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B. BALASSA CHRON FILE AUG 1981

Bela Balassa, DRC

Industrial Development and Exports

1. Your revised chapter represents a considerable advance over the earlier version. My main problem has been with the style, and I have done considerable editing on the chapter. In particular, I have attempted to eliminate repetition, to make the tone more "neutral," and to economize with words whenever possible. There is no need, for example, to repeat policy recommendations on lowering protection. A few comments follow on points that need further clarification.

2. All tables should be carefully reviewed for consistency. Furthermore I have found several cases where the figures in the text did not agree with those in the tables; there may be more such instances. Finally, reporting too many digits gives a false sense of accuracy; in general, decimals should be eliminated.

3. The data of Table 5.1 should refer to the periods 1960-73, 1973-76, 1976-79 and 1973-79 in order to conform to the data reported in Table 1.1. In turn, in Table 5.2, there is a problem of defining engineering industries; it is my recollection that Sethi has defined these including metal products. Finally, the expressions "establishment," "enterprise," and "plant" are apparently used interchangeably; this should be reviewed and the appropriate definitions provided.

B. Development of Industrial Exports

The Structure and Development of Manufacturing Industries

4. I continue to have a problem with the definition of industrial (manufactured) exports. Processed food are dealt with elsewhere in the report; they depend to a considerable extent on agricultural performance; and are not considered as manufactured exports in World Bank and U.N. statistics. In the analysis, emphasis should be given to manufactured exports, excluding processed food and petroleum products which, too, are excluded in World Bank and U.N. statistics. The concept of industrial exports needs to be introduced only when comparison is made with industrial production but, even then, export shares should also be shown excluding processed food and petroleum products. The latter definition is, incidentally, also used in Turkish trade statistics and I have employed it in writing the aide memoire.

5. We have agreed to use two alternative estimates of the future growth of manufactured exports. This should also be done here, with further reference made to the SPO projections which, incidentally, have not been appended to the chapter. As far as actual exports are concerned, they should be reported for the first six months of 1981. Michel has obtained the data, I believe; if not, we should get them from SPO.

6. I continue to be puzzled by the discussion of guarantees for construction contracts. My understanding is that only Saudi Arabia does not accept the Turkish Central Bank foreign exchange guarantee. At the same time,

it is not clear what the Central Bank is doing in other countries. There is need for a guarantee fund, the establishment of which is being negotiated by IFC; they know this entire question in detail and should be consulted. Finally, I fully share SPO's reluctance to establish a semi-public consortium to carry out a formal screening process for construction contracts. While this may have worked in Korea, it would probably lead to more bureaucracy and delays, with the consequent loss of contracts, in Turkey.

C. Investments and Capacity Utilization

7. These subjects belong to a separate section. Otherwise they do not require comments.

D. Factors Affecting Productivity

8. In the discussion of labor training, the lack of adequate skills is emphasized. In the discussion of Turkey's comparative advantage, however, it is stated that "skilled manpower is available." I have attempted to remove this apparent conflict in the editing, but additional information would be needed to clarify the issue. Also, in the section on training, reference is made to the low level of skills in tanning and the manufacture of footwear, while in the discussion of Turkey's comparative advantages, it is stated that this industry benefits from "existing skills and traditions." Finally, the meaning of the last column of Table 5.12 is not clear; nor is it referred to in the text.

E. Comparative Advantage

9. This section is fine but I have eliminated some of the exhortations addressed to the government. It will also benefit from the inclusion of the discussion on the engineering industries.

F. Markets and Institutions

10. I have revised some of the text to avoid the misleading impression that very much could be expected from an Export Promotion Center. Also, the stated functions of this Center overlap to a considerable extent with those of trading companies. As to the latter, the claim that "three of these belong to the large holding companies and hence are conducting the exporting business of their parent companies" is contradicted by the subsequent statement that Enka, the largest trading company "is serving the private sector, with only 5 percent of its exports coming from its parent company." Finally, the incentives provided to trading companies should be checked with Michel as there seems to be conflict in facts and language at some points.

11. As regards exports to the Middle East, Iran is not included among capital surplus oil exporters in WDR 81; also it is preferable to speak of oil exporters rather than oil-surplus countries when one deals with the Middle Eastern OPEC countries. As regards exports to the EEC, the discussion of taxable quotas will need to be clarified, in particular, the relevance of the breakdown of quotas among countries and recent events in the U.S. Also, the discussion needs to be better integrated with that on comparative advantage in textiles and clothing. Finally, the possibility of exporting engineering and other products to the EEC should be noted.

12. I am sending copies of the comments to Mr. Hong and Mrs. Walker whose tables have recently reached me, so that they can check some of the points before you return. I have mailed the edited chapter from Paris.

cc: Messrs. Dubey, EMNVP; Hume, EMP; Zaman, EM2; Hong, EM2; Noel, YP;
Mrs. Fan-Fan Walker EM2.

BBalassa:nc

SHORT-TERM AND LONG-TERM CHANGES IN THE WORLD ECONOMY 1/

Introduction

This report reviews short-term and long-term developments in the world economy. The first section of the report will examine changes in output, imports, exports, and the balance of payments in three country groupings, the OECD, OPEC, and the non-OPEC developing countries in 1980, 1981, and 1982. In the second section, past and expected future developments will be reviewed, taking a longer time horizon.

I. Short-Term Developments 2/

Changes in Output Levels

Largely as a result of the deflationary policies applied following the quadrupling of oil prices in 1973-74, the OECD countries experienced economic stagnation, with output in 1975 not exceeding the 1973 level.^{3/} However, output increased by over 5 percent in 1976 and despite a slowdown in Western Europe, growth rates were only slightly below 4 percent in the next three years.

The hundred-fifty percent rise in oil prices in 1979-80 again prompted the application of deflationary policies by the OECD countries. While a fall in output has been avoided with average

1/ This report follows "Recent and Prospective Changes in Trade, Aid and the Current Account Balance," prepared in January 1981. It is based on the following documents: International Monetary Fund, World Economic Outlook, June 1981; Organisation for Economic Co-operation and Development, OECD Economic Outlook, July 1981, and World Bank, World Development Report 1981, August 1981.

2/ The source for Tables 1 and 2 is OECD Economic Outlook; all other data cited in the section originate in the IMF, World Economic Outlook.

3/ "Output" refers to the gross national product or the gross domestic product, depending on the country concerned.

increases of 1.3 percent experienced in 1980, and a similar rise expected in 1981, a slow recovery is projected.

The OECD Secretariat forecasts average increases in output of 2 percent in 1982 (Table 1). This projection may be on the low side, however, as the estimate for the United States is only 1 percent while the U.S. Administration foresees output increases in excess of 2 percent next year. At the same time a one percent increase in U.S. output adds 0.35 percent to the OECD total.

Also, the OECD countries have made a more successful adjustment to the higher oil prices this time around than in 1973-74. Firstly, with smaller wage increases, there has been less of a fall in profits and hence in business investment. Secondly, the expansion of public spending is being restrained, in particular in the United States, the major exception being France. Thirdly, measures are being taken to encourage private savings and investment. Fourthly, largely as a result of domestic price increases, energy consumption was reduced by 3 percent in 1980, when it equaled the 1973 level although output rose by 19 percent in the meantime.

Among energy sources, the share of oil declined, with a 8 percent fall in oil consumption between 1978 and 1980 as compared to a 7 percent rise in the consumption of non-oil sources of energy. An even larger decline was experienced in the importation of OPEC oil as non-OPEC oil production increased. Thus, OECD imports from OPEC fell by 17.5 percent in 1980, with declines of 8.5 percent and 2.5 percent estimated for 1981 and 1982, respectively (Table 2).

In turn, an acceleration of the growth of OECD imports from the non-OPEC developing countries is projected. After increases slightly in

excess of 2 percent in 1980 and 1 percent in 1981, a 7 percent rise of these imports is foreseen. (Unless otherwise noted, all figures have been expressed in constant prices.)

Rapid increases in exports to the OECD countries, their major markets, should permit the non-OPEC developing countries to maintain the growth momentum they have achieved in recent years, when foreign borrowing permitted them to compensate for the higher oil prices. In fact, in recent years the non-OPEC developing countries have attained output growth rates of about 5 percent, on the average, in recent years and growth is projected to continue at this rate in 1981.

The Current Account Balance

Declines in OECD imports from OPEC were accompanied by increases in exports to OPEC at rates of over 15 percent in 1980 that are expected to be matched in 1982, after a temporary decline to 11.5 percent in 1981. It is further projected that OECD exports to the non-OPEC developing countries would rise somewhat more rapidly than their imports (Table 1).

The balance of trade is further affected by changes in the terms of trade. Following the adverse changes the OECD countries experienced in 1979 and 1980, due to increases in oil prices, some further deterioration is projected for 1981, followed by a slight improvement in 1982. Nonetheless, with favorable changes in trade volumes, the current account deficit of the OECD countries would decline from \$77 billion in 1980 to

\$63 billion in 1981 and to \$45 billion in 1982 (Table 2).^{1/}

In turn, the continued fall in exports, together with increases in imports of about 15 percent a year, would reduce the current account surplus of the OPEC countries from \$121 billion in 1980 to \$109 billion in 1981 and \$66 billion in 1982. This corresponds approximately to the rate of decline of the OPEC surplus between 1974 and 1976.

Finally, it is projected that the current account deficit of the non-OPEC developing countries would increase from \$53 billion in 1980 to \$61 billion in 1981 and to \$62 billion in 1982 as compared to a decline by more than one-third between 1974 and 1976. In interpreting these figures, however, it should be considered that the ratio of the current account deficit to output would fall in line with the growth of output and world inflation.

The latter result represents a continuation of recent tendencies with the ratio of the external debt to output declining from a peak of 24 percent in 1978 to 21 percent in 1981 in the non-oil developing countries.^{2/} Nevertheless, the ratio is higher than in 1974, when it was 16 percent.

Similar changes have been observed in the ratio of external debt to

^{1/} Slightly different figures are shown in the IMF World Economic Outlook for the industrial countries excluding Southern Europe. Differences in coverage also largely account for differences in the IMF estimates for the oil-exporting and the oil-importing developing countries. The OECD figures have been chosen for purposes of the analysis because they take the OECD and OPEC as units; they are available in six-month intervals; and they ensure comparability with the trade statistics published by GATT.

^{2/} As defined by the IMF, the non-oil developing countries include the non-OPEC developing countries in the OECD terminology plus Southern Europe, Ecuador, and Gabon.

the exports of goods and services in the non-oil developing countries. After having risen from 81 percent in 1974 to 110 percent in 1978, this ratio declined to 93 percent in 1980, with a small increase to 96 percent estimated for 1981.

However, the ratio of interest payments and amortization on external debt to the exports of goods and services (the debt service ratio) has continued to rise in the non-oil developing countries. The ratio was 11 percent in 1974; it attained 15 percent in 1978, 18 percent in 1979 and 1980, and 21 percent in 1981, reaching nearly double of the 1974 level in the latter years. Increases are shown in interest payments as well as in amortization.

Continued increases in debt service ratios create potential problems for further borrowing abroad. At the same time, considerable differences are shown among the non-oil developing countries. This, in turn, leads to questions of long-term adjustment that will be taken up in the next section.

Long-Term Developments

Adjustment to External Shocks, 1973-78

The World Development Report, 1981 (WDR 1981) examines policy responses to external shocks in the non-OPEC developing countries.^{1/} The external shocks in question include the deterioration of the terms of trade, due in large part to the quadrupling of oil prices in 1973-74, and the shortfall in exports, due to the 1974-75 world recession and relatively slow growth in subsequent years. In turn, policy responses

^{1/} The results reported in WDR, 1981 derive from Bela Balassa, "The Newly Industrializing Countries After the Oil Crisis," summarized earlier, and from other studies by the same author.

comprise structural adjustment in the form of export market penetration and import substitution, as well as additional real external financing, and slower growth.

Among groups of non-OPEC developing countries only the semi-industrial countries carried out structural adjustment. While these countries relied on external financing at the beginning of the period, they increasingly turned towards enlarging their market share and import substitution afterwards. All in all, external financing was used to offset only one-fourth of the balance-of-payments effects of external shocks in the 1974-78 period, on the average, in the semi-industrial countries (Table 3).

In turn, external financing exceeded the balance-of-payments effects of external shocks by nearly one-half in middle-income primary producing countries, indicating their failure to carry out structural adjustment. In fact, these countries lost export market shares and experienced negative import substitution, i.e. they increased rather than reduced reliance on imports.

Similar results are shown for the populous South Asian countries (Bangladesh, India, and Pakistan). Structural adjustment was also negative in the least developed countries where losses in export market shares exceeded import substitution by a large margin, so that external financing was about double that of the balance-of-payments effects of external shocks. Rather than adjusting to external shocks, then, these groups of countries relied on external financing to offset the balance-of-payments effects of inappropriate domestic policies in addition to those of external shocks.

At the same time, within the individual country groups, differences

are shown among countries following outward-oriented and inward-oriented policies. In the first case, providing similar incentives to sales in domestic as well as in foreign markets permitted specialization according to comparative advantage, involving the expansion of exports and efficient import substitution. In the second case, increasing self-sufficiency was aimed at, often leading to high-cost import substitution in the narrow confines of domestic markets. Also, outward-oriented economies were generally more successful in generating domestic savings than inward-oriented economies.

WDR, 1981 draws the lessons of the 1970s for dealing with external shocks in the 1980s. Thus, it is suggested that developing countries should move towards policies that provide equal encouragement to exports and to production for domestic markets, and give adequate incentives for saving. Further, it is considered important that funds borrowed abroad be applied towards productive investments, which will enhance the country's capacity to produce for exports and to efficiently reduce imports.

Perspectives for the 1980s

The policies followed will influence the economic prospects of the oil-importing developing countries during the 1980s.^{1/} According to World Bank projections, output (defined as the gross domestic product) in these countries would rise by 4.1 percent a year in the most unfavorable case and by 4.8 percent a year if appropriate domestic

^{1/} For purposes of the projections, oil-importing developing countries have been defined to exclude the OPEC countries as well as Angola, Bolivia, Brunei, Congo, Egypt, Malaysia, Mexico, Peru, Syria, Trinidad and Tobago, and Tunisia.

policies are followed but aid flows are relatively small and OECD growth rates average only 2.8 percent a year. In the event that appropriate domestic policies are applied, larger aid flows would raise output growth rates in the oil-importing developing countries to 5.0 percent a year and growth rates would reach 5.4 percent if the OECD countries were able to raise their incomes at an average annual rate of 3.6 percent.

At the same time, it is expected that middle-income oil-importing developing countries, with their better resource endowments and more outward-looking trade policies, would do relatively better than the low-income countries, thereby widening income disparities between the two groups. Still, as noted elsewhere in WDR, 1981, on the example of resource-poor middle-income countries, such as Korea, that had belonged to the low-income group two decades ago, present-day low-income countries also have possibilities for rapid economic growth if they follow appropriate domestic economic policies.

Table 1

Annual Changes in Output and in Export and Import Values, Volume, and Unit Values
(percent change from previous year)

	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
<u>OECD</u>						
Output	3.7	3.9	3.3	1.3	1.25	2.0
Exports: value	13.8	20.0	22.1	18.3	0.5	12.1
volume	5.4	5.7	6.2	4.25	1.75	5.5
unit value	8.2	13.5	15.0	13.5	-1.25	6.25
Imports: value	13.5	15.5	28.5	20.6	-0.75	9.7
volume	4.4	5.0	8.25	1.25	-1.25	4.0
unit value	8.75	10.0	18.75	22.55	0.5	5.5
of which, oil	...	...	...	60.0	11.25	5.0
Export volume to						
Other OECD	...	...	...	2.5	-0.5	4.0
OPEC	...	...	...	15.25	11.5	1.6
Non-OPEC Developing	...	...	...	6.5	2.5	8.25
Centrally Planned	...	...	...	3.0	2.5	8.25
Import volume from						
Other OECD	...	...	...	2.0	-0.5	4.0
OPEC	...	...	...	-17.5	-8.5	-2.5
Non-OPEC Developing	...	...	...	2.25	1.25	7.25
Centrally Planned	...	...	...	-2.0	1.0	6.0
<u>OPEC</u>						
Exports: value	10	0	45	39	3	1
volume	2	-2	0	-14	-8	-3
unit value	8	-2	45	62	10	4
Imports: value	23	23	-2	28	13	22
volume	14	4	-13	14	14	16
unit value	8	19	16	12	-1	5
<u>Non-OPEC Developing Countries</u>						
Exports: value	22	16	29	26	9	13
volume	8	7	9	4	4	7
unit value	13	8	18	21	5	6
Imports: value	18	20	31	28	9	11
volume	8	5	10	5	4	4
unit value	9	14	19	22	5	7

Source: OECD, Economic Outlook, July 1981, Tables 25,55,58.

Table 2

Summary of Balance of Payments on Current Account of the OECD Area and Other
Major Country Groupings^{a/}
 \$ billion

	1974	1975	1976	1977	1978	1979	1980	1981	1982
<u>OECD</u>									
Trade Balance	-26	5.5	-17.5	-23	6	-42	-75	62	-40
Services and Private Transfers, net	10	7	12	13.5	22.5	29	24	26	26
Balance on goods, services and private transfers	-16.5	12	-5.5	-10	28	-13	-51	-36	-14
Official transfers, net	-10.5	-12.5	-12.5	-14.5	-18	-22	-25	-27	-31
Current balance	-26	-5	-18	-24	10	-35	-77	63	-45
<u>OPEC</u>									
Trade balance	77	49	65	61	42	114	169	160	131
Services and private transfers, net	-15	-19	-26	-30	-37	-45	-46	-48	-60
Balance on goods, services and private transfers	62	30	39	31	5	69	123	112	71
Official transfers, net	-3	-3	-2	-2	-1	-3	-3	-4	-5
Current balance	59	27	36	29	4	66	121	109	66
<u>Non-OPEC Developing Countries</u>									
Trade balance	-23	-28	-15	-12	-21	-32	-45	-50	-51
Services and private transfers, net	-8	-9	-9	-7	-9	-16	-19	-24	-26
Balance on goods, services and private transfers	-31	-37	-24	-19	-30	-48	-64	-74	-77
Official transfers, net	5	7	7	7	7	9	11	12	14
Current balance	-26	-30	-17	-12	-23	-39	-53	-61	-62
<u>Centrally Planned Economies</u>									
Trade balance	-10	-18	-13	-8	-8	-1	6	5	2
Services and private transfers, net	1	0	0	0	-1	-4	-5	-5	-5
Balance on goods, services and private transfers	-9	-18	-13	-8	-9	-5	1	1	-3
Official transfers, net	0	0	0	0	0	0	0	0	0
Current balance	-9	-18	-13	-8	-9	-4	2	0	-3

Source: OECD, Economic Outlook, July 1981, Table 30.

a/ Historical data for the OECD are aggregates of reported balance of payments data for each individual country. For non-OECD groupings, the data are estimated; in deriving the trade balances of these country groups, use is being made of trade statistics reported by OECD countries. Due to statistical errors and asymmetries, the data for the four groupings do not add up to zero.

Table 3

Balance-of-payments effects of external shocks and modes of adjustment
in groups of oil importing developing countries, 1974-78 averages
 (percent of GNP)

	<u>Semi-industrial</u>	Primary producing ^{1/}	<u>Populous South Asia</u>	<u>Least developed</u>
I. <u>External shock</u>				
1. International price effects of which,	0.90	1.65	1.26	0.14
Export price effects	-0.83	-3.21	-0.19	-2.07
Import price effects	1.73	4.86	1.45	2.21
2. Export volume effect	0.91	1.99	0.69	1.39
Total	1.81	3.64	1.95	1.53
II. <u>Modes of adjustment</u>				
1. Structural adjustment of which,	0.78	0.61	-0.31	-2.03
Export market penetration	0.09	0.30	-0.51	-3.49
Import substitution	0.69	0.31	0.20	1.46
2. Additional real external financing ^{2/ 3/}	0.45	2.54	2.35	3.03
3. Slower growth	0.58	0.49	-0.09	0.53
Total	1.81	3.64	1.95	1.53

^{1/} Figures for this group are 1974-77 averages.

^{2/} Nominal external financing deflated by an international price index.

^{3/} Comprises changes in capital flows, reserves, services and transfers.

Sources: World Bank, World Development Report 1981, Table 6.2.

August 27, 1981.

Mr. Cesar Rodriguez
Acquisitions Librarian
Yale University Library
Social Science Library
Box 1958, Yale Station
New Haven, Connecticut 06520

Dear Sir:

Enclosed are Discussion Papers No. 29, 30 and 31. I have checked with our Addressograph Department and they have assured me that you are listed with us to receive Discussion Papers, and you will be receiving all future papers.

Yours sincerely,

Norma Campbell
Secretary to Mr. Balassa

Enclosures

August 27, 1981.

Professor Paul Marer
School of Business
Indiana University
Bloomington/Indianapolis
10th St & Fee Lane
Bloomington, Indiana 47405

Dear Professor Marer:

Mr. Balassa is out of the country till September 14th. Your letter was brought to his attention and he said he was very sorry but he will be in Latin America at the time of the Roundtable on the Hungarian economy and will not be able to participate.

He asked me to send you a copy of his paper "The Hungarian Economic Reform, 1968-81" and that comments would be appreciated.

Yours sincerely,

Enclosure

Borna Campbell
Secretary to Mr. Balassa

cc: Mr. Ed Hewett
Brookings Institution
1775 Massachusetts Avenue N.W.
Washington, D.C. 20036

August 27, 1981.

Messrs. Roberto Fendt Jr.,
Director
Fundação Centro de Estudos do
Comércio Exterior
Av. Rio Branco 120, gr 707
Rio de Janeiro
BRAZIL

and Mr. Antonio C. Lemgruber
Director-Chefe
Centro de Estudos Monetários
e de Economia Internacional
Fundação Getulio Vargas
Praia de Botafogo, 190 - 9º
CEP. 22250
Rio de Janeiro, RJ
BRAZIL

Dear Messrs. Fendt and Lemgruber:

Mr. Balassa is out of the country till September 14th. I brought your letter to his attention and he said that if he received the manuscript by October 15th this would be fine, but there must be no further delay.

Yours sincerely,

Norma Campbell
Secretary to Mr. Balassa

August 26, 1981.

Mr. David Kellogg
Pergamon Press Ltd.
Fairview Park
Elmsford, New York

Dear Mr. Kellogg:

Mr. Balassa is out of the country and will not be back until September 14th.

He indicated, however, that Fondo del Cultura Economica is interested in publishing his book, *The Newly Industrializing Countries in the World Economy*. This is the best publishing house in economics in Latin America and Mr. Balassa is asking you to take the necessary steps so that the publishing arrangements can be made.

Yours sincerely,

Borma Campbell
Secretary to Mr. Balassa

Enclosure

Fondo del Cultura Economica
Avenida Universidad 975
Mexico 12, D.F.
MEXICO

August 26, 1981.

Mr. Syed Nawab Haider Naqvi
Pakistan Institute of Development Economics
Quaid-I-Awam University Campus
Post Box No. 1091
Islamabad
Pakistan

Dear Mr. Naqvi:

Mr. Balassa is out of the country and will return on September 14th. He has suggested that he would be glad to see you during that week either in Baltimore, where he will be on Tuesdays and Wednesdays, or in Washington on the other days.

Yours sincerely,

Norma Campbell
Secretary to Mr. Balassa

August 21, 1981

Mr. J. Silva Lopes
Caixa Geral de Depositos
Rua Santa Catarina
1200 Lisboa
Portugal

Dear Mr. Silva Lopes:

Many thanks for your letter of August 10th and for the preliminary and the revised versions of the manuscript, both of which arrived a few days ago. The changes you have made in the earlier parts, and the addition of the sections on medium- and long-term credit and on agricultural credit, will further enhance the value of your excellent chapter.

Problems remain, however, concerning the length of the chapter. In the editing, I will try to reduce the length by eliminating repetitions and some statements of secondary importance. Several issues, in particular those concerning selective credits, are discussed at several places. Also, there are some minor points, the inclusion of which renders the text more difficult to read and may detract from the more important issues.

In the editing, I will also emphasize the importance of the objectives of the efficiency of resource allocation and the generation of savings. This is, in fact, brought out in the Summary and Conclusions but the text gives more emphasis to the conduct of monetary policy that fits in less well with the general objectives of the report.

I will not be able to complete the editing until I return to Washington on September 14th. It will then be typed and a copy will be sent to you for approval, in late September.

Yours sincerely,

Bela Balassa

Bela Balassa, DRC

Medium-Term Macroeconomic Projections

I have now had the chance to read more carefully the second draft of Medium-Term Macro-Economic Projections. The following comments deal with several issues that require consideration.

1. As I noted on the occasion of our last meeting, the two variants of the projections should be presented side-by-side. Nor should it be said that the first variant is "contingent upon the application of appropriate policies ... along the lines the Mission recommends." It is rather the second, higher, variant that would reflect the implementation of the mission's recommendations.
2. At the same time, both variants may underestimate the growth potential of the Turkish economy, judging from the assumed overall ICOR of 6. This much exceeds the ICORs experienced by other developing countries and by Turkey itself before the foreign exchange stringency of the years 1978-80. The assumptions made in regard to sectoral ICORs should be spelled out and modified in the light of historical experience. There should be sectoral estimates available in Tuncer's work, who should be contacted. Tuncer, in association with Anne Krueger, has also estimated sectoral production functions, I believe, that may be utilized.
3. The assumptions made in regard to international inflation and the terms of trade should also be specified and dollar values be presented in constant as well as in current prices. The latter comment applies to all components of the balance of payments, including tourism and workers' remittances. Incidentally, in Table A 1.6, interest payments are missing, and hence the current account balance cannot be derived from the trade balance and the above two items.
4. The interest payments item leads me to the assumptions made about interest rates and need to be specified. This should be done for each major component of the external debt as these are subject to very different interest rates, as well as amortization taxes that will also need to be specified. At the same time, questions arise about the debt service ratio of 34.5 percent estimated for 1985. It should be discussed with Mr. Dubey and with the IMF Turkey desk if such a high figure is acceptable in the case of Turkey.
5. The projections of oil imports appear to be on the low side, however. Setting aside the income elasticity of import demand of 3.2 assumed by the SPO, the import elasticity of 1.0 used in the projections is not consistent with the income elasticity of 2.2 postulated for the energy sector. I am not aware of import substitution possibilities that would permit maintaining such a large disparity between the two figures. On the other hand, the projected investment imports may be too high.
6. Finally, raising public disposable income from 15.3 percent of GNP in 1980 to 22.0 percent in 1985 could not fail to have unfavorable supply-side

effects in the private sector. One should give consideration to possible alternatives, including (a) reductions in current public expenditures; (b) further reductions in public investments; and (c) borrowing by the public sector. In fact, the latter alternative has been suggested by Mr. Silva-Lopez. But, at any rate, I am not prepared to recommend the increases in taxation that the 22 percent ratio would entail.

cc: Messrs. Dubey, EMNVP; Hume, EMP; Zaman, EM2; Roy, EM2; Ms. Walker, EM2.

BBalassa:nc

Dictated but not read.

Mr. Michel Noel, YP

August 15, 1981.

Bela Balassa, DRC

Production Incentives in Turkey

I have now completed the editing of the chapter on production incentives. The chapter presents a number of interesting results, several of which were not available beforehand. At the same time, the emphasis given to data collection led to a certain neglect of the evaluation of the results. The following comments aim at strengthening the evaluation and the interpretation of the data. I will return the edited version of the manuscript in about a week.

Introduction -- to be written; it should indicate the major components of the system of production incentives. It will also refer to incentives to agriculture which will be incorporated in the chapter in a summary form, once they become available. Mrs. Singh should have completed a first draft by now. Finally, the introduction of the Export Encouragement Certificate, and its scope should also be discussed.

A. The Exchange Rate System -- no comments.

B. Export Incentives

Introduction -- the statement according to which the impact of the export promotion measures was limited before 1980 contrasts with the results presented below, according to which the average rate of export subsidies declined between 1979 and 1980. Correspondingly, reference needs to be made to exchange rate changes. Also, the nature of, and changes in, export incentives need to be discussed in greater detail since otherwise the reader has to piece such information together from the individual sections. This can be done in an introduction running to about three pages.

1. The Export Tax Rebate Scheme

One is puzzled by the results shown in Table 5 as the subsequent results do not indicate the effects of transfers to lists having higher rebate rates or those of the introduction of new products on the rebate lists. On the basis of the transfers, one would have expected a shift towards higher rebate rates in the composition of the industrial branches, which does not seem to have occurred. Also, the introduction of new products on the rebate lists should have increased the share of eligible products but the opposite has happened.

A possible solution to the puzzle is that more products have been dropped from the rebate lists than the number of products added and that the omitted products had higher rebate rates than the ones added. Table 5 does not show the number of products deleted, presumably because it has been prepared "on the basis of the lists in effect since May 1981" which, by definition, do not include such products. More generally, there is need to consider the criteria of eligibility and changes in these criteria over time.

An alternative explanation for the decline in the share of eligible exports in the 16 industrial branches is that it takes time to have products added to the lists but exports proceed nevertheless. In times of rapid export expansion, this would lead to a fall in the share of eligible exports.

It should further be noted that the share of the 16 industrial branches in total exports increased from 31.1 percent in 1979 to 32.7 percent in 1980, and to 37.7 percent in the first quarter of 1981, presumably reflecting the increased share of manufacturing exports. At the same time, the coverage of the 16 industrial branches should be indicated, noting the extent to which they cover manufacturing production and exports.

Excluding the 16 industrial branches, one finds that the ratio of eligible exports to the value of the remaining exports fell from 11 percent in 1979 to 4 percent in 1980 and to 2 percent in the first quarter of 1981. These results presumably reflect changes in tax rebates to fresh fruits and vegetables. But they will need explanation, together with changes in rebate rates for eligible exports not included in the 16 industrial branches, which can be readily calculated from Tables 6 and 7.

2. The Export Credit Scheme

In the introduction, it was stated that since January 1980 recipients of Export Certificates "further received preferential prefinancing, in addition to ex-post credits." The existence of such credits should be discussed in this section, indicating further if prefinancing is available also for export credits without certificate. Incidentally, in the editing I have modified the discussion of the two types of export credits in order to minimize repetition. It will further be necessary to explain the meaning of export preparation credits and export promotion credits that are included in Table 9 but are not explained in the text.

It would appear that the latter two forms of credits have not been included in the sectoral breakdown presented in Table 10. If so, they will account for part of the difference between the export credit totals shown in Tables 9 and 10. Another reason for the difference is the fact that Table 10 does not include all industrial credits. But there remains a substantial difference, which presumably represents credit to agriculture. This should also be discussed, indicating which products are the beneficiaries.

Export credit should also be related to export values. A comparison of the data of Tables 7 and 10 shows a decline in the ratio of export credits to export values over time that is in conflict with statements made in the introduction about the increasing scope of export credits. Thus, for the 16 industrial branches, this ratio averaged 60% in 1979; it fell to 30% in 1980, and, again, to 20% in the first quarter of 1981. This result requires explanation especially in view of the alleged misuse of export credits. The decline in the share of export credits rather points to the conclusion that exporters encounter increasing difficulties in obtaining credit.

The ratio of export credit to export values should also be calculated for non-industrial exports as well as for total exports. Again, changes in the treatment of agricultural export credit should be indicated on the basis of available information.

3. The Foreign Exchange Allocation Scheme

It is suggested that since January 1980 the foreign exchange allocation scheme allows for the dutyfree importation of certain inputs for export production. Did the scheme not permit dutyfree importation beforehand? At the same time, the decline in foreign allocation in 1980 is puzzling and it conflicts with the statements made elsewhere, concerning the increase in export incentives after January 1980.

The decline in foreign exchange allocation is even larger in relation to export values. These ratios should be calculated for the 16 industrial sectors, for other exports, as well as for all exports. Changes in the combined share of the 16 industrial exports should also be shown. According to my calculations, this share increased from 72% in 1979 to 91% in 1980.

4. The Foreign Exchange Retention Scheme

The decline in foreign exchange retention rates is also puzzling; it cannot be explained by the inclusion of fruits and vegetables under the scheme that have high value added and a retention rate of 10%. More generally, an explanation would need to be provided for the low average retention rates. Information, if any, on the value added share of exports would be useful, but there must be additional reasons for the results.

5. The Temporary Import Regime

The discussion of this regime may immediately follow that of the foreign exchange allocation scheme as both permit the dutyfree entry of certain inputs and both depend on TUD. At the same time, the subsidy equivalent of the temporary import regime should be estimated if comparable data can be obtained for 1979.

6. Estimation of the Combined Export Subsidy and Export Exchange Rate

In presenting the results, it should be emphasized that some of the subsidy measures were reduced at the time of the large devaluations of June 1979 and January 1980 and that subsidies were increased again in 1981 as the real exchange rate appreciated. In this connection, it will be necessary to make calculations for the second quarter of 1981. If you have not obtained all the relevant data at the time of your visit to Ankara in early August, approaches should be made by telephone and telegram to obtain the necessary data.

The decline in the weighted average export subsidy rate for the 16 sectors between 1979 and 1980, from 23.3% to 12.8% cannot be explained by reference to changes in subsidies to textiles, which decreased at approximately the same rate, from 23.0% to 12.2%. Rather, the explanation should be framed in terms of changes in the ratio of eligible exports to total exports, and in terms of changes in the rate of subsidization, in regard to the various subsidy measures. The results should be presented in the form of a table, in which the two components for each of the subsidy measures are indicated.

In the case of import retention and import allocations, the relevant

subsidy rate is the ratio of the parallel market rate to the official exchange rate, which also declined following the two large devaluations. At the same time, the calculations should be revised on the basis of the new data provided by Meban Securities.

C. Measures of Import Protection

Introduction

Again, more attention should be given in the introduction to changes in import protection over time. Also, the distinction between general and special EEC tariffs should be indicated. The length of the introduction should be about 2, at maximum 3 pages.

1. Tariff and Tariff-type Measures

Apart from the editing I have done, this section requires no changes. I wonder, however, if the expressions "List I" and "List II" have in fact been used in regard to imports from the EEC as they may be easily confused with Liberalization Lists I and II. Perhaps one should refer to List 1 and List 2 in the former case.

2. The Import Regime

This section is generally fine. At the same time, I wonder if imports under Miscellaneous List have been included under the projected figures for Liberalization Lists I and II in the 1981 Import Program. Also, one should use the expression Import Program or Import Regime consistently.

In the concluding part of the section, note should be taken of the lack of possibility of providing overall estimates of the protective effect of import licensing. This should then lead to the estimates of NIP for selected products which uniformly indicate that licensing raises nominal rates of protection above the tariff rate. In the same subsection, effective implicit protection coefficients should also be provided from Annex I.

In turn, estimates of DRCs and SPCs have a better place in Roy's chapter. But I have serious doubts about the validity of the ex ante estimates presented here. Hopefully, it will be possible to make more ex post estimates of DRCs and SPCs. Finally, these performance indicators will have to be compared to estimates of the shadow exchange rate and the economic rate of return.

D. The General Structure of Production Incentives

The numerical results presented in this section are again puzzling. While it has been repeatedly stated that after January 1980 exports have received greater incentives, leading to their rapid expansion, the figures of Table 27 show an increased bias against exports. A possible explanation is that, under pervasive import licensing, nominal rates of protection (adjusted for exchange rate changes) do not change, thus maintaining import protection practically constant. On the other hand, the depreciation of the export exchange rate has increased incentives to export, thereby reducing the anti-export bias. This bias has been further reduced as a result of the

essentially free access of exporters to imported inputs, which fact does not received sufficient emphasis in the chapter. At the same time, the lack of consideration given to the increased availability of imported inputs for export production leads to the underestimation of export subsidy rates from 1980 onwards.

Under this explanation, nominal protection coefficients are essentially determined by the availability of foreign exchange. If increased foreign exchange availabilities have been used for input imports (including machinery), the protection of competing domestic production has not been affected. This, in turn, points to the need to de-emphasize the estimates of tariff protection, or rather to qualify them severely.

Note further that export subsidy and tariff protection estimates have been made at the existing exchange rate. In order to indicate the extent of net protection, these results would have to be adjusted for the difference between the first-best and the existing exchange rate. Such estimates cannot be made with any confidence in the presence of import licensing. Nevertheless, some illustrative figures should be used by reference to estimates that may have been made by others. Consult Baran Tuncer on this.

A general comment: section and table numbers should be revised in accordance with my earlier memo. Also, limit the number of decimals used in the tables. Finally, consistency should be achieved in references to industry and manufacturing as well as to branches and sectors. My preference goes for using the expression industry when referring to food processing plus the manufacturing sectors. Also, I prefer to use the expression "sectors" in the place of "branches" but you would have to coordinate with Roy on this and check the usual Bank terminology.

cc: Messrs. Dubey, EMNVP; Hume, EMP; Zaman, EM2; Roy, EM2.

BBalassa:nc

Dictated but not read.

August 5, 1981

Mr. Dudley Seers
Director, Institute of Development
Studies at the University of Sussex
Brighton BN1 9RE
ENGLAND

Dear Mr. Seers:

I recently received your letter to Professor Balassa requesting four additional copies of his new book, The Newly Industrializing Countries in the World Economy. As he is presently in France, I contacted him regarding your letter. Since there are no more copies available, he suggested you contact the publishers and receive the books through them. The address is:

Mr. David Kellogg
Pergamon Press Inc.
Maxwell House
Fairview Park
Elmsford, New York 10523
USA

Thank you for your interest.

Sincerely,

Patricia Candela
for Prof. Bela Balassa

August 5, 1981

Madame Elisabeth Boucherant
Administrative Assistant
Association Internationale des
Sciences Economiques
International Economic Association
Reid Hall
4, rue de Chevreuse
75006 Paris
FRANCE

Dear Madame Boucherant:

I received your notice of 20 July concerning Professor Balassa's hotel reservation at the Chandris Hotel in Athens. He is presently in France, however I spoke with him and confirmed the dates you indicated. He will be arriving late in the evening on September 2, and will be there until the 5th.

Thank you for your assistance.

Sincerely,

Patricia Candela
for Professor Bela Balassa