous effort on the part of the developing ECAFE countries to improve their economic performance. Many of the structural impediments to accelerated economic growth have been overcome. Considerable success has been achieved in the spread of modern technology. The rates of savings and investment have been raised and there has been a vigorous effort at export expansion.

There has been a significant structural transformation in the economies of the developing ECAFE countries in recent years. The development effort in the initial stages was greatly handicapped by the insufficiency of physical infrastructure. Considerable progress has been made in recent years in removing this impediment to growth. There has been a sizable expansion in transport facilities and communications networks, and a rapid advance in the development of water and power resources. This should facilitate faster growth in future years. The building up of a more adequate physical infrastructure means that

the "development potential" of the developing ECAFE countries has increased and that the development process in future will gain by the "external economies" associated with it.

The changes in the relative contributions of the agriculture, manufacturing and other sectors to gross domestic product disclose a significant structural transformation in the economies of the developing ECAFE countries. It will be seen from Table II-1-10 that, in almost all countries, the contribution of manufacturing to gross domestic product has gone up, though there are major inter-country variations in this respect. This has been accompanied by a decline in the share of agriculture in the gross domestic product.

Table II-1-10. Developing ECAFE countries: Industrial origin of gross domestic product in 1950, 1960 and 1968

(in percentages)

Country	Year	Agriculture, forestry, hunting and fishing	Mining and quarrying	Manufacturing	Construction	Electricity, gas and water	Transport, storage and communication	Wholesale and retail trade	Banking, insurance and real estate	Ownership of dwellings	Public admin. and defence	Services
Burma[a]	1950	40.3	0.5	7.1	2.2	0.1	3.3	27.2	0.4	[b]	6.3	12.8
	1960	31.8	1.0	13.2	3.3	0.3	4.0	27.0	1.3	[b]	9.0	9.1
	1967	34.3	0.7	9.1	2.3	0.7	6.6	29.0	1.0	[b]	8.2	8.2
Ceylon[c]	1950	54.8	0.2	4.0	6.8	0.5	7.7	8.5	0.4	1.4	8.4	7.4
	1960	46.4	1.3	5.2	7.7	0.5	7.2	9.7	0.8	3.1	6.7	12.6
	1968	38.8	0.7	10.9	6.3	0.5	9.4	12.1	1.3	2.6	4.8	12.7
China (Taiwan)[c]	1951	34.6	1.3	13.5	4.1	1.3	4.6	13.8	1.0	8.6	11.4	6.0
	1960	31.4	2.3	17.3	4.2	1.8	5.0	14.2	1.6	6.8	11.1	5.0
	1968	23.0	1.7	22.8	4.7	2.1	6.2	13.4	2.6	6.8	11.8	5.3
India[d]	1950	51.2	0.7	———	15.3	———	——	17.0	——	0.7	4.3	4.5	6.3
	1960	51.0	1.0	13.9	4.6	0.5	4.3	9.7	1.2	2.9	4.0	6.7
	1968	50.4	1.1	13.2	4.0	0.8	4.6	10.8	1.4	2.3	4.7	6.4
Indonesia[e]	1958	52.5	0.8	13.1	2.1	—	3.8	10.6	0.8	2.1	7.2	6.4
	1960	53.9	3.7	8.4	2.0	0.3	3.7	14.3	1.0	2.0	4.5	6.2
	1968	51.7	3.8	8.9	2.1	—	2.0	17.9	0.5	2.0	4.4	6.7
Iran[c]	1960	29.4	0.2	24.8	4.4	0.6	8.1	8.9	2.2	5.7	7.8	4.6
	1967	22.2	0.3	31.6	5.0	1.3	5.5	10.2	2.6	5.1	11.3	4.6
Khmer Republic[a]	1960	45.3	—	8.5	4.0	2.7	2.2	19.3	0.4	[b]	12.6	4.9
	1966	40.8	—	10.3	5.3	1.2	2.2	22.7	0.3	[b]	12.1	5.0
Korea, Republic of[c]	1953	49.3	1.2	7.7	2.2	0.4	1.6	11.7	0.7	13.0	6.1	6.1
	1960	40.0	2.3	12.0	3.5	0.7	4.6	9.6	1.5	7.1	7.7	11.0
	1968	32.3	1.4	17.9	5.5	1.4	6.4	14.2	1.8	3.3	6.1	9.7
Malaysia, West[c]	1955	46.5	5.5	——	5.3	——	——	4.0	——	9.6	[b]	12.2[f]	8.5	8.5
	1960	37.8	5.9	8.7	3.0	1.3	3.6	15.5	1.4	4.7	6.5	11.5
	1966	28.4	7.7	10.9	4.5	2.1	3.5	15.6	1.7	4.2	7.5	14.0
Nepal[e]	1961	64.5	0.5	12.1	3.8	—	1.0	4.9	0.6	9.1	2.1	1.3
	1965	65.7	0.4	10.7	3.3	0.2	1.8	4.8	1.1	8.1	1.4	2.5
Pakistan[c]	1950	58.0	0.1	7.6	1.2	0.1	4.8	12.3	0.3	5.5	4.4	5.7
	1960	53.0	0.2	9.5	2.3	0.4	6.0	12.0	0.7	5.3	4.1	6.4
	1968	46.0	0.3	11.4	5.2	0.8	6.7	12.2	1.4	4.6	5.7	5.7
Philippines[d]	1950	39.4	0.8	12.3	6.6	0.6	3.0	13.0	2.3	[b]	4.2	17.9
	1960	31.5	1.1	18.6	3.4	0.9	4.0	15.5	2.9	[b]	6.7	18.4
	1968	35.4	1.7	17.4	3.3	0.6	3.5	10.6	3.6	[b]	8.2	15.7
Singapore[e]	1960	6.1	0.2	9.0	2.0	2.3	—	31.8	—	4.5	5.2	38.9
	1968	3.5	0.2	16.6	4.2	2.6	—	30.7	—	3.9	7.1	31.2
Thailand[a]	1951	50.1	1.9	10.3	2.9	0.1	3.1	18.0	0.4	3.7	2.8	6.7
	1960	39.8	1.0	12.5	4.6	0.4	7.5	15.1	1.9	2.9	4.6	9.7
	1968	31.5	1.8	15.0	7.0	1.1	6.2	17.3	3.5	2.1	4.3	10.3
Viet-Nam, Republic of[c]	1960	34.2	0.4	10.8	1.6	0.8	4.9	10.2	1.1	7.6	15.8	6.4
	1966	28.6	0.2	9.2	1.8	0.5	4.3	14.4	1.9	6.4	24.4	6.9

Source: National official sources and *United Nations Yearbook of National Accounts Statistics.*

[a] GDP at market prices.

[b] Included in other services.

[c] GDP at factor cost.

[d] NDP at factor cost.

[e] 1958: GDP at factor cost.
1960 and 1968: GDP at market prices.

[f] Including religious and welfare organizations, trade associations and educational institutions.

It is also noteworthy that quite a few developing ECAFE countries, such as India, the Republic of Korea and China (Taiwan), have passed out of the first phase of industrialization and have made significant headway in more sophisticated lines of industrial production. It is estimated that the production of heavy industries in the developing ECAFE region rose at an average annual rate of 11 per cent during 1960-1966, while the production of light industries rose at the rate of only 7 per cent per annum. As a result, the contribution of heavy industry to total value added in manufacturing rose from 36 per cent in 1960 to 41.3 per cent in 1966, while that of light industry declined from 64 to 58.7 per cent.[56] This change in the internal structure of industry is likely to have beneficial "spread" effects, if other circumstances are favourable, and has the potentiality of improving productivity levels in other sectors of the economy.

By far the most encouraging development in the developing ECAFE region during the First Development Decade has been the breakthrough in agriculture. Table II-1-11 provides a comparison of the average annual growth rates of food production in a number of developing ECAFE countries during 1960-1966 and 1966-1968. It will be seen that there was a pronounced increase in the rate of growth of food production in India, Pakistan, Ceylon and Malaysia during 1966-1968 compared with 1960-1966. The dramatic increases in agricultural productivity in these countries reflect the successful introduction of new agricultural techniques based on high-yielding seed varieties and intensive application of fertilizers. The high-yielding strains of wheat and rice were first introduced into the developing ECAFE region in 1966/67, when it is estimated that about 64,000 hectares were planted with new varieties of wheat and 94,000 hectares with new varieties of rice. The area planted with the new strains was rapidly extended in subsequent years, and, by 1968/69, about 6 million hectares had been planted with new wheat varieties (representing about one sixth of the region's wheat land) and more than 5 million hectares had been planted with the new rice varieties (representing about 7 per cent of the region's rice land).[57] It is noteworthy that progress in the adoption of new varieties of seeds and greater use of fertilizers has been most rapid in the highly populated and food-deficit countries of the region, such as India, Pakistan and the Philippines, where the food situation had been particularly precarious in recent years and food imports had been sizable. The good performance of the agricultural sector has not only resulted in improving the growth performance of the developing ECAFE countries; it has also helped to stabilize the price level and improve the balance of payments. If this breakthrough in agriculture is sustained in future years (and there are good prospects that it will), it would be the most important single factor contributing towards the improvement of the living standards of the people of the region in the Second Development Decade.

Table II-1-11. Average annual rates of growth in food production in selected developing ECAFE countries, 1960-1966 and 1966-1968

Country	1960-1966	1966-1968
Ceylon	2.7	6.2
China (Taiwan)	4.9	3.0
India	0.1	6.8
Indonesia	1.7	1.6
Malaysia: West	3.7	5.8
Pakistan	1.5	7.1
Philippines	4.2	2.5

Source: FAO, *The State of Food and Agriculture*, 1969, p. 176.

Another encouraging feature which stands out prominently in the economic performance of the developing ECAFE countries in the First Development Decade relates to their savings and investment effort. The trends in gross domestic capital formation in these countries are set out in Table II-1-12. It will be seen that, about the middle of the decade, a number of developing ECAFE countries were devoting more than 15 per cent of their gross domestic product to capital formation. Later in the decade, some of the countries achieved even higher rates of capital formation which compared favourably with the rates of capital formation in some of the most advanced countries. It can also be seen from the table that most of the developing ECAFE countries have been able to bring about a considerable acceleration in their rates of capital formation during the 1960s; the only serious deceleration taking place in the case of Pakistan, and possibly India after 1965, partly caused by the decline in the availability of foreign aid.

The acceleration in the rate of capital formation has been accompanied by an increase in the rate of domestic savings in the case of almost all the developing ECAFE countries. A study of the marginal rates of savings in developing countries during the period 1950-1965 shows that the marginal rate of savings was as high as 20 per cent or more in the case of at least six developing ECAFE countries.[58] Considering the low level of *per capita* incomes, which is

[56] United Nations, *Asian Industrial Development News*, No. 3, 1968, p. 16.

[57] United Nations, *World Economic Survey, 1968*, Part II, p. 47.

[58] The countries were China (Taiwan), India, Iran, Malaysia, the Philippines and Thailand. In the case of Pakistan, the marginal rate of saving was between 15 and 20 per cent. See UNCTAD, *Problems and Policies of Financing*, 1968.

Table II-1-12. Developing ECAFE countries: Gross domestic capital formation as percentage of gross domestic product, 1960-1968

Country	1960	1961	1962	1963	1964	1965	1966	1967	1968
Burma	17.4	17.2	16.5	20.3	17.9	...	...	...	...
Ceylon	14.1	13.7	14.4	15.0	15.1	13.2	15.5	16.3	18.6
China (Taiwan)	20.1	19.9	19.0	17.6	19.2	23.0	23.2	25.2	25.6
India	15.9	15.6	16.6	16.9	16.4	17.7	...	...	...
Indonesia	7.9	10.2	5.6	8.2	12.1	6.7	4.5	8.0	9.1
Iran[a]	16.0	14.4	11.6	11.6	13.5	15.4	16.1	18.2	20.5
Khmer Republic	...	...	18.2	17.2	15.6	13.5	18.1	...	...
Korea, Republic of	10.9	13.2	13.2	18.5	14.6	14.8	21.9	22.3	27.1
Malaysia, West	14.2	15.9	19.0	18.5	17.9	17.4	17.1	...	...
Pakistan	12.5	14.8	14.7	16.9	19.0	13.1	13.8	16.4	...
Philippines	13.0	18.0	19.7	19.8	20.9	20.2	19.6	21.2	21.7
Singapore[a]	6.6	9.5	10.2	11.3	14.0	14.7	13.7	13.7	17.4
Thailand	15.7	15.1	18.4	21.5	20.1	20.2	23.6	22.8	24.2
Viet-Nam, Republic of	12.3	8.7	10.0	7.5	11.0	12.2	15.8	11.7	9.8

Source: *United Nations Yearbook of National Accounts Statistics* and national official publications.

[a] Percentage of gross fixed capital formation to gross domestic product.

a severe constraint on raising the level of savings, the performance of the developing ECAFE countries in the field of mobilization of savings is remarkable indeed. The fact that the marginal rate of savings in almost all developing ECAFE countries is higher than the average rate of saving gives cause for hope that gross domestic savings as a proportion of gross domestic product will show a further rise in the years ahead.

Viewed in the historical perspective, also, the savings and investment effort of the developing ECAFE countries apepars to be commendable. Examining the historical trend in savings and investment in present day developed countries, Kuznets found that both in the United Kingdom and the United States, gross savings as a proportion of GNP failed to rise for a period of about a century although *per capita* product was growing at a significant rate.[59] In other countries, such as Norway and Sweden, there was no clear evidence of a rise in the savings rate until about the First World War, notwithstanding a substantial rise in GNP. As the *per capita* income levels of the developing ECAFE countries are in most cases lower than those of the present day developed countries in the initial stages of their modern economic growth, the developing countries' relatively higher marginal rates of saving are evidence of the sizable restraint that these countries have imposed on consumption in order to increase savings and investment for promoting a faster rate of growth.

While the over-all savings and investment effort has been commendable, one should not lose sight of the fact that, on account of certain policies, it has sometimes involved a heavy sacrifice in terms of foregone consumption, specially for the poorer sections of the population. This is particularly so in countries which have relied mostly on indirect taxes and also experienced significant inflationary pressures.

Despite the numerous impediments in the way of export expansion,[60] the developing ECAFE countries were able to record an encouraging export performance in the First Development Decade. Some indication of the export effort of the developing ECAFE countries can be gathered from Table II-1-13

Table II-1-13. Developing ECAFE countries: Annual rates of growth of GDP and exports, 1960-1968

Country	GDP (at constant prices)	GDP (at current prices)	Exports (f.o.b.)
Burma	1.3[a]	2.8[a]	—8.5
Ceylon	4.8	5.9	—1.5
China (Taiwan)	10.0	13.2	21.7
India	3.3[c]	10.1[c]	3.5
Iran	8.0	8.7[a]	11.0
Korea, Rep. of	8.4	26.0	38.8
Malaysia, West	5.9[d]	5.2[d]	1.2
Pakistan	5.6	8.8	7.9
Philippines	4.5	10.5	6.8
Thailand	7.8	10.2	6.1

Source: United Nations, *Yearbook of National Accounts Statistics*, 1969;
United Nations, *Monthly Bulletin of Statistics* and national official publications.

[a] 1960-1967.

[b] 1962-1965.

[c] NDP.

[d] 1960-1966.

[59] Kuznets, S., *Modern Economic Growth, op. cit.*, p. 240.

[60] For a discussion of these impediments, see pp. 48-50 below.

which compares the growth rates in their exports with the growth rates in GDP. It will be seen that there were significant inter-country variations, but, in at least six of the eleven countries listed in the table, the rate of growth in exports was higher than the rate of growth in real GDP. Two countries of the region, namely the Republic of Korea with an average annual growth rate in exports of 38.8 per cent, and China (Taiwan) with 21.7 per cent, achieved the highest growth rates in exports in the entire developing world, except for Libya whose better performance was due to booming oil exports. The developing ECAFE countries also achieved notable success in diversifying their exports. The commodity composition of exports shows that regional exports of manufactured goods expanded most rapidly and the share of manufactured goods increased from one fourth of total regional exports in 1961 to nearly two fifths in 1967.[61]

Another solid achievement of the developing ECAFE countries during the First Development Decade has been the noticeable qualitative improvement in development planning techniques and the capacity of Governments to plan and implement development programmes. In the 1950s, very few developing countries had comprehensive national plans of economic and social development. During the First Development Decade, almost all the developing countries of the ECAFE region undertook formulation of medium-term plans for accelerating the rate of economic growth. The planning techniques used for the setting of various targets, and for ensuring mutual consistency amongst the targets, have also tended to become more sophisticated. The countries have achieved greater expertise in project formulation, and the government administrative machinery for the implementation of various projects has been considerably strengthened. The development experience of the 1960s, however, has revealed the need for better integration between the economic and social aspects of development. The widespread dissatisfaction with the results of planned development in recent years has given rise to considerable re-thinking about the goals of development policy and the instruments of growth. With planning procedures greatly improved, the developing ECAFE countries are now better placed to take the right decisions on major policy issues.

Impediments to greater progress

It appears, in retrospect, that greater progress in the developing ECAFE region during the First Development Decade was impeded by a number of factors. For evolving an appropriate policy framework for the Second Development Decade, it is necessary to review these impediments and to appraise their bearing on the process of economic growth and social welfare.

The experience of the First Development Decade indicates that the setting of global targets of various sorts is not of much use unless effective arrangements are made to assure their implementation. It has been said about the First Development Decade that it was "a development decade without a development policy. No wonder its results have been so meagre, for actually there was no policy at all in the sense of a series of converging measures involving concerted action by the industrial centres and the peripheral countries to tackle the problems of development".[62] The growth target of 5 per cent in the First Development Decade was not at all ambitious, considering the needs of the developing countries and the fact that they had already achieved an average annual growth rate of 4.8 per cent in the 1950s. However, the implications of even such a modest target in terms of such crucial variables as exports, import capacity of developing countries and the need for international financial assistance were not fully investigated. There was no internationally organized system either for determining need priorities among developing countries or of co-ordinating and marshalling aid for individual developing countries.[63] No clear commitments were undertaken in regard even to broad policy measures, either by developed or developing countries, nor was any machinery created for surveillance and follow-up action either at the regional or international level. These deficiencies need to be rectified if the Second Development Decade is to achieve more positive results.

Progress in the developing ECAFE region during the First Development Decade could have been faster if population had grown at a slower rate. Population growth in the developing countries was not considered a major problem till the 1950s, but, with the remarkable success achieved in reducing mortality rates while over-all fertility rates remained high, the developing countries have experienced a "population explosion" in the last two decades. The rate of population growth increased steadily in the 1950s and averaged 2.6 per cent per annum in the 1960s for the entire developing world. Population growth rates in some countries of the ECAFE region are appreciably higher than the average for all the developing countries.

[61] United Nations, *Economic Survey of Asia and the Far East, 1969*, p. 5.

[62] United Nations, *Towards a Global Strategy of Development*, Report by the Secretary-General of UNCTAD, 1968, p. 1.

[63] In the case of certain countries, a limited amount of aid co-ordination has been attempted through the technique of aid consortia and consultative groups. These consortia have been organized by certain international agencies (IBRD, OECD, IDB), thus introducing, to some extent the principle of collective decision-making. The consortium technique, however, is only a small and insufficient step towards a well co-ordinated international aid policy.

Progress in the developing ECAFE region has also been held back by lack of sufficient advance in removing the institutional impediments to faster growth. The land tenure systems in many developing ECAFE countries are a great obstacle in the way of modernization of agriculture, as well as a more equitable sharing of gains from development. The pattern of land ownership is highly skewed and the tenurial arrangements do not give the needed security to the tillers of the soil. Although it has long been recognized that such systems constitute a great disincentive to vigorous participation by the rural masses in the process of development, very few countries have effectively solved the problem. Several countries have enacted land reform legislation with the professed aim of redistributing land holdings more equitably and assuring security of tenure to the peasants, but the actual results have been disappointing, firstly, because the legislation left ample room for manoeuvre on the part of landed interests, and, secondly, because implementation was far from vigorous. In a number of countries the beneficiaries of land redistribution measures have failed to derive adequate benefit from land reforms as these were unaccompanied by measures designed to improve their access to credit and marketing facilities; this has often resulted in large numbers of newly created small holders lapsing once again into tenancy and landless labour. In general, the structure of rural society in most of the developing ECAFE countries has remained largely unchanged and inequitable and constitutes a great barrier to more rapid progress.[64]

The economic and social progress of a country is greatly conditioned by the pattern of its resource allocation. While generalizations would be out of place in the absence of a detailed study on the optimality of investment decisions, it might be said that the development strategy pursued in the 1960s involved certain imbalances both in intersectoral and intrasectoral resource allocation. In certain countries of the developing ECAFE region, inadequate attention was given to the social sectors in the allocation of resources, and this led to social tensions. In the 1950s and early 1960s, the investment pattern in productive sectors also revealed instances of considerable resource misallocation. A detailed study of the pattern of economic growth in the developing ECAFE countries during the 1950s concluded that "in economic terms, the poor performance of most countries would seem to reflect inadequate or misdirected investment. In some countries, lack of attention to agriculture has held back growth, with repercussions also upon industry. Sometimes the infrastructure has received too much attention and direct production not enough. Industrial investment has not always been guided by proper criteria in determining priorities and allocating resources."[65] An equally detailed study on the pattern of growth and investment in the 1960s is not yet available, but the assessments made so far point strongly towards the continuance of a number of deficiencies in investment planning in less developed countries.[66] It is encouraging to note, however, that a reconsideration of investment policies has begun in a number of countries and there has been re-ordering of priorities with a view to improving the pattern of resource allocation.

The lack of success in ensuring a reasonable degree of monetary stability has also hindered economic and social progress in a number of developing ECAFE countries. Table II-1-14 shows the trends in price level in some of these countries. It is true that certain countries in the region have achieved high rates of growth in the presence of substantial inflationary pressures. Inflation, however, generally results in regressive changes in the pattern of income distribution which are not socially desirable. It also gives rise to balance of payments problems. In countries where rapid inflation takes place in conditions of low income growth, the effects on the balance of payments and the pattern of income distribution are apt to be even more unfavourable. The experience of Indonesia typifies this situation. The price pressures in the case of India, Pakistan and the Philippines seem to have arisen primarily from the failure of food supply to rise in line with demand. The average annual rise in money supply in these countries during 1960-1968 was 8 to 10 per cent which was rather excessive in relation to the growth in the supply of wage goods.[67] The process of import substitution under high tariffs and a substantial increase in the level of indirect taxation also appeared to have had an adverse effect on the price level.

[64] For illustration of these points from country examples see United Nations, *Progress in Land Reform*, 4th Report, 1966, *Report of the Joint FAO/ECAFE/ILO Seminar on Land Reform Implementation in Asia and the Far East*, 1969, *United Nations Report on the World Social Situation*, 1967, *op. cit.*, pp. 109-115, Ahmed Zubeida M., and Sternberg, Marvin J., "Agrarian reform and employment with special reference to Asia", *International Labour Review*, February 1969, and FAO, *Ceres* (Issue on Land Reform), November-December 1969.

[65] Cf., "Economic Growth of ECAFE Countries" in the *Economic Survey of Asia and the Far East*, 1961, p. 39.

[66] See, for example, "The Problems and Policies of Economic Development: An Appraisal of Recent Experience" in the *United Nations World Economic Survey*, 1967, Part I, esp., pp. 65-68, "Some Issues of Development Policy in the Coming Decade" in the *World Economic Survey*, 1968, Part I, pp. 31-33 and the review of "Two Decades of Development" in the *Report of the Commission on International Development* (Mr. Lester Pearson, Chairman), *op. cit.*, pp. 36-38. The findings of these world bodies are corroborated by a number of studies by individual researchers in different countries, too numerous to be cited here.

[67] The appreciable rise in the production of foodgrains in the food-deficit countries of the ECAFE region in the last two years or so has exercised a salutary effect on the price level. The imbalance between the demand for and supply of non-cereal food items, however, it still a serious problem.

Table II-1-14. Selected developing ECAFE countries: Index numbers of money supply, gross domestic product at constant prices, wholesale prices and consumer prices, 1960-1968

(1960=100)

		1960	1961	1962	1963	1964	1965	1966	1967	1968	Annual compound rate of growth 1960-1968 (%)
Ceylon	Money supply[a]	100.0	106.5	111.4	124.8	134.5	142.3	137.4	149.5	158.4	5.9
	GDP[b]	100.0	101.7	104.2	110.8	116.9	118.1	124.5	130.4	145.5	4.8
	Wholesale prices	...	...	...	...	...	...	...	...	...	...
	Consumer prices[c]	100.0	101.1	103.2	105.3	108.4	108.4	108.4	111.6	117.9	2.1
China (Taiwan)	Money supply[a]	100.0	120.1	129.6	166.9	219.8	242.9	284.6	361.7	407.4	19.2
	GDP[d]	100.0	107.9	115.7	127.3	143.8	161.7	176.8	194.5	214.5	10.0
	Wholesale prices	100.0	103.4	106.8	113.6	115.9	111.4	112.5	115.9	119.3	2.2
	Consumer prices	100.0	107.9	110.1	112.4	112.4	112.4	114.6	121.3	127.0	3.0
India	Money supply	100.0	104.8	115.1	130.9	144.4	159.0	173.2	188.7	199.2	9.0
	GDP[e]	100.0	103.7	106.0	112.0	120.3	113.6	114.4	125.5	128.1	3.3
	Wholesale prices	100.0	102.2	103.2	107.5	120.4	131.2	148.4	172.0	169.8	6.9
	Consumer prices	100.0	102.2	105.4	108.7	122.8	134.8	148.9	169.6	173.9	7.2
Indonesia	Money supply[a]	100.0	141.7	283.3	579.2	1,510.4	5,358.3	46,266.7	107,231.3	237,279.2	162.5
	GDP[f]	100.0	105.7	107.7	105.3	109.0	110.2	113.2	114.9	122.4	2.7
	Wholesale prices	...	...	...	...	...	...	...	...	...	...
	Consumer prices	100.0	130.8	353.8	769.2	1,576.9	6,384.6	73,092.3	197,015.4	443,938.5	185.7
Iran	Money supply[g]	100.0[h]	98.4	105.6	114.8	128.6	144.8	158.2	181.4	207.6	9.6
	GDP[i]	100.0	105.8	110.8	117.6	124.2	140.1	149.1	167.8	184.5	8.0
	Wholesale prices	100.0	100.0	102.0	102.0	107.1	108.2	108.2	108.2	109.2	1.1
	Consumer prices	100.0	101.0	102.1	103.1	107.2	108.2	109.3	109.3	113.4	1.6
Korea, Rep. of	Money supply[a]	100.0	147.1	158.7	189.5	221.1	296.7	385.0	551.5	694.2	27.4
	GDP[j]	100.0	104.5	108.1	118.0	127.9	137.2	154.8	167.4	190.4	8.4
	Wholesale prices	100.0	113.4	123.9	149.3	201.5	220.9	240.3	256.7	276.1	13.5
	Consumer prices[k]	100.0	108.3	116.7	138.9	177.8	201.4	226.4	251.4	279.2	13.7
Malaysia, West	Money supply	100.0	93.7	98.0	104.9	110.8	117.9	128.9	118.8	132.4	3.6
	GDP[l]	100.0	107.1	113.3	119.0	124.6	133.4	140.9	...	...	5.9[m]
	Wholesale prices	...	...	...	...	...	...	...	...	...	...
	Consumer prices[n]	100.0	100.0	100.0	103.1	102.1	102.1	104.1	108.2	108.2	1.0
Pakistan	Money supply	100.0	100.7	105.7	121.3	141.7	156.3	178.5	173.5	190.9	8.4
	GDP[o]	100.0	105.9	109.8	119.0	123.9	129.7	136.3	146.5	154.1	5.6
	Wholesale prices	100.0	103.2	106.3	105.3	105.3	112.6	117.9	134.7	129.5	3.3
	Consumer prices[p]	100.0	101.0	104.1	102.0	105.1	111.2	117.3	129.6	129.6	3.3
Philippines	Money supply	100.0	116.9	134.2	153.9	150.3	162.0	174.6	201.6	208.7	9.6
	GDP[q]	100.0	104.8	105.3	115.7	119.6	125.8	133.7	135.7	139.5	4.2
	Wholesale prices	100.0	104.8	109.6	120.5	126.5	128.9	134.9	141.0	144.6	4.7
	Consumer prices	100.0	104.7	108.1	116.3	126.7	130.2	137.2	145.3	146.5	4.9
Thailand	Money supply	100.0	109.8	109.9	117.7	128.0	142.0	165.1	177.1	192.4	8.5
	GDP[r]	100.0	104.2	109.9	120.6	127.9	139.1	154.5	161.6	175.8	7.3
	Wholesale prices	100.0	107.5	115.1	107.5	101.1	104.3	118.3	128.0	121.5	2.5
	Consumer prices[s]	100.0	102.1	104.2	105.3	107.4	108.4	112.6	116.8	118.9	2.2

Source: ECAFE, *Statistical Yearbook for Asia and the Far East*, 1969 and United Nations, *Yearbook of National Accounts*, 1968 and 1969.

[a] End of period.
[b] At market prices of 1958.
[c] Colombo.
[d] At market prices of 1964.
[e] Net domestic product, at factor cost of 1960.
[f] At market prices of 1960.
[g] 20 of December.
[h] Average of 1959-1961.
[i] At market prices of 1959.
[j] At market prices of 1965.
[k] Seoul.
[l] At factor cost of 1964.
[m] 1960-1966.
[n] Retail prices.
[o] At factor cost of 1959.
[p] Karachi.
[q] At market prices of 1955.
[r] At market prices of 1962.
[s] Bangkok—Thonburi.

The rise in the cost of living has been an important element in creating social discontent in a number of developing ECAFE countries. In several countries, money wages have failed to rise in line with the rise in the cost of living, resulting in a fall in real wages. The fixed-income groups, unorganized labour and the lower middle class have been the main sufferers. The big industrialists and businessmen have, on the other hand, greatly benefited from the inflationary process. The savings capacity of the lower-income groups and middle classes has been eroded, and this has led to a more skewed ownership of capital assets, with further potentialities of aggravating the income inequalities.

The economic and social progress in the developing ECAFE region could probably have been faster if schemes of regional co-operation had made greater headway than they actually did in the First Development Decade. The slow progress is understandable, however, in view of the great diversity in the economic conditions of different countries, as well as the political factors. Some concrete steps have been taken recently in the sphere of trade liberalization in the developing ECAFE region, and, with further substantial progress in the study of these problems, fruitful negotiations on these matters should not be far off.[68]

A number of factors outside the control of the developing ECAFE countries impeded faster growth in these countries in the First Development Decade. These relate mainly to difficulties in the way of expansion of exports of developing countries on account of various tariff and non-tariff barriers in advanced countries, decline in the flow of foreign assistance, and rising debt-servicing liability. The share of developing countries in world exports has shown a steady decline over the years. In 1950, developing countries' exports accounted for almost one third of world exports as a whole, but their share declined to 22 per cent by 1960 and to 20 per cent by 1968. There are two principal reasons for the relative decline in the share of developing countries in world export trade. Firstly, primary products dominate the commodity composition of exports in these countries, and the world demand for these primary products, being less income elastic, has risen relatively slowly and has been affected by the growth of synthetic substitutes. Secondly, the trade and investment policies of developed countries have aggravated the export problems of developing countries in several ways. A number of industrial countries give protection to their own primary products, and this has held back the growth in the exports of primary products by developing countries, even in the case of items in which they have a big competitive cost advantage. In fact, as a recent study on commodity problems of developing countries pointed out, the result of these protectionist policies has been that "world commodity markets have in some cases taken on the character of unstable residual markets."[69] The exports of manufactured goods to developed countries also face a number of problems. They are subject to both tariff and non-tariff barriers. Tariff levels are usually higher on labour-intensive manufactures in which developing countries have a comparative advantage.[70] In addition to tariffs, quantitative restrictions constitute a big handicap to the exports of developing countries, particularly in respect of cotton textiles and clothing items. Foodstuffs are another major area where non-tariff trade barriers (such as variable levies, support systems and quantitative restrictions) are most prominent.

The tariff and non-tariff barriers to export expansion by developing countries have been the subject of detailed discussions in a number of international forums, such as UNCTAD, but progress towards their dismantling has been rather slow. In fact, certain new developments in the First Development Decade seemed to have aggravated these problems. The Kennedy Round of tariff cuts, for example, has given a greater boost to trade among the developed countries rather than between the developed and developing countries. The most significant concessions in the Kennedy Round tariff adjustments were concentrated in the areas of greatest interest to the principal trade partners (such as sophisticated chemicals, machinery and transport equipment) and tariff reductions in labour-intensive products were relatively smaller.[71] Moreover, in cases where quantitative restrictions in the form of quotas etc. are the real effective barrier to trade expansion by developing countries, the reduction in tariffs does hardly anything to improve market access.

The developing countries have also experienced considerable fluctuations in their export earnings from year to year, partly because of supply variations of primary commodities and partly because of shifts in demand. It has been estimated that fluctuations in export prices have been two and a half to three times larger in developing countries than in industrial countries; in export earnings, fluctuations have been

[68] See pp. 132, 133 below.

[69] IMF and IBRD Joint Staff Study, *The Problem of Stabilization of Prices of Primary Products*, 1969, p. 155.

[70] According to an UNCTAD secretariat study based on a sample of 500 items, there was a clear tendency for tariff rates to rise with the degree of labour-intensiveness. The tariffs were particularly high in such categories as clothing and textiles. See *Proceedings of UNCTAD* (second session), Vol. V, p. 3.

[71] *Ibid.*

about twice as large.[72] Such large fluctuations in export earnings impede the smooth implementation of development plans and necessitate the maintenance of unduly large foreign exchange reserves for cushioning the effects of the fluctuations. The Compensatory Financing Scheme of the International Monetary Fund (IMF) has been of some help in alleviating these problems, but measures of a more basic character are needed. This is another field where more effective and concerted irnternational action could have accelerated progress in the developing countries.

The economic development of less developed countries has also been impeded by the secular deterioration in their terms of trade. Based on 1963=100, the terms of trade of the ECAFE region declined from 110 in 1960 to 99 in 1967.[73] The destabilizing influence of this factor on the economies of less developed countries can be judged from the fact that each one per cent change in their terms of trade is estimated to entail a change of about $500 million in their visible trade balance.[74]

The most disturbing development in the field of international finance during the First Development Decade from the view-point of developing countries has been the failure of foreign assistance to grow in step with the growth in the national product of developed countries. Total net financial flows from the developed countries[75] to the developing countries had recorded an appreciable rise in the 1950s. From $4,000 to 5,000 million a year in the early 1950s, the total had risen to $9,200 million in 1961, fairly close to the one per cent of the combined GNP of the Development Assistance Committee (DAC) countries at that time. There were also transfers from the USSR and other centrally-planned economies. After 1961, however, the total flow has failed to grow as rapidly as the gross national product of developed countries. The 1968 level represented only 0.75 per cent of their combined GNP. This means that the one per cent target of resource flows to developed countries has not been met.[76] Trends in the international flow of financial resources are shown in Table II-1-15. It will be seen that even in absolute terms and at current prices (without adjustment for rise in prices in donor countries) official development assistance has increased very slowly in the 1960s[77] There has been an appreciable rise in private investment and commercial lending, but, since the flow of direct private investment is heavily concentrated in a few countries, this represents a compensation for only a limited number of countries.

The trends in the terms of foreign assistance were equally disturbing. The proportion of grants and grant-like assistance in total official flows recorded a fall. The rise in interest rates in world financial markets tended to make loan finance more expensive. The practice of tying aid to purchases in donor countries, which increased in intensity after 1960, made the terms of foreign assistance specially onerous. It is estimated that, in 1967, only 16 per cent of official aid flows remained untied and that this had reduced the real value of the aid by at least 20 per cent.[78]

The stiffening in the terms of official foreign assistance, and the widespread recourse to suppliers' credit by developing countries, resulted in a steep rise in their debt-servicing liability during the First Development Decade. This led to a number of debt crises in the 1960s, and the problem is likely to become much more acute in the 1970s. In the developing ECAFE region, India, Pakistan and Indonesia have been faced with a serious debt-servicing problem, although debt-servicing liability does not as yet weigh heavily on other countries. In the cases of Indonesia and India, where debt-service payments began to pre-empt more than 20 per cent of export earnings, emergency debt-relief operations had to be undertaken, and Pakistan appears to be approaching a similar situation.

The implementation of development programmes in less developed countries crucially depends on adequate availability of foreign exchange. The General Assembly resolution on the Second Development Decade clearly recognizes this and exhorts the developed countries to enhance the flow of foreign assistance. The level of foreign aid and the terms on which it is provided will crucially affect the performance of developing countries in the Second Development Decade and will, in a sense, hold the key to peace and stability in the developing regions.

[72] *IMF and IBRD Joint Staff Study*, *op. cit.*, p. 156.

[73] ECAFE, *Statistical Yearbook for Asia and the Far East*, 1968, p. 2.

[74] United Nations, *Trade Prospects and Capital Needs of Developing Countries*, study prepared by the UNCTAD secretariat, 1968, p. 40.

[75] The "developed countries" in the context of foreign aid are taken to mean the member countries of the Development Assistance Committee of the Organization for Economic Co-operation and Development.

[76] In terms of the General Assembly resolution of 1961, the target of 1 per cent of resource flows related to the national income of developed countries. DAC countries, however, associated themselves with the recommendation of the second session of UNCTAD in 1968 that they should allocate 1 per cent of their GNP to assistance purposes.

[77] This is primarily a reflection of the near stagnation in the level of United States official foreign assistance.

[78] *Report of the Committee on International Development* (Mr. Lester Pearson, Chairman), *op. cit.*, p. 77.

Table II-1-15. The net flow[a] of financial resources from DAC countries, 1960-1968

Net disbursements *(in million US dollars)*

	1960	1961	1962	1963	1964	1965	1966	1967	1968
Total official and private	8,115	9,249	8,487	8,632	9,142	10,488	10,510	11,346	12,962
I. Official development assistance[b]	4,718	5,217	5,539	5,889	6,018	6,076	6,293	6,690	6,430
1. Bilateral grants	3,716	4,031	4,100	4,032	3,868	3,770	3,802	3,676	3,418
2. Bilateral development loans at concessional terms	468	665	928	1,489	1,763	1,863	2,014	2,297	2,354
3. Contributions to multilateral institutions	534	521	511	368	387	443	477	717	658
II. Other official flows	247	926	496	187	−76	238	408	460	815
1. Bilateral	180	696	481	190	−69	233	355	441	814
2. Multilateral	67	230	15	−3	−7	5	53	19	1
Total official flows (I + II)	4,965	6,143	6,035	6,076	5,942	6,314	6,701	7,150	7,245
III. Private flows	3,150	3,106	2,453	2,557	3,200	4,174	3,809	4,197	5,717
1. Direct investment	1,767	1,830	1,495	1,603	1,784	2,489	2,185	2,103	2,918
2. Bilateral portfolio	633	614	147	327	416	687	502	809	724
3. Multilateral portfolio	204	90	239	−33	141	248	15	306	604
4. Export credits[c]	546	573	572	660	860	750	1,107	979	1,470

Source: OECD, *Development Assistance, 1969, Review*, p. 38.

[a] Gross disbursements minus amortization receipts on earlier lending.

[b] Flows which are intended primarily to promote the economic development and welfare of developing countries, and which are intended to be concessional in character.

[c] Coverage: guaranteed credits, including unguaranteed portions. Excludes credits which are not guaranteed in the donor country. Net flow is measured by some countries as change in outstanding amounts guaranteed, by others as change in outstanding amounts due on disbursed credits. Interest due is included in the sums recorded as outstanding, so that the net flow tends to be overstated if gross new guarantees are rising, and vice versa.

II. Objectives and targets of the Second Development Decade

The General Assembly resolution

Recognizing that "economic and social progress is the common and shared responsibility of the entire international community", the General Assembly of the United Nations has designated the 1970s as the Second United Nations Development Decade and member governments have pledged themselves, individually and collectively, to pursue policies designed to create "a more just and rational world economic and social order in which equality of opportunities should be as much a prerogative of nations as of individuals within a nation". To give substance to this pledge, the General Assembly resolution has laid down certain targets to be attained within the Second Development Decade and also outlined a broad policy framework for the attainment of these targets.

The resolution lays down that the average annual rate of growth in the gross product of the developing countries as a whole during the Second Development Decade should be at least 6 per cent, which, on the basis of an average annual increase of 2.5 per cent in population, would mean an average annual rise of 3.5 per cent in *per capita* product. The proposed growth target would imply achievement of an average annual expansion of 4 per cent in agricultural output and 8 per cent in manufacturing output. It would also necessitate an average annual expansion of 0.5 percentage point in the ratio of gross domestic saving to the gross product, so as to raise the ratio to around 20 per cent by 1980, together with an average annual expansion of somewhat less than 7 per cent in imports and somewhat more than 7 per cent in exports.

The resolution emphasizes that "qualitative and structural changes in the society must go hand in hand with rapid economic growth, and existing disparities — regional, sectoral and social — should be substantially reduced." To achieve the social objectives of development, the resolution calls upon each developing country to formulate its national employment objectives with a view to significantly reducing unemployment and under-employment, and to pay particular attention to expansion and improvement of education and health facilities, to improve levels of nutrition in terms of the average caloric intake and the protein content, and to expand and improve housing facilities, especially for the low-income groups.

As for policies to attain the specified goals and targets of the Second Development Decade, the resolution impresses upon the developing countries the need for vigorous resource mobilization and the most effective use of available resources. It recommends that developing countries which consider that their rate of population growth hampers their development should adopt measures of population control. The resolution calls for appropriate reform of land tenure

systems for promoting both social justice and farm efficiency. It also calls upon the developing countries to continue their efforts to negotiate and put into effect further commitments for instituting schemes for regional and sub-regional integration or measures of trade expansion among themselves.

The resolution calls upon the developed countries to provide adequate support for the developing countries to help achieve the targets of the Second Development Decade. In the field of international finance, it specifically recommends that, by 1972, each economically advanced country should endeavour to provide annually to developing countries financial resource transfers of a minimum net amount of 1 per cent of its gross national product at market prices in terms of actual disbursements, having regard to the special position of those countries which are net importers of capital. Those developed countries which are unable to achieve this target by 1972 should endeavour to attain it not later than 1975. It also recommends that developed countries should progressively increase their official development assistance to the developing countries and exert their best efforts to reach a minimum net amount of 0.7 per cent of their gross national product at market prices by the middle of the decade. As for the terms of foreign assistance, it recommends that the developed countries which are members of the Development Assistance Committee of the Organization for Economic Co-operation and Development, should exert their best efforts to reach as soon as possible, and in any case before 31 December 1971, the norms set out in the 1969 Supplement to the Recommendation of the Development Assistance Committee designed to soften and harmonize terms and conditions of assistance to developing countries. Financial assistance should, in principle, be untied and while it may not be possible to untie assistance in all cases, developed countries should rapidly and progressively take what measures they can in this respect, both to reduce the extent of tying of assistance and to mitigate any harmful effects. Among other measures to expand the flow of foreign resources to the developing countries, the volume of resources made available through the multilateral institutions should be increased to the fullest extent possible, and, as soon as adequate experience is available on the working of the scheme of Special Drawing Rights, serious consideration should be given to the possibility of the establishment of a link between the allocation of new reserve assets under the scheme and the provision of additional development finance for the benefit of all developing countries. This question should, in any case, be examined before the allocation of Special Drawing Rights in 1972.

The resolution recommends a number of measures in the field of international trade. It enjoins the developed countries not to raise new tariff and non-tariff barriers or increase existing ones against imports of primary products of particular interest to developing countries. It recommends that developed countries should, through international joint action or unilateral action, accord priority to reducing or eliminating duties and other barriers to imports of primary products (including those in processed or semi-processed form) of export interest to developing countries, with a view to ensuring that developing countries have improved access to world markets and to market growth for products in which they are presently or potentially competitive. Intergovernmental consultations should be continued and intensified, with a view to giving effect, early in the decade, to measures for the relaxation and progressive elimination of nontariff barriers affecting trade in manufactures and semi-manufactures of interest to developing countries, and efforts made to implement such measures before 31 December 1972. The resolution notes that mutually acceptable arrangements concerning the establishment of generalized, non-discriminatory, non-reciprocal preferential treatment for exports of developing countries in the markets of developed countries have been drawn up, and preference-giving countries are determined to take measures with a view to implementing the preferential arrangements as early as possible in 1971, and it recommends that efforts for further improvements of such arrangements should be vigorously pursued.

The resolution recommends the adoption of special measures for accelerating the growth of the least developed among the developing countries, including those which are landlocked. It calls for mobilization of public opinion in both developing and developed countries in support of the objectives and policies for the Second Development Decade. The resolution emphasizes the need for appropriate arrangements to keep the progress towards achieving the goals and objectives of the decade under systematic scrutiny, and recommends the undertaking of such reviews and appraisal at national, regional and global levels by appropriate agencies and institutions.

Feasibility of the recommended targets in the developing ECAFE region

Considerable work has been done by the ECAFE secretariat to determine the growth potential of developing ECAFE countries during the Second Development Decade. The growth potential of a country is generally determined with reference to (*a*) availability of domestic savings (*b*) availability of foreign exchange and (*c*) "efficiency" of fixed investment, representing a collection of technical, administrative and social factors which affect a country's capacity to absorb capital and effectively use it for productive purposes. The necessity to

distinguish between domestic savings and foreign resources arises because, in most developing countries, domestic savings may not always be convertible into investment either directly or by releasing sufficient foreign exchange to permit the import of needed capital goods which cannot be produced domestically. The growth potential of a country can therefore be frustrated both by a "savings-investment gap" and a "trade gap", and certain adjustments, for example, through import substitution and restriction, export promotion, increasing efficiency of capital, or savings mobilization, are called for.

The projections made by the ECAFE secretariat[1] indicate that fairly high growth rates should be feasible for most of the developing ECAFE countries during the Second Development Decade. The feasible growth rates, along with the sectoral growth rates implicit in these projections, are set out in Table II-1-16. It will be seen that feasible growth rates in the cases of China (Taiwan), Iran, the Republic of Korea and Thailand range between 7 and 10 per cent per annum, and, in the cases of Ceylon, India, Malaysia, Pakistan and the Philippines, between 4.5 to 7 per cent per annum. It is estimated that, on the basis of these growth rates, the developing ECAFE region as a whole can attain an average annual growth rate of 6 to 7 per cent per annum in line with the target of the Second Development Decade.

The projections assume a vigorous effort on the part of developing ECAFE countries to raise the level of their gross domestic savings. In most countries, the projected export-import gap or the trade gap has been found to be larger than the savings-investment gap and to assume the character of the "dominant" gap. Given the size of the dominant gaps, it is clear that the availability of foreign assistance will crucially determine the growth performance of the developing ECAFE countries in the Second Development Decade; it is estimated that a doubling or tripling of the present net annual resource transfers to the developing ECAFE countries will be required, in addition to increased finance for debt services. Such an increase is regarded as feasible, however, if the aid target of one per cent of the gross national product of the developed countries is implemented.[2]

[1] The projections are contained in the following two ECAFE publications: *Feasible Growth and Trade Gap Projections in Developing ECAFE Region*, Development Programming Techniques Series No. 7, 1968, and *Sectoral Output and Employment Projections for the Second Development Decade*, Development Programming Techniques Series No. 8, 1970.

[2] ECAFE, *Feasible Growth and Trade Gap Projections in the ECAFE Region, op. cit.*, p. 15.

Table II-1-16. Aggregate and sectoral growth rate projections, 1970/1980

(Per cent per annum)

Country	GDP (aggregate)	Agriculture (including fisheries and forestry)	Mining	Manufacturing	Construction	Industry (including mining and construction)	Services
Ceylon	4.5 — 5.5	4.2	5.8	9.7	5.5	8.5	5.2
China (Taiwan)	7.0 — 8.5	3.8	7.1— 8.4	9.0—10.3	6.1— 8.5	8.6—10.0	7.5— 8.5
India	5.5 — 6.5	3.6	7.9— 9.5	6.8— 7.9	8.1— 9.5	7.0— 8.2	6.7— 8.6
Iran	8.0 —10.0[a]	—	8.5— 9.5	11.3—11.8	9.0—10.0	10.8—11.4	8.8— 9.6
Korea, Rep. of	8.0[a]—10.0[a]	3.1	8.8— 9.9	10.0—14.4	8.0—10.9	9.5—13.5	9.8—12.6
Malaysia	6.5 — 6.5	4.3[b]	5.6[b]	6.9[b]	7.2[b]	7.2	7.0
Pakistan	6.0 — 7.0	4.2	...[c]	9.8—10.5	5.9— 6.5	8.8— 9.4	7.6— 8.1
Philippines	6.0[a]— 7.0[a]	4.2	8.8— 9.5	7.2— 8.2	6.0— 8.0	7.1— 8.3	6.3— 7.4
Thailand	8.0[a]— 8.5[a]	4.3	6.1	10.7—11.5	7.3— 7.8	9.6—10.2	9.2— 9.8

Sources: ECAFE, *Feasible Growth and Trade Gap Projections in the ECAFE Region*, Development Programming Techniques Series No. 7, 1968.

ECAFE, *Sectoral Output and Employment Projections for the Second Development Decade*, Development Programming Techniques Series No. 8, 1970.

FAO, *Indicative World Plan for Agricultural Development.*

Note: The growth rates of the mining, manufacturing, construction and services sectors have been computed from the sectoral output projections made by ECAFE's Regional Centre for Economic Projections and Programming, *Sectoral Output and Employment Projections for the Second Development Decade*, Development Programming Techniques Series No. 8. Growth rates of agriculture are estimates taken from the *Indicative World Plan for Agricultural Development*, FAO.

[a] Revised after the publication of Development Programming Techniques Series No. 7.

[b] West Malaysia.

[c] Included in the manufacturing sector.

The employment projections of the ECAFE secretariat[3] indicate that, with the anticipated acceleration in the pace of development and the projected structural changes in the economies of developing ECAFE countries, the employment problem is likely to be eased by the end of the Second Development Decade in some countries, such as China (Taiwan), Iran, the Republic of Korea, the Philippines and Thailand; in other countries, particularly the larger countries, a substantial backlog of unemployment is likely to persist. Moreover, if the growth rates do not record sufficient acceleration in these countries, the employment situation may, in fact, deteriorate.

Projections made by the ECAFE secretariat are not forecasts of what will necessarily happen in individual countries of the ECAFE region, but only broad magnitudes that result from certain assumptions. The actual performance of a country may turn out to be better or worse, depending on the interplay of economic and social forces and the type of policies pursued. The projections assume that countries will have the needed social stability for improving their economic performance and that the Governments will take necessary measures, in both the social and economic fields, to solve the major issues with which they are confronted. It is of utmost importance, therefore, to identify the major policy issues and to evolve a strategy best suited to meet the requirements of the situation.

III. Major policy issues and the development strategy

No two countries are exactly alike in respect of the policy problems that they face and the configuration of growth-promoting and growth-inhibiting factors. Even when the problem is seemingly common, the setting is always different. Since there are wide variations in the circumstances of individual countries, there can be no general prescription in regard to policies they should pursue. The specific constraints on development have to be isolated in each case, and solutions to various problems have to be worked out in the light of actual conditions in each country. The observations contained in this section are therefore intended to help in identifying major policy issues and finding ways of resolving them only in a very broad sense. The main focus is on problems which have already been touched upon while appraising developments during the First Development Decade.

[3] Cf., ECAFE, *Sectoral Output and Employment Projections for the Second Development Decade, op. cit.*, p. 6.

Economic growth and social justice

A major policy issue which confronts the developing ECAFE countries in acute form in the Second Development Decade is how to bring about a better combination of economic growth and social justice. In this context, it is necessary to examine whether there is any inherent incompatibility between a faster rate of economic growth and greater social justice, and also the question as to why economic growth in the First Development Decade was not accompanied by a substantial increase in social welfare. There is a school of thought in developing countries which feels that an increase in inequalities before the stage of take-off is inevitable if the aim is to accelerate the rate of economic growth. It also advocates concentration of investment on production sectors and only peripheral attention to social sectors. The belief that rapid economic growth is predicated upon increasing income inequalities and low priority to social sectors constitutes the focal point of "growth philosophy" which seeks to postpone ideas of equitable distribution and the welfare state.[1]

It is not easy to judge the actual influence exercised by such philosophy on government policies. The stated objectives of government policy in most developing ECAFE countries have always covered the social aspects of development. For example, one of the stated objectives of the third five-year plan of Pakistan (1965-1970) was "to make substantial progress towards achieving certain specific social objectives such as diminishing inequalities in the distribution of income, wealth and economic power, providing a measure of social security and promoting social and cultural change conducive to accelerated economic expansion." The third five-year plan of India (1960-1965) was even more specific about social objectives of development policy and stated that: "Economic activity must be so organized that the tests of production and growth and those of equitable distribution are equally met." In actual practice, however, the development strategy pursued in most of the developing ECAFE countries has not been able to preserve a balance between economic growth and social justice. In times of resource squeeze, it is frequently the social sectors which have been made to bear the major brunt of economies in expenditure, while an attempt has been made to protect the programmes of the "productive" sectors. In Pakistan, for example, when the increase in defence expenditure and decline in the availability of foreign aid in the third plan period necessitated a revision in plan priorities, the social sectors were the hardest hit and were the major sufferers.[2] The same happened

[1] For a typical expression of such a view, see Mahbub Ul Haq, *The Strategy of Economic Planning* (Oxford University Press, Pakistan Branch, 1963), especially pp. 3, 30 and 35.

[2] Cf., Planning Commission, Government of Pakistan, *The Mid-Plan Review of the Third Five-Year Plan* (April 1968), p. 4.

in the mid-1960s in the Philippines, where, on account of shortfall in resources, both the absolute size and the relative share of programmes for social development were pruned.[3] In India, also, in periods of financial stress, social sector programmes were considered more dispensable.[4]

It is quite possible that, in the absence of any settled body of doctrine in regard to the interrelationships between income inequalities, social justice and economic growth, the actual policies pursued in the developing ECAFE countries have been greatly influenced by the historical pattern of growth in the Western countries in the early stages of their economic growth. It is well known that, for quite a long time after modern economic growth began in some of the present day advanced countries, inequalities of income and wealth became worse, and very little attention was paid to the improvement of the living conditions of poorer sections of society. From this historical evidence, it was perhaps concluded that such excesses are inevitable in the early stages of growth, and, if the same pattern is not followed, economic growth might be impeded.

The lack of clear articulation of interrelationships between the economic and social aspects of development in the literature on economic growth, including the plan documents of various countries, also appears to have led to relatively less emphasis being placed on social aspects of development. Since the economic targets in the plans are generally derived on the basis of postulated relationships between purely economic variables, such as investment and output, the bearing on economic growth of such factors as changes in the pattern of income distribution and the living conditions of the poor, which have great social significance, has not received adequate attention. As for programmes designed to improve social welfare directly, the tendency has been to speak largely in qualitative terms, such as better health, better housing and better environmental conditions. The quantification of targets in the social sectors on the basis of specific criteria, which is admittedly difficult, has not received adequate attention, and the bearing of these targets on the levels of living has not been systematically investigated. In short, the development plans of most developing ECAFE countries have been characterized by a rather sparse specific social policy content, and, though the importance of social factors has been increasingly recognized in the enunciation of plan objectives, the interrelationships between social and economic aspects of development have to a large extent remained unexplored and undefined.[5]

The allocation of available financial resources among competing uses is one of the most difficult issues of development planning and the inadequate study of interrelationships between social and economic aspects of development makes the task even harder. It is reported that "serious differences of opinion have often arisen over the allocation of limited financial resources between the 'levels of living' objectives of development, on the one hand, and 'production' objectives on the other, and, in virtually every developing ECAFE country, programmes aimed at directly raising levels of living are facing increasingly formidable difficulties in securing a larger share of resource allocations".[6]

It is noteworthy that structural change away from agriculture, which has the potentiality of improving the pattern of income distribution because of *per capita* product being usually higher in the non-agricultural sector than in the agricultural sector, has not been of much help in reducing income inequalities in most of the developing ECAFE countries. This is because income distribution within the non-agricultural sector has tended to become more skewed.[7] A good part of the labour force which has drifted from the rural areas to the urban areas has not been absorbed in industry proper but in low-productivity occupations in the services sector where product *per capita* is not significantly different from that in the agricultural sector.[8]

In the agricultural sector also, it appears that income inequalities have tended to increase in recent years. The "green revolution" has primarily benefited the farmers with large holdings, good quality land, better irrigation facilities, higher educational levels and better financial standing. An expert group which recently studied the agricultural situation in developing ECAFE countries concluded that the new technology was at present "confined to only a small percentage of the farmers with large areas and ample resources. It had failed to reach the vast majority of small farmers, whether owners or tenants, who for lack of resources could not apply the package of practices required. . . . Besides, the possibility of higher yields was pushing up land values while at the same time making cultivation through hired

[3] Cf., *Economic Survey of Asia and the Far East, 1966*, p. 8.

[4] Cf., United Nations, *Planning for Balanced Social and Economic Development: Six Case Studies*, 1964, p. 33.

[5] Research is now under way, particularly in advanced countries and some international institutions, on the quantitative evaluation of social factors on the process of growth.

[6] Cf., United Nations, *The Planning and Financing of Social Development in the ECAFE, Region*, 1969, p. 10. The position seems to have changed somewhat in certain countries very recently.

[7] For some statistical evidence on this point, see pp. 14-18 above.

[8] The average product per worker in the services sector as a whole is higher than that in the agricultural sector in a number of developing ECAFE countries, but income distribution in the services sector itself seems to be highly skewed. A good proportion of income in the services sector in these countries probably emanates from scarcity and monopoly elements in the supply of certain types of capital and skills, while product per worker in a large number of occupations in the services sector (e.g., domestic service and services that are clearly a form of disguised unemployment, such as peddling) is extremely low. See Kuznets, S., *Modern Economic Growth, op. cit.*, pp. 414-415.

farm labour more profitable. Consequently, a tendency was seen among landowners to dispense with their tenants in favour of farm labourers. As of now, the immediate impact of the 'green revolution' has been a sharp increase in rentals, insecurity of tenure, landlessness and polarization in the levels of production and income which could result in increasing social tensions."[9]

The increase in income inequalities reflects in large measure the increased concentration of productive assets. In the agricultural sector, some progress had been made in regard to reducing the dominance of feudal or feudalistic interests, but "reforms had not reached the actual tiller in all cases and considerable concentration of land ownership still prevailed."[10] According to the results of a national sample survey undertaken in the early 1960s, over 86 per cent of all cultivating households in India owned and operated holdings of 10 acres or less, which accounted for only about 40 per cent of the total cultivated land.[11] In West Pakistan and the Philippines, about 80 per cent of all holdings, covering some 45 per cent of the area, were below 5 acres.[12] The pattern of land ownership is characterized by marked skewness in Thailand, Malaysia and Ceylon also.[13] In the industrial sector, there is extreme concentration of ownership in a few hands in most of the developing ECAFE countries. A survey carried out in Pakistan revealed that, in 1959, there were over 3,000 individual firms, but only seven individual units controlled as much as one quarter of all private industrial assets, and a mere twenty-four individual units controlled nearly half of all private industrial assets.[14] A study on the distribution of income in India[15] disclosed that ten groups had an interest of one kind or other in 929 companies in 1958, which accounted for 27 per cent of the share capital of non-government companies. Among these ten groups, the top four showed a still higher degree of concentration, the companies controlled by these complexes accounting for 20.8 per cent of the share capital of the entire corporate private sector. The study also showed that the top one-tenth of one per cent of households, when ranked by dividual income, owned more than half of the total personal wealth in the form of shares.

It appears that certain government policies have themselves led to increasing income inequalities in most of the developing ECAFE countries. The Indian study, referred to above, pinpoints the role of extensive tax concessions and finance provided by government institutions to show how "the working of the planned economy has contributed to the growth of big companies in India industry."[16] A similar situation obtained in Pakistan.[17] The manner in which various economic controls have been operated also seems to have increased income inequalities. In India, for example, according to the Monopoly Enquiry Committee, the industrial licensing authorities had favoured the big businesses and discriminated against small businessmen.[18] In Pakistan also, the working of the control system was "of maximum benefit to the large, well-established industrialist, and discriminated against the small enterprise."[19]

The banking system also appears to have played a significant part in this respect in a number of developing ECAFE countries. According to a study of the Indian situation, "the growth of large complexes which represent concentration of economic power, is due largely to bank loans."[20] Both in India and Pakistan, there is considerable interlocking between big industrial houses and joint-stock banks through common directors, and this has facilitated the expansion of big business. The distribution of bank credit is highly skewed, with the bulk of commercial banks' advances concentrated in a small number of loan accounts.[21] In the agricultural sector also, the bulk of institutional credit has been monopolized by bigger landowners, and small farmers do not have adequate credit facilities.

A number of developing ECAFE countries have sought to use fiscal policy as an instrument of income redistribution, but, in actual practice, the results have not been significant. Many countries in the region have fairly progressive income taxes, but, owing to a large number of tax exemptions and concessions on savings and investment, as well as substantial tax avoidance and evasion, they do not seem to have powerful redistributive effects.[22] In certain countries, such as India and Pakistan, income derived from agriculture is treated differently for purposes of

[9] *Report of the Joint FAO/ECAFE/ILO Seminar on Land Reform Implementation in Asia and the Far East* (Rome, 1969), p. 4.

[10] *Ibid.*

[11] Cf., *Economic Survey of Asia and the Far East, 1969*, p. 37.

[12] *Ibid.*

[13] *Ibid.*

[14] Papanek, Gustav F., *Pakistan's Development, Social Goals and Private Incentives, op. cit.*, p. 67.

[15] Planning Commission, Government of India, *Report of the Committee on Distribution of Income and Levels of Living*, Part I, pp. 40-41.

[16] *Ibid.*, p. 30.

[17] See Planning Commission, Government of Pakistan, *Fourth Five-Year Plan*, pp. 15-17.

[18] Government of India, *Monopoly Enquiry Committee Report*, 1956.

[19] Papanek, Gustav F., *Pakistan's Development, op. cit.*, p. 124.

[20] *Report of the Committee on Distribution of Income and Levels of Living, Part I, op. cit.*, p. 48.

[21] Even in the absence of interlocking of directorates, bank credit would have shown a marked skewness on account of the pattern of industrial growth which is dominated by a few big parties.

[22] Indian data suggest that the size distribution of income after tax is no less, if not indeed more, unequal than before the tax. See *Reserve Bank of India Bulletin*, September 1962, pp. 1359-1363.

income tax, and the tax proceeds from the agricultural sector have failed to grow in line with the increase in the value of agricultural produce. Moreover, the bulk of government revenue is derived from indirect taxes, which, in all probability, do not have a significantly positive redistributive effect.

Excessive resort to credit creation for financing planned programmes of development, in both the public and the private sector, appear to have accentuated income inequalities in a number of countries by giving rise to inflationary pressures. The results have been most pronounced in countries in which supply of wage goods has considerably lagged behind the demand. The lack of success in ensuring necessary commodity balances, particularly in respect of basic necessities of life, resulted in a steep rise in prices and cost of living in certain countries and reacted unfavourably on the "real" income of large sections of population.

The failure to generate employment opportunities in line with the growth in labour force has also militated against a more equitable distribution of income and wealth. According to expert assessment, lack of sufficient progress in reducing unemployment and under-employment has also been due to a number of deficiencies in economic policies.[23] Among other things, lack of scientific manpower planning and insufficient orientation of educational programmes to fit the potential job opportunities have been responsible for a good deal of avoidable unemployment. The interest rate and exchange rate policies pursued in several countries have unduly favoured more capital-intensive projects and less labour-intensive techniques by keeping the price of capital and foreign exchange lower than their scarcity value and have thereby interfered with the creation of greater employment opportunities.

Income inequalities and capital formation

The belief that greater inequality of incomes is conducive to a faster rate of growth is based on three main assumptions, namely (*a*) saving as a proportion of current income increases as income rises, (*b*) it is easier to use the tax device for mopping up a part of the incomes of higher-income groups for purposes of capital formation than it is in the case of low-income groups, and (*c*) the investible surplus between consumption and disposable income is likely to be invested more readily in productive projects in the case of high-income groups than in the case of low-income groups. Empirical evidence to test these hypotheses is rather scanty. Cross-sectional analysis in certain advanced countries does show that savings ratio increases with income. On the other hand, the data relating to Latin American countries seem to afford no statistical evidence of a definite correlation between the two variables.[24] Data for Asian countries are scantier and such as are available do not provide any clear relationship.[25] The argument that high-income earners are easier to tax does not go well with the observed tendency of greater reliance on indirect taxation for increasing government revenues, and substantial tax evasion in higher-income brackets. Finally, it is also doubtful whether it can be taken as axiomatic that high-income groups show greater willingness to invest their savings more productively than low-income groups. A part of the savings of the richer classes in less developed countries is used for investment in land and luxury construction, high-yielding short-term ventures and projects of low national priority, and accumulation of unauthorized cash balances and physical and financial assets in foreign countries. On the other hand, recent evidence suggests that, given favourable conditions, the lower-income groups' propensity to invest is much higher than generally assumed.[26] Obviously, there is need for much empirical research on these aspects before any meaningful conclusions can be drawn.

There is even less evidence to support the belief that reduction in inequalities of income and wealth would necessarily lead to a slowing down in the rate of economic growth. In fact, a number of considerations suggest that a more equitable income distribution may help rather than hinder capital formation and economic growth. Gross inequalities of income and wealth give rise to conspicuous consumption, which, through the demonstration effect, increases the consumption propensity of all classes of population. A more equitable income distribution may therefore tend to raise the level of savings by weakening the demonstration effect.[27] Moreover, reduction in income inequalities can affect economic growth favourably by improving the pattern of resource allocation through the market mechanism. Increased incomes in the hands of lower- and midle-income groups would also tend to enlarge the size of the domestic market

[23] See *Employment Objectives and Economic Development*, Report of a Meeting of Experts (ILO, Geneva, 1961) and *Employment and Economic Growth* (ILO, Geneva, 1964).

[24] Cf., "Income Distribution in Latin America", *Economic Bulletin for Latin America*, October 1967, p. 59.

[25] *Economic Survey of Asia and the Far East*, 1961, p. 56.

[26] In Pakistan, for example, a good number of small landholders also participated in the upsurge of investment in private tube-wells and fertilizers in the 1960s when the benefits of these agricultural inputs were clearly demonstrated. See Ghulam Mohammad, "Some Strategic Problems in Agricultural Development in Pakistan", *Pakistan Development Review*, Summer 1964. In India, one survey of farm investment showed that poor farmers invested proportionately more of their assets than rich farmers: All-India Rural Debt and Investment Survey 1961/62 cited in ECAFE, "Problems of Planning and Plan Implementation in the ECAFE region, 1950/51 to 1967/68".

[27] It is interesting to observe that, in the United Arab Republic, the personal savings ratio is reported to have remained constant during the entire postwar period up to 1962/63, notwithstanding the strong tendency towards a more equitable distribution of income and wealth. See Hansen, B., "Savings in the U.A.R.", Institute of National Planning (Cairo, 1965).

for a large number of goods of everyday use for which there is a felt need but no effective demand at the moment, raising the average profitability of investment and improving the general investment climate.

It has also to be remembered that economic growth is not a function of capital formation alone. In a very real sense, it is influenced by the motivations of the people. The motivations in turn are influenced by the reward for productive effort. If the economic and social system of a country fails to ensure a just apportionment of the gains from development, it breeds discontent and affects the productive efficiency of the people. It is not just a coincidence that agricultural productivity is often the lowest in cases where tenurial arrangements are the most inequitable. Similarly, it is difficult to realize significant gains in industrial productivity if labour is not adequately remunerated. Measures to reduce income inequalities can therefore stimulate productive efficiency and thereby promote a faster rate of growth.

Social sectors versus productive sectors

In view of the dissatisfaction with the results of planned growth in a number of developing ECAFE countries during the First Development Decade, it is a question of topical importance whether the provision for social services should be substantially enhanced in future programmes.

The main difficulty in raising the allocations for social sectors is that, given the quantum of available financial resources, increased provision for social sectors would leave less for directly productive sectors. Greater expenditure on social services would present no major problem if the output effects of the two types of expenditure were the same. However, the output effects per unit of expenditure differ considerably, not only between different sectors but also within the same sector in different lines of activity. Moreover, there is the question of time profile because the gestation periods of different types of expenditure are different. Another difficulty is that benefits accruing from social sector expenditure are not easily quantifiable.

The problem of resource allocation among competing uses, even within the productive sector, is not free from difficulty. A number of criteria have been suggested by different authors, but it has been increasingly realized that there is no single criterion which suffices for purposes of actual policy formulation. The development process is subject to several constraints, which differ from country to country, so that no investment policy can be regarded as ideal in all circumstances. The optimality of investment decisions can only be judged in the light of the actual mechanics of development in particular countries and the configuration of growth-inhibiting and growth-promoting factors. The development strategy to be pursued in the Second Development Decade will have to take cognizance of these aspects.

Economic growth with social stability

The major decisions on development policy in the Second Development Decade must be guided by the paramount consideration of achieving economic growth within a framework of social stability. It is vitally necessary to underline the fact that economic growth and social stability are closely inter related. Sustained economic growth is possible only in an environment which allows production processes to proceed uninterruptedly. Serious labour management disputes, frequent strikes, civil strife and political turmoil, which are manifestations of social instability, are inimical to economic growth. Labour trouble and social tensions cloud the horizon for private investment, and in countries where the private sector plays an important role in economic development, a decline in private investment can seriously retard economic growth. In a period of social turmoil, Governments may find it difficult to raise additional resources by way of taxation and other fiscal levies, while it may become necessary to enlarge current expenditures for maintenance of law and order, thereby reducing investible resources for development. Social pressures may also force the Governments to supplant private sector activity in certain fields by public undertakings. In countries where the public sector is not fully equipped for the purpose, this may lead to loss in economic efficiency and a slowing down in growth.

The fact that inequalities of income and wealth increased in the early stages of modern economic growth in the present day developed countries does not prove that repetition of such a pattern is an indispensable condition for growth in the developing countries. As Kuznets has pointed out, "all we can say is that unequal distribution of income in the earlier decades in the presently developed countries did not prevent rapid economic growth. But our data do not reveal the specific social and economic circumstances, and we cannot say that a somewhat less (or more) unequal size distribution might not have contributed to even faster growth."[28] Kuznets has also pointed out that, despite the attenuating circumstances in the case of Western economic development, such as a relatively higher level of real *per capita* income, pressures arising from income inequalities were "sufficiently acute to strain the political and social fabric of society, force major

[28] Kuznets, S., "Quantitative Aspects of the Economic Growth of Nations, VIII: Distribution of Income by Size", *Economic Development and Cultural Change*, Vol. XI, No. 2, Part II, 1963, p. 69.

political reforms, and sometimes result in civil war."[29] As already discussed, empirical evidence is not conclusive in regard to the relationship between income inequalities and capital formation. However, even if policies designed to bring about a more equitable income distribution were to result in some diminution in the rate of growth of private savings, it may be well worth taking this risk to avoid the more deleterious consequences of social instability. The decline in the rate of growth of private savings could moreover be offset by more vigorous resource mobilization in the public sector, so that the over-all rate of savings and investment in the economy is not unduly affected.

The development strategy for economic growth with social stability has to be evolved in the light of individual country circumstances. It is possible, however, to indicate the broad contours of such a policy in the light of the foregoing discussion. The major causes of social discontent in most of the developing ECAFE countries appear to be (*a*) the low level of *per capita* income, (*b*) the slow growth in *per capita* income, (*c*) increase in the cost of living, (*d*) insufficient employment opportunities, (*e*) increase in income inequalities and an institutional framework which does not provide equal opportunities to all for economic and social advancement and (*f*) inadequate attention to social sectors. It is apparent that action on a very broad front will be needed to ensure that economic growth proceeds within the framework of social stability.

A considerable acceleration in the rate of growth of *per capita* income is necessary for effectively tackling the major socio-economic problems of less developed countries. The slowness with which living conditions improved in the developing ECAFE region in the First Development Decade is in large part a reflection of the deep economic poverty which characterizes this part of the world. At the beginning of the 1960s, Asia was the poorest of the world's regions in terms of *per capita* income and it remains so today. It is true that lack of sufficient social orientation in some of the policies pursued in the First Development Decade aggravated social discontent, but it would be unrealistic to assume that the solution lies in mere egalitarianism. The average income in developing ECAFE countries is so low that even a drastic redistribution of incomes would not bring about significant increases in the levels of living for the many. Similarly, the low level of income imposes a severe constraint on the extent of increase in social sector expenditures. A considerable acceleration in the rate of growth of *per capita* income is therefore a necessary, if not a sufficient, condition for bringing about significant improvement in the living conditions of the people in the developing ECAFE region.

[29] Kuznets, S., "Economic Growth and Income Inequality", *American Economic Review*, March 1955, p. 25.

Achievement of a pronounced acceleration in the rate of growth of *per capita* income would necessitate measures aimed at slowing down the rate of population growth and raising the level of gross domestic product to the maximum extent feasible consistent with the attainment of other major policy objectives. Acceleration in the rate of growth of GDP would require increased domestic resource mobilization, vigorous export expansion and greater allocative efficiency. These measures would need to be supplemented by more active regional co-operation and greater assistance on the part of the international community in matters of trade and aid. To ensure that benefits of economic growth are widely distributed and economic growth proceeds within the framework of social stability, it would be necessary to stabilize the cost of living, reduce income inequalities, create employment opportunities on a much larger scale, give more attention to social sectors, and to so modify the institutional framework that all strata of society have opportunities for rapid economic and social advancement. Specific policies to achieve these objectives could have to be framed on the basis of detailed study of all relevant issues by the Governments concerned. The rest of this chapter attempts to provide a general approach to some of these problems.

The solution to the major problems facing the countries of the region would be facilitated by better planning and better execution of development plans. The planning agencies need to be suitably strengthened to enable them to undertake the preparation of well-integrated plans, with proper emphasis on the growth and social aspects of development. At present, in many countries, there are serious weaknesses in the machinery for integration of social and economic development planning which need to be remedied. It would also be necessary to ensure a more effective implementation of development plans; this would need the drawing together into the planning process of various decision-making and implementing groups—public and private—through co-ordination, consultation and agreement reached at various levels and at various stages. Finally, the importance of mobilizing popular support for national development plans cannot be over-emphasized. Without popular commitment and participation, the sacrifices that are necessary for development would not be easily made, nor would productive effort be commensurate with the needs. The extent of popular participation, of course, would depend largely on the character of the development process and the sharing of the benefits of growth among various population groups. This will involve difficult and delicate political decisions in several countries and the outcome of development effort in the Second Development Decade will crucially depend on those decisions.

Population policy

A slowing down in the rate of growth of population is necessary to attain a significant improvement in living conditions in the less developed countries of the ECAFE region. More than half of the increment in total output in the developing ECAFE countries in recent years went just to sustain more people rather than raise the living standards. Moreover, the higher the rate of population growth, the greater is the investment required in social overheads merely to maintain the same basic services and standards for increased numbers. The problem is complicated by the fact that countries with high rates of population growth have also high dependency ratios which reduce their savings capacity and thereby the potential for future growth.

There has been a growing awareness of the need to evolve proper population control policies in less developed countries in recent years. Before 1960, only two countries in the developing ECAFE region, India and Pakistan, had an official policy of family planning for the purpose of lowering birth rates. In contrast, there is scarcely any country now which does not have a population policy of some sort. Some countries have recorded a significant reduction in birth rates during the 1960s. It is reported, for example, that between 1960 and 1968, as a result of a substantial reduction in birth rates, the annual percentage rate of increase of population declined from 3.7 to 3.1 in China (Taiwan). While the experience of such countries shows the feasibility of making a pronounced impact on the population problem within a matter of a few years, it would be unrealistic to assume that success in containing future population growth in the developing ECAFE region can be achieved through a vigorous family planning programme alone. It is the view of demographic experts that the trends in population are related to numerous features of social and economic change in a number of ways.[30] Changes in education level, health and other conditions of life appear to have a significant bearing on the attitudes of people towards limitation of family size. An increase in educational levels, for example, has been found conducive to greater acceptance of family planning. Economic and social policies which reduce the need for having large families for purposes of economic security also tend to lower birth rates. The fact that birth rates have significantly declined only in those countries which have higher *per capita* income, higher educational standards and better environmental conditions suggests the need for giving greater attention to social aspects of development and accelerating growth in order to enhance the prospects of success of family planning programmes.

Reduction in income inequalities

The tendency of a private enterprise capitalistic system to aggravate income inequalities can best be tackled through countervailing action on the part of the State. Fiscal policy, in particular, can play an important role in bringing about a more equitable pattern of income distribution. As discussed earlier, the fiscal policies pursued so far do not seem to have achieved significant redistributive effects, on account of (*a*) the preponderance of indirect taxes (*b*) the large number of fiscal concessions which primarily benefit the higher income groups and (*c*) substantial tax evasion. The actual measures that should be taken to reform the tax system would need to be worked out in the light of local conditions in each country, but the general direction in which movement is necessary is quite apparent. By international standards, the upper-income groups in most of the developing ECAFE countries bear a light tax burden. In countries where direct taxes are not sufficiently progressive, consideration needs to be given to raising the rates of taxes. In most of the countries, the tax rates are already fairly high, but the actual tax realizations are unduly low on account of liberal tax concessions and widespread tax evasion. Fiscal concessions for savings and investment are justified in limited degree for a limited period in initial stages of growth, but they need to be kept under constant review. It seems that, in quite a few countries, liberal tax concessions have continued even after they had outlived their utility. This has not allowed fiscal policy to play its proper role in reducing income inequalities. Tax evasion, which is quite a serious problem in developing ECAFE countries, blunts the effectiveness of even highly progressive taxes in reducing income inequalities. In some of the developing ECAFE countries, high incomes in the agricultural sector are inadequately taxed and this tends to aggravate income inequalities. It is necessary that tax systems should be examined in their entirety in relation to the social objective of reducing income inequalities, and appropriate action taken in the light of such an investigation.

As mentioned earlier, the highly uneven distribution of income in the developing ECAFE countries is associated with a highly skewed pattern of assets ownership. Policies for income redistribution must therefore include effective measures for tackling this problem. The land reform programmes need to be implemented with greater vigour and determination to reduce income inequalities. In addition, fiscal policy measures, such as wealth taxes, gift taxes and estate duties, can act as important instruments for reducing the concentration of assets ownership.

[30] Cf., United Nations, *World Population: Challenge to Development, Summary of the Highlights of the World Population Conference*, 1966.

Action on a broad front is needed to reduce the concentration of economic power. The main instruments that can be employed are anti-monopoly legislation, prohibition of all types of restrictive practices, and promotion of ownership of shares on a wider basis. Experience shows, however, that enactment of such measures is not enough: desired results can only be achieved by vigorous implementation. Moreover, such measures need to be supplemented by steps designed to provide the necessary encouragement for small entrepreneurs and new comers. Of special importance, in this connexion, is the need to improve access to credit facilities. The availability of credit facilities for small farmers also needs urgent improvement to enable them to take advantage of improved agricultural practices and improve their relative income position. The development of the capital market, through such institutions as a stock exchange, investment trusts, underwriting institutions and equity participation funds, can also help in widening the ownership of assets.

Reduction in income inequalities will also necessitate vigorous government action to expand employment opportunities as fast as may be consistent with the attainment of other major objectives. This aspect is discussed later in this chapter. Unskilled labour, tenant-farmers and landless labourers are other sections of society which require effective government action to bolster their positions. The problem of landless labourers was given detailed consideration recently by an expert group and some of the measures recommended by them were (*a*) vigorous enforcement of minimum wage legislation (*b*) rights to homesteads now provided by landlords (*c*) provision of new homesteads in congested areas through state acquisition where necessary (*d*) promotion of agro-industries and (*e*) expanding land-settlement programmes.[31]

Vigorous action is also necessary to remove the frustrations caused by interergional income inequalities resulting from the uneven development of regions in the same country. This is another field where, in the absence of countervailing action on the part of the State, free market forces can easily aggravate the problem. There is a natural tendency for new enterprises and investments to gravitate towards the already developed areas because of the better facilities there. To the extent that the economic backwardness of a region is due to lack of an adequate physical infrastructure, the situation obviously calls for greater investment by the Government in that region. For inducing greater private investment in less developed regions, it may also be necessary to strengthen the incentives mechanism through suitable tax devices and increased credit facilities. To promote local initiative in poorer regions, which are also capital-deficient, equity participation funds and underwriting institutions can play a useful role. Experience indicates that, to promote speedier development of less developed regions of a country, it is also necessary to build up mutual trust among the inhabitants of different regions and to give adequate representation to local people both in the labour force and management.

Access to opportunities for economic advancement in all regions and in all strata of society depends significantly on education levels. Despite substantial progress in the field of education in recent years in most developing ECAFE countries, educational facilities are still highly deficient and unevenly distributed. This is particularly so in rural areas. The expenses of higher education cannot usually be borne by a large number of poorer families, and this, in effect, means inequality in opportunities for economic advancement.[32] Programmes designed to ensure equal educational opportunities for all can help significantly in reducing income inequalities.

Employment aspects

The employment situation will grow worse in a number of developing ECAFE countries in the Second Development Decade unless concerted measures are taken to tackle the problem. A successful population policy can alleviate it, but only in the long run. Those who will constitute the labour force in the Second Development Decade and seek employment opportunities have already been born. Increase in employment opportunities is closely related to the tempo of economic development. It will therefore be easier to tackle this problem in countries which are able to achieve a faster rate of economic growth, but, in view of the acuteness of the unemployment problem, it will be necessary to scrutinize all the economic policies to see that they exert the maximum favourable effect on employment consistent with the attainment of other major policy objectives.

Though labour is a more abundant resource in relation to capital, the interest rate and exchange rate policies pursued in a number of developing countries have favoured the adoption of production techniques which do not appropriately reflect their factor proportions. Admittedly, adoption of capital-intensive techniques is unavoidable in many cases on account of lack of sufficient choice in the matter or for reasons of competitive efficiency, but policies are needed which exercise the necessary compulsion in favour of less capital-intensive techniques, at least in cases where there is much greater technological flexibility. A reconsideration of fiscal, monetary, trade and other government policies, with a view to their reorientation

[31] Cf., *Report of the Joint FAO/ECAFE/ILO Seminar on Land Reform Implementation in Asia and the Far East, op. cit.*, pp. 7-9.

[32] In the developing ECAFE region, Ceylon is the only country which assures education up to the highest level for deserving students of all strata of society.

in the perspective of relative factor proportions, may therefore be expected to exercise a favourable effect on the employment situation.

The employment aspects should be given due weight in planning the investment pattern and execution of development projects. Development of infrastructural facilities (roads, power projects, irrigation works, soil reclamation and conservation, housing, schools etc.), which is mainly the responsibility of the Government, is a field where a wide range of different technologies are available. As emphasized by the Seventh Expert Group on Programming Techniques, public authorities should ensure that labour-intensive rather than capital-intensive methods are applied in this sector, even if the cost to public budgets is higher, because "the higher cost does not necessarily reflect real cost to the country, which is cost in terms of 'shadow prices' and for labour these are usually much lower than wage rates".[33] In other sectors, also, labour-intensive techniques should be promoted as far as possible. For expanding rural productive employment, more widespread use of high-yielding labour-intensive farming techniques, multiple cropping, livestock farming, and development of rural cottage industries should be encouraged.

The solution to the problem of the educated unemployed has to be sought primarily in better manpower planning and reorientation of education programmes. To a large extent, unemployment among educated youth is attributable to lack of functionality in the education system. As pointed out by an expert study on the subject,[34] the philosophy and practice of teaching and education in a number of Asian countries often work to discourage enquiry and initiative among the students and perpetuate a static and passive outlook on society and its problems; there is frequently an excessive emphasis on conformity and not enough on independent discovery; and literary subjects, looking towards prestigious white-collar employment, frequently take too great a precedence over practical instruction. The defects of the education system and lack of scientific manpower planning ill serve the objectives of both development and employment as they result in surpluses and scarcities of skills existing side by side. There is evidence that reorientation of the education system and manpower planning are receiving much greater attention now in a number of developing ECAFE countries so that better results are expected in the future.

[33] ECAFE, *Sectoral Output and Employment Projections for the Second Development Decade*, Development Programming Techniques Series No. 8, p. 9.

[34] UNESCO, *Perspectives of Educational Development in Asia* (Bangkok, 1965).

Cost of living

Family budget studies in a number of developing ECAFE countries show that, on account of the low level of *per capita* income, purchase of food and a relatively small number of simple manufactured goods accounts for an over-whelmingly large proportion of family expenditures in the case of the majority of the population. It has also been observed that, in these countries, the first reaction of low-income households to an increase in incomes is to increase the total quantity of consumption of cereals. With further rise in income, more and more families tend to increase their demand for more nutrient types of food and simple manufactured goods. Viewed in this perspective, a balance between the supply and demand of these items, commonly designated as "wage goods", is crucial for preserving monetary and price stability. It follows that countries of the developing ECAFE region should endeavour to promote a production mix which is closely in line with the pattern of demand to ensure a reasonable degree of price stability.

Till recently, inadequate increase in the production of foodgrains was one of the major factors responsible for the rise in the price level in a number of developing ECAFE countries. The position has improved in this respect in the last two to three years on account of the agricultural breakthrough. However, in most countries, it will be necessary to bring about a further substantial increase in the production of foodgrains before a stable long-run equilibrium between the demand for and supply of foodgrains is achieved.[35] At the same time, attention will need to be given to speedy expansion in the production of non-cereal food items which are in short supply in most of the developing ECAFE countries. A good deal of malnutrition in these countries is due to the serious lag in the production of more nutrient types of food which has resulted in a sharp rise in their prices. According to FAO projections, while the demand in Asia for cereals for human consumption is likely to double by 1985, the demand for meat, fish and eggs (taken as a group) is likely to increase by 250 per cent, and for milk, by 230 per cent.[36] The demand for other food products is also expected to rise appreciably. Unless steps are taken to meet the likely increase in the demand for these items well in time, the cost of living will experience a further rise. The main problem lies with protein supplies rather than with sugar, fruits and vegetables for which a large bulk can be produced from a relatively small area of land. This is not the case with animal proteins, particularly meat and milk, in whose case

[35] For numerical projections, see FAO, *Provisional Indicative World Plan for Agricultural Development.*

[36] FAO, *Provisional Indicative World Plan for Agricultural Development: Summary and Main Conclusions, op. cit.*, p. 7.

the gestation period is quite long and land area requirements quite large. The growth in the production of pulses, the main source of high-quality vegetable protein, has also been sluggish so far, and it will need to be given special attention. FAO has recommended a detailed action programme in the livestock sector for increasing the supply of animal proteins[37] which deserves earnest consideration by the developing ECAFE countries.

The housing shortage and the consequent rise in house rents has resulted in raising the cost of living in a number of countries in the developing ECAFE region. The same is true of transport costs and the costs of a number of other services. Public policies to improve the housing situation, transport facilities and other social amenities are therefore urgently needed to prevent a further rise in the cost of living of the less well-to-do sections of society.

While an attempt should be made to increase the supply of wage goods and other necessities of life as fast as possible, it is also necessary that appropriate monetary and fiscal policies should be pursued to regulate monetary demand in the economy to prevent an inflationary rise in prices. Experience has shown that unrestrained deficit financing can have highly deleterious consequences for the price level in a situation which is characterized by shortage of wage goods, and monetary policy alone cannot eliminate inflationary pressures unleashed by an unduly expansionary fiscal policy. Moreover, restriction of bank credit beyond a point can have harmful effects on productive activity and may therefore act as an ally of inflationary forces instead of producing the desired anti-inflationary impact. Monetary and fiscal policies in less developed countries are generally more effective in preventing the emergence of excess demand conditions than in reversing the process of inflation. This underlines the need for proper advance planning of monetary and fiscal policies, particularly in respect of their influence on the state of monetary demand.

In quite a few developing ECAFE countries, the rise in prices has also been associated with the process of import substitution. Industrialization in these countries has proceeded under a heavy protective umbrella, so that replacement of imports by domestically produced goods has served to raise the price level. Since, in most cases, domestic industries have enjoyed an assured market for their products inside the country, rationalization of cost of production has not received adequate attention. Moreover, in the case of goods where the market structure has been conspicuously oligopolistic, the manufacturers have had considerable scope for "administering" prices to the disadvantage of the consumer. The steady rise in the level of indirect taxation also seems to have exercised an upward pressure on the prices of manufactured goods, particularly in countries characterized by excess demand conditions where it is easy to pass on the burden of increased indirect taxation to the consumer in the form of higher prices. A review of industrial protection policies, measures designed to infuse more competition in the domestic manufacturing sector and reduced dependence on indirect taxes can therefore assist significantly in reducing price pressures in developing ECAFE countries.

Greater allocative efficiency

The developing countries face an acute shortage of resources in relation to needs. There is an imperative necessity, therefore, to use these resources most effectively. There are no rules of thumb, however, to determine the optimal pattern of resource allocation. Besides accelerating the rate of growth, development has a multiplicity of objectives which are less easily quantified, such as a higher level of gainful employment, reduction in inequalities of income and wealth, and improvement of health, education and levels of living in general. Even if some of these objectives could be given an exact quantitative connotation, the relative weights that should be assigned to different objectives would, in any case, require a subjective value judgment. In the matter of resource allocation, therefore, as Tinbergen has pointed out, "A final choice will always have to be made, on the basis of all information and on certain subjective valuations, by those who are particularly responsible at the highest level."[38]

The problem of optimum allocation of investment resources is, in a real sense, a problem of maintaining the needed balances between the "social" sectors and the "productive" sectors, as also within the social and productive sectors.

While seeking to achieve optimum resource allocation in the context of a country's actual conditions, attention should not be confined to public sector allocations under various heads. The policy instruments available to the Government should be deployed to influence the pattern of resource allocation in the private sector also. Fiscal, monetary and trade policies are used on a regular basis in most countries to influence investment decisions in the private sector so far as activity directly related to productive sectors is concerned. There is need, however, for using government policy instruments more actively to enhance the role of the private sector in the social field. In the housing sector, particularly, there are possibilities of much greater participation by the private sector. Private funds can be channelled for

[37] *Ibid.*, pp. 35-41.

[38] Tinbergen, J., *The Design of Development* (IBRD, 1958), p. 30.

low-cost housing through State initiative and incentive devices. At the same time, measures can be taken to induce industrial and business firms to provide housing for workers and to improve the environmental conditions in which they live and work. To reduce the housing shortage in general, people in lower-income groups should be enabled to own their houses through self-help, by means of credit facilities and the promotion of savings and loan associations.

The goal of allocative efficiency requires that a proper balance be maintained amongst various activities within the productive sectors as well. A certain balance between the growth of the agricultural and industrial sectors is necessary if economic development is to proceed smoothly. A number of developing countries tend to switch emphasis rather too soon from agriculture to industry in the hope of breaking through the low-level equilibrium trap. Available evidence suggests that this policy has not been a success and lack of sufficient progress in the agricultural sector has held down progress in the industrial sector itself. This has led to greater realization of the basic interrelationships between the growth of agriculture and industry, and, in turn, exercised an important influence in reshaping investment decisions in a number of developing ECAFE countries in recent years. In view of the general scarcity of investible resources, it is necessary that the creation of excess capacity in both industry and infrastructure projects should be carefully guarded against, except in cases where it is unavoidable because of technological indivisibility.

Considerations of allocative efficiency also warrant that planning in the productive and social sectors should be well integrated. This is a field in which much work is yet to be done. Best results can be achieved from limited resources if the programmes in the productive and social sectors are so designed as to be mutually reinforcing. Under a system of integrated planning, it should be possible to so adjust the content of social programmes as to maximize their economic value and to so reorientate the production programmes as to give maximum help in solving the most urgent social problems.

Agricultural strategy

In view of the predominance of agriculture in the economies of developing ECAFE countries, it is necessary to give careful attention to evolving an agricultural strategy which makes a maximum contribution both to economic growth and social stability.

The recent breakthrough in agriculture in a number of countries in the developing ECAFE region is based on intensive application of fertilizers and use of high-yielding varieties of seed.[39] While this strategy has yielded good dividends so far in terms of raising the level of agricultural productivity, agronomic studies point to a number of problems which countries are likely to face if they rely solely on it to solve all their agricultural problems.[40] The expansion of irrigation facilities and a highly developed water-management system are the major preconditions for the success of the new strategy. Not all areas of a country can therefore benefit from it, at least in the short run. Moreover, the new strategy calls for much larger initial outlays which small farmers in many countries are unable to afford. Thus, while concerted efforts should be made to develop high-quality and dependable irrigation facilities to promote wider adoption of the new strategy, other means must be found to increase agricultural productivity in areas and on farms where its adoption is not currently feasible.

Since the availability of water is a limiting factor in the expansion of agricultural production in large areas in a number of developing ECAFE countries, and the extensive building of dams and canals involves high capital costs, the emphasis in many places will have to be on minor irrigation projects and effective tapping of underground water, through such means as tube wells and water pumps. Increased availability of water through such means would allow the adoption of better farming practices in large areas and reduce the contrasts in the levels of agricultural productivity in different regions of the same country. It would also give a fillip to multiple-cropping which has the potentiality of raising agricultural production substantially in a number of developing ECAFE countries.

The recent breakthrough in agriculture in the developing ECAFE region is confined largely to wheat and rice. The per acre yields of other agricultural crops, particularly cash crops, have not risen appreciably. There is need for stimulating research to find ways of increasing yield from other crops to bring about all-round agricultural prosperity. Even in the case of foodgrains, there is need for continuing interdisciplinary research, both to improve the varieties already developed and to widen the spectrum of cereals covered. In fact, FAO has warned that, because of the emphasis being placed on a limited range of varieties, and the high hopes pinned on their success, an unusually severe setback to agricul-

[39] This is the position in India, Indonesia, Pakistan and the Philippines. Ceylon, Malaysia and Thailand are following a somewhat different agricultural strategy based on more conventional methods of raising the level of agricultural production, such as land development, double-cropping and extension of irrigation. See *Economic Survey of Asia and the Far East*, 1969, pp. 22-30.

[40] Cf., "Planning Strategies in Agricultural", *Economic Bulletin for Asia and the Far East*, September 1969.

tural progress could occur if adequate resources are not devoted to research work.[41]

It is also necessary to give greater attention to measures designed to eliminate the loss caused to crops by insects, pests and plant diseases which cause considerable damage every year in several countries.[42] In most countries, plant protection measures are as yet highly inadequate and cover only limited areas. A major acceleration of pest-control programmes is clearly indicated and has become especially necessary because the new high-yielding varieties often lack resistance to indigenous insects and diseases.

To achieve a more rapid progress in agriculture in the Second Development Decade, countries of the developing ECAFE region will have to bring about considerable improvement in their transport and communications networks. In large areas in these countries, subsistence farming is practised because of the difficulty of bringing the produce of more profitable crops to the market. A better transport system could induce greater agricultural production by breaking the isolation of the villages, increasing the farmer's share in the price paid by the final consumer and making the farmers' developmental needs, such as better seeds and fertilizers, more easily accessible. The community development programmes, already initiated in a number of developing ECAFE countries, could play a substantive role in improving the communications network, and the capital costs could be kept down if the co-operation of local people could be enlisted to provide free labour on a voluntary basis.

With the recent increase in the production of foodgrains, and the prospects of attaining self-sufficiency in a number of previously food-deficit countries, the importance of scientific crop planning and agricultural diversification has increased considerably. The rise in the yields of cereals is likely to release substantial land resources which could be profitably used for growing other crops or raising livestock. The increase in food production in food-deficit countries is also resulting in a shrinkage in the exports of food-exporting countries and a policy of agricultural diversification is called for in their case.

Apart from the technological aspects, the agricultural strategy in the Second Development Decade must give adequate attention to the institutional aspects of agricultural development. The importance of land reforms, improvement of tenurial arrangements and measures designed to ameliorate the conditions of landless labourers have already been emphasized in this chapter. The urgent need for expanding agricultural credit facilities to enable the small farmers to take advantage of improved agricultural practices was also stressed. To improve the relative position of small farmers, it will also be necessary to take measures to ensure an adequate supply of farm inputs for them well in time, to improve the marketing organization to prevent them from being exploited by the middlemen, and to organize efficient extension services to educate them in the benefits of improved farming practices.

Industrial strategy

A significant acceleration in the rate of growth of industrial production will be necessary in many developing ECAFE countries to achieve the targets of the Second Development Decade. The industrialization process consists of the implementation of a series of individual projects. The criteria that guide the selection of such projects, and the policies that are pursued to promote and foster the growth of industries, have an important bearing on the pattern of resource allocation and deserve careful consideration. A recent survey of industrial development in the developing ECAFE region during the First Development Decade points to a number of deficiencies in the industrial policies of developing ECAFE countries which did not allow full benefits to be reaped from the industrialization process.[43] Since industrialization is a costly process and absorbs a good deal of scarce resources, a reappraisal of industrial strategy by developing ECAFE countries with a view to improving the 'quality' of industrialization is of great importance.

The industrial status of developing ECAFE countries at the beginning of the Second Development Decade covers a wide spectrum. On the whole, it appears that policies for industrialization in the First Development Decade were concerned more with increasing the volume of new industrial investment than with the efficiency of the emerging industrial structure.[44] Under heavy protection, a large number of industrial units, greatly dependent on imported inputs, have sprung up, operating at a minimal level of cost efficiency in comparison with international standards. There is a well recognized 'Infant Industry' argument for promoting domestic industries in the initial stages of their growth. However,

[41] FAO, *Provisional Indicative World Plan for Agricultural Development: Summary and Main Conclusions* (Rome, 1970), p. 29.

[42] In India, for example, insect, pests, plant diseases and parasites are estimated to cause a pre-harvest loss of at least 15 to 20 per cent in potentical cereal grain production, and as high as 25 per cent in pulses, oilseeds, fruits and vegetables. See FAO, *Provisional Indicative World Plan for Agricultural Development*, Vol. I (Rome, 1969), p. 20.

[43] "Industrialization Policies, Achievements and Problems Encountered by Member Countries in the Region during the First United Nations Development Decade and Policies for the Second Development Decade", document prepared by UNIDO for the Asian Conference on Industrialization, 1970.

[44] See "Some Issues of Development Policy in the Coming Decade", *World Economic Survey, 1968*, Part I, p. 32.

industrial protection in many countries is not confined to infant industries nor is it related to the "age" of the industry. In fact, in a number of countries, since imports are subject to quantitative restrictions, the effective level of protection is determined not by the protective tariff but by the level of imports and domestic demand. In a number of cases, therefore, with the growth in domestic demand and intensification of import restrictions on account of balance-of-payments problems, the effective level of protection for individual industries has gone on increasing rather than declined. Such industries therefore have been under no compulsion to lower costs.[45] This is the main reason why, despite rapid industrialization, there has been no favourable impact on the price situation in a number of countries. In many countries, import restrictions have been severest in the case of consumer goods and this has encouraged the setting up of consumer goods industries on a broad front while intermediate goods and capital goods industries have not received sufficient encouragement, except in a few countries including India. This has militated against the building up of a more integrated industrial structure. The effects of this type of industrialization on the balance of payments have also been generally unfavourable. Industrial development has not lessened dependence on imported supplies; though the composition of imports has undergone substantial change, total import requirements have continued to rise over time.

The industrial policies in the Second Development Decade should seek to achieve a more integrated and efficient industrial structure. In view of the foreign exchange difficulty, it will not be possible, for most countries, to bring about the needed readjustments by following a more open-ended import policy. Foreign competition can induce greater allocative efficiency, but, for this to happen, it is necessary for a country to have sufficient external resources to cope with the impact of reduced import restrictions on the level of imports. Since the scope for this is highly limited in most countries, chief reliance for bringing about a more efficient industrial pattern has to be placed on government industrial licensing policies, import policies, tariff adjustments, fiscal policies and exchange rate policies.

At the current stage of their development, import substitution will continue to figure as the major element in the industrial growth of a number of developing ECAFE countries. Care should be exercised, however, to avoid the setting up of industries whose manufacturing costs are excessively high by international standards. Such industries place a great burden on the consumers and are also unable to export their products without unduly high subsidies which involve further costs for the community. An attempt should be made to evolve an industrial structure which really improves the balance of payments and promotes self-reliance. The capacity of an industry to bring about a net saving in foreign exchange and to augment foreign exchange earnings should be an important guiding principle in the selection of industries and choice of priorities.

The industrial policies should also seek to avoid the emergence of significant excess capacity in industry and try to ensure an optimum utilization of existing capacity. According to available evidence, the industrial sector in a number of developing ECAFE countries is characterized by substantial unutilized capacity.[46] Industrial development exerts the maximum beneficial effect on production and employment only when installed capacity is used reasonably well. While full utilization of industrial capacity is not easy to ensure, and the level of capacity utilization is bound to fluctuate from period to period on account of a number of factors including foreign exchange shortage, it should be possible by careful planning to reduce the degree of under-utilization and thereby promote greater allocative efficiency.

Countries differ widely in respect of resource endowment and other economic and social characteristics, and some degree of specialization is necessary for efficient industrial growth. However, conditions for specialization have not been particularly favourable so far. The import of manufactured goods from developing countries is subject to a number of tariff and non-tariff restrictions in developed countries; this narrows the scope for specialization. Trade liberalization on a regional and subregional basis could promote a degree of beneficial specialization, but progress in this respect was disappointing in the First Development Decade. Mutual efforts should be made by the developing ECAFE countries to promote freer trade on a regional and subregional basis in the Second Development Decade. The need for greater economic co-operation is particularly acute among countries of relatively small size where smallness of the domestic market acts as a severe constraint on rapid industrial progress. Trade liberalization and joint industrial planning can help a great deal in improving productive efficiency in the developing ECAFE countries by promoting greater specialization and more economical use of scarce resources.

[45] The need to find export markets after a certain level of production has been reached should generally result in more attention being given to cost aspects, but a number of countries give liberal export subsidies which dilute the influence of this factor.

[46] For some data relating to India, Indonesia, Philippines and Republic of Korea, see ECAFE, "Industrial Growth Prospects and Policies for the Second Development Decade" (E/CN.11/I&NR/L.91), p. 28.

Domestic resource mobilization

An increase in the marginal rate of saving will be crucial in most developing ECAFE countries for the average level of savings and capital formation to rise fast enough to achieve the target growth rate. Additional resources will be needed to accelerate progress in the social sectors. In fact, in the short run, capital requirements for achieving a target growth rate may be larger, the greater the emphasis on social sectors. This underlines the need for a considerable strengthening of the resource mobilization effort.

While seeking to mobilize additional resources, a distinction must be made between inflationary and non-inflationary means of resource mobilization. Deficit financing, as well as credit creation in the private sector, if they exceed "safe" limits,[47] inevitably lead to inflationary consequences. While this may, in certain conditions, raise the level of capital formation in the short run, its regressive income redistributive effects will run counter to the policy of reducing income inequalities and promoting greater social stability. In the longer run, the effects of inflationary finance on capital formation itself are far from favourable. Similarly, if an attempt is made to finance the large social sector expenditures through excessive resort to deficit financing or credit creation, resulting in a sharp increase in prices and cost of living, the over-all effects on the standard of living of the people may be harmful rather than beneficial. A survey of the trends in the financing of public sector expenditures in the developing ECAFE countries in the 1960s shows that, in quite a few cases, government borrowing from the banking system was excessive.[48] To achieve the social objectives of development, it will be necessary to reduce dependence on the banking system and to contain credit creation, in both the public and private sectors, within safe limits. This will necessitate a correspondingly greater effort to mobilize resources through non-inflationary means.

A good deal of investment in developing countries is self-financed. This is particularly true of the rural areas. Measures to encourage savings in such cases are synonymous with measures to stimulate investment. Redistribution of land ownership, reform of the land tenure systems and creation of conditions favourable to the spread of improved agricultural practices, which strengthen the incentive of the peasant to invest in land improvement, are also likely to encourage saving. Similarly, self-investment in the business and corporate sector can be promoted through appropriate government policy measures. Apart from self-investment, there are two fundamental ways of mobilizing resources — budgetary surpluses and the channelling of private savings to development-oriented financial institutions. Budgetary surpluses will have to play a much more important role in domestic resource mobilization in the developing ECAFE countries during the Second Development Decade on account of the clearly discernible rising trend in the ratio of public investment to total investment and GNP, and the expected rise in social sector expenditures. With rising *per capita* income, shrinkage of the subsistence sector and greater diversification of the economies in the ECAFE region, particular attention will also have to be given to the development of financial institutions to streamline and accelerate the process of resource mobilization.

The volume of government savings is determined by the trends in the current expenditure of the government and revenue receipts. Government revenues have recorded an appreciable rise both in absolute terms and in relation to GNP in a number of developing ECAFE countries in recent years, but current government expenditures have risen even faster, with the result that they have been unable to channel increasing resources to public investment.[49] While all possibilities of reducing unnecessary non-development expenditure should be explored, it is doubtful whether much increase in savings can accrue from this source. In fact, the rising trend in current government expenditures is likely to accentuate on account of the rising demand for public services and recurrent expenditure arising out of completed development projects. A major effort will therefore be needed to increase government revenues during the Second Development Decade. Taxation being the largest component of revenue receipts, a heavy onus for mobilizing resources rests on tax policies. The tax measures to increase government revenues will vary from country to country, but the general areas where action is needed are quite apparent. In most developing ECAFE countries, while revenues from indirect taxation have recorded a substantial rise, direct taxes have failed to show the same buoyancy. The reasons for the sluggish growth of revenue from direct taxes have been identified as "high exemption limits, the high degree of evasion in upper-income groups, a low rate-structure applicable to the middle-income ranges, revenue loss from tax incentives provided in preferred areas of activity, and the relative inefficiency in administration".[50] Removal of these deficiencies would serve the dual purpose of generating more resources for development and

[47] For a discussion of methods to determine the "safe" limits of deficit financing, see "Findings of the Seminar on Problems of Economic Development: Financing Public Sector Investment", *Economic Bulletin for Asia and the Far East*, September 1968, pp. 5-6.

[48] ECAFE, "Pattern of Financing Public Sector Investment in the ECAFE Region — A General Survey", *Economic Bulletin for Asia and the Far East*, September 1968.

[49] *Ibid.*, pp. 13-17.

[50] Cf., "Findings of the Seminar on Problems of Economic Development: Financing Public Sector Investment", *op. cit.*, p. 3.

promoting a more equitable pattern of income distribution.

Apart from improving the yield from the existing direct taxes, other possibilities of raising revenues should also be carefully explored. In developing countries, the proportion of total income generated in agriculture is relatively high. However, the contribution it makes to general revenues is very small. Farm incomes have risen considerably with the recent breakthrough in agriculture in several developing ECAFE countries, and an attempt should be made to mobilize a part of these incomes through suitable tax devices. Wealth, inheritance and gift taxes also need to be given more prominence in the tax systems of developing ECAFE countries. It is also necessary to improve the efficiency of public enterprises. In most countries, considerable sums of money have been invested in public enterprises but the return is very poor; in several cases they have not been able to meet even their operating expenses. Streamlining of public enterprises and improvement in their operational efficiency should help significantly in raising government revenue receipts.

Borrowing from the non-bank private sector is another method of resource mobilization which can be used for augmenting public sector resources for development. In almost all the developing ECAFE countries, the Governments provide a number of savings media for mobilizing private savings, but the share of gross domestic savings mobilized through these means is not yet appreciable. Organizational improvements in the administration of various savings schemes and extension in their coverage could be expected to increase resource availability from these sources. Another step worth considering is to link government borrowing with local development projects, particularly in rural areas, to increase the incentive of residents of particular areas and regions to subscribe to government loans.

The development of an appropriate set of financial institutions is also necessary for increased domestic resource mobilization. There has been impressive progress in a number of developing ECAFE countries in the setting up of commercial banks, insurance companies, investment corporations, co-operative financing institutions and stock exchanges. Financial intermediation by these institutions provides the vital market mechanism for the transference of resources from savers to investors. Continued attention should be given to the strengthening of these institutions in accordance with each country's social structure and level of development. The maintenance of an unduly low interest rates structure in the organized money market of several countries of the ECAFE region is usually a handicap in the way of additional resource mobilization, and consideration should be given to raising the yield on various types of financial assets.

Export expansion

The desired acceleration in the rate of economic growth in developing ECAFE countries will materialize only if there is adequate foreign exchange to carry through the planned development programmes. Apart from increased flow of foreign assistance, which is discussed later, increase in foreign exchange earnings is the only way in which the import requirements of development can be met. Merchandise exports account for about 80 per cent of total foreign exchange receipts of less developed countries. A number of studies point towards the close relationship between a country's export performance and its rate of growth.[51] The export performance of a country is governed by a number of factors on the demand and supply sides. The important factors on the demand side are the growth in the world economy in general, the income and price elasticities of demand for the various commodities exported by individual countries and the commercial policies followed by other countries. The difficulties in the way of export expansion of developing countries which arise from the predominance of agricultural products in their commodity structure were touched upon in an earlier section of this chapter, as were the obstacles arising from some of the commercial policies being pursued by developed countries. Other determinants of export performance lie within the control of the developing countries themselves. It is on these factors, which operate mainly on the supply side, that developing countries need to take appropriate policy action.

Promotion of exports requires measures on a broad front. In the first instance, it is necessary to increase the production of commodities whose export growth is handicapped by insufficient local production rather than world demand. Other measures which can help expand exports are (*a*) improvement in quality and reduction in the cost of production (*b*) development of new export markets and (*c*) a relative shift towards the production and export of those commodities for which the world demand is expected to grow at a faster pace in the future. Maintenance of a reasonable degree of monetary stability is also essential for the growth of exports because excessive internal demand tends to reduce exportable surplus and also affects the international competitiveness of exports by raising domestic costs and prices. It seems that these aspects have received insufficient attention and that export promotion has mainly relied on various measures of export subsidization. While export subsidization has a justifiable place in export promotion measures in less developed countries, it should not lead to the neglect of other basic factors

[51] See, for example, Emery, Robert F., "The Relation of Exports and Economic Growth", *Kyklos*, Vol. XX, 1967, pp. 470-486 and "Economic Growth, Trade and the Balance of Payments in the Developing Countries 1960-65" (IBRD, *Staff Paper*, 1968).

which crucially determine a country's export performance in the longer run.

The basic justification of export subsidization measures in developing countries lies in the need for diversifying their export trade and the inability of the current exchange rates to provide sufficient encouragement for the export of manufactured goods. Some countries have employed the system of direct subsidies to stimulate exports of selected industries. More common, however, are indirect methods of export subsidization, such as tax exemption of income earned from exports, concessional freight rates, and refund of import duty and sales tax etc. on raw materials used in the production of goods meant for export. A multiple exchange rate system is perhaps the easiest way of promoting exports, but it has to be operated with great care if the risk of misallocation of resources is to be avoided. The greatest need is to keep all the export subsidization measures under constant review and to ensure their mutual consistency as well as their consistency with the broader over-all objectives of economic policy.

Regional co-operation

Some of the problems with which developing ECAFE countries are faced could be alleviated, to a large extent, by greater regional and subregional co-operation. Measures of trade liberalization, commodity agreements and harmonization of development plans have the potentiality of appreciably aiding the development effort of individual countries by overcoming the problem of smallness of domestic markets, and increasing productive efficiency by permitting greater specialization and achievement of economies of scale. The need for greater economic co-operation is particularly acute among countries of a relatively smaller economic size. There is sufficient scope among the developing ECAFE countries for fruitful co-operation in many fields. The Third Ministerial Conference for Asian Economic Co-operation, held at Bangkok in December 1968, defined a strategy for integrated regional co-operation. Treating trade expansion as an end-product as well as an instrument of economic growth and social development, the strategy emphasized the importance of working out inter-dependent sectoral action programmes contributing directly to the over-all objectives of regional co-operation. Since then substantial progress has been made in evolving programmes for trade and monetary co-operation. The Fourth Meeting of the Council of Ministers for Asian Economic Co-operation, held at Kabul in December 1970, reviewed the progress and adopted the Kabul Declaration on Asian Economic Co-operation and Development. In regard to trade and monetary co-operation, the Kabul Declaration decided to establish a preparatory committee for examination and negotiation for an Asian clearing union, and intergovernmental committees for examination and further action in relation to the regional trade expansion programme and for the establishment of an Asian reserve bank.

It is encouraging that, although countries of the region as a whole have not yet entered into any comprehensive agreements for economic co-operation, concrete beginnings have been made in arrangements of different types. In September 1969, the six major coconut-producing countries of the region, namely Ceylon, India, Indonesia, Malaysia, the Philippines and Thailand, established an Asian Coconut Community for the purpose of promoting and co-ordinating all activities of the coconut industry in the region. A similar, though more limited agreement was arrived at between India and Ceylon in regard to tea and it has been decided in principle to set up an Indo-Ceylon Tea Consortium to collaborate in blending, packaging and selling tea in overseas markets, with a view to increasing the over-all exports of Indian and Ceylonese teas and ensuring a fair return to tea growers in both countries. The possibilities of concluding similar agreements in respect of other commodities, such as rice and rubber, are being studied. Another recent initiative of importance in this direction has been the decision of Indonesia, India and Malaysia to set up a Pepper Community. The subregional Association of South East Asian Nations (ASEAN) consisting of Malaysia, the Philippines, Thailand, Indonesia and Singapore, which was set up in 1967, is exploring possibilities of fruitful co-operation in various fields. The subregional grouping of Iran, Pakistan and Turkey, known as the Regional Co-operation for Development (RCD), which was formed in 1964, is reported to have made considerable headway in respect of working out the details of a number of joint industrial ventures approved for implementation on the basis of joint equity participation and production sharing. In the sphere of trade, an agreement on multilateral payments, involving credit limits of up to US$2 million, was signed in April 1967, and the question of removing or relaxing trade barriers is under study. Pakistan is also collaborating with Indonesia under an agreement known as Indonesia-Pakistan Economic and Cultural Co-operation (IPECC) which envisages the setting up of a number of joint ventures. A Trade Expansion and Economic Co-operation Agreement, concluded by India, the United Arab Republic and Yugoslavia in 1967, envisages special tariff concessions on goods specified in a "common list". Apart from trade, the Agreement also envisages co-operation in industrial and other projects.

It will be seen that a good beginning has been made in multinational co-operation in the economic sphere in the developing ECAFE region through such channels as agreed specialization and harmonization

of investment and production programmes, trade liberalization on a selective basis and payments arrangements. So far, the trend has been in favour of subregional groupings involving countries inside as well as outside the ECAFE region. Historical, cultural and political links have played a part in the evolution of subregional arrangements. The main reason for the slow progress in working out cooperative arrangements for the region as a whole lies in the unevenness of the countries in respect of their degree of development, and the related apprehension that schemes of regional cooperation might confer unequal benefits on some countries. However, with appropriate safeguards, regional cooperation arrangements can be worked out to the satisfaction of all concerned. In fact, after almost a decade of continuous discussions and exchange of opinions, a number of issues have been clarified and the stage has been set for active and fruitful economic cooperation among the countries of the ECAFE region in the Second Development Decade.

International trade policies

While discussing the "feasible" growth rates for different countries in the developing ECAFE region during the Second Development Decade, it was pointed out that most of them are faced with a dominant "trade gap" in the sense that even their domestic resource mobilization effort will fail and their development potential be frustrated unless adequate foreign exchange is available through exports or inflow of foreign assistance to enable them to import the needed investments goods which cannot be produced domestically. The measures that should be taken by developing ECAFE countries to expand their export earnings have already been discussed. However, their success in achieving a higher level of export earnings will also be largely conditioned by the commercial policies of the developed countries. While appraising the development experience of the First Development Decade, it was pointed out that a faster expansion in the export earnings of developing countries was impeded by various tariff and non-tariff restrictions on the imports from these countries in developed countries. Unless there is a significant change in the commercial policies of the developed countries, the developing countries will not be able to realise their full development potential, even in the Second Development Decade.

Increased access to the markets of developed countries is crucial for the export expansion of developing countries. There is need for the greatest possible lowering of barriers over the broadest possible front. Action in this respect should encompass both primary products and manufactured goods. This would enable developing countries to earn more foreign exchange from their traditional exports while the process of industrialization is under way, and also accelerate their industrialization by enlarging the markets for their industrial products in developed countries. As regards primary products, developed countries should undertake a gradual reduction of protection for the domestic producers of these products and their synthetic substitutes, and eliminate excessive consumption taxes on imported primary products. Where a primary commodity is also the raw material of a processing industry, and both the primary and processed forms are subject to tariff or non-tariff trade barriers, a reduction in trade barriers on the primary commodity should be accompanied by an appropriate reduction in the tariff or non-tariff barriers on the processed forms so as to prevent an increase in the effective rate of protection at the processing stages. As regards manufactures in general, the existing forms of special protection which discriminate against imports from developing countries should be eliminated. At present, a substantial proportion of manufactured exports from developing countries is subject to quota restrictions in developed countries. In addition, the existing tariff structures in developed countries discriminate against imports of manufactures and semi-manufactures from developing countries, as tariff levels are usually higher on labour-intensive manufactures in which developing countries have a comparative advantage. It is vital that these tariff and non-tariff barriers to the trade of the developing countries should be abolished as early as possible. To promote the exports of developing countries, the idea of generalized, non-reciprocal tariff preferences for manufactures from developing countries was unanimously endorsed by all parties at the second UNCTAD session in 1968. The UNCTAD Special Committee on Preferences has formulated a scheme of preferences, and, if, as is expected, it goes into effect at the beginning of the Second Development Decade, it will represent a real landmark in international co-operative endeavour.

The centrally-planned economies can also help a great deal in enlarging the export markets for developing countries. The trade between developing countries and centrally-planned economies has grown at a fast pace in recent years; during 1955-965, the rate of increase in exports from the developing countries to the centrally-planned economies was about three times as high as that of total developing country exports.[52] However, since the total volume of trade among them is still very small there is room for considerable expansion. At the second session of UNCTAD, centrally-planned economies agreed to take a number of measures to help expand the exports of developing countries; action along these lines should be continued. It is encouraging that, in the UNCTAD Special Committee on Preferences, socialist

[52] Cf., United Nations, *World Economic Survey, 1967*, Part I, pp. 125-126.

countries of Eastern Europe reaffirmed their support for the introduction of a general system of preferences applicable to imports from all developing countries.

The establishment of a general system of preferences in favour of exports by developing countries of manufactured and semi-manufactured products would help in achieving an international division of labour in harmony with the needs and interests of developing countries as a whole. There was a broad consensus at the second session of UNCTAD that the problem of restructuring the existing international division of labour was of fundamental importance.[53] This would need action whereby the more advanced countries would tend to concentrate their resources more on new products of a research-intensive or high-technology character, while the developing countries would be enabled to get an increasing share of the world market for those manufactures in the production of which they have an advantage. Some industrialized countries would no doubt face certain short-run problems of adjustment in this process, but, as a recent study by the International Labour Office observed on the basis of empirical research "such structural employment problems as may arise from increased import competition from developing countries seem far more manageable than the employment problems presented by rising labour productivity resulting from technological progress".[54] A similar view has been expressed in the Report of the Commission on International Development headed by Mr. Lester B. Pearson.[55] The economic progress of the developing countries will be considerably accelerated if a world-wide reallocation of productive capacity on this basis takes place.

Apart from improving market access to exports of developing countries and fostering a more rational international division of labour, concerted international action is also required to bring about greater stability in world market prices of primary commodities which are presently subject to considerable fluctuations from year to year. Efforts to achieve a degree of market stabilization by means of international commodity agreements have already borne fruit in the case of a few items, namely coffee, tin, wheat, sugar and olive oil. The possibility of concluding similar agreements in the case of other commodities should be actively explored. At the same time, an attempt should be made to improve the working of international commodity agreements in the light of the actual working of these agreements to date.[56] Buffer stock operations hold good promise for reducing short-term instability in the prices of certain primary products but have been rarely used so far, due primarily to lack of adequate financing arrangements. A report by the UNCTAD secretariat to the second session of the Conference specified a number of commodities, representing about one quarter of the commodity exports of developing countries (excluding petroleum and commodities covered by existing agreements) for which market stabilization by means of buffer stocks appeared to be both desirable and practicable.[57] The financial implications of buffer stock operations have been examined in a recent study on stabilization of prices of primary products jointly undertaken by the International Monetary Fund and the World Bank.[58] The Fund has expressed its willingness to provide temporary financial assistance to member countries which have a "balance of payments need" to facilitate their participation in international buffer stock schemes. The World Bank Group has also undertaken to extend loans and credits to member countries in "appropriate circumstances" to finance storage facilities for the holding of commodity stocks. The Fund and the Bank might have to play a much more active role in the financing of buffer stock operations if such schemes are to make any significant headway. In the meantime, the Compensatory Financing Scheme of the International Monetary Fund, which provides medium-term assistance to member countries to meet temporary balance-of-payments difficulties arising from undue fluctuations in export earnings, should be reviewed to see whether it can be further liberalized and made more helpful.[59] Action is also overdue on the IBRD staff report "Supplementary Financial Measures" (prepared in response to a recommendation of the first session of UNCTAD in 1964) which proposes organization of special financial facilities to save the development programmes of developing countries from disruption on account of unforeseen shortfalls in their export earnings.

The problems of the least developed of the developing countries and of those which are land locked deserve special attention. It has generally been agreed that, so far as is possible within the scheme of general preferences, special provisions should be made for the least developed developing

[53] United Nations, *Proceedings of the Unitel Nations Conference on Trade and Development*, Second Session, Volume I, Report and Annexes, 1968, p. 344.

[54] "Some Labour Implications of Increased Participation of Developing Countries in Trade in Manufactures and Semi-Manufactures" published in *Proceedings of United Nations Conference on Trade and Development*, Volume III, p. 155.

[55] *Op. cit.*, p. 91.

[56] For a critical evaluation of the post war experience in the working of international commodity agreements, see UNCTAD secretariat study "The Development of an International Commodity Policy" published in *Proceedings of the United Nations Conference on Trade and Development*, Second Session, *op. cit.*, Vol. II, pp. 13-24.

[57] *Ibid.*, pp. 25-32.

[58] *The Problem of Stabilization of Prices of Primary Products*, A Joint Staff Study, *op. cit.*, pp. 69-73.

[59] For a discussion on this subject see the UNCTAD secretariat's note "Progress Report on Compensatory Financing of Export Fluctuations", published in the *Proceedings of the United Nations Conference on Trade and Development*, Second Session, Vol. IV, pp. 220-223.

countries.[60] It has also generally been accepted that, in addition to preferences, the basic requirements of the least developed developing countries are the need for financial and technical assistance and the need to create regional markets to provide a more economic basis for domestic industry production; in this respect it is agreed that all possible assistance should be given to these countries.[61] The main problems of land locked countries relate to their transit trade, difficulties in bulk transactions, high transport costs and other invisible costs adversely affecting their competitive position. In the ECAFE region, the three land locked countries of Afghanistan, Laos and Nepal also happen to be among the least developed of the developing countries in the region. The Convention on Transit Trade of Land-locked States, adopted by the United Nations in 1965, established principles for reaching agreements between the land locked countries and the transit countries. Proper observance of these principles should go a long way in alleviating the problems of land locked countries and promoting their faster growth.

External assistance and capital flows

An increase in the net flow of external assistance to developing countries will be crucial for the achievement of the targets of the Second Development Decade. According to a number of studies, the attainment of the 6 per cent growth target in the 1970s will necessitate net resource transfers from developed to developing countries of an amount roughly equivalent to 1 per cent of the combined GNP of developed countries. According to provisional estimates, the actual net resource flows from the sixteen member countries of the OECD Development Assistance Committee amounted to only 0.72 per cent of their GNP in 1969.

The countries of the ECAFE region stand in special need of an early acceleration in the flow of foreign assistance. In the closing years of the First Development Decade, the balance-of-payments problems of food-deficit countries in the region were greatly relieved by the agricultural breakthrough. Some of the countries were also able to maintain the growth momentum by better utilization of industrial capacity which previously could not be fully used because of shortage of imported inputs, caused in turn by the need to give greater priority to food imports. These countries will need a greater flow of foreign assistance to improve their growth performance in the Second Development Decade. The need for foreign assistance will also be greater in those countries where the level of foreign military expenditures and procurements has begun to decline as a result of the United States policy of disengagement in southeast Asia. Moreover, Asia is both the largest and the poorest region in the world and a "big push" by way of external assistance is needed to bring about a perceptible improvement in living standards.

Apart from the quantum of foreign assistance, the quality of aid programmes should be progressively improved. The average terms on which official assistance has been made available in recent years have tended to harden, aggravating the balance-of-payments problems of developing countries. To increase the effectiveness of aid in promoting faster growth in developing countries during the Second Development Decade, it is not only necessary for gross transfers to be large enough to assure an adequate net inflow of new resources but also for the terms on which these resources are provided to be such that undue problems of debt management will not be incurred. The recommendations made by the OECD Development Advisory Committee in February 1969 in regard to the softening of the terms of foreign assistance provide a good guideline for the purpose.[62] Apart from increasing the "concessionary element" in foreign assistance, as recommended by DAC, there is need for progressive untying of foreign aid. Till such time as a country is unable to completely untie its aid, it would be helpful if repayments are also tied to specific exports from the borrowing country.

The foreign assistance channelled to developing countries through multilateral institutions should also be expanded to the maximum extent possible. In this connexion, forging of some kind of a link between the newly created Special Drawing Right in the International Monetary Fund and development assistance can be of significant help.[63] The role of the International Development Association, the subsidiary of the World Bank which lends funds at concessional terms, should be considerably expanded, and measures taken to assure a more regular flow of capital to it rather than continue with the present system of *ad hoc* replenishments of its resources. The World Bank is currently engaged in a dynamic programme of augmenting its lending operations, but the rise in its lending rates, occasioned by the rise in the interest rates in world capital markets from which it draws a good part of its funds, is proving onerous for the developing countries. In this connexion, the recommendation of the Pearson Commission that developed countries should commit the equivalent of one-half or more of the interest payments due to them on official

[60] See the UNCTAD secretariat report "The Question of the Granting and Extension of Preferences in Favour of Developing Countries" in the *Proceedings of the United Nations Conference on Trade and Development*, Second Session, p. 6.

[61] *Ibid.*

[62] "Supplement to the 1965 Recommendation on Financial Terms and Conditions Adopted by the DAC on 12 February 1969", *Development Assistance*, 1969 Review (OECD, 1969), pp. 267-270.

[63] For a powerful case in favour of such a link, see UNCTAD, *International Monetary Reform and Co-operation for Development: Report of the Expert Group on International Monetary Issues, 1969*. Such a link has also been favoured by the Pearson Committee; see pp. 225-226 of its *Report*.

bilateral loans from developing countries to subsidize the interest rates on some World Bank lending deserves earnest consideration.

The centrally-planned economies should also endeavour to expand the scale of their assistance to developing countries in the Second Development Decade. At present, the financial assistance of the countries of Eastern Europe to less developed countries amounts to about one tenth of 1 per cent of their GNP, and their aid is largely focused on a relatively small number of countries. The centrally-planned economies provide almost all their aid in the form of credits usable only in the donor country, but the redeeming feature is that they also allow repayments in the form of specific exports by the borrowing country. Obviously there is room for considerable expansion in resource flows from the centrally-planned economies to developing countries, and larger assistance by them can play a significant role in expanding the over-all availability of resources for development in the Second Development Decade.

Apart from official assistance, there is a need to stimulate the flow of private capital to developing countries. The net inflow of private capital to the developing ECAFE countries has been rather small so far. While the developing countries should take all steps consistent with the preservation of their legitimate national objectives to identify and remove disincentives to foreign private investment, developed countries should strengthen their investment incentive schemes, such as guarantees against commercial risks and special provisions for lower taxes on foreign investment income. A good part of private capital inflow in recent years has taken the form of suppliers' credits, but the terms on which these credits have been provided are extremely onerous and have aggravated the balance-of-payments problems of developing countries. The developing countries usually resort to this type of finance because of the insufficiency of external finance on better terms. Greater flow of foreign assistance through official channels and increased direct foreign private investment can help reduce dependence on suppliers' credit and minimize the pressure on the balance of payments of developing countries.

The acceleration in the flow of external resources to developing countries that is needed during the Second Development Decade will only materialize if there is a political will for it. It is unfortunate, as the Pearson Commission has pointed out, that international support for development seems to be flagging at a time when many of the developing countries have shown themselves capable of mounting a major development effort. The Secretary-General of the United Nations observed recently that "The truth is that now, for the first time, a number of less developed countries are able to change and grow at a rate faster than the advanced countries are prepared to support."[64] There are, no doubt, certain difficulties in the way of a substantial increase in aid levels by some major donor countries, but, given the will, ways can be found to overcome them and meet the challenge of the Second Development Decade. It was estimated by the Pearson Commission that meeting the 1 per cent target of foreign aid by 1975 would require no donor country to add to its then contribution more than 4 per cent of the expected annual increase in its gross national product. This is not an impossible target, and, given the necessary effort, should be realizable even before 1975.

Policy co-ordination and progress evaluation

For the success of the Second Development Decade, it is vital that there should be an effective machinery for policy co-ordination and periodic progress evaluation. As mentioned in chapter II above, the General Assembly resolution on the Second United Nations Development Decade emphasized the need for systematic scrutiny of the progress being made towards achieving the goals and objectives of the decade. The Second Development Decade should be a decade of implementation and vigorous, concerted policy action on the part of both the developed and developing countries. As the General Assembly resolution points out: "economic and social progress is the common and shared responsibility of the entire international community". To give concrete shape to this idea it is necessary to forge an effective international partnership whereby the efforts of both the developing and developed countries are united on a firm basis of definite commitment and implementation.

The first step in effective policy co-ordination consists of objective evaluation of the emerging trends. There are already a number of agencies which appraise progress in different fields on a more or less continuing basis. The Economic and Social Council, the regional economic commissions, other specialized and functional organizations of the United Nations, the World Bank, IMF, the Development Assistance Committee of OECD, the Consortia and Consultative groups all make periodic assessments of the progress and problems of developing countries. These reviews should be of great benefit in over-all appraisal of the progress being made in achieving the objectives and targets of the Second Development Decade. A sharper focus could perhaps be given to the review of current developments by devising and using certain standardized performance criteria; this would also facilitate greater co-ordination amongst various agencies.

[64] The "Keynote address" at the seminar on the Second Development Decade convened by the Institute on Man and Science, Rensselaerville, New York, May 1969.

Undoubtedly, the main task of appraising development will have to be pursued at the national level at which goals are determined, policies formulated and programmes executed. However, as the Executive Secretary of ECAFE stressed in his report to the Commission at its twenty-sixth session, the goals of economic development are intimately linked and often the programmes made to attain one or other of them have inevitable consequences on several other countries. The extent to which the countries in the region share the same problems emphasizes the great value of carrying out appraisals on a regional basis. By this means, detailed knowledge can be brought to bear upon critical problems and policies, and regional co-operation greatly strengthened. The international development strategy for the Second United Nations Development Decade, as adopted by the General Assembly, also calls for reviews and appraisals of the progress towards the goals and objectives of the decade at the regional level, and, for this, the regional commissions, in co-operation with the regional banks, have to assume the main responsibility. On 23 November 1970, the Second Committee adopted a resolution on the role of the regional commissions in the Second United Nations Development Decade. This resolution requests regional commissions to intensify their efforts in helping to promote trade expansion and economic co-operation on a regional, subregional and intraregional basis, and, in co-operation, where appropriate, with regional development banks and with assistance of other organizations of the United Nations, to make suitable arrangements for conducting regular appraisals and evaluations of progress in the implementation of the international development strategy for the Second Development Decade. It is also emphasized in the resolution that the regional commissions should be provided with adequate resources for fulfilling their role in the Second Development Decade.

At its twenty-sixth session, the Commission adopted resolution 106 (XXVI) which requested the Executive Secretary to take action for conducting regular appraisals and evaluation of progress during the Second Development Decade. As a result of this resolution, an International Expert Group on Criteria, Machinery and a Detailed Scheme for Periodic Performance Evaluation during the Second Development Decade was convened in Bangkok from 11 to 19 January 1971. Necessary action is being initiated in regard to performance evaluation in the light of the recommendation of this Expert Group.

To achieve co-ordination at the global level, it will be necessary to undertake a comprehensive exercise, at least biennially (as envisaged in the United Nations resolution on the Second Development Decade), to identify the bottlenecks, suggest remedial action and re-examine the international development strategy in the light of the actual situation. The appropriate forum for taking decisions on the policy issues which emerge from such appraisals will, of course, be the General Assembly of the United Nations, which, despite some current frustrations, is still the main hope of mankind for peace and prosperity throughout the world.

Chapter II

BROAD FEATURES OF DEVELOPMENT IN THE ECAFE REGION IN 1969/70 AND THEIR IMPLICATIONS FOR 1971

It is customary to preface the individual country studies of the *Survey* with a general description of economic developments and of emerging policy issues within the region. However, because a detailed account of policy issues arising from the First United Nations Development Decade appears elsewhere in this *Survey* in "Problems and prospects of the ECAFE region in the Second Development Decade", this section concentrates upon a description of recent economic developments and finally discusses only two or three policy issues which, although not peculiar to 1970 do emerge as important for 1971.

The international situation in 1969/70

Introduction

Before reviewing economic developments within the developing countries of the ECAFE region, something needs be said about developments in the world economy. Because of their greater economic weight, the policies and performances of the main industrial countries significantly influence the tempo of economic growth in other countries. During 1969 and early 1970, the world economy was characterized by strong inflationary pressures. The inflationary process developed because of intense demand pressures which caused a marked expension in the level of world output and trade. In 1968, excess demand conditions in the United States fed the inflation, and, in 1969, when the rate of expansion of United States output and imports was sharply reduced as a result of tighter domestic policies, excess demand conditions appeared in Europe and Japan.

The effect of this expansion in activity in the industrial countries, including the USSR, made for record rates of growth in the output and trade of primary producing countries in 1968, 1969 and early 1970, although the higher cost and reduced availability of international credit brought offsetting and adverse balance of payments effects.

Balance of payments and adjustment developments

While the inflationary pressures in the world economy continued to build up during 1969, towards the end of the year there was some improvement in the prospects for satisfactory balance of payments adjustment. The first three quarters of 1969 were marked by uncertainty and large speculative capital flows as the international money markets reacted to the strength of the Deutsch mark and to the relative weakness of some other currencies. In the last quarter of the year, however, the international financial situation changed for the better as individual countries adopted appropriate policies, and as a result of the establishment of the Special Drawing Rights (SDRs) and the proposed expansion of quotas within the International Monetary Fund. Actions taken by individual countries which significantly improved the situation were measures taken to improve aggregate demand in the United Kingdom, the devaluation of the French franc and the revaluation of the Deutsch mark. Furthermore, although the United States remained in deficit on current account, its tight monetary policy caused interest rates to rise and attracted large inflow of funds from the Eurodollar market which was sufficient to leave the United States' balance of payments situation in over-all surplus.

But early 1970, while it saw prices continue to rise at an even greater rate than in 1969, also witnessed a deceleration in the rate of growth of output in industrial countries which involved an absolute but small fall in output in the United States and a slow-down in the rate of expansion in output in other countries. These effects were attributable to tighter domestic monetary and fiscal policies. As a result, the balance of payments position of France and the United Kingdom continued to improve, although the United States over-all balance of payments position shifted noticeably into deficit as some easing of interest rates reduced the rate of inflow of capital. This last factor emphasizes the basic nature of the United States balance of payments problem which is that the usual current account surplus is not adequate to finance long-term capital outflow and government expenditures abroad.

Output trends

As Table II-2-1 indicates, output in the world economy in real terms increased by over 5.0 per cent between 1968 and 1969 and this despite a fall in the growth rate of the United States economy to below 3.0 per cent. In the USSR, preliminary estimates indicate a 7.6 per cent increase in real national income. Excluding the United States, the real rate of increase in GNP for developed and developing countries was approximately 7.0 per cent, and this was considerably in excess of the average

Table II-2-1. Growth of world trade and output, 1960-1969

(in percentages)

		Weight[a]	Trend	Change from preceding year		
			1960-1969[b]	1967	1968	1969
Exports						
World[c]	Value	100.0	8.5	5.0	12.0	14.5
	Volume		7.5	5.0	13.0	10.0
United States and Canada	Value	22.1	8.0	6.5	12.5	9.5
	Volume		6.5	3.5	10.0	5.0
Japan	Value	4.0	15.5	7.0	24.0	23.5
	Volume		16.0	3.5	24.0	18.0
EEC countries	Value	27.7	10.0	6.5	14.5	18.5
	Volume		9.5	7.0	16.0	13.5
EFTA countries[d]	Value	16.4	7.0	2.0	8.0	15.0
	Volume		6.0	2.0	12.5	11.5
Primary producing countries: more developed areas[e]	Value	6.6	8.5	7.5	4.5	15.5
	Volume		6.5	10.5	8.0	13.0
Primary producing countries: developing areas[e]	Value	23.2	6.0	2.5	9.5	11.5
	Volume		6.0	4.0	10.5	7.0
GNP in volume						
World[c]		100.0	5.0	4.0	5.5	5.5
Industrial and more developed primary producing countries		83.7	5.0	3.5	5.5	5.0
Excluding United States		41.0	5.5	4.5	6.5	7.0
Developing countries (including oil producers)		16.3	5.5	5.5	6.0	6.5

Sources: Trade data: United Nations, *Monthly Bulletin of Statistics*, and *International Financial Statistics*; GNP data: United States Agency for International Development, Office of Program and Policy Coordination, *Gross National Product*.

[a] Based on trade or gross national product in 1963.

[b] Annual rate of change, derived by fitting annual data to an exponential trend function.

[c] All countries except the CMEA countries, China (mainland), etc.

[d] Excluding Portugal.

[e] Figures for developing primary producing countries are partly estimated.

rate of growth of 5.5 per cent per annum attained individually by these two groups of countries over the course of the 1960s. Of special interest is the fact that in *per capita* terms in 1969 the rate of growth in real GNP of the developing nations was equal to that of the developed economies. This situation contrasts sharply with similar comparisons for other years of the 1960s.

Following a slow-down in 1967, world exports increased dramatically in 1968 and 1969, although the rate of increase in the volume of exports declined in the latter year for the world economy considered as a whole and for North America, Japan and Europe considered separately. In value terms, however, the rate of expansion in world exports accelerated in 1969. Only in the primary producing developed economies did the volume of exports expand. In developing economies, exports increased in value by 9.5 per cent and 11.5 per cent respectively in 1968 and 1969. There was a fall in the rate of increase in the volume of these exports to 7.5 per cent.

The inflationary process

The inflationary boom of 1969 and early 1970 had its origins in the slow-down of industrial activity in 1966-1967. In Europe, tight domestic monetary and fiscal policies eased the pressure on domestic resources, and, as a result, the expansion of economic activity which took place in 1968 merely used up excess capacity, and increases in prices and wages did not become clearly evident until 1969. In the United States, however, disinflationary policies adopted in 1966/67 caused only a temporary check to demand expansion, and, in 1968, further increases in demand generated strong inflationary pressures. Despite the adoption of firmer monetary policies in 1969 which terminated increases in real output by the end of the year, prices continued to rise. Similarly, the United Kingdom experienced rising prices, although the economy was operating at well below capacity output. Cost push factors which did not respond readily to adjustments in aggregate demand were responsible for the continued inflation

in the United Kingdom and the United States. These cost push factors were augmented in other industrial countries by burgeoning demand. As a result, industrial countries considered as a whole experienced inflation in excess of 5.0 per cent between 1968 and 1969, and this rate of inflation accelerated to approximately 6.0 per cent in the first half of 1970.

Consequences for developing economies

If the larger industrial countries are successful in checking the tendency for prices to rise rapidly, such success could cause a contraction in the rate of expansion of world output and trade. Already, in the first half of 1970, there was a modest decline in output in the United States and a marked reduction in the rate of growth of output in Germany. A slowing down of the rate of expansion of world trade (from the 14 per cent per annum registered between 1968 and 1969) is indicated by the import trends of the industrial countries in the first half of 1970.

Such a slow-down in the expansion rate of world trade would doubtless have an adverse effect on the exports of the developing countries and hence their growth performance. The stabilization measures in the developed countries need to take this into account and devise such measures as would have a minimum adverse impacts on the trade of the developing countries.

Economic developments in the ECAFE region, 1969/70

Gross national product

While there were exceptions, the developing economies of the region, when considered as a whole, recorded impressive increases in the level of real gross national products in 1969. From preliminary evidence available, it is obvious that these increases continued in 1970. Increases in gross national product were, in China (Taiwan) and the Republic of Korea especially, a result of the rapid expansion of demand in the developed industrial nations and in the remainder of the region, the result of the continued expansion of agricultural output.

Rates of growth in gross national product for a number of selected developing countries in the ECAFE region are given in Table II-2-2. Several points are worth noting. First, although some of the estimates for 1970 are not yet to hand, it is evident that, in 1969 and 1970, most countries in the region either attained or exceeded, in some cases considerably, the 5.0 per cent rate of growth in gross national product set for the First Development Decade. This strong performance in 1969 and 1970 probably means that, over the First Development Decade, the region considered as a whole will exceed the 5.0 per cent target. Secondly, there is encouraging evidence that in India and Indonesia the long-term rate of growth in real gross national product is rising and will continue to rise. Pakistan is maintaining its growth momentum. Because of the large size of these economies, this is of particular importance in assessing the prospects for the region in the ensuing development decade.

Thirdly, it should be noted that, in 1969, most of the countries achieved increases in real gross national product in excess of the targets laid down in their development plans (where these existed). In the Republic of Korea, in particular, the growth rate of 15.9 per cent considerably exceeded the plan target of 10 per cent.

The performance of some economies have not been included in Table II-2-1, either because data are not available for the 1960s as a whole or because more recent data are not yet to hand. In the 1960s, the Territory of Papua and New Guinea, which has not national income statistics, achieved an average real rate of growth of approximately 10 per cent in the monetary sector. When this is combined with the much lower real rate of growth of about 1.5 per cent in the subsistence sector, the economy as a whole can be seen to have grown in real terms at around 5 to 6 per cent. In Afghanistan, the recorded growth rate of 2.9 per cent in 1969/70 was higher than the 2.0 per cent growth rates of the recent past.

Table II-2-2. Selected developing countries of the ECAFE region: Growth rates of gross national products at constant prices

Country	Annual averages		Changes from the previous year		
	1960-1965	1965-1969	1968	1969	1970
Ceylon	3.9	6.1	8.3	5.7	5.5[a]
China (Taiwan)	10.1	9.9	10.1	8.7	n.a.
India[b]	3.3	4.4	9.7	2.2	5.5[a]
Indonesia	1.8	3.5	6.9	6.3[a]	n.a.
Iran[c]	6.6	9.3	11.8	10.2	11.4
Korea, Republic of	6.8	12.8	13.3	15.9	9.7[a]
Malaysia, West	5.9	6.9	5.8	9.0	n.a.
Pakistan[d]	5.5	6.0	7.8	5.0	5.8
Philippines[d]	5.6	6.3	6.2	6.5	5.0
Thailand	7.3	9.1	9.1	9.4	5.4[a]

Source: International Monetary Fund, *Annual Report, 1970*, p. 104; country reports included in this *Survey*; and various official publications.

[a] Estimate only.

[b] Year ending 31 March.

[c] Year ending 20 March.

[d] Year ending 30 June.

Agriculture

Total production in the agricultural sector of the ECAFE region was expected to increase in 1970. The relevant information for different types of product is given in Table II-2-3. On the basis of FAO index numbers, aggregate production in developing ECAFE countries increased by 3.3 per cent in 1970—a slower rate of growth than that attained in aggregate output in the preceding year. Of the countries in the region, the Republic of Korea achieved the highest rate of growth, with a 4.7 per cent increase in production.

The improvement in yields, upon which the "green revolution" has been based, continued for most of the relevant agricultural commodities in 1970. The yield from groundnuts increased substantially by 6.5 per cent. In 1969/70, the yields of wheat, maize and rice increased by 3.6, 2.8 and 2.2 per cent respectively and this compares favourably with long-term annual improvements in yield during the 1960s of 3.2, 1.5 and 1.4 per cent respectively. Not all yields increased. The yields of potatoes, sweet potatoes and cassava showed a decline per unit of land of 7.6, 3.4 and 2.4 per cent respectively.

Food production in developing ECAFE countries increased by 3.3 per cent during 1969/70. Ceylon achieved the best performance with a growth rate of 5.5 per cent per annum, followed by Burma and the Republic of Korea at slightly more than 4.0 per cent, India and Indonesia in the 3.0 per cent band, and the remaining countries from 3.0 to 1.9 per cent.

The record of individual developing economies is given in Table II-2-4. From it, a number of tentative conclusions can be made about developments in the agricultural sector in 1969/70.

First, it is obvious that the effect on production of new agricultural techniques, described as the "green revolution", is continuing throughout the area, except where unusually adverse climatic conditions have appeared. These new techniques which require an increased use of fertilizer and adequate watering or irrigation facilities, were mainly responsible for the continued expansion in agricultural activity in such countries as Pakistan and the Republic of Korea in 1969 and in the Philippines in 1970. At the same time, their very success poses new problems with regard to the prospects of traditionally food-exporting nations, such as Thailand, and with regard to income distribution problems in the agricultural sector.

It is the avowed intention of many countries in the region to achieve self-sufficiency in food production and the prospects for their success have been renewed as a result of the "green revolution". In 1969/70 the output of wheat, maize and rice increased by 6.1, 7.5 and 3.6 per cent respectively. Moreover, prospects for future improvements are excellent in that increased rice production can be attributed to better yields and yet only 7 per cent of the total rice area of the region in 1969/70 was planted with high-yielding varieties.

Much has already been written about the income distribution effects of the "green revolution". All economic growth, however, from whatever cause, requires change, and for some individuals the processes of change are never painless. The remedy, of course, is not to resist the processes of economic growth but to adopt appropriate policies to enable small farmers to share in the benefits of high-yielding varieties through substantial extension of bank credit and other assistance to them. Part of the answer may also require the development of techniques which are less capital-intensive and of seed types of wider geographic application.

The second major characteristic of the performance in agriculture of a number of countries in the ECAFE region in 1969 and 1970 is the continued dependence of agricultural output on climatic conditions. Whatever the benefits of the new techniques in agriculture, the beneficial effect can be arrested and temporarily reversed by typhoon, drought and flood. In 1969, for instance, agricultural output in China (Taiwan) declined by about 4.0 per cent following an 8.7 per cent increase in the preceding year, and this absolute reduction in output was the result of floods and typhoons in the latter part of the year. In a similar fashion, the growth rate in agriculture was retarded in the Republic of Korea in 1968, in the Philippines in 1968/69, and in Iran in 1969/70. Obviously, it is impossible to formulate policies which will deal with the vagaries of the climate, and, whatever the skills of the development planner, his projections will continue to suffer from such influences.

Manufacturing

Although estimates of industrial output for all ECAFE developing countries in 1969 and 1970 are not yet to hand, enough information is available to reach some tentative conclusions about activity in this sector in the last two years.

For the region as a whole, there has obviously been a continued expansion in the level of industrial output, but, whereas it appears that some countries sustained considerable increases in industrial activity for each of the three years 1968, 1969 and 1970, the performance of other countries was much less consistent. The Republic of Korea, China (Taiwan) and, although not included in Table II-2-4, Hong Kong and Singapore fall into the first group. The expansion of demand in the developed industrial

Table II-2-3. ECAFE countries: Agricultural production, 1968-1970 and its rate of growth, 1958-1960/1968-1970[a]

(in thousand tons)

Item	Production			Changes		Average production		Annual rate[b] of growth 1958-1960/ 1968-1970 (percentage)
	1968	1969	1970[a]	1968/69 (percentage)	1969/70 (percentage)	1958-1960	1968-1970	
All cereals	213,318	221,515	232,817	3.8	5.1	164,226	222,550	3.1
All pulses	13,569	12,236	13,742	—9.8	12.3	13,020	13,182	0.1
Tuber crops[c]	37,295	37,327	37,786	0.1	1.2	28,561	37,469	2.8
Jute and kenaf	2,027	3,007	3,030	48.3	0.7	2,223	2,688	1.9
Cotton (lint)	1,842	1,848	1,894	0.3	2.5	1,312	1,861	3.5
Oilseeds[d]	13,700	13,910	15,684	1.5	12.7	11,642	14,431	2.1
Sugar (cane and beet)[e]	7,005	8,739	10,218	24.7	16.9	6,396	8,654	3.1
Beef and veal	1,187	1,201	1,218	1.2	1.4	984	1,202	2.0
Mutton and lamb	839	836	840	—0.4	0.5	749	838	1.1
Pork	1,137	1,200	1,210	5.5	0.8	808	1,182	3.9
Total milk	37,987	38,577	39,136	1.5	1.4	33,838	38,567	1.3
Natural rubber	2,421	2,676	2,690	10.5	0.5	1,828	2,596	3.6
Copra	2,663	2,676	2,780	0.5	3.9	2,446	2,706	1.0

Source: FAO.

[a] Figures in 1970 are preliminary.

[b] Simple calculation between the two points is employed. Even if the Least Square Line or Method were fitted to these exponential trends the results are not likely to vary significantly.

[c] Potatoes, cassava, sweet potatoes and yams.

[d] Cotton seed, sesame seed, linseed, soybeans, castor beans, groundnut (in shell) and rape seeds.

[e] Split years. For instance, 1969 production = 1968/69, and 1970 production = 1969/70.

Table II-2-4. Selected developing countries in the ECAFE region: Annual growth rates in agriculture and manufacturing

(in percentages)

	Agriculture				Manufacturing[a]			
	1960-1968[b]	1968	1969	1970	1960-1968[b]	1968	1969	1970
Afghanistan	2.0	3.0	2.2	2.1	—	—	—	—
Ceylon	2.6	3.4	—	2.6	13.5	14.3	n.a.	n.a.
China (Taiwan)	5.8	2.3	—	2.3	13.8	23.6	18.3	n.a.
India	1.2	4.6	3.6	3.5	5.1	5.2	n.a.	n.a.
Indonesia	2.0	5.7	0.8	3.0	2.8	2.0	n.a.	n.a.
Iran[c]	4.7[d]	13.5	—5.1	1.2	11.3[e]	10.8	20.0	10.9[f]
Korea, Republic of	3.9	—0.6	13.8	4.7	15.9	34.8	21.8	18.5[f]
Malaysia, West	4.7	10.6	12.9	3.5	11.0[d]	n.a.	10.0	n.a.
Pakistan	3.7	6.2	3.9	2.5	8.3	7.1	10.8	n.a.
Philippines[g]	5.1	2.7	8.7	1.8	4.7	9.6	3.5	1.0[f]
Thailand	4.8	7.1	16.4	3.3	10.8	10.1	10.6	10.5

Sources: Various official publications; individual country reports included in this *Survey*; and FAO, *Record Sheets*, December 1970.

[a] From index numbers of industrial production, United Nations, *Monthly Bulletin of Statistics*.

[b] These estimates appear in Table II-1-4 of "Problems and prospects of the ECAFE region in the Second Development Decade" in this *Survey*.

[c] Year ending 20 March.

[d] 1960-1966.

[e] 1964-1968.

[f] Estimate only.

[g] Year ending 30 June.

economies in 1968, 1969 and early 1970 has been biased towards manufactured commodities and has benefited most the exports of these commodities. In turn, the increased flow of export receipts of these countries has been augmented by foreign direct investment in their now more profitable export sectors. Indeed, some of the above economies were responsible for the highest rates of increase of imports recorded internationally for 1968 and 1969.

In Pakistan, in 1969/70, there was a fall in the rate of growth of manufacturing activity which was in part the result of the decreased availability of imported raw materials brought about by reduced flows of foreign aid, by increasing debt service commitments and by a fall in export receipts. In Iran, a more rapid expansion of aggregate demand, including fixed-capital formation, than national output has been financed by short-term borrowing abroad. This has led to increased debt-servicing commitments and to a deteriorating balance of payments which will severely handicap an import-dependent industrial sector that has been primarily responsible for the impressive growth in manufacturing activity in recent years. As a consequence, no significant increase in the growth rate of manufacturing is anticipated in 1970/71. Ceylon and the Philippines provided further and even more dramatic examples where annual growth rates in industrial output, as high as 14.3 and 9.6 per cent in 1968, are expected to have declined sharply in 1970, as a result of balance of payments difficulties. There has been some slackening in the growth rates in Thailand also.

It should be emphasized, however, that, for a number of countries, the development of import-substituting industries (consumer, intermediate and capital goods) represents only one side of the industrial strategy. Since the traditional exports of Asian developing countries, consisting mainly of primary products, show, as in all other developing countries, a slow growth resulting from low income elasticity of demand and competition from synthetics, the developing countries of Asia will increasingly have to seek export trade in the manufacturing output during the next decade. Industrial development for exports is undoubtedly a far more formidable task than import-substitution. The trade policies of the developed countries vis-a-vis the developing countries, and the lack of financial resources in developing countries to provide seller's credit to purchasers, are major obstacles to the expansion of an export trade of manufactures and processed goods from the developing countries. At present, the manufactures and processed goods of the developing countries face formidable tariffs, quota restrictions and other barriers to trade from the developed countries. The proposals for the liberalization of trade policies by the developed countries towards the developing countries, along the lines suggested by UNCTAD at its second session held in New Delhi, if implemented, will help significantly to boost industrial development in the developing countries.

It is recognized that, until the intermediate and capital goods import-substitution industries begin operation, any large-scale industrial development programmes in a number of developing countries will require heavy imports of capital equipment and industrial raw materials. Therefore, the liberalization of trade policies by the developed countries for the imports of traditional primary products and potential new export commodities from the ECAFE developing countries, together with increased inflow of foreign aid, will play an important role in promoting industrial development in the developing countries of the ECAFE region during the next decade.

It should be recognized, however, that, in small developing countries of the region, the development of key industries, such as petro-chemicals (including fertilizers), basic materials (iron and steel, aluminium, etc.) ship-building, and machinery and equipment, based on a single country's market, will face severe difficulties and will lead to uneconomical use of scarce resources. Intraregional complementary specialization in domestic manufactures of particular kinds of basic industrial materials and types of industrial equipment would offer enormous gains to the developing countries of the region. The mutual exchange of such products under a preferential duty system or any other appropriate regional co-operation scheme, including joint ventures, would widen the narrow national markets and enable the developing countries to produce a wide range of industrial products economically.

The balance of payments

Tables II-2-5 to II-2-10 summarize international trade and balance of payments developments within the ECAFE region.

Tables II-2-5 and II-2-6 compare recent export performances with those of earlier years. Generally speaking, the record is a mixed one. On the one hand, estimates for 1968, 1969 and 1970 indicate that the Republic of Korea, China (Taiwan), Iran, Malaysia, India and Indonesia have improved considerably upon their performances in the earlier years of the decade. Indeed, with the exception of India, the exports of all these countries are currently growing at a rate in excess of 10 per cent per annum. As indicated in Table II-2-6, eight out of the twelve developing countries considered recorded their highest-ever level of export receipts either in 1969 or 1970. On the other hand, countries such as Thailand, the Philippines, Pakistan and Ceylon have encountered

difficulties in sustaining the rate of expansion of their exports.

Export growth rates for the different economies reflect the influence of several factors. Countries in which export development has been particularly strong, such as the Republic of Korea, China (Taiwan), Singapore and Hong Kong, have been influenced by the excess demand conditions in the developed industrial nations and by the bias of the import demand of these countries in favour of manufactured goods. Iran and Malaysia have benefited from buoyant demand conditions for their traditional exports, and Indonesia is reaping the benefits of policies, such as exchange rate alterations, which sought to improve the efficiency of their export sectors. In the case of India, the rationalization of the export promotion schemes after devaluation, and the industrial recession, accounted for a substantial increase in non-traditional exports.

Adverse balance of payments influences have also been operative. Rice exports from Thailand have fallen as a result of external demand factors. The failure of Ceylon and Pakistan to sustain export growth may be partly due to supply factors. At the same time, the reduced flow of foreign aid to Pakistan has curtailed the flow of imported inputs to the manufacturing sector and reduced the export of manufactured goods. Finally, climatic conditions, such as those prevailing in the Philippines in 1968, have interrupted the growth of exports.

The rate of growth of imports in Table II-2-5 reflects several basic influence. First, in the case of the Republic of Korea, China (Taiwan), and Malaysia, there is evidence of a strong export-led development of the domestic economy which has given rise to a rapid expansion of import demand. In the Republic of Korea and China (Taiwan), this development has been augmented by foreign investment flow and has resulted in the highest rates of import demand recorded internationally since 1968. Secondly, import demand has been affected by the availability of foreign aid. Both the reduction in import demand in Pakistan and the rapid increase in demand in Indonesia in 1970 are examples of this. Finally, import demand has been strongly influenced by a tendency for certain economies, such as the Philippines and Iran, to expand aggregate demand beyond the availability of domestically produced goods and services and to finance this excess of expenditure over income by large short-term borrowing from abroad. In each of these cases, the subsequent short-term debt-servicing problem has required the adoption of unpalatable monetary, fiscal and external policies to bring the balance of payments to order.

Table II-2-5. Selected less-developed countries of the ECAFE region: Growth of exports and imports of goods and services[a]

(in average annual percentage increases)

	Exports				*Imports*				*Coefficient of foreign trade dependency*[c]
	1960-1969	*1968*	*1969*	*1970*	*1960-1969*	*1968*	*1969*	*1970*	
Countries with the highest rates of growth of exports, 1960-1969									
Korea, Republic of	29.1	42.0	36.7	36.0	23.1	47.0	24.7	11.0	30
China (Taiwan)	24.0	25.0	32.0	34.3[b]	17.8	21.0	17.0	27.3	42
Iran[d]	11.7	20.0	12.0	n.a.	12.0	20.0	2.0	n.a.	40
Thailand	10.0	0.9	2.8	1.3	11.9	10.8	5.9	3.6	38
Countries with intermediate rates of growth of exports, 1960-1969									
Philippines[e]	6.3	5.0	0.1	17.6[b]	7.9	10.0	—2.0	—5.4	37
Pakistan[e]	6.3	12.0	9.4	—2.5[b]	7.8	—9.5	1.2	—2.0	16
Malaysia	5.0	10.0	23.0	12.1[b]	3.7	6.7	1.4	25.6	83
Countries with lowest rates of growth of exports, 1960-1969									
India[f]	3.8	9.0	9.0	3.0	2.5	—10.6	—15.0	10.0	10
Indonesia	1.1	5.0	12.0	15.0	4.4	9.7	—2.1	36.8	22
Ceylon	—1.4	—1.7	—5.8	0.8[b]	0.8	1.4	17.0	6.3	53
Burma	—5.6	—9.8	13.5	n.a.	—3.5	n.a.	n.a.	n.a.	32

Source International Monetary Fund, *Annual Report, 1970, and International Financial Statistics, August, 1970*, and various official publications.

[a] Data for 1960-1969 averages include unrequired transfers. Import calculations for individual years refer to c.i.f. value of imports only.

[b] Estimate based on comparison of performance in first and/or second quarters of 1969 and 1970.

[c] The sum of imports and exports of goods and services as a percentage of gross domestic product. Data refer to 1965. Figures taken from IMF, *Annual Report, 1970*.

[d] Year ending 20 March.

[e] Year ending 30 June.

[f] 1960-1968 and year ending 31 March.

Table II-2-6. Developing ECAFE countries export performance

(in million United States dollars)

Country	Highest export value recorded from 1960 to 1970	1968	1969	1970
Burma . . .	271 (1963)	111	126	132[a]
Ceylon . . .	409 (1965)	342	322	339[b]
China (Taiwan)	1,050 (1969)	802	1,050	1,026[a]
India . . .	1,885 (1970)[c]	1,753	1,833	1,885[c]
Indonesia . .	839 (1970)[b]	751	831	839[b]
Iran	2,506 (1970)[b]	1,879	2,099	2,506[b]
Korea, Republic of	746 (1970)[b]	455	622	746[b]
Laos . . .	6 (1968)	6	4	3[b]
Malaysia . .	1,702 (1970)[b]	1,343	1,651	1,702[b]
Pakistan . .	720 (1968)	720	676	677[c]
Philippines . .	1,016 (1970)[b]	848	855	1,016[b]
Thailand . .	751 (1970)[a]	660	711	751[a]

Source: International Monetary Fund, *International Financial Statistics*, March 1971.

[a] 3 months at annual rate.
[b] 6 months at annual rate.
[c] 9 months at annual rate.

Table II-2-7 summarizes recent developments in the balance of payments of a number of ECAFE countries. Since 1968, there have been several important changes. The over-all balance of payments situation in China (Taiwan) and Malaysia remains sound, but, in the Republic of Korea, there are recent developments which suggest that balance of payments considerations could arrest the spectacular economic growth of that country. First, there is the failure to arrest inflationary development which must affect the competitive position of the Republic's exports when inflation does not proceed as rapidly in the economies of trade rivals, such as China (Taiwan) and Singapore. In 1970, inflation was running at an annual rate of approximately 15 per cent. Secondly, the process of United States withdrawal from Viet-Nam is already affecting demand for exports and invisible earnings. Thirdly, the export target of US$1,300 million for 1971 requires a 30 per cent increase in exports (assuming that the 1970 target is attained) and prospects for export expansion in the United States market are not attractive at the present time. Fourthly, there is evidence that the net foreign capital inflow, which has financed more than half recent gross capital formation in the Republic of Korea, could decline. From 1968 to 1969, foreign grants fell from US$121 million to US$104 million. While foreign loans more than matched this decline in official donations, such loans must be serviced. Moreover, an increasing proportion of these loans are made for short terms and at high rates of interest. Such loans accounted for more than 70 per cent of foreign capital inflow other than donations in 1968 and 1969. Finally, there is evidence that foreign direct investment is declining. For instance, foreign capital contracted for in the first five months of 1970 was US$173 million, compared with US$903 million and US$577 million for similar time periods in 1969 and 1968 respectively.[1] For all these reasons, debt-servicing commitments are rising, and, according to unofficial estimates, they will absorb approximately one-third of the export target of US$1,000 million set for 1970. Given current trends, this debt service ratio can be expected to increase in the next few years.

There are two countries where the balance of payments situation has improved dramatically, but where long-term considerations give cause for some concern. As the table indicates, India's balance of payments was improved by the 1967 devaluation. It also improved because imports fell to their lowest level since 1961/62. The decline in imports was due to reduced dependency on foodgrains and to the development of import-competing industries. In the industrial sector, this last fact was responsible for the decline in capital equipment imports by US$70 million in 1969/70. Long-term considerations which give cause for concern are the decline in the rate of increase in export receipts to 3 per cent as a result of difficulties facing traditional exports, the likely increase in import demand when the economy moves to achieve its targeted rate of growth of GNP of 6 per cent, and the continued tendency for net capital inflow to decline absolutely as a consequence of debt-servicing commitments and reduced flows of foreign assistance. This trend on capital account was partially obscured this year by the allocation of Special Drawing Rights and by the changes in rupee liabilities to the United States Government arising out of PL480 Title 1 transactions.

Although data were not available for inclusion in Table II-2-7, the Indonesian economy has also achieved a remarkable improvement in its balance of payments situation. This has been brought about by a skilful use of multiple exchange rates, which culminated in the adoption of a unified exchange rate system in April 1970, and by the exercise of a remarkable degree of restraint in using monetary and fiscal policies. As Table II-2-5 shows, exports grew at 9 per cent per annum in 1968 and 1969, and recent data suggest that a rate of expansion as high as 15 per cent will be secured for 1970, despite the fall in rubber prices. Although the Government has been successful in stabilizing the Indonesian economy, import demand is certain to increase as development processes get under way. Moreover, not only is the economy still heavily dependent upon foreign capital inflow but the debt-servicing burden is a formidable one. Finally, the recent five-year plan projects a balance of payments deficit of US$910 million for

[1] See country chapter.

Table II-2-7. Balance of payments summaries for selected developing countries of the ECAFE region: 1960-1969[a]

(in million United States dollars)

		Current balance[b]	*Long-term capital and aid*	*Short-term capital and net errors and omissions*	*Over-all balance*[c]
China (Taiwan) . .	Average 1960–1966	—60	78	13	31
	1967	—45	116	8	79
	1968	—119	116	—33	—36
	1969	—49	136	9	96
India	Average 1960–1966	—962	939	—38	—61
	1967	—1,165	1,256	—122	—31
	1968	—680	926	—145	101
	1969	—250	. . .	. . .	377
Korea, Republic of . .	Average 1960–1966	—220	233	—	13
	1967	—326	384	53	111
	1968	—561	548	65	52
	1969	—654	699	96	141
Malaysia	Average 1961–1966	45	111	—136	20
	1967	—17	33	25	41
	1968	53	72	—66	59
	1969	—224	102	—160	166
Philippines	Average 1960–1966	48	47	—81	14
	1967	97	34	—145	—14
	1968	—304	184	47	—73
	1969	—285	148	96	—41
Iran	Average 1962–1966	—13	77	—51	13
	1967	—134	176	8	50
	1968	—366	418	—65	—13
	1969	—252	460	—188	20
Pakistan	Average 1963–1966	—480	484	—26	—22
	1967	—671	613	26	—32
	1968	—433	499	—18	47
	1969	—410	464	—18	35
Thailand	Average 1963–1966	—54	108	45	99
	1967	—99	152	43	96
	1968	—205	184	34	13
	1969	—238	166	36	—36

Source: International Monetary Fund, *Annual Report, 1970*, p. 105.

[a] For certain countries, data are not available for the early years of the 1960s.

[b] Balance on goods, services and private transfers; unrequired government transfers are included in long-term capital and aid.

[c] Over-all balance is the balance financed by changes in official gold and foreign exchange assets and in the net Fund position.

1973/74 and assumes that this will be met by capital inflow. Bearing in mind that the aid commitments of the IGGI Consortium for 1970/71 were US$571 million, and that commitments are lagging well behind disbursements, this estimate of aid flows in 1973/74 seems to be on the high side. Yet, if the IGGI countries do not meet this projected foreign exchange gap, and if exports do not expand at an even greater rate, the quite modest goals set out in the five-year plan will be seriously jeopardized.

Iran is an economy whose over-all balance of payments position appears to be satisfactory, but which, on close inspection, reveals certain problems. The problem arises because aggregate demand is running at high level in relation to available resources. The situation has been aggravated because current account deficits have been financed increasingly by short-term borrowing at high interest rates. As a result, debt-servicing commitments as a proportion of export income are now rising much more rapidly than is the gross inflow of foreign capital. Between 1960 and 1970, debt servicing absorbed 18 per cent of export earnings and this proportion is certain to increase in 1970/71. The recent increase in posted prices for oil exports will, however, ease the debt-servicing and balance of payments problem and permit the fine recent record of economic growth to continue.

In the last two years, Thailand also has been troubled by balance of payments difficulties that are of a long-term nature and likely to reduce the rate of economic development in 1971. These difficulties arise because of the declining value of rice exports, reduced United States expenditure in Thailand, the recent increased development of industries dependent

upon imports and an absolute decline in the level of foreign direct investment. While the present situation is not very serious, some further re-structuring of the economy, and particularly of the export sector, is obviously required. In the short run, something needs be done to curb import demand.

Finally, we come to these economies which are presently facing balance of payments difficulties. Pakistan has problems with debt-servicing commitments which, in reducing the availability of inputs for manufacturing, have checked the commendable rate of growth achieved in manufactured exports. Remedial measures adopted include alterations in the multiple exchange rate system which amount to a devaluation of the basic export rate of exchange and to some changes on the import side which more accurately reflect the real scarcity value of foreign exchange. In the short run, the devastating floods and cyclones which struck East Pakistan will further aggravate the situation. In the long run, if the net capital inflow does not increase, either exports or domestic saving as a proportion of GNP must rise. It is for this purpose that the recent policy changes were introduced, but the task will not be easy.

In the Philippines, balance of payments difficulties occurred in 1967 and 1968 as a result of excess demand pressures within the economy and the stagnation of exports, and the situation was exacerbated in 1969 by the failure of exports to expand as usual because of a fall in the international price of coconut and adverse weather conditions, and because of increased debt-servicing commitments resulting from the short-term financing of the current account deficit. As a result, imports were drastically curtailed, and the import-dependent manufacturing sector experienced an abrupt decline in its rate of growth of output. The recovery of production in general, and of output in the manufacturing sector in particular, depend upon recent monetary, fiscal and exchange rate reforms made to improve the balance of payments situation. At the moment, the rate of growth in industrial output has fallen from 9.3 per cent in 1968 to 3.5 per cent in 1969 and is likely to have fallen below 1.0 per cent in 1970. Balance of payments prospects, however, are improving. In the first two quarters of 1970, exports showed an annual rate of increase of about 17.0 per cent, while imports were running at an annual rate 4 or 5 per cent below that of 1969. While unofficial speculative capital outflow continues, the over-all reserve position has improved.

Finally, Ceylon has experienced a long period of balance of payments difficulties which have been aggravated recently. Essentially, the balance of payments position has been imposed exogenously as a result of the declining prices of traditional exports, including, in particular, tea. The situation has not been improved by the use of large amounts of Central Bank credit to finance government expenditure and by the problems in controlling inflation which was running at around 7 per cent in 1970. The basic problem is not merely an excess of national expenditure over income but the need for structural reform of the economy, including export diversification. The outright devaluation of 1967 and the introduction of a multiple exchange rate system in 1968 have been noteworthy moves. In many ways, the latter provides a useful control device because it is relatively simple to administer and because it enables the Government to pursue certain objectives, such as a desired distribution of income.

International liquidity

Table II-2-8 shows changes in the over-all international liquidity position of developing ECAFE countries, and Tables II-2-9 and II-2-10 describe the impact of the Special Drawing Rights (SDRs) scheme on the members of the region. Changes in the over-all balance of payments position given by comparing 1969 with 1970 figures overstate the improvement or the extent of deterioration in the balance of payments position of the countries listed because they include the addition of SDRs to official reserves.

Table II-2-9 gives the allocation of SDRs to members of the ECAFE region and Table II-2-10 indicates to what extent SDRs were used in the first few months of the scheme's existence. Total world allocation of SDRs amounted to the equivalent of US$3,414 million.[2] Of this amount, the ECAFE region was given US$530.88 million or approximately 16.0 per cent, and, of this amount, developing ECAFE countries secured about 56 per cent.

The ECAFE countries making use of and acquiring SDRs from January until June 1970 are listed in Tables II-2-9 and II-2-10. SDRs have been used to finance transactions between participants and transactions between them and the International Monetary Fund. Between January and June, 1970, for the world as a whole, 46 participants used a total of 549 million SDRs. Of this total, 165.7 million were used by members of the ECAFE region (all of them developing countries) and that amount constituted 55 per cent of the allocation of ECAFE developing members. From these figures, it is obvious that extensive use has been made of this new facility by the developing members of the ECAFE group.

Further increases in international liquidity should come from the proposed increase in quotas which await the consent of members. If all members do consent, the resources of the Fund will increase by about one third.

[2] The unit value of SDRs is equivalent to 0.888671 grammes of fine gold. This is equal to one United States dollar of the weight and fineness in effect on 1 July 1944.

Table II-2-8. Developing ECAFE countries: International liquidity[a]

(in million United States dollars)

Country	1965	1966	1967	1968	1969	1969 (Sept.)	1970 (Sept.)
Burma	177 (37.3)	184 (60.6)	155 (65.0)	152 (70.6)	129 (...)	138 (92.0)	94 (...)
Ceylon	73 (12.2)	43 (5.2)	55 (7.9)	51 (7.3)	40 (4.9)	39 (4.0)	41 (5.5)
China (Taiwan)	300 (28.1)	337 (28.2)	416 (26.8)	381 (21.9)	443 (19.0)	432 (21.2)	575 (28.3)
India	599 (10.6)	608 (11.2)	662 (12.3)	682 (14.1)	926 (23.6)	890 (20.7)	1,081 (26.0)
Korea, Republic of	146 (16.4)	245 (17.8)	356 (18.6)	391 (13.8)	553 (15.8)	532 (13.2)	618 (17.4)
Malaysia	470 (22.3)	494 (23.3)	457 (21.9)	516 (23.1)	683 (30.1)	690 (29.5)	725 (28.9)
Pakistan	220 (11.0)	198 (11.6)	157 (7.6)	239 (13.2)	323 (16.8)	320 (16.5)	231 (13.4)
Philippines	193 (11.2)	194 (10.5)	180 (8.0)	161 (6.5)	121 (5.0)	129 (4.9)	199 (8.3)
Thailand	739 (52.2)	924 (54.3)	1,009 (49.5)	1,021 (44.6)	985 (41.4)	999 (40.6)	943 (38.7)

Source: IMF, *International Financial Statistics.*

[a] Figures in parentheses refer to volume of international liquidity in terms of weeks of current imports.

Table II-2-9. Allocations of Special Drawing Rights (SDRs) received by ECAFE participants in the International Monetary Fund, 1 January 1970

Country	SDR (thousands)
Developing ECAFE member countries	
Afghanistan	4,872
Burma	8,064
Ceylon	13,104
India	126,000
Indonesia	34,776
Iran	21,000
Khmer Republic	3,192
Korea, Republic of	8,400
Laos	1,680
Malaysia	21,000
Pakistan	31,584
Philippines	18,480
Viet-Nam, Republic of	6,552
	298,704
Developed ECAFE member countries	
Australia	84,000
Japan	121,800
New Zealand	26,376
	232,176
Total	530,880

Source: International Monetary Fund, *Annual Report, 1970*, p. 30.

Table II-2-10. Acquisition and usage of Special Drawing Rights in ECAFE region, 1 January—30 June 1970

(in thousand of SDRs)

	Transactions between participants		Operations between participants and the finance account	
	Acquired	Used	Repurchases	Charges
Developing countries				
Afghanistan	—	1,500	—	—
Burma	—	7,951	—	103
Ceylon	—	6,000	7,000	23
India	—	—	35,000	12,592
Indonesia	—	31,000	3,157	476
Iran	—	20,000	—	—
Khmer Republic	—	1,596	—	—
Korea, Republic of	2,000	—	—	50
Laos	—	1,176	—	—
Malaysia, West	2,300	—	—	—
Pakistan	—	—	19,400	178
Philippines	—	18,480	—	—
Total	4,300	87,703	64,557	13,422
Developed countries				
Australia	4,000	—	—	—
Japan	18,676	—	—	—
Total	22,676	—	—	—
Grand total	26,976	87,703	64,557	13,422

Source: International Monetary Fund, *Annual Report, 1970*, p. 32.

Money supply and prices

Tight monetary policies have been in evidence where the country concerned is incurring balance of payments difficulties. Examples of such countries, which appear in Table II-2-11, are Ceylon, Iran, Thailand and the Republic of Viet-Nam. In these countries, the rate of expansion of the money supply in 1969, and especially 1970, fell below the annual compound rate of growth of the 1960s.

Table II-2-11. Developing ECAFE countries: Change in money supply

(in percentages)

Country	Annual compound rate of growth 1960-1968	1968	1969	1970	Central Bank rate[a]
Afghanistan	9.8[b]	7.3	18.2	12.1[c]	...
Ceylon	5.2[b]	5.9	—1.5	9.7[d]	6.5
China (Taiwan)	16.6[b]	12.6	16.2	19.3	13.3
India	7.9[b]	5.6	12.0	13.3[e]	5.0
Indonesia	162.5	121.3	50.8	32.1[d]	...
Iran	9.8[f]	14.4	1.9	7.6[g]	8.0
Korea, Rep. of	24.0[h]	25.9	42.1	44.1[d]	22.0
Malaysia	4.4[f]	11.4	13.3	7.5[d]	...
Pakistan	8.2[f]	7.8	14.8	11.9[i]	5.0
Philippines	8.5[b]	3.5	23.6	18.2[j]	10.0
Thailand	8.8[h]	8.6	2.9	3.8[j]	5.0
Viet-Nam, Rep. of	25.0[b]	48.5	13.3	12.4[d]	...

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

[a] As of 12 August.
[b] 1960-1968.
[c] Year ending December 21.
[d] Year ending September 30.
[e] Year ending last Friday in September.
[f] 1961-1968.
[g] Year ending September 20.
[h] 1963-1968.
[i] Year ending last Friday in December.
[j] Year ending June 30.

In Pakistan, there has been a faster than usual expansion of the money supply, despite balance of payments difficulties, in response to increased demand from the private sector. Extra credit is required to finance increases in working capital following wage increases and the increase in business activity that has followed the 1968/69 recession. In the Philippines, the rise in the money supply was caused mainly by deficit financing, some 97 per cent of credit expansion being directed to the public sector. At the same time, however, the balance of payments continued to improve, and, as business activity increases, more credit is being used by the private sector.

In Malaysia and China (Taiwan), there has been some easing of monetary policy in response to demands from the private sector. Recent developments in the latter country demonstrated how sudden increases in exports and rapid development of the industrial sector can be achieved without upsetting domestic economic stability. A judicious use of fiscal and monetary policy has prevented marked increases in prices, despite growth rates of output in excess of 10 per cent per annum. Other policies, such as measures to improve the mobility and quality of the labour force, were also used to eliminate supply bottlenecks.

The Republic of Korea is currently expanding credit at approximately twice the rate of the previous year in response to the demands of a rapidly growing economy. The high nominal rates of interest (Central Bank rate is 22.0 per cent) are no deterrent because, with inflation proceeding at around 15.0 per cent per annum, the real rates of interest are low by international standards.[3] In November 1969, the monetary authorities adopted a financial programme that was to limit the rise in domestic credit, tighten the reserve requirements of the commercial banks, and more carefully screen approvals of foreign cash loans. Steps were also taken to reduce the extension by the Central Bank of preferential credit treatment to the agricultural export sectors.

While a variety of local factors has affected prices, there is no doubt that conditions of excess demand and inflation in the developed industrial nations have been transmitted through the international economic system to some developing countries of the ECAFE area. Table II-2-12 sets out information concerning recent price changes in a group of developing countries. With the obvious exception of Indonesia, the only countries which have held rising prices to rates experienced in the earlier years of the 1960s are Malaysia, Singapore and Thailand. In all other cases, rising prices in 1969 or 1970 have been proceeding at rates which are in some cases considerably in excess of those experienced in earlier years in the decade. The situation gives cause for concern, because, apart from its likely effects on the balance of payments, rising prices through their effects on income distribution and resource allocation can be a particularly heavy burden for developing economies, especially where the rate of development is low.

[3] The same comment can be made of market rates of interest in India, Pakistan and Ceylon. In all these countries, if account is taken of inflation, the real rate of interest is too low to act adequately as a credit-rationing device.

Table II-2-12. Developing ECAFE countries: Percentage rates of change in consumer and wholesale price indices[a]

Country	Annual compound rate of growth[b] 1960-1968	1967	1968	1969	1970[c]
Ceylon	2.1	2.2	5.9	**7.3**	7.0
China (Taiwan)	3.0 (2.2)	3.3 (3.0)	7.9 (2.0)	5.0(—0.3)	4.9 (3.4)[d]
Hong Kong	—	5.7	2.7	3.5	5.4
India[b]	7.2 (6.9)	13.9 (15.9)	2.6(—1.3)	... (2.0)	... (1.0)
Indonesia	185.7	169.5	125.3	6.1	2.1
Iran	1.6 (1.1)	1.6 (0)	0.6 (0.9)	3.1 (1.7)	3.1 (3.4)
Khmer Republic	—	—0.6	6.0	6.3	1.4
Korea, Republic of[e]	13.7 (13.5)	11.0 (6.8)	11.1 (7.6)	12.4 (7.0)	15.3 (7.7)
Laos	—	7.9	5.1	3.1	—
Malaysia, West	1.0	4.0	—	—1.0	1.2
Pakistan[f]	3.3 (3.3)	10.5 (14.2)	0 (—4.0)	3.2 (5.8)	4.4 (1.8)[d]
Philippines[g]	4.9 (4.7)	6.9 (4.5)	0.6 (2.6)	3.2 (0.7)	3.7 (10.9)
Singapore	—	2.9	0.9	—0.3	0.4
Thailand[h]	2.2 (2.5)	3.7	1.8	2.1	2.1
Viet-Nam, Republic of	—	43.8 (33.1)	26.9 (8.8)	22.0 (19.5)	31.9 (28.1)

Source: (1) United Nations, *Statistical Yearbook for Asia and the Far East, 1969.*
(2) United Nations, *Bulletin of Statistics*, December 1970.

Note: Data prior to 1969 are derived to be consistent with Table II-1-14.

[a] Rates of change in wholesale prices are the figures which appear in brackets.
[b] Base year 1960 = 100.
[c] Year ending 30 June.
[d] Year ending 30 September.
[e] Base year 1965 = 100.
[f] Consumer price index for industrial workers only.
[g] Base year 1961 = 100.
[h] Estimate for Bangkok only.

1971: Prospects and policy issues

The international situation

At the 1970 calendar year closed it seemed evident that, while the rate of increase in output in industrial developed economies will fall as anti-inflationary policies become more effective, it will remain satisfactory. Recent OECD estimates[4] suggest that, for OECD countries as a whole, real output growth in 1971 will be slightly less than the 5.0 per cent growth rate achieved in 1969 but considerably more than the less impressive 1.75 and 3.75 per cent rates of increase in output anticipated in the first and second halves respectively of 1970. In the USSR, real national income in 1971 is expected to increase by 6.1 per cent, compared with the estimated increase of 7.6 per cent in 1970.

Output in the United States is expected to revive from its almost stagnant position. So far, the United States has been perplexed by the persistent and rapid rise in prices, despite a level of unemployment approaching 6 per cent, and by the continuation of its balance of payments problems.

In Japan, steady growth was recorded in 1969/70 and, despite some expected tightening of monetary policy, prospects for 1970/71 seem to be reasonably good. The Japan Economic Research Centre predicts that the real rate of growth in 1970/71 will be 11.4 per cent and that exports and imports are both likely to exceed US$20 billion; even if there is some slowing down, it may not be of a serious nature. The anticipated surplus in the over-all balance of payments position is expected to be about US$1 billion.

There is evidence, however, that less conventional policies will be used to control inflation at the same time as moves are made to re-expand the United States economy and reduce unemployment. Already the stock market has recovered from its long decline which reached its nadir in May 1970. Interest rates are moving down from their historical peak. The United States Government recently cut the maximum rate on mortgages issued by the Federal Housing Administration, some major banks have reduced the rate on their consumer loans and a public utility bond was sold at the lowest rate for eighteen months. Furthermore, the President of the United States has made it clear that he now conceives the government role as being an expansionary one in the United States economy. The chairman of the Federal Reserve

[4] See OECD, *Economic Outlook*, July 1970.

has also indicated that "the independent Federal Reserve System will provide fully for the increasing monetary needs of the economy".[5]

The projected increase in real output in the United States is expected to be matched by a small decline in the rate of expansion in other OECD countries as these countries adopt policies to deal with present excess demand conditions. Expansion in Japan, however, is expected to continue.

As a result of diminishing excess demand pressures, the rate of inflation in the OECD countries can be expected to decline from an annual rate of approximately 6.0 per cent in 1970 to slightly below 4.0 per cent by mid-1971. As a consequence, the rate of growth in OECD exports to the rest of the world can also be expected to decline because of the combined result of a much slower rise in prices and a fairly steady volume of exports.

Some easing of excess demand conditions and the continuing effects of the 1969 exchange rate alterations should combine to produce a better balance of payments situation within the OECD area. Forecasts to date suggest that, by mid-1971, the United States will be running a small but insufficient current account surplus and that Japan will be even more solidly in a surplus balance of payments position. Contrary to earlier expectations, there may be a slight tendency for interest rates to ease in 1971 in sympathy with movements in interest rates in the United States. But this could depend on the strength of capital outflows from the United States to countries adopting tighter monetary policies.

Impact on the ECAFE developing countries

The impact of the international situation is likely to be adverse on the balance of payments and hence on the growth prospects of the developing countries for several reasons. First, as was pointed out in the previous section, the rate of growth in output of the industrial countries can be expected to decline in 1971. For the last three years, the surge of activity in the industrial countries which followed the 1966/67 economic slow-down has been one of the major factors influencing the growth in exports in ECAFE developing economies, and a slower rate of expansion of activity in these economies will tend to reduce the rate of growth of such exports. While all countries in the region would be involved, countries such as the Republic of Korea, China (Taiwan), Hong Kong and Singapore would be the most affected.

Secondly, while the more pessimistic fears about a revival of protectionist philosophy in the United States are unlikely to materialize fully, there is no doubt that, at a time of excessive unemployment and of balance of payments difficulties, the arguments of protection groups are influential. Legislation before the United States Senate will probably be considered in 1971. For the most part, it is the very success which many developing nations have had in competing in the markets of the industrial developed countries that has prompted the unfortunate adoption of protectionist policies. It is satisfying to note, however, that, in the recently held meetings of the UNCTAD Committee on Preferences, the developed countries indicated their willingness to take measures by 1971 to accord non-discriminatory and non-reciprocal preferences to the developing countries. The developing economies should also seek every opportunity in international forums to press the case for no further increase in such barriers to trade in their export products. Indeed, their success in expanding exports will depend as much on these measures as on their efforts to gear their production and marketing to these opportunities.

Thirdly, the relatively favourable external conditions that have confronted ECAFE developing countries recently, and the increase in their international reserves resulting from the introduction of SDRs, has tended to obscure two disquieting developments. On the one hand, the absolute value of capital flows of a genuine concessionary nature has been declining as Table II-2-13 indicates. The decline is much more noticeable if real and not current values are used. On the other hand, while the flow of long- and short-term capital of a non-concessionary nature has tended to offset this decline in foreign assistance, the changed composition of the over-all capital flow to harder commercial terms, and the increased share of short-term capital in the over-all total, have increased the debt-servicing commitments of the developing economies. Unfortunately, up-to-date information for ECAFE developing countries is not yet to hand, but the total flow of financial resources from the countries belonging to the Development Assistance Committee (DAC) of the OECD to the developing countries (including those of southern Europe) is provisionally estimated at slightly over US$13 billion in 1969. This is approximately the same as the figure for 1968. However, the share of official aid and capital in this total financial flow has declined from two-thirds in 1964 to less than one-half in 1969.

A number of instances have been cited already, as in the case of Ceylon, Iran or Pakistan, where debt-servicing commitments and relatively declining aid flows have given rise to severe balance of payments problems.

[5] *New York Times Weekly Review*, 2 December 1970, p. 1.

Table II-2-13. Developing ECAFE countries: Total net official flows, 1965-1968

(in million United States dollars)

Country	*1965*	*1966*	*1967*	*1968*	*Official average aid (1966-1968) as percentage of imports of goods and services (1967)*
Afghanistan	53.9	51.2	39.7	27.9	71.6
Ceylon	15.7	31.5	46.2	44.6	11.3
China (Taiwan)	67.5	60.8	85.6	65.7	8.0
India	1,286.7	1,225.8	1,354.3	993.1	43.8
Indonesia	42.9	81.5	248.5	291.0	25.5
Korea, Republic of	220.4	209.2	261.5	287.2	23.7
Laos	68.2	68.5	73.6	60.5	217.8
Malaysia	34.4	47.2	39.9	59.8	4.0
Pakistan	523.2	411.6	535.2	491.7	35.9
Philippines	109.0	67.6	113.7	104.5	7.1
Thailand	46.8	53.6	60.9	70.3	5.8
Viet-Nam, Republic of	315.7	508.7	448.4	445.1	54.3
Unspecified	22.1	24.6	20.1	27.2	
	2,859.3	2,903.9	3,414.3	3,043.6	
Over-all total	6,646.9	6,861.4	7,267.1	7,080.4	
Official flows to Asia as percentage of total	43.0	42.3	47.0	43.0	
Official flows to India as percentage of flows to Asia	63.3	56.4	55.0	48.8	

Source: OECD.

Fourthly, there are the effects of the United States disengagement in Viet-Nam to be considered. While the effects of this withdrawal will not be sudden, they are likely to prove adverse to the balance of payments prospects of a number of countries in the region. To some extent, these effects will be offset by greater expenditure upon reconstruction, but already significant balance of payments effects have been experienced by the Republic of Korea and Thailand, without any offsetting increase in development expenditure.

Because of the new agricultural strategy and buoyant demand conditions in the developed countries, the favourable trend in agricultural and industrial output and in exports that started in 1967 was sustained in 1970 in a large number of the ECAFE developing countries, though the rates of increase were reduced in a few cases. In some countries, however, the investment situation has continued to stagnate for a variety of reasons, the more significant being the decline in external assistance and rising debt-service obligations.

The most disturbing feature of the current scene is that this stagnation in investment is likely to continue in 1971, and possibly in 1972, because of likely developments in the world economy. As mentioned above, the slowing down in economic activity in the developed countries as a group is likely to have an adverse effect on the exports of the developing countries. Further, because of rising debt-service obligations and the virtual stagnation in the level of external assistance, the net transfer of resources from the developed countries is likely to decline in absolute terms.

Growth rates of industrial output may fall in a number of countries because of the decline in demand by the developed countries and the consequent reduction in the capacity of the developing countries to import essential raw materials, spare parts, etc.

The impact of these factors on investment activity is likely to be serious because it will affect not merely the capacity utilization rates of the production capacities already built up but will also impair the growth potential of the developing countries in the Second Development Decade. Indeed, there is a serious possibility that the growth targets of the decade may not be realized, unless the international community plan their efforts in a concerted manner.

On the one hand, therefore, it is important that the stabilization policies in the developed countries should be devised so as not to affect adversely on

the prospects of the developing countries. Indeed, the developed countries and the international agencies need to increase the flow of external assistance and to put into action the proposals for trade preferences which, in many instances, have already been accepted in principle.

On the other hand, ECAFE developing countries should hasten to reach agreement about proposals for regional co-operation that are currently under discussion. Any delay in these steps towards greater regional co-operation will adversely affect growth possibilities in the Second Development Decade. Regardless of the actions of the developed countries, the developing countries cannot afford to lose time in assisting themselves.

It is obvious that the developing countries need to increase the rate of saving in relation to GNP in order to offset the possible decline in *net* external assistance. Indeed, apart from the external assistance factor, increased savings will be required if the growth objectives of the Second Development Decade are to be attained. Monetary and fiscal policies need to be directed towards this objective in a much more concerted and effective manner than has been the case so far. Policy instruments need to be devised to create surpluses in the agricultural sector and to channel these surpluses towards essential investment projects. The structure of financial institutions, and the structure of interest rates need to be effectively used in a well-co-ordinated manner for the purposes of raising the saving rate and for the efficient and rational allocation of investment funds.

In some cases, it is likely that attempts to increase the domestic saving rate may be frustrated if adequate external assistance is not available to meet the possible trade gap. For this reason, countries should explore the possibility of financing investment projects in certain fields with a low import content; these fields would largely be related to agriculture and the use of local materials and skills. Further, policy instruments should be devised with a view to economizing on the use of imports and reducing the import content of over-all investment and consumption; these instruments involve trade and exchange rate policies as well as monetary, fiscal and investment policies.

Finally, it is essential that recent progress in agricultural activity should be maintained. Vigorous efforts need to be made to promote cash crops, rice and other foodgrains, and to increase output of dairy farms, poultry farms, horticulture and fisheries. In order that research results may reach the farmers, agricultural extension activity must be adequately strengthened. Further, in such areas as the supply of exports, marketing, credit facilities, storage and irrigation and water management, machinery needs be devised for co-ordinated action. Reduction in income inequalities in the agricultural sector should be realized by positive measures to improve the condition of small farmers and dry farming areas, and by effective land reforms and rural works programmes.

The over-all performance during the Second Development Decade will determine whether there will be a sustained improvement in the living conditions in the developing countries in an international climate of peace and stability. The challenge has to be met not only by the developing countries but also, to a greater extent than previously, by the developed countries.

Chapter III

CURRENT ECONOMIC DEVELOPMENTS AND POLICIES IN THE COUNTRIES OF THE ECAFE REGION

Afghanistan

Introduction

On the eve of the fourth year of its third five-year plan (1967/68-1971/72) Afghanistan's economy rose from its low level of growth of the past three years. With excess capacity built up in its infrastructure during the second plan, it is now devoting more resources to commodity production, but such a shift is inevitably slow. In the agricultural sector, the strategy of supplying improved varieties of seeds, subsidizing the sale of fertilizers, and supplying water through minor irrigation works has begun to yield results. However, in the industrial sector, the increase in production actually achieved would have been greater if excess capacity had been more fully utilized.

Exports regained their past momentum. However, imports have also risen and external aid has declined, with consequent pressure on the balance of payments. To induce more exports, the gap has been narrowed between the free market exchange rate and the official exchange rate at which export proceeds have to be surrendered in the case of some of the country's major exports. Apart from this, the gap has been widening, so that greater support for the official rate has been required at the expense of convertible foreign exchange.

External aid to finance development expenditure has been decreasing more than was envisaged in the third plan, but the repayment burden on the external development loans received in the past has been growing. The budgetary surplus intended for development expenditure has not materialized at the rate anticipated in the plan owing to lack of legislative approval of proposed direct taxes on land. In fact, the budget for 1970/71 had still to be approved, even though the financial year started on 21 March. Resort to deficit financing has resulted in monetary expansion, but its potentially inflationary effect on the cost of living has so far been cushioned by increased agricultural output and the drawing down of foreign exchange reserves.

In Afghanistan, public investment has been the engine for economic growth, though steps are being taken to enhance the role of private investment. To achieve the targets of the third plan in the coming two years, without resort to inflationary deficit financing and the consequent pressure on the balance of payments, it will be necessary to mobilize more domestic resources to finance public development expenditure. With the larger part of income coming from land, more resources from land taxation will be necessary.

Rate of growth

The rate of economic growth of Afghanistan, which had averaged about 2 per cent in the recent past, increased to 2.9 per cent in 1969/70. Increases in output over that of 1968/69 were 3 per cent in grains, about 10 per cent in cash crops, about 2 per cent in fruits and vegetables, 29 per cent in gas and minerals, 15 per cent in manufacturing and 5 per cent in handicrafts.

Afghanistan's population in 1969 was 16.6 million, and, according to official estimates, it is growing at a rate of 2.5 per cent a year. Family planning has received low priority.

Development strategy

The Government's current development efforts are aimed at achieving the targets of its third five-year plan (1967/68-1971/72), as substantially modified in 1968.

The revised third plan provided for a further shift in the sectoral distribution of investment towards increasing agricultural and industrial production, with greater reliance on private investment, and for a reduction in the levels of investment in irrigation, power generation, and social services. However, this shift from infrastructural projects to commodity-producing sectors has been difficult to achieve. The existence of excess capacity in infrastructural facilities is recognized, but complementarity among large-scale projects has precluded a rapid shift. For example, a thermal power plant is required to take advantage of natural gas production and further construction of highways must take place to complete the network. In the revision of the third plan, the general objectives remained unchanged, but the size of the plan was reduced.

Development outlay

Public sector outlay

Public sector development outlay is budgeted at Af5,962 million for 1970/71, an increase of 53 per cent actual development expenditure in 1969/70. To

finance this accelerated expenditure, the Government has proposed an increase in the current budgetary surplus from the actual Af116 million in 1969/70 to Af862 million in 1969/70 and it anticipates an increase in external aid from Af2,467 million to Af4,200 million. Borrowing from the central bank, on the other hand, is to decrease from the previous year's level of Af1,317 million to Af900 million in 1970/71. Parliament has not yet approved tax proposals contained in the budget and budgetary operations are presumably being carried on monthly, on the basis of the previous budget.

External aid as a proportion of development expenditure declined from 84 per cent in 1966/67 to 63 per cent in 1969/70. The decline in the major component of external aid, i.e., project loans and grants, may be attributed to the decreasing number of large-scale projects, particularly infrastructural. The decline in commodity aid is related to improved agricultural performance. For example, the important item in commodity assistance is wheat, but, as a result of better harvests, not all of the imported wheat has been sold.

Budgeted surpluses on current account have been steadily declining as a percentage of development expenditures (from 16 to 3 per cent between 1966/67 and 1969/70). However, in 1970/71, 14 per cent of development spending is budgeted to come from this source. Expenditures on debt service and subsidies (particularly exchange subsidies) have shown a continuing upward trend, and, in the last three years, an accelerating trend. The other main components of ordinary expenditure, such as defence and administration, have maintained their share in the total, with the exception of expenditure on education.

Among the main sources of revenue, proceeds from the sale of natural gas have been growing fastest, rising from about 2 per cent of current revenue in 1967/68 to slightly more than 10 per cent in 1969/70. Another dynamic source of revenue has been profits from government monopoly operations. Revenues from import duties and export taxes account for nearly 30 per cent of the total and are likely to increase with the upward trend in commercial imports. More than three-fifths of the current surplus budgeted for 1970/71 is to come from increases in direct taxes which at present account for 9 per cent of total revenues. The scope for raising direct taxes is limited, however. In the industrial sector, exemptions are provided to stimulate expansion, and agriculture, the primary source of income, is exempt from the general income tax. A land tax, graduated according to different categories of land has been proposed, but has met with legislative opposition.

Private sector

The recent shift to directly productive sectors like agriculture, industry, and mining has enlarged the role of private investment in the country's "mixed and guided economy", and the Foreign and Domestic Private Investment Law of 1969 provides various financial incentives for foreign and domestic private investment in specified areas. The response appears to be encouraging. Legislation for setting up an Industrial Development Bank, to extend short- and long-term credit and provide managerial and technical assistance, was submitted to Parliament in 1967 but has not yet been enacted. The Agricultural Development Bank, whose function is to extend short- and long-term credit to farmers, has been reorganized and provided both with additional capital from domestic and external sources and with additional experienced personnel.

Production trends

Agriculture

Agriculture is the mainstay of the economy accounting for a little more than half of the gross domestic product, and, in 1969/70 there was a general upward shift from the low level of agricultural production of the past few years. In line with the recent shift in emphasis from infrastructural to directly productive activity, the Government has increased its efforts to augment agricultural production. It is putting greater emphasis on the construction of minor irrigation works, it is promoting the use of new and improved varieties of seeds, it has increased the supply of subsidized imported fertilizers, it provides price incentives for producers of cash crops, and it attempts to provide both short- and long-term agricultural credit.

The major development efforts in the agricultural sector have been directed towards irrigation. Thus, in the last three years, approximately one-half to three-fifths of the total agricultural and irrigational budget was earmarked for irrigation and land development, and, during the second plan period, the irrigation and land development budget was more than 80 per cent of the agriculture and irrigation budget. Of the arable land of 14 million ha, only 5.34 million is under cultivation, with 3.41 million ha dependent on irrigation from rivers and the rest on less reliable sources. There has been a shift away from large-scale irrigation projects to minor ones which have a shorter gestation period and are more easily maintained. In 1969/70, for example, the Government concluded an agreement with the Asian Development Bank for the extension of loans for four minor irrigation projects, to be financed after feasibility studies by the Bank, and it also expects International Bank for Reconstruction and Develop-

ment (IBRD) loans which will be channelled through the Agricultural Development Bank.

The output of wheat, the country's main staple cereal, is estimated to have increased by 9 per cent to 2.45 million tons in 1969/70, as a result of the expanded progress of the high-yield wheat programme. During 1969/70, the use of improved varieties rose threefold from the 1966/67 level to 19,000 tons, and the subsidized sale of imported fertilizers was expected to have increased from 16,000 tons in 1968 to about 33,000 tons in 1969. The irrigated area, planted with improved wheat varieties and properly fertilized, increased from one per cent of the total in 1966/67 to 4 per cent in 1968/69 and to about 8 per cent in 1969/70. With continued momentum, the wheat programme will enable the country to achieve its goal of self-sufficiency in wheat by the end of the third five-year plan, whereas between 1964/65 and 1969/70 an average of about 100,000 tons of wheat was imported annually. While technical aspects of the programme, such as the choice of fertilizers to be applied to Afghan soil, have been successfully studied, formidable problems remain with respect to (*a*) the distribution of improved varieties of seeds and proper fertilizers and (*b*) the provision of adequate supplies of water.

The output of cotton, the country's most important cash crop, had been continuously declining, but is estimated to have increased by about 15 per cent to 85,000 tons in 1969/70. This upward trend is believed to have continued in 1970/71, through the adoption of improved farming techniques and the provision of price incentives. Under a package programme, which included the use of improved seeds and both French-designed and locally-produced small-scale multipurpose implements, improved cultivation practices were adopted and the output per acre was nearly trebled. Fertilizers and seeds were supplied on credit to the cotton-growers by the ginning factories. Price incentives, which were generally effective in increasing the area under cash crops, were provided by the Government which depreciated the exchange rate on exports, raised the government-controlled ex-farm price by about 40 per cent, and granted a subsidy designed to divert exports to hard currency areas. However, the subsidy for exports to hard currency areas did not prove effective because prices in barter countries were too high. At the same time, the wheat-cotton price ratio moved in favour of cotton, though this is not expected to have an adverse effect on the production of wheat. Wheat and cotton do compete for land, but the belief is that, as cotton is grown on a very small part of the irrigated areas, wheat production will not suffer in the short run, while, in the long run, any increase in the acreage under cotton will be compensated for by increased productivity on the land remaining under wheat.

The new highway system has played an important role in the increased production, consumption, and export of fruits, production of which has risen from 826,000 tons in 1967/68 to 834,000 tons in 1968/69 and 850,000 tons in 1969/70. Another factor has been an eightfold increase in the development budget for plant protection over a period of thirteen years. With respect to grapes, a wide variety of which are cultivated in Afghanistan, the rise in production was mainly due to increased application of fertilizers and use of sprays by farmers acting on their own initiative.

Sugarbeet is cultivated in northern Afghanistan, mainly in the Baghan and Kataghan areas. Baghan also boasts the only sugar factory in the country. Although this factory has a production capacity of 10,000 tons, production in recent years has been only 7,000-8,000 tons, probably owing to managerial difficulties. In any event, the factory has not been able to satisfy local demand as sugar continues to be imported at a rate of 45,000 tons annually.

Oilseeds are another crop with a great potential for domestic production. With the growing internal demand for vegetable oils at present met by increasing imports, and with bright export prospects, oilseeds have a promising future for growth. In 1969/70, about 70 tons of sunflower seed were imported and planted and the results were promising enough for the pilot trials to be continued.

Livestock

Livestock products, such as karakul, wool, hides and skins, account for more than one-fourth of the total value of Afghanistan's exports. In the recent past, there has been increased awareness of the importance of livestock and of the complicated nature of the problems involved in its development. The number of karakul sheep has been estimated in recent years at 15 million, other sheep at about 6 million and goats at 3.2 million, and, despite measures taken to increase their population, the number has remained almost unchanged. The main reasons are the denuding of pastures from overgrazing, pests and diseases, and lack of shelter and shortage of food during the severe winters. In 1969 IBRD sent a livestock project identification and preparation mission and it is hoped that the Bank will provide a loan to carry out some livestock projects.

Manufacturing and mining

In 1969/70, there was a modest reversal of the downward trend of industrial production, though, in most cases, it has yet to reach the 1966/67 level. Industries which recorded increases in production in 1969/70 compared with the previous year were: ginned cotton (13,900-27,000 tons); sugar (5,300-7,600 tons); shoes (123,000-161,000 pairs); cement

(90,000-103,000 tons); and cotton textiles (48.7 to 49.2 million m). Only in the case of sugar, however, did the increase bring production to the level achieved in 1966/67.

Approximately 10 per cent of gross domestic product is accounted for by industry where the share of large-scale production is one-fifth of the total, most of the manufacturing being carried on in small-scale establishments. Factory production, except of cement, consists largely of consumer goods. There are modest-sized metal and repair industries, and a medium-sized fertilizer plant is being constructed. Carpet making is the major handicraft in the country.

Excess capacity prevails in such important industries as textiles and sugar, pointing to the possibilities of import substitution. For example, in the cotton textile industry (the most important manufacturing industry in the country), capacity is far from being fully utilized. In 1969/70, the three private mills with capacity of more than 90 million m produced only 49.2 million. Despite this situation, additions to installed capacity in the textile industry are being made with the construction of a mill at Bagrami which will have an installed capacity of 12 million m and another in Mazar-e-Sharif with 12 million m capacity; both mills are owned by the State. A large number of private rayon-textile projects have been approved, with a total installed capacity of 80 million m, and an estimated sales potential of US$27 million, compared with the present US$7 million imports of fabrics other than cotton.

In 1966/67, natural gas pipelines in the northern region of the country leading to the USSR were completed and gas has started flowing to the USSR in increasing volume, from 500 million m^3 in 1967/68 to 2,600 million m^3 in 1969/70. To take further advantage of gas reserves, a chemical fertilizer plant with a capacity of 105,000 tons of ammonia nitrate is under construction, to be completed by 1971. In addition to meeting domestic demand, the plant is expected to provide a sizable surplus for export.

The iron ore reserves at Hajigak, with a high purity of 60 per cent iron content, are estimated at more than 2,000 million tons. They have remained unexploited since their discovery in 1960 owing to lack of sufficient domestic demand and to transport problems. However, the Government of Pakistan has recently shown an active interest in using the Afghan ore in its steel projects.

Production of power in 1969/70 was 324 million kWh, but a large portion of the installed power capacity of 217,000 kW is not being fully utilized, mostly because of the inadequate distribution network. On the basis of the gas discovered in the northern part of the country, a thermal power station with an installed capacity of 36,000 kW is under construction and will be completed by the end of 1971. Power produced by this station will be utilized by the fertilizer plant mentioned above and will help in the industrial development of the region.

Transport and communications

Priority in Afghanistan's first and second five-year plans was given to the development of transport with more than 40 per cent of the Government's development budget devoted to this important sector of the economy. In the first three years of the third five-year plan, on the other hand, expenditure on transport was about 16 per cent of the total development budget.

Of the 6,500 km of useable roads in the country, some 4,000 km are all-weather roads, including 2,598 km of concrete and asphalted highways. Designs and surveys have been completed for linking the principal regions and cities by means of a ring road, and the circle will be completed with the improvement of the present unpaved road from Shiberghan to Herat (508 km). Surfaced roads have been built leading to the frontiers of Iran, Pakistan and the USSR, and, despite the present shift away from infrastructure projects, there are still some important highways to be built to facilitate the movement of goods from some agricultural, livestock, and industrial centres of the country to the main markets, both within the country and abroad. Hence, the construction of the Pul-e-Khumri Shiberghan Highway which was started in 1963/64 was continued in the third five-year plan, and, by the end of 1969/70, 220 km out of the total length of 361 km had been completed. Also included in the third plan is a project for improvement and asphalting of the Khabul-Khoat highway (248 km). In addition, emphasis has been given to the construction of a number of bridges and secondary roads, important in linking the rural areas with the main highways.

The traffic density on existing roads is low, the busiest roads carrying only 6,000 vehicles a month, which is roughly the capacity for a 24-h day. The current average growth of the volume of traffic is 10.6 per cent per year, and the road network will have a considerable reserve capacity for years to come. While excess transport capacity built in anticipation of economic growth will itself generate such growth, feeder roads will still be required to a greater degree for fuller utilization of the transport system.

Money supply and prices

The money supply, defined as currency in circulation and demand deposits, is estimated to have increased by 18 per cent in 1969/70, compared with an average annual increase of 2 per cent in the two

years preceding 1968/69 and an expansion of 7 per cent in 1968/69. The large-scale monetary expansion in 1969/70 can be attributed mostly to the expansion of domestic credit in the public sector for financing the deficits in the government budget, and, to a less extent, in the private sector because of the higher level of economic activity. In the external sector, net foreign assets declined after an increase in 1968/69.

In the public sector, the shortfall of revenue below expenditure is estimated to be larger than the originally anticipated Af623 million. In Afghanistan, government deficits are nearly always met by resorting to the central bank, and, in 1969/70, it is estimated that such borrowing amounted to Af1,000 million.

Private sector credit, which started expanding in the second quarter of 1969/70 even though the active karakul export season was over, is estimated to have been larger over the year as a whole than in 1968/69. Most of this credit is extended for financing domestic and external trade, and the sources are the Da Afghanistan Bank, which also acts as the central bank, the privately-owned Bank Mellie, and the Pashtany Tejaraty Bank, largely owned by the Government. Working capital loans to industry, including those for the short-term financing of cotton purchases by ginning factories, are, in the aggregate, comparatively small. Apart from the banks, there is no organized money market, and there are no provisions for the central bank to regulate and control credit.

Time and savings deposits have been declining from their record level in 1966/67. Along with demand deposits, they account for about a quarter of the total stock of money and quasi-money. Interest rates on time and savings deposits vary between 3 and 6 per cent, compared with lending rates of 8-10 per cent. However, higher interest rates prevail in the unorganized money market.

The National Price Index, the only one available for Afghanistan, fell by 7 points in 1969/70, compared with a sharp decline of 57 points during 1968/69. This continued, but more modest, decline in the context of an increased money supply during 1969/70 can be largely attributed to increased production of wheat (the basic staple food) and increased imports.

Balance of trade and payments

Merchandise exports in 1968/69 rebounded to their record level of 1964/65. During 1969/70, according to preliminary estimates, they continued to rise, and, with the revival of economic growth, merchandise imports were also expected to increase over their 1968/69 levels. Along with the increase in imports, there was a sizable reduction in aid-financing of imports, and these two in combination led to a severe strain on the balance of payments.

Exports

In 1969/70, merchandise exports increased by 13 per cent over the previous year to $81 million. The most dynamic element was natural gas, exports of which rose from $9 to $12 million, but primary exports (other than natural gas) still account for nearly four-fifths of the total. Among them, exports of fresh and dried fruits and nuts have shown a rapid growth of about 12 per cent annually. Eastern European countries constitute the main outlet, but new markets have been developed in Western Europe, and India's demand for fresh fruits from Afghanistan has also grown. Earnings from traditional export items, such as karakul, wool, and cotton, had been declining, but they too, shared in the over-all increase during 1969/70. Exports of karakul are estimated to have increased from 1.2 million skins in 1968/69 to 1.7 million in 1969/70, and the price of skins was also higher. Export earnings from raw cotton showed a marginal increase, but carpet export earnings continued to decline, on account of deterioration in quality and weakening of external demand. Oilseed exports, particularly of cottonseed, also fell, but the decline here was caused by increased domestic demand.

Unfavourable factors inhibiting the growth of exports are being gradually removed. Agricultural development programmes have been designed to reduce the impact of the vagaries of the weather on agricultural production and to increase the production of both cotton and wheat. Ways to increase the livestock population and protect the animals during severe winters are under active study. Marketing methods have been improved in the case of karakul, and an institute of producers and exporters of carpets has been set up under government aegis. In addition, the Karakul Institute has been successfully implementing an integrated programme which includes selective breeding to obtain the colour of pelts most in demand in foreign countries, improved feeding, sorting and cleaning, and, ultimately, the extension of credit for winter needs. Stimulus to higher production and exports has been given through an increase in the controlled price of cotton and an improvement in the exchange rate applicable to export earnings from cotton and wool.

The exchange rate system

Afghanistan has a system of multiple exchange rates. The official rate is Af45 per US dollar and the free (bazaar) rate has recently fluctuated within a range of Af70 to Af80. In March 1963, when

the official rate was fixed and applied to major exports and government imports, it was close to the free market rate. Since then, inflationary pressures have pushed the free rate upwards, and earnings from major exports, to which official rates were largely applied, have suffered. Because of this, the rates applicable to convertible export proceeds from karakul, cotton, and wool were officially depreciated to bring them closer to the free market rate. The differences in the discounts between the official and market rates, in respect of both bilateral accounts and convertible exchange, have also been narrowed by export subsidies to cotton and raw wool. Foreign exchange sales to the Government at the official rate for official imports have been declining, but such sales for the servicing of external debt have been increasing. The central bank's surplus from the purchase of private foreign exchange over sales to the Government, both at official rates, has been used to finance part of its excess of sales over purchases of foreign exchange at the free market rate, the rest being financed out of convertible foreign exchange reserves. There has been a steady decline in foreign exchange reserves (including the net IMF position), and the free market selling rate fell in June 1970 to Af81.5 to the United States dollar.

Imports

Commercial imports, which had been steadily increasing, seemed to level off in 1968/69, during which they amounted, as in 1967/68, to about US$66 million. However, with the pace of economic activity rising, an increase in commercial imports could be anticipated for 1969/70. Aid-financed imports, which used to be greater than commercial imports, have recently declined to near equality with them, but even if this trend is maintained in 1969/70, total imports would be greater than in 1968/69. (Official trade figures, like others, are provisional for 1968/69 and unavailable for 1969/70. Trade figures have to be interpreted with caution, as smuggling, both of imports and exports, is believed to be extensive.)

More than two-thirds of commercial imports are consumer goods, and imports of such goods have been rising continuously. Also expected to increase are imports of both intermediate goods, whose share in the total had been declining, and capital goods, whose share had remained unchanged. Programmes have been established for the attainment of self-sufficiency in wheat within a few years but the possibilities for increased domestic production of other agricultural products have yet to be explored. With respect to such consumer goods as sugar, textiles, fats, and leather products, there are significant possibilities for import substitution, as excess capacity prevails in the domestic industries which produce them. However, since there are no quantitative restrictions on imports and prohibited import items are few, revision of the present comparatively low import duties would be necessary for fostering infant domestic industries. Also required would be improved border control to prevent smuggling.

Direction of trade

Afghanistan's major trading partner is the USSR which continues to account for nearly one-third of Afghanistan's exports and nearly one-half of its imports. In addition to primary goods, major exports to the USSR include natural gas, the earnings from which are earmarked for servicing the debt incurred in connexion with the substantial aid received from the USSR. Other major destinations of Afghan exports are the United Kingdom, the United States, India and Pakistan. The second largest supplier of imports is the United States (this includes foodgrains under the PL480 programme) followed by the Federal Republic of Germany, Japan and India.

As a landlocked country, Afghanistan is vitally interested in improving the transit facilities for its imports and exports, and it also acts as a transit country for some of the goods sent overland from the USSR to Pakistan and India. Transit agreements exist with Iran and Pakistan, and a new one has been recently negotiated with Turkey.

Tourism

The number of tourists in Afghanistan increased considerably from 44,540 in 1968 to 63,000 in 1969, and the tourist industry, which is still of modest size, is rapidly growing. New hotels and roads have been built and air travel facilities have been expanded to connect fifteen cities. Projects for further improving tourist facilities, such as the construction of new hotels and the up-grading of the Kabul airport, are under study, and there is a possibility that IBRD will extend loans for the construction of new hote's. According to a non-official expert estimate, if the past growth rate of tourism continues for five years, the foreign exchange earnings from this sector will exceed the present earnings from both karakul and cotton.

Australia

Objectives and achievements

Australian Governments do not engage in long-term economic planning. Particular agencies of the Federal and State Governments do, however, plan the development of their own activities for some years ahead. The intentions of federal government agencies for one year ahead are brought together in the annual budget, and an attempt is made to produce a fiscal outcome that will stabilize the economy at a high level of employment. But, in general, it is not

possible to speak in terms of long-term targets, or of achievements and short-falls. It is possible, however, to distil from policy pronouncements and from the actions of Governments a statement of the principal objectives of Australian economic policy, and to assign to them an apparent order of priority.

Full employment has held first place for the past twenty-five years, yielding only occasionally to the balance of payments constraint; and, in the Australian context, full employment is in practice a demanding objective, permitting no more than 1.5 per cent of the labour force to be involuntarily out of work.

Priority goals manifest themselves in continuing attempts to maintain the established activities and incomes of farmers in the face of changes in costs, markets and technical possibilities of production; in a social security programme, which, in the middle of 1970, had 1,050,000 persons (or 8.4 per cent of the population), together with their dependants, in receipt of pensions on a means-test basis; in commitment to a policy of customs tariff protection for undersized as well as large manufacturing industries; and in the prescription of minimum wage rates through legislation and through the determinations of official arbitration tribunals. The third objective, in current order of priority, is probably population growth. Because the Australian population has always been relatively sparse, though highly urbanized, and because excellent population data have been available ever since the first European settlement in 1788, this has tended to be the most widely quoted index of progress towards national maturity.

Price stability, as an objective in itself, has many strong adherents. Generally speaking, however, people are prepared to sacrifice it, within the limit of perhaps 5 per cent annual inflation, in order to achieve one or more of the above-stated goals. Where the stability of price level has been given primary consideration, it has been because of its effect on the balance of payments.

Despite the strong desire for rising standards of living, productivity receives very little explicit attention in statements of Australian policy and in actual policy measures. Increases in productivity are regarded generally as something that just happens, and effects on productivity carry very little weight when decisions are made on the pursuit of the other four major policy objectives.

For the last eight years, Australia has been eminently successful in achieving the primary goal of full employment. The unemployment level in 1970, of about 1.3 per cent of the labour force, is the culmination of a slight but progressive improvement from 1.6 per cent in 1967.

As regards distributional policy, pragmatic actions in the rural field have been directed towards supporting existing producers and patterns of production, rather than towards changes that would maximize rural productivity as circumstances altered. In addition, unreliable seasonal conditions have strained the capability of Federal and State Governments to satisfy farmers' requests for aid. The machinery for general wage determination and settlement of industrial disputes has been rapidly losing its influence on the labour market. The resulting inflation, together with the failure of social security pensioners to organize themselves as a counter to other interest-groups, has, over the last four years, destroyed the *de facto* nexus between pension rates and average employee earnings.

Population growth has continued, year after year, at around 2 per cent, with seemingly no end to the supply of migrants who have constituted some 45 per cent of the increase. Perhaps partly because of the demands of immigration on the capital stock, despite the very high ratio of gross fixed-capital formation to gross national product, which, during the last six years, has lain between 26.6 and 27.8 per cent, the average annual rise in productivity during the same period has been a mere 2.4 per cent.

Australia's greatest good fortune of recent years has been the discovery and exploitation of vast and varied mineral resources. Because of this development, the balance of payments constraint will not enforce a dampening of domestic activity every few years. The most important problems for the immediate future lie in two fields that are amenable to domestic policy: rural reconstruction, where a determined programme will end the major problem of an indigent farm sector; and industrial relations and wage determination, where a new framework is needed in which the pursuit of sectional interests also serves the common good.

Over-all growth and the use of resources

The Australian gross domestic product, measured at constant prices, increased by about 5.6 per cent between 1968/69 and 1969/70. This was much the same as the average annual rate of increase over the previous five years. The increase for 1969/70 was made up of a growth in the labour force of about 3.2 per cent and a rise in productivity of about 2.3 per cent. During the previous five years, the increase in the labour force had averaged 2.8 per cent per annum, and the rise in productivity 2.5 per cent per annum. It must be borne in mind, however, that the measured rate of productivity growth in Australia is subject to a good deal of year-to-year variation because of the influence on rural production of seasonal factors and fluctuating world commodity

markets. Moreover, the estimate of gross domestic product at constant prices for 1969/70 is preliminary and may need to be revised when fuller information becomes available.

Australian import prices remained fairly stable from 1965/66 to 1968/69, but rose in the following year by about 1.7 per cent. Export prices fell by 3.5 per cent between 1966/67 and 1967/68, but by 1969/70 had recovered to about 1 per cent above the 1966/67 level. Thus, the terms of trade deteriorated markedly between 1966/67 and 1967/68, but had improved by 1969/70 to 99.6 per cent of the 1966/67 level. The economy gains from an improvement in the terms of trade but this gain is not included in the conventional measurement of changes in production and productivity. If the improvement in the terms of trade is included, the rates of growth of gross domestic product at constant prices in 1968/69 and 1969/70 become 9.0 per cent and 5.8 per cent respectively, instead of 8.6 per cent and 5.6 per cent.

Although the total labour force grew by 3.6 per cent between May 1969 and May 1970, the increase in the female component was 6.4 per cent and in the male component only 2.3 per cent. The difference resulted from increased work force participation by married women, and represented a continuation of a marked trend of recent years.

Measured at current factor prices, the gross product of farming enterprises declined between 1968/69 and 1969/70 by 8.4 per cent. Since 1964/65 the proportionate contribution of the farm sector to gross domestic product has fallen from 11.7 per cent to 7.5 per cent. On the other hand, the output of the mining industries continued to rise rapidly. There are indications that the 10 per cent increase in the value of factory production (at current prices) in 1968/69 has been repeated in 1969/70, although the price component of the latter increase was probably about 4 per cent, as compared with 3 per cent in the previous year.

There was practically no change in 1969/70 in the general composition of gross domestic expenditure, with personal consumption accounting for 58.0 per cent, government current expenditure for 12.2 per cent and fixed capital formation for 26.3 per cent. There was, however, a small shift from private towards public capital formation, with the latter accounting for 9.0 per cent of gross domestic expenditure in 1969/70, as compared with 8.4 per cent in 1968/69.

There was a large decrease in 1969/70 in the extent to which the economy relied on capital from overseas. The net capital inflow, less the increase in gold and foreign exchange reserves, represented 9.5 per cent of gross domestic capital formation in 1969/70. The corresponding figures for the years 1966/67 to 1968/69 were 10.1 per cent, 16.7 per cent and 12.5 per cent respectively. This was a reflection of a very healthy balance of trade, with exports exceeding imports by A$405 million: there had been a trading surplus of A$14 million in 1968/69 and a deficit of A$218 million in 1967/68. As far as can be determined at this stage, the voluntary private capital inflow remained buoyant, with undistributed income providing A$370 million and other direct investment A$330 million (together equalling a little over 8 per cent of gross domestic capital formation).

Personal saving was already unusually high in 1968/69, at 19.4 per cent of personal disposable income. In 1969/70, it increased further to 19.8 per cent. The surplus of public authorities on current account also showed a relative increase, rising from 6.2 per cent to 7.2 per cent of gross national product at market prices. Thus, gross domestic saving rose from 26.4 per cent to 27.0 per cent of gross national product. At the same time, the net increase in government debt fell from A$493 million in 1968/69 to A$211 million in 1969/70, a decline from 19.6 per cent to 7.8 per cent of government capital formation.

In 1968/69, imports were 15.6 per cent of gross domestic product and exports were 14.3 per cent. In 1969/70, imports remained at 15.6 per cent, but exports increased to 15.7 per cent. While a small part of the latter change is attributable to the 2.7 per cent rise in average export prices (calculated from official estimates of exports of goods and services at current and constant prices), most of it resulted from increases in the quantum of exports. The most notable of these were increases of 35 per cent in meats, 33 per cent in cereals, 43 per cent in metaliferous ores and concentrates, and 30 per cent in refined metals and machinery. The total increase in merchandise exports, valued at constant prices, was 19 per cent. Further large increases in most of the expanding categories of exports were evident in the early months of 1970/71: on a seasonally adjusted basis, the index of exports at constant prices for the September quarter of 1970 was 10 per cent above the average for 1969/70.

The fall of 8 per cent in gross farm product at current factor prices in 1969/70, combined with a small increase in wages and other costs, was reflected in a decline of 17 per cent in the income of farm unincorporated enterprises. In consequence, their share of gross national product at factor cost fell from 5.1 per cent to 3.9 per cent.

Despite the decline in the fortunes of major sectors of rural industry, gross national product *per capita*, adjusted approximately to eliminate the effect of price rises in the items of the gross national

expenditure, increased by 3.3 per cent in 1969/70. This followed increases of 6.7 per cent in 1968/69 and 0.8 per cent in 1967/68. There was a corresponding increase in the average real earnings of male employees (adjusted for the rise in consumer prices) of 6 per cent in 1969/70, following rises of 6 per cent in 1968/69 and 2 per cent in 1967/68.

Consumer prices rose by about 3.2 per cent between 1968/69 and 1969/70, following increases of 3.3 per cent between 1966/67 and 1967/68 and 2.6 per cent in the succeeding year. The largest increase occurred in the costs of housing, which went up by 5.9 per cent in 1969/70. The prices of clothing and drapery rose by 3.1 per cent, food by 2.2 per cent, household supplies and equipment by 1.2 per cent and miscellaneous items (tobacco, beer, newspapers, motoring, metropolitan fares and other services) by 3.8 per cent. The level of wholesale prices for basic materials and food-stuffs rose by only 1 per cent. This index, however, being based on the average consumption pattern in the years 1928/29 to 1934/35, has become increasingly inadequate as a measure of wholesale price levels; a new index for materials used in non-house building showed a rise of 4.6 per cent between 1968/69 and 1969/70. Towards the end of 1970, there were expectations of more rapid inflation as a result of a national increase of 6 per cent in the minimum wage rates determined by the industrial arbitration system, which was to operate from the beginning of 1971.

Sectoral production

(*a*) *Agriculture*

General. There has been a slight upward trend in recent years in the total area of rural holdings, accompanied by a small increase in the average size of holdings. At the same time, the rural work force has continued to decline: between March 1965 and March 1969 the number of males fell by 6 per cent, despite a growth of 9 per cent in the total male labour force of the economy.

Over the same four years, however, the area under crops increased by 36 per cent and the area under sown grasses and clovers by 20 per cent. Crop yields per acre, too, have shown a general upward trend despite the setbacks of droughts. The quantity of artificial fertilizers used rose by 18 per cent between 1964/65 and 1968/69 to reach 4.19 million tons in the latter year. There has been no significant increase in the last few years in the area of land under irrigation or in the use of aerial agriculture.

Production and exports. The net result of the foregoing factors has been a fairly consistent upward movement in the volume of rural production. Between 1964/65 and 1969/70, the output of wool rose by 15 per cent, of butter by 9 per cent, of mutton and lamb by 30 per cent, and of pigmeat by 45 per cent. Over the four years to 1968/69, the total production of crops, measured at constant prices, increased by 34 per cent; and this included an increase of 48 per cent in wheat output.

Australian rural production is heavily influenced by variations in annual rainfall and in its seasonal incidence. Agricultural output received a very serious setback in 1967/68 as a result of drought: there was a decline of 41 per cent in wheat production and of 20 per cent in production of other crops. Drought again depressed output levels in 1969/70. It was a reduction of 14 per cent in the quota for deliveries to the Australian Wheat Board, however, that was chiefly responsible for the decrease in wheat output from 544 million bushels in 1968/69 to about 400 million bushels in 1969/70. Dry conditions in Queensland led to a fall of about 20 per cent in the output of sugar. Meat production, on the other hand, rose because of considerably higher slaughtering rates in the southern States and, in the cattle industry, higher average weights at slaughter. With some movement of farmers out of wheat, wool production increased by almost 5 per cent to a record total of 2,043 million lb.

Generally speaking, variations in the output of Australian primary products are reflected in the quantities available for export rather than in the supplies coming on to the home market. Exports have tended to absorb more than 40 per cent of the output of butter, around 70 per cent of sugar and of wheat, and some 95 per cent of wool. In some cases there can be a substantial carry-forward of stocks from one year to another, as occurred with wheat in 1969. Thus, despite the reduced output of wheat in 1969/70, the physical volume of exports of cereals was 33 per cent higher than in the previous year. With greater meat production, exports were up by 36 per cent, while, for wool, the rise was 7.5 per cent. All other rural products together showed a decline in export volume of about 2 per cent.

Although 1969/70 saw an over-all increase in the physical volume of rural production, the gross value of production declined by 8 per cent. This was the result of a weakening of prices. Compared with 1968/69, the average export price of wool was down by 12 per cent, and of cereals by 8 per cent. The price of wool suffered a continuous decline throughout 1969/70 and into the early months of 1970/71. For cereals, also, 1970/71 began with price levels below the average for the previous year. Meats, however, showed an increase in export price levels of 7 per cent during 1969/70, and sugar an increase of 23 per cent; and, in both these cases, prices were still higher in the early part of 1970/71. Smaller price

increases were registered for dairy products and dried and canned fruits, but the export future for these commodities appeared less secure. In general, the problem of Australian rural industry is to identify the future growth sectors and to persuade farmers to make the necessary adjustments. It is a problem which arises mainly from conservatism and inertia, interstate jealousies, and the tradition of non-selective government assistance to rural sectors which get into difficulties from whatever cause.

In June 1970, after more than a decade of discussion and negotiations, the Federal Parliament passed legislation for a marginal dairy farms reconstruction scheme. The scheme was designed to help low-income farmers to leave the industry, and involved financial aid for the amalgamation of marginal farms into economic units, with emphasis on diversification away from dairying. The State of Western Australia offered its co-operation from the beginning, and, at a meeting of the Australian Agricultural Council, Queensland, South Australia and Tasmania assented to proposals to curb dairy production and to implement the reconstruction scheme. New South Wales and Victoria agreed subject to further negotiation.

(*b*) *Industrial production*

General. The Australia and New Zealand Bank index of factory production rose by 5 per cent in 1969/70, making a total rise of 26 per cent over the last 5 years. There were increases in 1969/70 in almost all items of manufacturing output.

All of the State Governments continued their policies of encouraging industrial development by the establishment of industrial estates, the provision of transport facilities and power at favourable rates, and the provision or guarantee of loan finance.

Manufacturing. There were significant increases in 1969/70 in the output of virtually all manufactured products, as a result of growth in domestic demand and in productive capacity. The most noteworthy increases were in newsprint (38 per cent), wood pulp (27 per cent), motor cars and station wagons (15 per cent), television sets (15 per cent) and rotary petrol mowers (30 per cent).

While total employment (excluding rural industry and private domestic service) grew during 1969/70 by 4.1 per cent, employment in manufacturing rose by only 2.8 per cent. Over the five years to May 1970, manufacturing employment declined relatively from 34.1 per cent of the total to 31.2 per cent.

During the last six years, exports of manufactures have grown from 11 per cent to 18 per cent of total exports of commodities. The largest contributors to this growth have been chemicals, motor vehicles and iron and steel.

There has been little change recently in the policy measures to encourage the export of manufactures. Export incentives are given through a special income tax allowance for export market development expenditure and a payroll tax rebate based on increases in export sales revenue. The government-established Export Payments Insurance Corporation, which began operating in 1957, offers protection to manufactures against risks of loss arising from the non-payment of their overseas accounts.

Exploitation of mineral resources. Although mining and quarrying account for only about 1.5 per cent of the employed labour force, employment in this industry group has risen by more than 40 per cent during the last five years, and it must be reckoned the most rapidly expanding area of the Australian economy. Between 1968/69 and 1969/70, the output of iron ore and concentrates rose by 26 per cent, and of alumina by 25 per cent. Among the refined metals, there was an increase of 50 per cent in aluminium, 13 per cent in zinc, 11 per cent in copper and 5 per cent in lead. Production of black coal rose by 12 per cent and crude oil by 118 per cent; and production of natural gas, starting from a very low base, rose almost fourteenfold to lift total gas output by 53 per cent. In 1969/70, exports absorbed about 40 per cent of coal production, 78 per cent of iron ore, 19 per cent of copper and 55 per cent of lead. The exploitation of mineral resources has thus been responsible for eliminating the recurrent incidence of crises in the Australian balance of payments.

Japan has been the major customer for Australian minerals, with long-term agreements for the export of iron ore, coal, bauxite and copper; and, in July 1970, the first refrigerated shipment of liquefied petroleum gas from the Bass Strait field left for Japan under a long-term contract. Much of the capital required to develop mineral resources for export has been supplied by the overseas customers. Australia meets a very high proportion of the world demand for mineral sands concentrates containing ilmenite, rutile and zircon. Recent exploration has greatly multiplied the known Australian reserves of nickel and uranium, and asbestos has been added to the list of minerals with which the country is known to be well endowed.

Production of electricity increased by 10 per cent in 1969/70, an acceleration of the trend which had produced a 37 per cent increase over the previous four years. In April 1970, an agreement was signed under which the Federal Government will provide financial assistance for the building of a very large

power station near the steaming coal deposits of Central Queensland. At about the same time, plans were announced to increase the capacity of the alumina refinery in the area, already the largest in the world, from 1.275 million to 2.4 million tons a year. It was expected that low-cost power and the local availability of large and varied mineral deposits would lead to the establishment of a complex of major export-oriented industries.

Construction. The building and construction industry employs a little over 8 per cent of the Australian work force. The percentage has declined slightly in recent years. The activities of the industry are heavily dependent upon the supply and cost of credit, and dwelling construction is especially vulnerable to variations in monetary policy.

In 1969/70, while total fixed-capital investment in Australia (measured at current prices) increased by 9.0 per cent, private expenditure on dwelling construction rose by 14.7 per cent and government expenditure on houses and flats by 11.3 per cent. For other private building and construction the increase was 9.7 per cent. There was some slackening of house-building activity in the second half of 1970.

In recent years, building costs have risen more rapidly than the general level of prices in Australia, and the same has been true of the housing component of the consumer price index.

Services. The most recent data on gross domestic product (at current factor prices) by industry of origin are for 1967/68. They indicate that, that year, service industries, other than ownership of dwellings, constituted 43.5 per cent of the total. This figure, however, was abnormally high because of the effect of drought on rural incomes, and a more normal contribution from the service industries would be between 41.5 and 42.0 per cent. Of the total gross product of the service industries in 1967/68, 19.3 per cent came from transport and communications, 33.4 per cent from wholesale and retail trade, 10.4 per cent from public administration and defence, 18.6 per cent from community and business services (including law and order, health, education and the professions), 7.9 per cent from finance and property, and 10.4 per cent from amusement, accommodation and other personal services.

External trade and the balance of payments

(*a*) *Current account*

Australia has been in deficit in the balance of payments on current account for the last thirteen years. The size of the deficit is partly dependent on seasonal conditions in the rural export industries and the state of world commodity markets for rural and mineral products, and partly on domestic fiscal and monetary policy which can either dampen the market for imports or generate spill-over demand. All of these factors are subject to quite severe fluctuations, and the deficit has consequently varied, in the ten years to 1969/70, between a negligible amount in 1961/62 and an amount of A$1,123 million in 1967/68. The latter figure represented 27.2 per cent of total imports of goods and services, and 4.7 per cent of the gross national product at market prices.

Until 1965, at least, the outturn of the balance of payments and the consequent state of Australia's international reserves tended to dominate domestic policy with regard to aggregate expenditure and employment; and because of lags in the recognition of balance of payments problems, in the introduction of fiscal changes and in their taking effect, federal government policy probably more often than not had a destabilizing effect on international transactions. Over the last decade as a whole, however, the autonomous inflow of private investment capital has served to maintain and even increase the level of Australian official reserve assets.

In the last few years, a new factor has assumed major importance. As a result of a succession of varied and very large discoveries of mineral deposits, some dating back to the 1950s, and long-term contracts for their export, the Australian balance of payments has gained an unprecedented immunity from really serious, short-term fluctuations. Merchandise exports, measured at current prices, increased by 35 per cent between 1967/68 and 1969/70; and, while imports also rose steeply, the current balance of payments deficit was reduced from A$1,123 million to A$803 million, or 17.0 per cent of imports of goods and services. The achievement was due, in some measure, to the recovery of rural industry (especially meat production) from the serious drought of 1967/68, though some sections suffered renewed drought in 1969/70; and it was partly due to a rise in exports of manufactures by 51 per cent, in continuation of the trend of the past twenty-five years. The main source of the healthy state of the balance of payments, however, was the persistent rise in mineral exports. Between 1967/68 and 1969/70, revenue from unwrought copper, lead and zinc rose by A$1,077 million, or 96 per cent, the increase in exports of coal was A$80 million, or 94 per cent, and of iron ore A$173 million, or 168 per cent.

Along with the changes in the pattern of Australian export trade, there have also been major changes in the direction of trade in both exports and imports. In 1960/61 the United Kingdom took 23.8 per cent of Australian merchandise exports, Japan 16.7 per cent, and the United States 7.5 per cent. Japan moved into the leading position in 1966/67, and by

1969/70 was purchasing 24.7 per cent of Australian exports, with 13.5 per cent going to the United States and 11.8 per cent to the United Kingdom. Of Australian imports in 1960/61, 31.3 per cent came from the United Kingdom, 20.0 per cent from the United States, and 6.0 per cent from Japan. The United States overtook the United Kingdom in 1966/67, and by 1969/70 the proportions were United States 24.9 per cent, United Kingdom 21.8 per cent, and Japan 16.7 per cent. The only significant changes between 1968/69 and 1969/70 in trade with these three countries were a small drop in the share of the United States in both exports and imports and a large increase in the Japanese share of Australian imports. Preliminary figures for the three months to September 1970 indicate a continued upsurge of trade with Japan, and a strong revival of imports from the United States in most categories of manufactured goods.

The tendency over the last few years has been for Australia's three major trading partners to increase their total share of both exports and imports. Australian trade with Asia, other than Japan, has in recent years been a diminishing proportion of total Australian trade, although the flows in both directions have risen in absolute money terms. Australian exports to these countries in 1969/70 amounted to A$724 million, and imports from them amounted to A$463 million.

New Zealand was fourth among Australian customers in 1969/70, taking 4.8 per cent of total Australian exports, and sixth among the suppliers of imports with 2.2 per cent. These two percentages have remained static over the last two years, but before that they were tending to converge. A limited free trade agreement between the two countries came into force at the beginning of 1966, and, from the beginning of 1970, its coverage was extended to a further list of commodities, mainly iron and steel goods.

(*b*) *Capital account*

For more than two decades, Australia has depended in most years on a large capital inflow to balance her external account. The inflow has fluctuated considerably, and though these fluctuations have tended to parallel and offset those in the current balance of payments, there have been sizable residual movements in Australia's international reserves. In 1967/68, the net capital inflow, less the increase in reserves, reached 16.7 per cent of gross domestic capital formation. By 1969/70, this figure had declined to 9.5 per cent; and, with buoyant and assured export income from minerals, it seems likely that the economy will become even less dependent on capital from overseas in the course of the 1970s.

The Australian policy towards foreign capital has been an open-door one. In practice, virtually no restrictions have been placed on private capital inflow, or on the repatriation of capital and earnings. It is only in the last two years that a policy on take-overs of Australian enterprises by overseas interests has begun to evolve, and to find expression in isolated instances of government intervention. While the need for foreign capital was so great, it was perhaps understandable that a very liberal policy should prevail, despite the misgivings that were expressed by many sections of the community at the growing commitment for the servicing of foreign indebtedness and the growth of foreign ownership of Australian industry and resources. But the problem is now being viewed more seriously. Investment income payable overseas in 1969/70, most of it in distributed and undistributed profits of companies, amounted to A$794 million, or 16.8 per cent of Australian exports of goods and services. This ratio had been stable during the three years from 1964/65 to 1966/67 at around 12 per cent. Australian investment income earned overseas has also been growing, though not nearly so rapidly: in 1969/70 the total was A$154 million. It seems likely that, with the diminishing dependence of the economy on overseas capital, moves will be made to require a certain level of Australian equity participation in foreign-sponsored ventures. It is very unlikely that any restrictions will be placed on the outflow of capital or income.

One of the arguments advanced by those who are uneasy at the large reliance on foreign capital is that Australia, as one of the richer nations in *per capita* terms, ought to be a net contributor to the international pool of capital rather than a sizable net drawer on it. But Australian contributions to international aid, all of them by way of grant rather than loan, have fluctuated in the last five years between 0.74 per cent and 0.84 per cent of the national income. This puts Australia very near the top of the list of donor countries in terms of proportionate effort. This year's budget includes estimates for nearly A$184 million for economic aid to developing countries and territories, an increase of 11 per cent over the preceding year. The total includes A$126.1 million for Papua and New Guinea, and A$57.9 million for other bilateral and multilateral aid. The latter type of aid has almost doubled since 1964/65, the major part of this aid going to Indonesia and to the Asian Development Bank. Australia's aid is mostly directed towards basic infrastructure projects, such as road and bridge construction, port development, dams and provision of water supplies, and telecommunication and aviation facilities.

In April 1970, the Federal Government announced an expanded programme of grants to Indonesia for the three years to June 1973, involving

a total of A$53.8 million, compared with the A$15 million given in 1969/70. The change from an annual basis of decision-making was intended to enable the Indonesian Government to integrate the grants with its own planning. In July 1970, the Federal Treasurer announced that Australia would contribute almost A$43 million over the three years to 1973/74 to the third replenishment of the resources of the International Development Association.

Population and social development

(*a*) *Population and labour force*

At 30 June 1970, the Australian population stood at 12,552,000. This is small in relation to the total area of 2,968,000 square miles; but it should be borne in mind that about one-third of the continent is arid, another third receives only a very light and very uncertain rainfall, and much of the remainder, around the eastern and southern coasts, is mountainous and has relatively poor agricultural potential.

In recent years, the population has been growing at about 2 per cent a year, with a tendency to accelerate in the last two years as a result of a slight rise in the birth rate. A little over one half of the growth in population typically comes from natural increase, and the remainder from net immigration.

The immigration programme, commencing in the middle 1940s with displaced persons from Europe, and continuing with free and assisted passage schemes negotiated with a number of countries, had added to the supply of both skilled and unskilled manpower and has provided cultural enrichment for the Australian society. Recently, however, there have been increasing doubts about the balance of the economic costs and benefits, especially as immigration has involved a heavy commitment for capital widening (in industry, in housing, and in the social infrastructure) and has thus diverted resources from a deepening of the capital structure which might have produced a more rapid rise in productivity. It has also been noted with some concern that immigrants have tended to settle in the few, large metropolitan complexes, and thus to accentuate the social and economic problems of over-large cities. Thus, towards the end of 1970, the Federal Government set up a major investigation into the effects of the immigration programme, and it is possible that some changes in policy may begin to emerge.

While the population grew by 10.2 per cent in the five years to June 1970, the labour force grew by 15.8 per cent. This was due almost entirely to a rapid increase in the participation of married women: the growth rates for males, married females and other females were respectively 11.4 per cent, 47.4 per cent and 6.7 per cent. By May 1970, the labour force participation rates (expressed as percentages of the corresponding section of the civilian population aged 15 and over) were 83.4 per cent for males, 33.5 per cent for married females, and 48.6 per cent for other females.

(*b*) *Income distribution*

Despite the lack of regular, comprehensive data, income distribution is a perennially live issue in Australia. Much of the debate centres on the respective shares in national income of farmers, the different groups of employees, social security pensioners, and retired persons who are dependent on their own savings.

Almost the whole range of employment in Australia is covered by a system of minimum wage and salary rates prescribed by federal and state industrial tribunals. In practice, it is the federal tribunal, the Commonwealth Arbitration Commission, that sets the standard; and its determinations thus affect the level of wages costs throughout most of the economy. Much of the output of farmers is sold on world markets at prices which are little influenced by the level of costs in Australia. Thus, wage increases redistribute income away from the farmers. The income of federal social security pensioners (aged, invalid, widow and ex-service), who number more than 1.6 million persons (or 13 per cent of the population), is determined by decisions on rates of pension which are usually incorporated in the annual federal budget. These groups suffer if wage and salary incomes rise more rapidly than pension rates.

In the annual national wage case in December 1969, the Arbitration Commission awarded a general increase of 3 per cent. As a result of this and other influence on the structure of minimum wages, including direct pressure by trade unions on employers, the average of adult male rates actually rose between May 1969 and May 1970 by 5.4 per cent, and the average of adult female rates by 7.5 per cent. Moreover, there was a further widening of the gap between award wage rates and the actual earnings of employees (the "wage drift", arising from the increasing incidence of above-award, overtime and similar payments), the latter increasing between the June quarter of 1969 and the June quarter of 1970 by 9.0 per cent.

During 1970, the Arbitration Commission seemed to become increasingly uneasy at the progressive diminution of its influence on the Australian industrial scene. In addition to the widening gap between its wage pronouncements and actual wage payments, it was losing effectiveness in its original function of settling industrial disputes. By late in 1970, it was clear that the number of man-days lost in disputes

during the year would be well over 2 million, more than twice as many as in 1968 and almost four times as many as in 1963.

The Commission's decision in the 1970 wage case, delivered in December 1970, to award a general increase of 6 per cent from the beginning of 1971, must be interpreted in this light. As an attempt to bring the unions back into its fold, it was perhaps a heroic gesture, but also almost certainly an unsuccessful one. The full cost to the economy will not be evident until the middle of 1971, but it cannot fail to be large. The increase has had an immediately disruptive effect on the budgets of State Governments and their instrumentalities. It has engendered pressure from the stronger unions to restore the relative wage advantages enjoyed by their members. It has further darkened the horizon of most of the rural export industries.

Social security pension rates were increased by an average of about 3.5 per cent in the 1970/71 federal budget, presented in August 1970. This was not quite enough to compensate for the rise of 3.8 per cent in consumer prices since the previous budget. For many years, up to 1966, the standard pension rate had maintained a fairly steady ratio of 22 per cent to the average earnings of male employees. Thereafter, the ratio showed a downward trend, and, even after the increase granted in the 1970/71 budget, it was only about 19.5 per cent. Following the decision in the national wage case, the Federal Government was subject to intensified criticism of its policy on pension rates, and it appeared likely that a further rise in rates would be introduced early in 1971.

Monetary developments

Interest rates overseas rose rapidly during 1969 and reached their peak in and around the early part of 1970. It was to be expected that Australian rates would respond; and the tendency for inflation to accelerate provided additional reason for stringency in domestic monetary policy. In August 1969, the statutory reserve deposit requirement for the trading banks was raised from 9.0 to 9.5 per cent of their deposits liabilities, and, in October, it was further increased to 10.0 per cent. The long-term government bond interest rate was lifted from 5.4 per cent to 6 per cent in July 1969, and sharp rises were authorized in bank lending and borrowing rates in August 1969 and March and April 1970.

Although world interest rates were tending downward from the middle of 1970 or earlier, the inflationary pressures in the Australian economy made it unlikely that there would be any large-scale easing of monetary policy, at least until the federal budget for 1971/72. Some sectional relief was provided, however. In September 1970, the statutory reserve deposit ratio was reduced to 9.4 per cent to permit the trading banks to transfer cash to their farm development loan and term loan funds, as an aid to rural recovery from the 1969/70 drought. In the following month, there was an increase in the proportion of their deposits that savings banks were permitted to devote to housing loans, in response to a decline in house-building activity from its peak about March 1970.

The Australian money supply, as officially defined (including fixed deposits with the trading banks and deposits with the savings banks), increased by 6.2 per cent between June 1969 and June 1970. On the narrower definition of means of payment (notes and coin in circulation and current trading bank deposits), the increase was only 4.9 per cent. The dominant source of increase was trading bank advances, although the rise in the banking system's holdings of government debt was also larger than usual. The Reserve Bank, on the other hand, after reaching a peak of A$622 million in March 1970 in its advances against unsold rural commodities, was able to finish the financial year with the outstanding balance reduced to A$358 million, or A$122 million less than a year earlier. In the first four months of 1970/71, the volume of money grew further, so that it was above the level of October 1969 by 5.1 per cent, on the narrow definition, and 5.2 per cent, on the broad definition. Given a prospective increase of the order of 10 per cent in gross domestic product in 1970/71, it was expected that money would become increasingly tight if the Reserve Bank continued to try to limit the rate of inflation.

Public finance

The Federal Government budget for 1969/70, presented in August 1969, made no important change in taxation rates, but provided for a 7 per cent increase in expenditure out of an expected revenue growth of 13.5 per cent. The latter arose largely from the effects of rising money incomes on the rates of personal income tax on the progressive scale, although it also reflected the carry-over into the 1969/70 tax year of the recovery of farm incomes in 1968/69. On the outlay side of the budget, the major innovation was an adjustment to the means test for social security pensions, whereby an individual's pension would be reduced by only 50 cents for each dollar of his independent means above the full-pension ceiling of A$520 a year. This, coupled with rises of around 6 and 7 per cent in pension rates, involved an increase in total social security payments of some 15 per cent.

The budget had been based on an expectation of inflation at the rate of about 3 per cent. In fact,

the rise in consumer prices between the 1969 and 1970 budget dates was about 3.8 per cent. Revenue thus exceeded the estimate, rising by 14.5 per cent, and expenditure rose by 8 per cent.

The budget for 1970/71 was brought down on 18 August, almost four months before the Commonwealth Arbitration Commission delivered its judgement in the 1970 national wage case. Again the Government appeared to anticipate being able to hold inflation to little more than 3 per cent for the ensuing year. The budget provided for rises of a little over 11 per cent in both revenue and expenditure. The revenue estimates allowed for a reduction of one-tenth in the rates of tax previously payable on personal incomes of up to A$10,000, with a tapered reduction above that level. This represented a concession to those who had protested at the automatic increase, year by year, in the weight of personal income taxation because of inflation. Its effect on the revenue was largely offset by a rise of 2.5 cents in the dollar in the standard company income tax rates; increases in the rates of tax on petroleum products, tobacco products, and motor cars and radio and television sets; and the introduction of a tax on wine. On the expenditure side, the main increases budgeted for were in grants and other financial allocations to the State Governments (a rise of A$291 million or 12 per cent), and in social security payments (a rise of A$131 million or 10 per cent, including an increase of about 3.5 per cent in pension rates).

The effect of the 6 per cent increase from January 1971 in prescribed minimum wage rates, and of the larger proportionate increases that will follow in negotiated rates and in actual employee earnings, will be to transform the federal budget drastically during the second half of 1970/71. Revenue will be increased by higher private money incomes and expenditure. On the outlay side the cost of federal government services will rise, and it will probably prove necessary to make supplementary financial allocations to the State Governments to enable them to pay their way. The net effect is likely to be a federal budget surplus rather larger than the nominal A$4 million that was budgeted for.

Federal-state financial relations have been generally recognized to have been in an unsatisfactory state for several decades. At a conference with the State Premiers in June 1970, the Prime Minister secured their acceptance of a new, five-year arrangement providing for the progressive assumption by the Federal Government of responsibility for debt charges on A$1,000 million of state debt; interest-free capital grants to the states, commencing with A$200 million in 1970/71 and rising thereafter in step with their borrowing; upward adjustments in the annual formula grants to the States (which originated with the Federal Government's pre-emption of the field of income tax in 1942); and some special supplementary grants to individual states.

In an effort to recover some of their lost financial independence and flexibility, the State Governments had, one after another, in the previous few years, adopted a turnover tax in the form of a receipts duty, which promised to be a large and growing source of revenue. In February 1970, however, the High Court, by a majority of four to three, ruled that levies by Victoria and Western Australia on two companies were invalid under the Constitution, and thus destroyed the legal basis of the tax in every state. The Federal Govefrnment agreed a week later to impose the receipts tax on behalf of the States, but had to abandon collection of the tax after 30 September. At a special conference with the Premiers on 8 October, the Federal Government agreed to make up the States' entire losses from the abandonment of receipts duties until the end of 1974/75.

Australian city administration appeared to have growing difficulties during 1970 to cope with the problems of growth, congestion and the despoliation of the environment. The deficiencies were partly fiscal, since Australian local governments are virtually confined to real property taxes and charges for business services as sources of current revenue, apart from federal and state grants for road works and some other, more minor purposes. But, perhaps the greater failing lay on the side of planning machinery and the enforcement of efficient development. At the end of 1970, there was little sign of impending improvements.

The outlook for 1971

Inflation seems likely to be the dominant economic problem for Australia during 1971. It will be mainly of the cost-push variety, and will be associated with an increasing incidence of industrial strife as the better organized and more militant employee groups vie with one another to keep ahead of the general increase in wages and salaries. It is a problem that has already recently beset other advanced economies, and the experience of none of them offers a ready solution. The Australian answer is likely to be a compromise in which the rate of inflation is reduced somewhat at the cost of a higher level of unemployment.

Inflation will accentuate the problems of rural industry and increase the urgency of proceeding with a massive reconstruction programme. It has taken some years to gain enough acceptance for this need to make it a political possibility, and progress will be slow, as well as costly in terms of subsidies and other special assistance. However, it is likely that there will be progress during 1971, especially in the dairying industry.

Inflation will also focus even more attention on the fiscal difficulties of state and local governments. The response during 1971 is likely to be more federal aid. But it may be expected that public pressure will build up for a thoroughgoing review of the allocation of functions and sources of revenue among the three levels of government. In particular, there will be an increasing campaign for effective planning of metropolitan development and for the allocation of greater funds for urban transportation facilities.

The debate on tariff protection for Australian manufacturing industry will certainly become more intense during 1971. The Tariff Board may be expected to continue its review of the justification for protection of large segments of secondary industry, and to influence public opinion towards a more selective approach.

On the social side, there are likely to be strong pressures to establish an automatic link between the rates of social security pensions and the incomes of the employed sections of the community. The system of government health benefits will also be subject to searching criticism. In neither of these fields, however, is there a prospect of substantial change before 1972.

In the main, the problems facing the Australian economy during 1971 will be problems arising from prosperity. The continued rise in aggregate real income raises difficulties in sharing the gains among the different sections of the community. The rise in real production raises difficulties in allocating the product among alternative uses, especially those involving expenditure by the subordinate levels of government.

BURMA[1]

In the year ending 30 September 1970, gross domestic product (GDP) at 1964/65 prices recorded a 3.9 per cent increase over 1968/69. This compared favourably with the average 3.0 per cent per annum increase recorded over the four years ending 1969/70. The average growth rate in population per annum over the same period of 2.2 per cent, however, meant that the growth in *per capita* income was, while positive, less impressive.

In the trade sector, the deficit of 212 million kyats in the balance of payments for 1969/70 reflects the deteriorating foreign trade position. Gold and foreign exchange reserves declined to US$107 million at the end of September 1970, the lowest level recorded since 1962/63.

[1] Detailed data were not available to the ECAFE secretariat at the time this paper was being written to permit the more comprehensive analysis that is normally prepared for the *Survey*.

The considerable efforts that the Government has made to develop the economy are reflected in the level of investment, which registered an annual rate of increase of 9.5 per cent, at constant prices, during the four years ending 1969/70. The degree of austerity that this involved is revealed by the slow growth rate of consumption. At over one percentage point less than the growth rate of GDP, this was slightly less than the population growth rate during the period and hence helped to raise the level of domestic savings. In 1969/70, total investment was equivalent to 13.4 per cent of the gross domestic product—a substantial increase over the 12.0 per cent of 1968/69. At the same time, consumption rose significantly and the share of domestic saving in GDP fell from 11.9 per cent in 1968/69 to 9.1 per cent in 1969/70.

In order to counteract the country's economic stagnation, the Government has been endeavouring to develop import-substitution industries, to diversify export commodities so as to reduce the traditional heavy reliance on exports of rice, to intensify domestic investment by continuing to curb consumption and to implement programmes for the modernization of agriculture.

Agriculture and forestry

The agricultural sector of the economy, which accounted for over one-quarter of national production, grew by 1.2 per cent in 1969/70, as measured in terms of 1964/65 prices. This increase is partly attributable to the increasing practice of multiple cropping which has more than offset the loss of output resulting from a marginal decline in the actual acreage cultivated.

Paddy output during the year under review showed a slight decline of 0.5 per cent to 7.859 million tons. Unfavourable weather and a shift to more profitable crops were responsible for this fall in rice output. While the yield of paddy per acre is similar to that of neighbouring countries, it is equivalent to only about 30 per cent of the Japanese performance. Much effort has been made to raise yields by increased use of chemical fertilizers, and, in 1969/70, about 94,000 tons of chemical fertilizer were applied. This increased use of chemical fertilizers was made possible by imported stocks held over from the previous year and by increased domestic production. Application of pesticides also increased considerably during the year under the review and a number of flood prevention projects, such as seawalls and dams, are under way. They will benefit a total of 37,000 acres of land when completed.

Efforts at modernization and diversification to assist agricultural development continued during 1969/70. A tractor assembly plant was constructed

in central Burma, and pilot co-operative tractor stations were established in twenty-two selected village circles in upper Burma. Farmers were instructed in the latest cultivation techniques and the most effective method of using fertilizers and insecticides. They were also encouraged to grow more jute, cotton, groundnut and other crops and 7.1 million kyats worth of quality seeds and plants representing twenty-one varieties were distributed for that purpose. Experimental cultivation of the high-yielding varieties of rice, IR 8 and IR 5, as well as Ngwetoe, a new Burmese strain, continued. Encouraging results were obtained in experiments in the cultivation of Mexipak, a high-yielding variety of wheat.

During the year under review the reconditioning of existing sawmills proceeded and three new sawmills were constructed. Lumber extraction capacity was enlarged and a plywood factory commenced operation. Teak output rose by 13 per cent to 340,000 tons and hardwood output rose by 4 per cent to 910,000 tons. Significantly, a ten-year plan, ending 1978/79, was formulated for the development of 9 million acres of forest and the re-afforestation programme (launched in 1967) has been extended.

Manufacturing industries

In the year under review, state-run factories, power stations and workshops numbered 1,295. Private sector factories and workshops totalled 16,381, of which 44 per cent are under government supervision. In 1969/70, 42.2 per cent of total public capital expenditure (372.2 million kyats) was allocated to manufacturing industries.

Many state-run enterprises have not been as efficient as the Government had expected. Serious consideration is being given to providing these enterprises with a larger measure of autonomy so that they might better respond to market influences.

Statistics on national production at 1964/65 prices reveal that manufacturing industries showed an increase of 3.2 per cent in 1968/69 over 1967/68 and rose further by 3.4 per cent in the subsequent year to 4,607 million kyats. In 1969/70, food and beverage output accounted for about three-fifths of total manufacturing output, while textiles, housing and household equipment accounted for about one-fifth.

Activities in the industrial sector are geared towards the construction of factories whose products aid import substitution and support agriculture. One major development has been the construction of a chemical fertilizer plant in Sale. Its test-run has been completed and it will initially produce about 55,000 tons of urea, or 81 per cent of its full output capacity, in 1971. Construction of a second fertilizer plant with an output capacity of 68,900 tons will be completed soon. Both plants will use locally available natural gas.

A plant for producing bottles for medicine, beer and soft drinks has been completed. A paper mill has been constructed and should have begun operation at 60 per cent of its full capacity in March 1971. It is intended that it will go into full operation in 1972/73 when it will produce 6,000 tons of printing paper, 6,000 tons of writing paper and 900 tons of packing paper. Locally available bamboo will be used as raw material. Planned developments, which include a paper mill with a daily production capacity of 20 tons and a textile complex consisting of a finishing plant and a spinning and weaving plant with 600 looms and 40,000 spindles, will provide welcome additions to the country's manufacturing industries. It is expected that annual production of the textile complex will be 20 million yards of textiles and 16 million yards of yarn.

Mining industries

Mining industries at 1964/65 prices accounted for only 1.7 per cent of national production in 1969/70. One of the nation's highest priorities is oil exploration. In the year under survey, the state-run oil corporation conducted an extensive geological survey covering 16,000 square miles. This effort will be intensified in subsequent years.

In 1969/70, a crude oil production of 210 million gallons was recorded, only slightly better than the previous year's record of 209 million gallons. Production at new oil fields was encouraging but declines in production occurred at old oil fields. The geological survey helped to find three test-wells which are reported to be capable of producing 40,000 gallons of crude oil per day. The Federal Republic of Germany has been helping Burma explore for new oil and gas resources and to develop existing oil fields by providing long-term loans for on-shore and off-shore areas.

Strenuous efforts are also being made to revive the mining of tungsten, tin, lead, lead concentrates and antimony. The Government introduced better terms for private enterprises so as to induce them to produce more and to curb the illegal outflow of these minerals. The USSR and Canada have been assisting in rehabilitating the country's mining industries.

Electricity

Power generation rose by 11.3 per cent in 1969/70 but the total installed capacity in that year was virtually the same as in 1968/69. The hydro-

electric industry has been suffering from an insufficient supply of water on a year-round basis, but a dam now under construction should supply water to power three additional 14,000 kW turbines as well as the existing three turbines at the Lawpila Power Station. This multipurpose dam will also provide irrigation facilities for 20,000 acres of crop land and 22,500 acres of fish breeding grounds, and serve as a waterway linking the towns of Loikaw and Yaungshve.

Transportation

Vigorous efforts are being made to improve transportation facilities for commodities as well as passengers. One hundred and seventy-five miles of the railway line between Rangoon and Kyungon have been double-tracked and the stock of railway cars and locomotives has been substantially increased. Work has also progressed on road construction, such as the 100-mile road connecting Pandaung and Taungup and the 168-mile Haka-Matupi road linking towns in the northern Chin Hills with those in the south. The renovation and extension of the road to Mandalay begun in 1966/67 is progressing, with 13 miles of road between Ntaukkyant and Pegu completed during 1969/70. An international telecommunication service was introduced during the year.

Trade and balance of payments

Foreign exchange receipts from exports have declined continuously since 1964/65 and preliminary estimates of the value of exports in 1969/70 indicated a fall of 4.1 per cent from the level recorded in 1968/69 to 534 million kyats. This is slightly less than one-half of the 1964/65 performance.

Foreign exchange earnings from exports of most traditional commodities except rice remained stable in the year under survey, but timber, metals and ores recorded declines on export value. In the case of rice, although the quantity exported rose by 72.3 per cent, foreign exchange receipts increasd by only 18.3 per cent because of the decline in the international price.

The unsatisfactory export performance of the Burmese economy has necessitated a reduction in imports. As a result, imports in 1969/70 were also less than half of the 1965/66 level. Until 1966/67, the reduced flow of imports mainly affected consumer goods, but, in recent years, capital goods imports have also been somewhat reduced, in spite of the attempts made to increase the level of fixed capital formation. In all, the trade balance registered a deficit of 217 million kyats in 1969/70.

Non-trade transactions recorded a further deficit of 91 million kyats which, together with a net capital inflow of 97 million kyats, resulted in a deficit of 211 million kyats or US$44.5 million 1969/70. Gold and foreign exchange holdings at the end of September 1970 stood at US$107 million, the lowest level recorded in the 1960s.

Ad valorem import tariff rates ranging from 10 per cent to as high as 400 per cent are used primarily for revenue purposes, but certain essential commodities, such as grains, chemical fertilizers, insecticides, agricultural machinery and implements, are exempt from import duties. In addition, most imported commodities are also subject to a sales tax levied on the duty-paid value. All of Burma's foreign trade and distribution of consumer goods, raw materials, machinery, etc. are directly controlled by the Government which attempts to balance export receipts and import payments so as to maintain foreign exchange reserves at a satisfactory level.

As in other Asian economies, Japan's share in Burma's imports has been increasing. However, India retains its position as the major market for Burma's exports, followed by Japan and the United Kingdom.

Public finance

Revised estimates of 1969/70 government expenditure and revenue reveal a deficit in which total government expenditure exceeded revenue by 7.8 per cent. The deficit of 593.1 million kyats was financed by short-term foreign loans (18.7 per cent), economic and technical co-operation assistance from Japan (12.5 per cent), inflow of foreign exchange from international organizations (5.6 per cent) and other sources, including Central Bank financing (73.1 per cent). In 1969/70, government revenue increased by 14.2 per cent. This increase was attributable partly to a rise in tax receipts and partly to an increase in the receipts of public enterprises as a result of their expanded economic activities. Among tax receipts, income tax receipts recorded an increase of 16.7 per cent and accounted for 9.0 per cent of total revenue. Receipts from commercial taxes and customs also rose by 32.7 per cent.

On the expenditure side, there was an increase in the current expenditure of the public enterprises, general administration, debt servicing and government investment. The increase in expenditure on social welfare activities such as education and health services accounted for a good portion of the sizeable increase in expenditure on general administration. The Government has allocated 67.0 per cent of total public capital expenditure to the development of manufacturing industries, transportation and communication, mining and power. The primary sector is to receive only 7.5 per cent of public capital expenditure.

It is estimated that comprehensive government receipts for 1970/71 will increase by nearly 10 per cent and expenditure by about 8 per cent over the 1969/70 revised estimates. The increase in receipts reflects the expanding activities of public enterprises, as expected receipts from most of the important taxes are below 1969/70 levels. Both income tax and commercial taxes will fall short of 1969/70 revised levels—income tax by 7 per cent and commercial taxes by 16 per cent. Revenue from customs and excise duties is expected to be at 1969/70 revised levels. On the expenditure side, expenses on general administration are expected to rise by about 4 per cent but no significant increase in debt-servicing is anticipated. Public capital expenditure is expected to rise by 14 per cent and this increase will be more evenly distributed than in 1969/70. Of the total public expenditure, 38.1 per cent will be for manufacturing, 12.8 per cent for transport and communication, 12.2 per cent for defence, 9.1 per cent for mining and 7 per cent for the primary sector.

The excess of expenditure over receipts, estimated at 521.4 million kyats, is being financed by drawing upon cash balances to the extent of 37 per cent and by foreign assistance to the extent of 60 per cent.

Table II-3-1. Burma: National production, consumption and investment in constant (1964/65) prices

(in million kyats)

	1965/66	*1966/67*	*1967/68*	*1968/69*	*1969/70*
Production	8,170	7,986	8,882	9,133	9,410
Agriculture	2,371	2,137	2,464	2,520	2,551
Manufacturing	4,029	3,874	4,317	4,455	4,607
Services	3,085	3,013	3,095	3,214	3,387
Trade	2,325	2,108	2,396	2,455	2,555
Less: Total inter-industry use	5,978	5,910	6,373	6,579	6,803
Gross domestic product	7,602	7,197	8,000	8,223	8,549
Consumption	7,210	6,424	6,849	7,246	7,771
Investment	800	913	973	985	1,149

Source: "Country chapter on Burma": paper submitted to the twenty-first meeting of the Consultative Committee of the Colombo Plan for Co-operative Economic Development in South and South-east Asia, February-March 1971.

Table II-3-2. Burma: Balance of payments

(in million kyats)

	1966/67	*1967/68*	*1968/69*	*1969/70*	*1970/71 budget estimates*
Total receipts	892	863	839	839	1,048
Trade	726	545	542	573	663
Non-trade	84	68	67	77	69
Loans and grants	82	250	230	189	316
Total payments	994	958	1,098	1,050	1,127
Trade	749	785	836	790	880
Non-trade	209	141	155	168	151
Repayments of loans	36	32	107	92	96
Errors and omissions	—10	5	13	—1	—
Surplus or deficits (—)	—112	—90	—246	—212	—79

Source: "Country chapter on Burma": paper submitted to the twenty-first meeting of the Consultative Committee of the Colombo Plan for Co-operative Economic Development in South and South-east Asia, February-March 1971.

Table II-3-3. Burma: Foreign trade
(in million kyats)

	1964/65	1965/66	1966/67	1967/68	1968/69	1969/70*
Exports	1,089	929	672	521	557	534
Rice and rice products	645	563	375	238	235	278
Other agricultural products	214	127	115	88	90	90
Metals and ores	61	50	29	19	47	33
Timber	148	163	131	155	160	114
All others	21	26	22	21	25	19
Imports	1,413	804	817	757	753	694
Consumer goods	990	312	263	333	404	392
Capital goods	423	492	554	424	349	302

Source: "Country chapter on Burma": paper submitted to the twenty-first meeting of the Consultative Committee of the Colombo Plan for Co-operative Economic Development in South and South-east Asia, February-March 1971.

* Preliminary figures.

Table II-3-4. Burma: Government receipts and expenditure
(in million kyats)

Receipts	1968/69 actual	1969/70 revised estimates	1970/71 budget estimates
Total receipts	6,663.4	7,611.4	8,358.2
(1) Taxes on production	565.3	646.2	621.1
Excise duties	151.2	162.4	166.1
Excise	51.2	54.8	46.0
Commercial taxes	133.4	170.3	144.7
Customs	182.9	220.0	220.0
State lottery	21.9	23.4	23.0
Other	24.7	24.3	21.3
(2) Income tax	584.6	682.2	635.2
(3) Taxes on the use of state property	124.4	118.1	123.0
(4) Other receipts	233.1	241.2	237.8
(5) Receipts of public enterprises	5,156.0	5,923.7	6,741.1
Total expenditure	7,172.8	8,204.5	8,879.6
(1) Non-developmental expenditure	1,528.5	1,789.5	1,813.0
(2) Current expenditure of public enterprises	4,917.7	5,533.9	6,061.1
(3) Public capital expenditure	726.6	881.1	1,005.5
(*a*) Agriculture and irrigation	54.7	50.0	56.4
(*b*) Livestock and fisheries	3.8	3.3	6.7
(*c*) Forestry	22.4	11.9	28.2
(*d*) Mining	39.4	54.4	91.0
(*e*) Manufacturing	244.2	372.2	382.9
(*f*) Power	19.7	28.7	45.3
(*g*) Transport and communication	144.5	135.0	128.9
(*h*) Construction	45.3	47.9	43.8
(*i*) Trade	11.4	17.6	14.8
(*j*) Social services	27.4	32.1	27.9
(*k*) Defence	73.8	84.3	112.9
(*l*) States	15.4	14.5	11.5
(*m*) Other	24.6	29.2	45.2
Excess of expenditure over revenue	509.4	593.1	521.4
Sources of finance	509.4	593.1	521.4
(1) Deposits and miscellaneous accounts—people's savings (net)	—2.0	1.9	2.9
(2) External assistance	210.4	218.9	322.8
(3) Other	301.0	372.3	195.7

Source: Government of Burma.

Ceylon

Introduction

Ceylon's gross national product rose by 5.7 per cent in 1969, a somewhat smaller increase than the 8.3 per cent recorded in the preceding year. The main reason for the difference was a slower growth of agricultural output.

While the growth of production slowed in 1969, the growth of demand continued unabated. With export earnings stagnant, the rise in import expenditure led to a sizable current account deficit. In addition, the strong increase in demand placed pressure on local supplies and an increase in the consumer price level resulted. While wages increased, real wages rose considerably less. Unemployment remained at a high level.

Tax revenue increased in the financial year 1969/70 (1 October to 31 September), but recurrent expenditure increased still more so that the current account budget deficit increased. Capital expenditure did not reach the 1968/69 level, nevertheless the size of the over-all deficit was slightly larger than that recorded in 1968/69. Recourse was made to bank borrowing to finance this deficit, and the expansionary impact of the budget was considerably larger than that of the 1968/69 budget.

Despite a large increase in bank credit to the private sector and dependence by the Government on the banking system, the money supply fell slightly in 1969. The expansionary factors were offset by a substantial fall in external banking assets as a result of the deterioration in the balance of payments, and a further large rise in private sector time and savings deposits.

The growth of output in 1970 is expected to be roughly equivalent to that achieved in 1969. The strong growth of demand has continued and the

increase in the consumer price index has again been significant. The Government expects to be able to hold imports at the 1969 level, but, with no clear prospect of an increase in export earnings, the trade deficit is likely to be as large in 1970 as it was in 1969. Service and capital payments will, however, increase, and greater dependence will have to be placed on short-term accommodating finance to bridge the external resources gap. For 1971, the Government indicated in the 1970/71 budget speech that it may be necessary to cut the import bill some 20 per cent in order to ease the balance of payments financing problem.

The budget for 1970/71 predicts a small decrease in revenue because of a reduced level of activity resulting from increasing restraints on the flow of imports. Current expenditure is to be held at the 1969/70 level, but an increase in capital expenditure is anticipated, so that there will be an increase in the size of the over-all budget deficit. A large part of this deficit is to be financed by domestic market loans and foreign aid, and the balance is to be financed by a package of new tax and other revenue proposals. It is anticipated that the expansionary impact of the budget will be small.

Economic growth and use of resources

Table II-3-5 summarizes GNP statistics for the period 1960-1969. Output grew by 5.7 per cent in 1969, lower than the rate of growth of output in 1968((8.3 per cent), but a creditable achievement. Indications for the first half of 1970 are that this growth rate has been broadly maintained, but, in the light of restraints on the flow of imports in the second half of 1970, it is likely that the growth rate of output for the year as a whole will be somewhat lower.

Ceylon has an export-oriented production structure; one quarter of its gross national product is exported. Since export earnings largely determine import capacity, it is necessary to take account of changes in the terms of trade to determine the real purchasing power of GNP. However, available statistics only permit account to be taken of the terms of trade effect of changes in the export price level. On this basis, the real purchasing power of output rose by 6 per cent in 1969, only slightly below the increase in 1968 (7.5 per cent). On the other hand, the import price level rose substantially in 1968 and rose further in 1969. When account is taken of this development, it would seem that the above figures overstate the growth rate for real purchasing power in both years. A large part of the increase in real gross national product has been eroded by the adverse movement in the terms of trade.

In 1969, population increased by only 2.3 per cent, compared with the 1968 growth rate of 2.5 per cent and the 1960 growth rate of more than 3 per cent. After making allowance for the growth of population, *per capita* GNP (adjusted for the terms of trade effect on the export side only) rose by 3.7 per cent in 1969, compared with an increase of 5.0 per cent in 1968. For 1970, it seems likely that, keeping in mind the prospective trend in export prices, the growth rate of *per capita* GNP will be around the 3 per cent mark.

Agriculture and service activities dominate Ceylon's productive structure. Manufacturing, construction and transportation have increased their percentage share of national product, but still trail behind agriculture and service activities in terms of relative importance.

Agricultural output grew impressively in 1968, the increase being due essentially to a large jump in rice production. The growth rate slowed in 1969. Unfavourable weather conditions adversely affected tea, coconut, and paddy production. For 1970, the outlook is not much more promising. Paddy production for the first half of 1970 was some 4 per cent greater than during the comparable period in 1969 and rubber and coconut production were up, but there was a further fall (6 per cent) in tea production. On the basis of available information, it would seem that the agricultural growth rate for 1970 may slightly exceed the 1969 growth rate.

Before making any allowance for the terms of trade effect, agriculture contributed 35.4 per cent to GNP in 1969, compared with a contribution of 38.7 per cent in 1960. In effect, the contribution of this sector to total output has been broadly maintained over the decade. If allowance is made for the effect of the almost continuous adverse movement in the terms of trade for Ceylon's major agricultural exports, however, the contribution of agriculture to the real purchasing power of GNP has declined from almost 40 per cent in 1960 to just under 30 per cent in 1969.

Despite this development which necessarily restrained the growth of Ceylon's import capacity, manufacturing activities have shown a very creditable growth performance. Growth in the second half of the decade has been slightly faster than growth in the first half, and growth was particularly rapid in 1968 (9.7 per cent). The growth rate slowed in 1969 (5.8 per cent), but there was a quite respectable increase in all major categories of industrial production. The 1969 growth rate was broadly maintained in the first half of 1970, but import restrictions imposed in the second half of 1970 may slow the growth rate for the year as a whole.

Table II-3-5. Ceylon: Gross national product, 1960-1969[a]

Item	1960	1965	1966	1967	1968	1969	Growth rate 1960-1964[b]	Growth rate 1965-1969[b]	Growth rate 1968	Growth rate 1969	Share of GNP (%) 1960[c]	Share of GNP (%) 1969[c]
	(in million rupees, constant 1959 factor cost prices)						(percentage)					
Agriculture (gross)	2,436	2,773	2,821	3,040	3,248	3,321	4.2	4.0	6.8	2.2	(38.7)	
Less terms of trade effect[d]	−11	−309	−505	−667	−784	−811						
of which												
Tea	−32	−212	−318	−419	−485	−546						
Rubber	+37	−104	−145	−190	−262	−194						
Coconut products	−26	−12	−45	−55	−18	−50						
Agriculture (net)	2,425	2,464	2,316	2,373	2,464	2,510	1.7	0.4	3.8	1.9	38.6	29.3
Manufacturing	728	937	1,008	1,052	1,154	1,221	4.8	6.1	9.7	5.8	11.6 (11.6)	14.3 (13.0)
Construction	281	266	293	351	446	527	0.1	19.6	27.1	18.2	4.5 (4.5)	6.2 (5.6)
Transport	585	740	792	782	824	923	1.9	4.9	5.4	12.0	9.3 (9.3)	10.8 (9.9)
Public administration	314	372	397	389	432	446	3.1	4.0	11.1	3.2	5.0 (5.0)	5.2 (4.8)
Other (mostly services)	1,989	2,477	2,544	2,612	2,796	2,998	2.8	4.2	7.0	7.2	31.7 (31.6)	35.0 (32.0)
Gross domestic product	6,321	7,256	7,349	7,559	8,116	8,624	2.4	3.8	7.4	6.3	100.7 (100.7)	100.8 (100.7)
Less net factor income from abroad	−44	−14	−36	−45	−39	−65					−0.7 (−0.7)	−0.8 (−0.7)
Gross national product[e]	6,278 (6,289)	7,242 (7,551)	7,313 (7,818)	7,514 (8,181)	8,078 (8,862)	8,560 (9,370)	2.3 (3.4)	3.6 (4.8)	7.5 (8.3)	6.0 (5.7)	100.0 (100.0)	100.0 (100.0)
Population growth rate							2.6	2.4	2.5	2.3		
Per capita GNP[e]							−0.3 (0.8)	1.2 (2.4)	5.0 (5.8)	3.7 (3.4)		

Source: Central Bank of Ceylon, *Annual Report 1969*, appendix II.

[a] Provisional estimates for 1967-1969.

[b] Average annual rate of growth.

[c] Figures in brackets indicate GNP, *per capita* GNP and sectoral shares of GNP before any adjustment is made for terms of trade effect on the export side. Available statistics do not permit allowance to be made for the terms of trade effect on the import side.

[d] Export side only.

Output of the construction sector increased 27.1 per cent in 1968. While the increase was lower in 1969 (18.2 per cent), this sector nevertheless experienced very rapid growth. In a large measure, the strong growth of demand, combined with greater availability of imports of intermediate and capital goods, lay behind the remarkable performance of this sector. The construction boom continued at a moderated pace into 1970.

Output of the transport sector jumped in 1969. Service activities also expanded quite rapidly. In each of these sectors it would appear that the 1969 growth rate has been broadly maintained in 1970.

Most of the sectors grew at a faster rate in the second half of the decade than in the first half. In comparison with preceding years, growth was particularly rapid in 1968 and 1969, and it was mainly developments in these years which pulled average annual growth rates for 1965-1969 above those for the period 1960-1964. The reasons for the higher growth rate in the latter part of the decade deserve consideration.

Despite a large rise in agricultural output in 1967, a serious adverse movement in the terms of trade negated the impact of this development on foreign exchange earnings, and the resulting tight import situation acted as a restraint on growth in other sectors of the economy. The expansion of agricultural output, particularly of rice, continued apace in 1968 and reduced demand for food imports. At the same time, there was a significant liberalization of imports. In consequence, imports of intermediate goods in particular increased sharply, a development which spurred growth in other sectors. The agricultural growth rate slowed markedly in 1969 and export earnings declined. Spending on imports, however, again rose substantially, and an already tight balance of payments situation deteriorated. In essence, the high 1969 growth rate was achieved by spending considerably more than the available domestic resources. The excess of GDE (gross domestic expenditure) over GNP jumped from an average of 3.6 per cent per annum for the period 1966-1968 to 6.8 per cent in 1969. The Government had hoped that an increase in the domestic production of rice and subsidiary food crops would free sufficient foreign exchange to permit a large rise in capital and intermediate goods imports in 1969 and thereby avoid any deterioration in the balance of payments. In the event, these hopes were not realized.

The 1969 pattern of development was carried over into 1970. With no significant increase in external assistance, it became increasingly apparent that the rapid growth outside of the agricultural sector could not long be maintained, for restraint would soon have to be imposed on the growth of import demand and this action would adversely affect the growth rate. Following the change in the Government in May 1970, the new Finance Minister announced that there was a critical shortage of foreign exchange, and quantitative import restrictions were imposed to restrain the growth of import demand.

Table II-3-6 provides details of GDE, the trade balance, and GNP, all in current market prices. Four points deserve attention. First GDE increased at a very rapid rate in the second half of the decade compared with the first half. The increase in GDE was particularly rapid in 1968 and 1969 and during the first half of 1970.[1] Apart from 1965, GDE has consistently exceeded GNP. With restraint on the flow of imports, part of the increase in money demand was necessarily diverted to home produced goods, the supply of which did not increase in step. In consequence, the consumer price index rose, especially in 1969 (table II-3-7).[2]

The second point of interest in Table II-3-6 is that consumption demand accounts for a high proportion of GDE, but as a result of the rise in domestic investment, its share has fallen from 87.4 per cent in 1965 to 82.1 per cent in 1969. The rate of growth of consumption demand, while high, has been less than the rate of growth of total domestic expenditure.

Third, investment demand, which barely increased during the period 1960-1964, increased significantly each year after 1965 and rose by a substantial 43 per cent in 1969 (private sector investment rose by 63 per cent). In a large measure, this increase was due to a relaxation of controls over the import of intermediate and capital goods.

Fourth, domestic saving jumped markedly in 1968 and again increased significantly in 1969, although the increase was below that achieved in 1968 and also below the rate of growth of national product in 1969. Investment has consistently exceeded saving, the difference rising significantly in 1969.

Balance of payments

The balance of payments has acted as a restraint on economic growth in Ceylon. Table II-3-8 summarizes Ceylon's balance of payments situation since 1967. Tea is the major source of Ceylon's export earnings; it accounted for 64 per cent of export earnings in 1967, 59 per cent in 1968, and 56 per

[1] Part of the large rise in 1968 was due to the effect of devaluation of the rupee.

[2] The increase in the consumer price index in 1967 and 1968 was due largely to an increase in import prices due to devalution and a rise in the world rice price level.

Table II-3-6. Ceylon: Gross domestic expenditure and gross national product, 1960-1969[a]

Item	1960	1965	1966	1967	1968	1969	Rate of change				Share of GDE		
	(in million rupees, current market prices)						1960-1964[b]	1965-1969[b]	1968	1969	1960	1965	1969
							(percentage)					(percentage)	
Consumption	5,931	7,038	7,432	7,940	8,958	10,221	3.1	9.0	12.8	14.1	85.8	87.4	82.1
Private sector	5,020	5,881	6,274	6,712	7,550	8,749	2.9	9.8	12.5	15.9	72.7	73.0	70.3
Public sector	911	1,157	1,158	1,228	1,408	1,472	3.9	5.4	14.7	4.5	13.2	14.4	11.8
Fixed capital formation	1,022	1,043	1,187	1,366	1,568	2,242	1.9	23.0	14.8	43.0	14.8	13.0	18.0
Private sector	617	514	578	737	824	1,343	0.4	32.3	11.8	63.0	8.9	6.4	10.8
Government	238	250	265	327	347	462	neg.	16.9	6.1	13.3	3.4	3.1	3.7
Public enterprises	70	130	124	115	119	102	5.8	−5.5	3.5	−16.7	1.1	1.6	0.8
Public corporations	88	150	221	187	278	335	14.3	24.7	48.7	20.5	1.3	1.9	2.7
Changes in stocks	−44	−30	+8	+11	+100	−10					−0.6	−0.4	−0.1
Gross domestic expenditure	6,909	8,051	8,627	9,317	10,626	12,453	3.0	10.9	14.0	17.2	100.0	100.0	100.0
Trade balance	−198	34	−290	−257	−309	−691					−2.9	0.4	−5.5
Exports	2,011	2,095	1,865	1,849	2,165	2,154	−0.8	0.6	17.1	−0.5	29.1	26.0	17.3
Imports	2,209	2,061	2,155	2,106	2,474	2,845	−1.0	7.6	17.5	15.0	32.0	25.6	22.8
Net factor income from abroad	−00	−15	−37	−54	−60	−104							
Gross national product	6,667	8,069	8,300	9,006	10,257	11,659	3.3	8.9	13.9	13.7			
Excess of item 4 over item 7													
(percentage)	3.6	−0.2	3.9	3.4	3.6	6.8							
(value)	242	−18	327	311	369	794							
Saving	736	1,031	869	1,067	1,299	1,438	5.5	7.9	21.7	10.7			

Source: Central Bank of Ceylon, *Annual Report 1969*, appendix II.

[a] Provisional estimates for 1967-1969.

[b] Average annual rate of growth.

Table II-3-7. Ceylon: Consumer prices, 1960-1969

(1963=100)

Item	*1960*	*1961*	*1962*	*1963*	*1964*	*1965*	*1966*	*1967*	*1968*	*1969*
Consumer prices	95	96	97	100	103	103	103	106	112	120
Domestic component	96	99	100	100	103	103	103	103	109	118
Imports after tax and subsidies	92	92	94	100	104	104	103	108	114	120

Source: IMF, *International Financial Statistics.*

Table II-3-8. Ceylon: Balance of payment statistics, 1967-1971[a]

(in million rupees)

Item	*1967*	*1968*	*1969*	*1970*	*1971*
Exports (f.o.b.)	1,650	1,976[b]	1,909	1,900	2,000
— of which:					
Tea	1,061	1,162	1,062		
Rubber	282	331	431		
Coconut products	167	331	221		
Imports (c.i.f.)	1,985	2,356	2,653	2,600	2,084
Trade balance	—335	—380	—744	—700	—84
Services and transfers (net)	—	—3	—64	—100	—130
— of which:					
Profits and dividends	—31	—23	—60		
Other (mostly interest)	—22	—30	—44		
Port charges, etc.	115	104	104		
Current account balance	—335	—383	—808	—800	—214
Capital payments	—78	—266	—390	—580	—963
— of which:					
Short-term finance	—30	—175	—284		
Long-term finance	—40	—70	—85		
Other	—8	—21	—21		
Deficit	—413	—649	—1,198	—1,380	—1,177
— financed by:					
Short-term finance	187	297	663		
Bilateral balances	80	42	18		
External assets	—131	—14	86		
Aid	258	323	407	461	
Private capital	9	8	9		
Other	10	—7	—15		

Source: Central Bank, *Annual Report* (1967-1969) and *Budget Speech*, 1970/71.

[a] Estimates for 1970 and 1971 are derived from the *Budget Speech*, 1970/71.

[b] The rise in export earnings in 1968 reflects the influence of the 1968 devaluation on the rupee value of exports. In foreign currency terms, the value of exports declined slightly.

cent in 1969. Rubber and coconut products are the other major exports. Together, these three exports accounted for 90 per cent of the value of Ceylon's exports in 1969.

The value of export earnings fell by Rs 67 million in 1969. There was a slight fall in the price of tea and a fall in the volume exported so that the value of tea exports slumped by Rs 100 million. There was also a sharp fall in both the price and the volume of coconut exports, with the result that the value of coconut exports was down by Rs 110 million. The one bright spot on the export side of the balance of payments was rubber. Although volume fell a little, price jumped by almost 40 per cent as a result of supply uncertainties following the Malaysian disturbances in May, and the value of rubber exports rose by Rs 100 million.

Data for the first six months of 1970 indicate that the quantity of tea exported is slightly down compared with the corresponding period in 1969, that price has held steady, and that earnings are down by Rs 23 million. The quantity of rubber exported is also marginally down but price is slightly up, as are earnings (up by Rs 3.6 million). The value of coconut exports is also up slightly (Rs 10 million). The main development of interest in the second half of 1970 has been the substantial fall in the export price of rubber. It would seem that for the year as a whole, the value of tea and rubber exports will be below the 1969 level, but the value of coconut exports will be up. It is difficult to foresee a significant increase in the level of export earnings in 1970.

Imports jumped markedly in 1968 and again in 1969. Part of the increase in 1968 was due to developments following a general devaluation of the rupee in November 1967 and part to a further but partial devaluation of the rupee in May 1968 (which led to a large rise in imports of basic materials, machinery and spare parts following the elimination of import controls on these goods). A further partial devaluation of the rupee occurred in June 1969 and the number of goods which could be imported without restriction at the depreciated foreign exchange entitlement certificate rate was increased. This relaxation of controls over the flow of imports was the essential reason behind the large rise in imports after 1967. Without any change in policy, it seemed that imports in 1970 would exceed Rs 2,900 million (compared with exports of Rs 1,900 million). In view of these trends, the new Government imposed a range of import restrictions in an endeavour to restrict the import bill to Rs 2,600 million, Rs 50 million below the 1969 level.

The difference between exports and imports was negligible in 1965. Exports fell in 1966 but imports rose slightly, and, in consequence, the trade deficit jumped to Rs 344 million. Despite a further fall in exports in 1967, imports were restricted and the trade deficit was almost unchanged (Rs 335 million). In terms of domestic currency, exports rose in 1968 but imports rose even more and the trade gap widened slightly to Rs 380 million. However, a marked deterioration in the trade balance occurred in 1969. Exports fell slightly, but imports increased strongly, and in consequence, the deficit climbed to Rs 744 million. The prospect for 1970 is no brighter. Exports are expected to have been around Rs 1,900 million and imports are expected to have been held to Rs 2,600 million, so the net deficit should be about Rs 700 million.

Added to the trade deficit is a growing deficit on services account. In 1967 and 1968, port charges offset profit, dividend, and interest remittances. However, in 1969, remittances jumped as a result of permitted releases from blocked private funds and a rise in interest payments. In consequence, the small deficit of Rs 3 million on services account in 1968 rose to Rs 64 million in 1969 and, largely as a result of an increase in interest payments on recently incurred foreign debt, is expected to rise to Rs 100 million in 1970. Thus the current account deficit rose from Rs 383 million in 1968 to Rs 808 million in 1969 and is expected to approximate Rs 800 million in 1970.

To obtain the external resources gap, it is necessary to add requisite capital payments. These payments have also jumped markedly from Rs 78 million in 1967 to Rs 266 million in 1968 and to Rs 390 million in 1969 and are expected to have reached Rs 600 million in 1970. In a large measure, the recent rise has been associated with the repayment of short-term foreign debts incurred in recent years to finance the external resources gap.

In sum, the total external resources gap has risen appreciably over the past three years. From Rs 413 million in 1967, it rose to Rs 649 million in 1968, almost doubled to Rs 1,198 million in 1969, and is expected to be almost Rs 1,400 million in 1970. The financing of this gap has proved to be difficult. There has been little autonomous private capital inflow. External assets, already very low, were modestly augmented in 1967 and 1968, but drawn down in 1969. Nevertheless, this was not a major means of closing the external resources gap. The two main sources of finance were aid (which has increased some Rs 60 million each year since 1967 and is expected to reach Rs 460 million in 1970) and short-term borrowing. The latter has grown substantially as the Government has been forced to rely more and more heavily on this source of accommodating finance; from Rs 187 million in 1967, it rose to Rs 297 million in 1968 and then rose to Rs 663 million in 1969. IMF drawings, bank borrowings, short-term credits, and supplier's credit are the main sources of short-term finance.

The future implications for the balance of payments of this trend towards increased use of short-term borrowing to close the external resources gap deserve consideration. First, as would be expected, there will be a further increase in interest payments, and thus an increase in the deficit on services account can be expected. Second, because the debt is short-term, it will have to be repaid in the near future. In consequence, it is estimated that capital payments will rise from Rs 390 million in 1969 to Rs 580 million in 1970 and to Rs 963 million in 1971.[3] Thus, before making any allowance for a trade deficit,

[3] *Budget Speech*, 1970/71, pp. 18-22.

the external resources gap in 1970 is estimated at Rs 700 million, and, in 1971, at Rs 1,100 million. External reserves are already low and aid is expected to amount to only Rs 450 million to Rs 500 million. Consequently, heavy dependence may again have to be placed on short-term borrowing unless the debt can be rolled forward and aid can be increased significantly. If the debt is rolled forward, and this seems likely, the flow of foreign aid will permit the Government to continue to run a deficit on current account and work towards effecting the structural readjustment required to bring demand more closely into line with supply.

Sectoral production

Tea

Tea production declined slightly in 1969 and the decline has continued into 1970. Because of low prices, tea producers are concentrating on picking only the best-quality leaves, because these command a higher price. In consequence, production has fallen steadily since 1965, although there was a small increase in 1968 in response to higher prices.

Apart from the tendency to pick only the choicest leaves, production has also been affected by the ageing of bushes. Attempts by the Government to encourage replanting, especially with high-yielding, high-quality, vegetatively-propagated clones, have not met with any significant success. Consequently, in the 1970/71 budget speech, it was indicated that all estates are to be required to outline their replanting programmes for the next five years. Moreover, "tea estates which do not evince any interest in developing their holdings will be liable to be taken over the State".[4] Apart from this, attempts will be made to concentrate production in maximum yield areas, other areas being converted to other crops. Efforts will also be made to ensure that tea factories reach the level of efficiency required for producing high-quality tea; failure in this respect will lead to registration cancellation.

The third related factor which has restrained production has been the restriction of world production under a programme arranged by FAO. Ceylon has a 1970 quota of 464 million lb (production in 1969 was 484 million lb). As a consequence of this scheme, prices, which have been under pressure for over a decade, steadied in the first half of 1970. To improve profit margins, the Government has introduced an export duty rebate scheme. The Government is also taking measures to encourage the growth of a domestic tea packing and blending industry.

[4] *Ibid.*, p. 33.

Rubber

Rubber production has increased significantly since 1960, the increase being comparable to that of Malaysia. Due to poor weather conditions which prevented latex collection for long periods, there was no significant increase in 1969; but production in the first six months of 1970 was up 14 per cent on the corresponding period in 1969.

Some 50 per cent of total acreage has been replanted with high-yielding varieties. There has been a decline, however, in the replanting rate in recent years. The Government is anxious to ensure that replanting proceeds at a satisfactory rate, and, to this end, it has asked estates to indicate their replanting programmes for the near future. Rubber is essentially an estate crop in Ceylon, but there is a large number of rubber smallholdings. To assist smallholder production, a rubber fertilizer subsidy scheme is to be introduced. Ceylon barters part of its rubber output with mainland China in exchange for rice. The effective price for sheet rubber offered by mainland China is 5 Singapore cents above the Singapore price, and, for RSSI rubber, 7 cents above the Singapore price. Given the currently low price of rubber, this barter arrangement is working to Ceylon's advantage.

Coconuts

Some 1.1 million acres are devoted to coconut production, and almost 65 per cent of this area consists of fairly large coconut holdings (20 acres and more). Production statistics are not completely reliable because of the difficulty of estimating home consumption. Nevertheless, there seems to have been a marked increase in production in 1968 in response to markedly higher world prices, and the value of coconut exports almost doubled. Production was maintained at the 1968 level in 1969, but prices declined and export earnings fell. Production in the first half of 1970, however, was up some 11 per cent over the first half of 1969, and prices were firmer, so export earnings rose. Productivity varies markedly from over 7,000 nuts per acre on well-managed, replanted estate acreage to less than 1,500 nuts on smallholdings. To improve the productivity of smallholdings, a fertilizer subsidy scheme is to be introduced.

Rice

Rice is a smallholder crop, and, at the end of 1969, some one-third of the total cultivated area was devoted to rice. As a result of a severe drought, production fell markedly in 1965. The drought continued into 1966 with less severity, and production recovered a little, but it was still below the 1964 level. With better weather conditions, and with

increased use of higher-quality seed and fertilizers, production increased substantially in 1967 and 1968. Production in 1969 was slightly above the 1968 level, but well below the targeted figure. While the first crop *(maha)* for 1969 showed a significant increase over the first crop of 1968, adverse weather conditions affected the second crop *(yala)* and the output of this crop was some 2.2 million bushels lower than in the previous year. The 1970 *maha* crop showed an increase of only 4 per cent over that of the previous year, a figure well below the targeted increase of almost 8 per cent.

Three-quarters of total consumption is produced locally. The balance is imported, largely from mainland China under the rubber-rice barter pact. A goal of government policy is to encourage an increase in production to enable Ceylon to be self-sufficient by 1975.

Subsidiary food crops

In 1969, the production of subsidiary food crops (chillies, red onions, maize, and potatoes, for example) was substantially higher than in the previous year, and this trend continued into 1970. The Government has given considerable financial assistance to farmers prepared to switch marginal land from traditional crops to these subsidiary food crops. A decrease in the prices of some of these crops (notably chillies and potatoes) slowed production increases in 1970.

Manufacturing

In response to the freer flow of imports of raw materials and capital goods after 1967, production in the manufacturing sector increased quite strongly. However, the increase in production was less in 1969 than in 1968, where a large part of the rapid growth had been attributable to fuller utilization of existing industrial capacity. Activity is largely concentrated in Colombo, and more than one-half of output consists of consumer goods produced mostly by relatively small establishments. There are several large government-owned factories, but, as indicated in the 1970/71 budget speech, the performance of several of these state corporations leaves much to be desired, and earnest endeavours are to be made to improve efficiency. The Government is concerned at the heavy dependence of the industrial sector on imports, particularly in the light of the Ceylonese foreign exchange situation. In consequence, steps are being taken to refashion industrial policy to give impetus to the development of industries based on local raw materials.

Construction and service activities

In response to strong growth of demand, construction activity expanded rapidly after 1967. There was a substantial increase in both residential and industrial building activity, as well as government construction. The growth of demand also facilitated a rapid expansion of service activities. Tourism, while still a largely under-developed sector, is beginning to expand rapidly and future growth prospects are very good.

Public finances

The salient features of public finances in Ceylon are set out in table II-3-9. Partly as a result of numerous tax adjustments, revenue has increased steadily, most of the growth having come from an increase in the amount of revenue collected on the import of goods and services and an increase in excise-cum-turnover tax revenue. There has been little change in export or income tax revenue. In consequence, dependence on indirect taxation has increased. The decision to introduce foreign exchange entitlement certificates (FEECs), a programme under which foreign exchange equivalent in value to some 50 per cent of Ceylon's total imports is sold to importers at a 55 per cent premium, facilitated this shift in emphasis.

The budget revenue estimate for 1969/70 was not quite reached, actual revenue for the year amounting to Rs 2,733 million. Income tax revenue exceeded the estimate, largely because of the maintenance of a high rate of economic growth and intensified revenue collection efforts, but revenues from the turnover tax, import duties and FEECs did not reach their targeted levels, the latter falling short of the estimate by some Rs 100 million.

Compared with financial year 1965/66, current expenditure was held in check in 1966/67, but it increased markedly thereafter. Apart from the rise associated with debt servicing, and the servicing of past investment outlays, particularly in the fields of education, health and agricultural extension, two other factors accounted for the rise in current expenditures. First, government employee wage rates have been increased. Second, food subsidy payments have risen.

The original estimate of current expenditure in 1969/70 provided for an outlay of Rs 2,923 million, but revised estimates place the figure at Rs 2,965 million, Rs 421 million above the 1968/69 outlay. There was a substantial increase in all spending categories, but particularly in expenditure on administration (due to further salary increases), social services (also due largely to enhanced wages to government employees) and transfer payments (food subsidy and interest payments in particular). Capital spending has been concentrated largely in the field of economic services, and particularly in agricultural and manufacturing activities. The capital expendi-

Table II-3-9. Ceylon: Public finance, 1967/68 to 1970/71

(in million rupees)

Item	*1967/68*	*1968/69*	*1969/70[a]*	*1969/70[b]*	*1970/71[a]*
Revenue	2,156	2,497	2,834	2,733	2,520
— of which:					
Income tax	316	343	330	n.a.	n.a.
Turnover tax	79	111	282	n.a.	n.a.
Selective sales tax	239	278	265	n.a.	n.a.
Import duties	514	460	324	n.a.	n.a.
FEEC revenues	77	285	540	n.a.	n.a.
Export duties	265	300	298	n.a.	n.a.
Current expenditure	2,321	2,544	2,923	2,965	3,001
— of which:					
Administration	328	339	416	n.a.	n.a.
Social services	598	648	729	n.a.	n.a.
Economic services	113	124	161	n.a.	n.a.
Transfer payments	1,053	1,194	1,278	n.a.	n.a.
(Food subsidies)	(573)	(620)	(611)	n.a.	n.a.
(Interest)	(167)	(206)	(263)	n.a.	n.a.
Capital expenditure	714	852	870	751	961
— of which:					
Administration	13	17	24	n.a.	n.a.
Social services	94	113	141	n.a.	n.a.
Economic services	387	396	552	n.a.	n.a.
Advance accounts	—29	49	—	161	—
Deficit	850	947	959	1,144	1,442
— financed by:					
Foreign finance	247	426	502	329	563
Domestic loans (non-market)	10	52	—	409[c]	88
Domestic loans (market)	630	358	457	406	275
Cash balances	—36	111	—	—	—
New measures	—	—	—	—	516

Source: Central Bank of Ceylon, *Annual Report*, 1969.

[a] Budget estimates.

[b] Revised estimates.

[c] Includes some decrease in cash balances.

ture estimate for 1969/70 of Rs 870 million was not reached and, compared with 1968/69, there was a fall in capital spending from Rs 852 million to Rs 751 million.

While government current revenue has risen quite substantially since 1965/66, government current and capital expenditure has increased in step. As a consequence, the over-all deficit increased from Rs 850 million in 1967/68 to Rs 947 million in 1968/69 and rose to Rs 1,144 million in 1969/70.

The main sources of finance for this deficit have been domestic market loans, foreign finance (use of commodity aid counterpart funds and project aid), and Central Bank borrowing. The substantial rise in current expenditure following devaluation led to an all-time record level of Central Bank borrowing in 1967/68 of Rs 302 million. As price pressures gathered momentum, the Government sought to restrain dependence on this source of finance. Increased foreign assistance permitted Central Bank borrowing to be reduced to Rs 115 million in 1968/69. Unfortunately, in 1969/70, projected foreign assistance fell well short of the expected level (Rs 329 million, compared with an estimated figure of Rs 502 million). Domestic market loans also fell short of target. Moreover, the deficit itself was significantly larger than the estimate (Rs 1,144 million compared with Rs 959 million). Consequently, there was a financing gap of some Rs 410 million, and the major part of this was raised from the banking system. As a result, the expansionary impact of the budget, which had been reduced significantly in 1968/69, and was expected to fall still further in 1969/70 (to Rs 80 million), turned out to be roughly Rs 400 million.

For 1970/71, budget revenue at constant tax rates is expected to be Rs 2,520 million, Rs 213 million below the revised estimate for 1969/70. The

restraint on the flow of imports, and on the growth of demand, is expected to reduce most sources of revenue, in particular import duty revenue, FEEC revenue, and income and turnover tax revenue. Despite an anticipated increase in interest and food subsidy payments, an earnest endeavour is to be made to cut current expenditures, and it is estimated that current expenditure in 1970/71 will approximate the 1969/70 level. In line with the earnest desire to foster economic development, capital expenditure is budgeted at Rs 961 million, some Rs 210 million above the revised estimate for 1969/70.

Because revenue is expected to decline while expenditure rises, the budget deficit is expected to rise from Rs 1,144 million in 1969/70 to Rs 1,442 million in 1970/71. Accumulated commodity aid counterpart funds are to cover Rs 450 million of this figure, project aid Rs 113 million, and domestic market loans Rs 275 million. This leaves a deficit of Rs 604 million, and this is to be financed by additional taxation (Rs 271 million), increased borrowing from the non-bank sector (Rs 170 million), commodity aid (Rs 75 million), and borrowing from the banking system (Rs 88 million). The finance minister concluded in his budget speech that, over all, the expansionary impact of the budget would be small.

Several important tax changes have been made, but the basic tax structure has not been altered. The main changes are:

(1) an increase in import duties designed to yield an additional Rs 60 million. At the same time, the tariff structure has been simplified into six basic duty rate bands. Nominal duties are imposed on basic consumer items that enter into the cost of living, basic industrial raw materials and most important items of machinery for agriculture and industry. Above this is a standard rate of 60 per cent, and rate bands above this level are designed to provide protection to domestic industry, the highest covering a residual group of commodities consisting almost wholly of non-essential and luxury items;

(2) an increase in excise duties on cigarettes, beer, and bottled toddy;

(3) an increase in the business turnover tax on a selected range of items;

(4) reintroduction of a bank debits tax (originally introduced in 1957/58 but repealed in 1965) which imposes a levy on the total amount of withdrawals made each calendar month against each current account maintained in commercial banks;

(5) an upward revision of postal telegraph and telephone charges, motor vehicle levies and port charges;

(6) introduction of a once-for-all capital levy in addition to the existing wealth tax, the levy being based on net wealth (with a Rs 200,000 exemption level), and rising progressively from 3 per cent on net wealth of Rs 200,000 to 25 per cent on net wealth above Rs 800,000;

(7) introduction of a temporary residence permit tax and an increase in the export tax on graphite from 25 per cent to 50 per cent; and

(8) a requirement that State Corporations must make a specified net contribution to consolidated revenue (Rs 45 million altogether).

Apart from these changes, an endeavour is to be made to reduce tax evasion. Towards this end, Rs 100 and Rs 50 currency notes were demonetized and replaced by new notes, the old notes being accepted by banks as deposits until 2 November 1970.

The other changes introduced in the budget were designed to increase the ability of the Government to raise domestic loans. Provident fund contributions were raised (for employees from 4 per cent to 6 per cent and for employers from 6 per cent to 9 per cent), the coverage of the scheme was extended, and greater efforts are to be made to collect arrears. The Government expects to be able to raise an additional Rs 70 million per annum from this source. Secondly, the interest rate on POSB deposits was doubled from 3.6 to 7.2 per cent per annum, a measure designed to encourage savings in rural areas. As a result of this, the Government expects to be able to issue an additional Rs 30 million of securities to the Post Office Savings Bank (POSB). Finally, the Government has proposed a compulsory saving scheme for individuals and companies. Taxpayers, other than those who contribute to the Employees Provident Fund, are to contribute at a progressive rate rising from 2 per cent of their total income, if it is between Rs 6,000 and Rs 12,000, to a maximum of 20 per cent if it exceeds Rs 140,000. Companies are to contribute 10 per cent of profits after payment of income tax and dividends. The scheme is to be in operation for one year only and deposits will carry interest at a rate of 5 per cent per annum. From this source of compulsory saving, the Government expects to be able to raise Rs 105 million by way of loan issues. The major emphasis in the budget proposals is on increasing the progressivity of the tax structure (even though this is being partly done by means of indirect taxation) and extending the scope for domestic borrowing by the Government.

Table II-3-10. Ceylon: Factors affecting money supply, 1966-1969

Factors affecting money supply	*Annual change*			
	1966	*1967*	*1968*	*1969*
Expansionary factors	282.0	373.4	456.3	463.3
Commercial bank credit to the private sector	68.4	92.4	173.5	156.2
Commercial bank credit to government corporations	20.1	11.4	90.6	69.9
Credit to the government from the banking system	118.1	199.7	192.0	117.5
Decrease in government cash balances	—	56.0	—	71.9
Decrease in central bank liabilities	25.2	13.9	—	46.1
Decrease in time and savings deposits of government corporations	50.2	—	—	—
Other adjustments	—	—	0.2	1.7
Contractionary factors	338.8	224.7	350.8	493.4
Decrease in external banking assets	196.3	91.5	115.7	299.6
Increase in time and savings deposits of the private sector	67.7	50.9	101.4	147.3
Increase in time and savings deposits of government corporations	—	51.2	23.2	10.8
Increase in other liabilities of the commercial banks	12.0	31.0	40.9	35.8
Increase in government cash balances	62.7	—	69.4	—
Increase in central bank liabilities	—	—	0.2	—
Other adjustments	0.1	0.1	—	—
Change in money supply (million rupees)	—56.8	148.7	105.6	—30.1
(percentages)	—3.3	9.0	5.8	—1.6

Source: Annual Reports of Central Bank of Ceylon, 1966-1969.

Monetary developments

Table II-3-10 summarizes the main factors affecting the money supply. The figures show annual increases and differ from the figures which would result from the average of the monthly changes in the money supply. Thus, for 1969, the table indicates that the money supply fell by 1.6 per cent, compared with a 5.8 per cent increase in 1968.

In 1967, the money supply expanded by some 9 per cent. There was a substantial increase in the level of borrowing by the Government from the banking system, and the increase in bank credit to the private sector exceeded that of 1966. The same pattern was broadly repeated in 1968, the main difference being that a very large increase in credit extended was partially offset by a large decrease in external assets and by a significant increase in private sector time and savings deposits. Nevertheless, the increase in the money supply amounted to some 6 per cent.

In 1969, credit to the private sector remained at a high level, reflecting the increased level of private sector activity. There was a decrease in the level of bank credit extended to the government sector, but the Government drew heavily on its cash balances so that the expansionary force of the budget in 1969 far exceeded that of 1968. Nevertheless, there was a substantial decrease in external banking assets, and, combined with a further large increase in time and savings deposits by the private sector, contractionary factors exceeded expansionary factors so that the money supply declined slightly.

In the first half of 1970, there was a large increase in the money supply. Bank credit to both the private and public sectors was running at high levels compared with 1969. In addition, there was a substantial decrease in government sector cash balances. Offsetting these expensionary factors, there was a further significant decrease in external banking assets and a modest increase in private sector time and savings deposits (the increase was less than one-third of the increase in the first half of 1969). Recent budgetary measures to increase private sector savings (the increase in POSB interest rates and in provident fund contribution rates, together with the compulsory saving scheme and demonetization of some currency notes) should moderate the increase in the money supply for the year as a whole. Moreover, the measures being taken to impose some restraints on bank credit to the private sector, and the restrictions imposed on the flow of imports, combined with the recent tax changes, may slow down expansion in the private sector. The Government, however, will continue to place some dependence on back finance until 1971 when the full impact of the 1970/71 budget changes are felt.

Prices, wages and employment

Table II-3-7 outlines consumer price trends. A large part of the rise in money demand has been diverted to locally produced goods, and, although the supply of these goods has increased, the increase has not been sufficient to avoid price pressures. The large price rise registered in 1969 continued into 1970. Pressure for increased wages is continuing.

In the 1970/71 budget speech, it was indicated that, of a total population of 12.25 million, the labour force amounts to some 3.25 million, and, of this force, some 700,000 are unemployed. Unemployment is higher in urban than in rural areas and higher in the younger age groups than in older age groups. Contributing to the problem of unemployment is the fact that some 100,000 young people are added to the labour force each year. Ceylon has the great advantage that its young population is well-educated.

The Government has recently announced plans to undertake projects which will significantly expand employment opportunities and thereby reduce the level of unemployment.

No long-term development programme has been followed in Ceylon, though short-term plans with rough longer-term projections have been used to guide government spending. In the 1970/71 budget speech, it was announced that work has begun on a medium-term plan which is to define national development goals over the next five years and to set out targets for all sectors of the economy.

China (Taiwan)

Introduction

The economy of the Republic of China enjoyed another good year in 1970, with a 10.1 per cent rise in gross national product.[1] The rise in consumer prices accelerated in 1970, amounting to 5 per cent in the first eight months, compared with 5.1 per cent for the whole of 1969. Regional and seasonal labour shortages have emerged, particularly in agriculture. Industrial output grew at about 16 per cent in the first half of the year, while total foreign trade (exports plus imports) increased by 32.5 per cent. A visible trade surplus was earned in the first eleven months of the year for the first time since 1964, and foreign exchange reserves went up by one-fifth in the first eight months of the year. Revisions in the tax system are being prepared, and it is expected that a value-added tax will be introduced within about a year. Current major policy objectives include more adequate infrastructural capacity and the modernization of the agricultural sector. However, a major issue is future policy with respect to export-processing zones.

National income

Gross national product for 1969 at current prices rose by 13.6 per cent to NT$190,806 million. Adjusted for price changes, the increase was 8.8 per cent and, after adjustment for changes in the terms of trade, the real growth rate in national income was 7.6 per cent in 1969.

[1] All data for 1970 are preliminary.

Preliminary estimates for 1970 indicate that the rate of growth increased, with gross national product rising by 14.1 per cent at current prices and 10.0 per cent at constant prices. The increase in national income (factor cost) is estimated at 10.2 per cent in 1970, after adjustments for changes in the terms of trade.

Information on the composition of net domestic product reveals that the steady decline in the share in agriculture continued in 1970, when it fell to 19.2 per cent from 20.3 per cent in the previous year. Manufacturing increased its share from 23.0 per cent in 1969 to 23.5 per cent in 1970 and has replaced agriculture as the major contributor to net domestic product.[2]

Agricultural output

Agricultural performance in 1969 did not continue the promising start during the first half of the year. Total agricultural production fell by 1 per cent in 1969, compared with a 6.1 per cent rise in the previous year. Typhoons and floods in the latter part of the year reduced the output of farm products by almost 4 per cent compared with 1968, although the output of some products, such as tea, jute, pineapple and asparagus, increased. A moderate growth in agriculture of perhaps 4 per cent was anticipated for 1970.

Industrial output

The growth of industrial output in 1969 was slightly over 18 per cent, lower than that registered in 1968 (23.6 per cent) which was a boom year. One, though by no means the only, reason for this slower growth rate may have been an inadequate supply of power to meet the demand of expanding industries in April and May. Measured by gross output value, building construction achieved the fastest growth, rising by 21.2 per cent over 1968, followed by manufacturing (18.4 per cent), public utilities (14.6 per cent) and mining (less than 1 per cent, despite a sizable 40 per cent increase in output of crude petroleum). In the first half of 1970, the general index of industrial production increased by 5 per cent, as did the manufacturing index, while the construction index rose by only 1 per cent over that of the previous year.

Prices

In the period from 1961 to 1967, the general indices of wholesale and consumer prices averaged yearly increases of 2.1 per cent and 2.5 per cent respectively, but in 1968 and 1969 a marked rise in

[2] *National Income of the Republic of China 1970*, Directorate-General of Budgets, Accounts and Statistics, table 31, pp. 92, 93.

consumer prices occurred. In 1969, the two indices moved in opposite directions, with a rise of 5.1 per cent in consumer prices and a slight fall in wholesale prices. The rise in the consumer price index resulted largely from increases in the price of food, as well as in the cost of education, recreation, housing and other services. After the two major typhoons in the second half of 1969, both the wholesale and consumer price indices rose, but there was a sharper rise in consumer than in wholesale prices. This pattern continued in 1970, when the wholesale price rise during the first eight months was only 1.2 per cent, compared with a consumer price rise of 5 per cent. As already noted, the eight months' rise in the consumer price index in 1970 was almost identical with the increase in consumer prices over the whole of the preceding year.

Population, employment and wages

The population at mid-1970 was estimated at 14,558,000, with a birth rate of 2.7 per cent, a death rate of 0.5 per cent and an estimated annual (natural) rate of growth of 2.2 per cent as in 1969, when the birth rate was put at 2.7 per cent and the death rate at 0.5 per cent. Efforts to control the rate of population increase are now under way, and family planning is being encouraged. In rural areas, where the birth rate is usually higher than in urban areas, a family planning programme is being pursued as part of a larger programme which includes improved sanitation and medical services. Over one-quarter of the married women in the child-bearing group are now practising birth control, mainly utilizing IUDs, and a new law permitting abortion under certain conditions is in the process of enactment.

Total employment in January 1970 was estimated to be 4.48 million, or 5 per cent above the level in January 1969. Unemployment also increased very slightly in 1969 to 1.9 per cent of the labour force, and there was an increase in the number of unemployed in absolute terms (yearly average) for the first time since the labour force survey was introduced in 1963.[3] As a result, the labour market eased in 1969, although shortages of labour still occurred on a seasonal and regional basis, particularly in and adjacent to Taipei and Kaohsiung. The trends in employment distribution in 1969 were for decreases in primary industry from 39.7 to 39 per cent[4] and in tertiary industry from 35.5 to 34.6 per cent, and for an increase in secondary industry from 24.8 to 26.4 per cent.

[3] Owing to seasonal variations, the numbers of unemployed naturally fluctuated throughout the year.

[4] 1968 figures given first.

Between 1965 and 1968, the fastest rise in real wages was in the electricity, gas, water, and sanitary services sector (17.0 per cent), followed by manufacturing (13.4 per cent), and transport and communications (11 per cent). In manufacturing, the 16.6 per cent difference between the rise in money and in real wages (30.2, compared with 13.4 per cent) was accounted for by changes in consumer prices. Over this period, real wages in the economy apparently increased by less than the increase in labour productivity, since from the end of 1964 to 1968 the rise in GDP at constant prices divided by total employment was 30 per cent approximately. If the data are disaggregated into the agricultural sector and the non-agricultural sector, from 1964 to 1968 real wages increased faster than productivity in the non-agricultural sector.

Monetary and fiscal developments

Particular reliance has been placed on monetary policy in recent years to achieve short-run stabilization. The Central Bank has reacted swiftly to developments in the money market, lowering its lending rates and reducing reserve requirements for bank deposits when the money market became tight. In addition, credit on easier terms has been made available by the Central Bank when the agricultural and industrial sectors ran into financial difficulties during particular periods, such as after the typhoon destruction in late 1969.

During the last decade, interest rates have gradually fallen, although the rates on secured and unsecured loans by commercial banks have stood at 13.32 per cent and 14.04 per cent per annum respectively since the middle of 1967.[5] On the other hand, in 1969, the Central Bank raised deposit rates of interest in an effort to encourage an increase in bank deposits.

The money supply rose by some 16.2 per cent in 1969 and showed little change in the rate of increase in 1970, with a rise of nearly 9 per cent over the first eight months of the year. The largest contributory factor to the increase in 1970 was the growth in net foreign assets. These rose by over 22 per cent in the first eight months of the year from NT$17,594 million in December 1969 to NT$22,475 million in August 1970. In an attempt to neutralize some of the influence of this increase on the economy, the monetary authorities suspended impact loans.[6]

[5] The rates in the unorganized money market vary locally; in August 1970, they stood at 21.6 per cent for secured loans and 28.8 per cent unsecured in Taipei.

[6] Impact loans are working capital borrowed from abroad by joint-venture factories in Taiwan.

Monetary policy played a large role in helping to maintain domestic stability over the greater part of the last decade. Heavy reliance was placed on interest rate policy, and high rates of interest helped to divert excess liquidity into time deposits. In the last three years, however, there was a tendency towards lower interest rates, and monetary policy did not prove to be as effective as before as a means of increasing domestic savings. Changes could perhaps be made in the banking system to improve general efficiency, possibly by narrowing the interest rate gap between loans and deposits.[7] However, it seems probable that the recent trend to greater stress on fiscal policy will continue and that fiscal policy will be increasingly used over the next few years.

Important changes have been occurring in recent years in fiscal policies. This has been in part because the growth in government revenue was lagging behind expenditure and increased taxation was felt necessary, and in part because there was an increasing need for government expenditures on an expanded scale, notably on infrastructural and educational and training facilities. A Tax Reform Commission was established in 1968 to consider the entire tax system and to devise ways to improve it. Its objectives were to make proposals to increase government revenue, to cut administrative costs, and, in particular, to make government revenue more income elastic so that the Government's share can increase with economic growth to meet the growing demands made on it. Tax revenue has increased rapidly in recent years due to improvement in tax administration, a wider tax base, and rapid economic growth. The introduction of computerized data processing is felt to be an important step toward reducing tax evasion and improving efficiency in collection. Preparations are being made to introduce a new value-added tax, designed to replace most of the existing commodity taxes and the stamp tax, together with the business tax. It is anticipated that it may be possible to introduce this in about one year.

Foreign trade

Total foreign trade continued to expand in 1969, and, according to foreign exchange statistics, reached $2,315 million, an increase of almost 24 per cent over 1968. The trade balance has been in deficit since 1964, but, in 1969, the deficit fell by half to $94 million because increased earnings on the export side were sufficiently large to more than cover the increase in imports. Exports rose by almost 32 per cent in 1969, which represented an increase over the 25 per cent recorded in 1968, and imports increased by about 17 per cent, rather less than the 21 per cent increase in 1968. Trading figures for the first eleven months of 1970 reveal that a trade surplus of $23 million was earned, and total trade for the year may have reached $3,000 million. In brief, not only are exports increasing faster than imports, but the rate of increase is rising for exports and falling for imports. Barring exogeneous changes, the recent improvement in the balance of payments should therefore continue, the improvement being largely due to favourable changes in the visible items.

The structure of exports has altered markedly in recent years. The major exports of the past, such as sugar, rice, tea, salt and citronella oil, have been replaced by new items of importance resulting from rapid industrialization. Major items[8] now are textiles ($265.9 million), metals and machinery ($223.5 million), plywood ($65.6 million), canned foods[9] ($84.5 million), and chemicals ($35.9 million). In 1969, unprocessed agricultural produce represented a mere 16 per cent of total exports, while industrial products constituted 72.5 per cent.

Total imports stood at $1.205 million in 1969, and, as with exports, there has been a steady structural change over the long run, with an increase in capital goods imports and a decrease in consumer goods imports. Capital goods made up 31 per cent of imports, although their share began to fall in 1968 and continued to decrease in 1969. Imports of consumer goods stood at a record low level of $78.5 million (6.5 per cent) of the total, while raw material imports increased rapidly to $753.7 million (62.6 per cent).

No important changes occurred in major export markets in 1969. The United States still held first place with 36 per cent of all exports, followed by Japan (16 per cent), and Hong Kong (8 per cent).

The sources of imports also continued in the pattern of the last few years, with Japan in first place (40.6 per cent), followed by the United States (27.7 per cent). The heavy reliance on these two suppliers continued, but a slight widening of sources of supply was achieved, since these two dominant countries normally supply over 70 per cent of total imports.

Efforts to expand exports have resulted in a high degree of specialization by some industries in export rather than domestic markets as illustrated in table II-3-11.

Generally speaking, exports to the industrial countries consist mainly of labour-intensive goods, such as agricultural produce, canned foods, textiles, and plywood, while exports to the developing countries increasingly consist of more capital-intensive industrial products.

[7] For instance, a three months' time deposit pays 6.48 per cent per annum, whereas secured loans are made at 13.32 per cent per annum.

[8] The 1969 export figures are in brackets. The source of data is *Taiwan Statistical Data Book*, 1970, table 10-8.

[9] Canned pineapple, mushrooms and asparagus spears.

Table II-3-11. China (Taiwan): Degree of export orientation in selected industries in 1969

Item	Percentage of total production exported
Canned pineapple	95.5
Canned mushroom	97.0
Canned asparagus	94.0
Plywood	94.6
Canvas and rubber shoes	91.9
Rain boots and shoes	89.1
Plate glass	66.2
Plastics	52.7

Source: National sources.

As can be seen from table II-3-12, the basic balance of payments improved in 1969, with a reduction in the trade deficit from $74 million in 1968 to $21 million, and an increase in net capital inflow from $57 million to $146 million. Preliminary estimates show that the over-all deficit of $43 million in 1968 was turned into a surplus of $89 million in 1969, while the current account showed a deficit of only $42 million in 1969, as against $117 million in the preceding year. Interesting developments in 1969 were that visible exports increased more than imports, the net deficit on service transactions was halved to $29 million, net transfer payments remained positive but fell to only $7.75 million, and capital inflow increased two and a half times within the year. In 1970, foreign exchange reserves increased rapidly, the net addition in the first quarter being $50 million, equal to more than half of the total increase of the entire preceding year. The major factor accounting for this was a substantial rise in export earnings, especially earnings from exports of manufactured products.

Table II-3-12. China (Taiwan): Balance of payments

(in million dollars)

Item	1968	1969
Exports (f.o.b.)	825.87	1,079.95
Imports (f.o.b.)	—899.78	—1,100.88
Services (net)	—59.99	—28.67
Transfer payments	16.12	7.75
Current account balance	—177.78	—41.85
Capital movements	57.73	146.15
Net errors and omissions	16.94	—15.07
International reserves	43.11	—89.23

Source: CBC, *Data on Balance of Payments.*
Note: Absence of sign indicates credit; minus sign, debit.

The debt service ratio[10] of the Republic in recent years has been low, at about 4 to 5 per cent, and it stood at 4.8 per cent in 1969. Debt servicing, therefore, constitutes no problem. Considerable investment in infrastructural facilities will be necessary in the next few years, and this will probably require larger inflows of foreign capital. If a larger proportion of this foreign capital is on commercial terms than in the past, it is likely that the debt service will rise slowly, but probably not to levels that would cause concern.[11]

Major policy issues

In planning for the 1970s, the Government has set a growth rate of 8.5 per cent in real GNP as a target; a much lower rate than the average achieved for 1965-1968, or during 1969. The reasons for this are a shift in the development programme towards more capital-intensive projects within industry and increased emphasis on infrastructure investment.

This shift in strategy involves two general problems in the years immediately ahead. First, the increased emphasis on capital-intensive projects will require a substantial increase in fixed-capital formation. The plan is for this to rise at 11.6 per cent per annum, which is more than twice as fast as the planned annual 5 per cent rise in private consumption. Consequently, the share of private consumption in GDP is to fall from 60.4 per cent in 1968 to 56.1 per cent in 1972, while that of investment is to rise from 19.9 per cent to 23.5 per cent. In addition, the share of government consumption in GDP is to increase in the same period only marginally from 18.5 per cent to 19 per cent, so that the share of consumption in GDP is projected to fall from 78.9 per cent in 1968 to 75.1 per cent in 1972. However, there is some doubt as to whether consumption can be so constrained at a time when money wages are rising rapidly, with the result that inflationary pressure, already evident in the economy, may be expected to increase in the next few years, especially since the pattern of industrial production is planned to move more in favour of capital goods.

The second problem is that, because of the need for heavier investments in infrastructure, the public sector's share of total fixed investment is likely to increase. Although efforts have been made to reform the tax system, it is likely that the gap between public saving and investment may widen in the short run, so that increasing recourse will have to be made to foreign sources of finance, if deficit financing is to be avoided.

[10] Measured as interest payments plus repayments of principal as a percentage of exports of goods and services.
[11] This assumes that exports will do as well as in the past.

Monetary and fiscal policies will continue to be of great importance to dampen the inflationary pressures that are likely to develop in the next few years, and especially to counteract the internal effects of a rising trend in net foreign assets. In this connexion, the gradual reduction in rates of interest during the latter part of the 1960s has probably had the desirable effect of stimulating investment, but too rapid a further reduction may create added inflationary problems.

Apart from the danger of inflation, the economy faces three other major problems at the present time, each of which is, however, related to the general issues discussed above. These concern the infrastructural bottleneck, the export-processing zones and the modernization of agriculture.

The infrastructural bottleneck

A good deal of investment in infrastructure was made in the past, much financed by United States aid, and this contributed to the rapid industrialization and high rates of growth of the last decade. However, the existing capacity has now been taken up and infrastructural facilities have become a bottleneck to future economic growth. This is particularly evident in the transport and power sectors which will both require quite substantial investment in the next few years. The Government has rightly decided to tackle this problem; plans have been prepared and work in this field has already commenced.

Since the Republic of China has such a large foreign trade sector (the share of exports in GDP in 1968 stood at 24.4 per cent), and relies on high and rising exports as a stimulus to growth, highways and harbours are being given first priority within the transport sector. The construction, servicing and maintenance of engines, roads and harbours are of major importance to a continuation of the country's successful export record.

The three sea ports of Kaohsiung, Keelung and Hualien will be expanded; in the case of the first, to double its present size as measured by tonnage capacity. Kaohsiung is also to be developed as a container relaying port, and container facilities are rapidly being established. A new fourth international harbour is planned at a cost of $208 million, and it is anticipated that it will be in partial operation in 1974. In addition, work will shortly commence on the construction of an oil harbour in the north.

Power supplies are barely adequate despite a threefold increase in installed capacity between 1960 and 1969 in the electricity supply industry. The Taiwan Power Company estimates a rate of growth of demand of 13 per cent annually up to 1975, the fastest expansion being in the demand for residential lighting. The programme for the next decade involves the construction of twenty-two more generating plants, of which three will be nuclear-powered.[12]

Efforts will also be made to develop other parts of the energy sector more rapidly. It is estimated that the annual rate of growth of demand for oil products will be 15 per cent, and for natural gas, 10 per cent.

The aim of the Government in expanding the energy sector is not only to provide added supplies of power, but to help the country's balance of payments position as well. The proportion of total energy used domestically which is imported, largely accounted for by fuel oil, has increased rapidly of late and stood at 44 per cent of the total energy supply in 1968. Development of domestic sources of supply can thus save on imports and strengthen the country's balance of payments position.

The export-processing zones

Export-processing zones are a device for inducing investment in export enterprises from both domestic and foreign sources. The advantages for the firms are the availability of all the facilities of an industrial park and minimal procedural requirements. The Government established the first zone at Kaohsiung in 1966, and two more are in the process of being set up, one more at Kaohsiung and one near Taichung. In August 1970, the Kaohsiung zone had about 150 factories operating on 69 ha, and, by May 1970, six applications had been approved for Taichung, which has, on 23 ha, a designed capacity for fifty firms. The third zone, which, with 115 ha, is the largest of the three, began to accept applications in mid-1970. The second and third zones are expected to be completed by the end of 1970.

The development of the export zone scheme is linked in some minds with the noteworthy successes achieved in exports, and some other countries of the region appear to be considering the possibilities of introducing such a scheme. However, the initial enthusiam in China (Taiwan) is giving way to a critical re-evaluation after several years' experience.

One problem that has emerged is that the linkage effects on the rest of the domestic economy have been weak. Few Taiwan products are used as material inputs, and these constitute perhaps no more than 10 per cent of total material inputs. In addition, there has been relatively little spillover of technology and expertise into the rest of the economy, so that this hoped-for major benefit of foreign investment has not been realized to the extent expected.

[12] The first, the Talin No. 2 thermo-electric station, with a capacity of 300 MW, went into operation in May 1970.

A second problem is that the industries that have been attracted are largely labour-, rather than capital-intensive, particularly the electronics and garment industries. This has reduced the availability of labour for firms operating mainly for the domestic market, and, by increasing the demand for labour, has led to wage increases. In addition, the zone has attracted workers from agriculture, and a seasonal and regional labour shortage has emerged there, causing some reduction in multiple-cropping.

Another problem has been the disposal of goods of a quality unsuitable for export, since products from the export zones cannot legally be sold within the Republic without a great deal of administrative effort. This seems to have reduced the attractiveness of the zones to local firms, which perhaps tend to face this problem to a greater degree than do joint ventures or foreign enterprises.

There is also a feeling in some quarters that the benefits offered by the zones may attract poorly-run firms that could not compete with the better firms without concessions. According to this view, if firms cannot survive without concessions, they should not be wanted.

It is not clear what the net assistance to the balance of payments has been from the establishment of the Kaohsiung zone. In 1969, this zone supplied less than 6 per cent of all exports by value and this is a gross figure. Net exports, gross exports less imports, would be less than this. For example, 46 per cent of the exports were electronic items, and these have a large import content. For the zone itself, net export earnings are about 25 per cent of gross export sales.

There is also some question as to whether the export zone already in operation has increased the inflow of foreign capital or merely directed some of it into this location within Taiwan. Figures seem to show that the average monthly inflow of overseas Chinese and foreign capital between 1952 and 1967 was greater than that in the first twenty months of operation of the first zone.[13] Finally, in the re-evaluation of the value of export zones their isolation from the domestic economy is considered to be something of a problem.

Agricultural modernization

One of the most significant developments in recent years has been the emergence of seasonal labour shortages in agriculture, and the demand for labour within industry continues to grow, with agriculture as one source of supply of workers. Consequently, the strategy of agricultural development in the next few years will be one of raising the productivity of those remaining in agriculture, so that the transfer of labour to industry will not be at the cost of reduced agricultural output. As part of this strategy, mechanization in various forms will become increasingly important in the agricultural sector.

The progress of mechanization is presently hindered by the small size of holdings and the cost of new equipment. The average size of farms has suffered a steady decline from 1.18 ha in 1956 to 1.03 ha in 1969. Since 1961, however, efforts have been made to consolidate small plots, and some farmers put their machines out on local hire. It has been suggested that hiring of machines could be encouraged by the Government, and that this, together with specialization of crop by area, would permit the purchase and economic utilization of more specialized machinery. Some machinery stations have already been established in traditional rice-growing areas, and local farmers can hire a team with machines from them.

The cost of machinery and fertilizer inputs is extremely high. Import substitution in fertilizer production has led to very high costs of domestic output so that, despite a price reduction of urea in March 1970, the domestic price is still about 60 per cent above prevailing world levels. In addition to this is the problem of credit availability. At present, the agricultural credit system does not seem to provide adequate facilities for long-term financing.

In sum, 1970, like 1969, was a good year for the country's economy, despite the emergence of some inflationary tendencies as shown by the rise in the consumer price index. The shift in development strategy to heavy industry and infrastructural development may result in some slowing down in the over-all rate of growth of GNP, but it will also help to remove important bottlenecks to future growth. Finally, both monetary and fiscal policies will continue to play an important role in containing inflationary pressures arising out of the current development programme.

Fiji

Introduction

Fiji consists of a group of some 800 islands spreading over 100,000 sq mi of ocean in the south central pacific. The largest island, Viti Levu, where the capital, Suva, is located, makes up nearly 60 per cent of the total land area. On 10 October 1970, following a period of rapid constitutional development in the 1960s, Fiji emerged as a fully self-governing dominion within the British Commonwealth.

[13] "The Kaohsiung Export Processing Zone", in *Industry of Free China*, September 1968, p. 30.

[1] This is the first time that a survey of Fiji has been included in the *Economic Survey of Asia and the Far East*.

The economy of Fiji is based essentially on agriculture, which occupies about 50 per cent of the labour force. Though subsistence agriculture and the production of cash crops and livestock products for local markets occupy a major part of the labour force, sugar production for export is the most important single activity. Bananas, coconuts and gold are the other principal export items, with fish products a more recent development. In recent years, there has been a considerable expansion of recipts from tourism which have largely offset the failure of traditional commodity export receipts to rise.

Expansion in tourism, government expenditure and the building and construction industry have been the main reasons why economic growth has been able to continue during the past five years in spite of stagnation in traditional export earnings. Over the period 1965-1970, gross domestic product rose at about 5.3 per cent per annum, which was only slightly below the planned rate of growth of 5.6 per cent per annum. Population increased during this period at an average annual rate of 2.5 per cent, so that the rise in real income *per capita* was about 2.8 per cent per annum, and the level of *per capita* income in 1970 is estimated at US$393. There were considerable differences in sectoral growth rates. Agricultural output grew at only 2.3 per cent per annum, reflecting the stagnation of sugar, copra, and banana production. Manufacturing output grew at an average rate of 5.2 per cent per annum. Both of these rates of growth were less than planned. By contrast, the building and construction sector grew by 12.8 per cent per annum, compared with the planned rate of growth of 4.8 per cent, and the transport and communications sector grew by 11.8 per cent per annum, compared with a planned increase of 6.1 per cent. The fastest growing sector has been tourism, at just over 20 per cent per annum since 1965; nearly twice as fast as the planned rate of growth of 10.7 per cent per annum.

The sixth development plan for the period 1970-1975 was published at the end of November 1970 and it provides for a growth rate of 6.7 per cent per annum. Particular emphasis is also laid on the need to secure better income distribution in the country, especially as between rural and urban areas, because this division to a large extent coincides with the ethnic divisions within the country. Better income distribution is seen as an essential part of avoiding urban-rural disharmony and political instability in the future. Although the new plan is expected to create 30,000 new jobs, a rise in the total number of urban unemployed from 9,600 to 12,100 is seen as likely, given the levels of expenditure projected under the plan.

Use of resources

The over-all growth of 5.3 per cent per annum in real terms of the Fiji economy for the period 1965-1970 was accompanied by changes in the structure of the economy. The main feature was a decline in the share of agriculture, forestry, and fishing from 33.5 per cent in 1965 to an estimated 27.2 per cent in 1970. Mining and quarrying as well as manufacturing also fell slightly. The building and construction industry increased its share from 5.4 per cent to 8.4 per cent over the same period, a movement which was roughly paralleled by the transport and communications sector which also increased its share to 8.4 per cent in 1970. The tourist sector, though small in total, doubled its share of gross domestic product from 1.7 per cent to 3.4 per cent, and, with a planned growth rate of around 20 per cent for the next five years, it is expected that it will once again nearly double its share during the forthcoming period of the sixth development plan.

A particularly noticeable feature of economic development in Fiji in recent years has been the sharp increase in the share of investment in gross domestic product and the reduced share of private consumption. In 1965, private consumption was 72.1 per cent of GDP at market prices, but fell to 61.9 per cent in 1969, and is estimated to have risen to just over 63 per cent in 1970. Government expenditure on goods and services has remained fairly constant as a share of gross domestic product at around 12 per cent. Gross fixed investment, however, has shown a large increase from 20.7 per cent in 1965, to 26.9 per cent in 1969, and to 28.3 per cent in 1970. The largest part of this investment is in the private sector, private investment being 20.7 per cent of gross domestic product at market prices in 1970. The large rise in investment and the slow growth in personal consumption have undoubtedly helped to lay solid investment foundations for future growth.

Consumer prices rose only 2.8 per cent in the period 1965-1968, but rose sharply in 1969. Part of the increase is accounted for by price rises which took place on the conversion to decimal currency at the beginning of 1969.

Agriculture

The main islands of Fiji are fairly mountainous, and agriculture and settlement are confined very largely to the relatively fertile coastal plains and river deltas. Approximately 30 per cent of the area cultivated was in sugarcane and 50 per cent in coconuts. Sugarcane is grown mostly on the dry western side of Viti Levu and Vanua Levu, the two main islands, with coconuts more generally distributed, but with significant commercial plantations on the third largest

island, Taveuni. Sugarcane, coconuts and bananas are the main cash crops, but a wide variety of tropical fruits and vegetables is grown, principally for local consumption but also, to some extent, for the export market.

Total agricultural production has fluctuated substantially over the years, mainly because of the size of sugar output in the total, and variable weather conditions have affected this crop in particular. A major problem in the rural sector is the provision of adequate marketing facilities. As a means of over-coming some of these difficulties, it was announced in 1969 that a National Marketing Authority would be created by the Government. Its basic task will be to facilitate marketing by private and co-operative agencies by the creation of storage, grading and handling facilities and the provision of advice and information. It will give assistance in particular to co-operatives, which have an important function in the Fiji economy. The number of co-operatives rose from 583 to 851 in 1969, and membership rose from 18,800 to 26,400. In addition, there was an increase in the number of thrift and credit societies from 86 in 1968 to 124 in 1969. There is an urgent need, however, for better management, and a co-operatives training school is being established in Suva under the sixth development plan. Consideration is also being given to a national co-operative bank as a means of mobilizing small savings and providing credit in rural areas.

Most of the basic foodstuffs required in Fiji, especially root crops, are produced locally, and production of other foodstuffs, such as meat and dairy products, has expanded considerably in recent years.

The principal commercial crops for export are copra, sugar and bananas. In 1969, sugar production was affected by drought conditions and cane crushed was only 2.3 million tons from 116,000 acres harvested by comparison with 2.8 million tons from 115,000 acres harvested in 1968. Production is not likely to increase much in the future as exports are effectively limited by quotas under the International Sugar Agreement. Internally, an important issue is the future ownership and management of the industry. The sole milling company is South Pacific Sugar Mills, a subsidiary of the Colonial Sugar Refining Company (Australia), and it announced its intention of withdrawing from operations in Fiji as from the end of the 1972 season. The reason is that the company considers unacceptable the terms of the new contract awarded by an independent tribunal following a dispute between the millers and growers. The new contract awarded an increased proportion of total sugar receipts to the growers and reduced the proportion going to the milling company. Since that time, discussions have been proceeding between the Fiji Government and the Colonial Sugar Refining Company on the terms under which the Government will take over the assets of the company, but no decisions have been made yet.

The other main export product is copra. Production in 1969 rose to 33,000 tons from the level of 28,000 tons reached in 1968. Most copra is now crushed in Fiji, exports being principally in the form of coconut oil. In 1969, exports of oil were around 17,000 tons, but at prices which were some 18 per cent below 1968. Copra production is expected to be about 30,000 tons in 1970, rising to around 48,000 tons by 1975.

Banana production for export was affected during the year by dry and cool weather and consequently export values fell back to F$289,000 compared with F$354,000 in 1968.

Of the grain crops, the most important is rice. Although there were increased plantings in 1969, it is estimated that over-all production did not increase because of adverse weather conditions; likely production in 1970 is 20,000 tons. The production target for 1975 is 36,000 tons.

Industrial production

With clearer evidence that traditional exports of sugar, copra, bananas and gold are not likely to show much expansion in the future, the need to develop industry, both for local needs and for export, is more deeply appreicated. Various concessions to assist the establishment of manufacturing enterprises have been introduced from time to time, but this policy has been very largely *ad hoc*. The tariff is principally a revenue instrument. Little thought has been given to its use as a positive means of promoting industrial growth.

The sixth development plan contains the most explicit and comprehensive statement of government policy about industrial development that has yet appeared in Fiji. It is recognized that, for a long time to come, the Fijian economy must continue to depend upon agriculture and traditional agricultural exports, such as sugar, but there is a clear recognition that a serious start must now be made toward expansion of industrial development in Fiji as a long-term policy. Furthermore, though the tourist industry has been expanding very rapidly, there is a desire to avoid having the economy become too dependent on tourism.

The limitations to the scope of industrial development in Fiji seem to be fully appreciated. Industrial development is not sought irrespective of cost, but is considered in the content of the relative competitiveness of products with those produced elsewhere in

the world. The small size of Fiji, with a population which will be only about 740,000 in 1985, places clear limitations on the types of industries that can be developed within the scope of the Fiji market. In the initial stages, therefore, industrial development policy will seek to concentrate on industries where economies of scale are not important, where transport costs from other countries are high, or where local advantages can be exploited. Industries processing local agricultural produce, therefore, have a high priority, and it seems clear that there is considerable scope for import substitution, especially in the production of processed foodstuffs. Priority is also to be given to those products for which export markets, especially in other Pacific islands and countries such as Australia and New Zealand, are likely to be available. This applies in particular to processed fruits and vegetables, fish products, and forestry products such as sawn timber, veneers and plywood. Exports of some manufactured goods have increased significantly in recent years, although, in total, they are relatively small contributors to foreign exchange receipts.

The Government's general approach to industrial development is to rely primarily upon private investment and to establish the infrastructure and investment climate within which such private investment can confidently proceed. So far as foreign investment is concerned, there are no significant constraints on the importation of private capital from abroad, and no major obstacles to the repatriation of profits and dividends and capital. There is also no discriminatory taxation against foreign investment. This policy is likely to continue.

Recognizing the difficulties that industries have to face in Fiji, where suitable land is scarce, and also to economize on infrastructure investment, a policy of industrial estates has been implemented. A major industrial estate at Vatawaqa (Suva) is due for completion in 1971 and further estates are planned.

Manufacturing and processing are at present a relatively small part of economic activity in Fiji. Total output grew at an average 5.2 per cent at constant prices over the period 1965-1970, but there were considerable fluctuations within this period. Manufacturing and processing accounted for 10.5 per cent of GNP in 1970. However, more than half of this is sugar processing, and, if this is excluded, it is clear that the share of other manufacturing in gross domestic product is small. The manufacturing sector also provides only a small share of total employment, estimated to be 8.6 per cent in 1970, the sugar industry being responsible for over 40 per cent of this employment.

Foreign investment is particularly important in the manufacturing sector. A survey of private sector capital investment expenditure in manufacturing showed that firms with 50 per cent or more of foreign capital accounted for 80 per cent of gross fixed-capital formation and 84 per cent of total turn-over.

Mining and quarrying

This sector contributes about 1.4 per cent to gross domestic product. The main activity is gold and silver mining, with, in recent years, some extraction of manganese and copper ores. The value of output, however, has continued to decline over the past five years, largely because of rising costs of development and extraction in the face of constant prices.

Energy industries

The main output of energy used in Fiji is electricity, derived almost wholly from diesel-oil generating plants. Public electricity supply is largely confined to the main urban areas; the population in areas so covered being about 170,000 in 1970, compared with 60,000 in 1965. Consumption of electricity has risen very rapidly. Rural electrification on a large scale is not planned for the immediate future, mainly because of the high cost involved. Nevertheless, it is proposed that assistance be given towards the provision of diesel generators in rural areas.

The growth of demand makes it possible to consider the feasibility of hydro-electric schemes. Some preliminary investigations have already been made, and there are indications that a good site exists in the central part of Viti Levu, with a capacity of about 200 million kWh per annum. A feasibility study of this project will be undertaken in the near future with a view to its implementation in the latter part of the 1970s.

Building and construction

The building and construction industry is one of the fastest growing sectors of the economy. In order to meet the targets of the sixth development plan, with its heavy emphasis on investment, the industry will need to grow in the next five years at an average rate of 9 per cent per annum. In 1965, building and construction accounted for 5.4 per cent of gross domestic product, but this had increased to 8.4 per cent in 1970. The industry employs about 7 per cent of the labour force. Wage rates are generally above the average for all industries, the daily mean wage being F$2.40 in 1969 by comparison with the all-industry figures of F$2.32. The expansion of the industry in recent years has been a result

of government and private investment in the hotel industry. The industry is at present suffering from an acute shortage of skilled workers and although the development plan recognizes the need to increase skilled manpower, it is likely that the industry will be under considerable pressure to meet the building and construction targets in the plan. The industry is an important user of local supplies, the main product being cement, the output of which was 55 per cent greater in 1970 than 1965. No clear data on building costs are available but it seems apparent that these costs rose sharply in 1970.

Services

The wholesale and retail trade of the economy grew by 4.5 per cent in real terms between 1966 and 1970, rather less than the growth of the economy as a whole. This sector contributed 15.8 per cent of gross domestic product in 1970 and is an important employer of labour, especially in urban areas. Much of this labour is self-employed or family labour rather than wage employment. One of the main problems facing the further development of the sector is the limited size of the Fiji market which makes it difficult for firms to grow to a size where significant economies of scale may be reaped.

The provision of adequate transport and communication is particularly difficult in Fiji with its widespread geographic dispersion. In the last five years, the transport and communications sector has expanded at an average of 11.8 per cent per annum. Its share of total gross domestic product has increased over the period from 5.6 per cent to 8.4 per cent. A general survey of transport and communication facilities and requirements for Fiji was carried out by United Nations experts and their report was presented in 1969. The report recommended expenditure of around F$40 million over the next ten years, and these recommendations are reflected in the provision of just over F$24 million in the sixth development plan, this being more than one-third of the total of central government capital expenditure for the period. Much of this expenditure will be on the provision of inter-island shipping and airport facilities but the largest element will be the expenditure of F$14 million on the reconstruction of the Suva-Nadi road.

The tourist industry is the fastest growing element in the services sector, though it is still relatively small in terms of contribution to gross domestic product. The most important sources of tourists to Fiji are Australia, the United States and New Zealand, and, in 1969, these countries provided about 75 per cent of all visitors.

As a means of encouraging investment in tourist facilities, assistance in the form of a grant equal to 7 per cent of the capital cost of an hotel (excluding land) may be granted, in addition to accelerated depreciation of the capital cost over a period of fifteen years. Alternatively, allowance on capital expenditure for tax deduction purposes equivalent to 55 per cent of the capital expenditure can be offset against taxable income. In addition, ordinary depreciation is allowed on the construction cost. Government expenditure for tourist is primarily in the provision of infrastructure in resort areas and the development of natural attractions. These expenditures are expected to amount to F$900,000 over the 1970-1975 period.

External trade and the balance of payments

Fiji operates a two-column tariff involving a general rate for goods from non-members of the Commonwealth and a preferential rate for goods from Commonwealth sources. The maximum general rate is 50 per cent, although a more usual rate would be 25 per cent, with 10-15 per cent the usual Commonwealth rate of tariff. A new customs tariff based on the Brussels Nomenclature was introduced in 1969, and simultaneously the Standard International Trade Classification was adopted. In 1969, a tariff review committee met to consider the tariff structure in relation to development, and, subsequently, duties were reduced in 1970 on a wide range of machinery, equipment and raw materials from both preferential and general tariff areas as a means of improving the competitiveness of local industry. In general, reductions were up to 5 per cent in respect of preference source and up to 15 per cent in respect of general sources. The sixth development plan has proposed the establishment of a tariff review board to undertake continuing review of the tariff structure in the light of both revenue and industrial development needs. As a means of assisting the export of manufactured products, the export tax of 2 per cent on all exports was abolished in 1970, except in the case of sugar and coconut oil.

The ratio of imports to gross domestic product rose from 43.2 per cent in 1966 to an estimated 51.7 per cent in 1970. As regards exports, the ratio has risen from 38.6 per cent to 45.3 per cent. Fiji exports agricultural commodities and services (tourism) and imports most of its capital equipment as well as a substantial proportion of final consumption goods and of raw materials required for manufacturing. Exports rose nearly 11 per cent in 1969 over 1968, from F$39.2 million to F$43.5 million. The principal commodities exported are sugar, which comprises about 66 per cent of the total, together with copra and coconut products, bananas and gold. Sugar exports, which were 341,000 tons in 1968, fell in 1969 to 317,000 tons, the main reason being lower production in Fiji as a result of a particularly dry

season in the growing areas. However, prices on average were 22 per cent better, so that receipts were F$3.2 million higher than in 1968. In the food-stuffs category, fish exports (mainly canned) rose from F$1.9 million in 1968 to F$3.5 million in 1969. Coconut oil exports showed little change in volume, but, because of lower prices, receipts were lower at F$3.9 million, compared with F$4.8 million. Gold exports also fell. Manufactured exports, though small, continued to show a steady increase, soaps, paints, footwear, clothing, biscuits and metal manufactures being the main items concerned. However, these are still only minor contributors to the balance of payments.

The principal markets for Fiji's exports are the United Kingdom, Australia, Canada, New Zealand and the United States. The share of the United Kingdom in Fiji's exports has steadily dropped from 41.5 per cent in 1965 to 34.6 per cent in 1969. Canada's share rose from 6.3 per cent in 1968 to 9.3 per cent in 1969, largely because of increased purchases of sugar. The United States share has risen from 13.6 per cent to 15.7 per cent, partly because of increased sugar purchases, but also because it is the main market for fish products from the Japanese-operated tuna-fish cannery.

The main sources of imports are the United Kingdom, Australia, Japan and New Zealand. The United Kingdom's share of imports fell from 23.4 per cent in 1965 to 19.9 per ecnt in 1969; Australia's share from 29.4 per cent to 25.3 per cent; and New Zealand's share increased from 8.1 per cent to 9.3 per cent over the period as the result of greater competitiveness following the devaluation of the New Zealand dollar in November 1967. The Japanese share in imports was 14.2 per cent in 1969.

A summary of the Fiji balance of payments for the period 1965-1970 is given in Table II-3-13. A noticeable feature is that there has been a growing commodity trade imbalance over the years, reaching nearly F$40 million on a c.i.f. basis in 1970. In large measure, this has been offset by rapidly increasing receipts from tourism, but there is still a deficit which has been met by public and private capital inflows. These have been sufficient to allow some increase in external reserves.

Population and social development

As at mid-1970, Fiji's population was estimated to be 520,000 and to be growing at an average rate of 3.3 per cent per annum. Since 1966, population growth has slowed down somewhat, partly as the result of an intensive family planning campaign but also because of such factors as the delayed marriage of Indian women. The population is multiracial, with 42.7 per cent indigenous Fijian, 50.1 per cent Indian, and the balance European, Chinese, and other ethnic groups, principally Pacific Islanders. In common with many other developing countries, Fiji's population is very young, 55 per cent being under the age of 19 years at the end of December 1969. This, of course, has particular significance for the provision of educational and medical and other social services, as well as for the provision of work opportunities in the 1970s and 1980s, though the rapid decline in the birth rate achieved since the mid-1960s will have some effect in reducing these demands. The labour force is estimated to be 149,500 in 1970, of which 139,900 were in employment. The labour force is growing by approximately 4.4 per cent per annum. One part of the problem of preventing a rise in unemployment is to ensure a reasonable rate of progress in rural development as a means of keeping people out of urban areas, but what is more important is the problem of up-grading the general level of skills of workers, and this is seen as one of the major tasks of education expenditure in the next development period.

Money credit and prices

The Government does not exert control over the level of money and credit in Fiji. The operations of the Currency Board, which is a part of the Ministry of Finance, are confined to the issue and redemption of currency against foreign exchange. The money supply is thus influenced directly by changes in the foreign exchange reserves of the commercial banks.

The money supply rose steadily from the end of 1965 to the end of 1968, from F$36.3 million to F$45.8 million. In 1969, there was a sharp expansion to F$55.2 million, since which time it has been fairly stable, reaching only F$55.8 million at the end of June 1970. Some part of this expansion reflects the monetization of the economy, but the general rise in economic activity of the last few years is the main factor involved. The money supply in Fiji is defined as notes and coins plus total net deposits.[2] Prices remained fairly stable over the period 1965-1968, but there was a sharp up-turn in 1969, and a further rise in the first five months of 1970 of just over 4 per cent. Rising import prices seem to be one factor and this is important because of the size of imports in relation to gross national product, but another factor has been wage increases, the wage index showing a rise of 5.6 per cent between 1968 and 1969, since when further increases have been granted, especially in the manufacturing, construction and government sectors. The rise in these sectors reflects

[2] Total net deposits = (deposits with trading banks *plus* deposits with commercial banks *plus* deposits with post office savings banks) minus (cash with trading banks *plus* commercial savings banks deposits with trading banks *plus* cash with post office savings banks *plus* post office savings banks deposits with commercial banks).

Table II-3-13. Fiji: Balance of payments, goods and services, 1965-1970

(in million Fijian dollars, current prices)

Item	*1965*	*1966*	*1967*	*1968*	*1969*	*1970*[a]
Receipts						
(*a*) Exports, f.o.b.	35.1	31.7	34.9	39.9	43.8	45.1
(*c*) Non-monetary gold	3.1	3.0	3.1	3.5	3.4	3.2
(*d*) Freight and insurance	0.9	1.0	0.9	0.9	1.0	1.0
(*e*) Other transport	6.0	5.8	6.4	8.3	8.9	9.5
(*f*) Foreign travel	7.5	8.6	11.1	15.6	20.9	26.7
(*g*) Investment income	1.4	1.7	1.1	1.5	1.5	1.6
(*h*) Government services	1.2	1.2	0.9	1.0	1.1	1.2
(*i*) Other services, n.e.s.	0.7	1.0	1.3	1.1	1.3	1.6
Total	55.9	54.0	59.7	71.8	81.9	89.9
Payments						
(*b*) Imports, f.o.b.	47.2	39.7	45.7	55.4	63.1	72.1
(*d*) Freight and insurance	10.3	9.8	9.9	12.3	13.9	15.8
(*e*) Other transport	3.0	3.3	3.0	4.0	4.4	4.9
(*f*) Foreign travel	1.1	2.2	1.4	1.6	1.7	1.8
(*g*) Investment income	6.6	5.0	6.3	7.5	8.0	8.7
(*h*) Government services	0.3	0.3	0.4	0.4	0.5	0.6
(*i*) Other services, n.e.s.	1.4	1.8	1.4	1.3	1.6	1.9
Total	69.9	62.1	68.1	82.5	93.2	105.8
Combined receipts and payments (net), 1965-1970						
Commodity trade balance[b]	−9.0	−5.0	−7.7	−12.0	−15.9	−23.8
Goods and services balance	−14.0	−8.1	−8.4	−10.7	−11.3	−15.9
Private capital inflow[c]	7.0	3.5	5.7	6.6	6.6	11.4
Public capital inflow	7.0	4.6	2.7	4.1	4.7	4.5
Total capital inflow	14.0	8.1	8.4	10.7	11.3	15.9
Commodity trade balance[d]	−19.3	−14.8	−17.6	−24.3	−29.8	−39.6
Net income paid abroad[e]	−5.2	−3.3	−5.2	−6.0	−6.5	−7.1

Note: Net inflow (+) net outflow (−).

[a] Estimated.

[b] Calculated on an f.o.b. basis.

[c] The capital inflow is the sum of transfer payments and changes in capital movements.

[d] Calculated on a c.i.f. basis for imports.

[e] Net income paid abroad is net investment income paid overseas, net value of item (*g*).

in large measure the pressure of demand. The construction industry, in particular, is hard-pressed for labour and is suffering severe shortages of skilled personnel. There has been little rise in agricultural wages.

Monetary controls are virtually non-existent, but some attempt to use them has been foreshadowed in the recent development plan. This could include not only controls over interest rates but also on the lending policies of banks. There is no central bank in Fiji, monetary policy being in the hands of the Ministry of Finance. Cabinet approval for the establishment of a central bank was given towards the end of 1970, and advice is being obtained on its establishment from the Bank of England and the Reserve Bank of Australia.

Public finance

In 1969 current expenditure was F$34.4 million, a rise of 12 per cent on the 1968 figure of F$30.7 million. Of current expenditure on goods and services, administration accounted for 32.1 per cent in 1969, community services (such as public health and sanitation) 1.8 per cent, social services (including education, health, and housing) 45.2 per cent, transport and communication 14.1 per cent, and various economic services (such as agriculture, forestry, fishing and economic surveys) 6.9 per cent.

Revenue in 1969 was up by 16.2 per cent on 1968. On the budget figures there was a surplus in the current account of F$3.1 million in the year ended December 1969. Of total revenue receipts, 71.3 per cent came from taxation. Import and export

duties showed a sharp rise, an upward trend related not only to rapidly rising imports but also the shift towards sources of imports which bear general rather than lower preferential tariff rates. The main element in direct taxation is income taxes on companies and individuals. These taxes showed an increase of F$1.4 million in 1969, reflecting the general rise in incomes as a result of increased economic activity.

For 1970, expenditure is expected to show another substantial increase of 14.3 per cent to F$39.4 million on the revised estimates. Education, health and welfare services show the biggest increases, but with continually rising prices and wages during 1970, including a substantial wage increase for civil servants, all headings are affected.

By contrast, revenue is expected to rise by only 5 per cent to F$39.5 million, thus showing a nominal surplus of about F$1.9 million. The budget introduced on 27 November 1970 provides for a rise in expenditure of 14.5 per cent to F$45.1 million in 1971, about the same percentage rise as in 1970, and tax revenue is expected to go up by 11.5 per cent.

Expenditure figures in 1971 are affected by the fact that this will be the first year of the sixth development plan. Substantial increases in expenditure on education and health are involved and in addition there are special requirements, such as the establishment of overseas missions which arise out of the fact that Fiji is now an independent country.

A detailed breakdown of the capital budget including government enterprise and statutory boards is available only for the year 1965 to 1969. In the latter year, it is estimated to have been F$10.5 million. Of total capital outlay, 34 per cent was spent on transport and communications, 20 per cent on social services and 39 per cent on economic services (including fuel and power). Approximately one-half of total capital expenditure in 1969 was met from local loans, one-quarter from foreign aid and the balance from surpluses in the recurrent budget.

Economic planning

The sixth development plan for the years 1970-1975 recognized agriculture as a major problem, particularly because of institutional impediments, such as the land tenure system, which are difficult to alter. The development of human resources is also seen as an urgent requirement in order to overcome the critical shortages of specialized personnel, as well as to make general education more widely available to the population as a whole. Related to this is the objective of providing employment opportunities, because, during the period covered by the new plan, the number reaching working age is especially large. Thus the plan places some emphasis on the need to seek out labour-intensive projects. In the minds of the planners there is also the realization of the need to provide a sound economic basis for the development of a stable multiracial society. The important element in this is to secure a better distribution of incomes. Rural development is especially relevant in this context, but improvement of housing, education and welfare services, as well as job opportunities for the urban population, are also necessary.

The over-all growth target for the plan is 6.7 per cent per annum. This is somewhat higher than the growth rate in real terms of 6 per cent which was achieved in the last three years of that plan.

Sectoral growth targets are shown in Table II-3-14.

Table II-3-14. Fiji: Projected growth

Item	*Gross domestic product*		*Annual growth rate*	
	1970	*1975*	*Sixth development plan*	*Fifth development plan**
	(million Fijian dollars, 1970 prices)		*(percentage)*	
Agriculture, forestry and fishing	48.4	57.7	3.5	2.3
— cash sector	(28.8)	(35.9)	(4.5)	(1.5)
— rural households	(19.6)	(21.8)	(2.1)	(3.5)
Mining and quarrying	2.5	2.8	2.4	—1.9
Manufacturing and processing	19.3	24.0	4.5	5.2
Building and construction	15.0	23.1	9.0	12.8
Electricity and water	2.0	2.9	8.0	5.9
Transport and communication	15.0	21.7	7.7	11.8
Commerce	28.0	39.1	6.9	2.6
Tourism	6.0	15.0	20.2	20.2
Government services	12.9	19.3	8.4	5.5
Other services	28.5	40.0	7.0	7.1
Gross domestic product (at factor cost)	177.6	245.6	6.7	5.3

* 1965 prices.

As the table shows, agricultural production is planned to rise at a rate greater than that achieved under the fifth development plan. This may be over-optimistic, since little growth can be expected from the main activity, sugar, nor is the subsistence sector likely to show much expansion. Thus, in order to achieve even a low rate of growth in the sector as a whole, the cash sector other than sugar must be expanded at a much faster rate than has previously been achieved. The cash sector includes both fisheries and forestry production, and there seem to be good prospects for both these types of production. Manufacturing output as a whole is expected to increase at a much lower rate than the economy as a whole. The most rapidly growing sector will again be tourism, as it was under the fifth plan, and this is projected at the same rate of growth as was then achieved. The tendency for the economy to become more service-oriented, as observed in previous years, will continue through the period of the new plan. Personal consumption will decline relatively from 63.0

per cent of GDP in 1970 to 59.8 per cent in 1975. Gross fixed-capital formation, however, will rise from 28.3 per cent to 30.2 per cent of GDP. The size of the proposed investment programme raises the question of whether the physical capacity of the building and construction industry will be sufficient. So far as finance is concerned, it is expected that 73 per cent of the total (F$266 million) will be provided from domestic sources, largely through personal savings of F$96 million and undistributed profits and depreciation reserves of F$150 million. The balance of 27 per cent is expected to be provided from external sources, through public and private capital inflows. So far as government investment is concerned, it is expected that F$52.9 million will be provided from borrowed funds both locally and externally (including a loan of F$9.50 million from IBRD). Grants-in-aid are estimated to be F$7.5 million, the balance of the funds required coming from revenue surpluses and reserves. Thus, reliance upon external sources of funds is likely to be of the order of 53 per cent of the total, compared with 41 per cent during the fifth development plan.

Hong Kong

The Hong Kong economy did well in 1970, continuing the success of recent years, but there are signs that the growth in industrial output may be slowing down and might possibly amount to only 10-15 per cent over the year.

The drastic reduction in building after 1967 is now reflected in quite substantial increases in the rents of domestic, industrial, and commercial buildings, and as a result a building boom has begun. The labour supply, which has been tight for the last few years, has grown even tighter, with money wages rising by almost 16 per cent between March 1969 and March 1970. Inflationary pressures now exist, caused by excess demand conditions and increases in the price of imports; the rise in the General Consumer Price Index in the first seven months of 1970 was 5.9 per cent, compared with 3.6 per cent for the whole of 1969.

Much effort has been devoted to improving infrastructural facilities in the past few years, and current projects include roads and flyovers, extensions to the airport, a cross-harbour tunnel, and container facilities at Kwai Chung. The possibility of a subway system for mass transit is under serious consideration.

The population passed the four million mark in 1969 and was estimated at 4.089 million at mid-1970. The rate of growth of population has slowed considerably, because of a lower level of immigration and a falling birth rate, and the population boom seems over, at least for the time being. This will ease the problem of providing new housing for the increase and allow more attention to be paid to families in substandard accommodation and to improving publicly supplied accommodation. The pressure on the primary schools has also eased somewhat, and cautious steps in the direction of free primary education are being taken.

Tourism continues to develop rapidly, receipts from this source amounting to a sizable $217 million in 1969. It is estimated that the number of tourist visitors may approach one million in 1970, and, on the average, each visitor is estimated to spend some $283.

With respect to foreign trade, Hong Kong's future depends heavily on the potential effects of the United Kingdom's entry into the European Economic Community, on whether UNCTAD decides to consider Hong Kong a developed or a developing economy, and on governmental decisions by other countries on trade restrictions.

The growth rate

Hong Kong does not keep official national income accounts, balance of payments accounts, foreign exchange reserve figures, or terms of trade indices, which makes a definitive analysis of the economy extremely difficult. However, it is believed that the growth of national income slowed in the second half of the decade, from about 12 per cent per annum between 1960 and 1965 to perhaps 8 per cent per annum between 1965 and 1969. The size of *per capita* GNP is especially uncertain, but a statement by the Financial Secretary indicated that it might have been about $600 in 1968.[2] Taking this as a base and assuming a growth rate of GNP of perhaps 8 per cent and a population growth rate of about 2 per cent since 1968, *per capita* GNP should be of the order of $670 in 1970.

The process of economic growth is generally so complex that it is difficult to identify specific factors as being independently crucial. For example, Hong Kong's rapid growth since the early 1950s was clearly given impetus by the inflow of large amounts of capital and skilled entrepreneurs and cheap labour from mainland China. Also important, however, was the setting. The Hong Kong Government has provided a good basic infrastructure, has imposed virtually no economic controls, and has maintained low taxes on business.

Hong Kong's entrepreneurs have proved to be highly responsive to shifts in demand and have

[1] This is the first ECAFE survey of Hong Kong since 1955.

[2] This is close to the figure of $559 for GDP *per capita* in 1967 that was given in the *Times* (London) of 21 September 1970. Assuming an increase of 8 per cent in GDP, *per capita* GDP in 1970 would be around $660.

effectively used their well-established trade connexions to discover and develop markets for new industrial products. Of similar importance has been a high degree of factor and especially of labour mobility without which Hong Kong would not have been able to respond so flexibly to constantly changing circumstances.

Also contributing to growth has been a continuing inflow of capital, particularly from overseas Chinese, the United Kingdom, the United States and Japan. In addition to the generally favourable climate for investment already described, easy exchange convertibility has been a factor in attracting this flow.

Finally, the Government has contributed in a direct way to growth, especially in the export sector. In 1966, it established a Trade Development Council with offices in Europe, Australia, Africa and the United States. This Council helps to promote exports, sends out trade missions, and promotes exhibitions at trade fairs. At about the same time, an Export Credit Insurance Corporation was established, and the Hong Kong Productivity Council, set up in 1967, actively promotes higher productivity in industry.

Industry

The few output figures currently available indicate that electricity output went up by some 14 per cent in 1969, while cement output increased by less than one per cent. The latter figure reflects the substantial decline in the construction of new buildings in 1969, when the number completed was only one-fourth of that in the boom year of 1967. In the industrial sector, the electronics, clothing, wig, and toy and doll industries are growing rapidly, while the cotton textile industry is declining both relatively and absolutely.

The problem of industrial finance is currently a subject of discussion in Hong Kong. There is no industrial development bank, and it is generally believed that, while large firms have no difficulty in securing finance for expansion, some small firms do face difficulties in this respect. A report issued in 1970,[3] following a study that lasted for almost two years, concluded that short-term loan facilities for small industry were adequate but that medium-term loans for the purchase of machinery were difficult to obtain. On the basis of these findings, the report recomemnded that a scheme be jointly established by the Government and the commercial banks to improve this aspect of industrial financing. An earlier report had concluded that the case for an industrial bank had not been proved at the time the report was issued, but that future developments might warrant reconsideration.[4]

[3] *Report of the Loans for Small Industry Committee to the Trade and Industry Advisory Board*, March 1970.

[4] A report by the Industrial Bank Committee, 1960.

Bearing on the subject of industrial finance, a chronic labour shortage exists, and the situation is worsening steadily. Moreover, this trend can be expected to continue, since the natural increase in population has considerably slowed down, and the rate of immigration is presently low. At the same time, the demand for labour is increasing as a result of rapid industrial development. It seems probable, therefore, that, in the next decade, firms will increasingly face the need to change their production techniques and to automate as much as possible. This process will require a much greater amount of industrial investment than in the past, and it is doubtful if the small firms will be able to make the necessary changes, given the present sources of industrial finance.[5] In addition, it is likely that some large firms will also face the need to re-equip with new types of machinery in the next decade.

In view of these considerations, it may be opportune to reconsider the question of establishing an industrial bank which could put to productive local use the admittedly surplus funds of commercial banks that are at present remitted abroad. It seems likely that such a bank would serve as a catalyst for development.

Industrial training is also an increasingly urgent problem for development, because the demand for trained and skilled technicians in industry is growing and will further increase. The Government is aware of the problem and is devoting much effort to its solution. At present, the Technical College has 16,280 students, mainly taking evening classes, and the Morrison Hill Technical Institute will eventually have about 11,000 students. As an addition to these facilities, the Government has decided to develop a Polytechnic which will include the Technical Institute. This Polytechnic is expected to have about 24,000 students, mainly part-time, by 1974.

Agriculture

Agriculture is, in relative terms, a declining sector in Hong Kong, and, in 1969, over 10 per cent of all suitable land was abandoned and lay fallow.[6] Despite this, the quantity and value of production of rice and vegetables, the two main crops, continued to increase in 1968/69, though the value of rice production was only 15 per cent of that of vegetable production owing to output changes in response to changes in consumer demands. Since the bulk of

[5] Small firms loom large in importance; for instance, nearly 60 per cent of exports of domestic products to the United Kingdom in 1968 were from small-scale factories.

[6] In the 1966 bi-census, 73,050 persons worked in agriculture and fishing, whereas 551,350 worked in manufacturing industry alone. Only 5 per cent of the economically active population worked in agriculture and fishing in 1966, a figure that corresponds to Western industrial countries.

the working population is urban, market-garden farming has emerged as the major type of farming, supplying vegetables and meat, particularly pigs and poultry, and it is anticipated that the share of vegetable production within agriculture as a whole will increase. Despite much government assistance to agriculture, such as extension services and cheap credit, the trend to relative decline is likely to continue over the long run, with more rapid growth elsewhere in the economy.

Population

That the population has grown rapidly in the past is well known, but a new era has apparently been entered with a slowing of the population growth rate (1.7 per cent in 1969). The natural rate of increase in population has fallen steadily and was down to 1.5 per cent in 1969, while the crude birth rate has declined from 3.0 per cent in 1964 to 2.0 per cent in 1969, and this despite an increase in registered marriage each year since 1966. This appears to reflect the fact that Hong Kong is a highly urbanized community, a growing awareness of the benefits of small families, a change in traditional attitudes, and the efforts of the Family Planning Association which now has an office in ten of the twenty-three resettlement estates.[7]

This slowing down of the birth rate is likely to worsen the situation with regard to the labour supply in the future, as the demand for labour increases. Concurrently, however, it should assist in the solution of social problems in such areas as housing and education. Working against the trend, on the other hand, is the fact that the 20-24 year old cohort is twice as large as the 25-29 or 30-34 year old cohorts, and, it is just possible that, in the very near future, this will result in an increase in the crude birth rate for a relatively short period.

Employment

The estimated employment distribution at the end of 1969 is as follows:

Within the manufacturing sector, the major employers in 1969 were clothing (141,755), textiles (other than clothing) and made-up textile goods (79,315), toys and dolls (38,779), electronics (37,417) and wigs (25,486).

Flexibility of resource allocation, which contributes much to the success of Hong Kong, is reflected in the high degree of labour mobility. This flexibility is clearly evident in table II-3-16 which examines for a three-year period the degree of change in employment in a selected group of industries.

[7] The resettlement estates house over one million people, and, on average, these people are among the poorest in Hong Kong. Under normal conditions, the birth rate of the poor is high, so that these estates provide a good field for family planning efforts.

Table II-3-15. Hong Kong: Distribution of employment as at the end of 1969

Item	*Number (thousand)*	*Percentage distributed*
Manufacturing industry	599.8	39.4
Services	367.0	24.1
Commerce	253.8	16.7
Construction	93.8	6.1
Agriculture, forestry and fishing	79.5	5.2
Communication	104.2	6.8
Public utilities	14.9	1.0
Mining and quarrying	4.6	0.3
Other	5.8	0.4
Total	1,523.4	100.0

Source: *Hong Kong 1969* (Hong Kong Government Press, 1970), p. 26.

Table II-3-16. Hong Kong: Changes in numbers of employees from the fourth quarter 1966 to the fourth quarter 1969

Item	*1966*	*1969*	*Change (percentage)*
Electrical machinery, apparatus	30,074	49,111	63.3
Paper and paper products	2,988	5,308	77.6
Metal products, except machinery	35,928	45,835	27.6
Rubber products	9,232	12,789	38.5
Mining, other than metal ore	1,731	769	—55.6
Tobacco manufacture	1,530	1,176	—23.1
Communications	4,804	4,472	—6.9
Beverage industries	2,639	2,155	—18.3

Source: *Hong Kong Monthly Digest of Statistics*, July 1970, table 4.1.

This apparent willingness of labour to move from declining or low-growth industries to industries facing an expanding market is important for maintaining economic growth, and, with the declining rate of population increase, it is likely to be even more important in the future. However, a growing tendency towards specialization of function, combined with the spread of higher education, may to some extent work against labour mobility in the long run.

Wages and prices

The growing labour shortage has been reflected in increases in the level of wages in recent years as illustrated in table II-3-17.

An acceleration of both real and money wages since early 1969 is clear, and, given future rates of growth no lower than in the past, this tendency to rising wages seems likely to continue.

Table II-3-17. Hong Kong: Index of wage change
(March 1964=100)

Date	Money wage			
	Index		Change over preceding 12 months	
	Over-all	Manufacturing industry	Over-all	Manufacturing industry
March 1967	126	127	—	—
March 1968	134	134	6.3	5.5
March 1969	142	142	6.0	6.0
March 1970	163	165	14.8	16.2
	Real wage[a]			
	Index		Change over preceding 12 months	
	Over-all	Manufacturing industry	Over-all	Manufacturing industry
March 1967	118	119	—	—
March 1968	117	117	—0.8	—1.7
March 1969	122	122	4.3	4.3
March 1970	132	134	8.2	9.8

Source: Labour Department statistics.

[a] The real wage is obtained by deflating the money wage by the changes in the Modified Consumer Price Index. There is reason to believe that the housing component of the latter may be under-weighted and that rental estimates are low.

Prices, like wages, are also rising in Hong Kong. The General Consumer Price Index in 1969 went up 3.6 per cent, and, in 1970, the price rise accelerated, the index showing a 5.9 per cent increase in the first seven months of the year. According to the index, the rise in food prices (9.1 per cent in the first seven months of 1970) is largely responsible. However, it is common knowledge that rents on property are also rising very rapidly, and it is likely that this increase in fixed costs is being passed on in the form of higher final product prices over a wide range of goods. It is further worthy of note that the price rise is affecting lower more than middle income groups. The Modified Consumer Price Index, weighted by consumption patterns of households spending between $17 and $99 per month, is rising faster than the General Consumer Price Index, which is weighted for household expenditure of up to $330 per month.[8]

However defined, the money supply increased rapidly in 1970. A broad definition[9] gives a rate of increase of 16.5 per cent in 1969, and, in the first seven months of 1970, the increase was a further 14.4 per cent. A narrow definition[10] gives a rate of increase of 13.3 per cent in 1969, and of 16.1 per cent in the first seven months of 1970. With respect to either measure, the minimum expectation for the whole of 1970 is an increase of about 25 per cent.

Social development

There has been a striking increase in government expenditure related directly to social development[11] from 12.5 per cent of total expenditure in 1965/66 to 25.2 per cent in 1968/69, and this during a period when total expenditure itself increased. The major part of the increase in social development expenditure was in the education field, but expenditure on all other items increased as well. With plans for a new public assistance scheme and further increases in education spending, the share of public expenditure allocated to social development is likely to increase still further over the next few years.

The Hong Kong Government has been involved in providing cheap housing facilities since the early 1950s, and, in 1969, the proportion of the population living in government and government-aided housing was approximately 40 per cent. By mid-1970, 1.14 million people lived in resettlement estates and cottage areas alone, and the increase in people housed in these two forms of government housing was 12,124 in the first half of the year. However, despite the successful rehousing of an extremely large number of squatters over the years, there were still 393,514 squatters as of 30 June 1970. Since 1965, there have been fewer squatters each year than the year before, but the number is still above what it was when the Government first began to tackle the problem, a fact which illustrates the magnitude of the task the Government has to face. Further problems include non-tolerated squatters, overcrowding in resettlement areas,[12] and some private tenements in which living conditions are even worse than in the squatter areas.

Under the resettlement building programme, homes are to be provided for 650,000 persons[13] in the six years from April 1966 to March 1972, with an additional 350,000 in government low-cost housing. It is estimated that, by 1975, over two million people will be in government-sponsored housing. Recent policy has put more stress on better housing than on the total number housed, and a trial scheme to convert the old Mark I resettlement blocks into self-contained flats is now underway. Similarly, more emphasis is being placed on low-cost and less on resettlement housing, the former being superior in quality and higher priced.

[8] The General Index is also pulled up by the inclusion of some weighting for the lower-expenditure group, so that the differential price rise for the lower-expenditure group is understated.

[9] Currency in circulation plus demand, time and saving deposits.

[10] Currency in circulation plus demand deposits.

[11] Defined in this particular case as spending by the Departments of Education, Medical and Health, Resettlement and Social Welfare.

[12] A density of 1,600–2,400 people per acre is commonly found, and the floor space available for a million people is only 6 × 4 ft. per person.

[13] Two children under 10 years of age counting as one adult.

In educational matters, there is growing pressure for free primary education, and it is the Government's intention to abolish primary school fees in government schools and government-aided schools in 1971,[14] following reductions in fees in 1969. From a development viewpoint, the biggest problem in education is the increasing demand for technically trained people. As already noted, this demand is likely to increase in the future, and a shortage of technically trained personnel could become a serious bottleneck for growth. With this in mind, emphasis is now being placed on technical training. Approval in principle has been given to a new type of school—a junior technical school—to provide pre-vocational training for students up to the age of 16 years, and this is in addition to the measures discussed elsewhere for the expansion of other facilities.

A new public assistance scheme is due to commence operation in January 1971. It will replace the old system of relief in kind (food, and, in a few cases, cash), entirely with cash payments. Owing to relaxations in eligibility requirements, a large increase in the number of recipients is anticipated, the figure perhaps doubling. As for costs, an official estimate is that they will rise perhaps five times, although some unofficial views are that they may increase a good deal more than this. The scheme will be administered by the Social Welfare Department, payments being made through post offices, and, in the New Territories, through District Offices. It is probable that shortages of trained social workers will lead to assessment by ordinary executive workers in the early period.

As the foregoing illustrates, a movement in the direction of an integrated pattern of social services is beginning to emerge in Hong Kong, but as the Governor himself stresses, it is still in the beginning stages and much remains to be done.

Foreign trade

The lack of official balance of payments estimates makes it difficult to provide a definitive over-all statement, but some observations are possible. Visible trade is increasing rapidly, domestic exports and total exports increasing by almost 25 per cent in 1969, whereas imports increased by only about 19 per cent. Both 1968 and 1969 were boom years, with exports rising by over 20 per cent for the first time in the decade. The pattern of imports rising less than exports had held since 1962. As a result, the visible trade gap has fallen from an average of HK$2,079 million in 1960-1962, to HK$1,755 million in 1967-1969 and stood at HK$1,696 million in 1969. Furthermore, this absolute fall has occurred despite the fast growth in national income, so that as a percentage of national income, the reduction in the trade gap must be very significant indeed. In the first nine months of 1970, however, the trade deficit increased slightly, and this despite a 21.6 per cent increase in exports. A relative fall in the entrepôt trade has occurred as the industrialization of Hong Kong has progressed, as can be seen from the fact that domestic exports, which were 72.8 per cent of total exports in 1960, rose to 79.7 per cent in 1969.

The major domestically produced exports in 1969 were clothing (632 million), followed by miscellaneous manufactured articles ($412 million),[15] textile yarn, fabrics and made up articles ($186 million), and electrical machinery, apparatus and appliances. Since all these export items also grew either rapidly or substantially over the year, there appears to be no structural problem in the export sector. Major imports, in order, were manufactured goods ($811 million), foodstuffs ($463 million) and machinery and transport equipment ($369 million).

The major export market is now the United States, which took 42.1 per cent of all domestic exports in 1969, followed by the United Kingdom (13.9 per cent) and the Federal Republic of Germany (7.3 per cent). The trend is for increasing reliance on markets in the United States and the European Common Market, with a falling share to the United Kingdom. In the first seven months of 1970, sales to the EEC countries were almost equal to those to the United Kingdom. On the import side, Japan remained the primary supplier in 1969 with 23.4 per cent, having displaced mainland China in 1968. The latter country was in second place with 18.1 per cent, and the United States was third with 13.4 per cent. The trend in the past few years has been toward a noticeable increase in the share of imports coming from Japan, a notable fall in the share from mainland China, a small but steady fall in the share from the United Kingdom,[16] and a barely perceptible rise in the share from EEC countries and particularly from the Federal Republic of Germany. Japan mainly supplies textile products, machinery, photographic goods, watches and clocks, and scientific instruments, mainland China supplies mainly textile and food products, and the United States supplies mostly machinery and non-metallic mineral manufactures.

Tourism has continued to boom in recent years, the receipts of $217.3 million in 1969 representing a welcome increase of over 35 per cent compared

[14] Address by the Governor of Hong Kong to the 1970/71 session of the Hong Kong Legislative Council, 1 October 1970.

[15] Mainly toys and dolls ($145 million), wigs and false beards ($107 million) and plastic flowers ($60 million).

[16] The share of exports to and imports from the EFTA countries, excluding the United Kingdom, has risen, however, in the past few years, the exact reverse of the situation with regard to the United Kingdom.

with the preceding year. An indication of the importance of tourist receipts is that they were almost equal to the combined receipts from exports of wigs and plastic toys in 1969. The expenditure per tourist is estimated at $283 for a stay of a little less than four days, and, of this amount, shopping expenditures constituted 56 per cent in 1969. The percentage spent on shopping is falling steadily, however, and since this element probably has a fairly high import content, it is likely that a greater part of the total expenditure is directly linked to and benefits the local economy. The increases in visitors in the first half of 1970 was 28.1 per cent, well above the 23.7 per cent recorded in the same period of 1969, and 1970 is expected to be a record year in terms of numbers. In part, the reason for this is that EXPO 1970, at Osaka in Japan, attracted more tourists to Asia.

If the United Kingdom joins EEC and Commonwealth Preferences are abandoned, Hong Kong's exports will, of course, be adversely affected, although Hong Kong now sells as much to the EEC countries as to the United Kingdom. A decision by UNCTAD to consider Hong Kong a developed rather than a developing economy would also have a serious bearing on Hong Kong, since this would put Hong Kong at a competitive disadvantage with other traders in Asia. Finally, the current economic situation in the United States is a matter for concern since this country in Hong Kong's major market for exports. If new import restrictions are imposed, the direct effects would obviously be adverse and there could be disturbing indirect effects as well. For example, the diversion of Japanese exports from the United States market to Asia and elsewhere would hardly be a favourable development from Hong Kong's point of view.

India

In 1969/70, the first year of its fourth five-year plan, India achieved a rate of growth of 5 to 5.5 per cent in its net domestic product, corresponding closely to the average annual plan target and substantially exceeding the previous year's growth of 2.2 per cent.

The annual plan for 1970/71 has as its objective a rate of growth of 5.5 per cent in national income with an increase of 5 per cent in net output from agriculture and 8 per cent in the large-scale industrial sector.[1] To sustain this rate of growth, the annual plan aims at raising to a little over 13 per cent the rate of investment to net national product which remained at 11.3 per cent in 1967/68 and 1968/69 and was estimated to have risen marginally to 12 per cent in 1969/70. The proportion of external assistance (net of debt repayment) to national income which has been continuously declining from 3.5 per cent in 1967/68 to 2.1 per cent in 1969/70 is to decline further to 1.8 per cent in 1970/71. Thus, the rate of domestic savings has to be accelerated from 9.9 per cent in 1969/70 to over 10 per cent in 1970/71.

Foodgrain output has shown a notable increase from its drought-stricken level of 72 to 74 million tons in 1965/66—1966/67 to 94 million tons in 1968/69, 99.5 million tons in 1969/70; the target for 1970/71 is 106 million tons. However, the increase has to be viewed against the long-term rate of growth of output of 3.2 per cent between 1950/51 and 1964/65 and the target rate of 5 per cent per annum in the fourth plan. The technical breakthrough achieved, based on high-yielding varieties with complementary inputs in areas with assured water supply, has so far been in wheat and some coarse grains; and it is expected that a similar breakthrough is not far off in rice. A significant increase in productivity is still to be achieved in pulses and agricultural raw materials. To deal with the likely accentuation of income inequality among the rural classes and among the regions, schemes have been initiated to help small farmers and to develop production in dry farming areas. There is also a growing awareness of the need for increased production and use of fertilizers and for adoption of improved farm practices.

The target rate of growth of 5 per cent in agricultural output under the fourth plan is an average of a somewhat higher rate for foodgrains and a rate no higher than the past trend for other agricultural commodities. The additional output of foodgrains envisaged over the fourth plan is of the order of 31 million tons, of which two-thirds are expected to come from the high-yielding variety (HYV) programme. Recent experience with the high-yielding varieties has clearly shown the role of water control and management and "having regard to the crucial importance of this factor it would be rash to postulate a growth rate significantly exceeding 4 per cent per annum for the output of foodgrains in the next few years".[2]

Compared with the corresponding previous period, the rate of growth of industrial output slackened between July 1969 and March 1970, particularly in basic and capital goods and in consumer durables. However, in the second quarter of 1970 there was a substantial rise in the output of the capital-goods industries, indicating signs of industrial recovery and a favourable investment outlook. Production and export by village and small industries equalled and, in some cases, exceeded the plan targets

[1] Planning Commission, Government of India, *Annual Plan, 1970-71*, p. 2.

[2] Agricultural Prices Commission, Government of India, *Report on Price Policy for Kharif Cereals*, August 1970, p. 7.

in 1969/70 and the trend is expected to continue. With the increase in agricultural income, a growth in demand for consumer goods (durable and non-durable) and agricultural machinery is already evident.

In the immediate future, industrial output can be raised by increasing the utilization of existing capacity through the provision of raw materials (imported wherever necessary) and other inputs. In the recent past, a considerable increase in capacity utilization has taken place in a large number of industries, except in the heavy and intermediate sectors. Steps have been taken towards liberalization of imports of steel and such agricultural raw materials as raw cotton. The substantial additions to the foreign exchange reserves in the last two years allow for manoeuverability in this respect. To obtain fuller utilization of existing capacity, through orienting it towards changing demand patterns, the steel plants have been renovated and balancing equipment installed in crucial sectors; domestic production has also been raised in the public sector projects in heavy engineering and hydro-electric plants, and this will increase the supply of both equipment and component parts.

However, in the long run, it is crucial to maintain an adequate volume of investment both in the public and private sectors. Budgeted outlay in 1970/71 indicates that investment in the public sector can be expected to proceed at a higher rate. There had been a stagnancy in private investment in industries, particularly in the large-scale sector, while investment in agriculture and in the small-scale sector has been rising, fostered by appropriate credit policy. The slackening in private industrial investment in large-scale projects is a matter of concern in view of the gestation lags. There have been signs of a slow revival since the middle of 1970. In this respect, the emphasis in the new industrial licensing policy on making all necessary inputs available to the core sector can be expected to accelerate the revival.

Prices, which had been relatively stable during 1968, showed a tendency to rise in 1969 and markedly so in the first half of 1970. The rate of monetary expansion, however, was on the decline, despite larger extension of bank credit and increased accumulation of foreign exchange reserves. Net bank credit to the government sector showed a considerable reduction as a result of increased resources mobilization and some shortfalls in public sector development outlay; such a reduction may not continue for long, however, as public sector development outlay gains momentum. In this respect, the likely monetary expansion on account of central bank lending to commercial banks and the virtual revolving nature of the central bank's annual advances to the State governments cannot be neglected. On the supply side, the increase in agricultural production may not be reflected in a commensurate fall in prices because price support policies are to be continued. The rise in prices has been marked in the cases of basic and capital goods and manufactures, underlining the need for accelerating production in these industries. Greater imports of steel and larger domestic production of agricultural raw materials would help relieve the cost-push pressure on industrial production.

Tax measures undertaken in 1969/70 and 1970/71 are "by any standard a bold effort." "The Plan target would be achieved, even if new additional tax measures in each of the remaining years of the Plan yield resources somewhat lower than raised in 1969/70."[3] There has been an encouraging record in the past three plans with respect to additional resources mobilization in the public sector. The tax-income ratio, which was around 7.7 per cent at the end of the second plan, rose to 14.1 per cent by the end of the third plan, but the momentum was lost during the annual plans and stood at 12.9 per cent in 1968/69. Also, it is noteworthy that the reliance on deficit financing in the first two budgets under the plan has not been at a rate higher than that visualized as a whole under the plan. Scope exists for further mobilization of resources through the public sector by improvement in the working of public sector enterprises and by increased efforts by the State governments. The resources mobilized from the agricultural sector still fall short of the potentialities. Steps have been taken to enlarge the scope of the agricultural income tax, the surcharge on land revenue and crops, and general indirect taxes, such as excise and sales tax. Possibilities exist for a rise in the levels of existing taxes, selective increases in irrigation and electricity charges, and floatation of rural debentures for financing rural development projects.

Efforts have been made to increase savings in the household sector of the economy by various tax concessions to savings in the form of financial assets and by new schemes for small savings. Consequent on the nationalization of banks, a concerted effort is being made by the banks to mobilize deposits in the rural areas, but the schemes for deposit mobilization have not yet had the anticipated impact on the rural sector's traditional preference for non-financial assets. The surveys made under the Lead Bank Scheme,[4] accompanied by effective and expeditious follow-up action, will play a major role in this respect.

[3] Reserve Bank of India Bulletin, *The Fourth Five Year Plan, 1969-70 to 1973-74*, July 1970, p. 1, 110.

[4] See section "Money supply and credit policy", below.

Along with enlarging development expenditure and mobilizing increased resources towards that end, the Government has instituted a number of institutional and policy measures to reduce concentration and to promote wider diffusion of wealth, income and economic power, and improve the living of the poorer sections of the community.

Agricultural sector

Production trends. Foodgrains production, according to final estimates, reached a new record in 1969/70 of 99.5 million tons, exceeding the previous highest level of 95.1 million tons in 1967/68 by 4.4 million tons, and the 1968/69 output of 94.0 million tons by 5.5 million tons. Sharing in the increase over 1968/69 were: wheat, with 20.1 million tons in 1969/70, an increase of about 7 per cent; rice, with a record 40.4 million tons, an increase of 1.5 per cent; other cereals, with 27.3 million tons, an increase of about 8 per cent; and pulses, with 11.7 million tons, an increase of about 12 per cent. Compared with its 1967/68 level, the yield per hectare has been increasing in the cases of wheat and rice, and declining in the cases of other cereals and pulses.

The three consecutive good harvests have led to an increase in the total availability of foodgrains in the country. The annual *per capita* availability of foodgrains, measured as an average of 1967, 1968 and 1969 at 156.5 kg, has declined from its average level of 1964 and 1965 of 169 kg.[5] Internal procurement in 1968 and 1969 was nearly 6 to 7 per cent of production and was higher than imports. Owing to increased open market availability there has been an easing of the public distribution, and the stocks with the Government stood at 5.5 million tons by the end of June 1970, as against the target for buffer stocks of about 5 million tons during the fourth plan.

Among the important agricultural raw materials: output of raw cotton is estimated by the trade to be only slightly higher at 6.1 million bales in 1969/70, compared with 6 million bales in the previous year; output of the five major oilseeds, which declined by 14.7 per cent to 7.08 million tons in 1968/69, is expected to show a modest improvement in view of the increase in groundnut production; the final estimate for raw jute and *mesta* production is 6.8 million bales, as against 3.8 in 1968/69; production of sugarcane continued to improve, with 12.5 million tons in 1969/70, as against 12 million tons the preceding year. The yield per hectare for cotton, raw jute and oilseeds has declined since 1967/68.

New agricultural strategy

As against the target of 25 million ha by 1973/74, the actual area under the HYV programme in 1969/70 was 9.8 million ha, one-tenth of the total crop area; nearly 30 per cent of the crop area under wheat is under HYV. Since the programme was launched, wheat output has shown an impressive rate of growth, an annual compound rate of increase of over 10 per cent between 1964/65 and 1969/70. With respect to the other major cereal, rice, varieties such as *jaya* and IRB are making progress under conditions of artificial irrigation or assured water supply; but, when subject to the vagaries of the monsoon rains, they face problems of drainage and attract pests and diseases; several new strains considered to be suited for waterlogged land have been evolved, but they are still to be tested on the farms.[6] New strains have still to be evolved for maize and *jowar*, and a technological breakthrough is still to be achieved in the case of pulses and agricultural raw materials.

For the realization of the full potentialities of HYV, it is generally recognized that there has to be timely availability of such inputs as water, fertilizers, adequate credit, and marketing arrangements, as well as widespread dissemination of improved farm management practices. It has been estimated that a little more than half of the total cropped area can be irrigated with the ground and surface water available. The accent has recently been on less capital-intensive minor irrigation works, on which institutional investment was to be raised to Rs 1,150 million during 1969/70 from Rs 1,060 million in 1968/69. The recently established Rural Electrification Corporation should also facilitate increased investment in irrigation. However, progress in ensuring efficient water control and management is still slow.[7]

Since the introduction of new technology, demand for fertilizers has grown substantially. It is estimated that, by the end of the fourth plan, the demand will have increased threefold to 5.5 million tons in nutrients, from the 1968/69 base level of 1.8 million tons; domestic production is targeted to increase from 750,000 tons to about 3.4 million tons in the same period. Although the consumption of fertilizers increased to 2.1 million tons during 1969/70 from 1.8 million tons in 1968/69, it was below the postulated annual increase of 25 per cent, owing partly to the delayed arrival of monsoon rains in some parts of the country, application of doses smaller than recommended, inadequacy in distribution arrangements, and restrictions in some States on free

[5] Ministry of Food, Agriculture, Community Development and Cooperation, Government of India, *Bulletin on Food Statistics, 1970*, p. 251.

[6] Agricultural Prices Commission, Government of India, *Report on Price Policy for Kharif Cereals for 1970-71*, August 1970, p. 6.

[7] *Ibid.*, p. 6.

movement. To increase fertilizer consumption, trading in fertilizers has been delicensed, and credit extension for the purchase of fertilizers has been liberalized. The target for fertilizer consumption in 1970/71 is 2.5 million tons.

It has been established that the high dosages of chemical nutrients recommended for the new varieties of wheat are justified under the prevailing grain-fertilizer price ratio.[8] The application of fertilizers at less than the recommended dosages is found on all sizes of farms. Apart from the special difficulties facing the small farmers, the actual prices paid by the farmers may be higher than the controlled price, the farmers may be making their own adjustment to suit local conditions, or they might be minimizing risks by applying the prescribed dosages to a limited number of their plots. The response of HYV to fertilizers has been found to vary over areas and over years, and the dosages have to be defined at a more detailed level.

As noted by the Programme Evaluation Organization, "although a significant breakthrough has been achieved in respect of wheat in physical terms of area coverage, a qualitative breakthrough in reaching the recomemnded levels of adoption [of improved farming practices] by the farmers is yet to be achieved"; an intensification of extension effort is thus needed. In addition, it has been found that it is necessary to plan ahead for improvement and expansion in the transport and marketing system and for special problems posed, for example, in drying the crops harvested under a multiple-cropping system.

The improved agricultural technology has no inherent bias with respect to scale. However, in a sample study for the *rabi* season, 1968/69, conducted by the Programme Evaluation Organization[9] "the extent of adoption of the recommended package of practices was noted to be showing an improving trend with the increased operational holdings of the participants for all the three crops, wheat, paddy and jowar". The prospect for achieving maximum output as well as the extension of multiple cropping depends on the availability of assured water supplies and farm equipment, and the ability to purchase fertilizers and pesticides, advantages enjoyed by the larger farmers. Land distribution is highly concentrated in almost all the States, and, with the high positive correlation between marketed surplus and size of land holdings, the cash income of farmers is likely to become more concentrated than output. An important step taken by the Government towards more equal distribution of benefits from the HYV programme is the setting up of Small Farmers Development Agencies in selected districts to identify small farmers' problems and help in the provision of institutional credit and inputs to strengthen their production capacity. The HYV programme is being implemented in areas which have adequate irrigational facilities or which enjoy assured and timely rainfall. It has been estimated that a little over one-third of the total area sown in the country has low rainfall. Schemes for agricultural development in dry farming areas have been initiated to evolve suitable agricultural technology and provide rural works for employment.

For the adoption of the new varieties by the small-scale cultivator, tenancy reforms have to be more effectively implemented to assure that he has an established right to land and a share in its produce. At present, cost-sharing arrangements between landlord and tenant are gradually being adopted, and, to the extent that they raise the tenant's share, he will be induced to use larger inputs; however, rents, particularly cash rents, have shown a persistent tendency to rise. Higher output per acre under the new varieties, it is held, may make their adoption worthwhile for the tenant, even after bearing the costs of production and parting with as high as half of the product to the landlord. However, for sure and widespread adoption of the new varieties by the small-scale cultivators, speedy and effective implementation of land-reform measures is imperative. The suggested lines of action in this respect are: effective implementation of the ceiling on land holdings, and the inclusion in the ceiling of the aggregate area held by all the members of the family; more careful legal scrutiny of the conditions of the resumption of the right to land for 'personal cultivation'; and the extension of tenancy legislation to share-croppers and tenant-at-will.[10]

The improved agricultural technology calls for increased application of labour, along with other inputs, and entails a larger volume of transport, marketing, and processing of agricultural products. Thus, an increased demand for labour and higher wages in the agricultural sector may be expected. However, on a comparison of the second agricultural labour enquiry data with the nineteenth round of the national sample survey and a study of intensive agricultural development districts, it has been found that, generally, employment has not expanded sufficiently with the increase in output.[11] There has been

[8] Cummings, Jr., R. W., Herdt, R. W., and Ray, S. K., "New agricultural strategy revisited", *Economic and Political Weekly*, 26 October 1968; Minhas, B. S., and Srinivasan, T. N., "New agricultural strategy analysed", *Yojana, 26 January 1966;* Srinivasan, T. N. (Rapporteur's report), "Economic aspects of HYV programme", *Indian Journal of Agricultural Economics*, October-December 1968; January-March 1969.

[9] Programme Evaluation Organization, Planning Commission, Government of India: *Evaluation of the HYV programme, Report for the rabi, 1968-69*, p. 45.

[10] Jakhade, V. M., "Agricultural development and income distrition", presidential address, *Indian Journal of Agricultural Economics*, January-March 1970.

[11] Bardhan, Pranab, " 'Green revolution' and agricultural labourers", *Economic and Political Weekly*, Special Number, July 1970.

an increase in money wages "though where wages are paid in kind there has been a tendency to reduce its proportion to produce harvested". The increase in money wages and employment, however, has taken place mostly in areas where the new technology is prevalent, thus accentuating regional imbalances. According to data available for the third five-year plan period, the progress achieved in the allotment of lands acquired through ceilings on land holdings and in the creation of employment through rural works programmes has fallen considerably below the third plan targets. Also the minimum wage legislation enacted in many of the States has been characterized by lack of adequate coverage and effective implementation.[12] In the long run, with the spread of the new agricultural technique and the building up of supporting infrastructural facilities as in transportation and marketing, higher employment opportunities and wages for agricultural labourers may be expected.

Industrial sector

Production trends. In the industrial sector, the over-all rate of growth in production during 1969 was only slightly higher at 6.9 per cent, compared with 6.4 per cent in 1968; during the nine months July 1969 to March 1970, the rate of growth actually slackened to 5.8 per cent, as measured by the average index for the period, from the 7.4 per cent growth in the corresponding period of the preceding year. Among the major groups of industries, classified according to uses, which showed such decline in growth rates between July 1969 and March 1970, were capital goods industries, with an absolute decline of 2 per cent, compared with a 6.8 per cent rise; consumer durable goods, with a decrease from 17.9 to 8.5 per cent; and basic industries, from 11.3 to 7.8 per cent. There was a marginal increase in intermediate goods output from 5.0 to 5.5 per cent and a relatively greater increase in consumer goods output from 5.9 to 7.7 per cent, particularly in food manufacturing. Index numbers of industrial production are available for India according to industrial inputs; agriculture-based industries registered an increased growth of 5.4 per cent owing to the substantial increase in output of sugar and tea and cotton spinning. The growth rates of metal-based and chemical-based industries declined substantially. According to the latest available figures, there has been an upward trend in industrial production, particularly marked in capital goods output; the index number of capital goods production for April-June 1970 registered an increase of 15.4 per cent over that for April-June 1969.

A disquieting feature of the comparative stagnancy in industrial growth, (characterized by slackening growth in the capital goods and basic and consumer durable goods industries), was the lack of growth of investment in industries. The lack of growth of industrial investment, which will affect industrial growth in the future after a time lag, has been a cause for concern. Official figures of capital issues indicate that in calendar year 1969 they amounted to Rs 582 million, compared with Rs 816 million in 1967 and Rs 684 million in 1968. Since the middle of 1970, there has been according to official sources, an increase in industrial investment, as indicated by the increase in term lending by financial organizations and licences issued for capital goods and maintenance imports. The marked turn upwards in capital goods production in the second quarter of 1970 points to industrial recovery and a favourable investment outlook for the coming year. Investment in industries can be expected to increase as the political situation is clarified after the next general election.

The recent slowing of the rate of growth of industrial production was attributable to the tight supply position of agricultural raw materials and shortages in special categories of steel that the engineering and allied industries faced. The availability of raw cotton, raw jute, and oilseeds in 1969/70 was only marginally better than in 1968/69 and was below its 1967/68 level. The output of the basic iron and steel industries remained at the previous year's level as a result of labour troubles and production difficulties in one of the public sector plants. The supply position of these industrial inputs is to be eased by larger imports of agricultural raw materials, such as cotton and oils and fats, as well as of steel. Industrial component imports continued to be liberalized. With respect to such maintenance imports, industrial units exporting 20 per cent (instead of 10 per cent as earlier) of their output were given greater preference.

Import substitution, as a stimulus to industrial expansion, received further impetus by the ban on import of 159 items and the restriction on the import of 56 other items. The Central Government budget for 1970/71, while providing incentives to export-oriented industries by either reducing or abolishing export duties, raised import duties on many import-substituting industries, such as machinery, motor vehicle parts, pharmaceutical chemicals, non-electrical instruments, apparatus and appliances. "In the four years 1966/67 to 1969/70, over-all imports declined by 29 per cent, the main areas accounting for the decline being foodgrains, raw jute and mesta, machinery and transport equipment, iron and steel and non-ferrous metals. The fact that a higher level of industrial output in 1969/70 as compared with 1965/66, has been sustained with a sharply lower level of non-foodgrain imports, possibly points to the

[12] Jakhade, V. M., *op. cit.*, p. 15.

working of import substitution effect in the Indian economy".[13] The broadening of the industrial base through import substitution has resulted in expansion in recent years of the export of manufactured goods at a comparatively low level of subsidies.

Industrial policy changes

The Monopolies and Restrictive Trade Practices Act came into effect from 1 June 1970. Under this Act, the concentration of economic power is regarded from the point of view of not only control over the supply of a particular commodity but also control over industries in the country as a whole by a few business houses. The Act penalizes "not the possession or acquisition of monopoly power but the abuse of such power". Under the Act,[14] the "abuse" of monopoly power is to be checked by control of monopolistic trade practices and by the imposition of a selective embargo on further expansion in the size of the business groups or single undertakings which are already "large".

The conditions under which monopolistic trade practices are to be controlled are defined in terms of the criteria laid down by the Act for a monopolistic undertaking and monopolistic trade practices. The Monopoly and Restrictive Trade Practices Commission set up under the Act will investigate any restrictive practice or agreement, parties to which have to justify that it is not or is not likely to be prejudicial to the public interest as defined in the Act. By a monopolistic undertaking is meant "(*i*) a dominant undertaking which or (*ii*) an undertaking, which together with not more than two other independent undertakings—controls or produces at least one half of the total supply of any good or service in India or any substantial part thereof". Any restrictive practice is presumed to be against the public interest and such a presumption is to be set aside only if the agreement successfully passes through one or more of eight "gateways" laying down the circumstances in which restrictions are beneficial to the public or consumers or traders; the benefit so derived has to be substantial enough to outweigh any harm to the public caused by the restrictive practice.

To control concentration of economic power, the Act lists four categories of undertakings which have to apply for and obtain prior sanction of the government before they can undertake substantial expansion (i.e. more than 25 per cent of the existing level) of capacity or production. The criterion of "largeness" is based on the absolute and not the relative size of the group. The concept of interconnected undertakings is defined in the Act in the most comprehensive way.

Criticism has been voiced that the restrictions imposed on the expansion of "big" firms would deprive the economy of the benefits of the economic growth that such expansion would bring about, and that the deleterious effects of concentration of economic assets could be checked through such government measures as fiscal policy, licensing policy, control over bank credit and term lending, and through the Bureau of Industrial Costs and Prices set up in March 1970. In this connexion, it is pointed out that scope exists under the Act for the expansion of "big" firms if it is in the public interest, that "large" industrial firms are given scope in areas like the core and heavy investment sector, and that the Act is necessary if medium- and small-scale entrepreneurs are to expand in industries which could otherwise be pre-empted by the big firms.

A comprehensive industrial licensing policy has been announced with the objective of stimulating industrial production, and, at the same time, preventing the concentration of economic power. The new industrial licensing policy has demarcated a sector of core industries and heavy investment where, except for industries reserved for the public sector, larger industrial houses, together with foreign concerns and their subsidiaries and branches, would be allowed to participate. Core industries comprise basic and strategic industries; all new investment propositions of over Rs 50 million would be considered to be in the heavy investment sector. In the case of investments in the middle sector, ranging from Rs 10 million—50 million, undertakings other than those belonging to large industrial houses would be given liberal and prior consideration, except where careful scrutiny is required on account of foreign exchange implications. Large industrial houses will be allowed to enter the middle sector if they undertake to export 60 per cent of their production and the remaining 40 per cent does not cause undue difficulties for the existing producers in that sector. New undertakings or substantial expansion of units requiring investment Rs 10 million or less will not require any licence. The existing policy for reservation of the small-scale sector to areas where economies of scale are not significant would be continued, with extension where it could adequately meet the growth in demand. Entry of the large industrial houses will be permitted in the small-scale sector, provided that the companies undertake to export 75 per cent of their production and the small-scale producers do not lose their domestic market.

[13] Reserve Bank of India, *Annual Report of the Reserve Bank of India and Trend and Progress of Banking in India for the Year ended June 30, 1970*, p. 45.

[14] For a detailed critique of this complicated legislation, see Oza, A. N., "Monopolies and Restrictive Practices Bill', *Economic and Political Weekly*, Annual Number, January 1969; "Monopolies and Restrictive Trade Practices Act", *Economic and Political Weekly*, 28 February 1970.

Government finances

Budgetary operations

The Union Budget for 1970/71 envisages a small increase (of 0.8 per cent) in its total disbursements and a comparatively larger increase in its receipts (by 1.6 per cent) over the estimated levels for 1969/70; the over-all deficit is budgeted at Rs 2,270 million, a decline by Rs 630 million from the level estimated for 1969/70. The budgetary position of the States indicates for 1970/71 an over-all deficit of Rs 2.040 million, an increase of Rs 580 million over 1969/70 budgets. The States have provided for an increase in development expenditure (by 6.7 per cent) along with a decrease in non-development expenditure (by 4.3 per cent) and in loans and advances (by 12.0 per cent). They propose to augment their own resources to finance 56.2 per cent of total disbursements in 1970/71, compared with 53.8 per cent in 1969/70. Their deficit on capital account is to be made up by a small surplus on current account and by an increase in the transfer of resources from the Centre as well as in their share in central revenues; actually, the credit taken by the State budgets for grants and loans from the Centre is less than the provision in the Central Budget.

To sustain the rate of economic growth, of about 5-5.5 per cent estimated for 1969/70, the share of development outlay in its total disbursements is to be enlarged, so as to increase the net investment in the public sector by 25 per cent over its level in 1969/70; net government savings, including savings of departmental commercial undertakings, are expected to finance 66.4 per cent of their net investment, compared with 33.9 per cent in 1969/70. In its outlay, the Government has sought to keep in view both the needs of economic growth and the needs of the disadvantaged sections of the community.

The new tax measures of the Centre for 1970/71 are designed to: achieve greater equality in income and wealth by raising the slab rates on the wealth tax, introducing greater progressivity in the income tax, and checking speculative increases in land values; restrain consumption by increasing revenue from Central excises, introducing progressivity, and carrying further the conversion of specific rates to *ad valorem;* tighten tax administration; liberalize concessions for savings and investment in financial assets by small investors. Of the total new revenues to be mobilized (Rs 2,120 million, including the States' share), changes in union excise duties are to account for about 60 per cent, postal and railway rate changes for about 16 per cent, import duty changes for 14 per cent, and changes in the income tax for about 10 per cent. In their budgets for 1970/71, the State governments have proposed measures which are expected to yield only Rs 240 million. The new revenues are to come mostly from an increase in indirect taxes: one-third is to accrue from sales taxes and more than one-tenth from the tax on immovable property. The increase proposed from the agricultural income tax is disappointingly low: only Rs 4 million.

Progress in plan outlay

Of the total public outlay of Rs 159,020 million proposed under the fourth five-year plan, the annual plan for 1970/71[15] envisages Rs 28,220 million, as against Rs 22,704.7 million in the annual plan for 1969/70, bringing the budgeted public outlay during the first two years of the plan to 32 per cent of the total plan outlay; however, the actual outlay during the first two years is likely to be less than that budgeted (the revised estimate for 1969/70 is Rs 22,390 million) and allowance has also to be made for the price rise since 1968/69 (the level of prices for that year was used for the projections of outlays under the plan). The sectoral pattern of the plan outlay proposed for the two years conforms broadly to the fourth plan allocation (about 24 per cent on agriculture and related irrigation and flood control and 16 per cent on power), though the outlays on industries and transport have slightly exceeded the plan allocation at the expense of social services.

Budgetary receipts corresponding to external assistance, in the form of PL480 and other loans, were envisaged at Rs 7,130 million in 1969/70 (at about 30 per cent of the public sector outlay) and were expected to decline to Rs 5,630 million in 1970/71 (about 20 per cent of the public sector outlay). Actually, latest estimates indicate that external assistance in 1969/70 was about Rs 6,110 million and that there has been a decline to about Rs 4,570 million for 1970/71.

A budgetary deficit in 1969/70, at Rs 2,540 million was expected to be about 11 per cent of the plan public outlay and to decrease to Rs 2,270 million, about 8 per cent of the outlay proposed for 1970/71. The estimate of the budgetary deficit for 1969/70 was revised upwards to Rs 2,900 million, but it is now expected that the deficit will be much less, because of improved tax collection, market borrowing, and a shortfall in planned capital expenditure in public sector projects. The budgetary deficit for 1970/71 may be expected, however, to be higher than the estimated actual for 1969/70. Tax collections generally conform to budgetary expectations, but progress in public sector outlay may be expected to be higher while external assistance figuring in the budget has been declining; the Central Bank's overdrafts to the States have not been cleared and bank credit to public sector undertakings may have to be

[15] Planning Commission, Government of India, *Annual Plan 1970-71* and *Annual Plan 1969-70.*

increased. As an indicator, the Reserve Bank's net credit to the Government between April and October 1970 has shown a small net increase, compared with the substantial contraction during the same period last year.

Money supply and credit policy

The money supply (currency with the public and demand deposits) slackened in its rate of growth to 9.6 per cent during 1969/70 (July to June), compared with the 10.3 per cent increase in the previous corresponding period. During 1969/70 (July to June), net bank credit to the Government showed only a slight increase of Rs 60 million, as against the large increase of Rs 4,330 million in 1968/69 (July to June). A much greater expansionary effect on the money supply was exerted by the improvement in the net foreign exchange assets position of the banking sector and by the increase in bank credit to the commercial sector. As a result of the decline in imports and growth in exports, the net foreign exchange assets of the banking sector registered a larger increase of Rs 2,850 million, as against Rs 1,530 million in the preceding period. Bank credit to the commercial sector, private sector, and commercial operations of the government expanded by Rs 950 million to Rs 7,360 million: a sizable part of this increase was accounted for by bank advances to public sector undertakings, such as the Food Corporation of India, and to State governments for food procurement and the purchase and distribution of fertilizers. There was a slow-down in the growth rate of time deposits, from 21.5 per cent in 1968/69 to 15.4 per cent in 1969/70.

Subsequent to the nationalization of banks, national credit policies were formulated and are under implementation, with the emphasis on priority and weak sectors of the economy and on the disadvantaged section of the population. By its nationalization of fourteen major Indian banks on 19 July 1969, the Government intended to serve better the needs of development of the economy in conformity with national policy and objectives. The total amount of bank credit made available to priority sectors, such as agriculture, the small-scale sector (comprising small-scale industries, road transport operators, and industrial estates), and exports, increased from Rs 7,459.4 million at the end of June 1969 to Rs 10,087.5 million at the end of March 1970, its proportion to total bank credit increasing from 20.7 per cent to 25.3 per cent. There has been an important shift in emphasis by the banks, consequent on nationalization, from the creditworthiness of the borrower to the creditworthiness of the project to be financed. Thus, between June 1969 and March 1970, advances made by the nationalized banks for retail trade and small business increased from Rs 190 million to Rs 410 million; for the self-employed, from Rs 3.3 million to Rs 65.6 million and, for education, from Rs 4.6 million to Rs 18 million. Proper end-use of credit is to be ensured by discouraging industrial units from utilizing short-term bank credit for the acquisition of non-current assets, by working out inventory norms in consultation with representatives of industry, by levying a commitment charge on unutilized portions of commercial credit, and by strengthening the credit authorization scheme under which prior approval of the Reserve Bank is necessary in cases where total advances exceed Rs 10 million.

Following the nationalization of banks, the major steps towards mobilization of savings in the form of financial assets have been the expansion in branch banking and the Lead Bank Scheme, introduced by the Reserve Bank in December 1969. During 1970, the twenty-two public sector banks and eight private sector banks were required to open 1,350 offices, of which 1,186 offices were to be at centres which had previously had no bank. Commercial banks were also asked to draw up a programme for opening offices in 1970. In addition, lead banks are to be set up, in virtually each of the districts allotted to the State Bank, the fourteen nationalized banks and two other Indian banks, and, their functions include (*i*) surveying the resources and potential for banking development in their districts (*ii*) surveying the number of industrial and commercial establishments and farms which do not have banking accounts or which depend primarily on money-lenders (*iii*) examining facilities for the marketing of agricultural and industrial products, storage and warehouse facilities, and linking of credit with marketing (*iv*) surveying the facilities for the stocking of fertilizers and other agricultural inputs and for the repair and servicing of farm equipment (*v*) conducting advisory services, with properly recruited and trained staff, for small borrowers and farmers, and supervising the end-use of credit. Some of the districts have been surveyed by the banks and their reports have been submitted to the Reserve Bank. It is believed that, under this scheme, the prior expansion of credit, with consequent economic expansion, will flow back as increased deposits with the banking system; in this connexion, there has to be an adequate interest policy which will discourage the likely flow of the credit created to the higher-interest yielding unorganized market and to the formation of physical as against financial assets.

Price behaviour

There was a re-emergence of a rising trend in prices during 1969 and, in particular, in the first half of 1970, compared with the relative stability that prevailed in 1968. The annual average of the wholesale price index rose by 4.6 per cent in 1969,

in contrast to the decline by 0.2 per cent in the preceding year. Prices rose more sharply in the first half of 1970, by 7.5 per cent compared with the 4.5 per cent in the first half of the previous year, and showed only slight abatement in the third quarter. Between June 1969 and June 1970, however, the price increase (4 per cent) was lower than the 7.4 per cent rise in the corresponding previous period.

Contributing to the 4 per cent increase were industrial raw materials, machinery and transport equipment, and manufactures, whose prices rose at twice the over-all rate. The rate of increase in prices of food articles, at 1.2 per cent, was lower than the 2.4 per cent rise in the previous period. Wheat and pulses showed an actual, though nominal, decrease in prices, compared with their previous significant rise; the price index for rice registered an increase of 3.4 per cent, as against a previous decline of 2.2 per cent; edible oils, which had increased by 59.4 per cent previously, further rose by 13.5 per cent. The absence of downward movement in food prices, particularly of cereals, in step with increased production and (higher rural consumption notwithstanding) increased marketed surplus, may be attributed to the deep cut in their imports, the price support provided by procurement, and monetary expansion.

An indication of changes in the cost of living is provided by the All-India Consumer Price Index for the Working Class which recorded an increase of 3.9 per cent between June 1969 and June 1970, as against a rise of 1 per cent during the corresponding preceding period.

Balance of payments

During the fiscal year 1969/70, there was a considerable improvement in India's external payments position, and foreign exchange reserves rose by $326 million, registering the highest rise in any year during the last two decades. The increase in reserves would actually amount to $374 million, as against $144 million during 1968/69 and $16 million during 1967/68, if the transactions with IMF (allocation of SDRs as well as repurchases from IMF), refund of IBRD special deposits, and the appreciation of the Deutschmark component of foreign exchange assets were excluded. The marked improvement was largely due to the substantial decline in imports, continued, though slower, increase in exports, and aid reimbursements.

Aggregate imports continued their downward movement of the previous two years to record the lowest level since 1961/62, with a decline in 1969/70 by $211 million to $2,110 million. Exports increased by $50 million to $1,873 million. Thus, the adverse trade balance was reduced by more than half to $237 million and the total deficit comprising the current account deficit and unidentified transactions narrowed to $308 million, from $638 million in 1968/69 and $1,186 million in 1967/68. The net inflow of capital, which declined from $689 to $625 million, more than offset the deficit.

The aggregate import bill decreased by 10 per cent, continuing the decline of 15 per cent during the preceding year. The decline, which was shared by a number of items, was particularly conspicuous in respect of foodgrains and capital equipment; there were small increases in maintenance imports, such as raw cotton, fertilizers, chemicals and iron and steel. More than four-fifths of the import reduction was on government account: imports of most commodities were lower, with sharp declines in foodgrains ($158 million) and capital equipment ($70 million). Private imports of mineral oils, vegetable oils, and machinery declined, while those of iron and steel rose.

Exports grew by $50 million at a rate of 3 per cent, compared with 9 per cent in 1968/69 and the fourth five-year plan target of 7 per cent. The deceleration in export growth reflected the difficulties facing major traditional Indian exports, such as tea and jute manufactures; industrial unrest; and problems in moving goods into the external market now that recessionary conditions were over. An encouraging feature of the modest export growth was the continued rise in non-traditional items, particularly engineering goods (despite the shortage of steel), iron ore, fish and fish preparations, and leather manufactures, exports of which increased by $34 million, $14 million, $12 million, and $14 million respectively. Among the traditional exports, exports of jute and jute manufactures declined by $38 million, of tea by $34 million, of cashew-nuts by $8 million, of tobacco by $9 million and of oilcakes by $6 million. The only traditional export to show an increase was cotton yarn and manufactures, with $17 million.

Invisible transactions, including official transfer payments, worsened significantly, resulting in a net deficit of $52 million, compared with the surplus of $11 million in the preceding year. Gross receipts on official grants declined from $75 million to $47 million, consequent on the sizable reduction in special food assistance. The deficit on account of other invisible transactions widened, from $42 million to $78 million, mostly as a result of increased gross payments on investment income and transport accounts.

At $625 million, the net inflow of capital was lower, by $64 million, than that in the preceding year. There was both a decline in the inflow to the official sector and an increase in the outflow on

account of private capital transactions, partly offset by a favourable swing in banking capital from a net outflow of $30 million in the previous year to a net inflow of $19 million. The net inflow to the official sector, at $652 million, was less than in the preceding year by $85 million, owing to a decrease in the utilization of loans and an increase in repayments to IMF and amortization payments on loans; more than two-thirds of the decline in loan drawings was accounted for by a fall in PL480 counterpart non-convertible rupee loans. The adverse movement in official capital was neutralized by more than two-thirds by miscellaneous capital transactions, particularly the allocation of SDRs and changes in rupee liabilities to the United States Government arising out of PL480 title 1 transactions. In the private long-term capital account, the net outflow more than doubled to $46 million owing to a significant increase in repayment of loans and an increase in disinvestment by oil companies.

External assistance

External assistance authorized in 1969/70, at $830 million,[16] was the smallest so far, below the previous low of 1967/68 of $949 million and $1,275 million in 1968/69. Nearly 90 per cent of the decrease in authorization during 1969/70, compared with the preceding year, was on account of the decrease, by $391 million, in loans authorized from the United States. Grants authorized were also lower, by $56 million, than in 1968/69. There was a marginal increase, by $2 million, in PL480 title 1 over the previous year.

As in the previous year, loans accounted for the dominant portion, nearly 84 per cent, of the aid authorized, the share of PL480 aid and grants being 12 per cent and 4 per cent respectively. About 45 per cent of the loans authorized in 1969/70 was non-project aid, and 9 per cent was for debt relief; loans tied to specific projects, provided by IBRD, IDA, USAID, United States Eximp Bank and project assistance from Canada and Italy, increased their share from 17 per cent in the previous year to 46 per cent during 1969/70. Non-project aid was almost entirely from the United Kingdom, the Federal Republic of Germany, Japan, the Netherlands and Belgium. There was some liberalization in terms in the authorization from the Federal Republic of Germany, the Netherlands and Belgium. The terms of PL480 assistance, on the other hand, were made more stringent, with a rise in the share of convertible local currency credits to 60 per cent, compared with the 40 per cent applicable under the December 1968 agreement.

[16] For a fuller account, see Reserve Bank of India: *Annual Report for the Year Ended June 30, 1970*, pp. 45-49.

For servicing the official aid, the foreign exchange utilized rose from $458 million in 1968/69 to $506 million in 1969/70, amounting to 27 per cent of the export earnings and 42 per cent of gross external aid utilized; the debt-service payments would have been higher, at $500 million and $550 million in 1968/69 and 1969/70 respectively, but for the debt relief provided in the form of rescheduling and postponement of payments due by IBRD, the United States, Japan and Canada. At $697 million, the net inflow of foreign resources under external aid programme in 1969/70 was marginally higher than in the previous year, by $67 million, owing to some improvement in the rate of utilization of external assistance.

Towards equality and social justice

As stated in the fourth five-year plan, there is no indication, from the information available, of any reduction in the concentration of income and wealth or of any lessening in the disparities in the standard of living of various classes. The Government adopted policies to reduce concentration and promote wider diffusion of wealth, income, and economic power, and to improve the conditions of the common man and the weaker sections by enlarging employment opportunities and educational facilities.

A number of institutional and policy measures, initiated during 1969/70, aim at the promotion of the social objectives enshrined in the plan. Progressive taxation policies, the new industrial licensing, the operation of the Monopolies Act, regional dispersion of industries, and the proposed more effective implementation of land reforms have as their objective the promotion of equality and social justice complementing economic progress. Consequent on nationalization of banks, credit policies have been drawn up towards such an end.

Among the weaker sections of the community, small farmers and a major part of small-scale family enterprise are to be made economically viable through an adequate supply of inputs at reasonable prices, the encouragement of subsidiary occupations, and the provision of credit; the Small Farmers' Development Agencies and the Lead Bank Scheme, along with increased funds for financial institutions and co-operative societies, are expected to contribute towards bettering their lot. Those who have to depend purely on their labour for their means of livelihood will benefit from the increase in employment opportunities resulting from the various development programmes, particularly in chronically drought-affected areas; the dispersal of industries; and the greater attention to local planning in development efforts. Towards the betterment of the weaker sections of the population, new measures were introduced during 1969/70, such

as special programmes for providing nutritional services to school children in tribal blocks and slum areas in the metropolitan cities, in addition to the existing schemes of school feeding; increase in financial provision for low- and middle-class housing and slum clearance; and expansion of drinking water facilities in rural areas.

Population and employment

At the end of 1969, the population of India was estimated at 543 million, and its annual growth rate at 2.5 per cent. India has budgeted for substantial expenditure on family planning. The fourth plan envisages a total outlay of Rs 3,150 million on family planning, almost fifteen times the allocation under the third plan; in the first two years of the plan, the outlay on family planning amounted to Rs 940 million. While the major emphasis originally was on IUD, sterilization and conventional contraceptives have gained greater and more permanent acceptance; the supply of oral pills is also to be increased. The demographic impact of the programme may be gauged when the 1971 census data are available.

Conventional concepts of labour force, unemployment and underemployment have been found to be of limited applicability in the socio-economic conditions prevailing in India, and the expert committee appointed by the Planning Commission for that purpose has concluded that estimates of unemployment would be neither useful nor meaningful in the absence of more adequate data and intensive studies. Accordingly, unlike the previous plans, the fourth plan does not present estimates of additions to the labour force or the additional employment opportunities that would be created through the implementation of plan projects. The development strategy adopted for the fourth plan is expected to provide significant enlargement of employment opportunities through: agricultural development programmes, development of rural industries and rural infrastructure and rural work programmes; labour intensive public works; prefential treatment for small-scale industries; and restriction of capital-intensive techniques for production to fields in which they are indispensable.

Indonesia

General review

The Indonesian economy made considerable progress during 1969 and 1970. Preliminary estimates of national income for 1969 by the Central Bureau of Statistics indicate an over-all growth of 6.2 per cent, slightly lower than the 6.9 per cent growth rate achieved in 1968, due mainly to a less than anticipated rise in agricultural production. Rice production increased by 6.2 per cent, compared with 9.0 per cent in 1968, as the intensification programme involving foreign contractors (Bimas Gotong Rojong) failed to achieve the results expected from it. It has been decided to replace this programme by an improved national one relying solely on domestic administration of extension services and of distribution of agricultural inputs to the farmers. The new programme will commence in the wet season of 1970/71. Both the wet and dry season harvests in 1970 are reported to have been better than average and there has been noticeable acceleration in the growth of the other sectors of the economy. As a result, gross domestic product in 1970 is expected to have grown at a higher rate than in 1969.

The success of the stabilization measures initiated in October 1966 continued through 1970 and the rate of inflation (measured by the Djakarta cost of living index) was brought down from 85 per cent in 1968 to 9.9 per cent in 1969 and 8.9 per cent in 1970. During 1970, the money supply rose by about 35 per cent, compared with an increase of 58 per cent in the previous year, and, because of the higher interest rates, there was a substantial increase in time and savings deposits. Part of the funds mobilized from these deposits have been channelled through the banking system to finance new medium-term investments in both the public and private sectors.

A tighter food supply situation, which developed during the second half of 1969, caused a sharp increase in the cost of living index and the Government had to make substantial commercial cash purchases of rice from abroad. During 1970, the food supply situation improved and the Djakarta cost of living index rose by only 8.9 per cent in spite of the 56 per cent increase in kerosene and gasoline prices announced by the Government early in January.

During the fiscal year 1969/70 (1 April - 31 March), improved tax administration and increased revenue from the oil sector resulted in a sizably greater than expected increase in government revenues (excluding receipts from foreign aid). Despite a marked rise in routine (non-development) expenditures during 1969/70, due mainly to an increase in government activities and salary bonuses to government employees, for the first time in many years the Government had a surplus of total domestic revenues over non-development expenditures (11 per cent). This surplus together with receipts from foreign aid were utilized to finance a public development programme of approximately Rp 123.4 billion. For 1970/71, a development budget of Rp 161.4 billion is planned of which Rp 37.1 billion is to be financed from government savings and the rest from foreign aid (programme as well as project).

After years of "hyper-inflation", relative price stability was attained in 1969, and this permitted policy-makers in Indonesia to shift emphasis to

development. Investment activity in both the private and public sectors gathered momentum as implementation of the 1969/70 public sector development programme progressed, though at a slower pace than anticipated, and as project aid committed in 1968 and 1969 began to materialize. However(Indonesia is still at an early stage of a process of rehabilitation, and the economic effects of investment will become significantly noticeable only towards the end of the plan period.

The balance of payments continues to be a major concern. A sharp loss of foreign exchange reserves during the last quarter of 1969 and the first quarter of 1970 was caused by a rise in imports which accompanied the increase in over-all economic activity, large commercial imports of rice, a decline in the world market price of rubber, and delays in programme aid disbursement. In April 1970, the Government decided to carry out a complete reform of the foreign exchange and trade system with a view to abolishing the multiple exchange rate system and adopting concrete measures to promote exports. A week later, the Inter-Government Group on Indonesia (IGGI) consortium accepted Indonesia's request for aid commitments of $600 million for the fiscal year 1970/71 and the Paris Club agreed to reschedule Indonesia's old debts (contracted prior to June 1966). According to preliminary figures, there has been a substantial improvement in the balance of payments since April. The long-run prospects now seem more encouraging in that export earnings are growing at about 15 per cent per year and an increasing inflow of foreign aid is assured on the basis of existing commitments. This must be balanced however against the still heavy debt service payments resulting from the Paris Club agreements and the rising demands for imports to carry out the five-year development plan (1969/70 - 1973/74).

Agriculture

Food crops account for nearly two-thirds of agricultural production and rice is the single most important crop. Rice production, which had registered a record increase of 9.0 per cent in 1968, went up in 1969 by 6.2 per cent to 10.8 million tons in 1969. The smaller increase in the output of rice during 1969 was due to a poor dry season harvest and the failure of the rice intensification programme operated by foreign contractors to achieve the result expected of it. At the same time, BULOG (the government rice procurement agency) failed to make large purchases during the good wet season harvest, repayment in rice of the Bimas Gotong Rojong credit extended as part of the previous intensification scheme was low, and the arrival of food aid was late. These developments resulted in the Government's having considerably lower supply in hand than had been expected. Consequently, as mentioned earlier, the rice supply situation during the second half of 1969 was tighter than expected, and this caused a sharp increase in both the price of rice and the cost of living index and led to substantial government cash purchases from abroad.

The rice supply situation in 1970 improved considerably. According to preliminary estimates, the 1970 harvest was about 11.4 million tons. The stocks of milled rice held by BULOG had also risen to about 407,000 tons by the end of September 1970 (as against 207,000 tons at the end of September 1969), largely because of the improved domestic procurement programme and the commercial imports made during the first half of 1970. During the second half of fiscal year 1970/71 (October 1970 - March 1971), no commercial imports are planned and heavy reliance is placed on food aid imports to fill the gap between domestic supply and demand. If there is any delay in the arrival of food aid under the PL480 programme, however, commercial imports may be necessary to avoid any further increase in the price of rice.

Production of other food crops declined during 1969, and, except for rubber, export crops registered no gains. Favourable world market conditions and intensified fertilization of rubber plants in 1968 raised rubber output in 1969 by about 5.2 per cent.

National Bimas/Inmas programmes[1]

One of the objectives of the five-year development plan is to achieve self-sufficiency in rice by the end of the plan period. To achieve this objective, very heavy reliance is being placed on the National Bimas/Inmas programmes to increase both rice yields per unit of land and economic returns to farmers. Unlike the Bimas Gotong Rojong programme which preceded them, these programmes will be entirely domestic. Bimas is a nation-wide agricultural extension programme to bring about the use of high-yielding varieties of rice, the proper application of fertilizers and other inputs, the adoption of improved cultivation practices, control of pests and diseases, and efficient use of irrigation water. Under this programme, also, farmers obtain credit facilities from the Bank Rakjat Indonesia. Inmas is similar to Bimas except that farmers are expected to obtain credit from private sources and, hence, probably at much higher interest rates.

The basic conception of the new programmes is to rely more upon permanent and presumably stable elements, such as local banks, local merchants and local extension agents, and to rely less on students and

[1] "Bimas" means "mass guidance"; "inmas" means "mass intensification".

foreign technicians or specially organized groups. It should be easier, therefore, to expand them throughout the country.

Mining

Mining, an important foreign exchange earning sector and one of the main sources of government revenues, is the fastest growing sector in the economy. The important minerals produced are oil, tin, nickel, and bauxite. Because mining operations involve heavy capital investment, heavy reliance is placed on foreign companies for exploration and production of minerals.

Production of crude oil increased by 23 per cent in 1969, compared with 18 per cent in 1968, and, during the first nine months of 1970, the increase was about 18 per cent over the same period in 1969. Production is expected to continue to rise in 1970 and 1971, probably at a lower rate. Increased production during the past year was mainly due to earlier investment in existing fields, but output from these fields is not expected to continue to grow at the present rate. Production from new fields (mainly offshore) is not expected to become significant until 1972.

New offshore oil explorations continue to draw the attention of foreign companies, and, in August 1970, it was announced that the first offshore production is expected to start in the middle of 1971 on the north coast of Java.

Tin output increased by 2.8 per cent in 1969 and is expected to increase at a high rate this year on account of improved repair and maintenance and more efficient use of equipment. Two other minerals which are becoming increasingly important are nickel and bauxite, but most of the private foreign investment here is still for exploration.

Manufacturing

According to the available official statistics, output of manufacturing industries increased substantially during 1969. In that year, the output of yarn and textile increased by 23 and 31.3 per cent respectively, while, during fiscal year 1969/70, textile production reached 449.8 million m, almost exactly the target set for the year in the plan.

The output of cement increased by 30 per cent during 1969 to 534,000 tons, but was still short of the estimated annual domestic requirement of 800,000 tons. Consequently, a substantial amount of cement was imported from abroad during the year. Steps are now being taken to increase the capacity of the Gresik cement factory by another 125,000 tons and capacity of the Padang plant by 100,000 tons. In order to speed up the expansion, the Gresik plant has recently been converted into an autonomous limited liability company. With the addition to the foregoing of the new Tjibinong plant of 500,000 tons capacity to be completed in 1973/74, cement production is expected to reach 1.34 million tons by the end of the plan period.

Despite declines in the output of some paper-producing plants, over-all production of paper increased by 40 per cent during 1969, and, in view of planned investment (foreign as well as domestic) for the establishment of new paper-producing factories, the output of paper will continue to increase rapidly during the next few years.

Fertilizer output fell by 10 per cent during 1969, mainly because of problems at the only fertilizer-producing facility in the country. There are plans for the expansion of the capacity of this factory, and agreement has been reached with IDA, ADB and the Japanese and United States Governments for the expansion of the factory to an annual capacity of 480,000 tons by 1973/74.

Private investment

In the first five-year plan, private investment has been accorded an important role to play in the development of the Indonesian economy. To promote investment activity in the private sector, various incentives, such as tax holidays and exemption from import duties, already existed under the Foreign Investment Law of 1967 and the Domestic Investment Law of 1968 and during 1970, several new policy measures were introduced. The corporation tax law was amended, reducing the maximum tax rate from 60 per cent to 45 per cent. Amendments made to laws dealing with foreign and domestic investment provide additional incentives for new firms, and the new foreign exchange and foreign trade regulations introduced in April 1970 grant exemption from the 10 per cent foreign exchange export tax to exports of finished manufacturing products.

Foreign investment applications continue to pour in to the Foreign Investment Board in Djakarta. By the end of August 1970, a total of 276 foreign investment projects, with a total intended capital investment of $1,250 million, had been approved by the Government and this did not include investment in the oil sector or the $1 million initial capital required for each of the eleven foreign banks that have branches in Djakarta. Oil investments are arranged under "production-sharing" agreements where each contract is negotiated separately between the applicant and the State oil company (Pertamina) on behalf of the Government.

Of the twenty-one investing countries, the major ones are the United States with forty-eight projects

and a total capital of $484.9 million, the Philippines with thirteen projects worth $261.5 million, and Japan with forty-eight projects amounting to $251.8 million.

In May 1967, the Government announced a new policy dealing with claims of foreign creditors whose loans had not been guaranteed. Most of these claims pertained to suppliers' credit extended prior to June 1966.[2] Under the Debt Investment Conversion Scheme (DICS), foreign claimants receive settlement of their foreign exchange claims in local currency which they may either invest in Indonesia themselves or sell to others who wish to do so. They may also use these rupiahs to purchase foreign exchange for imports of raw materials and capital goods falling under the foreign investment law. Most of the foreign investment made in 1969 came from this source.

While the amount of planned investment is quite encouraging, the amount disbursed is still very small, probably some 10 per cent of the total. Most of the foreign investment is concentrated in the mining and forestry sectors, and, in these sectors, investments have a fairly long gestation period. Therefore, the production and balance of payments effects of the investment will not be significant in the immediate future. However, foreign investment in the mining sector holds out hope for rapid growth of production in the long term and, through expansion of exports, improvements in the balance of payments. At present, activity in the mining sector is confined mainly to survey and exploration, while timber projects are still primarily logging operations.

As for domestic private investment, it is promoted under the Domestic Investment Law which grants domestic firms fiscal and import duty privileges for new investments similar to the ones offered to foreign investors. The Development Bank of Indonesia is charged with implementation of the Law on behalf of the Domestic Investment Board. By the end of August 1970, a total of 369 projects, with a total intended investment of Rp 110.6 billion, had been approved, a large proportion representing foreign exchange costs of the projects. Most of the intended investment projects are in industry, transport and communication, and tourism; investment projects in industry are mostly in textiles, paper, plastic goods, matches, and pharmaceutical products.

Government finance

The principal factor in past inflation had been large-scale government budget deficits due mainly to a serious deterioration in tax administration and to large increases in current expenditures (routine expenditures). Between 1960 and 1966, the ratio of government current receipts (domestic revenues) to gross domestic product is estimated to have declined from about 12.7 per cent to about 4.2 per cent, and the current account deficit in 1966 amounted to about 95.5 per cent of current receipts. The new Government's programme, therefore, gave high priority to major improvements in the fiscal field, including the early elimination of bank financing of the budget deficit. On the expenditure side, under the new programme, current budget expenditures (including wages and salaries of government employees) were maintained at an austerity level throughout the stabilization period. On the receipts side, a concerted effort was made to increase current budget receipts, largely through improved tax administration. Emphasis was placed on increasing collections from custom duties, direct tax revenues, and proceeds from excises and sales taxes. As a result of these measures, the current (routine) budget deficit was reduced considerably in 1967, and both the routine and over-all budget were balanced in 1968. To facilitate the implementation of fiscal policy in a rapidly changing economic situation, procedures for quarterly programming were introduced early in the stabilization period.

Since 1967, considerable improvement has taken place in the fiscal operations of the Government. During 1969/70, a surplus of Rp 27 billion was achieved, compared with the budgeted figure of Rp 24 billion.[3] Total routine (domestic) revenue, at Rp 244 billion, was greater by 39.7 per cent than during the same period in the previous year, while routine expenditure, at Rp 216 billion, was greater by 24.5 per cent than that of the previous year. The routine (non-development) expenditure of the Government was also higher than the budget estimate (about 6 per cent), owing mainly to greater than anticipated government activity and to salary bonuses granted to government employees.

Although both the counterpart value of programme aid and the routine budget surplus were greater than the budget estimates, total development revenue was lower than expected because of the slow disbursement of project aid. With reference to development budgeting, an important step taken in the preparation of the 1969/70 development budget was the establishment of systematic procedures for the selection, preparation and evaluation of projects.

The 1970/71 budget estimate is for domestic revenue of Rp 320.6 billion and routine expenditure of Rp 283.5 billion, i.e. for a budget surplus of Rp 37.1 billion. With expected revenue from foreign aid at Rp 124.3 billion (Rp 78.7 billion in programme aid and Rp 45.6 billion in project aid), development

[2] Guaranteed private export credits have become part of the Government's debt and the settlement of such claims a part of public debt re-negotiations.

[3] As from 1969, the fiscal year was changed from the calendar year to the twelve months from 1 April to 31 March.

expenditure is expected to be Rp 161.4 billion for 1970/71, 36.5 per cent higher than actual development expenditure in fiscal year 1969/70.

The public development programme of Rp 161.4 billion for 1970/71 may be somewhat ambitious in view of administrative bottlenecks which slowed the disbursement of development expenditures during 1969/70. Another factor is that development spending during the first quarter of 1970/71 was at a rather low level because of concern that the monetary expansion in the last quarter of the 1969/70 fiscal year would have inflationary consequences. Efforts are being made to smooth the rate of development expenditure by advancing the timing of processing and approval of the project request forms.

The 31.5 per cent increase in domestic revenue over the last fiscal year is expected to come mainly from the oil sector and from improved tax collection. However, the new regulations on trade and foreign exchange introduced in April 1970 to promote exports and domestic economic activity will also affect government revenue. A new amendment to the income tax law has raised the minimum taxable income and has changed the structure of rates from 15-50 per cent to 10-50 per cent. An amendment to the company tax law has reduced the maximum tax rate from 60 per cent to 45 per cent, and an amendment to the foreign and domestic investment law grants added incentives for new firms. On the other hand, the 17 April 1970 regulations abolish the 5 per cent export tax, although this may not affect receipts because of higher direct taxes on the increased incomes of exporters. Finally, a change in the exchange rate applied to the valuation of import duty and in the rate applied to oil transactions will yield some increase in the revenue.

Routine expenditure is expected to increase by 30.9 per cent over the previous fiscal year, mainly because of a 50 per cent increase in government salaries, replacement of the regional export tax by a central government subsidy to the regions, and rising debt service.

On 6 January 1971, the Government submitted to Parliament a draft budget for the fiscal year 1971/72. Domestic revenue is estimated at Rp 415.9 billion or a 29.7 per cent increase over the budgeted figure of 1970/71. Again, the increase is expected to come mainly from the oil sector and from further improvement in tax collection. Current expenditure is estimated at Rp 364.1 billion, representing an increase of 28.4 per cent over the budgeted figure of 1970/71. This includes a further increase in salaries and wages of government officials by one-third across-the-board, and selective salary increases in those areas of administration which are most important to the financing of the development programme (mainly in the revenue-collecting and development-spending departments).

A routine budget surplus of Rp 51.8 billion is planned for 1971/72, and together with projected receipts from foreign aid of Rp 169.2 billion (Rp 103.1 billion counterpart value of the programme aid and Rp 66.1 billion project aid), will make up a planned public development programme of Rp 221.0 billion, representing an increase of 36.9 per cent over the development budget of 1970/71. This development budget will be selectively aimed at increasing food production through wide-scale fertilizing and irrigation programmes, together with further rehabilitation and development of roads and bridges, sea communication and telecommunication.

Monetary development and prices

The rate of monetary expansion has decelerated sharply since 1966. The money supply which had increased by 763 per cent in 1966, rose by 132 per cent and 121 per cent in 1967 and 1968 respectively. During 1967 and 1968, the major part of the credit expansion was by the Central Bank, as the authorities sought to eliminate the physical shortages of essential consumer and producer goods which had been a major factor in the inflationary spiral. In 1969, when relative price stability had been largely restored, the money supply increased by about 58 per cent, most of the increase resulting from bank credit extended to the private sector, and, during 1969 and 1970, the share of commercial bank credit to total credit increased substantially. During the stabilization period, this primary credit expansion was essential for the Government's objective of restoring price stability while expanding over-all domestic production. This was because the level of real liquidity in the economy had been reduced by about 54 per cent during 1960-1966, and the capital resources of both business enterprises and the commercial banking system had been substantially depleted by the inflation. It was possible to tolerate a high rate of monetary expansion mainly because credit was directed primarily to essential economic activities rather than to financing governmental routine budget deficits, and the balance of payments impact of the expansion could be met by available foreign exchange resources, including foreign aid.

During the first two years of the stabilization programme, no serious attempt was made to generate private savings deposits, as the rate of inflation, though sharply falling, still remained very high. In October 1968, however, amidst indications that inflation was being contained, a saving deposit scheme was introduced. Under the scheme, state commercial banks paid an interest rate of 6 per cent a month on 12-month deposits and somewhat lower rates on 6-month and

3-month deposits. These deposit rates were higher than the average rate of interest earned on loans, and the Central Bank had to provide a subsidy to the state banks in the amount of one-third of the interest paid on 6-month and 12-month deposits. Deposit rates were reduced in March 1969, but still exceeded the average loan rate, and the Central Bank continued the subsidy (reduced to 1 per cent and for 12-month deposits only) until May 1969. Since then, deposit rates have been reduced several times, but the scheme has proved very successful. Time deposits increased substantially during 1969 and 1970, and, by the end of December 1970, time deposits at the state banks had reached Rp 50.4 billion. Deposit rates at the state banks since January 1970 are 2 per cent per month for 12-month deposits, 1.75 per cent per month for 6-month deposits, 1.5 per cent per month for 3-month deposits, and 1 per cent per month for 1-month deposits.

In February 1969, the Government introduced an instalment-saving scheme with lottery prizes, at first limited to the Djakarta area, but later extended to all Java, north Sumatra and north Sulawesi. These instalment deposits increased from Rp 20.6 million at the end of February 1969 to Rp 1,089.2 million by the end of September 1970.

Part of these deposits is being utilized through the banking system to finance new investments in both the public and the private sector. This new medium-term investment credit programme has been remarkably successful. By the end of the first year of the plan (end of March 1970) Rp 31.6 billion of loans had been approved, compared with the target of Rp 30 billion, and about 52 per cent had been disbursed. A considerable part of the approved loans went to the private sector, with distribution well balanced by sectors. The programme for fiscal year 1970/71 was again set at Rp 30 billion, but with a greater contribution expected from the state banks' own funds.

It should be noted that this credit policy has undoubtedly played a very important role in the the stabilization programme. Its basic premise was that the extension of credit to existing production units for financing rehabilitation and working capital requirements would facilitate the fight against inflation through its impact on production for the domestic market and for exports. It is also expected to play an important role in the investment financing of the five-year plan.

The Djakarta cost of living index, which is taken as a measure of the rate of inflation, rose by only 9.9 per cent during 1969, compared with 85 per cent in 1968 and 128 per cent in 1967. This 9.9 per cent rise in 1969 occurred mostly in the second half of the year and was due mainly to a tight rice supply situation. The index rose again in January 1970, partly for the same reason, but mainly owing to an increase in the domestic prices of petroleum products. The price of rice reached its peak in January 1970 and eased later as the supply situation improved. In January 1970, administered prices of domestically consumed petroleum products were also raised in order to abolish the subsidy and to bring them into line with other prices.

Despite the fact that the new exchange regulations of April 1970 raised the export bonus (BE) rate from Rp 326 per United States dollar to the complementary foreign exchange (DP) rate of Rp 378 per United States dollar, there was no significant increase in prices. During 1970, the Djakarta cost of living index increased by only 8.9 per cent; for food-stuffs it increased by 1.3 per cent, while housing increased by 49 per cent, clothing by 19 per cent, and other items by 12 per cent.

External trade and balance of payments

Despite a rapid growth in export earnings since 1966, balance of payments difficulties continue to be a major concern for policy-makers. A combination of rising import demand, large commercial imports of rice, a declining world market price of rubber and lagging aid disbursement caused a sharp loss of foreign exchange reserves during the last quarter of 1969 and the first quarter of 1970.

The balance of payments deficit on current account rose to $433 million during 1969, 27.7 per cent higher than in the previous year. The balance of trade reflected a surplus of $2 million during the year, much smaller than the $41 million achieved in 1968, while the net payment on services account (including the oil sector) of $376 million (23.3 per cent over 1968), together with debt service payment of $59 million, accounted for the current account deficit. Since both official and private capital inflow amounted to $378 million during 1969, the over-all balance of payments deficit stood at $55 million during the year. With respect to fiscal year 1969/70, the first year of the plan, the deficit on current account was $475 million, as against the $459 million target set in the plan. Since the capital inflow (official and private) amounted to $417 million during 1969/70, which was smaller than the $459 million expected during the year, the over-all balance of payments deficit during 1969/70 was $58 million, and this was financed by running down exchange reserves.

Estimates for the current fiscal year 1970/71 suggest a balance of payments deficit on current account of $477 million which is smaller than the plan forecast for the year. According to preliminary estimates, a trade surplus of about $33 million was

achieved in 1970. With the expected inflow of capital during the current fiscal year, improvement in the over-all balance of payments position is expected. In April, the IGGI consortium agreed to Indonesia's request for an aid commitment of $600 million for 1970/71, and the Paris Club agreed on a rescheduling of Indonesia's old debts to reduce pressure on the balance of payments. Also in April, a reform of the foreign exchange and trade system was carried out which abolished the multiple exchange rate system, and concrete measures were adopted to promote exports. Preliminary figures indicate that, since April, there has been substantial improvement in the balance of payments both on current and capital accounts. Again, in December, IGGI agreed to an aid commitment of $640 million for 1971/72 as requested by Indonesia.

It should be noted, however, that the debt service burden is rising, and import requirements of the economy will continue to grow for some years in the future. Thus, efforts to expand earnings from exports, to increase the inflow of foreign aid, and to obtain softer terms of foreign aid will all be crucial for the successful implementation of the five-year development plan.

Exports

Merchandise export earnings (excluding the oil sector) increased from $569 million in 1968 to $629 million in 1969, and the gross export earnings of the oil sector increased from $303 million to $336 million. Thus, total export proceeds rose by 14.1 per cent during 1969. In the fiscal year 1969/70, total non-oil export earnings exceeded the planned target by 9.7 per cent, and the total, including oil, exceeded the planned target by 9.1 per cent. Preliminary estimates for 1970 show that total surrendered non-oil export earnings amounted to $737 million, an increase of 17.2 per cent over the comparable period in 1969, and gross export earnings from the oil sector amounted to $426 million, an increase of 16.4 per cent.

Improved rubber prices were mainly responsible for the substantial increase in non-oil export earnings during 1969, and rubber exports (the surrendered value) in United States dollar terms increased by 25.8 per cent. Despite a sharp decline in the world market price of rubber since the last quarter of 1969, rubber exports continued to increase during 1970. Part of the increase during the first half may be attributed to the fact that some stocks of rubber were held in anticipation of a change in the BE rate of exchange and were released during the second quarter of 1970. In addition to rubber, which is the most important foreign exchange earner outside the oil sector, other important non-oil export products are tin, coffee, timber, and palm oil, all of which did well during 1969. Exports of minerals such as nickel and bauxite also increased significantly during 1969. Timber exports (in terms of United States dollars) were up by more than 100 per cent over the previous year, and it is now the fifth most important export commodity, with good promise for further expansion. Unfavourable prices were partly responsible for poor performances by copra, tobacco, and tea.

Oil has taken over the position of rubber as the leading export product. Crude oil production increased by about 58 per cent between 1966 and 1969, and, during the first nine months of 1970, daily production reached an average of 845,000 barrels. However, the output and export of oil may not rise as fast during the next two years as they did in 1969, because production from new fields (particularly from offshore drillings) is not expected to become significant before 1972.

Imports

With increased over-all economic activity, imports (including those of the oil sector) rose by 19.5 per cent during 1969 and were estimated to increase further, by about 13.8 per cent during 1970. With respect to composition, there has been a further shift towards imports of capital goods and raw materials. The share of capital goods increased from 28.6 per cent in 1968 to 29.8 per cent in 1969 and that of raw materials from 34.1 to 41.5 per cent. Imports of foodgrains (rice *bulgur* and wheat flour) decreased by 25 per cent to $161.4 million in 1969, though this was still larger than the planned figure, and decreased further, by 3 per cent to $156.5 million, during 1970. The poor dry season harvest and a decline in the output of other foodcrops were among the factors responsible for food grain imports being larger than expected during 1969. The proportion of imports financed by foreign aid also lagged behind the planned level because of the slow foreign aid disbursement.

As might be expected, imports during the four months after the foreign exchange reform in Apri. (excluding those of the oil sector) dropped somewhat, compared with the same period last year. This was temporary, however, since new import financing arrangements and the normal holiday season demand raised imports in the fourth quarter of 1970. In May, Bank Indonesia authorized imports with a "Merchant's L/C". This enables importers to obtain supplier's credit but does not involve bank guarantee of pay-

ment, and the purchase of foreign exchange is deferred until the settlement of the bill of exchange. This is expected to induce imports particularly from Hong Kong and Singapore.

External trade and exchange regulations

A new set of regulations in the field of external trade and foreign exchange was announced by the Government on 17 April 1970 involving a partial devaluation of the rupiah. Under the new scheme, the two foreign exchange rates of BE and DP were merged into a single general rate (DU). The DU exchange rate was initially set at the then current DP-rate of Rp 378 per United States dollar. All foreign exchange transactions must be made at this rate, except those for imports financed under programme aid. For these imports, the credit BE rate of Rp 326 per United States dollar was to be applied until December 1970, after which the DU rate would apply to them also.[4]

Under the new scheme, the overprice/checkprice system is abolished and exporters are required to surrender the full f.o.b. value of their exports to the foreign exchange banks at the prevailing DU rate. The 5 per cent export tax on group-A exports was abolished and the 10 per cent regional export tax ADO (automatic foreign exchange allocation) was converted into a tax accruing to the central Government, the regions being compensated for their loss by a rupiah subsidy equivalent to 105 per cent of the region's ADO receipts in the fiscal year 1969/70. Exports of manufactured articles and handicrafts were given exemption from the 10 per cent export tax. Export and import procedures were also simplified and bank charges were reduced.

As mentioned earlier, the effect of the new regulations on the domestic price level is so far almost insignificant, and it is too early to judge its effects on exports. The reform of the exchange system, however, has raised the average effective exchange rate received by exporters. For some commodities, on the other hand, particularly those in the old group-B which had enjoyed a large overprice under the old system, the gain may be very small, but exemption from the 10 per cent export tax has been granted to some commodities such as finished products and handicrafts as an additional incentive.

Capital inflow and debt service

Private capital inflow (including investments for oil explorations and the initial investment for the establishment of branches of foreign banks) amounted to about $140 million in 1969 and is expected to rise to about $200 million during 1970. In 1969, oil investments amounted to $96 million and are expected to increase to about $130 million in 1970.

In 1969, official foreign aid commitments amounted to $545 million ($321 million programme and food aid and $224 million project aid), but actual disbursements during the year were only $323 million. The most serious lag was in project aid, where only about 18 per cent of the commitments in 1968 and 1969 were utilized, the main factor being delay in the preparation of sound projects. The lag in programme aid, nonetheless, has a serious impact on the import programme and foreign exchange reserves.

Total provisional aid commitments for fiscal year 1970/71, as announced at the IGGI meeting in Amsterdam in April 1970, were $571.1 million ($126.1 million in food aid, $177 million in other programme aid, and $268 million in project aid). The United States and Japan are the leading donor countries. Two important proposals were made at the meeting, one by the Netherlands Government for untying BE-aid (credit-BE) and one by Australia for aid commitments three years ahead. The untying of aid was referred to a committee for further study. These proposals, if approved, would considerably increase the utility of aid to Indonesia.

At the Paris Club meeting held in April 1970, the Western creditor countries and Japan finally agreed on a modified version of the proposal to reschedule the Indonesian debts contracted before June 1966. Repayment of the capital will be spread over thirty years, beginning on 1 January 1970, and accumulated interest on the total debt in fifteen equal instalments, beginning on 1 January 1985. In the light of Indonesia's economic situation, it was also agreed that the terms of agreement will be open to revision at the request of either side at any time after 1980, either to accelerate payments or to reduce interest payments due. Indonesia has also continued negotiations with East European creditor countries and agreement was reached in August 1970 on the rescheduling of its debts to the USSR.

Despite the above arrangements for the repayment of old debts, the debt service burden on the balance of payments will substantially increase, starting from the current year. In view of rising import requirements for sustaining development and of the debt service burden, inflow of foreign aid on an expanded scale and at concessionary terms will be crucial for the Indonesian economy, at least for some years to come.

[4] The Government confirmed this change on 9 December 1970.

Iran

Introduction

During 1969/70,[1] Iran continued to experience rapid economic growth. Gross national product rose 11.4 per cent in real terms, a figure slightly above the 1969 growth rate of 10.2 per cent and considerably in excess of the current fourth development plan target of 9.4 per cent. Three sectors — oil, industry and services — registered very high growth rates. Agriculture, however, experienced a less successful year by comparison with 1968/69, drought conditions affecting crop output.

While the growth rate of output increased in 1969/70, the growth rate of domestic expenditure slowed and the excess of domestic expenditure over national product was reduced. Nevertheless, the balance of payments continued to be under pressure, largely as a result of the debt-servicing problems consequent on heavy external borrowing in recent years.

The outlook for 1970/71 is for a continuation of the high rate of economic growth, although at a slightly slower rate than that achieved in 1969/70. Largely because of continued adverse weather conditions, agricultural output has again grown slowly. Growth in other sectors of the economy has been well maintained, however, and a close relationship has been held between output and demand.

[1] The Iranian year is based on the solar calendar. Year 1348, for example, covers the period 21 March 1969–20 March 1970 and will be referred to as 1969/70 throughout this chapter. Other solar years have been treated similarly.

Growth and use of resources

Table II-3-18 indicates the industrial origin of GNP, sectoral growth rates, and the contribution of the sectors to the growth of GNP in 1969/70. The most striking feature of the Iranian economy is the variety and richness of its natural resources. Petroleum (including natural gas) dominates this resources structure. This sector contributed 18.6 per cent to gross domestic product in 1969/70, accounted for 73 per cent of Iran's export earnings, and provided 48 per cent of the central government budget revenue, and the continued rapid growth of petroleum production has stimulated and permitted (through its contribution to foreign exchange and government revenue) rapid growth throughout the rest of the economy.

Exploration activity has largely been concentrated on the search for additional crude oil and natural gas reserves, and several significant discoveries have been made in recent years. The discovery of a large, high-grade, open-cast copper deposit at Sar Cheshmeh near Kerman perhaps gives some indication of the magnitude of Iran's mineral wealth outside of oil. Apart from copper, sizable deposits of coal, iron ore, bauxite, phosphate, chromite, barytes, lead, and zinc have been discovered. It would seem that the contribution of minerals to both national product and export performance could be increased.[2]

[2] Depending on the world price of copper and the satisfactory conclusion of negotiations with the operating company (Selection Trust), particularly on production rates after the very rich surface layer of copper has been removed, copper export earnings may well exceed $150 million in 1974/75. Total non-oil foreign exchange earnings in 1969/70 were $409 million (see table II-3-18), so, even allowing for rapid growth of non-oil earnings, it is clear that copper will make a significant contribution to the balance of payments and to the diversification of export earnings.

Table II-3-18. Iran: Gross national product statistics, 1963-1970[a]

Sector	1963	1964	1965	1966	1967	1968	1969	1970[b]	Growth rate 1964-1968	Growth rate 1969	Growth rate 1970	Fourth plan (1969-1973) annual target growth rate	Sectoral share of GNP increase 1970
	(thousand million rials, constant 1960 prices)								(percentages)				
Agriculture	88.3	89.9	92.2	99.0	102.7	110.9	116.4	118.4	4.7	5.0	1.7	4.4	3.6
Industry and mining	29.5	32.1	36.2	40.2	44.6	50.3	57.3	63.5	11.3	13.9	10.9	13.0	11.1
Petroleum[c]	39.3	42.9	62.0[d]	56.8	64.1	76.0	86.7	101.9	15.4	14.1	17.5	15.3	27.1
Construction	13.5	15.2	16.2	19.9	20.3	25.3	30.1	28.8	13.3	19.0	—4.2	9.9	—2.3
Others (mostly services)	127.6	136.2	148.2	165.8	178.5	200.7	220.7	245.1	9.5	10.0	11.1	7.9	43.5
Statistical errors	4.0	2.0	—3.0	1.4	—12.9	—16.8	—19.2	—9.6	...	—	—	—	17.0
GNP (factor cost)	302.4	318.3	358.8	383.1	397.3	446.6	492.0	548.1	8.1	10.2	11.4	9.4	100.0

Source: Bank Markazi, Iran.

[a] Years ending 20 March.

[b] Preliminary estimates.

[c] Net balance of payments receipts from oil sector, plus value added by the National Iranian Oil Company (NIOC).

[d] Includes oil bonus.

Despite the fact that only 12 per cent of Iran's land can be cultivated and that limited rainfall severely restricts both the area cultivated each year and the scope for livestock farming, this sector contributed 21.6 per cent to GNP in 1969/70. Wheat, barley and livestock dominate the agricultural sector which supports more than one-half of Iran's population. However, apart from the well-watered Caspian littoral (which covers less than 25 per cent of the cropped area but produces more than 70 per cent of the output of wheat, barley, cotton, rice, tea, jute, tobacco and fruit) and some isolated pockets (mainly in the Persian Gulf area), average rural family income is much less than one-half of average urban family income. Apart from agriculture and petroleum, the other important sectors are industry, construction, and service activities.

Iran has experienced rapid growth since 1963/64, the growth rate climbing steadily to 10.2 per cent in 1968/69 and increasing further to 11.4 per cent in 1969/70. There has beeen some disparity, however, in sectoral growth rates. Petroleum, industry and construction activities have, on average, grown faster than GNP and have consequently increased their share of GNP, while that of agriculture has fallen, because the growth rate of this sector was below that of GNP. The service sector has grown roughly in step with GNP and has thus maintained its relative share.

Compared with 1968/69 and with fourth plan (1968-1972) annual average targets, five developments in 1969/70 are of interest. First, agriculture suffered a setback due to unfavourable weather conditions. Wheat and other cereals, together with fruit and nuts, were the crops most affected; cotton output rose slightly. The over-all agricultural growth rate in 1969/70 was below that of 1968/69 and of the fourth plan average annual target. The outlook for 1970/71 is not much more promising, poor spring rains having adversely affected cereal, cotton, and orchard crops. Current expectations are that the agricultural growth rate in 1970/71 will approximate 2 per cent. Second, the growth of industrial output was also lower in 1969/70 than in 1968/69 and failed to reach the fourth plan average annual target. Nevertheless, the growth of this sector was quite rapid, despite results below expectations in the consumer durables industry. Several major industrial projects will come into operation in 1970/71; but because of a tightening of credit requirements for financing imports and a slowdown in construction activity in 1969/70, no significant increase in the growth rate of this sector is expected in 1970/71. Third, there was a sharp slump in construction activities. In a large measure, this was due to direct government action to slow the growth of demand in order to ease growing balance of payments pressures. Apart from credit restraint, the Government restricted the granting of additional building licences. Both measures affected construction activities. Fourth, oil output continued to grow impressively, the growth of output in 1969/70 being well above that of 1968/69 and of the fourth plan average annual target growth rate. The 1969/70 growth rate has been sustained in 1970/71. Finally, the expansion of the service sector in 1969/70 was also up on 1968/69 and well in excess of the fourth plan average annual target; in a large measure, the expansion in 1969/70 was due to a sharp increase in civil service salaries and military expenditure. Oil and services together contributed more than 70 per cent to the growth of output in 1969/70, the other significant contribution coming from the continued expansion of the industrial sector.

Table II-3-19 shows expenditure on GNP. All categories of demand have risen strongly in recent years. In particular, there has been a marked expansion of investment demand (both public and private), of government current expenditure, and of demand for exports. As a consequence, the share of private consumption in expenditure on GNP has fallen. Nevertheless, the growth of private consumption demand was much faster than that of population growth; consumption *per capita* rose strongly, but, at the same time, a higher proportion of a growing resource base was diverted to private investment and to the government sector. Three recent developments are significant. First, the growth of consumption demand slowed slightly in 1969/70 compared with 1968/69, but remained well above the fourth plan annual average target growth rate. In a large measure, the excess continues to be due to a more rapid growth of public sector consumption expenditure than expected in the fourth plan. Second, there was a significant decline in the rate of growth of gross domestic fixed-capital formation in 1969/70, and the ratio of investment to GNP fell from 23.3 per cent in 1968/69 to 21.5 per cent. The growth of investment in 1969/70 was well below the fourth plan target. The major part of the slowdown occurred in the private sector (especially in construction activities), but government investment expenditure also fell short of the budgeted figure for 1969/70 by some 10 per cent, the major shortfall occurring in expenditure on agriculture. Third, up until 1969/70, domestic demand grew at a faster rate than domestic production. In consequence, imports grew very fast and outstripped the rapid growth of export earnings. The resources required to support this excess were obtained by utilization of Iran's external reserves and, more significantly, by an increase in external indebtedness, public and private. In 1969/70, external debt service (including amortization) absorbed 18 per cent of Iran's export earnings. To reduce balance of

Table II-3-19. Iran: Expenditure, gross national product, saving and investment, 1963-1970[a]

Item	1963	1964	1965	1966	1967	1968	1969	1970	Growth rate 1964-1968	Growth rate 1969	Growth rate 1970	Fourth plan annual target growth rate
	(in thousand million rials, current market prices)								(percentage)			
1. Consumption expenditure	316.6	353.8	393.1	412.3	458.4	493.0	548.2	604.7	7.9	11.2	10.3	7.4
Private sector	274.5	302.8	327.6	343.1	382.0	407.6	438.2	469.8	6.9	7.5	7.2	6.7
Public sector	42.1	51.0	65.5	69.2	76.4	85.4	110.0	134.9	13.5	29.0	22.6	10.0
2. Gross domestic fixed capital formation	46.9	59.7	77.4	85.0	109.8	134.1	154.8	159.4	24.9	15.4	3.0	13.7
Private sector	32.0	39.7	53.3	49.4	65.7	69.5	81.0	n.a.	15.0	16.6	n.a.	
Public sector	14.9	20.0	24.1	35.6	44.1	64.6	73.8	n.a.	44.6	14.2	n.a.	
3. Gross domestic expenditure	363.5	413.5	470.5	497.3	568.2	627.1	703.0	764.2	10.3	12.1	8.7	9.4
4. Net exports of goods and services	7.6	−0.6	−3.0	−8.3	−14.3	−24.1	−37.8	−23.8				
Exports	83.8	89.5	103.2	113.7	135.3	146.0	n.a.	n.a.				
Imports	42.3	60.4	70.1	82.1	101.8	117.8	n.a.	n.a.				
Net factor payments abroad	33.9	29.7	36.1	39.9	47.8	52.3	n.a.	n.a.				
5. Gross national product	371.1	412.9	467.5	489.0	553.9	603.1	665.2	740.4	9.2	10.3	11.3	9.4
6. National savings	54.5	59.1	74.4	76.7	95.5	110.1	117.0	135.7	17.3	6.3	16.0	13.9
7. Ratio of savings to GNP (%)	14.7	14.3	15.9	15.7	17.2	18.3	17.6	18.3				
8. Ratio of investment to GNP (%)	12.6	14.5	16.6	17.4	19.8	22.2	23.3	21.5				

Source: IMF, *International Financial Statistics*, December, 1970.

[a] Years ending 20 March.

payments difficulties, the Government increased the price of credit, attempted to tighten its supply, and increased the use of direct controls in those areas where such controls existed (notably in the granting of building licences). In consequence, the rate of growth of demand eased in 1969/70, but the effects of the past excess of demand over supply combined with the continued rapid growth of public sector spending caused an increase in the balance of payments deficit (see table II-3-22).

Sectoral production

Developments in the oil sector largely determine Iran's prosperity. Oil production has expanded very rapidly in the past decade, rising from 390 million barrels in 1960/61 to approximately 1,420 million barrels in 1969/70. Moreover, the results of intensive exploration activity have been equally impressive; estimated crude oil reserves having increased from 20,000 million barrels in 1960/61 to almost 55,000 million barrels in 1969/70. Oil is a wasting asset, but given the size of Iran's reserves (equal to some 15 per cent of proven world crude oil reserves), the emphasis placed on exploration activity, and the high success rate for newly completed wells, Iran has the capacity to increase oil production by 15 per cent per annum for several more decades before stabilizing the production level.

The resource contribution of the oil sector consists essentially of three components: the foreign exchange paid to the Government in the form of tax and bonus payments, expenditure by foreign companies on domestic inputs, and the net income of the National Iranian Oil Company (NIOC). While the income of NIOC is increasing rapidly, tax and bonus payments are by far the most important real resource contributions; because the industry is highly capital-intensive, expenditure on domestic inputs is relatively small and has tended to fall in recent years as further economies in the use of labour have been implemented.

Under the 1954 Consortium agreement, a 50 per cent income tax was levied on the Consortium's net profit and a 12.5 per cent royalty (calculated with respect to posted prices) was levied on crude oil offtake. After 1962/63, the Government sought to increase the growth of tax revenue from the oil industry to finance economic development. Since posted prices were firm, the key to an increase in tax revenue was to increase the rate of growth of production. Consequently, the Government has each year requested the Consortium to increase the rate of growth of production, to switch from heavier to lighter, more expensive crudes, and to increase its exports of refined products from its Abadan refinery.

The extent to which Iran has been able to process its oil output has been limited because importing countries prefer to import crude oil and process it themselves. Iran has endeavoured to enter this field by operating refineries jointly with importing countries, but achievements in this direction, while noteworthy, have been limited in number and in terms of direct and indirect contribution to Iran's GNP. The closure of the Suez Canal presented additional difficulties to the Iranian oil industry; the cost of delivering crude oil to the European market was substantially increased and the prospect of significant penetration of East European markets was delayed. In consequence, Iran looked elsewhere for markets and now exports almost half its output to Japan. Added to this development has been a growing world fuel shortage. As a result, the demand for oil is growing fast and prices are firming. Iran's ability to benefit from this development depends on the availability of tankers and on the ability of the Government to encourage the Consortium to continue to substantially increase oil production in Iran. For 1970/71, the Iranian Government asked the Consortium for oil revenue amounting to $1,161 million ($905.5 million was obtained in 1969/70). The Consortium indicated that the level of production implicit in this revenue figure could not be reached without disruption to its offtake programme in other regional countries. It offered to increase production, to make advance payments against 1971/72 production, and to provide loans of approximately $150 million. The Iranian Government then proposed that the income tax be increased from 50 to 55 per cent and that the posted price be increased to the level of Libyan, Algerian, and Venezuelan oil. The Consortium later agreed to an increase in the income tax from 50 to 55 per cent, to an increase in the posted price, and to maintain an increase in production of at least 12 per cent per annum. Apart from negotiations with the Consortium, the Government is endeavouring to encourage the substitution of gas oil for fuel oil domestically (by means of relatively lower indirect taxes on the abundant but underutilized supply of gas oil) in order to free more fuel oil for export. In addition, it is about to embark on the construction of a 1,800 km oil pipeline via Turkey to the east Mediterranean port of Iskanderun at a cost of between $700 million and $900 million to tap the eastern European market. However, the financial demands of this project may delay its initiation.[3]

In the past decade, Iran has placed considerably emphasis on the development of a manufacturing sector to replace imports, particularly imports of consumer goods. Incentives include low taxes on profits (with an initial five-year tax-free period), high tariffs on imports of consumer goods, low tariffs on the import of intermediate and capital goods, few domestic excise taxes, restraint on the number of firms investing in particular lines of activity by means of investment licensing, and easy, relatively cheap credit to industry. The growth of this sector has been very rapid since 1964. Output is concentrated on the production of final consumer goods: production of textiles, footwear, food processing, pharmaceuticals, cosmetics, and assembly of consumer durables (cars, radios, refrigerators and other electrical appliances). Production is essentially for the domestic market; apart from some of the more traditional Iranian industries (carpets and textiles), little of the output of the industrial sector is exported.

The existing policies have resulted in a successful expansion of the industrial sector and have thereby produced many valuable external economies, such as the development of a skilled industrial managerial class and of a skilled industrial labour force, but the Government is aware that the type of industrial development that has occurred has been achieved at a high cost of consumers.

More recently, the Government has attempted to reorient the industrial sector more in line with Iran's petroleum and mineral resource base. It is undertaking the establishment of a large petrochemical plant, an aluminium smelter, an integrated steel plant, a complex of machine tool and metal working plants, and a tractor factory. In addition, the Government has encouraged the Consortium to expand its refinery capacity, and new tax concessions have been granted for export activity. Emphasis is now being placed on developing an export-oriented industrial sector producing products based on resources which form the crux of Iran's comparative advantage in international trade. However, there is a general need to re-assess existing industrial policies to achieve both an increase in the share of domestic value added in final sales price and a closer relationship between final sales price and the price of competing imports, while at the same time maintaining a rapid growth rate.

Public finance

Table II-3-20 shows government expenditure and finance in Iran. It covers the transactions of the Budget Bureau and the Plan Organization, but not those of the numerous official entities which together account for almost one-quarter of total government sector transactions.

Several points stand out from a perusal of table II-3-20. The first point is the rapid rate of growth

[3] Turkey is in favour of the project from which it would gain cheap crude oil and transit revenue.

Table II-3-20. Iran: Summary of public sector finances[a]

(in thousand million rials)

Item	Actuals						Preliminary actuals	Budget	Preliminary actuals first half	
	1962/63	1963/64	1964/65	1965/66	1966/67	1967/68	1968/69	1969/70	1968/69	1969/70
1. Revenue	55.0	60.7	82.6	81.7	96.2	109.6	129.4	157.1	60.3	69.3
Oil revenue	(25.6)	(27.7)	(50.3)	(39.9)	(47.4)	(55.0)	(62.9)	(79.7)	(29.3)	(33.5)
Other revenue	(29.4)	(33.0)	(32.3)	(41.8)	(48.8)	(54.6)	(66.5)	(77.4)	(31.5)	(35.8)
2. Current expenditure	43.9	49.5	54.9	61.1	69.1	80.6	98.1	114.6	46.5	56.1
Defence and security	(15.9)	(17.1)	(19.1)	(22.6)	(27.2)	(35.7)	(43.9)	(51.6)	n.a.	n.a.
Other	(28.0)	(32.4)	(35.8)	(38.5)	(41.9)	(44.9)	(54.2)	(63.0)	n.a.	n.a.
3. Surplus on current operations (1—2)	11.1	11.2	27.7	20.6	27.1	29.0	31.3	42.5	14.3	13.2
4. Development expenditures	11.0	15.8	23.7	37.1	37.8	53.4	64.7	84.6	26.9	28.7
5. National government deficit (3—4)	0.1	—4.6	4.0	—16.5	—10.7	—24.4	—33.4	—42.1	—12.6	—15.5
6. Cash surplus or deficit or official entities	1.9	4.6	2.7	3.9	2.6	1.8	—5.1	—	0.8	5.6
7. Over-all public sector surplus or deficit (5+6)	2.0	—0.1	6.7	—12.6	—8.1	—22.6	—38.5	—42.1	—11.8	—9.9
8. Financing of deficit	—0.4	2.7	—7.2	14.6	10.8	23.6	37.0	42.1	8.3	6.8
External borrowing (net)	1.5	0.8	—0.5	0.1	3.0	8.1	17.9	18.6	6.3	6.8
Utilization of loans	(3.0)	(2.0)	(0.8)	(2.3)	(4.7)	(10.1)	(21.2)	(25.3)	(8.0)	(9.1)
Repayments	(—1.5)	(—1.2)	(—1.3)	(—2.2)	(—1.7)	(—2.0)	(—3.3)	(—6.7)	(—1.7)	(—2.3)
Change in nonbank holding of bills and bonds	—	1.1	1.1	1.1	5.6	3.0	3.3		2.3	2.4
Borrowing from the banking system (net)	—1.9	0.8	—7.8	13.4	2.2	12.5	15.8	23.5	—0.3	2.4
National government	(—)	(5.4)	(—5.1)	(17.3)	(4.8)	(14.3)	(10.7)		(0.5)	(8.0)
Official entities	(—1.9)	(—4.6)	(—2.7)	(—3.9)	(—2.6)	(—1.8)	(5.1)		(—0.8)	(—5.6)
9. Discrepancy (8+7)	1.6	2.6	—0.5	2.0	2.7	1.0	—1.5	—	—3.5	—3.1

Source: Official source.

[a] Data are for fiscal years ending 20 March.

of total current expenditure; all expenditure heads have increased and there was a substantial upsurge in 1968/69 and 1969/70. Second, despite the rapid growth of current expenditure, Iran has succeeded in retaining a surplus on current government operations. However, the surplus is not large, and, as a share of GNP, government saving has fallen over the past decade. Third, revenue yield is dominated by oil tax revenue (including oil bonus payments). Fourth, import duties dominate the yield and thus the course of non-oil revenue; non-oil revenue has risen in step with the growth of GNP in recent years, but this has largely been due to an increase in import duty revenue as a result of growth in the level of imports, together with a more determined effort to collect the income tax revenue, rather than any increase in the burden of taxation. Finally, the surplus on current account finances only a small part of development expenditure.

To finance most development expenditure, the Government relies on borrowing from the Central Bank and, more recently, on borrowing abroad and from domestic commercial banks.

The impact of the government sector on the level of domestic activity has been substantial. Apart from the rapid growth of its expenditure (current and capital), the method of financing such expenditure has been expansionary. Each of the Government's three main sources of finance (tax revenue derived from the oil sector, borrowing from the Central Bank, and borrowing abroad) permits an increase in spending within Iran without any initial transfer of resources from Iranian residents. Borrowing abroad has been used largely to finance government sector imports of goods and services and has not, therefore, led to a significant increase in demand for Iranian-produced

goods. But the proceeds of the other two sources of finance have been largely spent locally. Thus, a good part of government expenditure has a large multiplier effect on the domestic economy, and, in addition, government operations substantially enhance the cash base of the commercial banking system and thus permit a multiplied rise in bank credit. Controlling the impact of the government sector on the economy would seem to require regulation of the various components of domestic demand.

In these circumstances, it would seem that there is a need to increase the level of taxation and to develop financial institutions (life assurance and provident funds, for example) which could be used to mobilize domestic saving. By offering securities at a very attractive interest rate, the Government has begun to mobilize the resources of the commercial banking system.

Table II-3-21 shows planned and actual development expenditure. The fourth plan (covering the period March 1968 - March 1973) consisted in essence of a relatively small number of very large projects in petrochemicals, metallurgy, gas, and irrigation, together with related transport and power infrastructural developments. The objectives of the plan were to achieve a growth rate of 9.4 per cent per annum, to reduce unemployment, and to improve income distribution. Almost half of total plan expenditure was to be financed by government saving. In the first two years of the plan, development expenditure was large, though expenditure in 1969/70, while up by more than 25 per cent on expenditure in 1968/69, was some 10 per cent below the original budget estimate. The major sectors where expenditure so far lags behind targets are agriculture, power, fuel and social development. The most impressive increase in 1969/70 was in industry where investment expenditure doubled and exceeded the budgeted figure by 12 per cent. The 1970/71 budget provides an increase of 7 per cent in ordinary budget expenditure and 34 per cent for development expenditure. By developing regional centres, the fourth plan is making a marked contribution towards raising the level of economic activity and income outside of the capital, Tehran. The growth target for the economy as a whole (9.4 per cent per annum) has been surpassed and government spending has had a significant employment-generating effect.

Table II-3-21. Iran: Planned and actual development expenditure 1962-1973
(in thousand million rials)

Expenditure head	Third plan (1962-1968)		Fourth plan (1968-1973)	
	Planned	Actual	Planned	Disbursements 1968/69
Agriculture and irrigation	49.0	47.3	65.0	5.0
Industries and mines	28.6	17.1	125.3	24.6
Power and fuel	36.5	32.0	86.5	11.5
Transport and communications	59.5	53.8	100.3	13.2
Social services	44.0	42.9	71.7	8.0
Education	18.1	17.5	35.0	3.5
Health	13.5	13.2	13.7	1.0
Housing	12.4	12.2	23.0	3.5
Other	12.4	11.5	31.2	12.2
Total	230.0	204.6	480.0	74.8

Source: Economist Intelligence Unit, *Quarterly Economic Review*, Iran, Annual Supplement, 1970, pp. 5-6.

Monetary developments

Despite the rapid growth of the money supply (including quasi-money) since 1963, price pressures have not been apparent until quite recently. Growth has been rapid, and, combined with an expansion of the monetized sector, the public has increased its demand for monetary holdings broadly in step with the rapid expansion of the money supply resulting from the growing financial needs of the public and private sectors. However, the situation began to change late in 1967 and it became apparent that the increase in the money supply had begun to give rise to some price pressures. To encourage an increase in the savings ratio in view of the steep rise in the investment ratio prior to 1969/70, the Central Bank raised the discount rate (from 5 per cent to 7 per cent), raised legal reserve requirements on demand and non-sight deposits, and raised interest rates on non-sight deposits. In 1969, government spending rose substantially, and, as has been indicated, part of this spending was met by sources of finance which expand the cash base of the banking system. The commercial banks were liquid before the November 1968 measures were introduced, and, as a result of government operations and the strong capital inflow in 1969, they remained highly liquid. In August 1969, the Central Bank again raised the discount rate (to 8 per cent), legal reserve requirements, and the rate of interest on non-sight deposits, and asked the commercial banks to exercise restraint in their lending policy. These measures, combined with a tightening of import financing requirements, were more effective. Private sector import demand was restrained and construction activity slowed. However, private sector service activities, which rely substantially on bazaar sources of finance, were not so markedly affected. The use of monetary policy to restrain demand proved to be somewhat uneven in its incidence. To mitigate this problem, and to hold a close balance between output and demand, there was some relaxation of the measures in August 1970.

Balance of payments

Balance of payments statistics are set out in table II-3-22. Oil dominates export earnings. Other exports consist essentially of agricultural produce and minerals. A large proportion of oil income is remitted abroad by the foreign oil companies. Subtracting such remittances from total exports, a figure for net exports is obtained and it is this figure which is important in determining the foreign purchasing power earned by Iran on current account. Reflecting the strong growth of oil production, net export earnings have risen dramatically. However, rapid domestic economic growth and an excess of money demand over income have combined to produce an even more rapid growth of spending on imports. In consequence, the balance of payments has been in deficit in recent years. This deficit has been financed by public and private capital inflow and, to a lesser extent, by a decrease in the level of Iran's external reserves.

Iran's outstanding foreign debt has risen rapidly since 1965. Some part of this debt has been borrowed on short-term and at a high interest rate. As the debt service expenditure rises, heavier dependence will be placed on the growth of net export earnings in determining Iran's import capacity. For this reason, the Government is giving greater consideration to policies which would diversify Iran's exports and work towards maintaining the rate of growth of exports. As already noted, there is considerable potential for the further development of agriculture, for the establishment of agro-industries, for the exploration and exploitation of Iran's apparently rich mineral potential, and for the development of industries which have a comparative advantage in world trade. The recent increase in posted prices for oil exports will however ease the debt servicing problem and permit the fine recent record of economic growth to continue.

Conclusion

With rich natural resources and the potential for further significant discoveries, Iran is on the threshold of a significant development breakthrough. General economic and social development has been a relatively recent phenomenon, and the tasks ahead of the Government remain enormous to spread education, health facilities, rural development, and to solve the problems of urban development. Apart from the many challenges confronting the government sector, there would seem to be a need to re-assess some of the existing policies in respect of industrialization and the financing of government expenditure.

Table II-3-22. Iran: Balance of payments statistics

(in million dollars)

(Year ended March 20th)

Item	*1967*	*1968*	*1969*	*1970[a]*	*Three-year growth (percentages)*
Net oil receipts	716	858	958	1,104	54
Other exports and services	225	318	367	409	82
Total foreign exchange earnings[b]	941	1,176	1,325	1,513	61
Less: Imports of goods and services	1,089	1,388	1,798	2,087	92
Current deficit	—148	—212	—473	—574	
Covered by:					
Net loans and capital[c]	120	214	382	562	256
Other receipts	4	—	—4	84	
Fall in reserves (minus equals increase)	24	—2	95	—72	

Source: Industrial Mining and Development Bank of Iran.

[a] Preliminary estimates.

[b] Share of oil in total foreign exchange earnings (percentage)

1967	*1968*	*1969*	*1970[a]*
76.1	72.9	72.3	73.0

[c] Made up as follows:

Gross inflow	167	274	497	734
Less repayments and outflow	47	60	115	172

Japan

The economy in 1969

Japan's economy recorded steady growth throughout the 1969/70 fiscal year (April 1969 - March 1970). In its annual indicative plan, the Government set a target rate of growth in real GNP of 9.8 per cent. Government capital formation was expected to rise by 10.4 per cent and private plants and equipment expenditure by 16.3 per cent, both in money terms. The increase in the consumer price index was expected to be less than 5 per cent. In fact, these figures turned out to be underestimates.

As the year progressed, the economy showed signs of overheating. Prices started to rise more rapidly than expected and, in an effort to stabilize prices, the Central Bank raised its rediscount rate from 5.84 per cent to 6.25 per cent in September 1969. However, since the balance of payments registered significant surpluses in the first two quarters, the tighter money policy was motivated by purely domestic considerations and was in line with government attempts at price stabilization.

Though the rise in the rediscount rate was quite substantial, and market rates moved up in unison, this did not depress investment as prices continued to rise more rapidly than interest rates. Moreover, the Bank of Japan permitted a fairly large expansion in the money supply (stock of currency and demand deposits) which rose by an average of over 20 per cent in the last two quarters, compared with the corresponding periods in the previous year.

Private consumption, government current expenditure, and government fixed-capital formation continued to expand steadily. Private fixed investment, too, rose steadily on account of expectations of high earnings in a situation of strong demand pressures. Private housing expenditures also continued to rise.

As a result of these factors, real GNP is estimated to have increased by 12.8 per cent. Private plant and equipment investment rose by approximately 29.5 per cent, while government fixed-capital formation increased by 11.2 per cent, both in money terms. Consumer prices, on the other hand, rose by 6.4 per cent over the year. The plan had greatly underestimated the growth in private investment. Moreover, it is clear that the 1969 tight money policy did not adversely affect economic growth until the end of the fiscal year.

Another important objective of government policy in this year was increased provision of social overhead capital (SOC), which was planned to increase relative to directly productive capital (DPC). However, with the rapid expansion of private investment, the planned increase in social overhead capital relative to directly productive capital did not materialize and the ratio of SOC to DPC showed a decline.

Furthermore, in an attempt to reduce the rice surplus, the Government took further steps in 1970 to decrease rice production, including the grant of a subsidy for switching production from rice to other farm products. According to rough estimates, the decrease in the rice crop harvest in 1970 amounted to 1.3 million tons, as against the Government's goal of 1.5 million tons.

It is a striking feature of the Japanese economy since 1968 that the export surplus has increased rapidly while domestic demand has also grown substantially. Since a tight money policy for the sake of price stabilization could further increase the surplus in the balance of payments, the Government has sought to liberalize imports and relax foreign exchange controls. The council of the cabinet for price stabilization decided in April 1970 that the Government should advance the implementation of the remaining Kennedy Round tariff out by nine to twelve months. In September 1969, some types of profit repatriation and money transfers of non-residents to foreign countries were liberalized. The limitation on the taking out of foreign exchange by residents travelling abroad was relaxed from $500 to $700 in April 1969 and further to $1,000 in March 1970. The restrictions on direct investment are being gradually removed, for both inflow and outflow.

The economy in 1970

The Japanese economy has experienced a mild slowdown in its growth in the second half of the fiscal year 1970/71. According to the latest estimates of the Japanese Government, the real rate of growth in 1970/71 is expected to amount to 10.8 per cent, slightly less than the original government estimate of 11.1 per cent. Although the rise in consumer prices has exceeded original estimates, rising by about 7.3 per cent, wholesale prices have increased only by 2.6 per cent and, after April, the index of wholesale prices stopped rising. The reason for these developments is the change in the business situation which resulted in rapid accumulation of inventories and led to a levelling off in the index of industrial output.

In the latest forecasts, exports and imports (on a customs clearance basis) were placed at $19.9 billion and $19.5 billion respectively. The over-all surplus on the balance of payments is expected to amount to $900 million. Domestic price increases, inducing import expansion, have been a major factor in reduc-

ing the extent of the over-all surplus. However, the surplus would have been much greater had the Government not promoted capital outflow through various means, such as subscriptions to international financial organizations.

GNP by type of expenditure

Since the latest government estimates are available only in brief outline, Japanese Economic Research Centre (JERC) estimates will be used, although these are more optimistic than government estimates. Table II-3-23 gives JERC forecasts for the economy in fiscal years 1970/71 and 1971/72. According to the table, the rate of growth in private consumption expenditure is estimated to have been only 8.6 per cent in 1969/70 in real terms, owing to a rapid increase in consumer prices.

Private residential construction has steadily increased its share of GNP since 1965. It experienced a rise of 20.9 per cent in 1969/70, and 18.6 per cent in 1970/71, both in constant prices. The tight money conditions in 1969 may have affected company housing programmes as this is the first business activity to be affected by a tight credit policy. But company housing accounts for no more than 10 per cent of total private housing expenditure so that total private housing is not expected to have been depressed by the tight money policy.

In real terms, government current expenditure is expected to accelerate from 4.3 per cent in 1969/70 to 5.8 per cent in 1970/71 and 7.3 per cent in 1971/72. Government fixed-capital formation increased by 9.6 per cent in 1969/70, but for 1970/71 and 1971/72, the increase is likely to be 11.4 per cent and 13.2 per cent respectively. Private plant and equipment expenditure is expected to increase in real terms by 17.8 per cent in 1970/71 and by 17.1 per cent in 1971/72. (Government forecasts put the increase in private investment at only 12.6 per cent in current prices for 1971/72.) This deceleration in investment activity reflects the over-investment in equipment during the last few years which has been proceeding at over 25 per cent per annum, as well as the influence of the tight money policy. However, private investment demand is likely to grow more strongly in 1972/73 as total demand, including foreign demand, again exerts strong pressure to expand productive capacity and the high rate of wage increases gives an incentive to invest in labour-saving equip-

Table II-3-23. Japan: The JERC forecast (October 1970)

(in thousand million yen, at constant 1965 prices)

	1968/69	*1969/70*	*1970/71*	*1971/72*
Mining and manufacturing production index (1965 = 100)	164.9 (17.2)	194.3 (17.8)	224.6 (15.6)	261.4 (16.4)
Wholesale price index (1965 = 100) . . .	105.2 (0.6)	108.6 (3.2)	111.9 (3.0)	114.0 (1.9)
Consumer price index (1965 = 100) . . .	116.1 (4.9)	123.5 (6.4)	131.5 (6.5)	139.6 (6.2)
Private consumption	23,769.5 (9.6)	25,819.6 (8.6)	28,583.9 (10.7)	31,638.1 (10.7)
Government current expenditure	3,560.0 (6.8)	3,712.6 (4.3)	3,929.5 (5.8)	4,217.9 (7.3)
Private residential construction	2,723.0 (13.5)	3,293.4 (20.9)	3,904.7 (18.6)	4,607.7 (18.0)
Private plant and equipment investment . .	9,333.7 (21.6)	11,721.4 (25.6)	13,813.4 (17.8)	16,170.3 (17.1)
Government fixed-capital formation . . .	4,108.2 (14.2)	4,502.6 (9.6)	5,014.2 (11.4)	5,677.5 (13.2)
Private inventory investment	2,007.4 (12.3)	2,347.8 (17.0)	2,424.8 (3.3)	2,747.0 (13.3)
Government inventory investment	238.4 (—0.9)	168.4 (—29.3)	118.1 (—29.9)	98.7 (—16.4)
Exports and income from abroad	5,635.4 (24.9)	6,675.8 (18.5)	7,768.7 (16.4)	9,125.8 (17.5)
Imports and incomes to abroad	5,076.6 (11.5)	5,931.2 (16.8)	7,285.6 (22.8)	8,588.7 (17.9)
Gross national expenditure	46,298.7 (13.8)	52,310.5 (13.0)	58,271.7 (11.4)	65,694.3 (12.7)

Note: Figures in brackets indicate percentage changes over the preceding year.

ment. In October 1970, the Bank of Japan's rediscount rate was lowered from 6.25 per cent to 6.0 per cent to help counteract any deflationary tendencies. A further reduction to 5.75 per cent was announced in January 1971.

Reflecting the mild slowdown in activity, the Government's latest estimate is for private inventory investment to grow by 21.7 per cent in 1970/71, but by only 3.4 per cent (both in nominal terms) in 1971/72 as private inventory investment in the latter year is now likely to be stagnant.

Investment saving balance by sectors

It has been a common feature of the Japanese economy that the household sector supplies excess savings over investments and the corporate sector absorbs this saving surplus. There has been no significant change in this trend during the period under review. The total outlays and revenues of the household sector were 37 trillion yen and 41 trillion yen respectively in 1968/69. Thus, the excess of revenues over outlays amounted to 8.9 per cent of the revenues. As housing expenditure advanced rapidly, this ratio came down to 8.7 per cent (estimated) in 1969/70 and is forecast to drop to 8.4 per cent in 1970/71. The average propensity to consume (measured as private consumption expenditure/disposable personal income) was 80.8 per cent (estimated) in 1969/70, but is expected to fall to 79.6 per cent in 1970/71 and 79.7 per cent in 1971/72. Thus, it is the increased expenditure on residential construction that is tending to reduce the excess of saving over investment in this sector, despite the rise in the average propensity to save.

The "surplus ratio" of investment (defined as $\frac{I-S}{S}$ where S and I stand for savings and investments respectively) for the corporate sector stood at 35.2 per cent in 1969/70, but is expected to decrease to 34.3 per cent in 1970/71 and to 30.6 per cent in 1971/72. The fact that the self-financing ability of business firms is expected to improve considerably arises because investment (both fixed and variable) will not increase as rapidly during this period. The public sector, having kept investment and savings in balance till 1964/65, recorded excess investment until 1970. However, in 1970/71, the government sector may record excess savings according to the JERC projection.

Per capita income

Per capita income in current prices was estimated at 480,000 yen ($1,334) in 1969/70, and it is expected to rise to 566,000 yen ($1,573) in 1970/71 and 658,000 yen ($1,828) in 1971/72. As the consumer price index rose by 6.4 per cent in 1969/70 and is expected to rise by 7.3 per cent in 1970/71 and 5.5 per cent in 1971/72, the rate of increase in real *per capita* income can be derived from discounting the money income by these CPI increases. Roughly, it can be said that real *per capita* income is growing by about some 9-10 per cent per annum, discounting the some 17 per cent increase in national income at current prices by a 6-7 per cent rise in the price level and allowing for an increase of population of around 1 per cent.

Sector production

Agriculture. Rice production amounted to 14 million tons in 1969 and is estimated to stand at some 13 million tons in 1970. The producers' prices of the rice crop had been raised about 9 per cent each year for the sake of balancing the return to farmers with that of industrial labourers. When it became clear that some 2 million tons of surplus would be generated even under average climatic conditions due to increases in productivity on the one hand and stagnation in demand on the other, the Government decided to hold down the increase in producers' prices to 5.9 per cent in 1968 and kept the prices unchanged in 1969 and 1970. In 1970, the Government took further steps to reduce rice production by giving 110 billion yen as a "switch-sowing subsidy" and a 24 billion yen "high-grade rice" production subsidy. This was intended to reduce the area under rice cultivation by an equivalent of more than 1.5 million tons of rice production. Notwithstanding these measures, it is expected that there will be a one million ton rice surplus in 1970.

It is a characteristic of the Japanese agricultural situation that an excess supply of rice, an excess demand for wheat, and a shortage in the supply of meat, vegetables, and fruits co-exist. The excess supply of rice has probably been induced by the fact that farmers enjoy more certain expectations about rice prices than for any other farm product. The imbalance between the demand for, and supply of, various agricultural products contributed, in large measure, to the CPI increases in 1969/70, mainly through the rise in prices of seasonal foods, such as vegetables and fruits.

The number of persons engaged in agriculture and forestry has tended to decline over the years. Moreover, agriculture has been left with a poorer-quality labour force as the younger people graduating from schools have moved out to the urban-industrial areas. Lately, factories have begun to move out of the cities; the number of farm households who are at the same time engaged in other activities may now, therefore, be increasing. The total number of

farm households declined from 5.419 million in 1967 to 5.351 million in 1968 (a 1.3 per cent decrease). As regards size distribution, the reduction was more than proportionate in the case of small farms. This suggests that many small farms are tending to disappear because of the withdrawal of labour to industry. According to several medium-term projections, it is expected that the number of persons engaged in agriculture will decline to 6 million, representing 11.7 per cent of the total labour force (compared with the present proportion of 18 per cent), and that the number of farms will decrease to some 4 million.

The chief problem in agriculture seems to be the lag in the adjustment of production to changes in dietary habits. This is leading to increases in the prices of meat, fruits, and vegetables. In response to persistent consumer demand for removal of import restrictions on agricultural products, the Government has decided to liberalize the import of 16 out of 58 items under the control of the Ministry of Agriculture and Forestry which are still counted as residual import limitation items. It is further reported that the limitation on five other items, will be removed in the near future.

Industrial production

The production index of mining and manufacturing rose by 17.8 per cent in 1969/70, compared with the preceding year, and the index has increased by 17-18 per cent successively for the last four years. The production of investment goods expanded by 21.2 per cent in 1968/69 and 21.1 per cent in 1969/70, reflecting active investment demand, and it is expected to grow by 22.6 per cent in 1970/71, according to the JERC projection. The production of consumer durables increased by 30.4 per cent in 1968/69 and 21.2 per cent in 1969/70. The most prominent increases were in passenger cars, colour television sets and luxury furniture, following the boom in residential construction. Their production, however, is likely to slow down in 1970/71 as a result of a relaxation in demand. The distribution of certain consumer durables, such as cars, has actually fallen, and there has been some reduction in exports of home electric appliances to the United States because of import restrictions.

The production of consumer non-durables has so far shown slower expansion. The increase in 1968/69, compared with the preceding year, was 7.0 per cent, while it was 9.4 per cent in 1969/70. In 1970/71, however, the rise appears to be some 13.3 per cent supported by a steady rise in demand, especially for foods and clothes. The production of producer goods recorded an increase of 15.2 per cent in 1968/69 and of 18.2 per cent in 1969/70, which more or less paralleled the increase in over-all manufacturing production. In 1970/71, the rate of increase may slow down to 11.3 per cent.

Among individual industries, the steel industry entered into a new situation, characterized by excess supply and rapid inventory accumulation. This situation appeared in the summer of 1970 and quickly resulted in falling steel prices. The experience of the textile industry was similar. The decline in total demand for manufactured goods manifested itself around the summer of 1970 when wholesale prices turned down after fourteen months of successive increases.

Electricity generated in July 1970 was 15.5 per cent higher, compared with the same month of the preceding year. However, the location of electric-generation factories is posing problems on account of the threat of air pollution, and this is making the shortage of electric supply more serious in the face of growing demand. Electric companies may thus face some difficulties in realizing their investment plans. The oil-refining industry has enlarged its productive capacity to match the growing demand both for energy material and for inputs for petro-chemical manufacturing. Its production increased by 17.0 per cent in June 1970 over the same month of the previous year. Among other energy sources, gas is enjoying a steady growth of demand and the supply registered a 13.7 per cent increase in June 1970 over the corresponding period of the previous year. Coal mining, however, continued to show a declining trend from 1967 to 1969.

The construction industry has been enjoying buoyant demand. Taking, for example, the number of orders accepted for construction, the index has in some months increased around 30 per cent over the corresponding period of the previous year, both for manufacturing and non-manufacturing industries. The floor area of construction starts, a good indicator of construction activities, increased 47.2 per cent in March and 25.3 per cent in April 1970 over the same months of the previous year. The uptrend in construction activities is likely to continue with the growth of housing demand and urban development schemes in 1970 and 1971.

Services

Statistics show that, as regards domestic transport, cargo transport grew much more rapidly for trucks (18.1 per cent) than for railways (2.1 per cent) in 1969/70. Reflecting the continuing growth of economic activity, commercial activity continued to be buoyant, and travel and communications continued to grow, partly due to the 1970 World Exposition held at Osaka from March to September 1970.

External trade and the balance of payments

With growing surpluses in the balance of payments and increasing labour shortages, the Government has adopted a policy of significant import liberalization. The cabinet council on trade has decided on the full liberalization of sixty items by the end of calendar year 1971. In addition, it decided, in April 1970, that the limit on the importation of non-liberalized items should be raised to 2 per cent of domestic consumption.

Exports

It has been observed that the export elasticity of Japan with respect to world trade has generally been 1.8 - 2.0. In 1968, world imports (except those of Japan and communist countries) increased by 11.5 per cent and Japan's exports grew by 24.2 per cent. This implies that the elasticity was around 2.1. In 1969, the former grew by 13.0 per cent and Japan's exports by 23.3 per cent, with the elasticity working out at 1.8. As the largest markets of Japan are the United States (some 30 per cent of total exports) and southeast Asia (slightly less than 30 per cent), estimates of these two regions' import demand are essential for the forecast of Japan's exports. Japan's exports to the United States increased by 21.3 per cent and to southeast Asia by 23.1 per cent in 1969. During the same year, the total imports of these regions grew 8.4 per cent and 10.0 per cent respectively. Thus, the elasticities of Japan's exports with respect to these imports are calculated as 2.5 and 2.3 respectively. Exports to western Europe increased by 24.1 per cent in 1969.

Total exports rose at an annual rate of 23.3 per cent in 1969. Assuming that the growth rate of world trade slows down to 12.8 per cent in 1970 because of the recession in the United States, it is estimated that Japan's exports will expand by some 20 per cent. This forecast is consistent with the facts that Japan's exports to the United States will grow at a lower rate (17 per cent) due to the United States' recession and import restrictions and that those to western Europe will increase by 42 per cent as a result of inflationary trends there. Exports to southeast Asia may increase by about 11 per cent, which is considerably lower than the 23 per cent growth rate for 1969. Latest estimates indicate that total exports in 1970 grew by 21.4 per cent over 1969, to a level of $19.04 billion.

As for the commodity composition of exports, machinery exports increased by 25.4 per cent over the previous year and are expected to grow by 21.6 per cent in 1970/71 and 20.7 per cent in 1971/72, reflecting the steady expansion in overseas demand. The next important category of exports is metal and metal products (including iron and steel), the exports of which moved up by 28 per cent in both 1969/70 and 1970/71. The rate may slow down to 22 per cent in 1971/72, but this would still be fairly high. Steel exports, in particular, recorded a high growth rate of 30.3 per cent in 1969/70 and are expected to grow at the rate of 28 per cent in 1970/71 and at somewhat less than 20 per cent in 1971/72.

Imports

In 1969/70, total imports on a customs clearance basis rose by 20.4 per cent, and it is expected that, in 1970/71, the rise will be about 25 per cent, the larger increase being attributable to planned increases in raw material inventories and import liberalization. On the basis of the latest available information, the import of metal ores is likely to increase by over one-third in 1970/71 and that of machinery by 31 per cent. The JERC projections also envisage appreciable increases in the import of food-stuffs (20.7 per cent), mineral fuels (31 per cent), chemical products (28 per cent) and other manufactured goods (21 per cent).

Summing up, imports of materials (raw and processed) increased much more rapidly in 1970/71 than in 1969/70. In 1971/72, however, according to JERC forecasts, imports are likely to grow much more slowly (at about 16 per cent) in view of the disappearance of the temporary factors leading to the import upsurge in 1970/71. Imports during 1970 grew by 15 per cent over 1969 to $15.01 billion so that Japan's trade balance during this year amounted to $4.03 billion.

Invisible trade

Japan's balance on invisible trade has shown deficits for transport, insurance, travel, and investment profits accounts in recent years, the deficits growing from $1,487 million in 1969/70 to $1,933 million (forecast) for 1970/71. Though the 1970 World Exposition contributed in some measure to increased receipts, the balance of travel account has continued to show enlarged deficits, due principally to growing travel overseas by the Japanese people and the relaxations on the amount of foreign currencies which can be taken out by travellers. Increased payments for the transportation of imports and an increasing deficit on the investment profits account are other factors accounting for the increasing deficits on invisible transactions.

Capital account

The following figures summarize the over-all picture of the balance of long-term capital flows. Though the current account for 1969/70 showed a big surplus, the steep rise in the deficit on long-term capital account partly neutralized this. The increased capital outflow reflects such international financial transactions as a loan to the World Bank, subscriptions to other international organizations and the provision of rice to Pakistan and the Republic of Korea on a loan basis.

(In million dollars)

	1968/69	*1969/70*	*1970/71 (forecast)*
Outflow (domestic assets) .	1,145	1,892	2,462
Inflow (foreign capital)	1,065	1,250	1,093
Net outflow	80	642	1,369

As for individual components, Japan's direct overseas investment reached $230 million, while foreigners' investment in Japan amounted to $56 million, resulting in a deficit of $184 million. Government transactions recorded a substantial deficit, the net outflow increasing by some $300 million over the previous year. As the Government is expected to promote capital exportation through aid and international economic and financial co-operation, an example of which is the undertaking of Italian claims to IMF, the balance on long-term capital account is likely to show larger deficits in the future.

Taking into account other relatively smaller items also, the over-all balance of payments recorded a surplus of $1,989 million in 1969/70 and the surplus is expected to amount to $906 million in 1970/71. The decrease in the surplus reflects the expansion of imports and an increase in capital exports in 1970/71. Foreign exchange reserves increased by $655 million (including $122 million SDRs) to $3,868 million at the end of the fiscal year 1969/70. They are likely to exceed $4,000 million by the end of the fiscal year 1970/71.

Population and social development

(a) *Population, labour force and wage rate*

The population growth rate is estimated at 1.2 per cent for each year from 1967 to 1969. The labour force increased by 1.9 per cent in 1967, 1.6 per cent in 1968, and 0.7 per cent in 1969. The recent decline in the rate of growth of the labour force is due to the rapid increase in the number of the students entering upper-grade schools. This trend will be strengthened in the future, making the changes in the labour supply over time negative for some younger age groups. As a result, there has existed a strong excess demand for the younger labourers which has induced and accelerated wage increase for this kind of labour services.

Unemployment statistics, which are subject to a number of limitations, show that the unemployment rate has for a long time stayed at around 1 per cent and has not been sensitive to changes in employment conditions. The index of regular employees for all industries, (based on business establishments with more than 30 employees), increased by 3.3 per cent in 1969/70 but is expected to rise by only 2.7 per cent in 1970/71. Redistribution of employment out of agriculture seems to have become more difficult because it is the older-age people who remain in agriculture.

(b) *Income distribution*

Owing to the rise in wages and the growth in employment, the relative share of the incomes of employees (compensation of employees/national income) is estimated to have risen from 54.2 per cent in 1968/69 to 54.8 per cent in 1969/70. It is a conspicuous feature of the present situation that the incomes of labour and capital are growing simultaneously, while the relative shares of income of non-corporate firms and income from properties are falling.

According to household budget surveys, the monthly averaging income per household of wage and salary earners in cities with more than 50,000 population was 90,132 yen in 1968 and 100,533 yen in 1969. As the average number of persons per household in the meantime decreased from 4.11 persons for 1965 to 3.86 persons for 1969, the rise in income per person has been larger. As for the disposal of income, expenditures for consumer durables and miscellaneous expenditure for services explain the largest part of the rise in consumer expenditures. Savings have also increased. An average household saved 14,616 yen per month in 1965 (without netting out the withdrawal of deposits) and 26,193 yen in 1969.

Table II-3-24 gives the percentage distribution of household numbers by income brackets for May 1969 and May 1970.

Table II-3-24. Japan: City worker households, by income brackets

(in percentages)

Monthly income	*May 1969*	*May 1970*
Below 49,999 yen	16.0	11.4
50,000 — 99,999	63.6	56.9
100,000 — 199,999	19.3	29.4
Above 200,000	1.1	2.3
Total	100.0	100.0

Source: *Monthly Statistics of Japan*, August 1969, August 1970.

It will be seen that a number of households have moved to the upper-income brackets as a consequence of the rapid rise in wages. As regards farmers' incomes, the significant slowdown in growth since 1968 reflects the fact that average producers' rice prices have not risen as much as in the previous years. Since the average yearly income of wage and salary earners in the big cities was 1,206,000 yen and that of farmers 1,063,000 yen in 1969, city workers enjoy some 20 per cent higher incomes relative to farmers.

Monetary developments

The Bank of Japan raised the rediscount rate from 5.84 per cent to 6.25 per cent in September 1969 as one means to avoid overheating the economy. It also raised reserve ratios on deposits and strengthened the position guidance for large commercial banks. The position guidance, apparently guiding the banks not to increase their external borrowing beyond some limit, actually regulated the increase of lending to business corporations. The total money supply (currency plus demand deposits) had grown by 19.7 per cent in the July-September quarter of 1969 over the corresponding period of the previous year. Outstanding loans (including discounts) on the other hand, had increased by 16.2 per cent in the same quarter, compared with the corresponding quarter of the previous year. (All rates of changes hereafter in this section refer to comparison with the corresponding period of the previous year unless otherwise noted.) Even after the adoption of measures of monetary and credit restraint, the money supply continued to expand rapidly until April-June 1970. Subsequently, a slight reduction has become apparent, although monetary expansion has remained quite high. The control by the Bank of Japan on commercial banks' loans has not been so severe as might have been generally expected. The Bank has not tried to restrict credit too severely, as is shown by the fact that outstanding loans increased by 16.4 per cent in October-December 1969, 16.1 per cent in January-March 1970, and 16.3 per cent in April-June 1970.

Market rates of interest recorded a rise towards the end of 1969 due both to the raising of the rediscount rate and substantial expansion in investment demand. The average rate of interest contracted for loans and discounts of all commercial banks rose from 7.3 per cent per annum in July-September 1969 to 7.6 per cent in the corresponding quarter of 1970. However, the impact of the rise in interest rates on the domestic economy has been moderated by the rise in prices which exceeded the rise in interest rates so that the "real rate of interest" (the money rate discounted by the annual increase in wholesale prices) actually fell from 4.7 per cent in July-September 1969 to 4.34 per cent one year later.

In line with the general slow down in economic activity towards the end of 1970 and with the wholesale price index showing greater stability, the Bank of Japan lowered the rediscount rate at the end of October 1970.

Public finance

Government current expenditures, on the national account basis, increased by 16.7 per cent in 1969/70 at current prices, while fixed-capital formation rose by 11.2 per cent. According to the JERC projection, the current expenditure and fixed-capital formation of the Government are expected to grow by 17.0 per cent and 17.2 per cent in 1970/71 and 1971/72 respectively whereas the GNP growth rate in each of these fiscal years is also expected to be around 17 per cent. Tax revenues in 1971/72 are expected to grow by about 17-18 per cent.

As for the distribution of government expenditure by functional categories, expenditure on social sectors in 1969/70 recorded a significant increase. Pension payments grew by 44.5 per cent over the previous year, although at 279 million yen the absolute size of this item remains small. Comparing the 1969/70 original budget estimates with the 1968/69 settled accounts, social security expenditure increased by 14.5 per cent, education and science outlays by 14.8 per cent, and transfer to local governments by 14.3 per cent. Public construction works expanded at an annual rate of 15.5 per cent.

Tax revenues increased rapidly owing to steady expansion of economic activity. The ratio of tax revenues to total government revenues rose from 77.0 per cent in 1968/69 to 88.2 per cent in 1969/70 on the basis of the original budget estimates for that year. The proceeds from the individual income tax and the corporate income tax increased substantially. The former grew from 1,290 billion yen in 1967/68 to 1,466 billion yen in 1968/69 and further to 2,006 billion yen in 1969/70. A similar movement is seen in the corporate income tax, which increased by 168 billion yen in 1967/68 and by 532 billion yen in 1968/69 and amounted to 2,008 billion yen in 1969/70.

The rate of the corporate income tax was raised at the beginning of the 1970/71 fiscal year, partly for the sake of moderating investment demand. The over-all effect on tax revenues of this policy action is not so definite, however, because it is uncertain to what extent corporate activities will be affected by it.

Current outlook and major policy issues

As has been noted, there was a mild slowdown in the growth of the Japanese economy towards the end of 1970, but it unlikely that this will be more than a short run phenomenon. Latest official estimates indicate a real rate of growth of GNP of 10.1 per cent in 1971/72 over 1970/71, compared with the JERC estimate of 12.7 per cent. The Government has acted swiftly to counteract deflationary tendencies by lowering its rediscount rate and this, together with the planned increase in government capital formation in 1971, will help the economy to regain its past momentum.

At the present time, three major issues of fundamental importance are facing Japan. These are price stability, social and environmental problems, and improving the efficiency of the economy through the promotion of the international division of labour.

As regards price stability, consumer prices rose in 1970/71 by 7.3 per cent, compared with an annual rate of 6.0 per cent over the last ten years. The inflation is being prompted by a rate of increase of money wages in excess of the growth of labour productivity. The growth in money wages is, in turn, a result of excess demand for labour in industry, and so an important task for the Japanese economy is to bring about needed structural adjustment by reducing the proportion of the labour force engaged in agriculture.

As regards social and environmental problems, there has been a definite improvement in the social condition of the Japanese people over the last ten years as a consequence of rapid and sustained growth. There has been an increase in the coverage of the social security system run by the Government and in the establishment of health insurance schemes, both public and private. However, in the past, directly productive capital has risen much faster than social overhead capital; to change this trend, which is an important objective of government policy, will require determined action in the coming years.

The latest policy issue to emerge relates to the ecological effects of industrial activities. Japan, which supports a large population and a highly industrialized economy on a small land area, has obviously a much more serious pollution problem to contend with than other countries do. Discussions are going on concerning the trade-off between pollution and economic growth.

In the field of economic relations with both developed and developing countries, the mechanism whereby Japan can take an initiative in the promotion of freer trade is a topical subject of discussion. In this respect, Japan appears likely to play an increasing role in the next few years. As noted above, the gradual liberalization of imports has begun, and this process of import liberalization is to be used as a platform for export expansion in future years. By 1975, the Japanese Government aims to reach the aid target of 1 per cent of GNP. Furthermore, in 1971, Japan will grant preferential tariffs in favour of the developing countries. As regards trade with ECAFE countries, it is estimated in the JERC medium-term projections that imports from ECAFE countries will increase at 17.0 per cent per annum for 1970-1975 and their ratio to total Japanese imports will rise a little.

Laos

Introduction

The economy of Laos continued to improve modestly in 1969. Agriculture, the mainstay of the economy, sustained its momentum well into the year, reaching a level of production that surpassed the previous year's, despite some serious flood damage. There was also progress in the industrial sector although it was on a piecemeal basis reflecting, to some extent, the priority that development efforts have accorded to agriculture. The increase in agricultural production has made possible a further reduction in the import of foodstuffs, particularly rice, and it has, in addition, moderated the rise in the cost of living. These developments have taken place against a backdrop of prolonged political unrest and military conflict which, in addition to pre-empting at least one-fifth of the active male population for the armed forces, has resulted in an influx of refugees from the rural areas, amounting to 700,000 people in 1969.

In the field of public finance, the economy also revealed a slight improvement from fiscal year 1968/69, with the budget deficit reduced in both absolute and relative terms. Government revenue, however, continued to be less than 50 per cent of expenditure. As regards international trade, whereas the rate of growth of export earnings exceeded that of imports from 1965 to 1968, exports suffered a net decline in 1969, while the value of imports continued to rise. Consequently there was an 8 per cent increase in the already large trade deficit. Despite these and other difficulties, the first year of the current five-year plan (1969-1974) appeared to have ended on a rather encouraging note with most projects proceeding as scheduled.

Agriculture[1]

Although only 3.0 per cent of the total area of 23,680,000 ha is under cultivation, agriculture remains

[1] The ratio of total area to total population in Laos is over four times the average for the three other Mekong countries while the area of arable land per head of the population active in agriculture is twice as high as the average in those countries.

the leading sector of the Laotian economy. As much as 85 per cent of the country's population live in rural areas, and agriculture employs about 80 per cent of the labour force. Because of the potential for further expansion (of the total area of 1.9 million ha suitable for agriculture, only 713,000 ha or 38 per cent have so far been cultivated), much develoment effort has been devoted to increasing production in the agricultural sector. Because of the relative scarcity of labour, these efforts have been directed mainly towards the greater mechanization of farming and the adoption of more efficient farming techniques. With respect to mechanization, emphasis is placed on investments in simple agricultural tools and buffalo-drawn machines, since the farms are generally small and fragmented. In addition to credit facilities provided by the Agricultural Development Organization (ADO), the Government is attempting to promote co-operatives among farmers to enable the financing of those investments which they cannot afford to undertake individually. To improve efficiency, several experimental stations have been established under the guidance of foreign technical expertise, and these are exploring the possibilities of triple-cropping and of commercializing the cultivation of peanuts, mustard, wheat, maize, and a variety of vegetables.

Complementing these schemes, a number of irrigation works are in progress, ranging from pumps and small dams to the large-scale multipurpose Nam Ngum project which is expected to irrigate an area of 114,000 ha. Steps have been taken to improve transport conditions, particularly by increasing the number of feeder roads into villages, and other measures are being taken to enhance marketing.

Food crops

The degree of success of the afore-mentioned efforts is illustrated by the behaviour of rice production, rice being by far the most important agricultural commodity. Following the introduction of double-cropping in 1966, it was applied to a steadily expanding area at an average rate of 717 ha per annum and reached 2,500 ha in 1969. At the same time, milled-rice production experienced steady growth to 537,000 tons in 1969, representing an increase of 4.5 per cent over 1968, which, in turn, showed a 10.3 per cent rise over 1967.[2]

In 1967, the Directorate of Agriculture initiated a programme designed not only to make the country self-sufficient in rice but also to create an exportable surplus of 200,000 tons by the mid-1970s. This called for a rapid expansion of the acreage under double-cropping to 50,000 ha and accelerated use by farmers of improved seeds, fertilizers, insecticides and tractors. While it is premature to attempt a detailed evaluation of this programme, it appears that progress has been made, though actual performance has not fully measured up to expectations. It may thus be possible for Laos to end its traditional dependence on rice imports within the next two or three years. Rice imports in 1969 fell to 30,000 tons (10,000 less than predicted), and imports now account for only 5 per cent of total consumption, whereas previously they were 10 per cent. Should the rates of increase of output of the past few years continue, total home demand for rice will likely be met by domestic production by 1972, and the completion of the Nam Ngum project should vastly enhance the prospect of an exportable surplus.

The production of other crops, which consist mainly of vegetables, also increased substantially during the 1966-1969 period. The production of vegetables rose by 13 per cent from 1967 to 19,200 tons in 1969, and cabbages and carrots were produced in sufficient amounts to satisfy local demand and allow for a small amount to be exported to Thailand. The improvement was largely a result of ADO activities, particularly free distribution of seeds and subsidized provision of irrigation pumps, and it reflects greater productivity rather than enlargement of the cultivated area, yields per ha having risen by 8.5 per cent from 1967 to 1969.

Non-food crops

While food-crops, particularly rice, have done well, the production of non-food crops remained virtually stagnant. After an increase of 85 per cent between 1963 and 1967, the production of coffee has levelled off at around 3,500 tons per year for the last three years. With respect to tobacco, also, there has been little growth, with the level of production fluctuating around 4,000 tons annually. Only in the production of cotton has an upward movement been discernible, with production reaching 2,500 tons in 1969, an increase of 14 per cent over 1968, which, in turn, showed a rise of 39 per cent over 1967. This is explained, in part, by the relative security that the cotton fields have enjoyed.

Livestock and fisheries

There was a substantial gain in cattle in 1969, the number being nearly double that for 1968. This increase was in terms of slaughtered heads, however, and, as live cattle were also imported from Thailand to be slaughtered in Laos, it is not known how much was due to local increase. At the same time, the production of water buffaloes and hogs declined by 26 and 5 per cent respectively.

[2] As opposed to previous practice, rice statistics are now officially issued in terms of milled rice and not paddy. For the sake of convenience, the calendar year is here used to indicate the harvest year. The year 1967, for instance, represents the harvest year 1967/68.

Of considerable significance is the fact that the urban centres in the north of the country have to rely on imports to satisfy part of their meat consumption, while surpluses of livestock are generally available in the south. This, in turn, reflects the inadequacies and deficiencies in existing transport conditions. The absence of a railway and operative truck routes renders internal transport of livestock from surplus to deficit areas almost impossible. Larger-scale navigation along the Mekong River is under study, its feasibility is contingent upon the overall development of the long-term Mekong project. The boats which now operate are too limited in number and size to handle live animals, nor do they have the refrigeration equipment for handling meat. Importation of livestock to feed the people in the north of the country has therefore been necessary, and some of the imports are essentially re-imports, i.e. surpluses of livestock and other foodstuffs in the southern provinces are frequently carried across the Mekong into Thailand, to find their way northwards, and re-enter Laos as imports.

A massive improvement in internal transport conditions is necessary, but this is a long-run solution. In the short run, one solution is to try to raise the level of livestock production in deficit areas, and the main aim of a number of experimental farms which have been established in the Vientiane area is to reduce animal diseases and improve breeding. The effects of these efforts have yet to be felt, however.

A major part of the Laotian diet consists of fish, and the development of fish production would considerably increase the rate of protein intake. Since the country is landlocked, fishing is limited to the Mekong and its tributaries, and, because of the lack of modern equipment, it has so far been conducted on an antiquated basis. However, an important development in recent years has been the promotion of pisciculture on a self-help basis. Since their rehabilitation in 1966, the three major hatcheries, located in Luang Prabang, Vientiane and Pakse, have steadily increased their output of fingerlings. In 1969, they sold one million fingerlings to rearing ponds run by individuals, families, villages and other groups, and, although this was only 40 per cent of the target sale of 2.5 million fingerlings per year, it represented ten times the 1968 level.

Forestry

Following a season of premature monsoons which caused a drastic drop in production of 42 per cent in 1968, the production of timber recovered rapidly in 1969, reaching 117,000 m^3. At the same time, however, the value of timber exports declined from Kp 384.3 to Kp 376.5 million. Since forestry is one of the areas most affected by the military situation, development efforts in this domain have been minimal, consisting of a forest inventory aimed at making possible a more rational exploitation of forest resources. This project was begun in 1968 and is still in progress.

Industry

Manufacturing

The industrial sector in Laos is at a low stage of development. A scarcity of financial resources, combined with the growing need for food, left the Government little choice but to opt for a heavy concentration of effort on agricultural development. Consequently, manufacturing has not expanded much since 1965, either in terms of the scale of operations or of the number of factories within any particular industry.

Not only has there been little increase in capacity, but production in most enterprises runs at about two-thirds of capacity on the average. This is explained by generally low levels of purchasing power in the urban centres and by the largely non-monetized character of the rest of the economy. On the other hand, where demand stimulus has been relatively strong, expansion has occurred. Thus, export earnings from timber and lumber increased almost twenty times from 1965 to 1969 and the number of saw mills rose from thirty-two to eighty-four, with an output of 91,000 m^3 in 1968.

The public sector is attempting to establish some basic industries, especially cement. The current five-year plan lists as one of its major projects the establishment of a cement plant with a capacity of 50,000 tons per annum which is aimed to satisfy local demand and spare the country an annual expenditure of about Kp 400 million in foreign exchange. With feasibility studies completed and financing coming mainly from foreign loans, it is anticipated that construction of the plant will soon be under way.

Mining

Since the early 1960s, tin has been, by an overwhelming margin, the leading export commodity. Within a period of five years, from 1964 to 1968, its export earnings rose from Kp 166 million to Kp 806 million in foreign exchange, roughly a fivefold increase, and production has been more than one and a half times that of 1964 every year since the introduction of an additional mine at Nong Sun in Khammouane province in 1966. Despite a drop in export earnings from tin due to a reduction of the tin content in the ore in 1968, production in 1969 regained and surpassed the 1967 level, with an output of 1,262 tons of 50-60 per cent concentrate.

In addition to tin mines, there are several salt mines in the Vientiane area, but production is not sufficient to supply local consumption needs and salt has to be imported from Thailand. The introduction of mechanical evaporation should substantially improve production and eliminate the need for salt imports.

Preliminary surveys indicate the presence of other minerals, including iron ores, copper, anthracite, lignite and petroleum, but further exploration is needed.

Infrastructure

Power

Generation of electricity is mostly by state owned and operated plants. In the 1960s, production rose steadily from 8 million kWh in 1961 to 28 million kWh in 1968. The only domestic sources of thermal energy were firewood and charcoal, however, and petroleum products had to be imported as supplementary fuel. Further expansion was constrained by the very limited supply of firewood and charcoal and the high costs of imported petroleum inputs. The increase in output that did occur was outstripped by growing private use alone, and many industries had to resort to private generators. Resort also was made to borrowed power. In 1969, for example, out of a total of 37.6 million kWh used,[3] 16.9 million kWh came from Thailand: a loan to be repaid after the coming into operation of the hydro-electric plant at Nam Ngum.

On the other hand, because of the abundance of water resources and the progress that is being made in tapping them, the prospects of power supplies for both domestic use and development needs in the future appear highly promising. As the Nam Ngum dam approaches completion, it is envisaged that a total capacity of 135,000 kW will be installed at once rather than being spaced out in two phases as originally planned. This would mean a very great increase in power supply compared with the existing total capacity of roughly 10,000 kW. Together with the construction of this hydro-electric plant, a system of distribution is being designed to cover a large part of the rural areas surrounding Vientiane.

The increased power will not only satisfy domestic and industrial needs in the urban centres but also serve to support, facilitate, and expedite all the projects carried out under the programme of integrated agricultural development for the Vientiane plain. Meanwhile, the Selabam dam, with an installed capacity of 2,550 kW, has been constructed and put into service. The construction of another dam on the Nam Dong tributary will be completed by 1971, with an installed capacity of 1,200 kW for the electrification of the city of Luang Prabang.

Transport

Despite considerable attention, transport problems remain probably the most serious in the economy. They not only isolate the country from the outside world, but, within the country, south from north, rural from urban areas, and surplus from deficit regions. Basically unfavourable geographical conditions, the disruptive military situation, a grave lack of equipment, and the poorly developed state of roads, waterways, and airways, render communication and commerce very difficult. The one major artery, Highway 13, linking the north and south to Vientiane, would, even under the most peaceful circumstances, be serviceable for only a part of the year because of the monsoon rains. In 1965, the southern stretch from Vientiane to Pakse was rebuilt for all-weather use and the northern portion from Vientiane to Luang Prabang was restored. By 1969, however, extensive damage caused by hostilities made the use of this route extremely perilous and virtually impossible. Nor are prospects bright for implementing the plan to integrate this route into the Asian Highway network by extending it to the Burmese border.

Similarly adverse conditions exist in the case of water transportation. The Mekong River is the main waterway providing a traditional means of communication between the north and the south. Its fluctuating level and difficult rapids and falls, however, make navigation practicable only on a number of reaches at certain times of the year.

For the present, air transportation for both passengers and freight has assumed relatively greater importance as the mode of transport. Between 1965 and 1969, the number of air passengers increased by 64 per cent, while the tonnage of air freight doubled, and this despite a manifold increase in the charges. Because of high costs, inadequate facilities, and outmoded technical equipment, however, the use of air transport to move freight on a large scale is extremely limited.

Health and manpower training

Of a total population estimated at 2.893 million people, less than 40 per cent are classified as economically active and 8 per cent as active in non-agricultural fields. Limited in terms of quantity as well as of skill, the country's labour force has its working capacity further reduced by widespread malnutrition and endemic diseases. To cope with the country's medical problems, the total number of medical per-

[3] This is exclusive of privately generated electricity. The output figure for 1968 was revised from 26.2 million to 28 million kWh.

sonnel, including doctors, dentists, pharmacists, medical assistants and nurses, was less than 100 in 1969 and there is only one health centre and one bed for every 11,000 and 2,500 persons respectively.

Only about 8 per cent of the total planned investment in the five-year plan is allocated to the social sector. Half of this amount is to be devoted to the construction of a maternal and child health centre in Vientiane, a 200-bed hospital in Luang Prabang, two centres for malaria and tuberculosis, and a pharmaceutical laboratory, and these programmes will have to rely in large measures on United States aid. The shortage of qualified personnel to staff these institutions, however, poses a far more serious problem than their construction. A school for orderlies and nurses has recently been set up, but facilities do not exist for the training of higher medical personnel, while the number of doctors returning from abroad each year is extremely small.

The number of those who enter secondary schools is still a very small fraction of primary school enrolments. In 1966, the number of students registered in secondary schools was less than 2.5 per cent of those in primary schools, although the figure rose to 3 per cent in 1969. The fraction of those who manage to go on to universities is minute. The total number of enrolled students is only 7.5 per cent of the total population, or about 17 per cent of the school-age group. This poorly developed base is further plagued by the shortage of funds to support an increase in institutions, equipment, facilities and teaching staff. Specific steps which have been taken to improve the situation consist of an allocation of 10 per cent of the budget to the general field of education and a five-year plan to provide 600 teachers at the secondary level by 1975. A major consequence of these shortcomings in the field of education has been the absence of the competent clerical and administrative staff who are badly needed to ease the workload on the leadership.

There is a sizable pool of unskilled labour to be trained, including farmers who are prepared to work in the cities given job opportunities and those who do not enter or who drop out of secondary schools. As a start toward solving this problem, three technical schools for training operatives, foremen, and managers were set up in 1966. The courses offered range from mechanical and general engineering to electricity and metal work and represent a major change from the heavy emphasis which the regular schools traditionally place on academic subjects.

Government finance

From 1965/66 to 1967/68,[4] total government expenditure increased at an average rate of 5.4 per cent per annum, while revenue grew at a rate of 24.6 per cent per annum. Consequently, the budget deficit was reduced from Kp 9.7 billion in 1965/66 to Kp 8.7 billion in 1967/68 and the proportion of expenditure covered by revenue increased from 33 per cent to 46 per cent. The 1968/69 budget set expenditure at Kp 15.964 billion (a decrease of 0.1 per cent) and revenue at Kp 7.4 billion (an increase of 2 per cent), which would have reduced the deficit further by Kp 0.17 billion.

Fiscal performance in 1968/69 failed to come up to expectations, however. Actual revenue fell below the previous year's level to Kp 7.1 billion whereas expenditures went up by almost Kp 0.92 billion to Kp 16.9 billion causing a deficit of Kp 9.8 billion, the largest ever recorded (see table II-3-25). The rise in expenditure was explained by substantial increases in military and related payments, including veterans' benefits, compensation for dependents of personnel killed in action, and rehabilitation of refugees. On the revenue side, the yield from non-gold import duties and other indirect taxes was greater than estimated, but this was not sufficient to offset a drop in revenue derived from duties on gold imports, a revenue source which accounted for as much as 57 per cent of total import duty revenue in 1966/67. In 1968/69, total gold imports amounted to 26,900 kg, a drop of almost 50 per cent from the previous year's volume, despite the lowering of the duty rate from 8.5 per cent to 7.5 per cent since January 1969. This drastic decrease was attributed to narrowing profit margins of gold dealers due, in turn, to an increased buying price accompanied by a reduced selling price in the Republic of Viet-Nam. Finally, direct tax receipts did not measure up to estimates, as the National Assembly did not approve most of the Government's fiscal proposals aimed at increasing revenue.

Provisional estimates for the 1969/70 budget again reflect an attempt to reduce the deficit which is set at Kp 8.8 billion, almost Kp 1 billion less than the previous year's. Government revenue was estimated to increase by 20 per cent to Kp 8.5 billion while a slight increase, 2.6 per cent, to Kp 17.3 billion, was envisaged for expenditure. Indirect taxes remained the major source of revenue and were expected to yield Kp 6.63 billion or 78 per cent of total estimated revenue. Of the indirect taxes, the share of non-gold customs duties was the largest (about 63 per cent) while the proportion of gold-import duties declined to 18 per cent. Attainment of the revenue target is subject to the approval by the National Assembly of a set of fiscal measures and will depend on their effective enforcement. The new measures include the introduction of new taxes, increased rates of existing taxes, and improvements

[4] The fiscal year begins on 1 July.

Table II-3-25. Laos: Government receipts and expenditure, 1965/66-1969/70

(in million kips)

Item	1965/66 Actual	1966/67 Actual	1967/68 Actual	1968/69 Estimates	1968/69 Actual	1969/70 Estimates
A. *Receipts*	4,721	6,391	7,278	7,431	7,104	8,544
Indirect taxes	4,076	5,644	6,242	6,034	5,917	6,630
Duties on gold imports	(1,345)	(2,722)	(2,382)	(1,932)	(1,164)	(1,200)
Duties on non-gold imports	(2,012)	(2,063)	(2,867)	(3,217)	(3,812)	(4,170)
Registration fees	(90)	(124)	(159)	(180)	(184)	(200)
Other indirect taxes	(629)	(755)	(834)	(705)	(757)	(1,060)
Direct taxes	364	454	573	700	597	990
Fees from public services	236	228	415	537	450	724
Other receipts	45	45	48	160	140	200
B. *Expenditure*	14,390	15,310	15,984	15,964	16,902	17,344
Military	8,393	8,345	8,260	8,219	8,253	8,469
Police	1,173	1,185	1,164	1,117	1,160	1,215
Civilian	4,824	5,780	6,560	6,628	7,489	7,660
C. *Deficit*	9,669	8,191	8,706	8,533	9,798	8,800

Source: Ministère du Plan, *Rapport sur la situation économique et financière*, 1969-70.

in methods of collection which are expected to increase receipts from all sources except gold by 15 per cent.

The composition of expenditure in 1968/69 remained basically unchanged from the year before. Nearly half of the budget was allocated to the military; and about 44 per cent was for civilian expenses, the bulk for public administration. Of the civilian share, only Kp 801 million (4.6 per cent of the budget) was available for development purposes. Kp 416 million was for investments in the first year of the five-year plan for 1969-1974 (Kp 36 million for large-scale projects and Kp 380 million for other projects).

Foreign trade

Balance of trade

During 1969, there was poor performance in the export sector in the face of steadily rising imports. The value of imports for the first three quarters alone climbed to Kp 13.38 billion, while that of exports for the year dropped below the 1967 level to Kp 1.03 billion, widening the relative magnitude of the deficit to 92.3 per cent (see table II-3-26).

Tin, timber, and coffee remained the principal exports, in that order, their shares in total export earnings being 53.7 per cent, 36.4 per cent and 7.3 per cent respectively. The performance of these leading items in 1969 was poor in contrast to 1968 when their export earnings rose by 26 per cent over the previous year. Following the introduction of a second mine in 1966, the value of tin exports more than doubled, reaching Kp 497.6 million in 1967. After an increase of 62 per cent to Kp 806.1 million in 1968, they dropped to Kp 555.1 million in 1969. Timber earned Kp 376.5 million worth of foreign exchange in 1969, a 2 per cent drop from 1968. Coffee exports were valued at Kp 75.8 million in 1969, following a drastic drop from Kp 160.4 million in 1967 to Kp 60.2 million in 1968 (see tables II-3-27 and II-3-28).[5]

Table II-3-26. Laos: Balance of trade

(in thousand kips)

Year	Imports	Exports	Deficit	Deficit as percentage of imports
1965	7,893,227	240,169	7,653,058	97.0
1966	10,017,159	357,724	9,659,435	96.4
1967	11,796,359	1,064,790	10,731,569	91.0
1968[a]	12,878,558	1,448,096	11,430,462	88.8
1969[b]	13,384,000	1,032,853	12,351,147	92.3

Source: Ministère du Plan, *Rapport sur la situation économique et financière, 1969-70.*

[a] Revised figures.

[b] The value of imports is for only the first three quarters of the year and the deficit should be viewed with reference to this.

[5] All the figures given are based on customs data which do not include unofficial exports and re-exports. Malaysia, Singapore, and Thailand remained Laos' major customers, importing together 91 per cent of its exports. Japan, Thailand, the United States and France are the major suppliers.

Table II-3-27. Laos: Commodity composition of exports, 1965-1969

(in thousand kips)

Item	1965	1966	1967	1968	1969 Value	1969 Percentage
Tin	147,266	222,411	497,641	806,080	555,095	53.7
Timber	19,122	38,138	332,362	384,316	376,461	36.5
Coffee	11,107	53,708	160,415	60,187	75,821	7.3
Benzoin	26,845	16,941	24,408	3,820	215	—
Cardamom	1,200	15,351	10,877	51,049	4,800	0.5
Hides	1,032	—	3,683	5,463	8,276	0.8
Sticklac	225	—	150	342	—	—
Other	33,395	11,175	34,886	136,839	12,185	1.2
Total	240,162	357,724	1,064,422	1,448,096	1,032,853	100.0

Source: Ministère du Plan, *Rapport sur la situation économique et financière, 1969-70.*

Table II-3-28. Laos: Commodity composition of imports, 1965-1969

(in million kips)

Item	1965	1966	1967	1968	1969 January-September	1969 Percentage
Rice	930	2,435	2,545	2,066	1,895	14.2
Other food-stuffs	1,616	838	1,458	2,245	2,149	16.1
Petrol products	1,081	1,376	2,371	1,118	1,903	14.2
Textiles	727	516	403	595	817	6.1
Machinery	704	833	801	1,355	1,165	8.7
Chemicals	412	416	406	774	740	5.5
Metal products	434	410	472	634	911	6.8
Vehicles	800	1,314	1,542	1,763	1,442	10.8
Paper and paper products	268	258	315	267	603	4.5
Other	921	1,641	1,483	2,062	1,759	13.1
Total	7,893	10,037	11,796	12,879	13,384	100.0

Source: Ministère du Plan, *Rapport sur la situation économique et financière, 1969-70.*

Laos' poor trade performance has its roots in certain structural weaknesses of the economy. In the first place, the predominance of subsistence agriculture makes it necessary to import food to feed the urban centres, and whatever marketable surpluses there are cannot find outlets because of deficient transport and marketing conditions. Moreover, increasing grain supplies are required to meet the growing needs of military personnel and refugees. Second, export expansion and diversification are seriously constrained by the country's landlocked status. The transit of goods through other countries for access to the sea tends to render Laos' exports less competitive because of a wide margin of extra costs. The shortest route to the sea is across Viet-Nam and the longest is through the Khmer Republic. For the present, however, security factors rule out the use of both these routes, leaving Thailand as the only available route. Laos' transit problems are thus intensified by the present lack of choice among a number of competing transit countries from which greater competitive pricing as regards freight and other charges might be derived.

The monetary situation and prices

Before 1964, the trade deficit was financed mainly by foreign aid in the form of direct cash grants under which kips were created in direct relation to the amount of foreign exchange received. This practice, combined with the Government's borrowing from the National Bank to finance its budgetary deficits, led to serious inflationary pressures and a rapid decline in the external value of the kip during

the late 1950s and early 1960s. Between 1959 and 1964, while the domestic price level increased by more than four and a half times, the exchange rate depreciated from Kp 35 to between Kp 300 and Kp 600 on the United States dollar. This deteriorating situation prompted a series of monetary reforms, the central feature of which was the institution of a dual exchange-rate system with a built-in stabilizing mechanism. With contributions from a consortium of countries, including the United States, the United Kingdom, France, Australia and Japan, the Foreign Exchange Operations Fund (FEOF) was established for the purpose of stabilizing the market rate at Kp 500 to the dollar. This rate applies to all transactions except those which come under the commodity import programmes of the United States, the United Kingdom and Australia which cover such essential items as rice, flour, chemicals, textiles, agricultural machinery, utility vehicles and petroleum products.[6] Transactions concerning these commodities are governed by the official rate of exchange set at Kp 240 per dollar.

In contrast to the former practice of increasing the money supply proportionally to the amount of aid grants received, the Government now absorbs kips in the form of proceeds generated by the sales of foreign exchange through the FEOF and Commodity Import Programme (CIP). These proceeds are in turn used to retire government debt to the National Bank and are estimated to offset about 80 per cent of the expansionary effects of government borrowing from the banking system.[7] Since government borrowing from the National Bank was by far the principal expansionary force, the net effect of this arrangement was to dampen the inflationary process. Following the implementation of these reforms, the free market exchange rate has been stabilized around Kp 505 per dollar and the rate of increase of the domestic price level fell steadily from 15 per cent in 1965 to 5 per cent in 1968.

Prices in 1969 increased by only 3 per cent from 1968[8] (see table II-3-29). Indices show that, on the average, the prices of food (which commands over 50 per cent of the average consumer budget) rose less than those of any other items, increasing by 1.8 per cent, compared with 5.6 per cent for housing, 3.8 per cent for clothing, and 10.7 per cent for domestic services. Comparing the situation between December 1969 and December 1968, the rates of price increase were even lower, except in the case of housing. Food prices actually decreased by 0.9 per cent. The decrease was attributed to improved agricultural production, notably of rice, meat and vegetables, and to better marketing organization. In 1969, the price of pork fell from Kp 700/kg to Kp 600/kg; the price of glutinous rice, the staple item of the Laotian diet, decreased by 16 per cent; and the general index showed an over-all increase of only 2.3 per cent.

[6] Gasoline products have recently been removed from the list.

[7] FEOF kip proceeds which were used to write off government debt to the National Bank amounted to Kp 3,010 million in 1965, Kp 4,376 million in 1966, Kp 8,559 million in 1967 and Kp 4,052 million in 1968.

[8] Based on the consumer price index for Vientiane.

Table II-3-29. Laos: Consumer price index (CPI) for a Laotian family in Vientiane

(1964=100)

Item	*1965*	*1966*	*1967*	*1968*	*1969*	*Dec. 1968*	*Dec. 1969*	*Percentage change*
Food	107.8	127.3	135.0	142.8	145.4	144.9	143.6	—0.9
Housing	115.4	119.1	121.8	123.7	130.6	123.9	131.4	6.0
Domestic services	111.1	119.8	147.5	156.4	173.2	157.7	173.2	9.8
Clothing	117.9	125.3	130.0	135.4	140.5	137.1	140.5	2.5
Other	135.7	147.4	175.5	187.0	191.8	189.9	200.6	5.6
"General" index	112.7	128.3	138.6	145.5	150.1	147.3	150.7	2.3
Percentage change from year to year	13	14	8	5	3			

Source: Ministère du Plan, *Statistiques essentielles*, 1969.

Note: The annual index is calculated by taking an average increase in the CPI over the year.

Economic planning

A five-year plan, the "framework plan", has been formulated for 1969-1974. Given the uncertainties engendered by the drawn-out, hostilities and by paucity and deficiencies of statistical data, the plan is designed to be "more than indicative but less than imperative", with considerable allowance for flexibility. It represents a broad attempt to eliminate or minimize such "structural disequilibria" as the preponderance of subsistence agriculture, the underdeveloped state of the manufacturing sector, and the continuing budget and trade deficits.

Plan investment has been allocated into two broad categories: the "basic" sector incorporating twelve major projects, and the "general" sector consisting of seventy-nine small projects.[9] Of the planned investment of Kp 10.8 billion allocated to the general sector, about 44 per cent is to be devoted to increasing production in farming, animal rearing and forestry. The major projects in the basic sector, on the other hand, command about 82 per cent of total planned investment of Kp 59.08 billion. The plan envisages an increase in power output to the level of 150,250 MWh by 1974, 80 per cent of which is to come from the hydro-electric plants at Nam Ngum, Nam Dong and Selabam.

Information is too vague and fragmented to permit a satisfactory appraisal of progress. However, some indications are available. As regards the general sector, some progress has been made in the development of the Vientiane plain, which is of highest priority in the plan. The construction of dams has already enabled an extension, by over 1,200 ha, of the area that can be irrigated, and studies for the Tha Ngone project, aimed at irrigating a further 800 ha, have been undertaken. A station for the housing, repairing, and servicing of agricultural equipment has been completed, and experimental farms and research stations were established for the improvement of poultry and pig-raising. An agricultural school was due to open at the end of 1970.

Most of the major projects in the basic sector appear to be proceeding according to schedule. Selabam dam has been completed and indications are that the Nam Ngum and Nam Dong dams will be finished by the end of 1971. Another notable accomplishment was the extension of the runway at Vientiane airport, from 2,000 to 3,000 m. allowing, for the first time, the accommodation of aircraft of major international airlines. It is expected that the volume of traffic and, with it, the tourist trade will increase substantially once the other technical facilities of the airport have been modernized.

As for the other major projects, particularly the proposed cement plant, the mother and child health centre in Vientiane, the bridge across the Mekong and urban water treatment and distribution, progress cannot be gauged so far in quite the same concrete terms. It can only be noted here that, having passed the study phase, the projects are now ready to enter the construction phase.

Malaysia

Introduction

Thanks to strong demand for rubber and tin, 1969 was a boom year. Despite internal disturbances in May and a level of investment lower than expected, the rate of growth of GNP at current prices was 9.2 per cent. This was the highest annual rate of growth so far in the first Malaysia plan (1966-1970).

Conditions in export markets were not expected to be as favourable in 1970 as in 1969, however, and the Government planned to stimulate the economy by increasing the level of development spending. The Government expected that this compensatory fiscal policy, together with an anticipated increase in consumer spending in response to high incomes in 1969, would induce a higher level of investment spending without, however, generating serious pressure on prices or the balance of payments. Other goals of the Government for the year were the continuing ones of reducing unemployment and income disparities, diversification of exports, and increased import substitution.

Performance of the economy in 1969[1]

The year 1969 was a boom year, to a large extent because of favourable prices for most primary export commodities and especially for rubber. During the year, GNP grew by about 9 per cent, compared with the 1960-1968 average of 5.5 per cent. Moreover, this was achieved with little change in the domestic price level; the West Malaysian Retail Price Index actually fell nominally. While exports of goods and services were up from 1968 by 17 per cent, there was actually a slight decline in imports. The result was a favourable trade balance of M$836 million, the highest for the decade. This enabled the country to raise its external reserves to M$2.495 million at the end of 1969. Public consumption rose by 10.8 per cent over 1968, but private consumption increased only moderately by 2.5 per cent.

The major adverse trend in the year was an actual absolute decline in gross capital formation. A small increase of 3.6 per cent in the private sector

[9] For greater detail, see Commissariat Général du Plan et de la Coopération, *Plan cadre de development économique et social*, 1969-74.

[1] Unless otherwise indicated, data from this point forward are taken from Bank Negara Malaysia, *Quarterly Economic Bulletin*, vol. 3, No. 2, June 1970.

over 1968 was more than offset by a decline in public sector gross fixed-capital formation of 7.2 per cent. Gross national savings, on the other hand, rose substantially by 26.6 per cent to a record 22.3 per cent of GNP in 1969, against 19.1 per cent in 1968.

Performance in 1970

The economy continued to expand in 1970, though at a slower rate than in 1969. At current market prices, GNP rose to M$11.820 million, an increase of 6.3 per cent compared with the 9.8 per cent in 1969. In *per capita* terms, GNP rose from M$1,040 to M$1,080.

The main impetus to growth in 1970 came from domestic demand, whereas in 1969 the export boom had been the major factor. Private investment was up by an unprecedented 32.9 per cent as compared with a decline of 4.9 per cent in 1969, the rise being mainly in manufacturing and, to a lesser extent, in construction. The rate of growth in private consumption expenditure was up from 3.2 per cent in 1969 to 6.9 per cent in 1970. The public sector also showed higher rates of growth, 6.1 per cent and 18.7 per cent in investment and consumption respectively (4.5 and 10.7 per cent in 1969). In the external sector, on the other hand, due to a combination of a decline in the export price of rubber and a strong increase in imports, income from the net export of goods and services was less than half that of 1969.

The ratio of gross capital formation to GNP rose from 14.2 per cent in 1969 to 16.3 per cent in 1970, the increase resulting mainly from the strong growth of private sector investments. This ratio, however, was lower than the ratio of national savings to GNP, though to a lesser extent than in 1969.

As the Bank Negara Malaysia notes, a high rate of growth requires that public sector development expenditures expand at a rate commensurate with that in the private sector. This did not occur in 1970, and once again the Federal Government did not achieve the target level of development it had set for itself. In contrast with a rise of 5.0 per cent in Federal development expenditure, current expenditure rose in 1970 by 18.0 per cent. This latter increase was sufficiently large to cause a smaller current surplus than in 1969, despite a larger than budgeted rise in current revenue. The over-all deficit came to M$579 million, considerably larger than in 1969, and was financed mainly by net domestic borrowing and greater recourse to the use of the accumulated assets of the Federal Government.

The money supply and private sector liquidity grew at the substantially lower average rates of 8.6 per cent and 11.1 per cent respectively in 1970. Monetary expansion was generated mainly by the extension of bank credit to the private sector, while the external sector contributed only a fraction of the increase in the money supply that it had made in 1969. While the public sector's influence on the money supply in 1970 was contractionary, this was true to a much lesser extent than in 1969. Prices remained relatively stable, the West Malaysian retail price index rising by only 1.4 per cent.

Primary production and exports remained the mainstay of the economy. Except for rubber, the output of most major commodities increased in 1970, the output of rice rising to the point where 84 per cent of total consumption requirements were met.

Due to a very strong growth of imports, the merchandise surplus in the balance of payments was substantially smaller than in 1969, and the net deficit on services and transfers was higher. As a result, the surplus on current account fell by approximately 68 per cent to M$217 million in 1970. On the capital account, net private long-term capital inflow rose substantially over 1969, while net foreign borrowing of the Federal Government declined. The basic balance (the balance on current account and long-term capital movements), adjusted for errors and omissions and excluding the initial allocation of special drawing rights, showed a surplus of only M$50 million as compared with M$530 million in 1969. If the special drawing rights are included, total net external reserves rose by M$124 million at the end of 1970 to an amount sufficient to finance about eight months of retained imports.

Agriculture

Rice production

Rice maintained its position as the second most important economic activity in the country in terms of labour employed and land utilized. Total output increased from 1.6 million tons in the 1968/69 season to 1.7 million tons in the 1969/70 season, with West Malaysia accounting for 86 per cent of total production.

As a result of launching the first phase of the Muda River Irrigation Project in February 1970, double-cropping in West Malaysia increased by 36 per cent during the 1969/70 season. It is further worthy of note that efforts to increase productivity have enabled Malaysia to attain fourth place in paddy yield in Asia, with an average per harvested acre yield of 2,480 lb.

Major commercial crops

Due to a decline in rubber prices, output virtually stagnated in 1970, though rubber remained Malaysia's most important industry in terms of employment, exports, and foreign exchange earnings. Production of Standard Malaysian Rubber increased in 1970 by 62 per cent, and the discovery of a new stimulant was announced that can double yields of both low-yielding trees and the newer clones. For all other major commercial crops, output rose in 1970 as compared with 1969. Total output of saw logs was up by 4 per cent, sawn timber by 9 per cent, oil palm by 23 per cent, palm kernal by 17 per cent, coconut oil by 8 per cent and copra by 9 per cent.

Minerals

The principal minerals in Malaysia are tin, iron ore, petroleum and bauxite, and there was an increase of about one per cent in the over-all volume of output of these minerals during 1970. The output of tin-in-concentrates was up slightly in response to favourable prices, but there was increasing depletion of the richer tin deposits and increasing resort will have to be had to higher cost sources of ore. The output of iron ore declined by about 15 per cent as economic deposits continued to be exhausted. In fact, two of the largest mines ceased operations in 1970, and the Bank Negara Malaysia expressed the view that iron ore mining had lost its place as a major economic activity. Output of crude oil, on the other hand, increased during 1970 by 94 per cent, and exploratory activity continued in several areas. Bauxite production was up by 6 per cent over 1969 and a new mine was opened in July, bringing the total number of mines to three.

Industrial production

General

There were no major policy changes in this area during 1970. Rather, the Government continued to devote its energies to implementing the new industrial development strategy that had been announced in July 1969.

Under this strategy, the Government had announced that it would use investment incentives more aggressively to seek out capital, that it would streamline the procedure for granting incentives, and that it would itself participate in areas where the private investment flow was deemed inadequate.[2]

Finally, and as already noted, the Government's planned deficit in the 1970 budget was intended to ensure a level of aggregate demand which would sustain a high level of industrial production and stimulate new investment activity as well.

Manufacturing

On the basis of incomplete data, it is estimated that the value of manufacturing output (factor cost at current prices) rose by 7 per cent in 1970. Of the approximately fifteen industries where comparable figures with 1969 are available, output increased in nearly all of them. The total number of all types of firms given approval to start manufacturing operations in 1970 was up by 130 per cent over the previous year and total proposed called-up capital by approximately 84 per cent. While the manufacturing sector was still small in terms of relative size in 1970, it should provide substantial stimulus to the economy if it continues to show the high rate of growth of the last few years.

Construction and services

The value of output of the construction sector rose in 1970 by 1.5 per cent, while output of the services sector was up by 8.4 per cent, both measured at factor cost at current prices. The latter in particular reflected an upturn in both public and private consumption expenditure.

External trade and the balance of payments

Gross exports rose during 1970 by only 1.5 per cent in sharp contrast to an increase of 22.6 per cent in 1969. This was due primarily to a substantial decline in the price of rubber and in export receipts from that product, and, as a percentage of total exports, gross exports of rubber declined from 40.2 per cent in 1969 to 33.6 per cent in 1970. The major cause of the fall in the price of natural rubber was the disposal of stockpile rubber by the United States and the impending threat of further disposals. Other depressive factors were the automobile strike in the United States, the high level of stocks, and a slackening of demand from mainland China as well as the general slowdown of economic activity in some European countries and the recession in the United States.

Gross exports of tin increased by 8 per cent during 1970, the increase due mainly to an increase of 7 per cent in f.o.b. export unit value. Tin remained the second largest foreign exchange earner and accounted for 19.7 per cent of gross exports. Timber continued in third place, accounting for 12.3 per cent of gross exports, and total gross export receipts rose by 8 per cent. Due largely to a substantial increase in export unit value, export receipts

[2] Federal Industrial Development Authority, *Malaysia: A New Industrial Strategy*, Kuala Lumpur, July 1969.

from palm oil rose by 69 per cent in 1970; while export receipts from iron ore declined by 8 per cent as a result mainly of a decline in export volume of 9 per cent.

Gross exports of manufactured and processed products in 1970 increased by 12.2 per cent and accounted for 12.3 per cent of total gross exports. The growth of total net exports was even higher at 19 per cent, the highest growth rates being in exports of wood products, non-metallic mineral products, metal products, machinery and transport equipment, and textiles, clothing and footwear.

While the over-all increase of gross exports in 1970 was only marginal, gross imports rose very sharply by 17.8 per cent, and all categories of imports recorded increases. This reflected mainly an upsurge in consumption and investment activity, but was also partly the result of higher import prices. In terms of the rate of growth in 1970 over 1969, the rise was greatest in machinery and transport equipment (42.7 per cent) followed by manufactured goods classified chiefly by materials. These two categories also accounted for the highest percentages of gross imports, with 28.2 per cent and 17.9 per cent respectively. In terms of percentage of total gross imports, food was third in importance with 17.8 per cent, but the increase in gross imports of food was only 4.0 per cent.

As already indicated, the greater increase in gross imports than in gross exports led to a decline in the merchandise surplus, and this combined with an increased deficit on services balance resulted in a favourable balance on goods and services account in 1970 only 46 per cent as great as that in 1969. The rise in service payments was itself in part a reflection of the higher level of imports during 1970 but also of higher freight rate charges. Net transfer payments remained almost unchanged at M$180 million in 1970, and the balance on goods, services, and transfers stood at a surplus M$217 million, down by about 68 per cent from 1969.

There was an increase in net private long-term capital inflow during the year as well as in net borrowing abroad by statutory authorities, but these were more than offset by a decline in net foreign borrowing by the Federal Government. Compared with 1969, net long-term capital inflow was down by about 27 per cent.

After adjustments for errors and omissions, the over-all surplus in 1970 was M$60 million, down from M$530 million the year before. When the allocation of special drawing rights is added to this figure, the net change in external reserves proved to be M$124 million, only about 23 per cent as great as the increase in 1969. The reserves held by the central bank rose, as did those held by commercial banks, while there was a decline in the holdings of the Federal and State Governments and agencies.

Population and social development

As of mid-1969, the population of Malaysia was 10.66 million, 3 per cent higher than in 1968 and 13.2 per cent higher than in 1965. The Government's family planning programme has been growing year by year, but it is particularly difficult to bring population growth under control in rural areas, and, according to a recently released study, that is where 67.7 per cent of Malaysia's population still lives. It seems, therefore, most unlikely that there will be a dramatic decline in the population growth rate in the near future.

Public finance[3]

When the 1970 budget was announced, a deficit on current account was anticipated, despite the introduction of a number of new revenue measures. Because of a greater than expected increase in current revenue, however, there was a current surplus rather than a deficit, though the amount of the surplus (M$55 million) was about 66 per cent less than that of the year before.

Again, at the time the budget was announced, the Government had planned to stimulate the economy by increasing the level of total development spending and net lending to M$784 million. This goal was not achieved, however, the provisional figure for 1970 being M$634 million, or about 19 per cent less than expected.

The over-all Federal deficit was M$579 million, which was greater than that of the year before but not as large as planned. It was financed by M$324 million of net domestic borrowing, M$23 million of net foreign borrowing, M$18 million from special receipts, and use of assets amounting to M$214 million.

A considerable part of the anticipated increase in current revenue had been expected to come from higher export duty receipts on rubber, but this did not materialize, the export surtax on rubber yielding only M$7 million instead of the budgeted M$55 million. The actual increase was due instead largely to higher income tax yields and to increases in the yields from taxes on road transport, betting and sweepstakes, the surtax on imports, and excise duties. The rise in current expenditure was mainly due to

[3] Budget data for 1970 are still provisional.

larger outlays for social services, defence and internal security, and debt charges.

The shortfall in development disbursement was due to a number of factors, including limited construction capacity in the Public Works Department, lack of skilled labour, various administrative bottlenecks, delays in project clearance and the acquisition of sites, and the spreading out of payment for purchases of military equipment and materials.

Compared with 1969, disbursements for economic development and for defence and security accounted for greater percentages of the total, while those for social services and general administration accounted for less. Within the major sectors, however, the pattern was not significantly different.

Monetary developments

Monetary and price stability were maintained during 1970, despite strong growth of commercial bank credit, so no major change in monetary policy was required during the year. Commercial banks, however, were encouraged to increase their term lending and, at the same time, were allowed to accept medium-term fixed deposits up to three years to help them provide the necessary longer-term funds. The Central Bank also encouraged commercial banks to reorientate their lending operations toward giving more emphasis to loans based on the viability of projects rather than on availability of collateral and to provide loans for small enterprises.

While the liquidity ratio of the commercial banks substantially declined in 1970, this was not regarded as a cause for concern since the external sector was not performing sufficiently well to supply the economy with the necessary resources for expansion.

Economic planning

1970 was a year of preparation for the second Malaysia plan which will define the Government's aims for the years 1971-1975 and the policies which will be established to realize these goals. At present, only the guidelines for the second plan are available. These were given by the then Deputy Prime Minister at a meeting of personnel responsible for plan preparation and implementation.[4]

It is clear that the primary goal of the new plan will be to reduce income disparities and that an additional important objective will be to lessen regional economic imbalance. With respect to the former, it seems apparent that the Government feels that the political stability on which the realization of all other economic goals depends requires that rapid progress be made toward reducing this income gap. Details are not yet forthcoming, but it is clear that all other policies may be evaluated in terms of their contribution toward the realization of this goal.

A review of the first Malaysian plan

1970 was also the last year of the first Malaysia plan which covered the period 1966-1970. In the following, an attempt is made to review the five major objectives of that plan, assess the degree to which these goals were achieved, and discuss the reasons why it was not possible to realize all these goals fully.

Growth of per capita income

When the first Malaysia plan was published in November 1965, gross national income *per capita* was estimated to be approximately M$928.[5] By 1970, the Government hoped to see this figure rise by some 9 per cent to M$1,018 in terms of base-year prices. As *per capita* GNP at current prices had risen to an estimated M$1,080 in 1970, and as GNP at constant prices rose only slightly less than at current prices, it would seem that this important goal was achieved.

Given an estimated rate of population growth of approximately 3 per cent and an estimated incremental capital/output ratio of 3.9, it was estimated that gross investment of M$9,730 million would be required during the period if the *per capita* income goal was to be reached. Of this amount, 27 per cent was to be public and 63 per cent was to be private capital formation. In other words, investment as a percentage of GNP would have to be in the neighbourhood of 19-20 per cent over the plan period. As for financing, it was anticipated that 95-96 per cent would be financed out of domestic savings, while the remaining 4-5 per cent, equal to about one per cent of GNP, would come from external sources.

Much of the public investment was intended to support and stimulate private investment by expanding the infrastructure. Thus, a total of 32.6 per cent of projected development spending was to be allocated to industrial development (e.g. industrial parks), transport, communications and utilities. Public development spending in the agricultural sector was

[4] Deputy Prime Minister, *Guidelines: Second Malaysia Plan*, Federal Department of Information, Malaysia, Kuala Lumpur, February 1970.

[5] Data on initial targets are taken from Government of Malaysia to attract *First Malaysia Plan, 1966-1970, op. cit.* Information on revision of targets and of some data are from Government of Malaysia, *Mid-Term Review of the First Malaysia Plan, 1966-1970*, Kuala Lumpur, January 1969. Data on fulfilment are from the *1970 Budget, op. cit.*, and the Bank Negara Malaysia, *Quarterly Economic Review*, June 1970, *op. cit.*

to take 23.9 per cent of the total, the bulk going into rubber replanting, planting of oil palm, land development, and drainage and irrigation.

To attract private investment, the Government relied on a combination of tax incentives and tariffs, the tax incentives taking the form of tax relief and initial income tax allowances. From the beginning, it was desired to attract as much capital as possible into areas of import substitution (to reduce import requirements), and, when the plan was reviewed and revised in mid-term, greater encouragement was given to export activities by establishing incentives in this area. Much of the public investment had the same goal of promoting diversification.

As matters developed, gross capital formation did not reach the desired levels either in dollar terms or as a share of GNP. There were many reasons for this shortfall, but, as it developed, inadequate savings was not one of them. Over the first five years of the plan period (1965-1970), gross national savings averaged 18.0 per cent of GNP, and the Government had little difficulty in borrowing either at home or abroad.

In the public sector, the problem was a shortage of qualified personnel, so that projects could not be undertaken at the pace or on the scale desired. The planned amounts of money could have been spent, of course, but the Government was not willing to sacrifice efficiency and held to relatively high standards of performance in the public sector. Under these conditions, there were limits to how fast money could be spent, and the amount consistently fell below targeted levels.

The problem in the private sector is harder to pinpoint, but it was clear by the time of the mid-term review of the first Malaysia plan (January 1969) that private investment was lagging behind. It was in part to rectify this that, in July 1969, the Government announced the launching of the new industrial development strategy.

As already noted, however, *per capita* income promised to exceed the planned amount by 1970, despite the investment shortfall. In part, this was no doubt the result of better performance by rubber and tin exports than had been anticipated at the beginning of the period. In part, however, it seems likely that the Government had over-estimated the value of the incremental capital/output ratio when it established its initial investment targets, so that less investment than planned was needed to raise income by the desired amount.

In summary, Malaysia has succeeded in raising *per capita* income by more than had seemed possible at the beginning of the plan period, an accomplishment of no mean importance considering the obstacles that had to be overcome.

The export sector

For the year 1965, which was the base year for the first plan, exports of rubber and tin accounted for roughly 62 per cent of gross exports and for almost 27 per cent of GNP. Both because prospects for these commodities were not considered very bright and because the Government wished to reduce its dependence for export earnings on only two commodities, the diversification of exports was a major goal of the first Malaysia plan. To realize this goal, the Government planned to promote the growth of exports of timber and palm oil, while, at the same time, expanding both industrial production for export and the tourist industry.

To what extent progress in this area has been satisfactory is extremely difficult to say. In terms of relative importance, gross exports of rubber and tin had fallen from 58.9 per cent in 1966 to 53.3 per cent in 1970, but their continued key role was indicated by the fact that the boom in 1969 was largely due to their better-than-average performance. However, the increased value of timber and palm oil exports clearly represents progress in the sense that the number of major export commodities is now greater than before and hence the dependence on any one or two of them is less. As for manufacturing and tourism, some progress has been made, though there has not yet been time for the results of new incentive measures to make themselves fully felt. If these work as expected, manufacturing and tourism will assume the increased importance expected of them.

Import substitution

Looking forward from 1965, the Government expected a substantial increase in imports due to rising population and growing industrialization. On the other hand, the Government expected relatively little rise in exports over the period of the plan. The potential adverse impact of these trends on Malaysia's balance of payments was, of course, of major concern.

To minimize the increase in imports, the Government was determined to promote the development of industries producing for domestic use; in large part substitutes for goods and services that had tradition-

ally been imported. Both tax incentives and tariff protection were used from the beginning of the plan to promote such activity, and additional encouragement was provided in the Investment Incentives Act of 1968. Also, a major effort was made to increase the production of foodstuffs for domestic consumption, especially of rice. The major thrust here took the form of irrigation projects to increase the area under double-cropping, though efforts were also made to improve the efficiency of individual producers.

Some measure of the success of these efforts is that gross imports had risen from the 1965 level by only 7 per cent in 1969, while, as a percentage of GNP, gross imports had actually fallen from 39 per cent to 34 per cent. Imports of food and live animals, beverages and tobacco, and miscellaneous manufactured products had actually declined, and imports of manufactured goods had risen by only about 4 per cent. Imports of machinery and transport equipment, on the other hand, had risen by more than 15 per cent. While no firm conclusions can be reached on the basis of such aggregated data, the general pattern is certainly the one that the Government had sought to establish, and the decline of gross imports as a percentage of GNP is a clearly favourable sign.

It would seem, thus, that Malaysia has made good progress toward its goals of rising *per capita* income and import substitution, and some progress, though less than desired, toward diversifying its exports.

Unemployment

In the first Malaysia plan, the Government estimated that, in 1965, approximately 6 per cent of the labour force was unemployed, with the unemployment concentrated among the young and the urban population. For example, over-all unemployment in the 15 to 19 age group was estimated at 16 per cent, and urban unemployment was estimated at 27 per cent for this group, compared with a 14 per cent rate for the same group in rural areas.

Creating jobs for even this number would have been a major task but would only have been a beginning. The labour force was expected to grow over the period of the first Malaysia plan (1966-1970) by some 380,000, so that new jobs would have to be provided in large numbers just to keep the situation from getting worse.

While the long-range goal of the Government was full employment, it would have been unrealistic to expect to achieve this goal in the relatively short period of five years. For the period covered by the first Malaysia plan, therefore, the Government set as its target the creation of enough jobs to absorb all of the new entrants into the labour force. This would leave the number of unemployed at 160,000, but would represent a decline in the unemployment rate from 6 per cent to 5.2 per cent.

The greater part of the new jobs were to be created in the agricultural sector where land settlement programmes were expected to absorb 70 per cent of the farm youth coming of working age. For the rest, manufacturing was expected to provide jobs for 10 per cent, with other sectors taking up the remainder in unspecified proportions.

By the time of the mid-term review of the first Malaysia plan, it was apparent that this goal was not going to be reached, and a later study revealed that, by 1968, unemployment had risen to 6.8 per cent. Land development had not proceeded as rapidly as planned, investment had fallen below trageted levels, and increased output had resulted to a greater degree from increases in productivity than had been anticipated.

The situation seemed to have become serious by May 1969, and it was then that the new industrial strategy was announced, a major objective of which was to accelerate the process of job creation. At about the same time, and to relieve some of the immediate pressure, the Government set in motion a substantial expansion of its youth programme.

Despite determined efforts on the part of the Government to accelerate the process of development, however, unemployment in 1970 had climbed to 8 per cent. Over the long run, policies already in effect should produce the level of employment desired. The difficulty to date has primarily been a scarcity of personnel with the training and experience to implement these policies on the necessary scale, and the Government has geared its programmes in the field of education to turn out the needed specialists and technicians as quickly as possible. There is a limit to how fast this can be done, however, and, in the intervening period, the problems flowing from unemployment could affect the stability which is essential if the long-range programmes are to work.

Income disparities

In addition to the problem of continuing unemployment, the Government has had to contend with the existence of income disparity between rural and urban dwellers. The reduction of this disparity was a major goal of the first Malaysia plan, in which raising productivity in the rural sectors was given high priority. To accomplish this, a wide variety of programmes was introduced, the two largest ones being designed to open new land to settlement and to irrigate rice land to permit double cropping.

With respect to land settlement, the purpose was not just to multiply the number of units under cultivation, but to establish farms of economically viable size and to see to it that they were efficiently cultivated. This programme therefore not only required heavy outlays of public funds but a large number of supervisory and extension personnel. In point of fact, the latter proved to be more of a limitation than the former and has been the major reason that less land has been settled than was envisaged in the original plan.

In the long run, programmes already being implemented should greatly reduce the rural-urban income differential, but, in the meantime, the disparity contributes to tensions already present. To try to minimize this discontent, the Government is attempting to show the rural population that there has been progress toward equalizing rural-urban incomes and that there will be even greater progress in the future. Hopefully, this educational effort will provide the time needed for the longer-range measures to have effect.

Conclusions

To sum up, with respect to the goals of rising *per capita* incomes, diversification of exports, and increasing import substitution, progress has ranged from fair to excellent. It has not proved possible, on the other hand, to reduce either unemployment or rural-urban income disparities to any significant degree. Given time, policies already in force should lead to the solution of these problems, but their continued existence is a matter of concern at present.

The document *Guidelines: Second Malaysia Plan* makes it clear that, of these two problems, that of income disparity is to receive first priority during the next few years. In this document, the problem of unemployment is by no means ignored, but the major theme is the need to create national unity by achieving what the Government regards as better economic balance between sectors. How this is to be achieved has not yet been given in detail, but it seems most likely that the attack will be a two-pronged one. First, the Government will move forcefully to increase employment opportunities for those migrating from the rural sector, and, secondly, public development expenditures for rurally oriented projects, such as land development schemes, may be enlarged in relation to public spending for other purposes.

Nepal

Introduction

Over the third plan period (1965/66-1969/70), GDP at constant prices grew at an annual rate of 2.2 per cent from Rs 5,886 million to Rs 6,561 million. The increase in *per capita* income, however, was only marginal because population grew over the period at an average annual rate of approximately 2 per cent.

Performance during 1968/69

Data on GNP and GDP for 1968/69 are not available, but, assuming GDP at constant prices grew by 2.2 per cent per annum (the average rate of growth over the third plan period), its value for 1968/69 was Rs 6,420 million. A similar projection at current prices on the basis of 1964/65-1967/68 data gives 1968/69 GDP as Rs 8,278 million.

By far the largest component of GDP is agriculture (68 per cent of the total in 1967/68). During 1968/69, the output of foodgrains grew by approximately 5 per cent from 3.42 million tons in 1967/68 to 3.589 million tons in 1968/69. Of this increase in output, paddy accounted for about 65 per cent, and, at 5.0 per cent, the rate of increase in production was the same as in the previous year. The output of cash crops, on the other hand, grew by less than one per cent.

In volume terms, industrial output of sugar, stainless steel utensils, and of the domestic distillery rose sharply in 1967/68, and increases in output were recorded for all other principal industries, except synthetic textiles, where there was a marginal decline.

In these terms, receipts of convertible foreign exchange trade in 1968/69 (Rs 263.3 million) exceeded expenditure (Rs 117.0 million) by Rs 146.6 million giving a surplus more than 50 per cent larger than that of the year before.

The money supply (defined as currency plus demand deposits) was Rs 711 million as of mid-July 1969, up 15 per cent over mid-July 1968. Of this amount, Rs 470 million (66 per cent) consisted of currency and Rs 240 million (34 per cent) of demand deposits.

There was an over-all budget deficit in 1968/69 of Rs 124 million, 9 per cent less than the deficit of the preceding year. With respect to the "regular" budget, there was a surplus of Rs 220 million, the over-all deficit resulting from development expenditure of Rs 344 million. Foreign grants and receipts from the sale of internal development bonds more than covered this deficit and gave an increase in the government cash balances for the year of Rs 82 million.

Performance during 1969/70

GDP in constant prices (with base year 1965/66) rose by an estimated 2.2 per cent in 1969/70 to a level of Rs 6,561 million. Since population was growing almost as fast,[1] the rise in *per capita* income was negligible. In fact, GDP grew at an average of 2.2 per cent for the third plan period (1965/66-1969/70), so that the target set for the achievement of a growth rate of 3.8 per cent in GDP and 1.8 per cent in *per capita* income was not realized.

In the agricultural sector, the output of foodgrains was 3.4 per cent higher in 1969/70 than in the previous year, while the output of commercial crops rose by 2 per cent. In the industrial sector, the output of all principal industries, except textiles and stainless steel, increased over the previous year, the rise being especially marked in the case of sugar (almost 200 per cent).

Receipts of convertible foreign exchange (Rs 281.4 million) again exceeded expenditure (Rs 188.9 million), though the surplus of Rs 92.5 million was lower than in 1968/69 when it stood at Rs 146.6. One factor accounting for this was the slower rise in export receipts than in previous years.

In mid-June 1970, the money supply was estimated at Rs 831 million, representing an increase of 17 per cent over mid-July 1969. In the public sector, the over-all deficit for 1969/70 rose to Rs 279 million from Rs 124 million in 1968/69. However, as in the previous year, foreign grants and internal development loans, amounting to Rs 288 million, more than covered this deficit, thus making it possible for government cash balances to increase by approximately Rs 9 million. Government holdings of convertible reserves remained high.

Agriculture

Of the various sources of GDP, agriculture is of predominant importance, accounting, in 1967/68, for 68 per cent of the total. No other sector in that year accounted for as much as 10 per cent, and only three for 5 per cent or above: ownership of dwellings (8 per cent), cottage industries (7 per cent) and wholesale and retail trade (5 per cent).

During 1969/70, total output of foodgrains rose by 3.4 per cent over 1967/68, a rate that was in excess of the average annual rate of increase of the previous five years. As regards commercial crops, jute production experienced another large increase of 20 per cent. Of major importance in the recent improvement in agricultural production were favourable weather conditions and intensified efforts on the part of the Government in providing agricultural inputs and other services. However, inadequate supplies of various essential inputs have limited the growth of agricultural output, and efforts are being made to ease this bottleneck.

In spite of these gains, only moderate progress has been registered in agricultural production in general, partly because of inadequate infrastructure and partly because the increase in the supply of fertilizers and improved seeds has not so far had any significant effect on rice production. If the fourth plan (1970/71-1974/75) target of an annual growth of food production of 3.0 per cent is to be achieved, a number of co-ordinated steps will have to be taken, such as increased availability of credit to farmers for productive purposes, improved transport, storage and marketing, and an appropriate pricing policy for both agricultural inputs and outputs. Much also remains to be done in accelerating the process of land reform, initiated in 1964.

Industry

Production of all principal industries, except textiles and stainless steel, increased substantially during the fiscal year 1969/70.[2] This increase was stimulated by rising demand and utilized excess manufacturing capacity. The level of jute manufactures rose by 14 per cent as a result of incentives provided under the foreign exchange entitlement scheme, but did not reach the level attained in 1965/66. The slower growth of the principal export commodities is likely to be affected by uncertainties caused by the delay in arriving at an amicable agreement on the new trade and transit treaty with India.

During the year, sugar production increased by almost 200 per cent as a result of an excellent cropping year and expanded production capacity. Output of cigarettes, distillery products, matches, leather and shoes, and bricks achieved impressive increases because of increased tariff protection (table II-3-30).

[1] Estimated to be rising at 2 per cent per annum.

[2] In Nepal, the fiscal year covers the period mid-July to mid-July.

Table II-3-30. Nepal: Production of principal industries, 1965/66-1969/70

Type of manufacturing	Unit	1965/66	1966/67	1967/68	1968/69	1969/70[a]
Jute	Tons	17,325	12,191	12,179	13,958	16,000
Sugar	Tons	9,912	4,410	3,279	9,656	16,000
Cigarettes	Million pieces	636	954	1,115	1,677	2,150
Matches	Thousand gross boxes	444	465	424	468	501
Synthetic textile	Thousand yards	1,421	2,305	2,739	3,711	n.a.
Distillery	Imperial gallons	30,564	4,658	11,371	52,747	n.a.
Stainless steel utensils	Tons	232	381	738	2,419	750
Tanned leather	Thousand kilogrammes	59	57	64	100	160
Shoes	Thousand pairs	30	20	29	32	49
Bricks[b]	Million pieces	—	—	2	13	22

Sources: Data supplied by government departments. (Economic data papers, USAID/NEPAL).

[a] Estimates.

[b] Output of the government brick factory only.

Considerable efforts will be made in the fourth plan to continue the expansion of electric power generating capacity. By the end of 1966/67, total electric power generated in Nepal reached 35,000 kW, compared with about 14,000 kW in 1964/65. Under the fourth plan, to meet increasing demand, further projects will be initiated in both east and west Nepal, as part of the target of expanding electric power generating capacity by a further 40,300 kW.

Although the growth of industrial output was substantial, the industrial sector continued to face shortages of managers and skilled labour, as well as an inadequate infrastructure and a limited domestic market. The Government has directed its efforts towards overcoming these problems through general development policies, such as special incentives for selected industries under the revised Industrial Enterprises Act.

The Government's policy of favouring private sector activity has been continued in the current plan and import-substitution industries have been encouraged. However, if private enterprises prove to be slow in establishing themselves, the Government may well consider establishing public enterprises.

Employment, wages and prices

Although compilation of wage data has not yet been instituted in Nepal, it is generally agreed that wages have been rising rapidly in the last few years, with the rise being especially marked in the wages of skilled and semi-skilled workers in the urban areas.

In addition, although there are no comprehensive employment statistics, it is estimated that over 90 per cent of the Nepalese population derives its livelihood from agriculture and related occupations. A large section of the population living in rural areas is either unemployed or underemployed. There is also considerable unemployment or underemployment in urban areas, especially among unskilled workers. In some urban centres in the Kathmandu Valley and Tarai regions, increased construction and other activities are gradually helping to reduce the excess supply of unskilled labour.

There are acute shortages of administrators, managers, technicians and other skilled workers. In recent years, the Government has taken a number of measures to help reduce these shortages, such as the establishment of various training centres supervised by the Department of Cottage Industry, and the setting up of a technical training centre in Kathmandu with assistance from the Federal Republic of Germany.

Prices have risen considerably during the past few years. For example, the annual average of the Kathmandu consumer price index rose by 4.3 per cent in fiscal year 1968/69, reflecting mainly increases in the prices of clothing and foods except foodgrains which declined in this year. As usual, price increases varied from region to region, rising faster in the Tarai than in the hills. For the quarter ending mid-April 1970, the price indices for both Kathmandu and the Tarai went up by 1.8 per cent, while, in the hills, the rise was smaller (0.8 per cent).

External trade and balance of payments

A balance of payments statement for Nepal cannot be compiled because of a lack of basic statistics. Furthermore, data on invisible and capital transactions with India are seriously deficient because a large number of these do not pass through banking channels or through customs. Fuller statistics are

available only for transactions in convertible currencies. Despite all these deficiencies, the fact that Nepal's holdings of convertible and other foreign exchange reserves have risen sharply in recent years indicates that the balance of payments position has continued to improve, though at a lower rate.

During 1969/70, total official reserve increased by 15 per cent to $90 million at mid-July 1970, a lower increase than in the previous year (31 per cent to $78 million). The smaller increase was primarily due to a fall in export receipts of about 21 per cent and to a sharp increase in import payments from Rs 74.8 million in 1968/69 to Rs 130.6 million in 1969/70. If receipts from foreign aid and tourism had not increased substantially, total foreign exchange receipts would have declined considerably.

Nepal's exports, of which about 70 per cent are foodgrains and other food products, expanded substantially until 1968/69, but estimates for 1969/70 and the 1970s show that receipts from exports are expected to decline from Rs 137.3 million in 1968/69 to Rs 80 million in 1970/71. It is obvious that, as long as the close trading relationship with India continues (about 90 per cent of recorded exports go to India), Nepal's export growth will continue to be dominated by developments in India. If, through the success of the "green revolution", India attains a degree of self-sufficiency in foodgrains, this may seriously affect Nepal's exports of rice. Increasing exports to third countries involve problems of transit and transport costs. Therefore, negotiations which were initiated for a new treaty of trade and transit with India, the former agreement having expired in October 1970, are of major concern at present. The question of providing transit facilities according to internationally recognized conventions, on a long-term basis, is extremely important for a landlocked country like Nepal. Future long-term prospects for Nepal's trade will depend greatly on the outcome of negotiations between Nepal and India. Although agreement during 1969/70 was reached on the transit through India of goods traded between Nepal and India, no solution has yet been reached with regard to the conclusion of new treaty.

Imports comprise mainly cotton textiles (48 per cent of the total), foodgrains and other food products (16 per cent), chemicals (6 per cent) and machinery and equipment (5 per cent). Nearly 90 per cent of recorded imports come from India, about 2 per cent from Tibet and 8 per cent from other countries. In recent years, difficulties in importing certain goods from India have been experienced because of supply shortages in India. In addition, the over-burdening of Indian port and transportation facilities has delayed the transit of Nepalese shipments.

Nepal's policy of maintaining a strong exchange reserve position has continued. As trade with India expands, it is hoped to increase the proportion of Indian rupee holdings in total reserves. Considering the current high level of convertible reserves, it may be advisable to draw down these reserves and use them to finance imports of capital goods, while at the same time ensuring a surplus on transactions in convertible currencies during the next few years.

Monetary developments

Though monetary policy is becoming increasingly important, the predominance of the non-monetized sector in Nepal places a limit on its effectiveness. In recent years, there has been a rapid expansion in the money supply, as is shown by table II-3-31. As can be seen from the table, the growth of the money supply has accelerated continuously since 1967. The expansion in 1969/70 was associated mainly with increases in foreign assets (Rs 105.6 million) and with bank claims on the private sector (Rs 89.6

Table II-3-31. Nepal: Money supply

(in million Nepalese rupees)

Item	*Mid-July*							*Mid-June*	*Change over previous year (percentage)*						
	1963	*1964*	*1965*	*1966*	*1967*	*1968*	*1969*	*1970*	*1964*	*1965*	*1966*	*1967*	*1968*	*1969*	*1970*
Currency[a]	162	235	296	346	369	419	470	562	45	26	17	7	14	12	20
Demand deposits	103	130	150	161	185	199	240	269	27	15	7	15	8	21	12
Nepalese rupee deposits	75	126	144	160	185	198	240	269							
Indian rupee deposits[b]	28	5	6	1	—	—	—	—							
Total money supply	265	366	446	507	554	618	710	831	38	22	14	9	12	15	17

Source: *Quarterly Economic Bulletin*, Nepal Rastra Bank; data supplied by government departments.

[a] Excludes Indian currency in circulation.

[b] Since 17 September 1963, Indian rupee demand deposits with banks comprise only the deposits of foreign official entities; as of that date, all other Indian deposits were compulsorily converted into Nepalese rupee deposits.

million). Bank claims on the Government are expected to decrease sharply due to a surplus in the government budget. The large increase in time and savings deposits (Rs 43.8 million) was also an important offsetting factor. Indeed, the increase in time deposits has exceeded the growth in demand for credit which has suffered from the general uncertainty in business circles surrounding the Nepal-India trade treaty. As a result, the commercial banks are becoming increasingly liquid.

The dominant factor in monetary trends during the last three years has been the large cash surpluses of the government sector which have led to a continuing decline in bank credit to the Government. However, indications are that the accelerated growth of the money supply will be reversed in 1970/71. At the beginning of the fiscal year, the Nepal Rastra Bank projected a money supply increase during 1970/71 of only 10 per cent.

The encouragement of commercial banking and other financial institutions, such as the Agricultural Development Bank, and their sound development and wide geographical coverage of commercial banking, particularly in agriculture, are prerequisites for accelerated and sustained economic growth. However, in view of the shortage of managerial talent and other difficulties, it is essential that there should be no duplication of financial institutions in the country, particularly with respect to rural areas, in the wake of the present efforts to build up commercial banking and financial institutions. Therefore, it becomes imperative that past innovations are consolidated, and efforts are concentrated on assisting in the improvement of managerial skill in the newer financial institutions.

Government finance

The fiscal position has been characterized by a steady increase in the regular budget surplus which, however, has been insufficient to finance growing development expenditure. The resulting over-all budget deficits have been financed mainly by foreign grants and, to a smaller extent, by foreign loans.

The budgetary position improved markedly in 1970/71, revenue increasing by 11 per cent, compared with the 6 per cent increase in 1969/70. Because of the sizable expansion in development spending, the over-all deficit rose to Rs 145 million during 1970/71, the over-all budget deficit was estimated at Rs 408 million, but the realized figure is likely to be significantly smaller (table II-3-32). Since foreign grants are unlikely to cover the much wider over-all deficit on the government budget in 1970/71, more attention will have to be paid to raising tax revenues, especially from direct taxes. Although rapid expansion in government revenue has taken place in Nepal in recent years, revenue per head of population and in relation to GDP is still amongst the lowest in the world.

Current major policy issues and outlook

Current major policy issues must be viewed within the framework of the fourth plan which was launched in July 1970. Among its most important objectives are the attainment of an annual average growth rate of GDP of 4 per cent, which it is hoped to achieve by raising the rates of saving and investment in both the public and the private sectors. Greater emphasis is being placed on agriculture and infrastructure development. Other objectives include

Table II-3-32. Nepal: Government budget, 1965/66-1970/71

(in million Nepalese rupees)

Item	1965/66 Actual	1966/67 Actual[a]	1967/68 Actual	1968/69 Estimate	1968/69 Actual	1969/70 Revised estimate	1970/71 Estimate
Regular budget receipts	219	257	326	365	413	441	565
Revenue	(216)	(257)	(326)	(365)	(413)	(436)	(495)
Foreign loans	(3)	(—)	(—)	(—)	(—)	(5)	(70)
Expenditures	147	172	181	209	193	225	340
Surplus [or deficit (—)]	72	85	145	156	220	216	225
Development budget expenditure	281	282	281	458	344	495	633
Over-all budget deficit	1,209	—197	—136	—302	—124	—279	—408
Means of financing foreign grants	175	161	—158	276	186	268	333
Internal development bonds	8	1	10	20	20	20	30
Changes in cash balances (increase —)	26	35	—32	6	—82	—9	45

Sources: *Budget Speeches* and data supplied by government departments.

[a] Provisional.

expansion of international trade, control of population growth and prices. One feature of the plan is that the proposed acceleration of private investment may require complementary incentive measures as well as adequate access to capital and foreign exchange for the investor. It also requires improvement in administration and management, and the mobilization of greater financial resources. Neither of these will be easily obtained. Secondly, the composition of investment will reflect the necessity for earning quick returns, with direct implications for particular sectors, such as transport, health, education and power. Thirdly, priority has been given to fuller utilization of existing capacity, and this applies to virtually all sectors and training institutions. While recognizing the limitations arising out of the general inadequacy of statistical, administrative and other deficiencies, the fourth plan makes some concrete and realistic proposals for streamlining such activities. It thus represents a definite step forward in the over-all planning of the country.

In the light of the fourth plan, it is possible to identify the major policy issues and the outlook for the coming year. From the economic standpoint, it is essential that the productivity of the country's factors of production should be improved. Increases in the magnitude of factors of production may result in a higher growth rate, but this higher rate can be improved and sustained only through the simultaneous growth of productivity.

Another reason for slow economic progress during the last few years has been some insufficiency in the policy instruments of the Government. It is advisable for policies relating to foreign exchange and trade, monetary and fiscal aspects, utilization of natural resources, and investment strategy to be more purposefully planned and implemented in the framework of the over-all planning. In this respect, the current five-year plan has been based on greater realism and contains pragmatic solutions to difficult problems.

Apart from the major constraints to more rapid economic development, three major policies merit some consideration. In the first instance, partially to offset the geographical concentration of resources, a comprehensive strategy for the development of the Hills must be formulated. While sizable amounts of resources need not be diverted during the fourth plan, the foundation for future development should be laid on the basis of existing plans for that region.

Secondly, greater emphasis should be directed to the identification and measurement of the country's natural resources. Specifically, this means giving priority to soil analysis, groundwater surveys, and geological and mineral research.

Thirdly, there should be a new strategy for the development of human resources, particularly in the field of education. Education and training raise the productivity of labour, which is a basic condition for national development. Consequently, the educational system will have to undergo significant change, not only to facilitate and reinforce economic growth but also to avoid serious social instability. The expansion and re-orientation of an educational system takes years to accomplish, so that programmes for change need to be initiated without delay if Nepal (with its 13 per cent literacy rate) is to be able to meet its demands for scientific and technical personnel in the coming years.

Finally, the problem of overcoming the inherent difficulties of a landlocked country are of great importance to Nepal's development both in the near future and in the longer run. In this context, the present uncertainty surrounding the conclusion of a new treaty of trade and transit with India must be ended in order to assist Nepal's foreign trade and industrial investment. As a landlocked country, adequate warehousing facilities, simplified transit facilities at the ports and availability of road transportation (other than railways) for transit goods are of great importance to help Nepal's efforts to accelerate its overseas trade. An early conclusion of an amicable treaty will be of far-reaching value to Nepal's long-term development.

New Zealand [1]

Introduction

New Zealand enjoyed another year of rapid growth, with real national product in 1970 rising by approximately 5.5 per cent. Unemployment was extremely low, at between 0.1 and 0.2 per cent of the labour force. As a corollary, there was a serious shortage of labour, and large increases in money incomes occurred. In addition, there were substantial increases in the prices of consumers' goods and services, the index rising by 6 per cent by comparison with the previous year. The balance of payments on current account moved from substantial surplus at the beginning of the year to a small deficit. However, the country's official reserves of overseas exchange were built up to satisfactory levels and much short-term debt was repaid as a result of the surpluses achieved since devaluation in 1967.

The Government introduced a wide range of measures designed to bring inflationary pressures under better control and these should have some effect in the early months of 1971. However, the balance of payments is likely to deteriorate in 1971

[1] This is the first time that a survey of New Zealand has been included *in the Economic Survey of Asia and the Far East.*

partly due to a further significant increase in spending on imports and partly due to a much slower growth of export receipts. The meat market, which has been such an important element in increasing the country's earnings since 1967, is less buoyant than it was, and wool prices remain depressingly low. On the other hand, the short-term outlook for dairy products is satisfactory, and exports of other primary products, forest products, and especially a wide range of other manufactures, continue to grow.

Over-all growth and the use of resources

The following table indicates the general developments which have been taking place in the main elements of national income and expenditure.

On the expenditure side, there has been a pronounced expansion of investment expenditures. Private investment has risen by about 30 per cent in the past two years, after falling in the recession of 1967/68, and the central Government, which had maintained a policy of severe restraint in its own capital expenditure in the previous three years, increased its capital spending in 1970. As a result, total fixed investment rose to 22 per cent of gross national product, compared with 21 per cent in the previous three years, and gross capital formation (including increases in stocks) rose to 25 per cent of GNP.

The latter ratio is lower than the target of 27 per cent of GNP set by the National Development Conference (NDC) for the period 1967/68 to 1978/79. However, due to some net emigration during the recession, population has been growing more slowly than was anticipated when the targets were set. It is probable that the targets for gross capital formation will be revised downwards towards 25 per cent of GNP to take account of the effect of this lower population growth on the demand for housing and social capital and of lower projected requirements for investment in farming and in fuel and power.

Table II-3-33. New Zealand: Gross national product and expenditure

(in million New Zealand dollars)

Item	*1966/67*	*1967/68*	*1968/69*	*1969/70*	*Estimate 1970/71*
Income and product					
Salary and wage payments	2,080	2,170	2,289	2,545	2,870
Rental value, owner-occupied houses	119	129	136	150 }	930
Other personal income	663	658	695	715 }	
Company income	464	456	511	577	640
Public authority trading income	147	168	188	207	220
Public debt interest paid in New Zealand	—116	—124	—136	—148	—160
National income	3,356	3,457	3,683	4,034	4,500
Indirect taxation	301	316	343	376 }	400
Subsidies	—39	—21	—19	—24 }	
Depreciation	301	321	346	371	400
Gross national product	3,919	4,074	4,354	4,757	5,300
Expenditure					
Personal expenditure on consumer goods and services	2,394	2,541	2,667	2,871	3,225
Public authority current expenditure on goods and services	565	598	649	722	835
Gross domestic capital formation					
(*a*) Private	584	494	546	617	710
(*b*) Public	371	376	373	388	455
Change in stocks	144	132	64	120	150
Gross domestic expenditure	4,058	4,141	4,299	4,718	5,375
Exports of goods and services	881	854	1,121	1,273	1,350
Imports of goods and services	—955	—866	—986	—1,135	—1,315
Expenditure on gross domestic product	3,984	4,125	4,434	4,856	5,410
Net factor payments to rest of world	—66	—55	—81	—100	—110
Expenditure on gross national product	3,919	4,074	4,354	4,757	5,300

Sources: 1966/67–1969/70: Department of Statistics;
1970/71: Estimates of the New Zealand Institute of Economic Research and others.

If this revision is made, the targets for saving will also probably be revised downwards from 26 per cent towards 24 per cent of GNP, the extent depending on whether it is deemed wise to aim for a larger net inflow of capital from overseas than the original target of 1 per cent of GNP. Domestic saving in 1970/71 will probably be about 23.5 per cent of GNP.

Another feature of activity in 1970 was the large increase in current expenditure in the public sector. This reflects the pressure for improvement and expansion of government services, such as education, and for increases in the pay of public servants. As 1970 went on, rising personnel expenditures on consumption reflected the relatively rapid increase which had been occurring in wages, salaries, and most categories of personal income outside farming.

Despite a further improvement in the rate of growth of output, the large increase in gross domestic expenditure which occurred was accompanied by rapidly rising prices and a deterioration in the balance of payments.

GNP for 1970/71 will probably rise by about 5.5 per cent in real terms, compared with 5.2 per cent in 1969/70 and 1.1 per cent in 1968/69. The corresponding percentages per head of population are 4.2, 4.1 and 0.1 respectively. The average annual target increase of real GNP set by NDC was 4.5 per cent, and of real GNP per head 2.7 per cent. To achieve the target for the period 1967/68 to 1972/73 would require the high rate of increase achieved this year to continue for two further years in order to compensate for the slow growth of the initial year of the plan. With the labour force likely to grow at only 2 per cent per annum this would call for a continued large increases in "productivity" per head of the labour force (by about 3 to 3.5 per cent per annum, compared with the actual average of just less than 2 per cent per annum achieved in the past decade or so). It is likely that the average target rate of growth will be scaled down to about 4.2 per cent per annum for the first five years of the plan, implying a rate of growth of 4.5 per cent for the next two years. This would still enable the original target of an average 2.7 per cent per annum increase in real GNP per head to be attained.

The Consumers Price Index for the quarter ended September 1970 was 6.1 per cent higher than in the same period of 1969, while the wholesale price index rose by 5.6 per cent in the same period. It would seem that the average increase of consumers' prices for the year ending March 1971 will exceed 7 per cent, compared with 4.8 and 4.4 per cent in the two preceding years, and an annual average rise of 3.7 per cent for the five years 1962/63—1967/68.

A complicating factor for New Zealand in achieving its growth target is the continued deterioration which has been occurring the country's terms of trade. Taking 1957 as the base (100), the terms of trade have declined almost continuously from a peak of 110 in 1963 to 84 in September 1970. Declining wool prices, relatively unfavourable prices for butter and, more recently, rapidly rising import prices, have been the main factors in the adverse trend. Output of and earnings from pastoral exports are growing more slowly than had been hoped, but the shortfall on this front is likely to be offset by greater exports of manufactures, horticultural products and minerals than expected.

Sectoral production

The growth of output in the different sectors of the New Zealand economy in the last five years (ending June) is shown in table II-3-34. The setback occasioned by the recession of 1967/68 is clearly evident, especially in the building sector, but also, to a lesser extent, in the manufacturing and services sectors of the economy. The expansion of the economy was resumed in 1969 and, except in the farming sector, it gathered momentum throughout 1970.

Table II-3-34. New Zealand: Index of production (Base: 1965/66=1000)[a]

Year	*Farming*	*Manufacture*	*Building*	*Services*	*Total*
1965/66 . .	1,000	1,000	1,000	1,000	1,000
1966/67 . .	1,033 (3.3)	1,059 (5.9)	1,042 (4.2)	1,032 (3.2)	1,042 (4.2)
1967/68 . .	1,066 (3.2)	1,047 (−1.1)	999 (−4.1)	1,013 (−1.8)	1,033 (−0.9)
1968/69 . .	1,089 (2.2)	1,062 (1.4)	966 (−3.3)	1,033 (2.0)	1,050 (1.6)
1969/70 . .	1,080 (−0.8)	1,138 (7.2)	1,001 (3.6)	1,115 (7.8)	1,107 (5.5)
Average 4 years	1.9	3.3	0.0	2.8	2.6

Source: Department of Statistics, Government of New Zealand, *Supplement to October-November 1970, Monthly Abstract of Statistics.*

[a] Annual percentage changes are shown in brackets.

Agriculture

(*i*) *General.* Farming output actually declined slightly during 1970, whereas the NDC targets envisaged an average growth of about 3.5 to 4 per cent per annum. The growth of stock numbers in the past two years has also been appreciably slower than the target of 2.6 per cent per annum. Despite impressive improvements in productivity, the net incomes of farmers have been rising appreciably more slowly than those of most of the rest of the population; indeed, the average net income of sheep farmers was probably lower in 1969/70 than in 1960/61. The low incomes reflect the low prices received for wool and, to a lesser extent, dairy products, while costs have been rising persistently, the rise accelerating in the past year as inflation has gathered momentum.

This has affected the capacity of farmers to invest, and the combination of internal inflation, pessimism about prices for wool, and uncertainty about the longer-run outlook for dairy produce in the light of the United Kingdom's application to join EEC has led to some loss of confidence among farmers. Offsetting factors have been the buoyancy of meat prices since devaluation and the generally optimistic prognostications about future markets for beef, lamb, and mutton in a variety of countries outside the United Kingdom, especially in Japan and North America. There has been a marked increase in numbers of beef cattle and beef production, but unfortunately the numbers of sheep have not been growing sufficiently to enable full advantage to be taken of the expanding opportunities for exports of lamb.

The year 1970 saw a continuation of the trend towards larger individual farm units in terms both of size and of stock carried per acre. The New Zealand family farm is already relatively large by international standards, e.g. the average area of dairy farms in 1967 was 165 acres, and sheep farms are, of course, much larger. In dairying, the average stocking rate, in terms of cows per 100 acres, rose from 53 to 64 between 1964 and 1967, and the number of cows per labour unit went up by 20 per cent. Thus, New Zealand farmers have been attempting to offset the adverse economic conditions with which they have been confronted by strenuous efforts to improve efficiency.

In order to assist farmers in coping with the special difficulties confronting them, the Government made provision in the 1970 Budget for the establishment of a special agricultural assistance fund and for other assistance to the farm sector as well.

(*ii*) *Food production.* The trends in food production reflected the farming developments outlined above. Total production of meat in the year ended June 1970 increased, a rise in the output of beef and veal more than offsetting a decline in the production of sheep meats, and total output of milk declined by about 6 per cent. The area planted in wheat declined from 321,000 to 260,000 acres and the yield fell from nearly 16,800 thousand bushels to only 10,200 thousand bushels due to adverse weather conditions, which also lowered the yields of other crops. The year saw further expansion in the output of quick-frozen vegetables and canned fruit which are finding expanding markets overseas, especially in the United Kingdom, Australia and the Pacific basin.

(*iii*) *Wool.* The 1969/70 wool season was less favourable in almost all respects than the previous one. The production of wool fell by just over 1 per cent from 732 million lb to 723 million lb. The average price of greasy wool sold at auction, 25.62 cents per lb, was also lower (8.7 per cent). As a result, the value of wool sold was nearly 10 per cent less at NZ$185.3 million. Average selling prices at auction in the 1970/71 season so far have been about 13 per cent below those obtained at the early sales in 1969/70.

Industrial production

(*i*) *Manufacturing.* The plans emerging from NDC assigned to manufacturing an increasingly important role in the development of the New Zealand economy from the point of view of output, employment, and exports. The growth rate projected for manufacturing output is 6 per cent per annum; it is probable that the increase for the year ending June 1970 exceeded 7 per cent and that expansion continued at a similar rate in the second half of the calendar year.

The impressive expansion of exports of manufactured products, which has been a notable feature of the country's development since the devaluation of the New Zealand dollar in 1967, has not slackened. Government policy in 1970 was designed to place emphasis upon encouraging a continuation of this trend. Tax incentives based on increases in exports and concessions for expenditure on market development were continued. Moreover, while endeavours are being made to apply severe restraints to the growth of other types of advances for purposes of control of bank credit, exporters are clasisfied in the "top tier" which is relatively unrestricted.

The Government maintained its policy of extending the list of goods exempted from import licensing, with particular reference to raw materials and equipment imports, and some 65 per cent of imports are now so exempt. It also stated its intention of continuing with its policy of replacing import licens-

ing by tariffs in respect of goods produced by New Zealand manufacturers who have up to now enjoyed the protection of import controls. However, progress in this direction has been slow, and the list of products on which tariffs will be removed under the New Zealand/Australia Free Trade Agreement is also being extended slowly.

As the year ended, the main impediments to continued growth of manufacturing output and exports were the serious shortages of labour and the increases in wage costs and import prices which had occurred. Some of the measures taken by the Government to help bring inflation under control have also been criticised by manufacturers, particularly the introduction of a payroll tax at 2 per cent, not deductible from company tax, which will adversely affect the more labour intensive industries. The removal of a rebate on dividends has also been unwelcome to many manufacturers.

(*ii*) *Energy industries.* The completion of construction of a pipe-line from Kapuni, near New Plymouth, to major North Island centres, made it possible for a start to be made on the commercial use of the Kapuni natural gas field during the year. The year was also notable for intensive activity in oil exploration. While hopes that large quantities of oil would be found have not so far been fulfilled, the Shell/BP/Todd Consortium discovered a gas condensate field of international size under the sea near New Plymouth. Negotiations are in train between the Consortium and the Government on possibilities and terms of utilization of the find. It has already been decided that the projected New Plymouth thermal power station, which was to have utilized coal from the west coast of the South Island, will now be powered by natural gas should commercial exploitation of the offshore field prove possible. However, over 80 per cent of the country's electric power is still generated by hydro-electric power stations, and further development of water power is proceeding.

(*iii*) *Construction.* The recession of 1967-1969 naturally had a particularly adverse effect on the building and construction industry. The average numbers employed declined by over 5,000 between the year ended April 1967 and the year ended April 1969, many tradesmen crossing the Tasman Sea to find employment in a more buyoant industry in Australia. There was some recovery of employment in 1969/70 and the value of building work put in place in the year ended June 1970 was about 17 per cent higher than in the same period of the previous year. However, the slower growth of population has meant that the rate of growth of demand for dwellings has been less than had previously been anticipated. For the six months ended September 1970, the number of permits issued for new dwellings was only about 3 per cent higher than in the same period of the previous year and still below the numbers issued in the years preceding the recession.

Services

Turnover in retail trade increased markedly in money terms during 1970. Turnover for the year ending September was about 11 per cent higher than in the year before, and, for the quarter ending September, about 12.6 per cent higher than in the same quarter of 1969. Those enjoying the greatest gains in the latter period were chemists and household electrical appliance stores. However, when adjustments are made to remove the effects of price and population changes, real turnover per head in the year ending September 1970 was only 4.2 per cent greater.

During the year, the Government negotiated with the manufacturers of a limited number of foodstuffs and other household goods, a scheme whereby the producers would give the Government early notification of their desire to raise prices. Formal price control was also maintained over a limited number of other goods, principally cigarettes, tobacco, eggs, sugar, wheat, some farm requisites, steel and motor vehicles. In November, a price freeze was instituted for two months, and it was announced that it would be succeeded by a mandatory price justification scheme for a fairly wide range of items when it expired in the middle of January 1971.

Expansion of the tourist industry proceeds apace, and the Government is continuing to assist private enterprise to improve accommodation and other facilities for tourists.

External trade and the balance of payments

The main concern of the Government with respect to foreign trade during the year was the United Kingdom's application to become a member of EEC. Although less than 40 per cent of the country's total exports now go to the United Kingdom, about 90 per cent of exports of butter and lamb and 80 per cent of exports of cheese are still sold there. There is a clear danger that United Kingdom membership in a community which has been generating large surpluses of dairy products would lead to the gradual elimination of New Zealand's market in the United Kingdom for butter and cheese, unless a special arrangement were made for New Zealand. There is also some concern that the enlarged community might adopt a restrictive policy for lamb, although there seems no economic reason for it to do so in view of the low production and consumption of lamb in the area of the present six EEC members.

Against this background, the New Zealand Government has been active in seeking the agreement of the United Kingdom Government, EEC and other Governments involved to the effect that New Zealand has a special case for a special trading arrangement which would give continuing access to the enlarged community for New Zealand produce on reasonable terms.

The United Kingdom has indicated to EEC that New Zealand's problems with dairy products and lamb are two of a limited list of problems for which satisfactory solutions must be found before the United Kingdom will feel able to join. At the time of writing, the EEC position on the issues is not clear, although, during a recent tour, the Minister of Overseas Trade received a sympathetic response from individual ministers in the Community. The Commission of the Community has put forward initial suggestions for dealing with the New Zealand problem which, while not providing the assurances of access which Britain and New Zealand have been seeking, at least recognize the New Zealand is in a special position requiring a special arrangement. It further concedes, at least for butter, that some arrangement continuing beyond the transitional period would be necessary, unless satisfactory international arrangements had been negotiated by that time.

Through the GATT working party on dairy products, New Zealand's efforts to obtain international arrangements to limit subsidization and price cutting in the world dairy trade met with some limited success in 1970 in the form of a minimum price arrangement for skim milk powder. Efforts to extend the scheme to butter and butter fat have not been successful so far.

A further matter of concern to New Zealand during the year was the announcement of the United Kingdom Government's intention, regardless of whether or not the United Kingdom joined EEC, to introduce a levy on lamb as part of its policy to move away from a system of deficiency payments to a system more akin to that operating in EEC.

During 1970, the country's overseas exchange transactions moved rather rapidly into deficit on current account after two years of substantial surplus following devaluation. However, the official overseas reserves approximately doubled from NZ$170 million in October 1967 to NZ$342 million in October 1970. Table II-3-35 shows developments in the past two years in greater detail.

Imports of goods and services were rising more rapidly than exports during 1970 as inflation gathered momentum. Meat, dairy produce other than butter, forest products and other manufactures produced the major increases in receipts during the year, but

Table II-3-35. New Zealand: Receipts and payments, 1969 and 1970[a]

(in million New Zealand dollars)

Item	*1969*	*1970[b]*
Butter	116.9	116.8
Cheese	44.0	49.0
Other dairy products	63.7	78.9
Meat	359.8	407.5
Wool	242.0	213.7
Other animal products	90.7	89.4
Forest products	62.7	70.3
Other primary products	44.0	45.0
Manufactured exports	58.1	74.1
Miscellaneous	8.0	8.0
Total exports	1,090.3	1,152.7
Other current receipts	148.2	164.7
Total current receipts	1,238.5	1,317.4
Governments sale of investments	35.3	15.5
Government borrowing	29.6	41.7
IMF drawings	...	...
Other official borrowing	...	...
Private	49.0	73.5
Total capital receipts	113.9	130.6
	1,352.4	1,448.0
Government imports	45.0	52.0
Private imports	760.7	894.2
Total imports	805.7	946.2
Other government current payments	67.6	69.6
Other private current payments	276.5	301.8
Total current payments	1,149.7	1,317.6
Government investment	35.5	47.0
Government debt repayment	17.1	20.1
IMF repurchases	44.6	11.9
Other official repayments	27.5	7.6
Private	34.8	62.2
Total capital payments	159.5	148.7
	1,309.2	1,466.3
Balance on trade transactions	+284.6	+206.5
Balance on invisible transactions	−195.8	−206.7
Current account balance	+ 88.8	− 0.2
Capital account balance	− 45.6	− 18.1
Over-all balance	+ 43.2	− 18.3

Source: Reserve Bank of New Zealand.

[a] Years ended October.

[b] Provisional.

receipts from wool declined appreciably. Unfortunately, the period of rapid increase in meat prices and meat receipts, which had been so helpful to New Zealand since devaluation, seems now to be giving way to less buoyant conditions. However, the dairy market is improving significantly, at least temporarily, and expansion of manufactured exports continues at a good pace despite internal inflation.

The United Kingdom, though gradually declining in relative importance, remains by far the most important market for New Zealand's exports, taking 36 per cent of the total in the year ending June 1970, followed by the United States (15 per cent), Japan (10 per cent) and Australia (8 per cent). Collectively, the EEC countries took about 11 per cent. Export trade to other ECAFE countries remains low with only Malaysia-Singapore (about 1.3 per cent) and the Philippines (0.7 per cent) taking more than 0.5 per cent of the country's exports.

The sharp rise in imports has been spread over most categories, but particularly sharp increases have occurred in imports of transport equipment, sugar and other imported food-stuffs, and machinery. Again, though declining in relative importance, the United Kingdom remains the major source of imports, with about 30 per cent of the total, followed by Australia (21 per cent), United States (13 per cent) and Japan (8.5 per cent). Of the other countries of Asia, Hong Kong (1.9 per cent), Malaysia-Singapore (1.1 per cent) and India (about 1 per cent) are the main suppliers.

During the year, New Zealand made the final repurchase of its own currency needed to eliminate its outstanding drawings from IMF, which reached a peak of NZ$142 million at the end of 1967.

Population and labour force

The rate of growth of New Zealand's population has declined considerably by comparison with the rates of over 2 per cent per annum experienced in the early 1960s and about 1.8 per cent in the mid-1960s. In 1968 and 1969, the rate of increase fell to about 1 per cent, largely due to a substantial net emigration from the country. As prosperity has returned, the migration pattern has been gradually changing. For the year ending September 1970, there was a net migration gain of just over 5,000 compared with losses of over 9,000 and over 14,000 in the two preceding years.

Birth rates seem to have stabilized at about 2.25 per cent with death rates continuing to decline slightly to about 0.87 per cent. As a result, the rate of population growth is rising again, to about 1.5 per cent a year, and the total population is now about 2.85 million. The proportion of Maoris in the population continues to rise, having grown from about 7 per cent in 1961 to over 8 per cent now.

The labour force increased particularly rapidly during 1970, by nearly 3 per cent. Despite this, a severe labour shortage persisted, as a result of which a considerably greater number of women entered the labour force, their numbers rising by 5 per cent, while there was a 16 per cent rise in the number of part-time workers. Another consequence has been a good deal of pressure during the year on the Government, particularly from manufacturers, to increase its assistance to immigration into the country.

Monetary developments

The money supply, narrowly defined as currency and demand deposits at the trading banks, grew by between 8 and 9 per cent during the year, as did the total of money supply and liquid assets (see table II-3-36). Time and fixed term deposits continued to grow at a very rapid rate, being 19 per cent higher in September 1970 than a year before. Finance companies in particular enjoyed rapid expansion, deposits, debentures, and notes held with them grew by over 50 per cent during the year. The rate of growth of small savings did not maintain the rapid expansion achieved in the previous year, the excess of deposits over withdrawals in the year to September being 12 per cent below the previous year's. Trading bank advances rose markedly in March and have remained high since, being 15 per cent above the levels of the previous year on average from April to September and 18.5 per cent higher in October than in the same month of 1969. The net loans and advances of the larger finance companies in the middle of the year were over one-third higher than a year earlier.

The Reserve Bank continued to set ceilings for bank advances, but those set for the "upper tier" of export advances are largely meaningless, as no penalties are applied if they are exceeded. The ceilings for other advances have been exceeded appreciably, and the authorities recently increased the penalties which will be applied to banks for exceeding their ceilings. A sliding scale of interest ranging from 7 per cent for small excesses to 10 per cent for larger ones is now applied to required borrowings from the Reserve Bank.

By removing or relaxing controls over the interest rates which the banks can offer for long-term and larger deposits, the authorities moved further during the year towards encouraging the banks to compete more vigorously for these types of funds. The object is to reduce the ease with which other financial institutions can attract funds for lending. The banks have also been given some encouragement to do a

Table II-3-36. New Zealand: Money supply and selected liquid assets of the public

(in million New Zealand dollars)

Year and quarter	Notes coins[a]	Trading bank demand deposits[b]	Money supply	Other demand deposits[c]	Total	Time and fixed term deposits[d]	Total	Seasonally adjusted[e]
As at								
31 March 1966	140.6	565.0	705.6	1,090.0	1,795.6	446.2	2,242.0	
1967	139.8	567.4	707.2	1,103.1	1,810.3	545.0	2,355.1	
1968	133.6	550.7	684.3	1,152.4	1,836.7	609.1	2,445.8	
1969	144.9	568.0	712.9	1,219.9	1,932.8	698.5	2,631.3	
1970	166.7	595.4	762.1	1,235.3	1,997.4	863.8	2,861.2	
As at								
1968—31 March	133.6	550.7	684.3	1,152.4	1,836.7	609.1	2,445.8	2,459.2
30 June	133.2	567.5	700.7	1,181.4	1,882.1	635.8	2,517.9	2,528.4
30 September	139.1	549.6	688.7	1,192.4	1,881.1	670.5	2,551.6	2,576.9
31 December	156.9	599.0	755.9	1,220.9	1,976.8	700.9	2,677.7	2,607.9
1969—31 March	144.9	568.0	712.9	1,219.9	1,932.8	698.5	2,631.3	2,665.1
30 June	144.4	583.6	728.0	1,231.7	1,959.7	751.6	2,711.3	2,723.5
30 September	149.3	572.2	721.5	1,239.7	1,961.2	804.9	2,766.1	2,792.5
31 December	168.1	608.9	777.0	1,253.7	2,030.7	887.3	2,918.0	2,841.9
1970—31 March	166.7	595.4	762.1	1,235.3	1,997.4	863.8	2,861.2	2,898.8
30 June[f]	154.9	636.1	791.0	1,252.8	2,043.8	915.8	2,956.6	2,974.4

Source: Reserve Bank of New Zealand.

[a] Notes and coins on issue minus till money of the trading banks.

[b] Trading bank demand deposits minus the total of government deposits and trading bank deposits held by financial institutions including in the table.

[c] Demand and call deposits of the Post Office Savings Bank, trustee savings banks, private savings banks, official money market, finance companies and current accounts of stock and station agencies, net of call and demand deposits of all these financial institutions with each other.

[d] Fixed deposits and wool retention accounts of trading banks plus all other time deposits and special deposits of the Post Office Savings Bank, private savings bank, trustee savings, term deposits of stock and station agencies, money market and finance companies, net of term deposits of all these financial institutions with each other.

[e] Revised.

[f] Provisional.

higher proportion of their lending in the form of term loans on which no interest rate ceilings are imposed, as opposed to overdrafts for which rates remain officially fixed. However, the Government has not so far been prepared to use variations of interest rates on its own borrowing, save for a slight increase on government stock, or to raise other rates under its control as part of its policy to bring inflation under better control.

Public finance

Government expenditure rose appreciably during the year due to expansion of Government programmes and rising pay for public servants. The upsurge of expenditure in a period of inflation compelled the Government not only to raise taxation in its main budget in June, but also to introduce a supplementary budget in October in order to secure additional revenues.

The expenditures and revenues inherent in the proposals brought down by the Government in its original budget in June are summarized in table II-3-37. It will be observed that the biggest percentage increases were provided for assistance to farming, for electric power development, and for health and hospital services. By October, it was apparent that the 9 per cent increase in expenditure which had been budgeted for was an under-estimate and about another NZ$115 million was required, bringing the increase for the year to over 16 per cent.

On the taxation side, the Government, after giving notice of its intentions to reduce the rate of progression of the personal income tax and to lower the top personal rate from 66 per cent to 50 per cent from 1 April 1971, felt obliged to raise some additional revenue to reduce a prospective deficit. The Minister of Finance introduced a new tax of 2 per cent of payrolls for all but the smallest enter-

Table II-3-37. New Zealand: Financing of government expenditure
(in million New Zealand dollars)

Item	1968/69 (Actual)		1969/70 (Actual)		1970/71 (Estimated)	
Expenditure						
Social services						
Monetary benefits	237.0		255.8		263.2	
Education	175.9		196.3		212.5	
Hospitals	126.6		141.1		154.0	
Other social services	104.5		113.8		121.5	
		644.0		707.0		751.2
Defence	85.3		89.7		96.9	
Administration	102.5		114.1		122.5	
Stabilization	16.4		17.2		17.0	
Maintenance of works, etc.	39.5		42.1		43.4	
Development of industry	65.1		81.5		102.9	
Interest and management of public debt	133.4		145.2		154.0	
Roading	72.8		77.6		82.4	
Works and capital advances	187.1		191.6		205.0	
		702.1		759.0		824.1
Total expenditure		1,346.1		1,466.0		1,575.3
				Supplementary		25.0
						1,600.3
Financed from						
Taxation						
Income and social security tax	691.6		779.2		850.0	
Customs, sales tax and beer duty	236.9		253.8		285.5	
Other taxation	63.6		69.1		88.8[a]	
Total taxation	992.1		1,102.1		1,224.3	
Other receipts (interest, profits, etc.)	149.1		163.3		173.7	
	1,141.2		1,265.4		1,398.0	
Highways revenue	67.1		79.7		83.5	
Other miscellaneous receipts	28.8		43.0		25.0	
		1,237.1		1,388.1		1,506.5
Amount to be financed from borrowing		109.0		77.9		93.8
Borrowing in New Zealand	194.9		240.0			
Less repayments in New Zealand	77.4[b]		138.8			
	177.5		101.2[c]			
Less purchase of investments	+ 3.9[d]		+ 19.3[d]			
Net borrowing in New Zealand		121.4		120.5		...
Internal surplus (+) deficit (−)		+ 12.4		+ 42.6		
Borrowing overseas	47.7		5.7			
Less repayments overseas	46.6		16.5			
	+ 1.1		− 10.8			
Plus sales (less purchase) overseas investments	− 3.6		− 7.0			
Net borrowing overseas		− 2.5		− 17.8		...
Balance		+ 9.9		+ 24.8		
		...		− 12.8		
Cash surplus (+) deficit (−)		+ 9.9		+ 12.0		

Source: Reserve Bank of New Zealand.

[a] Includes payroll tax NZ$20 million.

[b] Includes devaluation on I.M.F. drawings NZ$25.5 million.

[c] Excludes Treasury Bills encashed NZ$169.9 million.

[d] Includes NZ$35 million deposited with trading banks in 1968/69 and NZ$30 million in 1969/70.

prises and made it non-deductible for purposes of company tax, but exempted some sectors, such as farmers, and provided for rebates for exporters. He also announced his intention to abolish, as from April 1971, a rebate on taxable dividends for all but those on relatively low incomes. The big increase in expenditure for which provision had to be made in October required further exactions to be made from the taxpayer in a supplementary budget. On that occasion, after announcing that the Committee of Officials on Public Expenditure had been instructed to base plans for expenditure in 1971/72 on an increase in real terms of no more than 4 per cent, compared with 8 per cent in 1970/71, the Minister introduced a temporary surcharge on personal income taxes of 10 per cent for eight months, estimated to bring in an additional NZ$50 million. Duties on cigarettes and tobacco were also increased, along with charges for postal and rail services (although these latter were later deferred until January 1971 as part of the price freeze). Provision was also subsequently made for a 3 cents a gallon tax on motor spirits to provide a supplement to the property tax to meet the requirements of local authorities. The new taxes will bring the growth of revenue into closer conformity with the growth of expenditure, but a fairly substantial deficit before borrowing will remain.

Major policy issues of 1970 and outlook for 1971

The major domestic policy issue of 1970 was inflation. The Government is now seeking the right combination of policies to curb the spiral of costs and prices which, if it persists, will not only continue to cause internal disharmony but also undermine the stimulus to export expansion which resulted from previously firm fiscal policies and devaluation.

Measures to bring inflation under better control are important to the policies needed to improve the efficiency of production in New Zealand, so that progress towards the expansion and diversification of the country's export trade will continue and a wider range of industries will become capable of supplying domestic requirements at prices which are internationally competitive. To expose New Zealand's industries to greater competition by removing import licensing and replacing this protection with a well-considered tariff is also an important element in progress towards this objective. Moreover, if its anti-inflationary policies are less successful than it hopes, the growth of the balance of payments deficit can be expected to accentuate the Government's natural caution in this field of policy.

On the external front, while the Government's major diplomatic activity in 1971 must necessarily be centred on the problems raised by the United Kingdom's bid for membership of EEC, increasing attention will also have to be paid to laying the basis for continued development of trade and aid activities in Asia and the Pacific basin. This area must continue to play an increasingly larger role in the country's economic life.

Pakistan

Pakistan's gross national product (GNP) rose by 5.8 per cent in 1969/70, the last year of the third five-year plan. In the third plan period, as a whole, GNP rose by an average of 5.7 per cent per annum, compared with the plan target of 6.5 per cent. The fourth five-year plan, launched on 1 July 1970, has, as its goal, an average annual growth rate of 6.5 per cent during 1970-1975. The annual plan for 1970/71, the first year of the fourth plan, envisaged a growth rate of 6.2 per cent, but, on account of the damage caused by floods and cyclones in East Pakistan, the actual growth rate may turn out to be somewhat lower.

Though the 5.7 per cent per annum growth rate achieved in the third plan (1965-1970) fell short of the target of 6.5 per cent, it represents a considerable achievement when account is taken of the number of problems faced by the country in this period. The hostilities between Pakistan and India in 1965 not only caused temporary dislocation of economic activity but also entailed substantial diversion of resources to defence. Reduced availability of foreign assistance, and droughts and floods in 1965/66 and 1966/67, necessitating substantial imports of foodgrains, further reduced resources available for development. The expansion of productive capacity, particularly in the manufacturing sector, was therefore much less than planned, and even existing industrial capacity could not be fully utilized because of a shortage of imported raw materials. Finally, the socio-political situation in 1968/69 adversely affected both industrial growth and exports. In fact, it was mainly the break-through in agriculture in West Pakistan which helped the country to achieve a respectable rate of growth of 5.7 per cent per annum during the third plan period, despite a number of adverse factors.

The resource squeeze faced by the country in the third plan period not only affected the level of investment, it also led to severe curtailment of expenditure on social services. At the same time, the effort to protect the investment level through increased resort to credit creation and higher rates of indirect taxes led to a pronounced rise in the price level. Real wages are reported to have declined by about one-third during the sixties.[1] According to the Fourth Plan's review of developments during the

[1] *The Fourth Five-Year Plan*, p. 13.

Third Plan period, the unemployment situation remained acute, while inter-personal and inter-regional inequalities of income and wealth increased. Dissatisfaction with this pattern of growth was an important element in the disturbances of the winter of 1968-1969.

The Fourth Plan (1970-1975) marks a bold departure from the development strategies pursued in the preceding plan periods. It proposes a more than 150 per cent rise in public sector allocations for social services compared to the Third Plan. It accords substantially greater attention to East Pakistan in regional allocations for development with a view to reducing inter-regional income disparities. It proposes a number of measures to bring about a more equitable distribution of personal income.

Major developments in 1969/70

The Annual Plan for 1969-1970 aimed at achieving an over-all growth rate of 6.5 per cent with the agricultural sector growing at about 5 per cent and industry at about 10 per cent. According to provisional estimates, GNP (at 1959/60 factor cost) increased by 5.8 per cent. The agricultural sector grew at 6.1 per cent which was higher than the Annual Plan target but the over-all growth rate fell short of the target due mainly to a smaller than anticipated rise in industrial production and a decline in the level of construction activity. Gross *per capita* income (at 1959/60 factor cost) is estimated to have risen from Rs 410 in 1968/69 to Rs 423 in 1969/70, an increase of 3.2 per cent compared to 3.0 per cent in 1968/69.

Fixed investment as a proportion of GNP at current prices is estimated to have declined from 12.9 per cent in 1968/69 to 12.3 per cent in 1969/70. The year also witnessed a substantial slowing down in exports. Recorded receipts from merchandise exports increased by less than 1 per cent in 1969/70 compared to 9.4 per cent in 1968/69. Actual disbursements of foreign assistance in 1969/70 were higher compared to the preceding year, permitting some rise in the level of imports. The rate of monetary expansion accelerated. This seemed to be related in some measure to the larger wage bill which followed implementation of a new wage policy, and larger consumption expenditures appeared to have accentuated the price rise. These developments have to be viewed, however, in the context of a number of policy measures which were initiated after March 1969 for the purpose of bringing about a better blend between economic growth and social justice. The Government sought to bolster the economic position of poorer sections of population through a new wage policy and other measures including a sizable increase in government "consumption expenditure" devoted to social services. This has naturally resulted in a faster rise in consumption expenditures in the economy. As it has not been possible to mobilize additional resources in equal measure, investment has had to bear the impact. The slowing down in exports, particularly of manufactured goods, is also partly a reflection of the liberalization of consumption in a situation where insufficient availability of commodity assistance is holding down production levels.

Resources and expenditure

As against the rise of 5.8 per cent in real GNP, the gross national product at current prices rose by 9.2 per cent in 1969/70. Imports on current account rose by 11.7 per cent, compared with the decline of 5.5 per cent in the preceding year. Total national resources at Rs 85,340 million represented a rise of 9.4 per cent.

The bulk of the increase in national resources during 1969/70 went to meet the consumption demand of the government and private sectors. Government consumption rose by 20.4 per cent in 1969/70, compared with the rise of 9.1 per cent in the preceding year. This reflected the full impact of the increase in the pay structure of government employees effectuated in the second half of 1968/69 as well as increased appropriations for defence and social sectors. Private consumption went up by 9.8 per cent in 1969/70, compared with the rise of 7.4 per cent in the preceding year.

Total investment in 1969/70 at current prices was estimated at Rs 10,600 million which, compared with Rs 10,224 million in the preceding year, represented a rise of only 3.7 per cent. As consumption expenditures rose more than proportionately to the rise in GNP, investment as a proportion of GNP fell from 14.2 per cent in 1968/69 to 13.5 per cent in 1969/70. Savings as a proportion of GNP declined from 10.9 per cent to 9.7 per cent.

Taking the third plan period as a whole (1965-1970), gross investment as a proportion of GNP fell from 18.3 per cent in 1964/65 to 13.5 per cent in 1969/70. This was caused by a fall in both the average rate of domestic savings and net resource transfers from abroad. The savings/GNP ratio declined from 11.7 per cent in 1964/65 to 9.7 per cent in 1969/70, while the ratio of net resource transfers from abroad to GNP fell from 6.6 per cent to 3.8 per cent. Domestic savings financed 72 per cent of investment in 1969/70 against 64 per cent in 1964/65, while the share of external resources in the financing of investment went down from 36 per cent to 28 per cent over the period.

Table II-3-38. Pakistan: Resources and expenditure at current prices

Item	1964/65	1965/66	1966/67	1967/68	1968/69	1969/70[a]	Annual change (percentage)	
			(in million Pakistani rupees)				1968/69	1969/70
1. GNP at market prices	48,616	53,037	62,411	66,082	72,000	78,600	9.0	9.2
2. Imports on current account[b]	6,200	5,800	7,120	6,860	6,480	7,240	—5.5	11.7
3. Total national resources	54,816	58,837	69,531	72,942	78,480	85,840	7.6	9.4
4. Total investment	8,890	8,030	9,545	9,572	10,224	10,600	6.8	3.7
5. Government consumption	3,247	4,949	4,424	4,568	4,985	6,000	9.1	20.4
6. Private consumption	39,669	42,368	52,022	55,092	59,171	64,990	7.4	9.8
7. Exports	3,010	3,490	3,540	3,710	4,100	4,250	10.5	3.7
8. Total national expenditure	54,816	58,837	69,631	72,942	78,480	85,840	7.6	9.4
9. Domestic savings	5,700	5,720	5,965	6,422	7,844	7,610	22.1	—3.0
10. Net resource transfer from abroad[b]	3,190	2,310	3,580	3,150	2,380	2,990	—24.4	25.6
Savings/GNP (%)	11.7	10.8	9.6	9.7	10.9	9.7		
Net resource transfer from abroad/GNP (%)	6.6	4.4	5.7	4.8	3.3	3.8		
Investment/GNP (%)	18.3	15.1	15.3	14.5	14.2	13.5		
Exports/GNP (%)	6.2	6.6	5.7	5.6	5.7	5.4		

Source: Plan documents.

[a] Provisional.

[b] 'Imports on current account' include all payments except 'principal repayments' on account of debt servicing. 'Net resource transfer from abroad' represents the difference between 'imports on current account' and export earnings. This concept is used to determine savings rates. It differs from the concept of net foreign assistance, which simply deducts entire debt servicing from gross aid flows.

Agriculture

The rate of growth of agricultural production accelerated sharply in 1969/70, with substantial expansion in the output of both food and non-food crops. The index of agricultural production rose by 6.8 per cent, almost twice the rate of 3.5 per cent recorded in the preceding year. The output of food crops went up by 7.7 per cent in 1969/70, compared with 3.6 per cent in the preceding year. The rise was even more pronounced in the case of the fibre crops cotton and jute, the combined output of which rose by 9.3 per cent in 1969/70, as against a decline of 2.8 per cent in the preceding year.

The production targets laid down in the annual plan for 1969/70 were more than fulfilled in the case of wheat in West Pakistan and jute in East Pakistan, and nearly achieved in the case of rice. The per acre yield of all the major crops showed an appreciable rise in 1969/70, compared with the preceding year. Greater diffusion of improved agricultural practices played an important part in raising the yield from various crops. The quantity of improved seeds of major crops distributed is estimated to have gone up to 61,000 tons in 1969/70, compared with 57,000 tons in 1968/69. The consumption of fertilizers rose to an estimated 472,000 nutrient tons in 1969/70, compared with 353,000 nutrient tons in the preceding year.

Agricultural production is estimated to have risen at an average annual rate of 4.5 per cent in the third plan period (1965-1970), compared with 3.4 per cent in the previous plan period. This acceleration in the growth rate was achieved despite adverse weather conditions for two consecutive years in 1965/66 and 1966/67 and a cut of about 12 per cent in the third plan allocations for agriculture at the time of the revision of the plan in 1967. The improvement was a result mainly of the adoption by farmers of new technology based on the use of better varieties of seed and fertilizers, a process which was greatly facilitated by increased availability of irrigation water. Improved agricultural credit facilities, subsidization of farm inputs, and guaranteed prices in the case of certain crops have been other important factors in speeding up agricultural progress. For various reasons, progress has been much more rapid in West Pakistan than in the eastern part of the country. The newly introduced high-yielding seed varieties have proved better suited to conditions in West Pakistan than in East Pakistan. The consumption of fertilizers has also risen more rapidly in West Pakistan than in the east because of the larger size of holdings, climatic factors, and the better financial position of farmers. Inadequate irrigation facilities, plus the frequent incidence of floods, have been other factors holding back progress in agriculture in East Pakistan. However, in West Pakistan also, small farmers and rain-fed areas have derived much less benefit from new technological advances. The breakthrough in agriculture has thus resulted in an increase of inter-personal and inter-regional income disparities which will have to be taken into account in the fourth plan period.

Among individual crops, best results have been achieved in the case of wheat. Prior to 1966/67, wheat production averaged 3.6 million tons between 1955 and 1960, and 4.1 million tons between 1960 and 1965. Average production in the last three years of the third plan period, following successful planting of the new Mexi-Pak wheat, amounted to 6.7 million tons, representing an increase of over 63 per cent compared with the average for 1960-1965. Rice production has also benefited from the introduction of a new IRRI variety, but it has not proved as adaptable in East Pakistan as in West Pakistan. The per acre yield of rice had gone up to 14.1 maunds[2] in 1969/70 in West Pakistan, compared with the average of 10.1 maunds in 1960-1965. In East Pakistan, on the other hand, the highest yield attained so far has been 12.6 maunds per acre in 1968/69, as against the average of 12.1 maunds per acre in 1960-1965. A new monsoon variety of IRRI rice with greater capability to withstand floods and better suited to conditions in East Pakistan is likely to become available in the fourth plan period and may help raise rice production appreciably. The production of maize, also, has been stimulated by the introduction of new hybrid varieties, and there is potential for a further appreciable rise in production provided an adequate supply of water can be assured.

Production of foodgrains rose substantially in the third plan period, but the rise in output of the two major cash crops, jute and cotton, was not as great. Cotton production rose by about 42 per cent between 1964/65 and 1969/70 as a result of increased acreage and higher yield per acre. As regards jute, the yield per acre actually showed a decline and the increase in production fell considerably short of the third plan target.

Industry

Output in the large-scale manufacturing sector is estimated to have risen by 7.5 per cent in 1969/70. This was well below the annual plan target of 12 per cent and was also lower than the rise of 10.3 per cent in the preceding year. Production statistics relating to individual industries show that, while certain industries recorded a major deceleration in the rate of growth of production in 1969/70 compared with the preceding year, others showed a marked improvement. Significant increases in the rate of growth of production occurred in the industries producing cotton yarn, cotton textiles, vegetable products, non-alcoholic beverages and safety razor blades; increases which appeared to be related to rising domestic demand for these common items of consumption. The group of industries producing fertilizers and other requirements of agriculture also recorded larger production gains in 1969/70, following from the increased demand for these items arising from the recent developments in the agricultural sector. On the other hand, there was a major decline in the rate of growth of production of cement, paints and varnishes, and certain building materials, on account of depressed activity in the construction sector. A number of industries based primarily on imported raw materials also recorded smaller production gains in 1969/70.

During the third plan period as a whole, the output of large-scale industries increased at an average annual rate of 8.6 per cent, against the plan target of 13 per cent and the second plan average of 15 per cent. A number of factors appeared to have contributed to the slowing down in the rate of industrial growth and non-fulfilment of the third plan target. Investment in industry fell short of planned levels in both the public and the private sectors. Investment in industry in the public sector is estimated to have amounted to Rs 2,331 million, as against the revised third plan allocation of Rs 3,513 million. Though figures of actual private investment in industry in the third plan period as a whole are not yet available, data relating to sanctions issued disclose a considerable shortfall. As against the third plan target of Rs 9,287 million, actual sanctions issued up to March 1970 amounted to Rs 6,326 million only. The slowing down in industrial sanctions was partly a matter of policy, as, for balance of payments considerations, a decision was taken to follow a more selective policy in regard to the setting up of import-based industries. Also, private investment in industry was affected by the disturbances in 1968/69.

While additions to capacity proceeded much more slowly than originally planned, the rate of growth in industrial production during the third plan period was also below expectations because of substantial under-utilization of existing capacity. The major reason for this was, of course, the shortage of imported raw materials which was a result both of inadequate availability of commodity assistance and of larger foreign exchange expenditure on food imports, defence, debt servicing and imports of agricultural inputs needed for the planned expansion of agricultural production. Capacity utilization in industry was probably affected by certain factors on the demand side also. The effective price of imported raw materials rose considerably after 1967 on account of progressive placement of the bulk of industrial raw material requirements on the cash-cum-bonus import list which meant an effective import surcharge of 80 per cent or more, depending on the ruling prices of bonus vouchers. An increase in wage levels further added to the cost of production. A number of industries catering for less essential requirements probably found it difficult to pass on the increase in their costs (plus the burden of

[2] One maund = 82.286 lb.

increased indirect taxation) to the consumer in the form of final prices; i.e. the more elastic the consumer demand, the greater the under-utilization of industrial capacity.

Monetary and price situation

The rate of monetary expansion rose to 10.7 per cent in 1969/70, compared with 9.7 per cent in the preceding year. An expansion of Rs 1,473 million in bank credit to the private sector was the major factor responsible for the rise of Rs 2,052 million in monetary assets during 1969/70. By contrast, the expansionary influence of the private sector in the preceding year was a mere Rs 149 million, as the demand for bank credit had been adversely affected by the socio-political situation. Government borrowing from the banking system exercised a much smaller expansionary influence of Rs 759 million in 1969/70, compared with Rs 1,302 million in the preceding year. The influence of the foreign sector was contractionary (Rs 153 million), in contrast to its strong expansionary influence (Rs 568 million) in 1968/69.

The large expansion in bank credit to the private sector in 1969/70 reflected the increased tempo of business activity after the depressed conditions in the latter half of 1968/69. An additional factor was the increase in the working capital requirements of industry following the general rise in wage levels. Government, on the other hand, was able to reduce its recourse to the banking system on account of a reduced need for funds for commodity financing operations.

The disparity between monetary demand and the availability of goods and services led to a further rise in prices in 1969/70. With respect to the prices of staple foodgrains, wheat prices were almost unchanged due to a comfortable supply situation. Rice prices in East Pakistan rose sharply in the first half of 1969/70 but declined subsequently as the supply position improved, and the monthly average of the wholesale price index for rice recorded a rise of 2.4 per cent over the year. It is significant that, despite the relative stability of wheat prices in West Pakistan, the sub-index of food prices in consumer price indexes of both industrial workers and clerical wage earners at almost all centres in West Pakistan showed a fairly sharp rise. This reflected the growing imbalance between the demand for and supply of noncereal food items.

The wholesale price index of manufactured goods recorded a rise of about 3 per cent during 1969/70 (6 per cent in 1968/69), and the monthly average of the over-all consumer price index for industrial workers recorded a rise of 3.1 to 6.2 per cent at various centres during the year. In the third plan period as a whole, the consumer price index for industrial workers went up by 21.7 to 26.9 per cent at various centres.

The fast pace of monetary expansion appeared to have been an important element in the rise of prices. In the five years ended June 1970, monetary assets increased by about 68 per cent, as against a rise of about 32 per cent in GNP. The increase in the level of indirect taxes, inadequate expansion in *per capita* availability of a number of items in the food group, and the rise in the cost of imports appeared to have been other important causes of the rise in the price level. The pronounced increase in the production of wheat did not bring about a fall in wheat prices on account of the wheat price support scheme.

Public sector financing

A large tax effort was mounted in fiscal year 1969/70 to provide for the larger budgeted expenditure on social services without affecting the size of the development programme. The tax measures included the imposition of a wealth tax on agricultural land and adjustments in income tax rates, the sales tax, and customs duties, including an increase in the import duty machinery and its components. At the province level, water rates and electricity duty rates were raised in West Pakistan. The effect of the new tax measures taken by the Central Government, after allowing for tax relief on a number of items, was expected to be a net gain of Rs 470 million, and total revenue receipts of the Central Government in 1969/70 were expected to amount to Rs 8,003 million as against budgeted revenue expenditure of Rs 4,883 million. After allowing for Rs 1,237 million payable to the provinces, the Central Government's revenue surplus available for financing the development programme was expected to amount to Rs 1,883 million. According to the revised estimates for 1969/70, however, the revenue surplus amounted to only Rs 1,309 million because of some shortfall in receipts and increase in revenue expenditure. The annual development programme for 1969/70 had provided for deficit financing of Rs 400 million, but actual deficit financing during the year is reported to have amounted to the somewhat higher figure of Rs 450 million.

Public sector development expenditure in the entire third plan period is estimated at Rs 21,746 million, as against the plan target of Rs 30,000 million. There was a shortfall in the availability of both domestic and foreign resources as will be seen from the following table:

Table II-3-39. Pakistan: Financing of the second and third plans—public sector

(in million Pakistani rupees)

Item	Second plan	Third plan		
	Actuals	Projections	Estimated	Difference
Revenue surplus	2,194	8,600	1,048	−7,552
Net capital receipts	1,995	2,400	1,229	−1,171
Additional taxation	1,800	3,000	6,523	3,523
Deficit financing	1,135	2,500[a]	2,635	135
Total domestic resources	7,124	16,500	11,435	−5,065
Foreign resources	6,826	13,500	10,311	−3,189
Grand total	13,950	30,000	21,746	−8,254

Source: *The Fourth Five-Year Plan 1970-75*, Planning Commission, Government of Pakistan, July 1970.

[a] Deficit financing level indicated in the plan was Rs 1,5000 million. An unbridged gap of Rs 1,000 million was left in the financing picture. This is shown here as likely additional deficit financing.

As against the estimate of Rs 13,500 million, the actual availability of foreign resources during the third plan period amounted to Rs 10,311 million. The availability of internal resources for development purposes was affected on the one hand by the increase in defence expenditure following the hostilities with India in 1965 and the suspension of United States military assistance, and on the other by the shortfall in revenue receipts caused in part by a fall in customs receipts resulting from the reduction in the volume of foreign economic assistance. The shortfall in internal resource availability would have been greater but for the massive additional tax effort which, during the third plan period, is estimated to have yielded a sum of Rs 6,523 million, as against the original plan target of only Rs 3,000 million.

Balance of payments

The over-all balance of payments recorded a deficit of Rs 184.3 million[3] during 1969/70, compared with the surplus of Rs 442.5 million in 1968/69. The adverse swing from a surplus to a deficit during the year was the combined result of a decline in net receipts under transfer payments and a fall in capital inflow and a larger deficit on goods and services account. The deficit on goods and services account during 1969/70 amounted to Rs 2,716.8 million, compared with Rs 2,569.0 million in 1968/69. The gold and foreign exchange reserves of the country declined by Rs 54.7 million to Rs 1,367.8 million at the end of 1969/70. But for the drawing of Rs 166.7 million from the IMF in August 1969 and the allocation of Rs 150.4 million of Special Drawing Rights in January 1970, the fall in reserves would have been much greater.

[3] Excluding Special Drawing Rights of Rs 150.4 million.

Foreign exchange receipts from merchandise exports (f.o.b.) during 1969/70 amounted to Rs 3,142.9 million, compared with Rs 3,123.4 million in the preceding year, showing a nominal rise of less than one per cent. The increase in over-all export earnings during the year occurred almost entirely under manufactured goods exports, and this increase was largely offset by lower earnings from exports of primary commodities. At Rs 1,344.2 million, export earnings from primary products during 1969/70 were down by about 12 per cent from the 1968/69 level. Earnings from manufactured goods exports, on the other hand, rose by about 12 per cent to Rs 1,906.9 million during this period, and constituted about 59 per cent of total export receipts. The rate of growth in manufactured goods exports was, however, markedly lower than the rate of 19 per cent recorded in 1968/69. The fall in earnings from primary products mainly resulted from slow growth in production in the face of rising domestic consumption. The reduction in the rate of growth of manufactured goods exports appeared to have been caused by a smaller rise in industrial production in 1969/70 compared with the preceding year and higher domestic consumption demand.

Imports (f.o.b.), including aid-financed imports, amounted to Rs 4,998.9 million in 1969/70, compared with Rs 4,575.1 million in the preceding year, a rise of about 9 per cent. Actual disbursements of foreign assistance in 1969/70 were estimated at $550 million, as against $517 million in the preceding year. Of this, an amount of $205 million was attributable to non-projected assistance, while the rest was in the form of project assistance. In addition, a sum of $87 million was obligated under the United States Public Law 480 during the first nine months of 1969/70.

The balance of payments developments during the third plan period as a whole disclose certain striking trends. Foreign exchange earnings from merchandise exports rose at an average annual rate of about 6.5 per cent, and the export of manufactured goods increased at an average annual rate of about 20 per cent. Export earnings from primary commodities, on the other hand, actually recorded a declining trend. Starting from 1970/71, the first year of the fourth plan, a 10 per cent bonus on the export of all primary commodities has been allowed to boost up their production and exports. As against the 6.5 per cent average annual rate of growth in merchandise exports and about 8 per cent annual rate of growth in total foreign exchange earnings during the third plan period, merchandise imports grew at an average annual rate of hardly 2 per cent. This was a consequence mainly of the significant slow down in the availability of foreign assistance which adversely affected the country's import capacity,

a hardening in the terms of foreign assistance, and an increase in debt servicing liability. During the third plan period, the gross flow of external assistance increased by about 37 per cent over the second plan period, but, on account of rising debt servicing liability, the level of the net flow of external assistance in 1969/70 was about the same as in 1964/65. The ratio of debt servicing to exchange earnings moved up from 11 per cent in 1964/65 to 19 per cent in 1969/70. To adjust to the situation created by the reduced import capacity of the economy caused by the above-mentioned factors, the effective price of imports was raised appreciably by placing most industrial raw materials on the cash-cum-bonus list, under which an importer has to purchase bonus vouchers for half his requirements to get cash licences for the remaining half. This has helped to balance the potential demand for these goods with the reduced availability of external resources, thereby avoiding the need for more stringent quantitative import controls. However, the decline in the availability of foreign assistance has given rise to the problem of substantial excess capacity in industry and retarded the country's industrial growth.

Outlook for 1970/71

The annual plan for 1970/71, the first year of the fourth five-year plan, envisages a growth rate of 6.2 per cent, as against the 5.8 per cent achieved in the preceding year. The main acecleration is expected to be in agriculture, though an appreciable increase in output is also anticipated in the industrial sector. The 1970/71 target for rice production in East Pakistan is set at 12.5 million tons, about 8 per cent higher than the estimated output of 11.5 million tons in 1969/70. Jute production in East Pakistan is expected to rise from 7 million bales in 1969/70 to 7.4 million bales in 1970/71, an increase of about 6 per cent. In West Pakistan, wheat production in 1970/71, is expected to rise to 7.5 million tons, showing an increase of about 7 per cent compared with the preceding year, while the target for cotton production is about 10 per cent higher. In the field of industry, the main increases in output are expected to take place in jute and cotton textiles, sugar, chemicals, and fertilizers.

The size of the annual development programme in 1970/71, the sectoral priorities, the regional breakdown of development expenditure, and other policy measures incorporated in the annual plan are oriented to make a decisive beginning towards the achievement of the objectives and targets of the fourth five-year plan (1970-1975) launched on 1 July 1970. As mentioned earlier, the fourth plan makes a bold departure from some of the policies pursued in the past. Though achievement of an adequate rate of growth remains an important objective of policy, the pattern of growth has to be so moulded as to better satisfy social objectives. More specifically, the fourth plan aims at reversing the trend towards growing inter-personal and inter-regional income inequalities and "to direct the forces of economic and social change towards the establishment of a just society".

The annual plan postulates a rise of over 24 per cent in the size of the public sector development programme from an estimated Rs 6,300 million in 1969/70 to Rs 7,770 million in 1970/71. Such a marked increase is considered necessary to arrest the falling trend in investment, to stimulate growth in the less developed areas, and to improve and strengthen social services. It is significant that about 90 per cent of the total increase in the size of the programme has been earmarked for East Pakistan to speed up its economic growth and hence to reduce inter-regional disparities. Out of the total programme of Rs 7,700 million, Rs 4,150 million (or nearly 54 per cent) is to be spent in East Pakistan, and this will mean an increase of about 48 per cent in 1970/71 compared with expenditure in the preceding year. The projected expenditure of Rs 3,550 million in West Pakistan represents a rise of only 5 per cent and constitutes 46 per cent of total development expenditure.

The sectoral allocations in the public sector development programme for 1970/71 reflect the increased emphasis accorded to social objectives of development policy in the fourth five-year plan. As against the 24 per cent increase in the size of the over-all programme, expenditure on education is postulated to rise by 93 per cent, on health and family planning by 73 per cent, and on physical planning and housing by 29 per cent over the preceding year's targets. The annual plan incorporates a number of measures designed to stimulate private investment in East Pakistan, including specific targets for funds to be disbursed in East Pakistan by the various government-sponsored financial institutions.

It is too early to judge how far the objectives of the annual plan for 1970/71 will be realized in practice. The devastating floods and cyclones in East Pakistan caused considerable damage to crops, and this is likely to affect the growth rate. According to the Jute Board, floods in September 1970 reduced the jute crop by about 0.2 million bales. The floods also affected the *Aus* rice crop in East Pakistan, and the devastating cyclone in the coastal areas of East Pakistan in November 1970 caused further damage to agricultural crops. There are indications that cotton output in West Pakistan may also fall short of the target of 3.3 million bales. Taking into consideration the factors affecting other sectors of the economy, and depending on the size of the wheat crop that is yet to be harvested, the likelihood is

that the economy may achieve a growth rate of 5 to 5.5 per cent in 1970/71, as against the annual plan target of 6.2 per cent.

There is also likely to be some shortfall in the achievement of the financial targets of the annual plan. As mentioned earlier, the annual plan postulated a rise of about 24 per cent in development expenditure during 1970/71. According to resource estimates of the Planning Commission, the implementation of a programme of the proposed size of Rs 7,700 million would have necessitated raising Rs 1,200 million by way of additional taxation and deficit financing. As the scope for deficit financing within "safe limits" was adjudged to be no more than Rs 600 million, an equal amount needed to be raised by way of additional taxation. As against this, the tax proposals of the Central Government budget for 1970/71 were intended to raise only about Rs 400 million from a number of alterations in existing tax rates, and the budgets of the various Provincial Governments contained no fresh taxation measures. Moreover, about a month after the announcement of the Central Government budget, a number of modifications in the original tax proposals were made in response to difficulties and grievances voiced by the public affected. Non-development expenditure, on the other hand, is likely to exceed the earlier estimate on account of flood and cyclone relief in East Pakistan. To reduce the incidence of these factors on the size of the annual development programme for 1970/71, a number of fiscal measures, including a 10 per cent surcharge on income tax assessments, were announced in January 1971 to raise additional resources of Rs 170 million.

A number of changes in the export bonus system were announced in July 1970 on the basis of a review of the working of the scheme in the third plan period. For the first time, the two major cash crops (cotton and jute) have been brought within the purview of the bonus scheme. It has been decided that exports of cotton and jute (and all other primary commodities) will be entitled to a bonus of 10 per cent. At the same time, all products which had so far received bonuses of 30 and 40 per cent were made eligible to receive bonuses of 35 and 45 per cent respectively. The bonus on home remittances was also raised from 40 to 45 per cent, while foreign tourists were allowed a bonus of 45 per cent on the foreign exchange that they converted in Pakistan. On the payments side, a number of items of invisible payments have been shifted to the cash-cum-bonus rate,[4] which means that remittances for these items will be allowed against the surrender of bonus vouchers equal to 50 per cent of the amount of the remittance involved in each case. The enlargement of the export bonus scheme, for both receipts and payments, is intended as a further move in the direction of more realistic pricing of foreign exchange. The bonus allowed on cotton and jute and other primary commodities, which had previously been outside the purview of the export bonus scheme, is a significant departure from earlier policy in which export incentives were almost exclusively confined to manufactured products. The rise in the local prices of cotton and jute, following the grant of bonuses on these items, is expected to lead to greater production of these cash crops in due course. At the same time, the bonus on jute has made possible a cut in prices for foreign buyers of jute which should not only help expand the demand for Pakistan jute but also improve the competitive position of jute goods in general vis-a-vis synthetic packing materials. The working of the export bonus scheme during the third plan period showed that, though it was making a significant contribution towards increasing the country's foreign exchange earnings, its restricted scope was leading to a certain misallocation of resources. The modifications now made should result in greater allocative efficiency.

Current policy issues

The major policy issue in Pakistan at present is how to maintain the momentum of economic growth, and, at the same time, reduce the stresses and strains caused by the inequitable sharing of the benefits of growth in the past. The real problem is that the reduction in inter-personal and inter-regional disparities, which has become one of the chief objectives of government policy, calls for a massive increase in government expenditure, whereas the government is faced with a tight resource position. The implementation of the public sector development programme in the third plan period lagged considerably behind targets; the actual realization is estimated to have been around Rs 21,750 million, as against the plan target of Rs 30,000 million. As private investment also did not rise much over the third plan period, the ratio of total investment to GNP declined almost steadily from 18.3 per cent in 1964/65 to 13.5 per cent in 1969/70. Though the decline in the investment ratio has not yet had a serious effect on the over-all growth rate of the economy, (thanks largely to the breakthrough in agriculture) a continuation of this trend cannot be viewed with equanimity. It will be necessary in the year ahead, therefore, to substantially raise the level of investment in the productive sectors at the same time that the Government is committed to sizable increase in expenditure on the social sectors.

The fourth five-year plan proposes an increase of about 60 per cent in the level of development

[4] Remittances for education abroad were also included in the group of invisible payments shifted to the cash-cum-bonus list, but this decision was subsequently rescinded.

expenditure during 1970-1975, compared with the estimated actual expenditure in the third plan period. This is intended to raise the ratio of gross investment to GNP from 13.5 per cent in 1969/70 to 15.5 per cent in the terminal year of the plan. As the ratio of net resources transfers from abroad to GNP is expected to decline further from 3.8 per cent in 1969/70 to 3 per cent by the end of the fourth plan period, the ratio of domestic savings to GNP will have to rise from 9.7 per cent in 1969/70 to 12.5 per cent in 1974/75 if the proposed investment level is to materialize. This will necessitate a rise in the marginal rate of savings from less than 10 per cent in the third plan period to roughly 20 per cent in the fourth plan period.

The projected sharp increase in the marginal rate of savings is based on a substantially increased resource mobilization effort in the public sector, and a considerably greater channelling of resources to private investment. The fourth plan envisages a total public sector programme of Rs 49,000 million which, allowing for an expected availability of Rs 18,000 million of foreign resources, will require domestic resources of Rs 31,000 million. As domestic resource availability from the normal growth of revenue and capital receipts and a likely increase in non-development expenditure is expected to amount to no more than Rs 19,700 million, there is a gap of Rs 11,300 million. This represents 36 per cent of the total domestic finance component of the public sector development programme. To cover the gap, the plan suggests raising a sum of Rs 7,800 million through additional revenue measures, and Rs 3,500 million by way of deficit financing.

While the size of the proposed plan seems to be reasonable in view of the imperative need to raise the investment level and to provide the needed acceleration in social sector expenditure, its financing is likely to present a number of problems. The fact that egalitarian objectives are now so important narrows the options available to the Government for resource mobilization. In the past, a good deal of reliance was placed on indirect taxation and deficit financing to meet government expenditures, and this served to aggravate income inequalities and caused inflationary pressures. As the emphasis is now on social justice, recourse to deficit financing will have to be kept to the minimum, and additional revenues will have to come mainly from direct taxation of a progressive type. Unfortunately, tax evasion is reported to be quite widespread and increases in the rates of direct taxes may not produce much in the way of additional revenues unless this problem is effectively tackled. A Taxation Commission is looking into the potential for additional taxation and is to report shortly.

The financial infrastructure of the country has developed rapidly in recent years and has been of significant help in mobilizing resources for development. In addition to commercial banks and insurance companies, the country has an investment trust, an investment corporation and a number of other specialized finance corporations. The mobilization effort of these institutions, however, has so far been confined almost exclusively to urban and semi-urban areas. With the shift in the terms of trade in favour of agriculture and large increases in value added in agriculture following the "green revolution", the monetary-institutional framework needs to be adapted to the task of mobilizing rural savings. This is particularly important because private savings in the urban-industrial sector are no longer growing at the previous rate on account of the retardation in the industrial growth rate and the declining trend in corporate savings. The lending activities of credit institutions also stand in need of considerable modification to encourage small businesses and the establishment of new businesses. In this connexion, the directive issued by the State Bank of Pakistan in May 1970 making it obligatory for all Pakistani commercial banks to earmark at least 20 per cent of their advances for smaller borrowers is of interest. Through credit budgeting, an attempt is also being made to expand credit facilities in the less developed areas of the country to help reduce inter-regional disparities.

Reduction in inter-regional income disparities has been an important objective of government policy, but the problem has proved much more intractable than was originally thought. The principal means by which economic growth was to be stimulated in East Pakistan during the third plan period was through larger development outlays in both the public and the private sectors. However, due to the general resource squeeze, public sector developmnt outlay in East Pakistan fell considerably short of the third plan target, and the shortfall in private investment was even greater. Total investment therefore, was not sufficiently large to have the desired impact. Moreover, for reasons already discussed, the new seeds-fertilizer technology did not yield as good results in East Pakistan as in the western part of the country. The disparity in *per capita* incomes between the two regions of the country therefore widened further during the third plan period. A much larger infusion of resources in East Pakistan is necessary if the problem of inter-regional income disparities is to be effectively tackled. At the same time, a concerted effort needs to be made to achieve the same type of agricultural breakthrough in East Pakistan as has already been witnessed in West Pakistan. The fourth five-year plan aims at raising the level of public sector development expenditure in East Pakistan by 160 per cent compared with the

third plan period, while the private investment target is twice as large. The fulfilment of the public sector target will depend crucially on the success of the resource mobilization effort to be mounted in the fourth plan period. A number of economic and non-economic factors will determine the trend in private investment. The Government has already initiated a series of measures to remove bottlenecks and enhance the relative level of profitability in the industrial sector in East Pakistan, and, given a favourable political climate, these measures should yield good results in the years ahead. A comprehensive flood control programme, which is expected to be launched during the fourth plan period, should also significantly improve long-term growth prospects.

The fourth plan emphasizes the need for moving on a broad front to bring about a better blend between economic growth and social justice. It stresses the necessity of evolving an integrated programme "defined not only to restore the momentum of the economy but to establish a sound basis of future relations between the Government and the business community on the one hand and among the employer, the labour and the consumer on the other".[5] The unanimity which has emerged amongst all shades of public opinion as to the need for fundamental changes in the development strategy to be pursued in the future should facilities the achievement of planned objectives, both economic and social.

[5] *The Fourth Five-Year Plan*, p. 17.

Papua and New Guinea

Introduction

The Territory of Papua and New Guinea, which comprises the Trust Territory of New Guinea and the Australian Territory of Papua administered as a unit by Australia, is at a comparatively early stage of development.

The Territory's economy is dominated by primary production which provides a livelihood for nearly all the local people who are self-employed and more than half of those who are employed in the monetary sector and accounts for the major share of export earnings. There are plentiful land resources, and the major development emphasis is on extension of the area under cultivation to increase primary production. However, the physical configuration of the land makes development a problem, and communal ownership with an absence of individual rights make administrative purchase and lease of land and extension of credit difficult. Output could also be expanded by taking measures to increase yields on land already under cultivation.

[1] This is the first time that a survey of Papua and New Guinea has been included in the *Economic Survey of Asia and the Far East*.

In the past, industrial development has been primarily based on processing for export, but the administration is now following a policy of establishing industries for replacing imports. A well-integrated transport system is being developed, with emphasis on road construction, but such development presents complex problems in a territory with 600 offshore islands, large expanses of mountain, swamp and sea, and a low population density of twelve persons per square mile. The Territory's economic growth will be further stimulated when the large-scale Bougainville copper-mining project is completed and its benefits spread through the economy.

The Administration has undertaken to increase its financial self-reliance by raising the levels of Territorial revenue and public borrowing. Revenue has been expanding, but it is expected to cover only a little more than one-third of development expenditure by the end of the development programmes (1972/73). Also, the Territory's external deficit on goods and services account is expected to grow by nearly four-fifths by the last year of the development programme. The Territory provides liberal inducements for foreign private investment and has begun to attract concessional loans from international aid agencies. However, official grants from the Government of Australia continue to be crucial in bridging the financial resource gap.

The development programme aims at maximum participation by the indigenous population in economic development, and its role will increase as it is integrated into the monetized sector. To bring about such integration, adequate inducement has to be offered to overcome traditional work-leisure preferences through, for example, increased availability of consumer goods and extension of the tax system. Moreover, employment opportunities, trained extension workers, and facilities for intra-regional mobility have to be provided. The non-monetized subsistence sector, in spite of its gradual decline, continues to be exceptionally large. Of the total work force, only one-fifth is in the monetized sector, with the balance in the subsistence and partially-monetized sectors. Further extension of small holdings under commercial crops and pasture, and stimulus to production of food for sale, will hasten entry into the cash market. Attempts to foster indigenous participation in industrial development have to be widened beyond the expansion of small-scale and cottage industries and the provision of credit to include management training and the active identification of industrial possibilities for the local population. The Administration has already accorded high priority to education, particularly at secondary and technical levels, both to improve the educational level of the indigenous population and to bridge their cultural, ethnic, and linguistic differences.

Rate of growth

During the 1960s, economic growth in the monetary sector has been at an average annual rate of 12.5 per cent at current prices, with a real rate of about 10 per cent. For the subsistence sector, the annual average rate of growth has been around 1.5 per cent, and, for the economy as a whole, about 5 to 6 per cent. (See table II-3-40) A great lift in the level of economic activity in Papua and New Guinea occurred in 1969/70. Much, but by no means all, of this growth was caused by major investment in the copper mining venture in Bougainville. Other factors were steep increases in both government expenditure and private investment, favourable prices for important export commodities, and continuing industrial expansion and employment. Papuans and New Guineans received a large share of the increase in income arising from this activity. According to preliminary estimates furnished in the 1970 budget papers, gross monetary sector product (i.e. excluding all subsistence and non-marketed production) at market prices increased by about 25 per cent. This is primarily due to the increase in capital formation, private capital formation in 1969/70 increasing over 1968/69 by about 156 per cent, and total, including public sector, by about 67 per cent (See tables II-3-41 and II-3-42).

The relative importance of the subsistence sector product has been declining since 1964/65 but continues to be exceptionally large, this sector producing nearly 45 per cent of the Territory's income. The indigenous population is moving into the modern commercial economy in the areas of small-scale agricultural production (particularly of commercial crops), trucking, the sale of handicrafts, and the beginnings of industrialization. However, the commanding sectors of the economy are in expatriate hands: plantations, industry, transport, banking and most of commerce.

As of 30 June 1969, the Territory had an indigenous population of 2.3 million, 0.6 million in Papua and 1.7 million in New Guinea. The non-indigenous population, according to the 1966 census, was 34,669, of whom 29,350 were Europeans. For the Territory as a whole, the average annual rate of growth of population during 1961-1965 was 2.12 per cent, the rate varying according to area—Papua

Table II-3-40. Papua and New Guinea: National income estimates, whole economy total market supplies, 1961-1968[a]

(in thousand Australian dollars, current prices)

Item	*1961*	*1962*	*1963*	*1964*	*1965*	*1966*	*1967*	*1968*
1. Wages, salaries and supplements	56,324	59,597	66,805	72,329	89,685	103,003	113,726	128,634
2. Primary production income								
(i) market production	10,683	9,503	12,883	15,173	17,837	19,569	21,401	25,421
(ii) non-market production	14,954	15,792	16,081	17,336	19,826	21,032	21,979	25,019
Total primary production	25,637	25,295	28,964	32,509	37,663	40,601	43,380	50,440
3. Subsistence sector income	154,491	161,343	168,094	172,818	174,790	179,684	185,265	190,079
4. Company income (excluding primary product and property income)	6,613	7,153	8,607	12,244	13,969	19,018	23,011	29,799
5. Operating surplus of public authorities business	—	—	—	399	734	619	979	612
6. Other business income	4,427	7,419	7,734	9,022	10,043	11,002	13,898	14,926
7. Income from property	1,457	1,507	1,526	1,916	1,756	1,390	1,562	1,912
Territory income	248,949	262,314	281,730	301,237	328,640	355,407	381,821	416,402
8. Allowance for depreciation	4,547	5,999	6,443	6,814	6,903	9,176	12,273	14,368
Territory product at factor cost	253,496	268,313	288,173	308,051	355,543	264,583	394,094	430,770
9. Indirect taxes less subsidies	4,724	5,542	5,954	6,851	8,068	10,626	14,299	15,944
Territory product at market prices	258,220	273,855	294,127	314,902	343,611	375,209	408,393	446,714
10. Imports and other payments for goods and services	67,191	68,079	74,174	93,135	110,953	138,855	157,356	180,940
Total market supplies	325,411	341,934	368,301	408,037	454,564	514,064	565,749	627,654

Source: Statistics Section, Department of External Territories, Government of Australia: *National Income Statistics for Papua and New Guinea 1960/61–1967/68*, May 1970.

[a] Years ended 30 June.

Table II-3-41. Papua and New Guinea: National income estimates, monetary sector[a] total market supplies, 1965-1970[b]

(in million Australian dollars)

Item	*1965*	*1966*	*1967*	*1968*	*1969[c]*	*1970[c]*
Wages, salaries and supplements	89.7	103.0	113.7	128.6	139.9	174.0
Primary production income market production	17.8	19.6	21.4	25.3	31.9	37.9
Company income (excluding primary production and property income)	14.0	19.1	23.0	29.8	34.0	41.3
Operating surplus of public authorities business	0.7	0.6	1.0	0.6	0.4	1.0
Other business income	10.0	11.0	13.9	14.6	16.7	24.5
Income from property	1.8	1.4	1.6	1.9	2.2	2.5
Monetary sector income	134.0	154.7	174.6	200.8	225.1	281.2
Allowance for depreciation	6.9	9.2	12.3	14.4	16.1	17.9
Gross monetary sector product at factor cost	140.9	163.9	186.9	215.2	241.2	299.1
Indirect taxes less subsidies	8.1	10.6	14.3	15.9	17.5	23.9
Gross monetary sector product at market prices	149.0	174.5	201.1	231.1	258.6	323.0
Imports and other payments for goods and services	111.0	138.9	157.4	178.3	187.5	264.3
Market supplies of monetary sector	260.0	313.3	358.5	409.4	446.2	587.3

Source: "Programmes and policies for the economic development of Papua and New Guinea", *Review of Progress*, 1969-70, p. 3.

[a] Excluding non-marketed primary production.

[b] Years ended 30 June.

[c] Preliminary. Columns do not necessarily add to totals, owing to rounding.

Table II-3-42. Papua and New Guinea: National income estimates, monetary sector[a] total market expenditure, 1965-1970[b]

(in million Australian dollars)

Item	*1965*	*1966*	*1967*	*1968*	*1969[c]*	*1970[c]*
Personal consumption[d]	82.0	99.1	110.6	124.1	134.7	160.4
Statistical discrepancy	—	—0.6	—0.1	—0.3	—0.4	—3.4
Net current expenditure						
Missions	5.1	6.0	6.4	7.2	6.4	6.9
Public authorities — Territory	43.9	50.2	58.5	65.8	74.9	83.4
— Commonwealth	8.4	9.9	11.6	13.7	17.9	20.3
Total net current expenditure	57.5	66.1	76.5	86.8	99.2	110.6
Gross domestic capital formation						
Private	19.5	32.9	40.1	47.5	51.4	131.7
Mission	0.8	1.2	1.4	1.5	2.1	2.3
Public authorities — Territory	29.5	33.5	40.1	44.4	47.4	57.5
— Commonwealth	7.0	17.7	25.0	17.6	12.0	10.2
Increase in the value of stocks	8.4	7.3	3.6	7.3	7.3	7.3
Total gross domestic capital formation	65.2	92.5	110.2	118.3	120.2	209.0
Gross monetary sector expenditure	204.6	157.1	297.2	329.5	353.6	476.6
Exports and other receipts	55.3	56.2	61.3	79.8	92.5	110.7
Total market expenditure of monetary sector	259.9	313.3	358.5	409.4	446.2	587.3

Source: "Programmes and policies for the economic development of Papua and New Guinea", *Review of Progress*, 1969-70, p. 4.

[a] Excluding non-marketed primary production.

[b] Years ended 30 June.

[c] Preliminary. Columns do not necessarily add to totals, owing to rounding.

[d] Market supplies.

2.15 per cent, New Guinea 1.88 per cent, New Britain 3.39 per cent, Sepik district 0.71 per cent, and Morobe district 2.32 per cent. A family-planning programme has been started by the Administration on a small scale with reliance mainly on IUDs. Nearly 44 per cent of the population is engaged wholly in the subsistence sector. Of the total work force of about 1.2 million, the number of indigenous people working for money wages is estimated at about 123,000. Of this latter group, 24 per cent is employed in the public sector, 37.4 per cent in private sector primary industry, 7.4 per cent in commerce, 6.3 per cent in manufacturing, 5.5 per cent in construction, and 12.8 per cent in the Christian missions.

Development programme

The development programme for 1968/69-1972/73, which has been adopted as the basis for annual planning, aims at a continued over-all rate of growth of about 6 per cent, with the monetized sector also growing at its past rate of about 12 per cent. To sustain the rate of growth, the present high investment rate is to be maintained, but with a shift in emphasis from public to private investment. The programme envisages substantial new private investment, from within the Territory and abroad, in the agricultural, livestock, forestry, manufacturing and service industries. In the public sector, emphasis is laid on the development of transport (particularly roads), power, secondary education, and agriculture. While the original development programme does not take into account the likely impact of the large-scale Bougainville copper project, the Administration has taken action to revise the current development programme.

In financing the development programme, the Territory is committed to increased self-reliance. However, even by 1972/73, internal revenue is to finance only 37 per cent of the Administration's expenditure of A$960.2 million, and the external deficit is also expected to increase from A$102 million in 1966/67 to A$185 million. Public borrowing is on a modest scale in the Territory, but the programme anticipates increased external resources in the form of private foreign capital and loans from international financial agencies. However, grants from the Australian Government will play the crucial role in bridging the resource gap, and Australia has, for example, agreed to finance almost 90 per cent of the deficit in the 1968/69 budget.

Development finance

Gross capital formation in the monetized sector of the Territory has been estimated as increasing at a rate of 23 per cent per annum at current prices. Public investment is believed to be nearly twice as large as private investment, as, at the present stage of the Territory's economic growth, natural as well as human resources have to be developed. In the non-monetized sector, the proportion of gross investment to gross sectoral product has been roughly estimated at about 20 per cent, and the subsistence sector contains surplus or underemployed labour that could be utilized for capital formation by the existing community organizations at the cost of a small increase in consumption.

Private sector savings have grown only slowly, as the corporate sector is as yet relatively undeveloped, but there is potential for increased personal monetary savings in the subsistence sector. Available evidence suggests that, in the south Pacific area, as household income increases, income elasticities for most goods and services decline. Except for a few relatively unimportant luxury items, consumption reaches a saturation level relatively quickly and the marginal propensity to save rises significantly. In the public sector, development expenditure has outstripped the rise in domestic public revenue and the deficit is met by grants from the Government of Australia.

The Administration's expenditures have increased in the recent past by an average of about 15 per cent per year, a rate much higher than the growth of national product in the monetary sector. Along with a continuing shift in emphasis from current to capital expenditure, public capital outlays on economic infrastructure have become larger than investment in social services and education. However, the share of current expenditure on social and economic services has increased because traditional civil expenditure, though substantial, has accounted for a decreasing proportion of total expenditure.

Social development expenditure rose from A$17.2 million in 1960/61 to A$48.2 million in 1967/68, but, as a percentage of total Administration expenditure, it has declined somewhat. Expenditure on education, on the other hand, rose both absolutely and proportionately, from 11.5 per cent in 1960/61 to 16.4 per cent in 1967/68. The Administration attaches high priority to the expansion of education at the secondary, technical and higher level as a means of preparing the native people to accept greater responsibility. However, it is official policy that the rate of advance in social development should be related to the capacity of the Territory's population to contribute to it. There has recently been a shift in emphasis from primary to secondary and tertiary levels of education, since shortages of manpower are particularly critical at professional and sub-professional levels. Among the important concerns of educational planning are regional imbalances in educational development and the possibility of disproportion in the educational pyramid as a result of "holding the line" in primary education. The

Territory has already achieved a comparatively high level of health services. Expenditure on health has been reduced from about 20 per cent of total expenditure in the past to about 10 per cent at present, and targets in the development programme for the provision of health and medical services are being met.

Government revenue has also been increasing rapidly, but at a rate considerably short of the increase in expenditure. About three-fourths of total revenue comes from taxes, mainly income taxes and customs duties. Non-tax revenue is mostly from postal services, from leases and royalties on natural resources, and from government services such as health. Rates of tax on individuals and companies in the Territory are only about half of the rates currently applicable in Australia. There has been an upward revision in the individual income tax which has also been made more progressive and graduated, and receipts from this source have been increasing faster than those from companies. A low personal tax falls mainly on the indigenous people, and they also contribute to the revenues of local councils. Excises are levied on beer, twist tobacco and cigarettes, and certain legal instruments are also taxed. The Teritory has a single-column tariff, primarily introduced for revenue purposes, but now used also for protecting nascent industries.

The present stage of the Territory's development and its large subsistence sector inhibit the extension of the tax base, but the implementation of the development programme should lead to increased revenues, and, as already noted, the Bougainville project will have far-reaching consequences. Even before there are any exports, the Administration will receive substantial revenue through income and company taxes paid by the participants in the construction of the Bougainville project, but the full impact on revenue collections will not be felt until exports of copper concentrates commence in 1972/73.

Budgetary deficits are large and growing, and are almost entirely financed by increasing grants from the Government of Australia. Direct Commonwealth expenditure in the Territory, not figuring in the budget, has also been rising, and, within the past decade, increased fivefold from a level of A$6.8 million in 1960/61. (See table II-3-43).

The size of the Australian Commonwealth grant (grants are not tied to any specific projects) has been increasing rapidly, from A$30 million in 1960/61 to A$87 million in 1968/69. The proportion of administration expenditure financed by the grant, on the other hand, has steadily declined from about two-thirds in 1960/61 to about 60 per cent in 1968/69. The formulation of the five-year development programme should help in the long-term planning of the grants required, though the Government of Australia's policy is to slow the rate of increase in its grants and to stimulate the Territory's financial self-reliance. To facilitate planning, Australian aid to the Territory is to be shown from now on in the Commonwealth budgetary estimates in four parts: the amount intended for economic development; grants-in-aid; allowances for expatriate civil servants of the Territory; and loans for special projects.

Table II-3-43. Papua and New Guinea: Internal revenue, loans and Commonwealth grants

Year	Amount of grants		Internal revenue		Total borrowings		Total receipts
	Australian dollars	Percentage	Australian dollars	Percentage	Australian dollars	Percentage	Australian dollars
1960/61	29,593,296	65.25	14,904,200	32.86	860,056	1.89	45,357,552
1961/62	34,586,796	67.75	15,411,598	30.18	1,059,418	2.07	51,057,812
1962/63	40,000,414	66.77	18,048,722	30.13	1,954,620	3.10	59,903,756
1963/64	50,498,616	65.90	22,753,758	29.70	3,368,262	4.40	76,620,636
1964/65	55,998,796	62.05	27,929,464	30.95	6,309,976	7.00	90,238,236
1965/66	61,999,743	60.67	34,046,168	33.31	6,156,774	6.02	102,202,685
1966/67	69,783,569	58.88	42,539,392	35.89	6,194,147	5.23	118,517,108
1967/68	77,594,251	58.01	47,766,375	35.71	8,397,214	6.28	133,757,840
1968/69	87,271,286	58.32	55,136,914	36.85	7,234,222	4.83	149,642,422
1969/70	99,270,921[b]	48.61	72,442,220	35.47	32,519,901	15.92	204,233,042
1970/71	79,050,000[c]	40.45	83,500,000[a,d]	42.72	32,900,000[a]	16.83	195,450,000

Source: The Territory of Papua and New Guinea, *Budget Papers 1970/71.*

Note: Before the Second World War, the grant from the Commonwealth was A$85,000 per annum to Papua. There was no grant-in-aid to New Guinea. From 1965/66, the internal revenue shown is a net figure after refunds have been deducted.

[a] Estimated.

[b] Includes A$2 million Commonwealth development loan-Arawa.

[c] Includes grant-in-aid A$33 million, development grant A$37.75 million and Commonwealth development grant — Arawa A$8.3 million.

[d] Includes consolidated revenue balance A$200,000.

Production trends

Agriculture

According to forecasts for 1969/70 and estimated actual production in 1968/69, the output of the main commercial crops increased in 1969/70 over the previous year's level. However, actual production fell short of the programme for 1969/70 by about 10 per cent in the case of copra, the most important commercial crop. The shortfall in cocoa was less than 4 per cent and in rubber about 18 per cent. By contrast, the output of tea, a comparatively recent commercial crop with bright prospects, is forecast to be more than twice the target for 1969/70. Coffee production, for which no target was fixed, has been steadily increasing. Despite physical output shortfalls, the value of output of the main commercial crops, except rubber, exceeded programme targets, mainly due to favourable export prices. Also, diversification of export crops has progressed with rapidly increasing cultivation of palm oil, passion fruit and pyrethrum.

With no lack of land resources for development, reliance is placed more on expanding the area under cultivation than on increasing the productivity of land already being cultivated. Ample scope exists for more use of fertilizers and more adequate protection against price fluctuations. Copra, for example, is protected against any severe fall in price by the Administration's Stabilization Fund. In view of the unfavourable international prospects for natural rubber, the Administration has not been encouraging expansion of the area producing it, though high-yielding varieties are supplied to new areas which find rubber the most suitable crop. The Territory's rubber output is at present wholly exported to Australia which provides a guaranteed preference including price support. Increased productivity is particularly important for coffee. Output has been increasing at such a rate that, in addition to satisfying Australian demand, the Territory will soon, within the framework of the International Coffee Agreement, be entering new and competitive markets, eg.g. Japan.

Because the targets for increased planting in the five-year programme are not being met, a more rapid expansion in area under cultivation is particularly important. The Administration's land purchases are behind schedule, particularly for small-holder development of the tea industry and for pastoral land, and this may adversely affect production in the long run.

Although, by 1967, the Administration owned or leased nearly two-thirds of the total land not owned by the indigenous population, there are still problems in the physical development of land for purposes of cultivation and grazing. Traditional group rights to land make not only land purchases but also extension of agricultural credit very difficult. Legislation exists to enable conversion into individual titles to land but the process has been slow. Three new bills have been introduced in the House of Assembly and they provide for: a single register of titles and procedures for all transactions in land; new procedures for determining customary ownership and converting it to individual ownership in selected areas; registration of customary groups so that they can be registered as owners of land; and a system of control by local bodies over land transactions.

With increasing incomes and the rapid movement of the indigenous people into the cash economy, there is an urgent need to develop the production of fresh foods on a commercial scale. Moreover, there is great potential for both import substitution and export promotion if production of such crops as rice, peanuts and sugarcane can be increased. However, poor communications, high freight cost, irregular supply, and inadequate handling facilities handicap increased production of fresh foods.

Forestry

Log production, which fell from 175 million superfeet in 1967/68 to 142 million in 1968/69, due to a set-back in the export market, was expected to reach its 1968/69 programme target of 236 million superfeet in 1969/70. The Territory's timber resources cover three-quarters of the land area, and it is estimated that they could be developed to supply an annual log cut of 500 million superfeet of timber in perpetuity. Fuller utilization has been impeded by inaccessibility and the lack of uniformity in the forest species. Progress in the preparation and release of major forest concessions has exceeded the targets originally proposed in the development programme.

Through the expansion and up-grading of the Forestry School at Buloho, there is progressive indigenization of technical manpower at the sub-professional level in both the public and private sectors. However, greater efforts need to be made to attract more school-leavers to forestry colleges. It is estimated that indigenous employment in the industry will be doubled to about 11,000 by 1972/73.

Fisheries

The fishing industry, subsistence and commercial, is being developed to provide nutritional balance and employment opportunity for the indigenous population, reduce the increasing imports and promote exports. Commercial fishing is expanding, and, in 1969/70, exports including exports of prawns, may exceed A$1 million. A survey in New Guinea waters has shown the presence of commercial quantities of

tuna, and, in two and a half months from March 1970, a joint Territory-Japanese group exported 1.2 million lb of tuna. Further expansion of this venture is being undertaken.

Fishery loans extended by the Development Bank have significantly increased. However, more investment is required in transport facilities from the ports to the main centres and in marketing facilities. The Administration's extension activities in this field have been handicapped by a continuing shortage of staff both at senior and at lower levels. The subprofessional ranks have been filled to a considerable extent by graduates from the Vedal Agricultural College.

Livestock

The development of a commercial beef cattle industry has been accorded very high priority, both to increase indigenous participation in a profitable area of the monetary sector and to replace the import of canned beef which has been steadily increasing.

Under the five-year programme, indigenous holdings of stock are to increase sixfold from their initially low level and non-indigenous holdings twofold. There has been a significant increase in the degree of indigenous participation in the industry. Import of breeders is subsidized by the Administration, and there has been a substantial increase in livestock loans from the Development Bank, with cattle as collateral. Among the obstacles to faster livestock development are the difficulties in obtaining breeders and acquiring suitable land.

Mining

Mining, mainly of gold and silver, contributes less than 1 per cent to gross domestic product in the monetary sector and has been slowly but steadily declining since 1967/68. However, the Administration is actively encouraging mineral and oil prospecting in the Territory, and the prospects are bright for expansion within a short span of years. The Bougainville copper project is expected to commence production in 1972/73, with an average annual production over the first ten years of 150,000 tons of copper in concentrate and 500,000 oz of gold. Work has started on the construction of infrastructural facilities for the project. In addition to its great direct impact on export earnings, revenue to the exchequer, and employment and income, the project will extend the monetization of the economy by providing a cash market for local products.

Indigenous small-scale gold mines now account for one-fourth of the gold output, and it is the Administration's stated policy to increase indigenous participation in small-scale mining and to expand employment and training of the indigenous people in exploration and development activities. The Bougainville Project is expected to provide employment for over 2,000 indigenous people, many of whom will receive technical training.

Manufacturing

Manufacturing output, which at present accounts for less than one-tenth of the product of the monetary sector, has been expanding substantially in recent years. Processing for export, e.g. of timber and coconuts, accounted for nearly 45 per cent of manufacturing output in 1968/69, and such activity continues to grow. There has also been a widening of the industrial base. According to estimates for 1969/70, the fastest growing sectors have been food, drink and tobacco, engineering, and ship- and boat-building.

With a limited and fragmented domestic market, production units are generally suboptimal, and most industrial expansion is in small- and medium-scale industries. The establishment of a small number of medium- and large-scale industries is being planned, and this kind of growth will gain momentum as the scope for import substitution through domestic production is fully explored. Industries producing import substitutes are expected either to use materials imported at the initial stages, or to assemble imported components, the import components to be gradually replaced by locally produced ones. While some of these industries such as motor-vehicle assembly, fibre-glass and aluminium products, crown seals and telephone equipment, have reached their targets, there has been some delay in the establishment of others, such as sugar, fertilizer, cement and plastics.

Industrial development in the Territory is primarily dependent on private enterprise. Private foreign investment has been actively encouraged by the Administration through such incentives as a low income tax (about half the rate in Australia), exemption from income taxation for an initial period of five years to selected pioneer industries, and assurances regarding non-discrimination. Investment on a large scale is taking place from Australia and is expected to continue. Japan is already participating in ship-building, and investment from Canada in plywood and from Malaysia in brewing is anticipated. The Administration provides industrial sites and related facilities, but the acquisition of sites in urban areas is meeting with increased difficulties. Tariff protection ranging up to 35 per cent *ad valorem* is extended to certain local manufacturing industries and a Tariff Advisory Committee has been set up.

The ownership of industrial undertakings is entirely in the hands of expatriates, but indigenous people have interests in sawmilling, a furniture

factory, a small engineering firm, and small-scale and cottage industries. Cottage and small-scale industries, whose output is planned to increase by three times under the development programme, range from traditional handicrafts and artifacts for tourists to small-scale urban and rural manufactures, such as local building materials, furniture and wool-weaving. The expansion of such enterprises is being promoted by the Administration as a means of increasing indigenous participation in the cash economy.

Indigenous participation in industrial development will grow as joint ventures between indigenous and expatriate concerns are set up and medium-sized enterprises are organized with indigenous capital and with expatriate management training indigenous understudies. In this connexion, the Investment Corporation Bill, introduced in the House of Assembly in October 1970, provides for obtaining a share for the ownership and control of major investment projects in the Territory which are largely financed from overseas and holding this share for future sale to the people of the Territory. The Papua and New Guinea Development Bank, set up in 1967 "having due regard to the stability and balanced development of the Territory's economy and the advancement of indigenous population" had, by the end of May 1969, approved 1,100 loans amounting to about A$8.6 million. Of these 870 loans totalling A$1.3 million went to indigenous applicants. In 1969/70, Development Bank lending to Papuan and New Guinean business and firms increased more than threefold.[2] The Bank's effectiveness would increase if the scope of its technical advice and assistance were enlarged to include helping the indigenous people to identify industrial prospects. The Business Advisory Service, set up under the aegis of the Government, is to be enlarged to assist indigenous people in the establishment and conduct of business. At present, it runs two business promotion centres which offer premises and training facilities for indigenous businessmen. In this connexion, the establishment of a national business administration exclusively concerned with the industrial advancement of Papuans and New Guineans may be of help.

Transport

With the Administration's shift in emphasis from airways and shipping to roads, an integrated transport network is being developed in the Territory. Based mainly on a UNDP transport survey and with IBRD as executing agency, the Administration proposes to increase its capital expenditure on roads from about A$6 million in 1969/70 to A$10 million in 1970, A$18 million in 1971/72, and A$17 million in each of the three years 1972-1975. While nearly half of the total expenditure is on highways, roads for special agricultural projects and village roads financed through a rural development fund are also being constructed.

With its rugged terrain and small and scattered population, the Territory has relied on an airway network for the movement of passengers, high-value exports and vital imports. With the increase in tourism and the establishment of links with international air routes, an up-grading of airport facilities has begun. The greater part of the expenditure on airports is covered by the Australian Commonwealth Government.

The major part of freight traffic is carried by a comprehensive and inter-island shipping service linking fifty ports. Uneconomic servicing of coastal shipping routes by ocean vessels has been reduced substantially with an increase in the number of coastal vessels. Some improvements in port facilities are being made.

Money, banking and prices

Reflecting the extension of monetization, the money supply has been estimated (on the basis of very incomplete data) as increasing at about three times the approximately 6 per cent rate of growth of the economy. Prices in general are also believed to be rising at a moderate rate, according to statistics on prices confronting expatriate households in three major towns.

The Territory has a considerable range of public and private financial institutions. Except for the Papua and New Guinea Development Bank, the banks are branches of Australian banks and are governed by Australian banking legislation. A branch of the Reserve Bank of Australia carries out central banking functions, and the banking system comes within the jurisdiction of the Reserve Bank of Australia. However, it has been decided that new bank lending in the Territory should not be restricted by any general limitations on lending policy current in Australia but take specific account of the needs and conditions in the Territory. As the Territory moves forward to independent nationhood, more urgent consideration will need to be given to the adaptation of the financial system to the needs of the Territory.

Information available on the over-all demand for and supply of credit in the Territory is not sufficient for detailed analysis. Between June 1965 and June 1968, trading (commercial) bank deposits increased from A$23.2 million to A$36.1 million, and outstanding loans, advances and bills discounted by these banks rose from A$8.3 million in July 1965 to A$22.2 million in June 1968. The ratio of advances to deposits has increased steeply and is almost com-

[2] *Review of Progress 1969-1970*, presented with budget proposals for 1970/71.

parable to that in Australia. Much of the increase in bank advances over recent years has been for financing stocks and for providing working capital.

There is increasing indigenous involvement in the banking and credit system through savings banks, savings and loan societies, and savings clubs organized by the Reserve Bank. The co-operative movement, perhaps the most indigenous of economic institutions, is at present under substantial reorganization and consolidation, and steps are being taken for the establishment or accelerated development of co-operative producer or consumer activities in all parts of the Territory.

Balance of payments

The most marked economic trend in recent years has been a large and growing unfavourable trade balance, from A$19 million in 1960/61 to A$68 million in 1966/67, and an even more unfavourable balance in goods and services from A$35 million in 1960/61 to A$102 million in 1966/67. The balance has been covered largely by Commonwealth grants to the Administration and direct Commonwealth expenditure in the Territory.

In the recent past, food imports accounted for about 40 per cent of the total, but have begun to show a decline. Imports of investment goods, such as metals, manufactures and machinery, which amounted to about 56 per cent of imports in 1960/61, have been increasing rapidly, and accounted for 66 per cent in 1966/67.

The pattern of exports has changed little in recent years. Coconut products are still the dominant element and contribute about 40 per cent of the total value, followed by coffee, cocoa, timber and rubber.

Exports increased at an average annual rate of 11 per cent between 1960/61 and 1967/68, and there has been diversification of the composition of exports. New items, such as tea, timber and plywood, palm oil and passion fruit, have encouraging prospects. Imports have been expanding at the same time by about 16 per cent, because of capital goods requirements for development and import demand for consumer goods. Despite the projected growth of exports in the development programme (10.7 per cent) and efforts at import substitution, the deficit in the last year of the five-year development programme may be about A$185 million, a deficit which is to be covered by Commonwealth assistance, private capital flow and international assistance.[3] The construction of the Bougainville copper-mining project will necessitate heavy imports of capital goods. The value of these is estimated officially at A$300 million, and they are to be financed by external capital. Such imports should decline after 1972/73, and exports of metallic copper in concentrated form and gold may be about A$111 million, doubling the Territory's exports to nearly A$200 million in 1972/73.

Tourism

The tourist industry, though at an early stage of development, has considerable potential for growth. Tourist traffic increased from 6,600 in 1961/62 to about 20,000 in 1967/68, and hotel accommodation was expanded and improved. Apart from indirect employment in transport and commerce, over 2,000 workers were directly employed in accommodation and ancillary services. A Tourist Board was established in 1966. With the development of air transport facilities within the territory, and air links with the Philippines and Hong Kong, it is estimated that there will be a fair increase in the flow of American and southeast Asian tourists in addition to visitors from Australia and New Zealand. Preliminary estimates indicate that direct expenditure by tourists and other visitors should increase from an estimated A$3.2 million in 1967/68 to A$17.5 million in 1972/73. In 1969, the value of tourism as an industry to the Territory was estimated at about A$10.5 million. Owing to the heavy import content of the goods and services provided for tourists, it is estimated that the net return to the economy may not exceed half of the tourists' expenditure.

Current outlook

With the five-year development programme as the basis, the Territory has adopted the technique of annual planning, keeping in view current developments and such emerging constraints as shortages of technical manpower and the rigidity of customary lend tenure. The five-year plan has been strengthened in the vital sectors of transport and education, and work has begun on the Bougainville development. Enlargement of the scope for indigenous participation is being kept in view. In his statement in July 1970, the Australian Prime Minister indicated "further steps short of self-government but towards self-government" and emphasized "more effort on the part of the local people to raise revenues inside the Territory, as years go by, for the purpose of the recurrent expenditure . . . . . in such fields as primary, secondary and technical education, public health, etc., for which authority to take decision should reside in the Ministerial Members or the Executive Council".

[3] The estimated value of exports increased from $75.0 million in 1968/69 to about $90.5 million in 1969/70, i.e. by 20 per cent. On the other hand, imports increased from about $148 million in 1968/69 to $220 million, i.e. by about 50 per cent. A good deal of these imports are attributed to the construction phase of the Bougainville project, but imports of consumption goods have also risen fast.

The Philippines

Introduction

Despite drought and typhoons and increasing intensity of restraints on imports, the Philippines economy, during 1969, maintained the growth momentum of the previous two years. During 1966-1969, the Government worked with considerable success towards improving the economic management which brought about a modest acceleration in economic growth. However, the balance of payments position of the country showed sharp deterioration, due largely to the world market conditions. In 1969, which was an election year, the balance of payments difficulties were compounded by relaxation of monetary and fiscal discipline. The deficit financing by the Government during the year, the acceleration in the growth of money supply to a record high level, and the mounting deficit in the balance of payments and the accompanying draw-down on the country's reserves prompted the monetary authorities to adopt, towards the end of 1969, a policy of tight credit and import restrictions. Subsequently, in February, 1970, a comprehensive stabilization programme was adopted, providing a number of measures aimed at reducing the excess liquidity in the economy, limiting the growth of short-term external debt, curbing the growth of imports and promoting exports.

With the recent introduction of the floating exchange rate system and the consequent downward movement of the external value of the local currency, there was a considerable improvement in the balance of payments during 1970. There was also a slight reduction in the money supply during the first half of 1970. Pressures on prices increased in intensity during the second and third quarters of 1970, compared with the first quarter, due to increased costs of imports and increase in the minimum wage by one-third.

During the last three years, the Government succeeded in raising its revenue substantially by means of improved tax administration and new tax measures. However, attempts to maintain essential services and, at the same time, increase infrastructural investments, which had for some years not received attention adequate to the country's needs, led to a widening of government budgetary deficits. These deficits, because of the limited scope of non-bank borrowings by the Government, have been in substantial measure financed by borrowing from the banking system and hence have been potentially inflationary. In the face of increasing intensity of inflationary pressure in recent months, government fiscal operations in the future will have to be non-inflationary. This will require much larger tax efforts to increase government revenue. At present, the tax burden in the Philippines economy is low in comparison with other countries of comparable economic size in the region.

In the light of the achievements in rice and corn production resulting from technological breakthroughs, the self-sufficiency programme originally covering rice and corn production was expanded in 1969 to include vegetables, fruits, livestock and poultry, and the National Food and Agricultural Council was instituted to co-ordinate the expanded food programme. In the years immediately preceding the programme of the application of high-yield variety seeds, the economy was unable to grow enough rice to feed its population. The country has now begun to export rice.

Growth in employment during the last plan period was rather slow, and substantial unemployment and underemployment, as in many other developing countries, are basic problems to the economy. In the pursuit of economic growth with social stability, changes in the investment policies will be required to take into account the employment problem. At the same time, specific policy measures will be needed to reduce rural unemployment and underemployment. So far, little progress has been made towards reducing the gap between rich and poor,[1] and, in fact, the real wages of industrial labour have shown some decline during the 1960s. Moreover, land reform has preceded at a rather slow pace.

Rate of growth

In the fiscal year 1968/69,[2] the Philippines economy achieved a growth rate of 6.5 per cent in real GNP, compared with 6.3 per cent in 1967/68 and 6.2 per cent in 1966/67. Thus, in aggregate terms, actual performance during the first three years of the last development plan (1966/67—1969/70), exceeded the target of a 6.2 per cent average annual growth in GNP. Because of foreign exchange constraints and internal adjustments to the recent introduction of the floating exchange rate, economic growth began to slow down in 1969/70, particularly in the second half, and, according to preliminary estimates, the growth rate of GNP was 5.3 per cent during 1969/70. Estimates for 1970/71 indicate a probable growth of GNP of only 4.5 per cent. From 1971/72, however, it is expected that economic growth will begin to accelerate towards the same level it reached during the past three years. The development plan covering 1970/71-1973/74 envisages an average annual growth rate of 5.5 per cent in GNP, rising from 4.5 per cent in the first year to 6.5 per cent in the last.

[1] See the Bureau of Census and Statistics Surveys of Household Bulletins, *Family Income and Expenditures*, 1956/57, 1961 and 1965.

[2] In the Philippines, the fiscal year covers the period 1 July to 30 June.

Commodity-producing sectors performed well during 1968/69. Value added in agriculture (at constant 1967 prices) increased by 6.2 per cent, and estimates for 1969/70 indicate a growth rate of 5.3 per cent. Although a still higher growth rate for agriculture (7.6 per cent) is envisaged in the plan for the year 1970/71, the feasibility of this target is doubtful in view of the fact that the price elasticity of demand for agricultural inputs like fertilizers and equipment is high and that the recent *de facto* devaluation of the currency has already caused significant price increases for these items. In addition, the damage caused by severe typhoons during the second half of 1970 adversely affected agricultural production for the crop year 1970/71.

Value added in the manufacturing sector expanded during 1968/69 at a rate of 5.0 per cent, considerably below the target set in the last plan. Estimates for 1969/70 indicate growth of 2.8 per cent. In view of the foreign exchange constraint, an average annual growth of 6.2 per cent is envisaged during the plan period, rising from 1.9 per cent in 1970/71 to 9.3 per cent in 1973/74. The mining sector, an important foreign exchange earner, has been showing outstanding performance in recent years. Its output in value terms expanded at 22.5 per cent in 1968/69, the estimates for 1969/70 indicate growth of 19.4 per cent, and the plan envisages an average annual growth of 17.7 per cent during 1970/71-1973/74.

Savings and investment

The acceleration of economic growth in recent years has followed an increase in the investment rate,[3] which rose from 19.4 per cent in 1965/66 to 21.2 per cent in 1968/69. This rise in the investment rate, however, went hand in hand with a decline in the average domestic saving rate (net of factor income payments abroad), which fell from 22.1 per cent in 1965/66 to 16.7 per cent in 1968/69. The biggest drop in the saving rate was in 1967/68, when it fell from 21.1 per cent in the previous year to 16.5 per cent, mainly accounted for by an increase in private consumption by over 13 per cent. There was thus a marginal improvement in the saving rate in 1968/69. Estimates for 1969/70 indicate a fall in the investment rate to 19.7 per cent and a further drop in the saving rate to 15.1 per cent.

Thus, although the development efforts during the last plan were financed largely through domestic resources, the resource gap widened rapidly. The net capital inflow from abroad (measured in terms of the current accounting deficits) rose from $61 million in 1966/67 to $421 million in 1968/69 and then fell to $259 million in 1969/70. These deficits have been largely financed through short-term borrowing from abroad, which generated the present problems of foreign debt servicing. Short-term foreign debt obligations reached unusual proportions in 1969, and it is partly due to this that the balance of payments gap has become the dominant constraint to future economic growth.

The four-year development plan proposes to maintain the investment rate at 19.7 per cent during the plan period, while the saving rate will be raised from 15.1 per cent in 1969/70 to 19.5 per cent in 1973/74. Thus by 1973/74, 92 per cent of investment (compared with 73 per cent in 1968/69) is to be financed from domestic savings. The share of public investment in the total is projected to increase from 14 per cent at the beginning of the plan to 17 per cent in 1973/74.

Government finance

During the last plan period, the Government succeeded in raising its revenue through improved tax administration and new tax measures of 1968 and 1969. Between 1963/64 and 1965/66, government revenue had stagnated in absolute terms, but, during the plan period, it rose not only in absolute terms but also in relative terms. As a share of GNP (at current prices), total government revenue, including taxes earmarked for transfer to local governments, rose from 9.2 per cent in 1965/66 to 10.7 per cent in 1968/69. However, the government revenue to GNP ratio still remains low in comparison with other developing countries of comparable economic size in the region. In addition, during the plan period, growth in public expenditure to maintain essential services and increase infrastructural investments, which had for many years not received adequate attention in relation to the country's needs, outpaced the growth in public revenue. As a result, government budgetary deficits have grown and since these deficits have been financed in substantial measure from the banking system, they had potentially inflationary impact.

In the fiscal year 1968/69, national government revenue increased by 10.1 per cent to 2,862 million pesos which was below the level programmed in the budget. On the other hand, national government expenditure (current and capital) increased in the same year by 22.6 per cent to 3,611 million pesos, considerably more than 3,090 million pesos programmed in the budget. Thus, fiscal operations during the year resulted in a substantial budget deficit of 849 million pesos, which exceeded that of the previous year by a very large margin. Of the total deficit, approximately 32 per cent was not funded and carried over into fiscal year 1969/70, hence the cash deficit in 1968/69 was 544 million pesos, of which more than 75 per cent was financed by the banking system.

[3] Gross capital formation as a percentage of GNP.

Owing to heavy government spending in the first half of the fiscal year 1969/70, the budget deficit reached a record level, and it became evident that unless government spending was controlled, it would be well in excess of 1 billion pesos for the full fiscal year. Beginning in November 1969, the Government imposed a rigid programme of public expenditure controls. Consequently, the budget deficit did not increase during the second half of the fiscal year. On the whole, for the fiscal year 1969/70, the budget deficit was 797 million pesos, slightly below that of the previous year.

In addition to the size of the deficit, a disturbing factor regarding the government fiscal operation in 1969/70 was, as in the previous year, the manner in which the deficit was financed, i.e. it was financed in substantial measure by the banking system, leading to an upward movement of prices in the second half of 1969/70.

The four-year fiscal plan covering the next plan period i.e. 1970/71-1973/74 specifies that government fiscal operations should be non-inflationary. The plan forecasts increases in national government revenue at an average annual rate of 13.3 per cent between 1969/70 and 1973/74. During the plan period, a total of 1.7 billion pesos is projected to come from new taxes, including a recent export tax.[4] Total tax revenue is projected to increase at a rate of 13.7 per cent a year during the plan period. This includes, of course, the effect of the change in exchange rate on customs revenues and sales tax *ad valorem* on higher prices. With this constraint on the Government's resource side, growth in government expenditure at current prices will be limited to an average annual rate of 9 per cent. Taking into account the expected rise in the general price levels in the course of next year and the effect of the recent increase in the legal minimum wage by one-third, to maintain essential services and, at the same time, increase public investments, as programmed in the plan, would require a higher target for growth in government expenditure than envisaged in the plan. Thus, if the government sector is to contribute to both economic stability and growth, government revenue must increase at a rate higher than programmed in the plan.

Production trends

Despite a credit squeeze, quantitative restrictions on imports, a series of typhoons in the first half of 1969 and prolonged drought in the second half of the year, major sectors of the economy registered gains in 1969, though at decelerated rate compared with those in 1968. While it is estimated that higher production levels were achieved in agriculture during the crop year 1969/70, the manufacturing output index during the first quarter of 1970 showed a declining trend. Mineral production maintained its upward trend at an accelerated pace during the first half of 1970.

Agriculture

Growth in agricultural output during the 1969/70 crop year recovered from the set-back suffered in the 1968/69 crop year as a result of drought and typhoon damage. According to preliminary estimates, agricultural output increased by 4.6 per cent in the 1969/70 crop year, as against 1.8 per cent in the previous crop year, the increase in food crop production of 7.4 per cent (as against 0.2 per cent in 1968/69) accounting for the entire growth in agricultural output. In turn, the increase in the output of food crops was due principally to the estimated 17.6 per cent increase in the paddy rice output (as against a 2.4 per cent decline in 1968/69) and a 10.1 per cent increase in maize (shelled) output (as against a 7.0 per cent increase in 1968/69). Maize output was not affected by drought and typhoon.

Export crops production, which had registered a record increase of 17.3 per cent in the 1967/68 crop year, was adversely affected in the following two crop years by drought and typhoon damage which affected the sugarcane, coconut and tobacco crops. Depressed export prices also contributed to the slackened growth of tobacco output. On the other hand, abaca prices improved markedly in 1969, compared with 1968, and abaca production recovered from a 12.1 per cent decline in the 1967/68 crop year to increase by 2.4 per cent in 1968/69. The over-all output of export crops is provisionally estimated to have suffered a decline of 1.3 per cent in 1969/70.

With the recent introduction of the floating exchange rate system which led to *de facto* devaluation of the peso, the prices of agricultural inputs, such as fertilizers and equipment, have risen markedly. The higher price of fertilizers has already resulted in a considerably decline in domestic sales, and it will be particularly felt on production costs of sugarcane, since the fertilizer accounts for about a quarter of its production costs. Any reduction in the fertilizer application on high-yielding rice and corn cultivation will adversely affect their yields. Meanwhile, bottlenecks in milling, drying, transportation, storage, and marketing facilities have become more acute with the increase in production. Despite considerable expansion of irrigated land during the last plan period (1966/67-1969/70), irrigation facilities remain inadequate in relation to the total area under cultivation. The Government has recognized that, if the growth in agricultural output achieved during the last four years has to be sustained in future years and the proposed aim of agricultural diversification

[4] 75 per cent of the export tax proceeds will go to the Government.

is to be achieved, a number of things must be done. There must be increased availability to farmers of credit (medium and long-term in particular) and other inputs such as fertilizers. Transport, storage, marketing and irrigation facilities must continue to be improved, but on an expanded scale. It is crucial that appropriate price policies for both agricultural inputs and outputs be formulated, and land reform measures, which have so far been implemented at a very slow pace, will have to be given more attention.

Mining

The growth of mining output continued in 1969, though at a slower rate compared with the previous year. Thus, combined output of gold and base metals rose in 1969 by 12.4 per cent, compared with the 14.6 per cent increase in the previous year, and, in both years, the production of copper concentrates (the most important foreign exchange earner) expanded most rapidly among the major base metals. Important factors in the growth in recent years have been discoveries of new mineral deposits and a rapidly growing world demand for minerals. With respect to copper, for example, a new mine commenced operation recently and, because of this, together with planned new investment in copper and smelting, copper production will continue to expand at a high rate during the next few years. In the case of iron, improved export prices, coupled with Japanese preference for iron beach sand, helped to raise output in 1969 by 10.0 per cent, as against the 8.5 per cent decline in the previous year. During the first half of 1970, the gold and base metals combined output index, at 243.4 was 12.9 per cent higher than in the corresponding period in 1969.

Manufacturing

The manufacturing sector in the Philippines, being heavily import-dependent, is vulnerable to balance of payment difficulties. Upsurge in demand for domestic manufactures generated by income increases in agriculture, increased public expenditure, and restrictions on imports of consumer goods protection to local producers, together with incentives offered by the Board of Investment to strategic industries, raised growth in manufacturing outputs, in 1968, to 9.3 per cent (well above the average growth rate of 6 per cent from 1960 to 1966 and the 3.7 per cent in 1967). On the other hand, the increasing intensity of import restrictions created a supply bottleneck in 1969 as most industries heavily dependent on imported raw materials encountered extreme difficulties in importing them. As a result, manufacturing activity began to slow down in 1969 and the output index rose by only 3.5 per cent.

Because of the balance of payment constraint and adjustment problems brought about by the floating exchange rate, growth in manufacturing activity, particularly that depending on imported materials, is expected to remain depressed during 1970. Among other problems, excess capacity which already exists in several industries, including cement, glass, textiles, and paper, is likely to be aggravated in many cases by these import constraints. Industrial recovery will depend on how rapidly the balance of payment situation improves. The four-year development plan (1970/71-1973/74) assumes a gradual recovery of the manufacturing sector after the fiscal year 1970/71.

During the last two decades, the rapid expansion of the manufacturing sector has been the result of a deliberate strategy of import substitution. However, the particular policies adopted in the 1950's to achieve this goal led to the evolution of an industrial structure which served mainly the domestic market and depended heavily on imports for its raw materials. Most of the industries set up are either assembly plants of durable goods or are manufacturing consumption products at the finished stage. The four-year development plan aims at reducing the import dependency of the industrial sector in future years and thus lays stress on (*a*) a shift in manufacturing activities from mere packaging and assembly operations to the production of intermediate and capital goods; and (*b*) the development of industries which are based on domestic raw materials as well as those with high export potential. Considerable improvements have already begun to take effect following the 1967 Investment Incentive Act. As shown by the composition of projects registered with the Board of Investment (BOI) to take advantage of the incentives offered under the Act, 113 out of the 157 non-agricultural projects registered between 1 July 1968 and 31 December 1969 will be engaged in the production of a wide spectrum of intermediate and capital goods. It should be noted, however, that there cannot be any quick reduction in the import dependency of the industrial sector.

Employment and wages

During the last plan period, employment growth was rather slow and failed to keep pace with the growth of labour force. Employment in mid-1970 was estimated at 12.2 million, as against an estimated labour force of 13.2 million,[5] which suggests that these were over one million unemployed at the beginning of the new plan period. In addition, it is estimated that nearly one-fourth of those employed suffer from underemployment. The slow employment growth in recent years has been caused by the increase in productivity and the use of capital-intensive methods of production, encouraged partly by the government policies.

[5] *Four-Year Development Plan:* 1970/71-1973/74, p. 71.

While it is recognized that the problem of unemployment and underemployment cannot be solved in a very short period, continuation of the present serious situation will create social instability in the economy, and signs of this began to appear not long after the last election. Wide disparities in income levels between different regions as well as between income groups are also a potential threat to social harmony in the country. Recently available data suggest that inequalities in income distribution in both rural and urban areas accentuated between 1956 and 1965.[6]

The Philippines authorities recognize that substantial unemployment and underemployment are basic problems of the economy. The 1970/71-1973/74 plan includes a chapter on employment requirements, the target being to reduce the unemployment rate of the labour force from 7.7 per cent in mid-1970 to 5 per cent by the end of the plan period. The plan estimates that the labour force will amount to 15 million in mid-1974, hence the target for the reduction of unemployment means providing over 2 million new jobs during the plan period, or an average annual growth in employment at around 4 per cent.

The employment target is modest and can be achieved, provided that future investment planning is based on careful appraisal of alternative projects on all aspects of the economy, including employment. It is true that the scope for choice in investment planning is limited by the narrow range of alternative technologies available in most industries and the fact that several highly capital-intensive industries will be needed because of the virtual impossibility of transporting their products or because of strategic considerations. However, where such choice exists, measures such as a rise in interest rate and profit tax allowances related to employment may be taken to induce the private sector to adopt relatively more labour-intensive methods of production. To some extent, this might come as a natural consequence of the recent *de facto* devaluation of the currency. Development of infrastructure (electricity, roads, housing, schools, minor irrigation works, soil conservation, etc.) is one of the few activities where a wide range of different technologies co-exist and a major part of infrastructural activities are organized by public authorities. Public authorities should ensure that labour-intensive rather than capital-intensive methods are being applied in this sector. For increasing rural productive employment, encouragement of the use of more labour-intensive techniques of farming, and adoption of diversified and multiple cropping, will have to be an important feature of agricultural policies.[7]

Average daily money wage rates of both skilled and unskilled labourers continued their upward trend in 1969, although at a slower pace compared with the previous year. During 1969, the average money wage rates for skilled and unskilled labourers increased by 5.3 per cent and 4.7 per cent respectively.

During 1969, average real wage rates of both skilled and unskilled workers increased by 3.7 per cent and 3.2 per cent, which were only one-half and one-third of their respective increases in 1968. It may be noted, however, that average daily wage rates for both skilled and unskilled workers had steadily declined from 1955 to 1967, and that, in 1969, the average real wage rate index for skilled workers was still lower than it had been in 1955.

Money and prices

Monetary and fiscal discipline was relaxed during 1969, despite continued deterioration in the balance of payments situation and falling of foreign exchange reserves. As a result, the money supply in 1969 expanded substantially by 772 million pesos, or 19.4 per cent, and this despite the contractionary influence of a fall in net foreign exchange reserves of 497 million pesos. As in the past, the principal factor responsible for the domestic monetary expansion was the net credit expansion to the public sector. Of the total net domestic credit expansion of 1,269 pesos, during the year, 87 per cent was to the public sector. The credit needs of the government sector arise mainly from the inadequacy of tax revenues and the limited scope of non-bank borrowings by the Government. However, relaxation of fiscal discipline during 1969 led to borrowing, direct and indirect, from the monetary system on a much larger scale than in the previous years. The net result of this large expansion of money supply was that, by the end of the year, the monetary situation in the economy was characterized by excess liquidity. At the same time, the balance of payments position continued to deteriorate during the year. Thus, before the end of the year, it became clear that a switch in economic policy was a matter of urgency.

The stabilization measures adopted since November 1969, which will be discussed later, helped reduce the excess liquidity in the economy, as reflected in the reduction in money supply during the first two quarters of 1970 by 123 million pesos.

After a year and half of relative price stability, both wholesale and retail prices began to move upwards in mid-1969. The upward movement of prices

[6] The Bureau of Census and Statistics Surveys of Household Bulletins, *Family Income and Expenditure*, 1956, 1961 and 1965.
Also see Reyes, S. R., and Chan, T. D., "Family Income Distribution in the Philippines" paper presented at the 1965 Annual Conference of the Philippine Statistical Association.

[7] United Nations, *Sectoral Output and Employment Projections for the Second Development Decade*, Development Programming Techniques Series No. 8.

touched off by the crop failure of 1968/69 was reinforced by the demand pressures generated by a very large increase in the money supply during the last five months of 1969. The adoption of the floating exchange rate, and consequent decline in the external value of the currency, accelerated price increases, particularly of imported commodities and import-dependent local manufactures. There is also cost-push pressure on prices as a result of the recent increase in minimum wages by about 33 per cent. The Philippines authorities recognize that continuation of fiscal and monetary restraints will be necessary for some time in order to keep the inflationary shock of the *de facto* devaluation from getting out of hand and becoming a full-blown spiral.

External trade and balance of payments

The deterioration in the balance of payments position, which started in 1967, continued through 1969. The over-all balance of payments deficit[8] rose to a record high level of $137 million, almost three times that of the previous year. There was a moderate improvement, however, in the balance of trade, which showed a deficit of $285 million, compared with the previous year's $294 million. This drop in the trade deficit was largely brought about by a narrowing of the merchandise trade deficit from $274 million in 1968 to $257 million.

The increase in prices in the world market for most of the principal export products of the Philippines and the adoption of a floating exchange rate brought significant improvement in the balance of trade as well as in the over-all balance of payments position during the current year. Preliminary estimates for the period 1 January to 15 October 1970 indicate an over-all balance of payments surplus of $6.9 million, compared with a deficit of $125 million for the same period in 1969. The merchandise trade deficit narrowed to $15 million during the first eight months of 1970, as exports increased during this period by 24.4 per cent over the same period in 1969, and imports declined by 5 per cent from the levels in the same period of 1969. A further decline in imports was expected during the remainder of 1970.

The Government recognizes, however, that although the measures adopted in late February under the stabilization programme will help overcome the balance of payments crisis that developed during the later months of 1969, the long-term solution to the balance of payments problem lies in achieving sustained growth of exports and restricturing its industry so as to reduce the economy's import dependence.

[8] Balance on account of goods and services, transfer payments and capital movements other than changes in central bank and commercial banks short-term assets and liabilities.

Export

Merchandise exports remainded nearly unchanged in 1969 (in dollar terms) after an increase of 5 per cent in 1968. Mainly due to bad weather conditions, which affected production of export crops, export earnings from all coconut products suffered a decline in 1969. As a result of a fall in price by 10 per cent and a contraction in volume by 21 per cent, export sales of copra fell to a low record of $67 million, a drop of 61 per cent from the previous year's level. Export sales of coconut oil, which had risen by 30 per cent in 1968, declined by 35 per cent in the following year because volume as well as prices failed to match the previous year's performance.

The decline in export sales of coconut products was offset by the remarkable performance of other major exports, such as copper concentrates and logs and lumber, and by the expansion of semi-manufactured and manufactured exports, such as base metals and fertilizers. Stimulated by an upward trend in price and growing world demand for copper, production and exports of copper concentrates continued to expand at an accelerated pace during 1969. Export sales at $133 million surpassed the previous year's level by almost 50 per cent. Influenced by the construction boom in Japan and the expanding plywood industry in the Republic of Korea, export sales of logs and lumber amounted to $266 million in 1969, an increase of 4 per cent over the previous year's level. Sugar export values were higher by 3 per cent during 1969.

As noted earlier, total exports during the first eight months of 1970 registered an increase of 24.4 per cent over those of the comparable period in 1969. Except for copra and plywood, all main exports registered gains, with copper concentrates, sugar and coconut oil accounting for most of the over-all increase.

The plan forecasts an average annual growth of 8.5 per cent in merchandise export earnings over the plan period. The existing structure of exports shows heavy dependence on the sale of a few primary commodities to traditional markets. In recent years, however, efforts have been made to seek new export products and to develop minor exports, some of which (e.g. bananas, canned pineapple, pharmaceutical products, refined metals, rolled steel, manufactured fertilizers and cement) are being exported in commercial quantities. Moreover, the major Philippines exports are vulnerable to fluctuations in prices, and the production of some of them (e.g. sugar, coconut products and abaca) depends on unforeseeable and uncontrollable factors. Thus, for any large expansion of total exports in future years, properly directed efforts will be needed to promote the sale of new

commodities and manufactures in existing and new markets. In this connexion, the new export policy embodied in the Export Incentives Act of 1970, which lays stress on market and product diversification, is commendable. To increase the export volumes of coconut products and sugar, government-supported schemes have been put into operation to improve methods of cultivation, promote multiplication and propagation of high-yield variety cane, increase fertilization and improve irrigation and extension services.

Imports

Merchandise imports decreased by some 2 per cent in 1969, after increasing consistently at around 10 per cent for the last six years. The imposition of additional restrictions on imports, large inventory build-ups out of imports of the previous year and a cut-back in imports by automotive assembly plants were mainly responsible for this reversal. A decline in imports of consumer goods by some 15 per cent accounted for the entire decline in total imports. Mixed trends were exhibited by the components of producer goods. While imports of machinery and equipment rose by some 4 per cent, imports of unprocessed raw materials (particularly raw jute, raw cotton and cocoa beans) and supplies declined by around 4 per cent. Imports of semi-processed raw materials remained nearly unchanged. Further curtailment of imports took place during 1970. As noted earlier, the curtailment of imports, particularly imports of industrial raw materials, adversely affected the growth of industrial production during the second half of 1969 and during 1970.

Changes in the structure of imports over the last few years reflect the impact of import substitution. The share of capital goods and raw materials in total imports steadily increased during the 1960s, and, in 1969, about 90 per cent of imports consisted of producer goods (i.e. machinery and equipment, unprocessed and semi-processed raw materials and parts). On the other hand, imports of foodgrains have, since 1967, declined considerably largely as a result of the technological breakthrough in the production of rice and maize. In view of the existing structure of imports, any drastic curtailment of imports is not feasible without slowing down economic growth and increasing the amount of unutilized capacity in that part of the manufacturing sector which depends on imported inputs. This predicament is recognized by the Philippines authorities.

Stabilization programme

Developments during the second half of 1969 prompted the monetary authorities to adopt a policy of tight credit and import controls towards the end of that year. Ceilings for import letters of credit were severely tightened and, later, all imports were suspended except for essential categories; foreign travel allowances were reduced as well. On the fiscal side, government investments and current expenditures were drastically curtailed, and duties on certain luxury items were raised. On the monetary side, reserve requirements for all types of deposits in commercial banks were increased by 2 points to 18 per cent, and banks were required to hold 50 per cent of their reserves in the form of deposits with the Central Bank.

Subsequently, in February 1970, a comprehensive stabilization programme was adopted in conjunction with a stand-by credit agreement with IMF. The most significant feature of the programme was the introduction of a floating exchange rate system, designed to stimulate exports and as an alternative to import and exchange controls. The programme also provided for more effective management of foreign debt with a view to limiting the growth of short-term foreign debt. On the monetary side, measures to tighten credit were introduced to reduce the monetary liquidity. On the fiscal front, the Government proposed to curb the growth of expenditure and, at the same time, substantially increase revenue through improved tax administration and new tax measures.

With the exception of four leading exports (logs, sugar, copra and copper concentrates), all trade transactions under the floating exchange rate system were to be carried out at the free market rate. In the case of these four leading traditional exports, 80 per cent of the export proceeds were to be surrendered to the Central Bank at the official exchange rate of 3.90 pesos to the dollar and the remaining 20 per cent to be sold by the exporters at the prevailing market rate. Later, in May, this 80 per cent retention scheme was dropped and an export tax was substituted for it. This tax was described as a "stabilization tax" and is intended to mop up part of the wind-fall profits created by the de facto devaluation of the currency.[9]

As noted earlier, monetary stabilization in recent months has proceeded satisfactorily, by and large. There has also been considerable improvement in the over-all balance of payments position. As is usual with any such stabilization measures as a floating rate or outright devaluation, some problems of adjustment have arisen. An over 50 per cent increase in the cost of imports has produced price

[9] According to the Export Tax Law, 75 per cent of the proceeds from this tax will go to government revenue, while the balance of 25 per cent will be deposited with the Development Bank of the Philippines in a special account for financing loans to export industries (especially those adversely affected by the floating rate) and agricultural development projects in the private sector.

repercussions on the economy. Industries which depend on imports for their raw materials are facing severe difficulties, and the increased cost of agricultural inputs, such as fertilizers and equipment, is currently creating difficulties for the implementation of the expanded food programme, as well as the sugarcane production programme. It is hoped, however, that this transitionary phase will soon be over and the economy will achieve a new equilibrium position which will ensure a more efficient allocation of resources.

Current outlook

As noted earlier, the stabilization measures adopted at the beginning of 1970 have led to a slowing down of over-all economic activity. During the period of adjustment, i.e. 1970 and the first half of 1971, economic activities will, on the whole, remain depressed. Because of the adjustment in the exchange rate, the main sectors responsible for growth, in the coming years, will be largely export-oriented and minimally import-dependent activities. Growth in manufacturing activities, since these are heavily import-dependent, will be considerably depressed during the period of adjustment, but is expected to recover rapidly after 1971. Because of the slowing down of the economy, there were prospects of some increase in unemployment during 1970. At the same time, rapidly rising prices pose another serious problem of economic management for the Government. While a serious or prolonged economic set-back seems unlikely, a close watch on the stabilization programme will be required in the coming months. A certain degree of monetary and financial stabilization has already been achieved, and the balance of payment outlook for 1971 is much brighter than in the previous three years. The Philippines authorities are confident that the monetary and fiscal aspects of the stabilization programme will be successfully implemented and that, from mid-1971, the economy will begin to regain the growth momentum experienced in the past three years.

Republic of Korea

Introduction

The Republic of Korea attained a record rate of growth during 1969, accompanied by continuing inflationary pressures, a growing deficit in external accounts, and rising foreign indebtedness. Because of these problems, the Government proposed to slow down the country's rate of economic growth in 1970 by curbing investment spending and to reduce its dependence on external sources of finance.

The Government devoted increased attention to developing the lagging agricultural sector and widening the range of basic industries, added sufficient capacity to meet fully the country's energy requirements and made good progress towards removing long-standing bottlenecks in the transport system. A steady decrease was noted in the rate of unemployment, particularly in the urban sector.

The Government planned to increase its efforts towards self-reliance in 1970, but increased defence expenditures may have forced it to curtail the rate of growth of outlays on economic development. Exports continued to be buoyant but the external deficit widened because of high import requirements. Since it will be necessary to rely less on foreign grants and more on foreign loans and private foreign capital, more of the loans will have to be on concessional terms if its growing external debt burden is not to hamper the country's pursuit of economic growth.

Rate of growth

According to the Bank of Korea, the gross national product of the Republic (at 1965 constant market prices) grew by 15.9 per cent in 1969, compared with 13.3 per cent in 1968, rising from 1968's won 1,127,320 million to won 1,306,190 million (table II-3-44). In fact, the country grew at such a rapid rate that, in 1969, it had already achieved the original major aggregate targets for 1971, the final year of the second five-year plan. There were shortfalls only in the agricultural sector and in the extent to which it had reduced its reliance on external sources for capital formation (table II-3-45).

Table II-3-44. Republic of Korea: National aggregates

(in percentages)

Item	*1962-1969*	*1967-1969*	*1968*	*1969*
A. *Rate of growth*[a]				
GNP	8.3	12.5	13.3	15.9
Consumption	6.1	10.8	11.6	11.1
Gross fixed-capital formation (GFCF)	23.9	29.5	40.3	25.2
Exports of goods and services	26.2	36.8	41.6	31.9
Imports of goods and services	17.5	35.1	45.9	24.7
B. *Ratios*				
Gross fixed-capital formation as percentage of GNP	15.5	28.4	28.9	31.2
Foreign savings as percentage of GNP	13.2	14.5	15.6	16.1
Foreign savings as percentage of GFCF	85.1	51.1	54.0	50.4
Unemployment as percentage of economically active population	7.6[b]	5.4	5.1	4.8

Sources: Bank of Korea, *Economic Statistics Yearbook*, 1970, and Economic Planning Board, *Monthly Bulletin*, June 1970.

[a] Annual rate of growth, in percentages at 1965 market prices.

[b] 1963-1966 only.

Table II-3-45. Republic of Korea: Plan targets and achievement

Item	Second five-year plan target for 1971	Performance in 1969	Percentage achieved	Plan for[a] 1971	Plan for[b] 1970
GNP (in thousand million wons at 1965 prices)	1,170	1,306	(112)	1,508	1,445
Agricultural	397	370	(93)	424	385
Mining and manufacturing	314	338	(108)	455	405
Tertiary	458	598	(130)	630	656
Consumption (in thousand million wons at 1965 prices)	1,002	1,088	(109)	1,232	1,176
Investment (in thousand million wons at 1965 prices)	233	451	(194)	387	471
Exports (in million dollars)	719	1,151	(160)	1,500	1,484
Imports (in million dollars)	962	1,945	(202)	1,861	2,348
Domestic savings (in thousand million wons at 1965 prices)	168	206	(123)	276	270
Foreign savings (in million dollars)	243	794	(327)	419	864

[a] As adjusted in 1969.

[b] Based on Economic Planning Board, *Overall Resources Budget for 1970*, January 1970; the figures are under revision.

Investment and saving

To sustain its high rate of growth, the Republic devoted 31.2 per cent of its gross national product to gross fixed-capital formation in 1969, compared with 28.9 per cent in 1968. It also reduced its reliance on net resource transfers from abroad for fixed-capital formation from 54 per cent in 1968 to about 50 per cent in 1969. According to non-official estimates, the contribution from private saving to capital formation increased during 1969, compared with 1968, while that from public saving fell.

The Government has intensified its efforts to increase public sector savings, despite a projected increase in government expenditures for 1970 of 16 per cent. The rate of increase in expenditures on economic development is to be slowed down to 8.8 per cent, compared with a 20.2 per cent increase in defence spending and a 16.8 per cent increase in civil expenditures. Total tax and non-tax revenues are to be raised by 27 per cent, with increased resort to commodity taxation and government monopoly profits, a smaller increase than in the recent past. Direct foreign grants, counterpart funds, and receipts for the dispatch of armed forces to the Republic of Viet-Nam continue to decline, and the Government proposes to devote a greater proportion of counterpart funds to defence. It is hoped to keep the monetary impact of these fiscal operations to a minimum by a significant reduction in the consolidated budget deficit and by not borrowing from the Central Bank (Table II-3-46). The first supplementary budget for 1970, approved on 18 July, provides for the rehabilation of flood-stricken areas, the increased expenditure to be financed mostly by the sale of imported foodgrains and by further increases in indirect taxation.

Table II-3-46. Republic of Korea: Government finance

(in billion won)

Item	1968 budget (final)	1969 budget (final)	1970 budget (original)
A. General government sector			
1. Receipts	256.7	372.6	431.5
Taxes	186.9	262.1	344.1
— Domestic	(152.0)	(209.9)	(283.7)
— Customs	(34.8)	(52.2)	(60.4)
Counterpart funds	24.8	21.1	16.2
Others	45.0	89.4	71.2
2. Expenditure	265.0	372.1	431.2
Civil	119.1	208.1	243.2
Defence	64.7	87.6	100.5
Economic development	81.2	80.4	87.5
3. Surplus or deficit	—8.3	0.5	0.3
B. Government enterprises accounts (net)	6.8	—10.5	—1.8
C. Other special accounts (net)	—30.2	—14.7	—0.3
D. Consolidated surplus or deficit	—31.7	—24.7	—1.8
Financed by			
Cash balances (increase)	9.0	—	—
Borrowing from the Bank of Korea (increase)	13.6	11.7	—
Borrowing from public (net)	2.2	3.4	1.0
Borrowing from abroad (net)	6.9	9.6	0.8

Source: Bank of Korea.

With a view to stimulating the mobilization of private savings, interest rates on deposits were increased in 1965. The annual interest rate on time deposits of one year, for instance, was raised from 15 to 30 per cent in September 1965, and, after three downward adjustments, it stands now at 22.8 per cent. The subsequent changes were made to align the deposit rates with the loan rates, reduce the rates of lending to enterprises, particularly export and "key" industries, and stimulate the discount market in commercial bills.

Production trends:

Agriculture

The output of foodgrains rose considerably over the drought-stricken level of 1968. Thus, the output of the Republic's major cereal, rice, not only recovered from the low 1968 level of 3.195 million tons but reached a record high in 1969 of 4.090 million tons. This increase in output, according to the official 1970 grain demand-supply programme, would enable the Republic to reduce its import dependence to 17.3 per cent of its requirements, compared with 20.7 per cent in 1969.

The bumper harvest in 1969 was due not only to favourable weather but also to expansion of the area under irrigation and double cropping, and to an increase in the availability of agricultural inputs, such as fertilizers, limestone, and improved seeds. The Republic, which has for some time supplied improved seeds of the conventional varieties, is keenly interested in the "green revolution", but promotion of the new varieties is still at an experimental stage in this country.

The Government's expenditure on rural development during 1969, was budgeted to increase by about 60 per cent over the 1968 level, with emphasis on all-weather farming through construction of small-scale irrigation facilities. Thus, budgeted expenditure on groundwater development, i.e. drilling shallow wells in drought-affected areas, increased in 1969 by 58 per cent over the previous year's level and was expected to rise by about another 52 per cent in 1970. At the same time, greater attention is being paid to the need for integrated development of major river basins, and work has begun on the multipurpose Pyongtaek-Kumgang project, one-half of whose capital requirement of $90 million is to be financed by IBRD.

Farm machinery used in the Republic has increased both in number and variety, but there is still need for an increased supply of improved agricultural inputs. Also needed is an increase in the average size of the unit of cultivation, which is low because of the adoption of improved farming techniques. The Government's target is to consolidate land holdings in 45 per cent of the total land under paddy, but only 25 per cent had been consolidated by 1969. However, the Government proposes to accelerate consolidation by introducing legislation to simplify the present complex legal procedures. The Government also recognizes that agricultural credit has to be extended for a longer period and at lower interest rates than at present if improved farming techniques are to be adopted.

An additional aim of the Government is to reduce the gap between urban and rural incomes. For example, the Government has tried to reverse the adverse movement of the terms of trade between the agricultural and industrial sectors by increasing the official purchase prices of rice (1969) and of barley (1970). Since the price of rice is being raised by more than the price of barley, this may reduce the consumption of rice and increase the consumption of barley. Also, the Government has, with help from Australia and New Zealand, vigorously promoted expansion of the livestock industry through the establishment of two livestock co-operatives in each state, and nearly twenty agro-industrial projects have been fostered by the Agriculture and Fishery Development Corporation. In addition, the Government plans, over a period of ten years, to provide increased land for farmers by developing slopeland.

Fishery output, on which the Republic relies significantly for primary export earnings, increased slightly in 1969 to 863,000 tons, compared with 852,000 tons in 1968. Unfortunately, the growth of this industry is handicapped by inadequate transportation, cold storage, and marketing facilities, and a further problem is the existence of international disputes over fishing rights.

Manufacturing

The manufacturing sector, and especially manufacturing for export, continues to have the highest growth rate of any sector of the economy. Though the exceptionally high rate of 1968 was not maintained in either 1969 or the first half of 1970, the rate of growth of manufacturing output continued to be nearly twice that of national product. The output of consumer goods accounts for nearly two-thirds of total industrial output, and the variety and sophistication of consumer goods have increased in response both to internal demand, as in the case of food-processing industries, and to export demand, as in the case of textiles. Recently, however, the rate of growth of output of consumer goods has been outstripped by that of intermediate and capital goods because industrial development has increased the opportunities for import substitution in this area. Thus, while the well-established fertilizer and cement

industries have continued to expand, important new industries have appeared, manufacturing such products as plastics, synthetic fibres and petrochemicals. In addition, construction of an integrated iron and steel mill, with an initial capacity of 1.032 million tons of crude steel, is under way. The foreign exchange component of this project is to be financed by $30.8 million in grants and $42.9 million in loans from Japan under the Republic of Korea-Japan property claims funds and $50 million in loans from the Export-Import Bank of Japan. The domestic component amounts to won 35,300 million.

The rapid industrial expansion within such a short period of time has resulted in some structural weaknesses, and the Government has become increasingly aware of the need for removing these weaknesses. For example, import substitution at higher stages has been impeded by preferential treatment of imports of raw material and component parts which are then processed for sale in the profitable domestic market. In this connexion, however, the Government proposes to increase the share of domestically manufactured components in, for example, the automotive and electronics industries. Products of newly established industries producing substitutes for imports are likely to have high prices, at least in the initial stages, but the Government proposes to maintain low prices for domestically produced inputs, such as petrochemicals and chemical products.

The cost structure of the Republic's industries is characterized by comparatively low wages and high capital cost, and the interest burden is particularly onerous as the scale of production prevailing in many industries is not always optimal. According to the latest available *Mining and manufacturing survey* (1967) industrial production is becoming increasingly concentrated in large enterprises, but small and medium-sized enterprises still accounted at that time for nearly 40.2 per cent of output and 56.8 per cent of employment. While large-scale units (employing 200 persons or more) produced 60 per cent of the output of the consumer goods industries and 71 per cent of that of the intermediate goods industries, they accounted for only 53 per cent in their capital goods industries. Thus, the Republic has an industrial structure in which the average size of an industrial enterprise producing capital goods is only about half the size of one in the consumer goods industries and even less than half the size of one in the intermediate goods industries. This prevalence of so many small-scale producers in the vital capital goods industry has led the Government to take steps towards their rationalization.

To provide long-term industrial financing, the Government has enlarged the scope of the Korea Development Bank, created new financial intermediaries, and authorized the establishment of a Korea Industrial Development Corporation charged with encouraging the growth of an organized capital market. The Korean Institute of Science and Technology was set up to enlarge the supply of locally trained personnel and to disseminate modern technology. In spite of these efforts, however, almost all the big industrial projects, past and present, have been of the "turn-key" variety.

Energy

The Republic's high rate of growth has been sustained by an expansion in energy supply. Since 1967/68 the Republic has been constructing power plants at a rapid pace, and generating capacity is expected to increase from 1,636 MW in 1969 to 2,668 MW by the end of 1970. Capacity is expected to be adequate for the near future although shortfalls remain in transmission and distribution facilities. Because coal reserves are limited, the Government is seeking to bring about a shift from coal to oil and planned to increase installed capacity for petroleum refining from 175,000 bpd in 1969 to 275,000 bpd in 1970. This will make the Republic almost self-sufficient in gasoline, diesel and other oils.

Transport

The Republic is making continued progress in removing long-standing bottlenecks in the transport sector. There are plans to relieve the strains on the railways by a shift to vehicular transport and coastal shipping; and, in July 1970, the Seoul-Pusan expressway, linking the capital to the large port, was completed. However, more feeder roads have to be constructed, minor roads need to be repaired, and minor ports improved. In the meantime, the railways still carry nearly three-fourths of the freight and there have been important improvements in this sector. With external financial assistance, more tracks have been laid, the number of diesel locomotives increased, and the rolling stock has grown and been modernized. The Republic has also been steadily adding to its present small ocean and coastal fleet, and plans to expand its shipbuilding industry with the co-operation of Japan.

Stabilization measures

The high rate of growth in 1969 was accompanied by a large expansion of credit and of the money supply, particularly in the latter half of the year. This resulted in inflationary pressure which continued to mount in 1970, in spite of the Government's attempt to "cool" the economy by slowing down the rate of investment and restricting the expansion of credit.

The money supply increased during 1969 by 45.5 per cent, nearly three times the rate of growth of real national product (15.9 per cent). Factors contributing to this expansion were: the budgetary deficit, bank credit extended to the private sector, and the large inflow of foreign cash loans. For 1970 the target increase in the money supply was set at a lower level than for the previous year.

The Government had earlier set the reserve base (notes and coins issued by the Bank of Korea and commercial banks deposits with the Bank of Korea) as the guide to the expansion of credits. The reserve base rose from won 156.100 million at the end of 1968 to won 215.800 million by the end of 1969 while the increase the Government desired was only won 199.100 million. Now, however, credit creation is to be controlled more directly through a ceiling on the expansion of domestic credit by the banking system. The plan for 1970 was to hold credit expansion to 40 per cent, compared with 60 per cent in 1969, but this is likely to be exceeded because of a probable inflow of foreign cash loans.

In line with this objective of reducing the growth rate of the money supply in 1970, credit was restrained in the earlier part of the year, and official figures for the money supply during the first half of the year seem to indicate that the official target was met. Expansionary pressures continued to be strong, however. The Government's original and first supplementary budgets for 1970 had aimed at holding expansionary forces to a minimum, but the planned reduction in the consolidated deficit on government account had not fully taken into account the amount of official grain purchases. In the latter part of the year, also, there were indications of relaxation of the restrictions on private sector credit, and there was no indication of a change in the Government's policy of subsidizing export industries. Finally, there were some large industrial firms with heavy internal and foreign debt burdens and with inadequate cash flows, and governmental reorganization of such firms had invariably involved provision of additional credit, including even foreign cash loans.

In recent years, a continuing inflationary factor in credit expansion in the external sector has been an increasing resort to foreign cash loans, even for financing the domestic expenditure on projects. Foreign cash loan inflow in 1969 was at three times the level the Government had set as a target, and a considerable spillover was expected in 1970. The Government is contemplating the imposition of an interest equalization tax to discourage an excessive inflow of foreign cash loans that take advantage of the higher interest rates in the Republic.

The Government officially continues to follow a floating exchange rate policy which allows the foreign exchange rate to find its own level. In theory, the commercial banks determine their own rates for foreign exchange, but, in practice, the market follows the lead of the official Korea Exchange Bank which dominates foreign exchange transactions. The won per dollar rate fell from won 281 on 31 December 1968 to won 305 on 31 December 1969 and won 311 on 30 June 1970. However, the fall in the exchange rate was not commensurate with the increase in the Republic's external deficit on current account or with the comparative rise in prices within the Republic. The Government continued to concentrate on stimulating exports through various subsidies and concessions and reducing imports through restrictive measures.

Price movements

Prices increased during 1969 at a lower rate than in the preceding years, but, in the first seven months of 1970, they started rising at a rate greater than in the corresponding period of 1969. The wholesale price index in 1969 recorded an increase of 6.8 per cent, compared with 8.1 per cent in 1968, but, in the first seven months of 1970 it rose by 5.8 per cent, compared with 4.8 per cent during the corresponding period of the year before. Among the factors accounting for this increase were a higher government purchase price for foodgrains, increased prices of imported commodities and construction materials, and the delayed effect of the monetary expansion of the latter part of 1969.

Higher prices of basic goods, along with continued shortfalls in the supply of social services (e.g. housing, education, and medical facilities), pushed the cost of living upwards. The all-urban consumer price index rose by 12.3 per cent in 1969, compared with 10.8 per cent in 1968, and continued to climb in the first four months of 1970 by nearly 5.3 per cent, compared with the rise of 4.5 per cent in the corresponding period of 1969.

Population, wages and employment

By the end of 1969, the Republic's population was estimated at 31.5 million. The rate of growth of population declined by about 0.05 percentage points annually during the period 1963-1968 to a rate of 2.3 per cent in 1968, and the goal is to reduce it to 2 per cent by 1971. The Government's own expenditure on family planning rose substantially in 1969, and this was supplemented by assistance from Sweden and the United States. The number of people migrating into urban areas has been increasing, on the average, by 2.7 per cent a year, with annual migration into Seoul as high as 6 per cent, and there is an acute shortage of housing in the urban areas.

Data on wages and productivity are fragmentary. According to an official statement, real wages rose during the 1960s, but the increase in productivity was greater. Thus, the labour productivity index rose from 72.5 in 1961 (1965=100) to 177.3 in 1969, while the real wage index increased from 113.9 in 1961 to only 137.8 in 1969. Shortages have begun to appear in the supply of technically skilled labour, and more rapid increases in average rates may result, but the level of wages is still generally considered to be low.

According to the *Survey of economically active population*, unemployment has steadily declined, the percentage of unemployed to economically active population decreasing from 6.2 in 1967 to 5.1 in 1968 and to 4.8 in 1969. The decline, which was in large part due to rapid industrial expansion and to growth in the service sectors, was greater in the non-farm sector than in the farm sector (which also has a higher degree of "disguised" unemployment).

Balance of trade and payments

The Republic's rapid rate of growth has been marked by buoyant expansion in its commodity exports which grew at an annual rate of 40.8 per cent during 1962-1969 and at 42.2 per cent in 1968. Although growth in 1969 was less impressive than in 1968, commodity exports continued to increase at a high rate of 36.7 per cent, from $455.4 million in 1968 to $622.5 million in 1969. This remarkable increase in commodity exports has been characterized by the expansion and diversification of exports of manufactured goods whose share in the total increased from 74.3 per cent in 1968 to 77.0 per cent in 1969. One-half of the total merchandise exports continued to go to the United States and a little more than one-fifth to Japan. The United States takes nearly all of the Republic's exports of human hair and wigs and of plywood and footwear, nearly three-fourths of electrical machinery exports, and slightly less than two-thirds of clothing exports.

The Republic is faced with a growing imbalance in its trade with Japan. Its deficit with that country accounted for half of its over-all trade deficit in both 1968 and 1969, the latter a year during which the over-all trade deficit increased by one-fifth. The Republic's imports from Japan consist not only of capital goods and transport equipment but also of industrial raw materials, such as synthetic fibres. The Republic hopes to benefit from a recent decision by Japan to change the base for import duties on a limited number of items which contain Japanese raw materials and intermediate components. The base had been the value of the goods, but it now becomes the value added to what was imported from Japan. The Republic also hopes to increase its exports to Japan of primary goods, particularly food items.

The import content of Korea's exports is very high, amounting in the aggregate to 37.6 per cent, and, in the case of manufactured goods, to 46.8 per cent. Also, subsidies to export industries, in the form of tax and credit concessions and preferential treatment with respect to imports of raw materials and capital goods, continue to be substantial. According to unofficial estimates, they amounted to nearly 27 per cent of export value in 1968, and indications are that they have been increasing since. There is growing official recognition of the vital need to make export industries more efficient in view of their dependence on imported raw materials and the inevitable tendency for wages to rise. However, there has been no attempt yet to make the system of export subsidies discriminatory with a view to encouraging productivity.

The imports of this rapidly growing economy continued to increase, rising from $1,462.9 million in 1968 to $1,823.6 million in 1969. The rate of increase in imports in 1969 (24.7 per cent) was, however, lower than in the previous year, owing to a decline in the rate of increase in capital goods imports. Consumer goods imports were kept under control, but imports of foodgrains rose significantly in 1969 due to the drought in 1968. Also of importance were increased imports of raw materials, such as lumber and wood for plywood manufacture, synthetic fibres and wood for the textile industry, and crude oil for petroleum refining. However, growing domestic production continued to replace imports of fertilizer and cement. Of the Republic's total imports, a little more than 40 per cent came from Japan and about 30 per cent from the United States.

The growth of imports has slowed down the momentum of the import liberalization initiated by the "negative list" introduced in 1967. Imports are controlled by quantitative import restrictions, advance deposits against imports, and import duties. Since 1969, the Government has been engaged in an over-all review of tariff policy with a view to providing discriminating protection. To this end, it has introduced modifications in the tariff structure in specified cases where domestic prices are higher than import prices.

The Republic's merchandise trade deficit increased from $835.8 million in 1968 to $991.7 million in 1969, and the surplus on "invisible" account continued to be small but growing. Total deficit on current account grew at a slower rate in 1969 to $550.8 million, compared with an increase of 60 per cent to $440.3 million during 1968.

External aid and foreign capital

External official transfers have increasingly taken the form of loans instead of grants. Thus, during 1969, foreign grants to the Republic amounted to $140.0 million, and foreign loans, $547.8 million, while, in 1968, the flow of grants was $135.9 million, and of foreign loans, $338.6 million. Of this inflow, most comes from the United States, but Japan's share has continued to increase.

There was a decline in project assistance and PL-480 grants from the United States from $85.5 million in 1968 to $67.7 million in 1969 and AID loans decreased from $42.4 million to $27.5 million. By contrast, with the increase in PL-480 assistance in the form of concessional loans, United States government loans to the Republic rose from $48.7 million in 1968 to $117.9 million in 1969. Claims funds from Japan increased significantly during 1969 with $32.7 million in grants and $21.1 million in loans, compared with $30.0 million in grants and $16.6 million in loans during 1968. Recently, there has also been an increase in loans from international financial organizations.

Foreign investors continue to be attracted to the Republic by its growth prospects and liberal concessions. There has been a relative slackening in the inflow recently, however, as the Government has taken measures to induce foreign capital to conform to plan priorities and to reduce the external debt burden.

As of May 1970, foreign capital contracted for introduction into the Republic stood at $2,600 million, but the rate of increase was declining. Thus, the amount contracted for during the first five months of 1970 was only $173.2 million, compared with $557.4 million in 1968 and $902.6 million in 1969. Nearly 94 per cent of foreign capital continues to be in the form of loans with government and commercial bank guarantees, so the share of direct investment is only about 6 per cent. Commercial loans, mostly guaranteed by commercial banks, generally have a comparatively short period of repayment and a high interest rate. Such loans accounted for 84 per cent of the total in 1968 and about 70 per cent in 1969, indicating the hardening terms at which they have been obtained. During 1970, the share of loans to the public sector continued to increase, and more than half of such loans were provided by international financial institutions such as ADB, IBRD, IDA and the International Financial Corporation, attesting to the Government's success in attracting concessional loans. Most foreign capital has been utilized for infrastructure projects in such areas as transportation and electricity, for the manufacture of producer goods, and for the development of medium and small-scale industries. Recently, however, rural development has slightly increased its share.

External debt burden

According to official figures, debt servicing will absorb nearly one-sixth of commodity export earnings in 1970 for which a target of $1,000 million has been set. These figures, however, do not include repayments on loans with a maturity of less than three years.

Current prospects

The Republic's annual plan for the fourth year of its second five-year plan, the over-all resources budget for 1970, was drawn up against the background of problems arising from the rapid growth in 1969. The projected rate of growth in gross national product for 1970 was reduced to 10 per cent; according to preliminary figures it had already reached 9.7 per cent (annual rate). The planned rate of gross capital formation was also lowered, from an estimated 34.3 per cent of GNP in 1969 to 32.5 per cent in 1970. The objective was to reduce dependence on foreign savings from 16.2 of GNP in 1969 to 13.9 per cent in 1970, with an increase in domestic savings from 18.1 to 18.6 per cent. Since the high-priority projects proposed for 1970 in the industrial as well as in the agricultural sectors are more capital-intensive than in the past, the desired decline in the investment rate can be achieved only if the proposed reduction or postponement of "inessential projects" is carried through.

A target of $1,000 million was set for commodity exports for 1970, although this increase of about 51 per cent will be difficult to achieve in the light of the current prospects for the Republic's leading exports, such as textiles and plywood. Invisible receipts were expected to increase slightly, though their main component, earnings from the war in Viet-Nam, had already started to decelerate in 1969. Merchandise imports were to decline to $1,805 million in 1970 from $1,823.6 million in 1969, but this, like the export target, may be hard to reach. While the import of capital goods may be kept down through rationalization of domestic industry, it will be difficult to restrict the import of raw materials and intermediate goods needed by the export industries for the achievement of their target of $1,000 million. Imports of services may also increase, compared with 1969, particularly shipping services.

In sum, the Republic may find it difficult to achieve a reduction in foreign capital inflow of the magnitude envisaged in the over-all resource budget. In view of the growing foreign debt service obligations, it may therefore need more foreign capital from official sources at concesisonal terms than envisaged in its plans.

Singapore

Major trends and policy issues for the year

The two major problems confronting the Government of Singapore at the beginning of 1970 were an anticipated decline in the rate of growth of world trade and an expected fall in British military spending. In neither case was there much that the Government could do to prevent the event from taking place, so the policy problem confronting the Government was how to offset the potentially adverse effects of these developments.[2]

With respect to British withdrawal, the Government has already instituted programmes for retraining workers and has begun implementing plans for putting those facilities given up by the British to other uses. To counter the aggregate impact of lower spending by the British, the Government expected to rely in part on funds provided from abroad, but, more importantly, on increased investment and exports, and this despite the projected slowing down in the rate of growth of world trade. In view of Singapore's very heavy dependence on foreign trade, no other policy was possible, and the Government of Singapore was realistic enough to recognize this.

The Government has long since recognized that prospects are limited for expanding the entrepôt trade on which Singapore's economy has traditionally been dependent. For several years, therefore, it has been engaged in efforts to develop new lines of activity, especially manufacturing and tourism. These efforts have taken the form of investment incentive schemes, the mechanics of which have changed over time, but which basically function by providing tax relief for a period the length of which depends on such criteria as export orientation and the size and technological intensity of the firms involved.[3]

In addition to investment incentives, the Government enacted labour legislation (the Employment Act of 1968) which, from a management point of view, is extremely attractive since it severely restricts the range of conditions of employment which are subject to collective bargaining. Also, the Government has progressively liberalized immigration legislation to combat a steadily increasing shortage of skilled labour.

Nor has the Government hesitated to become directly involved in the economy. It owns outright a major interest in several firms, including an ocean shipping line. The Jurong Town Corporation develops and manages industrial estates, the Development Bank of Singapore makes both loan and equity capital available to new enterprises, and the International Trading Corporation assists exporters at home and maintains a network of offices abroad to seek out new markets.

An important measure of the success of these efforts is that, by mid-1970, there were 255 pioneer establishments in production, supplying employment to 42,730 workers, with output of S$1,340 million, value added of S$340 million, and export sales of S$540 million.[4] These firms constituted only 14.3 per cent of manufacturing establishments with ten or more workers, but they provided 44.1 per cent of employment, 45.3 per cent of value of output and 35.1 per cent of value added. There were, in addition, forty-nine pioneer establishments in implementation.[5]

As for tourism, receipts in this sector were growing faster in 1969 than in any other sector in the economy. In fact, gains here were expected to be substantial enough to offset completely the impact of cut-backs in British military spending during 1970 and 1971.

The record in 1969

Gross domestic expenditure at current prices in 1969 rose to S$4,654.6 million, an increase of 9.8 per cent over 1968. In *per capita* terms, this was an 8.3 per cent rate of growth.

The increase in the supply of money[6] during 1969 amounted to 18.2 per cent. However, this had little effect on prices, the Consumer Price Index declining from 111.4 in 1968 to 111.1 in 1969.

Gross domestic fixed capital formation was up from the previous year by 25 per cent, of which 64.9 per cent was private sector investment and 35.1 per cent was public sector. This constituted 18 per cent of GDP at market prices, up from 16.4 per cent in 1968. While gross national savings are not necessarily used for capital formation, they were more than adequate for this purpose, amounting in 1969 to 18.9 per cent of GDP at market prices, compared with 23 per cent in 1968.

By industrial origin, the most important components of GDP (factor cost) were entrepôt trade (17.5 per cent), manufacturing (17.1 per cent), domestic trade (16.1 per cent), and "other" (15.7 per cent), the four between them accounting for 66.4 per cent of GDP in 1969. Considering Singapore's

[1] This is the first time since 1955 that a survey of Singapore has been included in the *Economic Survey of Asia and the Far East.*

[2] The Minister for Finance's Budget Statement on 9 March 1970.

[3] Economic Expansion Incentives (Relief from Income Tax) Act of 1967.

[4] Value of imported inputs and net foreign exchange earnings/losses.

[5] "Progress of Manufacturing Industries" (table), *Singapore Trade and Industry,* Singapore, September 1970, p. 27.

[6] Currency in active circulation plus demand deposits, excluding government demand deposits.

desire to boost manufacturing activities, it is worthy of note that manufacturing was up from the year before as a percentage of the total, and, in terms of year-to-year percentage gains, manufacturing rose by 22.5 per cent, exceeded only by the gains of 45 per cent in tourism and 31.1 per cent in the entrepôt trade.

In the foreign sector, there was a deficit of S$1,392 million on merchandise account, up from 1968's deficit by approximately 19 per cent. The deficit was reduced by a favourable balance on "Services and unrequited transfers" to S$687 million which was more than covered by a large "Net errors and omissions" item of S$975 million. There was also a private long-term capital inflow of S$109 million and a public inflow of S$64 million. Singapore's foreign exchange holdings increased to S$3,151 million in 1969, a rise of 35.6 per cent, compared with an increase of 22.3 per cent in 1968.

The commodity composition of trade shifted in a way which reflected the Malaysian export boom and, in all probability, the continuing apparent importance of trade with Indonesia.[7] For example, exports of crude rubber were up from 21.5 per cent of total exports in 1968 to 27.8 per cent in 1969. On the import side, food items and live animals dropped from 17.5 per cent in 1968 to 14.5 per cent in 1969, and, reflecting greater exports, imports of rubber were up from 11.7 per cent to 14.3 per cent.

The only sector whose output did not increase during 1969 was "Military services", where the effects of British withdrawal are beginning to be felt with increasing force. GDP originating in the manufacturing sector was up by 22.5 per cent, and this sector also rose as a percentage of GDP from 15.8 (1968) to 17.1 per cent (1969). The largest gain in percentage terms, however, was in tourism, which rose over 1968 by 45.5 per cent. This sector still accounts for only 4.4 per cent of GDP, but it is expected to continue to grow at a very rapid rate. Finally, the large 1969 rise in the entrepôt sector has already been noted and explained above in the discussion of the commodity composition of trade.

Figures on unemployment are not available, but the Finance Minister's speech on the 1970/71 budget makes it clear that unemployment is no longer considered a serious problem in Singapore. In fact, there is such a shortage of skilled labour that changes have been made in the immigration laws to encourage skilled workers to emigrate.

[7] Figures on trade with Indonesia have not been published since 1963.

It is difficult to deal with developments in the public sector for 1969 on a comparative basis because the Government was in the process of changing to a new fiscal year. In the future, the fiscal year will cover the period 1 April-31 March, but, during the transition period, 1 January 1969—31 March 1970 was used as the financial year. With respect to this period, data are available only on a 15-month basis. To cope with this problem, estimates for 1969 were obtained by taking four-fifths of the 15-month figures, and comparisons with 1968 are made on this basis. Wherever appropriate, however, the 1 January 1969—31 March 1970 figures appear in parentheses after those for 1969.

Current government expenditure for 1969 was up by 5.8 per cent from 1968. Of the total, general services accounted for 35.5 per cent (including S$30 million transferred to the Development Fund), social services for 33.4 per cent, economic services for 7 per cent, community services for 2.1 per cent, and unallocable expenditures for 21.9 per cent.

Current revenue amounted to S$840.4 million (S$1,050.6 million), higher by S$46.9 million than 1968, a 4.7 percentage increase. Of this sum, taxes provided 69.2 per cent, reimbursements on sales of goods and services 13.7 per cent, income from investments and property 5 per cent, and "other" 16.2 per cent. The revenue shortfall of S$9.4 million was covered by a transfer from reserves.

Pro rata development expenditure in 1969 was approximately S$257.6 million (S$322 million). These funds were allocated among the various ministries as follows: Ministry of Finance, 41.4 per cent for loans to statutory authorities and to industrial and commercial enterprises; Ministry of Education, 9.6 per cent; Ministry of Interior and Defence, 14.9 per cent; Ministry of Law and National Development, 27.2 per cent; and the remaining 6.9 per cent among the other Ministries.

Similarly revised data on Development Fund receipts are not yet available, but an idea of the manner in which development expenditure was financed can be obtained from unrevised data by noting what percentage of receipts was expected to come from what source. For 1969, the pro-rated total expected was S$249.4 million (S$311.6 million). Of this, 12 per cent was to come from the current budget (Consolidated revene account), 54.6 per cent from borrowing (Consolidated loan account), and 33.4 per cent from unspecified "other" sources. This would have left a surplus for the Development Fund, but whether such a surplus in fact materialized can only be determined when more recent data are available.

Performance in 1970[8]

Data for 1970 are still fragmentary, but are available in some areas of particular interest, such as the foreign trade sector. During the period July 1969-June 1970, imports increased over the previous 12 months by 27.4 per cent to a level of S$6,951 million. For the same period, exports were up 12.4 per cent to S$4,816 million. The merchandise account deficit for the 1969/70 period was therefore S$2,136 million, up substantially from S$1,175 million in 1968/69.

In May 1970, commercial bank deposits were S$2,959 million, or 20.7 per cent larger than in May 1969, while loans and advances had risen over the same period by 22.9 per cent. In June 1970, the Consumer Price Index stood at 110.8, compared with 111.8 at the beginning of the year and 110.9 in June 1969.

From July 1969 to June 1970, government revenue was S$1,111 million or 29.4 per cent higher than during the corresponding 12-month period a year earlier.[9] The greatest absolute increase was in income tax receipts which rose by S$72.7 million or 43.6 per cent.

In the manufacturing sector, the number of establishments with ten or more workers rose to 1,780 in mid-1970, a percentage increase of 7.9 over mid-1969. Between the same two dates, the number of workers employed by the establishments rose from 82,320 to 96,820 (17.6 per cent), the output from S$2,420 million to S$2,960 million (22.3 per cent), the census valued added from S$780 million to S$970 million (24.4 per cent), and domestic exports from S$750 million to S$970 million (29.3 per cent). Pioneer establishments accounted for much of the change.[10]

For the period July 1969-July 1970, outlays on construction were S$236 million, up by 8.15 per cent from the July 1968 to July 1969 figure. Growth in the private sector was 10.71 per cent, while in the public sector it was 6.99 per cent.

Finally, tourist arrivals by sea and air during the first five months of 1970 were up by 26 per cent from the same period in 1969, from 154,000 to 193,000.

In sum, events in 1970 were proceeding much as projected by the Finance Minister in his 1970 budget message. The rate of increase in exports was down and that of imports was up, the latter in good part due to increased imports of steel plates, industrial machinery and non-electrical machinery. These kinds of imports reflect Singapore's continuing success in attracting new industries and should later be reflected in rising exports. Finally, tourism was well up over the previous year, and this again as expected.

Over-all growth and the use of resources

Since 1965, Singapore's GNP has risen from S$3,266 million to S$5,206 million, an average of 12.4 per cent annually. The corresponding increase in GDP at market prices was from S$3,213 million to S$5,096 million. The difference between these two figures reflects a continuing net inflow of factor receipts from abroad. *Per capita* GNP has likewise grown rapidly, rising from $1,751 in 1965 to $2,581 in 1969, a compound rate of growth of 10.2 per cent.

As a percentage of gross domestic expenditure at market prices, gross domestic fixed-capital formation was 19.7 in 1969, up from 17.4 in 1968 and 14.7 in 1965. Private consumption expenditure also rose in absolute terms over the 1965/69 period, but, of course, fell as a percentage of gross domestic expenditure (GDE). As between public and private consumption, public spending was 11.4 per cent of GDE in 1969, up from 9.7 per cent in 1965, while private spending had declined from 75.6 per cent to 68.9 per cent.

Gross national savings rose from S$507 million in 1965 (15.8 per cent of GDP at market prices) to S$1.470 million in 1969 (28.8 per cent of GDP at market prices) an increase of 190 per cent. Except for 1965, GDE has been less each year than GDP, and this has been reflected in increasing annual additions to Singapore's foreign exchange reserves (S$514 million in 1969).

As a source of GDP (factor cost), manufacturing has steadily increased in both absolute and relative terms since 1965, rising from S$414.3 million in that year (13.6 per cent of GDP) to S$827 million in 1969 (17.1 per cent of GDP). With respect to other sectors, wholesale and retail trade continued to be the largest in 1969, accounting for 33.6 per cent of GDP. Slightly over half of this was entrepôt trade and the rest domestic. In declining order of relative importance, the two sectors already discussed were followed by "other services" (15.7 per cent), British military services (8.6 per cent), government services (6.7 per cent), tourism (4.4 per cent), construction (4.3 per cent), ownership of dwellings (3.8 per cent), agriculture and fisheries (3.3 per cent), and electricity, gas, and water services (2.5 per cent).

[8] Unless otherwise indicated, data from this point on are either from *Yearbook of Statistics, Singapore, 1969*, Department of Statistics, Singapore: *Monthly Digest of Statistics*, vol. IX, No. 8, August 1970, Department of Statistics, Singapore; or mimeographed statistical tables (undated) released by the Department of Statistics, Singapore.

[9] The figures for earlier 12-month period were estimated by the procedure explained above.

[10] "Progress of Manufacturing Industries", *op. cit.*

Agriculture

Gross domestic product (factor cost) originating in the agricultural and fisheries sector has grown in absolute terms, but has declined in relative terms from 4.9 per cent of GDP in 1965 to 3.3 per cent in 1969. Possibilities of further expansion in this sector, and particularly in agriculture, are, of course, limited, but by no means exhausted. Singapore can hardly supply itself with rice but has been able to meet most of its requirements for meat, poultry and eggs, and more than 50 per cent of its needs for fresh vegetables. Imports of fish continue to supply the bulk of domestic needs, but the Government is promoting increased domestic production and hopes to reverse the declining trend in local production and employment in this industry.

Industrial production

General

As already noted, it is a major objective of policy to promote the growth of industry in Singapore and especially of industry which is export-oriented.

As part of an intensified effort to encourage both foreign and domestic investment in Singapore, the Government in 1967 introduced new investment incentives which provided tax relief not only for new (pioneer) firms but for expansion by existing firms and for firms which met certain export goals as well. In general, the degree of tax relief varied directly with the amount invested. On 22 July 1970, this Act was amended to require greater investment to qualify for particular incentives, but the basic nature and purpose of the Act remained the same.

Initially the Government attempted to attract industries which were highly labour-intensive, because unemployment was a major problem during the first years of Singapore's existence as an independent country. However, the very success of the Government's efforts to attract industry led to virtually full employment and to a level of wages higher than in many other countries in the region, although, with high labour-productivity, unit labour costs have remained low. As a consequence, the Government has reversed its earlier position, and on 12 July 1970, the list of industries eligible for pioneer status was revised with a view to attracting industries not sensitive to wage increases.

Manufacturing

The success Singapore has had in encouraging the growth of manufacturing is apparent from a comparison of data for 1965 and 1970, the data for the latter year based on the situation at mid-year. The number of establishments has grown from 1,000 to 1,780 (78 per cent); the number of workers from 46,020 to 96,820 (110.4 per cent); output from S$1,036 million to S$2,960 million (172.6 per cent); value added (gross) from S$348.4 million to S$970 million (178.4 per cent), and direct or domestic exports from S$349.2 million to S$970 million (177.8 per cent).[11] These data indicate a substantial rise in the size of establishments and a conspicuous increase in the productivity per unit of labour.

The importance of the incentive programmes is also apparent from comparisons of the status of pioneer firms between the same dates. In 1965, pioneer establishments accounted for only 22.8 per cent of employment, 29.3 per cent of value of output, and 24.6 per cent of gross value added. By mid-1970, they contributed 44.1 per cent of employment, 45.3 per cent of value of output and 35.1 per cent of gross value added.

Data limitations preclude a detailed examination of the change in the composition of manufacturing output over the same period, but some comparison is possible between 1966 and 1969 for a limited number of manufacturing industries. In every case, comparison is with a 1966 base of 100. The general index (Quarterly Index of Production of Manufacturing Establishments) was up by 60.7 points, food manufacturing 38.7 beverages 6.3, wood and cork 15.1, printing, publishing, and allied industries 21.2, petroleum and coal 141.4, non-metallic mineral products 7.8, metal products (excluding machinery and transport equipment) 59.4, and transport equipment 135.2.

The importance of the petroleum industry is clearly illustrated by the fact that, in 1969, its value of production was second only to that of rubber processing and its value added was almost four times greater. However, it did not rank high among industrial employers in terms of either value added or employee remuneration, this being a very capital-intensive industry.

Energy

The production of electric power increased in 1969 to 1,653 million kWh from 1,446 million in 1968 and 913 million in 1965. Of the total in 1969, 1,058 million was for commercial and industrial use (64.0 per cent), 306 million (18.5 per cent) for domestic power, and 289 million (17.5 per cent) for lighting. By way of contrast, only 51.5 per cent of the total was used for industrial and commercial purposes in 1965.

Construction

Gross domestic expenditure on construction in 1969 was S$401 million, up 15.9 per cent from S$346

[11] "Progress of Manufacturing Industries", *op. cit.*

million in 1968. Of the 1969 total, S$146 million (36.4 per cent) represented dwellings, and there was an increase in 1969 over 1968 of 13,250 units under management by the Housing and Development Board. Industrial construction, as measured by thousands of square feet of floor space completed, was 1.087 million, an increase of 28.9 per cent over 1968, and such construction accounted for 55.3 per cent of total square feet completed in the private sector.

Services

Discussion of activities in this sector must of necessity be rather general because of data problems. Thus, for example, the activities of the financial sector are reflected in statistics on banking and insurance, while data on services rendered to ships in port do not appear readily available. As a consequence, discussion here will be centred on tourism which is, in any event, one of the fastest growing sectors of the economy.

During the first five months of 1970, tourist arrivals were estimated at 193,000, up 26 per cent from the same period in 1968. In terms of gross domestic product at factor cost, tourism accounted for S$210.7 million of the total in 1969 (4.4 per cent), up by 45 per cent from 1968 and by 227 per cent from 1965. As late as 1966, this sector was smaller than every other category except electricity, gas and water services as a percentage of GDP. By 1969, it accounted for a larger share than agriculture and fisheries, construction, utilities and the ownership of dwellings and was growing faster than any other sector.

External trade and the balance of payments

The value of Singapore's gross exports rose from approximately S$3,004 million in 1965 to nearly S$4,741 million in 1969, an increase of 57.8 per cent, and, for the first five months of 1970, they were 4.8 per cent over the comparable period in 1969. Of the total in 1969, the two largest categories were inedible crude materials except fuels (34.9 per cent) and mineral fuels, lubricants and related materials (19.6 per cent), and both were well up from their respective shares in 1965. Exports of domestic products were also up, being 22 per cent greater in 1969 than in 1968. Except for a brief and very small recovery in 1969, exports to Malaysia have declined in absolute terms every year since 1965, and this downward trend appeared to be continuing in 1970, based on figures for the first five months. Thus, in 1965, nearly 41 per cent of Singapore's exports were to Malaysia, while exports to Malaysia during the first five months of 1970 constituted only about 18 per cent of the total.

The rate of increase of gross imports has been even larger than that of exports since 1965. In that year, their value was S$3,807 million, but it had risen to S$6,903 million (annual rate based on the first five months) in 1970, an increase of 81.3 per cent per annum. Compared with the first five months of 1969, imports were up by S$577.3 million or 24.4 per cent.

Unfortunately, statistics of trade with Indonesia are not available for any part of the period under consideration, and one can only speculate that Indonesia has very likely replaced Malaysia as Singapore's most important trading partner.

With the exception of 1966, Singapore's unfavourable trade balance has been growing since 1965 and amounted to S$1,392 million in 1969, up from S$1,170 million in 1968 and S$760 million in 1965. The balance on services account has been consistently in Singapore's favour, but only in 1966 was it large enough to offset the merchandise trade deficit. Thus, in 1969, net services brought in S$742 million, which reduced the deficit on goods and services combined to S$650 million, compared with S$435 million in 1968 and S$101 million in 1965. The significance of these deficits is hard to evaluate, however, because, as already noted, data on trade with Indonesia are not available. This trade is reflected in a very large net errors and omissions item in the accounts—(S$975 million for 1969)—which more than offsets the trade and services deficit. Non-monetary capital inflows amounted to S$173 million, of which S$142 million was private and S$31 million was public.

The result of all this for 1969 was an over-all balance of payments surplus of S$461 million, down from S$548 million in 1968 but higher than for any other year in the 1965/69 period. S$104 million of the surplus took the form of an increase in the Currency Board's foreign assets holdings, commercial bank holdings of foreign assets rose by S$172 million, and the foreign assets of the central Government rose by S$185 million. Since 1965, which was the last year in which there was a balance of payments deficit, Singapore's total net foreign exchange reserves had risen by 1969 to S$3,128 million (from S$2,302 million in 1968 and S$1,391 million in 1965).

Population and social development

Singapore's population, as of mid-1969, was 2.017 million, an increase of 1.5 per cent over the previous year, but a decline from a rate of increase of 2.5 per cent in 1965. This decline has been the result of a number of factors, notable among which are that the population is almost entirely urban, that *per capita* income is relatively high, and that the Government has aggressively pursued a programme of family planning.

While complete labour force statistics are not available, the Commissioner of Labour compiles a series called "Persons engaged, by industry and occupation group" which provides some insight into the structure and composition of the employed labour force. In 1969, total reported employment according to this source was 399,480, of whom 2,361 (0.6 per cent) were in agriculture, forestry, hunting and fishing, 110,013 in manufacturing (27.5 per cent), 21,247 in construction (5.3 per cent), 13,098 in utilities (3.3 per cent), 89,314 in commerce (22.4 per cent), 38,225 in transport, storage, and communication (9.6 per cent), and 123,559 in services (30.9 per cent). Of these workers, 298,664 (74.8 per cent) were males and 100,816 (25.2 per cent) were females. Registered unemployment, as of 31 July 1970, was 52,000, down by 14 per cent from the year before. Considering the level of unemployment in several countries of the region, Singapore's present level of unemployment cannot be considered serious, although the Government regards involuntary unemployment as unfortunate and aims at achieving full employment.

For reported contributors to the Central Provident Fund in 1968 (282,000 contributors), 9 per cent earned S$500 a month and over, 4.5 per cent earned from S$400 to under S$500, 7.3 per cent from S$300 to under S$400, 18.3 per cent from S$200 to under S$300, 41.7 per cent from S$100 to under S$200, and 19.2 per cent less than S$100.

It is also instructive that the number of reported "work stoppages" declined from 30 in 1965 to zero in 1969. Two were reported in 1970, up to 10 July, but the number of man days lost was negligible.

Monetary developments

Between 1965 and June 1970, the Consumer Price Index had risen by only 6.4 points (8.7 per cent) from 105.0 to 111.4 (April/May 1960=100). Data on the money supply are not available for 1970, but, at the end of 1969, it stood at S$1,389 million, of which S$617 million was in the form of currency and S$772 million in the form of demand deposits. The total was 18 per cent higher than at the end of 1968 when the amount was S$1,175 million, and up 56 per cent from 1965's S$891 million.

The major institutional change in 1970 was the establishment of a new Monetary Authority of Singapore to act as the Government's banker and financial agent and to be, in effect, the forerunner of a Central Bank. It will also provide for more effective coordination of the functions of the various scattered monetary authorities inherited by the Government at the time of the Republic's formation.

Public finance

The Government's policy with respect to taxation, according to the Minister of Finance, has been to rely as much as possible on rapid economic expansion and improved tax administration to generate increasing revenues rather than to raise tax rates or to introduce new taxes. Because of the defence build-up in 1969, however, some new taxes were introduced, and there were some rate increases as well, adding S$30.4 million to government revenue that year. For the fiscal year 1970/71, on the other hand, no tax changes were introduced.

Total government revenue rose from S$419.8 million in 1965 to approximately S$840.5 million in 1969, an increase of 100.2 per cent. For 1970/71,[12] revenues are expected to total S$1,041 million, 23.9 per cent greater than for the previous 12-month period and 148 per cent greater than in 1965.

Of the anticipated 1970/71 revenue, 34.4 per cent is expected to come from direct taxes, 31 per cent from indirect taxes and taxes on outlay, 13.7 per cent as reimbursements and sales of goods and services, 6.5 per cent as income from investments and property, and 13.4 per cent from "other" sources.

Current expenditure for 1970/71 is budgeted at S$1,041 million, which provides for a small surplus even after allowing for the transfer of S$40 million to the Development Fund. Compared with the previous year's current expenditure, outlays for internal security and defence and statutory expenditures will account for a somewhat larger percentage of the total and social services a somewhat smaller percentage. In absolute terms, however, social services expenditure is projected to rise.

Projected development expenditure for 1970/71 is S$438.6 million, 70 per cent greater than for the previous 12-month period. Approximately half of this is projected for expenditure on government development projects and half for loans to statutory authorities and government-owned companies.

The future

In September 1970, Singapore's Prime Minister commented both on Singapore's past accomplishments and on its goals for the future.[13] With respect to the past and present, he stressed two areas of achievement: a growth rate of over 9 per cent for

[12] Data for 1970/71 are from *Estimates of the Revenue and Expenditure for the Financial Year 1st April 1970 to 31st March 1971*, Republic of Singapore, Government Publications Bureau, Singapore, 1970.

[13] Lee Kuan Yew, Prime Minister, "All Set for a Nine Per Cent Increase in Economic Growth", *Singapore Trade and Industry*, September 1970, p. 19.

1970 and a level of unemployment so low that work permits were being freely given to workers from outside Singapore.

For the future, the Prime Minister indicated that the growth rate must be maintained at 9 per cent to provide continuing full employment and to generate the revenue required for planned public expenditure.

Singapore has passed an important benchmark. When a country is in the early stages of development, goals are generally set in quantitative terms, and the aim is to provide as much of the population as possible with some minimal but hopefully rising level of such things as health care, housing, education and income. At some point, however, the society's goals begin to take on a more qualitative character, even though many of them may still be stated in quantitative terms. The Prime Minister's remarks would appear to indicate that Singapore has passed into this second stage.

The long-term future, as seen in the 1970/71 budget, is one where Singapore can sustain its economic growth in the absence of a world-wide depression. The major problem for the future will be to provide the large numbers and wide variety of skills needed by new industry. To meet these needs, Singapore proposes to relax its immigration and work permit restrictions still further, while, at the same time, enlarging its own capacity to produce personnel with needed skills. In part this will be accomplished by an expanded university system which will emphasize engineering and managerial training. In even larger part, however, investors should be encouraged to "import" such personnel. Singapore is anxious to learn from them and regards this process as a "brain drain" in reverse.

Singapore looks to the future with confidence based on past success and on the belief that it has reached the stage of development where continued growth will be self-sustaining. It is now planning for qualitative as well as quantitative change, both to enrich the lives of Singapore's people and to keep the country in the industrial forefront of the region.

Thailand

Introduction

Despite balance of payments and budgetary difficulties, Thailand, in 1969, succeeded not only in maintaining the growth momentum of the previous eight years but also in achieving a growth rate higher than the target set in the third development plan. Preliminary data for 1970, however, show that this momentum had slackened and that the rate of growth for the year was relatively modest. In 1969, for the first time in ten years, Thailand faced a deficit in its basic balance of payments, even after taking into account the inflow of foreign capital, and its foreign reserves fell by $48 million. This trend continued in 1970, when reserves fell again, this time by some $79 million.

With respect to the 1960s, a large inflow of foreign capital and transfer payments from abroad enabled Thailand not only to adopt a liberal import policy but also to accumulate substantial foreign exchange reserves. However, imports rose at a faster rate than exports and the trade deficit rose sharply from $94 million in 1962 (about 20.8 per cent of export earnings from merchandise) to $532 million in 1969 (about 76.9 per cent). The position in recent years has been rendered more difficult by stagnant demand for rice, which is the major export commodity, and by decreasing United States military expenditure. In response to these adverse developments, the Government, in 1970, adopted several remedial measures to promote exports and to curb imports.

Thailand's economic growth over the past decade has resulted largely from the dynamic role of the private sector, assisted by an inflow of foreign capital and a number of promotional policies taken by the Government. The activities of the public sector focus on the preservation of stability and security and the improvement of the country's infrastructure. Until 1968, government expenditure increased much faster than revenue, though revenue itself was growing at a rate slightly faster than national output and income. After 1968, the growth of both expenditure and revenue slowed down noticeably, and the growth in revenue lagged significantly behind that of expenditure. As a result, the cash deficit of the Treasury rose substantially and great reliance was placed on deficit financing, contrary to the policies pursued before when most of the treasury deficits were met from non-expansionary sources. In the middle of 1970, the Government introduced a number of increases in import duties and raised excise and business taxes. However, some of the increases which proved to be especially controversial were soon discontinued. It seems likely that, in the face of expansionary pressures, additional fiscal measures will be necessary, though the impact on government revenue of the measures already taken cannot yet be determined.

Before 1968, Thailand had a high domestic savings rate, with an impressive marginal propensity to save, but, since that time, consumption has increased sharply, thus reducing the marginal propensity to save. However, the marginal rate of savings was higher than the average and therefore the share of domestic savings in GDP continued to increase, although at a modest rate compared with the past. Even so, the rise in domestic savings was at rates

lower than gross domestic capital formation, with the consequence that both the savings and trade gaps widened. The Government is very keen to narrow this gap and several measures have been taken to promote austerity, increase the efficiency of capital and mobilize additional savings.

In spite of deficit financing and continued expansion of credit to the private sector, the money supply during recent years has grown at a moderate rate compared with the past. Naturally, the fall in foreign assets absorbed part of the excess liquidity and thus the consumer price index for the whole economy increased only marginally.

Generally speaking, the impressive past performance of the economy does not seem to have been maintained in 1970. A much more active government policy seems to be called for to cope with urgent problems connected with widening trade and budgetary deficits if economic growth in the future is to be maintained at rates not substantially below those achieved in the past.

Rate of growth

During the period 1960-1969 inclusive, Thailand's real gross domestic product (GDP) expanded at an average annual rate of 8.3 per cent. With respect to the last three years, it rose sharply from 5.5 per cent in 1967 to about 9.0 and 9.6 per cent in 1968 and 1969 respectively, the target per year in the second five-year plan for 1967-1971 being 8.5 per cent. However, it seems likely that such high growth rates were not maintained in 1970. The rough estimates available point to a modest rate of about 5.4 per cent,[1] the decrease being due mainly to declines in the growth rates of agricultural crops, mining, construction and services.

After 1967, when agricultural production suffered from a bad monsoon, output rose by 7.1 per cent in 1968 and 16.4 per cent in 1969, and agricultural production is expected to have increased in 1970 by about 3.3 per cent. The growth rate in the secondary sector (manufacturing, mining, and construction) decreased from 9.7 per cent in 1968 to 8.7 per cent in 1969 and is expected to have been less than 7.0 per cent in 1970. In the tertiary sector, the growth rate declined only slightly from 9.8 per cent in 1968 to 9.6 per cent in 1969 but was expected to drop sharply to below 6.0 per cent in 1970.

Investment and savings

An important factor behind the rapid growth of the economy in the past was substantial increases in investment. The share of gross domestic capital formation rose from 15.1 per cent of GDP in 1961 to 20.2 per cent in 1965 and to 26.0 per cent in 1969. Most of this gross domestic capital formation was financed from gross domestic savings whose share in GDP rose from 15.4 per cent in 1961 to 18.9 per cent in 1965 and 21.6 per cent in 1969. Indeed. Thailand succeeded in achieving a high marginal propensity to save of about 0.34 during the years 1961-1966 inclusive. In 1967, the marginal propensity to save became negative due to the fall in agricultural production but began to rise thereafter to 0.15 in 1968 and 0.35 in 1969. However, in spite of this remarkable expansion in domestic savings, the investment-savings gap financed by foreign savings expanded rapidly from about 1.3 per cent of GDP in 1965 to about 4.1 per cent in 1968 and 4.4 per cent in 1969. This was, of course, due to the fact that fixed-capital formation increased at a rate higher than domestic savings. A major factor behind the rise in consumption has been the widening of treasury cash deficits resulting from substantial increases in government expenditure (particularly on defence) and the slow growth in budgetary revenue.

The fall in the growth rate of domestic savings in recent years, with the consequent growth in balance of payments deficits, poses serious problems for Thailand, and the problems are compounded by the situation with respect to rice exports and the slowdown in United States military expenditure in Thailand.

Government finance

During the fiscal years 1963-1968, government expenditure increased at an average annual rate of 15.7 per cent.[2] In 1969 and 1970, over-all government expenditure increased at a lower rate of 10-11 per cent yearly and capital expenditure, which expanded at 25 per cent yearly during 1961-1968, rose at a modest rate of 7.1 per cent in 1969 and at an even lower rate in 1970. Nonetheless, the treasury cash deficit widened substantially during the last two years owing to a larger decline in the growth rate of revenue, and the position was compounded by larger reliance than before on borrowings from the Bank of Thailand to meet the deficits. Defence expenditure increased sharply from about 14.8 per cent of total expenditure in 1967 to about 17.0 per cent in 1969, and about 18.6 and 19.2 per cent in the budget estimates for 1970 and 1971 respectively. Expenditure on economic services, which increased by 20 per cent annually during the period 1961-1968, rose only by 6.1 per cent in 1969 and even slightly declined in the 1971 budget estimates (Tables II-3-47 and II-3-48).

[1] The Office of the National Economic Development Board (NEDB), but this estimate may be too pessimistic.

[2] In Thailand, the fiscal year runs from 1 October to 30 September.

Table II-3-47. Thailand: Government actual expenditure (cash basis)

(in billion baht)

Classification	1967/68	1968/69	1969		1970		1971
			Estimate	Actual	Estimate	Actual	Estimate
Total expenditure	16.52 (100.0)	19.36 (100.0)	23.06 (100.0)	21.39 (100.0)	26.33 (100.0)	23.59	28.07 (100.0)
Economic classification							
— current expenditure	11.55 (69.9)	13.10 (67.7)	16.20 (70.2)	14.69 (68.7)	17.87 (67.9)	n.a.	19.87 (70.8)
— capital expenditure	4.97 (30.1)	6.26 (32.3)	6.86 (29.8)	6.70 (31.3)	8.46 (32.1)	n.a.	8.20 (29.2)
Major functional classification							
— economic service	5.08 (30.8)	5.96 (30.8)	6.83 (29.6)	6.32 (29.6)	7.87 (29.9)	n.a.	7.82 (27.9)
— social service	4.37 (26.5)	5.03 (26.0)	6.05 (26.2)	5.46 (25.5)	6.89 (26.2)	n.a.	7.44 (26.5)
— defence	2.44 (14.8)	2.97 (15.4)	3.76 (16.3)	3.64 (17.0)	4.90 (18.6)	n.a.	5.38 (19.2)
— general administration and services	2.74 (16.6)	3.08 (15.9)	3.36 (14.6)	3.21 (15.0)	3.66 (23.9)	n.a.	3.89 (13.8)
— unallocable items	1.88 (11.4)	2.31 (11.9)	3.06 (13.3)	2.76 (12.9)	3.01 (11.4)	n.a.	3.54 (12.6)

Source: Bank of Thailand.

Note: Percentage distribution in brackets.

Table II-3-48. Thailand: Government revenue

(in billion baht)

	1967/68	1968/69	1969		1970	1971
			Actual	Estimate	Estimate	Estimate
Income taxes	1.50	1.72	1.97	1.85	2.13	2.52
Indirect taxes	11.80	13.14	14.62	14.12	15.42	15.96
— import duties	4.23	4.81	5.29	5.06	5.80	6.70
— export duties	1.26	1.37	1.68	1.48	1.31	
(rice premium)	(0.93)	(1.12)	(1.24)	(1.12)	(0.90)	(n.a.)
— business and sale taxes	4.82	5.32	5.99	5.93	6.50	6.68
— others	1.49	1.64	1.66	1.65	1.81	2.58
Total tax revenue	13.30	14.86	16.59	15.97	17.55	18.48
Other revenue	1.20	1.40	1.55	1.45	1.61	2.35
Total revenue	14.50	16.26	18.14	17.42	19.16	20.83

Source: Bank of Thailand and NEDB.

The growth rate of government revenue, around 12 to 14 per cent per year during the fiscal years 1963-1968 inclusive, declined to about 11.6 per cent in 1969 and to 5.6 per cent in 1970. Judging from the elasticity of government revenue with respect to GDP between 1960 and 1968 (about 1.3), it seems possible for the Government to increase revenue in 1971 at a rate higher than the 8.7 per cent implied in the 1971 budget estimates. It should be mentioned in this context that Thailand relies heavily on indirect taxes and, in particular, on customs revenue. In 1969, for example, such taxes contributed about 88 per cent of total tax revenue. In view of this fact and in the face of existing foreign trade difficulties; it seems necessary to re-examine the tax structure if government revenue is to increase significantly in future years.

In July 1970, the import duties on a large number of items were increased, as were business taxes and excise duties, with the dual objective of raising additional revenue and discouraging import demand

and consumption. It is too early to evaluate whether these tax measures will bring much higher revenue, but it has been noticed so far that revenue from the business tax is lower than the level expected, probably because of the large drop in the demand for commodities characterized by high price elasticity of demand. With the trend in the Thai manufacturing sector towards the assembly of consumer durable goods (whose import content is very high), it seems likely that the higher import duties on intermediate products and raw materials plus the higher business tax may adversely affect domestic manufacturing. In view of Thailand's industrial structure, this is, of course, unavoidable if the Government is to put the balance of payments into a manageable position pending more vigorous efforts to promote exports, although the Government is considering ways and means to assist manufacturers. Regarding further measures to increase government revenue, the Government may have to rely on the improvement of tax administration to reduce tax evasion and on new direct and indirect taxes, e.g. progressive taxation of profit from land speculation and heavy taxes on non-essential imports. Such measures would also help in reducing inequalities in income distribution.

Treasury cash deficits have increased continuously over the last decade, and in recent years the deficit rose sharply from about 6.8 per cent of total budget revenue in 1967 to 16.5 per cent in 1968 and 15.2 per cent in 1969. With respect to fiscal year 1969/70, it has increased even further to 21.8 per cent of budget revenue. Before 1968, the deficit was financed mainly from non-expansionary sources, but thereafter more reliance has been placed on the Bank of Thailand, together with the use of treasury cash balances accumulated during previous years. In 1970, for example, 84.5 per cent of the deficit was financed from the Bank of Thailand and 4.2 per cent by drawing on treasury cash balance.[3] This system of financing no doubt enhances the expansionary pressure in the economy and has been an important factor in the widening balance of payments deficit.

Production trends

Agriculture

Agriculture is the most important sector in Thailand, contributing about 30 per cent of total GDP and absorbing about three-quarters of the total labour force. Crops accounted for over two-thirds of the gross value of agricultural production in both 1968 and 1969. Next to crops, livestock contributed most (about 6 per cent in 1969), but its share has been falling constantly during the last decade (from over 7 per cent in 1960), as has forestry's (from 5.5 per cent in 1960 to 4.5 per cent in 1969). On the other hand, the share of fisheries increased rapidly from about 1.3 per cent in 1960 to over 3 per cent in 1969. It is expected that the share of crop production fell slightly in 1970, while fisheries surpassed livestock in importance and forestry maintained its 1969 share. With the abundance of grazing land and feed grain in Thailand, however, it may be possible to increase livestock production in the future at a faster rate than before.

Rice is the most important crop, contributing about 44.9 per cent of total crop value at current price and about 20 per cent for the export value of goods in 1969. The export price of rice decreased about 18.5 per cent in 1969 owing to the stagnant world demand and decreased further in 1970.[4] This directly affected both the domestic prices and the incomes of farmers, and, since 1969, the Government has purchased rice from farmers on a large scale under a price support scheme. However, in spite of the price support measures and an increase in the quantity of rice produced in 1969 of about 8.1 per cent, the value of production increased by only 3.4 per cent.

Foreign demand for maize, especially in Japan and China (Taiwan), increased rapidly following the maize blight in the United States, which is the major source of world supply.[5]

The production of rubber in 1969 increased by about 10.5 per cent over 1968 and is estimated to have risen by about another 4.3 per cent in 1970. Since rubber prices in 1969 increased appreciably by about 29.2 per cent, its production value grew sharply by about 42.8 per cent. Unfortunately, during the first half of 1970, rubber prices declined by about 8.7 per cent, and value of production is therefore expected to have dropped by about 5 per cent from the 1969 level.

In 1969, production of jute and kenaf rose sharply by about 99.4 per cent to 347,000 tons and rose further in 1970 to a level of 397,000 tons. The production of cassava rose in 1969 by about 9.1 per cent above the 1968 level, and production in 1970 is expected to have increased by about 1.9 per cent.

Other crops that have generally smooth-rising trends of production are groundnuts, mung beans, soy beans, castor beans and coconuts. Production of these crops is growing at average annual rates ranging from 4 to 5 per cent, and it is expected that they increased at about the same rates in 1970. Production of sugarcane rose in 1969 by about 12.9 per

[3] Bank of Thailand.

[4] *Bank of Thailand Monthly Bulletin.*

[5] The blight is estimated to have ruined 10-15 per cent of the 1970 crop in the United States (Bangkok Bank, *Monthly Review*, October 1970, p. 283).

cent and is provisionally estimated to have risen at a slightly lower rate in 1970. Tobacco production, which has been rising since 1963 at an average annual rate of about 10 per cent, is expected to have risen by about 4.5 per cent in 1970. The production of other crops generally increased at a rate of about 9.0 per cent between 1960 and 1969, and it is expected that this rate was maintained in 1970.

Manufacturing

The strategy for economic development in Thailand is to promote industrial development through the private sector. The Industrial Investment Act was enacted to give a variety of attractive privileges to both domestic and foreign investors, and the Board of Investment, the operating agency for the act, has granted an increasing number of promotion certificates to private investors who qualify under the conditions set out by the Board. Up to 1969, the policy was to concentrate mainly on import substitution. However, in 1970, the Board shifted its emphasis towards investment promotion for industries which depend mainly on indigenous raw materials, which are relatively labour-intensive and/or which produce mainly for export.[6] The number of promotion certificates issued decreased from 101 in 1968 to 85 in 1969, but the registered capital increased from 667 million to 1,342 million baht. The total registered capital of promoted industries since the establishment of the Board is about 6,180 million baht, of which foreign capital accounts for about 32 per cent.

The Industrial Finance Corporation of Thailand, publicly owned and established in 1959, provides medium- and long-term finance for industrial investors at low interest rates.[7] Up to 30 June 1970, the Corporation had granted loans totalling about 607.6 million baht. In 1969, the value of loans granted increased sharply by about 105 per cent to a level of approximately 149.5 million baht and a further increase of 17 per cent was expected in 1970.[8]

Another financing agency, designed particularly for small-scale industries, is the Loans Office for Small Industries Development, which comes under the auspices of the Ministry of Industry. This agency provides loans of less than 500,000 baht, at a low annual rate of interest of 9 per cent. Up to the end of September 1970, it had granted loans amounting to 135.4 million baht to 562 establishments. In the fiscal year 1970, about 26.4 million baht loans were made to 114 establishments while in fiscal years 1969 and 1968 loans went to 119 and 112 establishments for 31.6 and 26.2 million baht respectively.[9]

Production in the manufacturing sector grew at an average rate of 10.9 per cent per year between 1961 and 1969 inclusive, rising slightly more rapidly during the period 1961-1966 than during the more recent period 1967-1969 when the growth rate dropped to 10.2 per cent per year. For 1969 alone, the growth rate increased to 10.6 per cent from 10.1 per cent in the previous year. The share of manufacturing production in GDP at constant prices has increased continuously since 1960 from 13.1 per cent to 15.5 per cent in 1965 and 16.4 per cent in 1969. In 1970, it is expected that the growth rate of manufacturing production was about 10.5 per cent and that its share of GDP will rise to 17.2 per cent.

Cement output rose by 25 per cent in 1968 and 10.8 per cent in 1969, and was expected to grow by about 13 per cent in 1970. The growth of output picture for some other major manufacturing industries is as follows: petroleum products, 18.5 per cent in 1968, 25.1 per cent in 1969, and an expected 20 per cent in 1970; tobacco, 9.2 per cent in 1968, 6.5 per cent in 1969, and around 9 per cent in 1970; paper, 13.8 per cent in 1968, 21.5 per cent in 1969, and an anticipated 17.2 per cent in 1970; cotton textile, 10.8 per cent in 1968, 13.5 per cent in 1969, and approximately 14.7 per cent in 1970. After falling for three years, sugar production jumped by 68.5 per cent in 1969 and is expected to have increased by a further 4 per cent in 1970. The production of gunny bags increased sharply in 1963 but thereafter slowed down constantly till it reached a growth rate of only 1.1 per cent per year in 1968, and in 1969 declined by about 18.8 per cent. It is expected, however, that in 1970 it rose again at a rate of about 9.2 per cent.[10] Employment in manufacturing in 1966 stood at 0.8 million persons over the age of 15 years, or about 5.6 per cent of total employment in that year; it has been projected that, for 1970 manufacturing employed about 1 million persons, accounting for about 6.8 per cent of total employment.[11]

Mining

Mining and quarrying has increased its contribution to real GDP in recent years. The growth rate of output was quite high between 1961 and 1966, at about 15.3 per cent per year, but then fell to 14.9 per cent, 9.2 per cent and 7.4 per cent per year respectively during the three years ending in 1969, and it is expected that it fell further, to about 2.2

[6] Amnuay Viravan, Secretary General, Board of Investment, "Foreign investment in Thailand", August 1970.

[7] 10.5 per cent per year for local currency and 9.5 per cent per year for foreign currencies.

[8] The Industrial Finance Corporation of Thailand.

[9] Loans Office, Small Industries Development.

[10] *Bank of Thailand Monthly Bulletin* and NEDB.

[11] ECAFE, "Sectoral output and employment projections for Thailand: 1970-1980", *Sectoral Output and Employment Projections for the Second Development Decade.*

per cent in 1970. Among minerals, tin contributed about 45 per cent of total mining production. Because of restrictions set by the International Tin Council, the production of tin in 1969 declined by around 12.1 per cent from its 1968 level (5 per cent higher than that in 1967). The export quota was lifted at the end of 1969, but it is expected that production in 1970 was only slightly higher than in 1969 because it takes some time to increase production. The production of fluorite, a new product for export, has increased sharply in recent years. For 1970, output is expected to have been about 36 per cent higher than in 1969. The output of lignite increased by about 13.9 per cent in 1969 and is expected to have grown further in 1970. Gypsum production has a rising trend, but with a fluctuating rate of growth. After declining by about 28 per cent in 1969, its production is likely to have increased sharply in 1970. The output of iron and lead ores has declined constantly during the last three years and prospects are not promising.

Construction

Value added in construction rose very rapidly between 1961 and 1966, then the growth rate declined from 1967 to 1969. It is expected that, in 1970, production was about the same as in 1969.

Services

Among various services, value added in the wholesale and retail trade contributed more to GDP than other sectors, but there has been a deceleration in the growth of this sector over the last few years. Whereas this sector grew at 9.1 per cent in 1969, it is expected to have expanded by only 5.3 per cent in 1970. A similar trend of decelerating growth is found for transportation and communication, the second largest of the service sectors. Sectors that are projected to continue growing faster than GDP are electricity and water supply, banking, insurance and real estate.

External trade and the balance of payments

Exports. Thailand's merchandise exports, most of which are agricultural products, grew during the period 1961-1969 at about 5.3 per cent per year. Rice is the most important export, but its relative importance has declined, due partly to increased production in importing countries and partly to keen competition from other exporting countries, especially mainland China and the United States. Its share in total exports was about 27.6 per cent in 1968, but fell sharply to 20.0 per cent in 1969. Actually, in 1969 the quantity of rice exported was only about 4.2 per cent less than in 1968, but the export value decreased sharply by about 22.0 per cent, due to the rapid drop in the export price. The situation deteriorated further in 1970. With prices likely to have dropped a further 15 per cent, it is expected that, although the volume of rice exports might have increased by about 20.2 per cent, its value is likely to have gone up by only 1.8 per cent. The cash sales of United States rice on world markets increased sharply to 1.13 million tons in 1967/68 (almost four times the 1960/61 level), then tapered off later. However, this decline in cash exports was also accompanied by a rise in concessional sales at a rate of about 24 per cent per year to the level of about one million tons in 1969. United States rice exports seem to have expanded further as a result of the overseas offices and the promotional activities of the Rice Council for Market Development, financed as a joint venture with United States Department of Agriculture's Foreign Agricultural Service.[12]

Rubber contributed about 18 per cent to the total value of merchandise exports in 1969. Although export volume increased about 9.6 per cent, export receipts from this source rose sharply by about 46.7 per cent because of a rise in the export price by about one-third. However, such a fortunate situation is unlikely to have repeated itself in 1970, when both export prices and export receipts were expected to show a decline. Maize exports, on the other hand, should have increased in 1970, both in volume and price, by 14.3 and 11.9 per cent respectively, contributing to a rise in value of 27.8 per cent. It is believed that 2.0 per cent more tin was exported in 1970, and with a price rise of 4.7 per cent, the value of tin exports would have increased by 6.7 per cent in 1970. The export of tapioca continued to expand, but the opposite situation seemed to prevail for kenaf and jute. The volume of exports of kenaf and jute dropped about 11 per cent in 1969 but the value rose by 15 per cent because of a 25 per cent increase in price. However, the value of exports in 1970 is likely to have fallen by about 4.1 per cent because of a decline in export prices. As for teak, its contribution continues to decline. In sum, total merchandise exports, which increased by 8.1 per cent in 1969, are expected to have grown by only 5.9 per cent in 1970.

Imports

Merchandise imports rose sharply between 1962 and 1967, and, in 1967, the annual growth rate rose to nearly 20 per cent. Deceleration began in 1968, the growth rate fell to about 7.7 per cent in 1969, and, in 1970, it is expected that the increase was only 2.9 per cent.

[12] Bieber, Robert A. and Hopkins, John T., "Story of the 1960's: U.S. Rice in World Trade", *Foreign Agriculture*, March 1970, United States Department of Agriculture, pp. 4-5.

During the past decade, the pattern of imports has changed significantly. In 1960, while imports of consumer goods amounted to 35.0 per cent of total imports, intermediate products and raw materials 18.1 per cent, capital goods 24.6 per cent, and other imports 22.3 per cent, the consumer goods imports in 1965 were 27.0 per cent, intermediate products and raw materials 20.8 per cent, capital goods 30.9 per cent, and other imports 21.3 per cent. These trends have continued, and in 1969 the percentage shares were 22.8, 22.6, 35.3 and 19.3 per cent respectively, indicating the growing importance of imports of capital goods, intermediate goods and raw materials.

It is interesting to note that, while the marginal propensity to import consumer goods with respect to total consumption was about 0.068 on the average, it has decreased considerably during recent years to about 0.019 during 1968 and 1969. The marginal propensity to import capital goods with respect to gross fixed-capital formation, on the other hand, showed a stable tendency around 0.353, whereas the marginal propensity to import intermediate products and raw materials with respect to domestic production has shown a falling trend. On the basis of the foregoing, imports seem to be diminishing in relation to other relevant variables, and the trade deficit seems likely to have fallen in 1970.

Service account

On the service account, every credit and debit item, except the credit items of foreign travel and Government n.i.e., probably recorded an increase in 1970. The two decreases are expected because of the decline of United States military expenditure in Thailand, and it is believed that the surplus on service account decreased by 11.7 per cent in 1970. With respect to transfer payments, a decrease of the surplus by about 2.3 per cent from the 1969 level is also expected.

Capital account

In previous years in Thailand, increasing net capital surpluses normally compensated in part for the trade deficit, but, in 1970, the net capital inflow is expected to have decreased by 3.7 per cent from the 1969 level. The reason for this has been a drop in net private capital inflow which has exceeded the net gain in official capital movements. The decline in private net capital inflow in turn is explained by a decline in the net inflow of private loans and credits. Direct investment from abroad grew every year between 1962 and 1968. It declined sharply in 1969 and rose slightly again in 1970. Private loans and credits, especially suppliers' credits, have increased quite rapidly at an average rate of about 37 per cent per year. However, repayments of private loans and credits grew faster in 1970, causing the net inflow of private capital to decline noticeably by 13.5 per cent. As a result of these developments, the combined private and public net capital inflow in 1970 is likely to have declined about 3.7 per cent.

If the reductions in the surpluses on capital account, transfer payments, and services account from 1969 levels are combined with the change of trade deficit, it appears that Thailand may lose foreign reserves for the second year running, the likely amount being $78.8 million, or about 64.3 per cent more than the loss in 1969. (Table II-3-49). This is a situation which requires remedial measures as well as immediate and concerted action from a variety of agencies.

Money supply

During 1960-1968, the money supply increased at an average rate of about 8 per cent per year. In 1969, owing to the fall in foreign assets, this growth rate declined to only 4.6 per cent, and the expected increase for 1970 is about 5.9 per cent. Among the three main factors affecting the money supply, net claims on the public sector have consistently been the most important factor responsible for expansion since 1964. In the private sector, on the other hand, time and saving deposits, as well as other liabilities, have usually exceeded bank credit extended to the private sector, and this has helped to reduce somewhat the inflationary impact of the public sector position. However, in 1970, a net expansion in the private sector seems likely to have occurred for the first time during the past nine years. On the other hand, the fall in foreign assets exerted a contractionary influence on the money supply for the second year in succession.

Population and income distribution

According to a preliminary estimate of the results of the population census conducted in April this year, the population of Thailand in 1970 was around 34.15 million persons, with 17.00 million males and 17.15 million females, and a population growth rate of about 3.01 per cent per year.[13] From the income and expenditure survey conducted by the National Statistical Office 1969/70, it was discovered that about 10.77 per cent of family samples have an income per family of less than 3,000 baht per year, 65.23 per cent less than 18,000 baht, 86.56 per cent less than 33,000 baht. About 7.24 per cent of the samples have an annual income per family of 48,000 baht

[13] National Statistical Office (NSO), *Preliminary Report of the 1970 Population and Housing Census of Thailand*, pp. 2-8.

Table II-3-49. Thailand: Balance of payments

(in million baht)

Item	*1968*	*1969*	*1970*
Merchandise			
Export, f.o.b.	13,228	14,267	14,100
Import, c.i.f.	−23,878	−25,565	−25,450
Trade balance	−10,650	−11,298	−11,350
Services (net)	6,149	5,854	5,355
Receipts	9,210	9,284	9,490
Freight and insurance on merchandise	397	350	300
Other transportation	182	239	305
Travel	1,256	1,318	1,650
Investment income	1,053	1,285	1,645
Government, n.i.e.	5,572	5,288	4,760
Other services	750	805	830
Payments	−3,061	−3,431	−4,135
Freight and insurance on merchandise	−168	−142	−205
Other transportation	−115	−121	−170
Travel	−874	−1,001	−1,300
Investment income	−780	−1,059	−1,300
Government, n.i.e.	−478	−453	−400
Other services	−646	−655	−760
Net goods and services	−4,502	−5,444	−5,995
Unrequited transfers	1,548	1,187	1,035
Private	140	89	60
Official	1,407	1,098	975
Capital movements	2,395	2,522	2,243
Private capital (net)	1,834	2,325	2,232
Direct investment	1,238	973	936
Other	596	1,352	1,296
Official capital (net)	561	196	11
Loans: Drawings	756	837	887
Repayments	−156	−508	−389
Other	−39	−133	−487
Net errors and omissions	1,006	737	46
Monetary movements	−447	998	−2,671
Balance of international reserves (end of period)	19,177	18,179	15,517

Source: Bank of Thailand, *Monthly Bulletin.*

and above, and 4.56 per cent have 60,000 baht and above.[14] Unemployment as of 1966 was estimated to be 6.63 per cent.[15]

[14] Based upon the preliminary result of the survey, round one, December 1969; the income figures here include only income in cash without imputation on self-consumed goods and services produced.

[15] ECAFE, "Projections of sectoral output and employment, projections for Thailand, 1970-1980", *op. cit.*

Economic planning

The third five-year plan, to begin in October 1971, is now in the process of preparation. The five major objectives of the plan are: (*i*) to maintain military and police forces adequate to the needs of national security; (*ii*) to pursue a vigorous export promotion programme; (*iii*) to implement fiscal and monetary policies that will preserve stability and keep foreign exchange reserves at a prudent level; (*iv*) to maintain a satisfactory pace of social and economic development; and (*v*) to expand government revenue rapidly and to rely, to the maximum feasible extent, upon resources generated within the economy.[16]

Preliminary estimates of the aggregates within the third plan framework lead to the following targets: (*i*) *per capita* output in 1976 to reach $225; (*ii*) GDP to grow at 6.5-7.5 per cent in real terms; (*iii*) private consumption to increase at 6.6 per cent in real terms; (*iv*) government revenue to increase at 9-10 per cent; (*v*) government expenditure to grow at 8.8 per cent, of which government consumption is to increase at 9.2 per cent and government investment at 8.0 per cent; (*vi*) total exports to increase at 6-8 per cent, rising to a growth rate of over 7 per cent per annum by the end of the plan period; (*vii*) total imports to increase at 6-8 per cent, with the growth of merchandise imports slightly higher at 6-9 per cent; and (*viii*) a foreign exchange gap of 20.22 billion baht, out of which 3.50 billion baht is to be for debt servicing. To finance the foreign exchange gap, 10.00 billion baht is to come from foreign loans, 6.00 billion baht from grants, and the rest from reserves, which, it is estimated, will be about 12.25 billion baht at the end of 1976, equivalent to four months' import requirements.[17]

The tentative size of the plan is 100 billion baht, out of which 69 billion is to be financed through the Government's budget. The share of development expenditure for economic services is to fall from 36 per cent to 34 per cent. Social sectors, on the other hand, are to increase their share of development expenditure, the increase to come mostly in education, whose share is to rise from 39 per cent to more than 42 per cent.[18]

Major policy issues of 1970 and the outlook for 1971

Three major economic problems face the Thai economy: the trade deficit and loss of foreign reserves, the budget deficit, and income disparities. While all three problems are related, the slow growth of exports seems to be fundamental to all three. As a solution,

[16] NEDB, *External Assistance Requirements under the Third National Economic and Social Development Plan (1972-1976)*, p. 23.

[17] *Ibid.*, pp. 31-32.

[18] *Ibid.*, p. 33.

policies designed to increase production in both agriculture and manufacturing with the aim of expanding exports seem to be necessary. In addition, fiscal, monetary and foreign trade policies should be harmonized with policies relating to production and exports in order to attain the economic objectives of growth and stability.

In view of the changing pattern of world demand for agricultural products, a new strategy and plan for agricultural development is urgently needed. The structure of crop production in the future should be geared to export demand, the intermediate demands of the manufacturing sector and domestic final demand. It would be advisable to shift the emphasis of the agricultural plan from rice to maize, cotton, beans, oilseeds and other cash crops whose demand prospects are more promising. Methods of intensive cultivation using new technology should be applied to all crops, including rice, and it seems likely that the output of livestock and fresh-water fisheries could be expanded more rapidly than before. Greater effort should be made to promote industrial growth by creating industrial estates and it may be advisable to review, reorganize and revise, if necessary, all laws and regulations that seem to impede industrial development, particularly those having to do with exports.

As for budget revenue, the level of government revenue should be increased substantially over the likely growth rate of less than 9 per cent envisaged for 1971. In this connexion, an attempt should also be made to transform the tax structure towards more reliance on income and land speculation taxes, as this would not only raise tax revenue but would also be beneficial to income distribution and social justice. Moreover, with an appropriate progressive tax rate on capital gains from land speculation, the escalation of land prices would be greatly discouraged, and this would be greatly beneficial to industrial investment. It seems advisable also to thoroughly review and revise import duties in such a way as to promote domestic industries and exports, discourage luxury consumption, increase government revenue and reduce inequality of income distribution.

If efforts to increase budgetary revenue succeed, it will be possible for public expenditure to expand at a faster rate than is feasible in the current economic situation. Such increased government spending might also stimulate the economy to grow faster, provided that domestic supply increases and that such spending does not jeopardize the foreign exchange position. The paradox in Thailand is that, with an open import policy, increased government expenditure to stimulate the economy may leak into larger imports. Since essential government expenditure on both national security and social welfare seem to be equally important, it may be wiser to increase spending on both rather than increase spending on one at the expense of the other. A more important point, however, is the need for efficiency and prudence in spending these budgets. With proper financial administration, the whole of government spending can be fed back into the stream of economic transactions to generate multiplier effects in the whole economy. It is essential, therefore, to administer such spending efficiently and in such a way as to stimulate increased production of goods and services.

Efforts should be continued to prevent the loss of foreign exchange reserves, and activities that would bring about large inflows of foreign currencies, for example, tourism, should be greatly encouraged. At the same time, measures could be taken to discourage outflows, such as restricting unnecessary travel abroad for leisure or controlling certain import credits.

The existing economic problems of the Thai economy, and those likely to arise in the near future, intensify the importance of the third five-year plan which is under preparation. The economic situation in the immediate future may prove to be unfavourable, but, with determined planned efforts and careful implementation, the target growth rate of 7.5 per cent and other national policy objectives can still be achieved.

Western Samoa[1]

Introduction

Nine islands make up Western Samoa, two of which, Upolu and Savaii, account for almost the total area of 1,090 sq mi. The area of Savaii island is 660 sq mi and that of Upolu 430 sq mi.

Statistical data on the economy of Western Samoa are not yet adequate for the construction of national income accounts, hence the behaviour of income over time cannot be described. However, it is estimated that *per capita* income ranges between $230 and $250 and that total income is almost equally divided between the monetized and subsistence sectors.

It is likely that both national income and income *per capita* at constant prices have declined since 1965. As regards 1970, the slow growth of public expenditures (7.6 per cent), the decline in exports (4 per cent), and the continuance of a rapid rate of natural increase of population of 3.8 per cent (the excess of births over deaths)[2] make it unlikely that the downward trend in these indices was reversed.

[1] This is the first time that a survey of Western Samoa has been included in the *Economic Survey of Asia and the Far East*.

[2] Owing to net out-migration, the net rate of growth of population is somewhat lower, at 2.8 per cent.

The economy in 1969

Public finance

During 1969, total government expenditure amounted to WS$5,054 million as against revenues of WS$5.079 million and loan and grant receipts of WS$967,000. Consequently, there was an over-all surplus of WS$992,000. The composition of public revenue and expenditure for 1969 and 1970 is shown in table II-3-50.

Table II-3-50. Western Samoa: Government revenue and expenditure

(in thousand Western Samoan dollars)

Item	*1969*	*1970*
Government revenue		
Current account		
Export and import duty	3,056	2,999
Income tax	555	515
Indirect taxes	93	92
Sale of government services	1,251	1,302
Interest and rents	44	43
Surplus from state corporations	80	60
Total	5,079	5,011
Capital account		
Domestic loans	500	120
External loans and grants	467	954
Total	967	1,074
Government expenditure[a]		
Non-development expenditure	16	27
Statutory expenditure	325	335
Maintenance expenditure	3,923	4,182
Plan expenditure	790	859
Total	5,054	5,403

[a] Estimates.

From the table, it is seen that customs duties dominate the sources of government revenue, followed by sales of government services and the income tax. The contribution to revenue made by indirect taxes is very small. As regards the capital account, in 1969 the Government floated a national loan of WS$500,000 and, in 1970, borrowed WS$120,000 from the Copra Board. Of the external aid, amounting to WS$467,000 in 1969, a small proportion (about 25 per cent) was received in the form of a grant, the balance coming in loans, mainly from the Government of New Zealand and the Bank of New Zealand.

Trade and the balance of payments

Three commodities, copra, cocoa and bananas, continued to dominate Western Samoa's exports in 1969, accounting for 91 per cent of the value of total exports, compared with 89 per cent in 1968. The Commonwealth, mainly New Zealand, took 36 per cent of Western Samoa's exports, and the EEC countries 50 per cent, the latter representing a considerable increase in EEC's share of total exports over the 1968 figure (24.7 per cent).

Copra and cocoa were the largest earners of foreign exchange in 1969, total export receipts from these commodities amounting to around WS$1.8 million. However, receipts had declined from the previous year on account of a sudden fall in the export price of copra. In view of copra's importance to the economy, and in light of the fact that many of the trees are over 50 years old, an extensive replanting programme is being carried out during the first plan (1966-1971). An area of 36,000 acres has already been replanted and it is proposed to extend the programme to a further 61,000 acres during the second plan period (1971-1975). Although some results of the programme will be felt in the late 1970s, its full benefits will not be realized until the 1980s.

In 1969, the export earnings of cocoa rose sharply to WS$1.8 million from the previous year's level of WS$1.3 million. The major factor accounting for this rise was a substantial increase in price, the export price index rising from 169 (with base 1961=100) in 1968 to 206 in 1969. In the first plan period, high-quality cocoa (Lafi 7) was planted on 120 acres and it is proposed to extend the area by a further 600 acres during the second plan period.

Bananas again increased their contribution to export earnings in 1969, the amount rising to WS$600,000 from an average of approximately WS$300,000 in the previous year. However, earnings from this source are still far from the high levels attained in the early 1960s,[3] the reasons being that the ravages of disease and a severe hurricane in 1966 brought the banana industry to a virtual standstill. Under the first plan, 600 acres were replanted annually and, at the moment, about 4,000 acres are producing exportable bananas. With a banana plant's average life cycle of 5 years and a yearly target for new plantings of 700 acres, a constant producing acreage equal to the present 4,000 acres is envisaged in the second plan. After allowing for local consumption and increased productivity through more intensive and improved methods of cultivation, a total

[3] Export earnings from bananas in 1963 amounted to WS$1.65 million.

annual export volume of 600,000 cases is expected. At a price of WS$2.75 per case, the yearly export value would amount to WS$1.65 million.

Food and live animals, manufactured goods, and machinery and transport equipment continued to dominate Western Samoa's import bill in 1969. The value of imports amounted to approximately WS$7.4 million, or a 34 per cent rise over the previous year's total (WS$5.5 million). New Zealand continued to be the major supplier with 28 per cent of the total, followed by Australia (19 per cent) and Japan (11 per cent).

The largest single item on the import bill is food and live animals, and efforts are being made to substitute domestic production for some of the commodities now being imported. With assistance from UNDP/FAO and the Asian Development Bank, projects have been launched in 1970 to develop domestic meat and dairy industries, and it is hoped self-sufficiency in beef can be achieved by 1975, with the possibility of some exports. In this connexion, existing slaughtering facilities will be improved and refrigerated transport facilities introduced. A programme to stimulate pig and poultry production is also being developed. The annual import bill for fish and fish products is WS$330,000 (1969), yet there are large resources of tuna in the waters around Western Samoa, as well as of crayfish, shrimps and oysters. The second plan aims at self-sufficiency in this sector by 1973 and looks to it as a source of export earnings by 1974. Canneries will be organized and fishermen trained, and the whole programme will be implemented through fishermen's associations. Credit is to be provided locally by the Development Bank and the Bank of Western Samoa.

Table II-3-51 summarizes the main items of Western Samoa's balance of payments from 1968 to 1970.

Although exports on merchandise account came to WS$48 million (an increase of 20 per cent over 1968), the growth of imports was still larger (34 per cent) with the result that the deficit rose from WS$1.5 million to WS$2.6 million, and the estimates for 1970 indicate a still larger deficit of WS$3.7 million. However, a net credit in the invisibles account (mostly the result of an increase in remittances from Samoans abroad) reduced the current account deficit to WS$500,000, compared with a current account surplus the year before of WS$200,000.

It is estimated that the 1970 surplus on invisibles will also be insufficient to cover the deficit on the balance of trade and that the current account will again show a net deficit.

Table II-3-51. Western Samoa: Balance of payments

(in million Western Samoan dollars)

Item	1968	1969	1970 (estimates)
Current account			
Total exports	4.0	4.8	4.7
Of which:			
Copra	1.9	1.8	1.7
Cocoa	1.3	1.8	1.4
Bananas	0.3	0.6	0.8
Total imports	5.5	7.4	8.3
Balance of trade	−1.5	−2.6	−3.7
Balance of invisible	1.7	2.1	2.2
Balance on current account	0.2	−0.5	−1.5
Capital account			
Private	0	0.5	n.a.
Government	0.8	0.8	n.a.
Net borrowing or repayment to Western Samoa	−0.7	1.0	n.a.
Net change in foreign reserves	−0.3	−1.5	n.a.
Errors and omissions	0	−0.3	n.a.

Source: Second Five Year Development Plan, 1971-1975.

The economy in 1970 and future outlook

Foreign trade

The stagnation of export receipts in 1970 was a most disappointing development in this year. The main factor accounting for this was the fall in export earnings from cocoa on account of factors described earlier. However, export proceeds are projected to rise continuously after 1970, increasing from WS$4.6 million in 1970 to WS$9.8 million in 1975, indicating an annual average growth rate of approximately 22 per cent. Imports on the other hand are projected to grow by only 6 per cent per annum, so that the deficit on the balance of trade will decline from WS$3.7 million in 1970 to WS$1.0 million in 1975.[4]

Public services

In an attempt to generate increased economic activity in 1970, the Government substantially increased its expenditure on social services and infrastructure, especially on transport, education and health. On account of high maintenance expenditure during the earlier years of the first plan, only marginal investment was possible in the public sector. In 1970, however, and with the help of a loan of WS$500,000 from the Asian Development Bank, a WS$2.5 million project was initiated for the up-grading of Faleolo airport and road to cope with increased international

[4] *Second Five Year Development Plan, 1971-1975*, p. 17, table IV.

air traffic, although the full effects of this will not be felt until the second plan period. Between 1971 and 1975, investment in harbour development is expected to amount to WS$664,000. Over this period (1971-1975), there will also be further investments in water supply, sewerage, posts and communications, electricity and government offices.

As regards education, the Education Department budget is estimated at WS$900,000 in 1970, representing an increase of about 6 per cent over 1969. In 1970, school enrolment for the age group 5-14 was as high as 74 per cent, and about 80 per cent of the pupils were in government schools. Participation in the 15-19 age group is also high (26.9 per cent), indicating the importance that Western Samoa places on this aspect of development. By the last year of the second plan, primary-school enrolment is expected to increase to 90 per cent, while the objective in the secondary and post-secondary levels is to train graduates to meet the personnel requirements of Government, industry and commerce. The Trades Training Institute and its curriculum are being reorganized to meet the need for skilled workers, such as carpenters, auto mechanics, electricians and plumbers. In the more specialized and advanced fields, an arrangement is being made to train the required indigenous personnel through appropriate training courses overseas.

In order to finance the growing expenditure on public services, the Government has set up a Fiscal Review Committee which is to report soon. Three new revenue measures which are being given serious consideration are wholesale taxes on selected commodities, charges on health services and education, and some form of land tax. Also, an additional WS$350,000 can be collected annually if general tariff rates are applied to goods entering Western Samoa from Commonwealth countries. A non-tax source of revenue will be the provident fund which is to be established in the second plan. This fund is expected to start functioning in 1972, and it is estimated that it will contribute WS$1 million to government financial resources between 1972 and 1975.

Further attention will be paid to the possibility of mobilizing much larger financial resources from the banking system, which at the moment holds a large proportion of its assets overseas or as reserves, as can be seen from table II-3-52.

Since 1968, over half of domestic deposits have been invested overseas or retained as reserves, and there is, therefore, the possibility of extending more loans domestically, during the period of the second plan, both to the government and the private sector. In addition, the Government plans to float domestic loans amounting to about WS$1 million between 1971 and 1973, and these will bear a higher rate of interest than the general rate payable on bank deposits (2-3.5 per cent). This should serve to mobilize increased domestic savings and help to damp down the inflationary effects of the enlarged public expenditure programme.

Table II-3-52. Western Samoa: Bank of Western Samoa's domestic deposits, advances, overseas investments and reserves

(in thousand Western Samoan dollars)

Item	*1967*	*1968*	*1969*	*Increase or decrease (—) (percentage)*
Domestic deposits . . .	2,236	2,718	3,807	57
Domestic advances . . .	1,154	1,112	1,271	—7
Funds invested overseas or held as reserves by the Bank of Western Samoa .	1,188	1,550	2,839	123
Advances/deposits ratio . .	51.6%	40.9%	33.4%	

Foreign assistance and capital flows

External loans and grants contributed a much larger proportion of total financial resources in 1970 (15.5 per cent) than in 1969 (7.7 per cent), the main factor being the WS$500,000 loan from the Asian Development Bank for the Faleolo airport and road project. Over the course of the second plan period, the private sector will also require substantial inflows of foreign capital, and, to encourage such flows, the Government provides generous incentives in the form of tax holidays and duty-free importing.

In late 1970, an American timber mill subsidiary, Potlatch Forests Incorporated, commenced operation at Assau on the northern island of Savaii. An investment programme of about $3 million is projected, and, in 1971, the output of sawn timber is expected to be 8 million superfeet. In 1970, the demand for sawn timber of 2.9 million superfoot was met almost entirely by imports at a foreign exchange cost of WS$400,000, so it is likely that the operations of Potlatch will have a very favourable impact on the Western Samoan balance of payments position.

Official foreign assistance played an increasingly important role in the development of the Western Samoan economy in 1970, the most important contribution coming in the form of technical assistance to help the development of the local agricultural and livestock projects mentioned earlier. The second plan recognizes the need for a considerable increase in the inflow of foreign assistance in the form of loans and grants between 1971 and 1975, and these sources are expected to contribute over 65 per cent of total government receipts on capital account in this period.

Tourism

Tourism continued to grow in importance in 1970. The number of tourists visiting Western Samoa rose from 15,000 in 1969 to an estimated 20,000 in 1970, and tourist spending in the latter year amounted to approximately WS$1.2 million. Under the Enterprises Incentive Act, the Government encourages local and foreign investment in hotels and other tourist facilities, and the Economic Development Department is actively engaged in the overseas promotion of tourism to Western Samoa. With the upgrading of Faleolo airport, with Polynesian and Fiji Airways operating bigger planes, and with United States airlines flying jumbo jets into Pago Pago (American Samoa), the number of tourists is expected to rise to 40,000 by 1975, with a consequent improvement in foreign exchange earnings from this source.

Conclusion

The Government of Western Samoa is actively engaged in an attempt to increase the rate of economic development, and its participation in the economy will increase during the second plan which commences on 1 January 1971. This second plan is much more ambitious than the first in terms of techniques of planning, policy changes, institutional reforms and implementation procedures. However, several first plan programmes which are already under way should help greatly in the attainment of second plan targets.

In addition to the problems which flow from the relative smallness and isolation, Western Samoa has a rate of population growth which, if unchecked, could thwart its efforts to raise the *per capita* income of its people. However, the Government is fully aware of the implications of this situation and is giving it active attention in the second plan. Despite these and other problems, Western Samoa has important advantages, such as abundant land resource and a high degree of political stability, and these may be expected to exert a favourable influence on the country's future growth.

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