New Guinea Research Bulletin no. 56

# FOREIGN ECONOMIC RELATIONS OF PAPUA NEW GUINEA

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New Guinea Research Unit
The Australian National University
Port Moresby and Canberra
1974

Printed and manufactured in Australia by
The Australian National University

National Library of Australia
card no. and ISBN 0 85818 022 7

Library of Congress catalog
card no. 74-84790

Editor, New Guinea Research Bulletin
**R. J. May**

Manuscript editor
**Shirley Purchase**

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# Preface

Participation in the international division of labour provides the means to realisation of many of the ambitions of the people and government of Papua New Guinea. But at the same time as integration into the international economy provides these opportunities, it presents hazards to political and economic stability and progress. An understanding of the economic and political forces that shape the international economic environment is necessary for realisation of the opportunities and for avoidance of the hazards. This book aims to contribute to that understanding.

The comments of Governor To Robert in Chapter 9 underline one aspect of this aim:

> We cannot afford to forget our size. We in Papua New Guinea are a small country, and we conform to the classic economic test of smallness: that our own economic activities are unable to influence foreign income or interest levels in any meaningful sense...we are basically in the grip of world forces which we cannot influence and have only a limited ability to offset. This means implicitly, I think, that initially at least a lot of our foreign monetary responses are likely to be essentially negative ones: the larger nations with whom we trade or swap capital will in many cases be adopting or making policy decisions irrespective of our own wishes. All we can do is to move within that exogenously-set framework, so far as we are able, to adjust our own policies to minimise any external adverse effects and to maximise any benefits from involvement with other countries.

Some papers in this book focus primarily on the 'world forces' and others on the possible domestic responses. The main focus is on international trade, but the discussion of trade runs inevitably into investment and aid. The first chapter looks at the interrelationships between the growth in world demand for foodstuffs and raw materials and economic change in the various Melanesian economies, and proceeds to discuss the opportunities for regional trade that have emerged from the varied responses of the different Melanesian economies.

The second, third, fourth and fifth chapters analyse developments in the main centres of world trade, which have enormous effects on the economic prospects of Papua New Guinea while being largely beyond the influence of this country. The seventh chapter discusses the opportunities for access to markets in Australia and New Zealand, which are perhaps more amenable to Papua New Guinea policy initiatives. Chapters 6, 8, 9 and 10 discuss domestic policy issues that affect the benefits of involvement in international trade. Finally Chapter 11 seeks to integrate and develop some of the earlier discussion.

The papers contained in this volume were first presented at a seminar in Port Moresby in November 1973, just two weeks prior to Papua New Guinea's accession to self-government. The seminar was attended by a large number of government officials, university staff members and students, all of whom contributed in discussion to the development of the views reported in Chapter 11. In addition to my obvious debt to the contributors, I am especially grateful to the contributions in discussion of Mr John Vulupindi, Mr Meakoro Opa and Mr Dan Buchler.

The seminar was organised jointly by the New Guinea Research Unit and the University of Papua New Guinea. I would like to thank both of these organisations, and also Anthony Clunies Ross, John Conroy, Peter Drysdale and Ron May, for their very considerable assistance in organisation of the seminar. Mrs Jan Grocott, at the New Guinea Research Unit responded cheerfully and efficiently to unreasonable typing requests, and I am very grateful for her help.

The impetus for the seminar was provided by a suggestion of Messrs Emil Joseph and John Warnoch of the then Papua New Guinea Department of Trade and Industry, that the universities could contribute to the development of trade policies for Independent Papua New Guinea. The seminar was financed by the Department of Foreign Relations and Trade, and was well attended by members of that Department. I hope that the seminar itself and this volume have been of some assistance to persons engaged in the formulation of Papua New Guinea policy.

Ross Garnaut

Port Moresby
May 1974

Chapter 1

# The Melanesian economies in the international community*

Ross Garnaut

The Melanesian economies stretch from islands off the western tip of the big island of New Guinea, through the Bismarck and Solomons archipelagos and the New Hebrides, south to New Caledonia and east to Fiji. Similarities in traditional social and economic systems provide justification for considering Melanesia a region.[1] Historically, the whole region comprised tiny settlements, mostly of root crop agriculturalists, separated by great expanses of ocean or mountains or swampy terrain.

Over the past century, and especially over the past two decades, parts of the region have been drawn into very close relationship with the international economy. Differences in

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* In the preparation of this paper, the material on recent developments in eastern Melanesia was brought together with the considerable assistance of Mr Ian Fairbairn, Economist at the South Pacific Commission in Noumea, Mr Savenaca Siwatibau, Secretary for Finance in Fiji, Mr John Yaxley, then Acting Financial Secretary, British Solomons Islands protectorate, Mr Mahe Toupounia, Director, and Mr Ken Piddington, Deputy Director of the South Pacific Bureau for Economic Co-operation, together with many other officials in all parts of the region. The Irian Jaya material draws heavily on earlier work with Mr Chris Manning. The Papua New Guinea material has been generated in the course of a wider project on economic policy in this country, to which much has been contributed by colleagues at the New Guinea Research Unit and the Economics Department, University of Papua New Guinea.

[1] See H.C. Brookfield with Doreen Hart, Melanesia: a Geographical Interpretation of an Island World, Methuen, London, 1971, pp.xliii-xlvi.

the nature of contact with and response to the international economy have produced some complementarity in economic structure and opportunities for trade. But amongst the Melanesian economies there are also many similarities in the response to contact with the international economy and this has contributed to the existence of many common problems in foreign economic relations. Some of these problems can be solved more efficiently through regional co-operation. This paper outlines the nature of Melanesia's contact with the world economy and assesses the opportunities for profitable co-operation within the region.

## The Melanesian populations

The Melanesian region came into contact with the international economy late in the period of European imperial expansion and colonialism has lingered longer than elsewhere. Irian Jaya was the only part of the Netherlands East Indies to be administered by the Dutch after the international recognition of the Republic of Indonesia in 1949. Since the transfer of administration to Indonesia in 1962-63, this large province has undergone traumatic change in the process of integration into the Indonesian economy. Two other parts of the region are also closely integrated into nations with their main centres outside Melanesia: New Caledonia is an Overseas Territory of the French Republic, and the major Torres Strait islands are part of the Australian state of Queensland. Papua New Guinea has experienced several months of internal self-government while the Solomon Islands, with its striking economic similarities to lowland and island Papua New Guinea, follows a constitutional pace or two behind its larger neighbour. Fiji has entered its fourth year of prosperous independence. The constitutional future of the New Hebrides is little more certain than when the Anglo-French condominium began as a temporary compromise nearly seventy years ago. The Torres Strait islands have attracted considerable political interest in recent years, but they are not discussed in detail in this paper because of their small population and economic size.

Melanesia is lightly populated relative to most of the tropical world, and certainly relative to neighbouring countries in Asia and Polynesia. This is an important economic fact, as the region's high per capita natural resource endowment is a key determinant of its comparative advantage in world trade.

Relatively low population density is as much an effect as a determinant of Melanesia's economic relations with the rest

Table 1.1

The Melanesian territories: land area and population

| Country or region | Land area ('000 km$^2$) | Population 1971* ('000) | Annual rate of population increase 1966-71 (%) | Melanesian proportion of total* (%) |
|---|---|---|---|---|
| Fiji | 18 | 531 | 2.3 | 43 |
| Irian Jaya | 415 | 837 | n.a. | 91 |
| New Caledonia | 17 | 120 | 5.0 | 42 |
| New Hebrides | 12 | 84 | 1.9 | 93 |
| Papua New Guinea | 464 | 2,520 | 2.9 | 98 |
| Solomon Islands | 30 | 168 | 2.7 | 93** |
| Torres Strait Islands | 1 | 5 | n.a. | n.a. |

* Most recently published census results.
** The Solomons population at the 1970 census included 2,362 Micronesians and 6,437 Polynesians.

Sources: Brookfield with Hart, Melanesia, pp.1-liv; South Pacific Commission, Statistical Bulletin No.1: Population 1972, Noumea, 1973; Kantor Sensus dan Statistik, Propinsi Irian Barat, Sensus Penduduk 1971, Jayapura, 1972; E.K. Fisk and Maree Tait, 'The Islands are Queensland's', New Guinea, vol.8, no.1, 1973, p.16.

of the world. The late entry of colonialism into Melanesia delayed for more than a century the acceleration of population growth that accompanied the spread of European medical technology in Asian communities from the early nineteenth century. It is somewhat surprising that Melanesia and the rich neighbouring islands of Java-Madura had similar populations 170 years ago,[1] since the population of the latter is nearly twenty times greater today.

[1] Brookfield with Hart (Melanesia, p.67), drawing on N. Macarthur, Island Populations of the Pacific, Australian National University Press, Canberra, 1967, and other sources, estimate the Melanesian population at between 3,000,000 and 3,500,000 at the beginning of the colonial era. Gunnar Myrdal estimates the Java-Madura population at about 4 million in the year 1800 (Asian Drama: an Inquiry into the Poverty of Nations, Penguin, 1968, vol.III, p.435).

The demographic impact of colonial contact in Melanesia was complicated by the region's extreme isolation in earlier times. Exotic diseases contributed to sharp decline in population in the early years of contact in many parts of the region. This process continues today in less accessible areas when sporadic external contact precedes access to modern health services. Natural increase is negative in isolated, sparsely settled valleys of inland Papua New Guinea[1] and probably in extensive areas in southern and inland Irian Jaya.[2]

But despite the existence of areas of high mortality, population is now increasing rapidly in all countries in the region. Natural increase is probably low in Irian Jaya, but immigration from other parts of Indonesia augmented the provincial population by about 2 per cent in 1972 and this rate is likely to be maintained for at least several years.[3] Immigration, especially from Europe and the New Hebrides, also contributed much of the population growth in New Caledonia that is shown in Table 1.1. The very high rates of natural increase observed between 1966 and 1971 in Papua New Guinea and the Solomon Islands are exceeded today, as mortality continues to decline with the extension of health services to more isolated communities. The Solomons and Papua New Guinea are the most rapidly growing Melanesian populations: natural increase in the Melanesian populations of New Caledonia and the New Hebrides is about 2.5 per cent per annum, and in Fiji the natural growth rate has fallen from an explosive 3.33 per cent in 1962 to 2.29 per cent in 1972.[4] A spectacular decline in the Fiji birth rate coincided with a vigorous official program of birth control extension, and was associated as well with the high degree of urbanisation. There is no sign of similar declines in birth rates elsewhere in Melanesia.

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1 R.N.H. Bulmer, 'Victims of progress: the plight of ethnic minorities in underdeveloped areas', M.W. Ward (ed.), Change and Development in Rural Melanesia, The Australian National University, Port Moresby and Canberra, 1972, p.121.

2 Personal communication with health officials in Jayapura and Merauke, October 1972.

3 For discussion of migration of Indonesians to Irian Jaya, see Ross Garnaut and Chris Manning, Irian Jaya, Australian National University Press, forthcoming 1974, Ch.4.

4 Department of Finance, IMF/IBRD Questionnaires - Missions to Fiji July 1973, Suva, Fiji, 1973.

Intense contact with the outside world has altered considerably the composition and the distribution of population. Formal education in complex, modern skills is a recent phenomenon amongst Melanesians and outsiders have filled most managerial and technical tasks in government and business. Low-cost Asian labour was introduced to unskilled employment in Fiji, New Caledonia and Irian Jaya, and French convict labour to New Caledonia. Melanesians are now a racial minority in Fiji and New Caledonia and sustained economic growth led by expansion of investment in natural resource-based industries and in public expenditure is likely to produce a similar result in Irian Jaya.

The distribution of population has shifted in directions favourable to closer integration with the world economy. Accessibility has influenced the location of health services in a very similar way to the location of trade opportunities. The low mortality rates and high rates of natural increase have been concentrated near the ports and road systems, while mortality has remained high in isolated islands and valleys. There has been considerable migration towards export-oriented agricultural employment, especially in Papua New Guinea, and there has been very rapid growth of the towns, all of which are favourably located for and closely integrated into foreign trade.

## Comparative advantage: an historical outline

There are powerful economic reasons for the colonial powers' slight and late interest in Melanesia, which had such important implications for population and economic structure. Transport costs to major world markets for raw materials and foodstuffs were high as a result of the region's isolation and because geographic fragmentation raised internal transport costs and reduced the scale of potential trade from particular points. Although the *per capita* natural resource endowment of the region has been rich relative to other countries, the tropical tree crops that until recently contributed most trade from the less developed countries made intensive use of labour and Melanesian labour was rarely abundant or cheap. Indigenous Melanesian institutions are not easily adapted to commercial transactions and large-scale production for trade was thought to require direct investment in an unknown and difficult environment.

There had for many centuries been a small volume of trade in slaves, plumes and high-value forest products between the western tip of New Guinea and Indonesia, and in the first half of the nineteenth century a steady stream of European adventurers was scouring eastern Melanesia for sandalwood and _bêche-de-mer_. For their part, the Melanesians placed high value on the steel, steel implements, firearms and brightly coloured adornments that they met in their first contact with Europeans. A pattern of economic relationships emerged from the early trade in eastern Melanesia that was to be repeated in every Melanesian territory.[1]

There was high demand for some of the new trade goods and many villagers signed for work on plantations in Queensland, Fiji and New Caledonia and sold land to foreigners at very low prices. But work on the plantations at the low wages that were conventional in tropical colonies was a means to ownership of a few trade goods and not a substitute for life in the village which, with the usual abundance of land, supported a high standard of subsistence life. Even temporary wage employment was unacceptable to villagers close to the nodes of plantation activity, who could use the colonial infrastructure to sell their own crops and to buy trade goods. The labour-intensive industries that were established with foreign capital in some parts of the region relied on migrant labour. The British in Fiji and the French in New Caledonia brought labour from their Asian empires. Melanesians who worked on the plantations or in the mines were usually short-term migrants.

The foreign companies in all the Melanesian territories applied pressure for the introduction of Asian migration when it became clear that local labour supply at the low conventional wages was very limited. However, the Papuan labour market was protected from Asian competition by the new doctrine of White Australia. There was no German empire in Asia and the metropolitan government refused planters' requests for Asian labour recruitment, although workers were brought across the equator from the German Micronesian colony. Indian nationalist resentment stopped new recruitment to Fiji during World War I and blocked moves to use Indians on Solomons plantations in the early twenties. There were no restrictions on labour movements within the Netherlands East Indies to Irian Jaya, but that region was unattractive for plantation agriculture while land was available for expansion of agricultural investment elsewhere in Indonesia.

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[1] See H.C. Brookfield, _Colonialism, Development and Independence: the Case of the Melanesian Islands in the South Pacific_, Cambridge University Press, 1972, for a stimulating and informative history of European contact with the Melanesian territories.

High commodity prices in the rapid expansion of world trade immediately prior to World War I induced rapid expansion on the Fiji sugar plantations and the New Caledonian mines, employing Asian labour. Copra production, less demanding on labour than other plantation crops,[1] was established as a major industry in other parts of the region. At the copra industry's main centre in the Bismarck Archipelago, German planters sought labour further and further afield on mainland New Guinea as local villagers turned to development of their own cash crops.

The interwar period was characterised by slow growth in world trade. Expansion of world tropical agriculture was concentrated in Sumatra, Malaya and other countries with access to relatively low-cost labour. Apart from the New Guinea gold industry there was little new investment in the plantations and mines of Melanesia. There was, however, considerable expansion of smallholder production for export: in Fiji the Colonial Sugar Refinery withdrew from agriculture into extension services, processing and trade, and village copra production increased in the Gazelle Peninsula and near the plantations in the New Hebrides.

A number of major structural changes in the world and regional economies have expanded opportunities for profitable participation in the international division of labour since the Pacific War. The shift in the industrial world's centre of gravity with sustained, rapid economic growth in Japan has favoured production of raw materials and foodstuffs in the western Pacific region. The increasing pressure on world resources has raised the relative prices of minerals, energy, timber and marine foodstuffs, in the production of which the Melanesian territories have natural advantages. Technological change has lowered the cost of large-scale transport over long distances and allowed isolated economies to participate in trade in tourist services and bulk commodities. And the political factors that have made large-scale grants available to governments in Irian Jaya, Papua New Guinea, the Solomons and the New Hebrides have supported public investment in transport and communications infrastructure and lowered the cost of participation in foreign trade.

The reduction in the cost of participation in and production for trade that has been associated with postwar public expenditure has contributed to considerable expansion of village exports, especially in Papua New Guinea. This

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[1] Brookfield, Colonialism, Development and Independence, p.52.

expansion did not occur in Irian Jaya, where the withdrawal of the foreign trading and shipping companies and a breakdown in administration between 1963 and 1969 eliminated cash cropping from villages that were not adjacent to major towns. Worldwide shortages of foodstuffs in the 1973 boom in world trade and high prices for most tropical agricultural products have given a further fillip to village exports.

Despite the growing opportunities for village exports and the recent developments that have favoured production of foodstuffs, the main structural changes in postwar years have favoured the emergence of industries requiring large inputs of foreign management and capital. The realisation of the growing market value of Melanesian resources has coincided with the period of political decolonisation. This has very important implications for the distribution of the benefits of trade and allows Papua New Guineans, Solomon Islanders and Fijians to assess the effects and to limit the extent of foreign integration. The coincidence of political decolonisation and rapid growth in the market value of Melanesian resources makes 'neo-colonialism' a major issue in the early years of independence in all these countries.

## The structure of six Melanesian economies

The traditional Melanesian economies, comprising small villages separated by long distances and difficult terrain and often by problems of language and traditions of warfare, have been transformed in the past two decades. To understand the transformation it is necessary to analyse three types of change: the development of export production from natural resources through foreign investment; the expansion of towns as administrative, commercial and manufacturing centres supplying goods and services to the export enclaves and villages; and changes in village standards through government provision of services and through village specialisation in production of foodstuffs or raw materials for sale to the towns, or through the towns and enclaves to world markets.

Fed by high levels of public expenditure and foreign investment in tourism, mining and other natural resource-based industries, rapid expansion of the towns has drawn labour from the villages in all Melanesian territories. In the absence of satisfactory national accounts for several territories, the level of imports provides an indication of the region's growing integration into the international economy.

Table 1.2

<u>Value of imports, selected years</u>
($A million)*

| | 1962 | 1965 | 1968 | 1971 | 1972 |
|---|---|---|---|---|---|
| Fiji | 36.1 | 60.0 | 70.5 | 115.0 | 135.4 |
| Irian Jaya | n.a. | 18.4 | 13.7** | 26.3 | n.a. |
| New Caledonia | | | 72.6 | 204.6 | 116.5 |
| New Hebrides | 4.8 | 5.5 | 9.1 | 18.1 | 24.0*** |
| Papua New Guinea | 21.4 | 42.9 | 56.5 | 228.3 | 209.8 |
| Solomon Islands | 4.5 | 6.6 | 9.2 | 13.9 | 14.1 |

* Converted from local currencies at 1971 exchange rates, except for Irian Jaya data which are converted at exchange rates current in the year of the transactions.
** 1969.
*** Preliminary.

<u>Source</u>: Various government statistics.

There has been rapid growth in public expenditure in all Melanesian economies since the Pacific War. This has contributed to the provision of services, to the lowering of the cost of both village and capitalist production for trade, and to rising demand for wage labour and rapid urban growth. Postwar public expenditure has been underwritten by high and rising levels of external aid, augmented by foreign borrowing in Papua New Guinea and Fiji.

The importance of external grants in most budgets makes it difficult to predict future trends in public expenditure. Internal revenue is rising rapidly with general growth in Fiji and the 1973 Estimates anticipate much higher levels of foreign borrowing than shown for 1972 in Table 1.3. In addition, Fiji has been building fiscal reserves as a result of cautious policy. It is likely that public expenditure will expand strongly for several years.

In Irian Jaya and New Caledonia, levels of expenditure are determined to a considerable degree independently of local revenue by central government decisions. In the boom associated with expansion of the New Caledonian nickel industry in 1970 and 1971 some public investment was delayed to ease pressure on domestic resources, and there has been considerable expansion since then. In Irian Jaya, public expenditure declined slightly in 1972-73 and is likely to remain fairly

Table 1.3

Public expenditure and source of funds, 1971 or 1972

| | ($A million) | | | | | ($A) | |
|---|---|---|---|---|---|---|---|
| Country | Period to which data relate | Public expenditure | Local revenue | Loans | External grants | Per capita public expenditure | Per capita external grants |
| Fiji | 1972 | 70.9 | 62.1 | 3.7 | 1.9 | 134 | 4 |
| Irian Jaya | 1971-72 | 33.3 | 3.6 | | 29.7 | 40 | 35 |
| New Caledonia | 1971 | 121.7 | 87.0 | | 37.4 | 1,015 | 312 |
| New Hebrides* | 1971 | 10.4 | 4.6 | | 5.7 | 123 | 68 |
| Papua New Guinea** | 1971-72 | 248.8 | 95.3 | 45.4 | 112.4 | 96 | 43 |
| Solomon Islands | 1972 | 11.8 | 5.4 | | 6.5 | 70 | 39 |

* Based on data from the Condominium and British national administration budgets and the assumption that the structure and size of the French national administration budget parallels that of the British.

** Excludes direct expenditure by Australian government departments, including the Department of Civil Aviation and the Department of Defence. Spending by the latter two departments totalled about $A9.5 million and $A25 million respectively in 1972-73.

Sources: Fiji budget papers for 1973; Papua New Guinea budget papers for 1972-73; Garnaut and Manning, *Irian Jaya*, Ch.5; British Solomon Islands Protectorate, *Sixth Development Plan 1971-4:2, Second Annual Review*; Anglo-French Condominium, *Biennial Report 1969 and 1970*.

static in the short term since foreign grants will decline with the conclusion of the Fundwi program this financial year. But by the end of this decade additional revenues from resource projects already in operation or under construction will exceed greatly the current external subsidy to the province. Income tax from the mining projects will be paid to the central government in Jakarta, but it is possible that Irian Jaya's increased contribution to national finances will be reflected in increased grants to the province.

Internal revenue declined in both Papua New Guinea and the Solomons in 1972-73, but will grow strongly in future with contributions from mining, forestry and fisheries projects. The growth is more certain in Papua New Guinea, where the Bougainville project alone is likely to contribute over $100 million per annum later in the present decade. Papua New Guinea is entering Independence unusually dependent on foreign borrowing, and revenues will need to expand by about $30 million over the next decade merely to cover the increased debt servicing burden. The rate of growth of total Papua New Guinea and Solomons expenditure depends on whether and at what rate foreign grants are reduced with expansion of domestic revenue.

## Recent developments in the resource-based industries

Foreign investment in resource-based production for export has been the second major source of monetary sector growth. Different industries have been centres of major investment in different territories: tourism in Fiji; mining in Irian Jaya, New Caledonia and Papua New Guinea; tourism and commerce in the New Hebrides. There have also been significant investments in fishing, forest industries and tourism in most countries in the region.

Tourism is now Fiji's largest export industry in terms of gross earnings. It has risen from insignificance over the past decade, as shown in Table 1.4.

Gross receipts from tourism in Fiji totalled $38.2 million in 1972.[1] A recent report prepared under the auspices of the United Nations Development Program (UNDP), World Bank (IBRD) and the Government of Fiji projected visitor arrivals to a staggering 800,000 by 1981.[2] Eighty per cent of $F26 million

[1] Corrected version of replies to IBRD/IMF questionnaire.

[2] UNDP, IBRD and Government of Fiji, Tourism Development Programme for Fiji, Suva, 1973, referred to in answers to the IBRD/IMF questionnaire, Suva, 1973.

Table 1.4

Visitor arrivals, selected years
('000)

| | 1962 | 1965 | 1968 | 1971 | 1972 |
|---|---|---|---|---|---|
| Fiji | 18.3 | 40.1 | 66.5 | 152.2 | 165.6 |
| New Caledonia | | | 17.0 | 14.4 | 12.0 |
| New Hebrides | | | 6.0 | 17.8 | 19.4 |
| Papua New Guinea | | | 23.6 | 39.3 | 37.4 |
| Solomon Islands | | | 0.6* | 3.9 | 4.3 |

Note: Tourism to Irian Jaya is at present negligible.

* This figure from Sixth Development Plan, p.88, seems to be inconsistent with data presented in the Second Annual Review, p.30.

Sources: Various government statistics.

total long-term private capital inflow into Fiji in the year to June 1973 was for investment related to tourism.[1] The tourist industry provided 20 per cent of wage jobs in 1973 and was expected to provide 42 per cent of a much larger total in 1981. The greater part of investment in tourism has originated in the United States or Australia. In addition to the developments in tourism, a new tuna fishing and processing industry established by Japanese interests in the mid-sixties contributed about $6.5 million or 10 per cent to total commodity exports in 1972. Sugar continues to dominate domestic commodity exports, accounting for over two-thirds the total. The value of sugar exports has increased strongly every year since 1966 under the influence of favourable market conditions. The Fiji Sugar Corporation, owned by the Fiji government, purchased the assets of the Australian Colonial Sugar Refinery in April 1973 at the request of the company and so eliminated major foreign investment from the industry.

Mining has led the boom in export-oriented, resource-based investment in Irian Jaya. A copper mine yielding about 75,000 tons per annum of contained copper valued at over $100 million at present prices commenced production near Kokonau on the south coast late in 1972. Construction began in 1973 on a

[1] Personal communication, Secretary for Finance, Fiji, August 1973.

nickel mine and refinery at Gag Island near Sorong. A total investment of $US550 million is anticipated. It seems likely that a major oil field has been discovered near Sorong: a number of exploratory wells have yielded good flows, and one well has yielded 20,000 barrels per day. The last two years have seen the beginnings of large-scale fisheries investments, and foreign interest in timber investment quickened in 1973 as a result of high world prices. American investment has been dominant in mining and in petroleum and mineral exploration and Japanese investment in fishing.

The Papua New Guinea natural resource base resembles that of Irian Jaya, except that Papua New Guinea is considerably better endowed with agricultural land. The copper and gold mine on Bougainville has been the main source of monetary sector growth in Papua New Guinea since 1968-69. Investment in establishment of the mine was close to $400 million. Production this financial year is projected at 185,000 tons of copper in concentrates and over 20,000 kilograms of gold, valued at over $260 million after processing costs at current prices. It is likely that a mine at about half Bougainville's capacity will be established in the Western District after negotiation of mutually satisfactory conditions of access to the resource by the prospecting company and the government. Expenditure on mineral exploration is currently running at about $5 million per annum, as five further copper and nickel prospects are investigated.

There are strong indications that Papua New Guinea is as rich in energy as in mineral resources. There are good prospects for the export of natural gas from the Gulf of Papua and $11 million will be spent on petroleum exploration in 1973-74. The high rainfall and the steep fall from the southern edge of the highlands provides an unusually favourable environment for the generation of hydro-electric power. The total potential of seventeen sites investigated on the Purari River is estimated at 10,000 Mw and the potential of the Kikori system is estimated at 6,000 Mw. The Australian and Papua New Guinea governments commenced discussions on the possibility of joint development of the Purari resource early in 1973. Development of natural gas exports or the first stage of harnessing the Purari's power would have an impact on the economy similar in magnitude to the establishment of the Bougainville mine.

Exploitation of the timber and fish resources of Papua New Guinea will have less impact on government revenue and the domestic economy than investment based on the mineral and energy resources. But these resources are considerable and have contributed to expansion of monetary sector activity at a time when there has been little new activity in the potentially larger industries. The value of exports of timber in log or processed form rose from $4.9 million in 1968-69 to $10.6 million in 1972-73, and will double again to $20.9 million in 1975-76 on conservative price assumptions. Sustained yield of many times the latter figure is feasible with reafforestation. Exports of marine products rose from $0.4 million in 1968-69 to $6.3 million in 1972-73, and will rise to $16.4 million by 1975-76 on conservative price assumptions. Japanese investment has generated most of the increased output from the timber and fishing industries.

Like Irian Jaya and Papua New Guinea, the Solomons has opportunities for profitable investment in mining, timber and fisheries and like Papua New Guinea it provides opportunities for large-scale investment in export-oriented agriculture and tourism. The large Japanese company Taiyo established a tuna fishing industry in 1971. In 1972, exports of 12,000 tons were officially valued at $3.6 million. A cannery was established in August 1973 and will handle the greater part of future tuna exports. Four large Japanese, Australian and British-backed firms commenced the export of logs in the mid-sixties and exports were valued at $3.3 million in 1971. A slump in the Japanese market caused the value of exports to fall to $2.6 million in 1972, despite increased volume. Destruction of large areas of valuable forest in a cyclone in late 1972 has prevented the industry taking full advantage of the high timber prices of 1973. There are prospects for the establishment of small bauxite mines at Rennell and Wagina islands. The other major resource project is palm oil production near Honiara, where a company with British majority holdings has planted over 2,000 acres.

The nickel mines and smelter in New Caledonia represent an investment similar in magnitude to the Gag Island and Bougainville projects and they dominate the island's economy. The French firm Société le Nickel has been the major producer since late last century. The nickel ore resource is extremely large and production has been constrained only by markets and the availability of capital. In response to buoyant nickel prices in the late sixties, exports of contained nickel rose from 52,000 tonnes in 1965 to 120,000 tonnes in 1970, valued at about $158 million in the latter year. New investment lifted smelting capacity from 40,000 to 80,000 tonnes of metal in this period. From 1970, restrictions and taxes on unrefined ore caused total exports of contained nickel to fall, but the value of exports was almost maintained in 1971 because a higher proportion of exports was in metal form. Several companies have expressed interest in major investments in the industry. The Canadian International Nickel Company has announced proposals for $US275 million investment in developing lateritic ore deposits on the south coast, and a consortium of French and American interests has also submitted plans based on this resource. The French government is uneasy about 'foreign' control of a major part of the industry and has delayed decisions on this project. Under the French Sixth Plan, a major new nickel refinery in the north was due to be completed by French interests with Japanese financial backing in 1972. The financial arrangements did not materialise and low world nickel prices in 1971-72 encouraged delays. Each of the two planned extensions of the industry involves investment of a similar magnitude to the existing industry based on Noumea.

The value of commodity exports from the New Hebrides trebled in the decade to 1972, largely through the development of a long-line tuna fishing industry by Japanese, Korean and Taiwanese interests. Fish accounted for $9.0 million of a total $12.1 million exports in 1972. There was also considerable commercial investment in Vila associated with the territory's growing use as a tax haven, and investment in services for the rapidly expanding tourist trade, as suggested in Tables 1.2 and 1.4.

## The emerging Melanesian economies

It remains to assess the effects of the high level of public expenditure and investment in resource projects on the overall structure of the Melanesian economies. There has been rapid expansion of non-agricultural wage employment and, as a consequence, rapid urbanisation.

Since 1971, urban growth seems to have accelerated in Fiji, Irian Jaya and the New Hebrides, and to have declined in New Caledonia and in Papua New Guinea with the dampening of the mining booms. Deviations from past trends are less apparent in the Solomons.

Three types of response to the high recent levels of public expenditure and private foreign investment can be identified. In Irian Jaya, restoration of completely free immigration from other parts of Indonesia in 1969 has created an economic system similar to Fiji and New Caledonia in the period of export expansion immediately preceding World War I, with increased demand for labour being reflected in immigration rather than in increased wages. In Fiji, New Caledonia and the New Hebrides, rapid expansion in the demand for wage labour has caused workers'

Table 1.5

<u>Wage employment by sector, selected years</u>
('000)

| | Fiji 1963 | Fiji 1971 | New Caledonia 1967 | New Caledonia 1972 | Papua New Guinea 1964 | Papua New Guinea 1971 | Solomon Islands 1963 | Solomon Islands 1972 |
|---|---|---|---|---|---|---|---|---|
| Agriculture | | | | | 37.7 | 39.8 | 3.2 | 2.3 |
| Fishing | | 3.8 | 0.6 | 0.8 | 0.0 | 0.4 | 0.0 | 0.2 |
| Forestry and logging | | | | | 2.1* | 4.4* | 0.2 | 1.0 |
| Mining and metallurgy | | 1.9 | 4.7 | 6.0 | 1.4 | 2.2 | 0.0 | 0.2 |
| Manufacturing | | 10.0 | 1.5 | 4.4 | 1.9 | 8.9 | 0.3 | 0.8 |
| Service industries | | 41.5 | 11.3 | 23.1 | 37.2** | 90.0** | 6.2 | 10.0 |
| Total | 29.1 | 56.2 | 18.3 | 34.3 | 80.3** | 145.7** | 10.0 | 14.5 |
| Total male population aged 20-59 | | 113.0 | | 31.0 | | 600.0 | | 36.0 |

* Includes sawmilling and timber manufacture.
** Excludes armed forces and domestic service.

<u>Sources</u>: Various government publications.

Table 1.6

Urban populations, 1966 and 1971
('000 and %)

| | Fiji | Irian Jaya | New Caledonia | New Hebrides | Papua New Guinea | Solomon Islands |
|---|---|---|---|---|---|---|
| Urban population ('000) | | | | | | |
| 1966 | 157 | 48.6* (1961) | 47 | 9.5 | 129 | 10 |
| 1971 | 182 | 116.0** | 71 | 14.5 | 247 | 17 |
| Proportion of total population in urban areas (%) | | | | | | |
| 1966 | 33 | 6* (1961) | 50 | 12 | 6 | 7 |
| 1971 | 34 | 14** | 59 | 17 | 10 | 10 |
| Growth rate of urban population 1966-71 (%) | 3 | 14*** | 8.5 | 9 | 14 | 11 |

* Five main towns.
** Five main towns, including Abepura as part of Jayapura.
*** Based on rough estimate of the 1966 urban population.

Source: South Pacific Commission, Statistical Bulletin No.1, 1972; Garnaut and Manning, Irian Jaya, Chs.2 and 4.

incomes to rise and has contributed to a fall in the value of some agricultural production. In Papua New Guinea and the Solomons the recent expansion of the modern sector has been insufficiently large in relation to the total village labour supply to generate similar increases in the full employment wage level.

The greater part of recent expansion in the Irian Jaya economy has occurred in the northern towns, where wages have settled at levels close to the highest in Indonesia, but lower than elsewhere in modern Melanesia. In late 1972, labourers' wages in Jayapura were 80 cents to $1 per day, in other northern towns about 60 cents per day and in Merauke and Agats in the south only 20 cents per day. The cost of living for persons on low incomes is similar to that in, say, Rabaul, Lae or Madang but food costs are lower than in Port Moresby. The consumption standards supported by wage labour in Irian Jaya are too poor to attract workers from the villages, except temporarily to allow the purchase of a few highly valued trade store goods.

In colonial times, coastal and lowland river villages in Irian Jaya were connected to the towns by subsidised, regular shipping, but these services broke down in the early years of Indonesian administration and have been restored only between larger centres. Transport from the inland has always been difficult. Problems of transport and business organisation have caused village exports to fall markedly, from about $US2.2 million in 1960-61 to $US0.9 million in 1971. Poor communications, expensive transport and limited cash-earning opportunities in the villages limit severely opportunities for migration to the enclaves and towns for short-term employment. On the other hand, the supply of vegetables and fish from villages immediately adjacent to the towns has increased impressively over the past few years. Only Melanesians who own land close to the towns and mines and the very small number who qualify for more highly paid employment by climbing successfully the formal education hierarchy participate in the rapid expansion of monetised economic activity.

The longer-term prospect is for continued urban growth at a faster rate than elsewhere in Melanesia, with immigration from other Indonesian provinces contributing most of the urban population increase. Poor transport links between the new towns and villages will inhibit the growth of local food supplies in response to increased demand, and the province's heavy dependence on imports is likely to continue. Irian Jaya possesses in an extreme form the problem of every Melanesian territory: a very large number of persons in isolated locations can achieve higher standards of living only through subsidised government programs directed specifically at raising village welfare. As yet, only a tiny proportion of public expenditure has been allocated to such programs.

After Asian recruitment to New Caledonia ceased with the Pacific War, continued expansion of the money economy caused wages to rise from the subsistence levels that had prevailed. Annual average weekly earnings rose steadily from about $1,000 in 1962 to $1,800 in 1965 and $2,000 in 1968 and then sharply to about $3,000 in 1971.[1] Statutory minimum wages in agriculture rose from about 50 cents per hour in mid-1969 to 75 cents in mid-1972, while the general minimum rose from about 55 cents to 90 cents. Wage and salary earners but not village farmers received family allowances, valued at about $32 per month in early 1972 for a man with two children.

Both settler and Melanesian agriculture have contracted with rising costs and widening alternative opportunities for labour. Despite support programs that guarantee high and increasing prices, coffee production fell from 2,000 tonnes in 1957 to 1,089 tonnes in 1970 and 1,061 tonnes in 1971, and copra production fell dramatically from 1,392 tonnes in 1970 to 430 tonnes in 1971. Between 1970 and 1971 production of maize, yams, sweet potato, potato and fruit fell markedly. Amongst agricultural commodities, only production of green vegetables rose in 1971. Meat production, making fewer demands on labour, expanded from 22,490 tonnes to 23,280 tonnes. Imports of foodstuffs rose from $23 million in 1970 to $31 million in 1971, $17 million for the first six months of 1972 and $20 million for the first six months of 1973. Rising costs also caused decline in the tourist industry and in mining other than nickel.

The Melanesian New Caledonians have been involved in the wage economy principally as labourers and average earnings are very low compared with Europeans, Asians and even immigrant Polynesians. Many Melanesians use the town and the mines for short-term employment, despite the fact that the French administration has relied heavily on integration into the money economy as a means of raising Melanesian welfare. People on the reserves derive relatively little benefit from the very large public expenditures.[2]

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[1] Nouvelle-Calédonie et Dépendences, Annuaire Statistique de la Nouvelle Calédonie 1972, Noumea, 1973, p.105.

[2] For a discussion of the distribution problem, see John T. Macrae, 'New Caledonia: a summary of recent economic developments with special reference to Le Problème Mélanésien' (mimeo), Auckland University, 1973.

Wages and salaries would have grown at an even more rapid rate but for large-scale immigration into New Caledonia. Net immigration totalled 2,897 in 1969, 5,716 in 1970, 4,361 in 1971, and 488 in 1972. Skilled labour was drawn mainly from France and unskilled workers from other Pacific islands. An estimated 2,500 New Hebrideans were resident in the territory at the end of 1970, but since then the number of persons returning from the New Hebrides has exceeded new arrivals.

The commencement of the construction of either one of the proposed new smelters would recreate rapidly the boom conditions of 1969 to 1971. The development of new urban centres with new smelters at the south and north of the island would draw from the agricultural sector much of its remaining labour.

The New Caledonian boom was felt in the New Hebrides through increased demand for labour and, to a much lesser extent, demand for foodstuffs. Since the end of 1970 the return to the New Hebrides of some workers has been easily absorbed because commercial and tourist investment in Vila has generated rapid growth in wage employment. By mid-1973, rural wages were over $15 per week and urban labourers' wages somewhat higher. The copra plantations could not compete for labour and production was almost eliminated. Smallholder production was better maintained and accounted for most copra production in the New Hebrides by 1972. As in New Caledonia, the beef industry expanded through the period of rising wages since it used labour much less intensively.

Table 1.7

Export of copra and coconut oil, selected years
('000 tonnes)

| | 1962 | 1965 | 1968 | 1971 | 1972 |
|---|---|---|---|---|---|
| Fiji | 25.0 | 21.0 | 17.2 | 16.6 | 14.9 |
| Irian Jaya | 5.4 | 4.4* | 2.1** | 1.8 | |
| New Hebrides | 31.4 | 28.7 | 34.3 | 34.0 | 18.3 |
| Papua New Guinea | 105.9 | 112.8 | 110.0 | 141.4 | 134.9 |
| Solomon Islands | | 24.5*** | 20.5*** | 26.2 | 20.6 |

* 1966.
** 1969.
*** Production. Virtually all production is exported.

Sources: Various official statistics.

The New Hebrides is a very small economy, and continuation for a few years of high levels of investment in commerce and tourism or return to boom conditions in New Caledonia are likely to establish an economic structure very similar to that in the rich neighbouring territory. The pattern of future economic development will be set before constitutional development has given Melanesians a significant voice in policy-making.

Fiji is the third country in the region where the growth in demand for wage labour is outstripping supply and generating pressures for large increases in incomes. Although clearly led by the tourist sector, the modern sector boom is more broadly based than in the New Hebrides or New Caledonia. Rising wages have contributed to price inflation, especially in the non-trade sector. The Fiji government has expressed concern at effects of inflation on income distribution, especially between rural and urban areas, and has introduced an ambitious prices and incomes policy.

The period since Independence has been marked by dramatic growth in gross domestic capital formation: GDCF grew by 31.9 per cent in current prices (24.2 per cent in constant prices) in 1971 and, from the new high levels, by 21.2 per cent in current prices (5.4 per cent in constant prices) in 1972. Total wage and salary employment rose by 8.95 per cent from 51,590 to 56,210 between 1970 and 1971, and by 3.89 per cent from 56,210 to 58,399 between 1971 and 1972. At the same time, prosperity in the heavily populated sugar producing areas tended to raise the supply price for wage labour.[1]

Urban unemployment appears to have been slight.[2] Daily mean wages rose by 10 per cent in 1971 and 12 per cent in

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[1] The London Daily Price, at which half total exports are sold, has risen from £22 in 1968 to £34 in 1969, £40 in 1970, £46 in 1971, £73 in 1972 and well over £100 from the second half of 1973. Growers' incomes rose as well through the introduction of a new basis of determining cane prices in 1970.

[2] See Prime Minister's Working Party on Unemployment, Unemployment in Fiji, Suva, September 1972. A sample survey in Suva and Lautoka showed 7.4 per cent of the urban work force and 6.5 per cent of the male work force to be unemployed in January 1972. Nearly half the 'unemployed' had never looked for a job and 80 per cent were less than 25 years old. Given the frictions in a labour market like Fiji's, these rates of unemployment seem very low.

1972 to about $3.00, and salaries rose at a slightly faster rate. The price level has risen sharply, partly in response to service industries passing on cost increases and partly through the effects of overseas inflation compounded by devaluations against the currencies of major suppliers. Fiji has twice revalued against sterling since the 1971 international monetary crises, but the parity of the Fiji dollar in late 1973 represented a 20 per cent devaluation against the Australian dollar since late 1971. The Fiji dollar has continued to float downwards with the pound sterling. Partly as a result of the implicit devaluations, inflation has proceeded more rapidly in Fiji than in other Melanesian territories.

Table 1.8

Consumer price indexes, 1970-72

| | Food | | | All items | | |
|---|---|---|---|---|---|---|
| | 4th quarter | | | 4th quarter | | |
| | 1970 | 1971 | 1972 | 1970 | 1971 | 1972 |
| Fiji | 100 | 107.1 | 129.1 | 100 | 106.9 | 119.2 |
| New Caledonia | 100 | 108.3 | 115.0 | 100 | 108.2 | 115.6 |
| New Hebrides | 100 | 106.4 | 118.1 | 100 | 105.4 | 114.5 |
| Papua New Guinea | 100* | 106.9 | 110.8 | 100* | 104.5 | 109.6 |
| Solomon Islands | 100 | 110.0 | 114.1 | 100 | 106.8 | 108.1 |

* First quarter 1971 = 100.

Source: South Pacific Commission, Retail Price Indexes 1972, Noumea, 1973.

Supply problems in the aftermath of a cyclone contributed to the rise in Fiji food prices in late 1972 and the food index stabilised between December 1972 and April 1973. However, price increases in other commodities accelerated. In response the government introduced a prices and wages freeze from 1 April to 30 June and maintained tight controls through 1973.

The Fiji prices and incomes policy warrants careful study elsewhere in Melanesia. This is not the place for a detailed assessment of the policy. However, the Fiji experience does demonstrate the problems associated with maintaining tight controls on the market, including commodity scarcities and greatly increased industrial unrest. In seeking to control tightly the growth in incomes, Fiji may be denying itself some of the benefits of large-scale foreign investment and productivity growth without diminishing the costs.

It is likely that strong growth in real incomes can be maintained in Fiji. There is scope for considerable expansion in public expenditure: there are prospects for strong revenue growth since Fiji has yet to extract through fiscal policy many of the tourist industry's rents of favourable location, and recent accumulation of reserves and under-utilisation of borrowing capacity and aid suggests further opportunities for expansion of expenditure. The decline in population growth will free resources from expansion of education and other community services and, in the longer run, contribute to some diminution in the growth of labour supply.

Equity in income distribution in Fiji has been a major objective of policy since Independence, with the distribution between Fijians and other racial groups being of principal concern. But relatively little of the increased prosperity since Independence has been channelled through the Budget or by other means to Fijian groups in isolated locations. Some government effort has been focused on improvement in isolated villagers' capacity to trade with the major centres in Fiji and with the external world, especially by freight subsidies. However, the dominant strategy has been the rapid creation of wage employment so as to absorb the increasing numbers of school leavers in both rural and urban areas. It is not yet apparent whether the strategy will lead to a wider spread of the benefits of growth than it has in New Caledonia.

It is more difficult to assess the directions of change in the Papua New Guinea and Solomons economies, since there are many economic policy unknowns. The new governments in both countries have doubts about the strategies of promoting rapid growth that they have inherited and which are being followed elsewhere in Melanesia. But there are also strong pressures for increased incomes and it is not certain how the conflict of objectives will be resolved.

The pressures for incomes growth are less intense in the Solomons where the demonstration of expatriate consumption standards has been less overwhelming[1] and where there has been very much less investment in secondary and tertiary education.[2]

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[1] At the 1970 census there were 1,280 Europeans and 577 Chinese in the Solomons.

[2] In 1972 there were 1,321 secondary school students, and secondary school intake was not expected to expand for several years. By comparison, there were 27,681 secondary school enrolments in Papua New Guinea in 1973 and the number is expected to rise to 31,481 in 1974.

There has been a reduction in the size of the Solomons public service over the past few years and there were only 200 expatriate public servants in August 1973. The Solomons administration has not encouraged tourism, and political leaders have expressed distaste for what they have seen of the industry in other countries. There is also ambivalence about large-scale foreign investment following the recent establishment of the palm oil and tuna fishing industries. This ambivalence is likely to inhibit investment in resource projects, including the extension of tuna fishing to long-line techniques and the establishment of mining industries, while policies are being formulated. There has been less expansion of wage employment in the Solomons than elsewhere in Melanesia. Pressure on land resources on the island of Malaita and the high cost of participation in trade from smaller islands has maintained the supply of wage labour, and wage rates are low. In August 1973, the minimum wage, covering six occupations in Honiara, was $18.50 per month. There is no statutory minimum elsewhere and agricultural wage rates range from about 50 cents per day.

The decline in employment on the dispersed coconut plantations and the importance of public expenditure and agricultural and fisheries investment near Guadalcanal in the generation of new employment has tended to centralise modern sector economic activity in and around Honiara. This and the localisation of the public service has spurred the growth of Honiara town. However, village food supply to Honiara, mainly from neighbouring areas on Guadalcanal, seems to have kept pace with the growth of the town.

In some parts of the Solomons there are strong demands for small-scale village development, and the satisfaction of this demand requires expansion of public expenditures. The British government has stated that high levels of aid will be available for capital works projects but that budgetary support, currently running at nearly $2 million per annum, should be eliminated by the end of the next Development Plan. If the British insist on this approach very rapid growth in revenues will be required to maintain existing services and to meet the electorate's demand for village development, which contains a high proportion of 'recurrent' public expenditure. The revenue must come from the natural resource projects.

Efficient development of the palm oil, fishing and timber industries and the effective appropriation of the economic rents from them should provide the required growth in revenue without encouragement of investments that require a very much more intense presence of high income expatriates relative to their revenue contribution. But it is technically and administratively difficult to extract the rents from natural resource projects. The Solomons government relies heavily on an export tax on whole fish for revenue from the tuna fishing project and has found that it has given away much of the potential revenue as incentives for local processing.

The Solomons government will face a difficult choice once it has met its minimum revenue requirements. At this point the government could probably set the economy on the path to rapid incomes growth along the lines of other Melanesian economies, through utilisation of the foreign aid that will be available for capital works and through encouragement of tourism and other less outstandingly profitable areas of investment. The Solomons' choice is likely to be influenced strongly by the success of Papua New Guinean efforts to blend equity in income distribution with incomes growth.

The Solomons' doubts about large-scale investment and growth are shared by many members of the Papua New Guinea government, but there are stronger countervailing pressures in the larger country. Two of these pressures will have very important effects on policy decisions. First, much of the political concern in economic policy has related to disparities in incomes between Papua New Guineans and the expatriate community, which peaked at over 56,000 in 1971. Demands for the raising of Papua New Guinean consumption standards led to an increase in the urban minimum wage from $8 to $13.80 per week between September 1972 and September 1973. Second, very high rates of expansion in secondary and tertiary education raised expectations about access to education which the government has tried to fulfil, and expansion has continued at as rapid a rate since the commencement of national government. The high urban wages and the education policy can be validated only by very rapid modern sector growth, premised on high levels of foreign investment in the resource-based industries.

Gross monetary sector product fell slightly in real terms in both 1971-72 and 1972-73. The monetary sector workforce fell from a peak of 338,000 in 1970 to 324,000 in 1971 and 322,000 in 1972. This decline in modern sector activity was associated with the conclusion of construction on the Bougainville project, low commodity prices in 1971 and 1972 and business uncertainty in the transition to self-government. However, real incomes of Papua New Guineans rose despite static national product as localisation of the economy accelerated (total expatriate numbers fell from 53,000 in mid-1971 to 46,000 at the end of 1972 and about 35,000 at the end of 1973) and Papua New Guinean wages rose.

There was static production in real terms in most industries in 1971-72 and 1972-73. The very low timber prices of 1971-72 inhibited investment in the forest industries. The expansion of the fishing industry was checked by an unusually poor season in 1972. Agricultural employment fell with the poor commodity prices. The real value of manufacturing output was maintained in 1971-72, but fell in 1972-73 because export demand fell for sawn timber, plywood and other products of the processing industries. There was also a decline in total tourist expenditure. However, the decline in tourist arrivals in 1972-73 observed in Table 1.4 obscures an increase by 25 per cent in holiday tourists. The decline is more than fully accounted for by the reduction in business visitors. There are no adequate statistics on village food supply to urban markets but there seems to have been a very considerable improvement in supply in recent years.

Commodity prices returned to high levels in 1973, reaching all-time peaks for most important export commodities. Foreign investment in the modern sector was resumed, largely in the timber, fishing and tourist industries, and buoyant revenues contributed to an 18 per cent expansion in public expenditure in money terms in the 1973-74 Budget. Village incomes have risen strongly with high commodity prices and increased government grants for local projects, and the lifting of the economic clauses of the International Coffee Agreement has allowed an acceleration of agricultural investment in many highlands areas. Continuing increases in the relative price of high-protein foodstuffs including meat seem very likely and there is little prospect of a major retreat from the current high relative prices for basic foodstuffs. Relative to residents of other parts of the world and especially to the manufacturing worker, the villager who can produce his food requirements with a small proportion of the labour time available to him is becoming more wealthy. The total standard of living that the village can provide depends on the availability of opportunities for profitable use of time that is not required for subsistence production in the village. The latter proviso contains a major challenge to future planning in Papua New Guinea.

The future incomes of the many Papua New Guineans who have left wage employment depend on the balance that is struck between villagers' demands for wage jobs, as modified by government assistance to the villages, and the supply of modern sector employment. There will be many emigrants to the modern sector with continued population growth in the few areas where there is pressure on land resources, and perhaps a quarter of the total population lacks access to opportunities for trade and so relies on emigration or external grants for access to modern services and manufactured goods. The current level and pattern of public expenditure and modern sector activity cannot sustain the high urban wage levels without high levels of urban unemployment. But rapid expansion of the resource industries and village-focused public expenditure could validate existing and increased urban incomes within a few years, at the cost of a very large presence of high-income expatriates. The Papua New Guinea government must decide how far down the list of possible foreign investments, into projects yielding less taxation returns, it is prepared to go to raise Papua New Guinean incomes. However, the existence of resources that could yield very high rents suggests that substantial incomes growth is possible without encouragement of investments which require a very high expatriate presence for a given contribution to incomes growth, such as the tourist industry and protected manufacturing. There is a wide range of choices between Solomons and Fiji-type incomes and patterns of life, and with careful management the high-incomes choice may be available to Papua New Guineans at lower social cost.

## Regional co-operation

The economic history of each Melanesian territory can be written with little reference to other parts of the region. Opportunities for foreign trade are determined in a wider world and have been realised through investment by Australian, French or American companies or through grants from governments in Canberra, Jakarta, Paris or London.

Self-government in Fiji and Papua New Guinea has assisted the growth of some sense of regional identity, and the Indonesian and Australian governments have reacted sympathetically to this development. The French reaction has been more cautious, but there has been no French withdrawal from the intensification of regional contacts. Relations with economic centres outside the region continue to dominate the pattern of economic change in Melanesia, but there are opportunities for profitable regional co-operation. Realisation of these opportunities can raise regional benefits from external trade, aid and investment.

The growth in regional trade is limited by similarities in economic structure and patterns of export specialisation. However, some complementarity derives from differences in historical specialisation in production of particular commodities. And the different approach to development that is emerging in Papua New Guinea and the Solomons may foster new areas of complementarity and especially encourage trade in foodstuffs.

Economies of scale in shipping and communications give small, neighbouring economies special advantages in each other's market.[1] The prices obtained by exporters rise or the prices paid by importers fall with the utilisation of opportunities for regional trade provided that the total volume of potential trade is sufficient to justify frequent, relatively large-scale shipping, and provided that regional trade does not divert exports from protected, high-price markets outside the region.

Trade continues to flow in its historical channels long after these cease to be economically efficient. Shipping is more frequent and freight rates relatively lower on high-volume traditional trade routes. It is expensive to pioneer new trading routes and many of the benefits from pioneering effort do not accrue to the firms which bear the expense. There is greater trust between firms with an established trading relationship and consumers know the brands and characteristics of products from traditional sources. The traditional ties favour relatively intense trade between Australia and Papua New Guinea, the Solomons, the New Hebrides and Fiji, and between France and New Caledonia.

Levels of regional trade have changed very little over the past two years, but the relative importance of external trading partners has changed significantly, especially through the growth in trade with Japan. Of $194.9 million total exports from Papua New Guinea in the ten months to April 1973, Australia purchased $36.8 million, the United Kingdom $8.3 million, the Federal Republic of Germany $44.4 million, the United States $9.4 million and Japan $64.9 million. Exports to Melanesian territories totalled $1.2 million or less than one per cent of the total, of which only $0.2 million, mostly to the Solomons, represented domestic exports. Of $194.9 million imports in the same ten months, Australia supplied $102.6 million, Japan $31.7 million and the United States $18.1 million. Imports from the Melanesian territories totalled only $0.03 million.

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[1] These questions are discussed further in Ross Garnaut, 'National objectives and the choice of industries' in A.I. Clunies Ross and J.V. Langmore (eds), Alternative Strategies for Papua New Guinea, O.U.P., Melbourne, 1973.

Table 1.9

Sources of foreign imports, 1970
(%)

| | Australia and New Zealand | Enlarged EEC | North America | Japan | Other Melanesia |
|---|---|---|---|---|---|
| Fiji | 36 | 21 | 6 | 15 | 0 |
| Irian Jaya* | 11 | 4 | 45 | 19 | 0 |
| New Caledonia | 15 | 67 | 7 | 2 | 0 |
| New Hebrides | 46 | 25 | 2 | 4 | 4 |
| Papua New Guinea | 55 | 10 | 12 | 12 | 0 |
| Solomon Islands | 48 | 16 | 10 | 7 | 1 |

* 1971 data. The high North American share reflects direct shipment of supplies and equipment to the copper project at Kokonau.

Source: UN/UNCTAD, South Pacific Regional Transport Survey, July 1972; Garnaut and Manning, Irian Jaya.

Table 1.10

Destination of foreign exports, 1970
(%)

| | Australia and New Zealand | Enlarged EEC | North America | Japan | Other Melanesia |
|---|---|---|---|---|---|
| Fiji | 16 | 32 | 27 | 4 | 1 |
| Irian Jaya* | 0 | 0 | 0 | 64 | 0 |
| New Caledonia | 1 | 44 | 6 | 49 | 0 |
| New Hebrides | 3 | 44 | 36 | 13 | 4 |
| Papua New Guinea | 45 | 32 | 12 | 9 | 0 |
| Solomon Islands | 16 | 31 | 0 | 53 | 1 |

* 1971 data.

Source: UN/UNCTAD, South Pacific Regional Transport Survey, July 1972; Garnaut and Manning, Irian Jaya.

However, amongst Papua New Guinean exports now sold outside the region several have significant regional markets. The Melanesian countries other than Papua New Guinea in 1971 imported about $0.5 million of shellfish, $2.1 million sawn timber, \$2.7 million plywood and veneer, \$0.3 million coffee, \$0.8 million tea and \$0.3 million spices. Imports of some of these commodities are growing very much more rapidly than total imports as a result of rapid urban growth in Fiji, the New Hebrides and New Caledonia. Lumber imports into Fiji rose from \$0.6 million in 1971 to \$1.2 million in 1972 and total timber imports into the New Hebrides from \$0.2 million in 1971 to \$1.0 million in the first nine months of 1972. The nearby Melanesian markets also offer opportunities for the development of new areas of Papua New Guinea export specialisation. Many relatively small manufacturing industries would benefit from augmentation of their domestic market, including beer (Melanesian imports totalled \$2.4 million in 1971), glass bottles and jars (\$0.2 million into Fiji in 1971), matches, nails, wire and clothing. However, neither current policy nor current trends in comparative advantage favours encouragement of new manufacturing industries characterised by heavy reliance on expatriate skills and capital, so that there will be little growth in potential for trade from this source.

There may be considerable growth in potential for trade in foodstuffs from Papua New Guinea and the Solomons to other parts of Melanesia. Imports of vegetables into Fiji, the New Hebrides and New Caledonia exceeded \$3 million in 1971 and are expanding rapidly with growth in urban demand and contraction of the agricultural sector. Prices for Melanesian staples such as taro, yams and sweet potato are several times higher in New Caledonia than in the Solomons and in most of the towns of Papua New Guinea. A new export trade worth several million dollars a year could be developed if the Papua New Guinea government is successful in implementing its aim to raise agricultural productivity and to improve the supply of fresh food into the towns.

There are fewer potential imports into Papua New Guinea from other parts of Melanesia, but the list includes beef from the New Hebrides, sugar from Fiji, local trade in foodstuffs to Bougainville from adjacent islands in the Solomons, and shirts, soap and a few other manufactures from Fiji. Sugar imports total over 30,000 tons per annum. Less refined, cheaper Fiji sugar is more suitable for Papua New Guinean incomes than imports from the present source. Sugar trade would be critically important to the maintenance of regular, direct shipping between Fiji and Papua New Guinea, and the Fiji government is currently considering the supply on concessional terms of sugar to the regional market. New Hebrides beef is poor in quality and suitable for canning, and so is neatly complementary to Papua New Guinea production. However, there is no economic advantage in diverting New Hebrides meat exports from the high price New Caledonian market.

Realisation of the opportunities for regional trade requires major efforts to overcome high resistances associated with historical trade patterns. There is no scheduled direct shipping from Papua New Guinea to Fiji or Irian Jaya, and no returns from Fiji, Irian Jaya or New Caledonia. However, shipping can be attracted to these routes subject to an inducement of about 500 tons cargo. In Fiji the greater part of import trade and in the New Hebrides almost half the total is handled by the three large Australian trading companies which dominate Papua New Guinea commerce. Contacts within these firms can facilitate intra-regional trade, and have done so in the case of New Hebrides imports from Fiji and Papua New Guinea. The establishment of business contacts is more difficult elsewhere. The large Australian companies did not return to the Solomons when the British government declined to pay war damage compensation after 1945 and the Solomons import trade is managed largely by small Chinese firms. Chinese firms, branches of the national trading companies and now the resource companies handle most Irian Jaya imports. In New Caledonia, most of the import trade is conducted by French trading houses with close links to European and Sydney suppliers.

The exploitation of all potential for profitable regional trade in domestic produce could contribute one or two per cent of Papua New Guinea's foreign trade. It could give substance to the politically attractive concept of regional co-operation. However, it would be responsible for no transformation in Papua New Guinea's economic prospects, and at a time when administrative skills are scarce and in high demand, it is doubtful that these initiatives will be given high priority.

The exchange of ideas on economic management and technology amongst the Melanesian economies involves less administrative input and possibly greater benefits. The Melanesian economies share the problems of managing large, foreign investments, often with scanty administrative capacity. Even the details of resource management are common to several countries in the region in the cases of fish, timber, mining and tourism. Irian Jaya, Papua New Guinea and the Solomons share the problems of dependence on external aid and an interest in promoting conditions of foreign aid that are consistent with efficient economic management and the pursuit of national goals. All countries in the region share the problem of the exclusion of isolated communities from the benefits of rising incomes. Discussion of these problems among governments in the region and shared programs of research and evaluation could contribute to better solutions. Perhaps most important of all, perspective on how other, fundamentally similar social and economic organisms have reacted to different intensities of contact with foreign companies and different opportunities for participation in trade can illuminate the problems of individual countries. Regional institutions, including the South Pacific Commission, the South Pacific Bureau for Economic Cooperation and the broader gathering of Southeast Asian and South Pacific countries proposed by Indonesian foreign minister Adam Malik, must be assessed in terms of their capacity to contribute to a sharing of views on policy problems. The same world economy continues to influence the pattern of change throughout Melanesia, but the effects of foreign integration on the quality of national life is highly dependent on policy responses.

Integrated closely into the international economy, the Melanesian economies now share an interest in continued prosperity outside the region. With continued stability in the international trading system, market developments will continue to transfer wealth to these countries. At the same time, Melanesia can contribute to external prosperity through supply of a major part of future growth in western Pacific demand for energy, non-ferrous metals, timber and fish.

As small, trade-dependent countries, Melanesia has much to lose from any tendency to autarchic economic organisation in the industrial countries in response to the 'resources crisis'. But these are second order uncertainties. The major uncertainties over the economic future of Melanesia involve policy questions related more explicitly to the region. External policy decisions remain very important: Australian and British attitudes to aid; Indonesia's use of revenues from Irian Jaya resource projects; French conditions on major non-French investments. And in Fiji, Papua New Guinea and the Solomons, Melanesians are in the process of making decisions on the desirable extent of economic integration into the international community that will have far-reaching effects on economic life in these countries.

## Chapter 2

# Trends in word trade and world trade policy

Peter Drysdale

The world trade and monetary system is now at a major turning point. Significant changes in the structure of world trade and payments over the postwar years have induced the major trading nations to enter a new and wider ranging round of multilateral trade negotiations than have taken place previously within the GATT-based trading system, and forced them, at the same time, to set about the formal reform of the Bretton Woods-based international monetary system.[1] In addition, there are pressing problems arising from the shift around in the energy and resource goods trade and world-wide inflation.

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[1] The Joint Declaration on International Relations received by the GATT Secretariat on 10 February 1972 stated that the 'comprehensive review of international economic relations' should cover, *inter alia*, 'all elements of trade, including measures which impede or distort agricultural, raw materials and industrial trade' and that special attention should be given to the problems of developing countries. However, reform of the monetary system assumed priority throughout 1972 and 1973. In April 1973, the United States Administration presented a draft Trade Reform Act to Congress. *The Administration Proposal Entitled the 'Trade Reform Act of 1973'*, United States Government Printing Office, House of Representatives Committee on Ways and Means, United States Congress, Washington, H.R. 6767, 10 April 1973. In the same month, the Commission of the EEC produced for the Council a memorandum, 'Development of an Overall Approach to Trade in View of the Coming Multilateral Negotiations in GATT' (Brussels, 4 April 1974). Among the concessions obtained by the Smithsonian Accord of December 1971 was a tripartite agreement to enter comprehensive multilateral trade talks. See paragraph 5 in the *Communique* issued after the Ministerial Meeting of the Group of Ten, Washington, 18 December 1973.

It is difficult to separate the problems of monetary reform and commercial policy. They are, indeed, separate dimensions of the same problem: the problem of the adequacy of the adjustment mechanisms whereby trading nations adapt to changed competitive conditions in world markets. A freer-trading system without the complement of a sufficiently flexible monetary system, as experience in recent years attests, cannot easily be sustained. However, each dimension of the problem has to be managed separately and has its own characteristics, and the focus of this paper is upon developments in the management of world trade policy.

The changes that now have to be effected in the organisation of world trade and payments are a consequence of pressures produced by trends in the past. So, whilst it is not easy to forecast exactly the shape of the world trading and monetary system in the future, the origins of the changes that have now been set in train are clear enough.

The dominance of developed countries in world trade has not been eroded over the past fifteen years. Indeed, Table 2.1 shows that the share of industrial countries in world trade has increased significantly, from 65.5 per cent in 1955 to 71.7 per cent in 1971. But there has been a substantial change in the structure of trade among industrial countries themselves. The shares of industrial Europe, especially the European Economic Community and of Japan, in both world export and world import trade have grown considerably, whilst the United States and the United Kingdom have lost relative ground. Of course the trade expansion of these countries has been heavily concentrated in manufactured goods, principally because, with income growth and rapid technological change, there have been growing advantages from specialisation in industrial goods trade, but also because there have been restrictive policies inhibiting the growth of trade in agricultural commodities. The share of industrial goods in world exports climbed from 48 per cent in 1955 to 64 per cent in 1971. Whilst it is true that during the sixties manufactured goods exports from less developed countries grew even more rapidly than manufactured goods exports from industrial countries, they still comprise only a very small proportion of world trade in manufactured goods. These changes in the structure of trade among industrial countries are at the base of the shifts in world trade policy that are now under way. Now, on top of these changes, there are additional adjustments to be effected in the resource goods trade in consequence of the politicisation of oil supply and changed perceptions of the longer term resource supply situation.

Table 2.1

<u>Changes in the geographic structure of world trade, 1955 to 1971</u>*
(percentage shares)

| | Exports | | | | Imports | | | |
|---|---|---|---|---|---|---|---|---|
| | 1955 | 1960 | 1965 | 1971 | 1955 | 1960 | 1965 | 1971 |
| Industrial countries | 65.5 | 69.5 | 71.6 | 74.5 | 64.3 | 66.5 | 68.7 | 71.7 |
| United States | 18.7 | 18.2 | 16.6 | 14.1 | 14.1 | 13.7 | 13.2 | 14.7 |
| United Kingdom | 10.3 | 9.4 | 8.3 | 7.1 | 12.4 | 10.9 | 9.2 | 7.3 |
| Industrial Europe | 28.6 | 33.3 | 36.5 | 39.7 | 29.3 | 33.0 | 36.7 | 38.5 |
| Japan | 2.4 | 3.6 | 5.1 | 7.7 | 2.8 | 3.8 | 4.7 | 6.0 |
| Canada | 5.5 | 5.1 | 5.1 | 5.6 | 5.7 | 5.2 | 4.9 | 5.1 |
| Other industrial countries | 7.4 | 6.9 | 6.7 | 6.3 | 9.3 | 8.7 | 9.9 | 8.9 |
| Australia | 2.1 | 1.8 | 1.8 | 1.7 | 2.4 | 2.3 | 2.1 | 1.6 |
| Less developed countries | 27.1 | 23.6 | 21.7 | 19.2 | 26.4 | 24.8 | 21.4 | 19.4 |
| Middle East | 4.0 | 4.4 | 4.3 | 4.3 | 3.1 | 3.3 | 3.3 | 2.8 |
| Asia | 7.6 | 6.8 | 5.7 | 5.2 | 8.3 | 8.3 | 7.3 | 6.5 |
| World (excluding Communist Bloc countries) | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

* Excludes Communist Bloc trade.

<u>Source</u>: International Monetary Fund, <u>International Financial Statistics, 1972 Supplement</u>, Washington, 1972, pp.xxxi-xxxv.

The 1960s were a decade of considerable expansion in the world economy, achieved within the evolving framework of liberal trade and international economic policies. World trade as a whole grew at 9.3 per cent per annum throughout the decade but there were two major developments which appeared to threaten the orderly expansion of world trade and opportunities for trade and economic growth. The first was the emergence of the European Economic Community and the extension of its discriminatory trade arrangements with other countries. The second was the appearance of the strains in international monetary arrangements and the worsening of the United States balance-of-payments position as the impact of differential productivity and growth performances chafed against the overly rigid fixed exchange rate system.[1]

The effects of the emergence of the EEC on the trading interests of the major industrial countries outside Europe were constrained in the first half of the sixties by the successful initiatives towards general tariff reductions under the Kennedy Round of tariff negotiations. But by the end of the decade, changes in the competitive strength of Europe and Japan *vis-à-vis* the United States could no longer be accommodated by arrangements buttressing the existing monetary system, and the basic distortions resulting from the commercial policies of the major trading nations became more serious and obvious irritants in the conduct of international economic policy. European agricultural protectionism became a serious United States concern. Europe's restrictive policies towards manufactured imports from Japan of course directly affected Japan's aspirations towards globalisation of her trade expansion but also posed indirectly problems for the United States because of the added pressures they put upon the American market.[2]

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[1] Harry G. Johnson, 'World trade policy in the post-Kennedy Round era: a survey of alternatives, with special reference to the position of the Pacific and Asian regions', *Economic Record*, vol.44, no.106, 1968, pp.154-67.

[2] Harald B. Malmgren, 'Troubles ahead for world farm trade'. Address to the National Soybean Processers Association, Denver, Colorado, 25 August 1969; Kiyoshi Kojima, *Japan and a Pacific Free Trade Area*, Macmillan, London, 1971; Peter Drysdale, 'Japan, the Pacific community and world trade', address to the Foreign Affairs Club, London, 18 April 1973; and Malmgren, 'Japan, the United States, and the Pacific economy', *Pacific Community*, April 1973, pp.307-25.

The whole sequence of monetary disturbances at the end of the sixties produced two significant shifts in American attitudes towards the conduct of international economic policy. One was that the upsurge of protectionism in the United States, which followed the completion of the Kennedy Round of tariff negotiations in 1967, was increasingly reinforced by appeals to concern about the balance of payments - an attitude which is now firmly written into the rhetoric of American foreign economic policy. The other was that the mood which had already induced substantial reductions in expenditure on overseas defence and aid gathered strength, especially with commitment to withdrawal from Vietnam.[1] These trends assumed immense importance to Japan and to her economic partners in the Western Pacific. Directly, there were strains in American-Japanese economic relations, in consequence of President Nixon's promise to curb import competition in the market for synthetic and woollen textiles. This rapidly spilled over into a more general bilateral trade and payments dispute.[2] At the same time, the United States Administration began to adopt a tougher approach to 'neo-mercantilist' agricultural trade policies, preferential trade ties, and payments surpluses in Europe.[3]

Both the European issue and the problem of American payments and protectionism were major concerns for Japanese international economic policy during the last decade. The Japanese response to the emergence of a discriminatory bloc within Western Europe was to encourage closer economic relations with its major Pacific trading partners and pursue a commercial policy designed to counter the direct effects of European protectionism. Although Japanese exports to Europe were growing rapidly in the late 1960s, over 60 per cent of her export trade and almost the same proportion of her import trade was with Asian-Pacific countries, including the United States. Japan was anxious to develop an alignment of interests within the Pacific economic community as she pressed ahead steadily with trade and payments liberalisation, and to

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[1] Peter Drysdale, 'Japan, Australia, New Zealand: the prospect for Western Pacific economic integration', <u>Economic Record</u>, vol.45, no.111, 1969, pp.321-42.

[2] Peter Drysdale, 'Japanese agriculture and the trade policy outlook', <u>Australia's Neighbours</u>, November-December 1970, pp.5-7; and Saburo Okita, 'Emerging trends in United States-Japan economic and political relations', The Arthur Solomon Lecture, New York, 11 December 1972.

[3] Malmgren, 'Troubles ahead for world farm trade', p.1.

evolve contingency plans in the event of a more restrictionist attitude in Western Europe. In the longer run, Japan aimed to forge deeper trade links beyond the Asian-Pacific region, with industrial Europe and other countries.[1] But the evolution of trade relations with the EEC ran a number of significant risks, not only for Japan herself but also for her major trading partners. In the event, it proved impossible to conclude an equitable bilateral trade agreement with the EEC outside the framework of multilateral trade discussions.[2]

The bilateralisation of the essentially tripolar world trade and payments problems at the end of the sixties produced serious economic-political frictions. Fortunately, in the United States a reappraisal of international economic policy, in which the interests of the world as a whole figured very large was taking place.[3] The Nixon currency and trade measures of 15 August 1971 - the 'Nixon Shock' - were aimed not only at solving the immediate dollar crisis but also at catalysing governments and the commercial community throughout the world into a fundamental re-examination of world economic relationships. The United States initiative resulted in joint undertakings embodied in the Smithsonian Agreement in December 1971,

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1 Kiyoshi Kojima, Japan and a Pacific Free Trade Area.

2 Jean Royer, 'Greater European economic integration' in Kiyoshi Kojima (ed.), Structural Adjustment in Asian-Pacific Trade, Japan Economic Research Center, May 1973. See also European Communities Press and Information, Background Note, ISEC/B6/73, 22 February 1973.

3 Among the more important reports produced for the Administration were: Special Representative for Trade Negotiations, Future United States Foreign Trade Policy (Roth Report), United States Government Printing Office, Washington, 1969; Presidential Commission on International Trade and Investment Policy, United States International Economic Policy in an Interdependent World (Williams Report), United States Government Printing Office, Washington, 1971; Assistant to the President for International Economic Affairs, A Foreign Economic Perspective (Peterson Report), Executive Office of the President, Washington, 1972; and Assistant to the President for International Economic Affairs, Agricultural Trade and the Proposed Round of Multilateral Negotiations (Flanigan Report), United States Government Printing Office for the Senate Committee on Agriculture and Forestry, United States Congress, Washington, 1973.

the joint United States/European Community and United States/ Japan declarations on trade in January and February 1972.[1]

What could have been a deeply divisive crisis in multilateral relations was successfully turned into common undertakings which offered opportunities for real improvements in the international economic system. The major trading nations have not only taken short-term actions to adjust their imbalances with each other, but they have also agreed to begin negotiations on reforms or improvements in the world monetary and trading systems. There have already been significant de facto reforms in the international monetary system through the shift to a more flexible exchange rate regime. Substantial improvements in the international trading system, as American Trade Ambassador Malmgren has said, will not come easy.[2]

The multilateral trade negotiations were inaugurated in Tokyo in September 1973. They were focused on the outstanding trade issues between the three major centres of economic power. Of course, their outcome will affect the system within which all trading nations have to operate and some of the smaller trading nations have shown recently that they can successfully exert leverage alongside the big league players in the pursuit of other trading interests. But the issues that have brought both members and non-members of GATT to the negotiating table and the issues that are still likely to dominate the discussions are the issues that are of mutual concern to the United States, Europe and Japan.

The trade talks set out to cover five main subjects: the further reduction of tariffs on industrial goods trade; the review and reduction of non-tariff trade barriers to trade; the establishment and effective operation of new safeguard arrangements to protect against very rapid and indigestible changes in import competition; the reduction of agricultural protectionism; and trading opportunities for developing countries. The origins of these focal points for discussion in the trade problems of the recent past are clear enough.

There are residual tariffs on imports of interest to industrial countries in each others' markets and, whilst nominal tariffs, after successive rounds of trade liberations, are quite low, effective rates of protection are commonly higher.

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[1] Malmgren, 'Japan, the United States, and the Pacific Economy', p.308.

[2] Ibid.

The most-favoured-nation reduction of tariff barriers on entry into the world's largest markets will improve opportunities for trade expansion in the world at large. The Americans and Japanese stress the objective of eventual tariff elimination whilst the Europeans stress the objective of tariff harmonisation, the latter approach reflecting the EEC's interest in retaining a common external tariff and in levelling the peaks from the United States tariff structure. Either way, tariff reductions are negotiable and feasible.[1]

As tariffs on industrial goods have been gradually reduced over the years, non-tariff trade barriers have emerged as a major brake to efficient trade specialisation. The importance of non-tariff trade barriers in agricultural commodity trade has long been explicitly recognised but it is only relatively recently that non-tariff trade barriers on manufactured goods trade have become the subject of serious policy discussion.[2] Quantitative import restrictions, quite inconsistent with the spirit and obligations of GATT; government procurement policies which discriminate between domestic and foreign sources of supply; export subsidisation; variable import levies; extra-official and para-official export restraints: all have come to have major distorting effects on trade specialisation among industrial countries and will be subject to negotiation at the multilateral trade talks. No single approach can be adopted for all these restrictions on trade. Some are amenable to codes of conduct, others to general principles of international behaviour, and still others are directly negotiable. In any event the negotiations on non-tariff trade barriers promise to be extremely complex.

There is already provision for safeguard arrangements within the framework of GATT (Articles 12 and 19). But Article 19 of GATT has worked ineffectively in the face of the large and rapid adjustments in world trading structures, since it contains no effective requirements for adjustment to changed

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[1] High Level Group on Trade and Related Problems, Policy Perspectives for International Trade and Economic Relations (Rey Report), OECD Secretariat, Paris, 1972; and Presidential Commission on International Trade and Investment Policy, United States International Economic Policy in an Interdependent World (Williams Report), United States Government Printing Office, Washington, 1971.

[2] Harry G. Johnson and S.D. Metzger (eds), International Negotiations on Non-tariff Barriers, Allen and Unwin, London, 1973.

competitive conditions, and it incorporates, irrelevantly, the GATT principle of reciprocity in the form of provisions for compensations for safeguard measures. The proliferation of extra-legal safeguard arrangements poses a real threat to efficient adjustment to new structures of world trade specialisation. Japan, largely because her trade structure has been transformed so rapidly relative to those of the other major trading nations, has faced special problems in consequence of the undisciplined use of safeguards against import competition. Europe and the United States have successfully insisted upon extensive 'voluntary' export restraints. The acquiescent Japanese response, especially at the level of private commercial diplomacy, has tended to exacerbate the damaging effects of export restraints through encouraging a process of cartelisation in the world trading system. The United States and Europe have also employed support value 'safeguard' measures against each other, Japan, and other countries. Safeguard measures can be easily abused for protectionist purposes against smaller developing economies, the competitive position of whose new export industries is changing rapidly in industrial country markets for manufactured or processed goods. The danger inherent in the formulation of a new safeguard mechanism is that the major industrial countries will devise a system which effectively insulates them from growing import competition from developing country exporters of manufactured goods. Even Japan, which now herself faces the thrust of stronger and stronger competition in labour-intensive manufacturing from developing country suppliers, could be attracted to this approach. The important principles insisted upon in earlier bilateral negotiations are that safeguard measures should be non-discriminatory, temporary, comprehensive of all commodity trade, and subject to international surveillance. The important objective is to devise a mechanism which insures against the damaging political, social, and economic effects of, and resistances to, rapid changes in the competitiveness of traded goods industries.

The United States and other major agricultural exporters, including Australia and New Zealand, will press for concessions on agricultural protectionism in both Europe and Japan. The inclusion of the agricultural trade sector in the agenda for negotiations results from changing trade interests in the United States and provides further testimony, if it were needed, of the extent to which big trader interests inevitably dominate developments in world trade policy.

A fifth issue in the multilateral trade negotiations deserves explicit specification in this context. It is the issue of trading opportunities for developing countries. At least in the rhetoric of the preliminaries to negotiation and in the Declaration of Ministers in Tokyo on 14 September 1973, the trading interests of developing countries have been given special attention.[1] Firstly, the industrial countries will not seek reciprocal trade concessions from developing countries who are parties to the negotiations. Secondly, the extension of generalised preference schemes, in so far as it is consistent with all-round tariff reductions, has been given support. More substantially, the United States Trade Reform Bill, which establishes the authority for American participation in the talks, ties participation to the initiation of a United States generalised preference scheme for developing countries.[2] The relatively slow progress of the Bill through Congress has not, of course, been related to this particular provision. The proposed American preference scheme, though late in arrival, appears generous relative to the preference schemes of most industrial countries. Nonetheless, apart from this, it is probably fair to say that the principal benefits that will derive to developing countries through successful negotiations will be the spin-off from their contribution to the general health and growth of the largest markets in the world trading system. The integration of the important resource trade issue into the centre of the trade negotiations would appear to have offered significant advantages for a large number of developing countries. But the recency, the complexity and urgency of the question is likely to frustrate this desirable objective at so late a stage in preparation of the framework for negotiation. It may well be that this failure will be extremely costly to the success of the negotiations.

The present round of trade negotiations has three distinctive general characteristics, all of which bear upon assessment of the probabilities for their success in eliminating the distortions in national trade policies and ensuring more efficient trade specialisation, more rapid trade and income growth, and a more equitable distribution of the gains from trade growth.

First, the negotiations have introduced a new concept of reciprocity into the GATT framework for bargaining trade

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[1] Joint Declaration of Ministers on Multilateral Trade Negotiations, Tokyo, 14 September 1973.

[2] See proposed Trade Reform Act and Testimony by Treasury Secretary Shultz and Secretary of State, Rogers, Hearings on the Trade Reform Act of 1973, Committee on Ways and Means, Washington, 9 May 1973.

concessions. The aim is for 'overall reciprocity' in the bargaining process. There can be no exact reciprocity on non-tariff trade barriers, within the industrial sector or the agricultural sector, in concessions to developing countries, or even in tariff concessions on industrial goods trade. Each participant will aim for some desired package of concessions but each package will be quite different in character. Retreat from the old and narrow concept of reciprocity is very desirable but it will complicate negotiations at a time when negotiating time is valuable because of the cumbersome procedures for establishing a European Community position, the problems of American domestic politics, and because of the oil trade and inflation problems. Some commentators have suggested that a superior strategy towards world trade liberalisation, now that there is a new flexibility in exchange rates, would be to establish what could be called 'fair weather' rules for trade liberalisation. Countries could be encouraged to reduce trade restrictions when payments surpluses or pressures towards currency appreciation appeared strong.[1] Despite recent experience in Japan, Canada and Australia, this approach has its limitations and would require formal institutional implementation, and probably some sort of over time reciprocity, if it were to be successfully extended. The politics of trade liberalisation are probably more complex than implied by the model upon which the success of this strategy would depend. There is no clear evidence that governments would be able to persuade their electorates that the effects of trade liberalisation could be fully insured against by exchange rate flexibility and thereby be able to engineer trade liberalisation more easily.

Second, there is the interrelationship between the trade negotiations and reform of the international monetary system. It has often been suggested that concurrence of the trade and monetary negotiations will facilitate trade liberalisation since, again, more exchange rate flexibility will provide insulation against protectionist political pressures. This view would appear over-simple for two reasons. Firstly it assumes too much about the contours of domestic politics. Secondly and more importantly in present circumstances, it neglects the impact of the changes that have already taken place in the international monetary system on the will to

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[1] Jan Tumlir, 'Trade negotiations in the field of manufactures', paper presented to Cambridge Conference on Trade and Development, September 1972, pp.27-9.

negotiate trade matters. Monetary readjustments have taken some of the pressures off the need to correct imbalances on the trade side. The payments crises were a powerful incentive to launch the trade discussions. The shift-around in the United States payments position *vis-à-vis* Japan and Europe has almost certainly tipped the balance in favour of the more conservative elements at the negotiating table. The full impact of these changes is still difficult to gauge. The tendency towards stickier negotiations will be aggravated by what has, for the intermediate future, become an overwhelming preoccupation with the energy crisis and its independent influence on relative payments positions. This may be an 'irrational' negotiating response but it is understandable.

Third, the trade and monetary negotiations both are unique in the extent to which, in the American view at least, they are inextricably interrelated with overall political and strategic considerations. In this frame, the United States interest in better arrangements for trade with Communist bloc countries is also important. The trade-offs between economic, political, and strategic affairs were made explicit by Dr Kissinger in his Atlantic Charter Speech of 24 April 1973.[1] They are no less real in Asia and the Pacific, towards China and the Soviet Union. The positive aspects of the Guam Doctrine, the 'concept of a global era of negotiations, not confrontation, on economic as well as political and security matters', offered in the final analysis the best promise that the trade negotiations will be pushed through independently with some success.[2] And yet it is precisely for this reason, in the form of the same trade-offs over the Middle East, that the thrust of the negotiations could be lost and that little progress will come directly from them.

What do these developments promise for Papua New Guinea, if they are carried through reasonably successfully? Importantly they will provide for Papua New Guinea, as well as for other smaller economies, the benefit of continuing opportunities for economic development through trade growth within a stronger and expanding world economy. Papua New Guinea will also benefit, though probably in a relatively minor way, from the extension of general preferences to developing countries, more especially from establishment of the American scheme.

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[1] Henry Kissinger, 'Address to Associated Press luncheon', New York, 23 April 1973.

[2] Malmgren, 'Japan, the United States, and the Pacific economy', p.325.

The extent of these benefits will partly depend on Papua New Guineans' securing a more preferred position among the developing nations within UNCTAD. This may yet prove feasible and bring with it both trade and aid benefits.

For the rest, Papua New Guinea's trade policy could usefully focus on seeking, independently, advantages in the major markets of direct interest to her - Australia, Japan the United States, and Europe. There will be significant opportunities presented through the structural changes taking place in Japan, the United States, and other industrial country markets both as a result of independent policy initiatives and the changes negotiated in the world trading system. A key factor in the opportunity or independent initiatives is again the shift-around in the resource goods trade. This has re-emphasised Papua New Guinea's attractiveness as a partner in trade, investment and development assistance relationships aimed at expansion of supplies of resource goods for world markets. These advantages will have to be secured through bilateral arrangements and discussions, and perhaps, in the event of the establishment of a functional organisation for economic co-operation within the Western Pacific region, within that regional forum. In talks and negotiations on these and other matters including the reception of foreign investment and aid, Papua New Guinea would be wise to make maximum use of whatever leverage she can gain from her established aid and trade relationship with Australia.

## Chapter 3

### The multilateral issues: Papua New Guinea's interest in GATT, UNCTAD and the International Commodity Agreements*

David Charles

This chapter examines Papua New Guinea's interests in relation to the multilateral institutions which form an important part of the world trading environment in which Papua New Guinea must operate. The institutions considered are the General Agreement on Tariffs and Trade (GATT), a body dominated by and largely concerned with trade questions of interest to developed countries, United Nations Commission on Trade and Development (UNCTAD), a body dominated by and concerned with the trade, aid and development problems of developing countries, and the International Commodity Agreements covering products of export interest to Papua New Guinea.

### Papua New Guinea and GATT

The General Agreement on Tariffs and Trade is a multilateral agreement establishing a set of rules governing the conduct of trade among the contracting parties, over two-thirds of which are developing countries, and an institution performing a variety of functions related to the conduct of trade negotiations among its members.

The operation of GATT rests on four fundamental principles:

(i) Trade should be conducted on the basis of non-discrimination subject to the provisions that existing preferential arrangement can continue and customs unions or free trade area can be formed.

* I am indebted to Mr G. Hall, Mr C. McKenzie, Mr C. Willoughby and Mr B. Leedham for their helpful comments and assistance with documentation. The opinions expressed are those of the author.

(ii) Protection to domestic industries should be in the form of tariffs only[1] although maximum levels of tariffs can be bound in the course of tariff negotiations.

(iii) Consultations should be held to settle trading disputes between contracting parties.

(iv) Tariffs and other trade barriers should be reduced through multilateral negotiations.

GATT was originally designed to cover trade in agricultural and industrial products. However, GATT negotiations have in the main been limited to trade in industrial products. Despite the success of GATT in reducing barriers to trade in industrial goods among developed countries, by and large the GATT negotiations have yielded very little in the way of reduction in import barriers against the types of products exported by the developing countries: agricultural products in raw or processed form, and technologically unsophisticated goods manufactured by labour-intensive methods.

A major source of bias against the developing countries in the operation of GATT is that negotiations are based on the principle of reciprocity - the exchange of trade concessions of equal value to the negotiating countries. This principle ensures that trade negotiations are dominated by the major developed countries: the United States, Japan and the European Economic Community (EEC). In a sense the more recent GATT negotiations can be seen as an attempt by the United States and Japan to offset the trade discrimination effects of the EEC. This struggle has virtually precluded action within GATT to satisfy the developing countries' complaints about the obstacles to the expansion of their export earnings imposed by the trade policies of the developed countries.

Recognising the bias against the developing countries, the members of GATT attempted to remedy the bias by adopting in 1963 an action program, a large part of which has subsequently been embodied in UNCTAD resolutions. The main features of the action program were: a general standstill on tariff or non-

[1] Article 19 provides for import restrictions as an emergency measure in cases where imports are causing or threatening serious injury to local producers. These measures are supposed to be non-discriminatory. However, in the case of cotton textiles special action was taken under the umbrella of GATT to 'legalise' discrimination against particular countries.

tariff barriers against developing countries' exports; a lowering and elimination of tariff barriers to developing countries' export of semi-processed and processed products, starting with a reduction of at least 50 per cent over the subsequent three years; the elimination of restrictions not consistent with the provisions of GATT on developing countries' exports within a year; and the lifting of internal taxes bearing on developing countries' exports. Unfortunately, the contracting parties were unable to implement the action program. However, they did show their concern for the problems of the developing countries by adding to GATT a new chapter on trade and development.[1]

Australia has not accepted GATT in respect of Papua New Guinea. This raises two questions for policy makers. First, should Papua New Guinea accede to GATT? Second, if the answer to the first question is yes, how and when should Papua New Guinea become a member of GATT?

Should Papua New Guinea accede to GATT? The main result of acceding to GATT is that Papua New Guinea will be obliged under Article 1 to extend most favoured nation treatment to all members of GATT. This would not represent a departure from present practice as Papua New Guinea is presently bound by the United Nations Charter not to discriminate between countries in its tariff, and in fact has a single column tariff. The main tangible pay-off from joining GATT is that Papua New Guinea will be assured of most favoured nation treatment from member countries, and will be able to participate in GATT's deliberations. Intangible benefits are prestige and a symbol of independence. On the other hand, there will be costs of representation and some loss of flexibility in tariff setting. Very little flexibility of tariff setting would be lost as far as the negotiation of tariff preferences are concerned as most of the countries Papua New Guinea is likely to negotiate with are already members of GATT and therefore limited by the GATT rules.

Papua New Guinea has three options open to it regarding obtaining membership of GATT:

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[1] On 8 February 1965 Part IV, consisting of Articles 36-38, was added to the GATT. Article 36 sets out general principles, Article 37 largely embodies the action program, and Article 38 calls for joint action by the developed countries to achieve the general objectives of assisting the developing countries. Australia subscribed to the articles but with qualifications concerning the provisions of Article 37.

(i) Australian acceptance of GATT in respect of Papua New Guinea prior to independence;

(ii) the normal accession procedure on becoming independent, and

(iii) the procedure of provisional accession.

Option (i) entails Papua New Guinea becoming a member of GATT before independence by the ploy of Australia accepting GATT in respect of Papua New Guinea. On attaining independence Papua New Guinea could accede to GATT under Article 26. Alternatively Papua New Guinea could under the provisions of the same article have GATT applied to it on a '*de facto*' basis pending a decision by Papua New Guinea to become 'deemed' to be a contracting party. The difference between being '*de facto*' and being 'deemed' to be a contracting party is that in the first case the acceding country has no right to enter into negotiations with contracting parties seeking to make increases in previously bound tariffs on products of which the acceding country is a principal supplier.

This method of accession has the advantage that no negotiations before accession would be necessary. Moreover, Papua New Guinea could defer its acceptance for a period of years during which other contracting parties would be obliged to give it GATT treatment provided it gave them equal treatment. In a sense this is 'preferential' GATT membership as it enables a country to join GATT without having to negotiate a protocol of accession including a schedule of tariff concessions.

Under Option (ii), Papua New Guinea on becoming independent would become a member of GATT by virtue of the normal accession procedures. This involves applying for accession to GATT under Article 33, which provides that accession shall be on terms to be agreed between the government of the acceding country and the contracting parties of GATT. The accession procedure leading to the signing of a protocol of accession consists of two operations: first, a GATT Working Party Report on the commercial policy and practices of the acceding country to ensure it accords with the GATT Articles. If it is not in accord, accession could be made conditional upon the acceding country bringing its commercial policy and practice into line with the GATT Articles. Second, the negotiation of the acceding country of a schedule of tariff concessions with the existing members of GATT.

The negotiation of tariff concessions involves the submission of requests by the existing contracting parties to the acceding country to reduce and bind against increase or bind at existing levels the tariffs on items where they are principal suppliers. It is not expected in the case of Papua New Guinea that they would be very onerous. The concessions would be calculated to offset the benefits Papua New Guinea would be expected to enjoy by virtue of the rights it would acquire to the concessions previously granted by other countries. For most items the principal suppliers would appear to be Australia, Japan, the United States and West Germany. The schedule of concessions is open for re-negotiation once negotiated.

Finally, under Option (iii), should Papua New Guinea on independence wish to join GATT but not be in a position to enter immediately into accession negotiations it could apply for provisional accession. Under the provisional accession procedure GATT with the exception of Article 2 (i.e. the schedule of concessions of the existing members of GATT) is applied between the provisionally acceding country and those contracting parties accepting the particular declaration of provisional accession. When tariff negotiations are concluded, the status of the acceding country is changed from provisional accession to full accession through a protocol of accession under Article 33.

Comparing Options (i)-(iii) it appears on balance that Option (i) is probably the best method of becoming a member of GATT because it avoids the need to negotiate entry.

An important question concerns the status of the preferential treatment Australia applies to Papua New Guinea with GATT approval. In considering this issue it is useful to draw a distinction between preferences which pre-date GATT and preferences which have been negotiated since the establishment of GATT.

With respect to preferences which pre-date GATT, Article 1 of GATT makes an exception from the most favoured nation rule for those tariff preferences between two or more of the territories listed in the relevant annexes to GATT existing on certain 'base dates'. The annex relating to Commonwealth preferences includes the dependent territories of Australia and the base date for Australia is 15 October 1946. Accordingly, Australia would still be able to continue to accord these tariff preferences to Papua New Guinea during the interim self-governing period and when independence is achieved. These preferences derive from Papua New Guinea's inclusion under the British Preferential Tariff, Papua New Guinea exemption from primage duties and by virtue of the fact that some of those items on which Papua New Guinea obtains free entry under Part

VI of the Fifth Schedule of the Customs Tariff (i.e. the by-law provisions) pre-date GATT. It should be noted, however, that the first two elements of Australian preferences represent a wasting asset as both the British Preferential Tariff and primage duties are in the process of being phased out.

With respect to preferences negotiated under waivers from Article 1 if Papua New Guinea becomes independent, the status of the waivers is doubtful as reference is made in the pre-ambles to Australia's obligation as trustee for the Trust Territory of New Guinea and the main waiver refers to products of the Territory of Papua New Guinea. It is possible, however, that the status of the waivers would only be queried if new products are added to those already covered. Membership or otherwise of GATT by Papua New Guinea would not be relevant to the validity of the waivers.

The final point in relation to GATT of possible interest to Papua New Guinea is that it could accede to a 1971 GATT protocol relating to the exchange of concessions among developing countries.[1] On 26 November 1971 the contracting parties decided that the provisions of Article 1 of the General Agreement shall be waived to permit contracting parties participating in the arrangements set out in the Protocol Relating to Trade Negotiations Among Developing Countries[2] to accord preferential treatment as provided in the protocol with respect to products originating in other parties to the protocol, without being required to extend the same treatment to like goods when imported from other than contracting parties. In order to accede to the protocol and hence benefit from schedule of concessions of existing signatories of the protocol it would be necessary for Papua New Guinea to itself give a schedule of concessions. To date only India, Israel, Turkey, Yugoslavia, Brazil, Egypt, Korea, Pakistan, Spain and Tunisia - all relatively industrialised developing countries - have acceded to the protocol. Given the central aim of these countries to increase their mutual trade in manufactured goods, it is generally the case that the existing schedules of concessions are not of immediate interest to Papua New Guinea.

## Papua New Guinea and UNCTAD

With the accumulation of experience of the economic development problem and the high aspirations of the developing countries

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[1] See GATT document L/3636 of 30 November 1971.

[2] See GATT document L3643 of 14 December 1971 and GATT document L/3643/Add 1 of 20 March 1972.

for rapid economic development, it became clear that the amount of foreign aid likely to be provided by the developed countries was not a sufficient means of promoting economic growth. The developing countries thus began pressing for other forms of assistance to provide external resources necessary for development over and above the resources likely to be forthcoming from aid. In addition to demanding more aid on better terms, the developing countries focused their attention on obtaining external resources through international trade. What they were demanding was in essence a change in international trading relations in general, and GATT in particular, to allow them to increase significantly their earnings of foreign exchange. Their central criticism of GATT was that while it operated well to regulate trade between equal trading partners, it did not provide a suitable basis for regulating trade between unequal trading partners.

The emergence of many new nations meant that the developing countries were approaching the stage where they could muster a two-thirds voting majority in the organs of the United Nations. This provided them with the springboard from which to launch their efforts to obtain fundamental changes in the institutional arrangements regulating world trade.

At its 1961 meeting, the United Nations General Assembly adopted a resolution entitled 'International Trade as the Primary Instrument of Economic Development' and requested the Secretary-General to evaluate the desirability of holding an international conference on trade and development problems. In 1962 the Economic and Social Council of the United Nations (ECOSOC) resolved to convene such a conference early in 1964. Preparation for the conference was entrusted to Dr Raul Prebisch, who set out the main issues to be discussed at the conference and suggested an integrated program of measures for dealing with them in his paper 'Towards a New Trade Policy for Development'.

Prebisch called for multilateral action by the developed countries to assist the developing countries by increasing the availability of foreign exchange through changed trade and aid policies, but primarily through changed trade policies. The demand for trade policy change was a direct response to the realisation by the developing countries that the trade protection systems of the developed countries severely constrain their exports of both agricultural and manufactured goods. In order to increase the developing countries' export earnings, Prebisch called for international commodity agreements designed to guarantee fair market access and prices to exporting countries and for non-reciprocal temporary preferences for manufactured and semi-manufactured goods to be granted by developed to developing countries which in their most generous variant would allow duty-free imports from developing countries while maintaining existing tariffs against imports from developed countries.

In order to achieve their aims at UNCTAD-I the developing countries formed themselves into the Group of 77 and presented a united front to the conference. Given voting on a one-country-one-vote basis the developing countries had a majority at the conference. While majorities could be produced on most issues because of the nature of UNCTAD, victory had little substance without the agreement of the developed countries. The United States in particular adopted a very negative approach and cast a negative vote or abstained on almost all issues raised at the conference including the preferential tariff scheme.

In addition to making decisions relating to economic issues, the conference, against the wishes of the developed countries, decided to establish a permanent UNCTAD secretariat based in Geneva which would deal with: Commodities, Manufactures, Invisibles (which include shipping), Financial Problems, Economic Integrations and Trade Expansion and Developing Countries, and Trade with the Socialist Countries. (It is likely that Papua New Guinea will benefit from the flow of information associated with the various UNCTAD specialist committees, in particular the committee on shipping.) Subsequent to its establishment UNCTAD became involved in providing technical assistance to developing countries primarily through the UNCTAD/GATT International Trade Centre, which assists the developing countries in the promotion of their export trade by providing them with information on export markets and marketing, and helps them both to develop their export promotion services and to train the personnel required for these services.[1]

The role UNCTAD was designed to play was to bring together in one body the consideration of all these closely related matters and to act as a centre of initiative and above all pressure (both on the developed countries and other multilateral bodies) for new approaches to solving the development problems of the developing countries.

The developed countries maintain that UNCTAD is essentially a consultative body rather than a place for conducting negotiations. They insist that trade negotiations in particular

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[1] In between conferences, held every four years, the running of UNCTAD is assured by the Trade and Development Board which meets annually and is composed of 33 members including Australia.

should be conducted under the auspices of GATT, consequently while the General Preference Scheme was in fact 'negotiated' in UNCTAD, a waiver had to be obtained from GATT to legitimise its operation.

Papua New Guinea is not a member of UNCTAD. However, Australia is a member and represents Papua New Guinea's interests. Papua New Guinea representatives were included in the Australian delegation to UNCTAD I, II and III. Papua New Guinea does not at present take part in the discussions of the Group of 77. On attaining independence Papua New Guinea will probably join the Group of 77 as a member of the Asian group.

As far as Papua New Guinea is concerned there are three main UNCTAD initiatives which have been and are of importance: the General Preference Scheme, special measures for least developed countries, and special measures for developing island countries.[1]

General Preference Scheme (GPS). The developed countries' tariff systems tend in general to be structured so that tariffs are low or zero on raw materials and successively high as the degree of processing increases, i.e. the effective rate rises faster than the nominal rate with the degree of processing. The implications of developed countries' tariff structures for developing countries is that they reduce the possibility of developing export industries based on the processing of their raw materials. In order to give the developing countries a chance to overcome the difficulties they encounter in export markets because of their 'infant exporter' status, these countries called for temporary non-reciprocal tariff preferences on manufactured and semi-manufactured goods, preferably with duty-free entry for their exports.

The GPS was first proposed at UNCTAD-I where it encountered strong opposition from the United States, which saw the scheme as a further breakdown of the GATT most favoured nation principle. One of the major developments of UNCTAD-II was the acceptance by the developed countries of the principle of the GPS. The key factor in the acceptance of the scheme was the change in attitude of the United States which was expressed by President Johnson at the 1967 meeting of the Heads of State of the Organisation of American States. In order to facilitate the introduction of the GPS a Special Committee on Preferences was constituted.

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[1] UNCTAD initiatives in the field of commodity agreements are considered in the final section of this chapter.

By mid-1971 the EEC, Japan and Sweden had implemented their variants of the GPS. The only major developed countries not to have implemented a preference scheme at the time of writing are the United States[1] and Canada. Contrary to the hope expressed by Prebisch for duty-free entry of developing countries' exports of all manufactured and semi-manufactured goods, most of the developed countries preference schemes are closely hedged about with escape clauses and lists of product, and sometimes country, exceptions and quotas. The EEC and Japanese schemes in particular, based as they are on duty-free tariff quotas, are probably of only limited value in their present form to developing countries.

Because of Papua New Guinea's status as a dependent territory, and the implications of its inclusion for other dependent territories, in particular Hong Kong, representations had to be made over an extended period to some developed countries - Japan in particular - to ensure the acceptance of Papua New Guinea as a beneficiary. Papua New Guinea is currently a beneficiary under the schemes of Japan, the EEC, Sweden, Switzerland, Austria, Norway and New Zealand. While it is not a beneficiary under the schemes of Finland, Czechoslovakia and Hungary it is generally accepted that it will be upon attaining independence.

Even though most of the developed countries' general preference schemes fall short of the developing countries', there is some small benefit in being accepted as a beneficiary under the different schemes. In order to gain some idea of the sorts of benefits Papua New Guinea can expect to gain from the GPS it is useful to consider the schemes of Japan and the EEC in more detail.

Closer consideration of the Japanese scheme, of which Papua New Guinea has been a beneficiary since 1 April 1972 in relation to products of prime importance to Papua New Guinea, reveals that the scheme offers possible advantages to Papua New Guinea's exports of palm oil and sawn wood. In the case

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[1] The US preference scheme for developing countries, which is embodied in the Trade Reform Bill, was before Congress at the end of 1973. Whereas the US scheme when it was originally presented was probably more generous than those of Japan and the EEC, it is likely that when, and if, it finally emerges from Congress it will, in the name of equal burden sharing, closely resemble the existing schemes. An important feature of this US scheme is that developing countries giving preferences to developed countries after 1975 will be excluded.

of palm oil the preferential rate is 4 per cent and the general rate is 8 per cent. In the case of sawn wood of greater than 5mm thickness the preferential rate is 5 per cent and the general rate is 10 per cent, while in the case of sawn wood of less than 5mm thickness the preferential rate is 7.5 per cent and the general rate is 15 per cent. Unfortunately for Papua New Guinea, plywood, which carries tariffs of 15 and 20 per cent, and coconut oil, which will suffer from the loss of preferential access to the United Kingdom market, have not been included in the Japanese preference scheme.

The treatment of copper in the Japanese preference scheme illustrates clearly the way in which the tariff quota scheme operates. The tariff quota is calculated by adding the basic quota - which is based on dutiable imports from developing countries in 1968 and 1969 - to the supplementary quota - which is based on 10 per cent of dutiable imports two years previously. In the case of copper, which is subject to a sliding scale duty,[1] no duty was collected in 1968 and 1969, hence the basic quota is zero. The supplementary quota which results when duty is collected operates with a two-year time lag.

It is probably true to say that Japan's initial preference scheme did not offer major benefits for Papua New Guinea. The 1973 revisions to the Japanese scheme which involved increases in the quota limits improved the scheme as far as Papua New Guinea is concerned in relation to fish products and timber. However, until the scheme is significantly improved it is hard to see its becoming of major importance to Papua New Guinea.[2] The major barriers to increased Papua New Guinea exports to Japan are her substantial tariffs and in some cases indirect taxes on a number of tropical agricultural products (e.g. coffee, cocoa, coconut products).

The other major operative scheme is that of the EEC which, like the Japanese scheme, is also based on tariff quotas. The EEC scheme offers possible advantages to Papua New Guinea's sawn wood and plywood. In the case of sawn wood of greater than 5mm thickness the EEC scheme allows unlimited duty-free

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[1] If the price of copper imports falls below 351 yen per kilogram a duty of 24 yen per kilogram becomes payable.

[2] Growing direct investment in Papua New Guinea may lead to improvement in Japan's scheme in areas of importance to Papua New Guinea through representations made by Japanese businessmen with a direct interest in increased Papua New Guinea exports.

entry to exports from developing countries. In the case of sawn wood of less than 5mm thickness and plywood the EEC scheme extends duty-free quotas. Unlike the Japanese scheme, palm oil is not included in the EEC preferential list.

The two main limitations of the major GPS schemes as far as Papua New Guinea is concerned are, first, the fact that all developing countries have been treated equally (that is, there are no special advantages for the less developed of the developing countries) and, second, the poor treatment that has been accorded to processed agricultural products.

Special measures for least developed countries. The General Preference Scheme was felt by the African developing countries to be primarily of benefit to the more industrialised developing countries of Latin America and Southeast Asia. In order to achieve action which would primarily be of benefit to themselves, the Africans, in discussions about the GPS, pushed the idea of developing special measures for the least developed countries. The main special measure which the African countries had in mind was the establishment of a development fund which would be used to finance on soft terms projects in least developed countries.

Immediately before and during UNCTAD-III there was considerable jockeying by a number of developing countries to ensure their inclusion on the list of least developed countries. Various lists were produced using different sets of criteria. The most authoritative list prepared by the Committee on Developing Planning (CDP) used three criteria: (1) per capita income less than $US100; (2) a literacy rate of 20 per cent or less, and (3) a share of manufacturing in gross domestic product of 10 per cent or less. In preparing its list the CDP did not include dependent territories, consequently Papua New Guinea was not considered in the study. However, even if it had been included it would have been unlikely to make the list, for while it qualifies on the second and third criteria its per capita income is well above $US100.

Strenuous attempts were made by Australian and Papua New Guinea officials to get Papua New Guinea included in further studies aimed at identifying the least developed countries. In particular Mr Frank Miro made a strong statement in support of Papua New Guinea's inclusion in the 6th Committee at UNCTAD-III. The general conclusion appears to be that it is highly unlikely that Papua New Guinea will be recognised as one of the least developed countries.[1] There is room for doubt,

[1] Papua New Guinea is accepted by ECAFE as a least developed country in the region.

however, that the sorts of special measures set out in Resolution 62(III) of UNCTAD-III really represent anything substantial, for one of the requirements of the Resolution is that the special measures will not reduce aid going to other developing countries, that is the special measures must be financed out of additional aid from the developed countries.[1]

Developing island countries. Resolution 65(III) adopted at UNCTAD-III without dissent requested the Secretary-General of the United Nations to convene a small panel of experts to identify and study the particular problems of developing island countries and to make recommendations thereon, giving special attention to those countries which are facing major difficulties of communication and transportation with neighbouring countries as well as structural difficulties, and which are remote from major market centres. The report of the panel was to be submitted to the Trade and Development Board for its consideration before the end of 1973.

The Trade and Development Board at its thirteenth session noted the report of the panel of experts (which included Papua New Guinea and other dependent territories among the countries studied) and invited the governments of developed countries and relevant organisations and agencies of the United Nations system to provide technical assistance to facilitate the establishment and/or proper functioning of: (a) regional shipping lines; (b) regional air transport systems; and (c) national and sub-regional fishing industries. It also invited international and regional financial institutions to give sympathetic consideration to requests from developing island countries for the financing, on soft terms, of port installations and related investments including the acquisition of ships for the development of maritime transport and fishing industries, and of the training of personnel.

## The commodity agreements

Exports of primary products are an important source of Papua New Guinea's foreign exchange earnings. The major export products are coffee, copra, cocoa, coconut oil, dessicated coconut, timber, rubber and tea. Of these goods coffee and cocoa, which accounted for about 60 per cent of Papua New

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[1] A possible area of advantage for the least developed countries is the development of special measures within the context of existing measures such as the GPS and, perhaps, the commodity agreements.

Guinea's rural exports in 1971-72, are covered by international commodity agreements. In addition, preliminary discussions towards agreements covering tea and lauric oils are being conducted. It is arguable, therefore, that the commodity agreements are the most important international institutions concerned with international trade bearing upon Papua New Guinea.

The general objectives of commodity agreements are twofold: first, to reduce the market instability that occurs in a free market and, second, to raise the price above the long-term equilibrium level and hence raise producers' incomes. The two main techniques used to stabilise, and if possible raise the price of a commodity are export quotas and international buffer stocks.

Export quota schemes aim at stabilising the price of a commodity by regulating the quantity entering the world market from producing countries. In order to achieve market stabilisation in the short run, export quota schemes have to satisfy three main conditions. First, they must cover a sufficiently high proportion of world trade. If this is not the case export quota schemes are liable to be undermined by exports from non-members at prices below the agreed minimum. Second, effective provision should be made for appropriate adjustment of country export quotas to meet changing conditions of the world market. This is usually the weakest point of such schemes because the sharing of a market already in over-supply among exporting countries tends to create irreconcilable clashes of national interests, since it is in each country's interest to maximise its quota, though at the same time it is in the interest of all producers that the aggregate of quotas be minimised. Third, quotas should react quickly to changes in the market situation. If this is not the case instability of prices will not be greatly reduced by the export quota scheme.

International buffer stock schemes introduce a stabilising element over and above that possible by pure export quota schemes, since the buffer stock would be run in such a manner as to sell when the price was high and buy when the price was low, that is, it acts directly and with immediate effect on the commodity market concerned. The applicability of the buffer stock technique is clearly limited to those commodities which can be stored relatively cheaply and where an effective market with well-defined grades exists so that world prices can serve as an indicator for effective buffer stock action. The main drawback of operating a buffer stock is the cost involved, that is the capital and storage costs.

Experience has shown that commodity agreements are extremely difficult to negotiate. One of the problems has been the fact that, when export prices are high, many of the exporting countries are less interested in reaching agreement and importing countries consider that their bargaining position would be stronger at another time. When prices are low the opposite applies. Negotiating agreements which aim to raise producers' incomes rather than stabilise prices are hamstrung by the requirement that commodity agreements should include both producing and consuming countries, and the two groups should have equal voting strength.[1]

Coffee agreement. The Coffee Agreements of 1962 and 1968, which included both producers and consumers, were the successors of earlier agreements limited essentially to producers, namely the 1957 agreement among seven Latin American producers to limit exports, and the subsequent extension of this agreement in 1959 to include the African producers. Australia and Papua New Guinea constituted a joint importing member of the International Coffee Agreements for 1962 and 1968 because until recently Australia's imports exceeded Papua New Guinea's exports.[2]

The objective of the 1968 International Coffee Agreement which expired on 30 September 1973 was to stabilise price through controlling supply to the market. There were two basic mechanisms to control market supplies: an export quota system; and agreed price ranges for four different grades of coffee - with one average price range.[3] Basic export quotas calculated at the start of the agreement were based upon historical shares of the world market. Movements up or down to the limits of the price ranges set for each grade of coffee triggered quota releases or withdrawals either for particular grades of coffee or for all grades of coffee. No production

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[1] These operating rules were agreed to by ECOSOC in March 1947 and written into the Havana Charter later that year.

[2] Papua New Guinea's sales of coffee to Australia are helped by a by-law arrangement. Under the arrangement if an importer purchases 30 per cent of his requirements from Papua New Guinea, he gets the rest of his requirements duty free.

[3] The 1962 International Coffee Agreement laid down country quotas for coffee as such. However, as world demand shifted towards robusta coffees, so the pressure for changes in country quotas mounted. Of Papua New Guinea's production, 95 per cent is arabica and 5 per cent is robusta.

controls were enforced, although exporting members undertook to adjust production consistent with their needs for domestic consumption, permitted exports and normal stock. The fact that there was no buffer stock in the Coffee Agreement meant that the success of the scheme depended on certain major producing countries holding large stocks.

Export controls were enforced by the use of 'certificates of origin' validated by 'export stamps', collected by importers except in the case of sales to certain 'developing coffee markets' which were not included in the basic export quotas.[1] Imports by members from non-member exporting countries were controlled by restriction to the average level imported in 1960, 1961, 1962.

The Agreement also included a diversification fund to extend loans to producers to assist them to limit their dependence on coffee. The fund was financed by a levy of one US cent per kilo on all members exporting over 6 million kilos. There was also a levy of 15US cents per 60 kilos on exports to finance a campaign for the promotion of consumption.

The new agreement due to commence in October 1973 could not be negotiated due to the inability of producers and consumers to agree on acceptable arrangements to regulate the market. The main reason for the failure to reach agreement was the tight supply conditions and very high prices. The International Coffee Council decided to extend the Agreement for two years with no substantive economic provisions, the object being to allow time for the market to settle down and progress to be made towards the negotiation of a new agreement. Consistent with the fact that Papua New Guinea's exports now exceed Australia's imports Australia has accepted the Agreement and extended membership to Papua New Guinea to form a joint exporting membership.

The removal of export quotas means that Papua New Guinea now has an opportunity for some expansion of its export sales until at least the end of 1975. Because of the time lag before trees reach bearing age any export expansion will have to come from existing plantations. Also of importance is the fact that with the lifting of quotas Papua New Guinea will not be constrained to dispose of exports in excess of Australian exports

[1] Developing coffee markets are markets characterised by low per capita consumption of coffee. The only developed countries included in this list are Japan, Hungary, Poland, USSR and South Africa.

at a discount of up to 25 per cent on 'developing coffee markets'. In the recent past Papua New Guinea was selling between 5,000 and 8,000 tons out of total exports of between 28,000 and 32,000 tons to 'developing coffee markets'.

Cocoa agreement. Cocoa provides a good example of the difficulty of negotiating a commodity agreement. Preliminary discussions commenced in an FAO Study Group established in 1956. The following year a working group was charged with considering cocoa price stabilisation. This group prepared the Draft International Cocoa Agreement, which was the basis of the 1963 Negotiating Conference of the United Nations. After long and protracted negotiations, which since 1965 have taken place in UNCTAD, an agreement was negotiated in 1972 with the twin objectives of stabilising and increasing exporter incomes. The agreement, which came into force in October 1973, will run for three years. Australia extended ratification of the agreement to cover Papua New Guinea at the end of September 1973, thus forming a joint exporting membership.

The agreement is based on export quotas and an international buffer stock. The export quotas for the first quota year are calculated on the basis of each country's highest annual production figure during the years since and including 1964-65. Cocoa is divided into fine or flavour cocoa and bulk cocoa. Quotas are set for bulk cocoa but not for fine or flavour cocoa. Countries producing less than 10,000 tons of bulk cocoa are not subject to quotas. The agreement sets out rules for automatically changing annual export quotas.

As far as export quotas are concerned the relevant points for Papua New Guinea are, first, because Australia and Papua New Guinea are treated as one unit Papua New Guinea's exports to Australia do not enter the quota and, second, because Papua New Guinea is treated in the agreement as an exporting country producing 75 per cent fine or flavour cocoa,[1] only 25 per cent of Papua New Guinea's output is subject to quota and then only when in excess of 10,000 tons. The net result of both these points is that the bulk cocoa quota will not apply to Papua New Guinea until production of cocoa reaches around 45,000 tons.

The buffer stock is designed to ensure that the world price remains between a minimum of 23US cents per lb and a maximum of 32US cents per lb. At prices between these limits various

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[1] Papua New Guinea's production is mainly of a hybrid trinitario type, generally recognised as a fine or flavour cocoa.

buying and selling rules are set out for the manager of the buffer stock. A contribution of one US cent per lb of bulk cocoa exported is charged to finance the buffer stock which is authorised to hold up to a quarter of a million tons, that is, between 16 and 20 per cent of annual world exports. Given that Papua New Guinea's contribution is based on exports of bulk cocoa to countries other than Australia, its contribution could be around $US200,000.

The Cocoa Agreement 1972 sets out procedures similar to those contained in the Coffee Agreement 1968 to police export quotas and imports from non-member countries. Under Article 48 of the Agreement, exporters before permitting the shipment of cocoa and importers before permitting imports whether from members or non-members are obliged to require the presentation of a valid certificate of contribution or other authorised Council control document. Under Articles 54 and 55 importers agree to limit imports from non-members to the 1970, 1971, 1972 average and not to buy cocoa from non-members on more favourable terms than they would be prepared to accept at the same time from exporting members. Exporters for their part agree not to sell cocoa to non-members on more favourable terms than they would be prepared to offer at the same time to importing members.

Article 70(4) of the Cocoa Agreement provides that if a territory to which the Agreement has been extended subsequently attains independence, the government of the territory may, within ninety days after the attainment of independence, declare by notification to the Secretary-General of the United Nations that it has assumed the rights and obligations of a contracting party to the Agreement. The most important implication of Papua New Guinea's attainment of independence, as far as cocoa is concerned, will be the inclusion of Papua New Guinea's exports to Australia in its export for the purposes of calculating export quotas (and contributions to financing the buffer stock), that is, Papua New Guinea will be subject to export quotas on its bulk cocoa exports sooner than it would have if it had remained a joint member with Australia.

Chapter 4

# North Atlantic policies on development assistance and trade with developing countries*

Jan Tumlir

In discussing economic policies, often unclear in intent and always elusive in result, it is advisable to begin with a safe statement. In recent years, those policies of the North Atlantic countries which are directed at the problem of economic development in the poor areas of the world have been in a state of drift - some may call it suspension, others may see in it, hopefully, the offing of a reform.

The cause of the lack of conviction and uneasy temporising is obvious enough. The main industrial countries have been confronted, suddenly, in the second half of the 1960s, with economic problems essentially unrelated to their concern about economic progress of the poor areas abroad. Some of these problems arose in their mutual relations, e.g. the adjustment aspect of the international monetary system; some have emerged so to speak exogenously, affecting them all, e.g. those of energy supply, or environment; some, finally, have been purely domestic, e.g. the discovery of 'poverty amidst affluence', or of the problems arising from massive importation of cheap labour. In perspective, the 1950s and early 1960s were, for the developed countries as a group, a period of growth, and growth optimism, without any fundamental economic problems. The sudden emergence of a series of problems close to home could not but down-grade the policies towards developing countries in each national agenda of priorities.

While their urgency diminished, there has also occurred a change in thinking about these policies. One of its aspects was that, with the flow of aid stagnant and potential uses

* The opinions expressed in this paper are those of the author, and are in no way to be interpreted as reflecting the views of the organisation of which he is a member.

multiplying, new strategies and plans had to be elaborated for 'Aid Allocation when Aid is Inadequate', in the apt title in Michael Lipton's essay. At the same time, the lengthening statistical perspective on the development effort made it possible to review the main economic and political preconceptions on which it had been based. Many of them did not stand up well in the light of the documentation becoming available. A better understanding of the consequences of different types of internal policies in developing countries is being reflected in debates about assistance and trade policies in the donor countries.

Economic policies are framed to respond to current developments. At the same time, and ultimately, their effectiveness will depend on the degree to which they correctly perceive the long-run tendencies of the process at which they aim. This is especially true of policies to assist economic development of the poor countries. The purpose of this paper is to provide a factual background, and a framework for speculation, to those who are hopeful of a reform of these policies. It begins by presenting a long view of economic growth in the world at large and some of its implications for the increasingly heterogeneous group of 'developing countries'. In the subsequent sections, these implications are elaborated in the context, respectively, of development assistance policy and trade policy towards developing countries.

## The age of acceleration

In the last two decades of unprecedentedly rapid economic expansion, the economic profession has, broadly speaking, dealt with the phenomenon of growth either in terms of theoretical models, or on a relatively short-term basis, in comparative analyses of the growth performance of different countries, based on 10-15 year average growth rates of GNP and its main components, factor supplies, productivities, etc. What this approach inevitably missed was the sense of the continuing change in the growth process itself, above all its dominant characteristic, secular acceleration.

The major exceptions in this respect are the work of Simon Kuznets[1] and the related but more specialised work on long-term

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[1] S. Kuznets, Economic Growth of Nations, Harvard University Press, Cambridge, Mass., 1971; 'Modern economic growth: findings and reflections', American Economic Review, June 1973, pp.247-58.

productivity growth in the Kendrick-Denison approach, recently summed up and placed into broader theoretical context by William Fellner.[1]

<u>Epoch of modern economic growth</u>. Kuznets conducts his analysis of economic growth of nations over long historical periods in terms of secular epochs. The contemporary one, the epoch of modern economic growth, starting in the Industrial Revolution, is characterised by (a) marked acceleration of economic growth and structural transformation, (b) an increased power of technology and (c) its propensity to spread internationally.

Kuznets's statistical researches show pre-Industrial-Revolution growth of per capita income in countries which subsequently became developed to have been so slow - by 1, 2 or, at the most, 3 per cent per decade[2] - as to be imperceptible to the contemporaries. Even these averages almost certainly conceal a gradual acceleration. In the modern epoch, taken as a whole, income per head in the same countries has been growing by multiples of five, six, seven and more of the pre-industrial decadal rates.[3]

There is a strong case to be made for subdividing Kuznets's modern epoch into two periods separated by World War II. There is not only another pronounced quantitative acceleration between them but also a qualitative change significant enough to warrant speaking of 'new conditions' of economic growth. On the quantitative acceleration, Table 4.1 can stand without comment.

What is new in the conditions of economic growth in the post-World War II period need not detain us long either. They were fundamentally transformed by Keynes's insight into the structure and equilibrium conditions of national income, eliminating the periodic sharp recessions which had reduced the long-term growth rates of the pre-war period.

Only one corollary of the Keynesian revolution needs to be mentioned in this context. Kuznets includes the 'power of technology' among the few key characteristics of the modern epoch. Large-scale, systematic, increasingly better organised

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[1] W. Fellner, 'Trends in the activities generating technological progress', <u>American Economic Review</u>, March 1970, p.3.

[2] e.g., 1.9 per cent per decade in England and Wales in the first three-quarters of the eighteenth century: Kuznets, <u>Economic Growth of Nations</u>, p.11.

[3] Ibid.; see Table 4.1.

Table 4.1

Long-term growth of income per head
(rates of growth per decade, in %)

| Country | Average for century* ending 1963-67 | 1952-72 |
|---|---|---|
| United Kingdom | 13.4 | 26.8 |
| Federal Republic of Germany | 18.3 | 56.8 |
| France | 17.0 | 50.9 |
| Italy | 9.5 | 56.8 |
| Netherlands | 12.6 | 45.2 |
| Denmark | 20.2 | 42.4 |
| Norway | 21.3 | 39.7 |
| Sweden | 28.9 | 35.7 |
| United States | 17.3 | 23.1 |
| Canada | 18.7 | 30.5 |
| Australia | 10.2 | 26.8 |
| Japan | 32.3 | 124.0 |

* The period of measurement varies somewhat from country to country; 'approximately a century' would be more correct.

Sources: Kuznets, Economic Growth of Nations, for the secular trend. The post-war growth is based on the first and the last year's GNP estimates reported by AID in Gross National Product, Growth Rates and Trend Data, May 1973.

and more effective application of science to the techniques of production has indeed been the main cause of the growth of productivity; and a major change in the relationship between science and production occurred in the 1940s. A large increase took place in public expenditure on research and development related to the war effort, and the level of public spending on research continued to grow in the following decades. There was an equally dramatic increase in private expenditure on industrial research and development. The growth in both streams of research expenditure, but particularly in the private one, was largely a consequence of the newly-won economic stability. In the period before World War II, with its expectation of an economic crisis occurring on the average every seven years, the premium which this expectation placed on remaining liquid was a formidable deterrent to investing in long-term search for technological improvements. It was only when business became confident of stability ahead that industrial funds could be committed to research and development in a massive way.

The dynamic character of postwar economic expansion is illustrated in Table 4.2. In the last five years, the GDP growth rate of developed countries declined somewhat as cyclical factors affected several leading economies in 1972. It is of importance to note, however, that even in this period economic acceleration continued in the developing countries. It is for the first time that these economies have maintained enough momentum of their own to offset a recessionary influence emanating from the developed countries.

Table 4.2

Annual average growth rates of real GDP and exports
(%)

| | 1950-60 | 1960-70 | 1967-72 |
|---|---|---|---|
| Aggregate GDP of developed countries | 4.1 | 4.9 | 4.5 |
| Aggregate GDP of developing countries | 4.7 | 5.2 | 6.2 |
| Per head GDP of developed countries | 2.8 | 3.7 | 3.3 |
| Per head GDP of developing countries | 2.4 | 2.5 | 3.4 |
| World exports, value | 6.3 | 9.2 | 14.0 |
| World* exports, volume | 6.0 | 8.1 | 9.5 |
| Exports by developed countries, value | 7.0 | 10.0 | 14.7 |
| Exports by developed countries, volume | 7.0 | 8.4 | 9.8 |
| Exports by developing countries, value | 2.9 | 7.2 | 13.0 |
| Exports by developing countries, volume | 3.6 | 6.5 | 8.0 |
| World exports of primary products, value** | 3.7 | 7.5 | 9.1 |
| Exports of manufactures by developed countries, value** | 8.2 | 12.7 | 14.1 |
| Exports of manufactures by developing countries, value** | 6.5 | 17.3 | 19.5 |

* Exluding centrally planned economies
** 1955-62, 1962-71, 1965-72.

Sources: United Nations, Handbook of International Trade and Development Statistics, 1972; GATT, International Trade 1972; UNCTAD, TD/B429/Add.2, Reveiw and Appraisal of the Implementation of the International Strategy; United Nations, Monthly Bulletin of Statistics, various issues.

It is not my intention to maintain, in defiance of logic, that an acceleration, or even compound growth, can continue indefinitely. Obviously, there has to be a deceleration in the future. The logical expectation would be for it to occur in the developed countries first, probably in consequence of an increased valuation of leisure and environment, and only with a considerable lag in the developing ones.

Summarising the experience of economic growth in the modern epoch, we can say that if it were possible to plot the curve of aggregate world production from pre-industrial times, it would closely coincide with, being somewhat steeper than, the now familiar 'exploding' curve of world population growth.

'Developing countries'. The highly aggregated data of Table 4.2 hide important differences and trends in the distribution of income and income-growth. The GDP growth rates are based on United Nations definitions of developed and developing countries. In this definition, the latter category includes 152 countries and territories, varying so widely in total populations, income levels and income growth that it is next to impossible to make a meaningful statement about 'developing countries' at large.

It is, however, possible to discern patterns. If the petroleum-producing countries[1] and five or six 'developing' territories with per capita income in excess of $2,000 are excluded, two distinct groups become apparent among the rest.

Only thirty developing countries and territories, comprising less than a quarter of total population of developing countries, show a rate of growth of per capita income in excess of 2.5 per cent per annum on the average in the past eleven years. Fifteen countries[2] in this group, accounting for 85 per cent of its combined GNP and for 76 per cent of its population, with an average income of $417 per head, have a relatively large and rapidly growing export of manufactures. The level and growth of their average income can be attributed to a sustained expansion of manufacturing industries - accompanied, of course, and made possible, by appropriate changes in other sectors of

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[1] Not all of them attain or even approach the West European income levels but none can be said to have desperate problems with access to export markets or with financing their development program.

[2] Argentina, Brazil, Mexico, Puerto Rico, Guinea, Zambia, Cyprus, Israel, Syria, Malaysia, Pakistan, Republic of Korea, Hong Kong, Singapore and Taiwan.

their economies. These fifteen countries account for some nine-tenths of manufactured exports from developing countries in the United Nations definition, and for most of the acceleration in GDP growth of these 152 countries and territories combined.

In economic characteristics and performance, these fifteen resemble such European countries as Turkey, Yugoslavia, Greece, Spain and Portugal which the United Nations statistics classify as developed. If the latter five are added, we obtain a group of twenty industrialising countries, all of them dynamic exporters of manufactures, totalling some 400 million people whose average per capita income exceeds 500 pre-devaluation dollars and is growing at some 4-5 per cent per annum. Needless to add, total and manufactured exports of this larger group were growing in the last ten years at rates considerably in excess of those indicated in Table 4.2 for developing countries in general.

The remaining developing countries and territories on the United Nations list comprise some three-quarters of the developing population. These are the poor countries. On the average, their per capita income was, according to United Nations statistics, $135 in 1969 and growing slowly. In the most populous of them, India, Bangladesh and the Philippines, the already low rate of growth of average income has declined from the 1950s to the 1960s.[1] These countries, too, have significant characteristics in common. Their low income levels indicate that the majority of population lives in subsistence agriculture. Their exports are largely agricultural and have been declining sharply as a proportion of world trade, partly in consequence of a low income elasticity of world demand for their particular products. At the same time, many of these countries, especially the most populous ones, have experienced a relatively rapid growth of food imports which, in several cases, account for a growing proportion of total imports. The main development problem of these countries thus appears to be located in agriculture where the growth of productivity and output diversification are encountering serious obstacles. Under-utilisation of such industrial capacity as exists in several of these countries can be viewed as a short-term manifestation of this basic problem.

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[1] The United Nations statistics also show a sharp decline of growth in Indonesia. Here, however, the last six years suggest a more promising trend.

A possible future. Kuznets's findings and reflections on modern economic growth emphasise its special organisational requirements, the very special teleology of social organisation of the nations now considered developed.[1] The theory underlying the present text carries this notion to the conclusion, not to be further elaborated here, that the ultimate limit to growth (where growth is wanted) is the organisational capacity of each society; and any view of 'ultimate limits' is essentially future-oriented. Starting from relatively reliable demographic forecasts, and taking account of certain foreseeable improvements in social and economic organisation, it is possible to project what we consider the basic tendency of global economic growth in the familiar modern circumstances into the future. This is far from making predictions, for the basic tendency may be wholly frustrated by any number of breakdowns in the future. It should, nonetheless, be borne in mind in long-term economic policy planning.

The purpose of the calculations, the results of which are presented in Table 4.3, was to form an idea of the possible growth of industrial employment and production in the developed and developing countries until the end of the century, assuming that no drastic changes will occur in the basic conditions of economic activity. The methods and specific assumptions of the exercise are explained in the Appendix.

The result can be summed up in one sentence. In 1955, the respective volumes of industrial production in developing and developed countries were in a relation of one to ten; by the end of the century, the relation may be two-thirds to one.

An industrial production growth in the developing countries at the average rate of 10 per cent per annum, sustained over three decades, may seem too dramatic to be believable. But so might have seemed a correct forecast for the developed countries in 1948-73 to an observer at the close of the 1930s. In fact, several groups of countries have already achieved these rates over the last ten years.[2] There is a number of reasons, not perhaps for banking on this growth to materialise, but for not being surprised if it does.

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[1] Kuznets, 'Modern economic growth', American Economic Review, vol.63, no.3, 1973, pp.249-50.

[2] Manufacturing production in the south European countries increased by 10 per cent per annum in 1961-71, in the Middle East by 10.5 per cent per annum and in East Asia by 12 per cent per annum in the same period. IBRD, Annual Report, 1973, p.82.

Table 4.3

Population, industrial employment, production and productivity in developed and developing countries* in 1955, 1970, 1985 and 2000

(million, indices and annual average percentage rates of increase)

| | Developed countries | | | | | | | Developing countries | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Million | | | | Annual average % rate of increase | | | Million | | | | Indices of developing countries (developed countries = 100) | | | | Annual average % rate of increase | | |
| | 1955 | 1970 | 1985 | 2000 | 1955-1970 | 1970-1985 | 1985-2000 | 1955 | 1970 | 1985 | 2000 | 1955 | 1970 | 1985 | 2000 | 1955-1970 | 1970-1985 | 1985-2000 |
| Population - total | 597.0 | 743.0 | 872.0 | 997.0 | 1.5 | 1.1 | 0.9 | 1,242.0 | 1,736.0 | 2,660.0 | 3,840.0 | 208 | 234 | 305 | 385 | 2.3 | 2.9 | 2.5 |
| Population - urban | 355.0 | 504.0 | 661.0 | (826.0) | 2.4 | 1.8 | (1.5) | 253.0 | 453.0 | 893.0 | (1,700.0) | 71 | 90 | 135 | 206 | 4.0 | 4.6 | (4.4) |
| Total industrial equipment | 64.9 | 82.1 | (90.3) | (94.8) | 1.6 | (0.6) | (0.3) | 41.3 | 68.7 | (130.0) | (230.0) | 64 | 84 | 144 | 243 | 3.5 | (4.3) | (3.9) |
| Value added in industry** | 250.0 | 536.0 | (1,040.0) | (1,914.0) | 5.2 | (4.5) | (4.2) | 23.2 | 68.7 | (271.0) | (1,149.0) | 9 | 13 | 26 | 60 | 7.5 | (9.6) | (10.1) |
| Value added per person in industry*** | 3,852.0 | 6,529.0 | (11,517.0) | (20,190.0) | 3.6 | (3.9) | (3.8) | 562.0 | 1,000.0 | (2,085.0) | (4,996.0) | 15 | 15 | 18 | 25 | 3.9 | (5.0) | (6.0) |

* Excluding Asian and European centrally planned economies
** Thousand of million US dollars.
*** US dollars

Note: Data in brackets are our projections.

Sources: United Nations, Statistical Yearbook, various issues; United Nations, Monthly Bulletin of Statistics, April and November 1971; United Nations, The Growth of World Industry, 1969, vol.1.

The large extent to which modern economic growth depends on public policy has already been mentioned. Among developing countries, growth has been distributed very unevenly, and there appears to be an increasingly close correlation between characteristic sets of policies employed with respect to such key variables as the exchange rate and the terms of trade between industry and agriculture, and the resulting rate of growth. As growth-averages become available for two decades and more, the relative effectiveness of different policy approaches is becoming apparent, and the successful policies are beginning to make converts.

Apart from policies, account has to be taken of the learning process in the broadest sense, appropriately compounded by the continuously growing power of technology. The strengthening of public administrations, especially in such vital areas as taxation and agriculture, the increase in the number and qualifications of the managerial, engineering and sales staffs of large enterprises, the gradual emergence of an industrial labour force in the full sense of the term, and the increase in the technological-absorptive capacity which all this represents, may be expected significantly to raise the growth of industrial productivity in the years to come.

Implications for trade. Projecting past experience forward implies, *inter alia*, the assumption of a continued existence of the liberal trade system of the postwar period. It is obvious that the industrial investment projected for the developing countries would require large imports of equipment the bulk of which would have to be paid for from export earnings. But in this case, the obvious is also the superficial. For industrial investment in developing countries to grow at the sustained long-term rate projected, it would have to be highly efficient and profitable in each successive period, which in turn presupposes an investment pattern in broad conformity with the lines of comparative advantage (understood in the dynamic sense). Such a conformity can be secured only if a liberal[1] trade system can be taken for granted.

At present, developing countries supply only about 7 per cent of the total imports of manufactures into developed countries, and only about 1 per cent of their consumption of manufactures. In the postwar period, exchanges of

[1] 'Liberal' refers to a system free of quantitative restrictions. Tariffs at rates now prevailing in the developed countries hardly matter against the orders of comparative advantage at discussion here.

manufactures among the developed countries have not posed any serious problems of industrial adjustment. On the contrary, the acceleration of their economic growth in this period has vitally depended on the stimuli provided by the almost continuous process of mutual trade liberalisation and tarifff cutting. It is imports of manufactures from developing countries that are causing persistent problems of adjustment. These imports consist of products in which the industrial countries are at the greatest comparative disadvantage, that is the relatively labour-intensive manufactures; and where special protection and the consequent failure to adjust has left the corresponding industries on the import side in the position of large employers of labour, the problem posed by the rapid growth of export capacity in the developing areas is an acute one.

Imports of manufactures from developing countries are growing at a very high and a still rising rate. The compound element of this growth reflects the fact that a <u>growing</u> number of developing countries are reaching that stage of industrial organisation at which production at competitive prices is possible over a <u>widening</u> range of manufactures. It is impossible to estimate when the rate of this growth might stabilise and a deceleration set in. Assuming such a deceleration will occur after 1980, the share of developing countries in total imports of manufactures into developed countries could still rise to around 17 per cent by 1980, around 35 per cent by 1990, and to one half or more by the end of the century,[1] the relatively advanced developing countries being the leading suppliers.

Clearly, the limit to the expansion of manufactured exports from developing areas is not to be found on the supply side but in the import-absorption capacity of the industrial countries. Since the developing countries have no mercantilist

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[1] This, by the way, would imply a dramatic reversal, in the course of the present decade, of a tendency in the geographic distribution of exports of manufactures by developed countries which has prevailed in the past quarter-century. Whereas in 1948 some 60 per cent of these exports had been sold to developing countries, by 1972 this proportion was reduced to 18 per cent, exchanges among developed countries absorbing three-quarters of their exports of manufactures. On the calculations mentioned above, the mid-century geographic distribution of these exports could be approximately restored by the year 2000.

interest in accumulating reserves,[1] and will spend their export earnings on imports from industrial countries, these exchanges cannot cause any long-term aggregative equilibrium problem for the latter group. Its import-absorption capacity can thus be said to depend only on the rate at which resources can be transferred from the import-competing activities to those producing goods (such as industrial equipment) which will be demanded in payment for the additional imports.

This rate can be manipulated by policies in no way involving centralised intervention in, or direction of the economy. In the thirty years' perspective envisaged here, very high rates of import absorption can be achieved without any displacement and transfer of workers presently employed in the low-wage industries against which the export competition of the developing areas is mainly directed. All that is necessary is for these industries to reduce their rate of hiring, and for the public authorities to provide educational and vocational training systems which can qualify the new entrants into the labour force for employment in the high-wage and dynamic industries whose expansion is already being inhibited by short supply of adequately skilled labour.

Alternatives to a liberal trade system can be ranged and we shall only describe the extreme alternative. What is argued by individual protectionist pressure groups, each thinking only of its own interest, can be summed up into a logical system. It would consist of two separate international markets for manufactures. Among the developed countries, trade would be unimpeded except by tariffs; but imports into the developed markets from developing areas would thus correspond to the total export earnings of the former in the latter, plus the purchasing power transferred via official development assistance and private investment, minus imports of primary products into and reserve increases of the developing countries as a group.[2] One need not attempt to estimate (indeed, one could not do it) the amount of income that both developed and developing areas would forego under this alternative, for this extreme is unlikely to be realised. The world may yet get an intermediate trade system, liberal in outline though spotted

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[1] Indeed, they may need less reserves in relation to their imports as manufactures, historically the more stable trade flow, become relatively more important in the export total and dampen its fluctuations.

[2] Taking account of exchanges with the eastern trading area would not greatly complicate this schematic presentation.

with hopefully temporary and self-cancelling quantitative restrictions, but it should be aware that each degree by which that system deviated from the liberal norm would impose, for the benefit of very few, a very large cost on the populations of both developed and developing areas.

Development assistance policies

The 'crisis of aid' which the Pearson Commission was called to allay is still with us, if by 'crisis' we mean the low level and insufficient growth of official development assistance (ODA). The net flow of ODA - in the OECD definition which nets out repayment of concessionary loans but not the interest payments on them - increased from \$5.2 billion in 1961 to \$8.6 billion in 1972, having grown on the average by 4.7 per cent per annum. It is difficult to say exactly what this growth means in real terms.

First, the nominal amounts have to be deflated for price increases and parity changes among the donors. A special 'aid price-index' for each donor country would be needed for this purpose, structured according to the main categories of aid.

Second, an adjustment would have to be made for the stream of interest payments, included in the definition of net flow, from aid recipients to donors. Since most ODA loans stipulate a grace period which, on the average, has not lengthened in step with the growth in nominal lending, the reverse stream of interest payments must have grown in relation to the nominal flow of aid.

Third, the proportion of tied loans and grants in ODA has risen substantially over the eleven years to between three-quarters and four-fifths of the total; and the practice is estimated to raise the prices of tied goods by a good fifth.

With all these adjustments properly carried out, it would not be surprising to find the real volume of net ODA to be no larger in 1972 than in 1961. In the same period the population of developing countries increased by one-third. The reasons for the stagnation of development assistance have been alluded to in the introduction. It needs much optimism to believe that the main aid donors, having solved their mutual and domestic problems, will soon be able to reassign a higher priority to the requirements of international development.

The private component[1] of the net resource transfers to developing countries recorded by the Development Assistance

[1] In the case of private flows, the 'net' definition subtracts the repayment or depreciation as well as the service or earnings

Committee of the OECD has been growing twice as rapidly as ODA. Should the actual development bear any resemblance to our projection, the volume of private resource transfers could safely be expected to grow even more rapidly than in the past. That industrial growth will increase the attractiveness of developing countries for investment from the developed ones is, however, merely stating the obvious. It is more interesting to note that structural changes in the developed economies are increasing the incentives for such investment so to speak independently of the progress made by the developing countries. In their great postwar economic expansion, the West European economies have relied increasingly on immigrant labour from low-wage areas.[1] These additions to their labour force have tended to concentrate in certain industries and activities; in manufacturing, for example, pronounced concentrations can be found in textiles and clothing, and in metallurgy. Recent official statements and acts indicate that the period of unrestricted, rapidly growing immigration into Western Europe is coming to an end; and the resulting changes in the wage structure will eventually force those industries which most depended on foreign labour to invest and produce in the countries of emigration. Another force acting in the same direction is the environmental concern already beginning to impede further domestic expansion of such industries as metallurgy and chemicals in several developed countries. Finally, one of the main sources of tension and dynamism in the developed economies at this time is the competition between the multi-national and the purely or mainly national firms. The cost advantage of the former stems from its global information systems which allow it to subdivide production processes by their factor-intensity, and to locate them accordingly.

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1 (continued)
flows in the opposite direction. While not without economic meaning, in the case of direct investment, which accounts for some 40 per cent of all private resource transfers recorded by the DAC, this practice obscures the most important aspect of the flow, namely, its contribution to current investment and employment creation. Over time, the reverse flows will grow relatively to gross inflow whose growth and economic impact will thus be understated by presentation in net terms.

[1] Including refugees of the 1950s, and the United Kingdom's Commonwealth immigration, one can estimate more than 10 million immigrant workers active in Western Europe, the bulk of them from south-eastern Europe and north Africa, but the more recent arrivals from much farther afield.

The national firms cannot compete against this advantage but by imitation; and so they, too, are turning multi-national, having to produce, or sub-contract the production of, the relatively labour-intensive components and sub-assemblies of their final output in the developing countries. Even if sub-contracting were to become the predominant form of this production relationship, it would generate substantial international investment.

Rightly or wrongly, many developing countries are wary of direct foreign investment. The conditions just recounted point to a considerable strengthening of the bargaining position of their governments vis-à-vis foreign investors, and there is an additional element enlarging the scope of their choice. The rapidly growing involvement of banks in international business already makes it possible to transfer the 'unique package' of capital, technology and managerial expertise, which has been the main justification of direct foreign investment to developing countries, on the basis of long-term loan capital as well as on that of equity capital. The broadened range of choice will, of course, make for more investment.

The trend thus seems to point to a situation, not far off, in which the predominant part of the resource transfer from developed to developing countries will be effected by private capital. For reasons on which there is no need to expand, private capital flows are directed mainly to the relatively advanced developing countries possessing the organisational infra-structure which makes rapid growth possible. In recent years, close to two-thirds of all private resource transfers to developing areas were absorbed by the group of advanced countries discussed earlier; the proportion would be much higher, probably over four-fifths, if capital for extractive industries could be netted out of the total.

On all the considerations so far introduced - those of internal organisation, efficiency-increasing role of foreign trade, and availability of external resources for investment - it is to be expected that a major part of the industrial employment creation envisaged in our projection will take place in those developing countries which have already attained the stage of sustained industrial growth. The demographic forecasts of Table 4.3 indicate that, despite the rapid urbanisation, rural population in developing countries at large will almost double in the three decades to come. If, in addition, a major part of the total industrial employment to be created, and thus an even larger part of the shift to cities where the industry-supporting and accompanying services are located, is to materialise in countries comprising only a quarter of the 'developing' population, the problem the poorer countries would face in accommodating the vast population increase in their already overpopulated agriculture would be that much more difficult. Their difficulty in solving it could further inhibit their industrial development, not to speak of political stability.

This means that, on the international level, there is only the small and practically stagnant flow of ODA to act against the powerful cumulative tendency for inequality at work among the developing countries. The debate now going on within the aid-giving countries and their specialised agencies has been sparked by the realisation of this fact.

The debate is about a problem that has only recently been realised to be fundamental: should aid be distributed on the basis of merit, or on that of need? The foregoing account already suggests where the debate is tending. Distribution on merit, that is more aid to those who can make the most of it, tends to maximise both growth and inequality. But distribution on the basis of need does not have to sacrifice growth if a quantitative readjustment in favour of the poor countries, which at present receive some 55 per cent of attributable ODA, were combined with a qualitative readjustment concerning the projects to be financed.

Greater equity in the distribution of ODA among recipient countries can be ensured in several ways. First, assistance channelled through multilateral organisations is distributed more equitably than bilateral assistance, and a trend toward a growing proportion of flows through multilateral channels is already clearly established.

Second, as regards bilateral allocation, 'donors might at least reduce some of the random biases in their own aid programmes: towards small countries, towards their own former colonies, towards nations that "kindly" purchase their inefficiently produced and hence over-priced exports'.[1] This objective can be fulfilled through more intensive multilateral co-ordination of bilateral aid programs in such organisations as the Development Assistance Committee of the OECD. Let me note that private research could contribute to this objective by studying the allocation of bilateral ODA by the main donors

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[1] M. Lipton, 'Aid allocation when aid is inadequate: problems of the non-implementation of the Pearson Report', Foreign Resources and Economic Development, T.J. Byrnes (ed.), London, 1972, p.178.

among the recipients and regularly publishing the results of such studies.

Theoretically much more difficult is the problem of choice of appropriate projects to be financed by ODA in the poor countries. Comparing the relative magnitudes of development assistance and private capital flowing from developed to developing countries, and especially the relative magnitudes as they might be in a decade or two, it would seem wasteful for development assistance to be devoted to the creation of industrial capacities which private capital does not find it profitable to undertake. On the contrary, the objective in most general terms should be to create an environment in which private capital can be found and employed for that purpose.[1] And this is the crucial problem for development assistance, since such an environment is a matter of social organisation, efficient administration, particularly in such services as the provision of security and justice, agricultural extension, tax collection, and an organisation of educational systems geared to development needs.[2] The difficulty is that all these areas are essentially un-aidable.

It is this insight that accounts for the recent emphasis placed in project allocation of ODA, mainly by the World Bank but increasingly also by individual donors in their bilateral commitments, on agriculture and, in this area, on projects aimed specifically and verifiably at improving the productivity and incomes of the poorest peasants.

This effort has been explained and defended as growing out of the concern about equality of income distribution within developing countries. In some discussions it has been presented as a pragmatic scaling-down of the unsustainable ambitions of the earlier development assistance objectives: 'if we cannot do much to increase aggregate growth, we should at least try to do something about absolute poverty'. This, in my view, does less than justice to these new programs which are also defensible as good economics and a promising growth policy. If they succeed in improving the income situation (productivity) of the poorest and most numerous class, the peasants, they will increase the marketable surplus of agriculture, the

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[1] As explained before, this does not necessarily have to be direct foreign investment.

[2] In other words, the complex of issues that Myrdal comprises in his notion of a 'soft state' (G. Myrdal, Asian Drama: an Inquiry into the Poverty of Nations, New York, 1968).

size of which is the main determinant of the scope of investment in the long run. Finally, beyond this economic prospect, there is a political hope. If experience under assistance programs of this type convinced the largely apathetic peasantry of the possibility of progress, there would be a hope of a gradual improvement in the administrative and political systems as well.

## Trade policies toward developing countries

In trade policy towards developing countries different problems are posed in the area of primary products and in manufactures, and within the former a further distinction should be made between food products of temperate-zone agriculture and industrial raw materials. To facilitate discussion, the commodity pattern and growth of exports from developing countries is given in Table 4.4.

Trade in primary products. As to temperate-zone foodstuffs, the main export interests of developing countries are in sugar, meat, fish and other sea foods, fruit, and vegetables, all of these in both fresh (or raw) and processed forms. In this area, the import regimes are exceedingly complex, relying on an array of non-tariff means, with quotas often seasonally staggered, price agreements, sanitary rules, variable levies, tariffs escalated with the degree of processing, and tariff quotas. The ultimate obstacles to trade are, of course, the agricultural production policies of the industrial countries of which these import-control devices are only instruments.

Developing countries' negotiating problems in this area cannot be discussed here in specific detail. In general, it appears that the policy climate has been significantly changed by the commodity price boom of 1973 which has comprised many key products of temperate-zone agriculture. It seems to have introduced a new pragmatism into the policy discussion which had formerly been characterised by a confrontation of positions held with almost theological purity and rigidity: full reliance on 'free market forces' on the one hand versus comprehensive 'organisation of markets' on the other. There seems now to be a willingness to discuss specific situations and problems of individual products, including the possibility of international stock-holding agreements. In this loosening up of general policy positions there is a hope of achieving some improvements in the trading conditions affecting developing countries.

In tropical beverages, still one of the major exports of developing countries, the main difficulty is the low price

Table 4.4

Developing countries' exports by commodity groups

| | Average 1953-55 | Average 1960-61 | 1970 | 1972 |
|---|---|---|---|---|
| | (billion dollars) | | | |
| All commodities | 22.30 | 27.50 | 55.45 | 73.80 |
| of which: Agricultural* and forestry | 12.20 | 12.92 | 19.00 | 23.10 |
| of which: Cereals, oilseeds, oils and fats | 2.14 | 1.90*** | 2.56 | - |
| Tropical beverages | 3.51 | 2.98*** | 4.44 | - |
| Fibres and rubber | 3.17 | 3.35*** | 3.24 | - |
| Feedingstuffs, livestock products, fish | 0.40 | 0.73*** | 1.89 | - |
| Sugar, fresh fruit and vegetables | 1.37 | 1.73*** | 2.84 | - |
| Timber and pulp | 0.28 | 0.46 | 1.20 | - |
| Fuels | 5.25 | 7.88 | 18.09 | 27.80 |
| Ores and non-ferrous metals | 2.16 | 2.96 | 6.60 | 6.30 |
| Manufactures** | 1.74 | 2.53 | 9.80 | 15.60 |
| | (% share in total) | | | |
| Agricultural* and forestry | 54.7 | 47.0 | 34.3 | 31.3 |
| of which: Cereals, oilseeds, oils and fats | 9.6 | 6.9*** | 4.6 | - |
| Tropical beverages | 15.7 | 10.8*** | 8.0 | - |
| Fibres and rubber | 14.2 | 12.2*** | 5.8 | - |
| Feedingstuffs, livestock products, fish | 1.8 | 2.7*** | 3.4 | - |
| Sugar, fresh fruit and vegetables | 6.1 | 6.3*** | 5.1 | - |
| Timber and pulp | 1.3 | 1.7 | 2.2 | - |
| Fuels | 23.5 | 28.7 | 32.6 | 37.7 |
| Ores and non-ferrous metals | 9.7 | 10.8 | 11.9 | 8.5 |
| Manufactures** | 7.8 | 9.2 | 17.7 | 21.1 |

* Including processed foodstuffs.
** Excluding non-ferrous metals.

*** Average 1959-61 instead of 1960-61.

and income elasticity of demand. Tariffs are low or non-existent, and even excise taxes, which are relatively high in several countries, are not thought to inhibit demand significantly. A problem for trade policy in this area is the escalation of tariffs on the more processed forms of these products.

With respect to industrial raw materials, of both mineral and agricultural origin, there is little protection in the main trading countries, but also little possibility of further improvements in the trade position of the supplying developing countries. For agricultural raw materials, competition from synthetics will remain the main problem.

Beyond stabilising domestic economic activity at full employment levels, there is very little economic policy can do to accelerate the growth of demand for raw materials. Commodity agreements which would raise the long-term price trends of individual primary products are difficult to negotiate for many reasons, the main one being that these materials are produced as well as consumed in both developed and developing countries, and any change in their prices, both relative to the prices of manufactures and relative to each other, would have different repercussions on different groups of developing and developed countries which those in losing positions would strenuously resist.

This does not mean, however, that developing countries which at present export mainly raw materials are condemned in perpetuity to a less rapid growth of their exports relatively to world trade whose dynamism derives from exchanges of manufactures. The exports of these countries can be, and are being, accelerated by 'hitching' them, so to speak, to the dynamic element of world trade, that is by exporting them in increasingly processed forms.

Progress in this direction could receive a significant stimulus in the coming multilateral trade negotiations. It is precisely in the early processing stages, adding a relatively narrow margin of value added, that the existing escalated tariffs retain their maximum protective effect. A number of developments in the world economy suggest that the resistance to reducing effective protection in this area may be weaker in the new round of multilateral trade negotiations than it was in the 1960s.

(i) The new, so far unexploited, resources are mainly located in developing countries. While capital from developed countries is eager to engage in the exploitation of these resources, the growing demand will make the governments controlling these resources increasingly able to insist on participation in their exploitation and on a higher degree of processing at the extraction sites.

(ii) Processing at the extraction sites is energy-saving in that it eliminates the extensive cross-hauling in which significantly weight-losing materials are transported in one direction with a part of the processed products being re-exported.

(iii) Pollution and congestion in the industrial countries are rapidly increasing the cost of processing operations which require much space, water and air.

(iv) Differential growth of labour supplies between developed and developing countries, and the changing occupational preferences in the former, are also creating differential cost increases which shift the comparative advantage in such areas as metallurgy in favour of developing countries.

Trade in manufactures. A review of the main conditions and patterns of this area of trade will indicate the possibilities of policy action. There is a high, if slowly declining degree of concentration on the export end: some nine-tenths[1] of manufactured exports from developing countries originate in the groups of fifteen industrialising ones. A similar concentration exists on the import end, with some four-fifths of these exports absorbed by developed countries. The flow to industrial countries is already growing rapidly and there are pronounced differences in the rate of growth and degree of penetration attained by these exports in the markets of individual developed countries. These are illustrated in Table 4.5.

It would be a mistake to interpret these differences as indicating the relative 'openness', or degrees of protection, of individual import markets. Apart from an important statistical distortion,[2] they reflect the degree of attractiveness

[1] Little less if non-ferrous metals are included in manufactures, little more if they are excluded.

[2] The developing countries in Table 4.5 are again those of the United Nations definition. If the industrialising countries of southern and south-eastern Europe, for whom the EEC is the main market, were included, the contrast between the United States and the EEC would be sharply diminished; and it would probably disappear if intra-EEC exchanges were netted out.

Table 4.5

Imports of manufactures, excluding non-ferrous metals, into selected developed countries, 1962 and 1972
(million dollars c.i.f. and %)

| Importing countries | Value in million dollars c.i.f.: Total 1962 | Total 1972 | From developing countries 1962 | From developing countries 1972 | Imports from developing countries in % of total imports 1962 | 1972 | Annual growth rate of imports from developing countries 1962 to 1972 |
|---|---|---|---|---|---|---|---|
| United Kingdom | 3,683 | 14,137 | 483 | 1,196 | 13.1 | 8.5 | 9.5 |
| United States* | 6,445 | 35,816 | 657 | 5,399 | 10.2 | 15.1 | 23.5 |
| Norway | 1,108 | 3,203 | 45 | 103 | 4.1 | 3.2 | 8.6 |
| Australia | 1,574 | 3,514** | 58 | 122** | 3.7 | 3.5** | 8.6*** |
| Japan | 1,360 | 5,867 | 59 | 774 | 4.3 | 13.2 | 29.4 |
| Germany, Fed. Rep. | 4,695 | 22,269 | 132 | 982 | 2.8 | 4.4 | 22.2 |
| France | 3,101 | 16,074 | 87 | 423 | 2.8 | 2.6 | 17.1 |
| Switzerland | 1,990 | 6,316 | 31 | 136 | 1.6 | 2.2 | 15.9 |
| Belgium-Luxemburg Union | 2,399 | 9,882 | 32 | 190 | 1.3 | 1.9 | 19.5 |
| Denmark | 1,313 | 3,509 | 16 | 70 | 1.2 | 2.0 | 15.9 |
| Canada* | 4,030 | 15,028 | 54 | 390 | 1.3 | 2.6 | 21.9 |
| Sweden | 1,948 | 5,717 | 23 | 154 | 1.2 | 2.7 | 20.9 |
| Italy | 2,616 | 8,734 | 26 | 244 | 1.0 | 2.8 | 25.1 |
| Netherlands | 3,123 | 10,716 | 31 | 218 | 1.0 | 2.0 | 21.5 |
| Portugal | 322 | 1,425 | 3 | 106 | 0.9 | 7.4 | 42.8 |
| Austria | 965 | 3,864 | 7 | 42 | 0.7 | 1.1 | 19.6 |
| Spain | 721 | 3,597 | 5 | 80 | 0.7 | 2.2 | 32.0 |
| Total | 41,393 | 169,668 | 1,749 | 10,629 | 4.2 | 6.3 | 19.8 |

* Imports f.o.b. ** 1971. *** 1962-71.

Sources: United Nations, Commodity Trade Statistics; OECD, Trade by Commodities, Series B.

of these markets for developing country exporters. Protection matters in this respect, as does the valuation of the exchange rate, but what seems to matter even more is the size of the market, the distribution facilities it offers and its transaction language - i.e. factors bearing on the sales cost per unit of exports. To some extent, the rapid growth of United States and Canadian imports of manufactures from developing countries reflects the growing over-valuation of the American dollar in the 1960s; nonetheless, even in exchange-equilibrium, the United States market would continue to be the most attractive one for exporters from developing countries because its size and efficient organisation would continue to make for a very low unit sales cost. The enlarged European Economic Community is a larger importer of manufactures than North America. It is not, however, and will not be in the foreseeable future, a homogeneous market in the sense that its distribution systems are still largely national, so that the sales effort has to be conducted in several languages and production often geared to national tastes. These export-sales requirements of the European market are much more of an obstacle for the overseas developing countries than for the industrialising countries of southern Europe.

Against this factual background, two commercial issues directly affecting developing countries stand out in importance: tariff preferences, and possible changes in the multilateral safeguard system. While the former has so far attracted the most attention, the latter may eventually acquire a much greater importance. As to both, it may be added, significant differences of view have existed on the two sides of the Atlantic.

In the political process leading to the establishment of generalised schemes of preferences, the European countries became convinced of the desirability of the measure earlier than the two North American ones. In the light of the European tradition, particularly in that of the ex-imperial countries with continuing responsibilities toward their former colonies, tariff preferences appeared a familiar, legitimate and effective device for discharging that responsibility. United States and Canada were more reluctant to accept the scheme (although preferential precedents exist in both traditions).

Both were already experiencing a rapid inflow of manufactured imports from developing countries and some difficulty in adjusting to it, which in turn increased the difficulty of legislative action required for the establishment of generalised preference schemes. Also, both countries are vitally interested in further multilateral tariff reductions on a most-favoured-nation basis, and fears that a vested preferential interest might inhibit future tariff negotiations among industrial countries contributed to their reluctance.

Detailed empirical analyses now published[1] cast considerable doubt on the effectiveness of the existing preferential schemes in increasing imports of manufactures from developing countries.[2] The shortcomings, and the reforms needed, can be summarised under three broad headings.

(i) Incomplete implementation. United States and Canada together account for more than half of total imports of dutiable manufactures and semi-manufactures (excluding non-ferrous metals) from developing into the OECD countries. Without the participation of the United States and Canada, not only will the actual GSP benefit be less than a half of the potential one but, much more importantly, countries already granting generalised preferences, which they regard as a 'burden', will find it difficult to institute substantial improvements in their own schemes for fear that a greater liberality on their part might deflect less developed countries' exports from North America into their own markets.

(ii) Exclusion from preferential treatment. Less than a half of dutiable imports from developing countries into countries that have implemented a GSP actually qualify for tariff preference.[3] The exclusions from the GSP were dictated by

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[1] T. Murray, 'How helpful is the generalised system of preferences to developing countries', Economic Journal, vol.83, 1973, pp.449-64; P.J. Lloyd, 'The Australian Tariff Preference Scheme for developing countries', Journal of World Trade Law, vol.4, no.3, 1970, pp.448-73; T. Murray, 'UNCTAD's generalized preferences: an appraisal', Journal of World Trade Law, vol.7, no.4, 1973, pp.461-72; R. Cooper, 'The European Community's system of generalized tariff preferences: a critique', Journal of Development Studies, vol.8, 1972, pp.379-94.

[2] Among the countries listed in Table 4.5, only the United Kingdom and Australia were granting a fairly extensive preferential treatment to developing countries possessing significant manufacturing capacities. In both markets, the share of developing countries in total imports of manufactures declined over the period in question, broadly supporting the sceptical conclusions of the literature cited in the preceding footnote.

[3] T. Murray, 'Preferential tariffs for the LDCs' in Southern Economic Journal, July 1973, p.36. This was written before the announcement at the end of October 1973 of the revision and significant liberalisation of the EEC scheme.

the concern lest preferential imports create a problem for the domestic industry, developed trading partners, or some of the developing countries with whom a special trading relationship had traditionally been entertained by the donor. Although there are differences in exclusions under individual schemes, most are concentrated in the textile,[1] leather and petroleum product sectors. Exclusions thus comprise most of the relatively labour-intensive manufactures exported by our third group of the poorest developing countries.

(iii) Limits on, and insecurity of, preferential access. Some nine-tenths of imports presently benefiting from the GSP are imported under schemes which limit preferential entry by tariff quotas and ceilings. Given the formulae for calculating these quotas and ceilings, and the rate of growth of total imports of manufactures from developing countries in recent years, it is highly likely that the main beneficiaries of these schemes fill their preferential quota and continue to export across the most-favoured-nation tariff. Where preferential entry is unlimited in principle, the donor country retains the right to invoke a special escape clause allowing the re-imposition of the most-favoured-nation tariff in those cases where a continued growth of imports under the preference would create a serious adjustment problem for domestic industry. The GSP being a unilateral grant, the judgment as to the 'seriousness' of the problem is likely to be equally one-sided.

Two conclusions can be drawn from these criticisms. First, in its present form, the GSP does little to stimulate additional trade. It could permanently raise the rate of growth of exports from developing countries only if it guaranteed unlimited preferential access. With preferential quotas filled, additional exports face the most-favoured-nation tariff; at the margin, therefore, where it counts, the scheme as such provides no incentive for additional export effort. More fundamentally, even those schemes which in principle offer unlimited preferential access cannot furnish any additional incentive for investment in export capacities; given the uncertainty inherent in the unilateral escape clauses characteristic of the GSP, the scarce capital available to developing countries can be prudently committed only to such

[1] Where textiles are included in the GSP, they are, or shortly will be, limited (not in amounts qualifying for preference but in total amounts imported) by quantitative restrictions and bilaterally negotiated 'exporters' self restraints'.

investments whose products can be profitably sold across the most-favoured-nation tariffs.[1]

Second, by excluding manufactures which the poor developing countries are best suited to export, the GSP becomes another factor making for a growing disparity between the industrialising and the poor developing countries. And precisely because it is biased in favour of the former group, whose export capacities and competitiveness are growing rapidly, the GSP is unlikely to be improved by an inclusion of stronger guarantees of preferential access. Indeed, the problem of the industrialising countries is increasingly one of securing guaranteed unlimited access across the most-favoured-nation tariffs.

This is why the issue of safeguards will be ultimately more important than that of preferences. In this respect, too, there are at present different views among the North Atlantic countries. The proposed legislation and numerous policy statements of the United States announce the intention to negotiate a substantial reform of the international safeguard rights and obligations embodied in Article 19 of GATT. Other countries, while agreeing to review the provisions of Article 19, seem willing to contemplate only minor changes in the mode of their application. A part of this difference can perhaps also be explained by the distribution of imports from the developing among the OECD countries given in Table 4.5.

The problem of reforming the existing multilateral safeguard system, embodied in Article 19 of GATT, into one better adapted to the high rates of trade expansion, present and anticipated, is a difficult one, but it can be described simply. It divides into two parts. The first is to make the rules sufficiently flexible to cover all situations in which a country might need emergency protection, and so to eliminate the incentive for large importing countries to act unilaterally or bilaterally in situations where import-absorption problems emerge for individual industries. The second step comprises reforms that would make the safeguard system an instrument of industrial adjustment, raising the import-absorption capacity of the participating economies in the long run.

The difficulty of the first step is one of calibrating the degree of permissiveness of the rules of safeguard action. A

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[1] With guaranteed unlimited preferential access, one could expect much of the new export-oriented investment to be financed from preference-granting countries.

too permissive safeguard clause would destroy security of import access which has been the central purpose of the General Agreement. On the other hand, provisions so strict and rigid as to impose 'unbearable' costs on the invoking country would have a similar effect since they would force countries in emergency situations to act outside the framework of agreed principles and multilateral control. The problem is therefore one of establishing a balance of rights and obligations under multilateral control,[1] a solution which demands some surrender of national sovereignty but no greater than governments are willing to make.

Since in the matter of safeguards, as in other problems arising from the progressive integration of the world economy, a surrender of a degree of sovereignty can be viewed as a purchase of insurance, one may rightly ask what causes the obvious reluctance of governments to part with it. The answer is that no contractual obligations can fully anticipate future development, especially in such a dynamic period as the present; and although fully recognising the value of exchanging a degree of national sovereignty for a protecting right, the governments have to be extremely wary lest the wording of the contract deprive them of a possibility to act in some now unforeseeable emergency.

While the first step relates essentially to a reformulation of the safeguard or escape clause provisions existing in national legislations and international contracts, the second issue represents a conceptual innovation. We have to recall that the existing provisions, agreed upon and enacted a quarter-century ago, embody the experience and wisdom of a much slower, in some respects much more stable world. The existing safeguard provisions were intended for clearly exceptional and essentially temporary, mainly cyclical, emergencies; they are limited to provisions for emergency protection. In view of the current and anticipated growth of export capacities, the new system cannot be conceived of as one for exceptional situations; it has to be an instrument of the transformations and accommodations required. The objective of this part of the reform is to ensure that the safeguard action will provide only a temporary respite from 'excessive' import pressure, a

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[1] For a more detailed discussion, see J. Tumlir, 'A revised safeguard clause for GATT?' in Journal of World Trade Law, vol.7, no.4, 1973, pp.404-20, and same author, Proposals for Emergency Protection against Sharp Increases in Imports, London, 1973.

period during which something will be done to solve the problem which gave rise to the request for protection. To be effective in this respect, the safeguard system should combine the right to impose temporary protection with an obligation of the protecting country to prepare, discuss with its partners, and put into effect a convincing adjustment program for the industry under import pressure.

# Appendix

## 1. Population

The estimates of population in 1985 and 2000 have been taken from United Nations, Monthly Bulletin of Statistics (April and November 1971).

## 2. Industrial employment and value added in industry

### For 1955 and 1970

We have used the figures given for 1963 in United Nations, The Growth of World Industry (1969 edition) which have been extrapolated to 1955 and 1970 by the United Nations indices of industrial employment and production.

### For 1985 and 2000

For the developed countries it was assumed:

(a) that industrial employment, which represented around 11 per cent of total population in developed countries in 1955 and 1970, would represent in 1985 and 200, 10 and 9.5 per cent respectively of that population;

(b) that annual average increase of labour productivity would be slightly less than 4 per cent between 1970 and 1985 and between 1985 and 2000.

For the developing countries it was assumed:

(a) that industrial employment, which represented 3 and 4 per cent of total population in developing countries in 1955 and 1970 respectively, would represent in 1985 and 200, 5 and 6 per cent respectively of that population.

(b) that annual average increase of labour productivity would rise to 5 and 6 per cent between 1970 and 1985 and between 1985 and 2000 respectively.

## Chapter 5

# Japan and the developing countries

Hisao Kanamori

### Japan's trade with developing countries

Japan accounts for an extraordinarily large proportion of the trade that developing countries conduct with the rest of the world. The share has been increasing rapidly. Table 5.1 shows that, in 1970, Asian countries (excepting the communist bloc and Japan) imported from Japan 21 per cent of all their imports, African countries 9 per cent and Latin American nations 7 per cent. The percentages had almost doubled since 1960. These developing countries conducted intensive export trade with Japan as well. Table 5.2 indicates that Japan accounts for up to 33 per cent of the export trade of Asian countries.

There are two reasons for the large scale of the trade between Japan and the developing world.

First, it is attributed to the rapid pace at which the Japanese economy has been expanding, and the increases in Japan's import demand and export capacity. During the past decade, all of Japan's GNP (nominal), exports and imports have grown by 17 per cent at an annual average (see Table 5.3). Japan's GNP reached about $450 billion, or $4,100 per capita, in 1973. It is only natural that both exports and imports increase in such a gigantic economic power.

Second, it owes much to the character of Japan's economic structure which is so formed as to promote trade with developing countries.

In fact, Japan's economic structure is so complex that the nation complements economically not only developing countries but also other advanced countries. An examination of regional distribution of Japan's trade in 1970 reveals that, of her exports, the advanced region accounts for 54.7 per cent, the

Table 5.1

Japanese exports by area of destination

| | Exports ($ million) | | | | | Percentage | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1955 | 1960 | 1965 | 1970 | 1980 | 1955 | 1960 | 1965 | 1970 | 1980 |
| North America | 500 | 1,230 | 2,725 | 6,580 | 29,848 | 24.9 | 30.4 | 32.2 | 34.1 | 32.4 |
| USA | 455 | 1,110 | 2,510 | 6,020 | 26,751 | 22.6 | 27.4 | 29.7 | 31.2 | 29.0 |
| Canada | 45 | 120 | 215 | 560 | 3,097 | 2.2 | 3.0 | 2.5 | 2.9 | 3.4 |
| Western Europe | 195 | 475 | 1,100 | 2,920 | 17,679 | 9.7 | 11.7 | 13.0 | 15.1 | 19.2 |
| EEC | 81 | 175 | 485 | 1,300 | 9,116 | 4.0 | 4.3 | 5.7 | 6.7 | 9.9 |
| EFTA | 90 | 230 | 460 | 1,060 | 5,709 | 4.5 | 5.7 | 5.4 | 5.5 | 6.2 |
| ANS* | 92 | 227 | 515 | 1,070 | 5,156 | 4.6 | 5.6 | 6.1 | 5.5 | 5.6 |
| Latin America | 180 | 275 | 410 | 990 | 3,223 | 9.0 | 6.8 | 4.9 | 5.1 | 3.5 |
| Asia | 803 | 1,445 | 2,480 | 5,410 | 23,756 | 40.0 | 35.7 | 29.3 | 28.0 | 25.8 |
| Southeast | 720 | 1,310 | 2,200 | 4,870 | 19,063 | 35.8 | 32.3 | 26.0 | 25.2 | 20.7 |
| West | 83 | 135 | 280 | 540 | 4,693 | 4.1 | 3.3 | 3.3 | 2.8 | 5.1 |
| Africa | 170 | 290 | 670 | 1,070 | 4,051 | 8.5 | 7.2 | 7.9 | 5.5 | 4.4 |
| Planned economy bloc | 38 | 73 | 475 | 1,045 | 7,919 | 1.9 | 1.8 | 5.6 | 5.4 | 8.6 |
| USSR | 3 | 60 | 168 | 341 | 4,181 | 0.1 | 1.5 | 2.0 | 1.8 | 4.5 |
| China | 29 | 3 | 245 | 572 | 2,336 | 1.4 | 0.1 | 2.9 | 3.0 | 2.5 |
| Total exports** | 2,010 | 4,050 | 8,450 | 19,320 | 92,184 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

* Australia, New Zealand, and South Africa.
** Totals include exports to other countries.

Table 5.2

Japanese imports by area of origin

| | Imports ($ million) | | | | | Percentage | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1955 | 1960 | 1965 | 1970 | 1980 | 1955 | 1960 | 1965 | 1970 | 1980 |
| USA | 680 | 1,440 | 2,070 | 4,610 | 20,956 | 31.3 | 37.1 | 30.2 | 29.4 | 27.8 |
| Canada | 92 | 185 | 295 | 790 | 2,702 | 4.2 | 4.8 | 4.3 | 5.0 | 3.6 |
| Western Europe | 160 | 360 | 620 | 1,710 | 11,675 | 7.4 | 9.3 | 9.1 | 10.9 | 15.5 |
| EEC | 91 | 210 | 340 | 990 | 6,779 | 4.2 | 5.4 | 5.0 | 6.3 | 9.0 |
| EFTA | 59 | 135 | 250 | 650 | 4,670 | 2.7 | 3.5 | 3.7 | 4.7 | 6.2 |
| Latin America | 230 | 240 | 480 | 1,020 | 3,013 | 10.6 | 6.2 | 7.0 | 6.5 | 4.0 |
| ANS | 185 | 372 | 655 | 1,625 | 7,156 | 8.5 | 9.6 | 9.6 | 10.4 | 9.5 |
| Southeast Asia | 570 | 760 | 1,100 | 2,370 | 10,281 | 26.3 | 19.6 | 17.3 | 15.1 | 13.6 |
| West Asia | 125 | 300 | 890 | 2,080 | 9,153 | 5.8 | 7.7 | 13.0 | 13.3 | 12.1 |
| Africa | 35 | 73 | 165 | 620 | 3,013 | 1.6 | 1.9 | 2.4 | 4.0 | 4.0 |
| Planned economy bloc | 83 | 110 | 435 | 765 | 7,307 | 3.8 | 2.8 | 6.4 | 4.9 | 9.7 |
| Others | 15 | 5 | 50 | 120 | 151 | 0.7 | 0.1 | 0.7 | 0.8 | 0.2 |
| Total | 2,170 | 3,880 | 6,840 | 15,670 | 75,407 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

Table 5.3

World economy and Japanese exports and imports

| | 1960 | 1970 | 1980 |
|---|---|---|---|
| World GNP ($ billion) | 1,405 | 3,049 (8.2) | 7,643 (9.6) |
| Japan GNP ($ billion) | 43 | 196 (16.5) | 957 (17.2) |
| World trade ($ billion) | 128 | 311 (9.3) | 850 (10.6) |
| Japan exports ($ billion) | 4.1 | 19.3 (16.9) | 92.2 (16.9) |
| Japan imports ($ billion) | 3.9 | 15.7 (15.0) | 75.5 (17.0) |
| Japan's exports as a percentage of GNP | 9.4 | 9.9 | 9.6 |
| Japan's imports as a percentage of GNP | 9.0 | 8.0 | 7.9 |
| World trade elasticity of Japan exports | | 1.82 | 1.59 |
| Income elasticity of Japan imports | | 0.91 | 0.98 |
| Japan's share of world exports (%) | 3.2 | 6.2 | 10.8 |

Notes: 1. Figures in parentheses show the average annual rate of increase.
2. For 1980, the value of US dollar is calculated to be equivalent to 280 yen.
3. Value of trade is in f.o.b. price.

developing area 38.6 per cent and the communist world 5.4 per cent; while of her imports 55.7 per cent were accounted for by the advanced world, 38.9 per cent by the developing countries and 4.9 per cent by the communist bloc. In this way it is shown that Japan trades with both the advanced and developing areas. It is rarely the case as it is in Japan that nearly 40 per cent of one country's trade is accounted for by the trade with developing countries. In other industrial countries the trade with advanced countries accounts for a larger proportion than it does in Japan.

The structure of Japanese trade was of a type that the nation imported food and raw materials and exported industrial manufactures. This was in contrast to the trade of western industrial nations which centred around the exchange of industrial goods (see Table 5.4). Consequently, many Japanese

Table 5.4

Composition of imports of major countries
(%)

| | Food and beverage | | Raw materials | | Mineral fuels | | Processed goods | |
|---|---|---|---|---|---|---|---|---|
| | 1960 | 1969 | 1960 | 1969 | 1960 | 1969 | 1960 | 1969 |
| Japan | 13.6 | 14.2 | 49.5 | 33.0 | 14.1 | 20.3 | 22.7 | 31.4 |
| USA | 22.7 | 14.1 | 19.2 | 9.8 | 10.5 | 8.0 | 47.7 | 66.2 |
| UK | 34.0 | 23.3 | 23.8 | 15.1 | 10.6 | 10.9 | 31.6 | 50.7 |
| France | 20.3 | 13.3 | 24.6 | 12.0 | 17.0 | 11.4 | 33.2 | 63.3 |
| West Germany | 22.7 | 17.4 | 24.4 | 14.5 | 7.8 | 8.9 | 45.2 | 59.2 |
| Italy | 15.8 | 17.8 | 30.4 | 18.9 | 14.1 | 14.6 | 39.8 | 48.7 |

imports came from developing countries, and machinery, iron and steel, chemical fertiliser and synthetic fibres were exported in exchange. The pattern is clearly discernible in Table 5.5.

## Prospective growth of the Japanese economy

The economic relations in the future between Japan and developing countries will depend much on the pace and pattern in which the Japanese economy will grow hereafter.

(a) Rate of growth. As regards the growth rate, one opinion is that the economy will continue its high growth. Herman Kahn, a noted futurist, foresees that Japan will continue an economic growth at an annual rate of 11-12 per cent throughout the 1970s. This is almost the same as the actual growth of the Japanese economy in the 1960s. On the other hand, there are more pessimistic views. Z. Brzezinski, an American political scientist, predicts that the Japanese economy will slow down its annual rate of growth to 8 per cent in the first half of 1970s and 6 per cent in the latter half.

The right estimate would be between the two predictions. The London *Economist* projects that the Japanese economy will grow at an average annual rate of 9 per cent during the 1970s. The Japanese government foresees that it will grow by 9.4 per cent (1973-77), and the Japan Economic Research Center foresees a growth by 10 per cent (Table 5.6). It appears to me that a 9-10 per cent growth would be a reasonable guess. The

Table 5.5

Japan's foreign trade with Southeast and South Asia
($ million)

| | | Exports | | Imports | | Principal commodities of Japan's export | Principal commodities of Japan's import |
|---|---|---|---|---|---|---|---|
| | | 1961 | 1971 | 1961 | 1971 | | |
| (1) | Taiwan | 96 | 923 | 68 | 286 | Electrical machinery, general machinery, iron steel | Bananas, textile products, fish |
| | Korea | 126 | 856 | 22 | 274 | General machinery, iron steel, transport machinery | Textile products, fish, silk |
| | Hong Kong | 154 | 787 | 24 | 98 | Synthetic textiles, electrical machinery, precision instruments | Textile products, fish, jewellery |
| (2) | Singapore | 102 | 508 | 25 | 114 | Synthetic textiles, iron steel, general machinery | Petroleum products |
| | Thailand | 134 | 445 | 78 | 230 | General machinery, transport machinery, iron steel | Corn, rubber, shrimps |
| | India | 116 | 209 | 152 | 377 | Iron steel, transport machinery, general machinery | Iron ore, non-metallic ore, shrimps |
| | Pakistan | 52 | 113 | 29 | 58 | Rice, iron steel, general machinery | Cotton, textile products, shrimps |
| (3) | Philippines | 128 | 465 | 156 | 514 | General machinery, iron steel, electrical machinery | Lumber, copper ore, iron ore |
| | Indonesia | 154 | 453 | 85 | 854 | General machinery, iron steel transport machinery | Crude oil, lumber, petroleum products |
| | Malaysia | 32 | 204 | 223 | 373 | Transport machinery, general machinery, iron steel | Lumber, tin, rubber |

Table 5.6

Economic scale and production factors

| | Actual | | | Average annual % growth | |
|---|---|---|---|---|---|
| | 1960 actual | 1970 actual | 1980 10% growth | 1960-70 actual | 1970-80 10% growth |
| GNP (billion yen) | 19,099 | 56,364 | 146,192 | 11.1 | 10.0 |
| **Labour** | | | | | |
| Total population (10,000 persons) | 9,342 | 10,372 | 11,573 | 1.1 | 1.1 |
| 15 years old and over (10,000 persons) | 6,520 | 7,885 | 8,778 | 1.9 | 1.1 |
| Labour force (10,000 persons) | 4,511 | 5,153 | 5,491 | 1.3 | 0.6 |
| Employed (10,000 persons) | 4,436 | 5,094 | 5,436 | 1.4 | 0.7 |
| Actual working hours (hours/week) | 46.8 | 43.3 | 38.5 | 0.8 | 1.2 |
| **Technology** | | | | | |
| R and D expenditures (billion yen) | 184 | 1,195 | 8,591 | 20.6 | 21.8 |
| Technological progress | - | - | - | 4,491 | 4,465 |
| **Capital** | | | | | |
| Stock of private capital (billion yen) | 27,915 | 84,316 | 245,477 | 11.7 | 11.3 |
| Stock of government capital (billion yen) | 15,055 | 41,492 | 138,882 | 10.7 | 12.8 |

Source: The Japan Economic Research Center, A Long-term Outlook of Japanese and U.S. Economies.

high growth of the Japanese economy has been brought about by a number of factors:

(i) high educational standards and an industrious labour force

(ii) high rate of savings and equipment investments

(iii) technical innovation with the positive introduction of new technology

(iv) small expenditure for defence

(v) political and social stability.

Some of these factors may change to some extent in future, but the growth potential of the Japanese economy is deeply rooted in its constitution and it is not likely that the rate of its growth will decelerate greatly.

(b) Pattern of growth. On the other hand, the Japanese economy is likely to undergo major changes in the pattern of its growth.

The first is changes in the direction of investment. In Japan after the war the increasing rate of private equipment investment which directly leads to an increase in productive power has been so high that its ratio to GNP amounted to 20 per cent in 1970. As a result, however, though productive equipment of private enterprises has been modernised, there has been relative deterioration of environment and of public sectors such as traffic, sewerage systems, schools and hospitals. In consequence, the government decided to increase public investment in its new five-year economic plan (Basic Economic and Social Plan) starting in 1973. Such changes have already appeared in the government budget as well, with an indication that there is certain to be an expansion of the public sector.

The shift in the priority of investment from the private to the public sector will no doubt decelerate to some extent the growth of productive capacity. In Japan, however, the savings rate had been rising gradually along with the improvement of income level until 1970 when around 20 per cent of the after-tax personal income was saved. Future improvement of the social security system will reduce the need for individuals to save for their old age and may have some negative effects on the saving rate. The effects will not be so abrupt, however. The light burden of military defence (0.8 per cent of GNP) and the high rate of savings enables Japan to expand both public and private investment at the same time. The tax burden which now stands at the low level of 20 per cent of national income will increase and the dependence on public debt will grow from the present low level.

The second change is an expansion of social security programs. Despite the high rate of growth of her economy, Japan lags far behind in implementation of social security programs with her expenditure in this field accounting for only 6.2 per cent of national income in 1966-67. In the United Kingdom and West Germany the proportions are 15 and 22 per cent respectively. Defects in the social security systems are a source of increasing unrest, especially in regard to security in old age. As a consequence the government has set about the augmentation of a social security program.

The third change is that in the industrial structure. When such factors as the aggravation of the pollution problem and the future shortages of resources and labour are taken into account, the industrial structure is likely to change considerably. There will be a relative decline of the agricultural sector and increases in the manufacturing, construction and service industries. In manufacturing, textiles, paper and pulp, chemicals and primary metals will decline in relative size, while machinery will increase in importance (Table 5.7).

The fourth change is the progress of inflation. In Japan, consumer prices increased at an annual rate of 5.0 to 6.1 per cent, the most rapid rise in the industrial world, during the 1960s. Wholesale prices, on the other hand, remained almost unchanged and were the most stable in the world. The stability of wholesale prices might be attributable mostly to the fact that, while the wage rate rose as high as 15 per cent at an annual rate, the labour productivity in manufacturing industries increased at a high rate so that the imbalance between the two was not so severe and unit labour costs remained stable. In recent years, however, there has been a trend towards acceleration of wage increases as labour becomes increasingly scarce. Wage rates rose by 20 per cent in 1973. As a consequence, a possibility is emerging that the wage increases may exceed the productivity gains. In September 1973, consumer and wholesale prices staged abnormal rises of 20 and 14 per cent respectively above levels the year before. This was influenced in part by temporary factors such as worldwide inflation. Japan in the 1970s is unlikely to avert the cost push inflation that has been experienced in European countries. With the high labour productivity, however, the problem of inflation appears less serious in Japan than in other countries.

Thus, the Japanese economy is likely to continue a high growth, while changing its pattern of growth. Japan will

Table 5.7

Production and employment structures by industry

| | Absolute value | | | | | | Percentage proportion | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Gross domestic production (billion yen) | | | Persons employed (ten thousand) | | | Gross domestic production (%) | | | Persons employed (%) | | |
| | 1960 | 1970 | 1980 | 1960 | 1970 | 1980 | 1960 | 1970 | 1980 | 1960 | 1970 | 1980 |
| Agriculture, forestry and fishery | 2,106 | 4,689 | 14,081 | 1,340 | 886 | 569 | 12.9 | 6.5 | 4.8 | 30.2 | 17.4 | 10.5 |
| Mining | 278 | 566 | 2,362 | 43 | 20 | 10 | 1.7 | 0.8 | 0.8 | 1.0 | 0.4 | 0.2 |
| Manufacturing | 5,184 | 24,922 | 94,161 | 946 | 1,377 | 1,535 | 31.9 | 34.8 | 31.9 | 21.3 | 27.0 | 28.2 |
| Foods | 604 | 2,378 | 6,200 | 106 | 134 | 125 | 3.7 | 3.3 | 2.1 | 2.4 | 2.6 | 2.3 |
| Textiles | 443 | 1,434 | 2,805 | 171 | 198 | 180 | 2.7 | 2.0 | 1.0 | 3.9 | 3.9 | 3.3 |
| Pulp and paper | 155 | 644 | 2,269 | 31 | 40 | 40 | 1.0 | 0.9 | 0.8 | 0.7 | 0.8 | 0.7 |
| Chemicals | 520 | 2,395 | 8,992 | 50 | 59 | 60 | 3.2 | 3.3 | 3.0 | 1.1 | 1.2 | 1.1 |
| Petroleum and coal products | 191 | 897 | 4,321 | 4 | 5 | 5 | 1.2 | 1.3 | 1.6 | 0.1 | 0.1 | 0.1 |
| Ceramics, stones and clay products | 216 | 1,118 | 4,373 | 48 | 67 | 85 | 1.3 | 1.6 | 1.5 | 1.1 | 1.3 | 1.6 |
| Primary metals | 596 | 2,473 | 6,019 | 68 | 91 | 103 | 3.7 | 3.5 | 2.0 | 1.5 | 1.8 | 1.9 |
| Metal products | 222 | 1,632 | 7,380 | 54 | 104 | 127 | 1.4 | 2.3 | 2.5 | 1.2 | 2.0 | 2.3 |
| Machinery | 1,423 | 7,965 | 36,541 | 239 | 429 | 531 | 8.8 | 11.1 | 12.3 | 5.3 | 8.3 | 9.8 |
| Others | 815 | 3,987 | 14,761 | 175 | 250 | 279 | 5.0 | 5.6 | 5.0 | 3.9 | 4.9 | 5.1 |
| Electricity, gas and water | 370 | 1,358 | 7,380 | 22 | 29 | 30 | 2.3 | 1.9 | 2.5 | 0.5 | 0.6 | 0.6 |
| Construction | 869 | 4,949 | 25,684 | 253 | 394 | 487 | 5.3 | 6.9 | 8.7 | 5.7 | 7.7 | 9.0 |
| Transport and communications | 1,316 | 5,122 | 26,123 | 217 | 324 | 421 | 8.1 | 7.1 | 8.8 | 4.9 | 6.4 | 7.7 |
| Finance, insurance and real estate | 1,413 | 7,625 | 30,791 | 84 | 132 | 163 | 8.6 | 10.6 | 10.4 | 1.9 | 2.6 | 3.0 |
| Commerce and services | 4,732 | 22,425 | 94,632 | 1,531 | 1,924 | 2,221 | 29.1 | 31.3 | 32.0 | 34.5 | 37.8 | 41.0 |
| Total | 16,268 | 71,654 | 295,214 | 4,436 | 5,094 | 5,436 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Primary industries | 2,106 | 4,689 | 14,081 | 1,340 | 886 | 569 | 12.9 | 6.5 | 4.8 | 30.2 | 17.4 | 10.5 |
| Secondary industries | 6,331 | 30,437 | 122,207 | 1,242 | 1,791 | 2,032 | 38.9 | 42.5 | 41.4 | 28.0 | 35.2 | 37.4 |
| Tertiary industries | 7,831 | 36,528 | 158,926 | 1,854 | 2,417 | 2,835 | 48.2 | 51.0 | 53.8 | 41.8 | 47.4 | 52.2 |

Source: Japan Economic Research Center.

Table 5.8

World GNP, populations and exports

| | 1960 | 1970 | 1980 | % proportion 1960 | % proportion 1970 | % proportion 1980 | Average annual % change 1960-70 | Average annual % change 1970-80 |
|---|---|---|---|---|---|---|---|---|
| GNP, nominal ($ billion) | | | | | | | | |
| Advanced countries | 935.9 | 2,071.8 | 5,415.0 | 67.1 | 68.2 | 68.6 | 8.3 | 10.1 |
| Developing countries | 167.2 | 329.0 | 717.0 | 12.0 | 10.8 | 9.1 | 6.9 | 8.1 |
| Communist bloc | 291.8 | 637.8 | 1,760.0 | 20.9 | 21.0 | 22.3 | 8.2 | 10.7 |
| World total | 1,394.9 | 3,038.6 | 7,892.0 | 100.0 | 100.0 | 100.0 | 8.1 | 10.0 |
| Reference | | | | | | | | |
| Japan | 43.1 | 197.2 | 1,052.7 | 3.1 | 6.5 | 13.3 | 16.5 | 18.2 |
| USA | 503.7 | 976.4 | 2,038.8 | 36.1 | 32.1 | 25.8 | 6.8 | 7.6 |
| Populations (million) | | | | | | | | |
| Advanced countries | 671.8 | 754.5 | 843.2 | 22.4 | 20.8 | 18.9 | 1.2 | 1.1 |
| Developing countries | 1,371.8 | 1,756.9 | 2,315.2 | 45.8 | 48.4 | 52.0 | 2.5 | 2.8 |
| Communist bloc | 956.4 | 1,119.3 | 1,293.3 | 31.8 | 30.8 | 29.1 | 1.6 | 1.5 |
| World total | 3,005.0 | 3,630.7 | 4,451.7 | 100.0 | 100.0 | 100.0 | 1.9 | 2.1 |
| Reference | | | | | | | | |
| Japan | 93.4 | 103.7 | 117.5 | 3.1 | 2.9 | 2.6 | 1.1 | 1.3 |
| USA | 180.7 | 204.9 | 230.0 | 6.0 | 5.6 | 5.2 | 1.3 | 1.2 |
| GNP per capita ($/head) | | | | | | | | |
| Advanced countries | 1,393 | 2,746 | 6,422 | 300 | 328 | 362 | 7.0 | 8.9 |
| Developing countries | 121 | 187 | 310 | 26 | 22 | 17 | 4.4 | 5.2 |
| Communist bloc | 305 | 570 | 1,361 | 66 | 68 | 77 | 6.5 | 9.1 |
| World total | 464 | 837 | 1,773 | 100 | 100 | 100 | 6.1 | 7.8 |
| Reference | | | | | | | | |
| Japan | 461 | 1,901 | 8,959 | 99 | 227 | 505 | 15.2 | 16.8 |
| USA | 2,787 | 4,765 | 8,864 | 601 | 569 | 500 | 5.5 | 6.4 |
| Exports ($ million, f.o.b.) | | | | | | | | |
| Advanced countries | 85,440 | 224,700 | 628,734 | 66.8 | 71.9 | 74.8 | 10.2 | 10.8 |
| Developing countries | 27,390 | 55,000 | 135,112 | 21.4 | 17.6 | 16.1 | 7.2 | 9.4 |
| Communist bloc | 15,030 | 32,990 | 76,283 | 11.8 | 10.6 | 9.1 | 8.2 | 8.7 |
| World total | 128,700 | 312,700 | 840,131 | 100.0 | 100.0 | 100.0 | 9.3 | 10.4 |
| Reference | | | | | | | | |
| Japan | 4,055 | 19,318 | 90,683 | 3.2 | 6.2 | 10.8 | 10.6 | 16.7 |
| USA | 20,299 | 42,500 | 119,197 | 16.0 | 13.6 | 14.2 | 7.7 | 10.8 |

Notes:
1. Nominal GNP in 1980 is estimated assuming the changes in the exchange rate (1$ = 280).
2. Japan's population in 1980 includes that of Okinawa.
3. Export figures for 1960 and 1970 do not add to 100 per cent as there are some whose destinations are unknown.
4. Percentage proportions of per capita GNP are indices with world totals as 100.

Sources: IMF-IFS for GNP; data compiled by Population Estimate Division, United Nations, for populations; and United Nations World Statistical Yearbook for exports, provided OECD statistics for Japanese and United States exports.

become more welfare state-oriented internally while increasing in size as an international market. According to a projection by the Japan Economic Research Center, Japanese GNP in 1980 will approximate $1,000 billion, or be half as large as America's. It will reach about $9,000 in per capita terms, which will be larger than that of the United States of America (see Table 5.8).

## Relations between Japan and the developing countries

The impact of Japan's future economic growth on the developing countries will be seen in foreign trade, investment, and tourism.

(a) Trade. There are three main factors which will influence the future Japanese trade with the developing countries. The first is high wages. When the per capita GNP in Japan reaches a level similar to that of the United States, Japan's wage level also will be near to that in the United States. This will, in turn, weaken the international competitive power of such labour-intensive industries as textiles, sundries and TV assemblage. The second factor is pollution. Industrial expansion in such a small country as Japan inevitably makes the problem of pollution acute. Thus with the advent of the 1970s, popular opposition to pollution is becoming stronger, with the result that the development of such industries as petroleum refining, petroleum chemicals, paper pulp, etc. may be restricted in Japan and will have to depend more on imports. The third factor is the shortage of raw materials. As to such industries as non-ferrous metals, iron ore, etc., which depend heavily on imported raw materials, difficulties will arise concerning the acquisition of these raw materials. Japan's share in world imports of copper, aluminium, steel, petroleum, etc., will increase rapidly (Tables 5.9, 5.10). Taking these three factors into consideration it is inevitable that Japan will depend much on imports for such commodities which require large inputs of labour, resources, land and water.

Japan, which traditionally imported raw materials, fuels and food from developing countries, is now importing manufactured goods in rapidly increasing quantities. Take textile goods as an example. The nation's imports of textiles has grown twenty-three times from a negligible $24 million in 1962 to $547 million in 1972. Half of them were imported from Asian countries such as South Korea, Formosa and Hong Kong.

Knowledge-intensive industrial goods such as machinery will increase still further their share of exports.

Table 5.9

Japanese imports of selected commodities: textiles, lumber, metal and machinery

| | Textile raw materials | Textile products | Lumber | Metallic raw materials: Total | Metallic raw materials: Iron ore | Metallic raw materials: Iron scrap | Metallic raw materials: Copper | Metal products | Machinery |
|---|---|---|---|---|---|---|---|---|---|
| Imports ($ million) | | | | | | | | | |
| 1955 | 586 | 12 | 64 | | | | | | 142 |
| 1960 | 762 | 19 | 173 | 673 | 214 | 230 | 71 | 192 | 435 |
| 1965 | 847 | 57 | 502 | 1,019 | 524 | 153 | 108 | 388 | 760 |
| 1970 | 927* | 200* | 1,354* | 2,696 | 1,208 | 341 | 502 | 1,222 | 2,298 |
| 1980 | 1,167 | 3,854 | 7,738 | 7,029 | 2,902 | 826 | 1,604 | 9,083 | 16,938 |
| Average annual growth rate (%) | | | | | | | | | |
| 1955-60 | 5.6 | 9.6 | 22.0 | | | | | | 25.0 |
| 1960-65 | 1.4 | 24.6 | 23.8 | | | | | | 11.8 |
| 1965-70 | 2.3** | 36.9** | 28.1** | 21.4 | 18.2 | 19.3 | 36.0 | 25.8 | 24.8 |
| 1970-80 | 2.1*** | 30.8*** | 19.0*** | 10.1 | 9.2 | 9.3 | 12.3 | 22.2 | 22.1 |

* 1969.
** 1965-69.
*** 1969-80.

Table 5.10

Japan's share in world imports of selected mineral resources

| | Import value | | |
|---|---|---|---|
| | 1960 | 1969 | 1980 |
| Aluminium (1,000 tons) | | | |
| World import | 4,919 | 9,417 | 19,823 |
| Japan import | 297 | 1,160 | 4,097 |
| Japan's share (%) | 6.0 | 12.3 | 20.7 |
| Copper (1,000 tons) | | | |
| World import | 2,532 | 3,186 | 4,652 |
| Japan import | 168 | 629 | 1,777 |
| Japan's share (%) | 6.6 | 19.7 | 38.2 |
| Petroleum (million tons) | | | |
| World import | 557 | 1,331 | 3,221 |
| Japan import | 32 | 163 | 631 |
| Japan's share (%) | 5.7 | 12.2 | 19.6 |
| Iron ore (million tons) | | | |
| World import | 129 | 238 | 405 |
| Japan import | 15 | 83 | 217 |
| Japan's share (%) | 11.6 | 35.1 | 53.6 |

Notes: 1. Imports = raw materials + semifinished products + finished products.
2. For iron ores, 'world' comprises nine developed countries.

Sources: Metal Gesellschaft, Metal Statistics; Organization for Economic Co-operation and Development, Non-ferrous Metals; United Nations, World Energy Supplies; and Committee on Iron and Steel Statistics, Japan, Tekko tokei yoran [Iron-steel statistics dictionary].

(b) Investment. Japan's private investment will be the second channel of its impact on developing economies. Until quite recently, Japan was a capital importer and her overseas investment was low. But this situation has changed and now it seems that Japan is entering a stage of capital export, and we have seen a very sharp increase in overseas private investments from Japan in the past two or three years (Table 5.11). The change is ascribed to the facts that Japan's foreign exchange holdings have increased to enable the nation to invest

Table 5.11

Japan's direct investments abroad
(projected for fiscal 1980)
($ million)

| | Resource-oriented type (%) | Labour- or market-oriented type | Financial service and others | Total |
|---|---|---|---|---|
| All area | 13,910 (50.6) | 7,181 (26.2) | 6,367 (23.2) | 27,458 (100.0) |
| North America | 1,661 (6.0) | 396 (1.4) | 2,510 (9.2) | 4,567 (16.6) |
| Latin America | 1,491 (5.4) | 2,611 (9.5) | 835 (3.0) | 4,937 (18.0) |
| Southeast Asia | 2,293 (8.4) | 2,715 (9.9) | 534 (2.0) | 5,542 (20.2) |
| Europe | - - | 112 (0.4) | 2,157 (7.9) | 2,269 (8.3) |
| Middle and near East | 3,719 (13.6) | 53 (0.2) | 3 (0.1) | 3,775 (13.8) |
| Africa | 1,292 (4.7) | 205 (0.7) | 1 (0.1) | 1,498 (5.5) |
| Oceania | 2,494 (9.1) | 609 (2.2) | 287 (1.0) | 3,390 (12.4) |
| Planned economy bloc | 960 (3.5) | 480 (1.7) | 50 (0.1) | 1,490 (5.4) |

Note: Annual % growth, 1965 ($917 million)-1970 - 31.4%
1970 -1980 - 22.5%

overseas, that Japan needs to place more emphasis as a means to procure raw materials on helping foreign countries develop their natural resources, and that the higher domestic wage rates have made it more advantageous for Japan to manufacture goods abroad (see Table 5.12).

Japan's investment abroad has invigorated economic activities, upgraded entrepreneurial abilities, improved productivity, and increased exports in recipient countries. The best examples are provided by South Korea, Taiwan, Hong Kong and Singapore. Investment abroad is of great value, it is thought, in that it

Table 5.12

Summary of Japan's international payments

| | $ million | | | | | % growth | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1955 | 1960 | 1965 | 1970 | 1980 | 1955-60 | 1960-65 | 1965-70 | 1960-70 | 1970-80 |
| Trade balance | -53 | 268 | 1,901 | 3,963 | 14,375 | - | 48.0 | 15.8 | 30.9 | 13.8 |
| Export | 2,008 | 3,979 | 8,332 | 18,969 | 88,792 | 14.7 | 15.9 | 17.9 | 16.9 | 16.7 |
| Import | 2,061 | 3,711 | 6,431 | 15,006 | 74,417 | 12.5 | 11.6 | 18.5 | 15.0 | 17.4 |
| Invisible balance | 258 | -100 | -884 | -1,785 | -6,983 | - | 54.6 | 15.1 | 33.4 | 14.6 |
| Receipts | 712 | 949 | 1,563 | 4,009 | 18,604 | 5.9 | 10.5 | 20.7 | 15.5 | 16.6 |
| Payments | 454 | 1,049 | 2,447 | 5,794 | 25,587 | 18.2 | 18.5 | 18.8 | 18.6 | 16.0 |
| Goods and service | 205 | 168 | 1,017 | 2,178 | 7,392 | -3.9 | 43.4 | 16.5 | 29.2 | 13.0 |
| Receipts | 2,720 | 4,928 | 9,895 | 22,978 | 107,396 | 12.6 | 15.0 | 18.4 | 16.6 | 16.7 |
| Payments | 2,515 | 4,760 | 8,878 | 20,800 | 100,004 | 13.6 | 13.3 | 18.6 | 15.9 | 17.0 |
| Transfers | 25 | -25 | -85 | -208 | -4,392 | - | 27.7 | 19.5 | 23.6 | 35.7 |
| Receipts | 47 | 62 | 63 | 98 | 214 | 5.7 | 0.3 | 9.2 | 4.7 | 8.1 |
| Payments | 21 | 87 | 148 | 306 | 4,606 | 32.9 | 11.2 | 15.6 | 13.4 | 31.1 |
| Current balance | 227 | 143 | 932 | 1,970 | 3,000 | -8.8 | 45.5 | 16.1 | 30.0 | 4.3 |
| Receipts | 2,767 | 4,990 | 9,952 | 23,076 | 107,610 | 12.5 | 14.8 | 18.3 | 16.5 | 16.6 |
| Payments | 2,536 | 4,847 | 9,026 | 21,106 | 104,610 | 13.8 | 13.2 | 18.5 | 15.8 | 17.4 |
| Long-term capital | -24 | -55 | -415 | -1,591 | -3,000 | 18.0 | 49.8 | 30.8 | 40.0 | 6.5 |
| Inflow of debts | 7 | 117 | 31 | 440 | 8,659 | 75.6 | -23.3 | 70.0 | 14.2 | 34.7 |
| Outflow of capital | 32 | 172 | 446 | 2,031 | 11,659 | 40.0 | 21.0 | 35.4 | 28.0 | 19.1 |
| Basic balance | 202 | 88 | 517 | 379 | - | -15.3 | 42.5 | 6.0 | 15.7 | - |

Sources: Fiscal and Financial Statistical Monthly and International Payments Statistical Monthly.

is not a mere inflow of funds but contributes to the improvement of technology, marketing and management.

There have been instances, however, of Japan's overseas investment intensifying frictions between Japanese and local enterprises in host countries. There are complaints that local businesses have been subjected to Japanese competition, that Japanese enterprises employ local labour at unreasonably low wages and give them no chance for advancement and that Japanese enterprises do not reinvest profits but remit them home. Direct investment is liable to create greater frictions than trade. In Japan's own case, it seems to have been that in the past the government selected and permitted only those cases of foreign capital imports which were deemed to contribute to the improvement of national economy. More caution may need to be exercised in co-operation in the field of investment than in trade.

(c) Aid. Japanese aid has expanded with the growth of the economy and of Japan's international responsibilities. With its external aid reaching $7.2 billion in 1972, Japan has emerged as the world's second largest aid-giving country next to the United States. The amount represents 0.93 per cent of its GNP, or almost equal to the one per cent of GNP set by the United Nations as the aid-giving target. However, the ratio of Japan's Official Development Assistance (ODA) to its total aid is a mere 0.21 per cent of GNP, far below the 0.7 per cent goal set by the United Nations. This has made a further increase of ODA one of the major policy objectives of the nation. Much contribution will be made toward the economic development of developing countries if the ODA is used for the construction of infrastructure, such as transportation, agriculture, water control, and urban development, and for manpower training, medical care and the like. It is important that the use of ODA funds be co-ordinated carefully with other public expenditure and be invested in fields which constitute the foundation for development.

## Relations with Papua New Guinea

It is certain that the relations between Papua New Guinea and Japan will get very close in the future. Already the relative importance of Japan in the trade of Papua New Guinea has grown much larger. Japan's share in Papua New Guinea's total imports increased from 8.3 per cent in 1965 to 17.1 per cent in 1971. Its share in the exports expanded as well from 3.6 per cent to 11.8 per cent during the same period. In 1972, Japan imported from Papua New Guinea goods worth $15 million or six times the previous year's figure, and exported to the country goods worth \$22 million or twice the previous year's exports. There will be a big increase, though small in absolute value, in imports into Japan of such primary products as lumber, veneer logs, copra, coffee, cocoa, shrimps, prawns and lobsters. Development of electric power for bauxite smelting appears beneficial to both countries. The future of trade relations between the two countries will depend much on the extent of progress to be made in the development of such natural resources as copper, aluminium, natural gas, forests, hydro-electric power, etc. The Overseas Economic Cooperation Fund is providing Papua New Guinea with funds for the development of forestry and fishery industries. Japanese businesses are investing there more actively. It is expected that not only primary products but also manufactures such as copper, aluminium, lumber, veneer and palm oil will be imported into Japan in increasing quantities. On the other hand, exports are expected from Japan of such transportation equipment as trucks and buses, construction machinery, canned food, consumer durables such as transistor radios, iron and steel and so forth.

Papua New Guinea, which is richly endowed with mineral and agricultural-forestry-fishing products and water resources, and Japan, which exports manufactured goods for industrial development and consumption, may complement each other economically to a very high degree. Japan presently imports from Papua New Guinea agricultural-forestry-fishery products. The relative weight of mineral product and processed goods imports will increase gradually as the economic development of Papua New Guinea makes progress.

Appendix Table I

Japanese exports by commodity group

| | Value ($ million) | | | | | Annual growth rate (%) | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 1955 | 1960 | 1965 | 1970 | 1980 | 1955-60 | 1960-65 | 1965-70 | 1970-80 |
| Foodstuffs | 133 (6.6) | 256 (6.6) | 344 (4.1) | 648 (3.4) | 1,287 (1.4) | 14.5 | 5.1 | 13.5 | 7.1 |
| Raw materials and fuels | 39 (1.9) | 66 (1.6) | 127 (1.5) | 199 (1.0) | 346 (0.4) | 11.1 | 14.0 | 9.4 | 5.7 |
| Light industry products | 1,078 (53.5) | 1,959 (48.4) | 2,741 (31.9) | 4,335 (22.4) | 11,011 (11.9) | 12.7 | 6.9 | 9.6 | 9.8 |
| Heavy and chemical industry products | 761 (38.0) | 1,756 (43.4) | 5,240 (62.5) | 13,982 (72.4) | 79,540 (86.3) | 18.2 | 25.0 | 21.7 | 19.0 |
| Total exports | 2,011 (100.0) | 4,055 (100.0) | 8,452 (100.0) | 19,318 (100.0) | 92,184 (100.0) | 15.1 | 15.8 | 18.0 | 16.9 |

Note: Figures in parentheses show percentages of the total.

Appendix Table II

Japanese imports by commodity group

| | Imports ($ million) | | | | | Growth rate (annual average %) | | | | Percentage in total imports | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1955 | 1960 | 1965 | 1970 | 1980 | 1955-60 | 1960-65 | 1965-70 | 1970-80 | 1955 | 1960 | 1965 | 1970 | 1980 |
| Foodstuffs | 625 | 548 | 1,470 | 2,574 | 8,431 | -2.6 | 21.8 | 11.8 | 12.6 | 25.3 | 12.2 | 18.0 | 13.6 | 9.5 |
| Raw materials | 1,263 | 2,209 | 3,220 | 6,677 | 19,503 | 11.8 | 7.8 | 15.7 | 11.3 | 51.1 | 49.2 | 39.4 | 35.4 | 21.9 |
| Textile | 586 | 762 | 847 | 963 | 1,167 | 5.4 | 2.1 | 2.6 | 2.0 | 23.7 | 17.0 | 10.4 | 5.1 | 1.3 |
| Mineral | 186 | 673 | 1,019 | 2,696 | 7,029 | 29.3 | 8.7 | 21.4 | 10.0 | 7.5 | 15.0 | 12.5 | 14.3 | 7.9 |
| Other | 491 | 774 | 1,354 | 3,018 | 11,307 | 9.5 | 11.8 | 17.4 | 14.1 | 19.9 | 17.2 | 16.6 | 16.0 | 12.7 |
| Mineral fuels | 289 | 742 | 1,626 | 3,905 | 16,676 | 20.8 | 17.0 | 19.2 | 15.6 | 11.7 | 16.5 | 19.9 | 20.7 | 18.8 |
| Chemicals | 112 | 265 | 408 | 1,000 | 5,074 | 18.3 | 9.0 | 19.6 | 17.6 | 4.5 | 5.9 | 5.0 | 5.3 | 5.7 |
| Machinery | 142 | 435 | 760 | 2,298 | 16,938 | 25.0 | 11.8 | 24.8 | 22.1 | 5.7 | 9.7 | 9.3 | 12.2 | 19.0 |
| Other manufacture | 41 | 294 | 684 | 2,427 | 22,300 | 48.2 | 18.4 | 28.8 | 24.5 | 1.7 | 6.5 | 8.4 | 12.8 | 25.1 |
| Total | 2,471 | 4,491 | 8,169 | 18,881 | 88,922 | 12.7 | 12.7 | 18.3 | 16.8 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

Note: Values in c.i.f.

Appendix Table III

Share of Japanese imports in exports, selected areas, 1969 and 1980
(%)

| | Food-stuffs | Raw materials | Mineral fuels | Chemicals | Machinery and apparatus | Others | Total |
|---|---|---|---|---|---|---|---|
| Developed areas total | 5.2 (9.9) | 13.0(24.6) | 8.4(18.4) | 3.9 (6.8) | 2.1 (5.6) | 1.9 (6.7) | 3.8 (7.7) |
| USA | 13.5(24.9) | 24.7(45.5) | 28.3(44.9) | 9.0(15.2) | 4.9(13.1) | 6.0(18.7) | 9.2(18.0) |
| Canada | 6.8(14.7) | 11.6(16.2) | 1.8 (2.7) | 3.7 (8.2) | 0.2 (3.1) | 2.8 (3.8) | 4.2 (6.0) |
| Western Europe | 0.8 (3.0) | 0.9 (2.8) | 0.1 (0.1) | 2.4 (4.4) | 1.2 (2.8) | 1.0 (3.4) | 1.1 (3.2) |
| EEC | 0.8 (2.4) | 0.8 (1.4) | 0.0 (0.1) | 2.2 (3.8) | 1.0 (2.7) | 0.7 (2.6) | 1.0 (2.7) |
| EFTA | 1.1 (6.3) | 1.1 (5.4) | 0.2 (0.1) | 2.9 (6.3) | 1.5 (3.2) | 1.5 (5.6) | 1.5 (4.7) |
| ANS | 11.0(23.4) | 32.0(49.9) | 55.4(87.3) | 9.3 (8.2) | 0.3 (0.3) | 8.7(43.0) | 18.9(40.2) |
| Developing areas total | 5.3(10.0) | 16.8(33.1) | 12.1(23.5) | 4.8 (8.5) | 2.5 (6.4) | 7.8(20.4) | 10.2(20.8) |
| Southeast Asia | 14.5(18.3) | 26.8(53.3) | 22.0(48.8) | 11.6(16.8) | 3.2(27.9) | 6.3(20.8) | 14.8(28.2) |
| West Asia | 1.0 (2.2) | 4.0 (6.2) | 21.9(36.2) | 2.3 (4.7) | 0.0 (0.9) | 4.2(10.0) | 18.4(30.2) |
| Latin America | 3.9(11.2) | 16.3(25.3) | 0.8 (2.4) | 2.6 (2.1) | 0.0 (2.9) | 6.5(13.5) | 5.8(12.2) |
| Africa | 1.5 (5.2) | 6.3(10.9) | 0.1 (1.5) | 0.7 (4.3) | 7.7(10.6) | 13.2(33.5) | 4.6(11.2) |
| Others | 1.3 (2.2) | 10.8(11.6) | 1.6 (2.1) | 1.1 (0.0) | 0.0 (0.0) | 2.9 (3.9) | 3.6 (4.3) |
| Planned economy bloc | 1.8(12.4) | 10.1(29.1) | 3.1(14.9) | 1.4 (3.3) | 0.1 (1.0) | 1.3 (8.1) | 2.3 (8.6) |
| Total | 4.9(10.3) | 13.9(27.4) | 10.2(21.7) | 3.8 (6.7) | 1.9 (5.1) | 2.7(10.0) | 4.9(10.0) |

Note: Projection for 1980 in parentheses.

## Chapter 6

### Japan-Papua New Guinea ties: a comment

Mel Togolo

Mr Kanamori's paper is frank about the Japanese economy, the direction of its investment and trade, and the aim of creating a better relationship with the less developed countries. Japan is one of the biggest economic powers in the world. As the only major economic power in the Asian-Pacific region, its impact is going to be felt more strongly in this region than anywhere else. While Kanamori's paper presents some strong views on the economy of Japan, the emphasis is on the description and analysis of the aggregate demand and supply position of the Japanese economy and some of the things that directly affect Papua New Guinea are not treated in detail. The paper has exposed both the strength and weakness of the economy and the trend it is likely to take in the future. It is obvious that Japan's relationship is likely to expand with both the less developed countries and also with the metropolitan powers.

As far as Papua New Guinea is concerned, the true nature of Japanese business activities will be judged by how such ventures directly affect the people and by how much benefit the national government obtains. The long-term effects will arise from trade, incomes growth, the diseconomies of pollutive industries and general control of the economy by foreign investment. As more Japanese firms come to Papua New Guinea, their impact on the economy will grow and with it the pressure on decision-makers will grow. This is true for all investors, not only those from Japan.

As pollution and opposition to it grows, Japan will add to its dependence on imported commodities an increase in the level of private investment in less developed countries. A Japanese company has already established a wood chip industry in Papua New Guinea. It is also very likely that Japanese firms will wish to use the hydro-electricity resources (especially in the Purari) as a basis for manufacturing industries. Because many raw materials in Japan are approaching exhaustion and there are uncertainties about alternative locations for investment (especially in Southeast Asia), the relative abundance of these resources in Papua New Guinea is going to attract more Japanese private direct investment. This is especially likely since Papua New Guinea is incapable of exploiting these resources on its own. Not only will such private investment be attracted to regions like Papua New Guinea but it may be 'forced' out of Japan because of relatively high labour prices in Japan. Already, to a large degree, Japan is no longer investing in traditional industries (e.g. textiles) because labour costs are too high in these activities.

Aid is going to be one of the important areas in foreign relations. This is a sensitive and much debated subject. One important issue is whether aid is to support projects or programs. It is generally agreed that there are costs as well as benefits in aid transactions. The overall benefits of aid depend on how it is given and used. Kanamori points out that Japan is one of the biggest aid donors in the world. Japan's donations to Papua New Guinea are going to increase in the near future. Aid has its pitfalls. It can easily create a 'boy-girl' relationship and, especially at a time when Papua New Guinea is close to gaining political independence, there is a possibility that Japan may want to date her during that period. But it is not inevitable that things will turn out this way, because if aid is used properly and based on mutual understanding it can stimulate the productive capacity of Papua New Guinea.

Japan's relationship with Papua New Guinea must be created and maintained at the government level. The recent visit of a senior Japanese official would seem to indicate the desire to create a better image overseas. The visit suggested strongly that private Japanese investment has not been exercising enough caution and courtesy to the host government. Foreign investment and trade must benefit and be seen to benefit both sides. In the case of the Japan-Papua New Guinea relationship, it is perhaps a more far-sighted approach if negotiations and decisions are formed and take place on a government-to-government basis. Even though we recognise the profit motives of private entrepreneurs it is desirable that controls on foreign investment should not only be controlled by the host country, but that such controls should be exercised as well by the country of origin of investment. It is of course true that ultimate control should be exercised by the host country.

Papua New Guinea is endowed with mineral resources, water resources, fishing and timber products. Japan can offer manufactured goods and perhaps skills. It can also offer technical and managerial assistance. While these are hard facts, Papua New Guinea will probably have to learn a lot from the experience of the Southeast Asian countries with Japanese foreign investment. The government of Papua New Guinea must recognise that a fair deal is a deal that benefits as much as possible the people of this country. The advantages of a free market system and laissez-faire investment can easily be illusory. In fact, it is an outdated capitalist practice and tradition. Japanese involvement in the resources of Papua New Guinea is not just an investment by companies supported by private banks at home; the government also gives full support to private investors overseas by means of soft loans to Japanese nationals. The government has the instruments to influence its national investors' behaviour that is conducive to the acceptance of Japanese investment in other countries.

In the less developed countries today there are fears about domination by foreign investment. Where foreign investors influence politics and policies, the resulting relationship can be bad. Kanamori's paper does not really investigate this aspect of the phenomena of trade and investment. I think it is realistic to look at these questions. Economic domination by one country means that the other country is put in a position of economic dependence. Even Japan, to some degree, is dependent on most of the raw materials from overseas. It is not wholly true that Japan is dependent on Papua New Guinea or even to say that Japan's industrialisation depends on raw materials from Papua New Guinea. It imports most of her raw materials from Australia and other advanced countries as well as from other less developed countries. However, the size of the Papua New Guinea economy and the nature of its potential resources suggest strongly that Papua New Guinea is more dependent on Japan than Japan is on Papua New Guinea. Economic interdependence is beneficial and both countries are likely to share certain advantages. But interdependence requires recognition of certain responsibilities. Evasion of these responsibilities, perhaps by stretching to the limit the terms of a formal agreement, can cause a souring of the relationship. It would be dangerous for a situation to develop where economic and political adjustments were controlled by outsiders. This has not yet taken place on a large scale, but I think that we should be aware of some of the possibilities.

## Chapter 7

# Access to the Australian and New Zealand markets

Peter Lloyd

As the two nearest high-income countries Australia and New Zealand present potential markets to many Papua New Guinea producers. In this paper I review the degree of freedom of access by Papua New Guinea exporters to the markets of these two countries and the possibilities of encouraging further exports of commodities to them. Multilateral trade initiatives other than regional trade arrangements, and trade in services, shipping and policies towards foreign investment are not discussed. However, the benefits and costs of possible changes in Papua New Guinea's trading conditions with Australia and New Zealand are not independent of other global and multilateral trade developments and some brief references are made to these.

## Australian tariff policies and imports from Papua New Guinea

Australia has given Papua New Guinea 'favourite son' treatment in fixing tariff rates on imports into Australia. Papua New Guinea has been and still is the only developing country to receive the preferential tariff rates where they are applicable. Second, Australia received in 1953 from GATT a waiver from the non-discrimination Article 1 of GATT which permitted her to grant preferential duty-free treatment to the primary products of Papua New Guinea, without regard to the rates of duty applicable to like products of any other contracting party to the Agreement. In 1955 and 1956 this waiver was extended to include forest products and then products substantially derived from primary products.[1] Papua New Guinea is also

[1] See GATT, Basic Instruments and Documents, Second Supplement, pp.18-19, 93-5, Fourth Supplement, pp.14-16, and Fifth Supplement, pp.34-6, 114-15.

eligible for the tariff preferences under the Australian preference scheme for the developing countries. There are by-law concessions for some commodities, especially rubber, from Papua New Guinea. In sum, these arrangements mean Papua New Guinea receives more preferences in the customs tariff than any other of Australia's trading partners except New Zealand which receives substantial preferences from the New Zealand Australia Free Trade Agreement (NAFTA).

The value of any formal provision for preferential access depends on the particular commodities to which the preferences are extended in practice and on the levels of tariff preferences for these commodities. The latter depend on tariff levels on imports from Papua New Guinea relative to the tariff levels on imports of the same commodities from competitors in other supplying countries.

In order to examine how imports from Papua New Guinea have been treated in the Australian customs tariff, I have tabulated, in Table 7.1, Australian imports of nineteen commodities of which exports to Australia exceeded $50,000 in 1971-72. Although not presently exported to Australia, palm oil was included because of the plans for substantial exports of this commodity from Papua New Guinea in the future.[1] Exports of gold bullion, re-exports, outside packages and goods imported for repairs or alterations were excluded from the table even though imports from Papua New Guinea exceeded $50,000 in this year because they are determined by quite special factors. The commodities included in the table combined accounted for 93 per cent of the exports of Papua New Guinea to Australia in 1971-72 and 23 per cent of the total exports of Papua New Guinea produce in the same year.[2]

The statistics in this table were derived in the following way. Australia does not publish any cross-tabulations of its import statistics collected on a tariff item basis but the Bureau of Census and Statistics kindly gave me a copy of a print-out of all Australian imports on a tariff item basis from Papua New Guinea. This enabled me to identify readily Papua New Guinea's main exports to Australia and then to

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1 Papua New Guinea's Improvement Plan for 1973-74, Central Planning Office, Port Moresby, 1973.

2 Total exports of Papua New Guinea produce, excluding re-exports, in 1971-72, were $93,042,210; Papua New Guinea Statistics of Exports 1971-72 (preliminary figures), Department of External Territories, Canberra, 1973.

extract from the Imports Cleared for Home Consumption, 1971-72, statistics of Australian imports of the same tariff items from other countries. In the table Australian imports of these items are given separately for other Pacific islands, for other developing countries (excluding the Pacific islands) and for the developed countries (i.e. the remainder) as well as the imports from Papua New Guinea. I have also calculated the average *ad valorem* or equivalent *ad valorem* tariff rate on imports of each commodity from each of the three country groups and from Papua New Guinea. These averages reflect the application of the complex Australian tariff including the by-law provisions which mean that imports of a commodity from one country may enter Australia at different tariff rates.[1] Some of the nineteen 'commodities' are single seven-digit tariff items, but where the tariff classification included in the one item quite disparate commodities I have used sub-items as identified by the statistical key codes in column (2). For example, copra in the Australian tariff classification is a part of an item including oil and other vegetable seeds, denoted by statistical key code 23.

It is desirable to exclude such imports which are not close substitutes for the imports in which we are interested. Similarly, I have combined imports which enter Australia under different tariff items in cases where they are the same essential commodities differing only in respect to minor processing or because of a separate by-law item, as with coffee, and natural rubber.

From Table 7.1, consider first the actual rates of duty paid on imports from Papua New Guinea alone of these commodities. These rates are given in the first row for each commodity (Code 1). All but three of Papua New Guinea's principal exports to Australia entered free of duty. Their exports of plywood were taxed at rates varying from 0 (for government and by-law imports) to 32 per cent (the preferential rate) which averaged out at 8 per cent. There was a low duty of 10 cents per lb on prawns and shrimps and a 15 per cent preferential duty on the imports of 'disinfectants and insecticides' which were timber preservatives.

Roughly \$1½ million of imports of these commodities entered Australia duty-free because of by-law concessions, principally

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[1] The actual tariffs, for normal and by-law imports, which apply currently to imports of these commodities, may be obtained from The Annotated Customs Tariff, Department of Customs and Excise, under the respective tariff items.

Table 7.1

Principal Australian imports from Papua New Guinea, 1971-72

| Brief description | Tariff item | Country code | Value of Australian imports ($) | Duty ($) | Average tariff |
|---|---|---|---|---|---|
| Fish, fresh, chilled or frozen | 03.01.900 | 1 | 152,105 | 229 | 0.2 |
| | | 2 | 274 | 0 | 0.0 |
| | | 3 | 462,622 | 16,176 | 3.5 |
| | | 4 | 15,032,412 | 307,313 | 2.0 |
| | | Total | 15,647,413 | 323,718 | 2.1 |
| Crayfish, prawns, other crustacean and molluscs | 03.03 | 1 | 67,132 | 2,956 | 4.4 |
| | | 2 | - | - | - |
| | | 3 | 583,856 | 62,817 | 10.8 |
| | | 4 | 1,128,805 | 51,270 | 4.5 |
| | | Total | 1,779,793 | 117,043 | 6.6 |
| Coconuts, other than whole | 08.01.400 | 1 | 1,066,353 | 0 | 0.0 |
| | | 2 | 72,749 | 8,106 | 11.1 |
| | | 3 | 793,009 | 106,675 | 13.5 |
| | | 4 | 5,321 | 297 | 5.6 |
| | | Total | 1,937,432 | 115,078 | 5.9 |
| Raw coffee | 09.01.110 | 1 | 6,708,509 | 0 | 0.0 |
| | 09.01.190 | 2 | - | - | - |
| | | 3 | 8,654,741 | 1,491 | 0.0 |
| | | 4 | 67,872 | 0 | 0.0 |
| | | Total | 15,431,122 | 1,491 | 0.0 |
| Tea | 09.02.900 | 1 | 469,498 | - | 0.0 |
| | | 2 | - | - | - |
| | | 3 | 21,102,001 | 0 | 0.0 |
| | | 4 | 243,003 | 0 | 0.0 |
| | | Total | 21,814,502 | - | 0.0 |
| Ground-nut (peanuts) and kernels | 12.01.100 | 1 | 573,188 | 0 | 0.0 |
| | | 2 | - | - | - |
| | | 3 | 15,148 | 785 | 5.2 |
| | | 4 | 1,724 | 847 | 4.9 |
| | | Total | 590,060 | 1,632 | 0.3 |
| Copra | 12.01.900 | 1 | 2,338,869 | 0 | 0.0 |
| | (23) | 2 | 148 | 0 | 0.0 |
| | | 3 | - | - | - |
| | | 4 | - | - | - |
| | | Total | 2,339,017 | - | 0.0 |
| Coconut oil | 15.07.190 | 1 | 1,246,775 | 0 | 0.0 |
| | (12) | 2 | 31,316 | 0 | 0.0 |
| | | 3 | 467,996 | 0 | 0.0 |
| | | 4 | 1,394 | 0 | 0.0 |
| | | Total | 1,747,481 | 0 | 0.0 |
| Palm oil | 15.07.190 | 1 | - | - | - |
| | (45) | 2 | - | - | - |
| | | 3 | 1,726,975 | 0 | 0.0 |
| | | 4 | 118,404 | 0 | 0.0 |
| | | Total | 1,845,379 | 0 | 0.0 |
| Cocoa beans, raw or roasted | 18.01.000 | 1 | 1,635,791 | 0 | 0.0 |
| | | 2 | 16,107 | 0 | 0.0 |
| | | 3 | 5,301,715 | 0 | 0.0 |
| | | 4 | - | - | - |
| | | Total | 6,953,613 | 0 | 0.0 |
| Passionfruit juice | 20.07.300 | 1 | 188,655 | 0 | 0.0 |
| | | 2 | 9 | 3 | 33.3 |
| | | 3 | 501 | 105 | 21.0 |
| | | 4 | 3,397 | 2,497 | 73.5 |
| | | Total | 192,562 | 2,605 | 1.4 |

Table 7.1 (continued)

| Brief description | Tariff item | Country code | Value of Australian imports ($) | Duty ($) | Average tariff |
|---|---|---|---|---|---|
| Disinfectants, insecticides, etc. | 38.11.200 | 1 | 137,294 | 20,595 | 15.0 |
| | | 2 | - | - | - |
| | | 3 | 13,745 | 3,436 | 25.0 |
| | | 4 | 591.067 | 82,614 | 14.0 |
| | | Total | 742,106 | 106,645 | 14.4 |
| Natural rubber, crepe or other | 40.01.100 | 1 | 2,163,722 | 0 | 0.0 |
| | (IX and 31) | 2 | - | - | - |
| | 40.01.290 | 3 | 6,890,786 | 4,878 | 0.0 |
| | (16 and 38) | 4 | 2,095,420 | 18 | 0.0 |
| | | Total | 11,149,928 | 4,896 | 0.0 |
| Wood, in the rough | 44.03.900 | 1 | 58,832 | 0 | 0.0 |
| | | 2 | 271,672 | 0 | 0.0 |
| | | 3 | 2,101,934 | 1,310 | 0.1 |
| | | 4 | 8,196 | 793 | 9.7 |
| | | Total | 2,440,634 | 2,103 | 0.1 |
| Wood sawn lengthwise, sliced or peeled, other | 44.05.920 | 1 | 1,515,570 | 0 | 0.1 |
| | 44.05.990 | 2 | 122,635 | 16,257 | 13.3 |
| | | 3 | 10,722,977 | 1,810,608 | 16.9 |
| | | 4 | 671,291 | 4,875 | 0.7 |
| | | Total | 13,032,473 | 1,831,740 | 14.1 |
| Wood, planed, tongued, grooved, etc. | 44.13.900 | 1 | 488,783 | 0 | 0.0 |
| | | 2 | - | - | - |
| | | 3 | 1,061,289 | 168,154 | 15.8 |
| | | 4 | 673,431 | 25,878 | 3.8 |
| | | Total | 2,223,503 | 194,032 | 8.7 |
| Wood sawn lengthwise of a thickness not exceeding 5 mm (0.197 in.); veneer sheets and sheets for plywood | 44.14.910 | 1 | 270,142 | 0 | 0.0 |
| | | 2 | 153,296 | 45,988 | 30.0 |
| | | 3 | 480,325 | 143,600 | 29.9 |
| | | 4 | 463,565 | 110,984 | 23.9 |
| | | Total | 1,367,328 | 300,572 | 22.0 |
| Plywood | 44.15.100 | 1 | 2,028,102 | 160,867 | 7.9 |
| | | 2 | - | - | - |
| | | 3 | 2,336,353 | 1,335,549 | 57.0 |
| | | 4 | 1,164,950 | 596,717 | 51.2 |
| | | Total | 5,529,405 | 2,093,133 | 37.9 |
| Copper waste and scrap | 74.01.300 | 1 | 306,923 | 0 | 0.0 |
| | | 2 | 209,573 | 0 | 0.0 |
| | | 3 | 86,886 | 0 | 0.0 |
| | | 4 | 1,223,408 | 0 | 0.0 |
| | | Total | 1,826,790 | 0 | 0.0 |
| Total - principal imports | | 1 | 21,416,243 | 184,647 | 0.9 |
| | | 2 | 877,779 | 70,354 | 8.0 |
| | | 3 | 62,801,859 | 3,655,584 | 5.8 |
| | | 4 | 23,493,660 | 1,184,103 | 5.0 |
| | | Total | 108,590,541 | 5,094,688 | 4.7 |

Note: The average tariff is the (duty/value of imports) x 100.

Source: Calculated from data in Commonwealth Bureau of Census and Statistics, Imports Cleared for Home Consumption, 1970-71.

Numerical Code 1. Value of imports from Papua New Guinea
2. " " " " other Pacific islands
3. " " " " other developing countries
4. " " " " developed countries (including Mainland China and other communist countries)

raw rubber and passionfruit juice. The special preference to Papua New Guinea under the GATT waiver was used to obtain duty-free entry for exports of coconuts and peanuts but the forest products are by far the main beneficiaries of this concession. On the other hand there are some non-tariff barriers in the form of quarantine restrictions on imports of vegetable and fruit products.

Thus the actual exports of Papua New Guinea entered virtually duty-free. In fact the average duty was a mere 0.9 per cent. This was the lowest average rate of duty on total imports into Australia from any single country. The average rates for New Zealand and the United Kingdom, both of which receive substantial preferences, were 10.2 and 5.0 per cent respectively and the average for all countries was 12.8 per cent.[1]

Whether entry is really free depends not only on the rate of duty levied on actual imports but also on whether any potential imports were prohibited because of high duties. A few significant potential exports from Papua New Guinea may have been restricted because the Australian government refused a request from Papua New Guinea for tariff preferences; for example, pyrethrum extract[2] and dessicated coconuts. Overall entry has been almost free. On the other hand we should note that if Papua New Guinea should process more heavily some of

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[1] These rates for other individual countries have been calculated from the tables published by the Commonwealth Bureau of Census and Statistics, 'Customs Duty Collected at Specified Rates of Duty: Australia, 1971-72' and 'Customs Clearances at Specified Rates of Duty: Australia 1971-72'. These averages reflect the commodity composition of imports into Australia from each country as well as tariff preferences.

[2] In this case the government followed the recommendation of the Tariff Board; Tariff Board Report on Pyrethrum, 30 June 1972. At the time of the Board's enquiry pyrethrum extract imported into Australia for further refining was admitted at a general tariff rate of 7½ per cent and a preferential rate of zero. The Australian producers requested a 25 per cent general and preferential rate with the supplies from their affiliate in Papua New Guinea being admitted duty-free under by-law. The Tariff Board recommended no change in tariffs. This provides another illustration that it is the extent of preferences rather than the level of tariffs paid by imports from one country which is the important determinant of trade patterns.

her present exports such as timber or rubber, or begin to export other manufactured commodities, then the high levels of protection for Australian manufacturers in many industries might severely restrict such exports.

The advantage of free entry for one country depends on the degree of freedom of entry also granted to imports from competing countries. The ad valorem tariff rates paid by Papua New Guinea in the first row of statistics for each commodity can be compared with the average rates paid by other countries exporting these commodities to Australia. The latter are given in rows 2, 3 and 4 of the statistics for each commodity. In the majority of these commodities Papua New Guinea does not enjoy a tariff preference over any of its competitors because they too are able to export to the Australian markets duty-free either through the by-law concessions (as with some raw coffee, crepe rubber and copper waste and scrap) or through the zero nominal tariff rates that apply to several of these commodities (copra, coconut oil, cocoa beans and tea). To put it differently, most of the exports of Papua New Guinea would have entered duty-free without the special preferences to the Papua New Guinea primary products. There are some significant exceptions, notably forest products and the lesser exceptions of coconuts, peanuts and passionfruit juice, in which Papua New Guinea has enjoyed a real advantage over its competitors. It should be noted, however, that in the case of most forest products, including wood in the rough and timber, the producers in Papua New Guinea must now compete on an equal tariff basis with the New Zealand suppliers who have gained tariff-free entry into the Australian markets for these products under the 1966 New Zealand Australia Free Trade Agreement.

These tariff statistics do not give the full extent of some of the preferences. In the case of coffee, by-law entry is granted only to persons who during each coffee year obtain at least 30 per cent of their total requirements of raw or kiln-dried coffee from Papua New Guinea. In the case of raw rubber the by-law imports are granted to the Papua New Guinea exporters before the exporters of other countries and those imports which are not subject to by-law entry are subject to a sliding-scale duty which gives the Papua New Guinea exporters a preference when prices for imported raw rubber fall below 25 cents per pound.

Another question of particular interest to us is the treatment of imports from Papua New Guinea by comparison with the treatment of imports from the other Pacific islands. There are several commodities in the export of which Papua New Guinea enjoys a significant advantage over its Pacific island competitors. Imports of dried and other coconuts into Australia from Papua New Guinea entered duty-free whereas those from other Pacific islands (Tonga in this instance) and other countries paid a tariff of 1.7 cents per lb. In the case of passionfruit juice imports from countries other than Papua New Guinea paid a general tariff of either 90 or 82 cents per gallon. Imports of this commodity from Fiji were only $9 but imports from Fiji and other countries may have increased, and possibly to the detriment of Papua New Guinea, if there had been no tariff advantage for Papua New Guinea. In the case of wood, imports from Fiji enter Australia on much less favourable terms than those accorded Papua New Guinea.

New Zealand import policies and imports from Papua New Guinea

In contrast to Australia, New Zealand has not made any concessions to Papua New Guinea alone. Papua New Guinea has been eligible for British preferential tariff rates where these are lower than the most-favoured nation or general rates but New Zealand, unlike Australia, has also extended BP rates to all developing and developed member countries of the British Commonwealth.[1] Papua New Guinea was included, with other developing countries, in the preferences which New Zealand introduced in 1972 as a part of UNCTAD's Generalized System of Preferences (GSP).[2] Papua New Guinea was included in the countries, all members or observers of the South Pacific Forum, that may benefit from the Pacific Islands Handicraft Scheme which was announced by New Zealand in September 1973[3] and in the earlier scheme which provided import licensing allocations for handicrafts from a number of South Pacific countries but it received a very small allocation. Furthermore, New Zealand gives

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1 These British Preferences are to be phased out beginning in July 1974. It is not yet clear whether the New Zealand government will raise the BP rate to the general rate or lower the general to BP rate.

2 See United Nations Conference on Trade and Development, TD/B/373, 'Generalized System of Preferences: Scheme of New Zealand'. The commodity coverage of the NZ scheme is, like that of Australia, highly selective. Unlike Australia, in most cases their GSP rates are equal to the BP rates and in several they are greater than the BP rates.

3 Press statement, 'Pacific Islands Handicraft Scheme', from Department of Trade and Industry, 27 September 1973.

preferential access to its former territories over Papua New Guinea and other countries. This aspect is discussed later.

Table 7.2 presents statistics of the major imports into New Zealand from Papua New Guinea and imports of the same commodities from other Pacific islands, other developing countries and the developed countries. These statistics are comparable with those in the column (4) of Table 7.1 for Australian imports. They apply to 1970-71 which is the latest year for which New Zealand commodity trade statistics are presently available. Since New Zealand does not publish statistics of commodity trade on a tariff item basis, it is not possible to calculate the average rates of duty as was done for Australia. In any event, the comprehensive system of import licensing which New Zealand still maintains makes the average tariff rates of less relevance for some of the traded commodities than the import licensing allocations. As a substitute for the average tariffs, the actual rates of duty on the commodities in Table 7.2, and the import licensing allocation classification for these commodities, together with those for some other commodities, are set out in Appendix Table I. These data were kindly supplied to me by the New Zealand Department of Trade and Industry.

There are several obvious features of the New Zealand import trade from Papua New Guinea recorded in Table 7.2. First, the scale of New Zealand imports from Papua New Guinea is very much smaller than that of Australian imports. In order to identify the main commodities I had to include all those whose imports into New Zealand were in excess of $7,000. While the trade in the other commodities is insignificant in value, the importance of this trade relative to the imports from other Pacific islands is revealing. The only commodity imported from Papua New Guinea in any significant quantities and value is raw coffee. Second, Papua New Guinea is much less important as a source of imports to New Zealand than it is in Australia. For example, New Zealand imported only $7,600 in value from Papua New Guinea of dried coconuts compared to $219,600 from the other Pacific islands. (Of this total, $154,600 and $64,700 came from Tonga and West Samoa respectively.)

In order to get a more comprehensive picture of New Zealand treatment of imports from Papua New Guinea, a list was prepared of commodities which might be potential imports from New Zealand if there were no restrictions through tariff preferences to other countries or import licensing. The list was compiled by taking the principal exports in Table 7.1 from Papua New Guinea to Australia, which is nearby and has approximately the same level of per capita income. A few other commodities such

Table 7.2

Principal New Zealand imports from Papua New Guinea, 1970-71

| Brief description | SITC item | Code | Value of New Zealand imports ($) |
|---|---|---|---|
| Dessicated coconuts | 051.71.01 | 1 | 7,639 |
| | | 2 | 219,594 |
| | | 3 | 250,140 |
| | | 4 | 112 |
| | | Total | 477,485 |
| Coffee, raw | 071.10.11 | 1 | 491,611 |
| | | 2 | 14,270 |
| | | 3 | 5,047,073 |
| | | 4 | 6,294 |
| | | Total | 5,559,248 |
| Cocoa beans, raw | 072.10.01 | 1 | 23,952 |
| | | 2 | 9,509 |
| | | 3 | 1,954,009 |
| | | 4 | - |
| | | Total | 1,987,470 |
| Tea, packs 5 lb or over | 074.10.01 | 1 | 8,098 |
| | | 2 | - |
| | | 3 | 5,683,253 |
| | | 4 | 1,525 |
| | | Total | 5,692,876 |
| Nutmeg and mace | 075.24.02 | 1 | 9,051 |
| | | 2 | - |
| | | 3 | 13,619 |
| | | 4 | - |
| | | Total | 22,670 |
| Plywood | 631.21.01 | 1 | 8,075 |
| | | 2 | 7 |
| | | 3 | 16,098 |
| | | 4 | 273,541 |
| | | Total | 297,721 |

Source: New Zealand Department of Statistics, Imports,
Part A: Commodity by Country, 1970-71
Part B: Country by Commodity, 1970-71

as palm oil and pyrethrum extract which are expected to become significant exports from Papua New Guinea were added. For these commodities Appendix Table I gives the rates of duty on imports into New Zealand from groups of countries and the import licensing classification.

Imports from Papua New Guinea of most of these potential trade commodities do not receive any tariff preference over imports from other most-favoured-nation or general sources, and, as already noted, in all cases they do not receive any preference over other Pacific islands and other members of the British Commonwealth. In several cases, such as natural rubber, cocoa beans, raw coffee and nutmeg and mace, they must also compete on equal tariff terms with other developing countries which receive concessions under the GSP scheme. Many of these potential exports are subject to import licensing allocations so that applications for import licences are considered individually or are approved only in exceptional circumstances. In several cases the raw or unprocessed materials are admitted free or with low duty while more highly processed materials and products are subject to duties or higher duties. Similarly, import licences become more restrictive as the degree of processing in the export country increases; this applies to coffee, tea, cocoa, coconut products, rubber and wood products. For example, copra enters duty free and without import licensing, whereas coconut oil is subject to duties of 22½-27½ per cent and import licences are granted only under 'exceptional circumstances'. Imports of raw coffee are exempt from import licensing but imports of roasted coffee are allowed only under 'exceptional circumstances', and are subject to higher tariffs. Any expansion of New Guinea exports to New Zealand of several products would be restricted, perhaps severely, by import licensing. Some fish products, copra, coconut oil, roasted cocoa beans, passionfruit juice, wood for flooring and weather-boarding and plywood are in this category.

Clearly the scope for increased exports from Papua New Guinea to New Zealand depends on the willingness of the New Zealand administrators to grant further licences for potential exports from Papua New Guinea and, in a few cases such as coconut oil and handicraft, on the willingness of New Zealand to allow Papua New Guinea exporters to compete with the traditional New Zealand suppliers in the Pacific islands.

## Possible ways of increasing access to the Australian and New Zealand markets

There are a number of schemes by which Australia and New Zealand might increase Papua New Guinea access to their markets, acting unilaterally or in concert or together with a larger number of countries in the region.

The first possibility to be considered is that Papua New Guinea become an associate of the New Zealand Australia Free Trade Area. This is the most obvious possibility involving the three countries and one which is logically simpler to consider before the option of a wider regional trading arrangement which introduces new countries and further complicating questions.[1] Association has been mentioned in the past though never strongly recommended as far as this writer is aware.

Formally, Australia as defined means the mainland States and territories excluding Papua New Guinea, and New Zealand means the metropolitan territory, excluding the Cook Islands, Niue and the Tokelau Islands. There is explicit provision in Article 13 of the Agreement for the association with the Agreement of any territory of the member States (Papua New Guinea, Cook Islands, Niue or Tokelau Islands) on terms to be agreed upon by the member States(Australia and New Zealand). 'The purpose of such association shall be to promote the economic and social development of the territory and to permit closer economic relations between the territory and the Member States' (Article 13.2). There is also provision for the association of any other State on the terms to be negotiated between the member States and the other State (Article 14).

There is little to commend Papua New Guinea's association with the Agreement. Papua New Guinea already has virtual duty-free access for her principal exports to Australia, the most important of the two markets, as noted above. The access for more highly processed forms of some potential exports is less free. However, association by itself does not guarantee free access. The New Zealand Australia Free Trade Area is a

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[1] The alternative that Australia and Papua New Guinea alone form a free trade area is largely subsumed within the three country group from the Papua New Guinea point of view as it would gain from adding the free access to New Zealand markets and would face little additional competition from New Zealand producers. Hence Papua New Guinea would gain less from a free trade area with Australia than from a free trade area with Australia and New Zealand. A customs union with Australia, which would bind Papua New Guinea to the same tariff structure as Australia, is not desirable.

very limited free trade area,[1] with the commodity coverage limited to those commodities agreed upon by both members. No doubt with the prospective association of any new State or territory, the commodities proposed for free trade by the new associate would be closely scrutinised by the members. Access to the New Zealand market is less free at present, as noted, but New Zealand's willingness to increase access is hindered by the desire to protect its own manufacturers.

Access to the New Zealand market is also hindered by the desire to give preference to island suppliers. New Zealand does at present give preferential access to imports from its former territories over those from Papua New Guinea. Cook Islands, Niue and the Tokelau Islands, are all part of the New Zealand customs area and therefore have duty-free access and no import licensing on the intra-area trade with New Zealand. Under the Treaty of Friendship, Western Samoa exports are exempt from import licensing but subject to preferential rates of duty. By comparison imports from Papua New Guinea pay preferential rates of duty and are subject to import licensing, where applicable. The Labour government elected in 1972 indicated a desire to assist Papua New Guinea after it gained self-government. Its allocation of bilateral aid to Papua New Guinea is to increase severalfold to $200,000 in 1973-74, $500,000 in 1974-75 and to $750,000 in 1975-76. This will include project aid to Papua New Guinea for the first time and a list of potential projects was identified during the visit of a New Zealand aid mission to Papua New Guinea in July 1973. The choice of project priorities is to be left to Papua New Guinea. Nevertheless, the present New Zealand government has also made it clear that it ranks its responsibilities to the islands above those to Papua New Guinea. Its bilateral aid allocation to the South Pacific excluding Papua New Guinea is to rise from $3.4 million in 1973-74 to $5.2 million in 1974-75 and to $8.4 million in 1975-76 and these figures represent a higher percentage of total bilateral aid allocations going to the South Pacific than before. As another indication of its priorities, the press statement of the Pacific Islands Handicraft Scheme made in September 1973 said that 'Western Samoa will be perhaps the main beneficiary of the new scheme'.

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[1] For a general review of the coverage, achievements and failures of the Agreement to date see Australia New Zealand Trade, Report from the Senate Standing Committee on Industry and Trade, Commonwealth of Australia, 1973, or P.J. Lloyd, New Zealand Manufacturing Production and Trade with Australia, New Zealand Institute of Economic Research, Paper no.17, 1971.

During the visit of the Chief Minister to New Zealand in April 1973 the New Zealand Prime Minister 'referred to the Government's desire to promote and further co-operation in the South Pacific and expressed the hope that a self-governing and ultimately independent Papua New Guinea would give impetus to the development of a unified region'.[1] In view of this position it is likely that those commodities which Papua New Guinea might export to New Zealand in competition with the one or more of the other islands, such as coconut oil, timber, fresh and canned fruits, and fish, would not be included in the commodities covered with Papua New Guinea accession to the Agreement.

There may also be costs to Papua New Guinea in association with NAFTA if the association involved granting Australia and New Zealand duty-free or preferential access to the markets of Papua New Guinea. These costs would take the form of some trade diversion from the cheaper (in terms of foreign exchange) imports of commodities from suppliers in Japan and other countries outside the Area. However, it is unlikely that either Australia or New Zealand would seek reciprocity from Papua New Guinea. For this reason association is less appropriate than other joint or unilateral actions. These will be considered later.

A second possible form of increased Papua New Guinea access to the markets of Australia and New Zealand is some regional trading arrangements involving other South Pacific countries. This would be more acceptable to New Zealand because it would not involve giving Papua New Guinea any preferences over other South Pacific countries but it would presumably mean equal treatment for Papua New Guinea and the other South Pacific countries that might be included. As with the possibility of association with NAFTA, this arrangement would not mean reciprocal concessions by the South Pacific countries.

This possibility is bound up with discussions on an islands free trade area within the South Pacific Forum and its subsidiary body, the South Pacific Bureau for Economic Co-operation (SPEC).[2] The initiative for the South Pacific Forum came from

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[1] New Zealand Foreign Affairs Review, vol.23, no.4, 1973, p.30.

[2] The members of the South Pacific Forum are Australia and New Zealand and the island members, Cook Islands, Fiji, Nauru, Tonga and Western Samoa. At the third meeting of the Forum in Suva, September 1972, it was decided to invite Papua New Guinea to attend future Forum meetings as an observer until such time as it met the criterion for full membership at

the leaders of independent and self-governing island members, principally in response to the culmination of the United Kingdom negotiations for accession to the European Economic Community. Trade questions were the main item of discussion of the first meeting of the Forum held in Wellington in August 1971.

> The Forum resolved accordingly that a meeting of senior officials of the five Island Governments be held within three months to survey production potential and marketing prospects for Island commodities in the region, and to study and report on statistical, economic and agricultural implications with a view to making recommendations about the possibility of establishing an economic union for the area.... The question of treatment for Island products entering Australia and New Zealand would also be studied.[1]

These possibilities of free trade among these South Pacific countries have not been pursued for two reasons. First, the study prepared by officials for the Forum 'tended to downgrade the concept of a free-trade area among the Island nations on the basis that the main growth would inevitably come through an expansion of exports to the developed countries of the region'.[2] Second, for many of the principal exports of these countries the main prospects for increased exports lie outside the region, in their traditional West European markets for these commodities.[3] The bulk of Western Samoa's exports of cocoa go to the United Kingdom. Fiji's exports of sugar to

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2 (continued)
self-government or independence. All these countries are members of the British Commonwealth.

The functions and activities of the SPEC are outlined by its Deputy Director, K. Piddington, The South Pacific Bureau: a New Venture in Economic Co-operation, New Zealand Institute of International Affairs Pamphlet, 1973.

[1] Final Communique of the Meeting, issued at Wellington, August 1971, reprinted in Current Notes on International Affairs, Department of Foreign Affairs, Canberra, vol.42, no.8, 1971, p.431.

[2] Piddington, South Pacific Bureau, p.10.

[3] A useful review of the present direction and commodity composition of the export trade of the island members of the South Pacific Forum is given in the report by the New Zealand Ministry of Foreign Affairs, South Pacific Trade 1972, Wellington, 1973.

the United Kingdom are in jeopardy when the Commonwealth Sugar Agreement expires at the end of 1974. Most of Fiji's exports of coconut oil go to the United Kingdom and enter free of duty but the European Community has a high common external tariff on coconut oil. In other cases the islands as a group already supply the bulk of markets in Australia and New Zealand. For example, New Zealand imports its copra solely from Niue, the Cook Islands and Western Samoa and Australia imports all of its copra from Papua New Guinea (see Table 7.1). Australia and New Zealand are efficient producers of some other commodities which the Pacific islands seek to export such as canned fruit, pineapples and timber. The Pacific islands have had to look further for markets. At its Suva meeting in September 1972, the South Pacific Forum requested that SPEC undertake a commodity-by-commodity study of export development within the region and beyond the South Pacific. SPEC was also to investigate whether and on what conditions Fiji, Tonga and Western Samoa should seek associate status with the EEC. Negotiations on association between these three countries and other former United Kingdom territories on the one hand and the EEC began in August 1973.

At a seminar on New Zealand-Australia Co-operation in Wellington during September 1973, the New Zealand Prime Minister elaborated on the possibilities and gave some indication of New Zealand's likely position.[1]

> I think it is true that the Australia-New Zealand relationship will continue to be of considerable importance as a jumping-off platform for more integrated schemes of economic development in the region. The question is bound to arise at some future time of the desirability of some kind of formal trading arrangements encompassing the members of the South Pacific Forum.
>
> There are several possible approaches ranging from an association with NAFTA...to a separate trade agreement, possibly in conjunction with the South Pacific Bureau for Economic Co-operation providing for a binding of trade preferences and establishing a framework for the reduction of tariffs on items of interest to the Islanders. None of these possibilities has as yet received any more than a preliminary consideration pending the outcome of negotiations by the Islands with the enlarged EEC, the forthcoming GATT round, and, most of all, further study by the Islanders themselves of the most desirable arrangements.

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[1] Text of Prime Minister's Address to the seminar.

Given New Zealand's historical ties with the islands it will be at least as difficult for Papua New Guinea to gain greater access to the New Zealand market within the context of a regional trading agreement as through possible association with NAFTA.

In view of these conflicts of interests within a multilateral negotiation, I believe that more real progress in increasing the access of Papua New Guinea to the markets of Australia and New Zealand may come about from the third possible method, that of a unilateral approach by Papua New Guinea to Australia and New Zealand. This approach might take place under the auspices of the South Pacific Forum or it might take the form of a protocol attached to NAFTA rather than association but it would be essentially a country-to-country negotiation on an item-by-item basis rather than a more general free trade arrangement.

In such negotiations there are two distinct commodity groups. The first consists of the unprocessed or crudely processed raw materials which presently constitute the bulk of the exports of Papua New Guinea (and other Pacific islands) to Australia and New Zealand. Access by Papua New Guinea producers to the Australian and New Zealand market for all of these commodities is free or nearly free. Any remaining impediments could be negotiated as no large-scale Australian or New Zealand production is competitive with these products.

For more highly processed products the access of Papua New Guinea producers to the markets of Australia and New Zealand is less favourable. Access to the Australian markets is still generally free though there are some tariffs; for example, those on plywoods. Access to the New Zealand market for most processed materials is severely restricted by both tariffs and import licensing. In my view one of the bases of future trade negotiations between Papua New Guinea on the one hand and Australia and New Zealand on the other should be that these developed countries should not restrict duty-free access (and import-licensing-free access in the case of New Zealand) to raw and semi-processed materials. The preferences which Australia has given in the past to Papua New Guinea, together with agricultural extension programs, subsidies, and tax allowances, have helped diversify primary production and exports in the post-war period.[1] They have reduced the reliance

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[1] The effect of preferences in increasing trade is also indicated by the dependence of Western Samoa, the Cook Islands and Niue on the New Zealand and United Kingdom markets for their principal exports; see South Pacific Trade 1972, especially Chapter III.

on coconut products which until the mid-fifties accounted for 80 per cent of total exports by value. In the future industrialisation of Papua New Guinea Australia should be as generous in granting free access, preferably duty-free access, for processed products as it has been in granting duty-free access on raw materials. Favourable treatment of timber products in particular will be important since timber products have the highest projected rate of growth of exports, after copper, tea and palm oil, in the period up to 1975-76.[1] It is likely to prove more difficult to obtain entry to the New Zealand market for manufactured products[2] as New Zealand has retained import licensing to protect its own producers throughout the post-war period, even for some of the products that have been added to Schedule A of NAFTA and are therefore admitted duty-free into New Zealand from its partner in the free trade area.

Future reductions on processed materials or manufactures of interest to Papua New Guinea by governments of Australia and New Zealand might be made in the form of a protocol attached to NAFTA or possibly as a part of a trade agreement with the members of the South Pacific Forum. In the former case Article 3:7 of NAFTA, which permits special arrangements for free entry, by means of tariff reductions or import licensing concessions or other instruments such as tariff quotas in addition to the tariff reductions of Schedule A, might be used to assist Papua New Guinea exporters. These arrangements have the advantage that they may enable Australia and New Zealand to circumvent the no-new-preferences limitation of GATT. Alternatively, they might be added to the commodity list of the developing countries preference scheme of Australia and the list of New Zealand scheme of the generalised system of preferences.

## Main conclusions

Access to the Australian markets by Papua New Guinea is virtually free for producers of raw or semi-processed materials and for producers of most of the presently processed materials.

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[1] Papua New Guinea's Improvement Plan for 1973-74, Central Planning Office, Port Moresby, pp.55, 72, 78.

[2] New Zealand is contemplating freer access for island manufactures; see the Speech by the Deputy Prime Minister to the New Zealand Committee of the Pacific Basin Economic Council, on 25 July 1973, reported in New Zealand Foreign Affairs Review, vol.23, no.7, July 1973, p.10. But this action might not assist the Papua New Guinea case for such access.

Access to the New Zealand markets by Papua New Guinea is free for producers of several raw or semi-processed materials but not for producers of processed materials. In the Australian markets, Papua New Guinea exporters also receive substantial preferences for many commodities over competitors from other developing and developed countries (forest products, coconuts, peanuts, passionfruit juice). In the New Zealand markets, Papua New Guinea exporters will receive some preferences over non-British preference sources for the duration of these preferences but on other commodities (such as cocoa beans, raw coffee, natural rubber) they compete on equal terms with other developing countries and on some commodities (for example, coconut oil and passionfruit juice) they are at a disadvantage compared with other islands of the South Pacific.

The best method of obtaining greater access to the markets of Australia and New Zealand would seem to be an approach by the Papua New Guinea government to the two governments and limited to the items of interest to Papua New Guinea. Associated with NAFTA or participation in a free trade area involving the other members of the South Pacific Forum seem less promising at present for reasons indicated above.

While these potential gains should be pursued, it should also be borne in mind that they are likely to be less significant than gaining greater access to the principal world markets in Western Europe and North America because access to the Australian markets is already substantially free and the New Zealand markets are small and, apart from raw materials, highly protectionist.

Appendix Table I

New Zealand tariff and import licensing provisions for certain products

| Australian tariff item | Equivalent NZ tariff item | Brief description | Rates of duty BP | Rates of duty MFN | Rates of duty General | Import licensing allocation 1973-74 |
|---|---|---|---|---|---|---|
| 03.01 | 03.01 | Fish, fresh | | | | |
| | 03.01.001 | Live fish | Free | - | Free | E |
| | 03.01.002 | Fish livers | Free | - | Free | D |
| | 03.01.003 | Other, packed for retail sale | 25% Aust. free | - | 25% + 60% | D |
| | 03.01.009 | Other | $1.00 Aust. free | - | $1.80 | D |
| 03.03 | 03.03 | Crustaceans and molluscs | | | | |
| | 03.03.001 | Live | Free | - | Free | C |
| | 03.03.002 | Raw, packed for retail sale | 25% Aust. free | - | 25% + | D |
| | 03.03.003 | Raw, otherwise packed | $1.00 Aust. free | - | $1.00 | D |
| | 03.03.004 | Salted, in brine or dried | $1.00 Aust. free | - | $1.80 | D |
| | 03.03.009 | Crustaceans, in shell, simply boiled in water | 25% Aust. 5% | - | 55% | D |
| 08.01.300 | 08.01.202 | Coconuts, other kinds | Free | Free | Free | E |
| 08.01.400 | 08.01.201 | Dessicated coconut | Free | Free | Free | E |
| 09.01 | 09.01 | Coffee | | | | |
| | 09.01.101 | Raw (per 100 lb) | Free | 41.5c DC free | 83c | E |
| | 09.01.109 | Roasted | 25% | 50% | 60% | D |
| | 09.01.200 | Coffee husks and skins | Free | - | Free | E |
| | 09.01.900 | Coffee substitutes containing coffee in any proportion | 25% | - | 50% | D |
| 09.02 | 09.02 | Tea | | | | |
| | 09.02.001 | In packages of 5 lb net weight or over | Free | Free | Free | E |
| | 09.02.009 | Otherwise packed (per 100 lb) | $1.66 | $2.50 | $3.33 | D |
| 12.01.100 | 12.01.101 | Ground nuts in shell | Free | Free | Free | E) Except in retail packs - C |
| | | Shelled | Free | Free | Free | E) |

| | | | | | | |
|---|---|---|---|---|---|---|
| 12.01.900 (23) | 12.01.200 | Copra | Free | Free | Free | 110% imports under 1972 licences |
| 13.03.900 (57) | 13.03.001 | Pyrethrum extract | Free | Free | Free | E |
| 15.07.190 (12) | 15.07.081 | <u>Coconut oil</u> | | | | |
| | | In containers of a capacity of 1 gal. or more | 22½% | - | 22½% | D |
| | 15.07.089 | In other containers | 32½% | 32½% | 37½% | D |
| 15.07.190 | | <u>Palm kernel oil</u> | | | | |
| (45) | 15.07.091 | In containers of a capacity of 1 gal. or more | Free | Free | Free | E |
| | 15.07.099 | In other containers | 12½% | - | 17½% | D |
| 18.01.00 | 18.01.001 | <u>Cocoa beans</u> | | | | |
| | | Raw (per 100 lb) | Free DC free | 20.5c | 41c | E |
| | 18.01.009 | Roasted | 25% | 50% | 55% | 110% 1972 licences |
| 20.07.300 | | <u>Passionfruit juice</u> | | | | |
| | 20.07.009 | In bulk containers containing added sugar | 22½% | 37½% | 45% | 110% 1972 licences |
| | 20.07.109 | In bulk containers not containing added sugar | Free | - | Free | 110% 1972 licences |
| | 20.07.209 | In other containers containing added sugar | 32½% | 47½% | 55% | D |
| | 20.07.309 | " " " not containing added sugar | 10% | 25% | 35% | D |
| 40.01 | 40.01 | <u>Natural rubber</u> | | | | |
| | 40.01.001 | Natural latex with added synthetic latex or other additives | 10% Can. 15% | - DC 10% | 30% | E |
| | 40.01.011 | Latex, other | Free | Free | Free | E |
| | 40.01.012 | Creped or smoked | Free | Free | Free | E |
| | 40.01.013 | Chicle gum | Free | - | Free | E |
| | 40.01.019 | Other | Free | Free | Free | E |
| 44.03 | 44.03 | <u>Wood in the rough</u> | | | | |
| | 44.03.100 | Pulpwood | Free | Free | Free | E |
| | | Sawlogs and veneer logs: | | | | |
| | 44.03.200 | of coniferous species | Free | Free | Free | 110% 1972 licences |
| | 44.03.300 | of non-coniferous species | Free | Free | Free | E |
| | 44.03.400 | Pit-props | Free | Free | Free | E |
| | 44.03.501 | Other, in lengths exceeding 30 ft | Free | Free | Free | E |
| | 44.03.509 | Other, in other lengths per 100 cu. ft | $2.50 Aust. free | $2.50 | $2.50 | E |

Appendix Table I (continued)

| Australian tariff item | Equivalent NZ tariff item | Brief description | Rates of duty BP | MFN | General | Import licensing allocation 1973-74 |
|---|---|---|---|---|---|---|
| 44.05 | 44.05 | <u>Wood sawn lengthwise, sliced or peeled, but not further prepared, of a thickness exceeding 5 mm</u>: | | | | |
| | | Of coniferous species: | | | | |
| | 44.05.001 | Juniperus virginiana (red cedar), Pinus lambertiana, Pinus strobus, Pinus monticola | Free | - | Free | 110% 1972 licences |
| | | Sequoia sempervirens (redwood): | | | | |
| | 44.05.002* | In lengths of not less than 25 ft and having a minimum cross-sectional area of not less than 150 sq. in. per 100 su. ft | 75c Aust. free | 85c | 95c | 110% 1972 licences |
| | 44.05.009* | Other sizes per 100 su. ft | 95c Aust. free | $1.05 | $1.15 | 110% 1972 licences |
| | | Pseudotsuga douglasii (Douglas fir, Oregon pine): | | | | |
| | 44.05.011** | In lengths of not less than 25 ft having a minimum cross-sectional area of not less than 150 sq. in. per 100 su. ft | 75c Aust. free | 85c | 95c | 110% 1972 licences |
| | 44.05.019** | Other sizes per 100 su. ft | 95c Aust. free | $1.05 | $1.15 | 110% 1972 licences |
| | | Thuja plicata (western red cedar): | | | | |
| | 44.05.021* | In lengths of not less than 25 ft and having a minimum cross-sectional area of not less than 150 sq. in. per 100 su. ft | 75c | 85c | 95c | 110% 1972 licences |
| | 44.05.029* | Other sizes per 100 su. ft | 95c Aust. free | $1.05 | $1.15 | 110% 1972 licences |
| | | Other kinds: | | | | |
| | 44.05.031 | As may be approved by the Minister and under such conditions as he may prescribe | Free | - | Free | 110% 1972 licences |
| | | Other: | | | | |
| | 44.05.032 | In lengths of not less than 25 ft and having a minimum cross-sectional area of not less than 150 sq. in per 100 su. ft | 75c Aust. free | 85c | 95c | 110% 1972 licences |
| | 44.05.039 | Other sizes per 100 su. ft | 95c Aust. free | $1.05 | $1.15 | 110% 1972 licences |

| | | | | | | |
|---|---|---|---|---|---|---|
| | | Of non-coniferous species: | | | | |
| | 44.05.101 | Ash | Free | Free | Free | E |
| | | Hickory, Juglans species, oak (Quercus): | | | | |
| | 44.05.111 | Hickory, Juglans species, Quercus sessiliflora, Quercus pedunculata | Free | Free | Free | E |
| | 44.05.119 | Other per 100 su. ft | Free | 60c | 60c | E |
| | 44.05.121 | Eucalyptus species per 100 su. ft | 95c Aust. free | - | $1.20 | E |
| | 44.05.131 | Tropical hardwoods | Free | Free | Free | E |
| | | Other kinds: | | | | |
| | 44.05.141 | As may be approved by the Minister and under such conditions as he may prescribe | Free | - | Free | E |
| | 44.05.149 | Other per 100 su. ft | 95c Aust. free | - | $1.20 | E |
| 44.13 | 44.13 | <u>Wood, planed, tongued, grooved, rebated, chamfered, V-jointed, beaded, centre-beaded or the like, but not further manufactured:</u> | | | | |
| | | Of coniferous species: | | | | |
| | 44.13.001 | Cut to size for making boxes per 100 su. ft | $1.90 Aust. 75c | $2.00 | $2.20 | D |
| | 44.13.009 | Other per 100 su. ft | $1.90 Aust. 42c | $2.00 | $2.20 | D |
| | | Of non-coniferous species: | | | | |
| | 44.13.101 | Cut to size for making boxes per 100 su. ft | $1.90 Aust. 75c | - | $2.20 | D |
| | 44.13.109 | Other per 100 su. ft | $1.90 | - | $2.20 | D except balsawood - E |
| 44.14 | 44.14 | Wood sawn lengthwise, sliced or peeled but not further prepared, of a thickness not exceeding 5 mm; veneer sheets and sheets for plywood, of a thickness not exceeding 5 mm: | | | | |
| | 44.14.001 | Not exceeding 1 mm in thickness | Free | 15% | 20% | 110% 1972 licences |
| | 44.14.009 | Exceeding 11 mm but not exceeding 5 mm in thickness | 22½% Aust. 4½% | 37½% | 50% | 110% 1972 licences |
| 44.15.100 | 44.15.001 | Plywood | 22½% Aust. 6½% | 46½% | 55% | 110% 1972 licences |
| 74.01.300 | 74.01.400 | Copper waste and scrap | Free | - | Free | E |

* Duty suspended until 31 December 1973 (Customs Duties (Timber) Suspension Order 1972).
** Duty suspended until 31 December 1973 on 'Clears' timber (Customs Duties (Timber) Suspension Order 1972).

Notes: Key to import licensing allocation: E = Exempt import licensing; C = Applications for licence considered individually; D = Licences approved only in exceptional circumstances.

Source: New Zealand Department of Trade and Industry.

## Chapter 8

# Monetary aspects of Papua New Guinea's foreign economic relations*

Eddie Coppinger

The past two years have seen the rapid development in Papua New Guinea of a sense of nationalism. It is fashionable, and perhaps even politically expedient for some people, to point up the differences which exist in the Papua New Guinea community. However, these differences have been eclipsed by the emergence of a much more positive phenomenon - that of a national identity. This sense of nationalism is of course primarily evident in our urban centres and particularly in educational institutions, but it is difficult to believe that common objectives and common interest will not see this national spirit spreading quite quickly throughout the country.

The participants in the foreign economic relations seminar accepted the Papua New Guinea nation *per se*, and turned their attention and energies outwards towards the community of nations in which Papua New Guinea must begin to take its place. The seminar may be a benchmark in Papua New Guinea's development towards full national maturity.

If it is only in the past two years or so that Papua New Guinea has begun to accept its own independent identity, it is more recent still that it has really begun to think about its relations as a separate economic unit with overseas countries and institutions. However, Papua New Guinea's foreign economic relations have - and will continue to have - a dominating influence over the country's economic development. The seminar discussed in depth many important aspects of these relations, focusing in particular on the real considerations - that is, matters concerning actual goods and services. This

* The views expressed in this paper are the personal opinions of the author and should not in any way be seen as necessarily reflecting the views of his employing institution.

paper draws attention to some purely monetary issues arising out of these foreign relations which will confront Papua New Guinea from now on, and which will often have a direct influence on the country's development.

## Future policy dilemmas

Papua New Guinea's foreign economic relations will only really become meaningful with the advent of an independent Papua New Guinea currency. A separate currency implies a whole new series of problems and policy dilemmas. In particular, Papua New Guinea will for the first time become subject to effective balance of payments discipline. Hand in hand with balance of payments considerations will go the need to acquire and conserve foreign exchange reserves sufficient to maintain national and international confidence in our currency. The establishment of foreign exchange reserves will give rise to policy questions about their adequacy, their composition and the disposition of the currency component.

In addition, with the introduction of balance of payments constraints, the problem of obtaining adequate sources of overseas capital at an acceptable cost may become more pressing. This will bring into sharper focus the subordinate policy questions of whether we should seek long- or short-term capital in given world and domestic economic conditions; and whether we should seek equity or fixed interest capital? We will also need to consider what financial and other assistance might be available through international agencies. This latter question, in turn, will raise the matter of our future relations with international institutions.

Also, in the light of our experience in dealing with our balance of international payments, we will need to consider our policy attitudes to the management of both our own currency exchange rate and, in broader terms of principles, to the basic international monetary system which provides the framework within which our overseas economic relations will be set.

## Papua New Guinea's balance of payments

With the adoption of a separate currency, Papua New Guinea will lose its monetary anonymity: once a separate currency is introduced, the international commercial and financial fraternity will be able to turn to Papua New Guinea's balance of payments performance, and its international reserves holdings as visible and ready indicators of the country's economic viability. In the past, Papua New Guinea's balance of international payments has been of little or no policy concern in Papua New Guinea: shortfalls on current account have been automatically financed by capital inflow, mainly from Australia, and the net of foreign currency payments over receipts has been met from Australia's international reserves holdings.

It seems likely that Papua New Guinea will have the support of Australian capital inflow, both private and public, for some years to come. However, this support will not take the form of unconditional balance of payments support, and it is prudent - and essential, if genuine economic independence is to be achieved - for Papua New Guinea to take serious stock of the likely balance of its future international transactions. If an adverse balance of payments is not to undermine our domestic price and cost structures, erode national real incomes and retard development, it is essential that planning should begin now on conscious balance of payments policies and strategies.

## Exchange rates

Papua New Guinea has relatively unsophisticated monetary and taxation systems: this means that monetary and fiscal policy weapons are likely to be even less effective and flexible than in more developed economies. In these circumstances, there would seem to be particular merit in trying to limit the constraining effect which the external account may have on domestic economic policies, by making the balance of payments as self-tending as possible. A significant step in this direction could be achieved if major fluctuations in commodity prices, adverse climatic conditions, wars and other major events outside national control could be reflected largely in the external value of Papua New Guinea's currency rather than in domestic prices and incomes.

With respect to exchange rate policy, the two extremes of choice are between systems of fixed and systems of adjustable exchange rates. In practical terms, of course, the choice is not so clear-cut: exchange rate policy practices encompass a whole continuum of choices; and individual governments find themselves adopting one or another compromise depending upon the 'mix' of their overall economic policy objectives.

Under a fixed rate system, the international price of a country's domestic currency is held constant. This results in domestic price stability in the sense that the rate of domestic inflation keeps pace (with probably only a small lag) with the international rate of inflation. Meanwhile, the national monetary authorities are free to adjust the quantity of national currency pumped into the economy, in order to achieve whatever degree of balance of payments equilibrium that is desired (or can be afforded in the light of international reserves holdings). Of course, if the national authorities are prepared to let the monetary effects of the balance of payments run their course with no neutralising policy changes, then the balance of payments would eventually by itself tend towards equilibrium.

Under flexible exchange rates, the price (in terms of international currency) of the domestic currency is allowed to change to achieve balance of payments equilibrium, whilst the quantity of money is a free policy variable which may be held constant or managed, as appropriate, to achieve the desired rate of domestic inflation consistent with meeting other economic policy objectives.

In a way, therefore, the choice may be presented as being between stabilisation of national prices and incomes in terms of some 'international' criterion; or stabilisation in terms of a national index. The choice between these two will depend on whether one is prepared to trust in the general stability of the international economy, or prefers to trust in the soundness of domestic monetary policies.

It would be optimistic to think that a small country like Papua New Guinea, that is very heavily dependent on imports, could achieve complete success in running against the tide of world inflation. However, equally, it would be defeatist not to try to at least cut a diagonal across the stream. To the extent that Papua New Guinea could achieve a slower rate of inflation than the general world rate, this would be a step in the direction of improving Papua New Guinea real incomes.

Professor Parkin, in a talk to the Economics Society at the University of Papua New Guinea, recently suggested that perhaps Papua New Guinea should aim at achieving steady producer prices (or possibly consumer prices, as a second best); and for this to be attained through adjustment of the exchange rate from time to time. It would perhaps be naive to think that, with our existing economic and institutional structure, we could achieve this in any mechanistic sense: even if some flexibility could be built into Papua New Guinea's exchange rate, it is unlikely that it would be susceptible to management in any very precise and sensitive manner. However, it may be that we would not be doing a bad job if we could generally get the direction of changes right, and the magnitude half right!

In any case, there is no reason to expect that it will be appropriate to retain a fixed relationship with the Australian dollar. In the past, it may have been possible to argue that, because the bulk of Papua New Guinea's international trade was transacted with Australia and because external transactions were of first importance in total Papua New Guinea income and output, any change in our exchange rate vis-a-vis Australia would merely have produced a corresponding change in Papua New Guinea's domestic price level. Whatever the historical position, this is not the case now, and it is becoming less so every year.

## Some practical considerations

It is sometimes argued that flexibility in exchange rates would act as a disincentive to overseas investors. However, on the contrary, it seems reasonable to think that long-term investors in Papua New Guinea have a very real vested interest in our country following appropriate economic policies consistent with the full development of the economy. Any overseas investor that undertakes a project of, say, at least ten years' duration in any country and does not consider some change in that country's international exchange relationships, would be imprudent and unrealistic.

Moreover, it is established investors rather than potential new investors that would be mostly affected by any downward movement in the value of our currency (nobody seems to worry about an appreciation!). For new investors a depreciation of the currency reduces the foreign currency value of any required capital investment, at the same time as it reduces the foreign currency value of the stream of future profits: this leaves the yield unchanged. For established investors, the international value of the profits generated (and capital value) is reduced without any offset. However, because much overseas investment is centred on export industries, it is likely that the effects of any depreciation even on established industries would be small.

If it should become desirable in the future to depreciate the Papua New Guinea currency, but found to be politically difficult, it might be possible to consider a system of export incentives and import deterrents which would have the same effect as a depreciation. One such system could involve simple exports subsidies and imports levies; an alternative could employ a system of multiple exchange rates. In some cases, such measures might be unpalatable, particularly to international institutions like the International Monetary Fund. However, it is likely that such 'hidden devaluations' could quite soon be codified in a de jure depreciation, which could be seen to be simply a tidying-up measure with little or no price effects.

## General instability versus stability

Another argument against any degree of flexibility in exchange rates is that it creates uncertainty and, in particular, disrupts the flow of trade and commerce. For this reason, it was accepted traditionally that it was in the best interests of world trade in general, and the developing countries in particular, that exchange rates should be kept as stable as possible. Indeed, it is usually one of the prime objectives of central monetary authorities to maintain the external value of their domestic currencies.

Undoubtedly, life is less hazardous and less complicated for merchants and others transacting international business if exchange rates remain steady. Movements of exchange rates, both actual or anticipated, can be expensive either in terms of insurance (forward exchange cover) or in actual capital losses. The fact that many marketing arrangements for primary products involve fixed contracts, not only with overseas buyers but also between marketing authorities and domestic producers, operates to exaggerate the difficulties (political as well as economic) of exchange rate instability for primary producers.

It has to be recognised that changing exchange rates are a fact of international commercial life and must necessarily occur if each country is to maintain its appropriate share of overseas markets for its products in the light of changing tastes, supplies and cost/price relationships. In these circumstances, it seems that, in company with all other countries of the world, Papua New Guinea should be concerned not with whether there will be exchange rate stability or instability and therefore certainty or uncertainty, but rather how best international and domestic monetary arrangements can be modified to accommodate this built-in element of change. Of course, the nature of the 'arrangements' that can be made will depend very much on whether the world retains the 'old' system of relatively fixed parities with their inevitable cumulative distortions and periodic disruptive adjustments, or adopts a system where major exchange rates change more frequently but less violently.

A priori, it would seem likely that developing countries suffer much more from periodic financial crises and large exchange rate changes than they do from the uncertainties associated with more prolonged adjustments and relatively flexible exchange rates. It is unfortunate but perhaps understandable that as soon as a major industrialised country runs into external difficulties, almost its first move is to cut back on its aid program. Any remaining aid is likely to be more tightly controlled and/or 'tied'. Often such measures are followed by the adoption of illiberal trading policies and possibly restraints on private capital outflows.

More gradual and relatively controlled (although this begs another question) movements in exchange rates cut the uncertainty problem down to a manageable size and one which it should be possible to cover with a relatively cheap system of exchange insurance. It is in the provision of services such as this that Papua New Guinea may need to develop expertise and/or efficient machinery for the insurance of commercial contracts. It may be in specialised areas like this that it will be of benefit to Papua New Guinea to avail itself of technical assistance provided by certain international institutions.

## Papua New Guinea's membership of the International Monetary Fund

As Papua New Guinea makes its debut as an independent economy on the international stage, it is not without some backstage assistance. In particular, Papua New Guinea will become eligible for membership of the International Monetary Fund and will therefore have access to the resources and assistance which that institution provides.

As a member, Papua New Guinea would be able to borrow from the Fund foreign exchange equivalent to a maximum of 125 per cent of its quota - albeit with increasingly stringent conditions. Although these borrowings must be repaid, they do provide a very useful breathing-space in which a country may adjust its monetary and fiscal policies to arrest a decline in its 'owned' reserves. This facility could be important to Papua New Guinea. As in the case of other developing countries, economic expansion in Papua New Guinea will only be possible if there is adequate foreign exchange purchasing power to import the goods needed for development. Papua New Guinea's prime 'domestic' source of foreign exchange is export earnings - especially from primary commodities. Although exports of agricultural products, in particular, have tended to increase, the earnings from their sale overseas have fluctuated widely. In contrast, the prices of capital and other basic goods which we need for economic development, together with associated services, have risen steadily over the years and will probably do so in the future. This tendency for the terms of trade to move adversely in respect of primary producing countries has often undermined developing countries' efforts to become self-supporting. At present, the prices of Papua New Guinea's major exports are at high levels, but the conditions of 1971-72 could return again.

Membership of the Fund would give Papua New Guinea access to two specialised schemes which could also help to reduce its vulnerability to balance of payments pressures. The first is the compensatory financing facility by which countries experiencing a shortfall of export receipts for reasons beyond their control can draw from the Fund amounts of foreign exchange equivalent to what they would have earned had there been no shortfall. The second is the financing facility which enables countries to make drawings from the Fund to reimburse themselves for contributions they have made to an international buffer stock scheme. Papua New Guinea has recently agreed to participate in the International Cocoa Agreement: under this Agreement, Papua New Guinea will need to contribute to the financing of a buffer-stock of cocoa. It might at some stage be useful to be able to refinance this buffer-stock contribution.

However, in drawing attention to the palliatives which could become available to Papua New Guinea to help weather any balance of payments difficulties, it is not intended to give the impression that Papua New Guinea would be insulated from pressures on its external account. As far as they go, the IMF facilities are useful but they are not a complete insurance against all difficulties. In fact, the IMF facilities would only be available to Papua New Guinea under special and fairly restricted conditions. In particular, Papua New Guinea would need to have a balance of payments problem before it could draw on the Fund's resources. However, it is quite easy to foresee situations in which financial assistance would be desirable before a balance of payments problem matured: this could be so, for instance, if Papua New Guinea wished to keep its external reserves at a certain fairly healthy level in order to maintain confidence in the currency, but at the same time settle its net external payments.

Also, financial assistance which has to be repaid in no more than five years might be of little use in some circumstances. As with other primary producing countries, the largest threats to Papua New Guinea's external equilibrium are likely to come from external factors, such as a sustained decline in export proceeds or perhaps a decline in foreign aid and investment. Such situations could be entirely outside Papua New Guinea's control, and might be helped very little by temporary financial assistance.

In addition, the economic and monetary structure of the economy is such that fiscal and monetary policy measures will not have the impact that they do in industrialised countries with well-developed credit and taxation systems. A balance-of-payments problem that could be regarded as temporary in a developed country could, in a developing country like Papua New Guinea, get out of hand.

## Regional monetary relations

It seems possible that the movement towards regional institutions and other forms of localised economic co-operation, which has taken place in recent years, might be due at least in part to a feeling that the global international institutions like the International Monetary Fund operate within too rigid and too narrow frameworks.

In the ECAFE region, which embraces Papua New Guinea, there have been several proposals for regional co-operation, including that which led to the establishment of the Asian Development Bank (ADB). Other proposals, currently receiving attention, are for an Asian Clearing Union (ACU); an Asian Reserve Bank (ARB); and a South Pacific Development Bank.

Although it is easy to recognise the arguments for some decentralisation of international co-operation (particularly when it is put in the form that, without a regional lobby, one's own region is likely to be disadvantaged), it is important that such a movement should be kept in perspective. For example, the Asian Development Bank in many ways represents a *de facto* regional duplication of facilities which were already provided on a global scale by the World Bank. Whilst it would be churlish not to admit the benefits which have flowed from the establishment of this institution (and Papua New Guinea has already shared these), one wonders what efforts were first made to modify and adapt the World Bank to meet perceived deficiencies before the decision was taken to promote a new institution. Perhaps this example of decentralisation was a move to the improved distribution of development resources - but would the creation of a South Pacific Development Bank be equally justifiable?

In promoting the proliferation of regional development institutions, care should be taken that:

- scarce regional resources of skilled administrators are not wasted in inefficient duplication of services;
- other inefficiencies of small scale are not incurred;
- apparent benefits are not merely the result of unintentioned 'beggar thy neighbour' policies;

with the decreasing size and representation of the institution, national politics do not intrude to distort operations and policies (even more than they do in larger institutions!).

International monetary relations

Finally, there are some monetary aspects of Papua New Guinea's foreign economic relations which are common to many other developing countries. Amongst these, two major aspects giving rise to much discussion are the problem of the developing countries' growing debt servicing burden, and the possibility of linking development aid with international monetary reform.

(a) The burden of debt servicing. A recent study by UNCTAD has shown that debt servicing payments on the official and publicly guaranteed debt of developing countries have been increasing almost twice as fast as the export earnings with which those payments are mainly financed. Moreover, this trend is likely to continue over the next few years as 'grace' periods which were granted on many large loans in the early 1960s begin to expire. At the same time there is no evidence of a reversal of the trend of recent years which has seen a relative decline in official grants and 'soft' loans, and a relative increase in commercial borrowing on short-maturity loans at high interest rates. These problems will of course be aggravated by the recent world-wide movements towards increasing interest rates, but diminished by inflation.

Papua New Guinea does not yet have a pressing debt servicing problem, but as the country's needs for developmental finance grow, and as patterns of trade and capital flows change, there will be increasing pressures on Papua New Guinea to obtain loan capital in international capital markets on free-market terms. Whilst Papua New Guinea will probably have little difficulty in meeting its needs, this might sometimes be possible only on relatively onerous terms.

In this situation it will be important to weigh carefully the costs and benefits of the projects to be financed with overseas capital. It is easy to forget that borrowing represents a mortgaging of the nation's future production - that is, the proceeds of future exports and other overseas earnings will be required to repay these loans. To the extent that the terms of trade move against developing countries, the real burden of external debt is increased.

Against this background, it is desirable that capital made available to developing countries should be offered on generous terms with low interest rates, long repayment and grace periods etc. However, it is unfortunate that aid given on such terms, with no strings attached, has little advantage - particularly political advantage - to the aid-donating country. It therefore requires a considerable degree of altruism which many countries are apparently not willing or able to show.

Another alternative, of course, is that developing countries should be enabled more nearly to pay their own way by earning through increased exports foreign exchange which can be directed to meet part at least of their needs for development finance. It always seems surprising that countries which have no hesitation in admitting the logic and validity of the so-called 'law of comparative advantage' are always able to find reasons why they should not open up their economies to imports from developing countries.

In some ways, the distribution and development of the world's resources may be likened to an international game of Monopoly. In the initial share-out of properties - which is purely a matter of luck - some players gain rights to valuable resources and some gain rights to very little. If the lucky players, the 'haves', press their advantage to the full then the situation could arise where the 'have nots' quickly end up mortgaging to the 'haves' all their meagre assets; and, in the ultimate, face the threat of national bankruptcy and elimination from the game. Pressed to its conclusion, this process could mean that in the end the 'haves' no longer have anybody else left to play with!

It seems that there are two main courses that may be followed if this 'game' is to be sustained. The first is for the 'haves' continually to give 'handouts' to the 'have-nots' sufficient to enable them to continue playing: hopefully, over a long period, the 'have-nots' might be lucky and acquire ownership rights to sufficient property to enable them to play unassisted. The second is for each participant country to be permitted - indeed helped through the large-scale provision of scarce resources - to develop as fully as possible all its available property (assets) by directing its resources into those productive activities in which it has a comparative advantage. At present, the world seems to favour the former system whereby the 'have-nots' are sustained by escalating handouts: this is neither constructive nor efficient.

As it becomes clearer to the developed countries that the game can only continue on any humanitarian basis if they redistribute real resources to the 'have-nots', it is to be hoped that they will actively co-operate in international arrangements and schemes to make this possible in a way that allows the 'have-nots' to retain their dignity. Agreement has recently been reached for negotiations to start for another round of world-wide tariff reductions under the auspices of GATT. This will give the developed countries an opportunity to show the power of co-operation over competition. With goodwill and understanding, it should be possible to achieve important reforms which would make it easier for developing countries to market their exports in developed markets and so gain independent access to some of the development finance they need.

Such an improved division of labour would benefit not only the developing countries but would release resources in the developed countries which could be used relatively more efficiently in the production of industrialised products and so increase the total of international welfare.

(b) Development assistance and monetary reform. One solution for transferring real resources from the developed to the developing countries has been built into a proposal for international monetary reform. Under this scheme, developing countries would receive a disproportionately large allocation of IMF special drawing rights as these were issued for international liquidity purposes.

Although this proposal has received considerable support amongst developing countries, it may not necessarily be the most efficient or flexible solution to the problem. *A priori* it might be thought that the questions of both development finance and international liquidity were sufficiently complex to deserve (and probably require) separate treatments.

In particular, the need of the developing countries for development assistance is a continuing one, and one which should not be turned on or off with changes in the buoyancy of the international economy. Maximum benefit can be derived from overseas aid where it is made available in the form of a program, with firm commitments being entered into for a period of years ahead.

The world's liquidity needs cannot be predicted very far in advance. It was one of the problems with the last program for the issue of special drawing rights as international liquidity that the need had disappeared by the time the supply became available. Similarly, it seems appropriate that any system of managed world liquidity should provide for reductions in the supply of international spending power when required. If developing countries were the prime channel for the issue of international liquidity then presumably they could be called upon to bear the brunt of any cut-back in that spending power.

Since developing countries can seldom afford the luxury of reserves of idle assets, it might be expected that such a process would raise great difficulties.

However, to suggest that linking development finance to international monetary reform might not be the most efficient approach to meeting developing countries' financial needs, is not to suggest that developing countries therefore have no interest in proposals to amend the international monetary system. Mention has already been made of some of the effects which exchange rate movements can have, including the effects on debt burdens. In addition, continued disruption of exchange markets could limit the effectiveness of capital markets in traditional financial centres and therefore reduce capital flows to developing countries. Also, the recent trend towards bilateralism amongst the industrialised countries, the extension of the European Economic Community and the movements away from unitary exchange rates are all developments which do not favour the developing countries. Similarly, because of real or imagined balance of payments disequilibria, some countries have turned increasingly to restrictions on trade and capital flows.

In general, it would seem likely that all developing countries have a common interest in promoting an international monetary system which works smoothly, promptly and well. Only such a regime would seem to offer sufficient security to enable the leading trading nations of the world to follow expansionary and liberal trade and payments policies.

For this reason, it is important that even the smallest nations should be aware of international reform proposals; and should be prepared to take a view. It would probably also be useful if such matters could be discussed within regional forums. Papua New Guinea as an important South Pacific country might well be looked to for leadership in such matters.

In conclusion, Papua New Guinea, as a small and newly emerging developing country, in the course of determining its foreign economic relations, is going to be faced with a number of policy problems of a monetary nature in the months ahead. Because each country is subject to a unique set of economic, social and political conditions, it will be necessary for Papua New Guinea to work out its own solutions.

However, the country will seldom be without assistance, and will be able to turn in particular to overseas sources for help and advice. Many of the problems and dilemmas will be those that other countries in similar circumstances have had to face, and their experience will be available if required.

By the same token, as Papua New Guinea assumes political independence, overseas countries, corporations and individuals will expect Papua New Guinea to stand on its own two feet and be able to stand up to the knocks of everyday commercial life. In this situation, Papua New Guinea will need always to consider its own national interest - though not to the extent of allowing a sense of suspicion and inferiority to distort national policies.

Perhaps the best way to ensure that national policies, including those in respect of overseas economic relations, are reasonable and realistic, is for Papua New Guinea to try to anticipate the problems before they arise. In this way, it should be possible to consider each issue and question on its merits and to make an objective decision based on the best information available. If this course is followed, it should be possible to evolve a consistent set of general policies which give full weight to Papua New Guinea's interests. The foreign economic relations seminar and similar meetings, giving opportunity for open discussion of these matters, can play an invaluable role in this process.

Chapter 9

# Monetary aspects of Papua New Guinea's foreign economic relations: a comment

Henry To Robert

I would like to make very briefly and in a very generalised way a couple of points which are likely to be important influences on the monetary dimensions of Papua New Guinea's future foreign economic relations. Some of them have been made already, but I think they are worth underlining.

First of all, foreign economic relations, in so far as they affect Papua New Guinea or anyone else, involve not only economics; they equally, if not more, involve political considerations. I think this applies particularly to international monetary relations. National monetary policies result from political forces within countries; thus, if prices rise more rapidly in one country than another, payments imbalances result and adjustments to restore balances are required. Arguments about who should bear the cost and take the initiative in restoring balance then occur, as we have all very well seen in the past couple of years with the United States v. Japan, Germany and others, and all the post-Bretton Woods monetary uncertainty. Because countries want primarily to satisfy their self-interest, and bureaucrats and politicians within countries want to make sure that they stay in their jobs, economic policies are inevitably motivated in part at least by short-term expediency. The international monetary system then becomes the arena where disparate national policies have to be reconciled; and they cannot by the nature of the system - or perhaps until we have one vast world state - be reconciled without shocks and adjustments.

That point is pretty obvious, but it seems to me that we in Papua New Guinea need to be well aware of the fundamental nature of the international financial game: we would be fairly naive if we tried to convince ourselves that it has been taken straight from a macro-economics textbook.

Secondly we cannot afford to forget our size. Papua New Guinea is a small country, and we conform to the classic economic test of smallness: that our own economic activities are unable to influence foreign income or interest levels in any meaningful sense. So in the great world stage on which the international monetary game is played none of the important players really cares what Papua New Guinea does.

This argues several things to me: firstly, because we are small (economically small I mean), we are basically in the grip of world forces which we cannot influence and have only a limited ability to offset. It is implicit, I think, that initially at least a lot of our foreign monetary responses are likely to be essentially defensive ones: the larger nations with whom we trade or swap capital will in many cases be adopting or making policy decisions irrespective of our own wishes. All we can do is to move within that exogenously-set framework, so far as we are able, to adjust our own policies to minimise any external adverse effects and to maximise any benefits from involvement with other countries. Up to date of course, as you all know, the ability of Papua New Guinea to adjust its policies independently to meet changing international circumstances has scarcely existed: accidents of history and geography have seen to that and as part of the Australian currency area we have been riding in mother kangaroo's pouch, quite often (especially during recent revaluations of the Australian dollar) as a somewhat uneasy joey. No doubt one of these days someone will find the time to evaluate fully the costs and benefits to this country of the Australian monetary connection and so determine whether the bias of our trade that it induced is one which would have brought us greater benefits than trade and aid based more strictly on comparative advantage. I do not pass judgment on the issue and, in any case, for better or worse we are now moving relatively rapidly towards a loosening of close monetary ties with Australia and towards developing more outward-looking policies.

Even so, it is easy to suppose, I think, that we will be able to do much more once we have achieved our so-called monetary independence than in reality we can. Theories of the effectiveness of monetary policy in small open economies have recently been elegantly retreated by Mundell, Johnson and others and it seems to be becoming clear, even to ordinary practical men of this world, that as Professor Michael Parkin said recently, the systematic use of monetary policy to influence the levels of incomes and prices in economies like ours is, except perhaps in the short run, something of a mirage, given a fixed exchange rate.

Mr Coppinger has given some consideration to exchange rates in the Papua New Guinea context, and there is little I want to add to that except perhaps to reinforce the fact, now known even to central bankers, that to rule out the use of the exchange rate as a monetary policy weapon is to reduce substantially one's own economic sovereignty. This argument applies both to those who would advocate an exchange rate inviolably fixed (let's say) in terms of gold, or one which is allowed to be quite freely floating. If I remember correctly, Professor Parkin argued that the best strategy for Papua New Guinea might be to move our exchange rate on a monthly basis linked to price movements of a suitably weighted export bundle. No doubt in the medium term we shall need to give consideration to this idea, as one amongst a number of possible strategies. For the short term, however, I do not see it likely that we are in any position to so arrange our policies that the balance of payments takes care of itself through an appropriately fluctuating rate, leaving the government free to manipulate its other policy instruments to achieve internal structural transformation and, more ambitiously, some element of local demand management. To me, our first concern, now that the political decision has been made, is to get our own national currency firmly established and accepted by Papuans and New Guineans, and to establish in the minds of foreign investors a reputation for sound and sensible monetary management.

The search to achieve some kind of optimum currency area within our own geographic area of Asia and the South Pacific is to me, at present, something of a secondary priority, even if I thought, given present world monetary uncertainty, it were economically and politically feasible. Again, I share and would underline some of Mr Coppinger's strictures about the need to try and separate political from economic motives in this search for various forms of regional monetary cooperation, even though perhaps I am not sanguine enough to think that in practice the calculus can always be observed.

I have digressed a fair bit from what I started out to say: we are small, and our scope for really independent externally directed monetary action is at present not great. Increasingly our foreign monetary relations will be less closely centred on Australia; we must be alert to borrow funds and obtain other aid from where we can get terms that suit us best; we must be aware of the political nature of the game and we must make deals and allegiances, multilateral and bilateral, with caution and with as close an eye to the medium and longer term economic consequences as our political masters will allow. Our own problems in this area are certainly not unique, and though I do not think we have any special insight not shared by policy makers and theorists in other countries, perhaps the one advantage we do have is to be starting late and so to be aware of the mistakes and ploys of others. I hope, by skilful advice and a cool head we can turn our late start to some kind of advantage.

Chapter 10

# Protection and internal distortions in Papua New Guinea

Anthony Clunies Ross

Though the question of protection has agitated economic discourse for two hundred years to the point at which there is a fairly standard text-book treatment of the issue, there is still very little guidance on protection in practice. It is agreed that there are a number of possible economic justifications for protection of which one only depends on a first-best argument. But how to decide whether any of these justifications applies in a particular case, and if so how to tell the level of protection that is justified, has been much more difficult.

In practice, however, the issue refuses to be ignored. Much as theorists may regard it as unlikely that protection will by and large produce any gains that from an impartial viewpoint could be rated as outweighing its losses, protection continues to be popular, because the gains are more visible than the losses. Since a decision in favour of protection raises technical questions of how much, some kind of inquisition is needed on the desirable levels of protection in particular cases, the cases being either classes of industry or particular industries.

In what follows, 'protection' is taken to cover the imposition of a duty on the importation of a product or class of products or of a recurrent subsidy on its production or export with a view to improving the competitive position of, or the rewards for, an import-competing or export product. Protection thus implies a belief in the operation of some kind of market in international trade. In a country such as Papua New Guinea, with an absolutely very small monetary sector, a protected import-competing industry will often be in the hands of a single firm. In such cases the use of protection by tariff or subsidy may be regarded as an attempt to gain simultaneously the advantages of a competitive market and those of a state monopoly. Protection by tariff or subsidy represents a compromise between retaining competition and excluding it. If the relevant import-competing industries were in fact state monopolies, presumably simple exclusion or quota would be used; for the distribution problem raised by protection would not need to be a concern, and allocation questions would be answered (for better or for worse) by methods other than market competition. Papua New Guinea, however, has been content to leave the bulk of import-competing industry to private enterprise. This has its drawbacks but it does provide the government with rough and ready answers to allocative questions which would otherwise have to be met by difficult bureaucratic means. Modifications to the 'market' by consistent protective, wage and tax policies are an easy way of making allocative decisions in monetised areas of the economy. This approach enlists the planning capacities of private entrepreneurs, individual, collective or corporate. The protective, wage and tax policies (together with controls related to land use and environment and the like) should be designed to ensure that, as far as possible, the private interests of the entrepreneurs correspond to social objectives. This is not the only way of allocating resources, and over wide areas of the economy it is not applicable, but it is the method at present adopted for import-competing industries in Papua New Guinea; there is no sign that a coherent alternative is being thought out; and it behoves us to examine the logic of this method with a view to ensuring that, as far as our intellectual and administrative resources permit, it will be used in the interests of Papua New Guinean people.

An introduction or alteration of protection in Papua New Guinea is supposed normally to be brought about by the following process: an applicant, usually an interested firm, applies to the government (through the Director of Trade and Industry) for the imposition, increase, reduction or removal of some import duty, import restriction or subsidy. After investigation by the department (now the Department of Foreign Relations and Trade) this application may, if deemed worthy of consideration, be referred either to the Tariff Advisory Committee or (for quick action in emergency) to a Special Advisory Examiner. Either Committee or Examiner holds an investigation (which in the case of the Committee takes the form of a public hearing) for which members of the public are invited to make submissions. The Committee or Examiner then reports with a recommendation, the receipt of which by the government is publicly notified in the Gazette. Views of interested departments are sought on this recommendation, and the final decision rests with the government (hitherto the Administrator-in-Council, now the Cabinet), which either takes action (whether in accord with the recommendation or not) or (if it chooses) does nothing.

If protective action is recommended by the Examiner, the matter must be referred to the Committee before action is taken on it, and once the Committee makes its report, the measures recommended by the Examiner must be cancelled within three months unless the Committee recommends their continuation for longer.

Because both the facts and the considerations are complex, the expert body (as the Tariff Advisory Committee and Special Advisory Examiner are intended to be) should play a vital part in the making of tariff policy. Papua New Guinea, following Australian practice, has constituted the expert body as 'independent' of departmental control so that in effect it makes its own decisions as to how it fulfils the charge laid on it by legislation.

There are at least four possible approaches to tariff-making which will be discussed in turn.

(a) Seat-of-pants. One approach is to say that the issues are so complex and individual cases so different (and it might be added the TAC's brief from the government is so broad and all-embracing) that no rule can be adopted. Indeed it could be argued that the TAC's guidelines, adjuring it to take into account virtually every circumstance that anyone could possibly consider relevant, precludes any rule other than a monstrous weighting formula that (as it were) adds chalk to cheese. The experts must simply examine all the circumstances and draw on their collective wisdom.

Against this approach is the fact (as it appears to me) that the circumstances of tariff inquiries easily produce a psychological bias in favour of the applicant for protection, and more importantly that the recommendations made by this method, being only matters of opinion, will carry no particular weight against the opinions of politicians and other 'non-experts' who may also have very strong opinions.

(b) Made-to-order. This term is used to describe the approach of giving the local producer (or perhaps the most efficient or least efficient local producer if there is more than one) enough protection to ensure a minimum acceptable rate of return (or to achieve it if the best available techniques are adopted). A tough made-to-order approach would be to assure already existing industries of only the rate of return necessary to keep them producing while prospective ones are given enough to induce them to start production.

One problem here is that the necessary level is difficult to determine, particularly in the face of fluctuating local costs, overseas prices and exchange rates.

But the principal objection to this approach is that it aspires to deal only with distribution of income and not with allocation of resources. If effectively pursued it will ensure that no inordinate profits are made as a result of protection, but at its best it will not prevent producers from being given incentives to produce the wrong things and so to reduce the community's real income.

(c) Project appraisal. A third approach is to adapt the methods adopted for the social appraisal of public sector projects. In principle this involves what might be called a 'social profitability' or 'social cost-benefit' assessment of the particular project for which protection is sought. (In a country such as Papua New Guinea the industry seeking protection can often be thought of as a single project.) If the assessment (summing discounted costs and benefits) comes out positive, then the project is worth supporting and should presumably then be given protection necessary to allow it to compete; in other words such a project should then be awarded protection fixed on made-to-order principles.

A possibly valid objection to this approach is that it is over-elaborate. One value of making use of the market in allocation is that it obviates the necessity on the government's part for such elaborate calculations (which in principle in this approach have to be more elaborate than those made by the private investor).

There is, however, the possibility of a short cut still along the general lines of a project appraisal approach. The external (i.e. unrewarded) benefits and the external (i.e. unpenalised) costs of the project may be roughly estimated for a year of the project's life when it would reasonably expect to be paying its way (once-for-all external benefits and costs being 'amortised' in some way over the life of the project) and sufficient protection may then be given to compensate for the net external benefits. This is of course more easily said than done, but it is possible in principle, and one crude attempt at trying to do it in an actual tariff case leads me to think it may have some practical usefulness. The external benefits and costs may be quantified by using shadow prices. Just what shadow prices (if any) should be used as a matter of routine is discussed below. A possible source of bias is that attention may more readily be directed to external benefits than to external costs. Again the protection given might have an upward limit set on it by made-to-order principles.

(d) Rule-of-thumb. A practically attractive solution is to find a simple rule that can be applied to determine an appropriate level of protection.

Such a rule has been used (flexibly and with reservations) by the Australian Tariff Board with its target band of effective protective rates. The Papua New Guinea Tariff Advisory Committee in its 1972 Annual Report committed itself (again somewhat flexibly) to a limit to the effective rate.

To apply a uniform effective rate through the whole range of tradeable goods would be equivalent to adopting a consistent shadow price for foreign exchange that differed from the actual price and this would be the equivalent (as far as concerns trade flows) of a change in exchange rate. Administratively, probably the only way of doing this consistently would be to apply a uniform rate of duty (or subsidy) on imports and a corresponding uniform rate of subsidy (or duty) on exports, or of course actually to alter the exchange rate. The logic of the Australian policy depends on the belief that the currency would be overvalued under free trade with the existing exchange rate and that there are obstacles in the way of both dismantling the protective structure and altering the exchange rate (though recent moves in Australia have suggested that these obstacles are less than has often been supposed). A second-best solution is thus to treat foreign exchange as uniformly underpriced when applications are made on protection.

In Papua New Guinea, there is no protective structure to speak of, and present arrangements make it impossible for the currency circulating in Papua New Guinea to be overvalued in relation to that circulating in Australia (on whose reserves Papua New Guinean people draw for transactions with the rest of the world). If future currency arrangements reflect the realities of the present system, again overvaluation of the currency in the most obvious sense will not be possible, and 'overvaluation at free trade' would be possible only if a protective structure were to be built up.

Hence there is no specially strong reason for using this particular rule-of-thumb in Papua New Guinea. An alternative might be a limit to the effective subsidy per unskilled worker employed. This, of course, would be the rough equivalent of providing a shadow wage below the actual wage for unskilled labour. Yet the case for some fairly objective and easily applied rule-of-thumb <u>to set an upper limit</u> to the degree of protection awarded is very strong. Either an effective-rate-of-protection rule or an effective-unskilled-labour-subsidy rule probably makes more sense than a simple limit to the rate of import duty.

On the whole, given that protection has to be applied for and considered and that second-best solutions have to be adopted, the best method may be to have a combination of (b), (c) and (d), taking whichever is the least rate of protection of those prescribed by the three of them. This would mean (to put it another way) not giving more protection than external benefits seem to justify <u>or</u> more than is necessary to give a moderate rate of return <u>or</u> more than the rule-of-thumb indicates. This would mean that we set out to allow protection sufficient to cover the apparent net external benefits but refuse to use the protection to raise the producer's profit above an acceptable minimum rate <u>or</u> to give protection above a rate fairly arbitrarily fixed as a likely limit to the need for protection on account of external benefits. The count of external benefits in particular cases will be very dubious, and an upper limit that can be applied objectively, even though it may be theoretically dubious, may have a real advantage.

## Allowing for external benefits

There will be a number of possible occasions for supposing external benefits in an industry seeking protection, and one can not enumerate all of these in advance. Two kinds of external benefit, however, need some special consideration. These are the external benefits of employment creation and of unrewarded training costs. Should there be a shadow wage (below the actual wage) for unskilled labour or a shadow cost (below the actual cost) of training?

(i) Little and Mirrlees give a very subtle account of how to fix a <u>shadow wage for unskilled labour</u> in a country in which the marginal product per rural worker is supposed to be below the average product and in which the savings ratio is lower than socially desired. There is no strong reason for supposing that either of these conditions applies in Papua New Guinea and they will be assumed away in the following discussion. Yet the question of a shadow wage must be considered.

At one extreme in the shadow wage discussion is the view that movement of unskilled workers into the monetary sector workforce occurs independently of wages and employment opportunities, and that there is nonetheless involuntary unemployment in the monetary sector. The 'bright lights' hypothesis of the motivation of rural-urban migration would in its extreme form support this view. So long as there are completely unemployed unskilled workers in the monetary sector workforce, this view would demand a shadow unskilled wage of zero. In other words it would suppose that action to create urban-type monetary sector employment had no cost in terms of output forgone outside the monetary sector. This extreme 'bright lights' view must assume that the possibility of earning income is a negligible consideration in a decision to move into the urban monetary sector. In order to justify a shadow wage of zero, one must also assume that there is involuntary unemployment. These two assumptions may seem strange bedfellows.

To put it another way, this extreme view supposes a vertical supply function for monetary sector labour. If that supposition were true (and the demand function for labour were downward-sloping), subsidising employment would be equally 'first best' with lowering the wage. The difference in effect between the two would be merely one of distribution.

There is enough evidence to justify rejection of the extreme 'bright lights' view in its supposed application to Papua New Guinea.[1]

At the other extreme is the view that follows from the rural-urban-migration model of Harris and Todaro.[2] Their model supposes that net rural-urban unskilled labour movement is a function of the difference between actual (tangible and intangible) real income enjoyed or disposed of by marginal workers in the rural economy and the 'expected' reward for work at the urban minimum wage.

Expected cash earnings are assumed to be an important factor in determining the expected reward of urban work, and subjectively expected cash earnings are assumed to approximate to 'objectively expected' cash earnings for wage work, that is the product of the urban minimum wage and the probability of urban employment at that wage.

(For purposes of discussing applications of the model to Papua New Guinea, it is a good enough first approximation to treat subsistence and smallholder-cash production, rural business, and wage earnings from casual rural labour for whom migration is unnecessary as comprising a 'rural' sector, and all other non-agreement wage labour as comprising an 'urban' sector, with agreement labour and urban business activities ignored.)

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[1] See, for example, G. Harris, 'The determinants of internal migration in Papua New Guinea', U.P.N.G. (unpubl.), 1972, p.68; 'Internal migration in Papua New Guinea: a survey of recent literature', <u>Yagl-ambu</u>, vol.1, no.1, 1973.

[2] See M.P. Todaro, 'A model of labour migration and urban unemployment in less developed countries', <u>American Economic Review</u>, vol.59, no.1, 1969, pp.138-49.

The implication of the Harris-Todaro model is that urban-sector unemployment (at equilibrium) can be expected to be higher the higher the level of the urban real wage, and indeed in the strict terms of the model to rise proportionately with the wage provided the marginal level of rural incomes remains constant.

The urban employment survey being conducted in Papua New Guinea towns at the end of 1973-74 may provide supporting or contrary evidence to this hypothesis. There is a conveniently wide range of minimum wages in the various Papua New Guinea towns, and at the same time there is substantial, though by no means perfect, mobility of labour between regions.

If, as suggested above, marginal product and marginal disposable reward of labour in the rural sector can be assumed to be roughly the same, the Harris-Todaro model suggests that the shadow unskilled wage should be no lower than the actual unskilled wage. This can be illustrated by supposing that the minimum urban wage is $\frac{3}{2}$ times the rural marginal reward (which by hypothesis is equal to the rural marginal product). An additional urban job will in that case draw $\frac{3}{2}$ workers from the rural sector, so reducing rural sector product by the exact value of the urban minimum wage.

A Harris-Todaro type model used in this way is at best a simplification of the mechanisms that in fact operate. It has the inherent deficiency of static equilibrium models that it ignores the time taken to reach equilibrium. It leaves out of account the possibilities of the existence of pure target-earners among the migrant workforce (a possibility introduced by the non-negotiability of much rural product in this kind of economy); the complications introduced by the migration of men without their families; and the possibilities of day-labour by village-based people in certain urban-type industries (which probably reduces both the tangible and the hidden social costs of urban-type employment).

Nevertheless, it seems to me that until this kind of model is shown to be fairly clearly inconsistent with the facts or (failing this) until a model that accords better with experience is devised, the general conclusion that the shadow wage for unskilled labour in Papua New Guinea should equal the actual wage is a reasonable one to work with. Some of the complications of which the model does not take account can be dealt with effectively by methods that are more direct than protection. Some wedge could be introduced, through taxation or similar measures, between the disposable income of the single and the family-supporting urban worker, in order to overcome the special inducement to men to migrate without their families.

Areas in which urban industry may attract a commuting village-based labour force may either have their minimum wages kept below those of other urban areas (an expedient which may be consistent in those conditions with attracting an adequate workforce) or else be allowed some kind of once-for-all or continuing subsidy for industry, ideally a subsidy related to the amount of unskilled employment that the industry would offer. Such a subsidy would not come into the category of protection as defined here and as usually understood, since it is a subsidy to a location rather than to an industry. It is furthermore a kind of assistance which could not be provided by import duties since these do not discriminate between localities in a single country.

(ii) The appropriate allowance for external economies of training is something that may have to be assessed case by case. Two classes of training are in question: actual formal training on which a cost can be put, and informal training, for example by practice in general industrial activities, which is harder to cost.

The reason for giving special consideration for training is that, if there is staff turnover, training costs incurred by one firm in one industry may benefit another firm in another industry. This consideration should apply only in the early stages of industrialisation when a firm is clearly more likely to lose than to gain from labour turnover and it should depend on the rate of turnover. A study is in course of preparation for the Tariff Advisory Committee of which the raw data suggest a very high rate of labour turnover in Papua New Guinea secondary industry.

Probably the most significant external benefits occur through the training of people like accountants, office managers, marketing officers and the like, who have general skills that nevertheless demand some period of practical training in which their effective output is very low (so that the argument holds whether or not the firm has paid for their formal training). From casual observation, I would suspect that in the near future the rate of turnover of such people would be fairly high and that in the near future, too, a firm pioneering a new industry would be significantly more likely to train a Papua New Guinean for such a job and then to lose him, than to pick one up already trained. *Prima facie*, then, training is a source of external economies at this stage of Papua New Guinea's development. Some help in quantifying it for particular cases may be derived from the TAC's study when its results are fully analysed.

The mere fact that labour in the country concerned is less efficient with given techniques than labour in some other countries does not indicate external economies and is not in itself an argument for assistance. If it is a fixed fact of life it has a bearing on the country's comparative advantage in various industries, and of course it must have a bearing on the potential income of the country. If it is a temporary phenomenon overcome by a few months or years of practice, then at most the industry afflicted by this temporary inefficiency can ask for temporary protection on 'infant-industry' grounds which are discussed below.

(iii) Dynamic arguments. In discussing protection I would doubt the relevance of the type of external economy discussed by Scitovsky in his article 'Two concepts of external economies'[1] which is, I think, also implied by Hirschman's talk of linkages.[2] It is, to begin with, not very plausible that by virtue of being protected an industry will produce external economies of the 'forward linkage' type, since protection by tariff will raise the price of the protected product while protection by subsidy is not usually carried to the point at which it will lower the price. Hence user industries are not likely to gain and may lose.

It is possible that the fostering of an industry by protection will have a 'backward linkage' effect, that is to say that it will stimulate the production of an input of the protected industry. This, however, will not represent a net national external benefit unless the input-producing industry so stimulated is subject to (previously unexploited) economies of scale or the input-producing industry generates external economies itself for one of the reasons already given or enhances its rent at the expense of foreigners. If the stimulated inputs are raw materials, there is no particular likelihood that they will be subject to economies of scale in local production. Nevertheless the propensity for generating external economies through backward linkage effects is something that could be seriously examined in each case.

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[1] T. Scitovsky, 'Two concepts of external economies', Journal of Political Economy, vol.62, no.2, 1954, pp.143-51, reprinted in A.N. Agawala and S.P. Singh (eds), The Economics of Under-Development, O.U.P., 1958.

[2] A.O. Hirschman, The Strategy of Economic Development, Yale, 1958.

There are also less specific 'dynamic' arguments for protection of manufacturing. One strong dynamic argument against it, however, is that protection, whether by tariff or by subsidy, must reduce real income (unless the protection is balanced by quickly realised external economies) and, other things being equal, it will also reduce real personal disposable income. Manufacturing, being commonly subject to economies of scale and often dependent on the national market, is especially likely to have its further development damaged by protection that is not justified by immediate external economies. This effect is enhanced if protection is by tariff, which tends to hit differentially the industries that have export prospects. Hence protection, so often championed as a means for increasing manufacturing, may in the longer term have a particularly depressing effect on that sector.

(iv) Other external economies. One other alleged external economy is the benefit of improved service, and resulting reduction of investment in stocks, through the existence of a local industry. It may be alleged that users, while valuing the benefits that a local producer brings, will not necessarily be prepared to pay a higher price to the local producer if they have the opportunity of paying a lower one for an imported product. This is conceivable, and allegations of such benefits would have to be investigated case by case to see whether they were plausible. In recent tariff cases in Papua New Guinea, their occurrence has been alleged by 'user' witnesses, some of whom would have no interest in making the allegation if it were not true.

There may well be other arguable sources of external benefit which would have to be looked at in particular instances.

Special cases

Three special cases that do not fit neatly into the framework of subsidising for external economies will now be considered.

(i) 'Infant industry' is the name given to the argument that an industry will be subject to economies of scale or experience which will not be realised in the early part of its life. This opens the possibilities of the alteration of a country's absolute and comparative advantage through the development of new skills and experience, but it is not obvious whether this process is on balance promoted or deterred by infant-industry protection. One view is that all 'infant industry' appeals for protection ought to be rejected since an industry is not to be desired unless it is economically 'profitable' over the whole of its life, not just over the last part of it. If a concern were to be actually profitable over the whole of its life, it would be possible, according to this view, to borrow in order to cover early losses and then to repay from later profits. But again it is conceivable that, because of uncertainty, a parent company will not be prepared to plan for losses over a sufficiently long period to meet this requirement, and also that not enough loans at normal rates will be available for the purpose. The infant industry case, when valid, might thus be regarded as depending on a distortion in the capital market produced by uncertainty and ignorance.

Any protection given for 'infant-industry' reasons alone should be conceived of as temporary and applications should be examined individually to decide how long the period should be.

An alternative 'first-best' device would be to have a government lending agency providing loans to cover infant industry losses.

(ii) Marketing problems for the local product are sometimes advanced as a pretext for protection, and recent experience suggests that this may become a frequent plea in Papua New Guinea.

Where there are economies of scale, it is conceivable that, though a local product could, if it commanded the whole market, be produced to the same quality and price as the competitive import, it does not in fact command the whole market, either by chance (because purchasers are indifferent between the two products at the same price) or because of unreasonable prejudice against the local product on the part of either consumers or retailers.

If the facts as alleged could be established (and they involve some necessarily partly subjective judgments of quality), there would be a case for tariff, quota, or even exclusion of the imported product, provided (and it is an important proviso) that price of the local product could be kept down and quality up under those conditions.

This proviso, however, is not an easy one to secure. From a usually reliable source comes a cautionary tale of a producer who applied for protection on this ground and whose product was in the course of the investigation judged (by an arguably appropriate objective test) to be better value for money than that of most of its imported rivals. On discovering this, however, the applicant stated his intention of reducing the concentration of his product by half if he were granted the protection he asked for. Since this would have reduced the unit cost by a considerably smaller fraction than half, it was assumed that he did not intend to halve his prices at the same time.

Another cautionary tale is that of an applicant who alleged unjustified prejudice by retailers against his product, but who, during the delays of the investigation, introduced a technique practised by one of his overseas rivals which in the opinion of casual observers raised the product from being inferior to, to being equal with, the competing imported brands.

(iii) Papua New Guinea has an arguably special case over temperate-climate fruit and vegetables.

Many of these products can be produced in effectively unlimited quantities by village smallholders, and they are an important source of cash in some areas. On the other hand they are believed to be consumed very largely by expatriates, of whose budgets, however, they form a comparatively small part. Substantial quantities of these products are imported for reasons which appear to be those of marketing organisation rather than of comparative advantage in production.

The solution of choice to this problem is improvement of the marketing of locally produced foodstuffs, which ought to be (and is perhaps becoming) a major concern of the Department of Agriculture. Nonetheless, a solution to the marketing problem might be hastened by an embargo or vanishing quotas on fresh fruit and vegetables (other than the few types that cannot readily be grown in the country).

It is conceivable that such a policy, carefully managed, might have little effect on prices. Even if there were to be some rise in prices, however, it is very likely that the real income of Papua New Guineans (as distinct from expatriates) would be enhanced while that of expatriate residents would be reduced by a very small fraction.

This might be one of the rare examples of policy questions in which consideration of national (i.e. residents') income would give results different from those dictated by realistic consideration of Papua New Guineans' income.

## First-best solutions

The only generally recognised first-best argument for protection is that certain countries may be able to improve their terms of trade by protection to a degree that outweighs the disadvantages of a less efficient overall allocation of resources. Because of the smallness of Papua New Guinea in relation to world markets, there will be little scope for improving terms of trade by protection and exchange-rate changes. Hence this argument will have little application in Papua New Guinea.

The other main general reasons for protection discussed above - wages that do not reflect marginal social opportunity costs of the employment of labour, and external economies of training - provide second-best arguments for protection. If it were possible, it would be more satisfactory to fix minimum wages at appropriate levels (where they do represent marginal social opportunity cost of labour), and to provide subsidies for appropriate training.

There are other social purposes for which protection would be not only a 'second-best' but a highly inappropriate device. Such objectives are financial self-reliance (which is properly pursued by increasing locally-raised revenue or reducing expenditure, with or without exchange-rate variation which is probably inappropriate in Papua New Guinea); decentralisation (which might be promoted by local subsidies to, and local restrictions on, production and investment); and development of the informal sector of village industry (which is supported by legal changes and extension programs).[1]

In spite of the difficulties in principle of finding really satisfactory rules for protection, there may be some rational ways of setting limits in particular cases. Such limits should take account of the nature of the factor and foreign exchange markets in the country in which the rules are applied, and of external economies peculiar to the industry. It is suggested that a combination of made-to-order limits, some rule-of-thumb maximum for the rate of protection, and account of particular external economies should be applied in Papua New Guinea.

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[1] See Papua New Guinea Tariff Advisory Committee Annual Report, 1972, Appendix 1.

Chapter 11

# Towards a Papua New Guinea trade policy

Ross Garnaut and Ron J. May

Papua New Guinea's foreign trade interests can be deduced from its resource endowment and technology, its size and its geographic location. Papua New Guinea requires expanding markets for agricultural foodstuffs and raw material to support its ambitions for rural improvement. It requires expanding markets, especially proximate markets, for commodities produced by large-scale techniques from its marine, forest and mineral resources to support expansion of public expenditure and movement towards greater financial self-reliance. Markets for commodities processed from these raw materials and from Papua New Guinea's rich energy resources are likely to become increasingly important to the growth in public expenditure and to employment. The energy-based processing industries will require the importation of large quantities of materials, including uranium ore and bauxite. Papua New Guinea's trade interests on the import side include as well an interest in price stability and continued supply of a wide range of manufactured goods, petroleum and, at least for the next few years, some foodstuffs including rice, sugar and canned fish and meat.

This paper brings together suggestions about the formulation of Papua New Guinea trade policy that came forward in papers and discussion at the Foreign Economic Relations seminar in Port Moresby in November 1973. It discusses successively trends in the major centres of world trade that will affect Papua New Guinea, prospects for Papua New Guinea influencing these trends, the geographic location of Papua New Guinea's trade opportunities, and the domestic policy responses that accommodate best the available international opportunities.

## World trends

Tumlir characterised the 1950s and early 1960s, at least for the developed countries as a whole, as 'a period of growth, and growth optimism, without any fundamental economic problems'. The Drysdale, Tumlir and Kanamori papers all describe the very rapid growth of industrial countries' production and foreign trade.

Despite demand and technological factors which inhibited growth on the rich countries' imports of some foodstuffs and raw materials, and despite reluctance in the developed economies to extend trade liberalisation to agricultural commodities, developing countries have shared in the general expansion of trade, some much more than others. Among commodities exported in large quantities from the developing economies, trade expansion has been most rapid in fuels, ores and non-ferrous metals, animal feedstuffs, meat and fish, and labour-intensive manufactures. These are either commodities in relatively inelastic supply in the developed countries because of resource scarcity (fuels, timber, fish), subject to high income elasticity of demand (meat, fuels, non-ferrous metals) or subject to rapidly increasing production costs with rising living standards (labour-intensive manufactures). On the other hand, there was very little growth in the real value of world trade in fats and oils, fibres, rubber and tropical beverages through most of this period.

There were a number of developments in 1973 and early 1974 which contributed to an exceptional increase in the price and value of trade of most foodstuffs and raw materials. In late 1973 and early 1974, prices of fuels, metals and minerals, fats and oils, meat and fish, cereals, fibres and rubber were at all-time peaks in money terms, several of them at all-time peaks in real terms. This occurred at a time of exceptionally rapid growth in the Japanese, North American and European economies and so can be seen partly in the context of an unusually pronounced upturn in the normal commodity price cycle. It occurred at a time of uncertainty about international monetary and trade arrangements and so reflected in part, too, speculation against depreciation of the international currencies and dislocation in world commodity markets. In the case of petroleum, price was influenced by supply reductions by the OPEC cartel, and the increase in petroleum prices affected some other commodity markets. And it probably reflected as well the intensification of problems believed to derive from continuing pressure on a number of important natural resources.

How important each of these factors has been to the commodity price boom is critical to the future prospects of world economic growth, and to the economic prospects of resource-rich countries like Papua New Guinea. It was a recurring question at the Port Moresby seminar: are resource-rich regions such as Melanesia sitting pretty, or is this an illusion? Do high prices in late 1973 reflect merely the increase in quasi-rents accruing to established producers of resource-based products through a cyclical, international boom, or do they reflect an increase in the rent value of natural resources resulting from increasing scarcity? If the latter, does a major shift in the terms of trade in favour of resource exporters contain the seeds of its own destruction, through its effect on total world economic growth, or prior to this attitudes to growth and therefore growth performance?

There are no general answers. It seems likely that some natural resources are in such inelastic supply that prices would be on a rising trend (although not necessarily from the recent cyclical peaks) even if there was a substantial deceleration in the expansion of world economic activity and trade. Fuels and energy, fish and possibly timber, would seem to fall within this category. Demand and price for meat and animal feedstuffs is likely to be very sensitive to per capita income in the wealthy countries. Demand for copper is likely to be boosted by the shift from direct use of hydrocarbon fuels to the use of electric energy from alternative sources and also by the high energy-intensity of its major substitute, aluminium, and copper prices are likely to remain high by historical standards, although a ceiling may be placed on long-term price levels by the existence of large quantities of low-grade ore in many parts of the world. The price prospects for agricultural commodities are more difficult to predict, although if as some observers expect there is increasing difficulty in the supply of basic foodstuffs to a rapidly increasing world population, prices will rise for other agricultural products which compete with cereals for land resources in the temperate zone countries.

The direction of future price changes for agricultural products seems very dependent on the expansion of world incomes and trade, and the rate of increase of energy, fish, timber and metal prices is closely related to trade growth. The prospects of processed commodities are especially dependent on tariff policies and trade growth in the industrial countries, and further reduction of the high rates of effective protection on raw materials processing in the developed economies is critically important to the distribution of benefits from increased exports from the developing economies.

There have been in recent years a number of challenges to continued trade expansion within a liberal international system. Drysdale described the challenge posed by the European Community and the extension of its discriminatory trade arrangements with other countries and also the underlying causes of strains in international monetary arrangements. The latter effects were at first associated mainly with the changed United States trade and balance of payments position, but these effects have since been compounded by the transfer problem associated with the massive shift in the terms of trade against the industrial countries. With Tumlir and Kanamori he drew attention to the rethinking of growth ambitions and the reassessment of international goals in the industrial countries, associated with realisation of problems of energy supply, environment and domestic poverty.

The problems of growth have been felt most severely in Japan, whose own spectacular growth and economic internationalisation has been a major factor behind recent world trade growth and the 1973-74 boom in commodity prices. Japan is the world's largest importer of foodstuffs and raw materials and the shift in the terms of trade against her in 1973-74 reduced real income perceptibly, by perhaps two per cent, and compounded pre-existing balance of payments problems. The adjustment was severe and it seems that there will be little real growth in the first half of the 1974 fiscal year. However, Kanamori's widely respected Japan Economic Research Center is predicting a return to growth at a 'normal' annual rate of about 10 per cent in the second half of the fiscal year 1974. Japan may choose to lower its rate of industrial growth to levels well below its historical performance and below its capacity over the next decade, but despite difficulties of adjustment it seems that even increases in commodity prices on the massive, recent scale are compatible with continued real growth, and growing import demand for resource-based goods.

Tumlir raised the possibility that a new impetus to world industrial growth could come through industrial expansion in the now developing economies. The industrialisation of resource-exporting countries such as Brazil would increase pressure on resources, and resource rents, in other developing economies, in much the same way as industrial growth in earlier eras in the United States and Japan inverted those countries' patterns of specialisation in world trade. Industrialisation and incomes growth in the densely populated countries of East Asia, including China, Korea, Hong Kong and Singapore, will affect the growth of world trade as did Japanese economic expansion over the past two decades. But the process of industrialisation in these developing countries is, at least in its early stages, dependent on the maintenance of a liberal international trading regime. The willingness of the industrial countries to avoid adjustment to the development of new competitive manufacturing industries in the developing countries through restrictive 'safeguard' mechanisms gives little cause for optimism.

Papua New Guinea's interest in overall trade growth is considerably greater than her interest in the general preference schemes that have been implemented or considered in recent years. The general preference schemes have been hedged with very restrictive safeguards and have provided few new opportunities for expansion of trade in processed timber or non-ferrous metals, the commodities in which foreign protectionism has greatest adverse effects on Papua New Guinea. The direct benefits of the preference schemes would be greater if Papua New Guinea secured a more preferred position among developing nations within UNCTAD, and Papua New Guinea should continue to seek 'least developed' status, although recent developments have been moving this country up the international per capita income league table.

Papua New Guinea will have very little influence on the policy decisions which will determine the future growth of world trade. However, it is very important that Papua New Guinea is well informed of world trade developments. For this reason, and also to exert some small influence towards international trade liberalisation, Papua New Guinea should join the General Agreement on Tariffs, preferably through formal Australian acceptance of GATT in respect of Papua New Guinea before Independence. For these reasons and also for the reasons of national monetary management outlined by Coppinger, Papua New Guinea should also join the International Monetary Fund.

### Papua New Guinea's influence on world prices

As emphasised by To Robert, Papua New Guinea is a price-taker in international trade. It is doubtful that variation in the level of Papua New Guinea output of any commodity would affect significantly prices in international markets, although future developments could make this economy important to total western Pacific supply of energy, timber and non-ferrous mineral ores.

A significant issue is whether Papua New Guinea, through entering international groups in co-operation with trading partners or in confrontation with them, may exert some influence on the prices obtained for her exports. There are two means by which exporters of a commodity in combination can affect prices: through restriction of supply, which can in certain circumstances raise prices; and through counter-cyclical management of buffer stocks, which can in certain circumstances stabilise prices. There are two current approaches to influencing world prices by co-operative action: the international commodity agreements, described by Charles, and the cartel action of the kind used by the Organisation of Petroleum Exporting Countries.

Papua New Guinea has much to gain from stabilisation through the management of international buffer stocks. The gains from restrictions on supply are more doubtful. Papua New Guinea has potential for very much more rapid expansion in exports of its major products than do other producers, so that any limitations on supply based on historical levels of exports are likely to be discriminatory against Papua New Guinea. The old economic clauses of the International Coffee Agreement exemplify this discrimination. However, when major importers join exporters in an international commodity agreement which seeks to restrict supply on world markets, Papua New Guinea has little choice but to join and to seek export quotas that recognise her potential for growth.

There are serious doubts as to the effectiveness of restrictions on supply in raising prices for many commodities in the long term, although the restrictions may be useful in the lifting of prices out of a short-term cyclical down-turn. The petroleum producers' apparent success in raising oil prices over the last two years is alluring, but most other commodities, including copper, are neither so inelastic in supply nor so free of substitutes in demand as petroleum, and even in the petroleum case there are doubts about the effect of the cartel action on the long-term price level. The actions of militant producer cartels also threaten multilateral trade liberalisation and expansion, which is the main determinant of Papua New Guinea's terms of trade. Papua New Guinea should be cautious about joining producers' groups which aim to raise prices through restrictions on exports.

Papua New Guinea has a great deal to gain from international acceptance of the principle that world market prices, manipulated only by counter-cyclical management of buffer stocks and supply, should be the basis of international trade transactions. In international forums and in bilateral negotiations with Japan, Australia and other countries, Papua New Guinea can argue persuasively that international assistance in enforcing market prices and the appropriation of resource rents associated with these prices is a reasonable *quid pro quo* for an undertaking to forgo arbitrary restriction of supply.

Papua New Guinea also has some interest as an importer in price developments in some international commodity markets. She has been affected significantly and in the short run adversely by the increase in petroleum prices, although in the long run this is likely to be outweighed by the increase in the rent value of hydro-electric potential associated with the changes in the cost of alternative sources of energy. Cyclical increases in world prices for rice and sugar have been the source of considerable political problems in Papua New Guinea and, pending the development of efficient, local supplies of these or substitute commodities, membership as an importer of international groups with price stabilisation objectives would bring substantial benefits.

### Geographic distribution of trade opportunities

Papua New Guinea's trading interests are increasingly worldwide. The diversification in both her export and import trade away from Australia towards Japan, the United States and Europe is a significant long-term trend. However, her trade associations with neighbouring countries remain important and deserve special consideration in the formulation of trade policy. Papua New Guinea has competitive advantages in the nearby Melanesian, Australian and New Zealand markets. In Asia, the Japanese market with its large resource demand offers special opportunities for exports of commodities with relatively low ratios of value to weight such as mineral ores and timber.

Papua New Guinea could maintain an established trade with its Melanesian neighbours on relatively favourable terms, but the potential size of the trade is very small and the administrative costs of its extension high. Melanesian trade is, of course, attractive politically, since it could give tangible form to the frequently expressed desire for regional cooperation. But administrative skills of the type required to pioneer this trade are scarce in Papua New Guinea, and it will therefore probably be more appropriate for this country to support moves for closer integration initiated elsewhere in the region rather than take major initiatives herself in re-structuring South Pacific trading patterns. To be worth support, such initiatives would need to be based on the genuine opportunities for profitable trade that exist within the region and so the realisation that regional trade will always represent only a very small proportion of Papua New Guinea's foreign transactions. An attempt to extend regional trade beyond these modest limits, for example by attempting to establish direct shipping links with the Polynesian members of the South Pacific Forum, could lead to Papua New Guinea's heavy subsidisation of and eventual disillusionment with regional integration.

The Australian and New Zealand markets are very much larger but, as Lloyd has pointed out, they still offer relatively modest prospects for expansion of Papua New Guinea's exports. It is worthwhile to seek bilateral agreements with these countries on a commodity by commodity basis, with highest priority being attached to the maintenance of historical terms of access to the Australian market, including a guarantee of continued and unlimited duty free access for timber products. The negotiation of this access would place Papua New Guinea's exports of timber products on the same footing as New Zealand in the Australian market.

Recent moves towards tariff liberalisation in Australia, including the 1973 general tariff cut, have reduced the margin of preference accorded Papua New Guinea over other suppliers in the Australian market. The buoyant commodity prices through this period have insulated Papua New Guinea from the effects of increased competition, although there has almost certainly been some long-term reduction in the price commanded by some Papua New Guinea products, most importantly timber, in the Australian market. Against this, moves towards trade liberalisation in Australia have improved prospects for a few as yet minor Papua New Guinea exports that have not enjoyed preferred access to Australian markets, and the contribution of the Australian actions to the international trading environment is beneficial to Papua New Guinea. It would be counterproductive or at best unproductive for Papua New Guinea to seek to maintain historical preferential margins by opposing Australian trade liberalisation.

Some of the most difficult questions of future Papua New Guinea-Australian trade relations will be associated with imports of raw materials for processing in Papua New Guinea. The potential for generation of large quantities of very low cost electricity in the rivers south of the central cordillera gives Papua New Guinea a powerful comparative advantage in energy-intensive processing, especially the enrichment of uranium and the conversion of alumina into aluminium. The large and easily mined reserves of uranium and bauxite in northern Australia are the logical sources of raw materials for processing in Papua New Guinea. Should this logical trade development be threatened by Australian 'resources nationalism', it would be reasonable for Papua New Guinea to make the supply of raw materials for processing a test of Australia's commitment to regional co-operation. The development of energy-intensive processing in Papua New Guinea is not dependent on the Australian trade, since uranium ore is so valuable in relation to weight that it can be transported profitably from more distant sources and because there are alternative sources of bauxite in Indonesia and the Solomon Islands. However, integration of Papua New Guinea energy supplies with Australian mineral raw materials could raise considerably the profitability of both the Papua New Guinea and Australian industries.

Developments in the Japanese economy and in Japanese foreign economic policy are very important to Papua New Guinea's terms of trade through their effects on world commodity prices. In addition to this general effect, the bilateral trading relationship is likely to accommodate the greater part of the growth in Papua New Guinea's export trade over the next decade. Although Papua New Guinea is insufficiently important to Japan to secure significant preferential treatment above other suppliers of foodstuffs and raw materials, she has a very strong interest in certain developments in the Japanese economy that could be secured under multilateral arrangements. Despite major Japanese trade liberalisation, several processing industries in which Papua New Guinea has an apparent comparative advantage are still subject to high rates of effective protection. The tariffs on timber products and non-ferrous metals, including copper and aluminium, are of greatest importance.

The effect of the residual tariff on aluminium could be to appropriate for the Japanese government some of the rents associated with the hydro-electric power resources upon which Papua New Guinea processing would be based. Papua New Guinea would have very much to gain and perhaps little to lose from making the elimination of import duties on Papua New Guinea metal exports a condition of major Japanese investment in energy projects. This stance would be quite consistent with the general support for international trade liberalisation favoured in this paper; resistance in Japan would be quite inconsistent with that country's profession of support for trade liberalisation and mutually beneficial relations with developing countries.

Papua New Guinea's interests in the reduction of Japanese tariffs on timber products and metals is shared by the resource-rich Southeast Asian countries, including Malaysia, Indonesia and the Philippines, and by Australia and New Zealand. This interest might be pursued more effectively, along with other objectives relating to aid and investment policies, in co-operation with these countries, perhaps within the western Pacific forum suggested by Drysdale.

The question of Papua New Guinea's status in trade with the European Community is important in the context of access to that large element in the world market as too is her status within any eventual preferential scheme for developing countries in the United States market.

Domestic policy responses

These then, are the opportunities for Papua New Guinea to gain from participation in international trade. Given the range of opportunities, a number of basic questions remain: how much integration into the international economy; what industries; how to minimise the effects of fluctuations in the external economy and how to maximise national benefits from a given degree of foreign integration? These questions were discussed in the Clunies Ross, Coppinger, Garnaut, Togolo and To Robert contributions to the seminar. Consideration was given to tariff policy, investment policy and domestic monetary policy.

There was general agreement that tariff and other restrictions on foreign trade were likely to lower rather than raise the welfare of Papua New Guineans. One exception to the general rule might exist in an industry with economies of scale, where administrative controls on the local industry could maintain price and quality at the level of the tariff-free imported commodity. There was some dispute about whether the special characteristics of the fruit and vegetable industries argued a special case for restrictions on that trade, or whether national objectives could be pursued more effectively through direct assistance to domestic production and marketing of these commodities.

However, although the tariff will rarely raise national welfare and although a protectionist position could render more difficult the general objectives of Papua New Guinea trade policy, it was recognised that there would be strong demands for protection of import-competing production, and that, in some circumstances, support measures, not principally in the form of tariff protection, might be justifiable. The seminar discussed at considerable length the best procedure for assessing applications for protection.

The existing Papua New Guinea tariff-making procedure, described by Clunies Ross, was criticised on the grounds that it was structured on an inappropriate Australian model, that the type of information sought by the Papua New Guinea Tariff Advisory Committee was too complex for most firms to supply, and that too much time lapsed from the application for protection to a final decision. In defence of current procedure it was argued that public hearings and public reports provide a necessary safeguard against corruption entering procedures that can convey large benefits to special groups, that impartial and public advice to the government on protection issues helps to correct an anti-consumer bias that would otherwise be associated with consideration of producers' demands for protection, and that it eases the political leaders' task in resisting in the national interest special pleading of producers to be able to lean on independent, impartial and public advice. There was general agreement that existing procedures could be improved, especially through their streamlining where small firms were concerned and through the setting of time-limits on carriage of TAC references. There was also general support for the broadening of the TAC's terms of reference relating to applications for assistance to evaluation of requests for non-tariff assistance to industries.

The realisation of many opportunities for trade requires in Papua New Guinea large-scale foreign investment and employment of expatriate personnel. Direct investment raises more difficult problems than trade alone. There is a danger of disruption of domestic social and political life and a danger that inadequate administration could prejudice national gains from investment and trade. If the dangers are to be avoided and the benefits realised, the problems of foreign investment in development projects must be insured against.

The first administrative requirement is a single central agency to co-ordinate contact between the government and foreign investors. It is very important that the proposed National Investment and Development Authority play this role effectively. NIDA will need to co-ordinate the assessment of investment proposals by criteria that ensure the efficient use of domestic resources and generation of domestic incomes and employment. It will have an important responsibility to anticipate problems in the relationship between foreign investors and local communities, and to avoid them by adjustments in the investments or, where necessary, by exclusion of certain investments when national costs exceed benefits. It will also fall to NIDA to enforce the terms of agreements upon which foreign firms operate in Papua New Guinea.

There is also the critical question of the mobilisation of the benefits from foreign investment for Papua New Guinea nationals. The distribution of these benefits between the investing foreign companies and the Papua New Guinea community depends most importantly on the nature of the taxation mechanisms used and the effectiveness with which they are applied. It also depends on the effective integration of the modern sector projects with the local labour and commodity markets.

The Papua New Guinea government always faces the questions of 'how much foreign investment and foreign integration?' The choice in general is between higher Papua New Guinea incomes and less foreign integration. If the attractiveness to foreign investors of operations in Papua New Guinea remains high as it has been in consequence of developments in world commodity markets, the government could afford to be selective amongst applications for investment at the same time as maintaining high levels of Papua New Guinean incomes.

If the Papua New Guinea government seeks to limit foreign integration at the cost of some incomes growth, the basic criteria for exclusion should be industries' dependence on categories of manpower that are scarce in Papua New Guinea, and their economic profitability and hence potential contribution to the revenue. Taxation on foreign manpower and on company profits are the most efficient rationing instruments, accompanied by administrative controls on notably disruptive industries including tourism and by encouragement through assistance to general rural development programs for industries with special locational or other advantages.

The insulation of the domestic economy from external fluctuations is of critical importance to the implementation of economic development programs and to political stability in Papua New Guinea. Fluctuations in export earnings will have dramatic effects on rural incomes, the level of wage employment and government revenue. The efficient management of international reserves, facilitated by the new monetary system and by membership of the International Monetary Fund, is the most important instrument for the maintenance of budgetary viability. The introduction of major price stabilisation for all important village crops is necessary to the stabilisation of village incomes. The established stabilisation scheme for copra and the recently approved scheme for cocoa should be used with considerable vigour and there is a need for similar schemes for other export commodities, perhaps with government guarantees of realistic, minimum prices.

The establishment and management of a separate Papua New Guinean monetary system poses several problems. A prior question to be resolved is what will be the terms of separation of Papua New Guinea's monetary reserves from Australian monetary reserves. A minimal solution is for Australia to transfer Australian monetary assets equivalent to currency on issue and bank deposits held in Papua New Guinea at the time of monetary separation. These assets would comprise Papua New Guinea's international reserves, being, of course, freely convertible through the Australian dollar into other foreign currencies as required. The view that a more equitable arrangement would be for Australia to surrender the equivalent in monetary assets of, say, that proportion of its ofreign assets in some sense attributable to Papua New Guinea's external earning power (as defined by the ratio of Papua New Guinean to Australian gross foreign exchange receipts) was also put forcefully in discussions at the seminar.

More important questions relate to the management of the independent currency system and the prospects for exchange rate policy. An endemic belief in some circles is that an independent currency must soon be devalued. This belief has several origins, among them the idea that the exchange rate of a poor developing country such as Papua New Guinea must be inappropriately set if it is set at par with the economy of a rich developed country such as Australia; that the prospects of rural export expansion are seriously hindered by the current exchange parity; and that the 'balance of payments' position of Papua New Guinea will continue 'unfavourable'.

However, these are not convincing grounds for belief in the inevitability of devaluation in the short or even the intermediate run. First, the fact of initial parity with the Australian dollar has no special economic significance at all, except in so far as the legislated denomination of kina values *vis-à-vis* dollar values encourages, for whatever reason, a climate of economic confidence. The advisability of continued association with the Australian currency area will depend in the longer run on changes in the structure of integration of the Australian and Papua New Guinean economies as well as the extent to which both economies are subject to the same international economic forces within the same international market area. Second, the setting of an otherwise inappropriate exchange rate to encourage the expansion of an industry that is less profitable than other export industries will do little but induce the accumulation of unused international reserves, and may well have the side-effect of encouraging the erroneous view in aid donor country's that Papua New Guinea does not require significant external aid resources. Alternatively, the devaluation's inflationary impact will be reflected in demands for higher money wages, which, if met, would restore the pre-devaluation levels and distribution of real income at a higher price level. The exchange rate is likely to have a very minor influence on smallholder real incomes, since in addition to the effect on export income at domestic prices, rural costs are directly and proportionately affected through higher import prices. Third, concern about historical 'balance of payments' performance is based on a misconception of the nature of Papua New Guinea's monetary position within the Australian currency system up to this point. In the past, a 'payments' problem was impossible since falls in gross external receipts were compensated for automatically by increases in net capital inflow and by contractions of domestic demand. Papua New Guinea may choose to continue to use these adjustment mechanisms, although a larger burden of adjustment will now fall on demand when external receipts fall. But if economic management is based on awareness of the variability of foreign exchange receipts, the burden of adjustment may not be severe. The developments in commodity trade analysed in this discussion, the foreign aid guarantees, and the private capital flow position on balance suggest that increasing Papua New Guinean incomes will be consistent with the maintenance of external balance at the current foreign exchange parity for some time.

Indeed, it was argued in discussion that revaluation should be considered under an independent currency regime, in order to combat imported inflation. One suggestion that received attention in the context of international reserve accumulation through rising export prices, was that exchange rate movements (revaluation in term of rising prices) could be tied automatically to movements in the overall export price index. This mechanism, it was said, would neutralise the inflationary impact of external prices. However, the vagaries of the international copper market would hardly be an appropriate yardstick by which to make period by period exchange parity adjustments. Moreover, stabilisation of average export prices would be destabilising for the prices of some commodities and for real incomes. It seems better to insulate against commodity price instability through the variation of reserves, independently for each major export commodity. However, revaluations to stabilise import or consumer prices might well be appropriate, provided that their effects on the price level were fully taken into account in decisions on wages and public expenditure.

This discussion leads to the conclusion that external monetary management should be framed in the context of longer run developments in Papua New Guinea's overall competitiveness in international markets, domestic wage policy and government expenditure policies. Domestic monetary policy is unlikely to exert a significant independent influence for some years. Briefly, when unfavourable developments shift the balance of payments into deficit (or when domestic wage and public expenditure policies produce this same effect), the first response should be to utilise foreign exchange reserves. If the problem is of a longer term nature, then wage policy, the expenditure side of the budget, appear powerful instruments of relative internal/external price adjustment in the Papua New Guinea environment. Devaluation remains as an instrument to correct rapidly (and at the cost of a sudden increase in the price level) for disequilibria too severe to be left to the attrition of living standards through the effects of international inflation. These policies can be operated in reverse to correct for external surpluses.

Success in the pursuit of its announced policy goals and as a nation is linked closely with the nature of the relationship Papua New Guinea is able to establish with the international economy. Papua New Guinea's policy may have relatively little influence on developments in the world economy beyond the Pacific area, but systematisation of the effects of the important policy responses open to Papua New Guinean policy makers is an important prerequisite to ensuring that developments in the world economy are turned successfully to Papua New Guinea's advantage.

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Abstract

New Guinea Research Bulletin No.56, 1974

The foreign economic relations of Papua New Guinea

Questions of international trade and trade policy will have very important effects on the domestic economy of Papua New Guinea. General developments in the world economy, and the bilateral relationships between Papua and New Guinea and other Melanesian countries, Australia and New Zealand, Japan and the North Atlantic countries are discussed, together with problems of domestic policy response to international developments. The *Bulletin* contains papers delivered to a seminar in Port Moresby in November 1973, on Papua New Guinea's Foreign Economic Relations, together with an interpretation of discussion at the seminar.

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