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Dates:	01/01/1973 – 12/31/1973
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P. P. KUCZYNSKI

Research Committee F/Y 74 Research Proposals (1)

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

Mr. Kuczynski

D-448

OFFICE MEMORANDUM

TO: Mr. E. Stern, Senior Adviser, DP

DATE: April 4, 1973

FROM: Alexander Stevenson, Director, DED

SUBJECT: Research Committee Submissions

Will you please note that this Department will be submitting requests to the Committee totalling $474,250 later in FY74. Present estimates of the breakdown by subjects are as follows:

	Total Cost	FY74	Time of Presentation
Urban and Regional	74,250	49,250	Sept. 1973
Population	50,000	30,000	Sept. 1973
Rural Development	120,000	60,000	Nov. 1973
Public Finance	100,000	35,000	May 1973
Nutrition and Health	80,000	35,000	Nov. 1973
Education	50,000	20,000	Sept. 1973
Total	$474,250	$229,250	

Supporting information is attached for the proposals on Urban and Regional studies, Population Policy and Rural Development, Nutrition and Health. I will forward more information on Education proposals later; discussions are still in progress on the final shape of such proposals.

The pipeline for research projects appears to be large in relation to the budget. Not all these proposals will materialize during FY74 but it is hoped that many of them will be ready for implementation in the fall or towards the end of calendar 1973.

Attachments

cc: Members of Research Committee
cc: Mr. Gulhati
Mr. Hawkins
DED Division Chiefs
Mr. Ray

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. E. K. Hawkins

DATE: April 4, 1973

FROM: Douglas H. Keare

SUBJECT: Research Submissions - Urban and Regional Economics Division, April - August 1973

This is our first brief reply to your request for information. As I indicated to you over the phone on Friday, a considerably more detailed explanation/presentation will go to Mr. Ray before the end of the week.

	Item	Status	Funds required in FY74	Total required for new projects
1.	Models of Internal Migration	RP0240 To be completed by 6/73	None 1/	
2.	Urban Data Needs of the IBRD	RP0241 To be completed by 6/73	None 1/	
3.	Urban Public Finance	RP0270	30,000 1/	
4.	Site & Services Monitoring		None 2/	
5.	The Labor Market in a Rapidly Growing Urban Area (with P&HRD)	Already presented to Research Committee	19,850	28,750
6.	Urban Land Use/ Policies	Under preparation - will be ready July-August 1973	19,250	19,250
7.	Urban Low Income Housing	Under preparation - will be ready July-August 1973	20,000	40,000
8.	Intermediate/Medium Sized Cities	Under preparation - will be ready July-August 1973	10,000	15,000

1/ This is on the assumption that we will not be asked to stretch out payment on certain items, in effect postponing them from FY73 to FY74. This will be dealt with in my note to Mr. Ray.

2/ According to the agreement between Messrs. Baum and Stern, the FY74 requirement (a total of $21,500 as presently estimated) will be covered - in equal amounts in the budgets of the DED and the UPD. This is the case at present, i.e., we have each allowed for $10,750 in the Departmental Budget submissions. If these are not retained in the final budget, we will have to come to the Research Committee for a portion of the necessary funds.

Research on Population Policy

It is intended to initiate research on questions of population policy during FY74. Such research will go beyond the present work on comparative aspects of family planning but is closely related to it in that the basic question under consideration concerns the demand for family planning services. If it were possible to identify the factors determining the demand for such services, it might be possible, by appropriate policy instruments, to influence fertility decisions, encourage the greater use of facilities now available for family planning services, and design better delivery systems for such services in the future.

Population policies operate by singling out one or other possible motives for wanting children and then trying to offset or influence such motives by appropriate actions. Most attention has been concentrated so far on the provision of appropriate incentives. These incentives may be in kind or in terms of monetary payments, but they may also consist of the removal or the amelioration of conditions which encourage large family size. The most frequently mentioned case is that where child mortality is high so that parents attempt to over-compensate for the loss by infant mortality by a large number of pregnancies. This is to ensure that a minimum number of children survive to adulthood. This hypothesis is closely linked to the further idea that children are also desired for insurance purposes, to provide a family labor force and to protect and maintain parents in their old age.

The nature of the enquiries involved in such population policy research will necessitate the use of interdisciplinary techniques and almost certainly the carrying out of surveys in the field. It may, however, be possible to make use of the findings from other forms of field research, including sociological and anthropological enquiries. It may also be desirable to set up enquiries of an experimental type designed to test out hypotheses concerning the links between mortality and fertility.

The various options and possibilities will be explored in depth as a first step, with the intention of designing enquiries which will either analyze material available from other field work or will propose the collection of original data. As far as possible this work will be done in collaboration with local research institutes. At this stage it is not possible to indicate more than an order of magnitude for the funding of such work, which may well be able to tap outside sources of funds. For the purposes of considering priorities, however, an amount of $50,000 in FY74 might be appropriate.

Population and Human Resources Division

2 April 1973

EXPECTED RESEARCH PROPOSALS FY74

Rural Development Division

		Costs (000)		Exp. Date
		Total	FY74	
1.	Land Tenure Latin America (See Proposal)	55	55	Submitted
2.	Yugoslavia Smallholder (See Proposal)	32	32	Submitted
3.	Malaysia: Consumption, Savings, and Investment Patterns in the Rural Sector (Proposed) Consumption, savings, and investment behavior of different income and socio-economic classes of rural people will be examined, making use of existing studies and by participation in a special survey. The patterns of consumption etc., likely to emerge from different distributions of income will be studied. The implications of these findings for different investment programs, technologies, and organizations will be considered.	50	20	November 1973
4.	Africa Rural Development Study As analysis of the project reviews and the sector survey experience proceeds, it becomes increasingly clear that several types of further studies of the current Africa Rural Development Study would be useful. These might include further project reviews, in-depth case studies of some situations, some pilot projects, country studies and country comparisons.	70	40	November 1973
5.	Nutrition Policy Research We are currently proceeding with a group of consultants to identify research areas and proposals. The list of areas under consideration includes: Nutrition and productivity; nutrition and fertility, social and economic determinants of malnutrition; cost effectiveness of different programs; effects of agricultural programs and price policies; delivery systems.	50	20	November 1973

3 April 1973

New Research Project on Benefits of Public Expenditures

1. This is an advance notice of a study in the making. The Public & Private Finance Division expects to submit a research project entitled "Benefits of Public Expenditure" in time for the May meeting of the Research Committee. As a rough order of magnitude, the cost of this project may be about $100,000-$120,000; about 33 percent for expenditure in FY1974 and the rest in FY1975.

2. The project aims at testing the feasibility of making significant improvements in the analysis of public expenditures in Bank economic reports, particularly from the standpoint of the redistribution objective. It is hoped that individual case studies under this project will be integrated into the framework of economic work under the country-concentration program. In this way, it will be possible to use the findings of this project for defining new strategies and for examining the trade-off between the growth and the equity objectives. However, the possibility of undertaking case studies outside the country-concentration program should not be ruled out.

3. Improved analysis of public expenditure requires solutions to several conceptual problems:

- How to attribute benefits of "collective" goods to the population in different income brackets?

- How to define what constitutes the optimum distribution of public investment outlays as between income classes, taking account of the availability of complementary inputs to individuals in various income classes?

- How to assess the degree of substitution between public and private outlays on goods and services falling under the heading of "merit wants" (education, health services, etc.)?

- Other problems as yet unidentified.

4. In addition, improved analysis of public expenditure requires a massive effort to build an appropriate data-base. Meaningful statistics on public expenditures are severely lacking or defective. Functional breakdowns of public outlays do not exist in most of the developing countries; where they do exist, categories are rarely comparable; in the majority of cases, data are limited to the central government transactions only; and not much progress has been made in relating public expenditures to total expenditures in various (especially social) sectors. The "Government Financial Statistics" program of the IMF, which will collect data on a systematic and continuous basis, is not expected to generate data on the functional breakdown of expenditures in the next year or two; even when it will, the coverage will probably be limited to the central governments only.

5. The project will concentrate on a carefully selected group of about five countries at different levels of development, different geographical regions, and administrative systems. Bank interest, DPS country concentration and the availability of local research capacity will be additional factors in deciding on the final list of countries. The project will be carried out in three phases:

Phase I: Work on method of approach and data systems - July 1, 1973-December 31, 1973.

Phase II: Country case studies: data collection, processing, and analysis - January 1, 1974-December 31, 1974.

Phase III: Comparative studies and policy papers - January 1, 1975-June 30, 1975.

Phase I will be undertaken by the Division staff with the help of a consultant. Phase II will be contracted mostly to local institutions or consultants. Phase III will be carried out jointly by Division staff and consultants.

6. During the first phase, the literature, on-going research, and existing data sources on the distribution of public expenditures will be reviewed; the conceptual issues (see paragraph 3) will be addressed; the format for data collection will be prepared; the outlines of analyses will be drawn; the countries to be studied will be selected; and the institutions (or consultants) to be sponsored will be identified. This will be done by the Division staff with the help of a consultant (budgeted in the Division budget).

7. The details of the information to be collected in the second phase will be finalized as the result of Phase I work. It is, however, expected that the concentration will be on the following sets of data:

(a) distribution of public expenditures,

(b) distribution of the resources of financial institutions, and

(c) distribution of social expenditures (e.g., health, education) in the private sector.

Public finances will include the general government (central government, local government, and extra-budgetary funds) and the public enterprises. Financial institutions will include the central bank, banking system, and the other financial entities. All the social expenditures not accounted for by the first two categories of institutions will be estimated under the third heading.

8. The data work will aim at producing systematic and comparable consolidated totals of resource flows classified by economic use (current, capital, etc.), by functional purpose (education, health, etc.), and by the type of transaction (transfers, credits, etc.). Most of the needed details for this part of the study are probably available in the records of the treasuries or the institutions concerned, but these need to be transformed into meaningful and comparable categories. The estimates of private social expenditures will have to be put together largely on the basis of existing surveys or indicators; however, the collection of original data is not ruled out altogether. The other part of the empirical work will involve the study of the beneficiaries of public expenditures. Available information and new surveys will be employed to throw light on the relevant questions.

9. The third phase of the project will consist of the comparative analyses of the case studies and the review of policy implications. The factors affecting the distribution of benefits from public expenditures and credit will be analyzed under the following headings:

(a) the relationship between the types of public services and the characteristics of the beneficiaries from these services (This will not include cost-benefit analysis of projects.);

(b) the impact of socio-political circumstances and the institutional mechanism;

(c) the impact of budgetary procedures, procurement practices, etc. on capital-labor proportions in government projects; and

(d) pricing of government-produced goods and services as well as interest rates on public credit.

Research on Health

There is at present no center in the Bank in which research on policy aspects of health is being carried out. Some preliminary work along these lines was initiated in the Population and Human Resources Division in FY73. This involved the commissioning of a study by Professor Newman which has resulted in a document entitled "A Conceptual Framework for the Planning of Medicine in Developing Countries"; a revised draft of this paper is currently under preparation. It addresses itself to the theoretical issues involved and does not enter directly into operational or policy questions, although the findings of the paper are relevant to both areas. Plans to complement this work by a paper setting out the operational and policy issues have had to be revised following the reorganization of the Bank and the transfer of responsible staff to other departments. However, material collected for this purpose is available, and it is intended to prepare a short paper setting out the Bank's activities in this field and identifying the issues which will arise if the Bank involvement in health moves beyond its present level.

That involvement is necessarily limited by the present Bank policy which states that the Bank does not lend for health facilities per se, although such facilities have been included in other projects and form in practice a major part of the population projects carried out by the Bank. Even if this policy is maintained, there are reasons why it would be desirable to explore some of the policy implications of health investment in developing countries. It is increasingly obvious that such expenditures raise many questions of concern in the areas of public finance, and may be of central importance for country policies aimed at changing the distribution of income and seeking to benefit the poorer groups in society through varying the pattern of public expenditures. The objective of possible background work and research on health investments should be to provide the necessary information and guidance to the Bank in dealing with questions of investment strategy and policy alternatives. In particular, such work should be aimed at throwing light on the question of what is the least cost way of providing health and related facilities in order to meet the countries policy objectives in this area.

In order to begin to answer these questions, it will be necessary to examine the present position of Bank activities related to health in order to identify the key questions which arise. Although the manner in which this should be accomplished needs considerable thought, one possible suggestion is given below. This consists of two parts which would be interrelated and involve as far as possible the same staff and consultants. The first part would involve developing a health planning and research project in a country which is seeking to improve the quality of its health investments, especially for low income groups. Such a project would carry out surveys of the health needs of the low income populations and study alternative methods for meeting those needs in the most cost-effective fashion. Such a project might well experiment with various systems of health services. A rough estimate of the cost is $100,000 a year for 3 to 4 years, and it is possible that outside funding could be obtained for such an experimental project.

The second part would involve the commissioning of 2 to 3 consultants, including one on health manpower, to draft position papers on the critical issues that had been identified in the earlier stages. These position papers would also seek to establish policy alternatives for different types of countries. One aim would be to formulate hypotheses which could then be tested in subsequent work if it was felt desirable to do so. This work is tentatively estimated to cost $30,000 spread over two years. It would be carried out in close consultation with the health planning and research project and the consultants together with Bank staff would act as steering group for that project. Several different departments of the Bank will need to be involved in order to ensure the proper balance between the different disciplines involved in health systems.

4 April 1973

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

Mr Kuczynski

OFFICE MEMORANDUM

TO: Mr. E. Stern, Senior Adviser, DP

DATE: April 4, 1973

FROM: Alexander Stevenson, Director, DED

SUBJECT: Research Proposal - Comparative Experiences with Land Reform in Latin America

1. I have considered the points made in Mr. Avramovic's memorandum to yourself of March 30 concerning the Department's research proposal on land tenure and land reform. I wish to suggest the following changes and present some points of clarification for the consideration of the Research Committee. These points are generally in line with the suggestions made by Mr. Avramovic's memorandum and are intended to modify the proposal in line with his suggestions.

2. I propose a new title for the project, as given in the heading of this memorandum. This title will reflect more closely the focus of the study which will be limited in scope to the key topics which are listed in the document as "Tentative Hypotheses". I propose that this document be used as the basic outline and guide for the study. This will mean in practice that the study will:- (a) limit any macro-economic analysis on the effects of land reform to Mexico, where data are more readily available; (b) stress the development of a simple typology of land reform in terms of which the comparative experiences can be analyzed; (c) limit the study to key land reform processes and problems.

3. It should be made clear that the proposed collaborative research in the chosen countries is limited to seeking certain kinds of information, to be drawn from studies which are either underway or completed. We shall not commission these studies but hope to make use of their findings. Apart from the agreement already concluded with CDIA in Mexico, a tentative proposal along these lines has been discussed with the Fundacion para el Desarollo Nacional in Peru. Other institutes have been identified in the remaining countries and arrangements can be discussed with them once a budget is approved.

4. I have re-examined the proposed timetable of the study and would propose to make the following changes in order to ensure the availability of the results of collaborative research arrangements, and to make better use of our proposed consultant's time and services. The length of phases 4-6 will be extended by approximately two months. If resources are available to permit collaborative arrangements to be finalized during April, 1973, I anticipate that the material which will become available from such arrangements can be fully incorporated into the study by the end of 1973. To facilitate this, Dr. Eckstein will postpone his return to Israel, as needed, by up to two months. I also propose to increase substantially Dr. T. Carroll's participation in the study.

5. In order to be able to implement these changes in timing, I would like to request an additional budget allocation in FY74 of $5,000.

cc: Research Committee Members
Messrs. Gulhati, Hawkins, Reutlinger, Ray

Financial Summary

FY74 Research Proposals

Title	Total Cost ($,000)	FY1974 Cost*
I. 1- Economic Development of East and Southeast Asia	52.3	52.3
I. 2- Small-Scale Industry	30.0	30.0
I. 3- Export Development (India)	24.0	24.0
I. 4- Capital Utilization 1/	132.9	69.9
II. 1- Land Tenure and Land Reform	57.3	57.3
II. 2- Smallholder Agriculture (Yugoslavia)	35.7	35.7
III. 1- The Labor Market in Urban Area	28.7	28.7
III. 2- Development Strategies: N.E. Brazil 2/	305.0	189.0
TOTAL	665.9	486.9

'74	'75	
25	27	
30	–	
–	–	
?	–	
36	–	
29	–	

Priority subject to cost of no more than 100,000.

NOTE:

* In view of budgetary situation, all FY73 costs have been allocated to FY74.

1/ Revised figure, deleting the Bank staff salaries included in the budget estimate in the proposal.

2/ The actual project cost without adjusting for the $15,000 "saved" from RPO 273, as done in the proposal.

March 29, 1973

MEMORANDUM

Financial Summary

FY74 Research Proposals

Title	Total Cost ($,000)	FY1974 Cost*
I. 1- Economic Development of East and Southeast Asia	52.3	52.3
I. 2- Small-Scale Industry	30.0	30.0
I. 3- Export Development (India)	24.0	24.0
I. 4- Capital Utilization 1/	132.9	69.9
II. 1- Land Tenure and Land Reform	57.3	57.3
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TOTAL	665.9	486.9

NOTE:

* In view of budgetary situation, all FY73 costs have been allocated to FY74.

1/ Revised figure, deleting the Bank staff salaries included in the budget estimate in the proposal.

2/ The actual project cost without adjusting for the $15,000 "saved" from RPO 273, as done in the proposal.

March 29, 1973

Table 1

Summary of FY74 Request for Funds[1/]

Category	Request(,000) Ongoing	New	Total	Of Which Approved
I. Development Policy	296.3	123.5	419.8	30.0
II. Fiscal Policy	-	35.0	35.0	-
III. Trade & International Finance	-	72.3	72.3	-
IV. Agriculture & Rural Development	172.0	258.0	430.0	37.0
V. Industry	123.2	128.9	252.1	58.2
VI. Transportation	705.0[2/]	50.0	755.0	35.0
VII. Public Utilities	80.0	102.0	182.0	42.0
VIII. Urbanization & Regional Development	(n.a.)	189.0	189.0	-
IX. Population & Human Resources	94.0	53.7	147.7	63.0
TOTAL	1,470.5[2/]	1,012.4	2,482.9	265.2

1/ On a commitment basis. The information is partial and, in some cases, informal.

2/ Including $350,000 for accelerated work on Capital-Labor Substitution in Road Construction (RPO 226)

Table 2

Expected Request for FY74 Funds[1/]

Category & Title*			Request ($,000)	Prior Approval ($,000)
Ongoing				
1.	206:	Short Run/Long Run Influences on Income Distribution (DRC)	58.3	-
2.	208:	Shadow Prices (DRC)	32.0	-
3.	203:	Patterns of Demand and Savings: Phase II (DRC)	57.0	-
4.	268:	International Comparison Project (EPD)	70.0	-
5.	269:	Growth and Income Distribution: Brazil (DRC)	79.0	30.0
		TOTAL	296.3	30.0
New				
6.		Prototype Model for Country Analysis (DRC)	30.0	-
7.		Indonesia: Demand Study (DRC)	26.0	-
8.		Income Distribution (ECLA) (DRC)	37.5	-
9.		Income Distribution (ECIEL) (DRC)	30.0	-
		TOTAL	123.5	-
		SUB-TOTAL I:	419.8	30.0

1/ On a commitment basis. The information is partial and, in some cases, informal

* Projects marked with asterisk are not subject to review, as their entire FY74 costs have been approved

			Request	Prior Approval
	II. Fiscal Policy			
New	10.	Analysis of Public Expenditures (DED)	35.0	0
		SUB-TOTAL: II	35.0	0
	III. Trade and International Finance			
New	11.	Japanese Influence on Asia (ASIA)	52.3	0
	12.	Industrial Policies & Eco. Integration (DRC)	20.0	0
	13.	Private Investment in LDCs (Mr. Saxe) (EPD)	(n.a.)	0
		SUB-TOTAL: III	72.3	0
	IV. Agriculture and Rural Development			
Ongoing	14. 218:	East Africa Rural Development (ECD)	60.0	0
	15. 272:	Irrigation Water Charges (CPS)	70.0	20.0
	16.* 216:	Mexico Agriculture (DRC)	17.0	17.0
	17. 214:	Agricultural Mechanization Study (CPS)	25.0	0
		TOTAL	172.0	37.0
New	18.	Small-Holder Agriculture (CPS)	35.7	0
	19.	Land Tenure (ECD)	57.3	0
	20.	Choice of Agricultural Technology (ECD)	(n.a.)	0
	21.	Consumption, Savings in the Rural Sector (ECD)	(n.a.)	0
	22.	Semi-Arid Areas: Study of Selected Production Techniques (CPS)	50.0	0
	23.	Development of Representative Data for Traditional Farms for Appraisal Use (CPS)	50.0	0

			Request	Prior Approval
IV. Agriculture and Rural Development (Continue)				
	24.	Small-Scale Livestock Production Study (CPS)	20.0	0
	25.	Indonesia: Agriculture (DRC)	45.0	0
		TOTAL	258.0	0
		SUB-TOTAL: IV	430.0	37.0
V. Industry				
Ongoing	26* 225	Capital Utilization (Rodan) (CPS)	50.0	50.0
	27. 224	Programming in the Manufacturing Sector (DRC)	65.0	0
	28.* 223	Capital-Labor Substitution in Mech. Eng. (DRC)	8.2	8.2
		TOTAL	123.2	58.2
New	29.	Capital Utilization (ECD)	69.9	0
	30	Small-Scale Industry Financing (ECD)	35.0	0
	31.	Export Promotion in India (ECD)	24.0	0
		TOTAL	128.9	0
		SUB-TOTAL: V	252.1	58.2
VI. Transportation				
Ongoing	32. 234:	Urban Transport and Automobile: Phase II (CPS)	30.0	0
	33. 227:	Highway Design Standards	150.0	35.0
	34. 226:	Capital-Labor Substitution 2/	500.0	0
	35. 229:	Feeder Roads: Yemen A.R.	25.0	0
		TOTAL	705.0	35.0

2/ Includes $350,000 requested for accelerated work program.

			Request	Prior Approval
	VI. Transportation (Continue)			
New	36.	Feeder Roads (unidentified)	50.0	0
		SUB-TOTAL: VI	755.0	35.0
	VII. Public Utilities			
Ongoing	37. 237:	Village Water Supply (CPS)	20.0	0
	38. 238:	Village Electrification (CPS)	60.0	0
		TOTAL	80.0	0
New	39.	Public Utility Pricing (CPS)	60.0	0
	40.*	Investment and Pricing in Telecommunications (CPS) (Approved)	22.0	22.0
	41.*	Standards of Electricity Supply (CPS) (Approved)	20.0	20.0
		TOTAL	102.0	42.0
		SUB-TOTAL: VII	182.0	42.0
	VIII. Urbanization and Regional Development			
Ongoing	42. 270:	Urban Public Finance (ECD)	(n.a.)	0
New	43.	Development Strategies: N.E. Brazil (DRC)	189.0	0
		SUB-TOTAL: VIII	189.0	0

	IX. Population and Human Resources		Request	Prior Approval
Ongoing	44.* 242:	Professional Structure in S. E. Asia (ECD)	2.0	2.0
	45. 243:	Labor Markets (ECD)	31.0	-
	46.* 245:	Labor Force Participation (ECD)	28.0	28.0
	47.* 246:	Cost Effectiveness of Learning Techniques (CPS)	8.0	8.0
	48. 244:	Student Loan Schemes (CPS)	25.0	0
		TOTAL	94.0	38.0
New	49.*	Project Evaluation: Education (CPS) (Approved)	25.0	25.0
	50.	Labor Market in Urban Area (ECD)	28.7	0
	51.	The Benefits of Schooling for Workers (ECD)	(n.a.)	0
		TOTAL	53.7	25.0
		SUB-TOTAL: IX	147.7	63.0

GRAND TOTAL:

Ongoing:	1,470.5 2/	
New :	1,012.4	
TOTAL	2,482.9	265.2

2/ Including $350,000 for accelerated work on RPO 226.

Table 3

FY74 Funds Authorized

Title		Cost, FY74 ($,000)
Approved Projects (to start in FY74)		
267	Standards of Reliability in Electricity Supply	20.0
276	Investment and Pricing in Telecommunications	22.0
278	Project Evaluation Methodology (Education)	25.0
	SUB-TOTAL	67.0
Ongoing Projects		
269	Growth and Income Distribution: Brazil	30.0
216	Mexico Agriculture	17.0
223	Capital-Labor Substitution, Mech. Eng.	8.2
225	Capital Utilization (Rodan)	50.0
242	Professional Structure in S.E. Asia	2.0
245	Labor Force Participation	28.0
246	Cost Effectiveness of Learning Techniques	8.0
272	Irrigation Water Charges	20.0
227	Highway Design Study	35.0
	SUB-TOTAL	198.2
	GRAND TOTAL	265.2

Table 4

Additional Costs of Ongoing Projects to be Approved

	Title		Costs
206	Short Run/Long Run Influences on Income Distribution		58.3
208	Shadow Prices		32.0
203	Patterns of Demand and Savings: Phase II		57.0
268	International Comparison Project		70.0
269	Growth and Income Distribution: Brazil		49.0
218	East Africa Rural Development		60.0
272	Irrigation Water Charges		50.0
214	Agricultural Mechanization Study		25.0
224	Programming in the Manufacturing Sector		65.0
234	Urban Transport and the Automobile, Phase II		30.0
227	Highway Design Study		115.0
226	Capital-Labor Substitution	a) anticipated	150.0
		b) additional request	350.0
229	Feeder Roads, Yemen A.R.		25.0
237	Village Water Supply		20.0
238	Village Electrification		60.0
243	Labor Markets		31.0
244	Student Loan Schemes		25.0
		TOTAL	1,272.3

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RESEARCH PROPOSAL

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I. INDUSTRY AND TRADE

I. INDUSTRY AND TRADE

1. Economic Development of the East and Southeast Asia
2. Small-Scale Industry Financing
3. Export Development Program (India)
4. Capital Utilization in Manufacturing

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Ernest Stern

FROM: Bela Balassa

DATE: March 13, 1973

SUBJECT: Research Proposal: Japanese Economic Influence on East and Southeast Asia

1. A Subcommittee of the Research Committee met today with the participation of Messrs. Balassa (Chairman), Agarwala and Kuczynski, to discuss the research proposal on "A Study of Japanese Economic Influence on the Economies of East and Southeast Asian Countries" prepared by the International Development Center of Japan (IDCJ) and submitted by the Asian Regional Office (ARO). On the part of the ARO, Messrs. Baneth, Hablutzel, Asanuma, and Dunn participated in the meeting. Subject to certain provisos, the Subcommittee endorsed the research proposal; a recommendation to this effect has also been made by Mrs. Hughes who could not participate in the meeting.

2. The Subcommittee welcomed the intention expressed by ARO for continuing Bank involvement in the project. It is of especial importance to review the methodology of the study, the underlying growth assumptions, and the choice of industries for the detailed studies. While the methodology has been improved compared to the earlier submission by the IDCJ, there is a certain lack of clarity on projection methods and on the interrelationships of Parts I and II of the project; also, questions relating to foreign investment, the changing economic role of China, and uncertainties as regards exchange rates have not received adequate consideration. Furthermore, the assumptions for economic growth in Japan should be reviewed in the light of the projections made by the Japanese Economic Planning Agency. Finally, in selecting industries for detailed study, account should be taken of the expected export capabilities of the countries of Southeast Asia.

3. The research team working on the study has been strengthened as Mr. Kanamori has replaced Mr. Onishi as project leader. Still, given the new functions of Mr. Okita and the lack of experience of the IDCJ in carrying out such studies, it would appear desirable to formalize the relationship with the project of Professor Kojima who has been mentioned as a possible consultant by IDCJ. Mr. Kojima could also be invited to participate in meetings Bank staff will have with IDCJ.

cc. Messrs. Agarwala
Kuczynski
Ray
Hughes
Baneth
Gilmartin
Hablutzel
Asanuma
Dunn

BBalassa:alm

Schulmann: we ac

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

Hold for

OFFICE MEMORANDUM

TO: Mr. Ernest Stern

DATE: January 26, 1973

FROM: Raymond J. Goodman RJG.

SUBJECT: A Research Proposal on Asian Economic Development in the Seventies

I hereby submit a research proposal entitled the "Interrelated Economic Development of East and South-East Asia in the 1970's." The details of the proposal have been developed at my request by Dr. Saburo Okita of Japan and his associates in the International Development Center of Japan (IDCJ) in consultation with my staff.

The attached research write-up is the third revised proposal by the IDCJ. It incorporates most of the suggestions made by us in Mr. Gilmartin's letter to Dr. Okita (dated August 18, 1972, attached), and is acceptable in substance to us. Although there is still much room for editorial and other improvement, I recommend that the Research Committee consider the proposal in the present form and that further refinement of the research outline be made after deciding whether or not to proceed with the study.

Attachments:

1. A Research Proposal, "The Interrelated Economic Development of the East and South-East Asia in the Seventies";
2. IDCJ, "Research Proposal: A Study of Japanese Economic Influence on the Economies of East and South-East Asian Countries", Tokyo, November 1972;
3. Dr. Okita's letter of transmittal of the IDCJ research proposal dated November 22, 1972; and
4. Mr. Gilmartin's letter to Dr. Okita dated August 18, 1972.

Distribution:

Messrs. H.B. Chenery, H. Adler, B. Balassa, R. Gulhati, P. Kuczynski, H. Schulmann, D. Avramovic, J. Baneth, A. Karaosmanoğlu, M.A. Qureshi and H. van der Tak.

Attachment

World Bank Research Project Proposal

THE INTERRELATED ECONOMIC DEVELOPMENT OF
EAST AND SOUTH-EAST ASIA IN THE SEVENTIES

1. The main objectives of the proposed study would be (a) to analyze the nature of Japanese economic influences on and interactions with neighboring countries - in particular, East and South-East Asian countries - and (b) to quantify the order of magnitude of such influences and interactions, with particular emphasis on the implications for trade and industrial prospects of the developing economies in the East and South-East Asia Region. The proposed study would result in projections of the patterns of Japanese economic growth and of Japan's trade and investment relations with other economies in the region. This should provide a useful point of reference for national planners as well as interested outsiders (e.g. the World Bank Group) for the formulation of development policies which would take advantage of the emerging trade and investment patterns in the region and provide guidance for further industrialization and primary resources development.

2. According to the research proposal as it stands now, the study would consist of a two-part exercise as follows:

(a) The first part would be primarily macro-economic and would involve projections through 1980 of (i) the structure of world trade by major regions, and (ii) the Japanese economy. The projections of world trade through 1980 would be largely based on a large scale study already made by the Japan Economic Research Center (JERC), but some revisions (e.g. incorporation of new data) would be required. In this part of the work, the researchers would use econometric techniques but in such a way as to enable incorporation of judgmental factors (such as import policy changes both in advanced and developing countries, availability of primary resources, development of outward-looking manufacturing and processing industries in developing countries, etc.) at each stage of successive approximation; no use of a sophisticated, complete world trade model is planned. Work on the Japanese economy would involve use of a long-term growth model (adapted from the already existing JERC model) and a projection of industrial structure in a 40 sector input-output framework. A projected

pattern of Japanese trade (by major regions and by major industrial groupings) would be derived from these exercises; this projection should indicate and reflect changes in Japanese industrial structure due to changing international comparative advantages. The method of projection would be partly econometric and partly judgmental, and would also utilize the findings of the second part of the study - the two parts would be carried out simultaneously rather than sequentially.

(b) In the second part of the study, a selected number of industries (i.e. labor-intensive industries such as plywood, toys, textiles, shipbuilding, electrical machinery) would be studied in more detail, with a view to identifying the impact of changing comparative advantage on growth potential and viability of specific industries within the Japanese economy. This exercise would ascertain the validity of assumptions and judgments in the first part regarding the trends in Japanese imports of labor-intensive industrial products from LDC's and in relocation of the existing labor-intensive industries in Japan to LDC's. The method of the specific industry studies would be qualitative and in micro-economic terms and would rely partly on industry views, so as to enable consideration of a large number of factors (e.g. demand/supply, production/profitability, technological break-throughs, governmental protection and other import policies). The findings of Part I of the study would provide an overall macro-economic framework within which these industry-specific studies would be carried out: the findings of Part II exercise would, in turn, be fed back to the Part I exercise.

3. The focus of the proposed study would be on the influence of Japanese economic growth and changes in industrial structure on the neighboring region. In order to arrive at a broad-brush picture of the East and South- East Asian economies in 1980 and policy implications thereof, the proposed study would have to be accompanied and followed by an assessment of the response capacity of LDC's in the region to Japanese import demand and overseas investment. This would require considerable knowledge about, and detailed enquiry into, the East and South-East Asian economies - a task which Japanese research groups are not in a position to carry out more efficiently than others. Preliminary examination of response capabilities of individual LDC's in the region could be done by country economists in the East Asia Department. It is thus proposed to consider a separate research study on this aspect later, possibly in collaboration with research or planning agencies of LDC's in the region. Considerable Bank Staff input is also envisaged for this latter exercise.

4. The proposal as submitted by IDCJ reflects our initial request to have a study carrying us up to 1980. Unfortunately, it has taken more time than expected to develop the proposal; and thus we now propose that the time frame be extended to cover ten years from the date of expected completion of the study. We do not expect this to cause any problems for IDCJ.

5. Since it is closely related to Japan's economy and some work has been done by Japanese research agencies, the study will be commissioned from a Japanese research group. The East Asia Department has contacted, among others, the Japan Economic Research Center (JERC) and the International Development Center of Japan (IDCJ), both headed by Dr. Okita, for preliminary talks and received a favorable response and a proposal from the latter.

According to the IDCJ proposal, the research team would include the following senior researchers:

> Dr. S. Okita, Chairman of the Team: President of Japan Economic Research Center (JERC) and concurrently of the International Development Center of Japan (IDCJ);
>
> Mr. H. Kanamori, Team Leder: Deputy Director of Economic-Research Institute, Economic Planning Agency; and
>
> Prof. Onishi, Coordinator: Professor of Economics, Soka University and Senior Economist, IDCJ (part-time).

In addition, other researchers drawn from JERC, and research departments of specialized banks and universities would be mobilized. According to the IDCJ proposal, completion of the study would take about 12 months. The proposed work schedule does not seem to include time required to take into account the Bank's comments. If this is added, it should take about 15 months to complete the study, after the commencement of work. The contract cost of the study is estimated to amount to $52,280 by IDCJ, excluding Bank staff time and travel expenses.

6. Bank staff supervision (and travel, if necessary) would be required at three stages of the study. Shortly after the research contract is concluded, a more precise research methodology (including examination of the existing JERC models and the proposed model structure for the study) and a detailed work schedule (including assignment of responsibilities to specific researchers) would have to be worked out. This would require the Bank staff involvement. An interim report on the progress and initial results of projection work would have to be examined closely by the Bank staff; at this stage, it would also be desirable to review the research methods in the light of the work completed and to agree on the course to be taken to complete the study. The last-phase

supervision would consist of detailed comments on the first draft and suggestions for revisions and/or additional exercises thereof. Occasional Bank staff travel to Tokyo would be required to carry out supervision adequately. However, such travel time and cost would be minimized by combining visits to Japan with other mission work in the region to the extent practicable.

7. The third revised IDCJ proposal is attached, together with Mr. Gilmartin's letter to Dr. Okita which made suggestions on the research methods.

Attachment:

January 26, 1973

East Asia and Pacific Department.

(To Be Filled By Research Committee)

Project number

Review number

WORLD BANK RESEARCH PROGRAM
Project Proposal

Date of Submission

January , 1973

PART I. PROJECT IDENTIFICATION

1. Title: The Interrelated Economic Development of the East and South-East Asia in the Seventies

2. Department Responsible: East Asia & Pacific Dept. Asia Region	3. Staff Member Responsible: Rudolph Habluta
4. No. of Contracts: One	5. Total Estimated Cost: $52,280

6. Total Estimated Staff Time:
Professional: 11 man months

Special Services: -

Part II. COORDINATION AND APPROVAL

7. Interdepartmental Coordination:

	Department	Name & Signature	Support Project	Do not Support Project-Comments Submitted
a.	Development Research Center	Bela Balassa		
b.	"	Peter Clark		
c.	Development Economics	Mrs. Helen Hughes		
d.				

8. Approval:

David A. Dunn
Division Chief

R. L. Goodman
Raymond L. Goodman
Department Director

PART III. IMPLEMENTATION

1. Date Work to Start: In one month after contract	2. Date First Draft Expected: In 12 months

3. Final Report Due: In 15 months after contract

4. Implementation Method:

a. Bank Staff	
b. Individual Consultants	
c. LDC Contractor/Institute	
d. Developed Country Contractor/Institute	X
e. Seminar	

5. Reports Expected in Current Fiscal Year: None

PART IV. FINANCIAL AND STAFF DATA

1. Dollar Costs (Estimated Disbursements by Fiscal Year):

	FY 73	FY 74	FY 75	After FY	Total
a. Contractual	n.a.	n.a.	n.a.		$52,280
b. Travel					
c. Data Processing					
Total	n.a.	n.a.	n.a.		$52,280

2. Staff Requirements (man-months):

	FY 73	FY 74	FY 75	After FY	Total
a. Professional a/	1	5	5		11 See paragraph 6 of the attachment.

a/ Does not include professional time already incurred for development of the research outline.

PART V. PROJECT SUMMARY
(Use Additional Sheets if Necessary)

1. Research Objectives:

Support basis for Bank Policy	[ ]
Support for Bank Operation in Projects or Sectors	[X]
Support for Country Economic Work	[X]
Increase Knowledge of the Basic Development Process	[X]
Develop Institutional Capacity for Research in LDC's	[ ]

2. Description: See the attached note.

a. Problem

b. Method

c. Coordination

d. Implication for Bank Policy and Operations

e. Project Organization

THE INTERNATIONAL DEVELOPMENT CENTER OF JAPAN
TAKAGI BLDG., 7-2, NISHI-SHINBASHI 1-CHOME,
MINATOKU, TOKYO, JAPAN

TELEPHONE
TOKYO 502-3911

CABLE
INTLDEVCENTER TOKYO

November 22, 1972

① cc: Messrs. Hablutzel (Co.
Duan (Co.)
D.C. File
② Mr. Goodman (Co.)

Mr. Raymond J. Goodman
Director
East Asia and Pacific Department
International Bank for Reconstruction
and Development
1818 H Street, N. W.
Washington, D. C. 20433
U. S. A.

Dear Mr. Goodman:

Preparation of the revised research proposal, "A Study of Japanese Economic Influence on the Economies of East and Southeast Asian Countries" has required more time than we had anticipated, and I regret that a delay in sending the revised proposal has been necessary. We have attempted to incorporate, in the revision, the comments made by Mr. Gilmartin on the earlier proposal, as well as the comments made by Messrs. Hablutzel, Cheetham and Asanuma, on the occasion of their visit to Tokyo. In addition, a supplementary note showing disaggregation of the 40 industries in the I/O table, to supplement Flow Chart 2, and to provide a more descriptive explanation of the linkage between the projection of the Japanese economy and the break-down of the detailed industry studies, is in preparation and will be sent to you shortly. As for the cost estimate, in accordance with Mr. Gilmartin's comment, we have estimated the necessary direct costs of the research project.

We thus submit the revised proposal for your approval and comments. We shall be looking forward to hearing from you, and wish to also take this occasion to express our appreciation for the encouragement and support provided throughout this preparatory phase by yourself, and your colleagues.

With best wishes,

Sincerely yours,

S. Okita

Saburo Okita
President

SO/ny

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

1818 H Street, N.W. Washington, D. C. 20433, U.S.A.

Area Code 202 · Telephone 477-1234 · Telex 64145 · Cable Address - INTBAFRAD

August 18, 1972

Dr. Saburo Okita
President
International Development
Center of Japan
Takagi Bldg. 7-2, Nishi-Shinbashi 1-Chome
Minatoku, Tokyo, Japan

Dear Dr. Okita:

We were very sorry that you were unwell while in Washington, and that as a result we were unable to see you. I hope the illness was of short duration and that you were able to enjoy your further travels back to Tokyo. I was glad to have the opportunity to talk with you on the phone and this was most helpful. On the basis of that conversation, and the discussions of Messrs. Hablutzel, Asanuma and Cheetham in Tokyo, as well as consideration of IDCJ Research Proposal in the Bank, I should like to convey to you our comments and suggestions for finalizing the Proposal.

In general, the proposed research program now seems very much along the lines of our own thinking. Part I appears well designed to provide the general framework in which to consider prospective inter-related development between Japan and other Asian economies in the Seventies. It also would seem a suitable context for considering probable patterns of change in Japanese trade, and changing conditions of comparative advantage in particular Japanese industries.

With regard to Part II, our interest is well reflected on page 23; i.e. in the identification and examination of those industries most likely, in the changing patterns of the Japanese economy, to find advantage in shifting all or part of their processes from Japan to other countries of East and Southeast Asia. Such industries need not necessarily be important exporters at present. Their dispersion outside Japan would, however, effect Japanese imports to the extent that goods and components now made in Japan would in future be imported from other countries. Export patterns would also be affected, of course, if such industries so disbursed were also important exporters. (Industries relocated could well, of course, become exporters to other countries in addition to Japan).

Hence, our main interest is really in the future trade patterns of Japan; especially the pattern of imports of Japan from East and South-east Asia. We would hope on the basis of Parts I and II, that it would be possible to project the raw materials, intermediate products and components, and finished goods which Japan would import from the region in about 1980 after allowing for industrial shifts from Japan to other countries of the region because of changing comparative advantage.

Dr. Okita

Following this interest we would hope that within the proposed budget some attention could be given to prospective changes in comparative advantage and consequent regional dispersal of all the industries, or parts thereof, listed on page 7. We recognize, of course, that some would be examined in more detail than others.

May I then, indicate some further suggestions we have for finalizing the research proposal. I should note in this connection, that we are quite aware, from the discussions in Tokyo, that the present proposal does not necessarily reflect the clarity of the approach which you and your colleagues have devised for dealing with this difficult research problem. Hence, the suggestions below may have already been taken into consideration in your own formulations. However, unless they are also clearly reflected in the research proposal, our task in seeking endorsement and funding from the Bank's Research Committee is the more difficult. It is, hence, for this reason that the subsequent suggestions for revision of the research proposal are set forth.

I. First, with regard to Part I.

a. Projection of the world economy might be simplified with only one postulate, i.e., "the most likely world future." The assumptions underlying estimates of Japan's share in world trade might also be explained.

b. Concerning the macro-economic model (pages 7-9), we understand that existing projection models would be used for the macro-projections. This seems to us an advisable procedure. We would add the suggestion that perhaps two alternative growth assumptions be used as the bases for the projections. One of these might be a slower growth alternative which would take into account such possible constraints as considered in the recent Government White Paper on the economy; e.g. technology, material resources, labor supply, exports and environmental problems. For our purposes, these growth alternatives would be of interest mainly for their related production and import projections, and for the integration of these projections into the "Projection of the Industrial Structure by Means of the Input-Output Table" (pages 9-14).

c. Such integration of the macro-projections and the input-output analysis might be explained somewhat more succinctly and clearly in the Proposal. This seems to us important as the basis for estimating future import patterns and import shares of the various industries included in the input-output table. In this respect, the Flow Chart of Part I, which was provided to Mr. Hablutzel during his discussions in Tokyo but which is not included in the Proposal, would seem to be a clear and precise basis for an effective presentation of the approach which you have in mind. May we suggest then that Part I might consist mainly of this Flow Chart with an explanation of

the elements of the Chart, how they are interrelated, how the interrelationships are determined, how they are affected by the alternative growth assumptions, and how the integration of the different elements of the system would be reached (presumably by successive approximation). It is from this that projections would be derived of production for the industries included in the input-output model, which in turn should serve as the basis for projecting the import shares of the various industries.

d. The latter, i.e., the determination of the import patterns and import shares by means of the input-output analysis would seem to us to deserve particular attention. This appears to us more important than possible variations in the input-output coefficients which are given extended treatment in the Proposal. Studies of the U.S. economy which you mention suggest that material input coefficients are fairly stable, and for our purposes such stability would seem a reasonable assumption. On the other hand, import coefficients may vary considerably, and this is really at the heart of our interest in the study. It is in these variations, and their reflection in the future demand of Japan for imports of raw materials, of semi-processed goods and components, and of finished goods that influences of the changing Japanese economy on production of other countries of Asia would find focus. With this focus in mind, the procedure in line with your suggested approach, might be in the first place to arrive at two production and related import projections (one for the higher and one for the lower growth assumptions). This first step might be done before taking account of the future structural influences of changing comparative advantage. Such projections would presumably be derived by use of the Flow Chart methodology (including the 40 industry input-output analysis) and based on the already available input-output coefficients (e.g. those of EPA) and related import functions. Then particular attention could be given to such modification of these 40 industry production and import projections as might be expected because of changes in the comparative advantage of these 40 industries. The result would thus be a revised set of projections, under higher and lower growth assumptions, of Japan's future imports. These would incorporate adjustments for probable regional dispersion of Japanese industry, especially dispersion to other countries of East and Southeast Asia, and would consequently reflect the expected influence of changing comparative advantage on Japan's future imports from this region. Such adjustments of the projections for changing comparative advantage would probably have to depend mainly on qualitative judgments reflecting a broad knowledge of the Japanese industrial structure and likely influences for its change. In addition, it should also depend on examination in greater detail into particular industries, some in depth. This would be the input from Part II, with studies of likely structural effects of changing comparative advantage in particular

industries guiding adjustment of the production and import projections derived from the macro and input-output analyses.

II. Hence, we come to Part II:

a. The criteria for choice of particular industries for both general and detailed coverage in Part II is not very clear. Since our primary interest is the industrial and trade effects of adverse changes in comparative advantage, the industrial studies should probably focus on those industries which seem most vulnerable within the Japanese industrial structure to such adverse changes. Given a selection of industries for examination on the basis of likely adverse changes in comparative advantage, a second consideration for selection would be likely prospects for industrial relocation to developing countries, and in particular to the developing countries of East and South-East Asia. This should presumably take into account probable regional dispersion of parts of industries, as well as whole industries, including manufacture of industrial components (e.g. in the electronic and automobile industries, etc.) and the increased processing abroad of raw materials (e.g. oil refining, beneficiating and refining of ores, processing of agricultural and forestry products, etc.).

b. In selecting particular industries or parts of industries as probably vulnerable to adverse changes in comparative advantage, it is presumed that these would be the industries which, in comparison with Japanese industry generally, would be worse off because more vulnerable to prospective increases in cost without compensating improvements in productivity. In other words, these would be the industries or parts of industries which, if they were to remain in Japan, would be the more likely to be falling well below generally acceptable Japanese rates of return because of such adverse cost factors (with insufficient productivity offsets) as rising wages; increasing costs of material transport and handling because of congested shipping, ports and inland transport; higher costs associated with greater industrial and population density; and added costs of pollution control.

c. Starting with these general criteria of changing comparative advantage and suitability for location in developing countries, it would be helpful if the approach, scope and method of Part II studies were made somewhat clearer, including the steps to be undertaken in the examination of particular industries. A specific industry study should probably cover the following topics, although the details of analyses would naturally have to differ from one industry to another:

i. Analysis of historical and present supply/demand balances, including some commodity disaggregation, with special emphasis on exports and imports as components of supply and demand;

ii. Analysis of historical and present cost structure and profitability of the industry together, if possible, with international price comparisons, and an indication of factors which have been important for changes in cost structure;

iii. Examination of likely effects of the expected changes in the economy on the viability of the industry in Japan, focusing on changing comparative advantages due to rising costs relative to productivity gains because of prospective increases in labor costs; in costs of land, services and other facotrs of location because of increasing industrial and population density; in the cost of transporting and handling raw materials because of increasing congestion in ports and inland transport services; and in the cost of anti-pollution measures. The technological and research and development characteristics of the industry concerned, and of related industries in Japan and other industrial countries, and considerations of input substitution may be taken into account in assessing prospects for future improvements in productivity. A rough, illustrative projection of future trends in costs relative to prospective average trends in Japanese industrial prices might then be made on the basis of these cost and productivity prospects;

iv. Canvassing of industry opinions (including existing plans to this end) on how to counteract threatened adverse changes in comparative advantage, e.g., through introduction of labor-saving devices; input substitution; changes in commodity-mix towards higher quality products; partial relocation of industries by transferring production of certain parts, components or processing to developing countries; complete relocation of industrial process, etc.;

v. Where partial or total relocation of industries outside Japan appears a possible course to be taken, discussion, based partly on industry opinions, of the problems and prospects of such industry relocation. The discussion should cover not only the basic economics of relocation and the prerequisites for relocation (e.g. industrial infrastructure, incentives policies, risk elements, etc.) but also give consideration to possible candidate countries for industrial relocations in terms of the kinds of conditions which Japanese industrialists regard both favorably and unfavorably in possible recipient countries in East and Southeast Asia;

vi. Consideration of pressures from industrial, political and other interests, both pros and cons, for protective measures as an alternative to industrial relocation in order to maintain particular industries within the Japanese industrial structure despite adverse changes in comparative advantage;

vii. Consideration of the likely effects of relocation of the particular industry on Japan's trade with East and Southeast Asian countries.

d. Choice of selected labor-intensive industries for detailed examination seems appropriate. Probably, in revising the research proposal, the specific industries in this category could be indicated along with sources and availability of data and with the initial scope and approach for the study. We are less sure about the choice of steel and automotive industries for detailed study. On the basis of the thinking outlined in a. above, textiles, shipbuilding and electrical machinery may be as suitable for detailed study as the steel and automotive industries. Perhaps, within the proposed budget figures, it would be possible to reconsider the selection of industries in accordance with the research objective of clarifying prospective influences of Japanese growth and changing comparative advantage on regional industrialization in East and Southeast Asia and on future Japanese imports from the Area.

May I add a final word about the estimated cost of the proposed study. We have suggested changes in the proposal which should tend to reduce the work required on Part I (fewer variations in the macro-projection assumptions). There might be offsetting increases in our suggestions for Part II because of broader industrial coverage although we agree that the in-depth studies be limited to only a few industries. Some others might also require examination of certain aspects, but for most a reliance on generally available knowledge and judgments should be adequate. We would hope that these modifications would be accomodated within the proposed budget. We are also advised by the Research Committee of the Bank that it is not willing to consider broad, proportional, lump-sum provisions for overhead and that a breakdown by specific categories of overhead expenditure would be necessary. The point here is the view in the Bank that its main financial support for research should be in the developing countries, and that the financing of research in developed countries should be largely confined to marginal costs rather than overhead. May I therefore trouble you with the request that in revising the proposal, the component elements of the overhead provision be itemized insofar as possible, including costs for research assistance, secretarial and typing services and computer time.

In the above we have attempted to indicate as specifically as possible our need for a fairly precise research project design. We understand from Mr. Hablutzel that you have such a precise design clearly in mind, especially regarding Part I, but some of this clarity is lost in the design as presented in the research proposal. It is, however, on the proposal which we have to rely in seeking authorization for the study from the Research Committee. It is for that reason and also to make some detailed suggestions concerning Part II and its relation to Part I, that I have written at such length about a further revision of the proposal. If you have further points for clarification before you finalize the revision, please do not hesitate to write to us. In the meantime, may

I express our appreciation for the considerable trouble you have taken and all you have done toward the preparation of a proposal upon which you and we can find agreement, and collaborate in an effective research design on this interesting but difficult subject.

Sincerely yours,

William H. Gilmartin
Chief Economist
East Asia and Pacific Department

cc: Messrs. Goodman
Nablutzel
Dunn
Asanuma
Abadian
Stern
Balassa
Mrs. Hughes
P. Clark
Avramovic
Kuczynski

SAsanuma/ml
WHGilmartin:go

Research Proposal

A Study of Japanese Economic Influence on The Economies of East and Southeast Asian Countries

Prepared for

The International Bank for Reconstruction and Development

November 1972

The International Development Center of Japan

C O N T E N T S

1. OBJECTIVES

The purpose of this study is to provide the general framework in which to consider prospective inter-related development between Japan and other Asian economies in the Seventies. It also would provide a suitable context for considering probable patterns of change in Japanese trade, and changing conditions of comparative advantage in specific Japanese industries, which would be of considerable significance with regard to the economies of developing countries, particularly in Asia.

The research concentrates on the identification and examination of those industries most likely, in the changing patterns of the Japanese economy, to find it advantageous to shift all or part of their processing from Japan to East and Southeast Asian countries. This shift would effect Japanese imports to the extent that goods and components now made in Japan would in the future be imported. Export patterns would also change if the industries involved were also important exporters. Industries relocated could also export to other countries in addition to Japan.

Hence, the over all area of interest is really in the future trade patterns of Japan: especially the pattern of Japanese imports from East and Southeast Asia. We therefore wish to project the raw materials, intermediate products and components, and finished goods which Japan would import from the region by around 1980, making allowance for the relocation or shift of industry from Japan to other countries of the region because of changing comparative advantage. In accordance with this interest we plan to give attention to prospective changes in comparative advantage and consequent regional dispersal of production or processing activities of selected manufacturing industries, listed on page 11 and 12.

These detailed studies will provide information about the anticipated strategies of the selected Japanese industries which will significantly influence the economic development of East and Southeast Asian countries. Strategies will be reflected in the industries policies toward trade, and the transfer of capital and technology. This study will also necessarily take into account receptive capacities of these individual countries to Japan's trade and the transfer of capital and technology.

2. PROJECTIONS OF JAPAN'S ECONOMIC GROWTH

Scope and Methodology

Among the econometric studies made in Japan to project Japan's economic growth, in our evaluation, those of the Japan Economic Research Centre (JERC) are most fitted to our research purpose, since the JERC has accumulated a good stock of knowledge regarding this field of research.

According to a recent JERC study* Japan's economic growth in the 1970s may decelerate somewhat compared to the 1960s. However, there are still many factors which are likely to support rates of growth so they will be comparatively higher than those of other industrialized countries. Japan's most probable average growth rate of GNP in real terms during the 1970s is still likely to be around 9%. According to a more recent study,** which projects both the Japanese economy and the world economy in 1980, the per-capita GNP of Japan is likely

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* "The Outlook for a Trillion Dollar Economy," 1971, JERC

** "Japan's Economy in 1980 in the Global Context," 1972, JERC

to reach a level about equal to that of the United States for that year. Further, many aspects of Japan's economy, which will influence her society and Japan's relationship to the world, must be expected to undergo change. The total output of the economy, measured as GNP, is projected to be about half that of the United States in 1980. This will account for more than 10% of the total output of the world economy including Socialist-economy countries.

This implies that Japan's impact on the economies of East and Southeast Asian countries will be felt even more strongly in 1980 than it is at present.

Our study, based on these studies, will identify the likely changes in the growth and trade patterns of the Japanese economy considering prospective inter-related development between Japan and other Asian economies during the 1970s.

Existing projection models will be used for the macro-economic projections. In this study, however, two alternative growth assumptions will be used as the basis for projections;

One of these is an extrapolation of pattern of growth of the 1960s wherein the heavy and chemical industries have been given higher priority. This might be a high growth alternative.

The other might be a slow growth alternative which takes into account such possible constraints as considered in the recent White Paper on the economy; e.g. technology, material resources, labor supply, exports and environmental problems. In addition, we assume a pattern of much more welfare-oriented growth wherein there will be a sharp increase in social overhead investment and social security expenditures, and a pattern of

growth which is more oriented to research and development wherein the heavy and chemical industries are given lower priority.

In this study, these growth alternatives are of interest mainly for their related production and import projections, and for the integration of these projections into the projection of industrial structure by means of the input-output table.

In addition, we will make the following policy assumptions, to determine the economic influence of Japan on the economies of East and Southeast Asia.

1. To assume further increase in Japan's official development assistance for East and Southeast Asia and assume a more rapid increase in Japan's overseas private investment in manufacturing industries of East and Southeast Asian countries.
2. To assume more liberalization of trade by means of a lowering of tariffs and gradual trend toward lowering non-tariff barriers to manufactured and semi-manufactured goods from developing countries in East and Southeast Asia.

(1) Projection of the World Economy

First, we will make projection of the world economy in the 1970s. Projection of the world economy might be simplified with only one postulate, i.e., "the most likely world future."

The Japanese economy, however, is large enough to influence the world economy, so that it may no longer be possible to consider the world economy as influencing Japan, and not the opposite case as well. Therefore, interplay between the Japanese economy and the world economy should be considered in order to project a plausible future world economy. A world trade model will then be needed for the projections

l imports and Japanese exports at the regional level.

... study, however, the following steps will be taken. First,
d gross national product is provisionally determined by adding
mated gross national products of regional and national groups.
e total amount of world imports is determined by adding the
computed according to regional groups. On the basis of the
orts thereby determined, Japanese exports are projected for
groups, taking into account changes in Japan's share in the
ports.

, in the following macro-economic projections, Japan's exports
ed as an exogenous variable.

n of the Japanese Economy

the projections of Japanese economic growth, the existing macro
n model coupled with an input-output model will be used. The
simultaneous equations which comprises the macro-economic
epresented in greatly simplified form by Chart 1.
acro-economic model should provide information useful in
future patterns of expenditure on the GNP, and in particular
ing imports from East and Southeast Asia under the two
ioned alternative growth assumptions.
dition to the above information, we need further information
ailed industrial breakdown of outputs and imports. There-
acro-projections should be integrated with the input-output

2 shows the linkage of macro-economic projection model with
utpu model covering the following 40 sectors.
nteg ed approach is deemed appropriate for estimating
rt patterns and import shares of the various industries

Trend Projection

Chart 1 Flow Chart of Macro Economic Projection Model

1. Agriculture, forestry and fishing
2. Coal and lignite
3. Iron ores
4. Non-ferrous metallic ores
5. Crude petroleum and natural gas
6. Other mining
7. Food and beverages
8. Tobacco
9. Textiles
10. Wearing apparel
11. Sawed products, veneer, plywood and wooden products
12. Furniture
13. Pulp and paper
14. Printing and publishing
15. Leather and leather products
16. Rubber products
17. Chemicals
18. Petroleum products
19. Coal products
20. Non-metallic mineral products, except products of petroleum and coal
21. Steel products
22. Non-ferrous metal products
23. Metal products
24. Machinery, except electrical machinery
25. Electrical machinery, apparatus, appliances and supplies
26. Transport equipment
27. Precision instruments (including optical instruments, watches and clocks)
28. Miscellaneous manufactured goods
29. Building construction
30. Construction other than of buildings
31. Electricity, gas and water services
32. Wholesale and retail trade
33. Banking and insurance
34. Real estate
35. Transportation (include warehousing)
36. Communication
37. Public services
38. Miscellaneous services
39. Public administration and defense
40. Unclassified

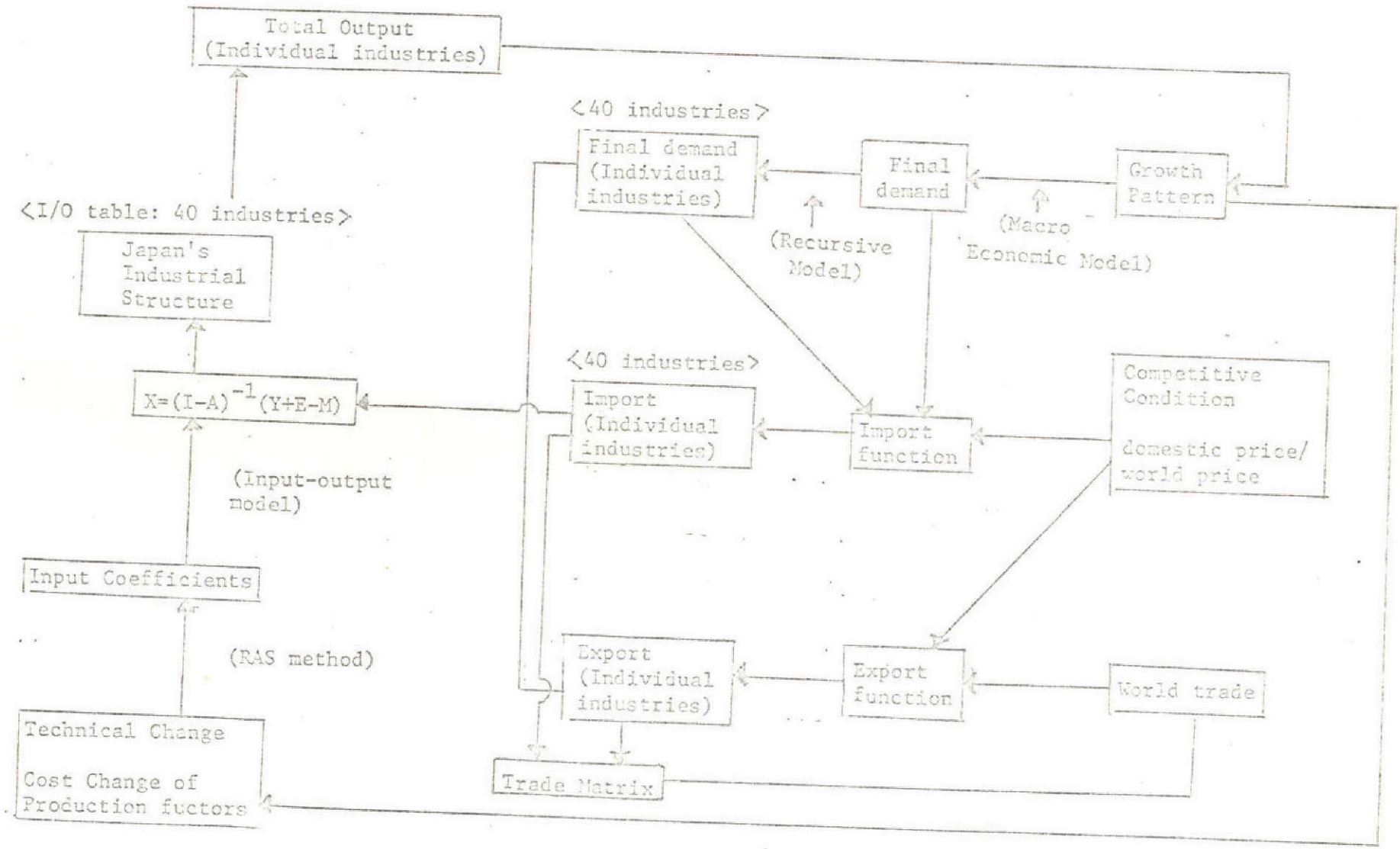
included in the input-output table.

The determination of the import patterns and import shares by means of the input-output analysis deserves particular attention. We judge this to be more important than possible variations in the input-output coefficients. Studies of the U.S. economy suggest that material input coefficients are fairly stable, and for the purposes of this study such stability would seem a reasonable assumption.

On the other hand, import coefficients may change considerably, and this is the nucleus of our study. It is in these changes, and their reflection in the future demand of Japan for imports of raw materials, of semi-processed goods and components, and of finished goods, that will determine the influences of the changing Japanese economy on production in other countries of Asia. With this in mind, in line with our suggested approach, the procedure will be to first arrive at two production and related import projections (one for the higher and one for the lower growth assumptions).

Such projections will be derived as illustrated by Flow Charts 1 and 2 (including the 40-industry input-output analysis and based on the already available input-output coefficients (e.g. those of the Economic Planning Agency) and related import functions. Then particular attention will be given to such modification of these 40-industry production and import projections as might be expected because of changes in the comparative advantage of these 40 industries. The result would thus be a revised set of projections, under higher and lower growth assumptions, of Japan's future imports. These would incorporate adjustments for probable regional dispersion of Japanese industry, especially dispersion to other countries of East and Southeast Asia, and would consequently reflect the expected influence of changing comparative

with Input Output Model



Notes: X denotes a column vector of output
Y " domestic final demand
E " exports
M denotes a column vector of imports
A denotes a n x n input coefficient matrix

advantage on Japan's future imports from this region.

Such adjustments of the projections for changing comparative advantage would probably have to depend mainly on qualitative judgments reflecting a broad knowledge of the Japanese industrial structure and likely influences for its change. In addition, it could also depend on examination in greater detail into particular industries, some in depth. This would be the input from detailed industrial studies of likely structural effects of changing comparative advantage, in particular industries--guiding adjustment of the production and import projections derived from the macro and input-output analyses.

3. DETAILED INDUSTRIAL STUDIES

Scope and Methodology

Based on projections of the future patterns of Japan's economic growth, we will study changes in the comparative advantages of selected Japanese industries that occur through changes in trade and transfers of technology, capital and management as well as changes in the regional complementarity which those industries might expect to develop in East and Southeast Asia.

Since our primary interest is the industrial and trade effects of adverse changes in comparative advantage, the industrial studies should focus on those industries which seem most vulnerable within the Japanese industrial structure to such adverse changes. Given a selection of industries for examination on the bases of likely adverse changes in comparative advantage, a second consideration for selection would be likely prospects for industrial relocation to developing countries, and

in particular to the developing countries of East and South-East Asia. This should take into account probable regional dispersion of entire industries, as well as parts of those industries. Included would be manufacture of industrial components (e.g. in the electronic, automobile and other industries) and the increased processing abroad of raw materials (e.g. oil refining, beneficiating and refining of ores, processing of agricultural and forestry products, etc.).

In selecting particular industries or parts of industries as being relatively vulnerable to adverse changes in comparative advantage, it is presumed that these would be the industries which, in comparison with Japanese industry generally, would be worse off because of being more vulnerable to prospective increases in cost without compensating improvements in productivity. In other words, these would be the industries or parts of industries which, if they were to remain in Japan, would be the more likely to be falling well below generally acceptable Japanese rates of return because of such adverse cost factors (with insufficient productivity offsets) as rising wages; increasing costs of material transport and handling because of congested shipping, ports and inland transport; higher costs associated with greater industrial and population density; and added costs of pollution control. In accordance with the research objective of clarifying prospective influences of Japanese growth and changes in comparative advantage on regional industrialization in East and Southeast Asia and on future Japanese imports from the area, we have selected the industries given below for the detailed industrial studies.

First, those labor-intensive industries which have been selected for detailed examination seems most appropriate. Probably, the

specific industries in this category could be indicated if we analysis Japan's recent import trends of those commodities groups from developing countries in East and Southeast Asia. These industries may include plywood, toys, footwear, wigs, jute, shoes, umbrellas, tableware etc. In addition to the above, textiles, shipbuilding and electrical machinery may be as suitable for detailed study.

A specific industry study should probably cover the following topics, although the details of analysis would naturally have to differ from one industry to another:

1. Analysis of historical and present supply/demand balances, including some commodity disaggregation, with special emphasis on exports and imports as components of supply and demand;

2. Analysis of historical and present cost structure and profitability of the industry, together with, if possible, international price comparisons, and an indication of factors which have been important in causing changes in cost structure;

3. Examination of likely effects of the expected changes in the economy on the viability of the industries in Japan, focusing on changing comparative advantages due to rising costs relative to productivity gains. Factors causing rising costs will be prospective increases in labor costs; costs of land, services and other site-related factors because of increasing industrial and population density; the cost of transporting and handling raw materials because of increasing congestion in ports and inland transport services; and the cost of anti-pollution measures. The technological, and research and development characteristics of the industries concerned, and of related industries in Japan and other industrial countries,

and considerations of input substitution may be taken into account in assessing prospects for future improvements in productivity. A rough, illustrative projection of future trends in costs relative to prospective average trends in Japanese industrial prices might then be made on the basis of these cost and productivity prospects;

4. Canvassing of opinions in industry (including existing plans to this end) on how to counter threatened adverse changes in comparative advantage, e.g., through introduction of labor-saving devices; input substitution; changes in commodity-mix towards higher-quality products; partial relocation of industries by transferring production of certain parts, components or processing to developing countries, complete relocation of industrial process, etc.;

5. Where partial or total relocation of industries outside Japan appears to be a possible course, there will be discussion, based partly on opinions in industry, of the problems and prospects of such industry relocation. The discussion should cover not only the basic economics of relocation and the prerequisites for relocation (e.g. industrial infrastructure, incentives policies, risk elements, etc.) but should also give consideration to possible candidate countries for industrial relocation in terms of the kinds of conditions which Japanese industrialists regard both favorably and unfavorably in possible recipient countries in East and Southeast Asia;

6. Consideration of pressure from industrial, political and other interests, both pro and con, for protective measures as an alternative to industrial relocation in order to maintain particular industries within the Japanese industrial structure despite

adverse changes in comparative advantage;

7. Consideration of the likely effects of relocation of the particular industry on Japan's trade with East and Southeast Asian countries.

Regarding the methodology, this type of analysis requires the opinions of industrial experts, since it is very important to take account of these expert opinions in our industrial model-building.

The complete development process of the creation of new industries, their growth and, eventually, their decline, may be seen in every country. If declining industries in Japan are sustained at the expense of new industries of other countries, international friction results. Moreover, as in the case of Japanese export industries, if those industries having excellent long-range prospects overtake the industries of other countries, unease and anxiety will arise in those countries and exports, rather than be helped, will be caused to suffer. Eventually, a dilemma will arise--that an increase in exports will of itself engender international friction. Within this economic reality, to facilitate the harmonious coordination of each country's industries and bring harmony to the trade structure of the world economy, it would be necessary to establish international rules of trade.

In light of such considerations, there is some doubt as to whether Japan's industries will be able to perform as well in 1980 as at the present. It is difficult to accept the hypothesis that Japan's export and import structure, of products and services, will remain unchanged from the present to 1980. More than a decade ago, it was labor-intensive products which functioned as the pillar of Japanese exports. Now, however, they have yielded their position to steel, ships, automobiles

and other products of the heavy and chemical industries. To imagine that the Japanese export structure will remain frozen as it is now is to ignore the dynamism which is invested in economy.

The Japanese economy is now at a major turning point. Ever since the Meiji Restoration more than one century ago, the industrial and economic pattern followed in the process of striving for the modernization of industry has been one of emphasizing exports, by importation of raw materials and processing them to make export products. However, as the economy advanced to higher levels, emphasis in export industries shifted from labor-intensive products of light industry to capital-intensive products of the heavy and chemical industries. This change is expected to be followed by further change, in the middle of the 1980s, whereby the major force in exports will become R & D or knowledge-intensive products such as fine chemicals, precision machines, and so on. The traditional heavy and chemical industries will, eventually, lose their position of dominance just as light industrial products lost its position before that.

There are a number of reasons for anticipating that the emphasis in Japan's industrial policies will undergo a change from the emphasis on the traditional heavy and chemical industries to the new R & D industries. First, the Japanese people are intent on bringing about a reorientation of the pattern of their country's economic growth, by reducing the emphasis assigned to heavy and chemical industries and by increasing the emphasis assigned to welfare and the attainment of qualitatively satisfying life. Secondly, it has become increasingly difficult, in the polluted confines of the Japanese islands, to secure desirable industrial sites, and this is one of the factors urging reorientation. It is becoming impossible to maintain the same pace as in the past in establishing

the base for production and exportation by the heavy and chemical industries. Thirdly, in industries and enterprises which could not meet, by means of progress in technological development, the demands imposed by elevation of the standard of living and increases in wages, costs have tended to increase. Whether the industries or enterprises are labor-intensive or capital-intensive, their traditional products have come to lose their international competitive power. Fourthly, even industries or enterprises which possess technological development capability are showing a shift in strategy from exporting products to exporting capital, because of an increase in local opposition to the Japanese presence in overseas markets. Finally, considering the difficulties in obtaining raw materials from overseas, the expansion of the heavy and chemical industries in Japan is gradually coming to face constraints. As the raw material exporting countries pursue economic development, Japanese interest in developing indigenous processing industries, and export industries, has been increasing.

Thus, during the 1980s, a considerable change in the structure of Japan's exports and imports is anticipated, whereby R & D products which have design characteristics, a system approach, or the latest technology as sales points, will displace traditional export products. Further, production overseas will tend to replace production in Japan for export. These tendencies will also affect the structure of Japan's imports.

The reason Japan's exports showed such vitality during the 1960s is that most of Japan's typical export industries had entered a period of maturity. If these industries enter a period of decline in the 1980s, they will no longer be able to maintain their position as key export industries. It is anticipated that new industries will develop to become the major leading industries of the 1980s. These industries

include electronics, space development, oceanological development, nuclear energy, and information processing.

Given these general expectations, we can brush in the broad outlines of an industrial development model which may be explained by Chart 3 as follows. As factors which control industrial development, first of all, the expansion of production, and of demand, may be cited. Expansion of production is directly regulated by such matters as the scale of the enterprise, its ability to obtain and balance capital, managerial ability, technological development, wages manpower, production site, pollution abatement ability, the possibility of inducing technology and managerial skills, and of obtaining raw materials from overseas, as well as other matters. Expansion of production, further, is mutually dependent upon an expansion of demand, and as variables which link the two, we may cite prices, product quality, design and marketingability, etc.

Demand may be divided into domestic demand and exports. Expansion of domestic demand depends upon the market size as reflected in the size of the gross national product and its tempo of growth, and final demand depends upon changes in the pattern of demand for intermediate goods. For example, the outlook for the expansion of production is influenced by the diversification in patterns of consumption brought about by elevation of living standards, and changes in patterns of demand brought about by urbanization and pollution problems. A source of feedback to production exists in the possibility of substitution of one product for another, and the possibility of competition from imported products. Furthermore, the expansion of production and domestic demand is influenced by the government's over-all economic policies, industrial policies and trade policies

(especially the reduction of tariffs and elimination of non-tariff barriers to trade).

Not only do exports depend upon the government's economic policies but they also greatly depend upon the overseas environment. Among major factors in the overseas environment, we may cite the growth of the world economy, degree of inflation, and changes in the pattern of export markets. Of course, one cannot ignore the influence of the growth of the Japanese economy on the growth of the world economy, consequent to the enlargement of the Japanese economy. For example, a business recession in Japan would lead to a decrease in her imports from developing countries, which in turn would have deleterious effects on Japanese exports. What links the increase of the latent force of overseas demand with the increase in production is the international competitive ability and marketing of Japan's export industries. These are closely related to the economic policies adopted by foreign countries, particularly import restriction measures, and to the catching-up on the part of developing countries. Further, another factor imparting great influence to the outlook for Japanese industries is the acceleration of foreign investment activities.

The above are more or less common strategic variables for each industry, but in addition there are many important variables which bear special relationships with specific individual industries and require expert judgement. The cause-and-effect relationships between these variables are expressed in the form of a model, which makes it possible to obtain a general outlook for the future of particular industries. For example, some industries which are now in a stage of maturity may be forecast to select a development strategy of expanding production overseas for reverse importation to Japan or sales to a third country, rather than increasing

domestic production, because of difficulties in resisting the pressure of rising wages, difficulties in obtaining suitable domestic industrial sites, and difficulties in obtaining imports of raw materials. Japan's steel, shipbuilding, automobile, machine tools, industrial machinery, chemical, telecommunications equipment, electric appliances and heavy electrical equipment have not yet reached their peak, but during the 1980s it is forecast that in some of those industries there will be need to face the question of how to solve the problems of maturation.

After passing their peak, and yielding in vitality to newer industries, these industries will become vulnerable to competition from overseas rivals which start later than they, and will enter a period of decline. It is forecast that a development strategy to avoid the advance from a stage of maturity to a stage of decline will be conceived, and that in industry a trend toward resisting this will appear. At this point, two types of development strategy may be identified. One would involve the promotion of marketing of new R & D products which rely upon the highest technological levels. The second would involve the combination of capital, technology and management for production overseas rather than production in Japan.

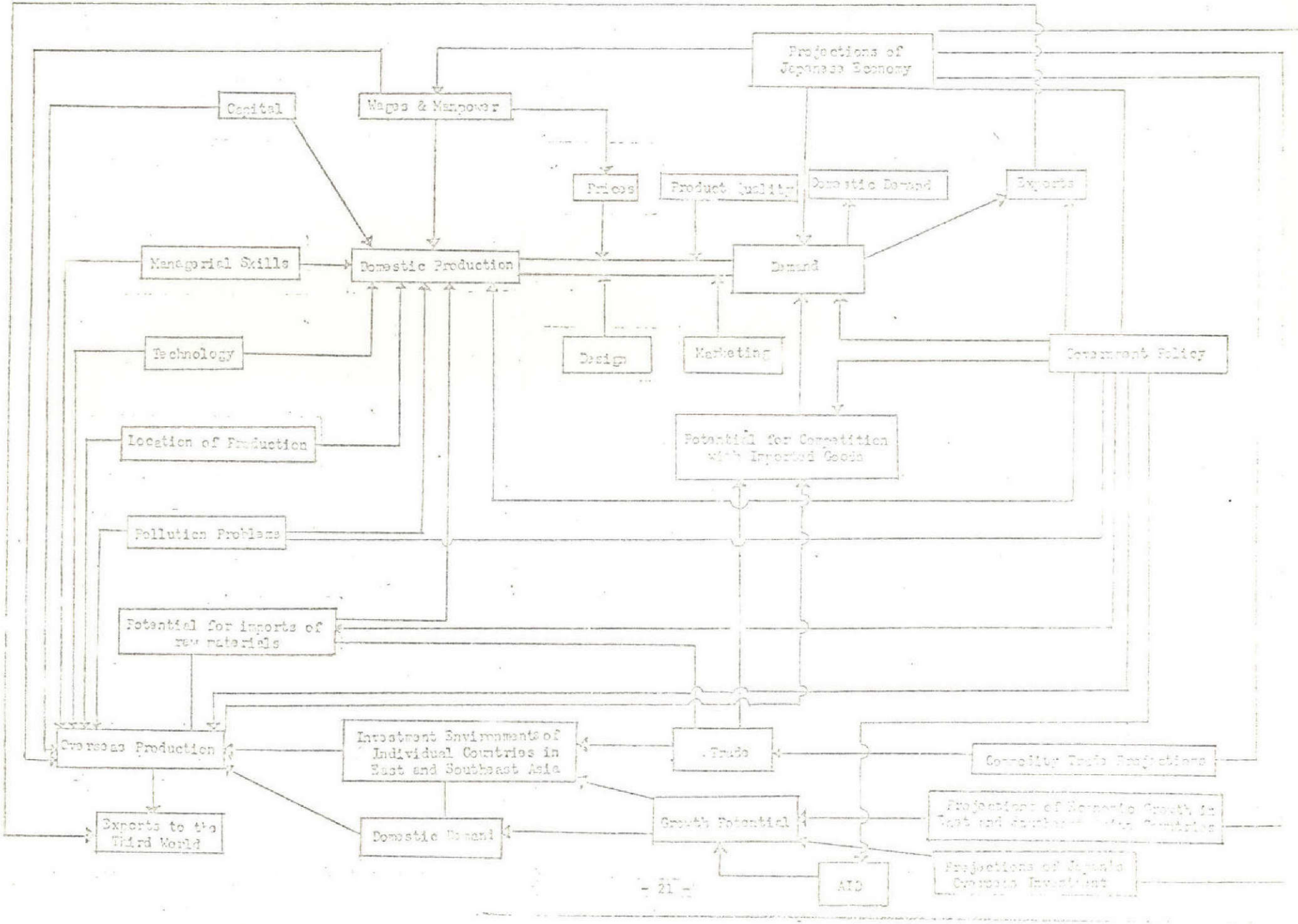
Industries which do not adopt the first strategy but emphasizes the second, as a result of the transfer of technology to the developing countries, probably chase to produce in Japan.

This part of study will largely depend upon expert judgement on the strategy for development of selected industries. The preceding study, in turn, will provide basic information regarding the nature of economic interdependency between Japan and individual countries in East and Southeast Asia which would be necessary for this expert judgement.

Based on these expert judgements, we will postulate the potential structure of international division of labor in the selected manufacturing industries listed above between Japan and individual countries in East and Southeast Asia through trade and transfer of capital, technology and management.

During this study we would attempt to assess in a general way the respective capacity of individual countries in the region with regard to Japanese oversees investment, Japanese import demand, and the market for Japanese exports, by seeking the opinions of Asian officials, scholars and experts.

Chart 3 Ir t Development Model



4 RESEARCH TEAM

Assignments of Team Members

The research will be conducted by economists associated with the International Development Center and the Japan Economic Research Center and experts associated with other institutions, universities, and business organizations.

Saburo Okita, President of the IDCJ, will be chairman of the working group for this study, and Akira Onishi, Senior Economist of the IDCJ will serve as the coordinator of the research team.

Hisao Kanamori, who has done pioneering work at the Japan Economic Research Center on the outlook of the Japanese economy, will be responsible for this study as a team leader. JERC economists Koichi Iio and Yasuhiro Murota will work on the projections of the Japanese economy. Hikoji Katano will review the patterns of commodity trade between Japan and countries of East and Southeast Asia, providing the basic information for the detailed industrial studies.

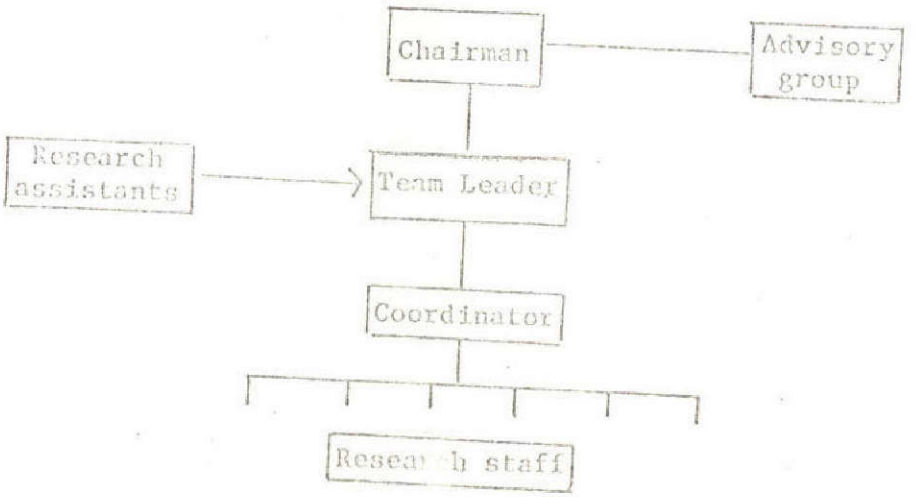
Regarding detailed industrial studies, Manjiro Miyata, Director of the Economic Research Department, Export-Import Bank of Japan, will make a comprehensive review of Japan's direct overseas investment, and Hideyuki Yamamoto, Deputy Chief of the Research Department of the Long-Term Credit Bank of Japan will make an over-all review of the industrial studies. For further sectoral breakdown, Minoru Kobayashi, Industrial Bank of Japan, will concentrate on a study of the textile industry. Takamichi Yamato, Export-Import Bank of Japan, will study the electronics industry, Tsuneo Nakauchi of International Christian University

will study labor-intensive sundry industries and Hiworu Kobayashi of the Industrial Bank of Japan will study the shipbuilding industry.

Since this research will require considerable expert judgement, the IDCJ will also utilize the ad hoc assistance of authoritative business and industrial experts. Dr. Miyohei Shinohara, Director of the Economic Research Institute, Economic Planning Agency, has already agreed to cooperate as a research adviser. If necessary, some members of the board of the International Development Center, such as Kiyoshi Kojima of Hitotsubashi University (international economics) and Shinichi Ichimura, President of the Center for Southeast Asian Studies, Kyoto University (development economics) would cooperate as research advisers, in their capacity as board members.

The proposed study will be carried out over an elapsed period of one year. The work shall begin one month after a contract is signed. A final report will be submitted at the completion of the study.

Organizational chart



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WORK SCHEDULE

Projection of Japanese economy

Collection of new data and revision of JERC model

Basic data processing

Projection work on Japan's economic growth, industrial structure, and trade structure (in particular imports)

Disaggregation

Analysis of import structure

Detailed industrial Study

Collection of data on specified industries

Analysis of comparative advantage or disadvantage regarding specific industries

Analysis of future economic complementarity of specific industries between Japan and individual countries of East and Southeast Asia

Analysis of commodity trade between Japan and individual countries of East and Southeast Asia

Analysis of Japanese private overseas investment toward countries of East and Southeast Asia

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Document Date	Document Type	
c. August 1972		

Correspondents / Participants

Subject / Title
Section 6 Cost Estimate

Exception(s)
Personal Information

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S. Thompson	August 19, 2025

APPENDIX

The Successive Approximation Method (SAM)

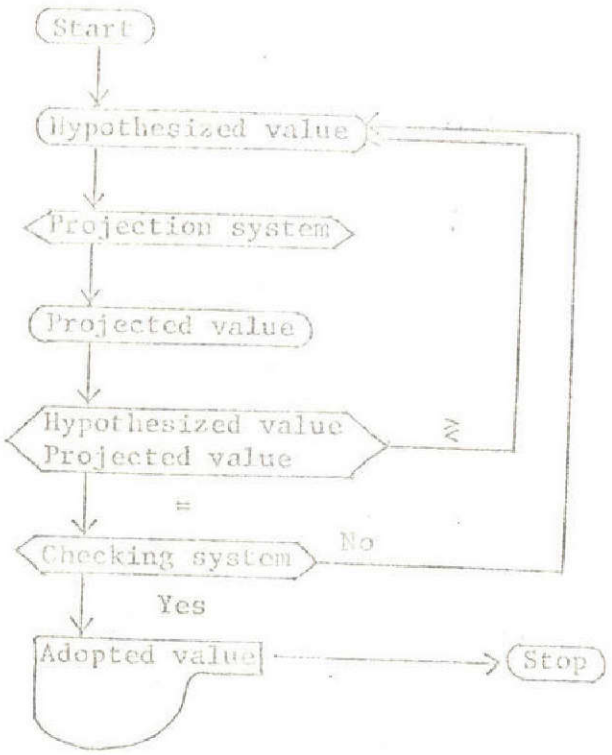
The structural characteristics of the Successive Approximation Method (SAM) which is to be used in our projections of the Japanese economy, can be explained as follows. First, SAM searches for a most plausible value by a multi-step trial-and-error process. Second, the projection process is started by assigning a hypothetical value to a variable or set of variables. Third, there exists a feedback loop between the initial hypothesized value and the computed value. The search process usually determines a final value of the variable after several iterations. This is clearly different from the usual econometric methods, by which a unique value is determined by the system of equations without iteration.

Since, in regard to the second characteristic, SAM starts with a hypothesized value and this method is not a simple trial-and-error, multi-step determination process. This characteristic of SAM reminds us of a similar approach applied in dynamic programming. Dr. R. E. Bellman, who originated dynamic programming, explains that SAM is convenient for large-scale systems. It initially assumes the optimum locus and dynamic programming is applied to adjust the loci of variables in order to fix them within the range of the assumed optimum locus.

In using SAM for economic projections, not only is a plausible value hypothesized for a variable initially, but also this hypothesized value and the computed value are connected to each other through the feedback loop which is the third characteristic of SAM. In other words, if the hypothesized value and the computed value do not coincide with each other, the hypothesized value is replaced and the computaion

process should be started again.

The following chart helps to visualize the whole process.



The analytical steps of SAM can be outlined as follows:

(1) First, the working assumptions are specified. In particular, a plausible value for consumption expenditure is specified.

(2) Based on the value for consumption expenditure assume above, GNP is estimated.

(3) Disposable income is estimated from the estimated GNP.

(4) Consumption expenditure can be computed from a consumption function using the value for disposable income computed above.

(5) If the consumption expenditure thus computed and that assumed in the first step coincide, this computation process should be finished. If they do not coincide, the assumed value of consumption expenditure should be replaced and all five steps should be repeated. Of course it need not be consumption expenditure in particular which is assumed in the first step.

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. E. Stern

DATE: April 4, 1973

FROM: Attila Karaosmanoglu A.K.

SUBJECT: Meeting on Three Research Proposals by Economics of Industry Division

A Review Panel consisting of Messrs. J. Duloy, F. Moore, D.C. Rao, and myself, met on March 29, to review three projects submitted by the Economics of Industry Division. Also present were Mrs. Hughes and Messrs. Hawkins, Ray and Thoumi.

The Panel agreed that all three research topics were of high priority but felt that a more precise presentation of methodology in each case would help in the evaluation of the proposals.

Below are summaries of the conclusions reached by the Review Panel on each project.

I. Small-Scale Industry Proposal NO

The Panel learned in the meeting that SIDA is interested in participating in this project. It is understood that SIDA's participation may be used to broaden (possibly to double the number of countries) the basis of observations. It is also understood that an issues paper will be prepared before the start of the project on the reasons for financing small-scale industry and the criteria for assessing the success of a financing program for small-scale industry.

Members of the Panel felt that the project with the given budget and manpower resources should concentrate only on the financing aspects of small-scale industries, and in doing so should preferably concentrate on specialized institutions or institutions with specialized departments in this field.

The Panel also felt that the questions posed in paragraphs 7 and 9 of the paper describing the proposal extremely relevant and expressed the hope that they would be kept strictly in mind in further work on the project.

II. Proposal on Export Development Program NO

The Panel felt that the proposal presented did not clearly identify how phase two, which is under consideration, was related to phase one. A reference was made by Mr. Moore to studies in-depth carried out by the Industrial Projects Department in India on commercial vehicles and tractors in the context of lending operations. Such work may in fact prove more capable of answering questions posed in phase two. It was agreed to suggest to the sponsors of the project to review the material available in the Industrial Projects Department and identify the relationships between the two phases and the research component before finally presenting the project to the Research Committee. One member of the Panel thought that

the proposal had little "research" content, and doubted whether the proposal was appropriate for financing through the research budget.

III. Proposal on Capacity Utilization NO

There was general agreement among the members of the panel about the importance of the topic and about the significance of contribution that could be made if policies could be identified to affect the capacity utilization in the developing countries. There was however a series of problematic aspects of the research project as defined hereunder.

(a) The proposal places great emphasis on the precise measurement of actual underutilization of capital (see reference to "factual information" in Section V). But there is no indication of what the measure of capital utilization will be and we are not satisfied that the well-known theoretical and practical problems have been overcome.

(b) Problems of measuring capital utilization vary immensely between different types of industry. Hence it is doubtful whether a cross-country, cross-sector approach will yield homogenous data amenable to statistical analysis.

(c) The proposed methodology consists of single equation regressions of capital utilization against various probable influences, supplemented by "impressions". We have doubts about the true exogeneity of some of the proposed right-hand-side variables (for example, the capital-labor ratio, and about their explanatory value or reliability). Doubts were expressed about the applicability of regression methods to a multi-dimensional dependent variable; e.g., planned and unplanned unutilized capacity, capacity versus intensity, and about whether the relevant variables, both dependent and explanatory, can be covered with sufficient precision for a sample of 800 firms. If conclusions rely more heavily on general impressions (which is likely), the size of the proposed sample seems excessive.

(d) The proposed sample consists of 800 firms in four countries. It is doubtful whether so many firms will be available for survey and whether the interviews can be conducted in sufficient depth in the allotted time.

(e) Given the methodology it is very difficult to see how policy variables will be introduced into the analysis in a manner that can lead to conclusions and recommendations.

The Research Committee has already approved another study of the problems, the results of which are expected in late 1973 or early 1974. The Panel was not convinced that we should finance another major project in this area parallel with the Rosenstein-Rodan study, in view of the doubts expressed in the above paragraphs. Some form of sequencing would appear to be preferable.

AKaraosmanoglu/sr
Cleared with and cc: Messrs. Ray (12)
Duloy
Moore
D.C. Rao

FORM NO. 57 | INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Anandarup Ray

DATE: March 30, 1973

FROM: Helen Hughes

SUBJECT: RESEARCH PROJECTS: Economics of Industry Division

Small Scale Industries Project NO

1. I would like to note that following the slippage of financing for this project, we are unfortunately unable to obtain the services of the consultant(Mr. Walinsky) we had proposed to use. We have therefore begun to negotiate with David Kohav whose knowledge of the Bank Group's operations and contacts with Israeli small scale industry institutions would be invaluable for the project. Mr. Kohav would be assisted by Miss Nurit Wahl, who is also familiar with the IBRD, and they would be able to draw on the services of Mr. Avraham Fein, the head of the Israeli Citizens Bank. Discussions with Mr. Kohav, however, suggest that, in view of past consulting rates he and Miss Wahl have received from the Bank, the $30,000 budget would be inadequate. Our negotiations suggest that a minimum $35,000 would be necessary to carry out the project on the lines indicated.

2. The smallness of this increment in the budget is being made possible by the increased allocation of staff time to a person year to provide support for this project within the Division.

3. I have initiated negotiations with the Swedish International Development Authority (SIDA) to extend the country coverage of the project by a joint program of research. It may be possible to double the number of countries covered in the research frame. SIDA would also possibly make a contribution to the extra consultants' cost of writing up the combined country analyses. Further negotiations are, of course, subject to final approval for the project.

Capacity Utilization - Interdepartmental Support NO

4. I would like to note that Mr. Gustafson (DFC) has informed me that he supported our undertaking the project in principle although he has not had time to discuss the final verious of the proposal in detail.

5. Mr. de Vries' reference is to the fact that the West Africa Program Department I, wishes us to "widen the project scope and to include an analysis, based on detailed cost data, of the competitive validity of selected major industries already established in Nigeria".

6. We would of course propose to comply with this request. The local

research base which this project would enable us to establish, would be essential to the in-depth approach suggested by the Department. Negotiations with a suitable consultant, and local counterparts only await approval for the project.

7. The Malaysia study is to form an integral part of the "concentration" research program being carried out in that country, and here too other aspects of industrial development, considered to be important by the Program Department will be covered. Negotiations are proceeding with Malaysian and Korean collaborators.

8. We have not solicited the support of the Latin American and Caribbean Region as it is to be covered by the Rosenstein-Rodan project. Mr. Thoumi will be actively involved to ensure comparability between the two sets of countries.

9. Further discussion is to take place on the country to be chosen in the EMENA Region. Yugoslavia was chosen some 6 months ago after consultation with the Regions' Senior Economists, and informal contact was made on this basis with local researchers who were very keen to collaborate on the project. No commitments were of course made, and the choice of the country is subject to the Region's wishes.

HHughes/kg

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Ernest Stern

DATE: March 20, 1973

FROM: Helen Hughes

SUBJECT: Supplementary methodology and budgetary statement for the Small-Scale Industries Project.

1. The substantive focus of the small scale industries research project is detailed in Section II of the research submission (attached to January 18, 1973, memo Hughes to Stern). The project, which is being supported by staff work in the Economics of Industry Division, is designed to yield the empirical data necessary to provide answers to the principal analytical problems posed. That is:

(a) Can meaningful generalizations be made regarding the conditions, necessary and sufficient, to foster the growth of small scale industries?

(b) Do financing institutions contribute to creating favorable conditions? Or, do these programs have a role to play only when conditions are ripe?

(c) What types of financial programs and financial institutions have been successful in fostering small scale industries, and how have they done so?

Emphasis is placed on (a) findings on a country-by-country and comparative basis, and (b) the role of financial institutions in the development of small scale industries. This approach will throw light on the situation of the specific countries studied, as well as contributing to the planning of a coherent Bank program for lending to small scale industries.

2. I am continuing to negotiate with David Kohav to head an Israeli consulting team. This team would include Avraham Fein, the head of the Artisan's Bank, who thus has experience in one of the most, if not the most, successful programs for small scale industries development in operation. I am planning to go to Israel to meet with the consultants in June 1973 to finalize their terms of reference.

3. The preparation of background materials for the project is now underway in the Bank. It will include (a) a review of the literature; (b) an analysis of the role of small industries in industrial development, with particular emphasis on the countries being chosen for the study; (c) an issues paper on the Bank's role in financing of small scale industries; and, (d) summary reports, bringing together available data and narrative on relevant characteristics of each country to be studied. The issues paper will inform the consultants of the salient problems as they relate to the Bank's objectives and approaches to further involvement in the field.

4. It is proposed that the three senior consultants spend one week in Washington in mid-October 1973, to be briefed by Bank personnel concerned with small industries, i.e. the country economists, representatives from DFCs and IFC, Industrial Projects, the Science and Technology Advisor, and other staff members.

5. For the remainder of October and November 1973, the team will proceed with fieldwork in Colombia, Singapore, Malaysia, and an East African country (the final country decision is subject to further discussion with East Africa Region). This selection has been made to yield a country combination of various sizes, levels of development, and financing programs of different longevity and reported degrees of success. The East African country will represent a situation where there has not been an ambitious program until very recently; and, Malaysia will represent a relatively unsuccessful experience. In each country the consultant will be expected to meet with leading officials of the financing and other small scale industry assistance institutions, to gather the following kinds of information:

(a) Exact nature of the institutions and of special program for lending to small industries, source of funds, and relevant history including functional changes in the organization;

(b) cost differences in lending to smaller as opposed to medium and larger enterprises and how they are handled;

(c) qualitative differences in lending to small firms;

(d) characteristics of clients and firms.

Depending on the situation in each country, the consultant will branch out from the institutions to gather information on related programs for small industries, and on industrial policies that effect investment in the small scale sector. Small entrepreneurs will be interviewed.

6. One member of the team will meet with ILO, UNIDO, and possibly other organizations in Europe to discuss thier approaches, programs, and potential for further cooperation with the Bank in this field.

7. It is planned that report writing will be done in Israel during December 1973 and January 1974. One of the senior consultants will return to Washington in February 1974 for discussions on the final report.

Enc. Budget.

II. Cost Independent of Country Studies

1.	Senior consultants. . . . . Report writing Presentation of report for discussion	2½ man months	$ 5,625
2.	International travel. . . . . Israel/Washington,D.C./Israel		1,520
3.	Per diem: Washington, D.C.	7 days	245
4.	Junior economist.	2 man months	1,600
5.	Secretarial support, supplies, etc.		1,910
		Sub-Total.....	$ 10,900

Total for project $ 30,000

He is a small industrialist!

NO

Estimated Budget for External Research Project on Small Scale Industries

I. Country Studies, in conjunction with one week briefing in Washington, D.C.

1. Tanzania [1] and Europe (ILO, UNIDO)

	Time	Est. Cost
(a) Senior Consultant.	1½ man months	$ 3,125
(b) International Travel Israel/Washington/Europe/ Tanzania/Israel		1,900
(c) Per diem: Washington, D.C.. . .	7 days	245
Europe.	7 days	280
Tanzania.	21 days	840
(d) Domestic Travel.		200
Sub-Total.....		$ 6,590

Haiti

2. Colombia

(a) Senior Consultant.	1 man month	$ 2,500
(b) International travel Israel/Washington/Colombia/ Israel		1,910
(c) Per diem: Washington D.C. . . .	7 days	245
Colombia.	21 days	735
(d) Domestic Travel.		200
Sub-Total.....		$ 5,590

3. Singapore and Malaysia

(a) Senior Consultant.	1½ man months	$ 3,125
(b) International travel Israel/Washington/Singapore/ Malaysia/Israel		2,300
(d) Per diem: Washington D. C.. . .	7 days	245
Singapore	14 days	490
Malaysia.	14 days	560
(e) Domestic Travel.		200
Sub-Total.....		$ 6,970

Country Studies Grand Total.....$ 19,100

1/ Subject to discussion with East Africa Region.

PROPOSAL FOR RESEARCH ON FINANCING SMALL SCALE INDUSTRIES

I. Objectives

1. In the past a disproportionate share of attention in promoting industrial development has been devoted to large projects. In recent years, with the development emphasis shifting to employment and income distribution problems (including regional distribution), more attention is being paid to small scale industries. Small scale industries, moreover, can contribute to the creation of very scarce entrepreneurial and managerial skills. This is particularly important for the least developed countries just starting on industrial development. In these countries, and in backward regions of more developed countries, the size of investment and the kinds of demands on human resources are more manageable in a small scale industry context as capital and skills are usually very scarce and markets are small.

2. Some aspects of the small scale industry problem are reasonably well known. Thus there is a general concensus that overall government policies - the rules of the game - must not be unduly biased against small scale industries if such enterprises are to succeed. Unfortunately, in many developing countries the opposite is the case and the rules of the game are biased against small scale industries. Policies have to be changed if a small scale industry program is to have any chance of success. Government policy is being examined in this respect on a country by country basis in the context of IBRD economic missions.

3. The IBRD is also undertaking long term background research on the economic efficiency of small scale industries, with attention to such

issues as capital intensity, employment potential, etc.

4. The Bank Group however has an immediate problem of financing small scale industries in developing countries; therefore it has decided to commission a study of the operational aspects of financing small scale industries to enable it to formulate appropriate policies and instruments.

5. The principal objectives of the study are:

(a) to ascertain how successful small scale industry finance programs operate. Although finance in itself is a need, it does not follow that small scale industries should receive subsidized credit in the sense of being charged lower interest rates or being offered better terms than large industries. A subsidy element is necessary for small scale lending, however, to cover the high costs of administering small loans and the high risks of small scale lending.

(b) to evaluate the organizations engaged in the field of small scale industry development with the intent of exploring the potential for cooperation with appropriate agencies in small scale industry programs. It is recognized that in many cases technical assistance of various types, beyond that associated with the working of such loans, may be necessary to make loans effective.

(c) to examine the most appropriate lending and organizational measures the Bank Group may take to facilitate a significant impact on the growth of the small scale industrial sector.

II. Characteristics of Financing Programs

6. It is proposed that a research team of, say, three consultants engage in a systematic field assessment of four or five of the more successful small industries financing programs. Materials on the conditions the more successful programs encounter, their methods of operations, their activities, and the sub-projects will be gathered through personal interviews, acquisition of written materials, and on-site examination of records. A comparative analysis of these findings in conjunction with relevant background information gathered on the countries will be undertaken.

7. Among the variables which influence the characteristics, current extent, and future growth of small scale industries in a country (or region) are the historical nature of indigenous social and economic organization, the availability of entrepreneurial and labor skills, the overall level of economic development (and particularly industrialization), and the policy framework. Acknowledging this array of potential influential factors, all of which are thought to have more or less impact either in isolation or in some combination, a framework for the comparative analysis will be designed by the consultants in collaboration with the IBRD staff to elicit information on the following questions. Can meaningful generalizations be made regarding the conditions, necessary and sufficient, to foster the growth of small scale industries? Do financing institutions contribute to creating favorable conditions? Or, do these programs have a role to play only when conditions are ripe? In any case, what types of financial programs and financial institutions have been successful in fostering small scale

industries and how have they done so? The consultants will provide in-depth information on environmental conditions as seen from the perspective of financing institutions and insights into factors to be considered in policy formulation and projects by the Bank Group in this field of operations.

8. The term financing program is used to include all types of institutions and programs which are used to channel investment resources to small scale industries in the countries selected. The selection will be representative of countries at various levels of industrialization and of different sizes. The aim is to bring together a reasonable mix of programs that will lend itself to finding answers to the questions enumerated in para. 7 above. Tentatively such a group would include Israel, Singapore, the Federal Republic of Germany, one sub-Saharan African country and one Latin American country.

9. The information to be gathered from the financing institutions may be categorized as follows:

(a) exact nature of the institution and of any special programs for lending to small industries, source of funds, and relevant history including functional changes in the organization;

(b) cost differences in lending to smaller as opposed to medium and larger enterprises;

(c) qualitative differences in lending to small firms, and

(d) characteristics of their clients and the sub-projects.

It will be noticed at this point that there are two levels of comparison to be made: one is to compare in one country the differences in financing different size firms and the other is to compare the four or five country programs, as mentioned above.

10. The nature of the institution, source of funding, regulations, etc., are all needed for background purposes. Of greater significance are the evolution of the organization, the methods of overcoming past problems, and the like. These points of information are necessary to establish how a successful program is created and whether the process can be reproduced elsewhere.

11. The quantitative or cost differences include the costs of the normal administrative burden in financing, the additional costs of unusual services required by small scale industries, the costs of risk or default, and the costs of any subsidies. It is of particular interest to find out if services other than financing are required for successful operations, (e.g., in the areas of technical and economic feasibility of projects, in selecting or improving production techniques, in developing better management techniques); how these requirements are met; and at what cost, if any, to the financing institution. In this connection, if a close working relationship with another agency is an integral part of the financing of small industries then this relationship (and the companion agency) would require further investigation.

12. The qualitative differences in financing smaller firms are more difficult to anticipate and to define. They may include the interests and the attitudes of all parties concerned as well as the attitudes and actions of other agencies that play a part in supporting or detracting from the operation of small industries. While the data here are not usually amenable to quantification, these considerations may be the deciding factors in the successful operation of the financing institution and of the sub-projects.

13. Information on the clients and their projects is necessary to determine who the financing institutions serves and what kind of projects they support under the umbrella of "small scale industries". At this point the operational definition of "small industries" and "small entrepreneur" must be discerned: what size projects actually are being financed (in fixed assets and in employment) and what kind of financial background did the entrepreneurs have when the projects were initiated? The available records on a sample of the sub-projects should be examined and interviews conducted to elicit details, such as investment/employment ratios, the rate of growth of the project, the kind and source of technology (and the choices open at the time of selection), the degree of specialization in management, relationships with other firms, and nature of the markets served. In short, within the allotted time as much information as possible should be gathered on sub-projects, as well as the financing institution, in order to gain a well-rounded picture of who is being financed, how, and for what purpose.

14. The size of small scale industry covered will be determined by the financing institutions selected, i.e. their clientele -- and not by the definitions laid down in their mandates since these definitions may not describe the average sub-project very accurately. The expected variation in size of firms financed will have to be taken into account as one of the variables in the analysis.

III. Organizations Active in the Field of Small Industries Development

15. There are a number of organizations--national, regional, and worldwide-- which have accumulated experience in providing financing, technical services, and various types of training to small scale industries.

The objective of this aspect of the project is to evaluate a select number of institutions on the basis of their expertise in their functional areas and of their prospects for using that expertise in cooperative efforts with appropriate members of the Bank Group. Thus far the candidates for evaluation are UNIDO and the German Development Bank (KfW). Other agencies may be added as the details of the project are worked out.

16. One of the tasks in this regard is to determine from the experience of the successful financing institutions whether small scale industries require other types of assistance, what is the precise nature of these requirements, and how the services are delivered most effectively. With these findings on the country programs as a guideline it should then be possible to begin to evaluate the capability of international organizations to function effectively in designated areas of competence. Forthright evaluation may be difficult to accomplish due to the wide range of what is considered "small scale industries". UNIDO, for example, may have developed its expertise along different lines (smaller scale firms) than any of the financing institutions. As a precautionary note, adjustments must be made for the wide-ranging definition of small scale industries. Furthermore, it is expected that throughout the reports that "small industries" will be defined adequately so that the size factor is clearly understood at each stage of the discussion.

IV. Recommendations for Tailoring Bank Lending to the Requirements of Small Industries

17. The consultants will spend approximately two weeks at the outset of the project in Washington, D.C. At that time they will meet with staff

members of the Bank Group organizations who are involved with policy-making and the operational side of small scale industries projects. With the briefing on the Bank's procedures and current thinking on the subject and with the results of the field work it is expected that the research team will come to some conclusions on alternatives open to the Bank Group for further action within the context of its activities.

18. Recommendations are solicited in roughly three areas:

(a) adjustments in the contractual agreements that effect the utilization of loans;

(b) services that should be attached to projects to insure greatest impact for the sub-projects, and the best methods to provide these services; and

(c) new approaches the Bank Group may take to help organize the international efforts to create employment opportunities and wider income distribution through development of the small scale industries sector.

October 27, 1972

Ms. Helen Hughes

Ernest Stern

Financing of Small-Scale Industry

1. The Research Committee agreed, in principle, to allocate up to $30,000 for this study if additional research funds become available, as appears likely. Prior to giving final approval, however, the Committee will need to have:

   a. a more definitive statement of the scope of the project; and

   b. a detailed budgetary statement so that the appropriate allocation can be more firmly determined.

The present project description provides inadequate information about the methodology or the scope of the study. It describes the general problem but gives little information about what issues the study will address, what data will be collected and what the product of the research will be, as distinct from the policy paper which is being prepared by the Division staff.

2. I understand that it is the intention to employ one consultant (Mr. Walinsky was mentioned). The work will be completed in about three months. This, however, seems inconsistent with a $35,000 cost estimate.

3. I will advise you when funds become available and we can, at that time, review the above problems.

cc: Messrs. Stevenson, P. Smith
Pending Project File

ARay/EStern:lm

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

Project file

DATE: September 19, 1972

TO: Mr. Ernest Stern

FROM: Dragoslav Avramovic

SUBJECT: Financing Small-Scale Industry

1. In response to Mr. Ray's request of September 5, a Review Panel consisting of Messrs. Yenal, Segal and myself met on September 13 to review the above project. Also present was Mrs. Helen Hughes from the Economics Department which is proposing the project.

2. The Panel agreed that the research topic was of high priority for Bank future operations. It was further agreed that the study should preferably be undertaken by an outside consultant, since Bank staff did not have significant experience in this field. The need for continuing liaison with Bank staff during the study was underlined, however, since the knowledge acquired would be of direct relevance for Bank future operations in financing small industry.

4. The Panel considered whether the main objective of the study may not be achieved by developing small industry financing schemes in several countries as projects for Bank/IDA financing. It was agreed that such project development was not a substitute for the proposed study. The objective of the latter is to help in arriving at general guidelines for policy by reviewing national and international experience in small industry financing. As such it would complement and assist the work on individual small industry financing schemes (projects) which the Bank may develop in the future.

cc: Mr. O. Yenal
Mr. N. Segal
Mr. W. Tims
Mr. A. Ray
Mrs. H. Hughes

(To B. Filled By Research Commit e)

Review number

Project number

WORLD BANK RESEARCH PROGRAM
Project Proposal

Date of Submission

PART I. PROJECT IDENTIFICATION

1. Title: Financing Small Scale Industry

2. Department Responsible: Economics	3. Staff Member Responsible: Helen Hughes
4. No. of Contracts: 1	5. Total Estimated Cost: $35,200

6. Total Estimated Staff Time: 2 weeks
Professional: Special Services:

Part II. COORDINATION AND APPROVAL

7. Interdepartmental Coordination:

Department	Name & Signature	Support Project	Do not Support Project-Comments Submitted
a. Industrial Projects	Sani El Darwish		
b. East Africa	Lyle Hansen/Please		
c. DFC	Ravi Gulhati		
d. West Africa	Barend de Vries		

8. Approval:

for Division Chief

P.D. Henderson
Department Director

PART III. IMPLEMENTATION

1. Date Work to Start: January 1973	2. Date First Draft Expected: June 1973

3. Final Report Due: September 1974

4. Implementation Method:

a. Bank Staff. . . . . [ ]
b. Individual Consultants. . . . . [xx]
c. LDC Contractor/Institute. . . . . [ ]
d. Developed Country Contractor/Institute. . . . [xx]
e. Seminar . . . . . [ ]

5. Reports Expected in Current Fiscal Year:

June 1973

PART IV. FINANCIAL AND STAFF DATA

1. Dollar Costs (Estimated Disbursements by Fiscal Year):

	FY 73	FY 74	FY	After FY	Total
a. Contractual	15,600	5,200			$20,800
b. Travel + Per diem	14,400				14,400
c. Data Processing					
Total					35,200

2. Staff Requirements (man-months):

	FY	FY	FY	After FY	Total
a. Professional	½				
b. Special Services					

PART V. PROJECT SUMMARY
(Use Additional Sheets if Necessary)

1. Research Objectives:

Support basis for Bank Policy	[x]
Support for Bank Operation in Projects or Sectors	[x]
Support for Country Economic Work	[x]
Increase Knowledge of the Basic Development Process	[x]
Develop Institutional Capacity for Research in LDC's	[ ]

2. Description:

a. Problem

b. Method

c. Coordination

d. Implication for Bank Policy and Operations

e. Project Organization

Financing Small Scale Industries

1. In the industry field, the Bank Group's concern with income distribution and employment has come to be reflected in a number of ways, but the most important is undoubtedly a concern with "small scale" industry. This concern does not ignore the fact that "small scale" industries are a very mixed group, that they are only part of the industrial development picture, that assisting "small scale" industries may affect handicrafts and cottage industries, and hence rural income and unemployment unfavorably, or indeed, that "small scale" industries may be more capital intensive than "large scale" industries under some circumstances. However, there appears to be a strong feeling within the Bank that even though there are problems and difficulties in assisting small scale industries which require careful resolution, in most situations the benefits tend to offset the costs because of the income distribution, and enterprise formation benefits. In many small, least developed countries, particularly in Africa, the stimulus to small industries appears to be the most important part of long-run industrial development strategy. The problem is how to stimulate their growth effectively, in keeping with other developmental aims, particularly those of rural development, and without cost to other economic sectors.

2. The Economics of Industry Division is proposing to undertake a program, initially, while the problems are being sorted out, wholly internally (and mainly on the basis of the considerable literature available), a study of such issues as meaningful typologies, capital output and capital labor ratios in small scale industry, opportunity for choice of technique, risk factors and so on. In the meantime, however, the practical problem of how the Bank Group could best finance the growth of "small scale" industries is of some urgency.

3. The Bank Group has not yet developed suitable financial intruments for financing small scale industries. Direct IBRD and IFC financing assists very large firms, and DFC financing generally assists development banks which finance large scale and medium firms which can be defined for practical purposes as those with say more than 100 workers and at least $1 million investment. It is true that some of the DFCs financed by the Bank handle smaller projects too, but they are not properly equipped to do so. One of the questions the proposed study is designed to answer is whether DFCs should have "small scale" windows with an appropriate financing and other modification, or whether separate institutions would be better. A number of countries, developed and developing, have, however, developed specialized institutions for small scale credit. Some for example, Ecuador, Puerto Rico, Israel and Singapore have had considerable success. There is also a considerable body of experience accumulated in UNIDO and ILO and other international institutions. It is envisaged that the study proposed would examine possible ways in which the IBRD might finance small scale industries in the light of such national and international experience and in relation to the minimum policy framework requirements and technical sources for it is quite clear that it is these three issues:

(a) the overall policy framework

(b) the availability of credit,
(c) the availability of technical advice

which, in the context of each individual country's stage of development are the key factors in the vigor of the small scale sector, and in its ability to foster balanced country-wide development.

4. The study would thus serve, together with the work which is to be undertaken in the Economics of Industry Division as a basis for a policy paper on the Bank Group's role in regard to small scale industry.

5. The project would require a consultant with an interest in the subject, broad vision, common sense, knowledge of the Bank Group, and the ability for clear and concise expression. The number of consultants who would fulfil these requirements is very limited. It is envisaged that the study would require one month's preparatory work, 6 to 8 weeks field work, and 4 to 6 weeks report writing.

(To Be Filled By Research Committee)

Review number

Project number

WORLD BANK RESEARCH PROGRAM
Project Proposal

Date of Submission

February 23, 1973

PART I. PROJECT IDENTIFICATION

Title: Export Development Program for India

Department Responsible: DED	3. Staff Member Responsible: David Wall
No. of Contracts: one	5. Total Estimated Cost:

Total Estimated Staff Time:
Professional: 8 person months

Special Services: 1 person month

Part II. COORDINATION AND APPROVAL

Interdepartmental Coordination:

Department	Name & Signature	Support Project	Do not Support Project-Comments Submitted
DED			
Asia Region, CPD II	J KRAIKE		
India Resident Mission			

Approval:

Division Chief

Department Director

PART III. IMPLEMENTATION

1. Date Work to Start: July 1973

2. Date First Draft Expected: September 1974

3. Final Report Due: December 1974

4. Implementation Method:

a. Bank Staff. . . . . [x]

b. Individual Consultants. . . . . [ ]

c. LDC ~~Contractor~~/Institute. . . . . [x]

d. Developed Country Contractor/Institute. . . . [ ]

e. Seminar . . . . . [ ]

5. Reports Expected in Current Fiscal Year:

Progress Report will be ready in May 1974

PART IV. FINANCIAL AND STAFF DATA

1. Dollar Costs (Estimated Disbursements by Fiscal Year):

	FY 74	FY	FY	After FY	Total
a. Contractual /1	Rs.90,000				
b. Travel	$11,000				
c. Data Processing	-				
Total /1	$11,000 + Rs. 90,000				

/1 Please see attached sheet for details of the Rupee Expenditure.

2. Staff Requirements (Man-months):

	FY 74	FY 75	FY	After FY	Total
a. Professional	6	2			
	1	-			

PART V. PROJECT SUMMARY
(Use Additional Sheets If Necessary)

Research Objectives:

Support basis for Bank Policy	/3/
Support for Bank Operation in Projects or Sectors	/4/
Support for Country Economic Work	/1/
Increase Knowledge of the Basic Development Process	/ /
Develop Institutional Capacity for Research in LDC's	/2/

2. Description:

a. Problem

b. Method

c. Coordination

d. Implication for Bank Policy and Operations

e. Project Organization

(a) Problem:

As a result of the experience gained in the pilot study (RP0221), 1/ which was intended to gauge the effect of the generalized preference system on Indian manufactured exports, the study would focus on the two following aspects of expott promotion in India.

(i) Export Promotion Policies

Recent changes in export promotion policies have added to an already complex set of export promotion regulations and procedures introduced by and large on an ad hoc basis. The Indian Fifth Five Year Plan's emphasis on "self reliance " is making export promotion a particularly important policy area. The project is being carried out in close consultation with the Chief Economic Adviser to the Government of India, Dr. Manmohan Singh. It is intended to obtain a thorough understanding of the issues involved in current policies to assist the Indian Government to rationalize its export policies and procedures.

(ii) Industry Studies

The pilot study undertaken in FY72/73 obtained material on selected industries. This data is now being collated in India and it is proposed to complete and extend the coverage once the initial results have been analyzed. The influence of various policies on export performance of

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1/ "The Impact of the Generalized System of Preferences on India's Exports"

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File Title		Barcode No.
Pedro-Pablo Kuczynski Files: Research proposals 01		1849443
Document Date c. February 1973	**Document Type**	
Correspondents / Participants		
Subject / Title Project Proposal		
Exception(s) Personal Information		
Additional Comments		

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Withdrawn by	Date
S. Thompson	August 19, 2025

Central Research Associates Production

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

Economic Staff Working Paper No.

February 1973

The Impact of the Generalized System of Preferences on India's Exports

This paper is the first in a series examining the prospects for exports of non-traditional industrial products from India. The research project out of which they arise is concerned with the effects of both internal and external factors on those prospects. The present paper is a first report on the relative importance of external factors. It is a preliminary report only, as some of the basic data on the operation of the Generalized System of Preferences are not yet available. The research is being conducted in collaboration with the Indian Trade Development Authority and this paper was written with the collaboration of Vijay Pande, Chief of the Authority's Research and Analysis Division, and with the assistance of Miss Rita Sehgal and Mr. R.K. Gupta. Full responsibility for the paper lies with the author.

Economics of Industry Division
Development Economics Department

Prepared by: David Wall (Consultant)

Table of Contents

Summary and Conclusions

i. This paper examines the claim that the Generalized System of Preferences (GSP) has significantly improved the prospects for exports of industrial products from the poor countries. It does so from the viewpoint of one poor country: India. Section A argues that the claim has to be based on two hypotheses. The first is that the GSP reduces the anti-poor country bias of the commercial policy structures of the rich countries. The second hypothesis is that the sort of tariff change contained in the various country schemes of the System are sufficient in themselves to induce increased export earnings for poor countries.

ii. Section B examines the international trade environment from the point of view of India and relates the GSP as it affects India, to current and prospective changes in that environment as they affect India. Changes taken into account include the expansion of the EEC, the establishment of free trade between the enlarged EEC and the rump-EFTA countries, and the loss of Commonwealth preferences. Possible implications of the 1973 round of GATT negotiations are also considered. The conclusion of this section is that tariff advantages contained in the GSP schemes after allowance is made for the operational restrictions placed on the schemes by the rich countries, pale into insignificance when compared with the worsening in the relative position of India vis a vis the commercial (and other relevant) policies of the rich countries due to these other changes in the international trade environment.

iii. Section C considers the hypothesis that the tariff changes contained in the GSP schemes are sufficient to generate increased export earnings for India. It is argued that this hypothesis has been based on naive theoretical models which were so designed that when GSP type tariff changes were fed into them they necessarily predicted increased export earnings for the beneficiaries of the preferences. A simple alternative model is developed which takes into account factors which were not included in the earlier models. Allowance for these factors, such as monopoly elements in importing countries and policy constraints on supply in exporting countries, leads to serious doubts as to the inevitability of GSP induced increases in export earnings. The conclusion of this section is that, even ignoring the qualifications to the effectiveness of the GSP discussed in the previous section, when the new factors in the model developed here are taken into account, it is no longer possible to claim, a priori, that the GSP will increase demand for Indian exports. Furthermore, even if demand were to increase factors at play on the supply side might make Indian firms unable or unwilling to respond to it.

iv. Finally, Section D reports (briefly) on field work in India and some importing countries. This field work is aimed at uncovering the relative importance of factors actually operating in the market which affect

demand in the rich countries for Indian exports, and the supply of products for export in India. While it is not yet possible, due to data deficiencies, to relate these market factors directly to the model presented in the previous section, it is already clear that some market factors reduce the effectiveness of the GSP in inducing increased demand for Indian exports, and some market factors reduce the ability and willingness of Indian firms to increase their exports, or to enter the export market for the first time. The necessarily tentative conclusion to this section is that policy determined supply constraints play a more important role in determining export flows than the early GSP models assumed. The completion and analysis of the field work being undertaken will provide detailed evidence of the market forces at play and relate them to policy issues.

A. INTRODUCTION

1. The Generalized System of Preferences (GSP) schemes which were introduced by several developed countries in 1971 and 1972 were claimed by them to be signs of their willingness to make economic concessions aimed at supporting development in poor countries. The poor countries, on the whole, welcomed the introduction of the schemes for two reasons. In the first case poor countries believed that the pre-GSP commercial policy structures of the rich countries were systematically and significantly biased against imports from poor countries. In the second case they believed that the tariff reductions embodied in the GSP schemes would at least reduce that bias and lead to increased export earnings for them. The first belief was supported by the evidence on the structure of the commercial policies of the rich countries produced by the UNCTAD Secretariat and others - particularly in connection with the GATT Kennedy Round. The second belief was based on somewhat naive theoretical reasons and simplistic empirical models, which predicted that the sort of discriminatory tariff reduction embodied in the GSP schemes would, alone, be sufficient to generate increased export earnings for poor countries.

2. In this paper I will accept, without further question, the contention that the commercial policy structures of the rich countries were, prior to the introduction of the GSP schemes, biased against products of export interest to poor countries. Later, in fact, I will argue that this bias has intensified and appears to be worsening. All the evidence points in this direction. Examined here are: (a) the claims of the developed countries that the GSP schemes modified the anti-poor country bias of their commercial policies; and (b) the reasoning behind the claim that tariff preferences alone can generate increased export earnings for poor countries. For various reasons, as will become clear in the paper, the GSP and other factors in the international trade environment affect different poor countries in different ways. This paper is primarily concerned with the position of India.

B. THE GSP SCHEMES AND COMMERCIAL POLICY BIAS

3. On the face of it, the claim of rich countries that the introduction of GSP schemes constitutes a unilateral non-reciprocated concession in favor of poor countries seems reasonable. Tariffs have indeed been reduced or removed on imports of a wide range of products into the countries operating the schemes. Close examination of the GSP program reveals, however, that in global terms the extent of the concessions involved is probably negligible. In the first case the U.S.A. and Canada have not introduced any schemes at all and those of Eire, New Zealand, and Australia (not strictly a GSP scheme, but one parallel to them) cover such a narrow range of products that they can be ignored.

4. Secondly, those schemes actually in operation (those of the

EEC, the Nordic countries, Japan, Austria, Switzerland, and the UK) are hedged about with exclusions, "non-inclusions", qualified applications, and other limitations in such a way as to seriously reduce any potential scope they may have had. The schemes were originally intended (by the poor countries) to provide one-way free trade in all semi-manufactured and manufactured goods. The extent of the limitations 1/ placed on the actual operation of the schemes is such, however, as to lead some people to argue that for many less developed countries these schemes have, on balance, worsened (or will come to worsen) the trade environment in which they operate. One reason for arguing this is that the two major schemes (in terms of market size) - that of the EEC (which will absorb those of the U.K., Denmark and Eire by 1974) and that of Japan - operate with a system of tariff preference quotas so that preferences are only available on fixed amounts of imports. One of the quotas restricts the share of the total tariff quota for a product which any single beneficiary exporter can enjoy. This implies that when a country has reached its quota position and it ceases to enjoy preferences its relative position (vis a vis other beneficiaries) worsens.

5. Thirdly, the point just made about tariff quotas, by drawing attention to one aspect of the theoretical underpinnings of the argument that the GSP schemes, by themselves, will reduce the bias in rich countries against imports from poor countries, leads to the need for an examination of those other (unrelated) trade policy changes which may affect the relative prices of these imports.

6. There are several imminent or prospective changes in the multilateral trade framework which are likely to, or could, affect India's export interests. Firstly, there is the Generalized System of Preferences itself. Secondly - and perhaps most importantly - there are those effects which will follow from the enlargement of the EEC. Thirdly, there is the imminent establishment of a Western Europe free trade area (WEFTA) parallel to the enlargement of the EEC. Fourthly, the multilateral negotiations to be held under GATT auspices, commencing in 1973, are likely to bring about changes in the world trade framework of consequence to India.

India's Interest in the GSP

7. The GSP schemes implemented by the various developed countries all include India as a beneficiary and all the various qualifications and generally held doubts as to the benefits of the schemes apply to India's

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1/ For a full account of the limitations embodied in the various schemes the interested reader is referred to a paper by Richard Cooper in the Journal of Development Studies July 1972, the two chapters by Harry Bell in "Integration or Fragmentation of International Markets" edited by [illegible] and I. Walter and "[illegible] Commonwealth and the Generalized System of Preferences", a report prepared by the author for the Commonwealth Secretariat, London 1972.

interests in them. To the extent that the schemes do reduce tariffs on imports from LDCs and to the extent that such tariff reductions affect relative prices and are passed forward to consumers, or back to producers, or induce monopolistic importers to increase their imports from GSP beneficiaries, then they could increase export opportunities to all LDCs as a group, India included. For India itself to benefit from the schemes its exports have to be relatively more attractive, price-wise and quality-wise, at the margin than all other LDC exports and Indian exporters have to be willing and able to supply increased quantities of the relevant products at the going international price. There is no way of knowing in advance the willingness or ability of Indian exporters to increase their exports (or prices) as a result of the schemes, or of knowing the competitive reactions of other LDC exporters or of producers in GSP extending countries in response to any Indian success in taking advantage of the schemes. Economic models can be devised which incorporate some of these effects with different assumed values of the various variables and parameters. Their theoretical basis is examined in the Section C below.

8. Two such models have been used recently to estimate India's possible (static) trade benefits under the schemes. One model was applied by the Research and Analysis Division of the Trade Development Authority to the GSP Schemes of the EEC and Japan. Using aggregate data this model predicts that India's exports to Japan and EEC would increase by Rs.134.84 lakhs on the assumption that no supply constraints exist and Rs. 79.57 lakhs on the assumption that export supply growth would be the same as the overall annual rate of growth of industrial production in 1971 (2 per cent). Another model, used by the Indian Institute of Foreign Trade, predicts a total static gain of Rs. 32 crores, with Rs. 2.5 crores being accounted for by Japan and 7.2 crores by the EEC.

9. Although these two (and other) models of India's interest in the GSP schemes vary in technical sophistication there is no way of distinguishing between them according to their "correctness" or realism. While both make various attempts to confine the values of the relevant parameters and variables to feasible and (assumed) realistic values, there is no way, a priori, of testing the future validity of such hypothesized values nor of establishing the correctness of assumptions (if any) concerning the reaction responses of competitive producers. Tariffs are, however, only one of many factors determining the size and direction of trade flows and the sort of marginal changes in tariffs embodied in the GSP schemes (when allowances are made for the various product coverage limitations and other qualifications they contain) pale into insignificance when other factors (actually or potentially) affecting the trade interests of LDCs are taking into consideration.

10. The restricted and qualified preferences being extended to the LDCs by the EEC, the U.K., and Denmark are insignificant when compared to the full reciprocal preferences they are preparing to afford each other following the enlargement of the EEC. Other economic benefits the nine European countries are proposing to extend to each other on enlargement reduce any

possible impact of the GSP on them to minor economic dimensions. For example, adjustments to its economy which the United Kingdom is willing to make in order to subscribe to the EEC's Common Agricultural Policy far outweigh any adjustments which may become necessary due to the operation of the GSP.

The Enlargement of the EEC

11. The effects of the expansion of the European Economic Community (EEC) into the largest trading bloc in the world are foremost in the minds of those concerned with formulating India's trade policies. It is not difficult to see why: the original six members of the EEC and the U.K. alone accounted for 17.5 per cent of India's total exports in 1970-71 and even before expansion India has been losing ground in both markets - relatively in the case of the EEC (from 6.9 per cent of total exports in 1965/66 to 6.4 per cent in 1970/71) and absolutely in the case of the U.K. (from $306 million in 1965/66 to $227 million in 1970/71). When one looks at the commodity composition of India's exports to the U.K. it is easy to understand why policy makers in India regard the entry of the U.K. into the EEC with pessimism rather than the optimism some would have them feel.

12. Fully 38.16 per cent of India's exports (1970-71) to the U.K. consist of tea, followed by manufactured tobacco (9.8 per cent), leather (9.2 per cent), and cotton piece goods (7.3 per cent). These top four items together, then, account for almost two-thirds (64.4 per cent) of all of India's exports to the U.K. followed (as shown in Table 1) by oil seed cake, cotton yarn and thread, vegetable saps and extracts etc., made up articles wholly or chiefly of cotton n.e.s. (not clothing), carpets etc., and woven jute fabrics. The share of these ten products in India's total exports to the U.K. is approximately 78 per cent. It has already been noted that the U.K. is not one of India's most dynamic export markets and when it is also recognized that almost all of India's major exports (in existing or more processed form) to the U.K. are subject to more rigorous import restraints in the EEC than they are in the U.K., Indian concern at the prospects of the effects of U.K. entry on its exports can be readily appreciated. These restraints include excise duties on tea, the restrictive effects of the Common Agricultural Policy on imports of oil seed cake and vegetable saps and extracts etc., state monopoly, preferential buying of tobacco (without the commitment to "buy Indian" which is currently part of U.K. policy), a more restrictive application of the GATT Long Term Agreement on Cotton Textiles, and high duties on jute and coir manufactures. To the extent that such restrictive treatment of imports of processed and non-processed agricultural products and textiles is adopted by the U.K. in the course of the harmonization of its various economic policies with those of the EEC, the prospects of countries such as India, whose basic trade with the U.K. is mostly in such products, are likely to be seriously affected. The potential damage to India's trade with the U.K. is increased due to the consequential loss of the preferential treatment it currently receives in the U.K. market under the Commonwealth Preference System which increases the advantages to its beneficiaries of the U.K.'s more liberal policies towards imports of such products.

13. If we compare (see Tables 1 and 2) India's export performance in the U.K. with that in the pre-enlarged (1970-71) EEC, the nature of the problem becomes more explicit. Although it is a much larger market, the total amount the EEC imports from India is only a little more than half the amount the U.K. imports. The proportion of the EEC's total imports from India accounted for by the ten most important items is approximately 58 per cent. There are significant differences between these two groups of ten most important items. Thus three items in the U.K. list which compete with important industries in the EEC are not found in the EEC list - these items being manufactured tobacco, oil seed cake, and cotton yarn. The three items which replace these 'sensitive' products do not compete with EEC industry, being artwares, diamonds (not industrial) and other precious stones, and tropical hardwood. Of the five common items, one (tea) does not compete with EEC industry and two (leather and vegetable saps and extracts) are used as inputs by it, as is iron ore (and concentrates) which appears in the EEC list but not in that of the U.K.

14. Indian policy makers fear that those items which the U.K. now imports in significant quantities but which the EEC does not and which compete with the protected EEC industry and agriculture will be subject to trade diversion as a result of the U.K. joining the EEC, to the detriment of India's export interest. Such a fear is rationally based in many cases, not just for the items in Tables 1 and 2, where EEC treatment is more restrictive than that of the U.K. It is also rational in all those cases where EEC producers could currently compete successfully with Indian exporters in the U.K. market in the absence of the special benefits accorded to Indian exports in that market under the Commonwealth Preference System (CPS) and in the bilateral trade treaty.

15. A comprehensive quantitative estimate of the effects of the U.K.'s entry into the EEC is beyond the scope of this study; it is, indeed, beyond the scope of any realistic predictive study given the complexity of the factors involved. All that can be done here is to identify the major consequences of U.K. entry in terms of the trade environment which will be faced by India after enlargement of the EEC. Such effects may be categorized into positive and negative effects, in the sense of whether they result in the elimination of preferential treatment currently enjoyed by India (negative) or in the creation of new obstacles to Indian exports (positive).

16. In the latter categories are those effects which derive from the nature of the European Economic Community and its complex of economic policies. The motive behind both the establishment and expansion of the EEC is the creation of a free trading zone in which non-members, including India, are purposefully put at a competitive disadvantage. The greater the number of countries having access to the free trade arrangements the worse off are non-members; the initial creation, the enlargement, and the proposed simultaneous creation of a Western European free trade area (WEFTA) all imply a worsening of the trading environment of all non-members of those groupings. As obstacles to trade among the members of the groupings are

removed or reduced so are, by the same act, trading disadvantages created for non-members. This is the rationale of the groupings. In addition, the various product-specific preferences afforded by the existing EEC countries which will be maintained (and thereby strengthened) by the enlarged Community, also worsen the trade position of non-members who do not have such special treatment. Examples of such comparatively adverse treatment affecting India, which have been created by these ad hoc departures from the MFN system, are the preferences afforded by the EEC to Turkey for opium and tobacco, to Spain for walnuts, and to Greece for tobacco.

17. Apart from the use of tariffs (and non-tariff barriers such as those affecting cotton textiles and jute products) to create artificially favorable trading environments for favored fellow members and Associates of the groupings, the EEC systematically uses (and will continue to do after enlargement - on a larger scale) subsidies (in one form or another) to protect sectional interest groups within its borders. These subsidies operate to the detriment of competitors in third party countries. The most obvious structure of such subsidies is that embodied in the Common Agricultural Policy (CAP). The adoption of the CAP by the U.K. will seriously affect India's competitive position in the U.K. market for such products as tobacco, sugar, vegetable oils and oil cakes.

18. A second important set of subsidies which restrict the trade possibilities of countries such as India are those associated with the regional policies of the European countries. These subsidies are particularly damaging as they are, for the most part, geared to the establishment or maintenance of employment generating labor-intensive industries, the very type of industry which India (and other LDCs) are trying to establish in order to modernize and develop their economies.

19. With much larger tax bases the rich countries, especially the more 'welfare-state' minded European countries, are able to maintain programs of subsidies at levels which LDCs cannot possibly hope to match with compensatory support programs for exporters to those markets. In addition to the subsidies of the agricultural and regional policies many European governments subsidize items such as social security, transport, training and education, and health programs which many if not most private firms in LDCs have to pay for themselves, thus adding to their costs of production.

20. A third, prospective, result of U.K. entry into the EEC which is likely to worsen the trade position of India is the harmonization of the GSP schemes of the U.K.(and the other three new entrants) to that of the EEC. While no definitive statement has yet been made on this issue (as the EEC scheme is to be reviewed in 1974) it is increasingly recognized in diplomatic and official circles that the new entrants will be expected to adopt the form of the EEC scheme, complete with its more restrictive treatment of agricultural and mineral products, and its restrictive set of quota limitations, beneficiary country limitations, and sub-quota market limitations. I have written at length about the consequences of

harmonization elsewhere. 1/ The situation is complicated by the existence of the Commonwealth Preference System (CPS) and the U.K. - India Trade Agreement of 1939. Comparing the two GSP schemes we can identify products in which India's export interests would be threatened by U.K. adoption of an EEC type GSP scheme - apart from the general threat posed by the various quota limitations of the EEC scheme. Ignoring the Commonwealth Preference System (CPS) for the moment, these are products which the U.K. has included in its GSP scheme but which are excluded from the EEC scheme. Examples of such products which are of export interest to India are: certain important jute and coir manufactures; cashew nut kernels; lentils; tamarind; papadam; rice; bran and meals; celery seeds; turmeric; opium; bones; mango chutney and mica. Other agricultural and mineral products which are included in the EEC scheme - such as many forms of several tropical fruits - are included on a restricted basis, with only minor tariff reductions being offered.

21. The first of the negative effects results from the fact that when the existing privileges India enjoys in the U.K. market under the CPS are taken into account the prospective effects on India's trade prospects of U.K. entry to the EEC worsen considerably. Apart from the general loss of preferential access to the U.K. market under the CPS due to the introduction of the GSP there are also products - of export interest to India - which are included in the CPS but not in either the U.K. or EEC GSP schemes (or are only included on a restricted basis). These "special preferences" will be lost as the CPS is phased out and eventually eliminated during the transition period in which the U.K. adopts its commercial policy to that of the EEC. Examples of Indian exports which fall into this category are: cashew shell oil; canned and fresh prawns; walnuts; coffee; many vegetables in various stages of processing; rice; oil cake; hog, pig and boar bristles; and mango slices in brine.

22. A second negative effect is likely to be the adoption by the U.K. of the EEC's more restrictive policy towards imports of cotton textiles (and leather footwear). If the U.K. were to reduce its imports/consumption ratio of cotton textiles to that of the EEC the effect on exporters of such products would be very marked. That the U.K. government may be willing to accept such a development is indicated by the introduction of new protective measures for its declining cotton industry - especially the introduction of the 15 per cent tariff on such imports as from January 1, 1972. The introduction of this tariff constituted a unilateral abrogation of a treaty commitment to India not to impose such a tariff on imports of cotton textiles into the U.K. from that source.

23. Finally, the imminent abolition of the Commonwealth Sugar Agreement (CSA) also threatens to harm India's export prospects. In this case the EEC and its four prospective new members have promised "to take to heart" the effects of the abolition of the CSA on its beneficiaries, but no definite quantitative commitments have been made.

1/ See The Commonwealth and the Generalized System of Preferences, op.cit.

24. In sum, the net effect of U.K. entry to the EEC, and also the accession to the Community by Denmark and Eire point to a worsening in the trade environment of India in terms of the relative prices of its exports to the enlarged EEC. This development is generally recognized, or admitted, by all concerned. This worsening will (or could) result from the creation of privileged access arrangements to each other's markets by the European countries involved; from the subsidization of India's competitors in Europe under the Common Agricultural, regional and other economic policies; from the harmonizing of the U.K.'s and other non-EEC countries' [illegible] with that of the EEC; from the abolition of the remnants of the CSA; from the adoption by the U.K. of more restrictive policies towards imports of textiles; and from the abolition of the CSA. The recognition that these changes portend effects on the Indian economy of the expansion of the EEC has led the European countries involved to write into the Brussels Treaty of Accession a declaration of intent "to examine (with India and Sri Lanka, Malaysia, Pakistan 1/ and Singapore) such problems as may arise in the field of trade with a view to seeking appropriate solutions".

EFTA and GATT 1973

25. While the enlargement of the EEC is probably the most important change in the international trade environment affecting India's interests other planned or mooted changes are of importance to it. For one, those member countries of EFTA which have not sought admission to the EEC have secured a reciprocal extension of trade preferences with EEC which will effectively create a Western European free trade area (WEFTA). Each of these countries have shown themselves willing to extend to each other trade concessions which they were not prepared to offer to LDCs under their GSP schemes. The only explanation for such discriminatory behavior is that the countries involved see their own interests better served by mutual exchanges of trade concessions than by unilateral concessions to LDCs. The same motive has led the U.S.A. (yet to implement any GSP scheme) and Japan (with the most restrictive GSP scheme) to take the initiative in pressing for a new round of GATT negotiations to commence in 1973 with the primary objective of minimizing the effects on themselves of the expansion of preferential trading among the European countries.

26. The prime objective of the new GATT round of negotiations is the reduction (and possibly elimination) of remaining obstacles (both tariffs and non-tariff barriers) to free trade in industrial products among developed countries. The LDCs will both lose and gain from the 'successful' completion of the negotiations to the extent that the discriminatory trading arrangements of the EEC and WEFTA are watered down by the introduction of multilaterally based (MFN) liberalization moves in international trade. LDCs, including India, will lose as the value of the GSP schemes are reduced as the MFN tariffs on which they are based are reduced. (And with EEC, WEFTA, and the EEC's various Association arrangements the only important trade flows subject to such barriers will be EEC/WEFTA trade with Japan and

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1/ This presumably refers to Pakistan and Bangladesh now.

U.S.A. and trade between Japan and U.S.A.) LDCs, including India, will gain to the extent that the negotiations result in multilaterally based trade liberalization above and beyond the tariff reductions contained in the GSP Schemes, and to the extent that they are competitive producers of the relevant products.

Conclusions

27. The formation of the EEC, the establishment of the various Association agreements between the EEC and several Mediterranean and other countries, the enlargement of the EEC, the creation of EFTA, and the initiation of the 1973 GATT negotiations are all based on the motive of rich countries seeking to enhance their own economic welfare - more or less without regard for the effects of such arrangements on third, including poor, countries. The, by comparison, trivial concessions explicitly extended by rich countries to poor countries under the GSP schemes do not come anywhere near to balancing the obstacles to their trade created by the various arragnements listed above. The rapid growth in the number of 'voluntarily accepted' export restraints; the unilateral establishment of non-tariff barriers on imports from LDCs into rich countries; the unilateral indiscriminate raising of tariff barriers at various times, by the U.S.A., U.K., Denmark; the stagnation of aid flows; and the disregard by the rich countries of the effects of their currency realignments on the trade interests and reserve position of LDCs all point to a lack of concern among the governments of rich countries for the economic welfare of the population of poor countries. To the extent, however, that the development of mutually advantageous economic relations between rich and poor countries could be devised and constructed - as they could be - such failures to take full advantage of the opportunities offered by a rational international division of labor also show a lack of concern by the governments of rich countries for the bulk of the populations of their own countries in order to favor sectional interest groups.

28. In sum then, the sort of relative price advantages granted by rich countries to imports from poor countries under the GSP schemes are more than balanced by the actual, prospective, and potential relative price advantages granted by rich countries to one another under their various programs of regional and global tariff reductions. But tariff reductions are not the only way in which the relative price advantages conferred by the GSP schemes have been eroded. We have already seen how subsidy programs of rich countries (such as those embodied in the EEC's agricultural and regional policies) have a similar effect. The growing reliance on non-tariff barriers as a protective device by developed countries also whittles away any competitive advantage enjoyed by poor countries as a result of favorable tariff treatment. Similarly the non-discriminatory across-the-board and unilateral tariff reductions of Japan and the revaluations 1/ of the Japanese and German currencies have also reduced the potential price advantage of those countries' GSP schemes - as have (in a different way) the

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1/ The Germans and Japanese could have allowed more favorable treatment of imports from poor countries to absorb the full adjustment requirements of their undervalued currencies.

devaluations 1/ of the dollar and pound.

29. From the poor country's viewpoint their trading environment, and changes in it, as defined by the commercial policy structures of the rich countries, will depend on their position prior to any changes in those policy structures and on any special treatment they may be afforded during the changes. As the sort of special treatment being given to or proposed for certain poor countries (e.g. the EEC current and potential Associates) never exceeds some concept of compensation for negative effects of the changes and others, such as India, definitely stand to lose (again, note that 'loss' is used in the sense of an unfavorable move in relative prices vis a vis [illegible]) the overall effect must be a general worsening of the position of poor countries in the changing international trade framework. The GSP schemes - the only change in favor of poor countries not related to improvements in intra-rich country trade conditions - have to be considered as insignificant compared to other changes in the trade environment which affect poor countries' interests. They are unlikely to involve improvements in the relative (after duty) price position of poor countries' products in rich countries which would be large enough to result in any significant changes in the patterns of world trade at all. We must conclude that the anti-poor country bias of the rich countries' commercial policies has not been more than marginally reduced by the introduction of the GSP schemes.

C. THE TRADE EFFECTS OF TARIFF PREFERENCES: THE THEORY

A Simple Theoretical Framework

30. Our concern in this section is to examine the theoretical basis for the belief that tariff preferences alone can result in increased export earnings for poor countries. Although the last section dismissed the claim that GSP schemes make a significant difference to the anti-poor country bias of the commercial policy structures of the rich countries, the GSP preferences (temporary, to be sure) which they embody do exist and we have to ask the question whether or not export earnings of poor countries will increase as a result - even if from a lower base than would have been the case in the absence of the factors mentioned.

31. Recent work on this question has generally assumed (a) that no other changes are taking place in the international trade framework; and (b) that no other determinants of trade flows change as a result of the introduction of the GSP schemes; and (c) that no distortions exist in the system which might prevent changes in relative prices, due to the GSP, from having a trade creating or diverting effect on the economic agents within the system. On the basis of these assumptions various predictions have been produced of the effects of the GSP schemes on the export earnings of poor countries which range from highly optimistic to somewhat pessimistic - but always positive gains are predicted. The actual degree of gain is

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1/ Which worsened the competitive position of all foreign suppliers to those markets - discrimination could have been introduced.

determined by the values given to the parameters and variables in the models. For example, high partial price elasticities of import demand will produce more optimistic results than do low ones.

32. Most models used to predict the effects of the GSP are single price models. That is, they assume that the price affected by the preferences (the duty paid c.i.f. price) is also the price faced by consumers and producers. On this basis the models then calculate static effects on recent trade flows by feeding the price changes into a framework of price elasticities of import demand and price elasticities of supply. By assuming infinitely elastic supply potential in poor countries the models have based their predictions entirely on the expected response of consumers in rich countries to falls in retail prices on the assumption that the full preference-induced price reduction is passed on to them - the increase in their demand at this lower retail price constituting the increase in the foreign exchange earnings of the poor countries. In these models then the benefits to poor countries derive from increased sales at constant prices.

33. Later models, mostly confined to academic journals, 1/ introduced qualifications to the infinite elasticity of supply assumption and calculated outcomes based on assumptions such as constant but less than infinite supply elasticities or supply elasticities equal to rates of industrial growth. In such cases the relation between the demand and supply elasticities becomes crucial and the tariff reduction may have to be split between increases to producers and reductions to consumers. Here the benefits to poor countries are composed of increased prices and increased quantities at these higher prices.

34. Apart from the obvious question of the empirical validity of the elasticity values these single price models are only valid as long as assumptions (a), (b) and (c) hold. In fact, they do not. In order to examine the consequences of dropping these assumptions ((b) and (c) only as (a) was covered in Section B and the reader should bear the necessary qualifications in mind) we first need to develop a simple multi-price model of trade determination. This is because the consequences of dropping assumptions (b) and (c) affect the markets at different points from the c.i.f. duty paid price stage.

1/ For example: R.G. Blackhurst, "General versus Preferential Tariff Reductions", Southern Economic Journal, Vol. 38 (Jan.1972); K. Kojima, "Trade Preferences for Developing Countries", Hitotsubashi Journal of Economics, Vol.9 (Feb. 1969); C. Clague, "The Trade Effects of Tariff Preferences", Southern Economic Journal, Vol.38 (Jan.1972); J. Cody, "Technical Papers" in D. Wall, The Commonwealth and the Generalized System of Preferences, Commonwealth Secretariat, London 1972 (mimeo); and H. Schilberg, "The Effects of Multilateral Trade Negotiations on the Exports of Developing Countries", an unpublished paper prepared for UNCTAD, Geneva 1972.

35. We can break the model up into two 'sides' for simplicity. On the demand side we can identify a spectrum of prices which intervene between the acts of importing and consuming. Such a spectrum may run as follows: from c.i.f. landed price to duty paid c.i.f. price to wholesaler price to retail price. A parallel structure on the supply side might consist of c.i.f. landed price from f.o.b. price from factory price from input prices. 1/ The introduction of preferences enters the system as a relative price change at the c.i.f. duty paid stage. At this stage importers must decide how to react to the change in relative prices and at all other stages decision takers will have to decide how to react to the decisions of the importers and to the consequences of those decisions. Assumption (c) implies that the importers will make "perfect competition type" decisions and (b) and (c) imply that other agents in the system simply pass on the market signals resulting from these decisions without distorting or modifying them in any way.

Limitations to the Effect of Preferences on Demand

36. Initially, attention will be focused on the importers' decisions and restricted to the question "Why might preferences not result in increased foreign exchange flows to poor countries?" When multi-price models are used and assumptions (b) and (c) dropped many outcomes are possible, although for space reasons only a few cases will be considered. These have been chosen according to empirical relevance, based on the author's experience.

37. In the first case let us assume that the importer is in a monopsonistic position vis a vis foreign suppliers of a product to this market. Let us further assume that prior to the introduction of preferences all imports come from poor countries eligible for preferences when introduced. The monopsony element may stem from any of a number of factors, such as a licensing system of import control; cartelization of importers; importers' control over wholesaling or retailing; importers' control of specialized shipping, internal transport and warehousing facilities; or "barriers to entry" etc. In this case the importer may decide, for a variety of reasons (e.g. low price elasticity of demand), to maintain retail and pre-duty c.i.f. prices unchanged after the introduction of preferences. Consequently no gains accrue to poor countries in the form of either higher export prices or expanded sales. All the previous tariff payments now accrue to the importer as windfall profits.

38. A second case (of which many variations are possible) in which poor countries do not benefit from preferences is where prior to preferences they share a market with competitors in rich countries (located in the preference giving or third party countries). When preferences are introduced the change in relative prices would induce importers to increase the proportion of supplies which they obtain from poor countries. But if, initially, the producers in the rich countries are not operating at full efficiency and are allowing their competitors in poor countries to set prices

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1/ Many other price stages can be identified, this simple structure will suffice here to allow the major points to be made.

they may react to the importer's decision by increasing their efficiency (or by accepting lower profit margins) and offer their products at prices matching the lower duty paid price of imports from poor countries. The lower prices may, however, have no effect on final consumer demand if, for example, the product in question is an industrial input, changes in whose price have little effect on the price of the final product. Again, poor countries fail to gain from increased prices or sales. This and the preceding example are admittedly extreme but are presented as a balance to the other more common extreme of assuming that no such possibilities exist. There is in fact a growing amount of evidence that distortions and reactions such as those mentioned here are important aspects of the real world trade environment. 1/

39. Moving forward from importers it is clear that the same arguments used in that case to suggest that preferences might not result in increased prices or sales for poor countries can also apply at the wholesale and retail level. That is, in the first case, wholesalers and retailers may, if their competitive position allows them, absorb any passed on price reductions due to preferences in the form of windfall profits rather than adjust their own selling prices. Where the market is preempted by poor countries this would mean that no trade effect of any sort would result. Similarly wholesalers or retailers drawing their supplies from non-poor country sources may maintain their market shares by increasing their efficiency, or they may accept lower margins and prevent trade effects again. In the wholesaler case, lower selling prices may be absorbed by monopoly in retailing and in the retailer case lower prices may be passed to consumers, market shares maintained and no increased demand result due to completely inelastic demand.

40. Although these two factors reducing the impact of preferences on import decisions are probably the most important in practice on the demand side (together with those which result from dropping assumption (a), as discussed in Section B) many other, more random, factors exist. Before going on, however, it would be noted that while the two types of leakage considered here are extreme in the sense of resulting in no trade effect, modifications to them do exist (e.g. only a partial response by competing producers in rich countries) which would modify the trade effect but not eliminate it altogether.

41. Other factors may reduce the impact of preferences on trade while not eliminating it. Thus, for example, if governments of rich countries feel that preference-induced imports are increasing too fast in terms of their domestic industries' ability to adjust to the new situation, they may provide such industries with subsidies to enable them to compete more effectively. Or they might resort to forms of protection other than

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1/ A belief in the relevance of the second case, for example, underlies the logic of the "cold shower effect" or "winds of competition" justification of British entry into the EEC.

tariffs with the intention of reducing the trade impact of preferences - examples are voluntary export restraints and biased government purchasing practices. Of course, where injury to domestic industry was expected, prior to the introduction of the GSP schemes, to reach unacceptable levels various restrictions - tariff quotas, exclusion lists, limited tariff reductions, etc. - were imposed on the schemes from the outset.

Limitations to the Response of Suppliers to Preferences

42. Starting from the duty paid c.i.f. price again, we can ask the simple question: in what ways can we expect supply to respond to any increased demand for imports from poor countries due to the introduction of preferences? There are only three possible answers. The first, most frequently assumed in early preference models, is that poor countries can supply increased quantities to rich countries at the pre-preference c.i.f. price - i.e. it is assumed that producers in poor countries are operating in constant cost conditions. The second possibility is that producers in poor countries will be able to increase supplies, but only in response to increased prices - i.e. the producers are operating in conditions of increasing costs. Later preference models have introduced this assumption. And the third possibility is that producers in poor countries will be willing to supply increased quantities at lower prices - i.e. the case of decreasing costs. This assumption has not been used at all in any preference model, which is rather surprising in view of the original logic of the argument for preferences - i.e. the infant industry/economy argument.

43. The popularity of the constant costs assumption has derived from the ease with which predictive models based on it can be devised and applied. To all intents and purposes it has no empirical relevance except in the case where producers can switch supplies from domestic to foreign markets. This exception is however limited to the few cases where the output for the domestic market is large enough to supply international orders and in any case is further limited to the short run. It can be dismissed (along with all models based on it) here.

44. Short run increasing costs can result from diseconomies of longer production runs, and longer run increasing costs can result from scale diseconomies - both can result from input bottlenecks. Given short run fixed capital stock, unit costs can increase as production runs increase: if machinery, labor or management efficiency is impaired; if overtime payments are required; or if inputs (including skills) are in short supply and their prices have to be bid up in order to acquire them. All the usual text book causes of diseconomies of scale may clearly come into play in the longer run, and the situation can also be worsened by supply bottlenecks, with attendant price increases.

45. The original logic for the GSP schemes was derived chiefly from the infant industry argument. That is, it was claimed that as most industry in poor countries is in an infant stage, over time they could be

expected to lower costs and prices to the point at which they would be able to compete on open world markets. Until that time, it was argued, due to imperfections in capital markets and the inability of poor countries' governments to provide adequate subsidies, rich countries could 'aid' poor countries by providing protection of the infant industries in the form of preferences. While this is a longer run argument (consistent with rising short run costs) it was (and is) sometimes argued that for a variety of reasons widespread excess capacity exists in industry in poor countries. This line of argument continues that any increased demand due to preferences could be met with increased supplies (thus assuming no input bottlenecks) at lower costs and prices, or at the same price but lower costs, thus making exporting relatively more profitable.

46. This brief sketch of the possible range of effects on costs of responding to increased demand indicates that only in the cases where the increased demand incorporates increased prices, sufficient to cover any increases in cost, or increased demand at constant price in a situation of no input constraints and where either (i) excess capacity; or (ii) economies of production runs; or (iii) relatively short run 1/ (and therefore easily anticipated) economies of scale exist, will increased demand for exports be met. The evidence available suggests that, on the whole, these conditions are not found to any significant extent in poor countries, at least in India where most of the research for this project has been carried out. The problem here is that the cost analysis/supply elasticity approach only considers an industrialist's ability to respond positively to increased demand on the basis of simplistic production function theory and fails to take into account the fact that his willingness to respond to increased foreign demand for his products may be determined independently of his conditions of production.

D. TRADE EFFECTS OF TARIFF PREFERENCES: THE INDIAN EXPERIENCE

Introduction

47. Only about one-fifth of India's exports go to countries offering it new (as opposed to CPS) preferences and of this only about one-third (i.e. roughly 7 per cent of the total) is of products subject to preferences. We do not yet have sufficient disaggregated data on this trade to see if any significant changes have taken place subsequent to the introduction of the GSP. Similarly, we do not have adequate data on which to estimate the loss (if any) to India resulting from the removal of the CPS. Furthermore, even when we have this trade flow data it will be difficult, if not impossible, to explain any changes which have occurred as it will be impossible to isolate (on the basis of trade data alone) the relative impact of the many factors which have determined those flows. Casual theorizing, on the basis of Section B, would not lead us, however, to predict any significant shift in rich country import sources towards India. This is because such advantages as have been created by the GSP will be removed vis a vis many competitors as the internal tariffs of the enlarged EEC and WEFTA (and

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1/ For example where new machinery can be easily obtained and quickly installed.

the new EEC Associations) are removed. They will be further reduced if the GATT 1973 negotiations lower or eliminate MFN on GSP products.

48. While aggregate trade flow data are never likely to allow us to draw conclusions about the effects of the GSP we can get some idea of how the schemes are operating by talking to firms who trade in products affected by them. As exports which are to take advantage of GSP have to be supplied with certificates of origin it is theoretically possible to identify exports made under the schemes. 1/ To bring the project to manageable proportions a sample of four product groups affected by the GSP and which India currently exports to preference giving countries was chosen. The four product groups were chosen from among those Indian exports which have grown most rapidly in recent years: they are bicycles, hand-tools, industrial fasteners and leather products. A small, but representative sample of Indian exporters of these products was selected and visited. A (random) sample of European and Japanese importers of these products, and relevant trade officials in India and various importing countries were interviewed. 2/ While the sampled firms have had a wide range of experiences in exporting, mainly specific to the firm or market, it is possible to make some generalizations and to indicate some points of interest.

Demand Factors

49. With respect to the GSP some of the firms interviewed could attribute any new export orders they had received to the introduction of the schemes. Nor did any claim that existing export flows had been adjusted or prices changed in any way as a result of the existence of GSP. (Most firms were aware of the existence of the GSP although one, currently exporting to Sweden - a GSP granting country - was not aware of it nor, apparently, was the importer in Sweden). None of the firms exporting to the U.K. were worried by increased competition from other poor countries when that market introduced its GSP scheme, although all were worried at the prospect of increased competition from Europe as intra-enlarged-EEC tariffs were changed.

50. This lack of (perceived) impact of the GSP schemes on demand for Indian exports was matched by statements in importing countries to the effect that import plans were unlikely to be affected by the schemes. 3/

1/ As part of this project the collaborating agency of the Indian Government (the TDA) has centralized the collection and collation of copies of these certificates.

2/ The writing up of the field work is still in progress.

3/ Unfortunately, shortage of time prevented the author from holding more than a token number of interviews in importing countries, where any effect of GSP on demand will be first felt. Nor was it possible to seek out interviewees involved in importing the sampled products.

The reason most frequently cited was that import patterns were based on long run decisions. In the sort of planning horizon held by most importers the uncertainties created by the expansion of free trade within Europe and by prospective changes in the international monetary system made the marginal price changes of imports from India due to GSP insufficiently attractive to induce importers to change their source of supply. This was felt to be particularly true in the case of industrial inputs where once a decision on a source of supply had been made the efficient operation of the importing firm became dependent on the chosen source. As India has yet to establish for itself a reputation as a regular supplier of high quality and stable priced products, importers are unlikely to switch orders to (or increase orders from) India on the basis of relatively small duty paid price changes. In fact, the second most frequently cited reason given to explain a reluctance to increase imports from India was an alleged widespread failure of Indian exporters to meet delivery deadlines, to meet quality requirements, and to follow conventional business practices (such as answering letters, turning up for appointments, and not selling the same product to both wholesalers and retailers in the same market).

51. In sum, nobody was found in India, the EEC or Japan who expected demand in GSP extending countries for affected imports from India to increase as a result of the tariff effects of the GSP. Nor was any evidence found that prices had been raised on existing flows covered by the GSP. (It was not possible in the time available to discover how the price effect of the GSP on existing flows was absorbed in the importing countries). 1/

Supply Factors

52. Unless we can identify demand changes due to the GSP we are unable, of course, to analyze its effects on supply. As no evidence has so far come to light to suggest that the GSP has led to either increased demand for, or increased prices of, Indian exports any analysis of supply response in India with respect to the GSP must be purely hypothetical i.e. restricted to the question of how Indian exporters would or could respond to any positive quantity and/or price effects. During the field work in India it became clear that the wide differences in the conditions under which Indian firms operate are such that it is not possible to give any general reply to this question. The nearest we can come to a generalization is: most interviewed firms only export because they have to under various policy requirements 2/ and do so at or near a loss. These firms would not willingly

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1/ The UNCTAD Secretariat is currently making a study of the initial impact of the GSP but results are not yet available.

2/ Either under the Government's anti-monopoly, anti-large house, or anti-foreign investor policies or under various provisions of the Import Policy for Registered Exporters.

increase exports beyond their obligations in response to increased demand unless the prices they obtained were significantly higher than those they receive at present. Some of these firms felt that even if the whole of the CSP tariff reductions were passed back to them as price increases the gains would be so marginal as to be insufficient to induce them to increase exports, largely due to the frequently much higher prices they obtain in the domestic markets. 1/ Others who would be willing in principle to expand exports in response to higher prices, felt that they would be unable to do so, for a variety of (Government policy determined) reasons. Examples of such constraints quoted are: (1) from several large firms - little prospect of being able to obtain licenses to expand production or receive higher raw material allocations due to anti-monopoly, anti-large house, and anti-foreign investor policies; (2) from small-scale firms - inability to supply orders of the size usually required by rich countries, and inability to meet the stringent deadlines required by importers in rich countries due to difficulties in obtaining smooth flows of the right raw materials from domestic suppliers (both State and private).

53. Many other reasons were cited to justify an unwillingness or inability to increase exports, even if prices obtained were to rise. For example almost all businessmen interviewed believe that they are technically competitive in the sense that if all policy caused cost effects and the price effect due to the overvaluation of the rupee were removed they would either be able to expand exports considerably or enter the export market for the first time.

54. Most of them regarded the import substitition policy as the worst problem in this context, i.e. in the sense of raising export costs most. It raises costs, in their view, in three ways: by requiring firms to use higher priced and lower quality indigenous machinery and raw materials; by requiring a time wasting and inefficiently implemented set of controls for its maintenance; and by raising the relative profitability of selling on the highly protected domestic market. The relative cheapness of imported vis a vis domestic machines and other manufactured inputs would, however, be lessened or removed if the rupee were to be correctly valued. There is, however, considerable evidence to support the view that it is the higher production costs resulting from the lower quality of some indigenous machines and raw materials which affects firms' willingness to export at existing world market prices, valued in terms of the overvalued rupee (which itself is a policy created factor reducing willingness to export, although no firm interviewed mentioned this point explicitly). The bureaucratic element, in the form of a formidable array of controls and regulations all requiring form filling and negotiation, raises costs by taking up managerial time and extra office manpower. These controls are found frustrating enough by some firms to prevent them entering the export trade or expanding exports beyond their legal obligations. On the whole, however, firms are not terribly upset by the anti-export bias of the import substitution program

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1/ This position has led some Government officials and politicians to call for extensions of the export obligation policy.

as the same program creates for them a highly protected market in which they can make (currently at least) large profits. In fact, the largest (actual, as against stated) single reduction of most firms' willingness to export is probably caused by the availability of the large, expanding and highly profitable domestic market partly created by the import substitution program. Their complaints are not directed to the protection they themselves enjoy, or to the anti-export bias, but to the protection given to the domestic suppliers of their machines and raw materials which reduces the profits they make on the domestic market.

55. Marketing problems were also cited by firms as reasons for not exporting. The most frequent examples given were: lack of contacts in markets; lack of knowledge (or understanding) of business customs and practices; lack of knowledge of different design requirements in different markets; and warehousing and freight difficulties preventing Indian firms from maintaining constant (and flexible) supply flows. These problems mirrored the complaints of officials close to business in Europe and Japan mentioned earlier. Although on the face of it these problems are concerned with demand conditions they are included here on the supply side because access to one (partial, at least) solution is restricted by Government policy. This leads us to another problem cited by exporters.

56. The marketing problems outlined above are not felt by (or are less worrying to) firms which have foreign collaboration (in some form, from ownership to technical agreements) or which are large enough to maintain their own overseas offices and contacts. Government bias against foreign private interests and large Indian concerns, expressed and implemented by restricted licensing arrangements, and strict export obligation requirements, restricts the willingness of such firms to expand capacity or establish new plants aimed at export markets. It also restricts the willingness of foreign investors to enter into collaboration agreements with Indian firms and thus prevents more Indian firms from being able to avail themselves of one way of overcoming some of the marketing problems listed above.

Conclusion

57. The conclusion of this brief examination of the experience of four product groups in India with the GSP schemes is that there is no evidence (yet) that the schemes have increased their orders from, or the prices they obtain in, the GSP granting countries. The reasons which were given for this failure of the GSP to generate a positive trade effect involved factors not considered by the simple preference models which predicted such positive effects. Similarly there was a widespread feeling among the sampled firms that they would not be willing or able to respond positively to any increased demand in rich countries whether such an increase took the form of higher prices or larger orders (or both). The reasons given by the firms for this lack of responsiveness were, again, not among those taken into account by the models so far used to estimate the

effects of the GSP. The results of the field work suggest that the GSP will have little effect because of the factors discussed in Section C. These empirical limitations are in addition to the theoretical limitations set out in the model. It has not been possible so far, due to incomplete data, to estimate the empirical relevance of the model's theoretical limitations. Such superficial evidence as is available, however, suggests that both sets of limitations are relevant in the Indian situation.

58. Further work is obviously required on the theoretical and empirical bases of models used to predict the effects of given changes in the world trading environment on the export prospects of individual poor countries. In particular, further research is required into the environment in which Indian producers make their decisions on whether to, and how much to, export. Various aspects of this research are being carried out in the project on which this paper has been a first, brief progress report.

TABLE 1

INDIA'S EXPORTS OF TEN MAJOR COMMODITIES (AT 4 DIGIT RITC LEVEL) TO UNITED KINGDOM IN 1970 - 71.

S.No.	RITC No.	B.T.N. No.	COMMODITY	1970-71 (Rs. in crores)	% of total exports excluding re-exports
1.	074.1	09.02	Tea Black (leaf and dust), Green, n.e.s. (eg. ball brick, tablet) and waste.	64.87	38.16
2.	121.0	24.01	Tobacco unmanufactured (incl. scrap tobacco and tobacco stems).	16.62	9.78
3.	611.3,4,9	41.02 to 41.08	Leather except reconstituted & artificial leather containing leather or leather fibre.	15.66	9.21
4.	658.2	55.07A&B to 55.09A&B and 58.04A	Cotton piece-goods (mill-made)	12.35	7.27
5.	081.3	23.04 /cake	Oil seed, cake and meal i.e. Expeller oil cake and oil/meal solvent extracted (defatted) oil cake and meal and oil residues except drugs.	8.66	5.09
6.	651.3	55.05A	Cotton yarn and thread, grey (unbleached), not put up for retail sale.	4.10	2.41
7.	892.9	13.03 14.02 to 14.05	Vegetable saps and extracts, pectic substances, vegetable material used primarily in brushes or brooms or as studding, and other materials of vegetable origin, n.e.s.	3.23	1.90

Table 1 contd.

1.	2.	3.	4.	5.	6.
8.	658.6	62.01B 62.02to 62.05	Made up articles wholly or chiefly of cotton, n.e.s. (i.e. bags, and sacks, tarpauline, tents, awning, sails etc. of canvas goods, blankets etc. of cotton, linen and other furnishing articles of cotton and other made up cotton articles n.e.s.)	3.00	1.76
9.	657.6	58.02	Carpets, carpeting and rugs (other than knotted) except of cotton and jute.	2.80	1.65
10.	659.1	57.10	Jute fabrics, woven	2.13	1.25
			Total of above items	123.42	72.48
			India's total exports to U.K. (excl. re-exports).	170.00	100.00

Source :- Monthly Statistics of Foreign Trade of India, Vol. I-Exports, 1970-71.

TABLE 2

INDIA'S EXPORTS OF 10 MAJOR COMMODITIES (AT 4 DIGIT RITC LEVEL) TO EUROPEAN COMMON MARKET COUNTRIES IN 1970-71

S.No.	RITC NO.	B.T.N. NO.	COMMODITY	1970-71 (Rs. in crores)	%of total exports excl. re-exports
1.	667.2&3	71.02B&C	Diamonds (other than industrial) and other pretious and semi-precious stones not set or strung.	14.74	15.02
2.	611.9	41.03to 41.08	Leather from sheep, lambs, goat, kid and chamois dressed and parchment dressed leather, etc., n.e.s.	13.11	13.36
3.	074.1	09.02A	Tea-Black (leaf & dust), Green, n.e.s.(e.g. ball, brick, tablet) and waste.	6.28	6.40
4.	281.3	26.01A	Iron ore & concentrates (except roasted iron pyrites).	4.89	4.98
5.	292.9	13.03, 14.02to 14.05	Vegetable saps and extracts, pectic substances, vegetable material used primarily in brushes or brooms or as studding, and other materials of vegetable origin, n.e.s.	4.31	4.39
6.	896.0	99.01to 99.06	Works of arts collectors' pieces and antiques	3.35	3.41
7.	658.2	55.07 A&B to 55.09 A&B and 58.04A	Cotton piece goods (mill made)	3.00	3.06

Table 2 contd.

1.	2.	3.	4.	5.	6.
8.	657.6	58.02	Other carpets, carpeting and rugs except of cotton & jute.	2.99	3.05
9.	242.3	44.03C & 44.04B	Saw logs and veneer logs, non-conifer (hardwood)	2.25	2.29
10.	651.9	52.01 57.06 57.07 57.08	Yarn of textile fibres spun with or covered with metal, yarn of jute and other vegetable textile fibres and paper yarn.	2.17	2.21
			Total of above items	57.09	58.17
			Total India's exports to EEC 1970-71 (excluding re-exports)	98.15	

Source :- Monthly Statistics of Foreign Trade of India, Vol. I - Exports, 1970-71.