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IMPORT LIBERALIZATION AND GROWTH:
The Second Post-War Restructuring

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Among the most pervasive of post-World War II phenomena has been the attempt of the less developed countries (LDC's) to try to achieve economic independence to supplement political independence. While it is, of course, difficult to generalize about the precise nature of this phenomenon, two features seem to recur: one, the typical LDC, even if not newly independent, has been subject to a set of "colonial" economic relationships as far as her previous foreign contacts are concerned; and second, the main instrument for development in the post-war has been the attempt by LDC governments to achieve a fundamental restructuring of these relationships. In short, in place of the nineteenth century colonial package of private capital, trade, know-how, and assured markets, orchestrated largely by commercial interests abroad, LDC governments have now interposed themselves and exercise their judgment on how aid, trade and technical assistance are best organized and harnessed for national growth and economic independence. But this effort has followed two very distinct patterns. Immediately after the War and in the first flush of independence LDC governments attempted to restructure the colonial pattern by taking direct action in a number of markets and across a wide area of public and private activities.

More recently, however, we have been witnessing what might be called an agonizing reappraisal among LDC governments as to the effectiveness of the instruments brought to bear. This has led to the attempt at a second restructuring, in which the basic objectives of government remain the same but the means of achieving them are undergoing substantial change.

The main purpose of this paper is to attempt a fuller understanding of this two-phased restructuring effort by LDC governments. We proceed by first, in Section I, delineating very briefly the nature of the colonial heritage. Secondly, in Section II, the immediate post-war effort by LDC governments is described and evaluated. Section III analyzes the general outlines of the change in attitudes--and actions--which has taken place over the past five to seven years--especially in the foreign trade sector. Section IV cites some particular country cases in evidence; and Section V tries to draw some general conclusions from the evidence presented.

I

The "typical" LDC structure inherited from the pre-war period consists of three domestic production sectors: a subsistence agricultural sector devoted mainly to food production, a smaller but often vigorously growing agricultural export sector producing minerals or cash crops for the foreign market, and a trading cum services sector providing the financial institutions and overheads to make the export sector expansion possible and to serve the needs of both the export-oriented entrepreneur and the landed aristocracy. The export sector utilizes the reservoir of cheap labor back in agriculture to exploit specific climate or geology-based raw materials in the form of fiber, tropical foods, or minerals. Inputs into this sector include food produced in the agricultural hinterland and services produced by the commercialized trade cum services sector. The output of this sector flows entirely abroad as part of what has been called the colonial pattern: i.e., the traditional exports which flow abroad are requited by simple consumer goods for the workers being pulled out of the agricultural subsistence sector and into the services and export sectors. The profits from this trading pattern, to the extent they are not repatriated, and as augmented by net capital flows, provide for the importation of capital goods which are reinvested in the agricultural export sector or in the overheads and services which support that sector. Increasingly, the role of the foreigner expands from that of trader to that of entrepreneur, servicing or actually taking over the direction of activity in the export sector. The service sector no longer ministers to the feudal needs of the nobility or the Church but meets the demands of the export sector for the services of banking, shipping, insurance, warehousing, etc. At a later stage this sector will also turn to the construction of trade-related social overhead capital (electric power, transportation, housing, etc.). The main involvement of the large and virtually stagnant agricultural hinterland in all this is to provide labor and food to the agricultural export sector and in return to receive incentive consumer goods (e.g., cloth, kerosene, radios) directly from abroad. As long as there is anticipation of continuing profitable export opportunities profits are likely to be reinvested in the service and/or export sector. To the extent prospects are less bright, profits may be repatriated, but in any case little domestic investment is undertaken which does not bear directly or indirectly on the profitability of the traditional export activity. While in this fashion the enclave export sector continues to grow in response to the foreign market, the domestic economy experiences little structural change. There is little tendency for the generation of a domestically oriented industrial sector, little tendency to stimulate major increases in productivity in the domestically-oriented agricultural sector and hence little opportunity for growth of these two sectors in a mutually reinforcing fashion.

II

Given these initial conditions, it was clear that post-World War II LDC governments would try to put their fingers on the critical flows in the colonial resource flow pattern in order to insure that the proceeds of the traditional agricultural export sales abroad are not automatically reinvested for the exclusive benefit of that sector and that the domestic industrial sector is given a new order of importance. With little relevant theory to fall back upon and with no possibility at all of calling a moratorium on the difficult policy choices that clearly had to be made, most less developed country governments responded to the common problem in somewhat similar ways. They saw the issue basically through (early) Prebish eyes, i.e., with a mixture of concern about unfavorable foreign demand conditions for traditional exports and a firm belief in the dynamic learning processes associated with the growth of a domestically oriented import substituting modern industrial structure.

As a consequence they sought ways and means for the government to intervene to restructure the flow of resources in behalf of "long-term" national development needs and away from the "short-term" private profit seekers, at home and abroad, associated with the colonial pattern. This meant first of all, assessing, as best they could, total resource availabilities that could be counted on, from inside as well as outside,--now in the form of government to government aid rather than private commercial investment--and, secondly, deploying these as effectively as possible in pursuit of some overall set of objectives, e.g., a politically determined minimum growth rate. In this process every LDC government essentially has to face up to the same problem, i.e., how to most effectively organize the human and natural resources, actual and potential, of the particular geographic entity under its control for purposes of growth. In virtually all cases this led to a more or less conscious and more or less formal attempt to plan for economic development, ranging on the one extreme from the simple adding up of ministerial investment budgets to fairly sophisticated 5 year plans complete with notions of what the private sector should be asked, induced, or coerced to do.

All such efforts, moreover, clearly bear the consensus that the government can and should provide social and economic overheads, guarantee a minimum of law and order, and establish all the other major basic preconditions of development; but there is much less consensus on either the ideal division of labor between the public and the private sectors or on how to organize the private sector, i.e., whether to induce it or order it to take certain actions considered socially desirable. Clearly many LDC governments have strong ideological convictions as to which industries must be in the public sector and there is a wide area of choice on how to try to affect the actions of what is left in private hands. There, in fact, exists a virtually continuous spectrum along which the typical less developed mixed economy can try to find a comfortable resting place. Neither the laissez-faire prescription of the textbooks, on one extreme, nor government ownership of all the means of production, on the other, has proven very relevant in terms of the vast majority of the countries we are concerned with. But there do exist very real choices as between the use of direct and indirect controls; between tariffs and quantitative restrictions; between the direct allocation of credit in the presence of very low interest rates, and its allocation as a consequence of the interactions in the market for credit; between, in short, the position of having government policy working through the market and government policy trying to displace the market.

Most LDC's faced with that choice in the post-war opted for a considerable measure of government ownership and/or substantial direct controls over the private sector. There is no one simple explanation for this phenomenon, but a number of factors can be cited. First of all, there does exist a clear interaction between the nature of the proposed colonial restructuring job and the tools considered appropriate for the purpose. Starting from the already described pattern of resource flows, the intent, broadly speaking was to redirect the proceeds of the traditional exports,--plus any foreign capital inflows--into industry and the overheads supporting that industry. The tools used were exchange controls to siphon off export earnings via the compulsory surrender of foreign exchange and to allocate import licenses to the socially desirable projects in industry. With government budgets typically in deficit and inflationary pressures building up, increasingly overvalued exchange rates served to subsidize importers and those who were operating the new industrial structure, and to penalize agriculture and exporters.

Basic to this twin decision on objectives and instruments was the feeling that development could now somehow be "ordered" by the same patriots who had previously succeeded in achieving political change. Related to this was the fundamental distrust of the competitive system already referred to which continues to pervade many of the newly independent countries of Asia, Africa and Latin America. All private initiative and profit maximization are distrusted because they are somehow associated with the workings of colonialism which stood to benefit mainly the export enclave and the mother country. Even less developed countries which do not profess to be socialist in orientation are nationalist and therefore provide strong support for any even half way intelligent autarkic policy. Moreover, there is the normal identification of industrialization with development. While it is clear that successful growth ultimately means industrialization--in terms of the well known pressures of demand as well as in terms of an economy's improving skill base--the fact that the causation does not necessarily run from industrialization to successful development was largely ignored.. The basic fact that an economy saddled with a large and preponderant agricultural hinterland must somehow devise ways and means of enlisting its support as a fuelling device for the industrialization effort was overlooked. Once there was a commitment to controls, coupled with the realization of the difficulty of making decisions relating to large numbers of widely dispersed decision-makers in industry or agriculture, the logical conclusion was "to do what was feasible", i.e., to allocate resources to the public sector and the large scale private sector and to down-grade would-be claimants outside of this rather narrow circle. Also playing a role was the normal lack of civil service sympathy for and understanding of the traditional agricultural sector where household and productive units are merged, coupled with the overall feeling that anything small-scale, labor intensive or indigenous rightly belongs to the past, and that it is the task of those who build for the future to concentrate on the latest, the most modern and the most imitative of western technique and output mixes.

As a consequence of all this much of the expansion in output took place in the large-scale industrial sector in accordance with an import substitution policy in some order of technological complexity--although even here daring jumps to fairly sophisticated production functions were often attempted at an early stage. Rapid rates of industrialization can, of course, be achieved,--and were--but they are likely to be purchased at a high price:

(1) As we have already noted, the system discriminates against traditional exports, since a local producer can acquire more local currency by saving a dollar of imports than by earning a dollar of exports. At the same time little incentive exists for the development of new export industries.

(2) There results a non-optimal composition of imports for any given level of total imports, since imports are allocated on the basis of bureaucratic decisions rather than by the marketplace.

(3) The licensing of imports, moreover, tends to lead to excess capacity in the economy. While excess capacity is not a logical concomitant, it is in fact ubiquitous because a firm's license for imported raw materials is usually linked to its "rated" capacity, which is usually conservatively defined. A firm does not, therefore, have the option of expanding output by running a second shift; it must expand its plant.

Normally, bursts of industrial expansion are followed by an inability to provide the necessary raw materials and spare parts, leading to substantial idleness of scarce capital and an ever more highly inefficient production structure.

(4) Import licensing leads to large inventories. While licensing gives the government more assurance than does the marketplace in controlling the level of total imports, individual firms have less certainty about acquiring the amount of imports necessary to achieve the most profitable output level, since profitability is not given much consideration in the allocation of licenses.

(5) The control system absorbs the time of a large group of talented people, both those in the government who administer it and those in the private sector who respond to it.

(6) Import licensing may lead to excessively capital-intensive methods of production for those firms lucky enough to get import licenses (this is in addition to the capital intensity resulting from the pressures on firms to expand their plants rather than run extra shifts). This undervaluation of imports is coupled with the practice of aid donor to emphasize the import component of capital projects and the preferential tariff treatment of capital goods.

(7) It is difficult to establish new firms, since a potential producer has no historical output as a basis for receiving licenses. On the other hand, giving a new firm assured import licenses is a good way for the government to insure its financial success.

(8) Small firms are discriminated against, since they cannot compete with large firms in keeping full-time personnel in the capital to watch and influence the allocation of import licenses.

(9) Agriculture is usually neglected both in terms of the direct attention paid to it but, more importantly, in terms of the incentives provided by the price structure. Ultimately this sector instead of being a major propelling device turns out to be a major drag on the economy, since it often becomes incapable of even keeping up with population increases, not to speak of freeing workers for industrial growth without running into food shortages and prematurely rising wages. As the terms of trade turn against industry, imports of food become necessary even in areas which had traditionally been food exporting.

(10) The development process is mainly fuelled by the reinvestment of industrial profits supplemented by foreign aid. To the extent that any savings are squeezed out of agriculture they are transferred to the large-scale importer and industrialist enjoying substantial growth under hot-house conditions.

(11) Finally, to round out this description of the normal landscape, 5 to 10 years after the big push for industrialization has gotten under way, you normally encounter a continuing employment lag, i.e., output elasticities of industrial employment of around .3, i.e., high labor productivity on a very small base abetted by an artificially high propensity to import capital-intensive technology and the neglect of indigenous labor using technology, resulting from the control structure.

It is difficult to come up with a quantitative measure of the costs associated with this system. There exists, however, scattered indirect evidence on this point. Based on a sample of ten industries, Anne Krueger estimated that import-substitution industries in Turkey used 20-75 lira to save a dollar of imports and export industries 8-14 lira to earn a dollar.[1] In a study of Chile's automobile industry, Johnson estimated that about 12 escudos were needed to save a dollar of imports at a time when the official exchange rate was 3 escudos per dollar.[2] Lewis estimated that Pakistani manufactures (which are mainly import-substitutes) received about 40 percent more rupees per dollar than agricultural goods (which are mainly exports) in the early 60's.[3]

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[1] Anne O. Krueger, "Some Economic Costs of Exchange Control: The Turkish Case", JPE (October 1966), Table 3, column 5.

[2] Leland J. Johnson, "Problems of Import Substitution: The Chilean Automobile Industry", Economic Development and Cultural Change (January 1967), p. 209.

[3] Stephen R. Lewis, Jr., "Effects of Trade Policy on Domestic Relative Prices: Pakistan, 1951-1965", AER (March 1968), Table I.

Clearly such a system soon begins to have its own life and becomes increasingly difficult to abandon. On the one hand, the industrial importing interests become more and more entrenched and used to making large windfall profits. Secondly, not only does the civil service have absolute power under such a disequilibrium system, but it is able to substantially supplement its income as sub rosa payments are required to grease the wheels of progress. Thirdly, the emotional residue of the rejection of the private enterprise-commercial-colonial package continues in most cases to have a stranglehold on the country, and any government will continue to have to be very careful to avoid the accusation that it is about to "give away" the country's resources once again. There also remain the generalized Prebish-type fears that participation in the world economy is bound to work to the disadvantage of the individual LDC and that it therefore must protect itself via unusual methods of insulation and autarky.

Finally, there exist honest concerns about the dissipation of resources if the control system were ever to be dismantled. Once controls have been instituted and new ones added on top of old ones it becomes increasingly difficult for governments--even those with the best intentions--to know just what would happen if parts of the structure are dismantled. There then appear real fears of the deluge, with respect to both foreign and domestic resources, once the gates are opened to the pressures of the market place. Even though efficiency may not be at its highest, there is a very strong belief that only as long as there are direct controls can the government in effect be sure it knows the claims on its foreign exchange and budgetary resources and can deal with them effectively.

In short, arguments for a reversal of the policies of the immediate post-war need to be strong enough to overcome substantial resistance. Such a reversal does not, in fact, have a chance unless and until the government concerned and those aiding it from abroad--become completely aware of the high cost--in terms of growth foregone--of present policies.

Such an awareness has made important strides in the less developed world during the past half a dozen years or so. Policy makers have been forced to note that per capita income growth in the LDC's as a whole declined from a rate of 2.5 per cent during 1950-55 to 1.8 per cent in 1955-60, while exports declined from a 4.2 per cent to a 2.9 per cent annual rate. They have been forced to conclude that the dynamic changes expected from a forced draft industrialization program remained on the horizon while agriculture languished and unemployment and underemployment mounted. Increasingly therefore, two views are now being heard: one, that the "cheap" import substitution possibilities have now been exhausted and that the LDC must turn to export promotion instead; and second, that the problem of substantially increasing agricultural output must be faced directly and soon. In other words, the conventional wisdom about the mainsprings of growth is undergoing gradual amendment, and it is recognized that policies must be altered accordingly.

More specifically, the realization has gradually taken hold that the first restructuring strategy was substantially in error and, in fact, seriously impaired LDC performance, precisely because it failed to set as its goal the mobilization of the whole LDC economy. The government must still try to tap the colonial flows and reorient them; but there are alternative ways of doing so, namely by involving the usually preponderant agricultural hinterland and encouraging its mutual interaction and "connectedness" with a more decentralized and rural-oriented industrial sector. Facilitating access to resources for medium and small-scale industrial entrepreneurs provides not only a chance for more efficient production for the domestic market but additional major flexibility for the exploration of new export markets.

In short, there is a growing appreciation that the controlled economy syndrome of overvalued exchange rates, import controls and a highly differentiated credit market, all geared to favoring public as well as large-scale private, import-substituting industries, has tended to lose for the LDC the chance to harness most of its economic agents to the development effort. If the scarce energies of officialdom can be freed from patching up an ever more cumbersome and complicated control system and the undoubtedly even more precious private energies from the game of avoiding or evading these same controls, the most vicious of the LDC vicious cycles, that of the self-fulfilling prophecy of the "absent entrepreneur" forcing an active government to do ever more, can be avoided. This means that while government must remain at center stage, the large supporting cast which is necessary, can no longer be neglected. The first restructuring effort has been substantially in error precisely because it failed to set as its goal the mobilization of the entire economy.

Perhaps the most remarkable change in the less developed world since World War II has been a growing realization of these facts and subsequent attempts to rethink the method by which governments can better induce socially desirable actions by the private sector. The "industrialization first" strategy has been shown to be costly and inefficient; starving the peasant and the industrial entrepreneur has led to starving the growth of the economy as a whole. While the restructuring of the colonial pattern remains a major objective, more and more attention is now being paid not only to the improved allocation of the imported resources purchased with traditional exports--and supplemented by foreign aid--but also to these qualitative aspects involving the incentives and energies of the economy's decision-makers, public and private.

Clearly most LDC's cannot afford a sufficiently large development effort to be willing or able to disregard a low quality of effort. This sets them off from the Soviets who, incidentally, are also beginning to feel the need to trade quantity for quality. The growing realization that successful development may require a different kind of restructuring usually comes down to a switch in policies by which the government tries to affect private sector actions. If agriculture and medium and small-scale industry are to be mobilized this cannot be done effectively either via direct government ownership or direct controls over resource allocation--if for no other reason than the sheer physical impossibility of reaching the millions of actors concerned. As a consequence, mobilization via policies which work increasingly through the market are gradually coming into vogue. This means that the catalytic role of government rather than the direct resources augmentation and reallocation role of government--as well as that of its foreign assistance supplement--must come into the spotlight.

That is perhaps the single most important lesson we have learned. While all societies share the problem of organizing themselves effectively to marshall the resources under their sway for commonly agreed on purposes, the less developed countries, in particular, need to broaden the base on which productive and innovative activities are carried on; this requires an opening up of their systems to a larger volume of decision-making by hitherto neglected or economically disenfranchised segments of the population. Methods somehow have to be found to spread domestic and foreign capital more broadly among decision-making units. Such a strategy has to be based in the first instance on an understanding of how a given system performs ideally and, secondly on what policy changes in each sector--and in terms of the interaction among sectors--are required to achieve a better approximation to that ideal.

This paper intends to analyze in somewhat greater detail this second post-World War II restructuring effort, especially with respect to the foreign trade sector. It is well recognized that any liberalization or opening up of the whole economy to broader participation through the market mechanism requires policy changes in a number of linked and inter-related sectors.

The market for credit, for example, is closely linked, i.e., complementary to the foreign exchange market. However, while we clearly should not be doctrinaire about which particular sector is likely to be "the" bottleneck sector in impeding progress, the foreign trade sector is inevitably high on the priority list, partly because foreign trade often plays a substantial role (up to 25% of gross domestic product) and partly, and more importantly, because even in the large domestically oriented economies, such as India, trade may provide a very important element of residual flexibility for a very tightly constrained economic system. Moreover, it can be said with some assurance, that the distortions brought about by misdirected, if well intentioned, government control policies, are usually most flagrant here and make a major contribution to the typical landscape described above. It is, in any case, an empirical fact that real world liberalization efforts in the LDC's have customarily been approached sequentially, sector by sector, with foreign trade--the sector which usually "pinches" the most--invariably receiving early attention.

While the realization that a second restructuring is required to improve performance must be reached by LDC governments themselves, foreign aid can and does help. If aid donors and at least certain segments of an aid recipient's bureaucracy are in agreement on the substance of the argument, e.g., that a more broadly based participation in development is necessary, and specifically, that liberalization of the foreign trade sector would be a substantial move in that direction, the basis for the required second restructuring can more easily be laid. The ability to persuade the rest of the decision-making machinery--on both sides--to make those changes may then prove the difference. Just as clearly, imposing a condition on aid without such full prior understanding and agreement on what needs to be done to serve the recipient's own development interests is not only precarious but almost sure to fail.

There are, of course, those who say that even such persuasion verges on intervention in the recipient country's internal affairs. But unwillingness to intervene in behalf of policy changes which are mutually agreed on as desirable at the technical level constitutes intervention on behalf of the status quo. It is not in the interest of the taxpayers of either the donor or the recipient country to continue to finance a development program whose effectiveness is so circumscribed that its ultimate success is seriously in doubt.

Foreign aid can play three distinct, if related, roles in this context. In the first instance, a certain volume of aid is often required in the political sense to permit a free and open discussion of changes in LDC government policies, for example, in the foreign trade sector. Without such an earnest of one's intentions to participate in the financing of the overall development program, it is difficult to raise questions with the recipient on matters of overall government policy. A second use of aid may be in the context of a more specific technical assistance or capital project. For example, an economic advisory team to help determine the precise nature of the policy changes required, or the creation of such financial intermediaries as development banks, represent examples of the bringing to bear of resources to address specific bottlenecks on a sector-by-sector basis, as necessary to implement any agreed-on restructuring strategy.

In the third instance, aid can serve a very important role in putting to rest, or at least allaying, the fears of those who worry about the resource dissipation which might result from a liberalization package. Clearly, the volume of resources required for this third purpose doesn't really have to be additive to the aid needed to get a seat at the discussion table; but the purposes are somewhat different, i.e., to provide the assurance that if there are shortfalls to tariff revenue or if foreign exchange reserves are threatened by liberalization, additional aid will be available to serve as a shock absorber. These fears may, in fact, be largely psychological since, in the textbook sense, the adoption of any particular policy package, say a shift from quantitative restrictions to tariffs, does not have to imply a larger volume of imports; nor does any particular change in structure have to imply a lower tax take. But there clearly exist real problems of timing and adjustment and, perhaps even more importantly, of reassurance for those who are taking the political risks inherent in making such changes.

In this fashion less developed countries have increasingly come to the realization, partly on their own and partly with the help of foreign experts, that a change in policy towards their foreign trade sector is needed to improve the quality of their growth performance. The question of what particular kind of policy package makes sense in any particular country situation, to effect the necessary second restructuring still needs to be examined.

III

In recent years import liberalization has played an increasingly important role in the attempt to reverse the distortions of past import substitution policies and to reintroduce some (but not all) of the discarded classical competitive elements into the developing economy. Most often, this is linked with movement towards a more realistic exchange rate either via a *de jure* or a *de facto* devaluation and (possibly) additional effort towards direct export promotion. We will be concerned here mainly with the import liberalization phenomenon--though we recognize that the last word has by no means been said on the issue of devaluations proceeding from an initial disequilibrium position.[1]

One crucial issue which clearly needs to be addressed at an early stage is the relevant definition of import liberalization. It is quite clear from the sparse literature on the subject--mainly confined to government reports and foreign aid analyses--that there exists a good deal of confusion about the precise meaning of the term. Many less developed countries think of import liberalization as simply "more imports". Recognizing that excess capacity constitutes a waste of resources--as well as that more planned imports may simply imply more foreign assistance--import liberalization is often understood as more "liberal" import quota allocations of raw materials and spare parts to come closer to filling existing capacity. Clearly, *ceteris paribus*, any industry operating substantially below capacity is likely to be a very high cost industry; the enhanced ability to bring capacity up to more normal levels will reduce unit costs and permit more of the existing industrial structure to become an efficient contributor to the economy. It should be noted, however, that initial "wrong" decisions on industry product mixes and technology are not necessarily solved by more generous current import allocations. If import liberalization means nothing more than adding more wine to leaky bottles this may not be the most effective way of increasing the competitiveness and efficiency of the developing economy.

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[1] See C. P. Kindleberger, "Liberal Policies vs. Controls in the Foreign Trade of Developing Countries", AID Discussion Paper #14, Office of Program Coordination, AID, April, 1967, for a beginning.

A second definition of import liberalization goes beyond the mere notion of "more imports" by emphasizing the partial dismantling of import controls either via a broadening of quotas or even permitting all comers to compete for raw material and spare part requirements on an open general license (OGL) basis. In other words, beyond assuring established firms a larger volume of raw materials and spare parts they are given more flexibility as to what precisely to procure within broad categories. If new industries and unlicensed importers are permitted to participate, this has additional benefits in letting the more efficient industries within the existing industrial complex obtain bottleneck current import requirements, and thus introduces an important competitive pressure into the industrial hothouse. This means that among the (typically) several hundred licensed importers and among the existing large scale claimants to industrial licenses, market pressures begin to have an increasing "bite" and the incentives for enhancing efficiency begin to make themselves felt.

This is about as far as most of the developing countries would initially like to go. Even if there exists a certain conviction on the merits of competitive pressures, it seldom extends to countenancing any real threat to the existing industrial structure from new investors; thus it is only at the final stage that most are willing to permit a dismantling of controls with respect to capital imports, along with raw materials and spare parts. This, of course, means that we usually do not easily get the desirable access of potential new entrepreneurs who want to "build a better mousetrap". In some cases, this unwillingness to permit capital goods to be imported on a competitive basis, with all comers large or small, new or old, participating, reflects the civil service's usual notion that "liberalization is fine but we must be in a position to confine it to the 'priority' industries". In other words, lip service is paid to the notion of enhancing the scope of the market mechanism in allocating resources, while great care is taken to ensure that none of the existing industries is, in fact, hurt. There are many instances, as a consequence, in which the expansion of OGL and free lists is accompanied by a growing ban list to provide absolute protection for industries in which injury can be claimed as a consequence of the importation of a specific type of capital or consumer good.

In the next section we expect to analyze the experience in a number of specific aid recipient developing countries which have attempted some import liberalization. While there are many LDC's which have experienced devaluation there are still only a few even partly documented cases of full devaluation/liberalization packages. One reason for this is the difficulty of establishing whether and how much liberalization has, in fact, occurred. The usual way of ascertaining whether quantitative controls are being more or less restrictive is for the investigator to get the "feel" of the situation by talking to businessmen and officials, but this approach is not terribly objective. A theoretically preferable way is to measure the discrepancy between domestic market prices of importables and the c.i.f. plus tariff price; any discrepancy can be attributed to the check on imports imposed by the quantitative restrictions. This approach has the obvious difficulty of requiring reliable price data.

While it would clearly be helpful to have unambiguous criteria for measuring the success or failure of such restructuring efforts in different countries, the literature provides little help for assessing an LDC devaluation which is accompanied by "trade liberalization" and/or a large inflow of foreign capital. In theory such a devaluation might not lead to any increase in the general price level even in the short run for three reasons:

(1) the inflow of extra capital will permit a larger volume of imports thus offsetting the initial increase in price and (2) even if the volume of imports does not immediately increase, domestic prices need not rise if de-control of imports accompanies the devaluation because the increase in the c.i.f. prices of imports simply eliminates some of the importers' monopoly profits. (3) The economy will operate more efficiently and so produce more goods with a fixed volume of resources; with money supply and velocity constant, prices may fall.[1] Besides looking at price changes, another criterion might be the extent to which excess capacity is reduced. A third criterion is the extent to which exports rise. A fourth might be changes in the saving rate as fiscal charges replace quantitative controls on imports and incentives for small and medium scale private savings are affected. Kindleberger[2] has suggested three preconditions for a successful devaluation/liberalization package: (i) an elastic supply of foodstuffs, i.e., a good harvest, (ii) an elastic short-run supply of imported raw materials so that output--especially of export goods--can rapidly expand, and (iii) a political consensus that the policy package is a wise one. This last factor might be measured by the change in money wage rates following adoption of the package.

Even if most people agreed that a devaluation/liberalization would make a system economically better off at some distant point in the future than it would otherwise have been, it is, of course, also helpful to know how long the transition will take and what the immediate consequences will be.

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[1] E. Sohmen, "The Effect of Devaluation on the Price Level", QJE (May 1958), pp. 273-283.

[2] Kindleberger, op. cit.

The country cases examined were chosen with the hope of illuminating somewhat the preconditions for success, the measurement of success, and the nature of the normal transition to an improved situation.

IV

A. Pakistan

In Pakistan, imports account for about 12 per cent of GNP and exports for about 6 per cent. In 1959 the Government of Pakistan (GOP) began liberalizing its import system by allowing exporters (or somebody to whom they sold the export bonus voucher) to import an amount equal to a certain fraction of their non-traditional (cotton and jute) export earnings (depending on the type of export); the Export Bonus Voucher could be used to import any good on a specified bonus list. By 1963 imports under this scheme amounted to about 7 per cent of total private sector imports (which in turn constituted about 70 per cent of total imports). In mid-1960, an additional Open General License was introduced which allowed newcomers to import for the first time and a system of "repeat licensing" was instituted, with import licenses being automatically replenished upon proof of utilization of the initial quantities (otherwise importers had to wait until the next six-months' licensing period began in order to get additional imports). By the end of 1963 imports entering under the Open General License accounted for another 14 per cent of total private imports.[1] Thus, by 1963 about 15 per cent of total imports had been liberalized.

In January 1964 four major iron and steel items were placed on a so-called "free list" (i.e., completely unrestricted imports) and another 50 items were added in July, 1964. By the end of 1964 such free list items

[1]Philip Thomas, "Import Licensing and Import Liberalization in Pakistan, A Critical Evaluation" (mimeo, Dec. 1965), p. 78. The above description of Pakistan's licensing system draws heavily on Thomas' work.

accounted for 26 per cent of total imports and for the bulk of imported raw materials. As goods were placed on the free list, relevant tariffs and other fiscal charges were increased by an average of 13 per cent.

With more than 40 per cent of total imports liberalized in one way or another, and foreign assistance levels simultaneously increased by substantial amounts, the annual level of imports almost tripled between 1959 and 1964. As a consequence, the amount of single shift capacity in use (based on a survey of 65 plants) rose from 53 per cent in the second half of 1963 to 76 per cent in the second half of 1964 and to 82 per cent in the first quarter of 1965;[1] industrial production rose by 12 per cent (seasonally adjusted)[2] from the third quarter of 1963 to the first quarter of 1965.[3]

Perhaps the most notable example of the improved resource allocation attributable to the import liberalization that began in 1959 was the dramatic rise in private tubewell installations in West Pakistan. Although unforeseen in government plans, . 32,000 such tubewells had been installed by 1965. While necessary pumps are produced domestically, by relatively small engineering firms, they use imported pig iron, which was not obtainable in the absence of import liberalization. This liberalization coincided with the government's withdrawal after 1960 from massive intervention in the major food crop markets permitting prices to rise, and contenting itself with a buffer stock stabilization program. With minimum prices guaranteed to producer and price ceilings maintained via the infusion of P.L. 480 stocks into the market,

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[1] Based on an A.I.D. survey cited in paper by Walter P. Falcon and Stephen R. Lewis, Jr., "Economic Policy in Pakistan's Second Plan", (mimeo, Nov. 1966), p. 13.

[2] All seasonal adjustments in this paper were done by A.I.D. in the summer of 1967.

[3] The unadjusted increase in industrial production was also 12 per cent during the period.

the incentives were "right" for tubewells to be installed, other crop practices to be improved and substantial increases in agricultural productivity to be registered. Falcon and Gotsch estimate that "private tubewells accounted for about one-fourth of the total 27 per cent increase in the value of crop output"[1] between 1960/61 and 1964/65. Later on the new "miracle" seed varieties (Mexican wheat and IRRI rice) became more important. As a consequence of all this, foodgrain production which had been growing at 1 per cent annually in 1950-60 spurted to 3.9 per cent annually during '60-65 with rates near 5 per cent obtained in more recent years.

Moreover the fillip provided by industries ancillary to pump production, coupled with the substantial rise in agricultural productivity, resulted in a general mushrooming of small-scale industry in the Punjab. In the small town of Daska, West Pakistan, for example, where there had existed hardly any machine tool activities in 1961, by mid-1965 there were 120 machine shops producing diesel engines for tubewell construction. The change, in aggregative terms, of Pakistani performance, from negligible per capita income increases in the late 50's to increases in the neighborhood of 3 per cent recently (in spite of drought and war) is quite remarkable. Admittedly, the Pakistan success cannot be laid simply at the doorstep of liberalization. There was the major contribution of liberalization in other sectors, expecially agriculture, which not only kept inflationary pressures in check but, for the first time, helped mobilize the agricultural surplus for domestic development. In fact, import liberalization, while important in giving the

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[1] Walter P. Falcon and Carl H. Gotsch, "Agricultural Development in Pakistan: Lessons from the Second-Plan Period" (June 1966, mimeo) p. 14. While other policies made tubewells profitable, import liberalization made them possible.

system an initial shove, was not sustained long enough to cause a major restructuring of the economy. As Mason concludes "the immediate consequences of the 1964 actions on industrial output in Pakistan were much more the result of the increase in the level of commodity imports than of any change in their allocation. Given time, the abandonment of licensing procedures would no doubt have brought market forces more effectively into play. As events conspired, however, the trade liberalization measures were one of the casualties of the Indo-Pakistan conflict".[1] Nevertheless, once liberalization had started it achieved its own forward momentum. Exports were substantially stimulated; while traditional raw jute and cotton exports rose by 21 per cent between 1959 and 1964, exports of non-traditional commodities rose by 89 per cent, accounting for about 60 per cent of the total by 1964. The effects of initial liberalization by way of helping to make possible the near tripling of the agricultural growth rate and by opening up new windows to farmers via non-agricultural investment opportunities and incentive consumer goods cannot easily be overstated. Once the mutually interacting processes had been started the economy's momentum has thus far proved sufficient to overcome the impact of bad monsoons, war with India and curtailment of foreign assistance.

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[1]Edward S. Mason, Economic Development in India and Pakistan (Harvard, Center for Int'l Affairs, September, 1966), p. 45.

B. <u>India</u>

Imports account for only about 7 per cent of Indian GNP and exports for about 4 per cent. In June 1966 India devalued its currency by 58 per cent (from 4.76 rupees per dollar to 7.50 rupees per dollar). At the same time selective tariffs were reduced by varying amounts so that one observer estimates that the c.i.f. plus tariff rupee price of some imports immediately rose by as little as 34 per cent.[1] On the export side the Government of India (GOI) accompanied the devaluation with the imposition of export taxes and the abolition of all export subsidies on some of the traditional exports, so that jute manufactures, for example, received a new effective exchange rate only 16 per cent higher than the old one. For non-traditional manufactured export items, the GOI abolished one kind of export subsidy (import entitlements) and introduced in their stead--with some delay--three categories of straight cash subsidies so that the new effective exchange rate increased from 11 per cent (for an item that formerly got a 75 per cent import entitlement and now has a 10 per cent cash subsidy) to 64 per cent (for an item that formerly got a 20 per cent import entitlement and now has a 20 per cent cash subsidy).[2]

Along with the de jure devaluation, the tariff changes, the imposition of export taxes, and changes in the form and amount of export subsidies, the Indian Government introduced an import liberalization scheme for 59 industries, covering about 70 per cent of the output of the "organized" industrial sector. In these 59 industries import licenses were to be issued "freely" for raw materials and spare parts. Moreover, six raw materials were placed on "open general license", with no restrictions on the amount that could be imported.

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[1] Philip S. Thomas, "The 1966 Devaluation and Import Liberalization in India" (December 1966, mimeo), Table 1.

[2] <u>Ibid.</u>, Table 2. These effective exchange rates do not take into account the increase in production costs resulting from the higher price of Indian imports. For example, the jute industry was granted a subsidy on imported raw jute following devaluation.

This package seems to have had several objectives: (1) to simplify the previous export subsidy scheme, (2) to simplify the import control system, (3) to raise the c.i.f. plus tariff price of imports and then allow the market place an increasing role in determining the composition of certain kinds of imports, and (4) to enhance the profitability of exports vs. import substitutes.

Based on a survey of 140 industries, one study estimated that in 1964 Indian industry was running at about 82 per cent of "desirable" output.[1] But this average figure is heavily influenced by textiles, basic metals, and food and tobacco which account for about 70 per cent of manufacturing value added and were operating at over 85 per cent of desirable output in 1964. Several other industries were running at much lower levels of "desirable" output in 1964: chemicals - 45%; metal products - 46%; electrical machinery - 58%; other machinery - 63%; and transport equipment - 64%.[2] Firms suggested three principal reasons why they were operating at such low levels of capacity; shortage and poor quality of raw materials, shortage of imports, and labor problems.[3]

Unfortunately the response of the Indian economy to the devaluation/liberalization package cannot be separated from the exogenous impact of two consecutive bad monsoons. For example, preliminary data suggest that total Indian exports for the twelve months ending August 31, 1967 were 5 per cent below exports of the preceding twelve months. The entire decline of $76 million can be accounted for by the drop in exports of "agricultural based"

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[1]National Council of Applied Economic Research, Under-Utilization of Industrial Capacity (New Delhi, 1965), p. 8. "Desirable" is based on a judgment of which industries it would be technically feasible to run two or three shifts.

[2]*Ibid.*, pp. 53-54.

[3]*Ibid.*, pp. 44-49.

commodities (jute goods, tea, cotton textiles, oilseeds, cashew nuts, tobacco, coffee, sugar, and raw cotton). The index of manufacturing output was only 2 per cent above its June 1966 level by June 1967. This failure of manufacturing output to respond to the devaluation/liberalization policies is again mainly due to the agricultural failure (it should be recalled that agriculture accounts for about half of Indian net domestic product). Agricultural failure affected manufacturing both via the supply of raw materials for the textile and food industries and via the provision of the required savings, on the one hand, and markets, on the other, for all industries.

The initial policy changes cited were considered to be part of a two-year program by the end of which all quantitative restrictions including on capital goods, and excepting only luxuries, were to have been removed. None of the remaining steps has as yet been taken. Indeed, in the fall of 1966, in partial compensation for doing away with the "indigenous angle clearance" system, the so-called ban ~~or~~ prohibited list of imports was expanded. From a fairly stable performance in the early 1960's (i.e., advances of 3.5 per cent per year) the wholesale price index rose by 17 per cent in 1964, 7 per cent in 1965, 14 per cent in 1966, and another 14 per cent in 1967. It is, however, helpful to isolate agricultural prices if one is to judge the effect of the 1966 package. Between June 1966 and June 1967 wholesale prices rose by 13 per cent, as compared to 18 per cent during the 12 months. While wholesale food prices rose by 26 per cent in this period (as compared to only 19 per cent in the preceding twelve months), wholesale prices of industrial raw materials rose by only 2 per cent in the year after devaluation (as compared to 29 per cent in the year preceding devaluation). The wholesale price index for manufactures rose by 4 per cent in the year after devaluation as compared to an 11 per cent increase in the year before devaluation. So it would seem that devaluation--accompanied by partial liberalization and the virtual doubling of commodity aid--did not lead to markedly higher prices; in fact, given the accident of bad monsoons, it seems likely that the policy package probably prevented more substantial inflationary pressures. It remains to be seen whether the Indian electorate and Indian policy-makers will reach the same conclusion or whether they will be blinded by the acceleration in the level of food prices. The underlying favorable structural changes of the 1966 policy package were thus virtually completely "masked" by the happenstance of bad weather. Foodgrain production declined from 89 million metric tons in 64/65 to 72 million tons in 65/66. The current (1968) wheat crop, on the other hand, is expected to be more than 100 million metric tons, considerably above the historical trend. It seems clear that "if the momentum achieved in agriculture and foreign exchange policy can be sustained, and if aid continues at least at the levels of the recent past then, provided the monsoons return to normal, near term Indian economic projects are far brighter than indicated by recent performance".[1]

C. Colombia

Colombian imports amount to roughly 12 per cent of GNP and exports to about 10 per cent. In September 1965, Colombia, a multiple exchange rate country, devalued the exchange rate relevant for about 75 per cent of her imports by 50 per cent (from 9 to 13.5 pesos per dollar), and agreed to place at least half of all imports on an automatic license list within six months

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[1]Kenneth Kaufman, "The Indian Economy: Some Recent History and Near Term Prospects" (March 1967, mimeo).

and 85 per cent of all imports within 14 months.[1] In October 1965 about 20 per cent of total import licenses covered goods on the free list; by September 1966 this had increased to about 80 per cent of total imports--all at the new rate of 13.5 pesos/dollar. The combination of higher tariff rates and the increased peso costs of given ad valorem tariffs (as the import exchange rate depreciated) led to an increase in (nominal) tariffs of over 21 per cent in 1966. The initially higher nominal exchange rate for "minor exports" (everything except coffee and petroleum) did not change.

The response of the Colombian economy to these new policies coupled with generous new aid allocations during this fourteen-month period is not unambiguously clear. The monthly level of imports rose from $35 million in September 1965 to $71 million in March 1966 (seasonally adjusted) and then fluctuated through November 1966 at a level of about $55 million per month. Total arrivals (seasonally adjusted) were $743 million in the fourteen months after September 1965 as compared to $598 million in the fourteen months before September 1965.

While prices of importables did not increase markedly, the consumer (workers') price index rose by 19 per cent (seasonally adjusted) between September 1965 and November 1966, as compared to 7 per cent in the preceding 14 months. Food prices rose by 19 per cent (seasonally adjusted) in the 14 months after September 1965 as compared to 4 per cent in the 14 months preceding September 1965. The rate of inflation clearly accelerated in the period after the new devaluation/liberalization policies were initiated.[2]

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[1]The liberalization percentages used in this section exclude imports which are financed by foreign credits for specific projects; such "non-reimbursable" imports account for about 10-15 per cent of the total imports.

[2]The wholesale price index rose by 17 percent (seasonally adjusted) in the fourteen months after September 1965 as compared to 10 per cent in the 14 preceding months.

One major contributing reason was the lag in agricultural output, which grew by less than 2 per cent in 1965, as compared to more than 5 per cent in both 1964 and 1966. This failure to simultaneously stir the agricultural sector into forward motion was undoubtedly decisive in rendering the relatively meager results of the policy package that was adopted. For one thing, devaluation affected the minor exports unfavorably, i.e., they rose by 3 per cent in 1966, as compared to a 40 per cent increase between 1964 and 1965. One might have predicted this slow growth, since the effective exchange rate for imports had depreciated substantially while the nominal exchange rate for minor exports had remained at 13.5 pesos since May 1965.[1] Secondly, there was a simultaneous effort to change the price relationship between agriculture and non-agriculture domestically. As a consequence with the money supply expanding at about the same rate as before (16% over 14 months) prices rose more rapidly and, as one might expect, the aggregative performance of real output was not significantly stimulated. Colombia has no published industrial production index. Seasonally adjusted cement production declined by 4 per cent in the 14 months after September 1965, as compared to an increase of 7 per cent in the preceding 14 months. Seasonally adjusted electric power output rose by 13 per cent in the 14 months after September 1965, the same rate as in the preceding 14 months. Seasonally adjusted steel production was 13 per cent higher in November 1966 than in September 1965, which in turn was 11 per cent below the July 1964 level. Unemployment in Bogota was 9.6 per cent in September 1966, as compared to

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[1] The average effective exchange rate for imports in all of 1966 depreciated by 29 per cent as compared to all of 1965. The average effective exchange rate for minor exports appreciated by 6 per cent in all of 1966 as compared to all of 1965. Urdinola and Mallon, <u>op. cit.</u>

9.7 per cent in September 1965 and 7.4 per cent in September 1964.[1] There are no data on changes in the rate at which capacity was used. One estimate is that industrial output grew by about 7 per cent in 1966, as compared to 5 per cent in 1965. Preliminary data indicate that real GNP grew by about 6 per cent in 1966, as compared to 3 per cent in 1965. While the evidence on aggregative performance is clearly mixed, we can conclude that output may have risen slightly more rapidly after the second restructuring policies were initiated. Clearly, however, they were not given a chance to work themselves out. In November 1966 negotiations over new loans between Colombia and the consultative group of national and international aid agencies broke down,[2] and strict controls on all foreign transactions were reimposed. Unlike earlier Colombian devaluation, the failure of coincident good harvests dealt this experiment a serious blow. Only recently are there signs that the Colombian government has not concluded that the liberalization medicine was inappropriate--only that foreign doctors were ministering it too publicly--from the view of domestic political feasibility.

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[1] There are no quarterly unemployment data for the country. These data for Bogota are from surveys by the Universidad de los Andes, as cited in Robert L. Slighton, Urban Unemployment in Colombia: Measurement, Characteristics, and Policy Problems (RAND, January 1968, RM-5393), p. 16.

[2] Colombia also failed to meet the September 1966 target for net foreign exchange reserves that would have allowed it to draw the final tranche of its IMF standby. Almost the entire shortfall from the reserve target could be accounted for by a $60 million shortfall from projected export earnings (excluding petroleum), and most of this export shortfall represented lower than projected coffee exports. In early 1967 Colombia drew $19 million from the IMF's Compensatory Financing Arrangement, as non-petroleum exports in 1966 were about $12 million less than the weighted average of actual 1964-66 exports. This seems to be the case where a shortfall from projected exports--as distinct from a shortfall from historical exports--adversely affected a country's development policies. The IBRD's proposed Supplementary Financial Measures is designed to deal with this problem.

D. Ghana

Ghana represents perhaps the most typical case of an unsuccessful attempt at restructuring a colonial flow pattern after independence. Without going into all the details of the Nkrumah regime it is clear that there existed a pronounced tendency here not only for expansion of the public sector, but also for the continuous increase in the extent of direct controls on the shrinking private sector. The goal of the Ghanaian government during the 1950's can be characterized as a big push for heavy industry with almost complete disregard for Ghana's comparative advantage internationally. Government deficit financing forced resources into the hands of the public sector, more and more industries were gradually brought under direct government ownership and the licensing and control arrangements in the domestic economy became more and more pervasive.

The realization that policies of the immediate post-war were in fact not bringing the desired results came late and less gradually in Ghana than in some other countries. The personal charisma of Nkrumah and his efforts to walk the pan-African stage postponed the day of reckoning until 1966, in spite of a truly miserable economic performance. At that time, Ghanaian industry was operating at roughly 35 per cent of capacity; the products of that industry were selling at from 3 to 4 times CIF international prices; unemployment was rising rapidly and agricultural output was virtually stagnant. The excesses of the Nkrumah regime in terms of the creation of an unusual array of "white elephants" in the field of public monuments, modern factories and the like, pales all other such cases by comparison. But while the realization of the high cost of pursuing these policies came only gradually, the new military government which took office in February 1966 came in, in large part, on the basis of a profound dissatisfaction with the economic performance to date.

In July 1967 the first substantial changes in policy, which may be called the beginning of the second restructuring in the case of Ghana, were put into effect. They consisted of a 30 per cent devaluation of the exchange rate, an equivalent rise in the producer price offered by the cocoa marketing board (to pass on the benefits of devaluation to the producer), and some moves in the direction of import liberalization. A very small existing open general license category was substantially extended to include most spare parts, chemicals, pig iron, pharmaceuticals, fertilizer, and simple tools, with the expectation that 15-20 per cent of imports would come in under what amounts to an automatic replenishment scheme. The objective of this package was to reach 55 per cent of one shift industrial capacity by the end of 1967. The Ghanaian authorities, moreover, stated their intention to liberalize raw materials as well, i.e., as soon as the foreign exchange reserves permitted such further liberalization. There has thus far been no official mention of any intended liberalization for capital goods. Moreover, the bulk of 1967 imports continued to be allocated under an individual license system, with 1,100 registered importers making applications on the conventional basis and with any new registrants considered in relation to "their prospective ability to utilize licenses effectively".

Clearly this has constituted a small beginning in the right direction. It is equally clear that the period since these initial steps were taken in the middle of 1967 is too short for any real assessment of consequences at this time. Several things can, nevertheless, be observed, even at this time: 1) the November 1967 post-devaluation consumer price index stood at 6 per cent below that of a year earlier. This happy result can be in large part laid at the doorstep of an exceptionally good maize harvest during calendar year 1967. This more than outweighed some increase in import prices in the consumer price index. In spite of some import liberalization, imports in the second half of calendar 1967 ran at a level about 20 per cent below that of the first half of the year.[1] For the year as a whole, 1967 imports were 24 per cent below those planned and 16 per cent below 1966 actuals.

On the export side an additional 20-25 million dollars of annual exports, or an increase of 7.4 per cent, is expected; timber exports have already increased substantially. The increase in the cocoa price to producers has led to a better care of trees, a decline in smuggling to neighboring countries, and an estimated increase in the harvest of the 1967 crop by 20-25 thousand tons. The picture on minor exports is less clear since the benefits of devaluation may not have been passed on in all cases. On the aggregative level GDP in 1967 increased by more than 3 per cent compared to a 1 per cent average earlier, indicating a net gain in per capita GDP for the first time in 4-5 years. It would, nevertheless, be premature to attribute this change to the benefits of the new policy package since clearly not enough time has as yet elapsed and since unusually good weather conditions leading to a very favorable harvest must carry much of the credit.

Moreover, it should be very clear that only very small steps have been taken to date in the direction of freeing the economy from the shackles of the Nkrumah policies. For one thing, close to 75 or 80 per cent of imports still remain very tightly controlled and as World Bank observers concluded earlier this year "partial evidence indicates that the larger private and joint state-private firms have adequate raw material imports and built up inventories approaching 3-4 months' supply. Most state enterprises have more than adequate import materials reflecting both ample licensing allocation and credit. On the other hand, many small and medium sized firms still do not have adequate imported raw materials and spare parts and the difficulties in arranging

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[1] There are some special reasons for this, relating to slowness in utilizing available aid.

credit undoubtedly play a major part here as well." The import of 79 specified commodities "which are considered to be manufacturable locally in sufficient quantities" is either restricted or completely banned. The attitude of a substantial proportion of the bureaucracy continues to be one of pro-liberalization but at a very slow pace and with considerable trepidations about the excesses of a profit-oriented industrial system. Nonetheless substantial beginnings have been made and there is talk and some evidence that as soon as the authorities feel a little more comfortable about their (currently non-existent) foreign exchange reserves further liberalization steps will be taken. There is, moreover, a realization that complementary policies in the domestic agricultural sector can be crucial to the overall liberalization effort. Consequently market price floors for rice and maize were announced for the first time early this year, improving agriculture's terms of trade and getting the Government into the business of supporting the private trade rather than displacing it. The required interaction between domestically oriented agriculture and industry on which so much depends has thus been facilitated. Whether Ghana has the storage and/or administrative capacity to run a buffer stock operation must, however, still be tested.

E. Korea

The main problems facing the Korean economy and those aiding her in the nineteen fifties were clearly to help repair the damages sustained by the triple blow administered since 1945: first the departure of the Japanese; second, the partition of the immediate post-war; and third, the massive destruction of the Korean War and its aftermath. What might be called the reconstruction period lasted until approximately 1960 and was characterized by a large number of government actions over a large area, mainly intended to get the badly mutilated economy back on its feet. Inevitably, such actions were often deficient in overall design and somewhat emergency oriented. Moreover the attempt to drive resources into the hands of the government brought with it inflationary fiscal policies which defeated the prime developmental purposes of the program by impairing the private sector's willingness and ability to save and invest. In fact, throughout the late 50's and even in the early 60's Korea was racked by substantial inflation in spite of a number of major stabilization efforts assisted by the United States. As long as these efforts were unsuccessful there was little chance to restore a sense of predictability to economic relationships and to begin to unloosen those forces in the private sector without whose contribution development in the mixed economy is very difficult. Those relatively fine allocative decisions which yield better developmental performance cannot be expected to be made by individual decision-makers unless there is some likelihood that contractual obligations will not be swamped by inflation and entrepreneurial energies will not be diverted into the circumvention of direct controls and the search for a quick financial return.

By 1963 the back of this self-feeding inflationary spiral was finally broken and the Government of Korea began to turn its attention to the need for a possible second restructuring of the kind we have previously described. Like others, it determined to first deal with the foreign exchange market before turning to reform in the complementary financial market. Exports amount to about 12 per cent and imports to about 22 per cent of GNP. In May 1964, Korea devalued by 29 to 96 per cent[1] and unified its various

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[1] It is difficult to say exactly how much devaluation occurred because Korea had a multiple exchange rate system, ranging from 130 won per dollar to 190 won per dollar. The new rate was set at 255 won per dollar.

multiple exchange rates and introduced what was supposed to be a floating exchange rate. This floating rate fluctuated between 257 won per dollar in May 1964 and 271 won per dollar in early 1965. Since then it has fluctuated between 274 and 267 won.

Along with this devaluation, the Korean Government gradually liberalized its import control system through a widening of import quotas and the introduction of a partial export retention scheme. In August 1964 a quasi-automatic licensing system was introduced, with which an importer could get automatic approval of import licenses equal in value to 20 per cent of his export earnings, sales to UN forces in Korea, and gold sales to the Bank of Korea. In November 1964 this was increased to 25 per cent. Further liberalization took place in 1965 with an automatic approval system for 1495 items, discretionary licenses for 138 items, and a prohibited list covering 620 items. This meant that almost 75 per cent of non-U.S. aid imports were now on an automatic approval basis.[1] This liberalization trend has continued steadily until, by the first half of 1967, 2,984 items are on the automatic approval list, 142 items are on the discretionary licensing list and only 362 items are on the prohibited or ban list. Almost 90 per cent of all imports other than those financed by U.S. aid are now admitted on an automatic replenishment basis.[2] Thus, for all practical purposes, quantitative restrictions no longer play an important role in determing the structure of Korean imports.

After adoption of the first substantive restructuring package the wholesale price index of imported goods rose by 29 per cent between May 1964

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[1] Exchange Restrictions, Seventeenth Annual Report (IMF, 1966), p. 335. U.S. aid financed 30 per cent of Korean imports in 1964.

[2] Ibid., 1967, p. 374.

and January 1965 and then remained almost constant. But this price increase was not passed on to other commodities. The total wholesale price index rose by only 2 per cent between May 1964 and January 1965; in the twelve months after devaluation wholesale prices rose by only 5 per cent, as compared to 52 per cent in the year preceding devaluation. This overall stability in wholesale prices was due in large part to improved agricultural performance permitting a decline in wholesale grain prices (by 24 per cent between May 1964 and May 1965, as compared to an increase of 77 per cent between May 1963 and May 1964).[1] Agricultural output (in constant 1960 prices) in fact, rose by 18 per cent in 1964 compared to 6 per cent in 1963.

The simultaneous unification of domestic interest rates at higher, and more realistic, levels provided for the first time incentives for domestic saving and production. The change in overall performance of the Korean economy has been little short of spectacular. From negative saving rates in the 1958-62 period, and at 5.8 per cent as late as 1962-64, Korea is now experiencing saving rates in excess of 13 and 14 per cent. Manufacturing output rose by 24 per cent in the 12 months after devaluation, as compared to an 8 per cent increase over the preceding 12 months. Exports also responded extremely well to the devaluation/liberalization package growing at a 29 per cent rate during 62-66, compared to 15 per cent in 58-62. In more recent years exports have grown at close to 40 per cent. Overall, per capita income growth has risen from 1 1/2 per cent for the 1958-62 period to 6.2 per cent in the 1962-66 period and in excess of that level in 1967.

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[1]This same price pattern occurred in the consumer price index. The Seoul consumer price index for grains fell by 18 per cent between May 1964 and May 1965, while the total consumer price index rose by only 8 per cent during the 12 months. In the twelve months prior to devaluation it had risen by 47 per cent, with grain prices rising by 96 per cent.

V

The above admittedly rather cursory review of a number of liberalization efforts--over an admittedly rather too short period of time-- does not lend itself to grand generalizations. Korea, India and Ghana had substantial de jure devaluations coupled with gradual import liberalizations--more extensive in the case of Korea and India than Ghana. Colombia had a large devaluation of the import rate coupled with rapid liberalization; and Pakistan gradually devalued, de facto via the export bonus scheme, accompanied by substantial import liberalization. None of the experiments have run long enough to permit great confidence to be attached to any conclusions that might be reached. Some of the experiments, e.g., Colombia and Pakistan, were, moreover, interrupted by political crisis or war; others suffered from the overwhelming effect of exogenous shocks which swept all before it, e.g., India. Nevertheless we may be permitted a few tentative observations on the nature of the second restructuring to date and the directions it is likely to take in the future.

Even at this early stage there is evidence of the possibilities of fundamental changes in economic performance. If we take the Pakistan and Korean examples which have had the benefit of at least several years of application and where liberalization did encompass capital goods, as well as raw materials and spare parts, we can note a real turn-about in performance, whether measured in terms of per capita income growth, saving behavior or export performance. How much of this is due to the higher import levels made possible and how much due to the restructuring of imports itself is, however, more difficult to document. The real test of this would be an examination of changes in the industrial production structure as well as between industry and other sectors. In the short-term, changes in the pattern of investment allocation at the margin might have to serve as a proxy. But neither of these two exercises has as yet been carried through due to problems with data availability.

The extent of "openness" of the economy must be of considerable relevance in terms of the potential for good--or evil--of any devaluation/ liberalization package. Ceteris paribus the linkages between the foreign trade sector in a successful case like Korea's and the rest of the economy must have much greater potential than in India where the trade tail can't be expected to "wag" the development dog.

Secondly, complementary policy changes, especially in the agricultural sector and in credit markets, may be of the utmost importance. In the more successful cases under scrutiny, e.g., Korea and Pakistan, harvests were good and agricultural productivity was increasing substantially both while and immediately after the new policies were adopted. This is essential if the eroding effects of inflation are to be held off and if there is to be time for the restructuring process to gather steam. Complementary changes--with devaluation--on the export side, i.e., the levying of export duties for traditional commodities facing an inelastic foreign demand, and the installation of a supplementary direct export promotion machinery, including subsidies, have been characteristic in the attempt to accelerate the usually somewhat slower response on the export side.

Thirdly, there can be little doubt concerning the importance of additional foreign exchange availabilities for the immediate post-restructuring period. At a time when private sector confidence still hangs precariously in the balance, there is little as important as the show of resoluteness and consistency in carrying through with a phased liberalization program.

Nothing can be as damaging at a time like that than hesitation, or a temporary return to restrictionism, none of which is conducive to eliminating a full-throated response from the previously disenfranchised economic sectors whose participation is so essential to final success. Where foreign exchange reserves are low, e.g., Ghana, or the confidence on future aid flows is missing, e.g., Colombia, the private sector is likely to adopt a wait and wee policy--proving the skeptics right once again. But the additional aid flows are also directly relevant to the ability to contain the inevitable inflationary pressures which ensue in the wake of such a policy shift. If the higher price of imports associated with the devaluation, especially of industrial raw materials and other imports, is not at least partially offset by the dismantling of controls and the larger volume of imports now made possible, the impact on consumer price indeces with all its consequences would have been virtually unavoidable.

Finally, it should be clear that our concentration on the dismantling of quantitative controls as part of the restructuring effort gives us only a partial or beginning representation of reality. As is well known, the typical less developed economy disequilibrium system can also be maintained by tariff and/or tax/subsidy packages. Ideally, in fact, we should measure the total extent of protection by calculating the effective tariff on various industries, including specific taxes, import surcharges and deposit requirements and, in the garden variety of cases in which QR's are dominant, using the resulting implicit tariffs (i.e., the percentage difference between domestic and c.i.f. world prices) as the equivalent of the nominal tariff structure. It is, however, true, in terms of a sequential liberalization effort, that it is the import licensing system which carries the effective "bite" in most real world cases. Once this "bite" is removed, tariffs usually become relevant, especially if some of them have been raised in the course of the earlier dismantling of the quantitative restrictions. Not infrequently the tariff pattern that emerges as binding and relevant, itself shows no really discernable logical pattern or scientific basis. A policy of high tariffs on finished goods and low or non-existent tariffs on intermediate goods has usually lead to a very high level of effective protection for domestic producers, which policy, while working through the market mechanism, is still substantially distorting and blunting of the competitive pressures which the policy makers apparently now want to admit. Tariff rationalization is therefore likely to provide the next--and hopefully final challenge--to those who wish to restructure the system along more efficient lines.

As we look into the future this will undoubtedly require the evolution of a country-specific tariff policy following the dismantling of quantitative restrictions, from which we might then deviate when necessary. In this connection the confusion between infant industry and revenue objectives of tariffs must be eliminated. In sequential terms, a move toward a uniform tariff rate, perhaps somewhat lower on raw materials and machinery than on finished goods, and the substitution of excises for tariffs in the luxury good category[1] may be sensible. This uniform tariff can then over time be lowered very much in the manner of a gradual withdrawal of temporary preferences. Deviations from uniformity along the way would have to be defended in terms of a convincing infant industry argument and protective tariffs set in relation to some objective criterion such as domestic value added at world prices.[2] But this takes us beyond the boundaries of the present paper.

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[1]See R. McKinnon, Tariff and Commodity Tax Reform in Korea" mimeo, July, 1967.

[2]This suggestion is made by R. McKinnon, op. cit.