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Date: 4/1/1981 – 4/30/1981

ISAD(G) Reference Code: WB IBRD/IDA DEC-03-15

Series: Reading File of Bela Balassa

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APRIL

1981

THE WILKINSON GROUP
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R1991-086 Other #. 5

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Bela Balassa's chron files - April 1981

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B. BALASSA CHRON FILE APR 1981

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 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. The tasks of the mission will include reconnaissance in regard to macro-relationships that will provide a framework for the discussion of policy issues. Estimates will be made of recent and prospective future changes in macro-economic variables, including the gross national product, employment, the money supply, government receipts and expenditures, exports, imports, and other items in the balance of payments. Past data and future projections on output, exports, and imports will be generated in sectoral detail that permits the consideration of the possible impact of policy changes on industry and trade.

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 protection, and the variability of incentives among industries. It will further examine the instruments of import protection and export incentives, with a view to indicating the possibilities for replacing quantitative import restrictions by tariffs and the appropriate choice of export incentives.

4. A review of investment incentives will be undertaken, covering domestic as well as foreign investment, with consideration given to the administrative regulations pertaining to the latter. The possible bias in the incentive system favoring capital-intensive over labor-intensive activities and large-scale enterprises over small-and medium-scale firms will also be investigated. The analysis will further extend to regional incentives and to obstacles to regional development.

5. The choice of capital-intensive industries and production processes is affected by the system of income and social security taxation that bears on industrial development and trade in general. The mission will evaluate the possible effects of the recent and prospective reforms of these taxes. It will further examine the proposed reforms of indirect taxes and their incentive effects.

6. The capital intensity of production is also influenced by the level and structure of interest rates, which affect the availability of investible funds and the process of financial intermediation. The mission will analyze relevant issues in the financial sector including the recent interest rate reform, the structure and the competitiveness of the banking system, the sectoral allocation of loans, and the availability of medium-and long-term financing, with a view to gauging their potential impact on industry and trade.

7. The mission will review the development of the industrial structure in Turkey. This will involve an examination of the institutional framework in which manufacturing industries operate and of the factors affecting the growth of productivity, such as research and development and labor training. Information will also be obtained on the development of private and public industries, including data on output, employment, factor intensity, the

relative importance of domestic and foreign markets, technology, costs, and profitability. The data will be used to examine the efficiency of private and public enterprises and to consider the prospects for exports and import substitution in a comparative advantage framework.

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, and marketing in general. Attention will further be given to the possibilities for foreign investment and for Bank projects in these industries.

9. As regards manufacturing enterprises in the public sector, the mission will focus on the influences that hinder efficient operations in general and the expansion of exports in particular. This will involve examining existing incentives and constraints for the SEEs, the system of management, and the character of interventions by the central authorities.

10. The mission will analyze the development prospects of agro-industries and the agricultural sector in general, with particular emphasis on export growth and comparative advantage. Consideration will be given to the incentives affecting agricultural production and food processing, as well as to institutional arrangements and the availability of cooperative factors. The potential contribution of foreign investment in food processing will further be investigated.

11. The mission will examine recent trends and prospective developments in tourism, taking account of Turkey's comparative advantages in this sector. It will further examine the potential impact of the sector on the balance of payments and evaluate its investment requirements. Finally, the possible role

of private and foreign investors and the system of government incentives in tourism will be assessed.

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

April 30, 1981

Mr. Jacob M. Myerson
OECD
2, rue André-Pascal
Paris-XVIIe
France

Dear Mr. Myerson:

As I indicated to you earlier, I am leading a Bank mission to Turkey in mid May. I will leave Washington on May 15th and return June 6th.

There has been a change in my plans inasmuch as I now plan to come to Paris at the end of my mission rather than at the beginning. I hope that this change in dates will be convenient for you. The World Bank's Paris office will call you to arrange a meeting on June 5th. A copy of my Terms of Reference is enclosed. Copies are sent also to Messrs. Anderson and Marris whom I would also like to meet on June 5th.

Yours sincerely,

Enclosure

Bela Balassa

cc: Messrs. Marris and Andersen

April 30, 1981

Hotel Scandinavia
27 rue de Tournon
Paris 6
France

Chère Madame:

Je vous prie de bien vouloir me retenir une chambre du
4 au 6 juin. J'arriverai le 4 juin vers minuit et repartirai le 6 juin
dans la matinée.

En attendant votre réponse, je vous prie de croire, Chère Madame,
à mes meilleurs sentiments.

Bela Balassa

cc: Mrs. Ponchon

Travel Office

April 30, 1981

Bela Balassa

Hotel Reservations

I will be leading a mission of 13 people to Ankara on May 17.
Please reserve a large suite for me where mission meetings could be held.
at the Buyuk Ankara hotel.

BBalassa:nc

April 27, 1981

Monsieur Yves Berthelot
Directeur de la recherche
Centre de développement de l'OCDE
94 rue Chardon-Lagache
75016 Paris
France

Dear Yves:

In reference to our telephone conversation I confirm that I am prepared to undertake the substantive editing on the second volume with the copy editing for English style to be done by someone else and reviewed by me. While I hope to do this in ten days, I prefer that the contract be given for twelve days. Incidentally, in the contract I am presently completing, I am spending more time than originally expected. This is due to the fact that giving instructions to the country authors has proved to be a time consuming task. I enclose my comments on the Portugal and Ivory Coast studies; comments on the Brazil study will be sent to you within a week.

I further enclose the preface to my book on newly-industrializing countries, which will be published by Pergamon Press in June. I understand, however, that your decision on Pergamon Press will depend on their publishing a set of books for the Centre, not only our volume.

Yours sincerely,

Enclosures

Bela Balassa

cc: Mr. Barsony

P.S. I do not plan to charge you for extra days worked under the present contract. However, I wish to avoid underestimating my time requirements under the next contract.

April 23, 1981

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

Dear Mr. Mateus:

I provide below some comments on the revision of Parts I and II of your study. These comments supplement my memorandum of April 8, 1981.

I have only a few comments on Chapters I and II of Part I; they are contained in the enclosure. Chapter III is very interesting but it contains too many numbers per page. Also, in interpreting the effects of policy responses, keep in mind that the estimates shown for a particular year refer to changes as compared to the "1972" average; to obtain year-to-year changes, differences in the estimates for successive years should be taken.

The conclusions need strengthening. Apart from the use of the various indicators referred to in Para. 9 of my memo, you should draw the lessons of the post-Revolutionary experience and indicate your expectations as to policy responses to the 1979-80 oil shock.

There are too many tables in Part I. Apart from the "standard" table described in my memo, I suggest that you retain Tables 1, 6, and 7 that provide interesting additional information and incorporate real exchange rate calculations made by using production cost data in the exchange rate table. In presenting the estimates in the "standard" tables, dollar figures without decimals should be used. In all tables, as well as in the text, percentages should be shown with one decimal.

Part II shows the results of a considerable amount of research but it is too detailed and contains too many tables. Also, it needs to be reorganized in accordance with the outline contained in my memo. Some general comments on individual chapters follow.

Chapter 1 is far too long and contains too much data, nor does it belong in Part II. It should rather come, in a shortened form (3-5 pages), as an introduction to the entire volume and should include no more than two summary tables, giving data on changes in aggregate expenditures savings rates, ICOR, and the sectoral composition of GNP. The section on the post-Revolution period should be included in the conclusions to Part I.

Chapter 2 does not belong to Part II of the volume either. It could be included, in a greatly abbreviated form, in the introduction to the entire volume. In this way, the information relating to the pre-1973 period will precede the analysis of the post-1973 period. Retain Tables 11 and 12 in a combined and abbreviated form. In view of space limitations, the other tables should be omitted.

Chapter 3 provides some interesting discussion of the relationship between domestic resource cost ratios, private profitability, export performance, and capital-labor ratios. Provide in a single table the data for these variables and calculate rank correlation coefficients for each pair. However, delete all tables providing information on input coefficients. Also, only direct DRCs should be reported.

It is not made clear if the tariffs used in calculating nominal and effective protection rates pertain to all imports. My understanding is that lower tariffs apply to imports from the EEC and EFTA. Protection rates for these imports should be calculated and their relative importance indicated. Also, in the discussion, more emphasis should be given to changes in protection rates between 1974 and 1977.

Please check the calculation of the rank correlation coefficient between ERPs and DRCs. The result seems to be too low in view of the relatively few adjustments made. But, if the result is correct, more attention should be given to explaining differences for particular product groups.

Table 3.14 should include information on imports under surcharge in effect in 1977 that is used in earlier tables. In turn, Table 3.15 needs clarification and the extent of import restrictions on consumer goods should be discussed in detail in the text. This should be done before the estimates on effective protection are presented.

In Chapter 4, investment incentives should be discussed before you get to the allocation of investment. At the same time, the earlier rebate system as well as the new, integrated system of fiscal and financial incentives should be criticized from the economic point of view.

On the allocation of investment, delete the detailed tables on the structure of manufactured investments and replace them by a table indicating changes over time in the relative importance of public and private investment and in the sectoral composition of public investment. As regards the Sines complex, some of the estimates of the internal rate of return are of doubtful validity and the discussion should also cover the economics of the investment in steel. At the same time, you should avoid giving the impression that a gain in foreign exchange is additional to the internal rate of return; the latter should take account of the scarcity of foreign exchange by including a shadow exchange rate in the calculations. On the whole a more critical analysis of the Sines complex is warranted; in this connection I enclose, on a confidential basis, my comments on an earlier version of the Bank report on public investment in Portugal.

I further enclose the paper on the three Latin American countries referred to in my memo. Finally, in a week or so, I will send you our calculations of policy responses to external shocks in Portugal that provides

estimates until 1978. Our calculations do not include tourism and workers' remittances. While there may be differences between your and our basic data, feel free to use your own when you consider them more appropriate.

Finally, I would like to ask you to pay particular attention to English style. Also, as the volume is destined for a wide audience, great clarity in the expressions used is necessary.

Yours sincerely,

A handwritten signature in dark ink, appearing to be 'Bela Balassa', written in a cursive style. The signature is positioned above the printed name.

Bela Balassa

Enclosures

P.S. I was sorry to hear that you are not coming to the Fund after all.

Comments on Portugal Study

Bela Balassa

PART I

Introduction

p. 1 It is not clear what period the growth rates refer to.

I. External Shocks

p. 3 The expression "terms of trade effect" should be used to refer to the sum of the pure terms of trade effect and the unbalanced trade or inflation effect. These effects should be related to the average value of trade and to GNP, both expressed in "1972" prices.

pp. 3-5 The discussion of terms of trade effects should be clarified and terms of trade effects for merchandise export trade and for tourism and workers' remittances separately considered. Indicate further the method of calculation used for the latter.

pp. 6-7 Discuss volume effects for merchandise exports as well as for tourism and workers' remittances, indicating the method of calculation used for the latter.

p. 6 Do not include formulas in text.

p. 7 The effects of the loss of colonies on exports is measured by changes in export market shares and should be discussed at a later point.

p. 7 Changes in the prices of intermediate products should be discussed in conjunction with terms of trade effects.

II. Policy Responses to External Shocks

p. 9 Note that additional net external financing is defined as the difference between the actual and the trend value of the resource gap.

p. 10 All figures should be expressed in million dollars; do not use decimals. In turn, use one decimal for percentage changes.

p. 13 Give reasons for gains in EEC markets and for losses in EFTA markets and in the United States.

III. The Policies Applied

p. 16 One cannot speak of spectral analysis in this context.

p. 16 Again, the reference to "the deterioration of the terms of trade and the pure price effect" is misleading. Also, there should be a transition in the discussion between changes over time and data for the latest year.

p. 18 Give full citation of your paper.

- p. 21 Loss to firms should be expressed in U.S. dollars or as a percentage of GNP.
- p. 21 Is illegal construction estimated in Portugal?
- p. 21 Inventories could not have decreased by 120 percent.
- p. 21 Again, the footnote should contain full citation.
- p. 22 The reference to distortion associated with a high consumption share should be clarified.
- p. 24 A 3 percent reduction in M_2 is not large.
- p. 24 The "existing financial distortions" were not discussed earlier.
- p. 25 Reference to basic balance should be deleted.
- p. 30 Delete comparisons with Latin American countries and references to Carter.
- p. 33 For 1980, actual data should be used.

Conclusions

- p. 34 External shocks should be expressed in terms of average figures for the entire period.

Part II

1. The Seventies and the Sixties: the Balance of Two Decades of Economic Growth

- p. 1 We can hardly speak of a take-off in the early sixties in Portugal that was already a middle-income country at the time. Rather, reference should be made to the pre-conditions of rapid economic growth.
- p. 1 I doubt that the increase in real savings is explained by the growth of financial intermediation.
- p. 1 Per capita incomes should be given in the constant prices of a recent year; data for the early sixties should also be provided.
- p. 2 The escudo was not devalued in the first half of the sixties.
- p. 5 How was the remainder of the trade deficit covered? Portugal accumulated reserves in 1972 and 1973.
- p. 6 The statement about the decline of competitiveness relates to exports rather than to imports.
- pp. 7-8 The low incremental capital-output ratio shows the success of Portuguese economic policies.

p. 9 The experience of 1970-73 should not be discussed in the section on the post-Revolutionary period.

p. 10 The question needs to be raised if the emphasis on heavy industry has not been overdone.

p. 11 Increase in agricultural productivity will also contribute to employment by creating demand for nonagricultural goods.

2. Outward-Looking and Inward-Looking Policies: Factors of Industrial Growth

See general comments.

3. Measures of Economic Efficiency, Comparative Advantages and Costs of Protection

p. 17 No need to provide discussion of general equilibrium and formulas for estimating DRC.

p. 22 The value of labor's marginal productivity in agriculture should be indicated.

p. 25 It is not clear why one should calculate with a real rate of devaluation of 4 percent a year. Also, references to the Chakravarty-Solow type model should be clarified.

p. 28 Provide the basis for the assumption that the shadow exchange rate was 20 percent above the official exchange rate in Portugal. This will require a consideration of the structure of protection.

p. 38 Reference to Schydrowsky and to Bhagwati-Srinivasan should be omitted. Do not report "Schydrowsky-rates."

p. 46 The protective effects of previous registration should be discussed in some detail.

4. Investment Incentives Policies in Portugal

p. 53 The last sentence on the page is unfinished.

p. 54 It does not appear that Portugal would have a comparative advantage in the production of fertilizers given the high import cost of energy.

p. 65 The drawback system should be described in more detail.

Mr. Michel Noel, YFP

April 27, 1981

Pela Balassa, DRC

Comments on Ivory Coast Study

1. Your paper provides a good basis for Part I of the study on the Ivory Coast. Apart from adding estimates for 1978, it needs a more extensive discussion of the balance-of-payments effects of external shocks and of the policy responses to these shocks. You may pattern your discussion on my "Policy Responses to External Shocks in Selected Latin American Countries," which discusses the estimates in greater detail and analyses each of the four forms of policy responses separately.
2. The discussion of the policies applied is fine but you should provide only a summary treatment of import protection, export promotion, and investment incentives in Chapter 3 as their detailed analysis belongs to Chapters 5, 6, and 7 in Part II. At the same time, in the later chapters, you should give greater detail on changes in the incentive system than what you have at present, with tabular information provided whenever available.
3. As noted in my memorandum dated April 8, there is need for a concluding chapter which provides an overall summary and evaluation of the results. In this connection, it should be emphasized that while the deceleration of economic growth represents an immediate response to external shocks, the GNP growth rate for the period as a whole and, in particular, for 1976-79, becomes an indicator of the success of economic policies.
4. Apart from changes in the incentive system you should analyse in Part II changes in the investment program in response to external shocks. This will be followed by detailed analysis of the food processing and textile sectors.

Comments on Ivory Coast Study
Bela Balassa

Part I

- p. 2 Delete discussion of methodology.
- p. 3 Differences between pure terms of trade effects and unbalanced trade effects should be noted.
- p. 3 Discuss export volume effects in regard to individual commodities and commodity groups.
- p. 5 Indicate meaning of actual to hypothetical ratios for exports.
- p. 6 After 1975, there were no further import savings due to the deceleration of economic growth, rather the opposite; year-to-year changes are measured by calculating differences between estimated values for successive years.
- p. 8 To link up the estimates of Tables 1 and 2, note should be taken of the difference between the actual and the trend value of the resource gap.
- p. 10 Changes in exchange rates are not just "curtailed" but totally excluded within the Franc Zone.
- p. 10 Explain the operation of the Franc Zone and the role of the CEEAO.
- p. 11 Revised data for 1979 and 1980 should be used.
- p. 13 Explain the composition of the CEAO and the CEDEAO and the rules under which they operate.
- p. 14 Archaic, not archaists.
- p. 14 Statement on import licensing is unclear.
- p. 15 Are there any export subsidies?

THE NEWLY-INDUSTRIALIZING COUNTRIES IN
THE WORLD ECONOMY

by

Bela Balassa

Pergamon Press

Oxford • New York • Toronto • Sydney • Paris • Frankfurt

PREFACE

The existence of considerable diversity among developing economies has been increasingly recognized. Within this group, the newly-industrializing countries have assumed considerable importance in the world economy over the last fifteen years. In several industries, they have become competitors of the developed countries in the markets of these countries as well as in third markets.

This volume of essays places the newly-industrializing countries in the context of the changing patterns of industrial development and world trade. The essays examine the interdependence of countries at different levels of economic development through trade, evaluate the policies followed, and consider policy measures that may be taken to exploit the benefits of international specialization and to attain high rates of economic growth.

The introductory essay provides an overview of the process of industrial development and alternative development strategies. It is followed by the essays of Part I that analyze the external shocks suffered by the newly-industrializing developing countries after 1973 and their policy responses to these shocks; examine the implications of the trade policies of the developed countries and of the Tokyo Round of Multilateral Trade Negotiations for the developing countries; investigate the changing pattern of comparative advantage in manufactured goods and the effects of these changes on employment in the developed countries; and review recent and prospective future trends in trade in manufactured goods between de-

veloped and developing countries.

The essays of Part II examine the policies applied by selected newly-industrializing countries following the oil crisis and the world recession, and review their economic plans and projections. Recommendations are further made on economic policies for the future.

The essay on Greece and two essays each on Korea and Taiwan were prepared as policy advisory reports for the governments concerned and are published with their concurrence. The essays on Brazil, Portugal, Turkey, and Hungary were written in response to invitations by national institutions; they were originally published in conference volumes or academic journals. The essays of Part I also first appeared in academic journals while the introductory essay was published in the Princeton Essays of International Finance. Permission for publication to all concerned is gratefully acknowledged.

The author further wishes to express his appreciation to government officials and economists in the individual countries for their interest and support and to the World Bank under whose auspices all the essays of the volume, except the one on Greece, were prepared. However, the essays express the opinions of the author and should not be interpreted to reflect the views of particular governments or the World Bank.

Bela Balassa

Mr. Michel Noel, YPP

April 27, 1981

Bela Balassa, DRC

Comments on Ivory Coast Study

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Comments on Ivory Coast Study
Bela Balassa

Part I

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- p. 13 Explain the composition of the CEAO and the CEDEAO and the rules under which they operate.
- p. 14 Arabica, not arobusta.
- p. 14 Statement on import licensing is unclear.
- p.15 Are there any export subsidies?

April 27, 1981

Mr. Cutler
Pergamon Press Ltd.
Fairview Park
Elmsford, New York

Dear Mr. Cutler:

In reference to our telephone conversation I include a suggested blurb for the book. If you find it too long you may wish to end the second sentence with the words "world trade." You may also wish to make changes to improve the style. However, please check any changes with me.

I further enclose another copy of the photograph that will be used on the cover. As I mentioned to you on the phone, I am anxious that the photo should show the details as this was done in publishing it in the World Bank Report which I earlier sent you.

Yours sincerely,

Enclosure

Bela Balassa

cc: Mr. Kellogg

THE NEWLY INDUSTRIALIZING COUNTRIES
IN THE WORLD ECONOMY

Bela Balassa

This volume is unique in its focus on the newly-industrializing countries and in its combination of comparative analysis and individual country studies. The COMPARATIVE ESSAYS place the newly-industrializing countries in the context of the changing patterns of industrial development and world trade, examine the economic interdependence of countries at different levels of development, and provide a critical evaluation of the policies applied.

The COUNTRY ESSAYS analyze the development strategies of BRAZIL, PORTUGAL, GREECE, TURKEY, HUNGARY, KOREA, and TAIWAN and make recommendations for future policies. The author, Professor of Political Economy at the Johns Hopkins University and Consultant at the World Bank, has wide experience as a policy adviser to developing countries, including those covered in the volume.

SERIOUS STUDENTS of world economy cannot afford to be without this definitive contemporary study of the newly industrializing countries.

~~XXXXXXXXXXXX~~ CABLE
TELEX MBAN 23111

APRIL 27, 1981
61991

MR. MEHMET GUN CALIKA, MBAN SECURITIES BROKERAGE, ODAKULE IS
MERKEZI ISTIKLAL CADDESI, 286 BEYOGLU, ISTANBUL, TURKEY

JULY FIRST DATE CONFIRMED. SINCERELY, BALASSA

Bela Balassa

Bela Balassa

BBalassa:nc

DRC - Director's Office

OFFICE MEMORANDUM

Mr. Demetrious Papageorgiou, DED

April 27, 1981

TO:

Bela Balassa, DRC

DATE:

FROM:

JAMAICA: The Manufacturing Sector

SUBJECT:

1. Your draft report provides some useful information on the Jamaican manufacturing sector. At the same time, an analysis of export performance would be necessary. From Table 4, it appears that manufactured exports outside the CARICOM area hardly changed in dollar terms in recent years and a decline is shown if we exclude food, beverages, and tobacco (mainly rum). The decline is even larger if the data are adjusted for price changes. Thus, the devaluation does not appear to have led to increases in Jamaica's non-CARICOM exports.
2. The latter result would require explanation. You should also deal with the question of trade diversion from non-CARICOM to CARICOM markets. Finally, the possibilities of increased exports from existing capacity would need to be examined. The discussion is rather vague on this point and I doubt that "the low rate of investment in manufacturing in the seventies has caused a considerable reduction in the capital stock of manufacturing and thus in employment" (p. 15).
3. There is some confusion about equilibrium and parity exchange rates. Adjusting for the difference between the actual and the free trade exchange rate will reduce rather than increase the estimated extent of protection. At the same time, the free trade exchange rate has nothing to do with the parity exchange rate, since the latter shows changes in competitiveness as compared to a base period.
4. The base period chosen for the calculation of the parity exchange rate should be one of balance-of-payments equilibrium. The year 1975 will therefore not be appropriate, given that it was a peak deficit year. Should you use 1973 instead, it will be apparent that the 1980 exchange rate appreciated in real terms, thereby reducing Jamaica's competitiveness. But you may have to go back to earlier years to find a situation of balance-of-payments equilibrium.
5. The finding that the competitiveness of Jamaican exports declined as compared to the early 1970s should be utilized as an argument in favor of establishing a parallel exchange market. Note further that establishing a parallel market would have the advantage of simplicity in administration, as compared to some of the measures you consider. But, free access to imported inputs should be extended to all exporters even if the parallel market is instituted.
6. Among the other measures you recommend, the cash subsidy has a budgetary cost that cannot be taken lightly. Such is not the case for foreign exchange retention. At the same time, exporters should be given the right to sell the retained foreign exchange. In countries with foreign exchange and budgetary difficulties, this has been a favored device to provide subsidy to exporters without burdening the budget.

cc: Messrs. Gonzalez-Cofino, LC2; A. Meyer, LC2; Westphal, DED

BBalassa:nc

CABLE

APRIL 27, 1981
61991

DR. MIKERREN NIG, ISTANBUL UNIVERSITY, FACULTY OF ECONOMICS
INSTITUTE OF ECONOMIC DEVELOPMENT, ISTANBUL, TURKEY

COMMENTS ON QUESTIONNAIRE SENT ON FRIDAY 24. PLEASE CALL ME
COLLECT FOR DISCUSSIONS ON THE ORGANIZING OF WORK ON THURSDAY
MORNING (202) 676-1991. REGARDS, BALASSA

Bela Balassa

Bela Balassa

DRC - Director's Office

BBalassa:hc



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Document Date Apr 24, 1981	Document Type Letter			
Correspondents / Participants Associated Scientific Publishers BV Bela Balsassa				
Subject / Title Invoice of a Journal Subscription				
Exception No(s). <input checked="" type="checkbox"/> 1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/> 4 <input type="checkbox"/> 5 <input type="checkbox"/> 6 <input type="checkbox"/> 7 <input type="checkbox"/> 8 <input type="checkbox"/> 9 <input type="checkbox"/> 10 A-C <input type="checkbox"/> 10 D <input type="checkbox"/> Prerogative to Restrict				
Reason for Removal Personal Information				
Additional Comments		<p>The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information. This Policy can be found on the World Bank Access to Information website.</p> <table border="1"><tr><td>Withdrawn by Chandra Kumar</td><td>Date May 30, 2014</td></tr></table>	Withdrawn by Chandra Kumar	Date May 30, 2014
Withdrawn by Chandra Kumar	Date May 30, 2014			

April 24, 1981

Mr. Peter Rashish
Wolfson College
Oxford OX2 6UD
England

Dear Peter,

The French counter-conference on the U.S. economy will take place on September 10-11. I am writing today to one of the organizers, Christian Stoffaes asking if you could participate. He should contact you directly on this.

I enclose a copy of the French version of my paper which appeared in Commentaire. The English version will be delay, I am afraid, due to Dick Erb's busy schedule. Last time I saw him, he spoke vaguely about publication in a few months.

Yours sincerely,

Enclosure

Bela Balassa

TELEX
842-620628

APRIL 24, 1981
61991

MISS RONDEAU, INTBAFRAD

PARIS, FRANCE 75116

STUDY WILL BE AVAILABLE IN JULY, REGARDS, BALASSA

Bela Balassa

Bela Balassa

BBalassa:nc

DRC - Director's Office

April 24, 1981

Professor D. J. Daly
York University
Faculty of Administrative Studies
4700 Kelle Street
Downsview, Ontario M3J 2R6
Canada

Dear Professor Daly:

I am sorry to say that I do not have estimates on effective rates reflecting the effects of the Tokyo round. You may, however, write to Jan Tumlir at GATT who might have prepared such an estimate.

Yours sincerely,

Bela Balassa

April 24, 1981

Monsieur Christian Stoffaes
Ministère de l'industrie
Centre d'étude et de prévision
101, rue de Grenelle
75700 Paris
France

Dear Christian,

Thank you for your letter of April 1st and the enclosure. I am glad to see that the date of the Conference has been set for September 10-11, when my teaching will not have yet started.

I hope that you are not serious in asking for a preliminary draft of the paper by May 1st and for a final draft by July 1st, 1981. I would certainly not be able to complete the French version of the paper for distribution before July. However, I will have it translated into French at the World Bank.

I think that the program is excellent and you have succeeded in getting together a responsible group of people. I will miss, however, having a genuine "supply-sider." I enclose a clipping that concerns Norman Ture, the Under Secretary for Tax and Economic Policy at the Treasury, who would be an excellent candidate.

You may recall that Peter Rashish was assisting Dick Erb at the AEI Conference. He is now studying at Oxford and would like to have the opportunity to participate at the Paris Conference. Peter has done a very good job at the AEI and I think that he deserves to be given this opportunity. It would only involve a letter indicating that he is free to come to the Conference. His address is, Wolfson College, Oxford OX2 6UD, England.

Yours sincerely,

Enclosure

Bela Balassa

Mr. David W. Berk, EM2

April 24, 1981

Bela Balassa, DRC

Terms of Reference

I enclose 5 copies of the proposed Terms of Reference to my mission for sending to the Turkish authorities. In the covering letter please note that we will be arriving on May 17th, Sunday and would like to have the first meeting with government officials the next morning. Also individual appointments for the mission members should be made starting the afternoon of the same day. I plan to send some additional details on appointment requirements in a few days.

Enclosures
BBalassa:nc

April 24, 1981

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

Dear Mr. Lemgruber:

I have been delayed with a variety of things and will not get to sending you my comments on the revision of your study until next year. I enclose a copy of the paper "Policy Responses to External Shocks in Selected Latin American Countries" as well as a print-out of our estimate for Brazil for the years 1974 to 1978. This should permit you to extend your own estimates until 1978.

With best regards,

Sincerely yours,

Enclosures

Bela Balassa

April 24, 1981

Professor Mukerrem Hic
Professor of Economics
Istanbul University
Faculty of Economics
Institute of Economic Development
Istanbul
Turkey

Dear Professor Hic:

Thank you for your letter of April 7th. In the meantime, I have received comments on your questionnaire from three of my collaborators, all of whom have experience in devising and utilizing questionnaires for effective protection-domestic resource cost calculations.

I would like to emphasize that these comments are designed to help you but you should decide on how you will take account of them. As noted below, I myself disagree with several of the comments. Also, some of the suggestions involve obtaining information which might not be necessary in the Turkish context. Some general comments follow.

1. I tend to agree with the suggestion made by Papageorgiou that a separate questionnaire be used to obtain information of a non-quantitative nature. The use of such questionnaires has proved helpful in interpreting the estimates and preparing the overall analysis and evaluation in studies on other countries. I enclose a copy of a questionnaire designed for a study of exporting firms. This explains the detail in Part I. However, many of the questions in Part II to IX should be useful in the Turkish context also.

2. Part VI of the questionnaire inquires about capacity utilization. As noted in your letter of April 7, this is an important issue for Turkey, given the situation existing in 1980. In order to avoid overstating domestic resource costs, it would be necessary to make calculations also by adjusting for capacity utilization as described in the Methodology I sent you. Suggestions made in Pursell's comments should be helpful in this regard.

3. I doubt that exports to the USSR or COMECON would be of importance in Turkey. Thus, the elaborate adjustment suggested by Papageorgiou and Pursell may not be necessary.

4. I also wonder if subcontracting is likely to be important in Turkey; perhaps one could deal with the matter by way of the non-quantitative questionnaire. Transactions within the firm may also represent a special case.

- 4 -

5. I agree with Papageorgiou and Pursell that your questionnaire may be overly detailed. In fact, all the information you plan to collect may not be necessary for the calculation, and for the interpretation, of incentive and domestic resource cost measures.

6. As regards Table 3.0.0, I agree with Noel that ex factory values should be used, with the exclusion of indirect taxes, but I doubt that exports would be reported on a cif basis as Pursell suggests. At the same time, I doubt the need for adding domestic transport cost to the cif import value as Pursell appears to suggest.

7. In Table 4.0.0, international price comparisons require obtaining detailed technical specifications for individual products as recommended by Pursell. He is also correct in pointing to the importance of such price comparisons, and to the difficulties involved. Finally, as Papageorgiou suggests, detailed information on incentive could be obtained by the use of the non-quantitative questionnaire.

8. Comments made by Papageorgiou and Pursell on Tables 5.0.0, 6.0.0 and 7.0.0 are generally correct. I also agree with them that Table 8.0.0 is overly lengthy. At the same time, there is need for information on administration, selling, and financial costs.

9. Table 9.0.0 is very important for revaluing the capital stock of the firm. This would require obtaining information on the dates of purchase of capital goods prior to 1970. However, as Pursell suggests, one can hardly ask for much detail.

The World Bank is financing \$53,200 out of the total budget of \$76,100 I prepared last January; the remaining \$22,900 is to be provided by the Government. We are suggesting to the Government that the Bank establish a direct contractual relationship with you for the payment of researchers' fees (\$30,000), office costs (\$4,400), and part of the cost of sampling and interviewing (\$18,800 out of \$38,900), with the Government financing the remainder of the cost of sampling and interviewing (\$20,100) as well as the cost of domestic travel (\$2,800). I hope that this is agreeable to you.

With best regards,

Sincerely yours,

Bela Balassa

OFFICE MEMORANDUM

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

DATE: April 23, 1981

1. As you have already been informed, a meeting on the pre-mission issues paper will be held on Monday, April 27th at 10:30. Immediately following this meeting, I would like to hold a short meeting of the mission members to discuss preparations for the mission.
2. We are sending today a description of the tasks of the mission (pp. 5-8 of the pre-issues paper) to the Turkish government. I would further like to ask the government to make arrangements for appointments for the members of the mission and to provide the necessary data at the time of arrival. Please give me your requirements next Monday.
3. You should arrive in Turkey on May 17th, Sunday to participate at a meeting with government officials the next morning. I am asking that individual appointments be made starting the afternoon of the same day.
4. In preparation for the mission, I suggest that all mission members read "Turkey: Policies and Prospects for Growth, 1980." The red cover version of this report is exhausted and you should obtain the grey cover version together with the postscript "Turkey: Policies and Prospects for Growth." Furthermore, I enclose for your reading "Turkey: Second Structural Adjustment Loan," March 20, 1981, and my back-to-office and its supplement, January 22, 1980. Finally, you may also wish to get sectoral reports from the Division that are available in white cover.

Enclosures
BBalassa:nc

Ms. Virginia Hitchcock, IPA

April 23, 1981

Bela Balassa, DRC

Reprint Series

I enclose in two copies the following papers for the Reprint Series. They have all been accepted by the Editorial Sub-Committee.

1. "Growth Policies and the Exchange Rate in Turkey"
2. "Trade in Manufactured Goods: Patterns of Change"
3. "Cambios en la división internacional del trabajo en productos manufacturados"
4. "La Ronda de Tokio y los países en desarrollo"

I enclose a letter from Meban Securities authorizing the reprinting of my paper on Turkey. I further enclose a letter from the Instituto para la Integración de America Latina giving approval for reprinting all recent and future Spanish translations of my papers published in Integración Latinoamericana. I understand that you have a similar blanket approval from World Development in which my paper listed in 2. above appeared.

As regards your memo of March 26th, I wish to include my "The Newly Industrializing Countries after the Oil Crisis" in the Reprint Series. Among the papers using my methodology on policy reactions to external shocks, this is of greatest interest. It will appear in the next issue of the Weltwirtschaftliches Archiv. Permission for reprinting is enclosed.

Enclosures
BBalassa:nc

BANCO INTERAMERICANO DE DESARROLLO

Instituto para la Integración de América Latina

DIRECTOR

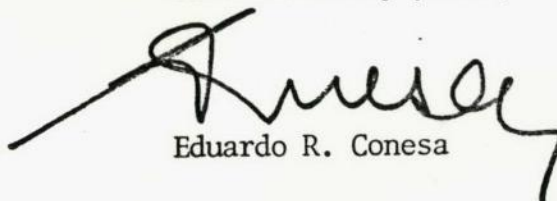
Buenos Aires, April 3, 1981

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

Dear Mr. Balassa:

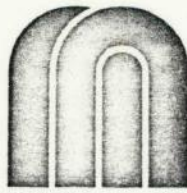
By means of this letter, INTAL/IDB gives permission for including in the World Bank Reprint series all our recent and future Spanish translations of your papers published in *Integración Latinoamericana*, giving due credit to our publication.

Most cordially yours,



Eduardo R. Conesa

ERC/cgv



MEBAN SECURITIES BROKERAGE and FINANCE CORPORATION

Odakule İş Merkezi İstiklal Caddesi, 286 Beyoğlu-Istanbul/Turkey
Telephone: 45 86 66- 45 53 21 Telex: 22685 TRTK TR/22875 ASDI TR

To whom it may concern:

10 April 1981

This is to certify that Pr. Bela Balassa (currently of the Johns Hopkins University at Baltimore, Md.) is fully authorized to reproduce at his discretion in partial or complete form, his paper : " Growth Policies and the Exchange Rate in Turkey ", which was delivered at a conference organized by us on 20-21 July 1979. Professor Balassa is similarly granted full discretion to have the said paper reprinted in any publication that he deems fit, either in partial or complete form, with the sole condition that mention be made of the fact that the paper was initially delivered at the Meban Conference.

Meban
Securities Brokerage
and Finance Corporation

Dr. H. Müller-Groeling
Institut für Weltwirtschaft
an der Universität Kiel

Redaktion

23 Kiel, ~~xxx~~ January 5, 1981/mg-wa
Düsternbrooker Weg 120/122
Fernruf: (04 31) 88 41
Durchwahl 88 4/App. 228
Anschrift: 2300 Kiel 1, Postfach 4309
Drahtanschrift: Weltwirtschaft Kiel

Professor
Bela Balassa
The World Bank
1818 H Street, N.W.

Washington, D.C. 20433/USA

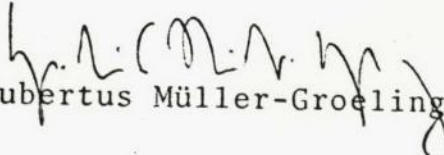
Dear Professor Balassa,

We grant permission as requested to include your paper

"The Newly-Industrializing Developing Countries
After the Oil Crisis"

in the Reprint Series of the World Bank under the condition
that Weltwirtschaftliches Archiv is clearly mentioned as
the source of first publication.

Sincerely yours,


Hubertus Müller-Groeling

April 23, 1981

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

Dear Mr. Mateus:

I provide below some comments on the revision of Parts I and II of your study. These comments supplement my memorandum of April 8, 1981.

I have only a few comments on Chapters I and II of Part I; they are contained in the enclosure. Chapter III is very interesting but it contains too many numbers per page. Also, in interpreting the effects of policy responses, keep in mind that the estimates shown for a particular year refer to changes as compared to the "1972" average; to obtain year-to-year changes, differences in the estimates for successive years should be taken.

The conclusions need strengthening. Apart from the use of the various indicators referred to in Para. 9 of my memo, you should draw the lessons of the post-Revolutionary experience and indicate your expectations as to policy responses to the 1979-80 oil shock.

There are too many tables in Part I. Apart from the "standard" table described in my memo, I suggest that you retain Tables 1, 6, and 7 that provide interesting additional information and incorporate real exchange rate calculations made by using production cost data in the exchange rate table. In presenting the estimates in the "standard" tables, dollar figures without decimals should be used. In all tables, as well as in the text, percentages should be shown with one decimal.

Part II shows the results of a considerable amount of research but it is too detailed and contains too many tables. Also, it needs to be reorganized in accordance with the outline contained in my memo. Some general comments on individual chapters follow.

Chapter 1 is far too long and contains too much data, nor does it belong in Part II. It should rather come, in a shortened form (3-5 pages), as an introduction to the entire volume and should include no more than two summary tables, giving data on changes in aggregate expenditures savings rates, ICOR, and the sectoral composition of GNP. The section on the post-Revolution period should be included in the conclusions to Part I.

Chapter 2 does not belong to Part II of the volume either. It could be included, in a greatly abbreviated form in the introduction to the entire volume. In this way, the information relating to the pre-1973 period will precede the analysis of the post-1973 period. Retain Tables 11 and 12 in a combined and abbreviated form. In view of space limitations, the other tables should be omitted.

Chapter 3 provides some interesting discussion of the relationship between domestic resource cost ratios, private profitability, export performance, and capital-labor ratios. Provide in a single table the data for these variables and calculate rank correlation coefficients for each pair. However, delete all tables providing information on input coefficients. Also, only direct DRCs should be reported.

It is not made clear if the tariffs used in calculating nominal and effective protection rates pertain to all imports. My understanding is that lower tariffs apply to imports from the EEC and EFTA. Protection rates for these imports should be calculated and their relative importance indicated. Also, in the discussion, more emphasis should be given to changes in protection rates between 1974 and 1977.

Please check the calculation of the rank correlation coefficient between ERPs and DRCs. The result seems to be too low in view of the relatively few adjustments made. But, if the result is correct, more attention should be given to explaining differences for particular product groups.

Table 3.14 should include information on imports under surcharge in effect in 1977 that is used in earlier tables. In turn, Table 3.15 needs clarification and the extent of import restrictions on consumer goods should be discussed in detail in the text. This should be done before the estimates on effective protection are presented.

In Chapter 4, investment incentives should be discussed before you get to the allocation of investment. At the same time, the earlier rebate system as well as the new, integrated system of fiscal and financial incentives should be criticized from the economic point of view.

On the allocation of investment, delete the detailed tables on the structure of manufactured investments and replace them by a table indicating changes over time in the relative importance of public and private investment and in the sectoral composition of public investment. As regards the Sines complex, some of the estimates of the internal rate of return are of doubtful validity and the discussion should also cover the economics of the investment in steel. At the same time, you should avoid giving the impression that a gain in foreign exchange is additional to the internal rate of return; the latter should take account of the scarcity of foreign exchange by including a shadow exchange rate in the calculations. On the whole a more critical analysis of the Sines complex is warranted; in this connection I enclose, on a confidential basis my comments on an earlier version of the Bank report on public investment in Portugal.

I further enclose the paper on the three Latin American countries referred to in my memo. Finally, in a week or so, I will send you our calculations of policy responses to external shocks in Portugal that provides

estimates until 1978. Our calculations do not include tourism and workers' remittances. While there may be differences between your and our basic data, feel free to use your own when you consider them more appropriate.

Finally, I would like to ask you to pay particular attention to English style. Also, as the volume is destined for a wide audience, great clarity in the expressions used is necessary.

Yours sincerely,

Enclosures

Bela Balassa

P.S. I was sorry to hear that you are not coming to the Fund after all.

Comments on Portugal Study

Bela Balassa

PART I

Introduction

p. 1 It is not clear what period the growth rates refer to.

I. External Shocks

p. 3 The expression "terms of trade effect" should be used to refer to the sum of the pure terms of trade effect and the unbalanced trade or inflation effect. These effects should be related to the average value of trade and to GNP, both expressed in "1972" prices.

pp. 3-5 The discussion of terms of trade effects should be clarified and terms of trade effects for merchandise export trade and for tourism and workers' remittances separately considered. Indicate further the method of calculation used for the latter.

pp. 6-7 Discuss volume effects for merchandise exports as well as for tourism and workers' remittances, indicating the method of calculation used for the latter.

p. 6 Do not include formulas in text.

p. 7 The effects of the loss of colonies on exports is measured by changes in export market shares and should be discussed at a later point.

p. 7 Changes in the prices of intermediate products should be discussed in conjunction with terms of trade effects.

II. Policy Responses to External Shocks

p. 9 Note that additional net external financing is defined as the difference between the actual and the trend value of the resource gap.

p. 10 All figures should be expressed in million dollars; do not use decimals. In turn, use one decimal for percentage changes.

p. 13 Give reasons for gains in EEC markets and for losses in EFTA markets and in the United States.

III. The Policies Applied

p. 16 One cannot speak of spectral analysis in this context.

p. 16 Again, the reference to "the deterioration of the terms of trade and the pure price effect" is misleading. Also, there should be a transition in the discussion between changes over time and data for the latest year.

p. 18 Give full citation of your paper.

- p. 21 Loss to firms should be expressed in U.S. dollars or as a percentage of GNP.
- p. 21 Is illegal construction estimated in Portugal?
- p. 21 Inventories could not have decreased by 120 percent.
- p. 21 Again, the footnote should contain full citation.
- p. 22 The reference to distortion associated with a high consumption share should be clarified.
- p. 24 A 3 percent reduction in M_2 is not large.
- p. 24 The "existing financial distortions" were not discussed earlier.
- p. 25 Reference to basic balance should be deleted.
- p. 30 Delete comparisons with Latin American countries and references to Carter.
- p. 33 For 1980, actual data should be used.

Conclusions

- p. 34 External shocks should be expressed in terms of average figures for the entire period.

Part II

1. The Seventies and the Sixties: the Balance of Two Decades of Economic Growth

- p. 1 We can hardly speak of a take-off in the early sixties in Portugal that was already a middle-income country at the time. Rather, reference should be made to the pre-conditions of rapid economic growth.
- p. 1 I doubt that the increase in real savings is explained by the growth of financial intermediation.
- p. 1 Per capita incomes should be given in the constant prices of a recent year; data for the early sixties should also be provided.
- p. 2 The escudo was not devalued in the first half of the sixties.
- p. 5 How was the remainder of the trade deficit covered? Portugal accumulated reserves in 1972 and 1973.
- p. 6 The statement about the decline of competitiveness relates to exports rather than to imports.
- pp. 7-8 The low incremental capital-output ratio shows the success of Portuguese economic policies.

- p. 9 The experience of 1970-73 should not be discussed in the section on the post-Revolutionary period.
- p. 10 The question needs to be raised if the emphasis on heavy industry has not been overdone.
- p. 11 Increase in agricultural productivity will also contribute to employment by creating demand for nonagricultural goods.

2. Outward-Looking and Inward-Looking Policies: Factors of Industrial Growth

See general comments.

3. Measures of Economic Efficiency, Comparative Advantages and Costs of Protection

- p. 17 No need to provide discussion of general equilibrium and formulas for estimating DRC.
- p. 22 The value of labor's marginal productivity in agriculture should be indicated.
- p. 25 It is not clear why one should calculate with a real rate of devaluation of 4 percent a year. Also, references to the Chakravarty-Solow type model should be clarified.
- p. 28 Provide the basis for the assumption that the shadow exchange rate was 20 percent above the official exchange rate in Portugal. This will require a consideration of the structure of protection.
- p. 38 Reference to Schydrowsky and to Bhagwati-Srinivasan should be omitted. Do not report "Schydrowsky-rates."
- p. 46 The protective effects of previous registration should be discussed in some detail.

4. Investment Incentives Policies in Portugal

- p. 53 The last sentence on the page is unfinished.
- p. 54 It does not appear that Portugal would have a comparative advantage in the production of fertilizers given the high import cost of energy.
- p. 65 The drawback system should be described in more detail.

April 23, 1981

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

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Yours sincerely,

Enclosures

Bela Balassa

P.S. I was sorry to hear that you are not coming to the Fund after all.

April 23, 1981

Mr. Luc Fauvel
Secretary General
International Economic Association
Camino al Ajusco No. 20
Apartado Postal 20-671
Mexico 20, D.F.
Mexico

Dear Mr. Fauvel:

Please excuse the delay in answering your letter of March 11th. My paper will be written in English and translated into French at the World Bank. The translation might not be finished by June 15th however, in which case I would send the English language text to participants. Please let me have the list of names and addresses; there is no need to reimburse for the cost involved. The Bank will also pay my travel cost to Athens.

Please let me know the exact location of the Conference. May I add that, due to other obligations, I will be arriving with a delay of two days. This should not cause problems, however, since my paper is scheduled for the last day of the Conference.

Yours sincerely,

Bela Balassa

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Nicolas Ardito-Barletta, LCNVP

FROM: Bela Balassa, DRC

SUBJECT: Chile Report

DATE: April 22, 1981

1. The "Current Economic Memorandum on Chile" reviews economic developments since the report on "Chile: An Economy in Transition." It confounds the critics of the earlier report, one of whom expressed the view that the report "does not succeed, in my judgment, to present a fully convincing case in support of its central hypothesis [according to which the Chilean government] has introduced policy changes which have opened the door to a more rapid and sustained growth in output and employment" (Parvez Hasan, "Chile: An Economy in Transition," March 14, 1979).
2. The present report describes Chile's achievements in rapidly increasing output in the major sectors of the economy, including agriculture that stagnated in the previous decade; expanding nontraditional exports at a high rate; establishing a balanced budget and reducing the rate of growth of the money supply; and attaining improvements in various social indicators in conjunction with the establishment of a "safety net." On the negative side, the rate of unemployment remained above the 1972 level and large profits were made on the domestic-foreign interest rate differential by those who were able to borrow abroad, although these profits are over-stated by neglecting the fact that risk and uncertainty would keep the domestic interest rate above the world market interest rate even under free capital movements (Para. 78-80).
3. The report is a model of clarity in discussing these and other issues. It does not, however, offer an explanation for the rapid increase in real wages in the face of high unemployment and for the relatively high rate of inflation which, incidentally, declined after 1979. Furthermore, the report does not provide a synthesis of Chilean economic performance and it deals rather perfunctorily with the effects of policy measures, such as the adoption of positive real interest rates, the institution of a land tax, and the replacement of social security contributions by a self-financed pension scheme.
4. It would be of considerable interest for the Bank, and for the development community at large, to provide an overall appraisal of the Chilean experience and to draw the lessons of this experience. It would also be desirable to examine in some detail the effects of the various policy schemes introduced in Chile to improve the workings of the market mechanism, which have often been recommended in other developing countries as well.
5. The statement made in the report that "GDP growth in 1978/79 was well in excess of the four percent annual average of the 1960's" (Para. 6) does not fully recognize the changes in Chile's growth performance. To begin with, GDP growth averaged 7.5 percent in 1978/79 while the four percent annual average

growth rate in the 1960's may be exaggerated. Also, GDP growth rates in the 1960s were overstated because price distortions raised the weight given to the relatively rapidly growing manufacturing sector and a substantial part of expansion in this sector was oriented towards high-cost, inefficient activities. Finally, while the world economy was buoyant in the 1960s, the 7.5 percent growth rate in 1978/79 was achieved in a slowly growing world economy and Chile's GDP continued to grow at a rate of 6.5 percent in 1980 when the world economy stagnated.

6. The poor "quality" of growth in the 1960s is reflected in the existence of "outmoded capacity" in the manufacturing sector that is repeatedly referred to in the report (Paras. 9, 14, 65). One wonders, however, if these statements sufficiently take account of the installation of modern capacity in recent years. The latter may also have contributed to the rapid rise of real wages, although this may have more to do with the indexing of wages which provides a floor to increases in wages.

7. The report appears to be overly pessimistic as regards exchange rates and the balance of payments in Chile. While it is true that the exchange rate appreciated in real terms over the past two years, this followed a considerable depreciation in the previous few years as indicated in the earlier report. There is a contrast here with Argentina which did not start out with an undervalued exchange when it adopted a fixed exchange rate policy.

8. As regards the balance of payments, distinction should be made between "autonomous" and "accommodating" items. Apart from trade in goods and services, private capital flows belong to the first category while public borrowing abroad for the purpose of financing a deficit resulting from autonomous items belongs to the second. In Chile's case, the autonomous flows gave rise to a surplus in 1980 as increases in reserves exceeded net foreign borrowing by the public sector.

9. Concerning possible future changes, the official Bank projections used in the report appear to overestimate prospective increases in petroleum prices. Rather than the assumed 3 percent annual increase during the 1980s, indications are that the real price of petroleum may not rise at all and may well decline this year and next. It would be desirable to indicate the implications of alternative petroleum price projections for Chile's balance of payments and to note the effects petroleum price increases had on the current account in 1980.

10. Finally, I find the projected rate of growth of exports, in particular for manufactured goods, overly low. The projected increase of 8-10 percent a year is below my estimate of 12.5 percent for the developing countries in the 1980s ("Prospects for Trade in Manufactured Goods between Industrial and Developing Countries, 1978-1990," World Bank Reprint No. 156). At the same time, given the outward-oriented policies applied and its small market share, Chile should be able to increase its share in the future.

11. Rapid growth of manufactured exports, and efficient import substitution, cannot be accomplished if the industrial structure is highly fragmented. One may wonder, therefore, if "increasing concentration of economic power could ... endanger Chile's free market strategy" (Summary and Conclusions, Para. 10). And, foreign competition does act as a powerful anti-monopoly device, so that the strengthening of anti-trust regulations may not be necessary.

cc: Messrs. Lari, LC1; Lerdau, LC2; Glaessner, LCP; Aguirre-Sacasa, LC1; Pfefferman, LCNVP; Landau, LCNVP; Levy, LC2; Meo, LC1; Ms. Shirley, LC1; Chernick, PPR; Landell-Mills, PPR; Leiserson, DED; Hasan, AENVP; Holsen, ASNVP; Koenig, Lipsky, Robichek (IMF), DRC Senior Staff

BBalassa:nc

April 21, 1981

Professor Paul Streeten
Boston University
Department of Economics
Boston, Massachusetts 02215

Dear Paul,

I enclose in two copies my paper "Structural Adjustment Policies in Developing Countries." I would appreciate your early answer concerning your possible interest in publishing it in World Development.

With best regards,

Yours sincerely,

Enclosures

Bela Balassa

Mr. David W. Berk, EM2

April 21, 1981

Bela Balassa, DRC

Pre-Mission Issues Paper

I enclose the revised version of the Pre-mission Issues Paper. It was typed after I left and might contain some errors. I will have a chance to read it Tuesday night and will call you if any changes are necessary. Please wait for my call before distributing the memo.

cc: Mr. Dubey, EMNVP

Enclosure

BBalassa:nc

OFFICE MEMORANDUM

TO: Mr. David W. Berk, EM2
FROM: Bela Balassa, DRC
SUBJECT: Pre-Mission Issues Paper

DATE: April 21, 1981

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Enclosure

BBalassa:nc

TURKEY

Industrialization and Trade Strategy Mission

Pre-Mission Issues Paper

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, with a view to making recommendations in various policy areas that have relevance for industrial development and trade in goods and services

Recent Economic Developments

2. Turkey is a semi-industrialized country, with an estimated per capita income of \$1330. Until recently, its development strategy was oriented towards import substitution in a market of about 45 million people. As a result, Turkey has one of the lowest import shares in the gross domestic product, approximately 9 percent. The share of exports is even lower, 4 percent, reflecting Turkey's large trade deficit that is only partly financed by workers' remittances.

3. Turkey responded to the quadrupling of oil prices by borrowing abroad, which permitted maintaining relatively rapid rates of economic growth in the mid-seventies. The resulting accumulation of external debt, however, brought into question Turkey's creditworthiness. By 1977, borrowing possibilities were exhausted and the rescheduling of the debt became necessary.

4. The increased foreign exchange stringency due to the lack of possibilities for further borrowing abroad and the adverse effects of import substitution-oriented policies on exports, led to a slowdown of economic growth in 1978, and to virtual stagnation in 1979. At the same time, inflation accelerated, notwithstanding controls on the prices of commodities

produced by the State Economic Enterprises (SEEs) which were not managed on the basis of economic principles. Turkey also suffered the effects of artificially low interest rates, which discouraged savings and the repatriation of workers' remittances, hindered the process of financial intermediation, and encouraged capital-intensive activities.

5. The policy reforms instituted in the course of 1980 aimed at opening the economy and increasing the role of prices and markets. The principal measures introduced in January 1980 were a large devaluation, accompanied by increased export incentives and the simplification of import regulations; the liberalization of foreign investment; and the relaxation of controls on the prices of most commodities produced by the SEEs. Subsequently, in June 1980, the rediscount rates of the Central Bank on short-term credits were raised from 14 percent to 26 percent and interest rates paid to savers, and charged to borrowers, were freed, although a "gentlemen's agreement" among banks limited the extent of increases in the rates.

6. The effects of the reforms were slow in coming. Until September 12, when the military assumed power, production was disrupted due to the intensification of violence, the decline in labor discipline, and the spread of strikes, with 7.7 million work-days lost in the first eight months of 1980 as compared to 1.1 million work-days in the corresponding period of 1979. Given these circumstances, and the tradition of selling on the highly protected domestic markets, the private sector did not make the effort required for vigorous export expansion. Also, increases in prices were not accompanied by changes in the modus operandi of the SEEs. With the rise in the cost of oil imports, the balance of trade deteriorated further, necessitating additional further debt rescheduling.

7. Improvements occurred after September 1980. Exports -- in particular, manufactured exports -- grew rapidly, foreign direct investment increased, and domestic savings rose. Furthermore, following a temporary acceleration in October 1980 when the military announced a 70 percent wage increase, the rise of prices decelerated.

8. The January 1981 reforms carried further the liberalization process begun a year earlier. The newly-instituted measures include the liberalization of imports, involving the abolition of quotas; greater incentives to exports in the form of credit and tax preferences; the reform of direct and indirect taxes, aimed at improving the efficiency and the buoyancy of the tax system; and the increased autonomy of the SEEs. Nevertheless, much remains to be done to modernize the Turkish economy. This is apparent from the following review of outstanding problems in various policy areas.

Policy Issues in Particular Areas

9. The abolition of import quotas notwithstanding, a wide range of products remain subject to import licensing. Also, tariffs are high and tend to vary to a considerable extent among products at the same level of transformation as well as between inputs and outputs. Import protection in the form of licensing and tariffs discriminates against manufactured and primary exports, and its effects are offset only in part by export incentives, which are particularly inadequate as far as the exports of machinery and equipment and construction abroad are concerned.

10. Apart from inadequate incentives, small and inadequately specialized plants established behind high protection have made the shift to exportation difficult. Correspondingly, Turkey has not exploited its potential to export manufactured products to the European Common Market where it enjoys preferential treatment and to nearby and buoyant Middle Eastern markets.

11. Overmanning, the inadequate compensation of managers and lack of discretion in firm decision-making have also hindered exports by the SEEs. At the same time, the proposed reforms have not come to grips with the need to provide appropriate incentives to export and to compete with private firms and, eventually, with imports.

12. Nor has Turkey utilized its potential for exporting agricultural products in raw and in processed form. The prices of inputs and outputs are out of line with world market prices; the investment allocation of the sector has been low; and there are inadequacies in regard to institutional arrangements and cooperative factors. These deficiencies concern extension services, erosion control, storage facilities, agricultural credit, marketing, as well as transportation and port facilities.

13. Similar considerations apply to tourism, where Turkey's potential advantages in terms of natural resources and cultural sites have not been exploited. Apart from political uncertainty, the lack of infrastructure has been a constraint to the expansion of tourism. At the same time, the danger is that, in the absence of an overall plan, decisions on tourism will be made in a piecemeal fashion.

14. Industrial development, understood in a larger sense to include food processing, the exportation of goods and services, and efficient import substitution has also suffered from the existence of an antiquated tax system in Turkey. The system of income taxes does not provide adequate incentives for work and risk-taking and social security legislation has raised the cost of labor to a considerable extent. The January 1981 reforms have improved the situation but the implications of inflation have not been fully taken into account. Also, the reform of indirect taxes is yet to be undertaken.

15. Also, real interest rates continue to be negative in Turkey and the banking system tends to be monopolistic. Correspondingly, financial intermediation does not adequately meet the needs of modern industry. Stock and bond markets too, are in a rudimentary stage.

The Tasks of the Mission

16. The foregoing discussion may serve as a basis to define the tasks of the mission in pursuing the general objectives outlined in Para. 1. These tasks further include reconnaissance in regard to macro-relationships and industrial structure that will provide a framework for the discussion of policy issues relating to industrialization and trade strategy.

17. The mission will make estimates of recent and prospective future changes in macro-economic variables, including the gross national product, employment, the money supply, government receipts and expenditures, exports, imports, and other items in the balance of payments. Past data and future projections on output exports and imports will be generated in sectoral detail that permits consideration of the possible impact of policy changes on industry and trade.

18. The mission will review the system of protection and export incentives. The review will concern relative incentives to import substitution and exports, incentives to manufacturing as compared to primary protection, and the variability of incentives among industries. It will further examine the instruments of import protection and export incentives, with a view to indicating the possibilities for replacing quantitative import restrictions by tariffs and the appropriate choice of export incentives.

19. A review of investment incentives will be undertaken, covering domestic as well as foreign investment, with consideration given to the administrative regulations pertaining to the latter. The possible bias in the incentive

system favoring capital-intensive over labor-intensive activities and large-scale enterprises over small-and medium-scale firms will also be investigated. The analysis will further extend to regional incentives and to obstacles to regional development.

20. The choice of capital-intensive industries and production processes is also affected by the system of income and social security taxation that bears on industrial development and trade in general. The mission will evaluate the possible effects of the recent and prospective reforms of these taxes. It will further examine the proposed reforms of indirect taxes and their incentive effects.

21. The capital intensity of production is also influenced by the level and structure of interest rates, which affect the availability of investible funds and the process of financial intermediation. The mission will analyze the recent interest rate reform, the structure and the competitiveness of the banking system, the sectoral allocation of loans, and the availability of medium-and long-term financing with a view to gauging their potential impact on industry and trade.

22. The mission will review the institutional framework in which manufacturing industries operate and examine factors affecting the growth of productivity, such as research and development and labor training. Information will also be obtained on the development of private and public industries, including data on output, employment, factor intensity, the relative importance of domestic and foreign markets, as well as technology, costs and profitability. The data will be used to examine the efficiency of private and public enterprises and to consider the prospects for exports and import substitution in a comparative advantage framework.

23. 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, and marketing in general. Attention will further be given to the possibilities for foreign investment and for Bank projects in their industries.

24. As regards the public sector, the mission will focus on the influences that hinder efficient operations in general and the expansion of exports in particular. This will involve examining existing incentives and constraints for the SEEs, the system of management, and the character of interventions by the central authorities.

25. The mission will analyze the development prospects of agro-industries and the agricultural sector in general, with particular emphasis on export growth and comparative advantage. Consideration will be given to the incentives affecting agricultural production and food processing, together with institutional arrangements and the availability of cooperative factors. The potential contribution of foreign investment in food processing will further be investigated.

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

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. consultant	mineral based chemical exports	to be confirmed
9. IPD staff member	engineering industries	to be confirmed
10. Pasquale Scandizzo, (AGR)	agricultural exports	confirmed
11. G. Swamy (EPD)	exports of processed food	confirmed

- | | | |
|----------------------------|--------------------------------|--------------------|
| 12. Isabelle Girardot-Berg | agriculture and processed food | confirmed |
| 13. David Davis | tourism | confirmed |
| 14. Bank staff member | secretary | to be
confirmed |

April 20, 1981

Mr. André Barsony
OECD Development Center
94 rue Chardon-Lagache
Paris 75016
France

Dear André,

The preface reached me only a few days ago. I enclose some proposed revisions. The revisions aim at eliminating the apparent conflict between the second and the third paragraphs and giving more attention to policy responses, the analysis of which represents the principal contribution of the study.

Anne also sent me the text of chapters II, III, and IV. I was surprised to see that the latter includes the section "A Perspective of the Debt Situation" which was not part of the previous version of the chapter that was sent to me for review. I have some specific comments on this section but also question its place in the volume as a similar analysis has not been prepared for the individual countries covered. Let us talk about this on the phone.

Yours sincerely,

Enclosure

Bela Balassa

cc: Ms. Anne Richards Loup

TURKEY

Industrialization and Trade Strategy Mission

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2. Turkey is a semi-industrialized country, with an estimated per capita income of \$1330. Until recently, its development strategy was oriented towards import substitution in a market of about 45 million people. As a result, Turkey has one of the lowest import shares in the gross domestic product, approximately 9 percent. The share of exports is even lower, 4 percent, reflecting Turkey's large trade deficit that is only partly financed by workers' remittances.

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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	mineral based chemical exports	to be confirmed
9. H. S. Sethi	engineering industries	to be confirmed
10. Pasquale Scandizzo, (AGR)	agricultural exports	confirmed
11. G. Swamy (EPD)	exports of processed food	confirmed
12. Isabelle Girardot-Berg	agriculture and processed food	confirmed
13. David Davis	tourism	confirmed
14. Bank staff member	secretary	to be confirmed



Record Removal Notice

File Title Bela Balassa's chron files - April 1981	Barcode No. 30225102
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Document Date Apr 20, 1981	Document Type Outgoing wire
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Correspondents / Participants
Mrs. Betty Eltezam, DRC
Bela Balsassa, DRC

Subject / Title
Terms of Reference for a Contract

Exception No(s).

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Additional Comments

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Withdrawn by Chandra Kumar	Date May 30, 2014
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Mr. Jacob Meerman, WANVP

April 20, 1981

Bela Balassa, DRC

Malaysia Data

I would like to request that you provide data on the Malaysia project of public expenditure to Mr. Soonwon Kwon.

BBalassa:nc

Mr. Rene Vaurs, EM2

April 20, 1981

Bela Balassa, DRC

The letters are fine but you seem to have misunderstood my statement concerning the first paper. The French version of the paper has now been xeroxed; a copy is enclosed. Please change the second paragraph accordingly. Also delete the statement made in the first sentence according to which these documents would have been prepared recently. In fact, one of them was written several years ago but the translation was done only now.

Enclosure
BBalassa:nc

April 20, 1981

Mr. Thierry de Montbrial
Directeur
Institut francais des relations internationales
6 rue Ferrus
75014 Paris
France

Dear Thierry:

It is with some delay that I am sending you my comments on RAMSES 1981. I hope that you find them useful, I discussed several of the comments with Albert Bressand when he was here.

In the comments, I emphasized points of disagreement rather than agreement. I would like to express, however, my admiration for an excellent first effort that was accomplished in a very short time.

I am afraid that I have to cancel the seminar we were planning for June 4th. It appears now that I will not be able to leave Turkey to arrive in Paris in time. I will be in touch with you to find another date when hopefully you will also be there.

With best regards,

Sincerely yours,


Enclosure

Bela Balassa

cc: Mr. Albert Bressand

OFFICE MEMORANDUM

TO: Robert Cassen, WDR

FROM: Bela Balassa, DRC 

SUBJECT: WDR 1981 - First Draft

DATE: April 20, 1981

1. This draft shows further progress, although it still has a way to go, in particular in unifying the discussion of the various topics in the individual chapters. The following comments concern Chapters 1, 2/3, 4, 5, and 9.

Chapter 1

2. The chapter has been much improved and I have only a few comments to make. In Para. 1.3, the comparison of absolute increases in incomes per head industrialized and in developing countries, measured at exchange rates, is hardly appropriate and should be replaced by growth rate comparisons. Also, the reference to industrialization "as the main path to prosperity" should be followed by a statement emphasizing the need for the expansion of primary activities.

3. The statement "After this happened in 1973-74, real oil prices declined for four years" (Para 1.5) should be preceded by a reference to the quadrupling of oil prices rather than by the vague phrase about "ending the era of cheap energy." Also, the rise in oil prices did not come "on top of" slower growth in the industrial countries but rather contributed to slow growth. Nor can one speak of a "marked slowdown in the industrial economies in the 1970s" (Para. 1.23) as these countries attained record growth rates in 1970-73. Finally, the statement according to which "the world economy reacted badly to the 1973-74 oil price increase" (Para. 1.17) needs clarification.

4. The statement that most non-market economies "have shifted to a strategy of intense development, emphasizing increased efficiency and improvements in product quality" (Para. 1.29) confuses desiderata and slogans with actual realization. In fact, productivity growth has declined in non-market economies and there is little evidence of improvements in product quality. The favorable results for Hungary reflect the impact of reforms involving the rationalization of prices, the decentralization of decision-making, and profit incentives to management.

5. As to developing countries, the reference to "indirect benefits from higher oil prices" (Para. 1.30) should be qualified by noting that these benefits offset only a small part of the oil price increase. In turn, in contrasting export growth in low-income and middle-income countries, it should be noted that the former lost, and the latter gained, market shares.

Chapter 2/3

6. Considerable improvements have been made in this chapter as compared to the earlier draft. However, I miss a substantive analysis of policies in their effects on economic performance. The proposed reorganization of the chapter promises improvements in this regard. The following comments pertain

to the text of the chapter as well as to some of the themes of the new outline.

7. As shown in my "Adjustment to External Shocks in Developing Countries," countries which avoided a bias against exports and adopted realistic exchange rates and interest rates, exhibited better export performance, lower ICORs, higher savings rates, and higher rates of economic growth than countries which biased the incentive system against exports and savings. And, the former group of countries did better than the latter even in import substitution. (For an explanation, see p. 15 of my paper.)

8. The report qualifies its discussion of the favorable economic effects of export orientation by adding that "these factors, though important, have been complemented in nearly all cases by enhanced domestic resource mobilization and attention to efficient use of investible funds" (Para. 2.49). It should be recognized, however, that export orientation favorably affects savings and efficiency. For one thing, according to available evidence a larger share of incomes derived from exports is saved and, in contributing to economic growth, increases in exports raise the average savings ratio since the marginal savings ratio exceeds the average. For another thing, the neutrality of incentives under export orientation contributes to efficiency in the use of new and existing resources; the ICOR, incidentally, does not measure "greater efficiency in the deployment of investible resources" alone (Para. 2.40).

9. The statement according to which the encouragement of "the movement of resources towards sectors producing export promoting and import substituting traded goods ... has to be weighed against the need to conserve energy" (Para. 2.10) is based on a misapprehension. Once policy neutrality, including realistic exchange rates and energy prices, is adopted, further adjustments and qualifications concerning energy inputs are necessary. Thus, there is no need for separate calculations on the grounds that "the extra foreign exchange [traded goods producing sectors] made available need be offset against the cost of the extra energy consumed in their production" (Para. 2.10). Doubts arise also concerning the usefulness of establishing "routine monitoring of energy intensities in different sectors of the economy" (Ibid.).

10. I suggest replacing the two-way classification scheme in Table 2.5 by a scatter diagram that will better indicate the relationship among the relevant variables. Diagrams showing the relationship between export promotion efforts and ICORs, on the one hand, and GNP growth rates, on the other, should also be added. Furthermore, information on the gross debt service ratio should be complemented by data on the ratio of external debt to GNP.

11. In Tables 2.1, 2.4, and 2.6 note that the source of the estimates is the forthcoming OECD Development Centre study, "Policy Responses to External Shocks in Developing Countries" (by Bela Balassa and Andre Barsony) which is summarized in the last issue of the OECD Outlook. The only exception is the data for the semi-industrial countries that originate from my "Adjustment to External Shocks in Developing Countries" (March 19, 1981).

12. The disaggregated estimates for primary producing economies also originate from the OECD study. At the same time, the results are misquoted, inasmuch as import substitution accounted for 89 percent of the balance-of-

payments effects of external shocks in less industrialized mineral-based rather than agriculture-based economies (Para 2.37). This result, incidentally, largely reflects the effects of extreme foreign exchange scarcity on imports. In turn, the statement that "the mineral based economies like Zaire and Zambia faced a difficult period" (Para. 2.36) neglects the fact that the policies applied by this group of countries contributed to losses in export market shares that augmented the adverse balance-of-payments effects of external shocks by over one-half.

13. In the lowest income Sub-Saharan African countries, import substitution offset 28 percent rather than 45 percent of the balance-of-payments effects of external shocks (Para. 2.37). At the same time, losses in export market shares augmented these effects by 67 percent while the OECD recession-induced export shortfall amounted to only 28 percent.

14. I welcome the use of estimates for individual countries. At the same time, you may consider citing the results for a larger number of countries within each group. Also, some of the references to individual countries need to be modified. In Jamaica, external shocks were aggravated by internal shocks, leading to virtual bankruptcy (Para. 2.3); in Tanzania, overvalued exchange rates and inadequate agricultural prices led to substantial losses in market shares (Para. 2.9); Thailand relied as much on export promotion as on import substitution in offsetting the balance-of-payments effects of external shocks (Para. 2.25); Nigeria, Indonesia, and Algeria spent substantial amounts of financial resources on 'white elephants' that cannot be justified under any investment criteria (Para. 2.59-2.61); and the adverse economic effects of policy errors in recent years may have compromised reform efforts in China (Para. 2.84-2.100). For a brief discussion of the recent policy experience of China, see my memo of April 3rd.

15. The distinction made between "adjustment with growth" and "adjustment with slowdown" reflects a confusion. Several of the countries that successfully adjusted to the oil shock, including Chile, Singapore, and Taiwan, accepted a temporary slowdown and even decline in GNP for the sake of rapid non-inflationary growth in subsequent years (reculer pour mieux sauter). In turn, countries such as Brazil, Turkey and Yugoslavia, which employed policy measures aimed at maintaining high growth rates after the quadrupling of oil prices (fuite en avant), experienced a subsequent decline in the rate of economic growth as the balance-of-payments constraint became binding. By hindsight, Korea might also have avoided some of the difficulties experienced in later years if it accepted some slowdown in 1974-75 for the sake of reducing the rate of inflation.

16. It follows that the distinction made in the new outline between "adjustment with growth" and "adjustment with deflation" is inappropriate. While rapid growth has been the result of an outward-oriented strategy, this has followed an initial slowdown in response to external shocks, with GNP growth rates averaging 7.3 percent in 1963-73, 5.5 percent in 1973-76 and 9.3 percent in 1976-79 in the outward-oriented economies covered in my paper.

17. The new outline also calls for a "discussion of the extent to which production and trade structure (a) made for vulnerability to external shocks, and (b) limited the range of adjustment policy options ..." In this connection, note that, in a statistical investigation of twenty-four

countries, it has been found that reliance on export promotion could not be explained by intercountry differences in the extent of external shocks, market size, incomes per head, or the composition of exports ("Adjustment to External Shocks in Developing Countries," p. 18).

Chapter 4

18. The GDP projections for the industrialized countries are on the low side; the high case may well be regarded as the most likely outcome. With efforts made to increase productivity in the major industrialized countries, they should do better than the report assumes. At the same time, comparisons with "the record of the early 70s" (Para. 4.6) are misleading as the period includes the biggest postwar boom as well as the biggest postwar recession. In turn, the projected 4.5 percent growth rate for non-market economies is much too high; these countries encounter increasing difficulties due to the inflexibility of economic management and the energy constraint (recent projections for the Soviet Union are around 3 percent).

19. As noted in my comments on Draft 0, the low case for the manufactured exports of the developing countries, 5.1 percent between 1980 and 1990, borders on the ridiculous. Not only did the growth in the volume of these exports exceed the projected high case of 12.2 percent in both 1978 and 1979, but a 18 percent rise in their dollar value cited in the latest GATT report may translate into a 10 percent volume increase in 1980 when the industrialized countries hardly grew at all. Furthermore, the report appears to be overly pessimistic as regards the prospects for private capital flows to the developing countries.

20. The report is also overly pessimistic as far as the prospects for energy prices are concerned. While I unsuccessfully objected to the assumption made in the 1979 WDR that the real price of energy would remain at its average 1975-78 level during the 1980s, following a doubling in real terms between 1978 and 1980 it is unrealistic to project a further rise of 34 percent (3 percent a year) during this period. In fact, conservation efforts, together with the rise in non-OPEC production, are reducing demand for OPEC oil, leading to a reconsideration of pricing strategy by the OPEC countries.

Chapter 6

21. The discussion in Section II continues to suffer from taking 1970 rather than 1973 as the base year. In particular, one cannot use data for a period including the world boom of 1972-73 to indicate the extent to which the oil-importing developing countries covered their share in the increased oil bill by exports (Para. 6.11). The choice of this period also conflicts with the analysis of Chapter 2 that examines the post-1973 situation.

22. Notwithstanding its obvious merits, the statistical analysis of trade expansion appears overly long for most WDR readers and may find a better place in an Annex. In turn, the discussion of industrial country policies concerning developing country exports would need expansion and clarification.

23. A case in point is the overall impact of import restrictions. While in Para. 6.32 it is correctly stated that "industrial country trade restrictions were generally aimed at other industrial countries," according to Table 6.5

the share of restricted imports from the developing countries is double of that from the other industrial countries. The results of Table 6.5 are puzzling and clarity is not served by the use of the expression "restrictions" in the column headings and "scrutiny" in the title of the table; these expressions have rather different connotations and it is difficult to believe that 58 percent of the exports of the oil-importing developing countries would be restricted in the industrialized countries. Para. 6.37 further adds to the confusion as regards the restrictive effects of import restrictions.

24. Section III provides an excellent description of outward-oriented policies. It should be noted, however, that while these policies were applied consistently in Korea (at least until 1978), such was not the case in Brazil. For a discussion of the policies followed both before and after 1973 see my "The Newly-Industrializing Developing Countries after the Oil Crisis," World Bank Staff Working Paper No. 437.

25. The discussion of adjustment in the industrialized countries is excellent. The section on international cooperation, however, has little to say on the subject; it should discuss the scope as well as the modalities of cooperation in some detail. As regards the former, the need for a safeguard code and for negotiations on trade in services should receive attention. As to the latter, the role of the GATT in the process of consultations and conflict resolution in general, and in the implementation of the rules established under the Tokyo Round in particular deserves examination. Finally, under specific areas of policy concern, one should include the Multifiber Arrangement and the use of export limitations in addition to tariff escalation.

Chapter 9

26. The introductory sections of this chapter provide a cogent, though standard, discussion of economic interdependence between the North and the South. Para. 9.7, however, overstates the effects of protection in the industrialized countries on world economic growth. Also, in the subsequent paragraphs, the importance of the international environment as compared to that of developing country policies is overstated. In particular, the lack of adjustment to external shocks after 1973 in many of the less developed countries, and the need for such adjustment in the future, would need to be emphasized.

27. One may also query the statement that the inability of the oil-importing developing countries "to limit their oil imports in the 1970s [is] a sign that their oil rise was already largely restricted to essential purposes" (Para. 9.13). And, the questionable statement that these countries cannot "significantly reduce the energy intensity of production" (Para. 9.13) lessens the import of the recommendations that they "make the best possible use of energy" (Ibid.).

28. The discussion of trade related issues correctly emphasizes the need to improve developing country policies. As far as the trade policies of the developed countries are concerned, more attention would need to be given to the use of non-tariff restrictions. Finally, it cannot be claimed that "commodity agreements between consumers and producers .. could yield considerable benefits to low-income countries" (Para. 9.23).

29. Figure 9.1 provides a useful overview of adjustment mechanisms. Its components would need to receive more attention, however, than is the case in the chapter at present. Also, a better balance needs to be established in the chapter as to the importance of international and domestic policy issues.

cc: Mr. Chenery, VPD; WDR Core Group

BBalassa:nc

Le 17 avril 1981

Monsieur Hamza Mohieddine
Secrétaire Général
Ministère du Plan et des Finances
Place de la Monnaie
Tunis, Tunisie

Monsieur le Secrétaire Général,

Je voudrais vous remercier pour l'excellent accueil que vous avez bien voulu me réserver lors de ma récente mission à Tunis. J'ai particulièrement apprécié les contacts très fructueux que j'ai pu avoir avec vous-même et vos collaborateurs, sur le système et les politiques d'incitation économique en Tunisie.

Je me permets de joindre à cette lettre deux documents que j'ai publiés. Le premier, intitulé "Incitations et performance à l'exportation des pays en voie de développement", compare les pays qui ont suivi une politique de repliement sur eux-mêmes avec ceux qui ont choisi une stratégie orientée vers l'extérieur. Le second document, intitulé "Evolution de la structure des échanges des produits industriels entre pays industriels et pays en voie de développement", analyse les projections jusqu'en 1990 des exportations de biens industriels provenant des pays en voie de développement.

En espérant avoir le plaisir de vous rencontrer à nouveau, je vous prie d'agréer, Monsieur le Secrétaire Général, l'expression de ma considération distinguée.

Bela Balassa
Professeur d'Economie Politique
Conseiller à la Banque Mondiale

Le 16 avril 1981

Son Excellence Mansour Moalla
Ministre du Plan et des Finances
Place de la Monnaie
Tunis, Tunisie

Monsieur le Ministre,

Je voudrais vous remercier pour l'excellent accueil que vous avez bien voulu me réserver lors de ma récente mission à Tunis. J'ai particulièrement apprécié les contacts très fructueux que j'ai pu avoir avec vous-même et vos collaborateurs, sur le système et les politiques d'incitation économique en Tunisie. Ces contacts m'ont permis de développer un certain nombre de recommandations que j'ai résumées dans une note qui vous a été remise après mon départ de Tunis. Bien que très préliminaire, j'espère que cette note a pu vous être de quelque utilité.

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Je suis, bien sûr, à votre disposition pour toute assistance que vous jugeriez utile de me demander. En espérant avoir le plaisir de vous rencontrer à nouveau, je vous prie d'agréer Monsieur le Ministre, l'expression de ma haute considération.

Bela Balassa
Professeur d'Economie Politique
Conseiller à la Banque Mondiale

Le 16 avril 1981

Son Excellence Abdelaziz Larraoui
Ministre de l'Economie Nationale
Ministère de l'Economie Nationale
Tunis, Tunisie

Monsieur le Ministre,

Je voudrais vous remercier pour l'excellent accueil que vous avez bien voulu me réserver lors de ma récente mission à Tunis. J'ai particulièrement apprécié les contacts très fructueux que j'ai pu avoir avec vous-même et vos collaborateurs, sur le système et les politiques d'incitation économique en Tunisie. Ces contacts m'ont permis de développer un certain nombre de recommandations que j'ai résumées dans une note qui vous a été remise après mon départ de Tunis. Bien que très préliminaire, j'espère que cette note a pu vous être de quelque utilité.

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Bela Balassa
Professeur d'Economie Politique
Conseiller à la Banque Mondiale

OFFICE MEMORANDUM

TO: Mr. Vinod Dubey, EMNVP
FROM: Bela Balassa, DRC
SUBJECT: Meeting on Draft Pre-Mission Issues Paper

DATE: April 16, 1981.

I enclose a draft version of "Turkey: Industrial Development Strategy and Policy Review Mission. Pre-Mission Issues Paper" for our meeting on Monday, April 20th at 12 o'clock. The Meeting will take place in Mr. Dubey's office.

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

Enclosure
BBalassa:nc

TURKEY

Industrial Development Strategy and Policy Review MissionPre-Mission Issues Paper

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, with a view to making recommendations in various policy areas. The mission report will also provide the background for the Third Structural Adjustment Loan to Turkey.

Recent Economic Developments

2. Turkey is a semi-industrialized country, with an estimated per capita income of \$1330. Until recently, its economic development strategy was oriented towards import substitution in a market of about 45 million people. As a result, Turkey has one of the lowest import shares in the gross domestic product, approximately 9 percent. The share of exports is even lower, 4 percent, reflecting Turkey's large trade deficit that is only partly financed by workers' remittances.

3. Turkey responded to the quadrupling of oil prices by borrowing abroad, which permitted maintaining relatively rapid rates of economic growth in the mid-seventies. The resulting accumulation of external debt, however, brought into question Turkey's creditworthiness. By 1977, borrowing possibilities ceased and the rescheduling of the debt became necessary.

4. The increased foreign exchange stringency due to the lack of possibilities for external borrowing and the adverse effects of import substitution-oriented policies on exports, led to a slowdown of economic growth in 1978, and to virtual stagnation in 1979. At the same time, inflation accelerated, notwithstanding controls on the prices of commodities

produced by the State Economic Enterprises (SEEs) which were not managed on the basis of economic principles. Turkey also suffered the effects of artificially low interest rates, which discouraged savings and the repatriation of workers' remittances hindered the process of financial intermediation and encouraged capital-intensive activities.

5. The policy reforms instituted in the course of 1980 aimed at opening the economy and increasing the role of prices and markets. The principal measures introduced in January 1980 were a large devaluation, accompanied by increased export incentives and the simplification of import regulations; the liberalization of foreign investment; and the relaxation of controls on the prices of most commodities produced by the SEEs. Subsequently, in June 1980, the rediscount rates of the Central Bank on short-term credits were raised from 14 percent to 26 percent and interest rates paid to savers, and charged to borrowers, were freed, although a "gentlemen's agreement" among banks limited the extent of increases in the rates.

6. The effects of the reforms were slow in coming. Until September 12, when the military assumed power, production was disrupted due to the intensification of violence, the decline in labor discipline, and the spread of strikes, with 7.7 million work-days lost in the first eight months of 1980 as compared to 1.1 million work-days in the corresponding period of 1979. Given these circumstances, and the tradition of selling on protected domestic markets, the private sector did not make the effort required for vigorous export expansion. Also, increases in prices were not accompanied by changes in the modus operandi of the SEEs. With the rise in the cost of oil imports, the balance of trade deteriorated further, additional further debt rescheduling.

7. Improvements occurred after September 1980. Exports -- in particular,

manufactured exports -- grew rapidly, foreign direct investment increased, and domestic savings rose. Furthermore, following a temporary acceleration in October 1980 when the military announced a 70 percent wage increase, the rise of prices decelerated.

8. The January 1981 reforms carried further the liberalization process begun a year earlier. The newly-instituted measures include the liberalization of imports, involving the abolition of quotas; greater incentives to exports in the form of credit and tax preferences; the reform of direct and indirect taxes, aimed at improving the efficiency and the buoyancy of the tax system; and the increased autonomy of the SEEs. Nevertheless, much remains to be done to modernize the Turkish economy. This is apparent from the following review of outstanding problems in various policy areas.

Policy Issues in Particular Areas

9. The abolition of import quotas notwithstanding, a wide range of products remain subject to import licensing. Also, tariffs are high and tend to vary to a considerable extent among products at the same level of transformation as well as between inputs and outputs. Import protection in the form of licensing and tariffs discriminates against manufactured and primary exports and against primary production in general. Its effects are only partially offset by export incentives, which are particularly inadequate as far as the exports of machinery and equipment and construction abroad are concerned.

10. The tax system in Turkey is antiquated. It does not provide sufficient incentives for work and risk-taking and revenues have not kept up with incomes. The January 1981 reforms have improved the situation but the implications of inflation have not been fully taken into account. Also, the reform of indirect taxes is yet to be undertaken.

11. Real interest rates continue to be negative in Turkey with adverse effects on savings, workers' remittances and the capital intensity of industry. Furthermore, the banking system tends to be monopolistic, and financial intermediation does not adequately meet the needs of a modern economy. Stock and bond markets are also in a rudimentary stage.

12. At the same time, Turkey has not exploited its potential to export manufactured products to the European Common Market where it enjoys preferential treatment and to nearby and buoyant Middle Eastern markets. As far as the private sector is concerned, small and inadequately specialized plants established behind high protection barriers have made exportation difficult.

13. In turn, the SEEs continue to be plagued by overmanning and the inadequate compensation of their managers. Furthermore, the proposed reforms have not come to grips with the need to provide appropriate incentives for the SEEs to export and to compete with private firms and, eventually, with imports.

14. Nor has Turkey utilized its potential for exporting agricultural products in raw and in processed form. The prices of inputs and outputs are out of line with world market prices; the investment allocation of the sector has been low; and there are inadequacies in regard to institutional arrangements and cooperative factors. These deficiencies concern extension services, erosion control, storage facilities, agricultural credit, marketing, as well as transportation and port facilities.

15. Similar considerations apply to tourism, where Turkey's potential advantages in terms of natural resources and cultural sites have not been exploited. Apart from political uncertainty, the lack of infrastructure has been a constraint to the expansion of tourism. At the same time, the danger

exists that, in the absence of an overall plan, decisions on tourism will be made in a piecemeal fashion.

The Tasks of the Mission

16. The foregoing discussion may serve as a basis to define the tasks of the mission in pursuing the general objectives outlined in Para. 1. The mission's tasks will further include reconnaissance in regard to macro-relationships and industrial structure that provide a framework for the discussion of policy issues. These tasks will be briefly described below.

17. The mission will make estimates of recent and prospective future changes in macro-economic variables, including the gross national product, sectoral output and employment, the money supply, government receipts and expenditures, and the balance of payments, both to provide a better understanding of the economic effects of the reforms and to support work on future policies. The projections will be made by using an expanded version of the standard Bank model or, alternatively, by utilizing a revised version of the Dervis-Robinson-Celasun macro model.

18. The mission will review the system of protection and export incentives. The review will concern the treatment of import substitution and exports, relative incentives to manufacturing and primary protection, and the variability of incentives among industries. It will further deal with the instruments of import protection and export incentives, including the question of replacing quantitative import restrictions by tariffs and the choice among tax and credit incentives to exports.

19. A review of investment incentives will be undertaken, covering domestic as well as foreign investment, with consideration given to the administrative regulations pertaining to the latter. The bias in the incentive system favoring capital-intensive industries and production methods as well as large-

scale industry will also be investigated. The analysis will further extend to regional incentives and to obstacles to regional development.

20. The choice of capital-intensive industries and production processes is further affected by the system of income and social security taxation. The mission will review the economic effects of recent and prospective reforms of these taxes. It will further examine prospective reforms of indirect taxes and their incentives effects.

21. The capital intensity of production is also influenced by the level and structure of interest rates, which further affect domestic savings, the repatriation of workers' remittances and the process of financial intermediation. The mission will analyze the effects of the recent interest rate reform, the structure and the competitiveness of the banking system, the sectoral allocation of loans, and the availability of medium-and long-term financing.

22. In the manufacturing sector, information will be obtained on the development of private and public industries, including data on output, employment, capital investment, the relative importance of domestic and foreign markets, as well as costs and profitability. The data will be used to examine the efficiency of private and public enterprises in a comparative framework

23. Among manufacturing industries, the mission will examine in some detail the prospects for the expansion of engineering and mineral-based chemicals in Turkey. This will involve a consideration of factors, such as scale, technology, worker training, and marketing, with further attention given to the possibilities for foreign investment and for Bank projects.

24. In the public sector, the mission will focus on the influences that hinder efficient operations in general and the expansion of exports in

particular. This will involve examining existing incentives and constraint for the SEEs, the system of management applied, and the institutional framework in which the SEEs operate.

25. The mission will analyze the development prospects of the agricultural sector, with particular emphasis to export growth and comparative advantage. Consideration will be given to the incentives affecting agriculture as well as to institutional arrangements and the availability of cooperative factors. The export possibilities for food processing and the potential contribution of foreign investment in this sector will also be investigated.

26. The mission will examine recent trends and prospective developments in tourism, taking account of Turkey's comparative advantages in this sector. It will further examine the potential impact of the sector on the national economy and evaluate its investment requirements. Finally, the possible role of private and foreign investors and the system of government incentives in tourism will be assessed.

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. consultant	mineral based chemical exports	to be confirmed
9. IPD staff member	engineering industries	to be confirmed
10. Pasquale Scandizzo, (AGR)	agricultural exports	confirmed
11. G. Swamy (EPD)	exports of processed food	confirmed
12. Isabelle Girardot-Berg	agriculture and processed food	confirmed
13. David Davis	tourism	confirmed
14. Bank staff member	secretary	to be confirmed

Mr. Vinod Dubey, EMNVP

April 16, 1981.

Bela Balassa, DRC

Meeting on Draft Pre-Mission Issues Paper

I enclose a draft version of "Turkey: Industrial Development Strategy and Policy Review Mission. Pre-Mission Issues Paper" for our meeting on Monday, April 20th at 12 o'clock. The Meeting will take place in Mr. Dubey's office.

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

Enclosure
BBalassa:nc

Turkey Mission Members

April 16, 1981.

Bela Balassa

Meeting on Draft Pre-Mission Issues Paper

I enclose a draft version of "Turkey: Industrial Development Strategy and Policy Review Mission. Pre-Mission Issues Paper." Your comments by Friday, April 17th cob would be appreciated.

Enclosure
BBalassa:nc

Mr. Rene Vaurs, EM2

April 13, 1981

Bela Balassa, DRC

I enclose ^{the} suggested text of a letter to be addressed to the two ministers and to Mr. Hamza. You may wish to clear the text of the letter with Mr. El Naaroufi.

I further enclose for your information the two papers that would be sent out; the first of these is available in an English version only, as the French version is being xeroxed.

Enclosures
BBalassa:nc

Enclosed: Reprint No. 59 "Export Incentives and Export Performance in Developing Countries: A Comparative Analysis"

"Evolution de la structure des echanges de produits manufactures entre pays industriels et pays en developpement"

Dear

It was a pleasure meeting you and I very much enjoyed the discussions I had with you and your collaborators. These discussions permitted me to develop my ideas as regards incentive policies in Tunisia that have been expressed in my advisory report. I hope that you will find the report useful.

As agreed, I enclose my papers on "Incitations et performance a l'exportation dans les pays en developpement" and "Evolution de la structure des echanges de produits manufactures entre pays industriels et pays en developpement." The former examines the experience of developing countries following outward-oriented and inward-oriented policies in the period up to 1973; the latter provides projections for the manufactured exports of the developing countries until 1990. I hope that you will find these papers useful.

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

With best regards,

Sincerely yours,

Bela Balassa

OFFICE MEMORANDUM

TO: Files
FROM: Bela Balassa
SUBJECT: RAMSES 1981

DATE: April 13, 1981

1. On my way to Tunisia last month, I met with Thierry de Montbrial, director of the major French institute of international relations and rapporteur of a recent report for the Trilateral Commission. De Montbrial asked me to comment on his institute's recent "world economic report." My comments on the report are enclosed.

2. While my comments emphasize its weaknesses, the report is commendable as a first effort. I have since had the visit of the main author of the report, who agrees with several of my criticisms and plans to make corresponding changes in next year's edition, for which an English language publication is also planned. It may be added that RAMSES received a very favorable review in Le Monde.

3. The report often cites the Bank and expresses appreciation of its work. It is noted that "in the somber picture of aid, the efforts of the World Bank stand out by the dynamism and the imagination they display" (p. 92). Also, "the World Bank gives evidence of promising ideas, in particular in attempting to establish a new mechanism for financing the accelerated development of energy in the countries of the Third World" (p. 89).

cc: Messrs. Stern, VPO; Qureshi, CEX; Benjenk, VPE; Merriam, IPA; Steckhan, Paris
DPS Directors, DRC Senior Staff, Chief Economists.
Mrs. Boskey, IRD

Enclosure
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RAMSES 1981: Coopération ou Guerre Economique
Rapport annuel mondial sur le système économique et les stratégies,
Institut Français des Relations Internationales,
Paris, Economica, 1981

Thierry de Montbrial, the Director of the Institut Français des Relations Internationales, states in the Preface that the objective of the report is "to present the public with a broad annual synthesis of the principal aspects of the international economy, examined simultaneously from the political and from the economic point of view." The report aims to do in the economic area what the Strategic Survey, published by the International Institute of Strategic Studies, does in the area of military security.

The present report, the first in a series, deals with the years 1979 and 1980. At the same time, according to Robert Bressand, the principal author of the report, "The analysis of the economic difficulties characterising the last two years could not be separated from an analysis of the basic trends -- political and strategic as well as economic -- that the world community has experienced since the beginning of the seventies" (p. 1).

1. Economie et géopolitique

In the chapter on economics and geopolitics, it is suggested that "the Soviet intervention in Afghanistan and the threats directed at Poland seem to indicate the end of détente as generally understood" (p. 8). It is claimed, however, that East and West have become increasingly interdependent economically, with the East being dependent on Western food supplies and technology and the West becoming vulnerable because of the spread of "compensation" agreements, the increased indebtedness of the countries of the Soviet bloc, and their rising share in the energy supply of Western Europe. It is concluded that "for the East as well as for the West, security by independence does not seem to be possible any more [and] one would need to

explore the possibility of equilibrium in interdependence..." (p. 36).

The emphasis on increased economic interdependence between the East and the West in general, and on the (economic) vulnerability of the West in particular, is much overdrawn in the report. Recent projections by the International Food Policy Research Institute do not foresee major increases in Soviet food imports and the East could also reduce reliance on Western technology, albeit at a cost in terms of the rate of economic growth. More importantly, the economic vulnerability of the West is greatly overstated.

To begin with, compensation agreements, calling for loan repayments in kind by the countries of the East, represent a small proportion of imports, not to speak of production, in the West. At the same time, shipments under such agreements reduce the financial obligations of the East which, at any rate, hardly exceed the debt of a single developing country, Brazil. Finally, West Germany is reconsidering plans for increasing imports of natural gas from the Soviet Union.

The report further claims that "East-West tensions, internal destabilization, and regional conflicts represent a threat to petroleum supply" from the Middle East (p. 37). In particular, "Saudi Arabia that, more than any other OPEC country, has taken account of the interest of consumers, and has showed itself to be sensitive to the requirements of interdependence, is in danger of becoming more and more isolated [and] the energy-security relationship in the long term appears to be largely determined by the danger of insufficient supply" (p. 47).

These fears appear exaggerated. Saudi Arabia did replace much of the petroleum lost as a result of the Iraq-Iran war and the world petroleum market is increasingly characterized by oversupply, with the spot price in Rotterdam falling substantially below the level shown in the graph on p. 57 of the

report. This fact, in turn, has strengthened the hands of Saudi Arabia in negotiations within OPEC. Considering further the prospective effects of measures taken by the developed countries on oil consumption and the emergence of new producers, it does not appear likely that shortages would occur for some time to come. (For an extremely optimistic view on the oil prices see S. Fred Singer, "A Crisis -- for OPEC," New York Times, March 31, 1981.)

Finally, notwithstanding the Iraq-Iran war, it is doubtful if one could speak of "the end of an era of relative stability in the Arab world" (p. 49) as Arab countries have shown a remarkable gift for accommodation. In fact, with the recent sales of military equipment to Iraq and improved relationships with Sudan, Egypt may again play a stabilizing role.

2. Les Economies de l'Ouest, du Sud et de l'Est en état de choc permanent

The thesis that the economies of the North, the South, and the East are "in the state of a permanent shock" also appears exaggerated. If the preceding analysis is correct, and the 1973-74 and 1979-80 oil shocks will not be repeated, there will be time for adjustment to the second oil shock.

At the same time, it is correct to say that "the present crisis is a 'crisis of restructuring'; it forces the countries of the West to carry out investments aimed at raising productivity levels and to modernize their productive apparatus" (p. 67). This is a response to the changing structure of comparative advantage, with the developed countries increasingly specializing in high-technology products, that will have beneficial effects for the long-term growth of the world economy.

Restructuring will be helped by the fact that, in contrast with the situation existing after the 1973-74 oil shock, the cost of the oil price increase is not borne exclusively by profits, so that there is less of an (unfavorable) effect on investment. Also, the developed countries are now

willing to accept continuing balance-of-payments deficits whereas in 1975 they eliminated their collective deficit by applying deflationary policies in unison. In particular, Germany and Japan are applying expansionary measures, however timid, notwithstanding their balance-of-payments deficits, while in 1975 the policies followed led to large surpluses in the two countries.

According to the report, "there is little chance that the international economic environment would permit financing the deficit that the Third World would experience if it attempted to preserve a high rate of economic growth" (p. 86). It is further suggested that "the economic risk of insufficient recycling is that developing countries very much in debt would see their growth rate reduced to only 4 percent (the middle hypothesis of the Morgan Guarantee Bank) and even to 1 percent (the low variant)" (Ibid.)

This appraisal of the situation of developing countries appears overly pessimistic. Nevertheless, the report is correct in pointing to the need for international action as commercial banks are becoming increasingly concerned about the risks involved in lending to developing countries that have substantial debt obligations.

At the same time, it should be recognized that the accumulation of external debt has occurred largely in countries which have failed to use the proceeds of foreign borrowing productively. These countries would need to increase exports and to efficiently replace imports, so as to improve their balance of payments position. Increased exports and import replacement, in turn, would permit maintaining high rates of economic growth.

3. Les rapports entre puissances économiques en 1978/1980

In examining the changing relationships among economic power centers, the report speaks of the establishment of a system of multiple reserve currencies (p. 142). While this view is supported by evidence on the diversification of

currency holdings by monetary institutions, the recent strength of the U.S. dollar, and the weakness of the German mark, point to the conclusion that the role of the dollar in the international monetary system will increase again. Corresponding, the need for a substitution facility is reduced.

The report correctly states that "apart from the very significant success realized by certain developing countries, the most important battles for the sharing of the world market take place among the three giants" (p. 162); i.e., the United States, the European Common Market, and Japan. It adds, however, that the developing countries are becoming increasingly important markets for the developed nations (p. 164).

As regards the measures affecting imports from the developing countries, the report overstates the importance of the General System of Preferences by implicitly assuming that imports under GSP would not have otherwise occurred (p. 175) and by disregarding the limits imposed on GSP imports. Also, it misreads the implications of the use of export limitations in the place of Article 9 of GATT, in contending that this entails replacing unilateral measures by multilateral actions (p. 176). Thus, the objective of the developed countries has been to escape the constraints of Article 19 through the use of export limitations which, rather than being negotiated, have generally been imposed on the developing countries. Finally, while correctly interpreting the achievements of the Tokyo Round negotiations, the report errs in excluding the possibilities for such negotiations in the future (p. 181).

The report notes the increased emphasis given to improving productivity and to restructuring industries in the developed countries. At the same time, it is inappropriate to regard Korea as an example of the "challengers" in difficulty" (p. 186), since Korea has lost market shares to other newly-industrializing countries as a result of the policies pursued by the former

President Park. These policies entailed expanding highly capital-intensive heavy industries at the expense of labor-intensive traditional export industries and failing to offset cost increases by a devaluation.

4. Le gestion politique de l'intérdependence

The report describes the failures of "global negotiations" between the North and the South. At the same time, in considering the establishment of the Common Fund as a positive achievement, it neglects to note that the financing of the Fund is too small to enable it to take effective action in the markets of any major primary commodity. In turn, market forces rather than the opposition of the United States, contributed to the failure of PANCAFE (p. 221). Nor can one expect that producer cartels would be "supported economically, that is financially, by the industrial countries" (p. 222). More generally, the report does not consider the implications of the election of President Reagan for the future of North-South relationships.

Files

April 13, 1981

Bela Balassa

RAMSES 1981

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Enclosure
BBalassa:nc

April 13, 1981

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

Dear Dr. Müller-Groeling:

Thank you for your letter of April 3rd. I would indeed have been very happy to participate at the reception honoring Professor Giersch but I am afraid I will not be able to come to Kiel on May 11th.

As regards your questions I provide the following information.

- (a) The title of the Samuelson article is "Economist Paul Samuelson Charts Global Shifts"; it is on page 20 of World Business Weekly, December 1, 1980.
- (b) The Zimmerman paper is a printed publication of the World Bank that is not part of any of the Bank series.

Yours sincerely,

Bela Balassa

April 13, 1981.

Prof. Dr. Mikerrem Hiç
Istanbul University
Europe and Middle East Economic
and Social Relations Research Institute
Istanbul
Turkey

Dear Professor Hiç:

I am happy to report that the Research Committee has approved financing the Research Project on incentive and protection in Turkey. An official letter to this effect will be sent to SPO shortly.

I was glad to learn from your letters of March 12th and March 22nd that the project is progressing. I have asked two of my colleagues to review your proposed questionnaire. I expect to receive their comments within a week.

With best regards,

Yours sincerely,

Bela Balassa

April 13, 1981.

Professor Gustav Ranis
Yale University
Department of Economics
Economic Growth Center
Box 1987, Yale Station
New Haven, Connecticut 06520

Dear Gus,

I enclose in two copies a slightly revised version of my contribution to the Reynolds Festschrift.

Yours sincerely,

Enclosures

Bela Balassa

Enclosed: "The Policy Experience of Twelve Less Developed Countries, 1973-1979"

April 13, 1981.

Mr. John H. Dunning
University of Reading
Department of Economics
Whiteknights
Reading
RG6 2AA
England

Dear John:

I am afraid that I have not been able to obtain a favorable response as regards the possibility of your spending some time working at the World Bank. I am sorry for this as I would have liked to have continuing contact with you here. I hope, however, that we will have the chance to meet before long.

With best regards,

Sincerely yours,

Bela Balassa

April 13, 1981

Dr. Mancur Olson
President-Elect
Southern Economic Association
University of Maryland
Department of Economics
College Park 20742
Maryland

Dear Mancur,

Thank you for your invitation to organize an Invited Session at the November meetings of the Southern Economic Association. I am afraid that I have accumulated so many ^{obligations} that I cannot accept your invitation. I am sorry for this but I hope that you will understand my reasons.

Yours sincerely,

Bela Balassa

April 13, 1981.

Mr. Geoffrey Shepherd
SERC
Mantell Building
The University of Sussex
Brighton BN1 9RF
England

Dear Geoff,

I am afraid that May 18th would not be a good time for your arrival. I am leading a large Bank mission to Turkey that would begin on May 18th and last for three weeks. I wonder if you could rather come a week earlier or three weeks later.

Yours sincerely,

Bela Balassa

OFFICE MEMORANDUM

TO: Files

DATE: April 9, 1981

FROM: Bela Balassa, DRC *M*

SUBJECT: Advisory Mission to Tunis, March 23-29, 1981

1. At the request of Mr. Stern, I went to Tunisia to advise the government on the policy orientation of the VIth Plan (1982-86). In the course of my visit, I met with the Minister of Planning and Finance, the Minister of National Economy and the Minister of Social Affairs, with other government officials and with several representatives of the private sector. Mr. Rene Vaurs accompanied me at the meetings.

2. During my visit, I prepared an advisory report, entitled "Quelques considerations sur le système d'incitations en Tunisie," various elements of which were discussed at my meetings. A copy of the advisory report is enclosed.

cc: Messrs. Stern, VPO; Please, VPO; Tolbert, IDF;
 Chauffournier, EMNVP; Bart, EM2; Picciotto, EMP; Zaidan, EMP;
 EL Maaroufi, EM2; Dubey, EMNVP; Asfour, EM2; Bachmann, EM2;
 Hume, EMP; Vaurs, EM2;
 DPS Directors, DRC Senior Staff,
 Landell-Mills, PPR; Westphal, DED

Enclosure
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QUELQUES CONSIDERATIONS SUR LE SYSTEME
D'INCITATIONS EN TUNISIE

BELA BALASSA
PROFESSEUR D'ECONOMIE POLITIQUE
CONSEILLER PRINCIPAL A LA BANQUE MONDIALE

INTRODUCTION :

La Tunisie a eu une excellente performance économique, en particulier parmi les pays du Maghreb, pendant la période qui a suivi le quadruplement du prix du pétrole en 1973-74 et la récession mondiale de 1974-75. La Tunisie a augmenté sa part dans l'exportation des produits manufacturiers en provenance des pays en voie de développement dans des proportions importantes tandis que la part des pays du Maghreb a diminué. Elle a augmenté son taux d'épargne comme les autres pays du Maghreb mais, malgré quelques investissements hautement capitalistiques dans les entreprises manufacturières publiques, elle a su éviter l'augmentation importante du coefficient de capital qu'on a observé dans les autres pays du Maghreb. Ainsi, la Tunisie a accéléré sa croissance économique à l'instar de l'Egypte qui a bénéficié du flux de capitaux étrangers et de l'augmentation importante des recettes du Canal de Suez tandis qu'un fléchissement est intervenu en Algérie et au Maroc.

L'augmentation du volume et du prix du pétrole exporté a contribué d'une façon non-négligeable à la croissance économique tunisienne. Les revenus pétroliers ont permis une augmentation importante de l'épargne nationale, des importations et des dépenses publiques. Ces dernières ont été utilisées en partie pour subventionner la consommation de certains produits et combler le déficit des entreprises publiques.

.../...

Pendant la prochaine décennie, la Tunisie va connaître un fléchissement de la croissance de la production pétrolière tandis que la consommation va continuer à augmenter à un rythme élevé malgré les mesures de conservation qu'on pourrait introduire. De plus, après l'augmentation récente du prix du pétrole, il ne faut pas trop compter sur des augmentations importantes de son prix réel.

Le ralentissement de la croissance des revenus pétroliers en termes réels et leur éventuelle diminution auront des effets défavorables sur la balance des paiements, le budget et l'épargne nationale. Afin de sauvegarder un taux de croissance économique élevé pour satisfaire les besoins et les exigences du peuple tunisien, il serait nécessaire de prendre des mesures pour améliorer la balance des paiements, éviter un déficit budgétaire, et maintenir l'épargne à un taux élevé, tout en favorisant son utilisation productive.

L'amélioration de la balance des paiements nécessiterait une augmentation nette des exportations ainsi que la substitution des importations. Mais cette dernière étant limitée par l'exiguïté du marché tunisien, elle devrait être liée, du moins en partie, à l'augmentation des exportations afin de pouvoir exploiter les économies d'échelle dans la production manufacturière.

La Tunisie ayant une fiscalité très élevée parmi les pays en voie de développement, on ne devrait pas envisager une augmentation de la part des impôts dans le revenu national. Pour éviter un déficit budgétaire, il sera alors nécessaire de réduire les dépenses, en particulier les subventions à la consommation et aux entreprises publiques.

Finalement, maintenir un taux d'épargne élevé demande un effort supplémentaire pour encourager l'épargne privée ainsi que l'établissement de circuits financiers pour que cette épargne soit utilisée d'une façon productive.

La réalisation de ces objectifs dans le but de poursuivre les grandes orientations du 6^{ème} Plan, notamment la régionalisation et la création d'emploi, nécessitera une révision du système d'incitation actuel. Cette révision devrait comporter des mesures concernant le code d'investissement, les exportations, la protection industrielle, le contrôle des prix et les subventions, les entreprises publiques, et le système financier.

.../...

LE CODE D'INVESTISSEMENT :

La loi d'août 1974 relative aux investissements dans les industries manufacturières a contribué à l'essor rapide des investissements dans ce secteur.

Les dispositions de la loi concernant l'échelonnement de l'exonération de l'impôt sur les bénéfices de l'entreprise selon le nombre d'emploi créé a favorisé les grandes entreprises dont les effectifs sont plus importants sans favoriser l'emploi. Elle a pu même avoir des effets néfastes sur l'emploi, étant donné que les grandes entreprises sont généralement plus capitalistiques que les petites et le coût de création de l'emploi en termes de capital investi est plus élevé.

De même, l'exemption des droits de douane sur l'importation des biens d'équipement a encouragé l'utilisation des méthodes capitalistiques, ainsi que l'établissement d'industries capitalistiques au dépens de l'emploi. Les charges sociales élevées ont eu des effets semblables.

La loi de 1974 accorde des avantages considérables à tout investissement agréé sous forme d'exonération d'impôts et de droits de douane. Par contre, les avantages supplémentaires pour les exportations et pour la régionalisation sont minimes ; ils comportent l'exonération de l'impôt sur les bénéfices pour une année supplémentaire après la période de cinq ans prévue pour tous les investissements agréés. Et quoique les projets régionaux ont pu bénéficier de la bonification du taux d'intérêt jusqu'à 5 % et d'une subvention d'investissement jusqu'à 10 %, dans les cas où ces dispositions ont été appliquées elles n'ont pas compensé les insuffisances des régions défavorisées en matière d'infrastructure physique et sociale. Ainsi, les investissements dans les régions défavorisées se sont situés en grand partie sur le périmètre de la capitale.

Finalement, les dispositions de la loi de 1974 sont les mêmes pour les branches industrielles traditionnelles et pour les branches nouvelles. Étant donné que les branches industrielles traditionnelles bénéficient de conditions plus favorables dues à leur antériorité par rapport aux nouvelles branches, ces dernières sont défavorisées. Ceci est, en particulier, le cas pour les industries de biens d'équipement qui se trouvent découragées par la franchise de droit sur les équipements importés. Il est proposé de modifier les dispositions de la loi de 1974 afin d'encourager, les exporta-

.../...

tions, les nouvelles branches industrielles, l'emploi, et la régionalisation, notamment par les mesures suivantes :

Premièrement

L'exonération des droits de douane sur l'importation des biens d'équipement devrait être abolie sauf pour les industries exportatrices et les nouvelles branches industrielles. Cependant, pour alléger le coût financier pour l'entreprise, le paiement des droits de douane devrait être échelonné sur une période de dix ans par l'octroi d'un crédit à un taux d'intérêt normal. Cette disposition permettrait d'accorder une exonération aux entreprises qui seraient fonction de la part exportée de leur production annuelle.

Deuxièmement :

L'exonération de l'impôt sur les bénéfices de l'entreprise devrait être accordée pour cinq ans aux investissements dans les nouvelles branches industrielles à concurrence de 50 %. Les investissements dans les régions défavorisées recevraient une exonération supplémentaire, allant de 30 % à 50 %, dans toutes les branches industrielles. En outre, la disposition de la loi établissant un taux réduit de l'impôt sur les bénéfices imputés aux exportations, pour les entreprises exportatrices à partir d'un seuil minimum de 20 % de leur production, devrait être étendue à toute entreprise sans seuil minimum.

Troisièmement :

Dans le but de réduire l'attrait de la capitale ainsi que d'éviter la fragmentation excessive de l'industrie manufacturière, l'objectif de régionalisation de l'industrie devrait être poursuivie par l'établissement de zones industrielles assorties d'équipement sociaux. À l'instar de la zone industrielle de Gabès, ces zones devraient revêtir un caractère spécialisé. Ceci est le cas, en particulier, pour les industries mécaniques et électriques qui nécessitent la disponibilité d'activités liées en amont et en aval.

LES EXPORTATIONS :

Les exportations des produits manufacturiers ont connu un essor remarquable en Tunisie. En même temps, dans une grande mesure, les entreprises exportatrices ne sont pas intégrées au tissu industriel tunisien et elles ont créé une valeur ajoutée nationale assez faible. Ceci résulte des avantages accordés par la loi d'avril 1972 aux entreprises qui exportent 100 % de leur production par comparaison avec les entreprises qui n'exportent qu'une partie de leur production et qui bénéficient de la loi de 1974.

.../...

Tandis que la loi de 1972 prévoit l'exonération totale de l'impôt sur les bénéfices pendant une période de dix ans, la loi de 1974 n'accorde qu'une réduction partielle de cet impôt et pour les entreprises réalisant à l'exportation un pourcentage minimum de leur chiffre d'affaire. Le dépassement de ce seuil est aussi nécessaire pour les entreprises soumises à la loi de 1974 bénéficient de l'admission temporaire pour laquelle elles doivent obtenir une caution à un coût élevé. Ces mêmes entreprises rencontrent des difficultés administratives considérables, avec des délais d'un an minimum, si elles veulent se servir du drawback dans le cas où elles n'avaient pas prévu d'exporter.

L'égalisation des avantages à l'exportation pour les entreprises soumises aux lois de 1972 et 1974 serait conforme à l'intérêt national. Les devises procurées dans les deux cas ont la même utilité pour la collectivité, et l'exportation partielle a l'avantage supplémentaire de contribuer à l'intégration industrielle dans l'économie nationale. Pour la même raison, il faudrait simplifier les conditions actuelles en ce qui concerne les transactions entre les entreprises soumises à la loi de 1972 et à la loi de 1974. Enfin, il faut assurer l'exonération totale des taxes indirectes payées aux stades antérieurs de la production. Cet objectif sera atteint, une fois l'intégration des taxes indirectes et l'établissement d'une seule taxe sur la valeur ajoutée achevés. Entre temps, à l'instar d'autres pays comme le Mexique, il faudrait établir des détaxes forfaitaires pour la taxe à la production non remboursée sur les produits intermédiaires ainsi que pour la taxe sur les prestations de services basées sur des normes établies pour chaque industrie. Suivant l'exemple de la Thaïlande, on devrait aussi établir des normes pour le remboursement des droits de douane payés aux divers stades antérieurs de la production locale des produits intermédiaires.

A l'instar d'autres pays, comme la Grèce, Taiwan, et la Thaïlande, on devrait encourager l'établissement des sociétés commerciales d'exportation qui prospecteraient de nouveaux marchés pour les produits traditionnels de la Tunisie et s'efforceraient de trouver des marchés pour les nouveaux produits. La diversification des débouchés et des produits exportés revêt une importance particulière, étant donné les limitations imposées sur l'exportation tunisienne de la confection en France et la nécessité d'encourager l'exportation par les petites et moyennes entreprises.

Suivant l'exemple des autres pays, il faudrait accorder les mêmes avantages aux sociétés commerciales d'exportation qu'aux producteurs qui exportent directement. Il n'y a pas de raison pour une imposition supplémentaire dans le premier cas et jusqu'à présent, cette imposition s'est avérée un obstacle majeur à la création de sociétés commerciales d'exportation. Les entreprises commerciales ainsi que les exportateurs directs devraient se voir accorder des facilités pour la prospection des marchés y compris l'établissement d'agences à l'étranger. Une assistance financière à la participation aux foires et salons et aux missions de prospection serait aussi souhaitable.

Ces mesures de caractère fiscal devraient être assorties de l'amélioration de la politique de crédit et l'établissement d'un système d'assurance & crédit à l'exportation. On devrait alléger les conditions de préfinancement, prolonger les délais de l'escompte à plus de 90 jours, et établir une facilité pour des crédits à moyen terme. Ces recommandations sont basées sur l'expérience des pays de l'Extrême-Orient. La dernière recommandation revêt une importance particulière pour encourager l'exportation des biens d'équipement.

L'assurance crédit pour risque politique et risque commercial, utilisée par les pays en voie de développement exportateurs de produits manufacturiers, encourage la prospection de nouveaux marchés et l'exportation dans les pays où les conditions politiques ne sont pas stables. Leur introduction est souhaitable pour les crédits à moyen terme mais aussi pour les crédits à court terme.

Pour que les mesures fiscales et le crédit aient les effets escomptés, il faudrait maintenir un taux de change réaliste. Ceci nécessite d'éviter les fluctuations par rapport aux devises des principaux marchés tunisiens et en particulier, l'appréciation du dinar tunisien, ce qui a été observé récemment. En préparant ces ajustements, les conséquences de la récente augmentation des salaires devraient être aussi prises en considération.

On devrait en même temps éviter un endettement excessif, ce qui maintiendrait le taux de change à un niveau inférieur au taux de change d'équilibre à long terme et nécessiterait le remboursement des emprunts à un taux de change déprécié. Notamment une baisse des revenus de pétrole entraînera une dépréciation de la monnaie tunisienne.

LA PROTECTION INDUSTRIELLE :

Le maintien d'un taux de change réaliste est aussi nécessaire pour la poursuite d'une politique de protection rationnelle. La pièce maîtresse de cette politique devrait être le système douanier. Ceci demanderait la libéralisation des restrictions quantitatives à l'importation qui constituent actuellement les principales mesures de protection en Tunisie.

Les restrictions quantitatives à l'importation ont aidé à l'établissement des grandes industries actuelles mais ces industries désormais traditionnelles ne nécessitent plus la protection "absolue"

.../...

que ces restrictions procurent. Quoique la comparaison des prix pour les produits relativement simples aurait pu permettre d'éviter la satisfaction des besoins nationaux avec des produits locaux excessivement chers, ces comparaisons rencontrent des difficultés pratiques dans le cas de produits sophistiqués, où la spécification technique varie de façon considérable pour les mêmes produits. Dans certains cas, la disponibilité d'un produit local semblable mais n'ayant pas toutes les caractéristiques techniques désirées a donné lieu à des difficultés pour obtenir la licence d'importation pour le produit requis. Ceci explique le remplacement des restrictions quantitatives à l'importation par des droits de douane au cours du développement industriel dans les autres pays. Dans le cas de la Tunisie, le processus de libéralisation pourrait être étalé sur une période de cinq ans, en commençant par les matières premières et les autres produits intermédiaires. Néanmoins, on pourrait protéger les nouveaux produits par des restrictions quantitatives à l'importation pendant une période limitée tandis qu'ils assurent leurs marchés.

Le remplacement de la protection par des restrictions quantitatives à l'importation par une protection par des droits de douane nécessiterait la réforme du système douanier. En l'absence d'un plan bien conçu, ce système s'est développé de façon ad-hoc en réponse aux demandes des entrepreneurs. Pour assurer sa cohérence et son efficacité, on devrait prendre en compte les relations d'échange intersectorielles et évaluer le taux de protection effective sur la valeur ajoutée.

Dans la réforme, on devrait éviter des variations importantes des taux de protection effective et réduire le taux moyen. Actuellement, plusieurs produits bénéficient d'un taux de protection de plus de 200 % et d'autres ont une protection effective négative due aux droits de douane élevés sur les produits intermédiaires par rapport au produit final. Néanmoins, la protection des biens d'équipement devrait rester modeste pour éviter l'augmentation excessive du prix de revient mais aussi l'établissement d'une industrie mécanique et électrique ne produisant que pour un marché national exigü et donc à une échelle insuffisante. Pour encourager le développement parallèle de la production de l'industrie mécanique et électrique pour le marché national et pour l'exportation, on devrait appliquer des mesures de promotion au lieu de ~~celles~~ de protection. Celles-ci incluront les incitations à l'investissement dé-

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crites plus haut, des crédits préférentiels, ainsi que l'exonération de droits de douane sur les produits intermédiaires.

La révision du système douanier permettra de faire face au dumping en introduisant des taxes anti-dumping ou des prix minimum à l'importation. En même temps, l'utilisation des droits de douane au lieu de restrictions quantitatives à l'importation entraînerait une réduction des prix en encourageant la concurrence entre produits locaux et importés ainsi qu'entre produits importés.

CÔNTRÔLE DES PRIX ET SUBVENTIONS :

Dans la situation actuelle, la limitation des importations a tendance à augmenter le prix des produits importés ce qui bénéficie souvent aux exportateurs étrangers. En outre, elle permet le maintien de prix élevés pour les produits locaux qui ne sont pas concurrencés par les importations. Le contrôle des prix ne peut pas influencer les prix des produits étrangers et ses effets sur les produits locaux ne manquent pas d'ambiguïté.

D'abord, l'homologation des prix permet à l'entreprise de récupérer ses coûts même excessifs, et d'obtenir des bénéfices proportionnels à ses coûts. Ainsi, il y a peu d'incitations à l'amélioration de la productivité et à la concurrence. Aussi, le souci de simplification des procédures de la part des autorités n'incite pas les entreprises à améliorer la qualité des marchandises pour lesquelles elles ne peuvent pas obtenir un prix plus élevé.

Le passage prévu de l'homologation à l'auto-homologation, avec la détermination des marges bénéficiaires par les autorités, permettrait une meilleure satisfaction des besoins par une gamme plus étendue de produits. Néanmoins, le problème demeure que l'amélioration de la productivité se trouve découragée par le fait qu'elle ne peut pas entraîner une augmentation des marges bénéficiaires, ce qui est nécessaire pour que l'entreprise accepte le risque. Ainsi la concurrence et les forces du marché menant à une amélioration de la productivité et du niveau de vie ne peuvent pas convenablement jouer.

La libéralisation des prix pourrait commencer par les produits où il y a un nombre de producteurs suffisant pour assurer la concurrence. Dans ces cas, on pourrait appliquer la liberté con-

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trôlée des prix, avec notification des changements de prix aux autorités, ce qui est actuellement le cas pour le cuir, le verre et les détergents.

Au cas où il existe une situation de monopole ou d'oligopole sur le marché national, la libéralisation des prix devrait être précédée par la libéralisation des restrictions quantitatives à l'importation. Une fois ce processus terminé, la concurrence étrangère pourra effectivement limiter l'augmentation des prix des produits locaux et rendre le contrôle de leurs prix superflu.

On pourrait éventuellement limiter le contrôle à un petit nombre des produits de grande consommation. Mais, ce contrôle ne devrait ni bénéficier aux citoyens aux dépens des agriculteurs, ni entraîner des subventions excessives. Il est particulièrement important qu'on établisse des prix rémunérateurs pour les petits et moyens agriculteurs. De cette façon, on pourrait améliorer la situation dans les régions défavorisées, augmenter la demande de la part des agriculteurs pour les produits industriels, et encourager l'augmentation de la production agricole.

La reconstitution des troupeaux qui a suivi la libéralisation du prix de la viande ovine indique des possibilités d'augmentation de la production. Des résultats semblables pourraient être obtenus par la libéralisation du prix de la viande bovine. En même temps, on devrait supprimer les subventions aux aliments concentrés qui sont consommés par les animaux et découragent l'utilisation des pâturages à un coût plus économique.

LES ENTREPRISES PUBLIQUES :

Plusieurs catégories de subventions sont accordées aux entreprises publiques. Ces entreprises sont soumises à un contrôle administratif, ce qui entraîne l'intervention presque quotidienne de l'Etat dans leur gestion. En même temps, malgré les ressources financières mises à leur disposition, un nombre important de ces entreprises ont un faible niveau de productivité.

Il serait souhaitable de remplacer le financement des entreprises publiques par l'Etat par un financement par les banques, comme cela a été proposé. Des représentants des banques devraient faire partie du Conseil d'Administration de ces entreprises afin de s'assurer que les fonds soient bien utilisés.

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Il a aussi été suggéré que le Conseil contienne des Administrateurs permanents et à temps plein ayant leur bureau dans l'entreprise et étant rémunérés par celle-ci. Il est douteux que ces dispositions puissent effectivement favoriser le but d'assurer le bon fonctionnement de l'entreprise. Elles donneraient lieu à une duplication et à des conflits avec le Directeur Général de l'entreprise et ne représenteraient pas une bonne utilisation des talents de gestionnaire existants.

Néanmoins, il serait souhaitable d'inclure des experts indépendants dans le Conseil d'Administration avec les représentants de l'Etat.

Le Directeur Général devrait être responsable devant le Conseil d'Administration qui assumerait les fonctions exercées par le Ministère de Tutelle. Avant de décider des réformes nécessaires, le gouvernement pourrait utilement examiner l'expérience des entreprises publiques autrichiennes qui sont insérées dans une économie de marché ainsi que l'expérience de la réforme économique hongroise qui a établi le principe du profit pour les entreprises publiques. A l'instar de l'Autriche et de la Hongrie, les entreprises publiques tunisiennes devraient subir la concurrence intérieure et extérieure.

Enfin les petites entreprises publiques et les entreprises publiques dans les industries traditionnelles pourraient être privatisées. On devrait aussi revoir le rôle et les fonctions des entreprises publiques dans l'agriculture dont la productivité est restée à un faible niveau.

LES MARCHES FINANCIERS :

Depuis la préparation d'une étude par la Banque Centrale en 1977, les taux d'intérêt ont été relevés et une nouvelle augmentation a été décidée pour le 1er Avril. Néanmoins, ces augmentations ont été inférieures à l'accroissement du taux d'inflation, et les taux d'intérêt réels ont diminué.

Quoique les taux d'intérêt réels ont été positifs au début des années soixante-dix, la compensation insuffisante de l'accélération de l'inflation par le relèvement des taux d'intérêt nominaux les a rendus négatifs. Cet état de choses devrait être modifié pour encourager l'épargne au dépens de l'augmentation rapide de la consommation, des achats immobiliers, et de l'auto-investissement dans les entreprises à faible rentabilité et pour décourager les investissements capitalistiques.

En particulier, on devrait augmenter le taux d'intérêt à long terme et exonérer tout intérêt payé pour les banques de l'impôt sur le revenu.

L'augmentation des taux d'intérêt devrait être accompagnée par une réforme des marchés financiers. Cet objectif serait plus facilement réalisé par l'augmentation des taux d'intérêt sur les obligations d'Etat ainsi que par l'exonération des revenus de ces obligations et des dividendes de l'impôt sur le revenu. En outre, des changements institutionnels seraient nécessaires pour développer le marché des actions et des obligations.

La réforme des marchés financiers serait complémentaire de la libéralisation des échanges et de la libéralisation des prix, et permettrait un flux de capitaux vers les secteurs où le taux de rendement est le meilleur. Néanmoins, le champ d'action des crédits préférentiels devrait être maintenu et même élargi, notamment pour l'exportation ainsi que pour l'agriculture et pour l'industrie mécanique et électrique. Dans ces secteurs, l'établissement de banques spécialisées pourrait augmenter la disponibilité des crédits et assurer leur utilisation efficace.

CONCLUSION :

L'objectif de cette note a été de proposer une réforme des incitations économiques pour les rendre compatibles avec les exigences d'une économie qui devient plus complexe et plus sophistiquée. Cela nécessite l'élargissement du champ d'action des forces du marché et une réduction de l'utilisation des contrôles administratifs. Les mesures proposées se renforcent mutuellement étant donnée l'interdépendance de la formation des prix, de la protection industrielle, et des dispositions fiscales et financières.

Ces recommandations tiennent compte du fléchissement du taux de croissance des revenus pétroliers, ce qui nécessitera un effort accru pour développer les exportations, augmenter l'épargne, et réduire les dépenses publiques. Elles visent aussi la création de branches industrielles nouvelles, le développement agricole, la régionalisation, et l'augmentation de l'emploi.

CABLE

APRIL 9, 1981
61991

MR. KEMNET GUN CALIKA, NEBAN SECURITIES BROKERSAGE, ODAKULE
IS MERKEZI ISTIKLAL CADDESI, 286 BEYOGLU, ISTANBUL, TURKEY

PLAN TO ARRIVE IN ISTANBUL ON JUNE 30 IN THE EARLY AFTERNOON
FOR MAKING PRESENTATION THE NEXT MORNING. DO NOT SEE
DIFFICULTIES IN OBTAINING PERMISSION FOR PARTICIPATION AT
THE CONFERENCE IN A PRIVATE CAPACITY. PLEASE SEND INVITATION
TO DELIVER PAPER ON THE POLICY EXPERIENCE OF DEVELOPING
COUNTRIES IN THE POST 1973 PERIOD. REGARDS, BALASSA

Bela Balassa

Bela Balassa

BRC - Director's Office

BBalassa:nc

CABLE

APRIL 6, 1981
61991

MR. MEHMET GUN CALIKA, MEBAN SECURITIES BROKERAGE, ODAKULE IS
MERKEZI ISTIKLAL CADDESİ, 286 BEYOGLU, ISTANBUL, TURKEY

WILL CALL ON THURSDAY FOR FURTHER DISCUSSION OF PROPOSED
SEMINAR, REGARDS, BALASSA

Bela Balassa

Bela Balassa

DRC - Director's Office

BBalassa:nc

Ms. Ann W. Hammond, PMD

April 6, 1981.

Bela Balassa, DRC

Dr. Bela Csikos-Nagy's visit

As agreed on the telephone, I enclose Dr. Csikos-Nagy's curriculum vitae. Given his eminent status, he should receive the highest possible fee for his lecture.

Enclosure
BBalassa:nc

OFFICE MEMORANDUM

TO: Mr. S. Shahid Husain, AENVP

DATE: April 3, 1981

FROM: Bela Balassa, DRC

SUBJECT: CHINA: Socialist Economic Developments. Main ReportOverall Evaluation

1. This report is very much superior to the earlier report on another socialist country, Romania. It critically evaluates official data on economic performance, submits the methods of central planning applied to a searching review, and makes recommendations for future policy changes. The report's shortcomings may be largely traced to haste in aiming at early completion; the interests of China and of the Bank would be served if sufficient time were allotted for revisions.
2. China has obviously made great strides in assuring the basic needs of its population. However, the official data overstates China's growth performance, and the adjustments made in the report are not sufficient to redress the balance. This is in part because in making adjustments use has been made of the highly distorted price structure of India and in part because the adjustments do not concern non-price forms of overstatement.
3. The report does not give sufficient attention to the twists and turns of Chinese policy making, which have affected economic performance to a considerable extent. Apart from the Great Leap Forward and the Cultural Revolution, attention would need to be given to changes in recent years, including the 1978 investment spree, the 1979 retrenchment, the increased equipment orders of 1980, and an even more far-reaching retrenchment in 1981. According to press reports, the contractionary measures applied will now extend to public current expenditures, with adverse effects on employment. Also, the re-centralization that has followed may conceivably jeopardize the prospects for meaningful reform for some time to come.
4. The statement in the report, according to which "the reform measures of the past two years have indeed made macroeconomic adjustment more difficult" (Para. 5.82), tends to disguise the fact that the crisis has been due to macroeconomic imbalances generated by excessive investment and wage increases, neither of which is a necessary concomitant of the reform. The recommendations, too, should concern themselves both with re-establishing macroeconomic equilibrium and pursuing reform efforts. As to the latter, the interdependence of prices, incentives and the decentralization of decision-making would need to receive greater emphasis. Not only are appropriate prices and incentives indispensable for successful decentralization, but decentralization is a pre-condition for the establishment of rational prices.
5. Shadow prices offer only a partial and imperfect substitute for actual transaction prices in their effects on resources allocation. Also, the "extension of planning, both aggregate and sectoral" (Para. 5.88) may conflict with the need for decentralization, when the distinction made between central planning and administrative control fails to consider that the former necessarily leads to the latter. One should further recognize the danger in half-way houses between planning and decentralization, and note that the pricing, incentives, decentralization "trilogy" may make an important

contribution towards increased efficiency in investment and in energy use, a better balance between supply and demand, and the expansion of exports. Finally, consideration should be given to the potential contribution of joint ventures with foreign firms to these objectives.

6. Several of these points have been made at various places in the report. But the report remains somewhat of a jigsaw puzzle, elements of which can be found in different chapters that also often overlap. An effort at revising and pruning the report would bring considerable dividends. Comments on the individual chapters follow.

1. The Chinese Inheritance

7. In providing the historical background, this chapter provides a useful introduction to the report. Some of the statements, however, require reconsideration. To begin with, the claim made as regards "the existence in late Sung China (i.e. between 1000 and 1300) of the essential concept of the industrial revolution" (Para. 1.16) is rather exaggerated. Also, it is difficult to accept the view that homogeneity and centralization stood in the way of industrial development in China (Para. 1.27). Thus, references to its "tradition of unity and cohesion" (Para 1.26) neglects the historical importance of regional power centers in China. This neglect is apparent, in particular, in comparisons with Japan, and the statement that "even the centralized feudalism of Tokugawa Japan permitted a considerable degree of local autonomy" (Para. 1.27) creates an erroneous impression. At the same time, references to Japan's "historical practice of borrowing technology from abroad" (Para 1.29) disregards the long period of Japanese isolation. Nor can rapid progress in Japan be explained by the role of the state in economic development alone.

8. There are some further ambiguities in the chapter as regards agricultural development. If indeed "by the nineteenth century at the latest, virtually all arable areas in China proper were being farmed" (Para. 1.22), the area under cultivation could not have been increasing during the twentieth century. It is also doubtful that "one can speak of advanced and sophisticated farm practices" (Ibid.), when "traditional agriculture in China had reached equilibrium at a very low level of output" (Ibid.).

2. The Economic System

9. While practically the entire first chapter is devoted to developments until 1949, little space is given to policy changes between 1949 and the mid-1950s (Paras. 1.30-1.31) or between the mid-1950s and the the late 1970s (Paras. 2.01-2.04). Yet, the present economic situation in China can only be imperfectly understood without a knowledge of the quite radical policy turns during the preceding two decades.

10. In particular, the claim that "China's economic management is, by international standards, extraordinarily centralized and characterized by strict vertical control" (p.30) appears to conflict with references to "a complete breakdown of the central planning system (Para. 2.02) during the period of the Great Leap Forward and "the breakdown of central management" (Para. 2.03) during the Cultural Revolution, and with the statement that "central planning has clearly been practiced only infrequently in China"

(Para. 2.05). One may also query the statement that "the response of units at the bottom to change in policy at the top is remarkably quick and uniform" (Para. 2.07).

11. The report tends to understate the importance of the provincial and country authorities in the process of decision-making in China. For one thing, there have been repeated efforts at regionalization since 1949. For another thing, notwithstanding budgetary control at the center, the provinces have found ways to assert their autonomy. Most recently, this was the case as provinces and cities disregarded instructions from the top to limit new investment.

12. The section on price determination needs improvement. In discussing the cost-plus character of prices (Para. 2.30), the lack of an allowance for the cost of capital should be emphasized. In turn, references to "theoretical concern about 'equal value exchange' and practical concern about rural living standards" (Para. 2.31) disguise the fact that the internal terms of trade has strongly disfavored agriculture. Thus, in comparison with India and other developing countries, "industrial relative prices are unusually high in China" (Para. A.17). The distortions are even greater if comparisons are made with world market prices, since industrial protection has raised relative industrial prices in India and in other developing countries to a considerable extent. This explains the profits made in exporting agricultural goods and the substantial losses suffered in exporting manufactured products (Para. 2.33).

13. In the discussion of the agricultural sector, more attention should be given to farming on private plots that represents 30 percent of total agricultural output produced on 5-7 percent of the land. The high productivity of private plots reflects the responsiveness of farmers to price incentives and has obvious implications for the system of decision-making in agriculture. In particular, questions arise about the validity of the statement according to which "the state-managed marketing and supply system, the control of prices and the tight-knit organizational structure of the commune together constitute an almost uniquely powerful apparatus for agricultural planning" (Para. 2.50) in China.

14. As regards industry, doubts arise about the claim according to which "what distinguishes these enterprise plans and targets from those common in businesses in other countries is the degree of external [i.e. central] influences and the amount of detail involved" (Para. 2.54). One may also wonder if "the enterprise's management has a hand in the formulation of its plan" (Para. 2.55). At any rate, the discussion of the planning system could be usefully expanded.

3. Growth and Poverty Reduction

15. The discussion of development strategy is rather cursory and tends towards overstatements. To begin with, it cannot be said that "China has been denied access to most Western markets, capital and technology" (Para. 3.03); apart from the U.S. embargo, its comparative isolation was the result of government policy. Also, references to "land scarcity" and the attainment of "the easiest advances in intensive cultivation" appear to conflict with the statement on the use of "out-of-date technology" (Para. 3.04). Finally, the

claim that "local resources and technology have contributed to industrialization through the establishment of commune enterprises" (Para. 3.06) disregards the waste involved in e.g. the establishment of backyard steel furnaces.

16. Further doubts arise about the reliability of data on growth rates, the sectoral composition of output, and the level of per capita incomes in China. As it is well-known, the valuation procedures applied and the production of unsaleable commodities exaggerate the rate of growth of output in centrally planned economies. The 28 percent adjustment in the relative prices of industry as compared to agriculture (Para. A.32) represents only a partial remedy as price distortions may exceed this figure several times. Finally, China-India comparisons of per capita incomes are of doubtful validity.

17. In evaluating the performance of the Chinese economy, the high incremental capital output ratio, and increases in this ratio over time, deserve particular attention. Successful developing countries operated with ICORs about one-half of that of China. And, references to "the fact that aggregate ICORs have tended to rise in most other developing countries suggests that increased inefficiency is unlikely to be the whole explanation" (Para. 3.40) tend to understate the importance of this problem in China.

18. Returns to factors in industry will appear even lower if world market prices rather than the highly distorted prices of India are used in adjusting the official figures. At the same time, making adjustment for the existence of large distortions in price relationships as between industrial and agricultural products would lead to the conclusion that urban-rural income inequalities are considerably greater in China than in low-income or middle-income developing countries.

19. Comparisons of rural and overall income inequalities with middle-income countries are limited to Thailand, Philippines, and Colombia in the report. China would appear in a less favorable light if Korea or Taiwan were chosen as standards of comparison. And, overall income inequalities would appear considerably greater if adjustment were made for distortions in relative prices.

4. Sectoral Development and Problems

20. Increases in per capita agricultural output of 1.0 percent a year between 1952 and 1979 exceed the performance of low-income developing countries. Questions have recently been raised, however, about the validity of the data, and statements by Chinese officials have been cited to the effect that output figures have been overstated. Net output per worker may then have changed little in China as compared to average increases of 1 percent a year in low-income developing countries. Such a conclusion should temper statements made about "substantial progress in agricultural development" (Para. 4.20) and "impressive technical progress and substantial degree of modernization in agriculture" (Para. 4.21).

21. Reported industrial output levels are exaggerated by reason of price distortions existing in China. For reasons mentioned earlier, growth rates of industrial output are also overstated, so that total factor productivity may

have declined rather than stagnating since 1957 as the report suggests. At the same time, the claim that "almost the entire range of modern industries has been set up" (Para. 4.32) neglects considerations of quality and levels of technology, which have contributed to low efficiency.

22. The findings of low efficiency as well as information made available recently appear to conflict with statements such as "Chinese enterprises show admirable attention to quality and great skill in workmanship" (Para 4.48), "management appears to maintain close touch with workers' concerns and keeps them well apprised of enterprise objectives and production methods" (Para. 4.48); and "managers in industry at all levels appear dedicated, energetic and remarkably able" (Para. 4.51). At the same time, the statement that "unsatisfactory results can be commonly traced to a dependence on supplies from a different ministry or organizational unit that places its own objectives ahead of those of its outside customers, or to some other failure in coordination, or conflict in objectives, among separate units" (Para. 4.50) tends to minimize the firm's own responsibility for its shortcomings.

5. Adjustment and Reform

23. The report correctly notes some of the deficiencies of the system of central planning as practiced in China and elsewhere. It may be added that "poor product quality, shortages of many items and excess supply of others" (Para. 5.9) apply not only to consumer goods sectors but also to sectors producing capital goods and intermediate products. This has to do with the lack of interest on the part of enterprises to cater to the users' needs, referred to earlier in the report.

24. While the report notes that "the state economy is in effect a giant bureaucracy [and] it suffers from many of the problems of bureaucratic behavior" (Para. 5.10), it suggests that "control is not tight enough to prevent enterprises from maximizing their demand on planners and supply agencies for material inputs and equipment without adequate consideration of cost" (Para. 5.10). The latter statement, and some other statements in the report, imply that greater centralization would remedy some of the defects of the Chinese economic system. Yet, in the absence of instant information and a giant computer operated by Superman, greater centralization is bound to lead to contradictory plan orders, with the enterprise expending its energies on fulfilling some and dodging others.

25. As in the case of the Soviet Union, attempts made "at devolution of administrative control to local government have ... accentuated an already strong regional tendency toward autarchy" (Para. 5.11) At the same time, regionalization is bound to lead to inefficiencies as long as prices do not reflect resource scarcities. Nevertheless, proposals for the regional decentralization of decision-making continue to be made in China and they would need to be dealt with in more detail in the report.

26. The description of the reforms is generally correct but the demand that "together they constitute the biggest innovation since completion of socialist transformation in the 1950s" (Para. 5.21) is much exaggerated. The retention of 10 percent of profits on the average (Para. 5.25) will not make much of a difference; freedom of purchase from other sources (Para. 5.31) will matter little as long as supply shortages predominate; the establishment of bilateral

relationships (Para. 5.32) tends to reinforce local autarchy; the retaining of foreign exchange may not provide much of an inducement to the firm as long as it "remains subject to local or central government approval" (Para. 5.34); the extent of freeing the prices of manufactured goods is more limited than the report seems to indicate (Para. 5.36); the imposition of interest rates of 1 to 3 percent (Para. 5.37) has been offset several times by the acceleration of inflation, leading to substantially negative real interest rates; and even if "the relative profitability of the various crops, markets and investment opportunities become the most important factors in decision making" (Para. 5.43), efficiency will be assured only if prices express resource scarcities.

27. At the same time, recent reports point to a tendency towards recentralization through a tightening of central planning, rigid price and wage setting, and the lack of extension of profit retention schemes to additional enterprises. Some of the recommendations of the report also call for greater centralization. The increased use of material balances (Para. 5.92), for example, would reduce the flexibility of the economic system. Also, one may query the distinction made between central planning and administrative control (Para. 5.89), since the former necessarily leads to the latter. Finally, the "extension of planning, both aggregate and sectoral" (Para. 5.88) is bound to conflict with the objectives of decentralization.

28. The recommendations made in the report reflect a touching faith in shadow prices (Para. 5.48, 5.55, and 5.62) without providing any indication of how shadow prices could be derived, given the existing price distortions in China. In turn, apart from its other defects, the use of average cost pricing will not give appropriate results as long as the relative prices of capital and labor are greatly out of line. In particular, interest rates should be considered not only in choosing among investment alternatives but also as a costing device.

29. The statement that "widespread decontrol of prices is probably ruled out by a strong political aversion to consumer price rises" (Para. 5.49) neglects the separation of producer and consumer prices in socialist countries in general and in China in particular. (This is, however, noted in Para. 5.55). Also, the warning that "price changes aimed at improving efficiency should not be made at the cost of adverse changes in the income distribution" (Para. 5.54) does not consider the fact that the existing system of price strongly discriminates against the poor in rural areas. At the same time, the differential treatment of areas of different land quality may be achieved through the traditional procedure of land rents.

30. While it is true that, in the event of the immediate decontrol of prices, "the resulting pattern of windfall gains and losses would partly reflect the many other rigidities in the system" (Para. 5.49), one should emphasize the benefits of the use of rational prices in ensuring the responsiveness of supply to demand, avoiding inventory accumulation, providing for the better use of inputs, including capital and energy, and contributing to the efficient allocation of investment funds. More generally, the interdependence of pricing, incentives, and the decentralization of decision-making needs greater emphasis.

31. The report makes reference to the need "for carefully planned and gradual changes in the price system" (Para. 5.54) and suggests that "a trial

and error approach that combines continuing elements of direct planning with gradually increased use of price adjustments seems necessary" (Para. 5.53). Piecemeal reform, however, has been shown to be ineffective in other socialist countries. At the same time, one may doubt the validity of the statement that "the collective system and the well-established hierarchy of planning controls facilitates such a mixed approach and indeed, in certain respects, confers some advantages that few other countries enjoy" (Para. 5.53)

32. A crucial issue neglected in the report is the choice between the use of world market prices and of market-clearing prices under autarchy. Some suggestions on the former are made in my back-to-office memo of November 24, 1980, on the U.S.-China Conference on Alternative Strategies for Economic Development, that is enclosed. Any further recommendations would require a better knowledge of the situation existing in China.

33. One may wonder if "the reform measures of the past two years have indeed made macro-economic adjustment more difficult" (Para. 5.82). It would rather seem that the macro-economic imbalances have been generated by excessive investments and wage increases, neither of which is a necessary ingredient of the reform. At the same time, the incorrect decisions made by the government have made reforms more difficult to carry out and the recent measures of re-centralization will strengthen the hand of the opponents of the reform.

34. The report could serve the interests of the reform by pointing to the adverse effects of policy errors in recent years. The report is surprisingly mild at this point, although the errors made are well-known from numerous press accounts. It should also be noted that excessive investments have contributed to wage and price increases by disturbing macro-economic balances. At the same time, the cited 7 percent increase in the urban cost of living between 1978 and 1980 much underestimates the extent of actual price increases; the reported increase was 6 percent for 1980 alone and Hong-Kong observers estimate the true increase at 10-15 percent. Finally, the re-establishment of price control only treats the surface of the problem and may exacerbate China's present economic difficulties.

6. Prospects and Options in the 1980s

35. As regards agriculture, excessive emphasis is given in the report to the need for expanding the production of staple foods. If the example of other countries can serve as a guide, a 3.5-4.0 percent growth of per capita consumption would entail not only a less than proportional increase in demand for agricultural products but a shift towards higher-value products within agriculture. For production to respond to the changing structure of demand, there is need for price incentives since compulsion is a notoriously inadequate means for this purpose. Also, on the example of other socialist countries, greater emphasis would need to be placed on household plots, which are not referred to in the recommendations of the report.

36. The report correctly notes that the most serious new constraint for economic growth is domestic energy production (Para. 6.02). Indeed, the production of crude oil may decline below the 90 million ton level projected for 1985 (Para. 6.51). Also, notwithstanding the successes of the last year, conservation efforts may fall short of the projections. At the same time,

conservation would require the appropriate pricing of energy that is not the case today. But, it is not sufficient to raise prices, if the incentive structure is not modified and decision-making is not decentralized.

7. Prospects for Foreign Trade and Capital

37. The trilogy of pricing, incentives, and decentralization is of considerable relevance to foreign trade as well. Thus, China cannot hope to approach the high projection for the exports of manufactured goods without a change in the incentive system. In fact, information available on the experience of Hong Kong firms in Southern China indicates that it may even be difficult to reach the moderate projection of 10 percent under the present system of decision-making.

38. Finally, in concentrating on foreign borrowing, the report neglects the issue of direct foreign investment in the form of joint ventures that has received considerable attention in recent years. While one needs to avoid the excesses of recent years, foreign direct investment may make an important contribution to technological progress, increased energy production, and manufactured exports.

cc: Recipients of Mr. S. Shahid Husain's memo of March 17, 1981.

BBalassa:nc

OFFICE MEMORANDUM

TO: Those listed

DATE: November 24, 1980.

FROM: Bela Balassa

SUBJECT: U.S.-China Conference on Alternative Strategies for Economic Development, November 21-24 (Racine, Wisconsin)

The Conference Program

1. Due to conflicting obligations, my participation at the Conference was limited to five of the eight sessions. Nevertheless, the nearly three days I spent in Racine permitted me to have detailed discussions with several of the Chinese participants. Some reflections on these discussions, and on the Conference itself, follow.
2. Altogether twenty-five papers were presented at the Conference, eighteen by American and British economists and seven by Chinese economists. The only change in the enclosed program was that I was asked to make a second presentation, in addition to the one included in the program, on the economic reform in Hungary. This topic proved to be of considerable interest to the Chinese participants who raised questions about the possible relevance of the Hungarian reform to China.
3. There were far too many papers for a four day Conference. The Chinese participants, most of whom had little familiarity with Western economic thought and analysis, faced particular difficulties; several of them complained to me that they were unable to read a number of papers and could not always follow the short (20 minute) presentations. These difficulties were aggravated by the fact that there were some highly abstract, methodological papers, the authors of which addressed themselves to their Western fellow economists and did not attempt to communicate to the Chinese participants, for whom the concepts used and the methods applied were unfamiliar. The discussion of these papers was also largely an "in-group" affair. The Chinese economists, however, vigorously participated in the discussions of the papers on issues, such as rural development and trade policy, which were of interest to them.

Contributions by Chinese Participants

4. The Chinese papers were largely historical and descriptive in character. They were written for a Western audience and sidestepped some of the controversial issues. With a few exceptions, the papers also showed a limited understanding of the actual practice of planning and the implications of the modifications under discussion. This fact reflects the comparative isolation of academic economists in China from government decision-making.
5. I learned more from private conversations with Chinese participants than from the papers and the formal discussions at the Conference. Conversations with Dr. Liu Suinian, the Deputy Director of the Institute of Economics of the State Planning Commission, the only nonacademic participant at the Conference, were especially useful. I further benefited from discussions with Dong Fureng, Deputy Director of the

Institute of Economics and of the Chinese Academy of Sciences and Teng Weizao, Vice President of Nankai University, who appeared to be the most knowledgeable about the practice of planning in China among the academic participants. Dong showed considerable comprehension of the experience and the practical problems with decentralization in Hungary and Yugoslavia; Teng displayed a good understanding of the import substitution-export promotion controversy and its implications for China.

6. Also, of greater interest than the papers presented at the Conference were the translations of articles written for Chinese consumption. These articles give an indication of the ongoing controversy that was also referred to in private discussions. The article by Liang Wensen and Tien Jianghai, "Relations between Readjusting, Restructuring Discussed," gives priority to the former, involving centralized decision-making, over the latter, entailing the decentralization of decision making. In turn, the enclosed article by Liu Suinian, "Tentative Schemes for Economic Restructuring Evaluated," takes a position in favor of the restructuring of the system of economic management.

7. After describing the principal problems of the existing economic management system, Liu describes three tentative schemes for restructuring this system. The first reaffirms the central role of planning and would involve only a limited degree of decentralization of decision-making; the second would entail decentralizing the management of the economy to provincial, municipal, and regional authorities; and the third would rely to a considerable extent on self-management of the enterprise. After a discussion of the relative merits of these schemes, Liu comes out strongly in favor of the third one. At the same time, in private conversation, he indicated to me that there is considerable opposition to this alternative on the part of unnamed "higher-ups."

8. The discussion of the relationship between planned regulations and market regulation in Liu's paper is of particular interest. The article emphasizes the need for the use of indirect methods, such as taxation and the financial system, in the place of the direct methods of command planning. It does not consider, however, the requirements of decentralized decision-making and, in particular, the establishment of a rational system of prices.

9. This comment also applies to Chinese literature I am familiar with. While attention has been given to the need for profit incentives, such incentives will not appropriately serve the interests of the national economy in the absence of rational pricing. In private conversations, however, Liu and others I spoke with readily admitted that pricing is the crucial issue in the decentralization of economic management. The following discussion draws on the discussions I had with them on the issue of pricing.

Establishing a Rational Price System

11. Some steps toward a more rational system of prices are being contemplated, including the imposition of interest charges on working capital and of amortization and interest payments on fixed capital. A further issue is the relevance for China of world market prices, which increasingly provide the basis for the system of producer prices in Hungary.

12. In view of the differences between the two countries as regards size and the extent of separation from world markets, one cannot recommend that China follow Hungary in adopting world market price relationships. However, the current separation of producer prices received by exporters from the f.o.b. price actually paid for exports does not provide an inducement to the firm to obtain high prices abroad, and the introduction of profit incentives would promote specialization according to domestic rather than international prices.

13. This problem may be dealt with by equating producer prices to export prices. At the same time, imported inputs used in export production should be valued at the price actually paid, lest unrealistically low import prices induce firms to export overly import-intensive commodities. The described procedure may also be applied to the domestic suppliers of exporting firms whose cost is affected by the pricing of imported inputs. Finally, efficiency would be served if the imports of machinery and intermediate products were sold at world market prices.

14. The implementation of the described scheme would necessitate adopting a realistic exchange rate in the place of the present rate that is apparently to a considerable extent overvalued. Should a devaluation encounter political difficulties, an export subsidy-import tariff scheme could be applied. Apart from providing appropriate incentives to exporters, one would end thereby the present underpricing of imported machinery and intermediate products, which may have contributed to excess demand for imports on the part of Chinese firms.

15. The described scheme could be implemented over time, with additional subsidies granted to high-cost exports during a transitional period. In emphasizing the transitional nature of these measures, the scheme would make exporters sensitive to foreign prices and thereby contribute to the objective of minimizing the domestic cost of earning foreign exchange. (Calculations of the domestic cost of foreign exchange could be usefully made even prior to the introduction of the use of world market prices as it had been done in Hungary prior to the 1978 reform.)

15. World market prices may not be used in the case of commodities produced for domestic markets, however. Apart from the difficulties involved in ascertaining the relevant world market prices in the presence of differences in quality, specifications and other product characteristics, it could not be assured that domestic demand and supply be equated at these prices. Under the conditions existing in China, a more appropriate solution would be to establish prices that equate demand and supply domestically, so as to avoid shortages and surpluses in individual commodities. With the establishment of market relationships among firms, these prices would tend to reflect scarcity relationships in the Chinese economy.

16. At the same time, as Helen Hughes suggested, in evaluating new investments undertaken centrally it would be desirable also to make calculations at world market prices, so as to provide an indication of the efficiency of exporting and of import substituting activities. This procedure may be extended to investment firms that obtain funds from the government or from banks for new investment.

17. In the further development of the described scheme, one would need to examine issues relating to the role of central decision-making and of market relations in setting producer prices; the relationship between producer and consumer prices; as well as the modalities of the practical application of the scheme. This would, however, require more detailed knowledge of the economic situation in China and of the constraints under which decisions are made.

cc: Messrs. Husain, AENVP; Kirmani, AEP; Jaycox, AEA; Koch-Weser, AEP;
Hasan, AENVP; Hawkins, AEA; Bussink, AEA; Lim, AEA; Keesing, DED; Wood, A
DPS Directors, DRC Senior Staff, Westphal, DED; Robinson DED

Enclosures
BBalassa:nc

CABLE

APRIL 3, 1981
61991

MR. SUK TAI SUH, KDIPROJECT

SEOUL, KOREA

1. WAS HAPPY TO HEAR OF YOUR OBTAINING GOOD RESULTS WITH NEW EXPORT INCENTIVE VARIABLE EXCLUDING INDIRECT TAX. SUGGEST THAT YOU CONTINUE USING THIS MEASURE. 2. PLEASE SEND WAGE DATA FOR THE FOURTH QUARTER OF 1980 BY RETURN TELEGRAM. 3. UNIT LABOR COST INDEX FOR THIRD QUARTER OF 1980 SEEMS TO BE IN ERROR. WE OBTAIN 209.9. REGARDS, BALASSA

Bela Balassa

Bela Balassa

DRC - Director's Office

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APRIL 3, 1981

61991

MS. MOON, PERGAPRESS

OXFORD, ENGLAND

TOO LATE TO WRITE THREATENING LETTER AT THIS TIME AS ALTERNATIVE PUBLISHER COULD NOT BE FOUND. REGARDS, BALASSA

BELA BALASSA

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BRC - Director's Office

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CABLE
~~781-24838~~

APRIL 3, 1981
61991

MS. OGAWA, INTBAFRAD

WORLD BANK TOKYO OFFICE, TOKYO, JAPAN

APRIL 20 DATE IS FINE. LOOKING FORWARD TO SEEING YOU. REGARDS

BALASSA

Bela Balassa

Bela Balassa

DRC - Director's Office

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WBG ARCHIVES

April 3, 1981

Mr. Albert Wohlstetter
2805 Woodstock Road
Los Angeles, California 90046

Dear Dr. Wohlstetter:

Thank you for your letter of March 11th. I saw Professor Celasun in January and he gave me a copy of his paper. I enclose, on a personal basis, a back-to-office report I wrote following my return from Turkey. I will be leading a large World Bank mission there in May.

With best regards,

Sincerely yours,

Enclosure

Bela Balassa

Recent Economic Developments in Turkey

Bela Balassa

The 1980 Policy Reforms

1. The policy reforms instituted in the course of 1980 aimed at increasing the role of prices and markets, and the extent of outward orientation in the Turkish economy. The principal measures introduced in January 1980 to pursue these objectives were the relaxation of controls on the prices of most commodities produced by the state economic enterprises (SEEs), a large devaluation, accompanied by increased export incentives and simplification in import regulations, and the liberalization of foreign investments. In June 1980, the Central Bank rediscount rate was substantially raised and limitations on interest rates removed.
2. The relaxation of controls on SEE prices extended to most products, with the resulting price increases ranging from 45 percent for gasoline to 300 percent for paper and 400 percent for fertilizer. Apart from reducing price distortions among goods sold domestically, increases in these prices sharply reduced the deficit of the SEEs which, being financed from the government budget, had importantly contributed to monetary expansion.
3. On January 25th, the exchange rate was devalued from TL47 to TL70 to the U.S. dollar, thereby increasing the profitability of exports and import substitution. On the export side, the devaluation was complemented by credit preferences, customs duty exemptions on imported inputs, and the automatic provision of licenses for the importation of inputs used directly or indirectly in export production. On the import side, the principal change was the streamlining of the operation of the import regime that involved greatly reducing the waiting time for licenses, and for foreign exchange allocations once the licenses had been granted.
4. The simplification of the administration of export and import regimes has brought benefits by lowering the cost of doing business with the government, and that of doing business in general, and by reinforcing the operation of the market mechanism. The simplification of procedures has been particularly important in the case of foreign investment, where all relevant measures have been consolidated in one department and the time needed for decisions has been reduced from several years to one month. Furthermore, some previously off-limit sectors, such as agriculture, mining, and banking, have been opened to foreign investment.
5. In June 1980, the rediscount rates of the Central Bank on short-term credits were raised from 14 percent to 26 percent and interest rates paid to savers, and charged to borrowers, were freed. While interest rates on two-year savings deposits increased from 20 percent to 33 percent and on short term credits from 21 percent to 32 percent, real interest rates continued to be negative as a result of a "gentlemen's agreement" among banks; it is only recently that there has been some competition among banks through added "sweeteners" to savers. Competition will increase further as a result of the establishment of three foreign banks in Turkey.

The Effects of the 1970 Reforms

6. For a variety of reasons, the effects of the reforms were slow in coming. To begin with, increases in prices were not accompanied by changes in the modus operandi of the state economic enterprises. Furthermore, the private sector had long been used to producing for domestic markets behind high protection and while the profitability of domestic sales declined with the recession, vigorous export expansion has required a change in attitude. Last but not least, until September 12 when the military assumed power, production was disrupted as a result of intensifying violence, declining labor discipline, and increases in strikes, with 7.7 million work-days lost in the first eight months of 1980 as compared to 1.1 million work-days in 1979.

7. These considerations largely explain that the dollar value of exports in the first eight months of 1980 was only 6 percent above that for the corresponding 1979 period. The situation changed in the following months, with 1980 exports exceeding the 1979 level by 21 percent in September, 33 percent in October, 53 percent in November, and 141 percent in December when exports surpassed \$0.5 billion, with the annual total approaching \$2.9 billion. The improvements have been even larger in manufactured exports that exceeded the corresponding 1979 figures by 54 percent in the September-November period as compared to 4 percent in January-August. While commodity details are not yet available for December, available information indicates that much of the expansion occurred in manufactured goods. Product groups with the largest increases include textiles, processed food, and chemicals, with the Middle East being an increasingly important market as Turkey has benefited from the Iran-Iraq war.

8. Foreign direct investment also picked up in the second half of 1980. For the year as a whole, the net inflow amounted to \$97 million, raising the cumulative total from \$228 million at the end of 1979 to \$325 million at the end of 1980. This result contrasts with yearly net inflows of -10 to +15 million dollars in the 1974-1979 period.

9. In response to the rise in interest rates, time deposits increased by 36 percent between July and November 1980, after rising by 7 percent between January and June. While some of this increase may be attributed to shifts among financial assets, the bulk is likely to represent genuine savings as strongly negative real interest rates had induced people to invest in consumer durables. The higher interest rates, then, have contributed to reductions in inflationary pressures.

10. Preliminary data show December to December increases of 80-90 percent in wholesale prices and 60-70 percent in the Istanbul cost-of-living, depending on whether use is made of the indices of the Istanbul Chamber of Commerce or the Ministry of Commerce. These results were much affected, however, by the rise in prices in February 1980, following the January devaluation and increases in SEE prices, that exceeded 20 percent on the wholesale, and 10 percent on the retail, level. Notwithstanding a temporary acceleration in October 1980 after the military announced a 70 percent wage increase in cases when agreements in collective contracts had not been reached, price increases in the February-December 1980 period were little more than one-half of that in the corresponding period in 1979. And, if recent trends continued, February

to February increases in wholesale as well as in consumer prices would be in the 45-50 percent range.

11. Furthermore, according to some sources, wage increases will be limited to 50 percent for the year 1981. This figure would be rationalized on the basis of an officially postulated 40 percent price increase in 1981 and of reductions in the tax burden of employees under the new tax legislation. General Evren is reported to have said that the tax burden on employees would decline from 60-65 percent to 40 percent, with further decreases to 30-35 percent planned. While these figures do not allow for increases in indirect taxes, according to newspaper reports "referring to amendment on income tax, General Evren said that a great difference will appear between the collective bargaining agreement of last year and of this year, due to advantage brought in favor of employees" (speech of January 15, 1981). At the same time, one may assume that the Supreme Arbitration Council, which has the final say in wage bargaining, will carry out the government's wishes.

12. There are several disquieting signs, however. Some price increases have apparently been postponed from last year; restaurant prices, for example, were raised by 25-30 percent in January 1981 after a freeze lasting for several months. Increases in some SEE prices have been postponed, too. This, in turn, has contributed to the rise in the budget deficit, leading to the acceleration of the growth of the money supply that was held back in the first half of 1980, when SEE prices were fully adjusted. Thus, after increases of 21 percent in the first, and 24 percent in the second, half of 1979, increases were 15 percent and, according to preliminary figures, 30 percent in the corresponding periods of 1980.

The January 1981 Reforms

13. The January 1981 reforms carry further the liberalization process begun a year earlier. The principal measures include the liberalization of the import regime, export incentives, the reform of the tax system, and SEE reform. These will be taken up in the following, with consideration given to possible future changes.

14. The liberalization of the import regime described in the memorandum on "Study on Restructuring the Existing Protection and Incentive System in Turkey," represents a first step towards the reform of the system of protection and incentives in Turkey. Such a reform should concentrate on reducing import protection, lest exports be again neglected as improvements in business conditions lead to higher profitability of domestic sales that continue to be highly protected. One may envisage the elimination of import licensing and reductions in tariffs, to be carried out over a period of several years, that may be made a condition of a SAL III.

15. Incentives to exports have been increased by raising the share of export loans in lending by commercial banks, reducing interest rates on export-oriented investments, and granting tax benefits to exporters. It would further be desirable to provide pre-export credits in full rather than in instalments, irrespective of the amount involved, to complement export credits by an export guarantee scheme, to provide letters of guarantee for Turkish construction firms abroad, and to establish an export development bank.

16. The reform of the tax system includes reducing the punitively high marginal income tax rates, increasing the taxation of farmers and other self-employed, and instituting a value added tax at uniform rates in the place of the production taxes that show considerable variations in rates. These changes will improve the efficiency and the bouyancy of the tax system. Further changes would be necessary in order to encourage the expansion of agricultural production and to ensure that increases in tax revenues match the rise in government expenditures.

17. Increases in SEE prices would further reduce the budget deficit. While increases in these prices have a short-term inflationary effect, the budget deficit financed from money creation has a larger impact on inflation through the operation of the money multiplier while borrowing in financial markets syphons off funds from private investment. The availability of funds for private investment is also affected by decisions on SEE investments that are discussed in the back-to-office report of Messrs. Sadove and Roy, dated January 9, 1981.

18. Questions of SEE pricing and investments lead to the issue of SEE reform. The reform proposals under review by the Council of Ministers envisage increasing the independence of the SEEs through the choice of their management by a Board of Directors, in which independent directors, drawn from the ranks of experts, professors, etc., would be in a majority. While these changes would represent a considerable improvement over the present situation, the proposed structure would be rather heavy; SEE firms in the manufacturing sector would be supervised by the Boards of eleven trusts, organized along industrial lines, which would in turn be supervised by a super-Board, established for all manufacturing industries in a newly-constituted ministry, that would appoint managers on the recommendations of the Board of Directors of the particular trust. Apart from simplifying the proposed organizational set-up, it would be desirable to ensure that firms within a trust will compete with each other and that firm managers have the freedom to set prices and to vary the size of their labor force, which would not be the case under the proposal. Finally, one may raise the possibility that some inefficient SEEs be closed down or sold to private interests.

BBalassa:nc

April 3, 1981

Professor Reghinos D. Theocharis
Center of Planning and Economic Research
22, Hippokratous Street
Athens 144
Greece

Dear Professor Theocharis:

Thank you for your letter of March 3rd. I was waiting for a response from the administration before replying. I am sorry to say that the reply was negative. I understand that this would make it difficult for you to provide an additional fee to Mr. Panourgias.

With best regards,

Sincerely yours,

A handwritten signature in dark ink, appearing to be 'Bela Balassa', written in a cursive style. The signature is positioned above the typed name.

Bela Balassa

cc: Mr. Voloudakis

CABLE

APRIL 2, 1981
61991

MR. EDUARDO CONESA, DIRECTOR, INTER-AMERICAN DEVELOPMENT BANK
CASILLA DE CORREO 39, SUCURSAL 1, 1401 BUENOS AIRES, ARGENTINA

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APRIL 2, 1981
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MR. MEHMET GUN CALIKA, NISAN SECURITIES BROKERAGE, ODAKULE IS
MERKEZI ISTIKLAL CADDESI, 286 BEYOGLU, ISTANBUL, TURKEY

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