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1983

The World Bank Group
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Bela Balassa's chron files - January 1983

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B. BALASSA CHRON FILE JAN 1983

January 31, 1983.

Mr. Eugenio Lari, LCI

Bela Balassa, DRD

61007

Paper on Chile

I enclose the revised version of my paper "Policy Issues in Chile" that has been transmitted to Mr. Rolf Luders. The revised paper includes a section on financial imbalances in Chile.

cc: Messrs. Ardito-Barletta, LCNVP; Van Der Meer, LCP; Glaessner, LCP;
Pfeffermann, LCNVP; Meo, LCI; Landau, LCNVP; Ray, LCP;
Aguirre-Sacasa, LCI; Mrs. Constance Mejia, LCI;

Enclosure
BBalassa:nc

1 1 61007

BOOK OF TWO

1. MR. ROBERTO TOSO, BANCO CENTRAL DE CHILE, SANTIAGO, CHILE
2. M L PATRICIO MELLER, CIEPLAN, AV. COLON 3494, CASILLA 16496,
CORREO 9, SANTIAGO, CHILE

CABLE

1/31/83

Bela Balassa

Bela Balassa

BBalassa:nc

DRD - Director's Office

1 1 61007

WOULD APPRECIATE RECEIVING BY AIR MAIL XEROX COPY OF THE WEIGHTING
SCHEME OF WHOLESALE PRICE INDICES FOR DOMESTIC PRODUCTS AND FOR
IMPORTS AS WELL AS QUARTERLY INDEX NUMBERS OF THESE INDICES FOR THE
YEARS 1970 TO 1982. SINCERELY, BELA BALASSA

CABLES

1/31/83

Bela Balassa

Bela Balassa

DRD - Director's Office

BBalassa:nc

1 1 61007

DR. BELA CSIKOS-NAGY, PRESIDENT, HUNGARIAN
ECONOMIC ASSOCIATION, 1370 BUDAPEST PF. 544, HUNGARY
CONFIRM LUNCH FOR FEBRUARY 28 AT ONE O'CLOCK FOLLOWED BY LECTURE AT
WORLD BANK AND DINNER AT MY HOUSE. LAUTER IS ARRANGING FOR LECTURE
ON THE FOLLOWING DAY. REGARDS, BALASSA

CABLE

1/28/83

Bela Balassa

Bela Balassa

DRD - Director's Office

1 1 61007

PROF. JOZSEF BOGNAR, KALLO ESPERES UTCA 15,
BUDAPEST, XII, HUNGARY

CONFIRM YOUR SEMINAR ON THE HUNGARIAN ECONOMIC REFORMS IN A SOCIO-
POLITICAL CONTEXT ON FEBRUARY 25 AT 11:30 A.M. FOLLOWED BY LUNCH.
YOU ARE FURTHER INVITED TO DINNER BY PROF. FELLNER ON FEBRUARY 25
AND IN MY HOME ON FEBRUARY 28. REGARDS, BALASSA

CABLE

1/28/83

Bela Balassa

Bela Balassa

BBalassa:nc

DRD - Director's Office

2134 Wyoming Avenue N.W.
Washington, D.C. 20008
January 28, 1983

Mr. Joseph Goosby
Government of the
District of Columbia
Department of Finance and Revenue
P.O. Box 419
Washington, D.C. 20044

Dear Mr. Goosby

In reference to our telephone conversation, I enclose a xerox copy of my original draft Franchise Tax return of 1981. Should you need any of the supporting documents, please let me know. I wish to add that the return was filed on April 15th, 1982.

Yours sincerely,

Enclosure

Bela Balassa

Mr. James K. Feather, PUB

January 28, 1983

Bela Balassa, DRD

Catalog of Publications

1. As in the previous year, I find the 1983 Catalog of Publications very attractive. Also, the short summaries of the individual publications give a good indication of their contents, providing an inducement to the would-be reader to obtain them. The reader's attention is also drawn to newly-issued papers. I wish to raise queries, however, about the coverage of the Catalog.
2. According to the statement made under the General Information heading "publications available for sale, as well as free publications, are listed and described in the following pages." But, while Staff Working Papers dated from July 1979 are listed, Reprints issued a year before the latest Catalog have been excluded.
3. At the same time, as I have often noted, the Reprint Series is much superior in quality to the Staff Working Paper series. The former represents finished work and, in most cases, it has passed through a rigorous selection process in competition with other papers; the latter often contains undigested material and shows considerable variations in quality. In order to indicate the breadth and the quality of Bank research, all Reprints for the past 3-4 years would need to be included in the Catalog.
4. I enclose a list of the Reprints of my recent papers. Nos. 1 to 8 were included in the 1982 Catalog but were omitted from the 1983 Catalog. No. 9 is included in its earlier Working Paper form that has subsequently been revised. As is apparent from the list, several of the papers have been reprinted in French, Portuguese, and Spanish, which are of interest for the Bank's non-English speaking audience.

cc: Mrs. Krueger, Messrs. Michalopolous, Duloy, VPERS
DRD Senior Staff

BBalass:nc

Reprints of Papers by Bela Balassa

1. "Incentive Policies in Brazil," World Development, November-December 1979, Reprint No. 133, 133a (in Portuguese).
2. "A Stages Approach to Comparative Advantage," Economic Growth and Resources, National and International Issues, 1979, Reprint No. 136.
3. "Intra-industry Trade and the Integration of Developing Countries in the World Economy," On the Economics of Intra-Industry Trade, July 1979, Reprint No. 113, 113a (in Spanish).
4. "The Tokyo Round and Developing Countries," Journal of World Trade Law, November 1980, Reprint No. 134, 134a (in Spanish).
5. "Prospects for Trade in Manufactured Goods Between Industrial and Developing Countries," Journal of Policy Modeling, September 1980, Reprint No. 156.
6. "Portugal in Face of the Common Market," 2a Conferencia Internacional sobre Economia Portuguesa, 1980, Reprint No. 164.
7. "Growth Policies and the Exchange Rate in Turkey," The Role of Exchange Rate Policy in Achieving the Outward Orientation of the Turkish Economy, 1980, Reprint No. 181.
8. "Trade in Manufactured Goods: Patterns of Change," World Development, March 1981, Reprint No. 180, 180a (in French).
9. "The Newly-Industrializing Countries After the Oil Crisis," Weltwirtschaftliches Archiv, 1981 (1). Reprint No. 190, 190a (in Spanish).

January 28, 1983.

Mr. Clive Bell, DRDEI

Bela Balassa, DRD

Mr. Patrick Conway

1. I have been very much impressed by Patrick Conway. He combines an excellent analytical capability with an interest in, and a good understanding of, real world problems. Conway is an outstanding candidate for the DRD and we should invite him to give a seminar at an early date.
2. Following my interview of Conway, I read his "Long-term Consequences of Short-run Government Policy." This is a very good paper of publishable quality. Conway has handled the problem in the confines of a two-period model with considerable ingenuity.

BBalassa:nc

OFFICE MEMORANDUM

TO: Mr. James K. Feather, PUB
FROM: Bela Balassa, DRD
SUBJECT: Catalog of Publications

DATE: January 28, 1983

1. As in the previous year, I find the 1983 Catalog of Publications very attractive. Also, the short summaries of the individual publications give a good indication of their contents, providing an inducement to the would-be reader to obtain them. The reader's attention is also drawn to newly-issued papers. I wish to raise queries, however, about the coverage of the Catalog.
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4. I enclose a list of the Reprints of my recent papers. Nos. 1 to 8 were included in the 1982 Catalog but were omitted from the 1983 Catalog. No. 9 is included in its earlier Working Paper form that has subsequently been revised. As is apparent from the list, several of the papers have been reprinted in French, Portuguese, and Spanish, which are of interest for the Bank's non-English speaking audience.

cc: Mrs. Krueger, Messrs. Michalopolous, Duloy, VPERS
DRD Senior Staff

BBalass:nc

Reprints of Papers by Bela Balassa

1. "Incentive Policies in Brazil," World Development, November-December 1979, Reprint No. 133, 133a (in Portuguese).
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9. "The Newly-Industrializing Countries After the Oil Crisis," Weltwirtschaftliches Archiv, 1981 (1). Reprint No. 190, 190a (in Spanish).

January 28, 1983.

Professor Robert L. West
Tufts University
The Fletcher School of Law
and Diplomacy
Medford, Massachusetts 02155

Dear Professor West:

In response to your letter of January 2nd, I enclose the revised text of my paper "The Policy Experience of Twelve Less Developed Countries, 1973-1978." I further enclose tables 2 and 3 of the paper. I understand that you will have the tables typed, hence, I am sending a handwritten copy.

These two tables should meet the requirements of the Westview Press, I believe. I fully agree with your treatment of tables 1A and 1B and appendix tables 1 and 2. Please proceed accordingly.

Yours sincerely,

Enclosures

Bela Balassa

TABLE 3

SUMMARY MEASURES OF THE BALANCE OF PAYMENTS EFFECTS OF EXTERNAL SHOCKS
AND OF POLICY RESPONSES TO THESE SHOCKS

(averages for the years 1974-78)

Year	Terms of Trade Effects	Export Volume Effects	Additional Net External Financing	Increase in Export Market Shares	Import Substitution	Import Effects of Lower GNP Growth Rate	Increase in Export Market Share / Exports	Import Substitution / Imports	Import Effects of Lower GNP Growth Rate / Imports	Debt Service Ratio (percent)		External Debt-GNP Ratio (percent)	
										1973	1978	1973	1978
78.9	87	13	250	-19	-133	3	-32	-69	1	24.4	82.8	47.8	69.9
43.9	78	22	210	-21	-60	-24	-15	-19	-9	13.1	32.4	18.0	32.8
43.2	65	35	187	15	-84	-18	11	-26	-6	30.1	24.3	32.3	43.7
50.5	80	20	45	-14	60	9	-21	26	4	33.5	8.5	19.0	22.8
36.1	90	10	11	43	43	4	17	14	1	20.6	29.1	7.8	11.4
67.0	78	22	113	7	-15	-4	5	-9	-3	23.3	41.7	16.1	28.0
59.3	50	50	-14	-34	60	88	-23	32	47	10.7	27.1	18.1	46.6
41.9	60	40	158	-18	-45	5	-8	-17	2	46.6	72.4	35.5	58.6
67.9	80	20	17	-48	68	8	-44	36	4	14.9	15.9	21.8	28.1
17.6	-113	13	-101	17	-20	4	21	-22	-3	3.5	9.5	22.8	28.6
23.1	-174	74	-132	85	-55	2	20	-13	1	9.0	12.6	17.4	40.6
96.2	-117	17	-30	-5	-64	-1	-7	-47	-1	1.0	0.7	2.8	1.9

on data from the World Bank data base.

1/11/11

SAVINGS RATIOS, INCREMENTAL CAPITAL-OUTPUT RATIOS AND GROWTH RATES

	1963-73	1973-76	1976-79	1973-79	1963-73	1973-76	1976-79	1973-79	1963-73	1973-76	1976-79	1973-79
	EGYPT				MOROCCO				TUNISIA			
Domestic Savings Ratio	9.9	12.3	17.6	15.4	13.2	14.6	11.8	12.9	17.3	23.3	22.0	22.5
Foreign Savings Ratio	4.3	16.2	13.7	14.8	1.4	10.8	15.2	13.5	4.9	4.5	8.0	6.7
Incremental Capital-Output Ratio	3.6	2.3	3.4	2.9	3.4	1.8	6.2	3.4	3.4	2.5	3.8	5.1
Rate of Growth of GNP	4.5	8.8	9.6	9.2	4.5	9.3	3.5	6.8	6.1	8.5	7.0	7.4
Growth Rate of Per Capita GNP	2.0	6.5	6.9	6.7	1.9	6.4	0.3	3.7	4.2	6.5	4.5	5.1
	KENYA				THAILAND				PHILIPPINES			
Domestic Savings Ratio	20.4	17.7	20.4	19.4	22.0	23.3	24.1	23.8	18.5	24.0	25.2	24.7
Foreign Savings Ratio	0.8	3.5	4.9	4.4	1.6	1.0	3.3	2.4	2.3	5.6	4.5	5.0
Incremental Capital-Output Ratio	2.6	3.4	3.2	3.3	3.2	2.9	2.7	2.8	3.5	3.0	3.8	3.4
Rate of Growth of GNP	6.5	5.6	6.5	6.2	7.7	6.9	8.0	7.6	5.0	5.9	5.9	5.9
Growth Rate of Per Capita GNP	3.0	2.2	3.0	2.8	4.6	4.1	5.8	5.1	2.0	3.4	3.2	3.3
	JAMAICA				PERU				TANZANIA			
Domestic Savings Ratio	26.0	12.8	14.1	13.4	17.1	13.0	16.9	14.9	16.5	11.9	10.1	10.9
Foreign Savings Ratio	5.4	10.3	0.8	5.5	-0.5	6.6	-3.3	1.8	2.8	9.2	11.0	10.3
Incremental Capital-Output Ratio	4.0	-5.7	-9.7	-6.7	3.1	3.9	-5.5	5.9	3.1	4.2	3.9	4.1
Rate of Growth of GNP	5.7	-4.8	-1.8	-3.3	4.9	3.6	-1.7	0.4	5.7	4.4	5.3	5.1
Growth Rate of Per Capita GNP	4.1	-6.4	-3.5	-5.0	2.1	0.9	-4.4	-2.4	2.9	1.5	2.2	2.1
	INDONESIA				IVORY COAST				NIGERIA			
Domestic Savings Ratio	9.0	21.9	24.2	23.3	21.9	25.9	28.9	27.9	20.4	30.8	26.8	28.4
Foreign Savings Ratio	1.4	-2.3	-3.6	-3.1	-1.6	-3.4	-0.3	-1.3	-1.1	-0.6	0.6	-1.8
Incremental Capital-Output Ratio	1.8	2.1	3.4	2.7	2.5	2.2	3.7	3.0	2.2	2.7	4.9	3.2
Rate of Growth of GNP	6.5	6.2	6.2	6.2	6.5	5.8	8.0	7.3	5.7	7.0	5.2	6.3
Growth Rate of Per Capita GNP	4.3	4.4	4.1	4.2	2.3	0.1	3.6	2.3	3.3	4.5	2.9	3.9

Source: Calculations based on data from World Bank data base.

January 27, 1983

Mr. Ian M. Hume, EMI

Bela Balassa, DRD

61007

Invitation for Mr. Béla Csikós-Nagy

1. As I have earlier indicated to you, Dr. József Bognár and Dr. Béla Csikós will be coming to Washington in late February. Bognár is available for a seminar on February 25th to speak on the political-social background of the reform. Csikos-Nagy proposes to talk about "Hungary's Liquidity, Problems and the Period of Consolidation" on February 28th.
2. I suggest that I will arrange payment of Bognár's fee through my Department and that you do the same for Csikós-Nagy through your Division. Both are high-ranking people and should get the highest possible fee. They should also have subsistence (no travel expenses).
3. I also suggest that Mr. Chaufournier gives a lunch for Messrs. Bognár and Csikós-Nagy on February 28th. I will subsequently provide bio-data for the two.

BBalassa:nc

Mr. Clive Bell, DRDSU

January 27, 1983.

Bela Balassa, DRDDR

Ms. Kathie L. Krumm

1. I have interviewed Ms. Krumm and have also read her paper "Credibility and Investment: Argentina's Attempted Liberalization 1976-1981." The paper is competently done and shows a good understanding of the Argentine economic situation. It is disappointing, however, that data limitations did not permit her to fully test the model. The paper will be part of Ms. Krumm's doctoral dissertation she expects to finish during her year at Brookings on a Research Fellowship in Economics (September 1982-August 1983).

2. The Brookings fellowship is a coveted award and is subject to considerable competition. Her award is thus an indication of Ms. Krumm's ability as an economist. Ms. Krumm also had practical experience in commercial banking as well as in a developing country, Tanzania. Finally, she has a wide range of interests in development problems.

3. Ms. Krumm's qualities fit well the needs of the Bank, I believe. The Country Policy Department, or the Industry Department would be a good place for her but she may eventually become a country economist or loan officer. Ms. Krumm would do high-level, conscientious work wherever she goes. I have been very favorably impressed by her.

BBalassa:nc



Record Removal Notice

File Title Bela Balassa's chron files - January 1983	Barcode No. 30225156
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Document Date Jan 24, 1983	Document Type Letter
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Correspondents / Participants
To : Mr. Garry Pursell, IND
From : Bela Balassa, DRD

Subject / Title
Mr. H. Gruska

Exception No(s).

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Withdrawn by Chandra Kumar	Date Jun 10, 2014
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January 24, 1983.

Confidential

Mr. Rolf Luders
Minister of Economy and Finance
Santiago
Chile

DECLASSIFIED
JUN 10 2014
WBG ARCHIVES

Dear Rolf,

I have the pleasure of enclosing two copies of my report for you and for Carlos Caceres. I hope that you find this report helpful, however imperfect it may be following the short visit I had to Santiago.

It was a pleasure seeing you again and I much enjoyed the discussions we have had.

Please let me know if I can be of any further assistance.

Yours sincerely,

Enclosures

Bela Balassa

Enclosed: Policy Issues in Chile

Mrs. Anne O. Krueger, VPERS

January 24, 1983

Ardy Stoutjesdijk, DRD

Reprint Series

1. We have reviewed the proposals made by the Working Group appointed by the Editorial Subcommittee concerning the Reprint Series. We are in complete agreement with the statement that "articles of high professional quality with clear relevance for policy and developmental practice would commend themselves" for the Series (Para. 2). Among the four objectives listed in Para. 1, we agree with the importance assigned to "the dissemination and propagation of ideas and information of practical use to the Third World." At the same time, for continuing our successful recruiting effort to the benefit of the Bank, importance attaches to the objective "to enable authors to maintain contact and visibility with and within the academic community."

2. We oppose any kind of quantity rationing of the number of reprints. This would impose an additional burden on the selection committee and would make its task extremely difficult in the absence of reliable forecasts on the number of reprints to be submitted for future meetings. At the same time, it would provide an incentive for early submission within each fiscal year.

3. More importantly, the Bank's research effort may not be adequately represented by 40 reprints a year. While there were only about 40 reprints in each of the last two fiscal years, their number exceeded 60 in the year before. By comparison, there were over one hundred reprints in the reprint series of the National Bureau of Economic Research over the last year. If the cost appears high (and we have doubts about the validity of the estimates), the reprints should be priced as are those of the NBER and of other organizations.

4. At any rate, we are told that the cost per reprint is considerably less than that of a Staff Working Paper. Yet, the reprint series is much superior in quality having gone through a vetting process and having survived competition from papers by non-Bank authors. For the same reason, we object to the fact that reprints issued at least one year prior to the publication of the 1983 Catalog have been excluded from the Catalog, which includes all Working Papers from the Summer 1979. Reprints should receive at the least the same treatment in the Catalog as the Working Papers.

cc: Messrs. Michalopoulos, Duloy, VPERS

BBalassa:nc

OFFICE MEMORANDUM

TO: Mr. Jayanta Roy, EM2

DATE: January 21, 1983

FROM: Bela Balassa, DRD

SUBJECT: Country Economic Memorandum: Turkey

1. This report usefully summarizes the policy recommendations made in earlier Bank reports and makes medium-term projections for Turkey. Apart from some queries raised about the medium-term framework, I will briefly consider questions relating to the financial system in Turkey and make reference to policies aimed at increasing savings and investment.

A Medium-Term Framework

2. According to the report "the implications of the new direction for the planning mechanism suggest a shift from prescriptive to indicative planning" (Para. 2.4). Reference is further made to a change in focus from a 'crisis management' philosophy to a medium-term plan (Para. 2.3), and it is added that "the establishment of a medium-term framework is also essential to the evaluation of the key issues in formulating a coherent development strategy" (Para. 2.5).

3. It is not clear what is meant by "the new direction for the planning mechanism" and by "indicative planning." At the same time, I wonder if the Bank should advocate planning, however indicative, in Turkey. While there is need for a public sector investment strategy, private firms should be free to make their decisions, with the incentive system ensuring that private and social profitability coincide.

4. Nor is it clear what is meant by a medium-term framework. If it refers to coherent medium-term projections, this would certainly be useful for public decision-making. More important, however, is the establishment of a medium-term policy framework that has been advocated in my "Industrialization and Trade Strategy" report. The recommendation for such a policy framework has been made in order to ensure the full application of the 1980 January reforms, which represent a shift towards an outward-oriented market economy and should not be considered to reflect a 'crisis management' philosophy or concentration "on the shorter term stabilization measures" (Para. 2.3).

5. The present report summarizes a number of the medium-term recommendations made in the "Industrialization and Trade Strategy" report at the neglect of others, such as tax reform, measures affecting foreign direct investment, and technological policy. Yet, through their effects on domestic and foreign savings and on technical change, these policies are of considerable importance to ensure the rapid economic growth projected for Turkey. In fact, while the report uses a trade gap model (Para. 2.12) limitations of domestic and foreign savings also

constrain economic growth in Turkey and the rate of growth is further affected by technological progress.

The Financial System

6. Recommendations made in the report regarding the financial system are more limited in scope than those made in the "Industrialization and Trade Strategy" report. Yet, recent developments point to the need for going even further with the reform of the financial system than suggested earlier. This is because the continued maintenance of high real interest rates creates liquidity problems and threatens the viability of a number of industrial enterprises and of several banks.

7. High real interest rates are in part caused by credit demands owing to the refinancing of existing loans, with interest payments added. Since the banks have to add to their reserves as they increase their loans to existing borrowers in nominal (although not in real) terms, the availability of credit to new borrowers is reduced. At the same time, a number of these loans continue to be refinanced without expectations for repayment.

8. Unless action is taken, the situation is bound to deteriorate further, increasing liquidity problems in Turkey and eventually affecting the solvency of firms as their debt-equity ratio deteriorates. In this connection, reference may be made to the suggestions contained in my back-to-office memo dated December 16, 1982: "At the same time, there would be need for the long-promised reform of the banking system. Such a reform could include a review of the loan portfolio of banks by the Ministry of Finance and the Central Bank, with a view to establishing reserves for bad debts; strengthening banks through consolidation; and making a start in reducing ties between banks and industrial groupings. In turn, the banks could give help to enterprises that are in financial difficulties but are basically sound."

Concluding Observations

9. Improving the financial system is a pre-condition for increasing private investment at rates projected in the report. This would further necessitate increased domestic and foreign savings that were referred to earlier. At the same time, appropriate incentives would need to be provided for new investment.

10. In its discussion of recent economic developments, the report should consider certain unfavorable trends, the continuation of which would threaten rapid export growth. Such changes include the appreciation of the real exchange rate and reductions in the volume of export credit. In turn, inadequate progress made in trade liberalization would adversely affect exports in the medium term. Finally, in view of the delays experienced in the reform of the SEEs, and the doubts raised as to whether the reform will in fact be carried out, it can hardly be said that "the Government has taken a gradual, but steady, approach to reform" (Para. 3.6).

cc: Messrs. Chaufournier, EMNVP; Bart, EM2; Picciotto, EMP; Chaffey, EM2;
Dubey, EMNVP; Asfour, EM2; Chernick, CPD; Robinson, DRD; Silva-Lopes, CONS.

BBalassa:nc

POLICY ISSUES IN CHILE

Bela Balassa

January 21, 1983

The author is Professor of Political Economy at the Johns Hopkins University and Consultant to the World Bank. He prepared this note for the Government of Chile following a visit to Santiago on January 10-14. The note reflects the author's personal views and should not be interpreted to express those of the World Bank.

Policy Issues in Chile

Bela Balassa

Introduction

The liberal course adopted following the military takeover of September 1973 brought its fruits in Chile once the effects of deflationary policies applied in response to the deterioration of the country's terms of trade, equalling 9 percent of GDP in 1974, were overcome. After declining by 14 percent in 1975, Chile's gross domestic product rose at an average annual rate of nearly 8 percent between 1975 and 1979, surpassing the 1973 level by about one-fifth percent in the latter year.

The expansion of exports, with Chile increasing its market share in non-copper exports to a considerable extent, importantly contributed to economic growth after 1975. According to the calculations I have made, there was also some import substitution during the 1973-78 period as trade liberalization was accompanied by a depreciation in the real value of the peso. However, the expansion of exports slowed down, and that of imports accelerated, after June 1979 when the exchange rate was fixed at 39 pesos to the U.S. dollar, resulting in an appreciation of the real exchange rate.

The real exchange rate, calculated by adjusting the nominal exchange rate by the Chilean wholesale price index and by the trade-weighted wholesale price indices of the partner countries, appreciated by 32 percent between 1978 and 1981. The decline in the competitiveness of Chilean goods is also indicated by the fact that, between July 1, 1981 and December 31, 1981, official wage adjustments amounted to 68 percent while the exchange rate was kept unchanged. At the same time, high real interest rates on loans denominated in pesos raised the cost of financing for the firms.

The cost-price squeeze in the traded goods sector is indicated by the fact that the average rate of profit changed from +11 percent in December 1980 to -12 percent in June 1982 in the forty-four largest private enterprises, representing 40-50 percent of the value of shares traded on the stock exchange. The fall in profitability, in turn, led to a 11 percent decline in the dollar value of non-copper exports in 1981 whereas imports rose by 24 percent. With the rising interest burden of the external debt, built up through large capital inflows in recent years, Chile's current account deficit reached \$4.9 in 1981, equalling 15 percent of GDP. As this situation could not be maintained, the peso was repeatedly devalued in 1982.

The devaluations have remedied the disequilibrium in the market for traded goods as the real exchange rate returned to approximately its 1978 level in December 1982. The disequilibrium in the capital market has continued, however. Apart from a temporary decline in August-November 1982 when domestic credit increased rapidly, real interest rates paid by borrowers in pesos have been about 40 percent a year since early 1981, when doubts arose about the maintenance of the 39 pesos to the dollar exchange rate.

High real interest rates reflect the demand for credit on the part of firms that were buffeted successively by the overvaluation of the exchange rate, uncertainty of future exchange rate changes and the increase in the domestic currency value of their debt, to which the adverse effects of the deep recession should be added. At the same time, high interest rates importantly add to the financial problems of the firms.

The labor market is also characterized by disequilibrium. Unemployment rates that did not decline below 9-10 percent, owing largely to the rationalization of firms exposed to foreign competition, are estimated by

the University of Chile to have approached 25 percent in 1982 when the gross domestic product fell by about 13 percent. In the same year, Chile's external debt reached \$17 billion, with a debt-service ratio approaching 100 percent.

Traditional ways of remedying an external imbalance include cutting expenditures and raising output. After the decline in GDP that occurred in 1982, the social problems associated with high unemployment, as well as the financial problems of firms and banks, call for adjustment to occur through increases in output in Chile.

In the following, recommendations will be made for increasing exports that would lead to increased employment and to improvements in the balance of payments, thereby adding to domestic liquidity. Increased liquidity in the banking system, in turn, can be utilized to expand output and employment elsewhere in the economy, with emphasis given to labor-intensive infrastructural investments.

There is further need to remedy the financial imbalances that increasingly interfere with the functioning of the Chilean economy and to cope with Chile's large foreign indebtedness. Also, one should encourage new investments in the productive sectors of the economy, and in particular in export activities. Finally, recent tendencies towards protectionism will need to be reversed. These issues will be considered in subsequent sections of this note.

The Exchange Rate Issue

At present, the basic exchange rate is 75 pesos to the dollar, with a preferential rate of 57 pesos applying to the repayment of loans contracted before June 1982 and a parallel market rate available to Chileans who wish to obtain foreign exchange in excess of their tourist allocation. The basic

exchange rate is scheduled to depreciate pari passu with domestic inflation, with adjustment made for an assumed monthly 1 percent rise in international prices. The preferential rate will approach the basic exchange rate over time while the parallel market rate responds largely to changes in confidence.

It has been suggested that the present system of exchange rate be replaced by a freely floating exchange rate. This alternative would have serious disadvantages, however. The rate would be bound to fluctuate to a considerable extent in response to internal and external events, thereby adversely affecting confidence and contributing to instability in incentives. In view of the need to re-establish confidence in economic policy making and stability in the system of incentives, it would not be desirable, therefore, to adopt freely floating exchange rates.

As noted above, in December 1982 the real value of the peso vis-a-vis the currencies of Chile's trading partners has returned to its 1978 level which may be considered an approximate equilibrium situation. While it has been suggested that the recent deterioration in Chile's terms of trade and its reduced possibilities for foreign borrowing would call for a depreciation in the real value of the peso compared to its 1978 level, the arguments put forward against freely floating exchange rate apply to an additional devaluation also. At any rate, as the recent decline in the value of the U.S. dollar is expected to continue, the existing link of the peso to the dollar will lead to a depreciation vis-a-vis the currencies of Chile's trading partners. Correspondingly, it is recommended to maintain the present system of the exchange rate.

There would be need, however, to modify the formula of exchange rate changes that is deficient in two respects. As presently constituted, the

formula assumes a 1 percent monthly inflation in the international economy, far exceeding the actual figure of about 0.3 percent a month. An appropriate solution would be to calculate the rate of depreciation by adjusting changes in the Chilean price index for the average change in the U.S. wholesale prices over the previous six or twelve months.

Furthermore, the Chilean consumer price index should be replaced by the wholesale price index for home goods in the formula. The consumer price index is affected by changes in retail margins and in the prices of nontraded goods, which do not bear on international competitiveness. In turn, the wholesale price index reflects changes in the prices of traded goods in Chile, which compete with foreign goods at home as well as abroad. With the wholesale price index rising more rapidly than the consumer price index as the relative prices of traded and nontraded goods adjust to exchange rate changes, the use of the consumer price index in the formula would lead to a loss of competitiveness for Chilean producers.

At the same time, one may object to proposals made to institute an exchange rate guarantee scheme in the Central Bank. Such schemes resulted in a considerable loss to the Treasury in Argentina and Turkey and may do so in Chile in the case of unforeseen events. And, in the absence of such events, the institution of an exchange guarantee scheme would imply that the Central Bank considers itself unable to maintain stability in the real exchange rate.

It would be desirable, however, to provide facilities for forward coverage, in order to reduce the risks associated with variations in values among the major foreign currencies (i.e. in gross rates) that have assumed considerable magnitude in recent years. In the absence of a forward market in foreign exchange, such risks discourage exporting.

Citibank attempted to create a forward market in foreign currencies but without success. On the example of Morocco, this task may be assumed by the Central Bank. As exports and imports occur in all major currencies, foreign transactions in different currencies balance to a considerable extent and the risk of loss to the Central Bank would be small. And, to the extent that there are imbalances in foreign transactions in particular currencies, the Central Bank could cover in the London market while utilizing the forward rates of this market in its transactions with Chilean exporters and importers.

Export Incentives

It has been noted above that the present exchange rate appears realistic in Chile and emphasis should be put on ensuring stability in the real value of the peso. At the same time, there would be need to compliment the recent devaluations by export incentives. The use of such incentives was in the past rejected by the Chilean government on the grounds that they would not conform to its free market policy. However, the 10 percent duty on imports does create a bias against exports, which needs to be corrected. Such is the case in Korea and Taiwan where exports and import substitution receive approximately equal incentives, on the average. In fact, one may argue that it would be desirable to provide additional incentives to infant export activities on a temporary basis.

Approaching the problem in a different way, there appears to be need to grant certain export incentives in order to complement the recent devaluations. A case in point is the provision of pre-export credits for working capital needs. Despite efforts made in direction, the lack of sufficient working capital is reported to be the most important obstacle to the expansion of exports in Chile today.

Pre-export credits played a particularly important role in Turkey following the 1980 devaluation and are widely used in other developing countries as well. On the example of these countries, credits may be provided up to 60-70 percent of expected export value for periods of three to nine months.

Pre-export credits could be granted in part in foreign currency, at international interest rates augmented by the usual margins, involving the re-lending of the proceeds of foreign loans e.g. to CORFO. In order to encourage the exportation of machinery and equipment, it would further be desirable to establish a medium-term export credit facility in terms of foreign currency. The establishment of such a scheme would permit domestic producers of capital goods to compete with the products of developed and developing countries, which provide such credits at low interest rates.

The government is expanding the activities of Pro-Chile, the official export promoting agency. While this is a desirable development, the exploration of foreign markets can be most effectively done by exporting interests who are the best judge of their export possibilities. In this connection, note that while much attention has been given to the Japanese and Korean governmental export agencies, the role of private trading companies in promoting exports has been far more important in the two countries.

Japan and Korea have provided credit and tax incentives to trading firms. More recently, Turkey has granted a direct subsidy in addition to preferential credits to such firms. While granting such a subsidy is not recommended, it would be desirable to extend the proposed pre-export credit scheme to trading companies that may have to store commodities, in particular agricultural products, before shipping them abroad. Consideration may further

be given to granting income tax exemptions to such companies on a temporary basis.

Temporary income tax exemptions to trading companies may be considered an infant export industry measure, aimed at encouraging the formation of trading companies that may play a particularly important role in promoting exports by small and medium-size companies. Infant export industry considerations would also favor the government sharing in the financing of participation in fairs and in the cost involved in seeking out new markets by trading companies and by individual firms. Following the example of successful developing country exporters, it would be desirable to diversify markets for Chilean exports. At the same time, efforts in this direction may involve a considerable additional cost for the firms concerned while benefits may also accrue to other firms that can follow in the footsteps of the pioneers.

On the example of other developing countries, the government may share in the cost of export promotion through double deduction for tax purposes or by direct subsidies. It would further be desirable to permit exporting firms and trading companies to keep part of their foreign exchange receipts for promotional expenditures, including travel. Morocco provides 3 percent of export earnings for this purpose; it has been proposed, however, to increase this percentage.

Credit Policy

The provision of export credit is a matter of urgent necessity. The experience of the October-November 1982 period, when large increases in domestic credit led to reserve losses of a similar magnitude, is not relevant in this case. Rather than losses, providing pre-export credits can contribute

to increases in reserves.

In the October-November 1982 period, domestic credit creation took largely the form of subsidies for the payment of foreign obligations, equal to the difference between the basic and the preferential exchange rate, thereby discouraging the postponement of payments due. The recent replacement of these subsidies by notes payable several years hence, provided irrespective of whether repayment is now made, does not provide incentives to repay; nor does it entail creating domestic credits through subsidies.

In turn, easing the credit bottleneck would permit increasing exports, albeit with a time lag, thereby improving the balance of payments and adding to the money supply through increases in reserves. Both the initial increase in domestic credit for export purposes and the subsequent increase in foreign exchange reserve-based credit, then, would add to domestic liquidity and thereby lower real interest rates. At present levels of real interest rates, the high debt charges threaten the liquidity position and compromise the profitability of Chilean business in all productive sectors.

The expansion of exports would also create employment, both directly and indirectly. Given the high level of unemployment, however, it would be desirable to take further measures in other areas. Investments in infrastructure geared to exports are particularly attractive as such investments have a high social rate of return, they are labor intensive, and they entail low import leakages. Correspondingly, it would be desirable to provide credit for such investments.

Remedying Financial Imbalances

The lowering of real interest rates would further require remedying the financial imbalances existing in Chile. Real interest rates are raised by

the refinancing of loans, inclusive of interest payments, that adds to the demand for credit and increases the debt burden of firms in relation to their equity.

In a growing number of firms, debt has come to exceed the equity, giving rise to insolvency in the event that the debts were to be called. Yet, the revenues of many of these firms cover their production costs even under the depressed conditions of today while others would show an operating profit if business improved. In this connection, distinction needs to be made, however, between domestic and foreign indebtedness.

In the case of domestic debts, it is in the interest of the creditors, and of the Chilean economy, to continue the operation of firms which can make an operating profit over the business cycle, since otherwise loans would be repudiated and production capacity lost. Ensuring the continued operation of these firms would require some form of funding of the debt, through the transformation of short-term debt into long-term obligations or the transformation of debt into equity.

Firms that have operating losses over the business cycle would have to be liquidated, however. The same conclusion applies to firms which are unable to repay their foreign loans, even if all effort is made to reschedule payments on such loans. This would need to be a joint effort between private interests and the government as noted below.

The liquidation of particular firms would unfavorably affect the portfolio of domestic banks. While some of these banks would have to be liquidated, most banks could cover their losses from future profits. To make this possible, the Central Bank should extend its existing facilities for the purchase of loans in exchange for notes payable over a long period. In

certain instances, the Central Bank would also have to provide additional liquidity to the commercial banks.

The application of these principles would reduce demand for loans, and thereby lower interest rates, as firms entering into bankruptcy would cease to use scarce financial resources. It would also reduce the interest burden of the surviving firms, both by the funding of their debt and through lower interest rates. At the same time, it would contribute to the stability of the banking system and to greater confidence in this system.

The above objectives would further be served by the separation of banks from the affiliated industrial groups. Such separation would also permit clarifying the situation of the banks in question and that of the individual firms which presently belong to the groups. Once this is accomplished and claims and obligations are sorted out, the management of the "intervened" banks should be returned to private hands, although ownership may have changed in the meantime.

Promoting Savings and Investment

The proposed measures would contribute to savings by removing the threat of losses of deposits. Under recent legislation savings will also be promoted through the transformation of the income tax system into a general expenditure tax that involves exempting the saved portion of personal incomes from taxation.

The change in the system of taxation would not affect, however, business savings. At the same time, the lack of investment incentives appears to have held back the expansion of investment even under favorable business conditions. And, with high real interest rates there is practically no private investment in the depressed economy of Chile today. Yet, the

prospects for future economic growth depend on the rate of investment and, in certain areas, new investment will be necessary to support the export effort.

The latter conclusion applies, in particular, to agriculture and fishing. On the example of the successful reforestation program, it would be desirable to promote investments in these sectors, where Chile has a comparative advantage but the limited supply of investible funds or uncertainties as regards government policies have discouraged investment. Apart from infrastructural investment referred to earlier, investment in these sectors may be supported through the establishment of special funds.

Lending for investment in industrial export activities would also be desirable. CORFO may play an important role in this regard in channeling credit obtained abroad for the purchase of foreign machinery and equipment. At the same time, on the example of other developing countries, it would be desirable to provide tax benefits for new investment in Chile. In order to avoid the unfavorable employment effects associated with accelerated depreciation, this may take the form of tax holidays or reductions in taxes on incomes generated by new investment.

Import Protection

Chile is unique among developing countries in having reduced its tariffs to 10 percent. This is especially remarkable, in view of the fact that Chile had one of the highest tariffs levels in the world before 1974. At the same time, given its small domestic market, the reduction in tariffs has been in Chile's long-term interest.

Recently, pressures have been generated to increase tariffs again. It would seem that these pressures represent a delayed reaction to the appreciation of the real exchange rate between June 1979 and June 1982 that

severely compromised the competitiveness of Chilean producers of traded goods. With the subsequent exchange rate adjustment, equivalent to a 90 percent export subsidy cum import tariff, the situation has been remedied. Any tariff increase, then, would encourage high-cost activities while discouraging exports.

Nor can increases in tariffs be recommended on the grounds that Chile could obtain reciprocal tariff concessions from other countries since, given its small size, Chile has little leverage in tariff negotiations. Similar considerations warn against the excessive use of anti-dumping duties that may lead to retaliation, compromising Chile's export position.

Nor can one recommend the replacement of a single tariff rate by differentiated tariffs. As it is well-known, efficiency considerations would call for equalizing effective protection, or the protection of value added. This purpose is served by a flat tariff unless protected industries use an exportable product as an input, in which case a lower tariff should be applied in order to offset the benefits provided by low input costs. But this is rarely the case in Chile, hence it will be appropriate to retain a single tariff rate.

Concluding Remarks

In this note, recommendations have been made for remedying Chile's external imbalance by increasing output rather than by reducing domestic expenditure. The recommendations have been formulated with a view to easing the serious liquidity shortage that has led to excessively high interest rates in Chile.

Proposals have been put forward to complement the favorable exchange rate by various export promotional measures, among which the provision of pre-

export credits is the most important. The expansion of the money supply associated with the growth of exports would in turn provide an opportunity to carry out investments in infrastructure, which have a high social rate of return, are labor intensive, and would not involve substantial import leakages.

Recommendations have further been made for providing investment incentives, with credit incentives granted to in export activities and tax incentives to all productive investment. Also, one would need to resist protectionist pressures in Chile and limit the application of anti-dumping duties.

Notwithstanding the expansion of exports in response to the incentives provided, Chile is expected to have gross borrowing requirements in excess of \$2 billion in 1983. The government would have to play an important role to ensure the lengthening of the maturity of private credits and it would also have to borrow on its own, so as to avoid reserve losses beyond the projected figure of \$600 million.

Last but not least, there is need to remedy the financial imbalances existing in Chile. This would necessitate reaching decisions on the future of banks and enterprises in financial difficulties, providing assistance to banks, and modifying the asset and liability structure of viable firms that represent the large majority.

OFFICE MEMORANDUM

TO: Mr. Paul Meo, LCI
FROM: Bela Balassa, DRD
SUBJECT: Financial Imbalances in Chile

DATE: January 21, 1983

I enclose pages 10 and 11 of the revised version of my "Policy Issues in Chile." My argument has been influenced by Frank Veneroso's excellent paper although differences remain.

I would appreciate your calling me if you have any comments.

cc: Messrs. Pfeffermann, Veneroso

BBalassa:nc

Remedying Financial Imbalances

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In the case of domestic debts, it is in the interest of the creditors, and of the Chilean economy, to continue the operation of firms which can make an operating profit over the business cycle, since otherwise loans would be repudiated and the production capacity lost. Ensuring the continued operation of these firms would require some form of funding of the debt, through the transformation of short-term debt into long-term obligations or the transformation of debt into equity.

Firms that have operating losses over the business cycle would have to be liquidated, however. The same conclusion applies to firms which are unable to repay their foreign loans, even if all effort is made to reschedule payments on such loans. This would need to be a joint effort between private interests and the government as noted below.

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liquidated, most banks could cover their losses from future profits. To make this possible, the Central Bank should extend its existing facilities for the purchase of loans in exchange for notes payable over a long period. In certain instances, the Central Bank would also have to provide additional liquidity to the commercial banks.

The application of these principles would reduce demand for loans, and thereby lower interest rates, as firms entering into bankruptcy would cease to use scarce financial resources. It would also reduce the interest burden of the surviving firms, both by the funding of their debt and through lower interest rates. At the same time, it would contribute to the stability of the banking system and to greater confidence in this system.

The above objectives would further be served by the separation of banks from the affiliated industrial groups. Such separation would also permit clarifying the situation of the banks in question and that of the individual firms which presently belong to the groups. Once this is accomplished and claims and obligations are sorted out, the management of the "intervened" banks should be returned to private hands, although ownership may have changed in the meantime.

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The proposed measures would contribute to savings by removing the threat of losses of deposits. Under recent legislation savings will also be promoted through the transformation of the income tax system into a general expenditure tax that involves exempting the saved portion of personal incomes from taxation.

The change in the system of taxation would not affect, however, business savings. At the same time, the lack of investment incentives appears

OFFICE MEMORANDUM

TO: Mr. Eugenio F. Lari, LCI

FROM: Bela Balassa, DRD

SUBJECT: Back-to-Office Report: Chile

DATE: January 18, 1983.

1. At the invitation of the Government, I visited Chile on January 10-14. At the beginning as well as at the end of my stay I had meetings with the Minister of Economy and Finance and the President of the Central Bank. I also met with Jorge Cauas, Sergio de Castro, Luis Escobar, Carlos Massad, and Juan Carlos Mendez, as well as with leading industrialists, bankers, and academic economists. I presented a public lecture in Santiago and gave seminars at the Central Bank, the Universidad Catolica, the Universidad de Chile, and the Escuela de Negocios in Valparaiso.
2. I enclose a preliminary version of a note on "Policy Issues in Chile" I am preparing for the Chilean Government; a revised version of this note will be part of a paper on Chile's policy experience during the last decade. As indicated in the note, the origin of Chile's present difficulties may be traced to maintaining the exchange rate constant in the face of large wage increases combined with the excessive inflow of foreign capital.
3. Following the tribulations of recent years, the re-establishment of confidence and stability in the economic environment are the principal issues in Chile today. The pursuit of these objectives received a, hopefully temporary, setback as a result of the liquidation of three banks and financial institutions and the takeover of the management of five banks, together accounting for 40 percent of peso deposits, 54 percent of dollar deposits, and 40 percent of private foreign debt on January 13th. Beyond a certain limit, holders of peso deposits in the liquidated financial institutions will be compensated only at a rate of 70 percent. Also, until the end of the year guarantees are provided for existing deposits in pesos at the banks whose management has been taken over by the state without, however, providing guarantees for dollar deposits.
4. As a result of the measures taken, brokers and holders of shares in mutual funds, as well as shareholders in banks and depositors in dollars, will suffer considerable losses. At the same time, the government hopes to be able to negotiate favorable terms with foreign creditors that hold the non-guaranteed debt of these institutions.
5. Whatever the success of these efforts, the situation in domestic financial markets needs to be stabilized and decisions reached on the future of banks and enterprises that are in financial difficulties. But, even after calm returns in financial markets, there will be a severe liquidity shortage in Chile. Correspondingly, external financing of working capital, in particular in export activities, would have multiplier effects on the economy.

cc: Messrs. Ardito-Barletta, LCNVP; Van Der Meer, LCP; Glaessner, LCP;
Pfeffermann, LCNVP; Meo, LCl; Landau, LCNVP; Ray, LCP; Aguirre-
Sacasa, LCl; Mrs. Constance Mejia, LCl;
ERS Directors, DRD Senior Staff, CPD Senior Staff

BBalassa:nc

POLICY ISSUES IN CHILE

Bela Balassa

January 18, 1983

The author is Professor of Political Economy at the Johns Hopkins University and Consultant to the World Bank. He prepared this note for the Government of Chile following a visit to Santiago on January 10-14. The note reflects the author's personal views and should not be interpreted to express those of the World Bank.

Policy Issues in Chile

Bela Balassa

Introduction

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The expansion of exports, with Chile increasing its market share in non-copper exports to a considerable extent, importantly contributed to economic growth after 1975. According to the calculations I have made, there was also some import substitution during the 1973-78 period as the effects of trade liberalization have been offset by a devaluation in real terms. However, the expansion of exports slowed down, while that of imports accelerated, after June 1979 when the exchange rate was fixed at 39 pesos to the dollar.

The real exchange rate, calculated by adjusting the nominal exchange rate by the Chilean wholesale price index and by the trade-weighted wholesale price indices of the partner countries, appreciated by 32 percent between 1978 and 1981. The decline of the competitiveness of Chilean goods is also indicated by the fact that, between July 1, 1981 and December 31, 1981, official wage adjustments amounted to 68 percent while the exchange rate was kept unchanged. The cost-price squeeze in the traded goods sector led to a 11 percent decline in the dollar value of non-copper exports in 1981 whereas

imports rose by 24 percent. With the rising interest burden of the external debt, built up through large capital inflows in recent years, Chile's current account deficit reached \$4.9 in 1981, equalling 15 percent of GDP. As this situation could not be maintained, the peso was repeatedly devalued in 1982.

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financial problems of firms and banks, call for adjustment to occur through increases in output in Chile.

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the forward rates of this market in its transactions with Chilean exporters and importers.

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The last point brings us to the question of export incentives. The use of such incentives was in the past rejected by the Chilean government on the grounds that they would not conform to its free market policy. However, the 10 percent duty on imports does create a bias against exports, which needs to be corrected. Such is the case in Korea and Taiwan where exports and import substitution receive approximately equal incentives, on the average. In fact, one may argue that it would be desirable to provide additional incentives to infant export activities on a temporary basis.

Approaching the problem in a different way, there appears to be need to grant certain export incentives in order to complement the recent devaluations. A case in point is the provision of pre-export credits for working capital needs. Despite efforts made in direction, the lack of sufficient working capital is reported to be the most important obstacle to the expansion of exports in Chile today.

Pre-export credits played a particularly important role in Turkey following the 1980 devaluation and are widely used in other developing countries as well. On the example of these countries, credits may be provided up to 60-70 percent of expected export value for periods of three to nine months at a preferential interest rate. Providing credits at preferential interest rates is of particular importance in Chile where real interest rates are excessively high.

Pre-export credits could be provided in pesos, even though they may in part be used to purchase imported inputs. In order to encourage the

exportation of machinery and equipment, it would further be desirable to establish a medium-term export credit facility in terms of foreign currency. The establishment of such a scheme would permit domestic producers of capital goods to compete with the products of developed and developing countries, which provide such credits at low interest rates.

The government is expanding the activities of Pro-Chile, the official export promoting agency. While this is a desirable development, the exploration of foreign markets can be most effectively done by exporting interests who are the best judge of their export possibilities. In this connection, note that while much attention has been given to the Japanese and Korean governmental export agencies, the role of private trading companies in promoting exports has been far more important in the two countries.

Japan and Korea have provided credit and tax incentives to trading firms. More recently, Turkey has granted a direct subsidy in addition to preferential credits to such firms. While granting such a subsidy is not recommended, it would be desirable to extend the proposed pre-export credit scheme to trading companies that may have to store commodities before shipping them abroad. Consideration may further be given to granting income tax exemptions to such companies on a temporary basis.

Temporary income tax exemptions to trading companies may be considered an infant export industry measure, aimed at encouraging the formation of trading companies that may play a particularly important role in promoting exports by small and medium-size companies. Infant export industry considerations would also favor the government sharing in the financing of participation in fairs and in the cost involved in seeking out new markets by trading companies and by individual firms. Following the example of

successful developing country exporters, it would be desirable to diversify markets for Chilean exports. At the same time, efforts in this direction may involve a considerable additional cost for the firms concerned while benefits may also accrue to other firms that can follow in the footsteps of the pioneers.

On the example of other developing countries, the government may share in the cost of export promotion through double deduction for tax purposes or by direct subsidies. It would further be desirable to permit exporting firms and trading companies to keep part of their foreign exchange receipts for promotional expenditures, including travel. Morocco provides 3 percent of export earnings for this purpose; it has been suggested, however, to increase this percentage.

Credit Policy

The provision of export credit is a matter of urgent necessity. It is recommended that such credits be made available even if this involves temporarily surpassing domestic credit targets. The experience of the October-November 1982 period, when large increases in domestic credit led to reserve losses of a similar magnitude is not relevant in this case. Rather than losses, providing pre-export credits can contribute to increases in reserves.

In the October-November 1982 period domestic credit creation took largely the form of subsidies for the payment of foreign obligations, equal to the difference between the basic and the preferential exchange rate, thereby discouraging the postponement of payments due. The recent replacement of these subsidies by notes payable several years hence, provided irrespective of

whether repayment is now made, does not provide incentives to repay; nor does it entail creating domestic credits through subsidies.

In turn, easing the credit bottleneck would permit increasing exports, albeit with a time lag, thereby improving the balance of payments and adding to the money supply through increases in reserves. Both the initial increase in domestic credit for export purposes and the subsequent increase in foreign exchange reserve-based credit, then, would add to domestic liquidity and thereby lower real interest rates. At present levels of real interest rates, the high debt charges compromise the profitability of Chilean business in all productive sectors and threaten their liquidity position.

The expansion of exports would also create employment, both directly and indirectly. Given the high level of unemployment, however, it would further be desirable to take measures in other areas. Investments in infrastructure geared to exports are particularly attractive as such investments have a high social rate of return, they are labor intensive, and they entail low import leakages. Correspondingly, it would be desirable to provide credit for such investments.

Promoting Savings and Investment

Legislation introduced recently would transform the income tax system into a general expenditure tax, a move long recommended by Lord Kaldor. This change would promote savings by exempting the saved portion of personal incomes from taxation.

The change in the system of taxation would not affect, however, business savings. At the same time, the lack of investment incentives appears to have held back the expansion of investment even under favorable business conditions. At the same time, with high real interest rates there is

practically no private investment in the depressed economy of Chile today. Yet, the prospects for future economic growth depend on the rate of investment and, in certain areas, new investment will be necessary to support the export effort.

The latter conclusion applies, in particular, to agriculture and fishing. On the example of the successful reforestation program, it would be desirable to promote investments in these sectors, where Chile has a comparative advantage but the limited supply of investible funds or uncertainties as regards government policies have discouraged investment. Apart from infrastructural investment referred to earlier, investment may be supported through the establishment of special funds lending at preferential interest rates.

Lending at preferential rates for investment in industrial export activities would also be desirable, with the interest rate actually paid being determined on the basis of the share of exports in output. CORFO may play an important role in this regard in channeling credit obtained abroad for the purchase of foreign machinery and equipment.

Beyond preferential credits, it would be desirable to provide tax benefits for new investment. In order to avoid the unfavorable employment effects associated with accelerated depreciation, this may take the form of tax holidays or reductions in taxes on incomes generated by new investment.

Import Protection

Chile is unique among developing countries in having reduced its tariffs to 10 percent. This is especially remarkable, given that Chile had one of the highest tariffs levels in the world. At the same time, given its

small domestic market, the reduction in tariffs has been in Chile's long-term interest.

Recently, pressures have been generated to increase tariffs again. It would seem that these pressures represent a delayed reaction to the appreciation of the real exchange rate between June 1979 and June 1982 that severely compromised the competitiveness of Chilean producers of traded goods. With the subsequent exchange rate adjustment, equivalent to a 90 percent export subsidy cum import tariff, the situation has been remedied. Any tariff increase, then, would encourage high-cost activities while discouraging exports.

Nor can increases in tariffs be recommended on the grounds that Chile could obtain reciprocal tariff concessions from other countries since, given its small size, Chile has little leverage in tariff negotiations. Similar considerations warn against the excessive use of anti-dumping duties that may lead to retaliation, compromising Chile's export position.

Nor can one recommend the replacement of a single tariff rate by differentiated tariffs. As it is well-known, efficiency considerations would call for equalizing effective protection, or the protection of value added. This purpose is served by a flat tariff unless protected industries use an exportable product as an input. This is rarely the case in Chile, hence it will be appropriate to retain a single tariff rate.

Concluding Remarks

In this note, recommendations have been made for remedying Chile's external imbalance by increasing output rather than by reducing domestic expenditure. The recommendations have been formulated with a view to easing the serious liquidity shortage that has led to excessively high interest rates

in Chile.

Proposals have been put forward to complement the favorable exchange rate by various export promotional measures, among which the provision of pre-export credits at preferential rates is the most important. Such credits need to be provided even if they would involve temporarily exceeding domestic credit targets. In turn, the expansion of the money supply associated with the growth of exports would provide an opportunity to carry out investments in infrastructure, which are labor intensive and would not involve substantial import leakages.

Recommendations have further been made for providing investment incentives, with credit incentives granted to in export activities and tax incentives to all productive investment. Also, one would need to resist protectionist pressures in Chile and limit the application of anti-dumping duties. Last but not least, solutions need to be found in regard to external and internal financial difficulties.

Notwithstanding the expansion of exports in response to the incentives provided Chile has gross borrowing requirements in excess of \$2 billion. The government would have to play an important role to ensure the lengthening of the maturity of private credits and it would also have to borrow on its own, so as to avoid reserve losses beyond the projected figure of \$600 million.

At the same time, there is need to stabilize the financial sector and to reach decisions on the future of banks and enterprises that are in financial difficulties. In the case of firms, the difficulties have in part been brought about by government policies, for which the government has to accept responsibility. Also, since for a number of firms the problem is one

of liquidity rather than solvency, a way has to be found to provide the necessary liquidity to minimize the loss of output.

January 18, 1983.

Fundline
P.O. Box 663
Woodland Hills
California 91365

Dear Sir:

Having received the first few issues of your News Letter,
I have decided to cancel my subscription.

Accordingly, I wish to ask that you refund my subscription.

Yours truly,

Bela Balassa

The paper lacks sophistication as far as methodology is concerned; the use of averages to establish conclusions is far from convincing. It does not deserve to be published in a journal of high standing.

January 17, 1983.

Mr. E. Stoutjesdijk, DRD

Bela Balassa, DRD

61007

Papers and Memos in December

I enclose copies of two substantive memos I wrote in December. You have received copies of other memos and of my paper on "Exports, Policy Choices and Economic Growth in Developing Countries After the 1973 Oil Shock."

Enclosures
BBalassa:nc

2134 Wyoming Avenue N.W.
Washington, D.C. 20008
January 11, 1982.

Working Papers, NBER
1050 Massachusetts Avenue
Cambridge, Massachusetts 02138

Dear Sir:

I would like to order the following Working Papers.

- No. 986 Social Security and Labor Supply Incentives by Roger H. Gordon.
- No. 995 Tax Policy, the Rate of Return, and Savings by Lawrence H. Summers.
- No. 991 Oil Prices, Welfare, and the Trade Balance: An Intertemporal Approach, by Lars E. O. Svensson
- No. 942 World Shocks, Macroeconomic Response, and the Productivity Puzzle, by Michael Bruno.

My check for \$6.00 is enclosed.

Yours sincerely,

Enclosure

Bela Balassa

January 11, 1983

Mr. Alan Gelb, DRDDS

Bela Balassa, DRD

61007

Oil Revenues and Policy Choices in Nigeria

This is an interesting paper but it needs a conclusion. Also, please obtain a memo from Shahid Chandry, supporting its inclusion in the Staff Working Paper series. Finally, we need the usual title page and submission form.

cc: Messrs. Stoutjesdijk, Robinson

Enclosure
BBalassa:nc

2134 Wyoming Avenue N.W.
Washington, D.C. 20008
January 11, 1982.

UNCTAD
Editorial and Documents Section
Palais des Nations
1211 Geneva 10
Switzerland

Dear Sir:

Please send me,

World inflation and the development process (TD/B/914), and
Basic data on the least developed countries (TD/B/AC21/10). Please bill
me at the time of delivery.


Yours sincerely,

Bela Balassa

OFFICE MEMORANDUM

DATE: January 7, 1983

TO: Mr. Eugenio Lari, LCl

FROM: Bela Balassa, DRD 

EXTENSION: 61007

SUBJECT: Back-to-Office Report: Mexico, January 2-4

1. At the invitation of the Colegio Nacional de Economistas, I went to Mexico City to give a talk on "Trade Policy in Mexico." On the same occasion, Irving Baskind spoke on "The Emerging Structure of Mexican Industry." The lectures were well-attended, with about 500 people in the audience, and were followed by a debate in which four designated commentators participated.
2. In my presentation, I emphasized the interdependence of macroeconomic and trade policies and examined possible future directions in these policies. They are discussed in Part IV and in the Concluding Remarks of the enclosed paper (The policy discussion was greatly expanded as compared to the earlier version of the paper; I would appreciate receiving comments for the final revision that would have to be completed by January 20th).
3. As noted in the paper, the new government made important steps in reducing macroeconomic disequilibria. But much remains to be done, in particular in lowering public expenditures and subsidies and increasing the prices of public goods and services. These changes would need to be made at an early date, so as to minimize the danger that political opposition were to thwart the reform efforts.
4. It would further be desirable to reach an early agreement on a program of trade liberalization, in order to prepare firms for the reduction of protection. At the same time, one should guard against excessive intervention at the firm level that would occur if the plans of some otherwise well-intentioned technocrats regarding industry policy were to materialize.

cc: Messrs. Ardito-Barletta, LCNVP; van der Meer, LCP; Glaessner, LCP;
Ray, LCP; Cook, LCP; Baskind, LCP;
Lari, LCl; Dutt, LCl; Varallyay, LCl;
Pfeffermann, LCNVP; Landau, LCNVP; Pastor, LCl; Ozkan, LCl.
ERS Directors, DRD Senior Staff, CPD Senior Staff

Enclosure
BBalassa:nc

Those listed

January 7, 1983.

Bela Balassa, DRD

Exports, Policy Choices and Economic Growth in
Developing Countries, After the 1973 Oil Shock

Your comments and suggestions on the above paper would be appreciated.

cc: Mrs. Krueger; Messrs. Chenery, Waide, Kavalsky, Wright, Landell-Mills
Messrs. Feder, Michalopoulos, Sussangkarn, Syrquin
Messrs. Agarwala, Gelb, Mitra, Choksi, Dervis

Enclosure
BBalassa:nc

2134 Wyoming Avenue N.W.
Washington, D.C. 20008
January 6, 1983

Ms. Fekete Ilona
Kultura
Hungarian Foreign Trading Company
Budapest, 1., Fo u. 32
Hungary

Dear Madam:

Your bill has not been adjusted for the credit I should have received for stopping in the middle of last year. Please send me a revised bill adjusting for this credit.

Yours sincerely,

Bela Balassa

2134 Wyoming Avenue N.W.
Washington, D.C. 20008
January 6, 1983.

Ms. Fekete Ilona
Kultura
Hungarian Foreign Trading Company
Budapest, l., Fo u. 32
Hungary

Dear Madam:

Your bill has not been adjusted for the credit I should have received for stopping Világgazdaság in the middle of last year. Please send me a revised bill adjusting for this credit.

Yours sincerely,

Bela Balassa

Mr. Goddard Winterbottom, PUB

January 6, 1983.

E. Stoutjesdijk, DRD

Reprints

I recommend the following papers for inclusion in the World Bank Reprint Series.

1. Kemal Dervis, Jaime de Melo and Sherman Robinson, "A General Equilibrium Analysis of Foreign Exchange Shortages in a Developing Economy" The Economic Journal, December 1981.
2. Jaime de Melo and Sherman Robinson, "Trade Adjustment Policies and Income Distribution in Three Archetype Developing Economies" Journal of Development Economies, 1982.
3. J. B. Knight and R. H. Sabot, "Labor Market Discrimination in a Poor Urban Economy" Journal of Development Studies, October 1982.

Enclosures
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1 1 61007

H. W. ARNDT, AUSTRALIAN NATIONAL UNIVERSITY
POST OFFICE BOX 4, CANBERRA ACT 2600 AUSTRALIA
WILL BE HAPPY FOR MY PAPER ON FRANCE PUBLISHED IN QUADRANT. TWO
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1/6/83

Bela Balassa

Bela Balassa

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DRD - Director's Office

2134 Wyoming Avenue N.W.
Washington, D.C. 20008
January 6, 1983

Mr. Robert S. Lefko
Vice President
Pergamon Press Inc.
Maxwell House
Fairview Park
Elmsford, New York 10523

Dear Mr. Lefko:

I enclose information for Form 1099 as you have requested. Please let me know by return mail the amount that was paid to me last year.

Yours sincerely,

Enclosure

Bela Balassa

Mrs. Ann Davis, ADM

January 3, 1982.

Norma Campbell DRD

Discussion Papers

Discussion Papers 41 and 42 are being sent to the Print Shop today.

:nc