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GROWTH PERSPECTIVE AND CHALLENGES FOR ASIA:
AREAS FOR POLICY REVIEW AND RESEARCH

by

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FOREWORD

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I. INTRODUCTION

1. The performance of the Asian developing countries (ADCs) during the 1980s has been spectacular with GDP growth rates averaging about 7 per cent per annum. In 1987 and 1988, GDP growth rates rose to 8.1 and 8.9 per cent, respectively. Within the ADCs, growth rates have varied widely. Both external and internal or domestic factors have contributed to the high growth rates and variations among countries. The external factors have included relatively high industrialized country growth rates, impact of currency realignments and the ballooning U.S. trade deficit. Since all ADCs faced the same external environment, differing growth rates among countries could be explained by internal factors like differing initial conditions including resource endowment, economic structure, stage of development and differing policy environments.

2. Public policy has been identified as the most important factor in explaining high growth rates in the ADCs and variations within them. Trade policy rationalization in the ADCs has been extensively researched and documented. The picture is one of sustained and, in many cases, accelerating trade liberalization. A number of factors have contributed to this. First, there has been a re-evaluation of the merits of import substitution strategies as well as a growing appreciation of the importance of maintaining as open a trading system as possible. Second, high industrialized country growth rates have provided export markets for the ADCs. An additional percentage point of GDP growth in the industrialized countries is estimated to contribute about 2 to 3 per cent to export revenue growth of non-oil developing countries. Third, there have been pressures from World Bank and International Monetary Fund (IMF) lending programs for trade policy rationalization as well as threatened bilateral trade actions by developed countries if liberalization does not occur in some ADCs.

3. While trade liberalization in the ADCs has received the greatest attention, the concern in most countries is to improve growth performance by making the domestic economy more efficient. Measures to increase efficiency have included reform of the industrial sector regulatory

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environment; financial sector reform to increase mobilization of domestic saving and improvement in allocation of mobilized saving; and tax and public sector initiatives. The supply response following macroeconomic and sector policy reform would depend on firm level behavior which is influenced by the level of domestic competition. While circumstances differ by country, the direction of both thinking and implementation of policy are guided mainly by efficiency considerations.

4. Against the background of trade and domestic policy reforms underway in ADCs, the paper begins by highlighting the issues in macroeconomic policy reform. This provides a background for examining the role of external factors in influencing the sustainability of policy reform in ADCs. Factors that are domestic or internal to the ADCs are then analyzed for assessing the need for and sustainability of policy reform. The core of the paper is concerned with the implications of the above on designing a research agenda to examine and analyze issues related to policy reform and growth strategy in the ADCs. Three aspects are highlighted. First, there is a need to assess the availability of export markets for ADCs in light of changing industrialized country growth rates, the emerging international trading system and growth of intra-Asian markets. Second, the impact of the above on growth strategy and policy in the ADCs needs to be established. Third, increasing the policy content of decision making on investment activities will call for research efforts in integrating sector with project analysis. The paper ends with a brief discussion of modalities for promoting research on policy issues in the ADCs.

II. ISSUES IN MACROECONOMIC POLICY REFORM

5. In terms of the Harrod-Domar growth model, the growth rate of a country depends on the rate of investment and the incremental capital-output ratio. Until the oil shocks of the 1970s, in most ADCs emphasis was placed on increasing the rate of investment to raise the rate of growth. The oil shocks led to aggregate demand policies curtailing aggregate investment. The conventional wisdom that is now emerging is that after or accompanying a decline in aggregate demand, steps must be taken to reduce the incremental capital-output ratio. This is to be achieved through improved efficiency by rationalizing government policy whereby distortions are reduced or removed leading to resource reallocation into sectors enjoying comparative advantage and improving capacity utilization by alleviating supply constraints. A reduction in the incremental capital-output ratio will dampen the impact of the lower volume of investment on economic growth. In addition, the improved efficiency of the economy will make manufactured exports more competitive, thereby increasing export earnings to alleviate balance of payments and external debt problems. This is essentially the rationale for the adjustment programs advocated by the multilateral development

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A critical assumption is that efficiently produced manufactured exports will find ready markets. While the achievement of efficient allocation of resources through trade policy reform has been emphasized in adjustment lending, it is important to note that what is also required for resource reallocation is a competitive environment which has three major elements: (i) competition among domestic producers; (ii) competition between domestic producers and foreign exporters to the domestic market; and (iii) competition between domestic exporters and foreign exporters in international markets. While (ii) has received the greatest attention, followed by (iii), (i) has not received the attention it deserves. This paper will emphasize the importance of (i).

6. Growth oriented adjustment in the ADCs will depend on two crucial factors: the amount of resources available for investment and the efficiency with which they are used. Consequently, the focus of policy reform should be aimed at mobilizing resources and enhancing their productivity. To achieve the above, policy reforms in the structure of economic incentives are needed in the following two areas: (i) mobilizing of external and domestic resources, and (ii) improving the efficiency of resource allocation including use by the public sector.

7. Reforms in the financial sector are needed to increase domestic savings and to allocate credit more efficiently among alternative investment uses. The former can be achieved through letting domestic real interest rates truly reflect the scarcity value of savings. For the latter, domestic markets should be liberalized by allowing lenders to charge different rates to different users so that credit is allocated to activities with the highest rates of return. The reform of the public sector has two main elements. First, enterprise level reform is needed to cut waste, improve technical parameters of production and efficiency. Second, pricing policies of public utilities should be rationalized to ensure efficient use of goods and services produced by them and encourage resource mobilization.

8. Improved efficiency of resource use will depend on the reform of the structure of incentives. Reforms of the trade regime to alleviate the bias against exports and encourage efficient import substitution and reforms of price systems to more accurately reflect opportunity costs rank high in priority. The objective of trade policy reform is to equalize, or make more neutral, the system of incentives across all producers of traded goods. This will encourage the expansion of those activities which can save or earn foreign exchange at lower costs. Exchange rates which reflect economic fundamentals and prices of goods and services that

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reflect opportunity cost will be key elements in determining the best mix of exports and import substitutes.

9. While there is general agreement on the desirability of the broad reforms described, the problem of the specific sequence of reforms continues to be difficult. Depending on initial conditions, alternative sequencing paths are possible. The subject of the sequencing of economic liberalization in developing countries is still evolving with only some general principles being enunciated. 9

10. Related to resource mobilization is the sequencing of the liberalization of the domestic financial market and of the capital account of the balance of payments. It is generally accepted that the capital account of the balance of payments should be opened only after the domestic financial market has been reformed and domestic interest rates have been raised. Otherwise there will be capital outflows. A precondition to raising interest rates is control of the fiscal deficit without which inflationary pressures will be quickly built up.

11. On the issue of external sector reforms and the real exchange rate, the second element of sequencing policy is that it is more prudent to liberalize the current account before relaxing capital controls. Otherwise, if the fiscal deficit has already been controlled and domestic financial markets liberalized, interest rate differentials will result in foreign capital inflows. These will lead to real appreciation whereas a successful liberalization of the trade account will require a real devaluation of the domestic currency. Real devaluation is needed to increase exports and limit imports.

12. The third element of sequencing policy deals with the trade account. Since adjustment costs associated with import liberalization preclude instant elimination of import restrictions, export promotion policies provide a means of offsetting the anti-export bias inherent in a trade regime. Export growth would increase the degree of freedom for the policy maker to undertake import liberalization. Therefore, a possible sequence would be to pursue export promotion policies designed to create a free trade status for exporters even prior to trade liberalization. This is the second best argument for export promotion since the export policies are designed to alleviate the anti-export bias of import restrictions which can only be reduced gradually. Administrative difficulties to ensure free trade status for exporters and countervailing actions of importers place strict limits on export promotion policies. Therefore, while export promotion measures can help in preceding and complementing trade liberalization, the primary focus of policy reform must remain on import liberalization. The sequence of reform in import liberalization is in the following three steps: (i) replace quantitative restrictions by tariffs; (ii) reduce the level of

nominal tariffs; (iii) move towards a more uniform tariff structure. Within (i), restrictions on imports of inputs should be eliminated or relaxed first. A first step within tariff reform would be to shift from specific to ad valorem duties.

13. The policy reforms described in this section can be put in two broad categories: (i) policies to improve efficiency and resource allocation; and (ii) policies to expand production capacity of the economy. While trade policy will be crucial in (i), financial policy reform will play a critical role in (ii). Alternatively, these could be described as liberalization policies to alleviate distortions in the external and internal sector respectively. In addition, policy reforms will be needed to control government budgetary deficits through tax and public sector initiatives.

14. An implicit assumption underpinning the discussion on macroeconomic policy reform is that adequate supply response will be forthcoming. Therefore, the interface between macroeconomic and microeconomic variables becomes a crucial issue. In this context, the importance of understanding firm or enterprise level behavior patterns cannot be overemphasized. The level of domestic competition will significantly influence the structure of incentives which will in turn affect firm or enterprise level responses. There is growing evidence that at the firm level, competition is a potent force for motivating increased efficiency and modernization as well as stimulating structural change. Consequently, domestic regulations pertaining to agricultural and industrial sectors and promotion policies which constitute significant barriers to domestic competition would need to be reformed.

III. EXTERNAL FACTORS AND SUSTAINABILITY OF POLICY REFORMS

15. Any process of reform will be conditioned by the external environment facing the ADCs. The external environment will be influenced by three major factors: (i) industrialized country growth rates and international trading arrangements having a bearing on growth and stability of export earnings of the ADCs; (ii) volume, terms and conditions of external capital flows from developed to developing countries; and (iii) terms and conditions for transfer of technology from developed to developing countries.

16. The trade liberalization programs in many ADCs are intended to generate a shift of resources from import-substituting to export activities. This is crucial in order to generate enough additional foreign exchange to further speed trade liberalization through increased imports. Therefore, the issue of the availability of access to export markets in developed countries is crucial in assessing the sustainability of policy reform in ADCs. Since the mid-1980s, relatively high industrialized country growth rates which resulted in the growth of export

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earnings of ADCs have been central in facilitating developing country trade liberalization. A reversal of this growth in export earnings through a combination of slowing industrialized country growth rates, a possible recession, a reversal of the U.S. trade deficit and increased protectionism in developed countries, could tighten foreign exchange constraints in developing countries and jeopardize trade liberalization efforts. An assessment of the realism of the export pessimism that could result from these factors is crucial.

17. While growth in real GNP and total domestic demand in industrialized countries are expected to fall from their 1987 and 1988 levels, inflation is expected to increase in 1989 and 1990. Consequently, trade protection which will slowdown structural adjustment in developed countries can be expected to increase. Trade protection could take two forms. They could be directed at products or sectors like textiles, steel and agriculture. In addition, they could take the form of market sharing through the formulation of regional trading blocks that would exclude imports from the ADCs.

18. The evolution of the international trading system over the next decade will be an important factor in determining access to export markets for the ADCs. The trading system is a set of rules that govern trade. Unilateral rules refer to arrangements and policies used by countries to restrict trade. Multilateral rules provide a set of guidelines on bilateral rules. For example, the General Agreement on Trade and Tariffs (GATT) provides an international legal framework between governments. Historically, the developing countries have not participated fully in the first seven rounds of trade bargaining after the formation of GATT. By the mid-1980s, there was deadlock over multilateral agreements between developing and industrialized countries. The industrialized countries demanded that the developing countries negotiate over non-GATT subjects like intellectual property, services and trade-related investments. The latter insisted that the industrialized countries live up to their trade commitments under existing agreement and looked to GATT for help.

19. Given the realization in developing countries that more trade involvement rather than less is desirable and the prospects for a rise of protectionism in the industrialized countries, developing countries have been much more active in the Uruguay Round of world trade negotiations than in any of the previous seven barrier reducing bargaining rounds. Of the 400 proposals and papers tabled in the 15 individual negotiating groups, about 170 have come from developing countries or involved them as co-signatories. The more liberal approach to trade by developing countries and their more active role in the global talks is likely to help them identify their interests and increase their leverage. Their markets, specially in Asia, are of growing importance to the industrialized countries. The Uruguay Round has indicated that coalitions of developing

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countries and smaller developed countries can be effective on some issues.\footnote{12}

20. A crucial change that is likely to occur is that the ADCs will no longer be bystanders in setting multi-lateral rules of the global trading system. Instead, as they grow, the ADCs among other developing countries will progressively gain more leverage in the trading system, both in negotiations and over enforcement of system rules. They are likely to become more assertive of their rights under the rules of the system, and especially in their search for enforcement of GATT disciplines. The interests of the ADCs in the Uruguay Round are likely to focus on seeking concessions over textiles, steel, and agricultural commodities. In addition, they are likely to seek concessions on safeguards against sudden import surges where the industrialized countries want to change the rules to allow more discriminatory action against exports from developing countries. The importance of the Uruguay Round in keeping the multilateral trading system open for the ADCs and the opportunities it offers them cannot be overemphasized.

21. While a slowing down of industrialized country growth rates and increased protection in developed countries will have a negative impact on the access to export markets for manufactured goods for the ADCs, active participation in the Uruguay Round in setting multi-lateral rules of the trading system could alleviate the problem by opening markets. In addition, in Asia there are two factors which are likely to be beneficial to the ADCs. First, Japan's market integration with the newly industrializing economies (NIEs) in Asia, consisting of Hong Kong, Korea, Singapore and Taipei, China has important implications for the international division of labor. The NIEs' increased export intensity and diversity in manufactured goods in relation to Japan will imply that the range of the horizontal division of labor will expand between them. Initially, this resulted from a change in industrial structure in Japan and improved comparative advantage of the NIEs. The rapid appreciation of the yen has greatly accelerated this process. Since the greater horizontal division of labor implies that industrialization in one country will induce the expansion of industries in another, the dynamic effects have enormous potential for Asia as a whole. Second, the impact of technological change will affect the composition of exports from NIEs. The share of knowledge-based export products will increase at the expense of raw material-based exports. An important aspect in the rising share of high technology products in the NIEs is related to pre and after-care servicing. Services of highly skilled human resources have become a key factor for exports. Exports of high technology products are increasingly becoming transactions of packages rather than of individual products. With rising real wages and exchange rate appreciation, the NIEs will need to move in the direction of shifting their exports to high value added products. One consequence of these changes could be a decline in the raw material content of the NIEs' exports.

\footnote{12 Hamilton, C. and J. Whalley, Coalitions in the Uruguay Round, (mimeo), Department of Economics, University of Western Ontario, Canada, May 1989.}
22. The changing comparative advantage implied by these factors open up possibilities for manufactured exports by other ADCs at a lower stage in their development process.\textsuperscript{13} A multi-stage catching-up process is taking place in Asia in which groups of countries have been moving up the market. This is a unique feature of the ADCs, and it requires constant restructuring of industries in their respective development stages.\textsuperscript{14} This flying geese pattern of Asian development where countries at different stages of development are continuously trying to catch up with countries ahead of them is likely to be accentuated thereby providing export niches for the ADCs. Timely identification of these niches by individual ADCs will be important in exploiting the resulting export market opportunities which will be changing rapidly over time. The positive and negative factors described on the availability of export markets will need to be carefully assessed by the ADCs to enable them to respond appropriately to the opportunities and challenges in the decade ahead.

23. The second external factor that will be important for the ADCs is the volume, terms and conditions of external flows of capital to them. The overall composition of net external flows to the ADCs has changed significantly in the 1980s. Multilateral net transfer levels have increased marginally while bilateral official development assistance from Japan has increased significantly.\textsuperscript{15} Net transfers from commercial bank lending and export credit financing schemes declined in absolute terms. Foreign direct investment from Japan and the NIEs in the People’s Republic of China, Southeast Asia and South Asia rose significantly from 1987. The strengthening of both official and private flows from Japan and the NIEs is essential for the ADCs to maintain their growth-oriented adjustment programs. Rising wage rates, currency appreciation and the need to recycle their trade surpluses, will induce Japan and the NIEs to relocate many of their industries through foreign direct investment in the 1990s.

24. Finally, technological progress is an important determinant of productivity. Issues relating to the terms and conditions of technology flows to the ADCs are highly relevant. As yet, no agreement has been reached on an international code for the transfer of technology. However, transfer of technology and management skills are likely to accompany foreign direct investment in ADCs.

\textsuperscript{13} Rana, P.B., Shifting Revealed Comparative Advantage: Experiences of Asian and Pacific Developing Countries”, Economics Office Report Series No. 42, November 1988, ADB.

\textsuperscript{14} Watanabe, T. and H. Kajiwara, Pacific Manufactured Trade and Japan’s Options, The Developing Economies, Vol. 21, No. 4, December 1983.

IV. DOMESTIC FACTORS AND SUSTAINABILITY OF POLICY REFORMS

25. The most successful countries in attracting foreign direct investment have been those with stable economic and political environments.\textsuperscript{16} Interestingly, developing countries which attracted such funds by offering special incentives to compensate for unfavorable macroeconomic policies have not attracted much direct investment in recent years. On the other hand, foreign direct investment has steadily flowed into countries where the overall policy environment has been favorable. This indicates that the policy reforms which are required for growth-oriented adjustment are not different from those required for attracting foreign direct investment. In fact, the open development strategy associated with growth-oriented adjustment not only promotes foreign direct investment but also increases its development impact in the recipient developing country. In Section II, the general discussion on macroeconomic policy reform indicated that the major areas of liberalization included trade and financial policies and the important areas of reforms included tax and public sector initiatives to alleviate government budgetary deficits.

26. The acceleration of growth is likely to be a major objective in many ADCs. While the experience of the NIEs with their export-led growth strategy has attracted widespread attention, no paradigm of development has emerged. Factors such as initial conditions, country size and endowments as well as absorptive capacity constraints for manufactured imports in industrialized countries need to be considered in the suitability of export-led versus domestic demand-led growth strategies for each country. The distinction between export as a strategy for growth and export as an instrument for achieving economic efficiency is important. A major lesson of the 1980s is that export growth as an instrument of ensuring efficiency has a key role regardless of the growth strategy adopted.

27. In the design of policy reform, two issues are pertinent. First, some ADCs have borrowed heavily abroad as well as domestically to finance their development efforts and these have led to heavy debt-service burdens. Second, there has been a steady erosion in public sector resources available for development. While the burden of debt from domestic and external borrowing has grown, the net income that has accrued to governments financed by these borrowings has been small and in some cases negative. At the same time, recurrent expenditure from past investments has continued to increase. The net result has been that resources available for development have steadily dwindled. In fact, in some ADCs, virtually all public sector development expenditure is now financed through domestic and external borrowing. Further, rather than

increasing taxes or keeping development outlays within available budgetary resources, governments have relied on domestic borrowing to maintain current expenditure. Consequently, the private sector has been crowded out. Private capital flight from indebted developing countries has aggravated the problem of the availability of resources for development. One symptom of commitments by governments to expenditures that cannot be financed is the balance of payments problem.

28. The reasons underlying the budgetary and balance of payments deficits suggest that there are built-in pressures in the ADCs for policy reforms which will include: (i) improving economic efficiency by putting greater stress on competition and the use of markets to allocate resources; (ii) increasing mobilization of domestic resources through improved tax collection, more prudent expenditure policy and attractive savings incentives for the private sector; and (iii) achieving better export performance from manufacturing and other non-traditional exports. A precondition for successfully implementing these three policy reforms is the adoption of appropriate macroeconomic policies, specially regarding exchange rates, government deficits and trade regulation.

29. Turning to policy reform, the trade regime in most ADCs is complex with an array of trade-restricting and trade-promoting measures. The Korean case is instructive. Korea initially adopted export promotion policies, not only through duty remission schemes, but also priority allocation of rationed credit and licensing arrangements. This generated substantial growth in export earnings which, in turn, facilitated trade liberalization at a later stage. The initial step in the Korean case was a move towards trade neutrality via export promotion, rather than conventional trade liberalization through reform of the trade restricting measures. Initially, second-best policies to ensure trade neutrality were used to alleviate the impact of policy introduced trade distortions. Two important issues can be raised about the effectiveness of such an approach. First, there are doubts about the advisability of using second-best policy instruments when first best measures could have been used. Second, in the 1980s, the likelihood of industrialized countries using countervailing measures against such policies that ensure trade neutrality has increased sharply. Hence, the usefulness of the adoption of these measures by the ADCs in the current trading environment are questionable.

17 In addition, the Korean case also highlights the important issue of timing. Korea managed to time the devaluation of the won in the 1970s and the restraint on external borrowing in the 1980s perfectly in rhythm with developments in the external environment. It, therefore, managed to ride out the second oil shock and debt crisis more successfully than other developing countries.


The links to the multilateral trading system must be explicitly incorporated in evolving trade policy in the ADCs in the future. This is an important lesson of the 1980s.

30. While Singapore and Hong Kong have open trading regimes, Korea and Taipei, China have been speeding-up the process of liberalization. To a lesser extent, Thailand and Malaysia also have open trade regimes and in recent years, Indonesia has gradually rationalized its trading system. However, unilateral liberalization of trade policies has been difficult for many governments and cannot be necessarily viewed as permanent. Popular support for liberalization is usually weak and diffuse. Domestic support relies crucially upon the supply response that liberalization is supposed to generate. If the supply response is weak, it becomes difficult to substantiate the claimed benefits of liberalization. Lack of political support makes either acceleration or continuation of liberalization difficult. Trade liberalization in the Philippines in the 1980s is a good example of reform running out of steam on account of a perceived lack of major improvements to economic performance attributable to liberalization.

31. Unilateral trade liberalization reflects concerns over weak economic performance and a desire to improve it through greater openness. Participation by the ADCs in multilateral fora reflects increased outward orientation in development thinking. Involvement by the ADCs in setting multilateral rules of the trading system suggests that the external market environment, could to some extent, be shaped by them. A concern of many ADCs is that they will be given no credit during the Uruguay Round for the unilateral liberalization that they have already undertaken. This has been partly caused by the decision to set 1986 as a baseline date for including unilateral liberalization in the Uruguay Round. Thus, the ADCs are concerned that instead of industrialized countries being prepared to make matching concessions for unilateral liberalization already undertaken, they will be asked to make additional concessions in any new deal. In the process, the issues of unilateral liberalization and multilateral trade negotiations could become increasingly intertwined.

32. The rationale for unilateral trade liberalization by the ADCs in a small open economy framework is analytically straightforward and is derived from a small economy trade model. The possibility of linking trade liberalization to market access through individual or collective action makes the sequencing of decision making extremely complex. This is a new area with an additional dimension that will require research. The costs and benefits associated with unilateral versus linked liberalization will need to be determined to separate fact from fancy. The realism of the expected gains from linked liberalizations will need to be established. The sustainability and direction of trade policy reform in the ADCs will depend on such analyses.

33. In the external sector, the exchange rate is also a crucial factor in the allocation of resources between traded and non-traded sectors. The exchange rate influences international competitiveness and the incentive to produce tradeable goods. It affects both domestic absorption and domestic supply. Recent research findings stress that economy-wide macro and micro measures notably fiscal, monetary, trade and
exchange rate policies have a much greater impact on sectoral efficiency, whether in agriculture or manufacturing, than the combined effect of intra-sectoral measures. 20 This is also true for the impact of economywide measures on the volume of direct foreign investment in an economy. In addition, the sustainability of policy reform at an economywide level will need to be assessed by its impact on sectoral responses. For example, a depreciation of the domestic currency may improve the terms of trade in favor of agriculture which is more tradeable than manufacturing in most ADCs because the latter is highly protected. As a result, there could be resource flow to agriculture. 21 This would run counter to a government’s industrialization drive.

34. In the domestic sector, the issues of government budgetary deficits and resource mobilization are likely to overshadow the policy reform process. Domestic resource mobilization will require financial sector liberalization. The key instruments of this are deregulation of interest rates, credit allocation, and promotion of more efficient and competitive banking systems and capital markets. Resource reallocation associated with trade liberalization critically depends on the market mechanism allocating credit. Apart from credit, mobility of important intermediate inputs like water, electricity, cement, and steel will be crucial. Many of these are produced in the public sector. Reform in public sector pricing and distribution procedures will be an integral part of resource reallocation. Rationalization of public utility pricing and enterprise reform will be the most necessary and yet the most difficult to sustain on political considerations. Reduction of subsidies which could be explicit or implicit in the existing pricing policies of public enterprises will be difficult to implement. The problems associated with raising prices could be partially alleviated if quality of supply improves as well. This would require enterprise reform with major adjustment costs for labor. These policy reforms will have to precede efforts, if any, at privatization which could be a politically sensitive issue. The mix of public and private sector could be improved in favor of the latter through the removal of barriers to entry by the private sector in certain sectors. Entry by the private sector hinges on pricing reforms.

35. The issue of price controls versus the price mechanism has both efficiency and equity considerations. It is on equity considerations that price controls are invoked in many cases in the ADCs. The sustainability of reform pertaining to the replacement of price controls by the use of the price mechanism would depend on explicitly incorporating the equity effects in designing the reform. The dual pricing policies used by some countries through which a percentage of output is preempted for public distribution and the rest sold in a free market warrant consideration as

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The cases of sugar and cement in India are noteworthy. The introduction of dual pricing led to marked increases in investment, efficiency and supply because profitability rose sharply as a result of market forces partially influencing prices. It should be emphasized that a dual market structure is only a stepping stone from controlled prices to market prices and is not an end in itself.

36. The sustainability of policy reform for both the external and domestic sectors will depend on economic and political factors. For example, political considerations play a crucial role in determining price policy for outputs and inputs. In the short-run, change may be difficult because of associated adjustment costs. However, there is a need to determine which aspect of a proposed reform package is objectionable, to whom and to what extent. Whenever possible, a compensation program and an information campaign to clarify the gainers and losers may need to be designed prior to implementing reform. While a do-nothing situation may be inevitable in the short-run, every effort will be needed to make policy reform possible over the medium-term. The areas of price policy reforms suggested arise out of a concern for increasing efficiency over the long-run. The adjustment costs associated with these areas of reform suggest that the issues of timing and sequencing will be crucial. These, in turn will be influenced by the government budget, credit market, and balance of payments impacts of government intervention. Alternatively, the long-run consequences of short-run decision making put pressures on countries to reform. The sustainability of domestic policy reform would depend greatly on minimizing the associated adverse equity effects through highly targeted time-bound programs which must accompany the reform process.

37. The sustainability of policy reforms hinges critically on the supply response associated with them. The level of domestic competition and firm level behavior pattern are crucial factors in this regard. Unlike the issue of foreign competition through trade liberalization, the importance of domestic competition in influencing supply responses has not received the recognition that it deserves. An understanding of factors that influence the level of domestic competition will be necessary to assess the sustainability of policy reform. Domestic competition is affected by a number of factors like barriers to entry and exit, public sector procurement systems and pricing policies. Investment incentive systems and regulatory controls frequently constitute effective barriers to entry.

38. The importance of firm level behavior is clearly seen in the context of technology development. While the availability of suitable

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infrastructure and conducive macroeconomic policies are important in determining the "technological environment" in a country, it is the microeconomic behavior which determines the success of technology transfer, adoption, adaptation and assimilation. Whether the international or domestic transfer of industrial technology does or does not contribute significantly to technological development as well as productivity increase depends largely on the active technological behavior of recipient firms -- both with respect to the behavior at the technological transfer phase and the subsequent phase of production.

39. The process of capability acquisition and accumulation has two inherent characteristics. Firstly, it has a cumulative nature; i.e., the greater the quantity and quality of the existing stock of capability, the greater the increments to that stock. Secondly, there is a dynamic relationship between the investment-related and post-investment capability accumulation. Some of the capability accumulated during the post-investment phase maybe useful for further post-investment changes and future investment projects. A part of the capability acquired during the investment phase may be useful for subsequent post-investment phases and future investment projects. These characteristics will thus generate a "virtuous circle" for the more technologically dynamic firms.

40. The basic function of all technology-related policies is to stimulate and foster efforts by firms to set the virtuous circle into rapid motion. To achieve this stage, there needs to be a redesigning of many policies and restructuring of policy instruments, e.g., industrial development policy and policies relating to international technology transfer and endogenous technology development. As for technology transfer policy, it might be useful to divert some of the efforts, from the hope of changing the behavior of technology-suppliers to the development of policy measures to generate demands by firms for pursuing an aggressive strategy to ensure that optimal outputs of knowledge, skill and experience are acquired by them along with their acquisition of production facilities.

41. The issue raised is that industry's capability to use technology and assessment of economic impacts are critically linked to individual firm level behavior. Firm level behavior in turn, is influenced by complex issues which have been indicated in the earlier paragraphs. Alternatively, the interface between the "technological environment" and firm level behavior needs to be strengthened for better assimilation, adoption and innovation of technology.

V. RESEARCH ON EXTERNAL FACTORS INFLUENCING GROWTH PROSPECTS OF ADCS

42. The discussion in Sections III and IV suggests that the external factors facing the ADCs will have major implications for sustainability of policy reform in them. External debt servicing needs and an uncertain market for exports will put pressure on the ADCs to increase export competitiveness through improved efficiency. Macroeconomic policies to improve efficiency will also be conducive to attracting foreign direct investment, technology and management skills. Internal or domestic policy
reforms will determine whether ADCs will exploit the opportunities and challenges offered by the external factors or succumb to them. The supply response expected to result from macroeconomic and sectoral policy reforms will depend crucially on firm or enterprise level behavior which will be significantly influenced by the level of domestic competition. Given that the sustainability of policy reform depends on adequate supply response, issues relating to domestic competition and firm level behavior will need to be adequately addressed.

43. The discussion on research will be divided into three parts. First, research should focus on an analysis of external factors that will be relevant to the ADCs to determine their export prospects. Second, research on growth strategies and policies in the ADCs will be important. Third, research on policy issues should be linked to investment decisions.

44. An assessment of access to export markets will be an important area of research. In this context, an assessment and analysis of global economic factors and their impact on the ADCs will enable them to plan their strategic responses. This information will also help alleviate the problem of uncertainty. The links between movements in global factors and their impact on the ADCs at different stages of development will need to be strengthened to provide country specific implications.

45. Changes in the international trading system need to be monitored and analyzed in terms of market access for exports. The ADCs should encourage a global trading system by participating in discussions and influencing the establishment of global rules of the game in trade and capital movement so that the multilateral system is kept open. The ADCs should participate actively in the multilateral trade negotiations in the Uruguay Round. The next two years of the Uruguay Round will be crucial in determining the outcome of the trade negotiations. The negotiations have been the most complex and far-reaching with widespread and active participation by the developing countries. The ADCs, at the very least, should keep themselves informed of the issues involved in the Uruguay Round. Some multilateral institutions like the World Bank have set up offices in Geneva to monitor the GATT negotiations. The Commonwealth Secretariat prepares an issues paper every three months on the Uruguay Round. These and other sources should be tapped by the ADCs for information on the Uruguay Round. The important products/sectors for the ADCs are textiles, tropical products, steel and agricultural goods. Only after each ADC clarifies the issues relevant for itself, can it embark on research and other activities of relevance to it. Assistance by the multilateral institutions during the trade negotiations to the smaller ADCs would be timely and pertinent. While rationalization of unilateral trading rules set by the ADCs has been the overriding concern of both the academic community as well as multilateral development institutions in the 1970s and 1980s, the potentials for developing countries to influence multilateral rules of the trading system need to be assessed. These issues will become increasingly important for the ADCs in the decade ahead even after the Uruguay Round has been completed and the ADCs need to keep themselves informed and assess the possibility of more active involvement. In particular, the multilateral development institutions should encourage the NIEs and other ADCs to participate actively in multilateral trade negotiations to keep up pressure for an open global trade system. This
46. While a possible slowdown in industrialized country growth rates and uncertainty in the international trading system are a cause for concern regarding access to developed country export markets, there is potential for export growth within Asia. Four major factors signify a changing international and regional environment which can support a major export drive by the ADCs: (i) an increasing degree of complementarity among countries in Asia in their industrial production and economic diversification; (ii) increased intra-regional trade; (iii) increased intra-regional investment; and (iv) increased opportunities for greater regional economic cooperation. Careful nurturing of these factors would play a key role in Asian development in the medium-term.

47. A research program should be designed to address the issue of changing comparative advantage within Asia to assess the potential for greater inter- and intra-regional trade. This research could play an active role in encouraging domestic policy reforms in the ADCs by demonstrating that export-oriented industrialization is not a zero-sum game confined to only the NIEs. The potentials offered by the dynamism of Asia are powerful arguments against the export pessimism that could result from the reasoning that in the present age of a slowdown in industrialized country growth rates and increased protectionism, the world cannot support economic growth of all ADCs based on manufactured exports. Their assessment of the availability of export markets will be crucial in judging the appropriateness of their growth strategies.

48. The evolving scene in Asia suggests that Japan and the NIEs with their growing trade surpluses will emerge as the major sources of capital for the ADCs. While official development assistance from these sources will grow, the major movements will be through private capital flows. The ADCs should make an assessment of the potential and pattern of financial flows to them and their underlying causes. This will be a fruitful area of research which could be the catalyst for facilitating public and private capital from the surplus countries of Asia to the ADCs. In particular, enormous possibilities exist for venture capital movements from the NIEs to the other ADCs. Private sector capital will be the wave of the future. Networking arrangements will be critical in foreign direct investment by Asian transnationals. The following initiatives warrant consideration: (i) monitor private sector foreign direct investment and evaluation of Asian transnationals; (ii) information exchange and analysis for joint ventures which would augment regional cooperation in trade and investment; and (iii) collect and analyze information on technology issues in industry and services that will be relevant for the ADCs.


49. The complexity and multifaceted nature of the process of technological change imply that there is a need for research that will provide a comprehensive perspective of the issues relating to science and technology (S&T). The proposed research on technology issues will help the ADCs to keep themselves informed of S&T developments occurring worldwide, examine their needs in S&T and determine appropriate responses.  

VI. RESEARCH ON GROWTH STRATEGIES AND POLICIES IN ADCs

50. Given national objectives and constraints, growth strategies and policies to implement them will follow. While the foreign exchange constraint has been emphasized through the discussion on export markets, domestic constraints will also be important. The sequential nature of binding constraints at both the macro and sectoral levels that is inherent in any development process needs to be analyzed and identified. This could be a fruitful area of research for clusters of ADCs at different stages of development to assess the replicability of the growth experience of ADCs at more advanced stage of development to those following in their footsteps but facing a changed external environment.

51. The suitability of a particular growth strategy, whether it is export-led or domestic demand-led will be country specific. In the context of changing binding constraints and development objectives, preparation of a framework to assess growth strategies would be useful. This kind of research is needed both at the macroeconomic as well as sectoral levels while explicitly accounting for intersectoral linkages. Country size, resource endowments and initial conditions would heavily influence the adoption of the appropriate growth strategy.

52. While the spectacular performance of the NIEs has led to the advocacy for market-oriented export-led growth, the heterogeneity of the NIEs precludes any easy generalizations of their growth experiences. It is increasingly being realized that though the success of the NIEs are market-based, they are hardly examples of laissez-faire economies free of government intervention. The NIEs success is attributable as much to neoclassical interventionism as the working of the invisible hand. This is perhaps the most important lesson that emerges from the NIEs experience that is highly relevant for the ADCs. While no clear paradigm of development has emerged from the experiences of the NIEs, it is important


to undertake a systematic study of them to assess areas of relevance and possibility for replication in other ADCs. The aspects of the NIEs experience that would be directly relevant to the ADCs would include: (i) development experience, institutions, flexibility in policy response and timing; (ii) internalizing uncertainty and need to undertake mid-stream changes; and (iii) sectoral responses and methods of adjustment.

53. On the issues of growth strategy and policy, diagnosis and prescription must be based on rigorous analysis and not on back of the envelope calculations or a rote application of the new conventional wisdom that is emerging: return to the market mechanism, stimulate privatization, denationalization and deregulations, cut expenditures, etc. The crucial issue is an analysis and understanding of market failure. Market failures which occur naturally in the absence of government intervention are called natural market failures. In contrast, artificial market failure is defined as (i) interventions which are designed to correct natural market but which are either inappropriate, insufficient, or excessive; or (ii) interventions which disrupt an otherwise efficiently functioning market. While seemingly obvious, the importance of the relationship between market failure and policy response cannot be overemphasized. Alternatively, the factors influencing the level and structure of domestic competition need to be analyzed and assessed. The level of domestic competition would be influenced by: entry policies like capacity licensing, investment incentives and public sector procurement; and pricing policies. Reforms in these areas to increase the level of domestic competition will be important in ensuring strong and speedy supply response. An understanding of the nature of market failure is crucial in distinguishing between passing fads in the development literature regarding policy reform and areas where sustained concrete actions are needed. This issue is critically related to the perceived role of the government. In many ADCs, it is being increasingly felt that the role of the government is to create a conducive policy and institutional framework for rational decision making and to provide the necessary investments in infrastructure, research and technology. Creation of a conducive policy environment will require reforms to increase the level of domestic competition.

54. Research on an integrated approach to identifying binding constraints, designing growth strategy and tailoring appropriate policy responses could be fruitful for both an understanding of the challenges facing the ADCs and working out appropriate responses. While the above may be far too ambitious to be achieved quickly, a beginning should be made to at least identify the issues. In the process, the ADCs will expand their development knowledge base and increase their ability to exchange information. This will expedite an exchange of experience between ADCs at different stages of development.

VII. RESEARCH ON LINKING POLICY REFORM WITH INVESTMENT DECISIONS

55. Given the constraints on resource mobilization in the ADCs, the efficiency of investment will need to be improved to sustain high growth rates. Efficiency improvements will be related to policy reform. A
discussion on research requirements for linking policy reform with investment decisions will need to be preceded by a brief description of methodology used in the economic analysis of projects. Until the mid-1980s, while the scarcity of capital resources in the ADCs seems to have been viewed as the binding constraint on growth, it was also recognized that market failure existed in the developing countries. Hence, shadow pricing was used in the economic analysis of projects to provide partial correction for the misallocation that occurs in an economy because of the distorted prices that result from market failures. Thus, through project investment, many ADCs alleviated the capital constraint and at the same time through the adoption of shadow pricing, some ADCs allocated capital to efficient sectors and activities. In the mid-1980s, it became increasingly clear that even potentially good projects could not succeed in poor policy environments. The multilateral development institutions and the ADCs have moved together in their recognition and concern for improved policy environments to increase the efficiency of investment. The ADCs must establish projects and technical operations within improving overall policy and institutional environments. The relevant issue for the ADCs is how the integration of project with policy analysis can be made smoothly and effectively.

56. The shadow or accounting prices that are used in the economic analysis of projects are designed to provide a partial correction for the distortions that are caused by market failure. They allow the project analyst to recommend projects which improve the degree to which static and dynamic efficiency are improved. Thus, the need to use shadow or accounting prices could be looked upon as a criticism of the government for failing to intervene appropriately in the economy. Alternatively, in all cases involving the use of shadow or accounting prices, it could be argued that a more desirable alternative could be to design an optimal intervention to correct for the underlying market failure that led to the need for the use of an accounting price in the first place. Thus, the crucial link between projects and policies is the shadow or accounting prices.

57. With the adoption of the Little Mirrlees methodology for the economic analysis of projects in many multilateral development institutions and ADCs, the use of specific, group and standard conversion factors was endorsed for valuing costs and benefits of non-traded items in border price equivalents or economic prices. This approach to investment analysis could have led to the use of two broad adjustments for valuing non-traded goods in border prices. First, the impact of domestic distortions arising from market imperfections, government intervention and market failure could have been removed from market price. In practice, only taxes and transfers have been netted out from market prices to account for the impact of government intervention. Second, the impact of foreign trade distortions arising from government intervention like the imposition of tariffs and quotas on individual commodities could have been removed through disaggregation. In practice, a standard conversion factor has generally been applied across all non-traded goods and services.

regardless of their share in total costs and benefits.\textsuperscript{30} Thus, both the multilateral development institutions and the ADCs have used partial rather than complete border pricing rules.\textsuperscript{31}

58. Much information regarding government taxation and sectoral policies is contained in conversion factors, and an analyst may gain valuable policy insights by simply comparing particular conversion factors with each other and with unity. By generally confining themselves to the use of a catch-all standard conversion factor, the multilateral development institutions and the ADCs have denied themselves many insights into policy distortions that impinge on the performance of a project. Thus, a major research initiative is needed to estimate disaggregated conversion factors, both for the purpose of improving valuation procedures to be used in the economic analysis of projects as well as to provide indicators of the extent of distortions prevailing in various sectors of the economy. For example, the power sector with its considerable investment requirements and upstream and downstream impacts is highly distorted in many ADCs. Disaggregated conversion factors for the power sector would be extremely useful in not only investment planning but also indicate resource allocation effects of inoptimal electricity tariff setting.

59. Having estimated the extent of distortions, the next research issue is to identify the reason for the distortions. They could be due to either external trade or domestic distortions or both. The former has received a lot more attention than the latter in the development literature. The issue of domestic distortions arising out of market imperfections, government intervention and natural market failure warrants attention. The domestic distortions will affect the level and structure of domestic competition. While policy reform to correct for artificial market failure is relatively easy to design, natural market failure requires the design of complex optimal government intervention. The matching of policy instruments with targets crucially depends on diagnosing the reason for the distortion in terms of natural and artificial market failure. Research at this level would be invaluable in highlighting sectoral policy issues like the level of domestic competition which would have major implications for project viability and performance.

60. Once the extent of sectoral policy distortions and their cause are determined, policy reform programs need to be designed. There could be cases when economy-wide macro and micro measures like fiscal, monetary, trade and exchange rate policies have a much greater impact on sectoral


efficiency than any or total microeconomic or sectoral measure.\textsuperscript{32} This is an area where research needs to be undertaken to assess effectiveness of sectoral policy reform in isolation as well as in combination with macro policy reform.\textsuperscript{33} The interface of macro, sectoral and project level issues is likely to become increasingly important in the future.

61. In this context, it is pertinent to point out that the literature on project evaluation that emerged in the 1960s and 1970s was based on the ceteris paribus assumption that existing policy distortions would continue into the future.\textsuperscript{34} The rationale for this stemmed from the consideration that a project's output would constitute a marginal increment and hence no policy changes could be expected from undertaking a single project. The fundamental change that has occurred in the 1980s and likely to continue is policy reform on a wide front. Asia has been characterized by piecemeal policy reform. However, continued over a sufficiently long period of time, this could have a major impact on the policy environment. The relationship between policy reform and shadow/accounting prices or conversion factors need to be explicitly considered.\textsuperscript{35} The shadow prices or conversion factors would need to be intertemporally estimated depending on a changing policy environment in a country.

62. Macro and sectoral policy reforms could be viewed as rationalizing price policy which will result in efficiency gains associated with resource reallocation. Structural and sectoral adjustment programs advocated by the multilateral development institutions have focussed attention on these reforms. An aspect of efficiency improvement that deserves attention is enterprise reform.\textsuperscript{36} Waste and inefficiency at the enterprise level is prevalent in many ADCs because of management and labor problems. The possibility of improving economic performance at the enterprise level without necessarily undertaking major policy reforms at the sector and macro level needs to be assessed. Research at a micro enterprise level to determine the prospects for efficiency improvements offers a challenging opportunity. It is possible that individual enterprises are so different that this is not research but consultant assignment for each enterprise. While not de-emphasizing the role of macro and sectoral policy reform, the potential for efficiency improvements on a broad front through enterprise reform needs to be assessed. Firm or enterprise level research will facilitate an

\textsuperscript{32} Krueger, Schiff and Valdes, op.cit.


\textsuperscript{35} Hughes, G., Conversion Factors and Shadow Exchange Rates (mimeo), Cambridge, England, 1983.

understanding of supply responses that could be expected from sectoral policy reform.

63. Closely related to the issue of enterprise reform, is pricing policy of public utilities. It becomes highly relevant in the context of constraints on resource mobilization, public sector deficit and efficiency considerations. The recent literature on public finance indicates that the imposition of financial constraints on enterprises can be an inefficient method of achieving fiscal objectives, because they neglect the differences in the distortionary costs of raising revenue in different industries. It is better to decide prices on the basis of their economy-wide effects without regard to financial targets. If financial targets are important in providing incentives to enterprises, the levels of these targets can then be determined on the basis of the pricing policy that is best for each enterprise. Such an approach would reverse a common situation where prices are determined by financial constraints. In most ADOs, policy on pricing of public utilities has focussed attention on financial rather than economic considerations. This will need to be changed in future.

64. Pricing of public utilities and implied resource allocation associated with use of public utility output needs to be analyzed. An example will clarify the issue. Consider the case when electricity tariff is lower than its long-run marginal cost. An important policy issue even in the project context is the misallocation of resources which results from suboptimal tariff setting. Electricity which is highly capital intensive is a universal intermediate input. Therefore, its optimal allocation across activities is likely to have major impact for many sectors. The important question that comes up is whether the cost to the economy of the misallocation of a project's output arising from distortionary pricing policy for electricity should not be netted out from a project's benefits. This is particularly relevant for sectors like power as electricity consumption is combined with the use of durable capital goods whose misallocation, in a capital scarce economy, could have serious consequences. Two issues come up: (i) whether adjustment should be made to the economic analysis to reflect secondary negative benefits; and (ii) whether greater attention is necessary for the price policy reform. This area warrants urgent attention with respect to setting both the structure and level of tariffs of public utilities.

65. The research issues highlighted in this section focus entirely on policy reform. Three issues have come out clearly: (i) project analysis and sectoral policy reform need to be closely interlinked; (ii) sector policy cannot be discussed independently of the macro policy environment; (iii) an understanding of the interaction of macro, sector and project analysis is essential. In the development literature, the focus of attention has been on foreign trade distortions. A vast up-to-


date literature already exists on it and there is little additional mileage the ADCs can get by going over already trodden ground. Instead, the multilateral development institutions and the ADGs should improve their understanding of domestic distortions, domestic competition and firm level behavior which is crucial in determining supply response linked to policy reform.

VIII. SUMMARY AND CONCLUSION

66. The 1980s can be characterized as ushering a fundamental revolution in development thinking in that policies, and not investment projects, are considered to be the cutting edge of development. The policies emphasized have been at the macroeconomic and sectoral levels and can be put into two broad groups: (i) policies to improve efficiency and resource allocation; and (ii) policies to expand productive capacity of the economy. Trade and financial sector reform policies have been advocated to improve efficiency and promote investment and savings respectively. The sustainability of policy reform depends crucially on the extent and speed of supply response. These in turn are determined by firm level behavior. At the firm level, the extent of domestic or internal competition is an important motivating factor to cut waste, improve efficiency and stimulate modernization. The factors determining the level of domestic competition and firm level behavior are being increasingly recognized as important determinants of the success of policy reform. Correspondingly, the micro foundations of macroeconomic policy reforms are expected to feature prominently as an emerging issue in the development literature.

67. Policy reforms in the ADCs are closely related with steps being taken to move to more liberal and open economic systems. As a result, their economic performance has become increasingly dependent on what happens in the rest of the world, particularly the industrialized countries. Consequently, external factors facing the ADCs will have major implications for them. External debt servicing needs and an uncertain market for exports will put pressure on ADCs to increase export competitiveness through improved efficiency. Macroeconomic policies to improve efficiency will also be conducive to attracting foreign direct investment, technology and management skills. Internal policy reforms will determine whether the ADCs will exploit the opportunities and challenges offered by the external factors or succumb to them.

68. Against this background, the discussion on identifying selected areas for research was divided into three parts: (i) research should focus on an analysis of external factors that will be relevant to the ADCs prospects for exports; (ii) research on growth strategies and policies in the ADCs will be important against the background of the external environment and domestic constraints to better understand and appreciate the larger issues facing them; and (iii) research on improving the efficiency of investment will be important for assessing growth prospects.

69. Research on external factors influencing prospects of ADCs should focus on: (i) an assessment of access to export markets in relation
to industrialized country growth rates; (ii) changes in the international trading system emphasizing issues involved in the Uruguay Round of trade negotiations; (iii) prospects for intra-Asian cooperation with respect to trade and foreign direct investment; (iv) changing comparative advantage within Asia to assess potential for intra-regional trading; (v) an assessment of the potential and pattern of financial flows to ADCs and their underlying causes; (vi) an assessment of science and technology (S&T) developments occurring worldwide and examination of the needs of ADCs in S&T.

70. Research on growth strategies and policies in ADCs could include studies on (i) analysis and identification of the sequential nature of binding constraints at both the macro and sectoral levels that are inherent in any development process, and (ii) a systematic assessment of the NIEs experience to pinpoint areas and possibilities for replication in other ADCs. On the issues of growth strategy and policy, diagnosis and prescription must be based on rigorous analysis and not on back of the envelope calculations or a rote application of the new conventional wisdom that is emerging: return to the market mechanism, stimulate privatization, denationalization and deregulation, cut expenditures, etc. The crucial issue is an analysis and understanding of market failure. Market failures which occur naturally in the absence of government intervention are called natural market failures. In contrast, artificial market failure is defined as (i) interventions which are designed to correct natural market but which are either inappropriate, insufficient, or excessive; or (ii) interventions which disrupt an otherwise efficiently functioning market. An understanding of the reasons for market failure is crucial for an analysis of the level and extent of domestic competition and firm level response.

71. While the achievement of efficient allocation of resources through trade policy reform has been emphasized, it is important to note that what is required is a competitive environment which has three major elements: (i) competition among domestic producers; (ii) competition between domestic producers and foreign exporters to the domestic market; and (iii) competition between domestic exporters and foreign exporters in international markets. While (ii) has received the greater attention, followed by (iii), (i) has not received the attention it deserves. This paper emphasizes the importance of undertaking intensive research on (i). The level of domestic competition would be influenced by: entry policies like capacity licensing, investment incentives and public sector procurement; exit policies like labor retraining, asset transfer and bankruptcy procedure; and pricing policies. Reforms in these areas to increase the level of domestic competition will be important in ensuring strong and speedy supply response.

72. The integration of project with policy analysis should be the focus of research on analysis of issues of relevance to increasing the efficiency of investment. Much information regarding government taxation and sectoral policies is contained in conversion factors, and an analyst may gain valuable policy insights by simply comparing particular conversion factors with each other and with unity. A major research initiative is needed to estimate disaggregated conversion factors, both for the purpose of improving valuation procedures to be used in the
economic analysis of projects as well as to provide indicators of the extent of distortions prevailing in various sectors of the economy. This research initiatives will be the starting point for determining the extent and nature of domestic competition and measures to enhance it. Once the extent of sectoral policy distortions and their cause are determined, policy reform programs need to be designed. There could be cases when economywide macro and micro measures like fiscal, monetary, trade and exchange rate policies have a much greater impact on sectoral efficiency than any or total microeconomic or sectoral measure. However, if macro policy issues have a major sectoral impact, then macro and sectoral policy reform may need to be considered together. This is an area where research to assess effectiveness of sectoral policy reform in isolation as well as in combination with macro policy reform. The interface of macro, sectoral and project level issues is likely to become increasingly important in the future.

The areas of research highlighted in this paper cover a wide canvas. Research will be undertaken by the ADCs themselves, the multilateral development institutions and there will also be sponsored research. An area worth exploring is to systematize and strengthen the collaborative relationship between the multilateral development institutions and regional research institutions of the ADCs through an ongoing program of regional research collaboration. The main objectives of the regional research collaboration could be to establish a well designed and integrated research network arrangement among national research institutions in the region to facilitate information exchange and dissemination, to assess scope for policy related research collaboration and to identify common research interests. Regional Research Collaboration could play a catalytic role in coordinating and strengthening research capabilities in the region. The network of national and regional research institutes would enable collaborative research efforts in policy related development issues and problems, facilitate a better exchange of information and help develop a relevant data base. In addition, the strengthening of the interactive process between the multilateral development institutions and the national and regional research institutes would serve not only to encourage and strengthen national research capabilities but would also enable the former to utilize a wide range of expertise in a coordinated and cost-effective manner.