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MAY

1981

THE WALTER D. PAPE GROUP  
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Beia Balassa's chron files - May 1981

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B. BALASSA CHRON FILE MAY 1981

CABLE

MAY 26, 1981

61991

MR. BELA DALASSA, BUYUK HOTEL

ANKARA, TURKEY

HOLD FOR ARRIVAL. TURKEY DOMESTIC EXPENDITURE SHARES, PRIVATE,  
72.0, 71.8, 72.7, 69.2, 70.9, PUBLIC, 12.8, 13.8, 12.2, 13.4,  
12.8, TOTAL, 84.8 85.6, 84.9, 82.6, 83.7, GDFI EQUALS SDI,  
17.5, 18.1, 22.7, 23.0, 22.8, MFI, 2.3, 3.7, 7.6, 5.5, 6.5.

REGARDS, BOB

ROBERT THERRIault

CLIVE BELL

RTherriault:nc

BRC

May 22, 1981

M. le Professeur H. Bourguinat  
Université de Bordeaux 1  
Faculté des Sciences Economiques  
avenue Léon Duguit  
33604 Pessac  
France

Dear Sir:

I spoke with Mr. Balassa in Ankara yesterday and he regrets that he will not be able to stay Tuesday, June 30th as he has a speaking engagement in Istanbul early on July 1st.

Please find enclosed two copies of the recently translated papers.

Yours truly,

Bob Therriault  
(for Bela Balassa)

15 mai 1981

M. le Professeur H. Bourguinat  
Université de Bordeaux I  
Faculté des Sciences Economiques  
avenue Léon Duguit  
33604 Pessac  
France

Cher Ami,

Je vous remercie de votre lettre du 23 avril et vous retourne dûment remplie la fiche verte que vous m'avez fait parvenir.

J'ai le regret de vous informer que ma femme ne pourra m'accompagner à Bordeaux, où j'arriverai moi-même le dimanche 28 juin, à midi ou dans l'après-midi. A cet égard, je vous saurais gré de m'indiquer l'heure qui vous paraît la plus souhaitable.

En ce qui concerne ma communication, j'ai le plaisir de vous faire savoir qu'elle a déjà été traduite et qu'elle est à la frappe. Comme je dois m'absenter de Washington à partir du samedi 17 mai, mon assistant vous transmettra mon texte dans le courant de la semaine prochaine.

Je me réjouis de vous revoir prochainement et vous prie de croire, cher Ami, à l'assurance de mes sentiments bien cordiaux.

Bela Balassa

p.j.

May 15, 1981

National Railroad Passenger Corporation  
400 North Capitol Street, N.W.  
Washington, D.C. 20001

Dear Sir:

I am a professor at the Johns Hopkins University in Baltimore and a Consultant at the World Bank in Washington. I also reside in Washington, and I am a frequent commuter between Washington and Baltimore.

I strongly object to the new regulations according to which some Metroliner trains do not take on passengers in Baltimore on the way to Washington. These regulations cause considerable inconvenience to passengers, condemning them to long waits at the station in Baltimore. Having missed the 5:42 Merchants Limited, on a recent occasion I had to wait for the 7:20 Cardinal as neither the 6:09 nor the 7:09 Metrolines took on passengers. With the Cardinal being late, I had a wait of about two hours; as a member of the Academic Council at the Johns Hopkins University, my departure times are very uncertain.

At the same time, the new regulations represent a false economy. As long as the Metroliner discharges passengers, there is little additional time involved in taking on new passengers in Baltimore. And, Amtrak suffers a financial loss if fewer people take the Metroliner. There may be further losses as the inconvenient scheduling induces people to take the bus or go by car. In the latter case, there is also a cost to the national economy due to the increased use of fuel.

For the described reasons, I wish to ask you to rescind the new regulations and to permit passengers to board in Baltimore all Metroliners going to Washington.

Very truly yours,



Bela Balassa

BBalassa:kvd

cc: U.S. Department of Transportation

# OFFICE MEMORANDUM

TO: Betty Eltezam, DRC

DATE: May 15, 1981

FROM: Bela Balassa, DRC

SUBJECT: Maxwell J. Fry

Professor Maxwell J. Fry has completed his paper "Financial Sector Reforms for Turkey." Please have his honorarium paid to him.

BBalassa:kvd

May 15, 1981

Dr. Alfonso Jozzo  
Chief of Economic Research Department  
Istituto Bancario San Paolo di Torino  
Pizza San Carlo, 156  
10121 Torino  
ITALY

Dear Dr. Jozzo:

Thank you for sending me your interesting paper on the Italian economy. I agree with your analysis but I wonder if you are not overly optimistic as regards the solution of Italy's problems through European integration. There is a considerable malaise in Europe and the recent French elections will not help matters. It would then seem that Italy would have to take internal measures in order to straighten out its economy.

Yours sincerely,

Bela Balassa

BBalassa:kvd





# Record Removal Notice

<b>File Title</b> Bela Balassa's chron files - May 1981	<b>Barcode No.</b>  30225103
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<b>Document Date</b> May 15, 1981	<b>Document Type</b> Memorandum
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**Correspondents / Participants**  
 To : Basil G. Kavalsky  
  
 From : Bela Balsassa and Roger Bowden

**Subject / Title**  
 Research Budget

**Exception No(s).**  
 1     2     3     4     5     6     7     8     9     10 A-C     10 D     Prerogative to Restrict

**Reason for Removal**  
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Withdrawn by Chandra Kumar	Date May 30, 2014
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MAY 12, 1981

61991

MR. ANTONIO C. LEMGRUBER, FUNDACAO GETULIO VARGAS, PRAIA DE  
BOTAFOGO, 190-9<sup>o</sup>, CEP 22250, RIO DE JANEIRO, RJ, BRAZIL

22 WORD PREPAID REPLY

PLEASE INFORM IF YOU HAVE RECEIVED THE FOLLOWING: APRIL 8 MEMO  
TO CONTRIBUTORS, PAPER ON POLICY RESPONSES TO EXTERNAL SHOCKS  
IN SELECTED LATIN AMERICAN COUNTRIES, THE PRINTOUT OF OUR  
CALCULATIONS IN BRAZIL, AND MY COMMENTS ON THE BRAZILIAN  
STUDY. ALSO INDICATE AGREEMENT WITH TIMETABLE. REGARDS,  
BALASSA

Bela Balassa

Bela Balassa

BBalassa:nc

GRC - Director's Office

CABLE

May 12, 1981  
61991

MR. ABEL MATEUS, BANCO DE PORTUGAL, AV. DE REPUBLICA 57-60,  
1094 LISBOA CODEX, PORTUGAL

22 WORD PREPAID REPLY

PLEASE INFORM IF YOU HAVE RECEIVED THE FOLLOWING: APRIL 8  
MEMO TO CONTRIBUTORS, PAPER ON POLICY RESPONSES TO EXTERNAL  
SHOCKS IN SELECTED LATIN AMERICAN COUNTRIES, **AID BY COMMENTS**  
ON PORTUGAL STUDY. ALSO INDICATE AGREEMENT WITH TIMETABLE.  
PRINTOUT OF OUR CALCULATIONS ON PORTUGAL MAILED TODAY.  
REGARDS, BALASSA

Bela Balassa

Bela Balassa

DRC - Director's Office

BBalassa:nc

**DECLASSIFIED**

**MAY 30 2014**

May 12, 1981.

Mr. Hollis B. Chenery, VPD

Bela Balassa, DRC

**WBG ARCHIVES**  
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Enclosed is my reply to Mr. Acharya's memo of May 8th. I would appreciate your advice as to whether I should take the matter further.

cc: Messrs. Waide, VPD; DuLoy, DRC

Enclosure  
Balassa:nc

May 12, 1981.

Mr. Abel Mateus  
Research Department  
Banco de Portugal  
Av. de Republica 57-60  
1094 Lisboa Codex  
Portugal

Dear Mr. Mateus:

In reference to my earlier communication, I enclose the printout of our calculations for the Portugal study. You should feel free to use the numbers in any way you see fit.

Yours sincerely,

Enclosure

Bela Balassa

May 12, 1981.

MBA Admission Office  
Faculty of Management Studies  
University of Toronto  
Toronto, Ontario  
Canada M5S 1A1

Dear Sir:

Bob Therriault has done an excellent job in working for me as a research assistant since July 1980. He has exhibited considerable intelligence and ingenuity in the performance of his tasks. He is able to work productively without close supervision.

In my contacts with him I have learned that Bob Therriault has a very good grounding in economics. This fact, together with his other qualities, makes him an excellent candidate for your school. I highly recommend that you admit him and provide him with a fellowship.

Yours sincerely,

Bela Balassa

May 12, 1981.

Ms. Alison Barker, Admissions Office  
MBA Program  
Faculty of Management  
McGill University  
1001 Sherbrooke Street W.  
Montreal, P.Q.  
Canada H3A 1G5

Dear Ms. Barker:

Bob Therriault has done an excellent job in working for me as a research assistant since July 1980. He has exhibited considerable intelligence and ingenuity in the performance of his tasks. He is able to work productively without close supervision.

In my contacts with him I have learned that Bob Therriault has a very good grounding in economics. This fact, together with his other qualities, makes him an excellent candidate for your school. I highly recommend that you admit him and provide him with a fellowship.

Yours sincerely,

Bela Balassa

PINK

Mr. Peter E. Wright, VPD

May 12, 1981.

Bela Balassa, DRC

Staff Working Paper

I enclose, in one original and one copy, the revised and retitled version of "Structural Adjustment Policies in Developing Countries." Following discussion with Mr. Bumgarner, I applied the guidelines according to which one should refer to "economies rather than countries" when these include Taiwan. However, there is no need to delete Taiwan from the tables; this is permitted in research publications although not in the WDR.

I am sending a copy of the paper, together with a memo to Jean Baneth who is responsible for ensuring compliance with the guidelines in DPS. As I am leaving for Turkey this weekend, you should address any questions you might have to him.

cc: Mr. Baneth, EPD

Enclosures  
BBalassa:nc



The views and interpretations in this document are those of the author and should not be attributed to the World Bank, to its affiliated organizations, or to any individual acting in their behalf.

WORLD BANK

Staff Working Paper No.

June 1981

STRUCTURAL ADJUSTMENT POLICIES IN DEVELOPING ECONOMIES

This paper examines structural adjustment policies in developing economies, defined as policy responses to external or internal shocks that are carried out with the objective of regaining the pre-shock growth path. Examples of external shocks are the quadrupling of petroleum prices of 1973-74 and the world recession of 1974-75. Internal shocks may find their origin in inappropriate economic policies, such as the excessively expansionary fiscal measures taken in Mexico after 1972, or in political events, such as the April 1974 Revolution in Portugal.

The introductory section of the paper reports on the policy experience of a number of developing countries after 1973, indicating that countries applying an outward-oriented development strategy were better able to cope with external shocks than economies following an inward-oriented strategy. It is further shown that the adoption of realistic exchange rates and interest rates, the avoidance of large budget deficits, and the productive use of the proceeds of foreign borrowing eased the process of adjustment.

The paper examines in detail the elements of a policy package that may be applied in response to external or internal shocks in the case prevalent in developing economies, when optimal policies are not applied. Thus, the recommendations simultaneously aim at responding to shocks and undertaking incentives (the exchange rate, import protection, export subsidies, and price control), incentives to save and to invest, the choice of public investments, sectoral policies in energy and agriculture, budgetary policies, and monetary policies. In the conclusions, the interdependence of the various policy measures is indicated, with further attention given to foreign borrowing. Finally, comments are offered on the international environment in which these policies operate.

Prepared by:  
Bela Balassa, The Johns Hopkins University  
and the World Bank

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The World Bank  
Washington, D.C. 20433  
U.S.A.

## OFFICE MEMORANDUM

TO: Mission Members  
FROM: Bela Balassa, DRC  
SUBJECT: Final Arrangements for Turkey Mission

DATE: May 12, 1981.

DECLASSIFIED

MAY 30 2014

WBG ARCHIVES

1. We plan to have a short meeting of mission members upon arrival in Ankara on May 17th at 8 p.m. in my hotel room. For confirmation, please contact me or Mrs. Helen Chin who is the administrative assistant and secretary to the mission.
2. I enclose an aide memoire that was written during the mission I led to Thailand two years ago. We will prepare a similar aide memoire - although necessarily broader in coverage - after the first two weeks of the mission in Ankara. Your contribution to the aide memoire will be requested by the end of the second week. Those traveling at the time should call Mrs. Chin and dictate their contribution to her.

cc: Messrs. Davar, EM2; Dubey, EMNVP; Hume, EMP, Zaman, EM2; (without enclosure).

Enclosure  
BBalassa:nc

## OFFICE MEMORANDUM

TO: Mr. S. Shahid Husain, RVP

DATE: August 3, 1979

FROM: Bela Balassa

DECLASSIFIED

SUBJECT: Back-to-Office Report: Mission to Thailand

MAY 30 2014

WBG ARCHIVES

1. The mission on industrial development strategy visited Thailand in the period July 16 - August 3, 1979. Following discussions held with Government officials and representatives of the private sectors, an aide memoire has been submitted to the Government together with a technical paper entitled "Industrial Development Strategy in Thailand".
2. The aide memoire summarizes policy recommendations made for an export-oriented industrial development strategy in Thailand. The technical paper reviews the policy measures presently in use and provides a rationale for the policy recommendations. We plan to complete the draft version of the report of the mission by November, followed by discussions with the Thai government on the policy recommendations made in January.
3. At this time, the key issue appears to be for the Government to adopt an industrial development strategy along the lines proposed by the mission. A further issue is to work out the various components of the strategy for subsequent implementation.
4. As regards the Bank's future role in furthering the application of an industrial development strategy in Thailand, reference may be made to the recent speech by Mr. McNamara who indicated his intention of providing financing to a country that adopts an export-oriented policy. Should Thailand adopt such a policy, it may become eligible for such financing.

cc: and cleared with Mr. Gibbs

cc: Mr. Chenery, DPS Directors, DRC Senior Staff

Messrs. P. Hasan AENVP, S. Please AEA, W. Bussink AEA, R. Powell AEP,

Fateh Chaudhri AEP, T. N. Dinh AEP, E.R. Lim AEA, I.C. Porter AEA,

Mission Members: Shilling AEA, Papageorgiou DED, Cu Kok AEP, Loevner, YPP

Ms. Badgley, YPP

AIDE MEMOIREONINDUSTRIAL DEVELOPMENT STRATEGY IN THAILAND

DECLASSIFIED

MAY 30 2014

WBG ARCHIVES

Introduction

The purpose of this mission of the World Bank has been to make recommendations for a coherent industrial development strategy in Thailand. The preliminary recommendations of the mission are summarized below. The detailed recommendations, and their rationale, are contained in the enclosed paper "Industrial Development Strategy in Thailand".

The recommendations aim at developing an export-oriented strategy in Thailand that would exploit the country's comparative advantage in products utilizing its natural resources and labor. The adoption of such a strategy would involve increasing incentives to exports and reforming the system of import protection.

The proposed export incentives include credit measures, such as preferential loans for investment in export activities and in export production, the increased availability of export credits, and the implementation of the export guarantee scheme. It is further recommended to reform the system of tax and tariff rebates, so as to ensure that business taxes and tariffs paid on inputs at all stages of production are fully rebated while simplifying the administration of the rebate scheme. Also, it is suggested to orient Governmental export promotion measures towards the needs of private industry; to widen the eligibility of commodities for fulfilling the minimum conditions imposed on trading firms; and to extend business tax exemptions on their purchases for export to all trading firms, regardless of size.

As regards import substitution, it is proposed that all large, Government-sponsored investments be subjected to economic project evaluation, the results of which should be made public together with information on the direct and indirect subsidies provided to these investments. A reform of the system of import protection is also recommended, involving reductions in tariff disparities and lowering their average level, as well as liberalizing price and import controls. The tariff reform would be carried out over a period of five years, with the announced tariff targets reached in annual steps. Higher rates would apply to luxury products and, on a temporary basis, to new commodities.

Additional elements of the proposed industrial development strategy concern the system of investment incentives, indirect taxes, human and physical infrastructure, and regional industrial development. Investment incentives would be modified by limiting tariff exemptions on

imported machinery and materials to investments in promotion zones and in export activities. The same recommendation is made in regard to reductions in business taxes on imported and domestic materials.

Consideration should further be given to shifting from the present system of business taxes to a value-added tax system. Finally, various supporting measures are recommended in order to ensure that the system of incentives has its full impact. They include providing human and physical infrastructure and, in particular, establishing export processing zones and industrial estates. These measures need to be coordinated with the Government's regional development objectives. In this connection, the development of the Eastern Seaboard, including Sattahip where port facilities are available, should be given priority.

The proposed policy measures complement each other and may be considered as a "package". At the same time, to the extent that administrative constraints limit their immediate application in toto, first priority should be given to the promotion of exports. This is because of the important contribution exports can make to industrial growth and to improving the balance of payments, which is given urgency by recent increases in oil prices.

The adoption of a coherent industrial development strategy and the application of the necessary policy measures require taking decisions at the highest Governmental level as well as coordination among economic ministries and agencies. In taking decisions on industrial strategy, the Economic Cabinet should act on recommendations by an interministerial technical committee, assisted by working parties.

INDUSTRIAL DEVELOPMENT STRATEGY IN THAILAND

Bela Balassa

DECLASSIFIED  
MAY 30 2014  
WBG ARCHIVESIntroduction

Thailand has maintained rapid rates of economic growth in the period following the oil crisis. Between 1973 and 1978, its GNP grew at an average annual rate of 7.3 percent, representing a rise of about 4.5 percent a year in per capita terms. All sectors participated in the expansion, with agricultural production increasing 4.4 percent and manufacturing output 11.7 percent a year. The expansion of the manufacturing sector responded to the needs of the growing domestic market, fueled by the rise of agricultural incomes, and complemented by import substitution and export expansion.

Import substitution occurred largely in industries producing non-durable consumer goods. This represents the first, "easy", stage of import substitution as the industries in question utilize labor-intensive production methods and do not require large-scale production for efficient operations. In turn, industries producing intermediate products and durable consumer goods are relatively capital-intensive and subject to important economies of scale.

A country such as Thailand that has completed the first stage of import substitution faces a choice between moving to the next stage of import substitution, involving the replacement of the imports of intermediate products and durable consumer goods by domestic production, or expanding manufactured exports. The first option was pursued by countries such as Argentina, Brazil and India while, in the early sixties, the second alternative was chosen by Korea and Taiwan.

Countries adopting an export-oriented strategy attained high rates of industrial growth and employment by specializing in labor-intensive industries in accordance with their comparative advantage. Growth was much slower in countries continuing with import substitution where production for the narrow national market necessitated high protection, leading to increased costs and lower returns on capital investment. As the limitations of continued import substitution came to be recognized, several countries applying this strategy, including a country of the size of Brazil, have turned towards promoting manufactured exports.

In the absence of a coherent industrial development strategy in Thailand, various largely uncoordinated moves have been made, or are contemplated to be made, in the directions of import substitution and export promotion simultaneously. The establishment of a number of car assembly plants, the subsequent ban on imports of assembled cars, and

the imposition of the 50 percent national content requirement point in the first direction; the introduction of tax and tariff rebates on exports and preferential export credits in the second. Furthermore, the Government has under consideration several large import-substituting investments and has at the same time expressed its intention to promote manufactured exports.

It should be recognized that it is difficult to pursue both strategies at once. For one thing, the large import-substituting projects would claim scarce capital resources that may otherwise be used in export industries. For another thing, incentives granted to these projects and to import-substitution in general create disincentives to export activities.

These considerations should be kept in mind in formulating Thailand's industrial strategy for the future. Recommendations for a coherent industrial strategy will be made below, following a review of incentives presently provided to import substitution and to export production and an analysis of Thailand's comparative advantage in the manufacturing sector. The main elements of the proposed strategy include introducing economic project evaluation for large Government-sponsored investment projects, promoting manufactured exports, reforming the system of import protection, modifying existing investment incentives, reviewing the system of indirect taxes, providing human and physical infrastructure, and promoting regional industrial development.

The proposed measures complement each other and may be considered a "package". Some of these measures can be applied immediately while others may be implemented over a period of several years. The recommendations extend over a time horizon of five years.

#### Alternative Industrial Development Strategies

The choice between continued reliance on import substitution and export orientation may be formulated in terms of alternative ways of saving and earning foreign exchange. The contribution of manufacturing industries to the growth of the economy will be maximized if saving foreign exchange through import substitution and earning foreign exchange through exports take place at the least possible cost to the national economy. In a market economy, this can be assured if production for domestic markets and for exports receive equal incentives. Such is not presently the case in Thailand as tariffs and, in several cases, import controls, shelter production for domestic markets from imports, thereby providing an implicit subsidy to these activities and discriminating against exports that do not receive subsidies.

The question arises as to what additional costs a country is willing to incur in favoring import substitution over exports on the oft-cited grounds that this would ensure the security of supply, limit the uncertainty associated with selling abroad, and generate technological change. While there is no simple answer to this question, it

should be recognized that the oil crisis and the subsequent world recession affected export-oriented economies, such as Korea and Taiwan, less than countries that have placed reliance on import substitution. Furthermore, exporting gives inducements for technological change, permits exploiting economies of scale, and ensures adequate specialization in the production of parts, components and accessories. Correspondingly, exportation also permits efficient import-substitution by reducing production costs; i.e. firms will produce for domestic as well as for export markets at a lower cost.

The latter considerations may explain why Korea and Taiwan have provided similar incentives to sales on domestic and export markets. In these countries, exporters and the domestic producers of inputs for export production enjoy free trade treatment and receive small additional subsidies sufficient to offset, on the average, the protection of domestic markets. In turn, Latin American countries provide direct export subsidies to compensate, albeit only partially, for the disadvantages to export industries due to high protection that raises the cost of their inputs and reduces the domestic currency equivalent of their foreign exchange earnings.

Thailand occupies an intermediate position between these two groups of countries as far as the level of import protection is concerned. At the same time, import protection has been increasing over time. Thus, after the declines experienced in earlier years, the average ratio of tariff collections to the value of manufactured imports rose from 14.6 percent in 1975 to 16.3 percent in 1976 and again, to 17.1 percent in 1977. Increases occurred in chemicals (from 12.0 percent in 1976 to 18.1 percent in 1977) and machinery (from 15.3 to 18.8 percent) as compared to a slight decrease for other manufactured goods (from 15.2 to 13.8 percent). Subsequently, in 1978, tariffs were raised on 141 items and the Board of Investment imposed import surcharges on twenty products. Furthermore, while import controls were rarely employed in the past, they have come into increased use in the recent years. Apart from the import bans initiated by the Board of Investment, a ban was imposed on the importation of eighteen commodities in early 1978.

On the export side, the tax and tariff rebates provided by the Fiscal Policy Office of the Ministry of Finance have averaged 2-3 percent on the value of exports receiving such rebates. Calculations made for several products, utilizing the 1975 input-output table, show that the rebates approximately compensate for business taxes on domestic inputs and for tariffs and business taxes on imported inputs used directly in the manufacturing process, but not for the taxes and tariffs levied at earlier stages of production. However, some firms report that they have not ever received full compensation for business taxes and tariffs paid on their direct inputs.

The share of exports receiving rebates rose from 0.4 percent in 1972 to 7.0 percent in 1977, but declined to 5.2 percent in 1978.



In the latter year, only 11.2 percent of eligible exports (i.e. excluding primary exports that are subject to business taxes) received rebates from the Fiscal Policy Office. And while firms have increasingly made use of the temporary admission and drawback schemes administered by the Customs Department, this covers only the imported inputs used directly in the production process for about one-third of the exports of manufactured goods and processed food.

By the end of 1978, the Fiscal Policy Office has set rebate rates for 107 products. The list excludes the following actually or potentially important export products (with 1978 export values in millions of Baht in parenthesis): cuttle fish not canned (169), watch cases (65), furniture (30), canned fruits other than pineapple (32), vegetable cakes (77), yarn of jute, twine, cordage (485), wood carvings (34), silks (37) precious stone cutting (1710), gold ornaments (181), and imitation jewelry (44). It further excludes the unclassified product category, for which the Fiscal Policy Office reported an export value of Baht 23.6 billion in 1978. This category comprises a number of manufactured goods, in particular machinery and equipment, the exports of which amounted to Baht 2.7 billion in 1978; only a few of these products, with an export value of Baht 82 million, received rebates.

The low coverage of exports by the rebate scheme reflects the cumbersome procedures involved in setting rebate rates, requiring detailed documentation of production by one or several firms manufacturing a particular product, and the limited manpower available for this purpose in the Fiscal Policy Office. The bureaucratic procedures involved and the delays experienced in processing rebate claims have also discouraged some firms from applying for rebates even if rates had been set.

The delays, which have in some cases reached 12 months, impose a cost on the exporter in the form of the interest on the funds involved. A cost is also incurred if the temporary admission procedure is used since firms have to pay a fee for the bank guarantee until clearance is received from the Customs Department. Also, the tariff has to be paid with interest if exports do not take place within a year of the importation of inputs. That is often the case for textiles and clothing.

It is apparent, then, that the rebates presently provided do not fully compensate exporters for the taxes and tariffs, burdening their production costs. The delays experienced under the rebate and the temporary admission schemes further impose a cost on exporters. Also, the export credit scheme provides relatively limited benefits while the Board of Investment has not yet utilized Section 36 of the Investment Promotion Act of 1977 to grant preferential treatment to investment in export activities. And, most importantly, by increasing the profitability of sales on the domestic market, import protection discriminates against exports.

Thailand's manufactured exports nevertheless grew rapidly. Excluding processed foods and non-ferrous metals, these exports increased from Baht 5.0 billion in 1973 to Baht 17.6 billion in 1978, a rise of 18 percent a year if we adjust for the 55 percent increase in the wholesale prices of manufactured goods during the period. Several factors have contributed to this outcome.

First of all, the exports of textiles and clothing, accounting for over two-fifths of manufactured exports in 1978, have benefitted from the imposition of quotas on the exports of Japan, Hong Kong, and Taiwan. This has led to a shift of production from these countries to Thailand as well as to increased demand on the part of foreign buyers for Thai textiles and clothing. In turn, the exports of precious stones and simple electronics, each accounting for one-eighth of manufactured exports in 1978, have benefitted from low labor costs. Last but not least, the strength of private enterprise in Thailand and the depreciation of the Baht in terms of non-U.S. currencies have helped exports.

The exports of textiles and clothing may not continue to increase at past rates, however. Thus, while Thailand has not yet fully utilized its quotas and there are further possibilities for upgrading existing exports, introducing new export products, and seeking out new markets, the 5-6 percent annual increases in the developed countries' imports of textiles and clothing under the International Multi-Fiber Agreement will constrain future expansion.

In turn, while the exportation of precious stones and simple electronic products promise continued growth, they represent the processing of imported and natural raw materials with few links to the rest of the national economy. Therefore, if an export oriented strategy is to be pursued, one cannot place exclusive reliance on these products. Rather, there is need to diversify exports towards commodities that contribute to the deepening of the industrial structure. The desirability of an export-oriented industrial development strategy will be considered in the following.

#### Comparative Advantage and Export Orientation

It has been noted that the contribution of manufacturing industries to economic growth will be maximized if foreign exchange is saved and earned at the least possible cost to the national economy. This, in turn, requires exploiting the country's comparative advantage which, in Thailand's case, lies in activities that utilize its natural resources and abundant labor.

The availability of natural resources favors the development of industries based on these resources, in particular in cases where perishables are processed domestically (e.g. processed fruits, vegetables,

and marine products) or there is a considerable weight loss in the course of processing (e.g. concentrated animal feed and vegetable oil). The expansion of these exports would have the further advantage of contributing to the development of agriculture and to the regional diversification of the manufacturing sector.

Furthermore, labor costs are low in Thailand, not only in relation to developed countries but also in comparison with the four export-oriented Asian countries (Hong Kong, Korea, Singapore and Taiwan). The Baht 35 per day minimum wage in the Bangkok area paid to the majority of unskilled workers in the manufacturing sector compares to daily wages of Baht 800-1,000 in the major developed countries and Baht 140-160 in the four Asian countries. With intercountry differences in labor productivity being substantially smaller, Thailand has a comparative advantage in labor-intensive commodities.

Among major industries, clothing, leather and leather products, and furniture and fixtures are the least capital-intensive (most labor-intensive) and create the largest number of jobs per unit of output. At the other end of the spectrum, capital cost per labor is the highest, and employment creation the smallest, for petroleum and coal products, primary metals, paper and paper products, and chemicals (Table 1).

Machinery and transport equipment occupy an intermediate position between these two groups of industries. At the same time, in these industries, as well as in stone, clay and glass products, and in the miscellaneous manufacturing category, considerable differences are shown from product to product. Table 2 provides information on capital requirements per job and on the number of jobs per unit of output for sixteen products exhibiting low capital intensity within these categories. Differences in factor intensity are also substantial among parts, components, and accessories in the manufacture of electrical and non-electrical machinery and motor vehicles.

While the data reported on Tables 1 and 2 pertain to the United States, they are indicative of the gains that may be obtained by specializing in labor intensive industries and, within particular industries, in labor intensive products and processes in Thailand. This is confirmed by calculations made for 34 IFCT projects which show that the cost of saving a dollar in relatively capital-intensive import substituting projects is two-to-three times as high as in labor intensive export projects.

#### Economic Project Evaluation and the System of Incentives

It would appear, then, that rapid industrial growth in Thailand would require allocating scarce capital to relatively labor-intensive activities. Conversely, the data provide prima facie

evidence of the low economic rates of return obtainable in large import-substituting projects, such as petrochemicals, fertilizers, and an integrated steel complex, all of which have high capital requirements and create few jobs per unit of output.

More accurate results can be obtained by applying the techniques of economic project evaluation to large, Government-sponsored investments. Project evaluation may take the form of calculating the domestic resource cost of saving and earning foreign exchange or estimating the economic rate of return at world market prices that indicate the alternatives available to Thailand. This is of particular importance in the case of the proposed industrial uses of natural gas, for which the saving of foreign exchange through the replacement of fuel oil in electricity generation provides the opportunity cost.

In order to ensure that project evaluation is carried out by utilizing appropriate techniques on a uniform basis, it would be necessary to establish a project evaluation unit in Thailand. This unit may report to the Economic Cabinet that would decide on the implementation of large-scale Government-sponsored investment projects and on industrial development strategy in general.

Prior to taking decisions, it would be useful to make public the results of project evaluation, so as to invite debate on the desirability of the projects in question. Information should also be provided on the protection of the output of these projects as well as on indirect subsidies granted through the establishment of project-specific infrastructure or the provision of inputs at less than world market prices.

While large, Government-sponsored projects should be subjected to economic project evaluation, one should rely on incentives to ensure that private business activities conform to the national interest. In particular, excessive protection would permit firms to expand at a high cost to the national economy and discourage efficient export activities.

At the same time exporting firms have to take risks and reap the rewards of their actions. Thus, although one may tentatively identify potential exports in food processing, nondurable consumer goods, simple assembly activities, and the production of labor-intensive parts and components for assembly elsewhere, the choice should be left to private initiative. At the same time, for the incentive system to be fully operative, it would be desirable to liberalize price controls.

As noted earlier, the contribution of manufacturing industries to the growth of the economy will be maximized if production for domestic markets and for exports receive equal incentives as has been the case in Korea and Taiwan. It is proposed that steps in this direction be taken in Thailand by increasing incentives to exports and reforming the system of import protection.

## Promoting Manufactured Exports

A variety of measures may be taken to promote manufactured exports in Thailand. The measures proposed here aim at increasing export capacity as well as utilizing existing productive capacity for export. They include an extension of preferences to investment and pre-export credit, the reform of the system of tax and tariff rebates, the application of governmental promotion measures, and the modified treatment of trading firms.

### Credit Preferences

In order to contribute to the establishment of new facilities for export, it is suggested here to provide low interest loans to investors who pledge to export, say at least 80 percent of the output of a new plant or the extension of an existing plant, with the benefits withdrawn if the target is not met within a prescribed period. Preferential loans have been used to good effect by several countries following export-oriented policies, among them Ireland.

Low-cost loans for investment in export capacity could be extended by commercial banks in cases approved by the Board of Investment, with the Bank of Thailand financing the difference between non-preferential and preferential rates. The cost involved may be defrayed by levying a tax on interest rates for non-preferential loans. Alternatively, commercial banks may be authorized to charge higher interest rates on such loans. This would not cause undue hardship since the 12.5 percent interest rate paid by industrial firms on loans with collateral has steadily declined in real terms as the rate of inflation, measured by the wholesale price index, rose from 4 percent in 1975 and 1976 to 5 percent in 1977 and 1978 and to 8-10 percent in 1979.

In order to encourage exporting from existing capacity, it would further be desirable to simplify the administration of the rediscounting of export bills that seems to have discouraged some small and medium size exporters from applying. Also, one should consider increasing the present 2 percent margin for commercial banks that reportedly provides inducement only to extend export credit to their more credit-worthy customers.

It would further be desirable to complement the rediscounting facility of export bills by pre-export credits, in particular the recently established fund for lending to small and medium size exporters without collateral should be increased several times to be effective in promoting exports by these firms. Finally, it would be desirable to establish the proposed export guarantee facility at the earliest possible date.

### Tax and Tariff Rebates

There is further need for reforming the existing system of tax and tariff rebates for exports. In this connection, reference

may be made to the procedure followed by Korea and Taiwan that provide rebates also to the domestic producers of inputs for export. Because of its administrative requirements, this procedure is not recommended for Thailand. Rather, it is suggested to follow the example of Mexico in setting rebate rates for broad export product categories that fully compensate for business taxes and tariffs paid on imported and domestic inputs in the last stage of manufacture as well as at earlier stages. While this procedure does not directly benefit the domestic producers of inputs for export, they enjoy an indirect benefit as exporters receive the tariff rebate even if they buy from domestic sources.

Rebate rates should be set in ad valorem terms for product categories representing the aggregation of the 93 food processing and manufacturing sectors of the 1975 input-output table, with exceptions made for textiles where the rebate rates would depend on the material utilized. The rates should be calculated as the average of business taxes and tariffs paid at the last and at all preceding stages of production by utilizing the input-output table. Firms should be allowed, however, to apply for additional rebate if they can show that the business taxes and tariffs paid by them exceed the average by at least one-fifth.

Also, firms could continue to utilize the temporary admission facilities of the Customs Department. Correspondingly, two sets of rebates should be set, as presently done by the Fiscal Policy Office, for use by this Office as well as by the Custom Department.

Rebates should be paid automatically once exportation takes place. Apart from providing for full rebates of business taxes and tariffs that bear on the cost of export production, the proposed procedures would simplify the setting of rebate rates and the processing of application for rebates.

#### Governmental Export Promotion Measures and Trading Firms

Among governmental export promotion measures, emphasis should be given to strengthening the network of commercial attaches, organizing trade fairs, and financing the participation of private exporters in trade missions. This is because private firms have proved to be better able to seek out trade opportunities than Governmental bodies.

In this connection, one may welcome the preferential treatment provided to trading firms. At the same time, the conditions imposed on these firms as to product composition would need to be reconsidered. Under present legislation, a number of products where Thailand has excellent export possibilities are counted only up to a certain limit in determining whether the trading firm has reached the prescribed minimum size. The products in question include various frozen and canned foods, plastics products and furniture, and consideration should be given to raising or eliminating their limits.

Furthermore, the exemption from business taxes on purchases for export should be extended to all trading firms. This is because trading firms that do not meet the minimum conditions in regard to size can play a useful role as specialized exporters and may contribute to the diversification of the commodity composition and the geographical distribution of Thai exports.

#### Reforming the System of Import Protection

Increases in export incentives should be accompanied by reducing the level of import protection and rationalizing its structure. For various reasons, the 17 percent average ratio of tariff proceeds to manufactured imports tends to understate the protection of the manufacturing sector. Tariffs that discourage imports are given a small weight in the average that is also lowered by the tariff exemptions provided to promoted firms and to exporters; the protection of the processing activity is augmented by the relatively low tariffs on inputs; and import controls further increase the extent of protection.

As tariff rates escalate from lower to higher degrees of fabrication, effective rates of protection--the protection of value added in processing--often exceed nominal tariff rates by a substantial margin. A major exception is agricultural machinery that is admitted duty-free and is subject to negative effective protection due to tariffs on its inputs. Tariff rates vary to a considerable extent from product to product without a clear economic rationale. The existing tariff structure has evolved as a result of actions taken in regard to particular items at different times without adequate consideration given to their interrelationships. There is need therefore to rationalize the tariff structure in order to serve Thailand's economic objectives.

It is suggested here to carry out a reform of the tariff structure over the next five years by establishing tariff targets for the end of the period, to be reached in annual installments. In announcing the target rates and the timing of changes on tariff rates in advance, producers will be given sufficient time to prepare for these changes.

With the exceptions noted below, a tariff target of 20 percent may be set for the end of the five-year period. This target is lower than the 30 percent benchmark used by the Board of Investment that excessively favors import substitution over exports in the manufacturing sector and manufacturing activities in general over primary production.

Higher tariff rates may be maintained, however, on products where the foreign variety is considered a luxury, such as high-fashion clothing. But, in order to avoid the expansion of domestic luxury production, tariff rates on such products should be limited to 40 percent as compared to rates presently ranging up to 100 percent (150 percent on assembled passenger cars). If higher taxation of luxury goods is desired, this should be done by raising indirect taxes that apply to domestic production also.

While--a few luxuries excepted--tariffs on all products presently manufactured domestically should be reduced to 20 percent by the end of the five-year period, new products may receive higher protection on a temporary basis. Such infant industry protection should not exceed 15 percent over and above the tariff target and should be granted on a degressive scale, to be eliminated over a period of five years. Import controls should not be used for this purpose and existing controls should be phased out.

Apart from reducing tariff rates presently in excess of 20 percent, the proposed reform would involve raising tariffs on items that are now subject to tariff rates of less than 20 percent, including various materials and agricultural machinery. Low tariffs on these items discriminate against their domestic production while the resulting subsidy to agriculture may be replaced by reductions in business taxes.

Although the revenue effects of the proposed tariff reform would need to be estimated, it should not be assumed that these effects would necessarily be negative. This is because the lowering of tariffs may lead to a more than proportionate increase in import volume. At the same time, it may be presumed that the increase in imports would be much exceeded by the rise in manufactured exports following the implementation of the proposed export promotion measures.

#### Investment Incentives

Under the Investment Promotion Act, promoted firms receive exemptions from, or reductions in, income taxes on profits and dividends, tariffs and business taxes on imported materials and machinery, and business taxes on domestic materials and machinery. Additional benefits may be provided to firms located in investment promotion zones as well as to export firms. However, there have been relatively few cases of investments in the promotion zones, and no exporter has received additional privileges under the Act.

The use of income tax exemptions on profits and dividends derived from promoted investments is a desirable measure as it rewards firms that lower their production costs, irrespective of whether they use labor or capital more intensively. By contrast, the accelerated depreciation provisions used in some other developing countries encourage capital intensive industries and production methods that is not desirable.



Capital-intensive products and processes are, however, favored by tariff exemptions on imported machinery that also tend to discourage the expansion of the domestic machinery industry. In view of these adverse consequences, it would be desirable to phase out tariff exemptions on machinery, with exceptions made for investment promotion zones and investments for export. The same recommendation is made in regard to tariff reductions on imported materials and reductions in business taxes on imported and domestic materials. Tariff reductions on imported materials discourage their domestic production while reductions in tariffs and business taxes on imported and domestic materials unduly increase the protection of value added in processing (effective protection). As noted earlier, protection for new industries should be provided by using tariffs and be done on a degressive scale.

#### The System of Indirect Taxes

The system of business taxes in Thailand is of the cascade-type as the taxes levied on sales at successive stages of production are cumulative. This tax system has several disadvantages. Firstly, as we have seen, rebating business taxes on exports is a complicated procedure. Also, incentives are provided for vertical concentration that permits reducing the tax burden. Last but not least, a cascade-type tax system discourages subcontracting and the deepening of the industrial structure in general.

In contrast, under the value-added tax system, taxes paid on inputs can be deducted from taxes on the output so that only value added in processing is taxed at each stage of production. This system minimizes the administrative problems involved in rebating indirect taxes; removes the fiscal advantage to concentration; and does not discriminate against subcontracting.

These considerations indicate the advantages Thailand may derive from adopting a value-added tax system. Partial steps in this direction have been taken by reducing business tax rates on inputs. The full adoption of the value-added tax system should be subject to further study in order to examine its administrative requirements.

#### Human and Physical Infrastructure

For the system of incentives to have its full impact, appropriate supporting measures need to be taken. They include providing human and physical infrastructure and in particular, establishing export processing zones and industrial estates.

As regards human capital, improvements in technical training would be desirable. Consideration should further be given to subsidizing training by firms. Such subsidization can be effective as, under present conditions, firms may refrain from training for fear of losing their workers after having incurred the cost of training.

Decisions on physical infrastructure would need to be coordinated with the government's regional development objectives. Questions relating to regional industrial development will be considered in the following.

### Regional Industrial Development

It has been suggested that further industrial expansion in Bangkok involves a social cost in the form of congestion and pollution, and the decentralization of industry has been proposed as a remedy. But decentralization, too, involves a cost since physical infrastructure would need to be provided to support the expansion of industrial activities in new areas.

In view of the cost of providing physical infrastructure and the natural advantages and disadvantages of various regions in Thailand, one should refrain from advocating the geographical dispersion of industry in the guise of decentralization. Rather, emphasis should be given to the establishment of a limited number of "growth poles" at appropriate locations, together with the extension of existing infrastructural facilities elsewhere.

Apart from processing local materials, areas in the interior of Thailand are generally not suitable locations for industries oriented towards exporting or selling in the Bangkok area, given the cost of the two-way transportation of inputs and the final product. Also, exporting requires the availability of port facilities and favors expansion in the Central Region that is easily accessible from Bangkok. In fact, the building of roads has soon led to rapid industrial expansion in this region. However, there is need to prepare plans for the development of the area, to be linked with a master plan for Bangkok itself.

Industrial expansion and export growth would further necessitate the development of the eastern seaboard, including the establishment of a new growth pole centered around the port at Sattahip. An important component of this growth pole would be an export processing zone. This zone, oriented towards the processing of imported materials, would need to be complemented by the establishment of interlinked industries. This, in turn, requires providing physical infrastructure as well as housing and various amenities in the area.

Given the cost involved, one may question the desirability of establishing additional growth poles in Thailand over the next five years. There is however need for setting up industrial estates, preferably specializing in particular industries. An example would be the establishment of an industrial estate for machinery production that would include metal working and machining shops and other specialist suppliers.

Apart from the processing of local materials, industries in the interior of Thailand may service the local market through assembly activities, repair and maintenance, and by catering to specific local needs. For example, the production of agricultural implements and small machines may take place in farming areas.

Exploiting the industrial potential of the interior would be assisted by the proposed changes in the system of investment incentives. It would further be desirable to improve existing infrastructure, banking, and governmental services. As regards the latter, decentralizing some of the economic services of the government, providing technical assistance to small and medium size firms, and granting increased autonomy to the local offices of the IFCT would be especially useful.

#### Concluding Remarks

In this paper, recommendations have been made for formulating an industrial development strategy for Thailand. The policy measures proposed to this end complement each other and may be considered a "package". At the same time, to the extent that administrative constraints limit the immediate application of all of these measures, first priority should be given to the promotion of exports. This is because of the important contribution exports can make to industrial growth and to improving balance of payments, which is given urgency by the recent increase in oil prices.

Nevertheless, the administrative requirements of the proposed measures should not be overestimated. Their application would result in increased automaticity in application and simplified administrative procedures. And, in line with past practice, reliance would be placed on private initiative, with the government establishing appropriate rules to ensure that private decisions are in the national interest.

The adoption of a coherent industrial development strategy and the application of the necessary policy measures require taking decisions at the highest Governmental level as well as coordination among economic ministries and agencies. In taking decisions on industrial strategy, the Economic Cabinet should act on recommendations by an interministerial Technical Committee. The preparation of the individual policy measures, in turn, would be entrusted to interministerial working policies established in liaison with the Technical Committee.

TABLE 1

CAPITAL REQUIREMENTS PER JOB (K/E) AND EMPLOYMENT PER  
UNIT OF OUTPUT (E/O) FOR INDUSTRY CATEGORIES a/

<u>SIC NO.</u>	<u>INDUSTRY CATEGORY</u>	<u>(K/E) (US\$000)</u>	<u>(E/O) (Jobs)</u>
22	TEXTILE MILL PRODUCTS	9.7	28
23	APPAREL AND OTHER TEXTILE PRODUCTS	2.0	40
24	LUMBER AND WOOD PRODUCTS	10.1	24
25	FURNITURE AND FIXTURES	4.5	31
26	PAPER AND ALLIED PRODUCTS	25.4	15
27	PRINTING AND PUBLISHING	9.6	28
28	CHEMICAL AND ALLIED PRODUCTS	23.4	13
	FERTILIZERS	39.7	13
29	PETROLEUM AND COAL PRODUCTS	103.5	2
30	RUBBER AND PLASTIC PRODUCTS	15.0	20
31	LEATHER AND LEATHER PRODUCTS	3.8	32
32	STONE, CLAY AND GLASS PRODUCTS	19.5	22
33	PRIMARY METAL AND ALLIED PRODUCTS	26.1	15
	STEEL AND STEEL PRODUCTS	37.8	13
34	FABRICATED METAL PRODUCTS	9.8	19
35	NONELECTRICAL MACHINERY	10.7	19
36	ELECTRICAL EQUIPMENT AND SUPPLIES	7.4	23
37	TRANSPORTATION EQUIPMENT	9.1	13
38	INSTRUMENTS AND RELATED PRODUCTS	9.2	21
39	MISCELLANEOUS CATEGORIES	5.7	25
	ALL CATEGORIES	13.3	18

a/ U.S. data for 1971, derived from the Census of Manufactures.

TABLE 2

CAPITAL REQUIREMENTS PER JOB (K/E) AND EMPLOYMENT PER  
UNIT OF OUTPUT (E/O) FOR SELECTED PRODUCT CATEGORIES a/

<u>PRODUCT CATEGORY</u>	<u>(K/E) (US\$000)</u>	<u>(E/O) (Jobs)</u>
VITREOUS CHINA FOOD UTENSILS	5.4	51
EARTHENWARE FOOD UTENSILS	3.5	61
SCALES AND BALANCES	4.9	21
ELECTRIC MEASURING INSTRUMENTS	5.7	33
RADIO AND TV EQUIPMENT	5.4	23
X-RAY APPARATUS AND TUBES	5.9	22
SHIPS AND BOATS	5.7	30
WATCHES AND CLOCKS	3.8	26
JEWELRY AND SILVERWARE	4.7	23
MUSICAL INSTRUMENTS AND PARTS	5.2	32
GAMES AND TOYS	5.1	37
SPORTING GOODS	5.2	25
COSTUME JEWELRY	3.3	30
BUTTONS	5.1	31
BROOMS AND BRUSHES	5.9	29
MISCELLANEOUS MANUFACTURES, n.e.s.	4.9	28

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a/ U.S. data for 1971, derived from the Census of Manufactures.

May 12, 1981.

Mr. Robert Heller  
Bank of America National Trust  
and Savings Association  
Bank of America Center  
Box 37000  
San Francisco, California 94137

Dear Mr. Heller:

Sorry for the delay, all my fault.

Yours sincerely,

Enclosures

Norma Campbell  
Secretary to  
Mr. Balassa

Mr. Adi J. Davar, EM2

May 12, 1981.

Bela Balassa, DRC

Terms of Reference: Turkey

I enclose the suggested draft of a memo by Mr. Bart addressed to me. After consultation with Mr. Dubey, please prepare it for signature if you agree with its contents.

cc: Mr. Dubey, EMNVP

Enclosure  
BBalassa:nc

May 12, 1981.

Professor Peter B. Kenen  
Princeton University  
International Finance Section  
Dickinson Hall  
Princeton, New Jersey 08544

Dear Peter,

I would like to ask your agreement for the reprinting of my paper "The Process of Industrial Development and Alternative Development Strategies" in a volume of essays entitled The Newly-Industrializing Countries in the World Economy Pergamon Press is publishing for me.

Thanking you in advance, I remain,

Sincerely yours

Bela Balassa



Mission Members

May 12, 1981.

Bela Balassa, DRC

Final Arrangements for Turkey Mission

1. We plan to have a short meeting of mission members upon arrival in Ankara on May 17th at 8 p.m. in my hotel room. For confirmation, please contact me or Mrs. Helen Chin who is the administrative assistant and secretary to the mission.

2. I enclose an aide memoire that was written during the mission I led to Thailand two years ago. We will prepare a similar aide memoire - although necessarily broader in coverage - after the first two weeks of the mission in Ankara. Your contribution to the aide memoire will be requested by the end of the second week. Those traveling at the time should call Mrs. Chin and dictate their contribution to her.

cc: Messrs. Davar, EM2; Dubey, EMNVP; Hume, EMP, Zaman, EM2; (without enclosure).

Enclosure  
BBalassa:nc

May 12, 1981.

Ms. Shirley W. Y. Kuo  
The Central Bank of China  
Taipei, Taiwan  
The Republic of China

Dear Mrs. Kuo:

Your letter reached me with some delay due to my absence from Washington. Since my return, Mr. Po-sheng Lin has written to Mr. Y. S. Lee.

May I use the occasion to ask if your staff could send me the enclosed data. I would also appreciate it, if I could continue to receive the publications you earlier sent me.

Yours sincerely,

Enclosures

Bela Balassa

TAIWAN

Data Requirements

1. Wages in Manufacturing in NT\$ for Fourth Quarter of 1980 and 1980 average.
2. Exchange rates for Fourth Quarter and 1980 ~~(averages)~~.
3. Working hours index for Fourth Quarter and 1980 ~~(averages)~~.
4. Industrial production Index for Fourth Quarter and 1980 average.
5. Manufacturing Employment for Fourth Quarter and 1980 average.

Mr. Peter E. Wright, VPD

May 12, 1981.

Bela Balassa, DRC

Staff Working Paper

I enclose, in one original and one copy, the revised and retitled version of "Structural Adjustment Policies in Developing Countries." Following discussion with Mr. Bumgarner, I applied the guidelines according to which one should refer to "economies rather than countries" when these include Taiwan. However, there is no need to delete Taiwan from the tables; this is permitted in research publications although not in the WDR.

I am sending a copy of the paper, together with a memo to Jean Baneth who is responsible for ensuring compliance with the guidelines in DPS. As I am leaving for Turkey this weekend, you should address any questions you might have to him.

cc: Mr. Baneth, EPD

Enclosures  
BBalassa:nc

Mr. John E. Merriam, IPA

May 12, 1981.

Bela Balassa, DRC

Korea Paper

Following discussions with the Region, I have decided to withdraw my paper on Korea at this time. The paper will be revised in the summer following a visit by a Korean delegation who will present an outline of the new five year plan.

cc: Messrs. Floyd, LCP; Agarwala, AEA

BBalassa:nc

Messenger Service

May 12, 1981.

Bela Balassa, DRC

Pick-up Parcel at National Airport

Would you please have a messenger pick up from National Airport Express Post Office a package for the World Bank, attention of Mr. Bela Balassa. The number of this package is C6656170. This parcel is from Professor Maxwell Fry University of Hawaii at Manoa, Department of Economics, Honolulu, Hawaii.

The post office in Hawaii guaranteed delivery by noon, May 12th.

BBalassa:nc

May 11, 1981.

Mr. Hubertus Müller-Groeling  
Institut für Weltwirtschaft an der  
Universität Kiel  
2300 Kiel 1, Postfach 4309  
Germany

Dear Mr. Müller-Groeling:

I have made a few changes on the first page of my "Industrial Prospects and Policies in the Developed Countries" in the interest of clarity. I hope that you can take account of these changes before the volume goes to press. Should this not be the case, I presume that I could make the changes in the proofs.

Yours sincerely,

Enclosure

Bela Balassa

# INDUSTRIAL PROSPECTS AND POLICIES IN THE DEVELOPED COUNTRIES

Bela Balassa

## Introduction

The growth of the developed countries' imports of manufactured goods from the developing countries has received much attention in recent years. It has been alleged that increases in imports have adversely affected the industrial sector of the developed countries and that the continuation of this trend bodes ill for the future of the sector.<sup>1/</sup> In turn, it has been claimed that growing protectionism in the developed countries has compromised the prospects for an outward-oriented industrial strategy in the developing countries and makes it necessary for these countries to turn to domestic markets or to trade among themselves.

The present paper will subject these, conflicting, claims to scrutiny. It will examine recent changes in the pattern of international specialization in manufactured goods and consider their impact on the industrial sector of the developed countries. The protectionist measures applied by these countries and their effects on international trade flows will also be analyzed.

The paper will further review the prospects for manufacturing trade and for industrial growth in the developed countries. This will be followed by a discussion of the possibilities for intra-industry trade between developed and developing countries, and of the implications this trade has for the process of adjustment in the developed countries. Finally, desirable

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<sup>1/</sup> A recent example is provided by Paul Samuelson, in whose view "manufacturing industry is trying to leave North America and Western Europe. The basic comparative advantage is moving to the 'Gang of Four': South Korea, Taiwan, Hong Kong, and Singapore" (*World Business Weekly*, December 1, 1980).



May 11, 1981.

Mr. Donald G. Morrison  
Director  
Center for Social Science  
Computation and Research  
Savery Hall 145 DK-45  
University of Washington  
Seattle, Washington 98195

Dear Mr. Morrison:

We should have copies of our Western Africa study by the end  
of the year. I will send you a copy at that time.

Yours sincerely,

Bela Balassa

Mr. Pham Van Thuyet, ASP

May 11, 1981.

Bela Balassa, DRC

Hasan Olgun

*confirm*  
Dr. Hasan Olgun recently wrote to me and sent me a paper of his concerning policy changes in Turkey. I found the paper excellent and it affirms my view that Olgun would do an excellent job in analyzing the system of protection in Pakistan.

BBalassa:nc

May 11, 1981.

Mr. Tercan Baysan  
Department of Economics  
Monash University  
Clayton, Victoria 3168  
Australia

Dear Mr. Baysan:

I recently heard about the dissertation you submitted to the University of Minnesota on "The Economic Implications of Turkey's Entry into the Common Market." I am leading a Bank mission to Turkey next week and would like to see your disseration on my return to Washington. May I ask you to air mail a copy to me. Please send me the bill for postage in case your university cannot cover it.

With best regards,

Yours sincerely,

Bela Balassa

cc: Mr. Michel Noel, YP with paper.

May 11, 1981

Mr. Dennis Thompson  
Journal of World Trade Law  
8, rue des Belles-Filles  
CH-1299 Crans  
Switzerland

Dear Mr. Thompson:

I would like to ask your agreement for the reprinting of my papers "The 'New Protectionism' and the International Economy" and "The Tokyo Round and the Developing Countries" in a volume of essays entitled The Newly-Industrializing Countries in the World Economy, Pergamon Press is publishing for me.

Thanking you in advance, I remain,

Sincerely yours,

Bela Balassa

May 11, 1981

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

Dear Dr. Ceriani:

I would like to ask your agreement for the reprinting of my paper "The Changing International Division of Labor in Manufactured Goods" in a volume of essays entitled The Newly-Industrializing Countries in the World Economy Pergamon Press is publishing for me.

Thanking you in advance, I remain,

Sincerely yours,

Bela Balassa

May 11, 1981.

Mr. Antonio Maria Costa  
United Nations  
Center for Development Planning  
Projections and Policies  
New York, New York 10018

Dear Mr. Costa:

I would like to ask your agreement for the reprinting of my paper "Prospects for Trade in Manufactured Goods between Industrial and Developing Countries, 1978-1990" in a volume of essays entitled The Newly-Industrializing Countries in the World Economy Pergamon Press is publishing for me.

Thanking you in advance, I remain,

Sincerely yours,

Bela Balassa

May 11, 1981

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

Dear Mr. Calika:

I would like to ask your agreement for the reprinting of my paper "Growth Policies and the Exchange Rate in Turkey" in a volume of essays entitled The Newly-Industrializing Countries in the World Economy Pergamon Press is publishing for me.

Thanking you in advance, I remain,

Sincerely yours,

Bela Balassa

May 11, 1981.

Mr. Jean L. Waelbroeck  
Université Libre de Bruxelles  
Faculté des Sciences Sociales  
Politiques et Economiques  
C.P. 139  
Avenue F.-D. Roosevelt 50  
B-1050 Brussels  
BELGIUM

Dear Jean,

I would like to ask your agreement for the reprinting of my paper "The Economic Reform in Hungary Ten Years After?" in a volume of essays entitled The Newly-Industrializing Countries in the World Economy Pergamon Press is publishing for me.

Thanking you in advance, I remain,

Sincerely yours,

Bela Balassa



May 11, 1981.

St. Martins Press Incorporated  
175 5th Avenue  
New York, New York 10010

Dear Sirs:

Re: JEL 80-0405

Please send me Trade Relations; Commercial Policy; International Economic Integration by Alexander J. Years. I am a professor and would appreciate receiving faculty discount. Please bill me at the above address.

Yours truly,

Bela Balassa

Mrs. Marie Rogue, PMD

May 11, 1981

Bela Balassa, DRC

Miss Kazuko Ogawa

Kazuko (Kathy) Ogawa was my student and is preparing her dissertation under my supervision at the Johns Hopkins University. She has shown intelligence and determination in her studies. She is also excellent in the organization of her work. Finally, she is well-spoken and is good in dealing with others.

All these qualities should make Kathy Ogawa an attractive candidate for the Bank. I highly recommend her for a professional position.

BBalassa:nc

May 11, 1981.

Professor Edwin S. Mills  
Department of Economics  
Princeton University  
Princeton, New Jersey 08544

Dear Ed,

Thank you for your letter of May 1st. I have sent Mr. Abreu's Curriculum vitae to one of my colleagues whose department might conceivably be interested in him. I would further suggest that you write to the Urban Institute where there are several jobs available.

Yours sincerely,

Bela Balassa

cc:  
Mr. Stoutjesdijk, DEDDR

May 11, 1981.

Dr. Sarfraz K. Qureshi  
Book Review Editor  
Pakistan Institute of Development Economics  
Post Box No. 1091  
Islamabad  
Pakistan

Dear Dr. Qureshi:

I am afraid, that due to my many obligations, I cannot write  
book reviews for the Pakistan Development Review for sometime to come.

Yours sincerely,

Bela Balassa

May 11, 1981

Mr. Pierre Pascallon  
Institut de Sciences Mathématiques  
et Economiques Appliquées  
11 rue Pierre et Marie Curie  
75005 Paris  
France

Dear Mr. Pascallon:

I am sorry to say that due to many obligations I have, I will not be able to write a paper for your proposed series.

Yours sincerely,

Bela Balassa

May 11, 1981

Mr. Harold Cataquet  
31 Irving Street 31  
Boston, Massachusetts 02114

Dear Mr. Cataquet:

I am sorry that you have not been able to get information from  
Mr. Leiva. I am afraid that I have no other source I could suggest to you.

Yours sincerely,

Bela Balassa

May 11, 1981.

MBA Admissions Office  
School of Business Administration  
The University of Western Ontario  
London, Ontario  
Canada N6A 3K7

Dear Sir:

Bob Therriault has done an excellent job in working for me as a research assistant since July 1980. He has exhibited considerable intelligence and ingenuity in the performance of his tasks. He is able to work productively without close supervision.

In my contacts with him I have learned that Bob Therriault has a very good grounding in economics. This fact, together with his other qualities, makes him an excellent candidate for your school. I highly recommend that you admit him and provide him with a fellowship.

Yours sincerely,

Bela Balassa

May 11, 1981.

Macmillan Publishing Company  
366 3rd Avenue  
New York, New York 10022

Dear Sir:

I would like to ask your agreement for the reprinting of my paper "The 'Stages' Approach to Comparative Advantage" in a volume of essays entitled The Newly-Industrializing Countries in the World Economy Pergamon Press is publishing for me.

Thanking you in advance, I remain,

Sincerely yours

Bela Balassa

"Economic Growth and Resources  
Volume 4, National and International Policies

Proceedings of the Fifth Congress of the  
International Economic Association held in Tokyo, Japan

Edited by Irma Adelman"



2134 Wyoming Avenue N.W.  
Washington, D.C. 20008  
May 9, 1981

International Rescue Committee  
386 Park Avenue South  
New York, N.Y. 10157

Dear Sir:

Enclosed is my contribution of \$25.00. Please use it as you  
see fit.

Yours sincerely,

Enclosure

Bela Balassa

P.S. I benefited from your efforts 25 years ago.

Mrs. Betty Eltezam, DRC

May 8, 1981

Bela Balassa, DRC

Publication

Mr. Duloy agreed to the purchase of 100 copies of the paperback edition of my The Newly-Industrializing Countries in the World Economy. I have now received an estimate from the publisher indicating that the cost of 100 copies at 30% off the list price of \$18.50 will amount to \$1,295. This is slightly higher than my original estimate of \$1,000. May I ask you to order the books so that shipment can be made in June when they are published.

cc: Mr. Duloy, DRC

BBalassa:nc

May 8, 1981.

Professor Erik Thorbecke  
Department of Economics  
Cornell University  
Ithaca, New York 14853

Dear Erik,

My sincere congratulations on your receipt of a honoris causa doctorate degree in economics from the University of Ghent. I read your lecture with interest and agree with its major conclusions. At the same time, under present conditions, I would give attention to efficiency consideration, that is to income distribution. The rationale for this view is given in the enclosed paper "Structural Adjustment Policies in Developing Countries."

Sincerely yours,

Enclosure

Bela Balassa

May 8, 1981.

Mr. Montek S. Ahluwalia  
A-1/47 Panchsheel Enclave  
New Delhi 110017  
India

Dear Montek,

I profusely apologize for not responding to your letter in which you announced the birth of your second child. By this time he must be quite grown.

This letter is motivated by your request to Martin Wolf for Bank papers on trade related issues. I enclose several of my recent papers that have not yet been circulated on the outside. Revised versions of these papers will be sent to you with my regular mailings. I just recently send you several reprints; I hope that you have received them.

Carol joins me in sending our best regards to Isher, yourself and the children.

Yours sincerely,

Enclosures

Bela Balassa

Enclosed: Industrial Prospects and Policies in the Developed Countries  
Adjustment to External Shocks in Developing Countries  
The Policy Experience of Twelve Less Developed Countries, 1973-79  
Structural Adjustment Policies in Developing Countries

May 8, 1981

Mr. José da Silva Lopes  
Caixa Geral de Depositos  
Largo de Santa Catarina  
Lisbon  
Portugal

Dear Mr. Silva Lopes:

Thank you for your letter of April 28th. I am sorry that you have not received the two books by Maxwell Fry. One of these is a large manuscript he has recently prepared. To be on the safe side I will ask him for another copy.

I enclose the revised version of my "Structural Adjustment Policies in Developing Countries" that contains some material relevant to our mission. I further enclose a copy of my aide memoire prepared during my mission to Thailand two years ago. I plan to write a similar aide memoire in Turkey, to which I will ask your contribution during our visit there.

I hope that you have received by now your ticket and reservation at the Buyuk Ankara hotel. I expect that everyone will arrive there on May 17th in the late afternoon. I plan to have a short meeting of the mission in my suite sometime Sunday evening.

Looking forward to seeing you, I remain,

Sincerely yours,

Enclosures

Bela Balassa

May 8, 1981

Mme. Françoise Carrière  
Revue Economique  
54, boul. Raspail  
75006 Paris  
France

Chère Françoise,

Merci de ta lettre du 23 avril. Je suis content de savoir que mon article va paraître prochainement dans la Revue Economique. Comme je pars le 16 mai pour la Turquie, où le service des postes n'est pas des plus efficaces, je te prie de ne pas m'envoyer les épreuves. Je te serais dès lors très reconnaissant si tu voulais bien lire les épreuves à ma place.

En te remerciant d'avance, je te prie de croire, chère Françoise, à mes meilleures amitiés ainsi qu'à celles de Carol.

Bela Balassa

May 8, 1981.

Mr. Ali Kocman  
Chairman  
Türk sanayicileri ve  
İs adamları derneği  
Cumhuriyet Caddesi  
Dortler Apt. 18/2 Elmadag  
Istanbul  
Turkey

Dear Mr. Kocman:

I will be arriving in Ankara on May 18th to lead a World Bank mission on Industrialization and Trade Strategies in Turkey. I plan to come to Istanbul to discuss this subject on May 25 and 26th. I would very much like to meet with you as well as with other industrialists during my visit. I will call your office from Ankara to arrange a meeting.

In the meantime, I would appreciate it if you would send me any TUSIAD publications which appeared in English since 1979. Please send these publications to the Buyuk Ankara Hotel.

Yours sincerely,

Bela Balassa

Ms. Phuong-Anh T. Tran, ADM

May 8, 1981

Bela Balassa, DRC

Hotel Reservation

I am leading a mission to Turkey consisting of 13 staff members and consultants. I wish to ask you to give your agreement to the Travel Office (Mr. Gabor Beres) that a large suite be reserved for me at the Buyuk Ankara hotel for [redacted] May 17th.

BBalassa:nc



Mr. John E. Merriam, IPA

May 8, 1981

Bela Balassa, DRC

Publication

I would like to ask your agreement for the Journal publication of the enclosed paper entitled "Korea in the Nineteen-Eighties: Policies and Prospects." I further enclose a telegram received from the Deputy Prime Minister and Minister of Economic Planning in Korea, agreeing to publication. I am also sending a copy of the paper to Mr. Flood the Division Chief for Korea.

I would appreciate receiving your answer next week as I am leading a mission to Turkey on May 17th.

cc: Messrs. Flood, Division Chief, AEA  
Agarwala, Senior Economist, AEA

Enclosures  
BBalassa:nc

DPMEPP K23202 (Telex No.)

*Ed*

SL 27 JAN 1981.

6158

MR. DELA BALASSA

INTRAFRAD

OKAY FOR THE PUBLICATION OF YOUR ARTICLE ABOUT 5 YEAR PLAN STOP  
SHIN, BYONG HYUN DEPUTY PRIME MINISTER AND  
MINISTER OF ECONOMIC PLANNING, SEOUL KOREA

242423 WORLDBANK

DPMEPP K23202

MM

RECEIVED

1981 JAN 27 AM 10 27  
COMMUNICATIONS DIVISION

Messrs. Rangopal Agarwala, AEA; George Szapary, IMF  
Larry Westphal, DED; Sweder van Wijberger, DRC  
Bela Balassa, DRC

May 8, 1981

Korea Paper

I enclose my revised and retitled paper you commented on sometime ago. Any further comments received by May 12 cob could be taken into account in the final version.

Enclosure  
BBalassa:nc

MR. KAZUKO OGAWA, WORLD BANK  
TOKYO, JAPAN

I DESCRIBE BELOW THE INFORMATION NEEDED FOR OUR RESEARCH PROJECT ON THE STAGES APPROACH TO COMPARATIVE ADVANTAGE. TO AVOID FURTHER DELAYS, AND IN THE EXPECTATION THAT WE CAN FIND A SATISFACTORY WAY TO LINK THE JAPANESE AND THE UN TRADE STATISTICS, PLEASE PROVIDE ME WITH THE DATA DESCRIBED UNDER II FOR ALL SECTORS. I. METHODS ASSUMPTIONS, AND SOURCES 1. THE METHODS OF CALCULATION USED TO DERIVE THE RATIOS OF PHYSICAL AND HUMAN CAPITAL TO LABOR. 2. THE ASSUMPTIONS UNDERLYING THE CALCULATIONS INCLUDING THE CHOICE OF THE DISCOUNT RATE AND THE DEFINITION OF UNSKILLED LABOR. 3. THE SOURCES USED FOR THE DATA. II. DATA FOR THE INDIVIDUAL SECTORS. 1. STOCK MEASURE OF PHYSICAL CAPITAL; 2. STOCK MEASURE OF HUMAN CAPITAL; 3. FLOW MEASURE OF PHYSICAL CAPITAL; 4. FLOW MEASURE OF HUMAN CAPITAL; 5. EMPLOYMENT; 6. UNSKILLED WAGES; 7. VALUE ADDED; 8. WAGE-VALUE ADDED; 9. SKILL COMPOSITION OF LABOR (PERCENT). III. RELATIONSHIP BETWEEN TRADE AND INDUSTRIAL STATISTICS. 1. RECONCILIATION OF SITC AND JAPANESE INDUSTRIAL AND TRADE CLASSIFICATION SCHEMES; 2. RECONCILIATION OF SITC

/2

Bela Balassa

Bela Balassa

DRC - Director's office

BBalassa:nc

TELEX  
781-26838

MAY 8, 1981  
61991

PAGE 2

AND JAPANESE TRADE CLASSIFICATION SCHEMES. PLEASE CALL ME  
NEXT WEEK IF YOU HAVE ANY QUESTIONS. I LEAVE FOR TURKEY ON  
MAY 17. REGARDS, BALASSA

BBalassa:nc

Bela Balassa

Bela Balassa

DRC - Director's Office

Mr. Ian M. Hume, EMP

May 8, 1981.

Bela Balassa, DRC

Mrs. Lucille W. Pevsner was a student of mine 12 years ago; her husband is my colleague at Hopkins. She came to me asking if there would be a possibility for her to get a job at the World Bank. Given her earlier work on Turkey and her interest in project evaluation, I thought that you may wish to consider her for EMENA Projects. Her curriculum vitae is enclosed.

Enclosure  
BBalassa:nc

May 5, 1981

KOREA IN THE NINETEEN-EIGHTIES:  
POLICIES AND PROSPECTS

Bela Balassa

\* The author is Professor of Political Economy at the Johns Hopkins University and consultant to the World Bank. An earlier version of this paper was prepared as an advisory report for the Government of Korea following a visit to Seoul in July 1980. The author is indebted to government officials and economists for helpful discussions. He is also thankful to Mr. Suk Tai Suh for the calculations of real exchange rates and to Messrs. Rangopol Agarwala, George Szapary, Larry Westphal and Sweder van Wijnberger for useful comments. He alone is responsible, however, for the content of the paper that should not be interpreted to reflect the views of the Government of Korea or of the World Bank.

## Introduction

Korea has been considered as one of the success stories among developing countries. Starting from a small industrial base, it developed a modern industrial structure and achieved high rates of economic growth based largely on export orientation, during the decade preceding the 1973-74 oil crisis. Also, Korea was able to rapidly surmount this crisis through the continued application of an export-oriented strategy.

In 1979, however, Korea suffered a decline in the volume of merchandise exports, and in 1980 it experienced a 5.7 percent fall in its gross national product, together with a current account deficit of \$5 billion. In these respects, Korea compares unfavorably with the other Far Eastern economies, Hong Kong, Singapore, and Taiwan, which have maintained rapid rates of growth of exports and GNP and avoided substantial balance-of-payments disequilibria.

This paper will attempt to explain recent economic developments in Korea by reference to the policies applied. It will further make recommendations for policies that may be pursued to redress the situation and to exploit the growth potential of the Korean economy during the eighties.

### Economic Developments in Korea, 1978-79<sup>1/</sup>

With real GNP rising about 10 percent a year in the decade and a half following the policy reforms of the early sixties, Korea was one of the star performers of the world economy. Rapid economic growth was achieved

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<sup>1/</sup> For an analysis of incentive policies in Korea, see Balassa, (1977, 1981a) and Westphal (1981); Korea's economic performance is discussed in considerable detail in Hasan and Rao (1979). Unless otherwise noted, the data cited in this section originate in *Economic Statistics Yearbook* and other publications of the Bank of Korea.



under an export-oriented strategy that led to increases in the volume of exports of goods and services at approximately 27 percent a year between 1963 and 1977.

Korea's high "export elasticity," with a ratio of the rate of growth of exports to that of GNP of 2.7 in the period 1963-77, indicates the central role exports played in the growth process. In terms of 1975 prices, the exports of goods and services equalled 42.5 percent of GNP in 1977 as compared to a ratio of 4.7 percent in 1963 and 17.1 percent in 1970. Exports contributed to economic growth by utilizing Korea's comparative advantage in labor-intensive industries, permitting the exploitation of economies of scale, ensuring the full use of capacity, and creating demand for domestically-produced goods used as inputs in export production and consumed by workers engaged in export activities.

Its outward orientation made it possible for the Korean economy to quickly overcome the effects of the quadrupling of petroleum prices of 1973-74 and the world recession of 1974-75. With the volume of merchandise exports rising by 22.9 percent in 1975 and 35.9 percent in 1976, Korea was able to re-establish rapid rates of economic growth while eliminating its large balance of payments deficit (Balassa, 1981b).

The slowdown in the world economy led to a decline in the rate of growth of the volume of Korean merchandise exports to 19.0 percent in 1977. Nevertheless, it still exceeded the export growth rate experienced by Korea's major competitors, Taiwan, Singapore and Hong Kong by a considerable margin. The situation changed to the detriment of Korea in 1978 and, in particular, in 1979 when it experienced a 1.1 percent decline in its merchandise exports,

expressed in constant prices, while exports increased by 6.6 percent in Taiwan, 20.1 percent in Singapore, and 16.6 percent in Hong Kong (Table 1).

The extent of the shortfall in Korean exports, associated with the loss of market shares to the other three Far Eastern economies, can be indicated in different ways. Calculating the dollar value of exports that would have occurred if increases in Korea matched average increases of exports by these countries in 1978 and in 1979, the export shortfall is estimated at \$2.2 billion in 1979. And, 1979 exports would have been \$8.2 billion higher had Korea maintained the advantage in export growth it experienced in 1976 and in 1977 vis-a-vis the three countries.

An important factor contributing to the deterioration of Korea's export performance was the decline in the competitiveness of its manufactured exports which account for over 90 percent of the total. Following increases in 1973, Korea's real exchange rate, calculated by adjusting the nominal exchange rate for changes in wholesale prices relative to its principal trading partners, returned to the level observed in the early seventies by 1975. The real exchange rate fell afterwards, declining by 12 percent between 1975 and 1979 (Table 2).

At the same time, calculations of real exchange rates derived by the use of wholesale price indices underestimate the extent of the deterioration of Korea's competitive position. This is because increases in the prices of goods that enter international trade are limited by foreign competition, and hence they do not fully reflect the rise in production costs. Correspondingly, interest attaches to changes in unit labor costs which show the extent of cost pressures on the firm due to increases in wages adjusted for variations in labor productivity. Differential changes in wholesale prices and in labor

Table 1

Export Performance in 1974-80: Korea, Taiwan, Singapore and Hong Kong  
(Annual Percent Change)

	1974	1975	1976	1977	1978	1979	1980
<u>Korea</u>							
Export value (US\$ bil.) <sup>a/</sup>	38.5	13.9	51.6	30.4	26.5	18.4	16.3
Export volume index	9.3	22.9	35.9	19.0	14.2	-1.1	10.9
Unit value index	26.6	-7.3	11.7	9.5	10.7	20.0	4.9
<u>Taiwan</u>							
Export value (\$bil.) <sup>a/</sup>	25.2	-5.8	53.8	14.6	31.9	23.6	23.0
Export volume index	-4.3	0.2	50.2	7.8	24.1	6.6	10.6
Unit value index	30.9	-5.9	2.4	6.4	6.1	16.0	11.2
<u>Singapore</u>							
Export value (\$bil.) <sup>a/</sup>	60.2	-7.9	21.8	24.9	23.5	39.9	36.0
Export volume index	10.1	-8.3	19.0	15.1	12.4	20.1	16.8
Unit value index	45.5	0.4	2.4	8.5	9.9	16.5	16.4
<u>Hong Kong</u> <sup>b/</sup>							
Export value (\$bil.)	-	-	41.7	12.9	19.5	31.8	29.5
Export volume index	-	-	30.0	4.6	11.0	16.6	10.2
Unit value index <sup>c/</sup>	-	-	9.0	7.9	7.7	13.0	17.5

a/ Based on balance of payments accounts.

b/ Trade figures from IMF Data Bank.

c/ Derived from export value and volume figures.

Source: IMF International Financial Statistics and Data Bank.

Table 2

Nominal and Real Exchange Rates  
(1975 = 100)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
	(Annual Averages)										
<u>Nominal and Real Exchange Rates, Korea</u>											
(1) Nominal Exchange rate, Won per U.S.\$	310.4	350.1	394.0	398.5	406.0	484.0	484.0	484.0	484.0	484.0	607.6
(2) Wholesale Prices, Korea	42.1	45.7	52.0	55.6	79.0	100.0	112.1	122.2	136.5	162.1	225.3
(3) Unit Labor Costs, Korea	62.4	66.7	71.8	72.3	85.8	100.0	124.2	144.0	168.6	200.5	239.3
(4) Foreign Wholesale Price, U.S.\$	58.8	61.4	66.0	78.6	93.6	100.0	104.3	112.8	129.9	143.3	163.5
(5) Relative Wholesale Prices (2) : (4)	71.6	74.4	78.8	70.7	84.4	100.0	107.5	108.3	105.1	113.1	137.8
(6) Relative Unit Labor Costs (3) : (4)	106.1	108.6	108.8	92.0	91.7	100.0	119.1	127.7	128.6	139.9	146.4
(7) Real Exchange Rate (Wholesale Prices) (1) : (5)	433.5	470.6	500.0	563.6	481.0	484.0	450.2	446.9	460.5	427.9	441.0
(8) Real Exchange Rate (Unit Labor Costs) (1) : (6)	292.6	322.3	362.1	433.2	442.7	484.0	406.4	379.0	376.4	346.0	415.2
<u>Unit Labor Costs, U.S. Dollars</u>											
(9) Korea	97.3	92.2	88.2	88.9	100.6	100.0	124.1	143.5	167.1	200.5	239.3
(10) United States	n.a.	n.a.	74.6	76.7	84.9	100.0	100.7	107.3	115.7	125.4	142.1
(11) Japan	n.a.	n.a.	58.0	67.5	80.4	100.0	99.4	113.2	144.0	133.7	129.1
(12) Taiwan	n.a.	n.a.	61.9	67.0	95.9	100.0	95.3	94.8	92.4	105.2	
(13) Singapore	n.a.	n.a.	n.a.	69.3	88.2	100.0	98.2	117.3			
<u>Unit Labor Cost and Real Wages, Korea</u>											
(14) Nominal Wage	37.9	45.2	52.4	58.2	78.7	100.0	134.7	180.2	242.1	311.4	383.1
(15) Manufacturing Output	35.3	41.1	47.8	64.8	83.7	100.0	131.8	158.7	196.4	220.2	215.8
(16) Manufacturing Employment	58.2	60.6	65.5	80.5	91.2	100.0	121.5	126.9	136.8	141.8	134.8
(17) Labor Productivity (15) : (16)	60.7	67.8	73.0	80.5	91.8	100.0	108.5	125.1	143.6	155.3	160.1
(18) Unit Labor Costs (14) : (17)	62.4	66.7	71.8	73.2	85.7	100.0	124.1	143.5	168.6	200.5	239.3
(19) Consumer Prices	49.1	55.7	62.2	64.2	79.8	100.0	115.3	127.0	145.3	171.9	221.3
(20) Real Wages (14) : (19)	77.2	81.1	84.2	90.7	98.6	100.0	116.8	141.8	166.6	181.2	173.1

Table 2 Cont'd.

Nominal and Real Exchange Rates  
(1975 = 100)

	1979				1980			
	I	II	III	IV	I	II	III	IV
<u>Nominal and Real Exchange Rates, Korea</u>								
(1) Nominal Exchange Rate, Won per US\$	484.0	484.0	484.0	484.0	571.0	594.1	613.3	652.1
(2) Wholesale Prices, Korea	146.0	156.3	170.6	175.4	201.1	222.6	231.0	245.9
(3) Unit Labor Costs, Korea	174.5	191.2	204.7	235.2	218.2	232.1	248.7	260.6
(4) Foreign Wholesale Price, US\$	140.0	139.9	146.8	147.7	153.5	159.5	167.2	171.6
(5) Relative Wholesale Prices (2) : (4)	104.3	111.7	116.2	118.8	131.0	139.6	138.2	143.3
(6) Relative Unit Labor Costs (3) : (4)	124.6	136.7	139.4	159.2	142.1	145.5	148.7	151.9
(7) Real Exchange Rate (Wholesale Prices) (1) : (5)	464.0	433.3	416.5	407.4	435.9	425.6	443.8	455.1
(8) Real Exchange Rate (Unit Labor Costs) (1) : (6)	388.4	354.1	347.2	304.0	401.8	408.3	412.5	429.3
<u>Unit Labor Costs, U.S. Dollars</u>								
(9) Korea	174.5	191.2	204.7	235.2	218.2	232.1	248.7	260.6
(10) United States	121.3	124.0	126.5	130.0	133.0	141.6	147.6	146.8
(11) Japan	145.7	135.5	133.9	121.7	115.0	124.1	136.6	142.9
(12) Taiwan	126.5	94.2	98.0	100.5	124.6	107.2	113.2	
(13) Singapore								
<u>Unit Labor Cost and Real Wages, Korea</u>								
(14) Nominal Wage	271.8	298.4	322.2	356.8	332.9	370.0	408.1	421.4
(15) Manufacturing Output	224.2	222.3	220.3	214.2	216.7	213.6	213.7	219.1
(16) Manufacturing Employment	143.9	142.4	140.0	141.2	142.0	134.0	130.2	135.5
(17) Labor Productivity (15) : (16)	155.8	156.1	157.4	151.7	152.6	159.4	164.1	161.7
(18) Unit Labor Costs (14) : (17)	174.5	191.2	204.7	235.2	218.2	232.1	248.6	260.6
(19) Consumer Prices	159.1	170.9	175.7	182.0	200.3	215.7	226.2	243.0
(20) Real Wages (14) : (19)	170.8	174.6	183.4	196.0	166.2	171.5	180.4	173.4

Source: IMF International Financial Statistics and Bank of Korea Monthly Economic Statistics

costs, in turn, provide an indication of changes in profit margins.

As shown in Table 2, unit labor costs in Korean manufacturing rose less rapidly than wholesale prices until 1975, thereby raising profit margins. The situation was reversed after 1975; between 1975 and 1979, unit labor costs doubled while wholesale prices increased by 62 percent. The ensuing decline in profit margins reduced the profitability of exports and raised the spectre of bankruptcy over a number of firms engaged in export activities.

The reduced profitability of exports is also indicated by real exchange rate calculations made with respect to changes in unit labor costs in Korea (for lack of information, wholesale price indices rather than indices of unit labor costs have been used in the calculations for Korea's principal trading partners). The results show a decline in Korea's labor-cost-adjusted real exchange rate by 29 percent between 1975 and 1979.

These calculations have been made by reference to Korea's principal markets in developed countries, so as to indicate changes in the competitiveness of Korean producers in these markets. Further interest attaches to comparisons of unit labor costs in Korea, in its principal export markets, and in countries competing with Korea in these markets. The data of Table 2 indicate that unit labor costs, expressed in terms of U.S. dollars, increased by 101 percent in Korea between 1975 and 1979 while increases were 34 percent in Japan and 25 percent in the United States and an increase of only 5 percent occurred in Taiwan.

Through its impact on exports, the deterioration of the competitiveness of Korean industry adversely affected economic growth, albeit with a time lag. This is indicated by the reversal of the pattern of year-to-year changes in real GNP between the four quarters of 1977 (9.7, 9.2, 11.2, and 13.7 percent)

and those of 1978 (17.1, 16.7, 13.8, and 4.9 percent). The pattern observed in 1978 continued in 1979 (13.6, 9.2, 6.0 and 1.0 percent), when seasonally adjusted real GNP actually declined in the last two quarters.

Exports and economic growth were also adversely affected by the sectoral allocation of investment. The government favored capital intensive industries producing intermediate goods and heavy machinery by the use of credit and fiscal measures as well as by "moral suasion," often practically forcing firms in labor-intensive export industries to invest in the favored industries.

Capital-intensive industries producing intermediate products, such as ferrous and nonferrous metals, petrochemicals, and chemicals, as well as heavy machinery, such as electrical power generators, heavy construction equipment, and heavy engineering, benefited from the decline in real interest rates after 1977. These industries were also given priority in the allocation of domestic credit and in providing access to foreign credit. 'Directed' credit assumed increased importance during the period and the cost of credit to the industries in question was further reduced through preferential interest rates. Finally, they benefited from fiscal incentives in the form of exemptions from corporate income taxes as well as accelerated depreciation provisions which also lowered the cost of capital.

While the availability and the low cost of credit and favorable tax treatment increased the profitability of the domestic production of capital-intensive intermediate goods and heavy machinery, the incentives alone did not suffice to ensure that investment in these industries was undertaken to the extent desired by the government. In order to obtain the desired pattern of investment, the government exerted pressure on firms in light industries to

invest in capital-intensive intermediate goods and heavy machinery. At the same time, the government had leverage over these firms through its control of much of the credit supply.

The effects of the measures taken are apparent in the pattern of investment during the Fourth Five-Year Plan period (1977-81). While the amount of industrial investment undertaken in the first three years was 80 percent of that planned for the entire five-year period, the relevant figures are 130 percent for basic metals and 101 percent for chemicals and other intermediate products. By contrast, only 50 percent of planned investment was undertaken in the textile industry and 42 percent in the other light industries. Machinery, electronics, and ships occupy a middle position, the relevant figure being 101 percent, with larger than planned increases for heavy machinery.<sup>1/</sup>

At the same time, the investment targets for capital-intensive intermediate goods and heavy machinery in the Fourth Five-Year Plan much exceeded figures for earlier periods. With the overfulfilment of plan targets, then, in 1977-79 26.8 percent of manufacturing investment was in basic metals, 28.8 percent in chemicals and other intermediate goods, 23.3 percent in machinery, electronics, and transport equipment, 12.6 percent in textiles and clothing and 8.5 percent in other light industrial goods. This contrasts with the relative shares of the same industries in industrial production in the base year of the plan, 1975: basic metals, 7.7 percent; chemicals and other intermediate goods, 25.8 percent; machinery, electronics, and transport

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<sup>1/</sup> The data have been provided by the Economic Planning Board of Korea.



equipment, 14.7 percent; textiles and clothing, 25.4 percent; and other light industrial goods, 26.4 percent.

The emphasis given to investments in industries producing capital-intensive intermediate goods and heavy machinery lowered the productivity of capital in Korean manufacturing. This is evidenced by the rise in the incremental capital-output ratio. This ratio was 1.34 in 1970-73 and 1.46 in 1973-76; it rose to 1.63 in 1976-78 and reached 2.73 in 1979.

The rise in the incremental capital-output ratio reflects high costs in industries producing intermediate goods and heavy machinery. Apart from the capital-intensity of the production process, firms in these industries could not fully utilize their capacity in the confines of the domestic market and are not sufficiently specialized.

Unused capacity in capital-intensive intermediate goods and heavy machinery industries contrasts with the lack of sufficient new capacity in traditional labor-intensive export industries that were disadvantaged by the system of credit allocation and suffered the adverse consequences of the increased overvaluation of the won. The scarcity of new investments in these industries, in turn, hindered the expansion and the upgrading of Korea's labor-intensive exports.

#### Exchange Rate Changes and Export Performance in 1980

It appears, then, that the maintenance of the exchange rate at 484 won to the dollar from 1974 to 1979 in the face of rapid increases in labor costs reduced the competitiveness of Korean industry, with adverse effects on exports. Increases in labor costs reflect the 81 percent rise in real wages between 1975 and 1979 in response to pressures on labor markets

resulting from the rapid expansion of construction activity in the course of the implementation of investments in industries producing capital-intensive intermediate goods and heavy machinery. These investments raised the share of gross fixed investment in GDP from about 25 percent in the mid-seventies to 32 percent in 1978 and 1979. At the same time, the capital needs of Korea's traditional export industries were not provided for.

Apart from reductions in export shares, the deterioration of the competitiveness of Korean industry gave rise to increased imports. The high import intensity of industries producing intermediate goods and heavy machinery further aggravated the situation. As a result, the rate of growth of the volume of imports accelerated, from 14 percent a year in the 1970-77 period to 21 percent a year between 1977 and 1979. The acceleration of imports is even greater if we exclude the import content of exports; the relevant figures are 11 percent in 1970-77 and 25 percent in 1977-79.

To improve the competitiveness of Korean industry, on January 12, 1980 the won was devalued by 20 percent in terms of the U.S. dollar. As a result, notwithstanding rapid price increases in the fourth quarter of 1980, the real exchange rate calculated by the use of wholesale price indices depreciated by 7 percent from the 1979 fourth quarter level, which represented a 16 percent appreciation as compared to 1975 (Table 2).

With small exchange rate adjustments in the remainder of the year, the exchange rate reached 656 won to the U.S. dollar, representing an additional depreciation of 13 percent over the January 1980 rate. However, this depreciation was barely sufficient to offset the rise in domestic prices, so that in the last quarter of 1980 the real exchange rate was still 8 percent lower than in 1975.

Greater improvements occurred in labor costs as pressures on profit margins, relatively high unemployment, and exhortation by the government led to a slow down of wage increases, with real wages declining by 3 percent between the fourth quarter of 1979 and 1980. Correspondingly, the real exchange rate, calculated by the use of unit labor cost indices, depreciated by 37 percent between the fourth quarter of 1979 and 1980. Nevertheless, this index still showed an appreciation of 14 percent as compared to 1975. Also, despite a decline in unit labor costs in terms of U.S. dollars, their 1980 level exceeded the 1975 figure by 139 percent while comparable figures were 29 percent for Japan, 42 percent for the United States, and 10 percent in Taiwan.

The depreciation of the real value of the won has led to increases in the volume of Korea's merchandise exports by 10.9 percent in 1980, approximately matching estimated changes in Taiwan and Hong Kong, although falling short of the 16.6 percent increase in Singapore (Table 1). With the depreciation limiting increases in export unit values,<sup>1/</sup> the dollar value of exports however increased substantially less in Korea (17.0 percent) than in the other three economies (Taiwan, 23.0 percent, Hong Kong, 29.5 percent; and Singapore, 36.0 percent). Thus, Korea continued to lose market shares to its Far Eastern competitors in 1980.

#### Domestic Policy Measures

Simultaneously with the January 12 devaluation, various domestic policy measures were taken. The target growth rate of the broadly defined

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<sup>1/</sup> By the end of 1980, average unit values in Korea relative to other countries nearly regained the 1975 level. I am indebted to Sweder van Wijenberg on this point.

money supply was reduced to 20 percent a year as compared to increases in end-year values of 39.7 percent between 1976 and 1977, 35.0 percent between 1977 and 1978, and 24.6 percent between 1978 and 1979. Also, interest rates were raised from 18.6 percent to 24.0 percent on one-year time deposits, from 18.5 percent to 24.5 percent on one-year loans to prime borrowers, and from 9.0 percent to 15.0 percent on export loans, with a rate of 12.0 percent applying until June 30.

In response to the deterioration of the economic situation, domestic expansionary measures were taken on June 5. They included raising the target growth rate of the broadly defined money supply to 25 percent, reducing interest rates on domestic savings and loans by one percentage point, and postponing the scheduled increase of interest rates on export loans from 12 percent to 15 percent for another six months. At the same time, the government released 113 billion won for public works programs, which had been withheld earlier in the year.

Further expansionary measures were taken on September 16, involving the liberalization of selective credit controls, increases in the availability of loans for construction activity and for small- and medium-size firms, and reductions in interest rates to savers as well as to borrowers. Interest rates were set at 21.9 percent on one-year time deposits and at 21.5 percent on one-year loans to prime borrowers.

Expansionary measures were again introduced on November 11, providing special loan facilities to firms in difficulties, lowering consumption taxes on durable consumer goods, including automobiles, color TV sets, and electrical home appliances, and reducing interest rates. Interest rates

were reduced by an additional two percentage points and were set at 19.5 percent on one-year deposits and loans.

In turn, wholesale prices rose by 44 percent and consumer prices by 35 percent between December 1979 and December 1980. And while these results were affected by the large oil price increase in the first half of 1980 and by the impact of the January devaluation, wholesale prices rose at an annual rate of 35 percent in the fourth quarter of 1980 as compared to 28 percent in the third quarter. Corresponding increases in consumer prices were 22 percent in the third quarter and 37 percent in the fourth quarter. The resulting negative real interest rates contrast with positive real interest rates established in Korea in the mid-sixties and re-established after the oil crisis.

Part of the increase in prices is explained by the rise in food prices due to the disastrous harvest in 1980. Still, excluding food, wholesale prices rose at an annual rate of 31 percent in the fourth quarter of 1980 while the increase in consumer prices was 7 percent. The expansionary measures taken were an important factor contributing to this increase. The consolidated public sector deficit reached 548 billion won in the fourth quarter of 1980 as compared to a small surplus in the first three quarters and a deficit of 197 billion won in the fourth quarter of 1979. For the year 1980 as a whole, the consolidated public sector deficit reached 3.7 percent of GNP as against the originally estimated figure of 2.5 percent. In turn, the broadly defined money supply rose by 26.7 percent between December 1979 and December 1980.

#### The Growth Potential of the Korean Economy

In analyzing desirable policy measures for Korea, one needs to consider their short-term as well as their long-term effects. This, in turn,

necessitates examining the growth potential of the Korean economy. In this connection, comparisons with Japan are of interest.

Notwithstanding its rapid economic growth, per capita incomes in Korea, expressed as a percentage of incomes in Japan and measured at the official exchange rate, changed relatively little, from 12 percent to 14 percent over the last fifteen years. This is because economic growth has been rapid in Japan as well, albeit it started from a much higher base, and its population has been rising more slowly.

Korea would have to attain high growth rates to approximate Japan's present income level at the turn of the century. Rapid economic growth is also necessary in order to fulfill the aspirations of the Korean people. While considerable attention has recently been given to social goals in Korea, it is economic growth that permits attaining these goals.

At the same time, the experience of Japan indicates the possibilities for rapid economic growth in Korea, provided that appropriate policies are followed. Such policies would have to aim at the rapid expansion of exports as has been the case in the past. In participating in the international division of labor, exports permit the exploitation of Korea's comparative advantage, the full use of capacity, and production at an efficient scale. Also, exports provide inducements for technological change and supply foreign exchange to purchase the imports necessary for economic growth.

In order to provide impetus for rapid economic growth, exports would have to rise more rapidly than the gross national product. This is indicated by the experience of every successful economy, including that of Japan. Thus, over the past quarter century, exports in Japan grew more than

one-and-a-half times as fast as its GNP.<sup>1/</sup>

The need for continued export orientation is recognized in the Proposed Guidelines for the Fifth Economic and Social Development Plan for 1982-86 (July 1980). Under each variant, the export elasticity (the ratio of the rate of growth of exports to that of GNP) is between 1.5 and 1.6. GNP and export growth rates are 9.0 percent and 14.2 percent; 8.0 percent and 12.1 percent; and 6.5 percent and 9.8 percent under the three variants, respectively.

With population rising 1.6 percent a year, and the labor force by 2.7 - 3.0 percent a year in the Fifth Five Year Plan period, a rate of economic growth of 6.5 percent would not permit fulfilling the economic and social aspirations of the Korean people, however. This variant would also give rise to unemployment averaging 6.2 percent of the labor force.

At the same time, income differentials with Japan indicate the potential for increases in productivity that would permit attaining high rates of economic growth in Korea. Nor does the required expansion of exports face unsurmountable obstacles in foreign markets. Thus, according to estimates made by the author, the exports of manufactured goods by the developing countries to the industrial countries would rise by 12.5 percent a year between 1978 and 1990. And manufactured exports may rise even more rapidly to other developing countries and, in particular to the Middle East (Balassa, 1980).

Through the upgrading and the diversification of exports, Korea may reach higher than average rates of export growth and regain losses in

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<sup>1/</sup> For a more detailed discussion, see Balassa, 1981a.

market shares in the industrial countries. Its increasingly sophisticated industrial structure would also permit exploiting the opportunities offered by the markets of OPEC and non-OPEC developing countries. The possibilities for export expansion are further indicated by the fact that, in per capita terms, Korea has only one-eighth of the exports of the smaller European countries, excluding intra-EEC trade.

Rapid export growth, and the acceleration of the growth of exports following the poor performance of the last two years, in turn, requires adopting appropriate policies. These will be considered under the following headings: incentive policies, investment allocation, and the accumulation of physical and human capital.

#### Incentive Policies

Apart from the long-term requirements of economic growth, the rapid expansion of exports is necessary in order to regain the "growth path" of the Korean economy. Rapid export expansion is also necessary in the short run, in order to reduce Korea's current account deficit that exceeded \$5 billion in 1980, equalling 9 percent of its gross national product. At the same time, this deficit was associated with a 5.7 percent decline in GNP and, given the high import elasticity in Korea,<sup>1/</sup> it would have been larger if the economy continued to expand. This conclusion follows even though the poor harvest, which entailed a reduction in GNP by about four percentage points, necessitated increased food imports.

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<sup>1/</sup> On the basis of past experience, it may be assumed that a one percent increase in GNP is associated with an approximately one-and-a-half percent rise in imports.



Attaining the goal of rapid export expansion would necessitate taking measures to improve the competitiveness of exports. At the same time, restoring the competitiveness of Korean industry is an urgent task since otherwise established export positions will be lost and new exports will not develop. In turn, a domestic expansionary policy would adversely affect the balance of payments both by drawing resources from export industries and leading to "import leakages."

The possible effects of alternative policies are indicated by simulations performed with the model of SRI International developed by Sung Y. Kwack and Michael Mered (1980). Simulations of the effects of a 100 billion won increase in government expenditures in 1970 prices, amounting to 3.0 percent of GNP in the base year, and those of a 10 percent devaluation of the won, offer particular interest.

Increased government expenditures would raise Korea's gross national product by 2.1 percent in the first year, but part of this gain would be lost in subsequent years through rising imports and, by the fifth year, GNP would be only 1.4 percent higher than before the expansionary measures were taken. At the same time, such a policy would lead to a fall in export volume, and it would increase Korea's current account deficit.

By contrast, the volume of exports would rise by 7.8 percent in the first year, and by 12.6 percent by the fifth year, following a 10 percent devaluation of the won. As a result, Korea's gross national product would increase by 3.8 percent initially and by 6.2 percent after five years. Notwithstanding the rise in import volume by 3.6 percent, the current account balance would improve since the 6 percent increase in export prices

expressed in terms of the domestic currency would limit the deterioration of the terms of trade.

Increases in export prices in terms of domestic currency are necessary in order to provide appropriate incentives to exporters through improvements in profit margins. Profit margins would increase substantially following a 10 percent devaluation as the consumer price index, heavily weighted with services, would rise by only 4 percent as a result, so that maintaining real wages at pre-devaluation levels would require only a 4 percent increase in nominal wages.

The devaluation of the won has been objected to in Korea by reason of its inflationary effects. But, an expansionary fiscal policy also contributes to inflation, and the inflationary effects of a devaluation may be mitigated by reductions in tariffs. Except for materials and foodstuffs that enter duty free, the prices of imports would not rise under a partially compensated devaluation that involves reductions in tariffs commensurate with the devaluation.<sup>1/</sup> In turn, with the duty-free entry of imported inputs for export production being maintained, value added in exports would receive the full benefits of the devaluation.

Apart from their anti-inflationary effects, compensating tariff reductions would contribute to efficient resource allocation and economic growth by lessening the extent of discrimination against exports, without however affecting the net protection of import-substituting activities. At the same time, with the devaluation and reductions in tariffs having offsetting

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<sup>1/</sup> The effects of a partially compensated devaluation are discussed in Balassa, 1975.

effects on inflation and on import-substituting activities, the objections against each of these measures, taken individually, would weaken.

The possibility of linking the devaluation of the won to tariff reductions provides an argument in favor of a one-step devaluation. And while it has been claimed that depreciation in small installments is less objectionable politically, the acceleration of minidevaluations in late 1980 encountered opposition in Korea, leading to a subsequent slowdown in the rate of depreciation. Thus, between December 31, 1980 and April 30, 1981, the won was devalued by less than four percent which was not sufficient to offset increases in domestic prices as compared to Korea's competitors. And while preliminary results for the first quarter of 1981 show improved export performance in Korea, these gains will be lost if sufficient exchange rate adjustments are not made.

At the same time, a substantial depreciation in the real value of the won would be necessary in order to regain Korea's competitive position in world markets. Considering the need to offset the effects of the 1979-80 oil price increase on the balance of payments, amounting to about 6 percent of Korea's GNP, the won would have to depreciate in real terms as compared to the 1975 exchange rate. If this is done with a one-step devaluation, the real exchange may be maintained unchanged afterwards.

Apart from tariff reductions, the inflationary effects of the depreciation of the currency may be mitigated by the pursuit of disinflationary monetary and fiscal policies. In fact, the application of such policies is necessary for a devaluation to be effective, in the sense that it is not eroded by domestic price increases. This objective would be served by implementing the monetary target of 25 percent for 1981 and avoiding an unduly expansionary fiscal policy.

The depreciation of the won would reduce labor costs in terms of dollars, which rose rapidly between 1975 and 1979, undermining Korea's competitive position. This objective may be pursued in an alternative way through a slow down in nominal wages, leading to a decline in real wages. This alternative has the obvious merit that it would reduce the rate of inflation while the depreciation of the exchange rate has the opposite effects. Wage restraint would have the further advantage that it would reduce costs in labor intensive industries, where Korea's comparative advantage lies.

Restraining wages, however, has a social and political cost. Also, as noted above, the depreciation of the currency leads to lower labor costs even if real wages remained unchanged. Nevertheless, following rapid increases in real wages between 1975 and 1979, some decline will be necessary in order to improve the competitiveness of Korean industry in world markets.

In view of these considerations, a combination of policies may be pursued, with wage restraint accompanying the depreciation of the won in real terms and disinflationary monetary and fiscal policies being pursued. At the same time, as noted below, incentives would need to be provided for savings and investments. Such a policy package would contribute to the rebuilding of confidence at home and abroad and it would have beneficial short-term and long-term effects on the Korean economy.

#### Investment Allocation

The depreciation of the won improves the profitability of all industries producing internationally traded goods while tariff reductions reduce discrimination against export industries and wage restraint further benefits these, relatively labor-intensive, industries. Apart from their favorable balance of payments effects, the described measures would improve

the allocation of investment, with favorable effects on economic growth.

The efficient allocation of investment would further be served by reducing and rationalizing protection. Korea has a relatively small economy, with its GNP being one-twentieth of that of Japan and one-half of that of Belgium, Sweden, or Switzerland. At the same time, present-day small developed countries traditionally followed a policy of low protection, with tariffs averaging 5-10 percent and excluding the use of quantitative import restrictions, in order to benefit from the international division of labor.

Reducing and rationalizing protection would necessitate tariff reform to follow the reductions in tariffs proposed to be undertaken in conjunction with the depreciation of the won. In order to prepare firms for tariff reductions, it would be desirable to carry out the reform during the period of the Fifth Five-Year Plan, according to a timetable made public in advance.

During the same period, quantitative import restrictions should be increasingly replaced by tariffs. Quantitative restrictions provide absolute protection, the incidence of which is not known with any confidence. They also tend to perpetuate inefficiencies and their replacement by tariffs would contribute to the modernization of the Korean economy.

The elimination of quantitative restrictions is of particular importance for the machinery industry. Experience shows that the application of such restrictions does not ensure adequate specialization in the production of machinery and its parts and components and it permits low quality production. A start in import liberalization may be made by eliminating quantitative restrictions on machinery parts and components.

More generally, the requirements of efficient scale and high quality operations in the machinery industry require the use of promotional measures, which do not discriminate between domestic and foreign sales, in the place of protection. Such measures may include tax benefits, preferential interest rates for investment and the sale of machinery, technical assistance, government-financed training, and support to research and development.

The use of promotional measures in the machinery industry is warranted because this is an infant-industry activity in Korea that has a long learning period. Nonetheless, the measures applied should remain temporary, so as to avoid the establishment and perpetuation of high-cost activities. Furthermore, the same incentives should be provided to all machinery firms, without favoring some firms and some activities over others. It is the firm that should decide if it wishes to make use of the promotional measures offered and should take the risks and reap the rewards of its production and export decisions.

One should also review domestic content regulations that raise the cost of domestic production and limit the firm's choice among inputs. This is the case, in particular, in the automotive industry where domestic content is about 90 percent and the cost of domestic inputs, manufactured for several models on a small scale, is very high.

In this connection, one may welcome the recent decision taken by the government to consolidate the production of passenger automobiles in one firm. Further consideration should be given to participation in the international division of the production process, involving the production of some parts and components for domestic use and for export while importing others. A possible alternative is to take part in worldwide sourcing by

General Motors that has an interest in one of the Korean car-producing firms; another possibility is to establish links with Japanese firms.

While infant industry considerations warrant taking promotional measures in the machinery industry on a temporary basis, such does not appear to be the case for process industries producing intermediate goods where production techniques are well-known and the learning period is relatively short. Rather, these industries should receive the same investment incentives as light industries, which increasingly suffered discrimination in recent years although they have good possibilities for expansion through upgrading and product differentiation.

In turn, capital-intensive industries benefited from the policy of low interest rates that also favored the use of capital-intensive production methods. Following a temporary decline in 1977 to 16.0 percent, interest rates on term loans of 3 to 8 years duration to prime borrowers were raised only to 19.5 percent in 1979 from 18.0 percent in 1976 whereas the rate of inflation, as measured by the wholesale price index, increased from 12.1 percent to 18.8 percent. And while interest rates were raised to 25.5 percent in January 1980, they were subsequently reduced in three instalments by five percentage points, notwithstanding the acceleration of inflation with wholesale prices rising at a rate of about 35 percent a year.

In the place of the increasingly negative real interest rates, it would be desirable to re-establish positive real interest rates, so as to eliminate the existing subsidy to capital-intensive industries and production process. Market-clearing interest rates will also serve as a rationing device among would-be borrowers, thereby obviating the need for credit allocation. At any rate, one would need to reduce the scope of directed credit that

was used in the past to benefit capital- (and energy-) intensive industries in Korea.

More generally, there is need to reform the Korean financial system, so that it conforms to the requirements of a modern industrial economy. This would involve establishing a rational interest rate policy, eventually introducing flexible interest rates; limiting the scope of central credit allocation, transferring over time responsibilities for lending to commercial and investment banks; limiting the role of preferential lending, with the exception of exports and the machinery industry; and reducing the role of government in the banking system.

#### The Accumulation of Physical and Human Capital

A necessary precondition of rapid economic growth is the accumulation of physical and human capital. The former requires providing inducements to domestic savings and investment and encouraging the inflow of foreign capital; the latter necessitates educational and training efforts. These will be briefly considered in the following.

As the Korean experience following the 1964-65 reform and after the re-establishment of positive real interest rates in 1975-76 indicates, household savings respond to interest rates. Correspondingly it would be desirable to provide positive real interest rates to savers. Also, in order to generate sufficient amounts of business savings, one should avoid limiting price increases through price control and the maintenance of low exchange rates.

Korea should continue to borrow abroad since the marginal efficiency of domestic investment exceeds the real rate of interest on foreign borrowing by a considerable margin. But, borrowing may not continue at present rates without eventually jeopardizing Korea's creditworthiness. Considerations of creditworthiness do not affect foreign direct investment in Korea. At the same



time, such investment brings additional benefits in the form of technical and managerial know-how and marketing experience. Foreign investment is of especial importance in the machinery industry that is characterized by rapid technical change. But it may also bring benefits in some consumer goods industries with export potential.

In this connection, one may welcome the policy changes announced in September 1980, allowing foreign ownership up to 100 percent in various industrial branches. It would further be desirable to extend the applicability of these regulations to certain service industries where foreign capital can make an important contribution to Korea's economic objectives.

To begin with, exporting would be helped by permitting foreign trading firms to hold inventories in Korea. Moreover, the modernization of the financial sector would be served if foreign interests were allowed greater participation in insurance and in banking. Finally, the speedy implementation of the proposal for establishing a mutual fund, consisting of the shares of Korean companies for sale to foreign investors, would contribute to the development of capital markets in Korea.

The investment effort would further be helped by increasing and simplifying incentives to productive investment. The system of investment incentives presently applied is unduly complicated and introduces considerable discrimination among industries. Investment incentives may be simplified and unified by enacting the Investment Promotion Law that has been repeatedly proposed in the past.<sup>1/</sup>

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<sup>1/</sup> Cf. e.g. Balassa, 1977.

In turn, an increased educational and learning effort would contribute to the accumulation of human capital. Particular attention would need to be given to technical education and to vocational learning. Apart from government-sponsored learning programs, these efforts would be helped by providing tax exemption to firms that train workers.

Finally, Korea's research and development effort would need to be stepped up. Despite rapid increases, in 1978 expenditures on research and development amounted to only two-thirds of one percent of the gross national product in Korea while the number of researchers per 1000 population was 0.3; the comparable figures are 2.0 percent and 2.3 in Japan. At the same time, the growth of government support to research and development slowed down after 1975, with private industry providing an increased share.

It would be desirable to accelerate the expansion of government financing of research and development during the Fifth Five Year Plan period and to provide greater incentives to private industry to engage in R & D activities. The coordination of existing research institutes and the expansion of university-based research may bring further benefits. Finally, there would be need for venture capital to ensure the application of new technologies.

#### Conclusions

This paper has examined the reasons for recent adverse developments in the Korean economy and has made recommendations for policies to redress the situation and to ensure rapid economic growth during the eighties. The recommendations concern incentive policies, investment allocation, and the accumulation of physical and human capital.

The major thrust of the recommendations is to return to a policy of export orientation in Korea. This would require providing increased incentives to exports and ensuring that export industries can obtain sufficient investment funds. Apart from the long-term benefits of export orientation, increased incentives to exports would serve the short-term objectives of economic recovery and improvements in the balance of payments.

The paper has also made recommendations for improving the allocation of investment, with emphasis given to export industries. Efforts would further need to be made to rationalize existing industries producing intermediate goods and heavy machinery in Korea. The decision to reduce the number of producers of passenger automobiles and electric generators, represents the first step in this direction. In conjunction with import liberalization and the increased participation of foreign capital, the government should let inefficient, high-cost activities disappear, to be replaced by firms that produce on an efficient scale and are integrated in the world economy.

Finally, efficient economic growth requires import liberalization and reductions in the scope of price control. Also, agricultural price support systems would need to be revised, with a view to reduce the burden on the government budget and to encourage a shift toward higher-value products. These measures aimed at increasing agricultural efficiency would complement the policies of industrial expansion and modernization.

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## OFFICE MEMORANDUM

TO: Turkey Mission Members  
FROM: Bela Balassa, DRC  
SUBJECT: Terms of Reference

DATE: May 5, 1981.

I enclose the following:

(1) The revised terms of reference of the mission that was sent to the Turkish authorities for your information.

(2) A complete set of terms of reference for the individual mission members. Please call me if you wish to make any further changes before signature by your supervisor.

(3) A tentative outline of the report of the mission for your comments.

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

BBalassa:nc

## TURKEY

### Industrialization and Trade Strategy Mission

#### Terms of Reference

1. The mission will review the implementation of the January 1980 reforms and the changes that have occurred in the policy orientation of the Turkish government. It will analyze the measures taken so far, and proposed to be taken in the future, in various policy areas which have relevance for industrial development and for international trade in goods and services. Emphasis will be given to policy actions that may be taken over a period of 4-5 years in developing a medium-term industrialization and trade strategy.

#### The Tasks of the Mission

2. In order to provide a background for the discussion of policy issues, the mission will examine recent and prospective future changes in macro-economic variables. This will be complemented by data and projections on output, exports, and imports in the sectoral detail appropriate for the work of the mission.
3. The mission will review the system of import protection and export incentives. The review will concern relative incentives to import substitution and exports, incentives to manufacturing as compared to primary production, and the variability of incentives among industries. It will further consider to the choice among alternative instruments of import protection and export incentives.
4. A review of investment incentives will be undertaken with consideration given to tax as well as to credit incentives. The review will cover domestic as well as foreign investment, with consideration given to the administrative regulations pertaining to the latter. The analysis will also extend to regional incentives and to obstacles to regional development.

5. The mission will review the system of income and social security taxation and evaluate the recent and prospective reforms of these taxes, with attention given to their effects on work effort, risk taking, savings, and the choice of capital-(labor) intensive industries and production methods. It will further examine the proposed reforms of indirect taxes and their incentive effects.

6. The mission will analyze the prospective contribution of the financial sector to economic development in Turkey and the measures that may be taken to modernize this sector. It will cover the system of interest rates, the structure and the competitiveness of the banking system, the availability of medium-and long-term financing, and the development of capital markets.

7. The mission will review the development of the industrial structure and the factors that affect the growth of productivity, such as research and development and labor training. Also, comparisons of public and private industry will be made in the available sectoral breakdown as regards their principal characteristics, such as plant size, labor productivity, capital-output and capital-labor ratios, profitability, and orientation towards domestic and foreign markets. The data will be used to examine the efficiency of public and private industry and to consider the possibilities for exports and import substitution in a comparative advantage framework. In this connection, consideration will be given to preferential access to the EEC market and sales in Middle Eastern markets.

8. Within the manufacturing sector, the mission will analyze in some detail the possibilities for the expansion of engineering industries and mineral-based chemicals in Turkey. This will involve a consideration of factors, such as scale, product specialization, technology, capital-intensity,

labor training, international subcontracting, marketing, costs, and profitability.

9. As regards manufacturing enterprises in the public sector, the mission will examine existing incentives and constraints for the SEEs, the system of management, and the character of interventions by the central authorities. It will further evaluate recent and prospective reforms of the operation and management of the SEEs.

10. The mission will analyze the contribution of the agricultural sector to national economy through the supply of agricultural products for exportation in unprocessed form as well as for industrial transformation destined for sale on domestic or in export markets. Consideration will be given to the incentives affecting agricultural production and food processing, Turkey's comparative advantage in these sectors, institutional arrangements, the availability of cooperative factors, and the potential contribution of foreign investment in food processing for export.

11. The mission will examine recent trends and prospective developments in tourism, taking account of Turkey's comparative advantages and market possibilities in this sector. It will further consider the potential impact of the sector on the balance of payments, evaluate its investment requirements, and assess the system of government incentives and the possible role of private and foreign investors in tourism.



The Composition of the Mission

1.	Bela Balassa, (DRC)	Mission Chief	confirmed
2.	Jayanta Roy, (EM2)	Deputy Mission Chief industrial structure	confirmed
3.	Seok Hyun Hong, (EM2)	macroeconomics	confirmed
4.	Jose da Silva Lopes (consultant)	financial sector	confirmed
5.	Sheetal K. Chand, (IMF)	investment incentives	confirmed
6.	Michael Noel, (YP)	incentives in private industry	confirmed
7.	Martin Wolf (EPD)	incentives in public industry	confirmed
8.	Turgut Ogmen (Consultant)	mineral based chemical exports	to be confirmed
9.	H. S. Sethi (IPD)	engineering industries	confirmed
10.	Pasquale Scandizzo, (AGR)	agricultural exports	confirmed
11.	G. Swamy (EPD)	exports of processed food	confirmed
12.	Isabelle Girardot-Berg (AGR)	agriculture and processed food	confirmed
13.	David Davis (URB)	tourism	confirmed
14.	Bank staff member	secretary	to be confirmed

## OFFICE MEMORANDUM

TO: Mr. J. Roy, EM2

FROM: Adi J. Davar, EM2

SUBJECT: Terms of Reference: Turkey Mission

DATE: May 5, 1981

1. You will arrive in Ankara on May 17th to participate, as Deputy Chief, in the Industrialization and Trade Strategy Mission led by Mr. Bela Balassa. You will directly supervise work on macroeconomic relationships carried out by Mr. Seok Hyun Hong, on engineering industries by Mr. H. S. Sethi, and on mineral-based chemical exports by Mr. Turgut Ogmen. On your return to Washington, you will ensure that draft reports on these subjects be completed in due form by July 3rd.

2. Assisted by Mr. Hong, you will be responsible for work on the development and structure of Turkish industry and complete a report on the subject in draft form by July 3rd. On the basis of available information, the report will examine factors affecting the growth of productivity, such as, technology, research and development, and labor training; make comparisons of public and private industry in the available sectoral breakdown as regards their principal characteristic, including plant size, labor productivity, capital-output and capital-labor ratios, profitability and orientation towards domestic and foreign markets, and analyze the comparative advantage and foreign market possibilities of Turkish industry, with attention given to preferential access to the EEC market and sales in Middle Eastern markets.

cc: Messrs. Balassa, DRC; Dubey, EMNVP; Zaman, EM2; Berk, EM2; Roy, EM2

BBalassa:nc

## OFFICE MEMORANDUM

TO: Mr. Seok Hyun Hong, EM2

FROM: Adi J. Davar, EM2

SUBJECT: Terms of Reference: Turkey Mission

DATE: May 5, 1981

1. You will arrive in Ankara on May 17th to participate in the Industrialization and Trade Strategy Mission led by Mr. Bela Balassa. You will be responsible for the macroeconomic forecasts prepared by the use of the Revised Minimum Standard Model and for the collection of statistical information on industry and related topics.
2. In preparation for the mission, you will revise the RMSM model, incorporating the following elements: (a) output, exports, imports and investment in the following sectors: agriculture, mining, food processing, textiles and clothing, other consumer goods, intermediate goods, capital goods, services; (b) the disaggregation of agricultural exports, separating cereals and pulses, nuts and raisins, fruits, vegetables, tobacco, cotton and other agricultural products; (c) the budget of the government, including revenues, public consumption, public investment, and savings, as well as the consolidated budget of the public enterprises, thereby obtaining private disposable income, consumption, investment, and savings as a residual. Average and marginal private savings ratios will be calculated and sectoral incremental capital-output ratios will be used to derive investment requirements. You should critically examine the assumptions underlying the projections, with a view to revising them following discussions in Turkey. On your return to Washington, you will prepare a draft report on recent and prospective future changes in macro-economic variables by July 3rd under the direction of Mr. Roy.
3. You will be responsible for obtaining the information necessary for the updating the statistical tables contained in "Turkey Policies and Prospects for Growth," with the exception of Section 8, Agriculture, and Section 10, Others. Most of these tables have been updated in the course of the Public Sector mission but revised data for 1980 will have to be obtained. You should familiarize yourself with the data and the statistical sources before departing for the mission
4. You will further be responsible for obtaining data in the available material breakdown for private and public industry, on output, employment, the composition of the labor force, fixed assets, investment, exports, imports, value added, wages, depreciation, taxes, subsidies, profits, the size distribution of industry, and its regional composition. On your return from the mission, you will make international comparisons of output, productivity, exports, and imports and assist Mr. Roy in the writing of a report on the development and structure of Turkish industry.

cc: Messrs. Balassa, DRC; Dubey, EMNVP; Zaman, EM2; Berk, EM2; Roy, EM2.

BBalassa:nc

## OFFICE MEMORANDUM

TO: Mr. Jose da Silva Lopes, CON  
FROM: Bela Balassa, DRC  
SUBJECT: Terms of Reference: Turkey Mission

DATE: May 1, 1981

1. You will arrive in Ankara on May 17, 1981 to participate in the Industrialization and Trade Strategy Mission. You will be responsible for questions relating to the financial sector and macroeconomic policies.
2. You will examine the present and the prospective role of the financial sector in the Turkish economy in encouraging savings, providing financial intermediation, and contributing to the appropriate choice of investment. The analysis will cover the structure and the competitiveness of the banking system, the role of non-bank financial institutions, the bond and stock markets, and the availability of medium-term and long-term financing. You will further analyse government policies relating to the financial sector, including interest rate policy, reserve requirements, selective credits, preferential interest rates, and the financing of the state economic enterprises. Your conclusions and recommendations will be incorporated in a draft report to be prepared by July 6th. As regards credit incentives to investment, you will provide the relevant material to Mr. Chand for incorporation in the report on investment incentives.
3. You will further review the macroeconomic policies followed, with particular attention given to the effects of the measures applied on inflation. This will involve examining the government's exchange rate, monetary, fiscal, and wage policies. You will prepare a short draft report on the subject by July 6th.

cc: Messrs. Davar, EM2; Dubey, EMNVP; Zaman, EM2; Berk, EM2; Roy, EM2.

BBalassa:nc

## OFFICE MEMORANDUM

TO: Mr. Sheetal Chand, IMF

FROM: Richard B. Goode IMF

SUBJECT: Terms of Reference: Turkey Mission

DATE: May 5, 1981

1. You will arrive in Ankara on May 17, 1981 to participate in the World Bank's Industrialization and Trade Strategy Mission led by Mr. Bela Balassa. On the mission you will be responsible for questions relating to taxation and investment incentives.
2. You will review the system of income and social security taxes, as well as recent and proposed reforms of these taxes, with a view to analysing their effects on work effort, risk taking, savings, and the choice of capital- (labor-) intensive industries and production methods. You will further examine the present system, and the proposed reforms, of indirect taxes and assess their effects on the industrial structure and on exports. You will review existing estimates on the revenue effect of alternative tax schemes. On return to Washington, you will complete a draft report on the Turkish tax system by July 3rd.
3. You will review the system of investment incentives, the administrative regulations in effect, and their practical implementation. The review will cover domestic as well as foreign investment with a view to analyzing their effects on the choice of industries, the choice of production methods, regional location, and orientation towards domestic and export markets. In the review you will utilize the findings of Mr. Silva-Lopes on credit incentives to investment. On return to Washington, you will complete a draft report on investment incentives by July 3rd.

cc: Messrs. Balassa, DRC; Davar, EM2; Dubey, EMNVP; Zaman, EM2;  
Berk, EM2; Roy, EM2.

BBalassa:nc

## OFFICE MEMORANDUM

TO: Mr. Michel Noel, YP, EM2DA

FROM: Adi J. Davar, EM2

SUBJECT: Terms of Reference: Turkey Mission

DATE: May 5, 1981

1. You will arrive in Ankara on May 17, 1981 to participate in the Industrialization and Trade Strategy Mission led by Mr. Bela Balassa. On the mission you will (a) review the system of production incentives; (b) examine the project selection criteria used by SPO and TSKB, (c) participate in work on incentives, pricing, costs, productivity and financing in selected engineering industries, and (d) monitor the implementation of the long-term study on Restructuring the Existing Protection and Incentive System in Turkey.
2. The review of the system of production incentives will concern the exchange rate regime, measures of import protection, export incentives, price control, support prices, and the pricing of public utilities. You will analyze the effects of the measures applied on the choice of industries, the choice of production methods, and orientation towards domestic and foreign markets, with further attention given to their impact on foreign exchange receipts and the government budget. On your return to Washington, you will prepare the draft version of the chapter on production incentives, including recommendations for future changes, by July 3rd. Your report will incorporate, in a summary form, the relevant findings of Mr. Chand (IMF) on investment incentives as well as the findings of the mission on incentives in the agriculture and tourism sectors.
3. You will review and evaluate the criteria of project evaluation in public and private investment utilized by SPO and TSKB. On return to Washington, you will prepare a draft report on project evaluation criteria by July 3rd.
4. You will further participate in work on incentives, pricing, costs, productivity, and financing in selected engineering industries. You will draw up a preliminary questionnaire in consultation with Mr. Sethi, review this questionnaire with Professor Hic and his collaborators, and supervise data collection by the Turkish consultant. On your return, you will prepare a section on incentives, prices, and costs for incorporation in the report on the engineering industries.
5. You will take part in the monitoring of the long-term study on protection and incentive reform, reviewing in particular the questionnaire and the selection of firms in the sample, and providing advice on the methodology of the research project.

cc: Messrs. Balassa, EM2; Dubey, EMNVP; Davar, EM2; Zaman, EM2; Berk, EM2; Roy, EM2;

BBalassa:nc

## OFFICE MEMORANDUM

TO: Mr. Martin Wolf, EPDIT

FROM: Jean Baneth, Asst. Director, EPD *JB*

SUBJECT: Terms of Reference: Turkey Mission

DATE: May 1, 1981

1. You will arrive in Ankara on May 17th to participate in the Industrialization and Trade Strategy Mission led by Mr. Bela Balassa. You will be responsible for analyzing the possibilities for improving the operation of state economic enterprises in general and increasing their export orientation in particular.
2. In carrying out this work, you will review the organizational, managerial, and technical constraints under which the SEEs operate including, but not limited to, the existence of conflicting objectives, interventions by the central authorities, the system of incentives, the existence of overmanning, inefficient regional dispersion, and inappropriate plant size. This will be done with respect to industries selected from the following: textiles, cement, and pulp and paper.
3. You will further evaluate recent and perspective reforms concerning the organization, management, operations, financing and incentives of the SEEs, with particular attention given to the need to improve their competitiveness for efficient exporting and import substitution.
4. On your way to Turkey you will spend one day in London, in order to discuss the research project on the direction of developing countries' trade with interested parties at the Overseas Development Institute and the Trade Policy Research Centre. On your departure from Turkey on the 3rd of June you will spend two days in Geneva in the company of Oli Havrylyshyn in order to discuss the same research project with officials at the UNCTAD and the GATT.
5. Following your return to Washington on June 8th you will prepare a brief back-to-office report and complete your draft report on Turkey by July 3rd.

cc and cleared with: Mr. Francis X. Colaço, Chief, EPDIT *FXC*  
 cc: Mrs. Hughes  
 Messers. Baneth, Balassa, Davar, Dubey, Roy, Zaman

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## OFFICE MEMORANDUM

TO: Mr. Turget Ogmen, CON

FROM: Bela Balassa, DRC

SUBJECT: Terms of Reference: Turkey Mission

DATE: May 5, 1981

1. You will join the Industrialization and Trade Strategy Mission on May 18th. On the mission you will be responsible for questions related to mineral-based chemicals in Turkey.
2. You will review the TSKB study on mineral-based chemicals and, jointly with Mr. Roy, select six to eight products for further analysis. You will make cost-price comparisons for these products and examine their potential for exports and for import replacement. You will further consider possibilities for Bank projects and for foreign investment in the products in question.
3. Your conclusions and recommendations will be incorporated in a report to be completed by July 6th. Subsequently, you will visit Washington for discussions on the report.

cc: Messrs. Balassa, DRC; Davar, EM2, Dubey, EMNVP; Berk, EM2, Zaman, EM2; Roy, EM2.

BBalassa:nc



## OFFICE MEMORANDUM

TO: Mr. H. Sethi and (Consultant)

FROM: Harold E. Wackman, Acting Division Chief, IPDD 3

SUBJECT: Terms of Reference: Turkey Mission

DATE: May 5, 1981

1. You should arrive in Ankara on or around May 17, 1981 to participate in the Bank's Industrialization and Trade Strategy Mission led by Mr. Bela Balassa. You shall spend approximately three weeks in Turkey and will be responsible for the analysis of certain engineering industries which will be defined in consultation with the mission leader and the concerned Turkish authorities. Industries of particular interest include castings and forgings, agricultural machinery, metal fabrication, simple electric motors, machine tools, and passenger automobiles.
2. Your work will involve (i) a review of the individual industries with respect to plant size, product specialization, research and development, manufacturing technology, labor and management capability, operational and economic efficiency, marketing organization, including international subcontracting; (ii) an analysis of possibilities for the expansion of these industries; and (iii) an assessment of constraints and potentials of these industries for exports of their products.
3. You will coordinate your activities with Mr. Noel and a person or persons to be assigned by Professor Hic who will examine incentives, prices, and costs in the industries you will cover.
4. On your return to Washington, you will prepare a draft report on the assignment by July 3rd.

cc: and cleared with Messrs. Balassa DRC; and Berk, EM2.  
cc: Messrs. Rajagopalan, PAS; Fuchs, IPD; Dewey, IPD; Ms. Haug, IPD;  
Kohli, IPD; Iskander, IPD; Jaffe, IPD; Perram, IPD; Wackman, IPD;  
Davar, EM2; Gregory, EM2; Ms. Perera, EMP; Zaidan, EMP;  
Dubey, EMNVP; Roy, EM2; Zaman, EM2.

BBalassa:nc

## OFFICE MEMORANDUM

TO: Mr. Pasquale Scandizzo, AGR

FROM: Graham Donaldson, AGR

SUBJECT: Terms of Reference: Turkey Mission

DATE: May 5, 1981

1. You will arrive in Ankara on May 17th to participate in the Industrialization and Trade Strategy Mission led by Mr. Bela Balassa. The agricultural team, under your direction, will analyze the contribution of the agricultural sector to the Turkish economy through the supply of agricultural products for industrial transformation, destined for sale in domestic and in export markets, as well as for exportation in unprocessed form. In this connection, you will examine desirable improvements in pricing and incentive policies, the organization of production, support services, marketing, storage facilities, infrastructure, and financial requirements.

2. You will coordinate the work of the agricultural team and provide a general framework for the analysis of the policy options of the sector, with a view to examining Turkey's short term and long term comparative advantage in agricultural products, the market prospects for these products, and processing possibilities, with consideration given to risk. You will also analyze some economy-wide issues related to the selection of alternative strategies for the agricultural sector, including the pattern of resource flows in and from agriculture, the linkages of agriculture with the industrial sector, and the infrastructure needs.

cc: Messrs. Balassa, DRC; Davar, EM2; Dubey, EMNVP; Zaman, EM2; Berk, EM2; Roy, EM2; Ms. Girardot-Berg, AGR; Ms. Swamy, EPD.

BBalassa:nc

## OFFICE MEMORANDUM

TO: Ms. Gurushri N. Swamy, EPD

FROM: Jean Baneth, EPD

SUBJECT: Terms of Reference: Turkey Mission

DATE: May 5, 1981.

1. You will arrive in Ankara on May 17th to participate in the Industrialization and Trade Strategy Mission led by Mr. Bela Balassa. As a member of the agricultural team, headed by Mr. Scandizzo you will analyze the contribution of the agricultural sector to the Turkish economy through the supply of agricultural products for industrial transformation, destined for sale in domestic and in export markets, as well as for exportation in unprocessed form. In this connection, you will examine desirable improvements in pricing and incentive policies, the organization of production, support services, marketing, storage facilities, infrastructure and financial requirements.
2. You will be responsible for analyzing past performance and future prospects for production and exports of major agricultural and agro-industrial products. You will examine the determinants of production, and exports, the pre-conditions of substantially increasing the exports of products where Turkey appears to have a comparative advantage, and the role of the private and the public investment. You will devote particular attention to the agro-industry sector and its development potential.

cc: Messrs. Baneth, EPD; Colaco, EPD; Balassa, DRC; Davar, EM2; Dubey, EMNVP; Zaman, EM2; Berk, EM2; Roy, EM2; Scandizzo, AGR; Mrs. Hughes, EPD; Mrs. Girardot-Berg, AGR.

BBalassa:nc

## OFFICE MEMORANDUM

TO: Mrs. Isabelle Girardot-Berg, AGR

FROM: Graham Donaldson, AGR

SUBJECT: Terms of Reference: Turkey Mission

DATE: May 5, 1981.

1. You will arrive in Ankara on May 17th to participate in the Industrialization and Trade Strategy Mission led by Mr. Bela Balassa. As a member of the agricultural team, headed by Mr. Scandizzo you will analyze the contribution of the agricultural sector to the Turkish economy through the supply of agricultural products for industrial transformations, destined for sale in domestic and in export markets, as well as for exportation in unprocessed form. In this connection, you will examine desirable improvements in pricing and incentive policies, the organization of production, support services, marketing, storage facilities, infrastructure and financial requirements.

2. You will be responsible for analyzing market and non market incentives for producers of agricultural goods at the various levels of the market chain. You will develop estimates of nominal and effective rates of protection for these products under the present and alternative price regimes and examine their effects on supply, demand, trade, and incomes. You will also make tentative calculations of domestic resource cost ratios.

cc: Messrs. Balassa, DRC; Davar, EM2; Dubey, EMNVP; Zaman, EM2; Berk, EM2, Roy, EM2; Donaldson, AGR; Scandizzo, AGR; Ms. Swamy, EPD.

BBalassa:nc

## OFFICE MEMORANDUM

TO: Mr. David H. Davis, URB

FROM: Anthony A. Churchill, URB

SUBJECT: Terms of Reference: Turkey Mission

DATE: May 1, 1981.

1. You will arrive in Ankara on May 17th to participate in the Industrialization and Trade Strategy Mission led by Mr. Bela Balassa. You will assess the potential for the development of Turkey's tourism sector and make recommendations for a coordinated set of policies and programs designed to efficiently promote such development.
2. In particular, you will: (a) examine recent trends in tourist traffic; (b) analyze the present supply and demand for hotel and other tourist accommodations, together with occupancy and profitability rates; (c) assess the market potential for tourism in Turkey and its competitiveness in terms of physical assets, accessibility and price structure, as compared to other Mediterranean countries; (d) analyze the availability of tourism-related infrastructure, the infrastructure needs of additional accommodation capacity and existing plans for infrastructural investment; (e) examine the government's organization, policies, and incentive (subsidy) programs with respect to tourism; (f) assess the role of the private sector, the possibilities for foreign investment, and the institutional and other constraints that impede such investments; (g) analyze the present and potential impact of the tourism sector on foreign exchange earnings and on regional development, taking account of the indirect effects of tourism.
3. On your return to Washington, you will prepare a draft report on the tourism sector in Turkey by July 3rd. In your report, you will include brief analysis of the experience of other Mediterranean countries with tourism, indicating the relevance of price factors and the development of particular forms of tourism.

cc: Messrs. Balassa, DRC; Davar, EM2; Dubey, EMNVP; Zaman, EM2; Berk, EM2; Roy, EM2.

BBalassa:nc

INDUSTRIALIZATION AND TRADE STRATEGY IN TURKEY  
Outline of Report

1. Recent Developments and Policy Choices

Policy Responses to External Shocks after 1973  
The January 1970 Policy Reforms and Subsequent Policy Changes  
The Economic Effects of the Reform Measures  
Medium- and Long-Term Policy Choices in Industry and Trade  
Short-Term Policy Issues

Part I. THE SYSTEM OF INCENTIVES

2. Production Incentives

The Exchange Rate Regime  
Measures of Import Protection: Tariffs and Licensing  
Export Incentives: Tax Measures, Credit Preferences and  
Foreign Exchange Retention Schemes  
Price Control, Support Prices and the Pricing of Public Utilities  
Incentives to Import Substitution and Exports  
The Sectoral Pattern of Incentives

3. The Financing of Economic Activity

Government Regulations of the Financial Sector  
Interest Rate Policy  
The Structure and Competitiveness of the Banking System  
The Role of Non-Bank Financial Institutions  
Capital Markets and Long-Term Financing for the Private-Sector  
The Financing of State Economic Enterprises

4. The System of Taxation

Income Taxes  
Social Security Taxes  
Indirect Taxes  
The Revenue Effects of Alternative Tax Schemes

5. Investment Incentives and Criteria for Project Selection

Tax Incentives  
Preferential Interest Rates and Selective Credits  
Criteria for Public and Private Investment  
Criteria for TSKB Lending  
Regional Investment Incentives  
Incentives to Small and Medium Scale Industry  
The Treatment of Foreign Investment  
Criteria for Public and Private Investment

Part II. SECTORAL ISSUES

6. The Industrial Sector

The Structure and Development of Manufacturing Industries  
Comparisons of Public and Private Industries  
Technology, Research and Development, and Labor Training  
- Comparative Advantage in Industry  
- Market Prospects in the EEC and the Middle East  
The Engineering Industries  
Mineral-Based Chemicals

7. Public Enterprises in Manufacturing Industries

The Role of the SEEs in the Development of Industry  
Central Interventions in SEE Operations  
Other Constraints Affecting Operations  
The System of Management and Performance Evaluation  
Proposals for Reform

8. Agriculture and Agro-Industries

The Development of Agriculture and Agro-Industries  
Incentives for Production and Exports  
The Availability and Cost of Inputs  
Infrastructural Requirements and Marketing  
Comparative Advantage in Agriculture and Agro-Industries  
Market Prospects in Domestic Transformation and in Exports

9. Tourism

The Development of Tourism  
Market Potential and Competitiveness  
The Economic Effects of Tourism  
Incentives and Constraints  
The Role of Private and Foreign Investment

APPENDICES

1. Macro-Economic Projections

Trends in Sectoral Output  
Investment and Savings  
Exports and Imports  
Balance of Payments  
External Debt and Debt Servicing

2. Engineering Industries

Structure and Characteristics of Engineering Industries  
Incentive Measures  
Technical and Technological Constraints  
Organizational, Labor, and Management Issues  
International Competitiveness  
Market Possibilities

3. Mineral Based Chemicals

Availability of Minerals for Further Transformation  
Constraints to Expansion  
International Competitiveness  
Market Possibilities

4. Agriculture

Development and Structure  
Constraints to Expansion  
Indicators of Incentives  
Domestic Resource Costs and Comparative Advantage  
Market Possibilities

5. Agro-Industries

Development and Structure  
Constraints to Expansion  
Indicators of Incentives  
Domestic Resource Costs and Comparative Advantage  
Market Possibilities

BBalassa:nc



2134 Wyoming Avenue N.W.  
Washington, D.C. 20008  
May 5, 1981

Smithsonian Exposition Books  
P.O. Box 10229  
Des Moines, Iowa 50336

Dear Sir:

The book for which you charged me was returned to you in late  
March.

Sincerely,

Bela Balassa

May 5, 1981

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

Dear Mr. Kellogg:

This is to inform you that I wish to purchase 100 copies of the paperback edition of the Newly Industrializing Countries in the World Economy at forty percent discount of the \$18.50 list price. Let me add here that I have not yet received your revised offer regarding purchase of 100 copies by the World Bank. Please send this to me by return mail as I will be leaving for a long trip late next week.

I hope that the cover and front matter are now o.k. I am especially anxious to have my name correctly spelled on the title page of the book.

With best regards,

Sincerely yours,

Bela Balassa

cc: Mr. Cutler

2134 Wyoming Avenue N.W.  
Washington, D.C. 20008  
May 5, 1981

Riggs National Bank  
Federal Office  
1750 Pennsylvania Avenue N.W.  
Washington, D.C. 20006

Dear Sir:

A few days ago I sent you an application for an American Express Gold Card. As a long-standing American Express cardmember I have received a special form from American Express to apply for a gold card. I have done so today and I wish to withdraw the application I submitted to you.

Yours sincerely,

Bela Balassa

Mr. Mr. Vinod Dubey, EMNVP

May 4, 1981

Bela Balassa, DRC

Mr. Tim Rose

In reference to our conversation, I enclose the curriculum vitae of Mr. Tim H. Rose. I have been consulting with his firm and Rose has been my principal contact. I found him highly competent and I think he would make a good loan officer in EMENA. As you see from the curriculum vitae, for the past three years he and his firm worked for the Saudi Minister of Finance.

Enclosure  
BBalassa:nc

Mrs. Liliana Ponchon, European Office, Paris

May 4, 1981

Bela Balassa, DRC

Meetings

I enclose copies of my letters to Messrs. Myerson and Sabourin as well as to the Hotel Scandinavia. May I ask you to set up my meetings with the first two as well as with Stephen Marris. I presume that Kjell Andersen will participate at my meeting with Myerson; I would like to see Marris even if he takes part at the meeting.

I will inform you subsequently concerning restaurant reservations I will ask you to make.

Enclosures  
BBalassa:nc

May 4, 1981.

Mr. Robert Heller  
Bank of America  
P.O. Box 466  
Church Street Station  
New York, New York 10015

Dear Bob:

It was good to talk with you; I hope that we will meet in person the next time you come to Washington. Please let me know in advance so I can invite you for lunch.

I enclose my comments on Walter Hoadley's paper as well as the final version of my paper on structural adjustment policies. I hope you will find these of interest.

Yours sincerely,

Enclosures

Bela Balassa

Enclosed: Structural Adjustment Policies in Developing Countries - April 20, 1981  
Statement made by Bela Balassa, at the Seminar on North-South:  
A Business Viewpoint - March 12, 1981

Mr. John H. Duloy, DRC

May 4, 1981.

Bela Balassa, DRC

Statement of Expenses

During my two days stay in Paris, on the way to Tunis, I saw Mr. Thierry de Montbrial, Director of Institut Francais des Relations Internationales, (IFRI) and discussed with him the report of his institute on the the world economy (RAMSES memo of April 13th). I also saw Danielle Boetch, an expert on North Africa at the Agence France Press, who gave me valuable information for my Tunisia mission. On my way back from Tunis, I spent two nights and one day in Paris and had discussions with Pierre Uri, the Research Director of the Atlantic Institute, who is one of the chief advisors to Mitterand and is preparing an important book on food problems in the developing countries. Let me add here that, on the way back, I spent two nights in Paris because the Travel Office was unable to book me on the flight I originally requested.

May I ask you to give your approval to the above. I wish to add that I was entitled to a stopover on my way to, as well as returning from Tunis.

BBalassa:nc

2134 Wyoming Avenue N.W.  
Washington, D.C. 20008  
May 4, 1981

YMCA of Metropolitan Washington  
1711 Rhode Island Avenue N.W.  
Washington, D.C. 20036

Dear Sir:

On April 30th I visited your office to suspend my membership for a six months period. I indicated at the time that I would return the membership cards for my wife and children. They are enclosed.

Sincerely,

Enclosures

Bela Balassa



Mr. Martin Wolf, EPD

May 4, 1981

Bela Balassa, DRC

SEEs

1. Here are some further points concerning the SEEs. You may wish to incorporate them in your terms of reference or keep them in mind for the mission. They concern government interventions and other constraints under which the SEEs operate.
2. Government interventions include decisions made on the establishment of the SEEs, new or replacement investments in existing SEEs, the selection of managers, the choice of production targets and product composition, interference with hiring decisions, the setting of prices and wages, the financing of investments and of operating deficits, and day-to-day interventions.
3. Apart from government interventions, the operation of the SEEs are (7) subject to a number of constraints. They include inappropriate plant size and technology, excessively diversified product composition, inadequate compensation of managers, overstaffing, and high transportation costs related to regional dispersion.
4. I have included the following headings in the outline of the report under the title "Public Enterprises in Manufacturing Industries."  
The Role of the SEEs in the Development of Industries  
Incentives and Constraints  
Central Interventions in SEE Operations  
The System of Management and Performance Evaluation  
Proposals for Reform
5. Please return your terms of reference, even if it is not yet signed by Mr. Colaco, and comments on the above headings by Monday c.o.b.

BBalassa:nc

May 4, 1981.

Mr. Geoffrey Shepherd  
The University of Sussex  
Sussex European Research Centre  
Brighton BN1 9RF  
England

Dear Geoff,

The week of June 15th is fine with me. Please let me know what flights you plan to take so I can have the ticket sent to you.

Yours sincerely,

Bela Balassa

cc: Ms. Vivian Couchoud

May 4, 1981.

Dr. Felix Butschek  
Institut fur Wirtschaftsforschung  
Osterreichisches  
Postfach 91  
A-1103 Wien  
Vienna  
Austria

Dear Dr. Butschek:

Please excuse the delayed answer to your letter of March 19th, which is explained by my frequent absences from Washington. I found no errors in the German translation of my speech. I look forward to receiving copies of the published version.

Yours sincerely,

Bela Balassa

May 1, 1981.

Mr. Jose da Silva Lopes  
Caixa Geral de Depositos  
Largo de Santa Catarina  
Lisbon  
Portugal

Dear Mr. Silva Lopes:

I enclose the Terms of Reference for your participation in the mission. We can discuss further details after we arrive in Ankara. Let me add here that it would be desirable if you could come to Washington after July 6th to discuss your report.

I am in receipt of your letter of March 18th. I wonder, however, if you have received the two documents I sent you in March on the financial sector; both were written by Maxwell Fry. I also sent you material pertaining to the mission on April 16th and 23rd. Please let me know by cable if you have received these communications.

Sincerely,

Enclosure

Bela Balassa

Working Paper Submission

Cover Sheet

1. Title: "Structural Adjustment Policies in Developing Countries"
2. Author: Bela Balassa
3. Derived from Research Project No. \_\_\_\_\_
4. Division Chief Concurrence \_\_\_\_\_
5. Department Concurrence \_\_\_\_\_
6. A seminar to discuss the paper (was) (~~was not~~) held.

Date: \_\_\_\_\_

Non-Departmental Participants: \_\_\_\_\_  
(Attach separate list, if necessary)

Altogether three seminars were held with a large number of nondepartmental participants. The first seminar was in Wry in November at a workshop on Structural Adjustment Lending; the second seminar took place at the IMF in December; and the third seminar was given as part of a series of international trade workshops.

7. If no seminar was held, indicate which individuals outside the Department have reviewed and commented on the draft.

A copy of a memo from Mr. Stern is enclosed.

NOTE: This form should serve as a cover sheet when submitting a working paper (for review and approval) to DPS management.

The views and interpretations in this document are those of the author and should not be attributed to the World Bank, to its affiliated organizations, or to any individual acting in their behalf.

WORLD BANK

Staff Working Paper No.

May 1981

STRUCTURAL ADJUSTMENT POLICIES IN DEVELOPING COUNTRIES

This paper examines structural adjustment policies in developing countries, defined as policy responses to external or internal shocks that are carried out with the objective of regaining the pre-shock growth path of the national economy. Examples of external shocks are the quadrupling of petroleum prices of 1973-74 and the world recession of 1974-75. Internal shocks may find their origin in inappropriate economic policies, such as the excessively expansionary fiscal measures taken in Mexico after 1972, or in political events, such as the April 1974 Revolution in Portugal.

The introductory section of the paper reports on the policy experience of a number of developing countries after 1973, indicating that countries applying an outward-oriented development strategy were better able to cope with external shocks than countries following an inward-oriented strategy. It is further shown that the adoption of realistic exchange rates and interest rates, the avoidance of large budget deficits, and the productive use of the proceeds of foreign borrowing eased the process of adjustment.

The paper examines in detail the elements of a policy package that may be applied in response to external or internal shocks in the case prevalent in developing countries, when optimal policies are not applied. Thus, the recommendations simultaneously aim at responding to shocks and undertaking policy reforms. The elements of the policy package include production incentives (the exchange rate, import protection, export subsidies, and price control), incentives to save and to invest, the choice of public investments, sectoral policies in energy and agriculture, budgetary policies, and monetary policies. In the conclusions, the interdependence of the various policy measures is indicated, with further attention given to foreign borrowing. Finally, comments are offered on the international environment in which these policies operate.

Prepared by:  
Bela Balassa, The Johns Hopkins University  
and the World Bank

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The World Bank  
Washington, D.C. 20433  
U.S.A.

May 1, 1981

Mr. Louis Sabourin  
President  
OECD Development Center  
94 rue Chardon-Lagache  
Paris 16<sup>e</sup>  
France

My dear friend,

I will be leading a Bank mission to Turkey in mid May and will be in Paris on my way back to Washington on June 5. I would like to have the opportunity to speak to you on matters relating to the publication of the Policy Responses to External Shocks study. The Paris office of the Bank will call you to arrange a meeting.

I understand that Yves Berthelot will be leaving the Center at the end of May. It might be useful to involve André Barsony in our discussions.

My wife joins me in sending you and your wife our best regards,

Yours sincerely,

Bela Balassa

Mr. Jose da Silva Lopes, CON

May 1, 1981

Bela Balassa, DRC

Terms of Reference: Turkey Mission

1. You will arrive in Ankara on May 17, 1981 to participate in the Industrialization and Trade Strategy Mission. You will be responsible for questions relating to the financial sector and macroeconomic policies.
2. You will examine the present and the prospective role of the financial sector in the Turkish economy in encouraging savings, providing financial intermediation, and contributing to the appropriate choice of investment. The analysis will cover the structure and the competitiveness of the banking system, the role of non-bank financial institutions, the bond and stock markets, and the availability of medium-term and long-term financing. You will further analyse government policies relating to the financial sector, including interest rate policy, reserve requirements, selective credits, preferential interest rates, and the financing of the state economic enterprises. Your conclusions and recommendations will be incorporated in a draft report to be prepared by July 6th. As regards credit incentives to investment, you will provide the relevant material to Mr. Chand for incorporation in the report on investment incentives.
3. You will further review the macroeconomic policies followed, with particular attention given to the effects of the measures applied on inflation. This will involve examining the government's exchange rate, monetary, fiscal, and wage policies. You will prepare a short draft report on the subject by July 6th.

cc: Messrs. Davar, EM2; Dubey, EMNVP; Zaman, EM2; Berk, EM2; Roy, EM2.

BBalassa:nc



May 1, 1981

Dr. Snoh Unakul  
Secretary General of NESDB

Dear Dr. Snoh:

I wish to utilize the visit of one of my colleagues to Bangkok to send you some reprints that may be of interest to you.

I ~~was~~ glad to learn of your appointment ~~as~~ to head NESDB; they are in need of your talents. Please let me know if I can be of help sometime in the future.

Yours sincerely,

Enclosures

Bela Balassa

May 1, 1981

Mr. Henri Bourguinat  
Universite de Bordeaux 1  
Faculte des Sciences Economiques  
Avenue Léon Duguit  
33604 Pessac  
France

Cher Ami:

Mon étude, intitulée "Les tendances actuelles de la spécialisation internationale en produits manufacturés" est en train d'être traduite elle vous sera envoyée avant le 15 mai. Je pars en même temps pour la Turquie et reviendrai à Washington le 8 juin.

Je me réjouis de vous revoir prochainement. Je regrette néanmoins le changement des dates du Colloque qui ne me permettra pas d'y rester le deuxième jour. Selon votre dernière lettre, les nouvelles dates sont le 29-30 juin. Me basant sur les dates qui avaient été initialement prévues, j'ai pris des engagements pour le 30 ~~juin~~.

Je vous prie d'agréer, Cher Ami, l'expression de mes sentiments amicaux.

Bela Balassa

May 1, 1981

Monsieur Patrick Guillaumont  
Universite de Clermont  
Faculte des Sciences Economiques  
BP 54  
41, Boulevard Gergovia  
63002 Clermont-Ferrand  
France

Cher Ami:

Je vous remercie de votre lettre du 24 février. Je n'ai pas encore reçu le numéro des Annales Economiques contenant mon article, mais sans doute cela ne va pas tarder.

Je vous prie de bien vouloir me renseigner concernant les cours de développement économique. La fille d'une de nos amies est en train de finir le deuxième cycle à Dauphine et aimerait étudier le développement en troisième cycle. Est-ce que vous pourriez me faire savoir où elle pourrait mieux poursuivre ses études à Paris? (Je lui ai dit que Clérmont-Ferrand est le chef-lieu de l'étude du développement économique en France, mais elle est retenue par des attachements sentimentaux à Paris.)

Je vous serais reconnaissant de bien vouloir me répondre par retour du courrier. En effet, je pars pour la Turquie le 15 mai et ne reviendrai pas à Washington avant le 5 juin.

En vous remerciant d'avance, je vous prie de croire, Cher Ami, à mes sentiments les meilleurs.

Bela Balassa

Mr. Sheetal Chand, IMF

May 1, 1981.

Bela Balassa, DRC

Terms of Reference

I enclose a revised draft of your Terms of Reference. Please call me after 4 p.m. today or Monday morning to discuss this. I have, in particular, a question if the analysis of criteria used in selecting investment projects should be part of your Terms of Reference or those of Michel Noel?

Enclosure  
BBalassa:nc

Dictated but not read.

Mr. Sheetal Chand, IMF

May 1, 1981

Richard B. Goode IMF

Terms of Reference: Turkey Mission

1. You will arrive in Ankara on May 17, 1981 to participate in the World Bank's Industrialization and Trade Strategy Mission led by Mr. Bela Balassa. On the mission you will be responsible for questions relating to taxation and investment incentives.
2. You will review the system of income and social security taxes, as well as recent and proposed reforms of these taxes, with a view to analysing their effects on work effort, risk taking, savings, and the choice of capital- (labor-) intensive industries and production methods. You will further examine the present system, and the proposed reforms of indirect taxes and assess their effects on the industrial structure and on exports. Finally, you will examine revenue effects of alternative tax schemes and their administrative requirements. On return to Washington, you will complete a draft report on the Turkish tax system by July 3rd.
3. You will review the system of investment incentives, including tax and credit measures, the administrative regulations in effect, and their practical implementation. The review will cover domestic as well as foreign investment with a view to analyzing their effects on the choice of industries, the choice of production methods, regional location, and orientation towards domestic and export markets. The review will extend to the criteria used by the SPO and the TSKB in selecting investment projects, and the prospective role of foreign investment in Turkey.

cc: Messrs. Balassa, DRC; Davar, EM2; Dubey, EMNVP; Zaman, EM2;  
Berk, EM2; Roy, EM2.

BBalassa:nc

## OFFICE MEMORANDUM

TO: Mr. Jose da Silva Lopes, CON

FROM: Bela Balassa, DRC

SUBJECT: Terms of Reference: Turkey Mission

DATE: May 1, 1981

1. You will arrive in Ankara on May 17, 1981 to participate in the Industrialization and Trade Strategy Mission. You will be responsible for questions relating to the financial sector and macroeconomic policies.
2. You will examine the present and the prospective role of the financial sector in the Turkish economy in encouraging savings, providing financial intermediation, and contributing to the appropriate choice of investment. The analysis will cover the structure and the competitiveness of the banking system, the role of non-bank financial institutions, the bond and stock markets, and the availability of medium-term and long-term financing. You will further analyse government policies relating to the financial sector, including interest rate policy, reserve requirements, selective credits, preferential interest rates, and the financing of the state economic enterprises. Your conclusions and recommendations will be incorporated in a draft report to be prepared by July 6th. As regards credit incentives to investment, you will provide the relevant material to Mr. Chand for incorporation in the report on investment incentives.
3. You will further review the macroeconomic policies followed, with particular attention given to the effects of the measures applied on inflation. This will involve examining the government's exchange rate, monetary, fiscal, and wage policies. You will prepare a short draft report on the subject by July 6th.

cc: Messrs. Davar, EM2; Dubey, EMNVP; Zaman, EM2; Berk, EM2; Roy, EM2.

BBalassa:nc