

ASIAN DEVELOPING COUNTRIES AND PAFTA : DEVELOPMENT, AID AND TRADE PREFERENCES*

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I. *A New Stage in the North-South Problems*

The second United Nations Conference on Trade and Development (UNCTAD) at New Delhi in February-March, 1968, ended with frustration and disappointment for the developing countries.¹ This was not surprising since it was held at a very unfavourable time when the developed countries were involved in difficulties of their own such as the devaluation of sterling, the gold crisis, and a rising tide of restrictive and protectionist foreign trade and aid policies in the United States. The main positive achievement of the conference was an agreement to proceed with the establishment of a "General System of Preferences" for developing country exports of manufactures, to be worked out in the course of 1968-69 and, hopefully, implemented in 1970.

An important question arises. How effective is a global approach to the North-South problem likely to be? It is doubtful whether a multi-country meeting of this scale can substitute for more intensive negotiations between a small number of countries. The problems raised by the persistence of the basic cleavages of interests both within and between the two groups of developed and less developed countries are multiplied by more than the number of countries involved.² Even if agreement could be reached, concessions are likely to be severely limited and of nominal value. It is urgently necessary to formulate a more effective and constructive approach to the problem. A regional approach in which like-minded countries, from both the developed and less developed group, to foster trade development among themselves seems more promising. However, a regional approach can not be a substitute for a global approach to development problems. Rather, it represents an effective step towards the global approach.

Currently, the North-South problem seems to be facing a turning point: there is a shift in emphasis from aid and trade expansion of a "vent-for-surplus" type to that of a "structural adjustment" type.

In the last decade, less developed countries sought as much aid as possible from the developed countries. This aid was mainly used to provide social overhead capital and to fill the gap in the trade balance incurred by accelerated imports of capital equipment. In short,

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¹ UNCTAD, *The Significance of the Second Session of UNCTAD*, report to the Secretary-General of the United Nations, TD/96, 7 May 1968.

² See, for example, David Howell, "Failure at UNCTAD II," *The Round Table*, July 1968, pp. 249-253.

it was not really directed towards increasing exports. However, foreign substantial debts have accumulated in many developing countries and repayments and service charges surpass new borrowings. Thus, in addition to increased aid and a softening of terms of aid, the expansion of exports from developing countries is an urgent task.

Since economic development in many developing countries has been confined to investment of the "infrastructural" type and the establishment of import-substituting industries, exports have continued to consist mainly of traditional primary products. These exports have suffered from a declining importance in total world trade and also from severe fluctuation in their prices. Prospects for these exports look even worse because of the rapid growth in the supply of synthetic substitutes and the world-wide tendency towards trade liberalization both of which make things even harder for the low-quality, high-cost type of exports of the developing countries.

Thus, developing countries must turn to the expansion of export-oriented productive activities. The expansion of exports, not only in speciality tropical goods but also in certain labour-intensive manufactured and semi-manufactured goods, appropriate to the factor endowment ratio in developing countries now seems the most promising line of economic development. Developing countries have to shift the emphasis from receiving aid to the expansion of exports, and from agricultural exports to a structural transformation of their economies towards the export of manufactures.

Developed countries should take appropriate measures to facilitate structural transformation in developing countries. However, in the last decade, developed countries have confined themselves significantly to providing the vent-for-surplus type aid. U.S. aid in the form of surplus agricultural products under Public Law 480 is one good example. To take another example, Japanese aid has so far been provided mainly for the purpose of increasing her own exports of heavy manufactures and chemicals. Japanese reparations to Asian countries up to about 1960 were directed towards stimulating the expansion of newly established heavy industries and at the same time absorbing a large amount of unemployed labour. Aid from developed countries has been provided partly because there has been surplus produce or surplus capacity in resources, and aid has served as the vent for these surpluses.

Since about 1960, developed countries, including Japan, have been subject to more inflationary pressure. Aid of the vent-for-surplus type could not be continued easily. A new concept of aid and new aid policies have become necessary.

New types of aid and access for the exports of the developing countries to the markets of the developed countries should be provided by means of the structural adjustment of industries in developed countries. The developed countries would be better off substituting the production of a number of domestic industries for imports from the developing countries. There are certainly some "declining" industries in the developed countries which are so old and inefficient that, from all the criteria of comparative advantage and efficiency in resource allocation, it would be better to phase out of existence. Productive resources thus released should then be transferred to promising growth industries, effective demand for the products of which would be increased as a result of the successful economic development in less developed countries. Given that full employment is maintained, this sort of structural adjustment in the developed countries is the only real way to increase national incomes. Moreover, only this kind of structural adjustment in developed countries could create room for expanding exports from developing countries. Structural adjustment on both sides is required in

order to achieve a "new international division of labour" and the better utilization of world resources.

Recently it was convincingly demonstrated by Hal B. Lary that "the ranking of industries by factor intensities is much the same from country to country, even from the most developed to the least developed. That is to say, the phenomenon of 'factor-intensity reversals' seems to be much less common, at least in manufacturing, than some other empirical studies would suggest."³ I also have verified the validity of the factor-proportions theorem as regards exports of manufactures (74 commodities) from the U.S., Canada, Sweden, the U.K., EEC and Japan.⁴ These studies lead to support the conclusion that the potential manufactured exports from less developed countries is promising, provided that a receptive and cooperative attitude is adopted by the importing countries and an appropriate export-oriented industrialization policies suited to their factor endowments are pursued by the less developed countries themselves. "A readiness on both sides to share in the international division of labor among countries at varying levels of economic development"⁵ would assure successful growth in trade from less-developed to developed countries.

One of the most important consequences of the validity of the factor-proportions theorem is that trade in manufactured goods throughout the world should be liberalized. This liberalization is necessary to maximize world productivity by providing increased opportunities for international division of labour in manufacturing industries among countries at different stages of economic development and possessing different factor endowments. This means that advanced countries should abolish the protection given to their declining labour-intensive industries, as rapidly as possible, transferring the production of these goods to less developed countries. To achieve "a new international division of labour",⁶ the growth of promising manufacturing industries suited to the factor-proportions of the less developed countries should be assisted by capital and technological aid and by the extension of tariff preferences.

Structural adjustment in developed countries is an essential element if new development policies are to be successful. Structural adjustment is also a key factor in the liberalization of trade and the establishment of a free trade area among the advanced countries. How can this structural adjustment be undertaken effectively? Strong resistance, both economic and political, can be expected. Various steps will have to be taken to assist the adjustment, along the lines of those under the U.S. Trade Expansion Act of 1962 and the amended act of 1968.

There are two measures that would assist the adjustments desired. First, a fund for assisting structural adjustment should be established in every advanced country. This should become an international obligation similar to the one per cent of national income foreign aid target. A certain per cent (say, a quarter of one per cent) of national income could be collected through taxation for this purpose. The fund should be used for bringing about the

³ Hal B. Lary, *Imports of Manufactures from Less Developed Countries*, National Bureau of Economic Research, New York, 1968, p. 19. Total value added per employee which is taken to represent the difference in capital-intensity in 13 industry groups is compared among 9 countries (the U.S., Canada, Australia, Sweden, the U.K., Japan, Brazil, Mexico, and India), and both Kendall's coefficient of concordance (0.853) and chi-square test (92.12) are very significant (*Ibid.*, p. 71).

⁴ Kiyoshi Kojima, "Comparative Advantage among Industrial Countries: A Verification of the Factor-Proportions Theorem," (forthcoming).

⁵ Hal B. Lary, *ibid.*, Preface, p. xv.

⁶ Harry G. Johnson, *Economic Policies Toward Less Developed Countries*, Brookings Institution, Washington, D.C., 1967, pp. 201-204.

gradual elimination of uneconomic industries and the transfer of factors of production to more productive activities where the advanced country enjoys a comparative advantage. The optimum policy would be a "package" of subsidies to allow uncompetitive production to continue over the retirement period and of cash grants to finance the closing down of capacity. Facilities should be provided, in addition, for the retraining and movement of redundant labour.

This fund would be more efficient than direct aid to developing countries for it could be used in the advanced countries for economic rationalization and thus raise national welfare in their own interests. In many advanced countries, slum clearance has been widely undertaken by governments. Why should not the reclamation of uneconomic industries be undertaken also?

Secondly, some safeguards for gradual running down of inefficient, heavily protected industries in the developed countries should be devised. A Tariff Board should be established in each developed country or preferably as an international institution, which obliged industries to justify their claim for continued protection by tariffs and quantitative controls. The subsidies noted on an annual basis should replace tariff protection for uncompetitive production. Each year subsidised producers could be required to make out a case as to why they should continue to receive cost-reducing subsidies rather than grants designed to facilitate the running down of their productive capacity.⁷

In this way the burden of maintaining protected industries would fall on the consumers and taxpayers of the developed countries concerned rather than on the less developed countries and other exporters. Consumers in the developed countries would thus be more clearly aware of their interest in seeing uneconomic industries closed down and the harmful effects of tariffs and quantitative restrictions than they seem to be at present.

Careful investigation should be made as to how best to provide aid and preferences for the purpose of facilitating structural adjustment with the least friction and greatest incentives in the advanced and less developed countries alike.

II. *Directly Productive Aid*

I have advocated closer economic integration among the Pacific basin countries, preferably the formation of Pacific Free Trade Area (PAFTA) but, as a first step, the establishment of an Organization for Pacific Trade and Development (OPTAD).⁸ Trade liberalization among the five advanced countries of the Pacific, the U.S.A., Canada, Japan, Australia and New Zealand, would bring about a large expansion of intra-areal trade (as large as \$ US 5,000 millions or 28 per cent of intra-areal trade in 1965) which would be more significant than what can be expected through the Kennedy Round tariff reductions. Complete regional trade liberalization would appear to have considerable advantages over partial trade liberalization in world markets. Since another major round of global tariff reductions is not feasible within

⁷ David Wall, *The Third World Challenge, Preferences for Development*, The Atlantic Trade Study, London, January 1968, pp. 61-62.

⁸ Kiyoshi Kojima, "A Pacific Economic Community and Asian Developing Countries," *Hitotsubashi Journal of Economics*, June 1966, and "Japan's Interest in the Pacific Trade Expansion," Kiyoshi Kojima, ed., *Pacific Trade and Development*, Japan Economic Research Center, February 1968 (reprinted in *Hitotsubashi Journal of Economics*, June 1968). Cf. G. C. Allen, *Japan's Place in Trade Strategy, Larger Role in Pacific Region*, The Atlantic Trade Study, London, September 1968.

the foreseeable future, the formation of a free trade area would seem to be an effective alternative for, and the only remaining practical road to, fostering world trade liberalization.

Moreover, the formation of PAFTA or some such alternative is particularly desirable from the viewpoint of developing well harmonized and efficient trade and aid policies⁹ towards the less developed countries in the Pacific basin. If a PAFTA arrangement were established, the group of developed countries could (and should) offer associate membership to the less developed countries of the Pacific and provide the latter with aid, investment and trading privileges. To increase aid and trade with less developed countries, what is most needed is structural adjustment of industries in the developed countries as explained above.

The creation of PAFTA would imply that each member would be prepared eventually to adjust to full competition from the other member countries. This would certainly provide developed countries with a great impetus to undertake structural reorganization and, if this could be started, it would not be difficult to include structural adjustments required to provide the less developed countries with wider markets. Each advanced country in isolation might be reluctant to grant aid and trading preferences to less developed countries on the scale required, either because of its lack of resources, or because it could not face alone the structural consequences for its own economy. Only harmonized and coordinated efforts among the advanced countries would make aid and trade expansion with less developed countries possible. The increased prosperity and higher incomes which the advanced Pacific countries would gain through PAFTA would provide them with additional resources which they could share with less developed countries of the Pacific. Only the process of rapid economic growth within the developed countries, stimulated to some extent by trade liberalization, makes possible structural adjustment.

Aid and trade preferences should be provided from advanced to less developed countries of the Pacific in a direction which would accelerate most the structural adjustment needed on both sides. With this aim, it is strongly recommended that international economic aid should be increasingly provided to Asian (and Latin American) developing countries by the advanced Pacific countries in the form of machinery, equipment, fertilizer, and other capital goods for directly productive (preferably export-oriented) activities in the coming decade. Both humanitarian and infrastructural aid which were the main form of aid in the past can continue to make an important contribution in the future, but in addition to these types of aid directly productive aid is more urgently required now. As mentioned above, it can be expected that an increase in directly productive aid will have several beneficial effects not only for the developing countries but also for the donor countries.¹⁰

Suppose there was an outright grant of \$US 1,000 millions annually for the coming ten years, in addition to the current level of aid, to the Asian developing countries from the five advanced countries of the Pacific specifically for the purpose of the importation of machinery, equipment, fertilizers, and other capital goods. This would certainly stimulate the expansion of heavy and chemical industries in advanced countries, and many other indirect effects

⁹ See, David Wall, *The Third World Challenge, Preferences for Development*, The Atlantic Trade Study, London, January 1968, and "Markets for the Underdeveloped," *The Round Table*, October 1968, pp. 406-407.

¹⁰ A more detailed explanation is presented in Kiyoshi Kojima, "A Proposal for International Aid," *The Developing Economies*, The Institute of Asian Economic Affairs, Tokyo, December 1964, pp. 337-357.

could be anticipated.

Private capital investment in the developing countries should also increase, if the capital requirements of new manufacturing industries, which need such large and risky investments that private firms sometimes hesitate to undertake the investment, are met by international grants and, in addition, if preferential treatment of their exports by the advanced countries is assured. Private capital would assist in establishing a series of ancillary, interrelated, or higher-stage processing industries. For example, a big cotton spinning mill could be established by international grants; then the weaving and clothing industries might be supplemented by foreign private as well as local capital. The mill would produce yarn cheaply, owing to low capital costs, and ancillary and interrelated industries would become profitable.

Private capital investment from advanced countries would be stimulated. Increases both in the directly productive aid and in the private capital investment would directly, and in addition the "acceleration effect" indirectly, create a new demand for heavy and chemical industries in the advanced countries. Moreover, the expansion of those industries would have multiplied income effects resulting in further additional demand.

A substantial expansion of heavy and chemical industries in the advanced countries could provide a stimulus large enough to reallocate resources in such a way as to expedite a rapid transfer of labour and capital (with the aid of adjustment assistance, if necessary) from agriculture and light manufactures of a labour-intensive type to heavy and chemical industries, that is, from comparatively disadvantageous to advantageous industries. Both the structural adjustments and increased national income in the advanced countries would enlarge the scope for importing certain kinds of agricultural products and light manufactures of a labour-intensive type from developing countries. Thus, if both the necessary capital goods, including technical know-how and managerial skill, and markets are provided, the expansion of export-oriented activities in the developing countries will be assured of success.

To sum up, my proposal for increasing international economic aid towards the provision of directly productive capital goods would have three distinct advantages. (1) It would provide the developing countries with the means necessary to expand export-oriented activities. (2) In the advanced countries, it would lead to a reallocation of resources towards heavy and chemical industries in which they possess a comparative advantage. (3) The expansion of heavy industries stimulated, in the advanced countries, by the increase in demand for capital goods in the developing nations, would provide the markets necessary for growing export industries in the latter. Thus, the international division of labour would move closer towards an optimum.

III. *Agricultural Development in Asian Developing Countries*

Although the expansion of the exports of manufactures suited to their abundant supply of labour is becoming the most promising path to long-term development for Asian developing countries, agricultural development is an even more urgent task in order to economize foreign exchange, to increase export earnings and to feed their people better and elevate their will to work. Pacific advanced countries (PAC) should provide extensive directly productive aid to facilitate agricultural development in Asian developing countries.

(i) A Scheme for Fertilizer Aid

Although the countries of Southeast Asia, such as India, Pakistan, Indonesia, and the Republic of Korea, are agricultural countries they suffer from severe food-shortages and import foodstuffs to the approximate annual value of \$US 1,000 millions from advanced countries in the Pacific area such as America, Australia and Canada. Although some of these imports are available in the form of American surplus agricultural aid, this is exercising a serious pressure on their already unfavourable balance-of-payments position. What is more, when future increases in population and per-capita consumption are taken into consideration, these countries will require a large increase in production, equivalent approximately \$US 3,500 millions per annum, and foodstuffs to the value of approximately \$US 1,000 millions will have to be procured in addition to the plans for increased production already tabled by the governments concerned. There is an urgent need to improve the food-producing capacity of those Asian countries in order to cover the \$US 2,000 millions deficit in foodstuffs—the \$US 1,000 millions already being imported from the advanced countries plus the \$US 1,000 millions worth of additional production. The provision of chemical fertilizer aid and the construction of fertilizer factories would seem the best method of attacking this problem.

Advanced countries of the Pacific area should shift the emphasis in their agricultural assistance programs from the provision of foodstuffs themselves to the provision of fertilizer aid. While the supply of surplus agricultural products under the American PL 480 program is very useful for relief in times of famine, it has made little contribution to improving agricultural productivity in Southeast Asia. On the contrary, it has even tended to impair the morale of the local peasants. Fertilizer aid and the building of fertilizer factories involve much lower expenditure than assistance in foodstuffs. Today, now that America's stocks of surplus agricultural products are beginning to dry up, a switch towards emphasis on fertilizer aid would be advantageous.

A number of facts already testify that crop yields increase greatly if chemical fertilizers are applied appropriately. While production of rice per hectare is more than four tons in Japan, and around three tons both in the Republic of Korea and Taiwan which follow Japan, in the other countries of Southeast Asia yields are only about 1.2 tons per hectare, the lowest being India with 0.4 tons per hectare. The yield per hectare is clearly related to the quantities of fertilizers used, low productivity being caused by the virtual non-application of fertilizer. To take another example, of the total increase in food production of 11.2 million tons provided for under the second Indian Five-Year Plan (1956-61), 4.6 million tons of almost half was estimated to be produced by the increased use of chemical fertilizers.

For chemical fertilizer to be used effectively it is of course necessary that irrigation and drainage facilities should be provided in advance. Although not all Southeast Asia is ready to employ fertilizers, a fairly extensive area is. Increased production should be brought about by increased use of fertilizers, beginning in the regions in which the pre-conditions have been established. At the same time technical advice about the use of fertilizers, insecticide, and improving the seed strains should also be made available. It is an encouraging fact that superior seed strains such as IR-8 and ADT-27 have been developed and successfully used over a wide area. The diffusion of these modern agricultural inputs will take a long time and will need assiduous technical help and institutional reform, but they have already offered great hope for progress in Southeast Asia.

The main features of the scheme for fertilizer aid are as follows:

- 1) PAC should give a gift of fertilizers to the value of \$US 60 millions yearly, or a total

value of \$US 300 millions over a five-year period, to the countries of Southeast Asia which are in a position to use them.

2) The countries which receive these gifts of fertilizer should sell it at appropriate prices to the farmers, and should accumulate the proceeds as counterpart funds.

3) At an appropriate time factories for the production of fertilizers should be set up in the aid-receiving countries. When this is done the counterpart funds should be used to pay for such local expenses as acquisition of land, local labour costs, the remuneration of PAC personnel dispatched, etc. The equipment required in setting up these factories should be supplied from PAC on a long-term, deferred-payment basis.

4) The counterpart funds should be used for the following purposes in addition to the construction of fertilizer factories: a) additional or supplementary irrigation works directly necessary for fertilizer application: b) running expenses necessary for PAC's agricultural technical cooperation activities (experimental centers, pilot or model farms, technical direction, extension work with improved strains of seed, etc; c) the purchase of agricultural machinery and implements, seeds, insecticide, etc; d) the establishment of fertilizer storage and transportation facilities.

In summary, this is an aid formula under which fertilizers (especially nitrogenous fertilizer) for which PAC has a surplus productive capacity are first given as gifts, followed by which fertilizers factories will be built for the aid-receiving countries with the help of their counterpart funds and capital supplied under deferred-payment arrangements.

For example, if in the first year \$US 60 millions worth of fertilizer aid were given to India and Pakistan respectively, in the second year, two standard factories with a daily capacity of 600 tons of ammonium and 1,000 tons of urea could be built in each country. The cost of building one of these factories is estimated at \$US 25 millions for the plant, and about \$US 15 millions for local costs (to be met out of counterpart funds). In addition to this, during the second year both Indonesia and the Philippines should each be given gifts of fertilizers to the value of \$US 30 millions. In the third year, two fertilizer factories should be built in each of these two countries. In the small countries of Southeast Asia, it would, of course, be proper to make the fertilizer factories small-scale ones of half, or quarter, of the capacity of the standard factories. It would also be possible to effect exchanges among the countries receiving fertilizers and countries building factories with their counterpart funds (e.g. by exchanging fertilizers produced in India for Burmese or Thai rice), a variety of flexible applications of the scheme being conceivable.

Fertilizer aid at the rate of \$US 60 millions yearly, or \$US 300 millions over five years, seems modest both from point of view of PAC's ability to meet the burden and its surplus capacity in fertilizer production. This aid alone would be probably be sufficient to make up the whole of the \$US 2,000 millions increase in food production required by Southeast Asia, which was mentioned above. It is to be hoped that other advanced countries in Western Europe would also participate in the fertilizer aid scheme.

PAC would not only be enabled to carry through a meaningful aid program aimed at the solution of the most urgent problem of food shortage in the countries of Southeast Asia, but the deferred-payments scheme would also enable PAC to export fertilizer plants and equipment valued at as much as \$US 500 millions over a five-year period. Once the farmers of Southeast Asia became thoroughly familiar with the use of fertilizers and conscious of their value, the demand for fertilizers could be expected to increase, and even the demand for

commercial exports of fertilizers from PAC could be stimulated.

(ii) A Program for Cash Crop Plantations

There is a strong desire for industrialization in the countries of Southeast Asia, but as capital equipment imports for the purposes of industrialization are costly developing countries commonly fall into serious balance-of-payments difficulties. If along with the above-mentioned increased food production, which reduces the demand for foreign exchange, it were possible to enlarge exports of such cash crops as raw cotton and sugar, their additional foreign exchange earnings would become available for the promotion of economic development.

There is considerable scope for the Pacific advanced countries to switch the imports of raw materials and foodstuffs from other advanced countries in the Pacific or Europe to Asian developing countries for those primary products which can be produced in Asian developing countries competitively in terms of quality, price, delivery, etc. Between five and ten years should be allowed for the developing countries to improve productivity and to increase export capacity. For advanced countries too, some time will be required for adjusting their industrial and employment structures.

The possibilities for switching sources of supply are especially great in Japan's case. Japan will have to import increasingly large quantities of raw materials, fuels and foodstuffs to sustain its expanding economy. In 1965, Japan imported two-thirds of its total consumption of energy—mostly in the form of petroleum. Japan will continue to import most of the iron ore and non-ferrous metal ores it requires.

Its imports of raw cotton and raw wool may decline somewhat, but Japan must continue to rely on imports for its entire consumption of these raw materials. In 1966, lumber was Japan's second largest import, coming only after petroleum, and imports will further increase in the years to come. Imports of animal feeds such as maize and kaoliang are rapidly increasing. In 1966, Japan's fodder imports amounted to 5.7 million tons; and in the near future they will exceed the 10 million ton mark. Imports of oil seeds, sugar, bananas, and marine products will also expand. If Asian developing countries can produce these products efficiently, they will be able to expand their exports to Japan greatly.¹¹

For the U.S.A., Canada, Australia and New Zealand, the possibility of increasing imports of raw materials and foodstuffs from Asian developing countries may be limited only to their traditional imports from these countries, but rapid economic growth and structural adjustments in these advanced countries will induce fairly large increases in imports from Asian developing countries for those traditional goods. It is hoped that those advanced countries are able to refrain from expanding competitive agricultural production through the abolition of support schemes and protection.

For agricultural products which Japan is importing both from the advanced countries of the Pacific area and from Southeast Asia, possible increases in Japanese imports from Southeast Asia are expected to amount to about seven or eight hundred million dollars within the next five years, if one takes into account the possible trade diversion effects away from the advanced countries and towards imports from the developing countries envisaged by our plan as well as the influence of the general increase in imports projected for Japan during this five-year period. Increased demand for Asian agricultural products in other Pacific advanced countries will be approximately the same as in Japan, making a total of roughly \$US 1,500

¹¹ Saburo Okita and Akira Ohnishi, "Japan's Role in Asian Economic Development," Kiyoshi Kojima, ed., *Pacific Trade and Development*, Japan Economic Research Center, Tokyo, 1968, pp. 360-361.

millions.¹² It is desirable to have this met by increased production in Southeast Asia brought about by the efficient use of directly-productive aid. Although it is not easy to estimate the amount of aid required, the importation of investment goods to be used in the agricultural development projects backed by Pacific advanced countries (PAC) alone would require \$US 240 millions. This figure is obtained from the estimates of the capital coefficient in Southeast Asia (1.6) and the foreign exchange requirement rate, (0.1), together with the projected total increase in demand for the agricultural products of Southeast Asia of \$US 1,500 millions. If this sum is provided over a five-year period about \$US 50 millions annually would be sufficient.

As an efficient aid formula would be to grant funds and technology for the establishment and operation of cash crop plantations. Possible cash crops to be grown on these plantations would be cotton, maize, sugar, soybeans and tobacco. Here, however, I should like to consider a plan for a cotton plantation company as a representative of such undertakings.

1) The PAC would disburse aid at an annual rate of say, \$US 30 millions or a total of \$US 150 millions over five years in the form of technical cooperation expenses, and would set up a parent cotton plantation company. It would probably be best to entrust the running of the company's affairs to efficient private enterprise.

2) The cotton plantation company would set up and run a number of cotton plantation joint enterprises organized with the help of local capital in suitable areas of Asia.

3) As well as exercising control over the joint enterprises in their various locations the parent company could provide technical assistance and would send out technicians on an organized basis. At the same time it would carry on research in marketing and technical questions of common interest, and would make joint purchases of fertilizers, machinery, agricultural implements, etc.

4) The cotton plantation joint enterprises set up in various parts of Asia would possess the following attributes: a) They would have at least one primary processing factory, i.e., a factory where the seed and waste are removed by ginning machines and the selected material made up in bales, and then would possess plantations sufficient in size to make possible efficient use of the factory. b) They could carry out positive direction in relation to the cotton production carried on by peasant croppers in the vicinity of the plantation, buy up the raw cotton they produced, and carry out the primary processing. c) When a plurality of cotton plantation joint enterprises had been established in various areas in Asia, they would take steps to consider differentiating the varieties of cotton grown by the various joint enterprises in response to the needs of the demand for raw cotton in both PAC and Southeast Asia and with a view to distributing risks.

Japan imports most of her raw cotton from America at present, but it is quite possible from the technical point of view to grow American cotton in almost all parts of Southeast Asia, and it is already being grown extensively in Pakistan. What is needed is a switch in Southeast Asian cotton production to the superior variety of cotton, modern production management characterized by uniform quality, quality supervision, etc., and reduced costs. These should be the aims of the cotton plantation companies, and if they were achieved not only could PAC's imports of cotton from Asian developing countries be increased but it would also be possible to meet the demand for raw cotton which is rapidly increasing within Southeast Asia itself.

¹² Some estimates were attempted in Kiyoshi Kojima, "A Pacific Economic Community and Asian Developing Countries," *Hitotsubashi Journal of Economics*, June 1966, pp. 30-37.

It would be possible to disburse PAC aid by the same method for the purpose of fostering other cash crop plantations such as growing sugar, maize, soybeans, tobacco and other crops. All these industries would produce results quickly with comparatively little aid and contribute to the solution of Asian balance of payments problems.

Concessions, and, positive support, by the advanced producing countries of the Pacific area will all be necessary to enquire the expansion of cash crop exports from Southeast Asia. The advanced countries will have to refrain from artificially stimulating their own exports, and, better still, to substitute imports from Southeast Asia for domestic production. What reaction will be forthcoming from the American cotton producer is the chief worry. But it seems advisable for America to effect a gradual change-over from cotton production, which in that country is in process of losing its comparative advantage because of high wages and rising costs, to other more profitable industrial activities, and furthermore that it might be more advantageous for American cotton growers to operate plantations in Southeast Asia where cheap labour is abundantly available. Thus, Southeast Asia should be given an appropriate role in changing the international division of labour. Similar adjustment are required in the production of American maize and soybeans and Australian sugar.

"Fertilizer aid" and "cash crop plantations assistance" are two examples of aid which could be provided by the cooperative action of the Pacific advanced countries and implemented immediately perhaps with the help of the Asian Development Bank. These directly productive aid projects should be additional to aid already planned for other purposes since much aid is also required to equip a huge agricultural infrastructure comprising large scale irrigation works, transport and communications facilities, education, as well as for undertaking land reform. The present scheme stresses the importance of complementary aid which allows the fruits of infrastructural aid to be realized.

The Pacific advanced countries should also assist with the development of mineral resources in Asian developing countries. This can be done best, however, mainly by private capital. Promising mineral resource developments in Asian developing countries are rather limited—iron ore in India, petroleum in Indonesia, and copper in the Philippines. The development of mineral resources in Australia, Canada and Alaska presently appears less expensive and offers more stable supplies.

IV. *Aid cum Trade-Preferences*

Great faith has been put in general trade preferences to less developed countries as a means of increasing their export earnings and promoting their economic growth. Trade preferences for developing countries are justifiable if divergence from the principle of non-discrimination within GATT is temporary and if they foster liberalization of world trade. They are positively desirable if they encourage transformation in the international division of labour in such a way as to strengthen specialization in the export of labour intensive exports from developing countries.

Will the general trade preferences bring about really substantial beneficial effects to developing countries as it is hoped they will? This question should be looked into.

(i) The Trade Creation Effects: Increases in Japan's Imports

Increases in Japan's imports due to the extension of general preferences to developing

countries are estimated¹³ according to the familiar model of tariff reductions, first, neglecting the trade diversion effects which other developed countries might suffer. Attention is focussed on the trade creation effects on Japanese imports. The estimate is attempted with regard to 12 sensitive items¹⁴ of interest to developing countries on the basis of 1964 trade figures.

In 1964, developing country exports of these twelve commodities to Japan were valued at \$US 3.69 millions which represented a 10 per cent share in the relevant Japanese markets. The estimates suggest that if tariffs were abolished on developing country exports to Japan, they would expand by \$US 0.91 millions, or 24.7 per cent. Although the percentage increase appears large, the absolute size of the increase is relatively insignificant when compared with annual increases in Japanese exports of the order of \$US 1,000 millions. The fact is that Japan still maintains a strong comparative advantage in traditional labour intensive manufacturing industries of the type most competitive with potential export industries in developing countries.

It is true that in recent years, Japan's imports of manufactured goods from Hong Kong, Taiwan, Korea, Singapore and India have been increasing rapidly, but they are still insignificant. However, taking this trend into account, and broadening the commodity coverage, it might be that around \$US 50 millions worth of Japanese imports could be affected by the extension of trade preferences. If tariffs against developing country exports were completely eliminated, imports would increase by \$US 13 millions only. A fifty per cent tariff cut is probably a more realistic possibility, and besides some commodities are likely to be excepted. On this basis, the increase in Japanese imports would be somewhat less than \$US 6.5 millions. There seem no strong grounds for Japan to oppose the provision of general trade preferences for fear of unmanageable increases in her imports.

(ii) The Trade Diversion Effects: Decreases in Japan's Exports

A more serious problem for Japan is that her exports, particularly to North American markets, might suffer from the trade diversion effects of trade preferences extended by other developed countries to developing countries. A more complicated model is required in order to estimate the effects of both trade creation and trade diversion in a given developed country market, such as the United States.

An estimate is attempted for nineteen manufactured commodities¹⁵ of importance to developing countries which compete with Japanese exports in the American market. In 1964, United States' imports of these commodities were valued at \$US 1,600 millions. Japan supplied \$US 450 millions and developing countries supplied \$US 465 millions. The nineteen items cover almost all the manufactured and semi-manufactured goods for which developing countries, as well as Japan, seek larger markets in the United States.

Let us suppose that the U.S. abolishes tariffs preferentially on the imports coming from developing countries while she retains tariffs on the imports from other developed countries. It is estimated according to our model that the developing countries would increase their exports to America by the amount of \$US 176 millions or 37.8 per cent over the total 19 items

¹³ A more detailed explanation is presented by Kiyoshi Kojima, "Trade Preferences for Developing Countries: A Japanese Assessment," *Hitotsubashi Journal of Economics*, February 1969, pp. 1-12.

¹⁴ They are mostly labour-intensive manufactures: plywood, cotton yarn and thread, yarn and thread of synthetic fibres, cotton fabrics woven, floor coverings, clothing, footwear, articles of artificial plastic materials, travel goods and handbags, small-wares and toilet articles, children's toys, and lighters.

¹⁵ Cotton fabrics woven, yarn of wool, wollen fabrics woven, jute fabrics woven, floor coverings, clothing, manufactures of leather, footwear, sporting goods, children's toys, articles of rubber, plywood, cement, glass, glassware, soaps, sewing machines, bicycles, and radio.

on 1964 trade figures and enjoy an average rise of export prices of 18.3 per cent.

On the other hand, \$US 22.5 millions or 4.1 per cent of Japanese exports would be diverted to developing countries and Japanese export prices would be forced down on average by 2.0 per cent. Thus, the United States would increase her imports by \$US 153.5 millions or about 10 per cent on 1964 figures—the difference between the increase in developing countries' exports and the reduction in Japan's exports. The increase in American imports is the trade creation effect of preferences resulting from the average fall of 2.0 per cent in American import prices inclusive of the tariff.

The question is would the effect of trade diversion on Japanese exports be really serious? Although there have been some exaggerated estimates for Japan, it is not likely that the effects would be nearly serious as is widely feared, as far as the static effects of preferences are concerned.

(iii) Preferences through an "Advance Cut"

Two alternative preference schemes have been presented to OECD countries: the advance cut plan advocated by the United States and the tariff quota plan supported by EEC countries. It has been suggested that the advance cut preference scheme could be applied *either* by reducing tariffs on developing country products to the full extent of concessions agreed under Kennedy Round negotiations *or* by reducing tariffs on developing country products under negotiations between developing countries and developed countries within GATT, to be followed by a new round of negotiations among developed countries designed to effect the staged reduction of MFN tariffs over 5 or 10 years. Either way, the advance cut plan ensures that general preferences are temporary and that they are consistent with progress towards global free trade. These are the significant merits of the advance cut proposals.

On the other hand, the tariff quota scheme appears more open to protectionist abuses, and unlikely to promote trade liberalization in developed countries. Quotas on selected commodities from particular developing country sources would be subject to arbitrary alteration and MFN tariffs could even be raised to provide larger preference margins. Fundamentally, the tariff quota plan does not aim at progress towards global free trade but sets out to prevent "market disruption" by developing country products. From the standpoint of encouraging the expansion of world trade, the advance cut proposals seem preferable.

Permanent preferences, i.e., general preferences with no limitation in duration, are certainly more favourable to less developed countries than the AC plan, but they will not be accorded by developed countries. It may be interesting, however, to illustrate the difference in effects of both schemes for the case of Japan.

Let us suppose that (1) America imported in the initial year \$US 600 millions from Japan and \$US 400 millions from developing countries, following closely to the 1964 trade figures; (2) the American tariff level was 30 per cent *ad valorem*; (3) preferential margin equals 0.5 both under the AC plan and the permanent preferences plan; (4) tariffs are reduced by 10 per cent every year for five years under the AC plan but they are reduced by 50 per cent from the first year under the permanent preferences plan; (5) the price elasticity of American import-demand is taken as 2.5 and the price elasticity of export-supply from Japan 2.2 throughout the five years; and (6) the price elasticity of export-supply from developing countries will increase from 1.1 in the first year to 1.65, 2.2, 2.75 and 3.3 in successive years.

Under these assumptions, over the whole five year period, Japanese exports would fall by \$US 205 millions or 6.8 per cent under the permanent preferences plan, whilst they would

increase by \$US 306 millions or 10.2 per cent under the AC plan.

Exports of developing countries would increase by \$US 671 millions or 33.4 per cent in the case of the permanent preferences plan and by \$US 514 millions or 23.7 per in the case of the AC plan.

American imports would increase by \$US 466 millions, i.e., net of increase from developing countries and decrease from Japan, in the case of the permanent preferences plan whilst they would increase by \$US 820 millions, i.e., the sum of increase both from developing countries and Japan, in the case of the AC plan.

Thus, it appears that a permanent preferences plan, if it were accorded, would be most favourable to developing countries. It should be noted, however, that increases in American imports which designates the degree of liberalization of world trade would be far larger in the case of the AC plan than permanent preferences plan. The more favourable effects for developing countries in the case of the permanent preferences plan resulted from discrimination caused by trade diversion effects against Japan and not from the greater expansion of world trade. Japan has many interests in common with developing countries. She still depends heavily on the exports of traditional labour intensive manufactures in competition with developing countries but, like them, she desires freer access to developed country markets for these exports.

It is important to emphasize that for developing countries, too, the benefits of trade preference schemes derive not so much from *discrimination* in tariff treatment but more from the *reduction* of tariffs in developed countries and also from the increase in productive capacity and competitiveness of exportable products from developing countries. It is of the utmost urgency to the developing countries that some jolt be administered to the high-wage economies of the advanced nations so that protectionism is broken down and also so that they be given more efficient assistance from the advanced countries to foster their infant industries. These aims would be realized most practically.

(iv) PAFTA Aid *cum* Preference System

What this study and others have shown is that the static effects of preference schemes are not likely to be substantial.¹⁶ The prospects are generally discouraging for developing countries. The benefits for them may be even too small to justify the cost of carrying out the cumbersome administration of preferential treatment. The increased earning power of developing countries which results from trade preference is certainly not likely to fill their huge foreign exchange gap.¹⁷

Moreover, there are conflicting interests among the potential preference receivers. The main interest of the less developed among the developing countries is not so much preferential tariff treatment on manufactured exports but, first, the expansion of traditional primary commodity exports and, second, the initiation of industrialization with heavy dependence on aid from developed countries.

In fact, developed countries have been reluctantly lead towards the provision of general trade preferences, not because they expect any substantial benefits to flow to developing

¹⁶ See, Gardner Patterson, *Discrimination in International Trade, The Policy Issues, 1945-1965*, Princeton, 1966, pp. 358-359, pp. 381-383. John Pincus, *Trade, Aid and Development*, Council on Foreign Relations, 1967, Chap. 6. Pincus, *ibid.*, p. 231, estimates that a general preference scheme could increase the export receipts of developing countries by the general order of \$1 billion annually if processed products were included. This estimate is the largest at several estimates made.

¹⁷ Grant L. Reuber, *Canada's Interest in the Trade Problems of Less-Developed Countries*, The Canadian Trade Committee and Private Planning Association of Canada, 1964, p. xii.

countries but because they recognize the political expedience of providing them.

It may be true that if the effective rates of protection which are on average 1.5 or 2 times over the nominal tariff rates,¹⁸ and the dynamic effects of preferences are taken into account, the favourable effects of general preferences for less developed countries would be more substantial. But these effects depend heavily upon the developed countries assistance of capital, know-how and management for establishing and rationalizing production facilities in developing countries.

An aid *cum* preference scheme could offer more benefits to developing countries. Aid, linked directly to preferential tariff treatment, appears consistent with the Prebisch report's emphasis on the infant industry argument for preferences.¹⁹ Firstly, as proposed in previous sections, directly productive aid in the form of capital goods, advanced techniques of production, managerial know-how and worker training, should be provided to developing countries on an increasingly large scale if the efficiency of new export-oriented industries, primary as well as manufacturing, is to be improved to the point where they become increasingly competitive in world markets. Secondly, developed countries should provide preferential treatment, say for five or ten years, to developing country exports launched with the help of directly productive aid. Preferences aimed at ensuring wider markets would serve as a sort of aid 'after-care', and might well be regarded as indispensable to realizing the full benefits of aid. It is important that the provision of preferences should be closely linked with the provision of aid since either is likely to be ineffective and result in a waste of resources if applied independently.

The aid *cum* preference scheme need not be confined to manufactured goods. It could also be useful for agricultural and mineral commodities of interest to developing countries. Commonly, however, developed country tariffs on these latter products are very low or non-existent and there is little margin for granting preferences. In such cases, governments of the developed countries could provide a subsidy on imports from the developing countries for some specific period, say five years, until competitiveness is sufficiently well established.²⁰

It is clear that a large-scale scheme of aid *cum* preference could be provided more efficiently and without much difficulty by a group of like-minded advanced countries. This suggests the advisability of a Free Trade Area Aid *cum* Preference System.

The optimum arrangements for the less developed countries would be for, as rapid as possible, a reduction and elimination of barriers on their exports to FTA countries, combined with the slow and gradual elimination of barriers among FTA countries. It might be best to establish a FTA by eliminating tariffs gradually within ten to fifteen years but to reduce tariffs on developing countries products from the first year to the full extent, following on

¹⁸ See, Harry G. Johnson, "Trade Preferences and Developing Countries," *Lloyds Bank Review*, April 1966, pp. 13-17, and Bela Balassa, "The Structure of Protection in the Industrial Countries and its Effects on the Exports of Processed Goods from Developing Countries," *IBRD Report*, No. EC-152a, February 1968.

¹⁹ United Nations, *Towards a New Trade Policy for Development*, New York, 1964.

²⁰ As a kind of aid, Japan has stressed "development investment for imports," i.e., to assist the development of primary products in developing countries with the aim of importing raw materials and foodstuffs most needed for the Japanese economy at a cheaper price and from a stable source. Thailand's export of maize to Japan is a good example. In order to promote this, an "Agency for Asian Trade and Development" will be established under the support of the Japanese Ministry of International Trade and Industry.

the principle of an advance cut plan. At the same time, FTA governments could increase directly productive aid and encourage the flow of private investment to developing countries which would be stimulated by these trade measures.

The FTA aid *cum* preference system has a number of advantages, including greater feasibility, over the general preference system considered by UNCTAD. There have been excellently summarized by David Wall as follows:²¹

"In the first place, the spirit behind the FTA movement is based on belief in the benefits to be gained from free trade and the concessions called for in the proposed preference system would represent a more extensive diffusion of this particular spirit.

Secondly, if FTA was to be successfully established, its members would be better off and consequently able to bear the cost of the preference system more easily, which contrasts with the UNCTAD scheme that incorporates no *quid pro quo* for developed countries.

Thirdly, the extension of preferences by FTA as a group would ensure that the burden of accommodating those preferences would be shared as broadly as possible.

In addition, such action would reverse the tendency for the world to break up into discriminatory trading blocs bent on protecting the interests of producers within each bloc."²²

It should be stressed again that the jolt to the economies of the developed countries which the provision of preferences to the less developed countries entails would be alleviated by the formation of FTA. The creation of FTA implies that each member would be prepared, eventually, to adjust to full competition from other member countries. Only with such commitments would FTA countries be ready to provide preferences to developing countries more widely and effectively. It is practically impossible under present world trade policies to abolish non-tariff restrictions. The abolition of non-tariff restrictions could be realized between FTA members and the benefits extended to associated developing countries. Thus, the commodity coverage for reducing both tariffs and other trade barriers in favour of less developed countries would be much greater under FTA preference than under the UNCTAD scheme. Tariffs and other trade barriers for less developed countries would be completely eliminated by FTA preferences while only a fifty per cent reduction of tariffs might be the largest feasible tariff cut under the UNCTAD scheme. In addition, greater assistance from FTA countries would be assured. Thus, the FTA aid *cum* preference system would be more beneficial to less developed countries than a general system of preferences considered by UNCTAD.²³

FTA preferences along the lines of the advance cut plan would automatically assure that the advantages to developing nation exporters would last as long as the period over which FTA members gradually removed barriers to trade among themselves, and also with respect to FTA imports from third party developed countries. On this point, it may appear to the less developed countries that FTA preferences would be less beneficial than permanent general preferences. It should be noted, however, that any preference scheme should not be allowed to be permanent. The duration of the preference scheme should be long enough to allow

²¹ David Wall, *The Third World Challenge, Preferences for Development*, The Atlantic Trade Study, London, 1967, p. 65.

²² The UNCTAD scheme of general preferences creates new discrimination, while FTA preference would prevent increased discrimination.

²³ It should be remembered why the British Commonwealth preference has been beneficial to developing countries. Beneficial effects have been brought about mainly from all-round assistance in capital, management, marketing, etc., but not so much from preference itself. See, Donald MacDougall and Rosemary Hutt, "Imperial Preference: A Quantitative Analysis," *Economic Journal*, June 1954, p. 269.

the successful establishment of some industries, but not so long as to encourage the establishment of industries in which developing nations have no prospects of long term comparative advantage.

It might be claimed by the less developed countries that the FTA preference system is not general as regards countries which provide preferences, since the free trade area is unlikely cover the all developed countries. However, less developed countries may become associated with more than one FTA and receive preferential treatment from all that were prepared to provide it. Moreover, advanced countries could belong to more than one FTA. This possibility arises from the characteristics of free trade areas, which differ from customs union or more solid political unions. If more free trade areas provide non-discriminative preferences to any less developed countries generally, FTA preferences would really become more general and effective than those intended under the UNCTAD scheme.

V. Conclusion

The establishment of Pacific Free Trade Area or an alternative organization has the twin objectives of providing a step towards free world trade and of assisting more effectively the less developed economies particularly in Southeast Asia, in their efforts to develop. This paper has examined how the Pacific advanced countries can cooperate to increase directly productive aid for food production, cash-crop plantations, and manufacturing industries to the Asian developing countries. It has also recommended that FTA preferences should be provided in close association with aid efforts.

To make those aid *cum* preference efforts fruitful both for the Pacific advanced countries and Asian developing countries, three steps are necessary. Firstly, trade liberalization among the Pacific advanced countries, preferably through the formation of a Pacific Free Trade Area, is a prerequisite for increasing their aid-giving capacity and for providing the necessary jolt to carry out structural adjustment which will allow the absorption of increased imports from developing countries. Secondly, the structural adjustment of industries in advanced countries is a key factor in the success of the entire PAFTA aid *cum* preference system. Thirdly, it goes without saying that efforts of self-help considered policies for economic development in Asian developing countries are essential to the success of the scheme. Finally, improved financial arrangements in the Asian-Pacific region would facilitate the implementation of these trade and development policies.