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Fonds: Records of the Office of the Chief Economist

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Bela Balassa's chron files - July 1982

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B. BALASSA CHRON FILE JUL 1982



## OFFICE MEMORANDUM

TO: Files

FROM: Bela Balassa, DRD

SUBJECT: Hungarian Contacts

DATE: July 27, 1982

On the occasion of Hungary becoming a member of the Bank, several people have inquired about my professional contacts in Hungary. In this connection, the following information may be of interest.

1. I have frequently been invited to lecture in Hungary on developing country policies and on the Hungarian economic reform. The latest invitation came from Mr. Bela Csikós-Nagy, the President of the Hungarian Price and Material Board. Csikós-Nagy originally asked me to discuss my work on external shocks and policy responses to these shocks in developing countries, the methodology of which he wishes to apply to the Hungarian economy. He has subsequently broadened the subject to policies of import substitution and export promotion, with application to Hungary. It had been planned that I give a seminar on the subject to a high-level audience in Budapest in late August; with my leading an industrial policy mission to Morocco the date has been postponed to December.
2. My "Adjustment Policies in Developing Countries" (World Development, January 1982) will serve as a basis for the seminar and will be published in Hungarian in the next issue of Gazdaság (Economy), the Hungarian monthly on economic policy. Gazdaság earlier published the Hungarian translation of my "The Changing International Division of Labor in Manufactured Goods" (Banca Nazionale del Lavoro, Quarterly Review, September 1979). Among my papers on the Hungarian economy, "The Economic Reform in Hungary Ten Years After" (European Economic Review, November 1978) was published in Hungarian translation in Valóság (Reality), the leading Hungarian periodical dealing with public policy issues. My "Reforming the New Economic Mechanism in Hungary" will appear in Hungarian in Kozgazdasagi Szemle (Economic Review), the official journal of the Hungarian Economic Association; it will be published in English in the Journal of Comparative Economics early next year.
3. I presented the last mentioned paper at the Institute of Economics of the Academy of Sciences in Budapest, at the meetings of the American Economic Association in Washington, as well as at the Bloomington Conference on the Hungarian Economy, which was attended by fifteen economists from Hungary. The enclosed excerpts of a report on the Conference, published in Magyar Nemzet (Hungarian Nation), a Hungarian daily, provides a short analysis of my paper. It was written by Gyorgy Ranki, the best-known Hungarian modern economic historian.
4. I further enclose the English translation of a letter received from Lajos Faluvégi, Deputy Prime Minister and President of the Hungarian Planning Office, commenting on my recent book. I have known Faluvégi for fourteen years and have regularly seen him on my visits to Hungary, first as Minister of Finance and subsequently as President of the Planning Office. While Faluvégi was not able to receive the Bank mission last month, future contacts

with him would be desirable, given the prominent place he occupies among reform-minded government officials in Hungary.

cc: Chaufournier, EMNVP; Karaosmanoglu, EMI; Picciotto, EMP; Hume, EMI;  
Dubey, EMNVP; Colaco, EMI; Mrs. Denton, EMI;  
ERS Directors, DRD Senior Staff

Enclosures  
BBalassa:nc

Excerpts from Gyorgy Ranki, "Two Conferences in Bloomington,"  
published in the Magyar Nemzet (Hungarian Nation) in May 1982

"Bela Balassa, professor at the Johns Hopkins University and a senior consultant at the World Bank, has provided a profound analysis of Hungarian economic developments since 1968. He has indicated that the difficulties experienced after the mid-seventies find their origin in part in the lack of consistent application of the reforms and in part in the combination of new world economic events. In analyzing the recently introduced policy measures, he has reached the conclusion that a price reform without a coherent wage reform cannot bring the expected results, just as we cannot overcome our difficulties if we do not establish a closer link between wages and labor productivity. Balassa sees the weakness of Hungarian industry in three factors: the lack of suitable small enterprises, the inadequacies of the so-called background industry, and excessive centralization."

"The great merit of Balassa's presentation has been that he not only sees the problems of the Hungarian economy from the inside but also situates it in the framework of the economic problems of countries at similar levels of development. In such a framework, one can better evaluate the achievements and indicate the further requirements of the reform, not the least the need to overcome the still existing lack of consistency."



Unofficial translation.

Mr. Béla B a l a s s a

Budapest, 16<sup>th</sup> 6. 1982

World Bank  
Development Research Center  
Washington D.C. 20433

Dear Mr. Balassa,

I consider it as an honour that you have made available one copy of your study "Development Strategies in Semi-industrial Economies" for me.

The economic incentives being conform to GATT regulations play a very important role in our economic regulation system.

Owing to the extremely rapid changes in world economy our regulators must be defined in such a way and character that economy could adjust to the new conditions at a proper pace.

Your study contains precious analyses among others about the effect of the incentive system on foreign trade and economic growth. A detailed study of the volume must provide us with interesting angels considering the scientific evaluation and further development of our economic regulators.

I sincerely wish you much success in your later work.

Yours sincerely

Faluvégi Lajos



Mr. James K. Feather, PUB

July 30, 1982

E. Stoutjesdijk, DRD

Submission to Reprint Series

I wish to submit the following papers to the World Bank Reprint Series. Paper No. 1 had been submitted earlier and supplementary information has been requested. For papers Nos. 2 to 9 the required 15 copies are enclosed.

1. Balassa, Bela, "Shifting Patterns of World Trade and Competition," Growth and Entrepreneurship: Opportunities and Challenges in a Changing World, Paris, International Chamber of Commerce, 1981.
2. \_\_\_\_\_, "Economic Reform in China," Banca Nazionale del Lavoro, Quarterly Review, September 1982.
3. Feder, Gershon, "On Exports and Economic Growth," Journal of Development Economics, forthcoming.
4. \_\_\_\_\_, "On the Relation between Origin Income and Migration," Annals of Regional Science, 1982.
5. Jamison, Dean T., "Reduced Class Size and Other Alternatives for Improving Schools: An Economist's View," School Class Research and Policy, (Gene V. Glass, Leonard S. Cahen, Mary Lee Smith and Nikola Filby eds.) Sage Publications, 1982.
6. King, Timothy "Population Growth, International Resource Transfers, and International Migration," Proceedings of the International Union for the Scientific Study of Population, International Population Conference, Manila, 1981.
7. Newbery, David, and Joseph E. Stiglitz, "Optimal Commodity Stock-Piling Rules," Oxford Economic Papers, November 1982.
8. Nishimizu, Mieko and John M. Page, Jr. "Total Factor Productivity Growth, Technological Progress and Technical Efficiency Change: Dimensions of Productivity Change in Yugoslavia, 1965-78," The Economic Journal, December 1982.
9. Pleskovic, Boris, and Marjan Dolenc, "Regional Development in a Socialist, Developing and Multinational Country: The Case of Yugoslavia," International Regional Science Review, 1982.

cc: DRD SeniorStaff

Enclosures  
BBalassa:nc



Mrs. Christine Wallich, VPD

July 30, 1982

E. Stoutjesdijk, DRD

Research Proposals to be Submitted in FY83

1. In response to your request dated June 23rd, I enclose statements prepared on the research plans of individual units within DRD. It should be understood that these statements are highly tentative. Their budgetary effects for FY83 is summarized below (in thousand dollars):

	<u>Probable</u>	<u>Possible</u>	<u>Total</u>
<u>Analytical Support Unit</u>			
GAMS, 671-58, supplementary	20	-	20
Indian Fertilizer Model, 672-22, supplementary	20	-	20
GAMS, 671-58 phase III	-	30	30
GAMS conversion project (Exxon)	-	35	35
	<u>40</u>	<u>65</u>	<u>105</u>
<u>Development Strategy Division</u>			
Research on China, new proposal	50	20	70
Stabilization Regimes and Development Strategies in Egypt, new proposal	15	-	15
Structuralist Models of Inflation, new proposal	20	-	20
	<u>85</u>	<u>20</u>	<u>105</u>
<u>Public Economics Division</u>			
Analysis of the World Market for Petroleum, new proposal	30	10	40
Energy Demand in LDCs, new proposal	16	-	16
Public Finance Book, new proposal	27	-	27
Cross-Country Analysis of Tax Regimes, new proposal	30	10	30
	<u>95</u>	<u>20</u>	<u>113</u>
<u>Productivity Division</u>			
Human Capital Accumulation and Development, 672-01, phase II	50	-	30
	<u>50</u>		<u>50</u>
<u>Employment and Income Distribution Division</u>			
Household Welfare and Consumption in Ivory Coast, new proposal	30	-	30
Women and the Subsistence Sector, new proposal	15	-	15
	<u>45</u>		<u>45</u>
Grand Total	313	105	418

2. It is apparent that the total is quite small compared to previous years. An important factor limiting project preparation work in the latter half of FY82 was the reorganization and the uncertainty associated with it.

cc: Messrs. Chenery, Duloy,; Mrs. Krueger, VPD;  
DRD Senior Staff

BBalassa:nc



Mr. Goddard Winterbottom, PUB

July 30, 1982.

Bela Balassa, DRD

Working Paper

The enclosed paper, "Women and the Subsistence Sector; Economic Participation and Household Decision-Making in Nepal" by Meena Acharya and Lynn Bennett is for your consideration for inclusion in the Working Paper Series. Please inform us of your decision concerning the paper.

cc: Messrs. Stoutjesdijk, Pyatt, T. King, DRD

Enclosure  
BBalassa:nc



# OFFICE MEMORANDUM

TO: Mr. James K. Feather, PUB

FROM: E. Stoutjesdijk, DRD *MS*

SUBJECT: Submission to Reprint Series

DATE: July 30, 1982

I wish to submit the following papers to the World Bank Reprint Series. Paper No. 1 had been submitted earlier and supplementary information has been requested. For papers Nos. 2 to 9 the required 15 copies are enclosed.

1. Balassa, Bela, "Shifting Patterns of World Trade and Competition," Growth and Entrepreneurship: Opportunities and Challenges in a Changing World, Paris, International Chamber of Commerce, 1981.
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7. Newbery, David, and Joseph E. Stiglitz, "Optimal Commodity Stock-Piling Rules," Oxford Economic Papers, November 1982.
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9. Pleskovic, Boris, and Marjan Dolenc, "Regional Development in a Socialist, Developing and Multinational Country: The Case of Yugoslavia," International Regional Science Review, 1982.

cc: DRD SeniorStaff

Enclosures  
BBalassa:nc

## OFFICE MEMORANDUM

TO: Distribution

FROM: Bela Balassa, DRD and Rene Bonnel, EMENA, CPIIB

SUBJECT: MOROCCO: Industrial Incentives and Export Promotion  
Issues Paper

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DATE: July 29, 1982

### Objective

1. The Industrial Incentives and Export Promotion mission is scheduled to arrive in Morocco on August 30 for a period of two to three weeks. This paper outlines the scope of the mission and the main issues to be covered. The principal objective of the mission is to make recommendations for reforming the system of industrial incentives and export promotion, so as to improve the efficiency of the industrialization process and to increase its contribution to the overall objectives of Morocco's industrialization strategy.
2. In carrying out its task, the mission will review the system of import protection, the export promotion scheme, the application of price control, the industrial investment code, the financing of industry, as well as the system of taxation, and it will make recommendations for their reform. The mission will also analyze prospective markets for Morocco's manufactured exports and the impact of the future adhesion of Portugal and Spain to the EEC.

### Industrial Development Strategy and the System of Incentives in Morocco

3. The stated objectives of Morocco's industrial development strategy include (i) increasing productivity growth; (ii) earning foreign exchange through exports and ensuring efficient import-substitution; (iii) generating rapid growth in employment; and (iv) stimulating balanced regional development. To achieve these goals, Morocco relies on direct interventions through the public sector and indirect interventions through the system of incentives.
4. Among industrial incentives, import protection takes the form of customs duties, special import taxes, and quantitative import restrictions. Export promotion measures have been introduced to partially offset the negative impact of protection on manufacturing costs; they consist of preferential access to bank credit at reduced interest rates, duty and tax exemptions (rebates) on material inputs and machinery, tax exemptions on profits derived from exports, foreign exchange allocation, and institutional measures. Since protection often generates economic rents for industrial producers, the Government applies a policy of fixing industrial prices on a cost-plus basis. In turn, industrial investment incentives include duty and tax exemptions on imported capital goods, a 2% interest rate rebate, income tax exemptions, and employment subsidies, the level of which varies regionally. For projects below DH 100 million (about \$17 million), the incentives are granted automatically; for larger projects, they are subject to negotiations. Incentives to industry are further affected by the system of industrial finance and taxation. Overall, the incentive system is extremely complex and its net effects are not known with any confidence.



5. The Basic Economic Report (1979) and the ensuing policy dialogue with the Government have highlighted the fact that the objectives of industrial development strategy are met only partially. Despite rapid increases in investment in 1972-77, value-added and employment in industry have risen relatively slowly. At the same time, emphasis was put on large capital-intensive projects for import substitution, in particular in cement, sugar and petroleum refining, leading to a rapid rise in the imports of capital goods and intermediate products. Furthermore, with the exception of traditional exports, such as textiles, carpets and leather goods, and phosphate-based products, industrial exports have not developed to an appreciable extent and the overall contribution of the industrial sector to Morocco's trade balance has been disappointing.

6. In recent years, the persistence of large budgetary and current account deficits have made it necessary for Morocco to implement a stabilization program, involving reductions in public investment, in imports, and in external borrowing. As a result, the principal factors behind the 1972-77 surge in economic activity have disappeared, and the rate of economic growth has declined to a considerable extent (from 6.5% a year in 1972-77 to 3.8% in 1977-80).

7. The Government is now faced with the problem of how to revive economic growth in a way consistent with a manageable current account deficit. Because of the shortage of public funds, its capacity to undertake large industrial investments has greatly declined and reliance on private investment -- domestic as well as foreign -- to sustain industrial growth has become crucial. For private investment to take place, and to generate the foreign exchange earnings necessary to finance the ambitious 1981-85 Development Plan, the Government realizes that its industrial development strategy would have to be modified.

#### Background and Scope of the Mission

8. The 1981-85 Development Plan aims at improving the situation by (i) increasing public investment in natural resource-based export-oriented sectors (mining, phosphates and phosphoric acid); (ii) raising the share of Government investment allocated to agriculture so as to increase production and exports and to provide processing industries with the required inputs (fish, leather and food products); and (iii) reforming the system of incentives. The 1981-85 public sector investment program was reviewed by the Bank for the forthcoming Plan Review report. The proposed Industrial Incentives and Export Promotion mission will thus focus primarily on the reform of incentives, government policies and institutions, and their efficiency in meeting the objectives of Morocco's industrial development strategy.

9. Since 1979, the Government and the Bank have been involved in a joint research project designed to estimate (i) incentive indicators (nominal protection, effective protection and effective subsidy); and (ii) cost-benefit indicators (domestic resource costs and economic rates of return), utilizing a methodology developed at the Bank. The study is based on firm level data for four industrial sectors (textiles, engineering and mechanical industries, chemicals and agro-industries). As this project is expected to be completed by mid-August, the mission will be able to draw on the considerable body of



data and results already generated by the Bank consultant (in Morocco) and the Moroccan team assigned to this project within the Ministry of Industry, Commerce, and Tourism.

10. The mission will utilize the findings of the research project to review the net effects of the various incentives granted to different sectors through protection, export subsidies, price control, and credit and tax measures and to examine Morocco's comparative advantage in industry. It will further make recommendations for improving the industrial incentives system and its effectiveness in meeting the overall objectives of Morocco's industrialization development strategy. The recommendations will cover the system of import protection, the export promotion scheme, price control, the industrial investment code, the financing of industry, and the system of taxation. The mission will also review marketing prospects for Morocco's exports of manufactured products and the impact of the EEC (trade arrangements with Morocco, the admission of Greece, and the future entry of Portugal and Spain).

#### Industrial Development and Protection -- The Issues

11. The development of the industrial sector has proceeded behind protection provided in the form of customs duties, the special import tax, and quantitative import restrictions. The present system of tariff protection was introduced to grant increasing rates of protection according to the degree of processing, in replacement of the system in existence until 1957 that consisted of a uniform tariff rate (12.5%) on all commodities. In 1960, the Government introduced an industrial investment code, subsequently revised in 1973 and in 1982, under which duty exemptions have been provided on the importation of capital goods. Inputs used in export production also enjoy duty exemptions (rebates). In turn, a special import tax was introduced in 1973 and its rate gradually raised from 5% in 1973 to 15% in 1979. Finally, increased use has been made of quantitative import restrictions.

12. The structure of import protection that has developed over time does not reflect a rational pattern and Morocco's industrial development strategy is faced with the usual contradictions implicit in import-substitution policies. As was highlighted by the 1975 industrial survey, the substitution process appears to have gone as far as it can in the consumer goods sector, while extension of import-substitution to intermediate or capital goods industries is not financially profitable for private entrepreneurs due to negative or low effective protection.

13. The main issues to be investigated in regard to import protection are

- (i) the desirable average rate of effective protection in the manufacturing sector;
- (ii) an appropriate structure of tariffs;
- (iii) the procedures used in providing protection;
- (iv) the rationalization of quantitative import restrictions;



- (v) the possible impact of the reform of the protection system on industrial sub-sectors and on budgetary revenues;
- (vi) the promotion of "backward" integration in the manufacturing sector; and,
- (vii) the stimulation of the development of engineering industries.

13. These issues will be examined by the mission by drawing on the results of the research project on industrial incentives, which will provide a detailed analysis (at the firm level and by sub-sectors) of the level and structure of import protection in the manufacturing sector. Furthermore, comparisons of domestic resource costs (DRC's) and economic rates of return at sub-sectoral and sectoral levels will provide a first indication of the comparative advantages of Morocco's manufacturing sector. An attempt will further be made to indicate the relative importance of technical inefficiency, market size, and inappropriate factor intensity (capital-labor ratio) in explaining the pattern of domestic resource costs.

14. The following issues pertaining to comparative advantage in the manufacturing sector will be investigated:

- (i) the relationship between the level of incentives and Morocco's comparative advantage;
- (ii) the relationship between capital intensity, employment and the structure of incentives; and
- (iii) the relationship between private and economic profitability in manufacturing;
- (iv) possible measures that may be used to improve the efficiency of the industrialization process on a sectoral or sub-sectoral basis.

#### Export Promotion

15. Reliance on export expansion to generate the foreign exchange necessary for attaining a high rate of economic growth has been an important feature of every Development Plan since 1972. However, actual exports have fallen considerably short of the targets. In 1973-77, exports of goods and non-factor services grew by only 0.6% a year in real terms compared to a Plan target of 10%; in 1978-80, the actual growth rate was 2.6% compared to the Plan objective of 6.6%. Judging from past experience, the 1981-85 Development Plan's objective of a 7.5% annual growth rate for exports appears unlikely to be achieved unless substantial changes are made in the present system of incentives. At the same time, Bank reports have consistently stated that potential long-term growth prospects for Morocco's exports are quite favorable.

16. In 1981, the two largest sources of export earnings, exclusive of services, were agricultural products (31.1% of merchandise exports) and phosphate rock (31.2%). In the case of agricultural exports, growth has been quite slow in the past, in part because of the stagnation of production since



1971. The system of incentives in agriculture involves a complex system of intervention by the Government at the production level (in irrigated areas) and at the marketing level (through OCE which controls exports of primary and processed agricultural products). In the case of phosphate exports, the report prepared by IPD for the 1982 Plan Review Mission emphasized the importance of the investment and pricing strategy of OCP. The mission will focus on the promotion of manufactured exports other than processed agricultural and phosphate-based products but will also draw on existing information concerning the latter two categories of products.

17. Between 1967 and 1980, Morocco's manufactured exports rose at an average annual rate of 9.3 percent in real terms, below the average rate of increase of 13 percent for all developing countries. At the same time, growth was largely limited to a few traditional industries processing mainly local natural resources (textiles, clothing, carpets, leather products), where Morocco enjoyed the advantages of low wages and preferential access to the Common Market, and phosphate-based products (phosphoric acid and fertilizers). With insufficient incentives due to low effective protection of exports and the overvaluation of the exchange rate, the contribution of non-traditional industries has remained small, although exports of transport equipment, electronics and electrical machinery, rubber and plastic manufactures have begun in recent years.

18. While the exports of phosphate rock and phosphate-based products could grow in the eighties at a rate close to that achieved in 1967-80 (5.3% a year in real terms), exports of agricultural products are likely to increase at a very slow rate, if at all. In 1979, the EEC accounted for 74% of Morocco's food exports, and according to current estimates, a substantial part of these exports would be replaced by products from Greece, Portugal, and Spain.

19. If total export earnings are to grow at a faster rate, Morocco will have to expand its exports of manufactured goods, including non-traditional products. In order to assist Morocco in this effort, the mission will make recommendations for improving the export promotion effort.

20. The recommendations for improving the system of incentives to exports will draw on the results of the research project on industrial incentives. The mission will review and discuss with the Government the overall issue of the level of incentives granted to exports, including the effects of the present exchange rate. Policy recommendations will focus on specific incentives to exports and on the fiscal cost of possible alternatives. This will involve

- (i) examining the extent of the anti-export bias in the present system of incentives;
- (ii) making recommendations for reducing this bias; and
- (iii) analyzing the measures that may be used for this purpose.

21. At the institutional level, the mission will review progress made by the Government in improving administrative procedures for exporters, including

- (i) foreign exchange regulations affecting exports;
- (ii) the administration of duty exemptions and rebates;
- (iii) the administration of the export credit and export insurance schemes (see also the financing of industry);
- (iv) the role and functions of the Export Promotion Center; and
- (v) the creation of an agency responsible for establishing standards and promoting quality control.

#### Price Control

22. Price control has been used in Morocco to appropriate some of the profits generated by protection and to limit price increases. The mission will update earlier work on price control by the Bank, focusing on the following issues:

- (i) the scope of price control;
- (ii) the methods used in setting prices;
- (iii) the need for price liberalization; and
- (iv) the possible effects of the freeing of prices on individual sectors and on the rate of inflation.

#### The System of Investment Incentives

23. Morocco has relied on investment codes to promote investment in various branches of the economy. Although this policy may have led to increases in the rate of return to capital, the results obtained have not been up to expectations. According to the limited data available, the policy has probably been responsible for the rise in the capital-labor ratio, and the expected surge in foreign investment has not materialized. The Government has recently revised the industrial investment code and it is presently engaged in the revision of some of the other codes.

24. Specific issues addressed by the mission in regard to investment incentives will include

- (i) the administrative complexity of the investment codes;
- (ii) the harmonization of incentives provided by the various codes and their relationship with the overall reform of industrial incentives; and
- (iii) the probable effects of the new industrial investment code on foreign investment, exports, the choice of technique, location, and the domestic capital goods industry.



### The Financing of Industry

25. The use of quantitative controls on domestic credit, which have been the main instrument for controlling the money supply since 1976, and the large domestic borrowings of the Treasury have led to a fall in the share in total domestic credit of productive enterprises, in particular in the private sector. This raises the following questions the mission will address:

- (i) the implications of credit controls for the financing of investment, and
- (ii) the preference given to public enterprises over private firms in granting credit.

26. During the seventies, interest rates have played a minor role in allocating credit among borrowers as they were kept at relatively low levels and the Government relied on other means to achieve financial objectives. Since 1977, interest rates have been regularly raised, so that their average levels approximately equals the rate of inflation. However, the structure of interest rates may not correspond to that which would emerge if existing controls were removed. The mission will examine

- (i) the relative role of interest rates and other criteria in rationing available credit among borrowers; and
- (ii) the desirable rate structure.

27. Traditionally, selectivity of credit in Morocco has been assured by the creation of lending institutions specialized by sector. In recent years, this policy has been generalized by creating special lending facilities that provide preferential access to credit at subsidized interest rates. At present, these facilities cover projects benefiting from investment codes, investment projects for exports, specific activities (tourism, shipping, etc.), specific investors (small and medium scale firms, handicrafts), and specific types of credit (rediscountable medium-term credit).

28. In view of the increasing complexity of the system of credit, and the reduced competition between the financial institutions it implies, the efficiency of this highly selective approach to credit policy needs to be assessed. Also, one needs to examine the access to credit by firms which are not covered by preferential schemes and the possible ways to improve the mobilization of financial resources for productive investment. The relevant issues include

- (i) the system of financial intermediation and the extent of competition between banks and financial institutions,
- (ii) the system of selective credits;
- (iii) the extent of subsidies to certain types of credit;
- (iv) the system of export credit, export insurance, and insurance against exchange rate fluctuations; and



- (v) the dependence on automatic rediscounting by the Central Bank for certain types of credit.

### The System of Taxation

29. Since 1976, budget deficits have remained at a high level, and the Government has raised in successive stages the rate of the special import tax in order to increase revenues. While the recommendations of the mission will have budgetary implications, they should not lead to an increased deficit that would be contrary to the objectives of the current stand-by agreement between Morocco and the IMF. Thus, to the extent that the recommendations involve additional Government expenditures or loss of revenue, offsetting sources of tax revenue will need to be identified.

30. The Moroccan tax system was extensively studied by the IMF in 1978, and the IMF has recently reviewed proposals for tax reform. The mission will consider alternative ways to offset the budgetary impact of the proposed reform of industrial incentives and export promotion in the framework of the IMF recommendations and in close cooperation with the IMF. This raises the following issues:

- (i) the effects of the system of direct and indirect taxes on industry;
- (ii) the fiscal implications of additional incentives to exports;
- (iii) the impact of the proposed modifications in the structure of tariffs and quantitative import restrictions on government revenues; and
- (iv) alternative ways to offset the budgetary effects of the proposed incentive reforms.

### Staffing and Timing

31. Formal Government approval for the Industrial Incentives and Export Promotion mission has been obtained. In view of the long involvement of the Ministry of Industry, Commerce and Tourism in the joint research project on industrial incentives with the Bank, we have proposed to the Ministry that the Moroccan team involved in the research project joins the mission. This has been accepted by the Government in June. The role of this team will be determined subsequently.

32. The mission would include a mission chief (Mr. Balassa), a deputy mission chief (Mr. Bonnel), a general economist, the Bank consultant assigned to the research project in Morocco, a consultant who will be responsible for the study of industrial finance, and a Moroccan team consisting of two or three people

33. The schedule for report processing is as follows:

White Cover Report	December 1, 1982
Yellow Cover Report	January 10, 1982
Review Meeting	January 20, 1982
Green Cover Report	February 15, 1982
Discussions with Govt.	March 21, 1982

Distribution:

Messrs. Chaufournier, Bart, Picciotto, Carmignani

Messrs. Dubey (2), Khalilzadeh-Shirazi, Fitchett (EMNVP); Afour, Bonnel, de Merode, Prasad (EM2); Elwan, Zaidan, Ettori (EMP); van der Tak (OPS); Kohli (IPD); Tolbert (IDF); Robless (2) (PAB); Richardson, Blondel (IFC); Francois, Tahari, Happe (IMF)

Ms. Ruggeri, Guerard, Hees, Nowicki (EM2)  
EMENA files

BBalassa:nc



# MOROCCO: INDUSTRIAL INCENTIVES AND EXPORT PROMOTION

## PART I

### INCENTIVES AND COMPARATIVE ADVANTAGE

#### Chapter 1. The Structure of Incentives in Manufacturing Industries

1. The Structure of Nominal Protection (product protection)
2. The Structure of Effective Protection (joint effects of protective measures on inputs and outputs)
3. The Structure of Effective Subsidies (joint effects of protective, tax, and credit measures)
4. The Bias Against Exports
5. Comparison with Primary Activities

#### Chapter 2. Comparative Advantage in Manufacturing Industries

1. The Measurement of Comparative Advantage (domestic resource cost of foreign exchange and economic rates of return)
2. Comparison of Incentives and Comparative Advantage (effective rates and domestic resource cost measure, private and social profitability)
3. Relationships between Comparative Advantage, Capital Productivity and Labor Productivity
4. Comparisons with Primary Activities

## PART II

### INDUSTRIAL DEVELOPMENT AND POLICY RECOMMENDATIONS .

#### Chapter 3. Industrial Development and Exports

1. The Place of Manufacturing in the National Economy (value added, employment, investment, exports, and imports)
2. The Structure and Development of Manufacturing Industries (sectoral composition, public and private industry, employment, investment, capital and labor productivity, capacity utilization)
3. The Structure and Development of Manufactured Exports (export growth and composition, relationship between exports and industrial production, the contribution of exports and imports to output growth)

#### Chapter 4. The Development of the System of Production Incentives

1. The Exchange Rate Regime (nominal and real exchange rates)
2. The System of Import Protection
  - A. Tariffs and tariff-type measures
  - B. Quantitative import restrictions
  - C. Price Control
3. The Export Promotion Scheme
  - A. Foreign exchange regulations
  - B. Duty exemptions and rebates
  - C. Income tax benefits
  - D. Export Promotion Center
  - E. Standards and Quality Control



Chapter 5. Development of the System of Taxation and Investment Incentives

1. The System of Income Taxes (personal and corporate income taxes)
2. The Incidence of Indirect Taxes (sales vs. value added taxes)
3. The Industrial Investment Code (changes over time, effects on foreign investment, exports, the choice of techniques, location, and the development of the domestic capital goods industry)
4. Comparisons with Other Investment Codes

Chapter 6. The Development of Industrial Finance

1. The Role of Financial Intermediaries
  - A. Commercial banks
  - B. Investment banks
  - C. Securities market
2. The Role of Interest Rates
  - A. Interest rates to savers
  - B. Interest rates to borrowers
  - C. Cost of intermediation
3. Credit Rationing and Preferences
  - A. Quantitative controls on credit
  - B. System of selective credits
  - C. Export credit and export insurance

1 1 61007

MEHMET GUN CALIKA, MEBAN SECURITIES BROKERAGE  
ODAKULE IS MERKEZI ISTIKLAL CADDESİ, 286 BEYOGLU, ISTANBUL, TURKEY  
FINAL TITLE OF PAPER IS QUOTE OUTWARD ORIENTATION AND EXCHANGE RATE  
POLICY IN DEVELOPING COUNTRIES AND THE TURKISH EXPERIENCE UNQUOTE.  
PLEASE CONFIRM THAT RESERVATIONS HAVE BEEN MADE FOR ME AT THE  
ISTANBUL SHERATON HOTEL FOR AUGUST 5 AND 6. REGARDS, BALASSA

CABLE

7/29/82

Bela Balassa

Bela Balassa

DRD - Director's Office

BBalassa:nc



Mr. Kanella C. Vasiliades, EDI

July 28, 1982.

Bela Balassa, DRD

Industrial Development Course

In response to your request, I enclose a short outline of my lecture on "Industrial and Trade Policies" scheduled for the morning of November 4th. I further enclose a copy of my current curriculum vitae.

Enclosures  
BBalassa:nc

Synopsis of Lecture on

"Industrial and Trade Policies" on November 4, 1982

The subject matter of the lecture ~~on~~ the process of industrial development and industrial development strategies. It will cover the determinants of early industrial development, the first stage of import substitution, the principal characteristics and results of inward-oriented and outward-oriented industrial development strategies, and the responses of the newly-industrializing developing countries to the external shocks suffered after 1973. Finally, future policies will be discussed, with consideration given to the prospects for world trade in manufactured goods.



Mr. Basil Kavalsky, CEP

July 28, 1982.

Bela Balassa, DRD

This Year's Issue

I agree that managing aggregate demand in developing countries is an important issue that would require attention on the part of the Bank. I also repeatedly observed a ratchet effect with countries, with increases in expenditures in good years and a failure to reduce them afterwards. I would be glad to participate in any discussions on this issue.

cc? International Economy Steering Group; Mr. Waide

BBalassa:nc

International Economy Steering Group - Baneth, Colaco, Pfeffermann, Holsen,  
Ikram, Moe, Duloy, Wallich, and Waide

Mr. Rene Bonnel, EM2

July 29, 1982.

Bela Balassa, DRD

Morocco Mission

Please read, sign and distribute the enclosed memo. Also send copies to Messrs. Horton and Silva Lopes.

Enclosure  
BBalassa:nc



Mr. Basil Kavalsky, CPD

July 29, 1982

Bela Balassa, DRD

Seminar on Economic Reforms

1. As a follow-up to our conversation, I would like to ask you to organize a Bank-wide seminar on the topic: "Socialist Economic Reforms Compared: China and Hungary." I would suggest to schedule the seminar for the second half of September, after the Annual Meetings and before those working on China and Hungary leave for missions (I am myself returning from mission on September 13th and am available on any days other than Tuesdays and Wednesdays).
2. In the announcement, you may wish to list two background papers for the seminar: "Reforming the New Economic Mechanism in Hungary" and "Economic Reform in China" both of which are available from my office. Furthermore, an overview of the development of the Hungarian reforms is provided in my "The Hungarian Economic Reform, 1968-81," World Bank Staff Working Paper No. 506, February 1982.
3. In order to emphasize the operational relevance of the topic, it would be desirable to have the seminar in the main building complex. I presume that one would need to reserve a room that would accommodate the expected audience quite early.

BBalassa:nc



## OFFICE MEMORANDUM

TO: Distribution

FROM: Bela Balassa, DRD and Rene Bonnel, EMENA, CPIIB

SUBJECT: MOROCCO: Industrial Incentives and Export Promotion  
Issues Paper

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DATE: July 29, 1982

Objective

1. The Industrial Incentives and Export Promotion mission is scheduled to arrive in Morocco on August 30 for a period of two to three weeks. This paper outlines the scope of the mission and the main issues to be covered. The principal objective of the mission is to make recommendations for reforming the system of industrial incentives and export promotion, so as to improve the efficiency of the industrialization process and to increase its contribution to the overall objectives of Morocco's industrialization strategy.
2. In carrying out its task, the mission will review the system of import protection, the export promotion scheme, the application of price control, the industrial investment code, the financing of industry, as well as the system of taxation, and it will make recommendations for their reform. The mission will also analyze prospective markets for Morocco's manufactured exports and the impact of the future adhesion of Portugal and Spain to the EEC.

Industrial Development Strategy and the System of Incentives in Morocco

3. The stated objectives of Morocco's industrial development strategy include (i) increasing productivity growth; (ii) earning foreign exchange through exports and ensuring efficient import-substitution; (iii) generating rapid growth in employment; and (iv) stimulating balanced regional development. To achieve these goals, Morocco relies on direct interventions through the public sector and indirect interventions through the system of incentives.
4. Among industrial incentives, import protection takes the form of customs duties, special import taxes, and quantitative import restrictions. Export promotion measures have been introduced to partially offset the negative impact of protection on manufacturing costs; they consist of preferential access to bank credit at reduced interest rates, duty and tax exemptions (rebates) on material inputs and machinery, tax exemptions on profits derived from exports, foreign exchange allocation, and institutional measures. Since protection often generates economic rents for industrial producers, the Government applies a policy of fixing industrial prices on a cost-plus basis. In turn, industrial investment incentives include duty and tax exemptions on imported capital goods, a 2% interest rate rebate, income tax exemptions, and employment subsidies, the level of which varies regionally. For projects below DH 100 million (about \$17 million), the incentives are granted automatically; for larger projects, they are subject to negotiations. Incentives to industry are further affected by the system of industrial finance and taxation. Overall, the incentive system is extremely complex and its net effects are not known with any confidence.



5. The Basic Economic Report (1979) and the ensuing policy dialogue with the Government have highlighted the fact that the objectives of industrial development strategy are met only partially. Despite rapid increases in investment in 1972-77, value-added and employment in industry have risen relatively slowly. At the same time, emphasis was put on large capital-intensive projects for import substitution, in particular in cement, sugar and petroleum refining, leading to a rapid rise in the imports of capital goods and intermediate products. Furthermore, with the exception of traditional exports, such as textiles, carpets and leather goods, and phosphate-based products, industrial exports have not developed to an appreciable extent and the overall contribution of the industrial sector to Morocco's trade balance has been disappointing.

6. In recent years, the persistence of large budgetary and current account deficits have made it necessary for Morocco to implement a stabilization program, involving reductions in public investment, in imports, and in external borrowing. As a result, the principal factors behind the 1972-77 surge in economic activity have disappeared, and the rate of economic growth has declined to a considerable extent (from 6.5% a year in 1972-77 to 3.8% in 1977-80).

7. The Government is now faced with the problem of how to revive economic growth in a way consistent with a manageable current account deficit. Because of the shortage of public funds, its capacity to undertake large industrial investments has greatly declined and reliance on private investment -- domestic as well as foreign -- to sustain industrial growth has become crucial. For private investment to take place, and to generate the foreign exchange earnings necessary to finance the ambitious 1981-85 Development Plan, the Government realizes that its industrial development strategy would have to be modified.

#### Background and Scope of the Mission

8. The 1981-85 Development Plan aims at improving the situation by (i) increasing public investment in natural resource-based export-oriented sectors (mining, phosphates and phosphoric acid); (ii) raising the share of Government investment allocated to agriculture so as to increase production and exports and to provide processing industries with the required inputs (fish, leather and food products); and (iii) reforming the system of incentives. The 1981-85 public sector investment program was reviewed by the Bank for the forthcoming Plan Review report. The proposed Industrial Incentives and Export Promotion mission will thus focus primarily on the reform of incentives, government policies and institutions, and their efficiency in meeting the objectives of Morocco's industrial development strategy.

9. Since 1979, the Government and the Bank have been involved in a joint research project designed to estimate (i) incentive indicators (nominal protection, effective protection and effective subsidy); and (ii) cost-benefit indicators (domestic resource costs and economic rates of return), utilizing a methodology developed at the Bank. The study is based on firm level data for four industrial sectors (textiles, engineering and mechanical industries, chemicals and agro-industries). As this project is expected to be completed by mid-August, the mission will be able to draw on the considerable body of



data and results already generated by the Bank consultant (in Morocco) and the Moroccan team assigned to this project within the Ministry of Industry, Commerce, and Tourism.

10. The mission will utilize the findings of the research project to review the net effects of the various incentives granted to different sectors through protection, export subsidies, price control, and credit and tax measures and to examine Morocco's comparative advantage in industry. It will further make recommendations for improving the industrial incentives system and its effectiveness in meeting the overall objectives of Morocco's industrialization development strategy. The recommendations will cover the system of import protection, the export promotion scheme, price control, the industrial investment code, the financing of industry, and the system of taxation. The mission will also review marketing prospects for Morocco's exports of manufactured products and the impact of the EEC (trade arrangements with Morocco, the admission of Greece, and the future entry of Portugal and Spain).

#### Industrial Development and Protection -- The Issues

11. The development of the industrial sector has proceeded behind protection provided in the form of customs duties, the special import tax, and quantitative import restrictions. The present system of tariff protection was introduced to grant increasing rates of protection according to the degree of processing, in replacement of the system in existence until 1957 that consisted of a uniform tariff rate (12.5%) on all commodities. In 1960, the Government introduced an industrial investment code, subsequently revised in 1973 and in 1982, under which duty exemptions have been provided on the importation of capital goods. Inputs used in export production also enjoy duty exemptions (rebates). In turn, a special import tax was introduced in 1973 and its rate gradually raised from 5% in 1973 to 15% in 1979. Finally, increased use has been made of quantitative import restrictions.

12. The structure of import protection that has developed over time does not reflect a rational pattern and Morocco's industrial development strategy is faced with the usual contradictions implicit in import-substitution policies. As was highlighted by the 1975 industrial survey, the substitution process appears to have gone as far as it can in the consumer goods sector, while extension of import-substitution to intermediate or capital goods industries is not financially profitable for private entrepreneurs due to negative or low effective protection.

13. The main issues to be investigated in regard to import protection are

- (i) the desirable average rate of effective protection in the manufacturing sector;
- (ii) an appropriate structure of tariffs;
- (iii) the procedures used in providing protection;
- (iv) the rationalization of quantitative import restrictions;



- (v) the possible impact of the reform of the protection system on industrial sub-sectors and on budgetary revenues;
- (vi) the promotion of "backward" integration in the manufacturing sector; and,
- (vii) the stimulation of the development of engineering industries.

13. These issues will be examined by the mission by drawing on the results of the research project on industrial incentives, which will provide a detailed analysis (at the firm level and by sub-sectors) of the level and structure of import protection in the manufacturing sector. Furthermore, comparisons of domestic resource costs (DRC's) and economic rates of return at sub-sectoral and sectoral levels will provide a first indication of the comparative advantages of Morocco's manufacturing sector. An attempt will further be made to indicate the relative importance of technical inefficiency, market size, and inappropriate factor intensity (capital-labor ratio) in explaining the pattern of domestic resource costs.

14. The following issues pertaining to comparative advantage in the manufacturing sector will be investigated:

- (i) the relationship between the level of incentives and Morocco's comparative advantage;
- (ii) the relationship between capital intensity, employment and the structure of incentives; and
- (iii) the relationship between private and economic profitability in manufacturing;
- (iv) possible measures that may be used to improve the efficiency of the industrialization process on a sectoral or sub-sectoral basis.

#### Export Promotion

15. Reliance on export expansion to generate the foreign exchange necessary for attaining a high rate of economic growth has been an important feature of every Development Plan since 1972. However, actual exports have fallen considerably short of the targets. In 1973-77, exports of goods and non-factor services grew by only 0.6% a year in real terms compared to a Plan target of 10%; in 1978-80, the actual growth rate was 2.6% compared to the Plan objective of 6.6%. Judging from past experience, the 1981-85 Development Plan's objective of a 7.5% annual growth rate for exports appears unlikely to be achieved unless substantial changes are made in the present system of incentives. At the same time, Bank reports have consistently stated that potential long-term growth prospects for Morocco's exports are quite favorable.

16. In 1981, the two largest sources of export earnings, exclusive of services, were agricultural products (31.1% of merchandise exports) and phosphate rock (31.2%). In the case of agricultural exports, growth has been quite slow in the past, in part because of the stagnation of production since



1971. The system of incentives in agriculture involves a complex system of intervention by the Government at the production level (in irrigated areas) and at the marketing level (through OCE which controls exports of primary and processed agricultural products). In the case of phosphate exports, the report prepared by IPD for the 1982 Plan Review Mission emphasized the importance of the investment and pricing strategy of OCP. The mission will focus on the promotion of manufactured exports other than processed agricultural and phosphate-based products but will also draw on existing information concerning the latter two categories of products.

17. Between 1967 and 1980, Morocco's manufactured exports rose at an average annual rate of 9.3 percent in real terms, below the average rate of increase of 13 percent for all developing countries. At the same time, growth was largely limited to a few traditional industries processing mainly local natural resources (textiles, clothing, carpets, leather products), where Morocco enjoyed the advantages of low wages and preferential access to the Common Market, and phosphate-based products (phosphoric acid and fertilizers). With insufficient incentives due to low effective protection of exports and the overvaluation of the exchange rate, the contribution of non-traditional industries has remained small, although exports of transport equipment, electronics and electrical machinery, rubber and plastic manufactures have begun in recent years.

18. While the exports of phosphate rock and phosphate-based products could grow in the eighties at a rate close to that achieved in 1967-80 (5.3% a year in real terms), exports of agricultural products are likely to increase at a very slow rate, if at all. In 1979, the EEC accounted for 74% of Morocco's food exports, and according to current estimates, a substantial part of these exports would be replaced by products from Greece, Portugal, and Spain.

19. If total export earnings are to grow at a faster rate, Morocco will have to expand its exports of manufactured goods, including non-traditional products. In order to assist Morocco in this effort, the mission will make recommendations for improving the export promotion effort.

20. The recommendations for improving the system of incentives to exports will draw on the results of the research project on industrial incentives. The mission will review and discuss with the Government the overall issue of the level of incentives granted to exports, including the effects of the present exchange rate. Policy recommendations will focus on specific incentives to exports and on the fiscal cost of possible alternatives. This will involve

- (i) examining the extent of the anti-export bias in the present system of incentives;
- (ii) making recommendations for reducing this bias; and
- (iii) analyzing the measures that may be used for this purpose.

21. At the institutional level, the mission will review progress made by the Government in improving administrative procedures for exporters, including



- (i) foreign exchange regulations affecting exports;
- (ii) the administration of duty exemptions and rebates;
- (iii) the administration of the export credit and export insurance schemes (see also the financing of industry);
- (iv) the role and functions of the Export Promotion Center; and
- (v) the creation of an agency responsible for establishing standards and promoting quality control.

#### Price Control

22. Price control has been used in Morocco to appropriate some of the profits generated by protection and to limit price increases. The mission will update earlier work on price control by the Bank, focusing on the following issues:

- (i) the scope of price control;
- (ii) the methods used in setting prices;
- (iii) the need for price liberalization; and
- (iv) the possible effects of the freeing of prices on individual sectors and on the rate of inflation.

#### The System of Investment Incentives

23. Morocco has relied on investment codes to promote investment in various branches of the economy. Although this policy may have led to increases in the rate of return to capital, the results obtained have not been up to expectations. According to the limited data available, the policy has probably been responsible for the rise in the capital-labor ratio, and the expected surge in foreign investment has not materialized. The Government has recently revised the industrial investment code and it is presently engaged in the revision of some of the other codes.

24. Specific issues addressed by the mission in regard to investment incentives will include

- (i) the administrative complexity of the investment codes;
- (ii) the harmonization of incentives provided by the various codes and their relationship with the overall reform of industrial incentives; and
- (iii) the probable effects of the new industrial investment code on foreign investment, exports, the choice of technique, location, and the domestic capital goods industry.

## The Financing of Industry

25. The use of quantitative controls on domestic credit, which have been the main instrument for controlling the money supply since 1976, and the large domestic borrowings of the Treasury have led to a fall in the share in total domestic credit of productive enterprises, in particular in the private sector. This raises the following questions the mission will address:

- (i) the implications of credit controls for the financing of investment, and
- (ii) the preference given to public enterprises over private firms in granting credit.

26. During the seventies, interest rates have played a minor role in allocating credit among borrowers as they were kept at relatively low levels and the Government relied on other means to achieve financial objectives. Since 1977, interest rates have been regularly raised, so that their average levels approximately equals the rate of inflation. However, the structure of interest rates may not correspond to that which would emerge if existing controls were removed. The mission will examine

- (i) the relative role of interest rates and other criteria in rationing available credit among borrowers; and
- (ii) the desirable rate structure.

27. Traditionally, selectivity of credit in Morocco has been assured by the creation of lending institutions specialized by sector. In recent years, this policy has been generalized by creating special lending facilities that provide preferential access to credit at subsidized interest rates. At present, these facilities cover projects benefiting from investment codes, investment projects for exports, specific activities (tourism, shipping, etc.), specific investors (small and medium scale firms, handicrafts), and specific types of credit (rediscountable medium-term credit).

28. In view of the increasing complexity of the system of credit, and the reduced competition between the financial institutions it implies, the efficiency of this highly selective approach to credit policy needs to be assessed. Also, one needs to examine the access to credit by firms which are not covered by preferential schemes and the possible ways to improve the mobilization of financial resources for productive investment. The relevant issues include

- (i) the system of financial intermediation and the extent of competition between banks and financial institutions,
- (ii) the system of selective credits;
- (iii) the extent of subsidies to certain types of credit;
- (iv) the system of export credit, export insurance, and insurance against exchange rate fluctuations; and



- (v) the dependence on automatic rediscounting by the Central Bank for certain types of credit.

#### The System of Taxation

29. Since 1976, budget deficits have remained at a high level, and the Government has raised in successive stages the rate of the special import tax in order to increase revenues. While the recommendations of the mission will have budgetary implications, they should not lead to an increased deficit that would be contrary to the objectives of the current stand-by agreement between Morocco and the IMF. Thus, to the extent that the recommendations involve additional Government expenditures or loss of revenue, offsetting sources of tax revenue will need to be identified.

30. The Moroccan tax system was extensively studied by the IMF in 1978, and the IMF has recently reviewed proposals for tax reform. The mission will consider alternative ways to offset the budgetary impact of the proposed reform of industrial incentives and export promotion in the framework of the IMF recommendations and in close cooperation with the IMF. This raises the following issues:

- (i) the effects of the system of direct and indirect taxes on industry;
- (ii) the fiscal implications of additional incentives to exports;
- (iii) the impact of the proposed modifications in the structure of tariffs and quantitative import restrictions on government revenues; and
- (iv) alternative ways to offset the budgetary effects of the proposed incentive reforms.

#### Staffing and Timing

31. Formal Government approval for the Industrial Incentives and Export Promotion mission has been obtained. In view of the long involvement of the Ministry of Industry, Commerce and Tourism in the joint research project on industrial incentives with the Bank, we have proposed to the Ministry that the Moroccan team involved in the research project joins the mission. This has been accepted by the Government in June. The role of this team will be determined subsequently.

32. The mission would include a mission chief (Mr. Balassa), a deputy mission chief (Mr. Bonnel), a general economist, the Bank consultant assigned to the research project in Morocco, a consultant who will be responsible for the study of industrial finance, and a Moroccan team consisting of two or three people

33. The schedule for report processing is as follows:

White Cover Report	December 1, 1982
Yellow Cover Report	January 10, 1982
Review Meeting	January 20, 1982
Green Cover Report	February 15, 1982
Discussions with Govt.	March 21, 1982

Distribution:

Messrs. Chaufournier, Bart, Picciotto, Carmignani

Messrs. Dubey (2), Khalilzadeh-Shirazi, Fitchett (EMNVP); Afour, Bonnel, de Merode, Prasad (EM2); Elwan, Zaidan, Etti (EMP); van der Tak (OPS); Kohli (IPD); Tolbert (IDF); Robless (2) (PAB); Richardson, Blondel (IFC); Francois, Tahari, Happe (IMF)

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EMENA files

BBalassa:nc



# MOROCCO: INDUSTRIAL INCENTIVES AND EXPORT PROMOTION

## PART I

### INCENTIVES AND COMPARATIVE ADVANTAGE

#### Chapter 1. The Structure of Incentives in Manufacturing Industries

1. The Structure of Nominal Protection (product protection)
2. The Structure of Effective Protection (joint effects of protective measures on inputs and outputs)
3. The Structure of Effective Subsidies (joint effects of protective, tax, and credit measures)
4. The Bias Against Exports
5. Comparison with Primary Activities

#### Chapter 2. Comparative Advantage in Manufacturing Industries

1. The Measurement of Comparative Advantage (domestic resource cost of foreign exchange and economic rates of return)
2. Comparison of Incentives and Comparative Advantage (effective rates and domestic resource cost measure, private and social profitability)
3. Relationships between Comparative Advantage, Capital Productivity and Labor Productivity
4. Comparisons with Primary Activities

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  - A. Quantitative controls on credit
  - B. System of selective credits
  - C. Export credit and export insurance

July 28, 1982.

Professor K. J. Banerjee  
Department of Mathematics  
University of Maryland Baltimore County  
Catonsville, Maryland 21228

Dear Professor Banerjee:

Thank you for your letter of July 15. While I do not see any possibility at present for your working with us, I transmitted the material you sent me to Mr. Graham Pyatt who has a particular interest in index numbers.

Yours sincerely,

Bela Balassa

cc: Mr. Graham Pyatt



July 28, 1982.

Mr. Jeffrey Sachs  
Associate Professor of Economics  
Department of Economics  
Harvard University  
Cambridge, Massachusetts 02138

Dear Jeff,

It was good to hear from you and many thanks for your papers.  
I passed over the ones dealing with debt to Gershon Feder who is our  
resident expert on the subject.

I will be away until September 13 but I hope that we can meet  
between my return and your departure from Washington.

With best regards,

Yours sincerely,

Bela Balassa

July 28, 1982.

Mr. James C. Hersey  
Project Manager  
Applied Research Evaluation Project  
National Science Foundation  
Kappa Systems, Inc.  
1501 Wilson Boulevard  
Arlington, Virginia 22209

Dear Mr. Hersey:

Having reviewed the material you sent me, I found that this is longer than expected (nearly 300 pages rather than 200). Furthermore, you now request that I write a report that will be published under my signature. I am not prepared to do so. Please let me know at 676-1007 if the material you sent me should be returned.

Yours sincerely,

Bela Balassa

cc: Mr. Asim Erdilek





# Record Removal Notice

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<b>Subject / Title</b> Re : Case S-3929				
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<b>Additional Comments</b>		<p>The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information. This Policy can be found on the World Bank Access to Information website.</p> <table border="1"><tr><td><b>Withdrawn by</b> Chandra Kumar</td><td><b>Date</b> Jun 10, 2014</td></tr></table>	<b>Withdrawn by</b> Chandra Kumar	<b>Date</b> Jun 10, 2014
<b>Withdrawn by</b> Chandra Kumar	<b>Date</b> Jun 10, 2014			

Mr. Adrian Wood, AEA

July 27, 1982

Bela Balassa, DRD

Price Formation in a Socialist Economy

1. This paper may well serve as a college primer. At the same time, its usefulness for a Chinese audience could be enhanced by giving greater emphasis to the practical application of alternative ways of price setting and by indicating possible ways to combine them under the circumstances existing in China. These issues will be taken up in the following.

2. While Pasinetti indeed presents a "brilliant exposition of [the] Ricardian proposition" that "the true efficiency prices of many commodities are ... primarily determined not merely by production costs, but simply by the state of technology and the rate of profit" (Para. 13), this proposition does not provide a practical guide for price setting in China. In particular, the assumptions underlying the Ricardian proposition are not fulfilled in practice, largely because of the existence of non-constant costs, joint products, and imbalances between supply and demand which cannot be regarded as a short-term phenomenon. At the same time, introducing demand considerations in price determination would permit dealing with natural resource products (Para. 16) whose prices should be equated to marginal costs. The same observation applies to nontraded goods, such as electricity and transportation, where marginal costs may substantially differ from average costs.

3. As the Hungarian experience has shown, the introduction of world prices in price determination for differentiated products would require the liberalization of imports. In turn, one may equate the exchange rate to the domestic resource cost of marginal exports. The Hungarian experience shows the inappropriateness of using average costs in the determination of the exchange rate that necessitates the widespread subsidization of intra-marginal exports.

4. The paper correctly indicates the conditions under which efficiency prices would be established in the domestic market. At the same time, its pessimism as regards the transition from output maximization to profit maximization (Para. 29) may not be warranted. Thus, recent experience indicates that the transition can be quite rapid if appropriate incentives are provided. In turn, the scope of nonproductive public organizations could be reduced and different pricing rules applied to the remainder.

5. The last point leads to the desirability of instituting a system of "mixed" pricing under the conditions existing in China. A proposal to this effect is made in my "Economic Reform in China" and does not need to be taken up here.

6. The final question relates to the reconciliation of efficiency and income distributional considerations. In my "The Income Distributional Parameter in Project Evaluation" (World Bank Reprint No. 41), I have argued that the two be kept separate, with efficiency prices being used in project evaluation. At the same time, as suggested in my "Economic Reform in China,"



reliance should be based on land rents so as to avoid creating unearned income in agriculture.

cc: Recipients of paper.

BBalassa:nc

PIUK

## OFFICE MEMORANDUM

TO: Mr. David Newbery, DRD

FROM: Bela Balassa, DRD

SUBJECT: Proposed Book: Modern Tax Theory for Developing Countries

DATE: July 27, 1982

1. I welcome your proposal for the preparation of a book on the above subject. At the same time, I would suggest going beyond the topics of the June workshop, so as to give greater emphasis to development policy issues in general and to structural adjustment policies in particular. For this purpose, I suggest devoting a separate section of the book to the effects of taxes on factor markets, savings, investments, and growth, that is the title of chapter 19 in the present outline.
2. Investment incentives present important issues in developing countries, including their effects on domestic and foreign investment, foreign trade (in particular, through domestic content and export requirements), capital intensity, and regionalization. A Bank-financed study of the subject is directed by Stephen Guisinger, who may be asked to write a chapter. Furthermore, Dan Usher has made theoretical contributions to the subject and may be willing to write a chapter that would complement that by Guisinger.
3. Important work on the welfare cost of capital income taxation in the United States has been done in recent years by Michael Boskin and by Lawrence Summers, indicating that taxes on capital income affect savings and economic growth to a considerable extent. I am particularly impressed by Summers' contribution who builds on that by Boskin. He could be asked to write a chapter, examining the relevance of his work to developing countries.
4. It would be of further interest to commission the writing of a chapter on income and social security taxation, with emphasis given to effects on work, risk-taking, and labor costs. In this connection, consideration would need to be given to the progressivity of the tax system, the taxation of different sources of income, and the financing of social security benefits. While I do not have a candidate for this subject, its practical importance in developing countries would warrant making a search.

cc: Bank recipients of July 23rd memo

BBalassa:nc



Specific Comments on Rhee, Pursell, and Ross-Larson,  
Promoting Exports: Institutions, Technology,  
and Marketing in Korea

Introductory Note

p. iii            Comparison with nation wide averages is misleading as the latter also includes small-scale firms outside the manufacturing sector. One should rather limit the comparison to firms in this sector.

pp. iii-iv        As noted in the general comments, several of the concepts and distinctions introduced here suffer from lack of clarity.

Chapter 1. The Drive to Export

p. 1            One should not begin the book by reference to the former President Park. Apart from the political overtones, it should be remembered that Park favored import substitution in capital-intensive industries over exports towards the end of his reign (and life).

p. 1            The commitment to export did have its inspiration in Japan, although, given the difference in market size, exports were called upon to play a more important role to ensure rapid growth in Korea than in Japan.

p. 1            The statement, "the most effort was denoted to economic activity" is far from clear.

p. 2            For Korea there were no "traditional exports" at the time the export drive started. At any rate, the distinction between "traditional" and "modern" exports is rather tenuous.

p. 2            The rate of growth of exports in current prices is meaningless; use constant price figures instead. This will also ensure comparability with GNP growth rates.

p. 2            One should speak of the ratio of exports to GNP, rather than of export shares, since exports are a value concept and GNP a value added concept

(the "share" of exports in GNP exceeds 100 percent in the Netherlands).

p. 3           The meaning of the reference as to "what enabled the bureaus to be so facile in spurring firms to perform well" is unclear.

p. 5           The expressions "hard state," "parameter manipulation," and "field augmentation" are far from clear.

p. 6           The statement "we concur with most of the foregoing explanations of Korea's export performance" fails to recognize that some of the explanations are in conflict.

p. 6           The statement of "Korea having found some effective ways of deflecting attention to exporting firms" and the reference to "these ways of deflecting attention" should be clarified.



Messrs. Yung Rhee, DRD; Bruce Ross-Larson, CON;  
Garry Pursell, IDF

July 27, 1982

Bela Balassa, DRD

"Promoting Exports: Institutions, Technology, and Marketing in Korea"

1. As it will be apparent from the enclosed general comments, I am far from happy with the volume in its present state. I do not find the style felicitous. At places it obscures the scientific results while elsewhere the conclusions are drawn that go beyond the survey material collected in the framework of the study.
2. I also started to write specific comments, page by page, but it would have been too time-consuming to continue. Still, the enclosed specific comments on the initial parts of the study may be helpful.

cc: Mr. Westphal, DRD

Enclosure  
BBalassa:nc

Specific Comments on Rhee, Pursell, and Ross-Larson,  
Promoting Exports: Institutions, Technology,  
and Marketing in Korea

Introductory Note

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Pink

Files

July 27, 1982

Bela Balassa, DRD

Hungarian Contacts

On the occasion of Hungary becoming a member of the Bank, several people have inquired about my professional contacts in Hungary. In this connection, the following information may be of interest.

1. I have frequently been invited to lecture in Hungary on developing country policies and on the Hungarian economic reform. The latest invitation came from Mr. Bela Csikós-Nagy, the President of the Hungarian Price and Material Board. Csikós-Nagy originally asked me to discuss my work on external shocks and policy responses to these shocks in developing countries, the methodology of which he wishes to apply to the Hungarian economy. He has subsequently broadened the subject to policies of import substitution and export promotion, with application to Hungary. It had been planned that I give a seminar on the subject to a high-level audience in Budapest in late August; with my leading an industrial policy mission to Morocco the date has been postponed to December.
2. My "Adjustment Policies in Developing Countries" (World Development, January 1982) will serve as a basis for the seminar and will be published in Hungarian in the next issue of Gazdaság (Economy), the Hungarian monthly on economic policy. Gazdaság earlier published the Hungarian translation of my "The Changing International Division of Labor in Manufactured Goods" (Banca Nazionale del Lavoro, Quarterly Review, September 1979). Among my papers on the Hungarian economy, "The Economic Reform in Hungary Ten Years After" (European Economic Review, November 1978) was published in Hungarian translation in Valóság (Reality), the leading Hungarian periodical dealing with public policy issues. My "Reforming the New Economic Mechanism in Hungary" will appear in Hungarian in Kozgazdasagi Szemle (Economic Review), the official journal of the Hungarian Economic Association; it will be published in English in the Journal of Comparative Economics early next year.
3. I presented the last mentioned paper at the Institute of Economics of the Academy of Sciences in Budapest, at the meetings of the American Economic Association in Washington, as well as at the Bloomington Conference on the Hungarian Economy, which was attended by fifteen economists from Hungary. The enclosed excerpts of a report on the Conference, published in Magyar Nemzet (Hungarian Nation), a Hungarian daily, provides a short analysis of my paper. It was written by Gyorgy Ranki, the best-known Hungarian modern economic historian.
4. I further enclose the English translation of a letter received from Lajos Faluvégi, Deputy Prime Minister and President of the Hungarian Planning Office, commenting on my recent book. I have known Faluvégi for fourteen years and have regularly seen him on my visits to Hungary, first as Minister of Finance and subsequently as President of the Planning Office. While Faluvégi was not able to receive the Bank mission last month, future contacts



with him would be desirable, given the prominent place he occupies among reform-minded government officials in Hungary.

cc: Chauffournier, EMNVP; Karaosmanoglu, EMI; Picciotto, EMP; Hume, EMI;  
Dubey, EMNVP; Colaco, EMI; Mrs. Denton, EMI;  
ERS Directors, DRD Senior Staff

Enclosures  
BBalassa:nc

PINK

Mr. David Newbery, DRD

July 27, 1982

Bela Balassa, DRD

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cc: Bank recipients of July 23rd memo

BBalassa:nc



1 1 61007

MEHMET GUN CALIKA, MEDAN SECURITIES BROKERAGE  
ODAKULE IS MERKEZI ISTIKLAL CADDESİ, 286 BEYOĞLU, ISTANBUL, TURKEY  
CONFIRM ARRIVAL ON AUGUST 5 THURSDAY AT 3.55 PM ON SWISSAIR 324 WILL  
LEAVE ON AUGUST 7 SATURDAY AT 4.45 PM ON SWISSAIR 327. TITLE OF  
PAPER OUTWARD ORIENTATION AND EXCHANGE RATE POLICY IN DEVELOPING  
COUNTRIES: THE CASE OF TURKEY. REGARDS, BALASSA

CABLE

7/27/82

Bela Balassa

Bela Balassa

BBalassa:nc

DRD - Director's Office

July 27, 1982.

Messrs. Dong Fu-reng and Wu Jing-liang  
Institute of Economics  
Chinese Academy of Social Sciences  
5 Jianguomen Nei Dajie  
Beijing  
China

Dear Messrs. Dong and Wu:

Thank you for your letter of July 15th. I am indeed sorry that the first version of my paper reached you so late. I hope that you have in the meantime received the final version.

I very much appreciate your comments on the paper. I fully agree on the need to elaborate on the price problems further. I hope to do so on another occasion.

Yours sincerely,

Bela Balassa



July 23, 1982

Faluvegi Lajos  
Miniszterelnokhelyettes Urnak  
Az Orszagos Tervhivatal Elnoke  
Budapest  
HUNGARY

Kedves Miniszter Ur:

Konyvemmel kapcsolatos kedves sorait nagyon koszonom. Orulok hogy a konyv erdeklodeset megnyerte. Ha megengedi, tovabbra is el fogom irasaimat Onnek kuldeni.

Pulai Miklos volt itt nehany hete es jo benyomast keltett mindenkire. A magyar ugyekkel foglalkozo vezetokkal es eloadokkal valo megbeszeleseken kivul erdekes eloadast is tartott.

En magam Kinaban jartam mint tanacsado. Nagy az erdeklodes a magyar reform irant es sok kerdest tettem fel nekem a reform alapelveivel es gyakorlati alkalmazasaval kapcsolatban. Itt mellekelem az utrol keszitett rovid beszamolomat. Augustusban majd Kinarol keszitett tanacsadoi jelenteseimet is el fogom kuldeni.

Iden nyaron nem jutok el Pestre de Csikos-Nagy Bela meghivasara egy decemberi utat tervezek. Remelem hogy ez az ut lehetoseget fog arra adni hogy Onnel megint találkozzam

Tiszteletteljes udvozlettel

Balassa Bela

Ms. Virginia Hitchcock, PUB

July 23, 1982.

Bela Balassa, DRD

Permission to Reprint

I enclose permission to reprint my "Policy Responses to External Shocks in Selected Latin-American Countries" together with two reprints of the paper. Please proceed to reprint; the editorial committee decided to include my paper in the Reprint Series last May.

Enclosure  
BBalassa:nc



Messrs. Paul Blay, and Michel Devaux, EA2

July 23, 1982

Bela Balassa, DRD

Mauritius

1. Due to missions abroad and several urgent matters, I had to delay the promised review of the material you sent me on Mauritius. A reading of these documents indeed points to the desirability of carrying out a review of industrial policy. But, this would need to be linked to a general policy review to cover the exchange rate, export taxes on sugar, wages, social spending, as well as the budget. From press reports, it appears that the new government is making some of the same mistakes that Mitterand made in France (you are welcome to peruse my "The First Year of Socialist Government in France" on the subject).

2. At the same time, despite two devaluations, wages and social benefits were rising too rapidly in dollar terms even before the political change. This explains the need for subsidy measures and the declining competitiveness of industrial exports in Maritius. It would seem that reducing the cost of labor in dollar terms is a crucial issue under present circumstances. The French socialists are doing this today and it is a question of time when it will be understood by the authorities in Mauritius.

3. I have attempted to indicate above what may be considered priortiy issues in Mauritius. Actions on these issues would also permit getting the incentives right. At the same time, to the extent that staff time to be expended in the country is limited, I would suggest postponing a quaantitative investigation of incentives under present conditions until a later time.

Messrs. Gulhati, EANVP; Armstrong, EA2; Payson, EA2; Schott EA2.

BBalassa:nc

July 23, 1982.

Mrs. Maxula Mannil  
c/o Galeria Yakera  
Edificio Everi/Local 4  
Avenida Andres Bello  
Caracas  
Venezuela

Dear Maxula,

Several years ago I send you a copy of my culinary guide to your address at Los Jaguares, but it came back with the notation that it could not be delivered. I recently met a young American, Misti Dewar, (Wilcox) who gave me several of your addresses. I am sending this letter to two of them. I further enclose my culinary guide with the letters. Carol and I often think of you and Harry and wish very much that there would be an opportunity for us to meet again. While we do not plan a trip to Venezuela in the near future perhaps you will come to Washington or we can meet in Paris.

Yours sincerely,

Enclosure

Bela Balassa





# Record Removal Notice

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<b>Exception No(s).</b> <input type="checkbox"/> 1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/> 4 <input type="checkbox"/> 5 <input type="checkbox"/> 6 <input type="checkbox"/> 7 <input type="checkbox"/> 8 <input type="checkbox"/> 9 <input type="checkbox"/> 10 A-C <input checked="" type="checkbox"/> 10 D <input type="checkbox"/> Prerogative to Restrict				
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<b>Withdrawn by</b> Chandra Kumar	<b>Date</b> Jun 10, 2014			

July 23, 1982.

Mr. Azizali F. Mohammed  
Director  
External Relations Department  
International Monetary Fund  
Washington, D.C. 20431

Dear Mr. Mohammed:

Thank you for inviting me to the seminar sponsored by the IMF and the NBER. I am sorry to say that I will be leading a Bank mission at the time of the seminar and will not be able to attend.

Yours sincerely,

Bela Balassa



July 23, 1982.

Professor Wynne Godley  
Department of Applied Economics  
University of Cambridge  
Sidgwick Avenue  
Cambridge CB3 9DE  
England

Dear Godley,

Thank you for your letter of June 29th. I agree with you that the organizers of the conference tried to do too much and less would have been more.

I am sorry to say that I am unable to find the little note I prepared about a year ago on the Cambridge model. It provided a short description of your model.

I look forward to reading the paper you have sent me.

Yours sincerely,

Bela Balassa

July 23, 1982.

Professor Martin Feldstein  
Department of Economics  
Harvard University  
Cambridge, Massachusetts

Dear Marty,

I was interested to read your article on China in the Wall Street Journal. Some of the themes of the article I developed in my paper "Economic Reform in China" that will be published in the Banca Nazionale del Lavoro Quarterly Review. A copy of the paper is enclosed.

Yours sincerely,

Enclosure

Bela Balassa



July 23, 1982.

Mr. Aloysius Ordu  
13 Bishopstone Road  
Seaford  
East Sussex  
BN25 2UB  
England

Dear Mr. Ordu:

In response to your letter I enclose a copy of the English version of my article on comparative advantages and economic integration in West Africa.

Yours sincerely,

Enclosure

Bela Balassa

July 23, 1982.

Dr. Andras Nagy  
Institute of Economics  
Hungarian Academy of Sciences  
Budapest XI., Budaorsi ut 45  
1502 Budapest Postafio 262  
Hungary

Dear Andras,

I received sometime ago your excellent volume on development alternatives for world trade. I will be sending some reprints to you in a few weeks. I enclose with this letter a copy of a short report on China which may be of interest to you.

I hope that all is well with you and Agi. We are leaving on vacation soon and I will subsequently lead a Bank mission to Morocco.

Yours sincerely,

Enclosure

Bela Balassa



July 23, 1982.

Professor Laura Tyson  
Department of Economics  
University of California, Berkeley  
Berkeley, California 94720

Dear Laura,

I enclose the printout of my Yugoslav calculations which provides the values of the variables you request in your letter of July 8. Enclosed is also a list explaining the relevant variables.

Yours sincerely,

Enclosures

Bela Balassa

Mr. Goddard Winterbottom, PUB

July 23, 1982.

Bela Balassa, DRD

Working Paper Series

I enclose "Adoption of Agricultural Innovations in Developing Countries: A Survey" by G. Feder et. al. for inclusion in the Bank Staff Working Paper Series. The earlier version of this paper has been exhausted and the extensive revisions made by the authors warrant re-publication. On this point, I enclose your exchange with Feder.

cc: Messrs. Stoutjesdijk, Pyatt, Feder, DRD (with enclosure)

Enclosure  
BBalassa:nc



THE WORLD BANK

(9-78)		DATE: 7/13/82	
ROUTING SLIP			
NAME		ROOM NO.	
Gershon Feder			
APPROPRIATE DISPOSITION		NOTE AND RETURN	
APPROVAL		NOTE AND SEND ON	
CLEARANCE		PER OUR CONVERSATION	
COMMENT		PER YOUR REQUEST	
FOR ACTION		PREPARE REPLY	
INFORMATION		RECOMMENDATION	
INITIAL		SIGNATURE	
NOTE AND FILE		URGENT	
REMARKS:			
<p>Attached tells the story. We'd like not to reprint, but we'll use the new version and give it a new WP number. It can refer to its original state.</p>			
FROM: GWWinterbottom		ROOM NO.:	EXTENSION:

The World Bank

July 12

Mr. Winterbottom:

Re: W.P. 444

Per your request of the quantity held by PUBPD  
for the above-mentioned WP, we have none in  
stock expect for a handful on our display rack.

Orhan  
x72058

①



1 1 61007

BRENDAN HORTON, C/O MR. MOUMILE, DIRECTOR,  
MINISTERE DU COMMERCE ET DE D'INDUSTRIE, RABAT, MOROCCO

THIS IS TO CONFIRM OUR TELEPHONE CONVERSATION THAT I WILL ARRIVE  
WITH MY FAMILY ON AIR FRANCE 2099 AT 11 AM SUNDAY AUGUST 29.

PLEASE LET ME KNOW AT MY ADDRESS IN FRANCE IF YOU COULD NOT MEET US  
AT THE AIRPORT. WE WILL HAVE LUNCH ON THE PLANE BUT WOULD LIKE TO  
INVITE YOU AND YOUR FAMILY FOR DINNER ON THE SAME DAY. THE ADDRESS  
IS C/O M. Ayme BERNARD, IRIGNY, RHONE, FRANCE. ANY PAPERS MAILED  
MAILED AFTER AUGUST 1 SHOULD BE SENT TO THE ABOVE ADDRESS. EARLIER  
MAILINGS SHOULD GO TO BANQUE MONDIZABEE, 64 AVENUE D'IEHA, 75116 PARIS  
FRANCE. PLEASE MAKE RESERVATIONS FOR ME AND MY FAMILY AT THE  
PALAIS JAMAI HOTEL IN FEZ FOR SATURDAY SEPTEMBER 4. REGARDS,  
BALASSA

CABLE

7/23/82

Bela Balassa

Bela Balassa

BBalassa:nc

DRD - Director's Office

2 2 61007

PLEASE INFORM ME OF THE COMPLETION DATE OF YOUR STUDY FOR THE  
WESTERN AFRICA PROJECT. ANY FURTHER DELAY IN COMPLETION MAY  
JEOPARDIZE PUBLICATION OF THE STUDY. REGARDS, BALASSA

*Stryker  
Shepherd  
Kerton*

CABLE

7/23/82

cc: Mr. Pursell

Bela Balassa

Bela Balassa

DRD - Director's Office



Ms. Virginia Hitchcock, PUB

July 23, 1982.

Bela Balassa, DRD

Permission to Reprint

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Enclosure  
BBalassa:nc

1 2 61007

BOOK OF THREE

J. DIRCK STRYKER, FLETCHER SCHOOL OF LAW & DIPLOMACY, TUFTS  
UNIVERSITY, MEDFORD, MASSACHUSETTS 01255

GEOFFREY SHEPHERD, UNIVERSITY OF SUSSEX, CENTER FOR CONTEMPORARY  
EUROPEAN AFFAIRS, BRIGHTON BN1 9RF, ENGLAND

BRENDON HORTON, C/O MR. MOUMILE, DIRECTOR, MINISTERE DU COMMERCE ET  
DE L'INDUSTRIE, RABAT, MOROCCO

CABLE

7/22/82

BELA BALASSA

BELA BALASSA

DRD - Director's Office



2 2 61007

PLEASE INFORM ME OF THE COMPLETION DATE OF YOUR STUDY FOR THE  
WESTERN AFRICA PROJECT. ANY SUBSTANTIAL DELAY IN COMPLETION MAY  
JEOPARDIZE PUBLICATION OF THE STUDY. REGARDS, BALASSA

CABLE

7/22/82

cc: Mr. Pursell

Bela Balassa

Bela Balassa

DRD - Director's Office

Travel - Consultant Section - Ann

July 22, 1982.

Bela Balassa, DRD

Reservation at Rabat Hilton

Please reserve for me a suite at the Rabat Hilton for the period August 29 to September 10. I am leading a bank mission to Morocco that has six members in addition to myself (two staff members, two consultants and two Moroccan mission members). It is necessary for me to have a suite to have meetings with the mission.

BBalassa:nc



July 22, 1982.

Professor Maxwell J. Fry  
Economics Department  
University of California  
Irvin  
California 92717

Dear Max,

Moshe Syrquin provided me with some new information which necessitated revising pages 11 and 14 of my paper. Two copies of the revised pages are enclosed. Please further add the following two items to the reference list.

Harberg, Arnold C. (1974) Taxation and Welfare, Chicago, Illinois, University of Chicago Press.

Syrquin, Moshe, "Efficient Input Frontiers for the Manufacturing Sector in Mexico, 1965-1980" International Economic Review, October 1973.

Please let me know urgently if you have any comments on the paper. I will be leaving on August 4th for five weeks trip abroad.

With best regards,

Sincerely yours,

Enclosures

Bela Balassa

## Product Markets

The present author suggested that Harberger had underestimated the cost of protection in Chile by understating the level of tariffs and the share of imports in national income and by excluding the possibility that some inefficient industries may disappear under protection (Balassa, 1966).<sup>1/</sup> Subsequently, Bergsman estimated the cost of protection for Brazil by separating industries into two groups, depending on whether they can be expected to disappear or to survive under free trade. The savings in costs in the first group of industries following a move to free trade were considered to represent an improvement in allocative efficiency; in the second group, production costs were assumed to decline to competitive levels under free trade, representing an improvement in X-efficiency (1970, Appendix 4).

Having further calculated the consumption cost of protection, the terms-of-trade loss due to reductions in export prices, and the cost of increased exports under free trade, the present author estimated the cost of protection, including monopoly profits, for several developing economies with relatively high levels of protection. The results, expressed as a proportion of GNP, were 9.5 percent in 1966 for Brazil, 6.2 percent in 1962 for Chile, 6.2 percent in 1963-64 for Pakistan, and 3.7 percent in 1965 for the Philippines (Balassa and Associates, 1971, p. 82). <sup>2/</sup> In turn, in extrapolating the results obtained for a sample of industries to the entire Turkish manufacturing sector, Krueger (1966) concluded that the reallocation of resources from import-substituting to export industries under free trade would lead to the doubling of the world market value of manufacturing output; with

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<sup>1/</sup> Moshe Syrquin pointed out to me that Harberger has subsequently reconsidered his estimate removing the assumption that there would be some domestic production of each importable good in the absence of restrictions and assuming more realistic tariffs. With these modifications, he estimated the cost of protection at 10-15 percent of GNP in Chile (1974, p. 107).

<sup>2/</sup> Bergsman's revised estimate -- derived by the use of the same methodology -- was 7.1 percent for Brazil in 1967, following reductions in the extent of protection below the 1966 level (1974, p. 421).



two agricultural and thirteen non-agricultural sectors. Thus, de Melo found that the intersectoral movement of labor in response to the elimination of wage differences among non-agricultural sectors would lead to a 5.7 percent rise in GNP if capital was immobile and to a 13.3 percent gain if capital was mobile among sectors (1977, p. 402).

De Melo's use of a general equilibrium framework made it possible to allow for the interactions of product and factor markets through changes in relative prices, as well as for sectoral interdependence, which are absent from the partial equilibrium estimates. But while Dougherty and Selowsky distinguished among seven classes of labor, de Melo separated only skilled and unskilled labor, thereby overstating the welfare cost of factor market distortions associated with intersectoral wage differences.

In the second variant of his estimates, de Melo introduced capital mobility in addition to labor mobility. The welfare effects of the misallocation of both factors were considered by Syrquin in a study of Mexico. Utilizing a seventeen-sector model and assuming labor and capital to be homogeneous, Syrquin estimated that the misallocation of labor and capital entailed a loss of output of 15.5 percent in the Mexican manufacturing sector (1973, p. 664).

The authors cited considered the welfare cost of factor market imperfections, reflected in intersectoral differences in factor prices, under the assumption that factor prices equalled marginal productivities in each. Harberger, however, assumed that a substantial part of factor market distortions originated in "other influences, such as monopoly and taxes, which would cause differences between wages and the value of marginal product, and might make for more variance among sectors in marginal productivity than there is in wages" (1959, p. 138).

As noted earlier, wage differences may also originate in government regulations other than taxes; they may be due, for example, to differences in legal minimum wages among sectors. Furthermore, in investigating wage

Mr. Rudolf Hablutzel, EA2

July 22, 1982.

Bela Balassa, DRD

Mr. Otto Gado

This is in reference to our discussions concerning a high level Hungarian economist who could be sent to Guinea for discussions on exchange rate policy. I indicated to you that Mr. Otto Gado may be the appropriate person for this purpose, but, unfortunately, I do not recall what position he took in the fixed-flexible exchange rate controversy in Hungary. By and large, it was research economists who called for using the exchange rate as a flexible instrument.

Mr. Gado is 62 years old; he had to retire at the normal retirement age of 60 from his job as Vice President of the Hungarian Planning Office. He is presently a consultant to the Finance Ministry. His address is,

Tarnok u. 13  
Budapest 1014  
Hungary

In indicating the task to be performed, you could inquire from Mr. Gado concerning his views on exchange rates. You could also inquire if he speaks French which would presumably be desirable.

BBalassa:nc



July 22, 1982.

Dr. Harman Lehment  
Institut für Weltwirtschaft  
an der Universität Kiel  
Postfach 4309  
2300 Kiel 1  
West Germany

Dear Dr. Lehment:

I would like to ask you to distribute copies of the enclosed paper "Adjustment to External Shocks in Developing Economies" ~~Worthe~~ Bank Staff Working Paper No. 472 in advance of my seminar. The paper will take the place of "The Newly Industrializing Developing Countries After the Oil Crisis." As I indicated to you earlier, my paper "The Process of Industrial Development and Alternative Development Strategies" should also be distributed to the participants.

I understand that my ticket will be sent to me at my summer address,

c/o M. Aymé Bernard  
Irigny  
Rhône  
France

Yours sincerely,

Enclosure

Bela Balassa

Enclosed: "Adjustment to External Shocks in Developing Economies"



# Record Removal Notice

The World Bank Group  
**Archives**  
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<b>File Title</b> Bela Balassa's chron files - July 1982		<b>Barcode No.</b>  30225148		
<b>Document Date</b> Jul 22, 1982	<b>Document Type</b> Letter			
<b>Correspondents / Participants</b> To : Boston Financial Data Services, Inc. From : Bela Balassa,				
<b>Subject / Title</b> Purchase of Shares				
<b>Exception No(s).</b> <input type="checkbox"/> 1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/> 4 <input type="checkbox"/> 5 <input type="checkbox"/> 6 <input type="checkbox"/> 7 <input type="checkbox"/> 8 <input type="checkbox"/> 9 <input type="checkbox"/> 10 A-C <input checked="" type="checkbox"/> 10 D <input type="checkbox"/> Prerogative to Restrict				
<b>Reason for Removal</b> Financial Information				
<b>Additional Comments</b>		<p>The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information. This Policy can be found on the World Bank Access to Information website.</p> <table border="1"><tr><td>Withdrawn by Chandra Kumar</td><td>Date Jun 10, 2014</td></tr></table>	Withdrawn by Chandra Kumar	Date Jun 10, 2014
Withdrawn by Chandra Kumar	Date Jun 10, 2014			





# Record Removal Notice

The World Bank Group  
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& Records Management

**File Title**

Bela Balassa's chron files - July 1982

**Barcode No.**

30225148

**Document Date**

Jul 22, 1982

**Document Type**

Letter

**Correspondents / Participants**

To : The Reserve Fund, Inc.

From : Bela Balassa,

**Subject / Title**

Check to be deposited

**Exception No(s).**

☐ 1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐ 6 ☐ 7 ☐ 8 ☐ 9 ☐ 10 A-C ☒ 10 D ☐ Prerogative to Restrict

**Reason for Removal**

Financial Information

**Additional Comments**

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information. This Policy can be found on the World Bank Access to Information website.

Withdrawn by

Chandra Kumar

Date

Jun 10, 2014

July 21, 1982.

Mr. Jesse R. Pitts, Editor  
The Tocqueville Review  
Department of Sociology-Anthropology  
Oakland University  
Rochester, MI 48063

Dear Sir:

I enclose two copies of my paper, "The First Year of Socialist Government in France" for consideration for publication in the Tocqueville Review. I believe that the paper would well compliment Mark Kesselman's article in your spring-summer 1982 issue. I would like to add that the paper will be published in French in Commentaire.

I would appreciate your early reply as I will be leaving for abroad on August 4th. Should you wish to contact me afterwards, I enclose my list of addresses.

Yours sincerely,

Enclosures

Bela Balassa

P.S. I would also be interested in presenting my paper at the annual meeting of the Tocqueville Society provided that it can be scheduled for

Enclosure List of addresses

Two copies of The First Year of Socialist Government in France

313  
315 + 555-1212

377-2100 - 1 Oakland

377-2420 h. Anth-doo.

Tocqueville Review



2134 Wyoming Avenue N.W.  
Washington, D.C. 20008  
July 21, 1982.

Foreign Affairs Reader Services  
58 East 68th Street  
New York, N.Y. 10021

Dear Sir:

Several months ago I wrote to you indicating that I paid my subscription to Foreign Affairs for the year 1982 twice. I have since received a refund for one of the subscriptions. I have not received, however, any further issue of Foreign Affairs. The last one I had is the Annual 1981 issue. Please check on this and ensure that I receive all issues.

Yours sincerely,

Bela Balassa

Mr. Goddard W. Winterbottom, PUB

July 21, 1982

Bela Balassa, DRD

Review Copies of Development Strategies in Semi-Industrial Economies

The list of review copies of my Development Strategies in Semi-Industrial Economies, sent out by the Johns Hopkins University Press, does not include some of the major U.S. economic journals. I enclose a list with the request that review copies be sent to the journals in question.

The list further includes some foreign journals in the event that they might have been missed by the London office of Hopkins Press.

Enclosure  
BBalassa:nc



Journal to which review copies  
have not been sent:

- US Journal of Development Economics
- US Journal of Economic Literature (has been sent to American Economic Review)
- Journal of Development Studies
- Economic Journal
- Economica
- US Econometrica
- US Journal of Comparative Economics
- US Journal of International Economics
- US Journal of Policy Modelling
- US Quarterly Journal of Economics
- US Review of Economics & Statistics
- The World Economy
- European Economic Review
- Indian Economic Journal
- Hitotsubashi Journal of Economics
- Manchester School of Economics & Social Studies
- Kyklos
- Oxford Economic Papers
- Pakistan Development Review
- US Southern Economic Journal
- Swedish Journal of Economics
- Weltwirtschaftliches Archiv

July 21, 1982.

Dr. Thomas Johnson  
Director, Economic Policy Studies  
American Enterprise Institute  
1150 17th Street N.W.  
Washington, D.C. 20036

Dear Tom,

I enclose two copies of my paper on France. I look forward to your comments to having lunch with you and others at the AEI.

Yours sincerely,

Enclosures

Bela Balassa

Enclosed: The First Year of Socialism in France



July 21, 1982.

Mr. Paul Mentre de Loye  
80 Boulevard Flandrin  
75016 Paris  
France

Dear Paul,

I did not get to Paris after all because my mission to Morocco was postponed. I will be there on August 9 and 10 and would like to have the opportunity to see you. Please let me know if you would be free for lunch on the 10th.

With best regards,

Yours sincerely,

Enclosure

Bela Balassa

P.S. I enclose my paper "Une année d'experience socialiste en France" to be published in Commentaire.

July 21, 1982.

Mr. Nicholas Wahl  
8 rue Poullétier  
Paris, 4e  
France

Dear Nicholas,

I am sorry that the French and American colloquium was cancelled and thus we have not had the chance to meet. My trip to Paris has also been postponed and I will be there only on August 9 and 10. Please let me know if we could have dinner on the 9th.

With best regards,

Sincerely yours,

Enclosure

Bela Balassa

P.S. I enclose my ~~paper~~ "Une année d'expérience socialiste en France" to be published in Commentaire.



2134 Wyoming Avenue N.W.  
Washington, D.C. 20008  
July 21, 1982

Washington Gas  
P.O. Box 2432  
Washington, D.C. 20081

Dear Sir:

Your last statement shows a credit balance, in my favor of  
\$144.34. I would appreciate your sending me a check in this amount.

Yours sincerely,

Bela Balassa

July 21, 1982.

Mrs. Ina Wahl  
15 av. de la Bourdonnais  
Paris 75007  
France

Dear Ina,

I was very sorry to hear of the illness of your mother and son. I very much hope that they have fully recovered by now.

We have our own little problems with illness as Mara got the chicken pox at camp. This puts Gabor in danger and we had to cancel our trip to Turkey. This also means that we will be in Paris in early rather than in late August. But I presume that you will have departed by then. In all eventuality, I enclose my address list (Carol and the children will come with me to Morocco for a week).

I also enclose the revised version of my paper "Une Année d'expérience socialiste en France" that is to be published in the next issue of Commentaire. At the end I did not use the OECD projections.

Carol and the children join me in sending our best regards to you and your children.

Yours sincerely,

Enclosures

Bela Balassa

Enclosed: Address list  
UNE ANNEE D'EXPERIENCE SOCIALISTE EN FRANCE



July 21, 1982.

Foreign Affairs  
Council on Foreign Relations, Inc.  
Editorial Office  
58 East 68th Street  
New York, N.Y. 10021

Dear Sir:

I am enclosing a copy of my paper "The First Year of Socialist Government in France" for your consideration for publication in Foreign Affairs. Your early answer would be appreciated as I will be leaving for abroad on August 4th. Should you wish to contact my afterwards, I enclose my list of addresses.

Yours sincerely,

Enclosures

Bela Balassa

Enclosed List of summer addresses and two copies of paper.  
cc: Mr. William Diebold

July 21, 1982.

Professor Robert H. Bates  
California Institute of Technology  
Division of the Humanities  
and Social Sciences 228-77  
Pasadena  
California 91125

Dear Professor Bates:

Please excuse the delay in answering your letter of June 10th. While I have little familiarity with writings on the politics of development, you may find useful the articles marked in red on the enclosed reading list. I have marked quite a few of my own papers, copies of which are enclosed. You may wish to make a choice among them. Several of my recent papers deal with the adjustment of developing countries to the external shocks they suffered, including the oil price rise and the world recession.

Yours sincerely,

Enclosures

Bela Balassa

Enclosed: Development Policies and Project Evaluation 18.628  
Bibliography and Reading List - Spring 1982  
Structural Adjustment Policies in Developing Economies  
Trade in Manufactured Goods: Patterns of Change  
The Newly Industrializing Developing Countries after the Oil Crisis  
The Tokyo Round and the Developing Countries  
Prospects for Trade in Manufactured Goods between Industrial and  
Developing Countries, 1978-1990  
The Process of Industrial Development and Alternative Development Strategies



July 20, 1982.

Mr. André Sapir  
Department of Economics  
University of Wisconsin  
Madison, Wisconsin 53706

Dear André,

I enclose a preliminary version of the comments I made at the "New Issues in the 1980s" session of the Conference on Trade Policy in the 80s. Should you have any reactions to my comments, I would appreciate receiving them by July 28th, Wednesday.

Yours sincerely,

Enclosure

Bela Balassa

1 1 61007

MEHMET GUN CALIKA, NEBAN SECURITIES BROKERAGE  
ODAKULE IS MERKEZI ISTIKLAL CADDESI, 286 BEYOGLU, ISTANBUL, TURKEY  
PLANNING TO ARRIVE ON AUGUST 5 THURSDAY SWISSAIR 324 AT 3:55 PM.  
LEAVING ON AUGUST 7 SATURDAY ON SWISSAIR 327 AT 4:55 PM. YOUR  
SISTER ARRIVING ISTANBUL ONLY ON AUGUST 15. WILL TRY TO FIND SOME-  
ONE TO HAND CARRY PAPER THE END OF JULY. PLEASE CONFIRM SEMINAR AS  
SOON AS POSSIBLE. REGARDS, BALASSA

CABLE

7/20.82

Bela Balassa

Bela Balassa

DRD - Director's Office

BBalassano



Those listed

July 20, 1982.

Bela Balassa, DRD

Comments Made at Trade Policy Conference

I enclose a preliminary version of the comments I made at the "New Issues in the 1980s" session of the Conference on Trade Policy in the 80s. Should you have any reactions to my comments, I would appreciate receiving them by July 28th, Wednesday.

cc: Messrs. Cline, Deardorf, J. Diebold, W. Diebold, Hufbauer, Safarian,  
Ms. Stalson, Mr. Stern

Enclosure  
BBalassa:nc

## OFFICE MEMORANDUM

Those listed

July 20, 1982.

Bela Balassa, DRD *M*

Comments Made at Trade Policy Conference

I enclose a preliminary version of the comments I made at the "New Issues in the 1980s" session of the Conference on Trade Policy in the 80s. Should you have any reactions to my comments, I would appreciate receiving them by July 28th, Wednesday.

cc: Messrs. Cline, Deardorf, J. Diebold, W. Diebold, Hufbauer, Safarian,  
Ms. Stalson, Mr. Stern

Enclosure  
BBalassa:nc



Mr. Tun Thin, IMF

July 19, 1982

Bela Balassa, DRD

Paper on China

I enclose my recent advisory report on China that will be published in the next issue of Bollettino Nazionale del Lavoro Quarterly Review. I hope that you will find it of interest.

cc: Mr. Neiss, IMF (with enclosure)

Enclosure  
BBalassa:nc

Enclosed: Economic Reform in China

Mr. L. A. Whittome, IMF

July 19, 1982.

Bela Balassa, DRD

Paper on France

I enclose my paper on the first year of a socialist government in France that will be published in the next issue of Commentaire. I hope that you will find it of interest.

cc: with enclosure, Messrs. de Fontenay  
Hans Schmitt  
Dhonte

Enclosure  
BBalassa:nc

Enclosed UNE ANNEE D'EXPERIENCE SOCIALISTE EN FRANCE



Mr. J. de Larosiere, IMF

July 19, 1982.

Bela Balassa, DRD

Papers on China and France

I enclose my recent advisory report on China that will be published in the next issue of Banca Nazionale del Lavoro Quarterly Review. I further enclose my paper on the first year of a socialist government in France that will be published in the next issue of Commentaire.

I hope that you will find the papers of interest. I am sending copies to the directors of the respective departments.

Enclosures  
BBalassa:nc

~~Copy of China report sent to Tun Thin DMF 4-320~~  
~~Copy of French paper sent to L.A. Whitcomb 9-120~~

Enclosed: Economic Reform in China  
UNE ANNEE D'EXPERIENCE SOCIALISTE EN FRANCE

July 19, 1982.

Mr. Oscar Soberon  
El Trimestre Economico  
Fondo de Cultura Economica  
Apartado Postal 44975  
Mexico 12, D.F.  
Mexico

Dear Mr. Soberon:

I had hoped to be able to send you a paper for inclusion in your anniversary issue. I am sorry to say, however, that due to other engagements I have not been able to do so. I, therefore, enclose a short statement expressing my admiration of your Journal.

Yours sincerely,

Enclosure

Bela Balassa



July 19, 1982.

El Trimestre Economico is by far the best economists journal in the Spanish language. In fact, it ranks with the better English language journals on development issues.

El Trimestre Economico provides a judicious selection of articles dealing with theoretical and policy issues. I have much benefitted from the reading of the journal in the past and wish it much luck on the occasion of its fiftieth anniversary.

Bela Balassa  
Professor of Political Economy  
The Johns Hopkins University  
and  
Consultant to the World Bank

Travel - Consultant Section - Ann

July 16, 1982.

Bela Balassa,

Flight Reservations

Due to an illness in my family, I have to modify my travel plans. Enclosed is the revised itinerary. As some of the flights are difficult ones, I would appreciate your early attention to this matter.

Enclosure  
BBalassa:nc



Mr. R. Barker, AMEX

July 16, 1982.

Bela Balassa, DRD

Flight Reservations

Due to the illness of my daughter, we have to postpone our vacation and cancel the trip to Turkey. I am sorry to have to impose on you again but this necessitates changing all the reservations of my family. As some of the flights are difficult ones, I would appreciate your early attention to this matter.

Enclosure  
BBalassa:nc

July 16, 1982.

Professor Dr. Armin Gutowski  
President des HWWA-Institut  
fur Wirtschaftsforschung-Hamburg  
Neuer Jungfernstieg 21  
2000 Hamburg 36  
Germany

Dear Armin,

I enclose the final version of my paper "Economic Reform in China" that will appear in the Banca Nazionale del Lavoro Quarterly Review. I hope that you find the paper of interest.

Sincerely yours,

Enclosure

Bela Balassa



July 16, 1982.

Mr. Yves Berthelot  
Director  
Centre d'études prospectives  
et d'informations internationales  
9, rue Georges Pitard  
75015 Paris  
France

Dear Yves,

I enclose the revised version of my paper "Une année d'expérience socialiste en France" that will appear in the next issue of Commentaire. I very much appreciated having your comments on the earlier version of the paper.

With best regards,

Sincerely yours,

Enclosure

Bela Balassa

July 16, 1982.

Mr. Gérard de Margerie  
4430 Linnean Avenue N.W.  
Washington, D.C. 20008

Dear Gérard,

I enclose the revised version of my "une année d'expérience socialiste en France." I hope that you will find it to your liking.

I very much appreciated the comments you made and the conversations we had on my paper. I have taken account of most of your comments in the revised version.

Carol joins me in sending our best regards to Isaure.

Yours sincerely,

Enclosure

Bela Balassa



July 16, 1982.

Mr. Pierre-Henri Cassou  
6 rue Guy Maupassant  
Paris 75016  
France

My dear friend,

I have been trying to call you in Paris but without success. Since our telephone conversation, I have spoken to Gérard de Margerie and he doesn't want to be mentioned in the introduction of my paper. He also expressed the view that it would be inappropriate for me to refer either to Yves Berthelot or to yourself. Correspondingly, I have eliminated reference to the three of you in the paper. I hope that this meets with your approval.

I would like to thank you again for your excellent comments and hope that the revised version of the paper is to your liking.

Yours sincerely,

Enclosure

Bela Balassa

Enclosed: Une année d'expérience socialiste en France

Changes in Comparative Advantage in Manufactured Goods: Part I

Work Program

I. Estimation for 1971

A. Re-estimate Existing Equations

- (a) retain Bel-Rog formulation and original RCA.
- (b) make estimates for exports, imports, and net exports.
- (c) Adjust human capital coefficients by deducting unskilled wage from average wage.
- (d) adjust physical endowment variables by using .9 and .96 depreciation factors.

B. Adding New Variables

1. R&D variable

- (a) input coefficients: use NSF data
- (b) country endowment: review UNESCO data

2. Economies of scale variable

- (a) input coefficients: use Hufbauer's data
- (b) country endowment: manufacturing output

3. Product-cycle variable

- (a) input coefficients: use first trade data
- (b) country variable: per capita incomes

C. Estimating Bilateral Trade of Individual Countries

1. make estimates using two-stage approach

2. make estimates using absolute values of trade

- (a) introduce distance variable, utilizing sources cited by Linnemann on p. 227.
- (b) introduce dummy variables for the following country groupings.



- (i) Old EEC: Belgium, France, Germany, Italy, Netherlands
- (ii) EFTA: Austria, Denmark, Finland, Norway,  
Portugal, Sweden, Switzerland, United Kingdom
- (iii) U.K.-Irish Free Trade Area: Ireland and the  
United Kingdom

D. Make Calculations with Japanese Input Coefficients (four digit)

- (a) Calculate average wages
- (b) deduct unskilled wage from average wage
- (c) use 11 percent discount factor

E. Combine Estimates of Two Stages

II. Make Estimates for Alternative Years

- 1. Re-estimate physical endowment variable for individual year
- 2. Use Harbison-Myers index for corresponding year

III. Time Series Estimation

same as under II

IV. Combination of Cross-Section and Time Series Estimation

estimation procedures would need to be devised

2134 Wyoming Avenue N.W.  
Washington, D.C. 20008  
July 16, 1982.

The Economists' Bookshop Ltd.  
Clare Market  
Portugal Street  
London WC2A 2AB  
England

Dear Sir:

I would like to order,

Trade and Development Policies: Leading Issues for the 1980s by Alexander  
J. Yeats, London: Macmillan, 1981, pp. xiii ç208, £ 20.00.

Please bill me at the time of delivery.

Yours truly,

Bela Balassa



ent to home address.

July 16, 1982.

Mrs. Nicole Solyom  
Régie Renault  
34 Quai du Point du Jour  
92109 Boulogne Billancourt  
France

Dear Nicôle,

I enclose the revised version of my paper "Une année d'expérience socialiste en France" that will appear in the next issue of Commentaire. Thank you for sending me the Renault-Peugeot comparison which I also had from the embassy.

Our plans have changed and we expect to be in Parisoon the 10th of August. I will give you details as soon as I have them.

Yours sincerely,

Enclosure

Bela Balassa

July 16, 1982.

Professor Maxwell J. Fry  
Economic Department  
University of California  
Irvin  
California 92717

Dear Maxwell,

Please find enclosed Table 1 which is missing from the paper  
"Disequilibrium Analysis in Developing Economies: An Overview" that I  
sent you earlier.

Yours sincerely,

Enclosure

Bela Balassa



Table 1

Effective Protection in Twelve Developing Economies

	<u>Gross Effective Protection (<math>z_1</math>)</u>			<u>Net Effective Protection (<math>z_1^1</math>) a/</u>			<u>Bias Against Exports (<math>x_1</math>)</u>		
	Primary	Manufacturing	Together	Primary	Manufacturing	Together	Primary	Manufacturing	Together
Brazil (1966)	52	113	83	20	68	44	na	122	na
Chile (1961)	21	182	84	-28	68	10	na	324	na
Mexico (1960)	1	26	12	-7	16	3	13	87	58
Malaysia (1960)	-6	-6	-6	-10	-10	-10	na	25	na
Pakistan (1963-64)	na	271	na	na	147	na	na	na	na
Philippines (1965)	-1	61	8	-14	41	-6	na	228	na
Argentina (1969)	0	112	47	-29	38	1	24	241	94
Colombia (1969)	-10	35	-2	-20	10	-15	13	42	23
Israel (1968)	48	76	62	-8	7	0	26	63	50
Korea (1968)	9	13	10	1	-11	-1	16	10	10
Singapore (1967)	9	4	6	5	-4	0	13	6	9
Taiwan (1969)	0	14	5	-8	9	-2	4	26	10

---

Source: Bela Balassa and Associates, The Structure of Protection in Developing Countries, Baltimore, Md., Johns Hopkins University Press, 1971 and Bela Balassa and Associates, Development Strategies in Semi-Industrial Economies, Baltimore, Md., Johns Hopkins University Press, 1982.

Mr. James K. Feather, PUB

July 15, 1982

Bela Balassa, DRD

Reprint Series

1. This is in reference to our brief conversation the other day concerning the inclusion of my paper "Structural Adjustment Policies," published in World Development, in the World Bank Reprint Series. The paper was accepted for the Reprint Series by the Editorial Committee in early February. However, Mr. Winterbottom has subsequently stopped the process on the grounds that the Working Paper version of the paper was still available. More recently, to my telephone inquiry, I have received the enclosed memorandum.
2. In my memo of March 18th to you, I suggested that one should not change rules in mid-stream. In the present case, the number of Working Papers made by the Printshop was apparently not adjusted for reduced demand in response to the Bank requiring payment for the Working Papers. At the same time, many people, like myself, do not read working papers but only published materials that have gone through a vetting procedure.
3. Mr. Winterbottom suggests that "reprints are usually available for purchase from the journal." This indeed was the case at the time of publication of my paper but not six months later. Thus, while I could have purchased reprints had the Editorial Committee rejected the paper, I cannot do it now. At the same time, you may wish to review the enclosed memorandum from Mr. Stern, concerning the contribution of the paper to the discussion of structural adjustment policies.
4. I would appreciate it if you made the appropriate steps so that the February 1982 decision of the Editorial Committee is carried out and that further delays in reprinting my paper can be avoided.

cc: Mr. Winterbottom, PUB


Enclosure  
BBalassa:nc



## OFFICE MEMORANDUM

TO: Mr. Bela Balassa, DRD

DATE: June 30, 1982

FROM: Goddard Winterbottom, PUBPT 

SUBJECT: Reprint Series/Staff Working Papers

Mrs. Hitchcock has reminded me that you are still concerned about getting articles into the Reprint Series while they are still available as Staff Working Papers.

The following is from the minutes of the Editorial Subcommittee meeting of April 21, 1982: "The Subcommittee discussed Mr. Sherman Robinson's memorandum of March 19, 1982. It was not thought likely that material would be withheld from the Staff Working Papers Series if reprint proposals were turned down because the articles in question were available as Staff Working Papers. [Member X] said that the policy had always been, and should remain, that a paper should not be included in the reprint series if it existed in a similar form in the Staff Working Papers and if a substantial quantity of the SWP were still in stock. The Subcommittee agreed that this should remain the policy."

As you know, reprints are usually available for purchase from the journal.

## OFFICE MEMORANDUM

TO: Mr. Bela Balassa, Development Research Center      DATE: December 15, 1980  
FROM: Ernest Stern, Senior Vice President, Operations *ES.*  
SUBJECT: Paper - "Structural Adjustment Policies"

I thought your paper on Structural Adjustment Policies excellent and an important contribution to the discussion of the concept. I have no suggestions for changes. One point you might want to consider further is whether in some of the less developed countries, with not only limited institutional capacity but also limited political capacity to change policies, a more limited approach would be effective (e.g. start in a major sector line -- agricultural with prices, export orientation, etc.), and, if so, what the limitations of a sectoral approach might be?

EStern:ct



July 14, 1982.

Professor Jacques Lesourne  
Conservatoire National des Arts et Métiers  
Poste 648  
292, rue Saint-Martin  
75141 Paris CEDEX 03  
France

Dear Professor Lesourne:

Thank you for your letter of June 30th that arrived after the revision of my paper had been completed. The mail is indeed very slow between Paris and Washington!

I think, however, that you will find the paper improved. A new section has also been added dealing with the situation following the June 1982 devaluation.

Yours sincerely,

Enclosure

Bela Balassa

Enclosed Une Année d'Experience Socialiste en France

Mr. T. King, DRDEI

July 14, 1982.

Bela Balassa, DRD

Reprint Series

Your own paper and the paper by Jamison would make a fine addition to the Reprint Series. Please provide us with 15 copies of each and prepare Form 1834 for your paper.

BBalassa:nc



July 14, 1982.

Mr. Dong Furen  
Deputy Director  
Institute of Economics  
Chinese Academy of Social Sciences  
5 Jianguomen Nei Dajie  
Beijing  
CHINA

Dear Mr. Dong:

Thank you for sending me your comments on my article on Hungary. While this article has already been sent to the publisher, I will make use of the comments in future work I will do on Hungary.

I sent you a few days ago my revised paper on "Economic Reform in China" that will be published in the Banca Nazionale del Lavoro Quarterly Review. I would be interested in having your reaction to the paper.

Yours sincerely,

Bela Balassa

July 14, 1982.

M. Jean-Claude Casanova  
87, bd. St. Michel, 5e  
Paris 75005  
France

My dear friend,

Thank you for your letter of June 29th which reached me last week. I enclose the French translation of the revised version of the paper that incorporates a discussion of the situation following the June devaluation. Rather than examining several possible alternatives, I have focused on the conditions for successful adjustment.

In the meantime, I have received a letter from Jacques Lesourne who has made some interesting points.

To be on the safe side, I am sending copies of the letter as well as the paper to your two offices as well. I also enclose a list of my addresses where proofs could be sent. Finally, I would like to purchase a 120 reprints of the paper, provided that the cost is not too high.

With best regards,

Sincerely yours,

Enclosures

Bela Balassa



July 13, 1982.

Working Papers, NBER  
1050 Massachusetts Avenue  
Cambridge, Massachusetts 02138

Dear Sir:

I would like to order,

NBER Working Paper No. 784 by David G. Hartman, "Domestic Tax Policy and Foreign Investment: Some Evidence",

NBER Working Paper No. 791 by William Branson, "The OPEC Surplus and U.S.-LDC Trade",

NBER Working Paper No. 798 by Daniel J. Frisch, "Issues in the Taxation of Foreign Source Income".

My check for \$4.50 is enclosed.

Yours truly,

Enclosure

Bela Balassa

July 13, 1982.

Mr. Nessim Shallon  
UNDP Office  
57 Binhelu Sanlitun  
Beijing  
China

Dear Mr. Shallon:

It was a pleasure meeting you in Beijing and I very much enjoyed the conversations we had. Please also thank your wife for me for the pleasant lunch.

I enclose a copy of my "Economic Reform in China" that may be of interest to you. The paper will be published in the next issue of Banca Nazionale del Lavoro Quarterly Review.

Hoping that you had a pleasant trip to Korea, I remain,

Sincerely yours,

Enclosure

Bela Balassa



July 13, 1982.

Lic. Antonio Gazol, S.,  
Presidente  
Colegio Nacional de Economistas, A.C.  
Antonio Caso No. 86 2<sup>o</sup> piso  
Mexico 4, D.F.  
MEXICO

Dear Mr. Gazol:

Thank you for inviting me to the seminar on "Industrialization and Foreign Trade" that will be held in Mexico City on January 3. I will be happy to present a paper on Mexican foreign policy at the Conference.

With best regards,

Sincerely yours,

Bela Balassa

cc: Lic. Alejandro Violante M.  
Mexican Embassy  
2829 16th Street N.W.  
Washington, D.C. 20009

July 13, 1982.

Dr. Bela Csikos-Nagy  
President  
Hungarian Economic Association  
1370 Budapest Pf. 544  
HUNGARY

Dear Bela,

Thank you for your letter of June 15th. I was glad to hear that you had a good meeting with the World Bank mission and that you plan to come to Washington to give a talk at the World Bank in September 1983.

I spoke to Victor Urquidi who tells me that IEA is organizing two sessions at the meetings of the American Economic Association to be held in the last week of December in New York. I presume that it is these meetings you might participate at. This means you would presumably be in Budapest before Christmas. I wonder, therefore, if it would be convenient for you if I presented the seminar we discussed around December 13th.

I will not go to Budapest after all in August, we will thus not see each other until December and I would like to clarify the topic of my seminar. At our last meeting you asked me to speak about policies of export orientation and import substitution. In your letter of June 15th, however, you suggest that I should deal with methodology issues. I would appreciate it if you would inform me in some detail what you would like me to discuss at the seminar.

I will be away from Washington from July 30th for about six weeks. Should you wish to get in touch with me during this period I enclose a list of my addresses.

Yours sincerely,

Enclosures

Bela Balassa

P.S. I enclose a short report on my visit to China which may be of interest to you.



July 13, 1982.

Mr. Jerzy Thieme  
522 West 112th Street, Apt. 44  
New York, New York 10025

Dear Mr. Thieme:

Thank you for your letter of June 15th inquiring about the possibility of employment at the World Bank.

I have asked our recruitment staff to look into employment possibilities for you and to consider you carefully for any assignment for which you may be qualified. They will be in touch with you direct in two to three weeks.

Sincerely,

Bela Balassa

cc: Personnel Department



Mr. James K. Feather, PUB

July 13, 1982

Bela Balassa, DRD

Reprint Series

1. This is in reference to our brief conversation the other day concerning the inclusion of my paper "Structural Adjustment Policies," published in World Development, in the World Bank Reprint Series. The paper was accepted for the Reprint Series by the Editorial Committee in early February, but Mr. Winterbottom has subsequently stopped the process on the grounds that the Working Paper version of the paper was still available. More recently, to my telephone inquiry, I have received the enclosed memo that I find unsatisfactory.
2. In my memo of March 18th to you, I suggested that one should not change rules in mid-stream. In the present case, the number of Working Papers made by the Printshop was apparently not adjusted for reduced demand in response to the Bank requiring payment for the Working Papers. At the same time, many, like myself, do not read working papers but published materials which have gone through a vetting procedure.
3. Mr. Winterbottom suggests that "reprints are usually available for purchase from the journal." This indeed was the case at the time of publication but not six months later. Thus, while I could have purchased reprints had the Editorial Committee rejected the paper, I cannot do it now. At the same time, I wish to refer to the memorandum from Mr. Stern, enclosed with my submission to the Reprint Series, that indicated the importance of the paper.
4. I would appreciate it if you made the appropriate steps so that the February 1982 decision of the Editorial Committee is carried out and that further delays in reprinting my paper may be avoided.

cc: Mr. Winterbottom, PUB

Enclosure  
BBalassa:nc



## OFFICE MEMORANDUM

TO: Mr. Bela Balassa, DRD

DATE: June 30, 1982

FROM: Goddard Winterbottom, PUBPT *GW*

SUBJECT: Reprint Series/Staff Working Papers

Mrs. Hitchcock has reminded me that you are still concerned about getting articles into the Reprint Series while they are still available as Staff Working Papers.

The following is from the minutes of the Editorial Subcommittee meeting of April 21, 1982: "The Subcommittee discussed Mr. Sherman Robinson's memorandum of March 19, 1982. It was not thought likely that material would be withheld from the Staff Working Papers Series if reprint proposals were turned down because the articles in question were available as Staff Working Papers. [Member X] said that the policy had always been, and should remain, that a paper should not be included in the reprint series if it existed in a similar form in the Staff Working Papers and if a substantial quantity of the SWP were still in stock. The Subcommittee agreed that this should remain the policy."

As you know, reprints are usually available for purchase from the journal.

July 13, 1982.

Professor Henry Neil Goldstein  
Department of Economics  
University of Oregon  
Eugene, Oregon 97403

Dear Professor Goldstein:

Thank you for your letter of June 23rd inquiring about the possibility of employment with the World Bank. Indeed you have an impressive list of publications albeit the topics have a greater relevance for the Fund than for the Bank.

I have asked our recruitment staff to look into employment possibilities for you and to consider you carefully for any assignment for which you may be qualified. They will be in touch with you direct in two to three weeks.

Sincerely,

Bela Balassa

cc: Personnel Department



July 13, 1988

Professor Thomas O'Toole  
The University of North Carolina  
at Chapel Hill  
Gardner Hall 017 A  
Chapel Hill, North Carolina 27514

Dear Tom,

It was good to hear from you and I would be happy to write letters of recommendation for you now or in the future. I look forward to reading the papers you have sent me. Hoping that your son has recovered fully, I remain,

Sincerely yours,

Bela Balassa

July 13, 1982.

Dr. Mukerrem Hic  
Faculty of Economics  
Institute of Economic Development  
Istanbul University  
Istanbul  
TURKEY

Dear Dr. Hic:

Thank you for sending me your article "Development Since 1980 in the Turkish Economy." I look forward to reading it.

Baran Tuncer tells me there is a hotel five to ten minutes drive from the airport where my family and I could spend a few hours between the two flights. Should you not be at the airport at the time of our arrival, we could perhaps meet there. We plan to arrive on Swissair 326 at 3:55 p.m. on July 31 Saturday. Looking forward to seeing you, I remain,

Sincerely yours,

Bela Balassa



## OFFICE MEMORANDUM

TO: Mr. James K. Feather, PUB

FROM: Bela Balassa, DRD

SUBJECT: Reprint Series

DATE: July 13, 1982

1. This is in reference to our brief conversation the other day concerning the inclusion of my paper "Structural Adjustment Policies," published in World Development, in the World Bank Reprint Series. The paper was accepted for the Reprint Series by the Editorial Committee in early February, but Mr. Winterbottom has subsequently stopped the process on the grounds that the Working Paper version of the paper was still available. More recently, to my telephone inquiry, I have received the enclosed memo that I find unsatisfactory.

2. In my memo of March 18th to you, I suggested that one should not change rules in mid-stream. In the present case, the number of Working Papers made by the Printshop was apparently not adjusted for reduced demand in response to the Bank requiring payment for the Working Papers. At the same time, many, like myself, do not read working papers but published materials which have gone through a vetting procedure.

3. Mr. Winterbottom suggests that "reprints are usually available for purchase from the journal." This indeed was the case at the time of publication but not six months later. Thus, while I could have purchased reprints had the Editorial Committee rejected the paper, I cannot do it now. At the same time, I wish to refer to the memorandum from Mr. Stern, enclosed with my submission to the Reprint Series, that indicated the importance of the paper.

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cc: Mr. Winterbottom, PUB

Enclosure  
BBalassa:nc



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Withdrawn by Chandra Kumar	Date Jun 10, 2014			



July 12, 1982.

Professor Nicholas Lardy  
Department of Economics  
Yale University  
Box 1987, Yale Station  
New Haven, Connecticut 06520

Dear Nick,

Thank you for your letter of June 28th which reached me as I was putting the final touches on the revision of my paper on China. A copy of the revised version is enclosed. It will be published in the next issue of the Banca Nazionale del Lavoro, Quarterly Review.

I do understand the political difficulties involved in changing things in China. At the present time, however, I have found it useful to indicate the outlines of comprehensive reform even if some parts cannot find immediate application.

Yours sincerely,

Enclosure

Bela Balassa

1 1 61007

MR. YVES FRANCHET, INTBAFRAD

75116 PARIS, FRANCE

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BELA BALASSA

BELA BALASSA

BBalassa:nc

DRD - Director's Office



Policy Responses to External Shocks  
in Sub-Saharan African Countries, 1973-78

Bela Balassa

The author earlier analyzed the balance-of-payments effects of external shocks, and of policy responses to these shocks, in newly-industrializing developing and in less developed countries during the 1973-78 period (1981a, b, c,). The external shocks in question include terms of trade effects, resulting in large part from the quadrupling of oil prices of 1973-74, as well as export shortfalls, resulting from the deceleration of the growth of world trade in the wake of the world recession of 1974-75. In turn, the policy responses comprise additional net external financing, export promotion, import substitution, and lowering the rate of economic growth.

Apart from India and Tanzania, the studies have not covered any developing country that is classified in the low-income group in World Development Report, 1981 (World Bank, 1981b), which may be considered representative of the customary distinction made between middle-income and low-income countries. Also, the the studies have included only four middle-income sub-Saharan African countries, the Ivory Coast, Kenya, Mauritius, and Zambia, within a grand total of twenty-six.

At the same time, it has been repeatedly suggested in public discussions and, in particular, in the criticism of the so-called Berg Report (World Bank, 1981a), that sub-Saharan African countries represent a special case as far as their responsiveness to price signals is concerned. Thus, it has been alleged that the economic structure of these countries limits their ability to respond to price signals and, correspondingly, makes adjustment to external shocks difficult. This conclusion is said to apply a fortiori to the low-income countries of sub-Saharan Africa.

The controversy concerning the countries of sub-Saharan Africa points to the desirability of examining their experience during the 1973-78 period of external shocks. This has been done in the present paper, with distinction made among countries at different levels of development, 1/

The classification scheme utilized is described in Section I of the paper. Section II examines the balance-of-payments effects of external shocks while Section III analyzes the policy responses to these shocks in sub-Saharan African countries. Finally, the policies applied in middle-income and low-income countries are analyzed in Section IV of the paper.

#### I. The Classification Scheme Applied

The investigation covers 19 oil-importing and three oil-exporting countries in sub-Saharan Africa. According to the geographical classification of the World Bank, ten of the oil-importing countries are located in Eastern Africa: Botswana, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Sudan, Tanzania, Zaire, and Zambia. In turn, the countries studied include nine oil-importing countries (Cameroon, Ghana, Guinea, Ivory Coast, Mali, Senegal, Sierra Leone, Togo, and Upper Volta) and three oil-exporting countries (Congo, Gabon, and Nigeria) in Western Africa.

In distinguishing between middle-income and low-income countries, 1970 incomes per head of 300 U.S. dollars, estimated at 1979 prices and exchange rates, has been used as the dividing line in the present paper. The choice of the year 1970 has been dictated by the desire to avoid using an ex-post classification that may reflect the effects of the policies followed during

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1/ A companion paper, "Adjustment Policies and Development Strategies in Sub-Saharan Africa, 1973-78" examines the experience of the countries of the region applying different development strategies as regards the role of the state in economic life and the extent of reliance on market forces. The Annex to the paper provides a description of the methodology.



the period under consideration.

Utilizing this benchmark, Kenya, Mauritius, Sudan, and Zambia in Eastern Africa, as well as Cameroon, Ghana, Ivory Coast, Senegal, and Ghana among oil-importing countries and all three oil-exporting countries in Western Africa are classified in the middle-income group. In turn, low-income countries include Botswana, Ethiopia, Madagascar, Malawi, Tanzania, and Zaire, as well as Guinea, Mali, Sierra Leone, and Upper Volta (Table A).

Applying the median per capita income growth rate of 1.5 percent would give a dividing line of \$340 in 1979 prices for 1979. As a result of its rapid rate of economic growth, Botswana would qualify as a middle income country under this benchmark. No other country would need to be reclassified, however. 2/

2/ The data originates from the 1981 World Bank Atlas that includes countries with less than 1 million inhabitants (in the present case, Botswana and Mauritius) which are not covered in the World Development Report, 1981 that provided earlier estimates of per capita incomes and used a benchmark of \$375. Under this benchmark, Sudan and Togo would have been reclassified as low-income countries. However, according to the revised figures of the Atlas, per capita incomes in these countries exceed that of Kenya.

Comments on  
H. W. Singer, The Terms of Trade Controversy  
and the Evolution of Soft Financing

by

Bela Balassa

Dr. Singer's principal claim to fame is his paper on "The Distribution of Gains between Investing and Borrowing Countries," presented at the December 1949 meetings of the American Economic Association and published in the AER Proceedings of May 1950. The paper has been reprinted in practically all readings volumes on economic development and has been read by an untold number of students. It has also led to the pairing of Singer's name with that of Raul Prebisch, in referring to the Prebisch-Singer thesis on the alleged tendency for the secular decline of the terms of trade of the developing countries. The terms of trade issue was central to Singer's 1950 paper as it is in the present lecture.

Singer suggests that "treated as a projection, one can certainly claim that [the historical downward trend in terms of trade for primary products] has passed the test better than most other economic projections" (Singer, 1982, p. 17). He further adds: "If I had been clearer about [the] growing distinction between the terms of trade of primary products versus manufactures on the one hand, and developing countries versus industrialized countries on the other hand, the logic of my argument would have been to lay more emphasis on a tendency towards deteriorating terms of trade in relation to countries as well as groups of commodities. ... If I had been able to make this point more clearly, it would have added to the strength of the projection" (p. 37-38).

Thus, in Singer's view, "the terms of trade of Third World countries have declined in relation to those of industrial countries even if the analysis is



restricted to trade in manufactured goods only, or to primary commodities only" (p. 30). These differences are said to be reinforced by "the lower proportion in total exports of LDCs of manufactures (for which unit values have increased more), and a higher proportion of primary commodities in their exports (for which unit values have increased less)" (p. 42), with the extent of the deterioration of the terms of trade being the greater at lower levels of development (pp. 38-41). I will submit these propositions to scrutiny.

The first question relates to the choice of the time period. Singer states that "in this paper, we are concerned only with the implicit postwar projection from the 1949-50 paper onwards, not with the entire 1900-1970 period" (p. 36). However, results for a relatively short period are affected to a considerable extent by the choice of the initial and the terminal years. In the present case, the choice of the initial years introduces a bias as, in conforming to the old adage "what goes up, will come down," primary product prices could not have remained at the lofty levels reached during the early fifties, the period of the Korean war. <sup>1/</sup> At any rate, just as Prebisch has done in his original article, Singer considered long-term tendencies; hence, in judging the validity of the proposition, data for a longer period would be needed.

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<sup>1/</sup> According to Singer, "by 1952, of course, the Korean war boom had more or less exhausted its effect on primary commodity prices, so that it seems a conservative starting point in showing a deterioration in terms of trade of developing countries" (p. 41). But, the data used by Spraos, whose calculations Singer cites, show a decline of 17 percent and 22 percent, respectively, from 1952 to the trough of the cycle in 1962, depending on whether the UN or the World Bank index for primary products is utilized. This followed a decrease between 1950 and 1952 of 4 percent and 10 percent under the two variants. Thus, Singer's use of Spraos' results for the 1950-77 period is even more objectionable than the choice of the 1952 base year. -- For completeness sake, note that the UN index shows no change between 1952 and 1953 while the World Bank index exhibits a further 3 percent decline (Spraos, 1980).

The only estimates pertaining to a longer period Singer cites are those reported by Spraos for 1900-70. According to Singer, "even if the individual trends [Spraos] calculates are statistically insignificant when taken one by one, the fact that they all point in the same direction surely adds significance" (p. 35). This is a curious argument. If none of the several sets of index numbers using largely the same basic data exhibit a statistically significant trend, such a trend cannot be established even when they are considered together. At any rate, the trend coefficient derived by the use of the UN index is positive — representing a terms of trade improvement for the developing countries — rather than negative for the 1900-70 period; a negative result is obtained only if the UN index is spliced to the World Bank's index for the postwar period (Spraos, 1980).

The UN statistics utilized by Spraos uniformly employ unit value indices. <sup>1/</sup> Yet, as a long series of writers have pointed out, changes in unit values do not appropriately represent changes in prices, leading in particular to an overestimation of increases in the prices of manufactured exports. This is hardly surprising if we consider that, for example, the unit value of machinery is measured as the ratio of value to weight, so that a shift towards lighter materials ipso facto raises unit values.

Singer dismisses these objections, claiming that "Spraos has shown convincingly that these difficulties of measurement do not go to the heart of the matter, even empirically" (p. 23). In so doing, Singer — as well as Spraos — have overlooked the monumental work of Kravis and Lipsey, who painstakingly collected price observations for metal and machinery exports

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<sup>1/</sup> The World Bank utilized a unit value index for manufactured goods and a price index for primary products.



from the United States, the United Kingdom, Germany, and Japan. The export price indices derived from the data show a 13 percent average increase in the prices of machinery between 1953 and 1964, compared to a 24 percent rise in the UN unit value index for the same product group (1971).

Kravis and Lipsey have subsequently extended the country, commodity, and time coverage of their investigation and have estimated a price index for manufactured goods exported by the developed countries to the developing countries. The index shows a 127 percent increase between 1953 and 1977, the time period covered by the estimates, compared to a rise of 162 percent in the UN unit value index for these exports. Deflating by the UN price index for the world exports of primary products other than petroleum, <sup>1/</sup> the authors find that the terms of trade of manufactured goods, exported by the developed to the developing countries, relative to the prices of nonfuel primary products, declined by 6 percent during the period. This compares with an increase of 13 percent estimated from the UN unit value indices for manufactured goods and for food and raw materials (Kravis and Lipsey, 1981).

I have adjusted the Kravis-Lipsey estimates by replacing the UN price index for the world exports of primary commodities other than petroleum by the price index estimated by the World Bank for 33 nonfuel primary commodities, weighted by the exports of the developing countries. This index shows an average price increase of 154 percent for these primary products between 1953 and 1977. There has thus been a decline of 10 percent in the terms of trade of the developed countries in their exchange of manufactured goods for primary products other than fuels with the developing countries during the period.

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<sup>1/</sup> Up to 1970, the index includes petroleum.

It is apparent that the prices of nonfuel primary products exported by the developing countries rose more rapidly than average world primary product prices during the period under consideration. This conclusion is confirmed by Michaely's (1980) estimates that show unit value indices for primary products exported by low-income countries to have risen by 120 percent between 1952 and 1970, compared to an increase of only 16 percent for primary products exported by high income countries. <sup>1/</sup> Michaely's results further show a 86 percent improvement in the case of low-income countries, compared to a 47 percent deterioration for high income countries, in their terms of trade for primary products during the period. <sup>2/</sup>

The unit values of manufactured goods exported by low income countries also increased more rapidly (60 percent) than those of high income countries (39 percent) between 1952 and 1970. In the same period, the terms of trade for manufactured goods' trade remained unchanged in the low income countries and deteriorated by 2 percent in the high income countries.

For merchandise trade, taken as a whole, Michaely has observed an improvement of 24 percent in the terms of trade for low-income countries and a deterioration of 18 percent for high-income countries during the 1952-70 period. He has further established that terms of trade changes are negatively correlated with income levels in a five-fold classification scheme. Thus,

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<sup>1/</sup> The differential trends are largely explained by the decline in the prices of cereals, wool and cotton that loom large in the primary exports of the high-income countries.

<sup>2/</sup> More exactly, the calculations refer to price changes for goods classified by income levels, when the income level of exports (imports) is derived as an income-weighted average of exports by individual countries. The relevant formula is provided in Michaely, 1980.



terms of trade changes between 1952 and 1970 were -37, -5, -10, +6, and +83 percent as one moves from the top to the bottom quintile.

Michael's results thus reinforce the findings of Kravis and Lipsey, indicating that the developing countries have improved their terms of trade vis-a-vis the developed countries in the post-Korean war period. It is further apparent that primary and manufactured commodities exported by the developing countries increased more in price than goods in the same categories exported by the developed countries and that improvements in the terms of trade were inversely correlated with the level of economic development.

These results pertain to the post-Korean war period, for which price observations are available. While the period is relatively short, it begins with high primary product prices as noted above. Kravis and Lipsey (1981) have further calculated changes in the terms of trade between Industrial Europe and the developing countries, by replacing the world export unit value indices of the United Nations by unit value indices for the manufactured exports of Industrial Europe to the developing countries and for the primary imports of Industrial Europe from these countries in the 1872-1953 period.

The results show a 24 percent deterioration in the terms of trade of Industrial Europe vis-a-vis the developing countries between 1872 and 1953. In view of the upward bias of the unit value indices for manufactured goods, the use of price indices would show an even greater deterioration in the terms of trade of Industrial Europe, and thus a greater improvement in the terms of trade of the developing countries, during this period.

The cited estimates effectively refute the Prebisch-Singer thesis on the alleged tendency for the secular deterioration of the terms of trade of the developing countries. This is not to say that particular countries may not suffer a deterioration in their terms of trade. Thus, the oil-importing

developing countries have suffered as a result of the tenfold rise of petroleum prices since 1973. Also, the decline in the prices of industrial fibers has adversely affected several countries in East Africa.

But how about the choice of appropriate policies for the developing countries? Singer resurrects the old shibboleth that the terms of trade "would presumably be improved as a result of biases against the export sector and reduced export volumes" (p. 46). But, apart from petroleum, there are few commodities where the producing countries could improve their terms of trade by acting in unison to reduce the volume of exports. And, in the case of tropical beverages, where such action may be effective, repeated attempts made by the producing countries have not led to an agreement.

In regard to other primary commodities, the principal result of anti-export policies has been a decline in the world market shares of the developing countries. Singer notes this fact but attributes it to the unequalizing effects of international trade, without however offering any evidence in support of the proposition (p. 52).

Few developing countries, acting alone, can affect the world market prices of their exports. At the same time, in countries that are price-takers in world markets, the protection of the capital-intensive sector under incomplete specialization may lead to immiserization in the event that the rate of capital accumulation exceeds the rate of growth of the labor force (Johnson, 1967). Under the assumptions made, this possibility becomes a certainty if foreign capital is invested in the protected industry and it receives the full (untaxed) value of its marginal product at protection-distorted prices (Brecher and Diaz-Alejandro, 1977).



As Singer is preoccupied with transfer pricing and, more generally, with exploitation by developed country investors, he fails to recognize the adverse effects foreign direct investment may have if inappropriate domestic policies are followed by the host countries. Nor does he consider the effects of domestic policies on primary and manufactured exports, and the beneficial impact of export expansion on economic growth.

To begin with, Singer underestimates the extent to which developing countries have succeeded in increasing their manufactured exports. Thus, rather than rising from 12 percent in 1960 to 20 percent in 1977 (p. 47), the share of manufactured goods in the nonfuel exports of the developing countries — defined as SITC classes 5 to 8 — increased from 20 percent to 48 percent during this period. The increase is even larger if one excludes nonferrous metals (SITC 68), which are customarily considered primary products. The share of manufactured goods thus defined in the exports of the developing to the developed countries, for which such data are available, increased from 6 percent to 30 percent between 1960 and 1977, rising further to 42 percent in 1979 (the corresponding percentages are 17, 43, and 50 percent for the SITC classes 5 to 8).

At the same time, the expansion of exports has contributed to economic growth in developing countries. This relationship has been observed in the pre-1973 period, characterized by the rapid expansion of world trade, as well as in the post-1973 period, characterized by external shocks in the form of the quadrupling of petroleum prices and the world recession (Feder 1982; Balassa, 1981). Apart from the gains from international specialization according to comparative advantage, the results reflect the fact that export expansion permits utilizing large-scale production methods and attaining

higher levels of capacity utilization, with the "stick and carrot" of foreign competition further providing inducements for technological improvements.

Nor has export expansion been limited to the "Gang of Four" (Korea, Taiwan, Hong Kong, and Singapore). In the mid-sixties, several major Latin American countries, including Brazil, reduced the anti-export bias of their incentive system, with favorable effects for exports and economic growth. In the mid-seventies Chile and Uruguay, and, in the early eighties Turkey, made the shift from inward- to outward-orientation.

And while no one would suggest that all developing countries should aim at the high export shares of the four East Asian countries, of which two are city states, I have shown that an annual rate of growth of 12.5 percent in the manufactured exports of the developing to the developed countries between 1978 and 1990 would not lead to an absolute decline in the production of any of the industries of the latter (Balassa, 1980). At the same time, it should be remembered that developing countries do not tend to accumulate reserves, so that increases in their export earnings are spent on imports, mostly from developed countries. Thus, even though a rate of export expansion in excess of 12.5 percent may lead to temporary dislocation in the developed countries, both partners would benefit from increased trade through the exploitation of their comparative advantage.

Comparative advantage is changing over time, with the export structure being upgraded in the course of economic development. In addition to Japan that has progressed from the exportation of unskilled labor intensive commodities to high-technology products, the relevance of the "stages approach" to comparative advantage is apparent in developing countries at different levels of industrialization as well as in a cross-section relationship (Balassa, 1979).



The application of the stages of approach to comparative advantage also indicates the possibilities for trade among developing countries. These possibilities are far from being realized today largely because high protection in many of these countries tends to discriminate most heavily against countries at similar, or at lower, levels of development. The adoption of an outward-oriented development strategy, involving a reduction in the bias against exports and in favor of import substitution, would thus contribute to increased trade among the developing countries themselves.

Adopting an outward-oriented strategy would also involve reducing the bias of the incentive system against primary activities. Such a change in incentives would promote exports as well as import substitution in primary products, in particular food and fuels. But efficient import substitution may also occur in manufactured goods, such as machinery, that often suffer discrimination in developing countries.

These considerations may explain that, in the 1973-78 period, outward-oriented developing countries not only were more successful in increasing their exports but also did better in import substitution than inward-oriented economies. As a result, their economic growth accelerated while GDP growth rates declined under inward orientation (Balassa, 1981).

It follows that, if appropriate domestic policies are applied, export expansion and efficient import substitution will go hand-in-hand. At the same time, in industries that need to be promoted on infant industry grounds, the measures of promotion should extend to exports, lest high-cost import substitution occurs in the confines of small domestic markets. But, the infant industry argument does not imply that unrestricted trade would lead to losses to one of the partners or that de-linking would be an appropriate strategy (p. 25).

I now come to the second half of the title, and of the lecture, on the evolution of soft financing. According to Singer, "ODA or aid, ... was in fact the natural avenue to which the interest of the UN, and my own with it, turned as a result of trade pessimism" (p. 54). While one may not consider foreign aid as a compensatory measure for the declining terms of trade of the developing countries (p. 53) that did not occur, it can usefully complement trade in particular in countries at lower levels of development.

One should, however, put things into perspective as far as the relative importance of trade and aid are concerned. In 1979, official development assistance amounted to \$28 billion while the nonfuel exports of the developing countries to the developed countries were \$116 billion and nonconcessional flows, largely private capital, \$53 billion. At the same time, while some authors have pointed to the possible adverse effects of foreign aid on production and on savings, these adverse effects can be avoided if appropriate domestic policies are followed.

More generally, as the example of the sub-Saharan African countries discussed in the Berg-report (1981) indicates, the effective use of foreign aid again the application of appropriate domestic policies by the developing countries. IDA — and the World Bank in general — can continue to play an important role in this regard, not only because of its professionalism and apolitical character, but also because of the emphasis on the domestic policies of the recipients.



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Security Office

July 12, 1982.

Jack Lemoine Lowther, DRD

Building Pass

Mr. Nadeem A. Burney will be collaborating with Mr. Balassa for the next two weeks. Would you please provide him with a building pass.

JLLowther:nc



July 9, 1982

Mr. Gerardo Bueno  
El Colegio de Mexico  
Camino Al Ajusco No. 20  
Mexico 20, D.F.  
Mexico

Dear Gerardo,

I enclose the list of variables shown in the computer output. I also enclose my "The Newly Industrializing Countries After the Oil Crisis" that describes the methodology utilized. Needless to say, I would be glad to answer any questions you may have.

I will be in Washington until the end of July and will return here again on September 13th. By that time, my assistants should have completed the calculations for several Central American countries, and I will be able to send them to you.

I called Fernando Rivera yesterday and he informed me that for budgetary reasons, CEMLA will not be able to publish the Spanish version of my book. I expressed unhappiness about the delays in the decision and for not being informed about it. This is water over the dam, however, and I would rather like to ask you if you see a possibility in Fondo de Cultura publishing the book in Spanish. I wish that I would have taken you up on this six months ago.

I am glad to say that, in response to my request, the Colegio Nacional de Economistas set the date of the Conference on Mexican trade policies for January 3rd. This would make it possible for me and my family to spend the previous week vacationing in Mexico. In this connection, I would like to ask you about the possibility of renting a small apartment for the four of us in Cancun, where we had a very pleasant time. We would subsequently come to Mexico City for two days.

Carol joins me in sending our best regards to Maria Marta and yourself.

Sincerely,

BBalassa

Bela Balassa

P.S. I enclose my list of addresses in the event that you would wish to get in touch with me during my absence from Washington.

## Descriptions

1. Imports (CIF)
2. Exports (FOB)
3. Nonfactor Services
4. Private Transfers
5. Interest Received
6. Interest Paid
7. Dividends
8. Other Factor Payments
9. Official Transfers
10. Direct Investment
11. Portfolio Capital
12. Errors and Omissions
13. Changes in Reserves
14. Amortization
16. Value of Fuel Exports
17. Value of Manufactured Exports to the World
18. Value of Manufactured Exports to Developed Countries
19. Value of Manufactured Exports to Less Developing Countries
20. Fuel Exports, Unit Value Index
21. Nontraditional Exports, Unit Value Index
22. Manufactured Exports, Unit Value Index
23. Fuel Exports, Hypothetical Volume Index
24. Non-fuel Exports, Hypothetical Volume Index
25. Manufactured Exports to Developed Countries, Hypothetical Volume Index
26. Manufactured Exports to Developing Countries, Hypothetical Volume Index
27. Manufactured Exports to Central Planned Economies, Hypothetical Volume Index
28. Value of Fuel Imports
29. Fuel Imports, Unit Value Index
30. Fuel Imports, Hypothetical Volume Index
31. Non-fuel Imports, Hypothetical Volume Index
32. Total Imports, Unit Value Index
33. GNP, Current \$
34. GNP, Constant \$
35. Gross External Debt
36. Net Reserves
38. Developed Countries' Income Elasticity of Demand for Manufactured Imports
39. Developing Countries' Income Elasticity of Demand for Manufactured Imports
40. Centrally Planned Economies' Income Elasticity of Demand for Manufactured Imports

### Traditional Primary Exports

(defined as export values greater than 1.5% of total export value)

41. SITC, Value of Exports of Good
42. SITC, Quantity of Exports of Good
43. SITC, Quantity of Exports of Good by the World as a Whole
44. SITC, Quantity of Exports of Good
45. SITC, Quantity of Exports of Good
46. SITC, Quantity of Exports of Good
47. SITC, Quantity of Exports of Good



July 9, 1982.

Mrs. Irma Adelman  
Department of Agricultural  
and Resources Economics  
University of California at Berkeley  
Berkeley, California 94720

Dear Irma,

I enclose a slightly modified version of my "The Hungarian Economic Reform, 1968-81" for inclusion in the proceedings of the U.S.-China Conference on Alternative Strategies for Economic Development. Sorry for the delay.

I further enclose the final version of my "Economic Reform in China."

Yours sincerely,

Enclosures

Bela Balassa

P.S. The China paper has not yet come back from the print shop. It will be sent to you next week.

July 8, 1982

Dr. William Y. Davis, Chairman  
Department of Economics  
University of North Carolina - Charlotte,  
Charlotte, North Carolina 28223

Dear Sir:

This is to recommend Mr. Tamal Datta Chaudhuri for a position at your Department. I am supervising Mr. Datta Chaudhuri's dissertation and have been working with him over the past several years.

Mr. Datta Chaudhuri is our prize student this year and one of the best I can remember since I have come to Hopkins in 1966. He has done very well in his course work and has shown considerable originality in his dissertation.

The dissertation consists of a number of essays, one of which has already been accepted for publication. Given the quality of the essays, I believe that several more will get published.

Mr. Datta Chaudhuri presents his ideas in a clear and forthcoming manner orally as well as in writing. I am confident that he will be an excellent teacher.

Please let me know if you have any further questions.

Yours sincerely,

Bela Balassa



July 8, 1982

Dr. Alan E. Dillingham  
Department of Economics  
Illinois State University College  
Normal, Illinois 61761

Dear Sir:

This is to recommend Mr. Tamal Datta Chaudhuri for a position at your Department. I am supervising Mr. Datta Chaudhuri's dissertation and have been working with him over the past several years.

Mr. Datta Chaudhuri is our prize student this year and one of the best I can remember since I have come to Hopkins in 1966. He has done very well in his course work and has shown considerable originality in his dissertation.

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Mr. Datta Chaudhuri presents his ideas in a clear and forthcoming manner orally as well as in writing. I am confident that he will be an excellent teacher.

Please let me know if you have any further questions.

Yours sincerely,

Bela Balassa



July 8, 1982

Professor Michael Weinstein  
Economics Department  
Haverford College  
Haverford, Pennsylvania 19041

Dear Sir:

This is to recommend Mr. Tamal Datta Chaudhuri for a position at your Department. I am supervising Mr. Datta Chaudhuri's dissertation and have been working with him over the past several years.

Mr. Datta Chaudhuri is our prize student this year and one of the best I can remember since I have come to Hopkins in 1966. He has done very well in his course work and has shown considerable originality in his dissertation.

The dissertation consists of a number of essays, one of which has already been accepted for publication. Given the quality of the essays, I believe that several more will get published.

Mr. Datta Chaudhuri presents his ideas in a clear and forthcoming manner orally as well as in writing. I am confident that he will be an excellent teacher.

Please let me know if you have any further questions.

Yours sincerely,

Bela Balassa



July 8, 1982

Academic Dean's Office  
Antioch College  
Yellow Spring, Ohio 45387

Dear Sir:

This is to recommend Mr. Tamal Datta Chaudhuri for a position at your Department. I am supervising Mr. Datta Chaudhuri's dissertation and have been working with him over the past several years.

Mr. Datta Chaudhuri is our prize student this year and one of the best I can remember since I have come to Hopkins in 1966. He has done very well in his course work and has shown considerable originality in his dissertation.

The dissertation consists of a number of essays, one of which has already been accepted for publication. Given the quality of the essays, I believe that several more will get published.

Mr. Datta Chaudhuri presents his ideas in a clear and forthcoming manner orally as well as in writing. I am confident that he will be an excellent teacher.

Please let me know if you have any further questions.

Yours sincerely,

Bela Balassa

Ann - Consultant Section - Travel

July 8, 1982.

Bela Balassa, DRD

Travel Request

In reference to our conversation today I would like to ask you to delete the flights Istanbul-Ankara-Istanbul (August 9) from my travel request. Also, instead of Istanbul-Zurich-Lyon flights on August 9, please retain my bookings on the Istanbul-Rome-Lyon flights on the same day.

Bookings on the same flights have also been made by Mr. Barker for my family.

BBalassa:nc



1-7/82

Monsieur E. Malinvaud  
INSEE  
18 Boulevard Adolphe Pinard  
9th Floor  
Paris 75675  
France

Dear Friend:

Thank you for your letter of June 29th and for your comments and reflections on the preliminary version of my paper on France. The revised version contains a section on the devaluation and its aftermath.

In the revised version, I have also qualified several of the statements you have objected to. Thus, the statement on limiting the extent of internationalization now relates only to the newly-nationalized firms (I am familiar with the Elf-Aquitaine case) and the reference to possible implications for protection have been eliminated. At the same time, while I agree that the nationalization of the steel industry has not represented much of a change, this does not appear to be the case for computers and for electronic in general. Among other things, I consider the changes in the status of Honeywell quite important, and they have been at the volition of the present government.

Since there is little information on protective measures in the French press, I have found appropriate to cite foreign press reports with a full indication of the source. The same point applies to government procurement where indications are that a duraissement has occurred.

Indeed, it is difficult to say today in what direction industrial policy would be moving. But, the contradictions in the objectives I have noted exist, and I do not wish to speculate how they would be resolved.

Thanking you again for your comments and reflections, and hoping to see you in the near future. I remain,

Sincerely yours,

Le 7 juillet 1982

Cher ami,

J'ai bien reçu votre lettre du 29 juin et vous remercie des observations et des réflexions que vous m'y communiquez sur la première version de mon article. J'ai depuis ajouté une partie relative à la dévaluation et à ses conséquences.

Dans la version remaniée, j'ai également modifié plusieurs passages sur lesquels vous aviez des objections à faire. Ainsi, la partie relative à la limite de l'internationalisation ne concerne que les deux entreprises récemment nationalisées (je suis au courant du cas Elf-Aquitaine); quant au passage relatif aux conséquences éventuelles sur la protection, il a été éliminé. En même temps, bien que la nationalisation de "iron ore" et de "iron and steel" n'ait pas changé grand chose, tel ne semble pas être le cas de "office, computing and accounting machinery". Je considère notamment que la modification des statuts de Honeywell est très importante et qu'elle est le fait de la volonté du Gouvernement actuel.

Comme il y a peu de renseignements sur les mesures de protection dans la presse française, j'ai jugé bon de me référer à la presse étrangère en citant mes sources. Cela est aussi vrai pour les achats publics qui ont subi un durcissement.

Il est effectivement difficile de prévoir l'orientation future de la politique industrielle. Néanmoins, les contradictions que j'ai relevées dans les objectifs existent, et je ne souhaite pas faire de conjectures quant à leur solution.

Je vous remercie encore de vos observations et réflexions et j'espère vous voir bientôt. Dans cette attente, je vous prie de croire, cher ami, à mes sentiments les plus cordiaux.

Bela Balassa

Monsieur E. Malinvaud  
INSEE  
18, boulevard Adolphe Pinard  
Paris 75675 (France)

P.S. Le version française de l'article vous sera envoyée la semaine prochaine.



2134 Wyoming Avenue N.W.  
Washington, D.C. 20008  
July 7, 1982.

Republic Air Lines  
2021 K Street N.W.  
Washington, D.C. 20006

Dear Sir:

I cancelled my reservation on your air line for July 3 and 4.

I enclose the ticket with the request that you credit my American Express account for \$258.

Yours sincerely,

Enclosure

Bela Balassa

July 7, 1982.

Professor Teng Weizao  
President  
Nankai University  
Weijin Road 94, Tianjin  
People's Republic of China

Dear Professor Teng:

Thank you for your letter of June 17th. I am indeed sorry that we did not have the occasion to meet either in China or in the United States. I hope, however, that we will have other occasions to do so. I enclose a copy of my paper "Economic Reform in China" which may be of interest to you.

Yours sincerely,

Enclosure

Bela Balassa



July 7, 1982.

Dean James W. Schmotter  
Assistant Dean for Admissions  
and Student Affairs  
Graduate School of Business and Public Administration  
Cornell University  
Malott Hall  
Ithaca, New York 14853

Dear Dean Schmotter:

It was good to hear about Steven Reass. I remember him well  
and I am glad that he performed according to expectations.

Yours sincerely,

Bela Balassa

July 7, 1982.

Dr. M. Shahid Alam  
Co-editor  
Applied Economics Research Centre  
(Institution of National Capability in  
Applied Economics)  
University of Karachi  
P.O. Box 8403  
Karachi 32  
Pakistan

Dear Dr. Alam:

Thank you for your letter of June 16th and for sending me the first issue of the new "Pakistan Journal of Applied Economics." It looks very interesting and I expect to read the paper by Thirlwall.

I am sorry, however, that I cannot write a paper for your Journal in the foreseeable future. I have many obligations and I have not yet been able to send a paper to the "The Pakistan Development Review," where I am a member of the International Board of Editors.

Yours sincerely

Bela Balassa



July 7, 1982.

Dr. Jorge Cauas  
President  
Bank of Santiago  
Casilla 14437  
Santiago  
CHILE

Dear Jorge,

Thank you for your letter of June 14th. As indicated in the enclosure, I have suggested to Mr. de la Cuadra the last week of October for my visit. Once the agreement on the date is reached, I will call you to have some discussions on it.

Yours sincerely,

Enclosure

Bela Balassa

July 7, 1982.

Professor Jeffrey Sachs  
Department of Economics  
Harvard University  
Cambridge, Massachusetts

Dear Jeffrey,

I would be interested in having copies of your NBER Working  
Papers Nos. 861 and 862. Thanking you in advance, I remain,

Sincerely yours,

Bela Balassa



July 7, 1982.

Professor Ortiz Villalobos  
Decanato  
Fac. Administracion y Economia  
Universidad de Santiago de Chile  
Santiago  
Republica de Chile

Dear Professor Villalobos:

I am sorry to say that due to a previous engagement I will not be able to participate at the International Symposium to be held in Santiago between August 26 and 27. I plan, however, to go to Santiago later in the year and I hope that we will have the opportunity to meet at that time.

Yours sincerely,

Bela Balassa

July 7, 1982.

Mr. Sergio de la Cuadra F.  
Ministro de Hacienda  
Banco Central de Chile  
Santiago  
CHILE

Dear Mr. de la Cuadra:

Thank you for your letter of June 8th inviting me to Santiago. I will be happy to come and would suggest the last week of October for my visit. Please let me know if this is convenient. Looking forward to see you, I remain,

Sincerely yours,

Bela Balassa

cc: Messrs. Ardito-Barletta, LCNVP; Lari, LCl; van der Meer, LCP;  
Aguirre-Sacasa, LCl; Pfeffermann, LCNVP; Meo, LCl.  
Stoutjesdijk, DRD



BANCO CENTRAL DE CHILE  
SANTIAGO

---

June 8, <sup>th</sup> 1982

Mr. Bela Balassa  
The World Bank  
1818 H. Street, Washington D.C. 20433  
USA

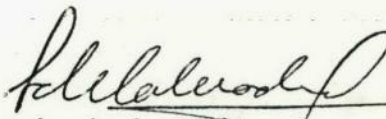
Dear Mr. Balassa:

Regrettably, due to various circumstances, it was not feasible to coordinate and arrive at a mutually convenient date for your trip to Chile last April. As you certainly are aware at the end of that month the cabinet reshuffle took place and in addition, there was previously some travelling scheduled for Mr. de Castro.

I would be delighted to have you in Chile, maybe in October or November, at your convenience. We hope that at this point in time the climate both of the country and the economy will be much improved.

Please let me know as soon as possible about this new possibility of coming to visit with us. After receiving your answer in this respect, the Central Bank will contact you in order to make the proper arrangements with respect to the trip and the program.

Sincerely yours,



Sergio de la Cuadra F.  
MINISTRO DE HACIENDA



Mr. E. Stoutjesdijk, DRD

July 6, 1982.

Bela Balassa, DRD

June Memos

Enclosed are my substantive memos for the month of June.

Enclosure  
BBalassa:nc



July 5, 1982.

Mr. Dong Furen  
Deputy Director  
Institute of Economics  
Chinese Academy of Social Sciences  
5 Jianguomen Nei Dajie  
Beijing  
China

Dear Mr. Dong:

I take the pleasure of enclosing the revised version of my paper "Economic Reform in China." I hope that you will find it useful. The paper will appear in the next issue of the Banca Nazionale del Lavoro Quarterly Review.

I am sending a copy of the paper to Messrs. Xu Dixin, Huang Xiang, Xu Ming and Liu Suinan. You may also wish to distribute the paper to others who participated at our meetings.

Yours sincerely,

Enclosure

Bela Balassa

July 5, 1982.

Mr. Liu Suinan  
Planning Institute of the State  
Planning Commission  
Beijing  
China

Dear Mr. Liu:

I am sorry to have missed you on my visit to China. The enclosed paper "Economic Reform in China" provides the results of my visit. I hope that you will find it of interest.

Yours sincerely,

Enclosure

Bela Balassa



July 5, 1982.

Mr. Huang Xiang  
Vice President  
Chinese Academy of Social Sciences  
5 Jianguomenwai Dajie  
Beijing  
China

Dear Mr. Huang:

It was a pleasure meeting you and I much enjoyed the conversations we had. The enclosed paper "Economic Reform in China" provides the results of my visit. I hope that you will find it of interest.

Yours sincerely,

Enclosure

Bela Balassa

July 5, 1982.

Mr. Xu Dixin  
Director  
Institute of Economic Research  
Beijing  
China

Dear Mr. Xu:

It was a pleasure meeting you and I much enjoyed the conversations we had. The enclosed paper "Economic Reform in China" provides the results of my visit. I hope that you will find it of interest.

Yours sincerely,

Enclosure

Bela Balassa



July 5, 1982.

Mr. Xu Ming  
Deputy Director  
Planning Institute of the State  
Planning Commission  
Beijing  
China

Dear Mr. Xu:

It was a pleasure meeting you and I much enjoyed the conversations we had. The enclosed paper "Economic Reform in China" provides the results of my visit. I hope that you will find it of interest.

Yours sincerely,

Enclosure

Bela Balassa

Mr. Frederick Berger, AEP

July 2, 1982.

Bela Balassa, DRD

Disequilibrium Paper

I enclose a copy of my paper "Disequilibrium Analysis in Developing Economies: An Overview." Please check if the quotation of your report is appropriate.

A Thai student of mine, Mr. Nidhiprabla, would like to meet with you before departing for Thailand in search of data. His dissertation will consist of a macro model for Thailand, including the modelling of the financial sector.

Enclosure

BBalassa:nc



Mrs. Dominique Phung, ADM

July 2, 1982.

Bela Balassa, DRD

French Translation

In accordance with my discussions with Mrs. Bernard and yourself, I enclose a copy of my paper for translation into French. We further agreed that the translation will be done by Mrs. de la Renaudiere to whom I am sending a copy directly. Three additional pages of the paper will be provided next Tuesday.

Enclosure  
BBalassa:nc

July 1, 1982.

Mr. Mehmet Gun Calika  
Meban Securities Brokerage  
and Finance Corporation  
Odakule Is Merkezi Istiklal Caddesi  
286 Beyoglu  
Istanbul, Turkey

Dear Mr. Calika:

This refers to my letter of June 18th in which I informed you about my travel plans. I am glad to report that it was possible for us to get reservations on an earlier flight on July 31st, Saturday from Zurich to Istanbul that will give us plenty of time for our connection to Anatalya. There is no need, therefore, to make a reservation for next mornings flight to Anatalya or to give us help in moving from the international to the domestic airport.

You have not told me if you would need a copy of my paper in advance. Please inform me by telegram.

Yours sincerely,

Bela Balassa



Mr. Aklog Birara, PMDSP

July 1, 1982.

Bela Balassa, DRD

Ms. Christine Assis

1. Ms. Assis prepared her Ph.D. dissertation under my direction at the Johns Hopkins University. She showed considerable determination in her work on the dissertation and learnt a new mathematical technique for this purpose. The dissertation is of high quality and Ms. Assis also performed well in graduate school.

2. I believe that Ms. Assis would do well in the Bank environment and would be effective in her dealings with officials of developing countries. She is a well-trained economist and a serious person who attains the goals she has set out for herself without fail.

BBalassa:nc

1 1 61007

DR. CERIANI, BANCA NAZIONALE DEL LAVORO  
UFFICIO STUDI VIA VITTORIO VENETO, 119, ROME, ITALY  
COPIES OF THE PAPER QUOTE ECONOMIC REFORM IN CHINA UNQUOTE ARE  
BEING MAILED TODAY DIRECTLY TO ROME THROUGH YOUR NEW YORK OFFICE  
AND VIA PARIS. PLEASE ACKNOWLEDGE RECEIPT. REGARDS, BALASSA

CABLE

7/1/82

Bela Balassa

Bela Balassa

BBalassa:nc

DRD - Director's Office



Consultant Travel - Ann

July 1, 1982.

Bela Balassa

Mr. Barker has made the same reservations for me as he has made for my family. In the event that you are unable to book me on the Istanbul-Zurich, Zurich-Lyon flights, please retain the Zurich-Rome, Rome-Lyon reservations. I will accordingly change my plans for Ankara.

BBalassa:nc

Mail Room

July 1, 1982.

Bela Balassa

The enclosed envelope must reach the address in New York tomorrow.  
Please ~~ensure~~ appropriate way to ensure this.

BBalassa:nc



July 1, 1982.

Dr. Luigi Ceriani  
Editor  
Banca Nazionale del Lavoro  
Quarterly Review  
Ufficio Studi  
Via Vittorio Veneto, 119  
Rome  
ITALY

Dear Dr. Ceriani:

As agreed, I enclose a copy of my paper "Economic Reform in China."  
An additional copy is being sent through the New York office of your Bank  
and a third copy will be mailed in Paris. To be entirely sure, I am  
sending to you tomorrow a fourth copy under separate cover to Rome.

Yours sincerely,

Enclosure

Bela Balassa

P.S. I enclose my summer addresses where proofs can be sent.

July 1, 1982.

Professor Maxwell J. Fry  
Economics Department  
University of California  
Irvin  
California 92717

Dear Max,

Please excuse the delay in sending you the revised version of my paper "Disequilibrium Analysis in Developing Economies: An Overview." Apart from the change in the title the paper has undergone substantial revisions. Two copies are enclosed.

Yours sincerely,

Enclosures

Bela Balassa

cc: Mrs. Krueger, VPERS; Tanzi, IMF; with enclosure



# OFFICE MEMORANDUM

TO: Chief Economists

DATE: July 1, 1982.

FROM: Bela Balassa, DRD

SUBJECT: Paper on China

You may be interested in the enclosed paper "Economic Reform in China."

Enclosure  
BBalassa:nc

Memoranda Distributed for  
Research Committee Meeting - July 8

1. Productivity Change in Infant Industry  
Gulhati May 19, 1982
2. Pricing and Taxing Transport Fuels in Developing Countries  
Selowsky May 25, 1982
3. Liberalization with Stabilization in the Southern Cone  
Holsen June 28, 1982
4. Proposal for Research Application  
A Computable General Equilibrium Model for the Ivory Coast  
Sherman Robinson April 23, 1982



Chief Economists

July 1, 1982.

Bela Balassa, DRD

Paper on China

You may be interested in the enclosed paper "Economic Reform in China."

Enclosure  
BBalassa:nc

Recipients of Back-to-Office Report, China

July 1, 1982.

Bela Balassa

Paper on China

I enclose the revised version of my paper "Economic Reform in China" that will be published in the next issue of the Banca Nazionale del Lavoro Quarterly Review.

cc: Messrs. Byrd, Helmers

Enclosure  
BBalassa:nc



## ECONOMIC REFORM IN CHINA

Bela Balassa\*

July 1, 1982

\* The author is Professor of Political Economy at the Johns Hopkins University and Consultant at the World Bank. He wrote this paper following a visit to China at the invitation of the Chinese Academy of Social Sciences in May 16-28, 1982. The author is indebted for helpful discussions to officials of the Beijing and Chengtu Institutes of Economic Research of the Chinese Academy of Social Sciences, other Institutes of the Academy, and the Institute of the Planning Commission and the State Economic Commission. Comments received on the paper from William Byrd, Jack Duloy, Nicholas Lardy, and Adrian Wood are also appreciated. However, the author alone is responsible for the opinions expressed in the paper, that should not be interpreted to reflect the views of the Chinese institutes or those of the World Bank.

## ECONOMIC REFORM IN CHINA

Bela Balassa

### I. Reforming a Centrally Planned Economy

#### Reform Efforts in Socialist Countries

After the Second World War, the newly-established socialist states of Asia and Europe adopted, with few modifications, the system of centralized physical planning practiced in the Soviet Union. Under this system, the authorities set output targets, material allocation, employment, and other objectives for the producing units and determined the pattern of investment, exports, and imports. The principal targets were established in physical terms, with prices serving chiefly an accounting function. 1/

The system of centralized physical planning permitted the large-scale mobilization of resources in pursuing selected objectives, in the manner of a war economy. However, the shortcomings of this system became apparent as multiple objectives were to be pursued. As all details could not be perceived from the center, the plan objectives of output, material allocation, employment, and production costs often came into conflict, and the producing units had to abandon some targets in order to attain others. Also, the lack of scarcity prices for products, factors (capital, labor and natural resources), and foreign exchange did not permit making appropriate choices in production, investment, and foreign trade. Finally, the system of incentives was not conducive to technological improvements.

The workings of the system of centralized physical planning are exemplified by the Soviet Union, where it has been applied since the nineteen-

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1/ For a detailed description, see Bela Balassa, The Hungarian Experience in Economic Planning, New Haven, Conn., Yale University Press, 1959.



thirties. As long as a few, selected objectives such as the development of heavy industry were followed, rapid rates of economic growth could be attained by mobilizing labor reserves and maintaining a high rate of investment. The subsequent pursuit of multiple objectives, however, led to imbalances in the economy composed of sectors with disparate levels of efficiency: a highly modern sector producing for armament and space exploration; comparatively backward sectors manufacturing consumer goods and producer durables, several of which have required the infusion of Western technology; and an inefficient agricultural sector that has increasingly necessitated food imports to provide for the needs of the population. At the same time, there continue to be shortages of various consumer goods, the available industrial products are of rather low quality, and they are limited in variety.

Following the absorption of labor reserves, except for those of agriculture that could not be mobilized under the incentives applied, the low rate of technological change led to increases in incremental capital-output ratios in the Soviet Union. In the absence of a rise in investment shares, there resulted a decline in rates of economic growth.

Several attempts were made to reform the system of centralized physical planning, in the Soviet Union and elsewhere. Piecemeal reforms were unsuccessful, however, and they may have even brought a deterioration of the situation by combining the negative features of centralized and decentralized systems. These adverse consequences, leading to the subsequent abandonment of the reforms, reflected a failure to recognize the interrelationships of decentralized decision making, the use of prices as signals for resource allocation, incentives at the production level, and competition among producing units.

Thus, in the absence of scarcity prices, delegating decision-making power to regional authorities and introducing profit criteria for firms as La Liberman did not bring the desired results in the Soviet Union. In turn, barring the improbable case of solving an all-encompassing economic model on a giant computer, one cannot establish appropriate scarcity prices for individual commodities unless decision-making is decentralized, supply and demand are equated, and competition is ensured. Nor would the shadow prices derived in the model ensure conforming behavior on the part of producing units if appropriate incentives are not provided.

Comprehensive reforms were introduced in Yugoslavia in 1949 and in Hungary in 1968. The reforms aimed at replacing central directives by market relations among producing units; liberalizing prices; linking the prices of exports and imports to world market prices at realistic exchange rates; using interest rates as a cost element and as a criterion of investment choice in partially decentralized decision making on investment; and relying on profit criteria for decision-making on the level of the producing units.

In Yugoslavia, the reforms represented a response to the situation that was created as the Soviet Union and its allies, accounting for three-fourths of its exports and imports, suddenly ceased all trading relationships with Yugoslavia. In Hungary, the reform was motivated by the increased sophistication of the economy and the salient importance of foreign trade in national income that puts into focus the shortcomings of centralized physical planning. And, in both cases, economists were able to convince a forward-looking leadership of the need for reforms that was not the case in e.g. Poland. The reform efforts were successful in the two countries, despite resistance on the part of vested interests in the bureaucracy, although practical difficulties of implementation were encountered because of the



limitations of competition in small national markets. <sup>1/</sup>

China does not yet have a highly sophisticated economic structure and foreign trade represents a small share of national income. However, it has some industrially advanced regions and, in its large territory, the multiple objectives of modernizing the economy and providing for the growing and increasingly diversified needs of the population may not be efficiently pursued through central decision making.

In particular, reforms are needed to increase the productivity of investment that has declined over time. According to official figures, the incremental capital-output ratio increased from 1.68 in 1953-57 to 3.76 in 1971-75. <sup>2/</sup> Yet, the incremental capital-output ratio is underestimated in China because of the overstatement of rates of economic growth owing to the overpricing of industrial goods.

And, while the reduction in the average number of people supported by each income earner from 2.60 in 1952 to 2.08 in 1978 and, again, to 1.77 in 1981 contributed to economic growth in the past, this ratio may well increase in the future as the share of old people in the population rises. The reduced share of investment in national income, and the decrease in the share of productive investment in total investment, also point to the need for

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1/ On the Yugoslav reform, see Branko Horvat, The Yugoslav Economic System, New York, M. E. Sharpe, 1976; a description of the development of the Hungarian reform and an evaluation of recent changes, respectively, are provided in the author's "The Hungarian Economic Reform, 1968-81," World Bank Staff Working Paper No. 506, Washington, D.C. February 1982 (to be published in the Proceedings of the U.S.-China Conference on Alternative Development Strategies) and "Reforming the New Economic Mechanism in Hungary," Journal of Comparative Economics, forthcoming. All subsequent references to Hungary derive from these sources.

2/ Sources for all the figures cited in respect to China are available from the author.

improving investment efficiency.<sup>1/</sup> At the same time, a few industries apart, competition may be ensured in China, so that the market mechanism could operate even if import competition is limited at the present stage of its economic development. In turn, postponing the reform would lead to the establishment of an inefficient production structure that may be difficult to subsequently modify.

#### Readjustment and Reform

In recent years, much has been said about the alleged conflict between readjustment and reform in China, when readjustment has been defined in terms of remedying macro-economic disequilibria that have generated inflationary pressures. Yet, readjustment and reform are not necessarily in conflict and may even complement each other. This has been the case in Hungary, where investments were substantially reduced to redress macro-economic imbalances in 1980-81 and, simultaneously, additional reform measures were taken to improve the rationality of prices and to further the decentralization of decision making at the firm level.

Inflationary pressures in China, with the official cost-of-living index rising by 9.3 percent between 1978 and 1980, may be largely explained by the macroeconomic policies followed, or the lack thereof. Such pressures were generated as capital construction expenditures (fixed investment) financed from extra-budgetary funds rose at a rapid rate while, despite a cutback of capital construction financed from the state budget, a large budget deficit was incurred.

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<sup>1/</sup> Between 1978 and 1981, the share of investment in national income (net material product) was reduced from 36.5 percent to below 30 percent and that of productive investment in the total fell from 82.6 percent to 58.9 percent, with commensurate increases in the share of housing, cultural, educational, and health-related investments that are classified as unproductive.



Capital construction expenditures financed from extra-budgetary funds increased from 8.4 billion yuan in 1978 to 25.8 billion in 1980, reflecting reduced transfers to the central government, increased levies by local governments, and the institution of investment loans from the People Bank's of China. At the same time, notwithstanding the decline in budget-financed capital construction in state-owned units from 39.6 billion yuan in 1978 to 28.1 billion yuan in 1980, with lower revenues and increased subsidies to urban consumers the small budget surplus of earlier years turned into a deficit of 17.1 billion yuan in 1979 that was followed by a deficit of 12.7 billion yuan in 1980, equivalent for 3.0 percent of national income in that year. In 1979, one-half of the deficit in the state budget was financed by money creation and the remainder by running down the accumulated reserves of the Treasury with the People Bank's of China 1/; in 1980, the share of money creation was about two-thirds, 8.0 billion yuan, with the compulsory purchase of long-term treasury bonds by localities and enterprises in early 1981 accounting for the remainder.

China succeeded in limiting inflationary pressures in 1981, with the official cost-of-living index rising by 2.4 percent. This was accomplished by lowering expenditures on capital construction in state-owned units by 21 percent, reducing the budget deficit to 2.5 billion yuan and asking local authorities to lend 7 billion yuan to the central authorities in 1981.

The decline in capital construction was more than offset by increases in the production of domestic consumer goods and by eliminating the deficit of 2.8 billion yuan in the balance of trade of the previous year. As a result of

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1/ It is conceivable, however, that these reserves were not considered to be part of the money supply.

these changes, the combined value of agricultural and industrial output rose by 4.5 percent over the 1980 level while the increase in national income was 3.0 percent.

It is especially noteworthy that agricultural output increased by 5.7 percent in 1981, although floods and drought reduced the harvest in several areas of the country. This result, and the 5.6 percent average annual rate of increase of agricultural output in the preceding two years that included the year 1980 characterized by natural calamities, reflect the impact of the incentive measures applied and contrast with slow agricultural growth in the previous two decades.

Industrial production increased by 4.1 percent in 1981. Although the production of heavy industry fell by 4.7 percent, this was the result of deliberate efforts to limit output at lower investment levels. In turn, with the reform measures providing inducement to the expansion of production, the output of light industry rose by 14.1 percent and there was a considerable increase in the provision of simple consumer goods by collective (i.e. cooperative) and by individual enterprises.

The reform measures applied thus contributed to the satisfaction of the needs of the population and, in increasing supply, reduced inflationary pressures. At the same time, certain adverse changes occurred owing to the fact that, in the absence of scarcity prices and the lack of competition in a number of industries, the interests of producing units and those of the national economy do not necessarily coincide. The measures taken, and their effects, will be briefly considered in Section III below.

#### The Need for a Comprehensive Reform

Any adverse consequences the reform measures may have had should not however lead to limiting reform efforts or undoing the measures taken.



Rather, such consequences may be eliminated, and the favorable effects of the reform enhanced, by adopting a comprehensive approach. This would require taking measures simultaneously to decentralize decision-making, rationalize prices, provide appropriate incentives to producing units, and encourage competition. In the following, recommendations will be made for a reform package that combines these elements and also provides a macroeconomic framework in which the reform measures can bring fruit.

As regards the macroeconomic framework, Section II will examine the requirements of a suitable credit and interest rate policy as well as budgetary policy in China. This will be followed by a consideration of appropriate balance-of-payments policies pertaining to the inflow of foreign capital, exchange rate tariffs, and subsidies.

A consideration of exchange rates, tariffs and subsidies leads to the issue of domestic price formation. Section III will analyze the pricing of exports and imports and of goods produced for the domestic market, together with possible reforms of the decision making process in industry. Policies aimed at increasing agricultural value added and the potential role of private initiative will also be discussed in this section.

## II. The Macroeconomic Framework

### Credit and Interest Rate Policy

As noted above, financing the government budget deficit in 1980 involved money creation of 8 billion yuan. This amount represented, however, only one-fifth of total money creation. Currency and deposits increased by 40 billion yuan between the end of 1979 and the end of 1980, corresponding to an increase of 25 percent. This compares with annual increases averaging 8 percent in the 1955-79 period, and while the figures need to be adjusted for inflation that reportedly averaged 6 percent in 1980, increases in the real value of the

money supply were still 18 percent.

Various considerations explain the acceleration of the growth of the money supply in 1980. Apart from the direct effects of the government budget deficit, reduced budgetary appropriations for working capital led to increased demands for credit. Also, the People's Bank of China began providing investment loans in substantial amounts, totalling 5.6 billion yuan in 1980. At the same time, in the application of government priorities, there were large increases in loans to rural communes and production brigades (3.6 billion yuan) and to urban collective and individual enterprises (2.1 billion yuan). Finally, negative real interest rates, with the rate on loans for circulating capital remaining at 5.2 percent a year for industry and commerce and 4.4 percent a year for agriculture, (compounded monthly interest rates), notwithstanding inflation rates of 6 percent following the price stability of the earlier period, may have encouraged the accumulation of inventories.

In accordance with its traditional mode of operations, the People's Bank of China continued to grant loans virtually automatically on the presentation of documents concerning the purchase of materials. At the same time, the decentralization of credit management, which stimulated the local branches of the PBC to attract deposits and to make loans, has added to money creation through the operation of the money multiplier. 1/

Improvements were registered in 1981. The rate of increase in outstanding loans granted by the PCB declined to 14.5 percent from 18.4 percent the year earlier while the rate of increase of the money supply fell from 25.2 percent to 21.2 percent. These results were attained, despite the

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1/ This point is made in William Byrd, "China's Financial System: The Changing Role of Banks," Cambridge, Mass., Harvard University, September 1981 (mimeo).



fact that increased private activity required additional liquidity and time deposits rose to a considerable extent.

Notwithstanding these improvements, there is need to reform the financial system in China, both to carry out an active monetary policy and to conform to the requirements of its changing economic structure. To begin with, rather than continuing to take a passive stance in providing loans for the purchase of materials, it would be desirable that the PBC followed an active monetary policy. This may involve relying on interest rates and/or credit ceilings.

Interest rates on circulating capital to industry were increased to 7.4 percent in April 1982, practically eliminating the "negative financial transformation" that existed after April 1980 when interest rates on time deposits were substantially raised. <sup>1/</sup> Increases in time deposit rates, in turn, contributed to the rise in urban and rural savings. Total time deposits increased from 21.1 billion yuan at the end of 1978 to 39.9 billion yuan at the end of 1980, followed by an increase to 52.3 billion yuan in the following year.

Individuals will receive an interest rate of 8 percent on long-term treasury bonds issued in 1982, of which they are expected to take about one-half. While this rate slightly exceeds the 7.1 percent interest rate on five-year time deposits, the differential is warranted given that the repayment of treasury bonds begins only in the sixth year after issue and it is undertaken in five annual instalments. At the same time, following the decline in

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<sup>1/</sup> Interest rates on six-month deposits were increased from 3.7 to 4.4 percent, on one-year deposits from 4.1 to 5.6 percent, on three-year deposits from 4.6 to 6.3 percent, and on five year deposits from 5.1 to 7.1 percent. Prior to April 1979, interest rates on all time deposits were 2.2 percent. In turn, interest rates on demand deposits were raised to 3.0 percent in April 1980 from 2.3 percent in the preceding two decades.

inflation rates, the present interest rate structure on demand and time deposits seems appropriate.

It would be desirable, however, to further increase interest rates on circulating capital, so as to limit credit demand for purposes of holding inventories. Interest rates on loans for capital construction would also need to be raised. The PCB presently charges interest rates of 5.2 to 6.6 percent, depending on maturity, while budget-financed loans by the People's Construction Bank of China carry an annual interest rate of 3.0 percent.

But it cannot be expected that, under the present system of economic incentives, interest rates could be increased sufficiently to equilibrate the demand for, and the supply of, credit. Correspondingly, one may employ a combination of higher interest rates and credit ceilings to the branches of the PBC. These branches could eventually become regional banks managed on commercial principles and be subject to reserve requirements. This would permit establishing a separate central bank, to be responsible for overall monetary policy.

#### Budgetary Policy

The compulsory purchase of treasury bonds by local governments and by state-owned and collective enterprises, and borrowing from the local authorities, partly compensated for the reduced transfers to the central government. Such financial transactions can provide only a temporary remedy, however, since they create a repayment obligation for the future. At the same time, notwithstanding these transactions, capital construction expenditures financed from the state budget fell by 7.3 billion yuan in 1981 while the decrease in capital construction financed from extra-budgetary funds was only 3.8 billion yuan, raising the share of the latter from 47.8 percent in 1980 to



51.4 percent in 1981. 1/

In fact, there is evidence that local authorities have utilized the increased availability of extra-budgetary funds to undertake investments that were not warranted by economic considerations. These investments have reinforced autarchical tendencies and have led to the local small-scale processing of materials that would have been better utilized in efficient, large-scale establishments. In Sichuan province, such has reportedly been the case in regard to silk and tobacco, for example.

More generally, local authorities do not have an overview of alternative investment possibilities and they are inclined to pursue regional rather than national interests. At the same time, rapid economic development in China requires substantial investments in infrastructure, in particular in transportation and energy. Also, increased funds would need to be provided to state-owned enterprises for investment purposes. This may be done through the People's Construction Bank of China, with the interest rate increasingly used as an allocative device.

The above considerations point to the need for reducing the share of the local authorities in government revenues and limiting their power of taxation. Central revenues would be further increased through the institution of capital charges on a uniform basis and through higher depreciation allowances as suggested below.

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1/ According to an official report, "the investment not covered by the national budget exceeded the plan to a fairly large extent, and blind and duplicate construction was not eliminated." "Communique on Fulfilment of China's 1981 National Economic Plan for 1981," Beijing Review, No. 20, May 19, 1982, p. 19.

### Balance-of-Payments Policy

Foreign sources of investment in China comprise borrowing abroad as well as foreign direct investment. China attempts to attract increasing amounts of capital in the form of equity and contractual joint ventures, when the former but not the latter involves a capital expenditure by the domestic partner. Furthermore, compensation agreements involving the repayment of foreign loans in kind have assumed importance.

In evaluating the desirability of foreign borrowing, it is customary to introduce liquidity as well as profitability considerations. The former played a role in the cutback of borrowing for major investment projects but, at this point of time, the debt-service ratio is relatively low in China. Correspondingly, attention may be focused on profitability considerations, an appropriate objective being that the investment has a rate of return at world market prices at least as high as the rate of interest on the loan. In this way, it can be avoided that the cost of the domestic production of capital-intensive industrial materials financed from foreign loans, such as steel and petrochemicals, exceed the cost of importing them.

At the same time, the continued encouragement of joint ventures is desirable since, in addition to capital, they bring technological knowhow and marketing expertise and involve a sharing of profits rather than a fixed interest charge. Such ventures could be further encouraged by clarifying some of the provisions of China's 1979 foreign investment law and by negotiating investment treaties with additional foreign countries.

Joint ventures designed for production for domestic markets, such as automobiles, trucks, and diesel engines, should be evaluated at world market prices, lest high-cost industries be established behind protection and profit transfers made from high prices paid by domestic users. Such is not the case



for export-oriented investments and, in particular, for investments in the special economic zones where in addition to wages, China earns foreign exchange from taxes and other fees imposed on foreign operations.

But, one should not give excessive emphasis to the special economic zones that are largely isolated from the domestic economy, and hence multiplier effects are foregone. Rather, it would be desirable to create similar conditions for exports throughout China, so that exporting firms increasingly use domestic materials and also produce for domestic markets. Finally, "straight" borrowing and sales will often be superior to compensation agreements that may involve getting unduly low prices for exported products.

Making estimates on the rate of return at world market prices would necessitate using a realistic exchange rate in the calculations. Increasing the accounting rate from 1.5 yuan to 2.8 yuan to the U.S. dollar in January 1981 was an important step in this direction. However, notwithstanding the substantial appreciation of the U.S. dollar vis-a-vis other currencies in the following eighteen months, the accounting exchange rate has not been subsequently changed.

In a market economy, the exchange rate should equilibrate the balance of payments, with allowance made for the desired inflow of foreign capital. While the exchange rate cannot be called upon to perform this role in China under the present system of import restrictions, a further step in this direction may be taken, and exports encouraged, if a more flexible procedure is applied in setting the accounting exchange rate.

It would appear that foreign exchange retention schemes for exporting firms and the provision of foreign exchange to firms producing inputs for export production have encouraged the expansion of exports in China. There is no particular rationale, however, for the retention of foreign exchange by

local authorities that do not engage in productive pursuits.

In increasing the profitability of domestic sales, the high protection of domestic markets through import restrictions and tariffs tends to discourage exports. Also, China's tariff structure has developed in a rather haphazard way, and it unduly raises costs to some industries and provides too little protection to others. There is need, therefore, to rationalize the system of protection by reducing disparities in tariff rates. At the same time, pari passu with the establishment of a realistic accounting exchange rate, average tariffs may be lowered.

The expansion of exports would further permit easing the foreign exchange bottleneck and accelerating economic growth through the increased imports of industrial materials and capital goods embodying sophisticated technology. For exchange rates to have appropriate effects, however, they should enter into domestic price formation and decisions on production and exports would need to be decentralized, with producing units aiming at higher profits. These conditions will be considered in Section III in the context of economic reforms in China for manufacturing industry as well as for agriculture, with further attention given to the role of collective and individual enterprises.

### III. Reforming the Operation of the Productive Sectors

#### Reform Efforts in Manufacturing Industry

Manufacturing industry in China made considerable strides during the period following the Second World War. However, it suffered from the usual shortcomings of centralized physical planning, including low-quality production, the accumulation of stocks of material inputs, an excess supply of goods that did not correspond to user needs, as well as shortages of various commodities for which there was demand. Largely as a result of the accumulation of stocks of material inputs, circulating capital per 100 yuan of



output increased from 17 yuan in 1956 to 31 yuan in 1979. There were also growing inventories of finished goods. In 1980, inventories of steel products and machinery and equipment reportedly exceeded one year's production. In the same year, stockpiles of unsold goods for export accounted for more than one-third of annual exports. 1/

Various reforms were introduced on an experimental basis to improve the operation of industrial enterprises in China. They included profit retention schemes; the use of retained profits for reinvestment, for social and cultural purposes, for the payment of bonuses, and for reserves; the right to sell above-plan output directly at negotiated prices up to 15 percent higher or lower than plan prices; and greater freedom in labor relations. While the reforms originally applied to a few firms, in 1981 they were extended to 6000 enterprises accounting for about 60 percent of industrial output. Since 1982, investment decisions again require permission by the supervising authorities and, in practice, little change has occurred in labor relations. However, de facto, if not de iure, the remaining reforms have been extended to practically all industrial firms.

In the Shanghai area, an average of 8 percent of profits was retained in 1980, with workers receiving annual bonuses averaging two months' wages. The profit retention ratio was higher -- often by a substantial margin -- in other areas where profits tend to be lower; 2/ it reportedly varied between 10 and 20 percent in Sichuan province. In the same province, 40 percent of retained profits were to be used for investments, 30 percent for social and cultural

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1/ Byrd, op. cit., p. 38.

2/ In 1979, profit rates on total assets reportedly averaged 24.2 percent in Chinese industry and 47.1 percent in Shanghai alone (Ibid., p. 61).

purposes, 20 percent for bonuses and awards, and 10 percent for reserves in the 417 firms that participated in the decentralization experiment in 1980.

The introduction of the profit retention and bonus schemes led to the expansion of industrial production while the increased practice of negotiated sales contributed to the satisfaction of the users' needs. In 1980, the 417 firms applying these schemes in Sichuan province experienced production increases one-half larger than the other firms of the province.

Profits also increased more rapidly in the former group of firms than in the latter. However, profits on the firm level do not necessarily conform to the national interest, because of the existence of price distortions. This is of particular importance in China where prices were set at the time of the introduction of particular products and seldom changed afterwards. Prices were not raised in response of increases in costs, so as to avoid inflation; <sup>1/</sup> nor were prices reduced in cases when productivity increased, in order to provide revenue for the state budget.

Thus, some firms changed their product composition, with little consideration given to their saleability. They could do so, even though inventories accumulated, since profits are measured on the basis of production value rather than sales. There were further cases when the firm raised prices by replacing existing products with new ones that had a higher price.

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<sup>1/</sup> A case in point is silk brocade where a collective enterprise in Sichuan could not increase its price despite the rise in the price of silk paid to farmers, leading to a decline in profit margins.



Finally, there were instances of lowering product quality.<sup>1/</sup>

These adverse consequences may be limited if profits are based on actual sales rather than on production value. Also, as suggested above, inventory accumulation may be discouraged by raising interest rates on circulating capital, a measure that has been successfully used in Hungary. At the same time, in order to avoid distortions owing to interfirm differences in the cost of circulating capital financed from budgetary appropriations and from bank loans, the same interest rate should be applied to both. <sup>2/</sup>

For the same reason, the treatment of funds provided directly from the budget and in the form of loans for capital construction would need to be equalized. Every firm should pay a charge for the use of its fixed capital, over and above depreciation, equal to the rate of interest on investment loans, which would also have to be raised from existing levels. In addition, depreciation charges would need to be increased from their present low level of 4-5 percent a year, in order to account for the obsolescence of equipment.

Under the described procedures, the cost of capital would enter into the calculations of the firm, thus allowing differences in capital intensity among firms and among industries to bear on the cost of production. At the same time, in view of the high profits noted above, capital charges would not

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1/ The official report on plan fulfilment in 1981 writes: "Owing to the blind pursuit by some enterprises of output value and speed in disregard of quality of products and market demand, the output of some products that should be limited under the plan also increased blindly, so that there is warehouse overstocking... In addition, some enterprises sold shoddy goods for quality goods, decreased quantities at original prices or otherwise raised prices in disguised forms." (op. cit., pp. 18, 21.)

2/ This is being done today on an experimental basis. Such exceptions aside, however, firms do not pay interest on circulating capital provided from the budget. This is also generally the case for budgetary appropriations for capital construction, except for the loans provided through the People's Construction Bank of China in recent years.

impose an undue burden on most industrial enterprises.

It would further be desirable to limit the present proliferation of profit retention rates. While the purpose has been to differentiate among firms having different production conditions, these cannot be measured even in an approximate way. Nor is there a rationale for varying profit retention rates, and income tax rates, according to the absolute size of profits when there are interfirm differences in the capital stock.

A possible solution is to replace profit retention schemes by profit taxes, with progressivity in the tax rates based on the rate of profit on fixed and circulating capital. These rates would be applied to base level profits, and lower taxes paid on subsequent increases in profits. In this way, one could avoid the arbitrariness involved in setting different profit retention rates for different industries, and for firms within each industry, while appropriating the "rent" element in profits without affecting incentives to improve operations.

It would further be desirable to modify the present system of bonuses. While bonuses had been designed to reward work performance, they have often become a supplement to wages provided without distinction to all workers in the firm. Also, under the existing schemes, bonuses tend to be higher in firms that earn higher profits. Correspondingly, bonuses have frequently become divorced from individual performance while adding to inflationary pressures as well as to income differentials. Average real wages in state-owned enterprises increased by 5 percent between 1979 and 1981, while industrial labor productivity stagnated. At the same time, in industrial enterprises making losses as well as many nonindustrial enterprises bonuses were not provided.



In his report to the Fifth National People's Congress on November 30 and December 1, 1981, Premier Zhao Ziyang demanded that "the present practice of handing out bonuses indiscriminately should be strictly checked"

1/, and subsequently called for limiting bonuses payable in 1982 to the 1981 level. Further steps would include integrating bonuses into an extended piece-wage system; providing bonuses independently of profits; and including bonus payments in production costs.

At the same time, on the example of Hungary, it would be desirable to provide profit-based bonuses to management that directly contributes to the profitability of the firm's operations. Hungary further rejected the Yugoslav system of labor management on the grounds that it tends to be conservative, both in discouraging new investments and in limiting increases in the firm's labor force, and it reduces labor discipline.

It has been reported that in China "democratic election of factory directors began last year on an experimental basis in a number of provinces, autonomous regions and municipalities including Beijing. This is an effective move towards democratic management, ensuring the exercise of democratic rights by the workers." 2/ The experience of Yugoslavia and Hungary raises doubts about the desirability of having workers elect managers, however. A more appropriate alternative would seem to be to entrust the task of hiring -- and firing -- managers to a board of supervisors, consisting of the representatives of governmental authorities, the banks, management, labor, as well as independent experts, when utilizing experienced cadres on the board of supervisors would also permit making room for the young and the middle aged in

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1/ Beijing Review, No. 51, December 21, 1981, p. 28.

2/ "Election of Directors," Beijing Review, No. 52, December 29, 1981, p. 6.

government administration.

A related issue is to provide greater authority to managers to fire undisciplined workers. This possibility has been officially admitted but it involves a rather complicated process. This fact may explain that few workers have been fired, and only for gross undiscipline, such as being absent without leave for several months.

A more difficult question is the need to reduce the labor force of the firm that encounters difficulties and, in extreme cases, closing down the firm itself. Premier Zhao stated that "factories and enterprises that fail to meet [established] requirements within a certain time limit must either suspend operations pending consolidation or close down." <sup>1/</sup> In fact, a number of plants have closed down; for example, the number of small iron plants run by prefectures and counties has been cut from 466 to 276, representing a reversal of the policy of "backyard iron furnaces" of some time ago. An extension of this policy would involve closing down high-cost units of particular enterprises.

#### The Pricing of Industrial Products

The described measures would contribute to improving the performance of Chinese industry. Their effects would, however, be limited as long as prices are not reformed. Establishing rational prices that reflect resource scarcities, in turn, requires the decentralization of decision-making to the firm level as well as effective competition. In this connection, comparisons with Hungary may be of interest.

Its small market size limits the extent of domestic competition in Hungary. By contrast, China has a number of producing units in practically

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<sup>1/</sup> Op. cit., p. 21.



all industries, thereby providing possibilities for competition. There has in fact been competition following reductions in plan targets for firms manufacturing steel products and machinery as these firms have attempted to increase the extent of capacity utilization.

In turn, given its large market size and relatively low level of industrial development, it would not be appropriate for China to follow the example of Hungary in adopting world market price relations for its domestic sales, as a general principle. <sup>1/</sup> At the same time, continuing with the separation of domestic and world market prices for China's exports and imports would not permit exploiting its possibilities in international trade to best advantage. In the following, recommendations will be made for a mixed system of pricing, to be applied in conjunction with decentralized decision making and profit incentives.

For manufactured exports, the appropriate goal is to equate prices paid to domestic producers to the fob export price less domestic transportation costs. In conjunction with an appropriate exchange rate policy, this would contribute to the expansion of exports that are profitable from the point of view of the national economy and encourage investment in such activities by ploughing back profits.

Exceptions would need to be made, however, in cases when exports are limited by foreign restrictions (e.g. textiles) or by the extent of foreign demand (tungsten). In such instances, an export quota system may be employed to avoid price-cutting through competition among Chinese exporters. At the

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<sup>1/</sup> In fact, the Hungarian price system is much more complicated than this statement would indicate. Also, the adoption of world market price relations necessitates import competition that would not be practicable under present conditions in China. For a detailed discussion of the Hungarian experience, the reader is referred to the papers by the author cited earlier.

same time, it is doubtful that this would be the case for many of the 173 export commodities, for which unified export management was established in May 1982. Extending the export quota scheme to products that are not subject to limitations abroad may have adverse effects by stifling initiative to seek out new markets and to introduce new product varieties.

Rather, it would be desirable to increase the number of industries and products where firms can establish direct market relations abroad. This would permit firms to adjust to world market conditions and to seek out profitable market outlets. With domestic prices linked to export prices, firms would also have a direct interest in obtaining better prices abroad.

It would further be desirable to equate the domestic prices of imported industrial materials to the cif import price plus tariffs and domestic transportation and distribution costs, so as to induce firms to economize with these products. In the case of materials subject to considerable price fluctuations, however, a price compensation scheme may need to be employed.

Investment projects for the replacement of imported industrial materials should also be evaluated at world market prices. As noted above, this is of particular importance in cases where domestic production is undertaken by utilizing borrowed funds. The importation of capital and that of products, then, become alternatives and the choice between them will require careful economic evaluation.

More generally, for industrial materials imports provide an alternative to domestic production, and hence world market prices may appropriately serve as a basis for domestic price formation. At the same time, the application of this procedure is facilitated by the fact that the products in question are homogeneous, so that differences in quality and in specifications do not affect the price comparisons.



Different conclusions apply to differentiated products that account for the vast bulk of manufactured goods, in particular consumer goods, machinery and equipment. For these products, the varieties manufactured in China generally differ in quality and in specifications from those available in the world market. As a practical matter, then, it would not be possible to utilize world market prices in domestic pricing. At any rate, given its large market and relatively low level of industrial development, it would seem appropriate for China to have domestic prices reflect domestic scarcities rather than world market price relationships for these products.

Two alternative procedures for setting the domestic producer prices of differentiated products in the manufacturing sector have been suggested in discussions among Chinese economists. One of these would entail the use of a large input-output table to indicate the interindustry relationships of costs and prices. The other alternative would involve extending the scope of negotiated prices to eventually encompass all sales of differentiated products.

While the first alternative may appear attractive in theory, it would encounter practical difficulties because of the great variety of industrial products manufactured in China and the importance of quality differences for product prices. Thus, a central authority could not set appropriate prices for all conceivable product specifications and there is the danger that firms would lower quality in the pursuit of profits.

Nor would the central determination of prices by the use of an input-output table ensure that demand and supply for individual products are equated, which is a precondition for establishing rational, or scarcity, prices. This purpose can be served by placing reliance on market relationships that would also permit avoiding reductions in quality.

Negotiated sales among industrial firms are expressions of market relations in China. These relationships have assumed importance in heavy industry, where reductions in plan targets have led firms to seek out market outlets. In so doing, firms have changed their product composition to suit the users' needs and genuine competition has emerged among suppliers. <sup>1/</sup>

The scope of negotiated sales in heavy industry could be extended further by reducing plan targets, with a view to their eventual elimination. In this industry, competition could be relied upon to limit price increases, when the first step to liberalize prices would entail enlarging the margins around the prices determined centrally.

The described procedure could be applied in heavy industry because of the existence of excess capacity. This is not generally the case in light industry where, despite the increase of production by one-half between 1978 and 1981, there is unsatisfied demand for a number of products. In such instances, production would need to be increased before negotiated prices could come into general use.

The output of light industry could be increased, first of all, by raising the extent of capacity utilization. While firms in Shanghai reportedly work in three shifts, one-shift operations predominate in some other parts of China. A case in point is a shirt factory in Beijing, which utilizes expensive modern Japanese machinery in only one shift.

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<sup>1/</sup> In Chengtu, for example, a machinery-producing enterprise was given a plan for 1980 that would have permitted utilizing only 28 percent of its capacity; in finding new markets through negotiated sales, the extent of capacity utilization was raised to 61 percent. Also, Shanghai machine-building factories created new kinds of machinery for light industry and agriculture and embarked on the production of durable consumer goods while a steel plant developed 80 new products for use in light industry.



In order to increase the extent of capacity utilization, incentives for multi-shift operations would need to be provided. Increasing the cost of capital to the firm, suggested above, would provide such incentives. Furthermore, firms may be allowed to establish a double deduction for part of the cost of overtime in calculating their profit tax.

Investment in light industry would also need to be increased. While the share of light industry in manufacturing output rose from 42.7 percent in 1978 to 51.4 percent in 1981, with a commensurate decline in the share of heavy industry, investment in light industry was only one-fourth of that in heavy industry in 1981. Although this represents an increase compared to an investment share of one-sixth in 1978, further increases are necessary for light industry to fully meet demand by urban dwellers and, in particular, by the rural population.

While the need for increasing the service orientation of heavy industry vis-a-vis light industry and agriculture has been well recognized in China, there is further need for establishing a dynamic equilibrium between light industry and agriculture. This would take the form of expanding the production of light industry to provide consumer goods for the rural population who, in turn, would increase the output of food for the urban dwellers.

In order to ensure that such an equilibrium is attained, appropriate incentives would need to be provided. As far as light industry is concerned, this would entail increasing the scope of negotiated sales pari passu with the elimination of excess demand in regard to particular products. It would further be necessary to ensure competition among producing units.

In this connection, reference may be made to recent tendencies for concentration in Chinese industries. Although improvements in productivity

could be achieved by reducing the number of the nearly 400,000 state-owned enterprises in China, one should avoid excessive concentration that would reduce competition. Also, while the transformation of certain ministries into corporations will increase their flexibility, 1/ the enterprises within the corporations should be encouraged to compete with each other.

Also, as noted above, industrial enterprises should be free to invest by using their own funds as well as funds borrowed at appropriate interest rates. At the same time, the central government would have to make investment decisions in regard to basic industries and utilize economic project evaluation in making these decisions.

Particular importance attaches to improving transportation facilities and increasing the supply of energy. And while this will take time to accomplish, the establishment of highly energy-intensive plants producing industrial materials, which often have also considerable transportation requirements, would need to be postponed further for the sake of providing for the energy needs of consumer goods industries. 2/

#### Agriculture

Since 1979, a number of important measures have been taken in China to reform agriculture. The measures in question include the introduction of the "responsibility" system, with remuneration based on output; reductions in

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1/ The first case is shipbuilding, to be followed by automobiles.

2/ In this connection, note may be taken of a statement made in an article in the official Party daily. "There is an acute shortage of energy supplies such as fuel, oil, and electric power, and communication and transportation facilities are insufficient. However, many of the current projects under construction consume a large quantity of energy resources and materials which need to be transported from far away places." ("How Are We to Grasp this Year's Economic Work Well," Renmin Ribao, March 9, 1981, p. 22 as quoted in Foreign Broadcast Service, March 11, 1981, p. L12).



compulsory procurement, with higher prices applying to above-procurement sales; increases in absolute prices and changes in relative prices for procurement; and the encouragement of sideline activities.

The responsibility system has replaced the earlier system, denoted in popular parlance as "eating from the same big public pot," under which work was apportioned by the leader of the production team and remuneration based on hours worked; it now applies to over 90 percent of production teams. The principal variants of the responsibility system include providing remuneration on the basis of the production tasks performed in the framework of the production team and the family responsibility system, *bao gan dao hu*, under which each household retains everything it has produced on the land assigned to it after paying taxes and contributing its share to the accumulation and public welfare funds of the commune. In some instances, households have organized themselves into "integrated units," made up of three to five households, with specialization according to tasks within each unit.

Furthermore, the area available for household plots has been increased from 7 percent to 15 percent of the total; under the Cultural Revolution, household plots were not officially allowed. Finally, the draft of the revised Constitution calls for separating local government administration from commune management, with a view to avoiding the use of compulsory methods.

The family responsibility system has assumed increased importance, covering 60 percent of the land area of the communes in Sichuan province, with family groups accounting for another 7 percent. In the same province, production on private plots, occupying 13.5 percent of the land area, and sideline activities carried out by the family, reportedly accounted for 47 percent of agricultural income in 1981. A slightly lower proportion, 42 percent, applies to a sample of 18,529 peasant households throughout China,

for which data were collected by the State Statistical Bureau; the corresponding figure was 29 percent in 1978. 1/

The establishment of the responsibility system has been accompanied by some easing of acreage limitations and reductions in procurement targets. According to one estimate, private sales in rural areas nearly doubled between 1978 and 1980, reaching one-third of state purchases in that year. 2/ Prices for such sales exceeded the procurement price of wheat, that was first permitted to be sold in private markets in 1979, by 70 percent in 1981. Approximately the same price applied to the so-called negotiated sales to the state, accounting for one-sixth of procurement sales, while above-quota sales to the state, in approximately the same volume, were made at a 50 percent premium. Similar price differences were observed in regard to oilseeds, a 30 percent premium applied to above-quota sales of cotton, while the differences were smaller for other crops.

Also, procurement prices were raised and relative prices adjusted for some major crops, thereby reducing differences vis-a-vis world market prices. Increases in the price of cotton have led to higher output and lower imports, more than offsetting increased wheat imports. Nevertheless, the effects of price changes on output have been limited by acreage controls and by continued restrictions on the interprovincial marketing of grains. 3/

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1/ In interpreting this figure, it should be noted that household plots are characterized by intensive cultivation and the product can be freely sold at negotiated prices without any tax obligation or payment to the commune.

2/ Nicholas R. Lardy, "China's Agricultural Pricing Policy," New Haven, Conn., Yale Economic Growth Center, April 1982, mimeo, p. 24. -- The data also include sales of sideline products, to be considered below.

3/ Ibid., p. 48.



In 1978, the ban on the ownership of small factories by production teams was lifted and limitations on the time allocation of production teams to sideline activities were also abolished. There resulted a considerable expansion of sideline activities in producing simple farm implements, consumer goods, as well as industrial materials. In 1981, such production rose by 9.3 percent compared to a 5.7 percent increase in agricultural output, accounting for 27 percent of the increment in output.

Although the expansion of sideline activities raised fears that the production of agricultural staples would be neglected, no action has been taken to limit their expansion. And while emphasis has again been given to the control of acreage, with the objective of avoiding further shifts from grains to rapeseed and tobacco, the continued development of the responsibility system has been repeatedly endorsed. <sup>1/</sup>

Acreage limitations and the continued maintenance of government procurement, however, conflict with the peasants' interest to increase their incomes by changing the product composition of output. This interest could be harnessed to pursue national economic objectives by increasing reliance on prices to guide production decisions while reducing the scope of acreage limitations and government procurement.

In fact, under present-day conditions, the principal gains in agricultural productivity are likely to come through increased specialization within the commune, within individual provinces, and among provinces in

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1/ Liu Hujia, the Minister of Agriculture, stressed the need to "further improve the various forms of responsibility system in farm production with remuneration based on output, since they are welcomed by the peasants. While upholding the principle of collectivization, the system of responsibility in production will not be changed for a long time to come." (Beijing Review, No. 47, November 23, 1981, p. 5).

China. Increased specialization within the commune would permit limiting the disadvantages of the cultivation of small land areas under the family responsibility system. The extension of the contractual system, applied experimentally in several provinces, would serve this objective as it determines the obligations of the family towards the commune in money terms rather than in kind.

Intra-provincial and, in particular, inter-provincial specialization would further contribute to the better utilization of China's natural resources. At the same time, for the time being, specialization among individual provinces is constrained by the inadequacies of transportation facilities.

Specialization in response to price incentives may, however, further widen income inequalities in rural areas that have increased in recent years. And while income disparities owing to differences in effort are considered desirable, such disparities also result from differences in the quality of land as it is often not possible to produce on poor land more than the amount required under procurement. To eliminate this source of inequality, and to simultaneously provide incentives to increase output, it would be desirable to place increased reliance on land taxes while raising agricultural prices.

Land taxes should be fixed in amount but vary according to the quality of land, so as to absorb a considerable part of the rent element in agricultural incomes. Although China has long had a land tax under the name of agricultural tax, its importance has declined over time; it now accounts for only 3 percent of the value of agricultural output in Sichuan province, for example. While the determination of the land tax encounters administrative difficulties, basing it on past output levels is still preferable to the



progressive taxation of agricultural incomes that would reduce income differences at the expense of discouraging effort.

It would further be desirable to review the subsidization of foodstuffs that benefits the recipients of rations in urban areas. These subsidies reportedly increased fourfold between 1979 and 1981, reaching about 6 percent of national income but benefiting only 13 percent of the population.

Finally, a review of agricultural prices would provide an opportunity to align these prices more closely with world market prices. The domestic price of wheat is higher than that of rice in China whereas the opposite is the case in the world market. Also, despite recent changes, cotton is cheaper relative to wheat in China than in the world market. Greater alignment with world market price relations would permit exploiting China's advantages in international trade in agricultural products. While the narrowness of the world rice market and the sensitivity of wheat prices to increased demand in world markets demand caution, steps taken in this direction would increase agricultural -- and national -- income in China.

#### Collective and Individual Enterprises

Following earlier prohibitions, since 1978 individual enterprises can be established in China, and newly-created collective and individual enterprises may receive tax benefits and preferential credits. Provisions have further been made for the establishment of new forms of enterprises. These new forms include joint ventures between state-owned and collective enterprises, between state-owned enterprises and individuals, and between collective enterprises and individuals, as well as enterprises established using funds pooled by individuals, with shareholders receiving part of the profits in the form of dividends.

The purpose of the new regulations has been to create employment and to contribute to the satisfaction of the needs of the population. The results have been quite impressive. In 1980, 810 thousand individuals started their own businesses. In 1981, state-owned enterprises provided jobs for only 29 percent of the 6 million newly-employed urban workers while collective enterprises accounted for 49 percent and individual enterprises for 5 percent of the total, with the remaining 17 percent being temporary workers. Collective and the individual enterprises have engaged in a variety of activities, including tailoring, shoe-making, arts and crafts, the manufacture of toys, rubber products, the selling of their own products, as well as personal services, such as restaurants and hairdressers.

Further expansion of individual enterprises is expected following the October 1981 Decision on Solving Urban Unemployment Problems by the Central Committee of the Chinese Communist Party and the State Council. Having reviewed the rise of employment in collective and individual enterprises, the Decision states:

"Nonetheless, a number of problems remain unsolved. This refers mainly to the fact that some places put undue emphasis on arranging jobs in already overstaffed state-owned enterprises and undertakings which is detrimental to the improvement of management ... In the future, emphasis should be placed on creating jobs in the collective and in individual sectors of the economy." <sup>1/</sup>

This purpose is to be served by permitting individuals to hire two helpers and five apprentices. Furthermore, workers in collective and individual enterprises have been given the same rights and privileges as workers in state-owned enterprises. At the same time, collective and

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1/ Beijing Review, No. 6 February 8, 1982, p. 22 -- This means that the state does not any more take responsibility to provide jobs to all those who enter working age. In fact, it has not been able to discharge this responsibility in recent years.



individual enterprises bear sole responsibility for their profits and losses, and they cannot expect that the authorities would help them out in case of financial difficulties.

Given their profit-seeking character, collective and individual enterprises create productive employment in adding to the supply of goods and services. At the same time, these enterprises have considerable flexibility to respond to changes in demand, thus easing shortages in individual commodities. Through their activities, then, the collective and individual enterprises reduce the scope for illicit actions, which tend to proliferate in the absence of market relationships. 1/

The practical application of the October 1981 Decision will, however, require avoiding interference on the part of state and local authorities, which has limited the scope of individual enterprises in several cases where they competed with state-owned units. 2/ The danger of interference on the part of the authorities has been recognized in the Decision that took pains to identify the rights and privileges of the cooperative and individual enterprises.

"The ownership of property, regular business activities and incomes of the collective enterprises and individual laborers should be protected by the law and no department or unit is allowed without authorization to interfere in their affairs, transfer their property and resources or swallow them up. They are required to pay taxes and other fees according to state law and the rules and regulations of the various provinces, municipalities and autonomous regions No

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1/ While in the Chinese press it has been alleged that the introduction of market activities is responsible for illicit actions, such actions would not occur if market activities were given full scope.

2/ In Beijing, for example, there is still only one small private restaurant.

department or unit is allowed to change them under any other pretext." 1/

Potentially, collective and individual enterprises can also play an important role in commerce by improving the distribution of goods. Under recent regulations, no organizations, army units, schools, industrial or mining enterprises are allowed to engage in commercial activities, except for the sale of their own products. While these regulations aim at limiting the proliferation of trading activities, provisions would need to be made for providing alternative forms. This may be done by extending the licensing of private traders outside country fairs and urban markets. Furthermore, it would be desirable to remove existing limitations on the sale of goods produced by others and on the transportation of goods for sale by collective and private enterprises.

#### Conclusions

This paper has briefly reviewed the experience of centrally planned economies with reforms and the relevance of their experience to China. Attempts made at the decentralization of decision-making in China have further been considered, and recommendations have been put forward for continued reform efforts.

In the discussion, emphasis has been given to the interdependence of decentralized decision making, the use of prices as signals for resource allocation, incentives at the production level, and competition among producing units. In manufacturing industry, recommendations have been made for the increased decentralization of decision making to producing units and the application of bonus schemes for management aimed at improving operations,

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1/ Op. cit., pp. 22-23.



together with the reform of the price system and an effort to ensure competition, so that decisions taken by state enterprises conform to the national interest.

As regards industrial prices, the application of a mixed system has been proposed that would rely on world market prices in regard to exports, as well as for industrial materials, and would extend the scope of negotiated prices to the bulk of industry. Negotiated prices also provide the appropriate norm for collective and individual enterprises that are called upon to play an increased role in China in creating employment and in contributing to the satisfaction of the needs of the population.

The easing of existing constraints on decision-making and the rationalization of prices would also be desirable in agriculture, involving reductions in differences between relative domestic and world market prices. It would further be desirable to make increased use of land taxes that would permit appropriating a greater part of the rent element in agricultural incomes without adversely affecting effort.

As regards both industry and agriculture, increased reliance would need to be placed on interest rates as a device for allocating investment funds and for limiting credit demands for purposes of inventory holdings. Interest rates, together with credit ceilings, should also be used to pursue an appropriate monetary policy that would eventually necessitate establishing a separate central bank. In conjunction with a balance-of-payments policy pertaining to the inflow of foreign capital, tariffs, and subsidies, then, a macroeconomic framework would be provided for the decentralization of decision making in the productive sectors of the economy.

Objections may be raised, however, to the regional decentralization of investment decisions as the local authorities are not profit-making units and

do not have an overview of alternative investment possibilities.

Correspondingly, it would be desirable to partially recentralize state revenues. These revenues could be used for increasing lending to productive units as well as for investments in basic industries, in particular infrastructure, where use needs to be made of economic project evaluation.

Investments in infrastructure are necessary for the expansion of manufacturing industry as well as agriculture and for obtaining gains through increased regional specialization. At the same time, the measures proposed for industry and agriculture are interdependent, inasmuch as the two sectors provide consumer goods as well as inputs for each other. Political and administrative constraints will, however, affect the pace at which progress can be made and there may be differences in this regard between the two sectors.