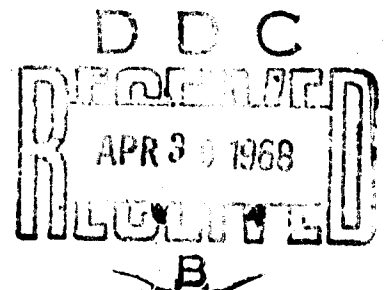


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The following remarks comprise a loose agenda on various aspects of modernization in Asia likely to be of continuing concern to Japan and the U.S. in the future.

At the outset it is worthwhile to acknowledge that discussing Asian economic futures apart from political futures is fanciful, and discussing them together is difficult. One can, for example, posit various ways in which events in Vietnam may unfold in the next several years, and these may strongly affect economic problems, programs, and prospects (e.g., foreign aid, trade, other economic transactions, defense budgets, etc.). Nevertheless, at the risk of being fanciful, I will deliberately ignore Vietnam, apart from one conjecture. When Vietnam emerges from the present war, I would guess that it will probably be a decade closer to economic "takeoff" than most of its neighbors, notwithstanding the destruction and suffering it has undergone. The explanation for this irony lies not only in the modernizing effects of massive current inputs of tangible capital (e.g., for roads, communications, harbor facilities, airfields, etc.),

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nor in the substantial aid programs that are likely to be available after the war to repair wartime destruction. The explanation lies in the possibly more significant effects of exposure to new opportunities, modern organizations, advanced technology and advanced labor skills. Technological diffusion, as well as social and economic mobility, which seem to be such important parts of economic development, may thus be accelerated by the war. None of this, of course, alters the fact that war is, in this case as in others, a cruel and expensive way to accomplish these changes.

Let me move on to the question of "regionalism," or what I prefer to call multicountry associations (MCA). Regionalism is much talked of and advocated these days. In the U.S. and elsewhere, it frequently serves as a focal point around which quite divergent interests and groups converge. Many liberals and conservatives, isolationists, neo-isolationists and erstwhile internationalists, economic developers and military hard-liners, frequently find a considerable area of agreement on this matter. They contend that regional blocs are desirable because the economies of the region are likely to flourish under such arrangements," thereby reducing the need for foreign aid and hopefully providing a bulwark against various security threats as well. The proliferation in recent years of Asian regional associations, having either or both an economic and a security connotation, is impressive: ASEAN, ASPAC, SEATO, MAPHILINDO, ASA, ADB, APO, etc. Although the acronyms are impressive, there is some uncertainty about what lies beneath them.

* Whether they might flourish even more under other arrangements is typically ignored.

The origins of the current penchant toward regional groupings are multiple: the geopolitics of Haushofer and Mackinder; the related views concerning "natural" spheres of influence, largely geographically based; and the postwar experience of Europe, beginning with ERP and going on to the Common Market. The Vietnam experience has further intensified the regional fashion in the United States, inasmuch as regionalism is thought to offer a means or a justification for reducing our foreign involvements.

The growing interest in economic regionalism also relates to a major unresolved issue in economic theory. Essentially, the economic theory of the "second-best" has formalized the following notion: if some of the conditions and assumptions required for free trade to be optimal are not met, then trade restrictions and preferences of various sorts may be desirable from a national, and even from an international, point of view as well. In a second-best world, and in a world in which there are significant economies of scale and significant economies-through-learning, MCAs may become appealing and may, in some cases, be productive. There are many major analytical and empirical questions raised by second-best theory which have not been resolved, but which must be if anything useful is to be inferred from it. I will mention only one.

If an MCA is to be formed, the question arises whether the appropriate criterion for choosing members is geographic proximity? If a country or several countries wish to develop various forms of preferential treatment for "insiders," and raise some barriers against "outsiders," should those on the "inside" be in the same geographic area? The correct answer is: not necessarily. For some purposes, a preferred combination

of countries may include those in the same geographic area; for others not; and for many purposes the two may be mixed.

In choosing membership for MCAs, a more reliable criterion would be one concerned with functional complementarity among members; specifically, a criterion that combines common purposes and divergent capabilities. I would suggest that the criterion applies whether the purpose is trade, investment, labor mobility, or national security -- though of course the membership may vary depending on the purpose. "Regions" should perhaps be thought of not in terms of geographic accident, but rather in terms of purpose and function.

It is worth considering how much of a difference such an approach would make for Japanese and U.S. policies and programs concerned with trade and development. I would conjecture that it would make a great difference: geographically distant areas are extremely important for Asia (particularly for Japan itself, but also for Indonesia, the Philippines and India, among others) as markets, sources of supply, and for other classes of transactions. Consequently, if MCAs are good, second-best, or best for Asian countries, their membership ought very likely include countries that are geographically quite remote from Asia. This conjecture will be tested in research presently underway at RAND concerned with the evaluation of many hypothetical MCAs.

Let me now turn to some matters relating to aid and development in Asia. At the present time Japan and the U.S. both devote a roughly similar percentage of their respective GNPs to foreign aid, about one-half of one percent. In terms of grant-equivalents, the amount is less, particularly for the Japanese percentage. They are both well below the one percent UNCTAD and DAC aspirations.

There are a number of differences between the U.S. and Japanese aid programs: for example, the U.S. percentage is falling, for a variety of reasons, while the Japanese percentage is rising, though slowly. Japan's aid terms tend to be harder in terms of interest rates and repayment periods than U.S. programs. Japanese aid is more concentrated than the U.S.; nearly all of Japanese aid is concentrated in a dozen countries in the Asian perimeter from Korea to Pakistan. The U.S. has economic aid programs in nearly all of these countries, with a few exceptions, e.g., Taiwan. But the U.S. also has programs in several dozen other countries in the rest of the world.

Despite these differences, both Japan and the U.S. confront many of the same basic problems in understanding and influencing development in the less developed countries (LDCs) of the Asian area. Let me mention three such problems.

1. Investment in People vs. Investment in Things

Although fast growing LDCs (e.g., Korea, Taiwan, and Thailand, as well as such non-Asian cases as Venezuela and Mexico) typically are characterized by a large excess of investment over internal savings (and hence an import surplus), other equally prominent characteristics exist: (a) there is a high ratio between the "quality" of the labor force (i.e., in terms of education, skills, literacy, etc.), and the initial level of per capita income; and (b) the rate of growth is substantially more than can be explained by increases in investment and employment alone, implying that improvements in organization, management and human resources may account for much of the residual.

On both counts the implication seems to be that investment in people is no less, and may be more, important than investment in things. Exactly what this means -- what kinds of investment in people, educational programs, management training, vocational training, in-service training, literacy training, etc. -- is a subject currently receiving increasing study, and needing more.

2. Policies vs. Investment

In most LDCs, various policy changes -- in pricing policies, foreign exchange policies, tax policies, organization, administration, etc. -- would have major growth-promoting effects. Indeed, it is fair to say that the present value of increased growth generated by such changes would often be higher than the present value of increased income resulting from large increases in capital investment. In this sense, it can be said that policy changes are "more important" than increases in investment. The problem for development strategy is, in large measure, how to use investment as a means of facilitating growth-promoting policies. Development programs should be regarded as packages of policies and investment proposals, not just the latter alone. The strategic question is how to use one set of changes to bring about changes in the other.

Analytically, the problem is how to take account of desirable policy and institutional changes in designing investment plans. What kinds of investment, executed in what ways, will have greater influence in conducing to desirable policy and institutional changes? Specifically, where public investment alternatives are under consideration, how can the crucial question of the organizational capacity of

different agencies to carry out programs be assessed and improved? (If we could assess organizational capacity more accurately, it might make better sense to make allocations for public investment on the basis of past organizational performance rather than the expected yield of specific projects.) And how can the already excessive demands on limited organizational capacity in the government sector be reduced by making the market mechanism work better and using it more? Answers to these questions may be more important for successful development and effective aid programs than achieving higher rates of return on individual projects.

3. Economic Development and Political Development

In most of the LDCs, major increases in growth rates could be obtained by improved use of existing resources on the basis of information and analysis already available. It is rare that a reasonably well-trained person can't find within the span of a few weeks in any of the Asian countries some major and fairly evident improvements that could be made. The effective constraint is usually not foreign imports or technical knowledge. The immediate constraint is more often administrative and management capabilities.

But there are also more fundamental constraints. They arise from the fact that frequently "efficient" courses of action -- from the standpoint of economic development -- conflict with or threaten the interests of particular groups and powerful interests. More important still, such actions may disrupt the internal political balance: within the governing groups, between regions, among ethnic groups, etc. While development may lead to stronger political institutions

and enhanced internal security in the longer run, it more likely does not in a short run which may be as long as a generation or more.

There is a real dilemma here. If the governing groups and institutions are or feel threatened by development, they will drag their feet. If they are successfully circumvented, the resulting disruption to the fragile structures of authority in these countries may make the status quo ante look better than the status quo post -- the "survivors may envy the dead!"

These considerations open up a range of problems that is usually totally ignored by those concerned with development and modernization: how to govern while rapid economic and social change is underway. The problems are similar for both Japanese and American programs in these areas. It would be interesting to compare experience and possible solutions.