SWP725

Instruments for Export Policy and Administration

Lessons from the East Asian Experience

Yung Whee Rhee

WORLD BANK STAFF WORKING PAPERS
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The World Bank
Washington, D.C., U.S.A.

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Library of Congress Cataloging in Publication Data

Rhee, Yung W.
Instruments for export policy and administration.

(World Bank staff working papers ; no. 725)
Bibliography: p.
1. East Asia--Commercial policy. 2. Foreign trade promotion--East Asia. I. Title. II. Series.
HF1600.5.R48 1985 382'.63'095 85-3348
ISBN 0-8213-0519-0

ABSTRACT

By examining the specific policy and administrative instruments that successful East Asian countries used to carry out their outward-looking development strategies, this paper attempts to draw practical lessons for other developing countries, especially those at an earlier stage of developing their export capabilities. Focusing more on useful specifics than on broad generalities, the paper provides a foundation from which specific guidelines needed for policy and administrative reforms and institution building can be derived.

The discussion presented in this paper centers around two key concepts: "neutral status" and "extended neutral status." Neutral status enables exporters to compete with foreign competitors in world markets on an equal footing in regard to undistorted markets and policies. Extended neutral status enables equal incentives between export and import substitution firms. Conventional export policy and administrative instruments that are designed to achieve neutral or extended neutral status discussed in the paper include:

(1) those for maintaining a realistic exchange rate;

(2) those for achieving a free trade regime for exporters;

(3) those for assuring automatic access to export financing;

(4) those for keeping primary input prices competitive;

(5) those for compensatory export incentives.

Even though first-best policy instruments are emphasized, circumstances under which the need arises to adopt second-best policy instruments as transitional measures are carefully analyzed.

The paper also discusses the unconventional policy instruments for export development and stresses the critical contributions of effective institutional mechanisms to the export successes in the East Asian countries--institutional mechanisms that have served as catalysts in:

(i) implementing conventional export policies effectively;

(ii) developing the ability and desire of producers and traders to respond aggressively to opportunities in the world market.

CONDENSE

En examinant les divers instruments administratifs et de politique générale que certains pays d'Extrême-Orient en expansion ont utilisés pour mettre en oeuvre leurs stratégies du développement orientées vers l'extérieur, le présent document tente de tirer des enseignements pratiques valables pour d'autres pays en développement, particulièrement ceux qui n'en sont pas encore au même stade du point de vue du développement de leurs capacités d'exportation. On pourra à partir de ce document - qui expose des faits précis plutôt que des généralités - définir les directives spécifiques nécessaires pour procéder à des réformes administratives et de politique générale ainsi qu'au renforcement des institutions.

Le débat exposé dans le présent document tourne autour de deux concepts fondamentaux : l'"état neutre" et l'"état neutre élargi". Le premier permet aux exportateurs de lutter sur un pied d'égalité avec leurs concurrents étrangers sur les marchés mondiaux en l'absence de distorsions au niveau des marchés et des politiques suivies. Le second fournit des stimulants égaux aux sociétés exportatrices et à celles dont la production se substitue aux importations. Les instruments classiques au niveau de la politique d'exportation et des dispositions administratives en la matière qui sont destinés à assurer le statut de neutralité ou le statut de neutralité élargi dont il est question dans le document comprennent :

1) les instruments qui visent à maintenir un taux de change réaliste;
2) les instruments qui assurent un régime de libre change aux exportateurs;
3) les instruments qui assurent un accès automatique au financement des exportations;
4) les instruments qui permettent aux prix des intrants primaires de rester compétitifs;
5) les instruments qui offrent des incitations compensatoires à l'exportation.

Bien que l'accent soit mis sur les instruments de politique générale optimaux du premier ordre, les circonstances dans lesquelles il est indispensable d'adopter provisoirement des instruments de politique générale optimaux de second ordre sont soigneusement analysées.

Le document étudie également les instruments de politique générale non classiques visant à assurer le développement des exportations et souligne combien des mécanismes institutionnels efficaces contribuent aux succès des pays d'Extrême-Orient en matière d'exportations, mécanismes qui ont joué un rôle de catalyseur :

i) en assurant la mise en oeuvre efficace de politiques d'exportation de type classique;

ii) en donnant aux producteurs et aux opérateurs le désir et les moyens de profiter de façon dynamique des débouchés offerts par le marché mondial.

EXTRACTO

—Al examinar los instrumentos específicos de política y administración usados por los países de Asia Oriental que han tenido éxito con las exportaciones para llevar a cabo sus estrategias de orientación externa, en este documento se intenta extraer enseñanzas de valor práctico para otras naciones en desarrollo, especialmente para las que están en una etapa inicial de expansión de su capacidad exportadora. El documento, que se concentra más en aspectos concretos pertinentes que en grandes generalidades, proporciona una información básica de la que pueden derivarse los lineamientos específicos necesarios para la reforma de las políticas y la administración y para el desarrollo institucional.

El examen presentado en este documento gira en torno a dos conceptos claves: el "estado neutral" y el "estado neutral ampliado". El estado neutral permite que los exportadores nacionales compitan con los extranjeros en los mercados mundiales en un pie de igualdad en lo que respecta a mercados y políticas libres de distorsiones. El estado neutral ampliado hace posible la igualdad de incentivos para los exportadores y para las empresas de sustitución de importaciones. En el documento se examinan los instrumentos corrientes de política y administración concebidos para lograr un estado neutral o un estado neutral ampliado, es decir, los necesarios para:

1) Mantener un tipo de cambio realista;
2) Lograr un régimen de libre comercio para los exportadores;
3) Asegurar un acceso automático al crédito de exportación;

4) Mantener precios competitivos para los insumos primarios;

5) Ofrecer incentivos de exportación compensatorios.

Aunque se hace hincapié en los instrumentos de política óptimos, se analizan cuidadosamente las circunstancias en que surge la necesidad de adoptar como medida de transición los que ocupan el segundo lugar.

En el documento se examinan también los instrumentos de política poco corrientes para el fomento de las exportaciones y se recalca el carácter crítico de las contribuciones que los mecanismos institucionales eficaces han aportado al éxito de los países de Asia Oriental en sus exportaciones. Esos mecanismos institucionales, han actuado como elementos catalizadores para:

i) Aplicar eficazmente las políticas corrientes de exportación, y

ii) Desarrollar la capacidad y el interés de los productores y los comerciantes para reaccionar con actitud emprendedora ante las oportunidades del mercado mundial.

Acknowledgements

This paper was written as part of the policy-related research work of the Industrial Strategy and Policy Division, based on an extension of my previous work on Korea's export incentive administration carried out under the research project, Export Incentives in Developing Countries. I am grateful to Harinder Kohli and Kemal Dervis for supporting the extension of the previous work to include other East Asian countries, as well as to Bela Balassa and Larry Westphal for supporting the earlier work on Korea. The paper has benefited from comments by Kemal Dervis, Alan Roe, Mahmood Ayub, Bruce Ross-Larson, and Kevin Young. Finally, I would like to acknowledge Philip Sawikis' editorial assistance.

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INTRODUCTION

The recent balance of payments crises in many developing countries have led to increased attention to export promotion efforts. In pursuing these efforts, countries in earlier stages of export development are interested in learning how a number of East Asia's developing countries have achieved such remarkable success in expanding their exports. The purpose of this paper is to explore the detailed instruments of export policy and administration in the successful East Asian countries, drawing practical lessons that might be applicable--or at least adaptable--in other countries.

A search for lessons from the East Asian experience must begin with recognition of two critical considerations: First, export promotion has recently been undertaken by many developing countries largely to satisfy urgent needs for earning foreign exchanges. But the export success in the East Asian countries has resulted from successful trade and industrial strategies that stress specialization based on comparative advantages, rather than from a simple desire to earn foreign exchanges. Second, while much has been written about the success stories of the East Asian countries, the broad generalities describing these successes are of little practical use unless supplemented with explanations of specific policies and institutions that provided the foundation for export growth at early stages of export development. Therefore, in articulating the lessons

of the East Asian experience in export policy and administration, this paper stresses these considerations: (a) export policy within the context of a rational development strategy and (b) specific policy tools and public and private institutions. These are discussed further below.

Because the primary objective of this undertaking is to discover and relate specific means by which the successful East Asian countries accomplished their export development and growth, this is inevitably quite lengthy and detailed. Readers who are interested in an introduction to the significant points presented here, unaccompanied by the detailed examination included in this paper, are referred to a separate paper entitled, "A Framework for Export Policy and Administration: Lessons From the East Asian Experience."

The countries examined in drawing lessons from the East Asian success stories are Hong Kong, Singapore, and Korea. To illustrate some of the practical issues that developing economies face as they attempt to rationalize their policies and build export capabilities, some of the ongoing developments in Indonesia, the Philippines, and Malaysia are sketched. This paper is not a comparative analysis of these six East Asian countries. Rather, it attempts to build an analytic framework, to the extent possible, based on the East Asian experience. The basic approach taken, however, is one that focuses on describing the East Asian experience rather than prescribing policies to be pursued by other developing countries.

Information on Korea has been based largely on materials collected through the author's involvement in the World Bank research project, Export Incentives in Developing Countries. Information on Singapore and Hong Kong was collected through the author's brief visits to these countries during May 22-30, 1983. Information on Indonesia and the Philippines has been based on materials collected through the author's participation in several operational missions to these countries during 1982-83. Information on Malaysia is mainly based on materials collected during the author's participation in a manufacturing sector mission in 1980.

(a) Export and Development Strategy

A rational development strategy of a developing country strives for production specialization in both domestic and export markets (i.e., import substitution and exports) where the country has comparative advantages, while imports are not discouraged where the country has comparative disadvantages. Our discussion of export policy and administration focuses on the export side within the context of such a rational development strategy. As such, import substitution and imports are dealt with only implicitly, not because they are not important in a rational development strategy, but because the focus of this undertaking is on the specifics of export policy and administration. As our discussion of the export side unfolds, the equal regard for the importance of import substitution and imports will be apparent.

As used in this paper, "exports" include processing, manufacturing, and sales activities for all commodities that generate export value added. This definition therefore encompasses the activities of indirect as well as direct exporters. Excluded from the term "exports" are activities involved in the production of primary goods that are exported.

A look at the role of export in the development strategies of the successful East Asian countries can further define the context of our discussion. The development strategies in these countries started with an export policy that focused on removing disadvantages vis-a-vis foreign competitors in world markets. This export policy has played the dual role of: (i) encouraging industrial efficiency by exploiting the tremendous externality of exporting and competing in world markets and (ii) laying the groundwork for putting domestic competitors in the domestic market on an equal footing with exporters and foreign competitors, thereby preventing the development of inefficient import substitution. This paper summrizes the specific tools used for such strategies.

(b) Specific Policy Tools and Institutions

To dig beneath broad generalities and provide practical guidance for developing countries at the early stage of export development, several factors that are implicit in export development efforts must be recognized. First, the market fragmentation, externalities, uncertainties, and

lack of institutional development that are characteristic of most developing countries dictate the use of transitional policies when first-best policies are not feasible. Second, the lessons from successful developing countries would be of little use if we failed to consider the institutional requirements needed to implement policies. Finally, because we are concerned with the behavior to the business firm, any consideration of export incentives that is not based on disaggregation at the firm level will be misleading. Therefore, our discussion of the lessons of the successful East Asian countries in export policy and administration emphasizes (i) institutional development, (ii) specific transitional policy tools, and (iii) incentives at the firm level. These factors are discussed in Chapter I.

(c) Structure of the Paper

Chapter 1 defines neutral status and extended neutral status, discusses the above three key elements in achieving neutral status, introduces principles of administrative arrangements for neutral status, and explains methods of payment for exports and imports. Chapters 2 through 6 deal with the specific policies and administrative arrangements necessary to achieve neutral status for export activities: maintaining a realistic exchange rate, achieving a free trade regime for exporters, assuring automatic access to export financing, keeping primary input prices competitive, and implementing compensatory export incentives to establish neutral status. Chapter 7 discusses issues related to extended neutral status.

Chapter 8 focuses on how public and private institutional mechanisms can be designed to achieve a synergistic partnership between government and business in implementing effective export policies and competing successfully in world markets. Chapter 9 summarizes the major findings and discusses their implications for other developing countries.

CHAPTER I

NEUTRAL STATUS--ITS MEANING, KEY ELEMENTS, AND RELATED ISSUES

Because export policy and administration in developing countries are best analyzed within the context of an overall development strategy, the discussion presented in this paper centers around two key concepts: "neutral status" and "extended neutral status." This chapter defines these concepts and, based on the experiences of the successful East Asian countries, discusses the key elements and principles of administrative arrangements for achieving neutral status. The chapter concludes with a discussion of methods of payment for exports and imports, which sets the stage for introducing administrative arrangements and institutional factors that have proven critical for export success.

(a) Definitions of Neutral Status and Extended Neutral Status

A country cannot exploit its comparative advantages in the world market through specialization if it is not able to compete with other countries on an equal footing in regard to undistorted markets and policies. For example, if a tariff on an input required for the production of a potential export results in higher production costs for a dometic producer than for a similar foreign producer who operates under free trade, the domestic producer is not on an equal footing. In this case, the exporter can achieve equal footing with his foreign competitors if imports used for export production are tariff free.

We therefore will define neutral status as the set of arrangements that will enable exporters to compete with foreign competitors in world markets on an equal footing in regard to undistorted markets and policies. These competitors operate under (i) a flexible and realistic exchange rate, (ii) free trade in inputs and outputs, (iii) competitive financial and money markets, (iv) competitive primary input markets, and (v) nondiscriminatory domestic taxes. Neutral status for export activities in a developing country can be achieved by providing a combination of these five elements or equivalent compensating incentives in all activities that generate export value added.

If a country provides positive protection for import substitution activities, achieving neutral status for export activities puts potential exporters on an equal footing with world market competitors in regard to undistorted markets and policies, but does not provide incentives equivalent to those for import substitution activities. With high effective protection for import substitution, anti-export bias in the domestic economy is reduced, but not eliminated, by putting exporters on an equal footing with foreign competitors in regard to undistorted markets and policies. In the example above, neutral status achieved by duty-free import of inputs for export production that results in a zero effective protection rate provides an incentive level lower than that for an import substitution firm whose effective protection rate is, say, 50 percent.

Anti-export bias can be eliminated by "extending" neutral status for export activities such that export is not discouraged relative to

import substitution. We will define extended neutral status as a situation in which the level of export incentives is as high as the level of incentives for import substitution activities. If--in addition to neutral status provided by duty-free imports used for export production--the exporter in the example above is granted tax incentives of 50 percent of world market value added, then the exporter would enjoy extended neutrality with respect to the import substitution firm that enjoys an effective protection rate of 50 percent. These firms, then, would have equal incentives for import substitution and for export.

(b) Key Elements in Achieving Neutral Status

Three major empirical studies of the effects of foreign trade regimes on the economic growth of developing countries (World Bank: Balassa 1971, 1982; OECD: Little, Scitovsky, and Scott 1970; NBER: Bhagwati 1978 and Krueger 1978) more or less reach the same conclusion: economies with outward-looking strategies have had better export performance and better economic growth than economies with inward-looking strategies. Three hypotheses have been suggested to explain this conclusion: (i) an incentive neutrality hypothesis, (b) an allocative- and X-inefficiency hypothesis, and (iii) a technology and externality hypothesis. The meanings of these hypotheses are given below in relevant parts of the paper. The relative importance of these hypotheses has not been empirically tested (Krueger 1980). One thing, however, appears clear. These hypotheses are not mutually exclusive, and therefore all of them may be helpful in explaining the performance of most developing economies.

As we shall see throughout this paper, the policies and administrative arrangements that have achieved neutral status, and sometimes extended neutral status, for export activities at the firm and product level have been the cornerstone of the export promotion systems of the successful East Asian countries. Three elements--incentives at the firm level, transititional policies, and institutional development--have been the key factors in achieving this. These are discussed below.

Incentives at the Firm Level: The first of the three hypotheses mentioned above, the incentive neutrality hypothesis, is based on empirical evidence that in developing countries with outward-looking strategies, aggregate (i.e., economy-wide or average) effective incentives for exports have come close to matching aggregate effective incentives for import substitution (see Chapter VII). In other words, extended neutrality at the aggregate level is the basis of the incentive neutrality hypothesis. But despite this empirical evidence, the critical importance of the internal structure of such extended neutrality and the detailed administrative apparatus needed to achieve extended neutrality at the firm or product level has not received the attention it deserves. The major reason for this may be that the studies mentioned earlier were devoted to analyzing aggregate or sectoral incentives rather than incentives at the firm or product level. A recent study that focuses on institutional and administrative arrangements at the firm and product level (Rhee and others, forthcoming) found that in some developing economies that have succeeded in establishing outward-looking strategies, true neutral status for export

activities at the product and firm level has been the essential precondition for extended neutrality.

This paper argues that in the East Asian developing economies that have established outward-looking strategies, neutral status for export activities at the product and firm level has been an essential precondition for extended neutrality. Referring again to the example above, we presented the achievement of neutral status (by assuring duty-free status for all imports used in export production) as a precondition for providing extended neutral status (through tax incentives). The successful East Asian countries adopted this course. Hypothetically, however, we can envision another course, which could achieve aggregate extended neutral status even though neutral status at the firm level has not been achieved. This could be accomplished, say, by providing huge cash grants to a select number of exporters, while no duty-free imports of inputs are allowed to all exporters. The selected exporters would then enjoy highly positive effective incentives, while other exporters would suffer a negative effective incentives. Aggregate figures, however, would indicate that firms have achieved extended neutrality.

Transitional Policies: As mentioned above, developing countries at early stages of export development compete in the world market with countries that have provided these key ingredients of an efficient economy: (i) a flexible equilibrium exchange rate, (ii) free trade in inputs and outputs, (iii) competitive financial markets, (iv) competitive primary input markets, and (v) nondiscriminatory domestic taxes. The first step

toward achieving an efficient economy, then (as well as the first step in export development), is to come as close as possible to replicating the conditions created by these key ingredients, at least with respect to all activities that generate export value added. Such a policy may be considered either still distortive or necessarily transitional, depending on one's perception.

This raises questions, however, about what constitutes distortive policy measures in developing economies--which are characterized by market fragmentation, externalities, uncertainties, and lack of institutional development--as opposed to developed economies (Bruno 1981). Therefore, circumstances that dictate a set of transitional policies 1/ may have to be understood, even though the ultimate goal may be to establish first-best policies (Bruno 1981, McKinnon 1980). The development process is a transitional one moving from one stationary state to another, and transitional policies deal with such a transitional process. This paper concerns itself not only with the proper mix of second-best policy tools but also the appropriate time for switching from second-best to first-best policies.2/

1/ A transitional policy is characterized as a second-best policy. Such a policy is suitable at a certain stage for a developing country, even though it may not be the best policy for a developed country. A first-best policy is defined as a policy suitable for a developed country.

2/ Recently, increasing attention has been given to the phasing and sequencing of liberalizations in a set of interrelated markets (such as foreign exchange, financial, and commodity markets). See Krueger (1983b), Edwards (1983).

Adoption of several second-best policies--with respect to all activities that generate export value added--has been critical to the achievement of neutrality for some successful East Asian developing countries during transitional periods. These second-best policies are:

(i) Guaranteeing a realistic exchange rate (including compensation for overvaluation) for exporters. This is a minimum condition for competing in world markets, and is equivalent to maintaining an equilibrium exchange rate for exporters.

(ii) Providing free trade status for export production activities. This is not only a precondition for competing in world markets on the basis of a country's comparative advantage, but also could be a first step toward liberalizing domestic sales of imports.

(iii) Guaranteeing automatic access to working capital at uniform interest rates which are not higher than the neutral rate for all export production and sales activities. This is not only a minimum condition for competing in world markets but also amounts to creating a situation that comes close to the situation provided by competitive financial markets.

(iv) Guaranteeing that the actual prices of inputs for export activities are equal to shadow prices. This creates a situation that comes close to a situation of competitive primary input markets.

(v) Using differential compensatory tax incentives to achieve the preceding four policies. This amounts to maintaining non-discriminatory domestic taxes.

Since the adoption of these policies means (i) that a realistic exchange rate will be maintained for exporters even if the official exchange rate is overvalued, (ii) that free trade status for export activities will be guaranteed even if imports for domestic sales are subject to restrictions, (iii) that access to export financing will be assured even if other sectors of the economy are subject to credit rationing, (iv) that shadow prices for primary inputs will be guaranteed notwithstanding the existence of noncompetitive primary input markets, and (v) that non-discriminatory taxes will be maintained by using tax instruments as compensatory export incentive tools, it is clearly not simple to achieve neutral status. It is therefore necessary to create efficient administrative arrangements that are designed to guarantee neutral status. Section (c) of this Chapter focuses on the key elements of such administrative arrangements.

Institutional Development: Adoption of second-best transitional policies in the developing East Asian economies (when first-best policies were not possible) has required innovation and diligence by government. Experience shows that it is far from simple to achieve neutral status, and any theory about markets and government policies which assumes that it is

possible to ignore the critical importance of institutions and institutional development is unrealistic and impractical.3/ Analytic results based on a general characterization of policy issues in terms of "liberalization" within the abstract frameworks of "free markets" and "government intervention" have little value unless they are also based on a careful evaluation of the underlying institutional background. The reason is that neither market operations nor government policies can be implemented without proper institutional development. Such institutional development, in turn, requires not only deliberate efforts (both private and public) but also considerable time. A financial market, for example, can hardly exist unless the appropriate financial institutions also exist; financial policies can hardly be implemented unless government as well as private financial instruments and institutions have been developed. In many instances, therefore, conclusions about how to improve export policies will necessarily imply answering interdependent questions: "How is it possible to develop markets?", "How is it possible to improve government policies?", and "What kinds of institutional developments are necessary?"

3/ In his Nobel lecture, Herbert Simon (1979) refuted the argument that the unrealism of some of the microeconomic assumptions underlying classical or neoclassical theory on the operations of markets is harmless. He reinterpreted the rule known as Occam's razor to mean that theory should make no more assumptions than necessary to account for observed phenomena, and not to mean merely the achievement of a theoretical simplicity.

(c) Principles of Administrative Arrangements

Table 1 provides an overview of an export incentive system characteristic of a successful East Asian developing country. While laws and regulations administered by government and private agencies constitute the formal administrative machinery, we deal here mainly with the key principles of an export incentive system.

Those principles are (a) automaticity; (b) equal treatment of all activities that generate export value added; (c) prevention of abuse; and (d) administrative convenience.

Automaticity: Unless discretionary or case-by-case rulings are prohibited--in other words, unless neutral status is granted automatically and immediately--would-be exporters may not be willing to brave the ensuing administrative uncertainty, and would-be entrepreneurs may be unable or unwilling to respond to incentives granted by the government to stimulate exports. Speed is the name of the game in international trade. Without

TABLE 1

A Typical Export Incentive System

Export Incentives	Laws and Regulations	Administering Agencies
1. Realistic Exchange Rates	° Foreign Exchange Laws	° Ministry of Finance ° Central Bank
2. Free Trade Regime for Exporters	° International Trade Law ° Tariff Law ° Duty Drawback Law ° Free Trade Zone Law	° Ministry of Trade and Industry ° Commercial Banks
3. Automatic Access to Export Financing	° Banking Regulations ° EX-IM Bank Law ° Export Credit Insurance Law	° Central Bank ° Commercial Banks ° Development Banks ° EX-IM Bank ° Export Credit Insurance Agency
4. Competitive Prices of Primary Inputs	° Labor Law	° Ministry of Labor ° Wage Council
5. Compensatory Export Incentives	° Tax Laws ° Banking Regulations ° Export Estate Development Law ° Technical Assistance Regulations	° Ministry of Finance ° Central Bank ° Commercial Banks ° Ministry of Trade and Industry ° Ministry of Technology
6. Institutional Support	° Export Association Law ° Export Inspection Law ° Trade Development Decree	° Ministry of Trade and Industry ° Export Associations ° Export-Inspection Agency ° Trade Development Council

it, sales opportunities in world markets (and domestic production opportunities as well) will be lost.

Equal Treatment of all activities that generate export value added[4]/: This means several things:

° Equal treatment of exports sold through different methods of payment, such as letters of credit (L/Cs), sight or time drafts, and or other methods.

° Equal treatment of both direct and indirect exports--that is, equal treatment of all processes that generate value added for export.

° Equal treatment of both imported and domestically produced inputs.

° Equal treatment of all manufacturing, processing, and sales activities pertaining to manufacturing, agricultural, or fishery products.

° Equal treatment of foreign exchange, whether earned through construction or service contracts.

4/ Activities for which optimum export taxes are justified--that is, activities for the production of primary export goods--should be treated separately.

Prevention of abuse: Rules are strictly applied to minimize abuses of the incentive system.

Administrative convenience: Administrative costs and feasibility are important factors in determining the most suitable administrative arrangements. To keep administrative costs down and increasing administrative efficiency, many administrative tasks can be delegated, say, to commercial banks or export associations. The administrative and banking procedures necessary to import intermediate inputs, for example, could be integrated with those for making export loans.

(d) Methods of Payment for Exports and Imports

Because the selection of particular instruments for export and import policy and administration is closely related to methods of payment, we will examine here the methods used to pay for exports. Similar methods are used to pay for imports. This discussion will serve as a background for analyses throughout the paper that hinge in important ways on these methods of payment.

Sales of export commodities are generally concluded on the basis of an export letter of credit (L/C), an export draft, a cash deposit prior to full payment, cash against document (CAD), consignment, an open account,

or some other method. Of these, the first two are the most commonly used in international trade.[5]/

An export L/C [6]/ is a document created by a bank, acting on behalf of the importer, that declares to the exporter that the bank will pay a draft drawn on it if the exporter submits, together with the draft, such documents as invoices, insurance certification, or negotiable bills of lading (B/L).[7]/ An export draft based on a L/C is an order written by an exporter (the seller) ordering an importer (the buyer) or his agent to pay a specific amount of money at a specified time. Except for a cash payment in advance, an export L/C gives the exporter the greatest amount of protection. The L/C calls for sight or time drafts to be drawn on the bank that opens (or confirms) the L/C. A sight draft is payable immediately upon being presented to the drawee (that is, the importer's bank). A time draft (also called a usance draft) allows a delay in payment. It is presented to the drawee, who accepts it and thus acknowledges in writing his obligation to pay the sum indicated on the face of the draft. Such a draft then becomes an acceptance. The maturity of the draft, referred to as its usance, usually is 90 days. A "red clause" L/C is similar to a normal L/C except that it contains a clause (originally typed in red) authorizing the negotiating bank to make cash advances to the exporter even if the L/C is not accompanied by invoices, bills of lading, or other proof of sale.

5/ For further explanation of these terms, see any standard textbook on international business finance: for example, Eiteman and Stonehill (1973).

6/ Unless specified otherwise, L/C means an irrevocable L/C.

7/ There are documentary L/Cs with deferred payment that do not require beneficiary's drafts.

Exporters may agree to payment by a draft without an L/C if the protection afforded by an L/C is not needed or if an exporter is willing to take such a risk. An export draft is an unconditional order drawn by the exporter on the importer instructing him to pay the amount of the draft, either on presentation (a sight draft) or at an agreed future date (a time draft). A sight draft is often called a document against payment (D/P) draft; a time draft is often called a document against acceptance (D/A) draft.

Under a cash against document (CAD) agreement, an exporter receives payment by presenting shipping documents to the importer's agent or bank in the exporter's country.

Under a consignment sale, an exporter retains title to the exported goods and agrees that payment will not be required until the goods have been sold in the country of import. Sales on an open account are usually settled on the basis of periodic statements of account. When sales of exports are based on a CAD, consignment, or open account, the seller is not protected against nonpayment. Therefore, CAD or consignment sales are usually limited to transactions where the buyer or consignee is a proven and trusted agent. Open account sales are generally restricted to cases where there is an inter-company relationship between seller and buyer and there are no exchange restrictions to complicate settlement. Generally, the financing on both consignment and open account sales is arranged by the exporter.

Empirical Evidence on Methods of Payment: Statistics on the degree to which these different methods of payment are used in developing countries would be useful. Unfortunately, however, virtually all the published trade data on both developed and developing economies omits such information, except for some data provided by the Bank of Korea. On the basis of the payment methods used in Korean trade, we can draw some inferences about the relative importance of the various methods of payments. Such information is critical in assessing the need for government policies to achieve equal treatment for all activities earning foreign exchange, in particular the needs for different types of export financing, export credit insurance, and finance guarantees.

Table 1 of Annex I shows Korean exports by type of payment for the period 1968-80; Tables 4 and 5 of Annex I show Korean imports by type of payment for the periods 1968-72 and 1975-80. An attempt to obtain comparable data for U.S. trade failed, but data on U.S. exports for one quarter in 1975, based on a sample survey of exporters, were obtained (Table 2 of Annex 1). These data, however, only show the relative shares of immediate cash and deferred payment trade.

During the years from 1968 to 1980, sight drafts drawn under L/Cs were the basis of 77 to 91 percent of sales of Korean exports. Only 3 to 7 percent were based on time drafts drawn under L/Cs, and only 1 to 6 percent were based on red clause L/Cs. Only 0.1 to 10 percent of Korean exports during the same period were based on D/P and D/A drafts (Table 1 of Annex I).

While 36 percent of U.S. exports in 1975 were sold on the basis of deferred payment, Korean exports sold on the same basis were less than 11 percent. This comparison indicates the greater importance of postshipment export financing and export credit insurance for the U.S. exports. In Korea, as will become clear below, preshipment financing is of greater importance.

As in the case of exports, information on the relative importance of different methods of paying for imports would also be valuable, since it would then be possible to assess the need to finance imports used in the production of exports. About one-third of Korea's total import bills during the years from 1968 to 1980 were for the purchase of inputs used for export production. While imports of grain and fuel for domestic consumption were mainly based on time drafts, imports of raw materials and intermediate inputs for export production were based mainly on sight drafts (Tables 4 and 5 of Annex I). Because only a minor part of the imports used in export production has been purchased on credit terms, the financing of imports used in export production has been an important part of Korea's preshipment export financing system.

Information on the different methods of paying for exports and imports is also one of the important elements in designing and implementing administrative arrangements for imports and exports. Such factors as importers' and exporters' preferences, or importing and exporting countries' trade restrictions and financing availability, may influence the payment methods used in international trade. The most important

determinants of payment methods, however, will be the characteristics of the commodities traded. Therefore, as the exports of a developing economy change, so will the relative importance of the different payment methods. This can be seen in the estimates of the shares of Korea's exports based on the different methods of payment shown in Table 3 of Annex I. As per capita exports (and heavy industry exports)[8/] increased, while the shares of exports based on L/Cs decreased, the shares of exports based on drafts without L/Cs and the shares of exports based on deferred payment both increased. It should also be noted, however, that the share of exports based on sight drafts drawn under L/Cs has been dominant, as shown in Table 1 of Annex I. This does not, of course, imply that a dollar earned from exports through the other payment methods is less important than a dollar earned from exports based on sight drafts drawn under L/Cs. The principle of equal treatment of all activity earning foreign exchange requires equal treatment of all export sales, regardless of payment method.

(e) Conclusions

The experiences of the successful East Asian countries indicate that only by assuring neutral status at the individual product and firm level for all activities that generate export value added can a country exploit its comparative advantages in the world market through specialization. Neutral status has been achieved by providing a combination of the five following elements or equivalent compensating incentives: (i) flexible and realistic exchange rates, (ii) free trade in

8/ More than 90 percent of Korea's exports in 1980 were manufactured goods.

inputs and outputs, (iii) competitive money and financial markets, (iv) competitive primary input markets, and (v) nondiscriminatory domestic taxes.

Neutral status, however, does not provide incentives equivalent to those for import substitution activities when an economy provides high effective protection for import substitution in order to protect infant industries. Anti-export bias created in such a situation can be eliminated through extended neutral status, which provides a level of export incentives as high as the level of incentives for import substitution activities.

The policies and administrative arrangements that have achieved neutral status, and sometimes extended neutral status, for export activities at the firm and product level have been the cornerstone of the export promotion systems of the successful East Asian countries. Three elements have been key factors in achieving this: (i) incentives at the firm level--which have been essential preconditions for extended neutrality; (ii) transitional policies--which have provided second-best measures with respect to all activities that generate export value added until first-best measures are possible; and (iii) institutional development--which has been critical for implementation of policies designed to achieve neutral status at the firm and product level.

The key principles of administrative arrangements that have characterized export incentive systems in the successful East Asian

countries are (i) automaticity, (ii) equal treatment of all activities that generate export value added, (iii) prevention of abuse, and (iv) administrative convenience. Finally, information on methods of payment for exports and imports is one of the important elements in designing and implementing administrative arrangements for imports and exports.

CHAPTER II

MAINTAINING A REALISTIC EXCHANGE RATE

The most important and central variable affecting the returns exporters realize in local currency for the foreign exchange they earn through export value added is exchange rate. The exchange rate is most important to exporters, and our discussion focuses on its incentive aspects. However, macroeconomic aspects can hardly be neglected because exchange rates are also key macroeconomic variables. Furthermore, the exchange rate policy of a country cannot be separated from its regime for managing foreign exchange. Because the approach of a developing country to foreign exchange management depends on its particular circumstances, this chapter discusses such factors as stages of financial institution development and trade regimes.

(a) Overview

Fixed parities in exchange rates among the currencies of the Western industrial countries were central to the Bretton Woods Agreement of 1945, which was the basis of the international monetary system prevailing after the Second World War. Even though the postwar system was envisaged as one of "fixed but adjustable" exchange rates, it evolved increasingly as a fixed exchange rate system with periodic large-scale devaluations. Then, in the late 1960's, a number of factors combined to disrupt the system. These included the inability of many countries to make the adjustments

needed to eliminate their external imbalances under the fixed exchange rate system, declining confidence in the dollar as U.S. inflation worsened, and the increasingly integrated character of the world capital market. In 1971 the US terminated conversion of the dollar into gold, and by 1973 the fixed exchange rate system had disintegrated into a system of floating exchange rates in the industrial economies.

Since then, exchange rates have fluctuated in a much more unstable manner than was anticipated by the proponents of a flexible rate system. Owing to this volatility, many observers have expressed increasing concern about the effectiveness of the present system (Witteveen 1983, McKinnon 1983a). In turn, exchange rate theory as applied to Western industrial economies has gradually switched from a theory of commercial policy (or balance of payments) to monetary theory (Krueger 1983a). Since exchange rate value in a floating exchange rate system is determined by equilibrium conditions in asset markets, some argue that one should expect floating exchange rates to exhibit the larger fluctuations typical of stock prices rather than the smaller fluctuations of goods prices (Frenkel 1981).

But this discussion is relevant mainly to the developed industrial economies. What about developing economies? One perspective is well summarized in the following statement by Arthur Lewis:

> "It is now the conventional wisdom that the currencies of the developed countries should float, but the currencies of the less developed countries should not; that is to say, that each LDC

should choose a more developed country as a partner - or the SDR - and tie itself in a fixed relationship" (Lewis 1977).

This statement suggests several questions about "the conventional wisdom." First, why is it infeasible to have floating exchange rates in developing countries? Second, doesn't pegging the currency of a developing country to one of the major currencies imply floating vis-a-vis all the others, since major currencies continuously move against each other? Third, isn't the real exchange rate, rather than the nominal exchange rate, the essential matter of concern?

According to recent IMF publications (Hooke 1983, IMF 1983a), 54 IMF members were pegging their currencies to the currency of a major trading and financial partner at the end of June 1983 (See Table 2). A second group of 39 countries was pegging its currencies to various composites of currencies, such as the SDR. Among members that choose not to peg, five were adjusting the exchange rate of their currency on the basis of a set of indicators. Eight other countries were participating in an arrangement in which the value of each member's currency was maintained in relation to the values of the currencies of the remaining members. Most of those remaining members were maintaining systems of managed or independently floating currencies, with several of the Western industrial countries in particular maintaining systems of independently floating currencies. Since exchange rate regimes are related to regimes of foreign exchange management, a brief history of the latter is sketched below.

Table 2. Exchange Arrangements of IMF Member Countries as of June 30, 1983

Type of Arrangement	Number of Countries
Currency pegged to	
U.S. dollar	36
French franc	13
Other currency	5
SDR	14
Other currency composite	25
Exchange rate adjusted to set of indicators	5
Cooperative exchange arrangements	8
Other arrangements	39
Total	145

Article VIII of the IMF's Articles of Agreement provides a definition of current account convertibility[9/]. While dollar-area countries, such as Canada and the US, have maintained convertibility since 1945, it was not until 1958 that the major European trading countries

9/ Article VII underpins the Fund's role in encouraging its members to avoid restrictions on payments for trade and other currency payments, which Article XXX defines to include payments due in connection with normal short-term banking and credit facilities, and moderate amortization payments on capital. Therefore, commercial credits normally granted by exporters or received by importers are considered current for the purpose of satisfying Article VIII. Most of the Article VIII status countries retain substantial restrictions on capital account. The current-capital account distinction is not very sharp under Article VIII. It is not impossible to manipulate net capital inflows based on commercial credits.

achieved free convertibility. At that time, fourteen Western European countries made their currencies externally convertible for current transactions. Japan did not formally achieve convertibility until April 1964. As of December 1975, 44 out of 128 members (34 percent) had formally accepted convertibility under Article VIII. As of June 1983, 57 out of 145 members (39 percent) had done so. Meanwhile, 88 members (61 percent) had been availing themselves of the transitional arrangements allowed under Article XIV. These arrangements permit a country to maintain restrictions on current payments and transfers until it is satisfied that its balance of payments is strong enough to remove such restrictions (IMF 1983a). A majority of the developing countries belong to this latter group.

Hong Kong, Singapore, and Malaysia maintain Article VIII status, while Korea, Indonesia, and the Philippines belong to the Article XIV group. In turn, according to the IMF publication, while Korea, Indonesia, and the Philippines are classified as maintaining a system of managed floating exchange rates, Singapore and Malaysia are classified as pegging their currencies to composites of currencies, even though there are free foreign exchange markets in the latter (and in Hong Kong) but not in the former. In our discussion of foreign exchange management and exchange rate policies, we consider the East Asian countries under headings describing the general policies and procedures that govern operation of their foreign exchange markets.

(b) A Market-Based Foreign Exchange Regime

Institutional Requirements

A free, market-based, foreign exchange regime is feasible when the domestic currency is convertible. Then commercial banks can establish a unified market in foreign exchange by intermediating the unrestricted demand and supply of nonbank customers and by operating in interbank markets. In short, a free market foreign exchange regime is feasible for countries with mature financial markets that are integrated with international financial markets.

A free market foreign exchange regime requires the existence of a large number of agents in the private sector who hold their home currency as part of their portfolio and who can sell home currency when the exchange rate rises above its expected level and buy any home currency when the exchange rate falls below that level. Such activities can hardly be expected to occur without well-developed financial markets. The short-run determination of floating exchange rates through financial market equilibrium makes financial structure the center of analysis in the choice of foreign exchange regimes (Branson 1983).10/ The previous statements by Lewis on the infeasibility of floating exchange rates in most developing

10/ One might argue that another condition for a market-based foreign exchange regime is a large volume of trade denominated in the currency concerned. However, this view is based only on transaction demands for foreign exchange. If one includes speculative demands, such a regime is feasible as long as a country has liberalized forward-covering activities, interest arbitrage, and capital flows, even though trade volume is not large.

economies is probably based not only on his understanding of the underdeveloped status of financial institutions and markets in these economies but also on the long periods required to develop mature financial institutions and markets.

It is important to understand clearly the process by which free foreign exchange markets developed in Hong Kong, Singapore, and Malaysia. Hong Kong and Singapore were cities founded by the British to carry out entrepot functions, while Malaysia became a source of primary goods for international trade. Their early British connections and early exposure to international trade-related activities gave Hong Kong, Singapore, and Malaysia ample opportunities to develop Western-style financial and trade-related institutions. Because they were entrepot trade centers, their financial institutions developed around international trade. As early as the 1850s, more than ten foreign banks representing British, Dutch, French, and American interests were operating in Singapore and Penang. In 1980, Hong Kong had 115 licensed banks with 1,123 branches operating within the territory, or about one branch for every 4,000 people, a ratio exceeding that of many developed countries. But despite the extensive British influence and international trade activities, it took more than a century for the financial institutions and markets of Hong Kong and Singapore to develop to the point of becoming international financial centers (Geiger and Geiger 1975, Drake 1969).

Foreign Exchange Markets

A foreign exchange market has several functions. It offers a mechanism for clearing payments related to international trade or investment on a multinational basis, it provides credit in different currencies, it includes facilities for hedging foreign exchange, and it determines exchange rates between convertible currencies. National markets for the major currencies are effectively joined together by arbitrage[11/], so that a currency's value is more or less the same all over the world. A foreign exchange market is a network of telephone, cable, and computer communications among banks, investors, foreign exchange brokers, and dealers all over the world. The market operates on three levels: (i) commercial banks engage in foreign exchange transactions on behalf of their non-bank customers; (ii) commercial banks deal with each other in an interbank market; and (iii) central banks intervene in the market to maintain the value of currencies within desired levels.

A foreign exchange market determines not only the spot exchange rate but also forward exchange rates. A forward rate is one agreed to now for an exchange of currency at some date in the future. The forward rate is based on the current value of a currency in the spot market plus or minus a premium or discount for forward delivery. A forward exchange cover based on the forward margin (i.e. forward sale of foreign exchange)

11/ Arbitrage is the process of taking advantage of the differences in buying and selling prices within a single market or between markets, through dealing in spot and/or forward transactions, or in combination with money market or capital market rates.

provides an exporter who draws an export draft in a major convertible foreign currency with protection against unexpected fluctuations in exchange rates that may occur between the date of the export contract and the date on which the export bill is negotiated. The cover is usually arranged by the exporter's bank. Similarly, an importer who receives an import draft drawn in foreign currency can make a forward purchase of that currency that will enable him to make future payments before the date of import bill clearance.

Even though Singapore conformed to IMF's convertibility requirements (Article VIII status) in November 1968, it maintained controls over foreign exchange transactions until 1978.[12/] Singapore's foreign exchange market became much more active after the Singapore dollar began to float in 1973. Daily market turnover grew from $369 million in 1974 to $8.5 billion in 1982. Participants in the market include banks, money brokers, Asian Currency Units (or ACUs--bookkeeping entities established to deal only in foreign currencies), and non-bank customers. About three-quarters of all foreign exchange transactions in Singapore are on a spot basis. U.S. dollar-Singapore dollar transactions account for 15 percent of total transactions, with the remaining 85 percent being transactions in other currencies. A major development has been greater utilization of U.S. dollar-Singapore dollar swaps[13/] as a money market instrument by the

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12/ Until 1978, Singapore residents were restricted from borrowing or depositing in foreign currencies, particularly in Asian Currency Units.

13/ A common swap transaction involves converting the deposit currency into loan currency in spot exchange and simultaneously selling the loan currency forward for the deposit currency to meet the maturing fixed deposit.

Monetary Authority of Singapore. Such swap operations have served also to promote the forward exchange market.

Deliberate efforts by the Government of Singapore were instrumental in establishing the Asian Dollar Market in Singapore rather than Tokyo or Hong Kong. Japan has not been as liberal as Singapore in allowing capital movements, and Singapore offered exemptions from its withholding tax to dollar depositors much earlier than Hong Kong did. The Asian Dollar Market is an international money and capital market similar to the Euro-Dollar Market. Financial institutions that want to operate in the Asian Dollar Market have to obtain approval from the Monetary Authority of Singapore to set up ACUs to carry out transactions in the market. At the end of 1982 there were 150 ACUs. Funds in the market came mainly from inter-bank borrowings. Government policies have been instrumental in making Singapore an active foreign exchange market while at the same time maintaining the stability of the Singapore dollar through market intervention.

Hong Kong's foreign exchange market became active after Hong Kong's exclusion from the Sterling Area in 1972. US dollar-Hong Kong dollar transactions are the most prevalent, accounting for some 25 percent of all transactions. Deposit-taking companies and foreign banks obtain Hong Kong dollars through swap transactions in the spot and forward markets by selling foreign currencies for Hong Kong dollars, with an agreement to repurchase them at a fixed date at a price reflecting market interest rates

and exchange risks.[14]/ The residual source of liquidity for the banking system as a whole is the foreign exchange market and the ability of each individual bank to acquire Hong Kong dollars against the sale of US dollars, an ability assured through the activities of the government's Exchange Fund.

Malaysia also operates a foreign exchange market, although it is not as big as the exchange markets of Singapore and Hong Kong. Here again, US dollar-Malaysian currency trading is by far the most important, accounting for over half of all business. In recent years the central bank's use of swap facilities between the Malaysian dollar and other currencies as a means of relieving short-term liquidity problems has also helped the two markets (i.e., the exchange market and the credit market) move as one (Skully 1983).

Free-Floating vs. Managed Floating Exchange Rate

There are two things that distinguish a free (clean or independent) floating exchange rate from a managed (or dirty) floating exchange rate: (i) whether the monetary authorities intervene in the foreign exchange market and (ii) whether they adjust the domestic money supply to smooth exchange rate fluctuations. Countries with market-based foreign exchange regimes have the option of pegging or not pegging to a convertible foreign currency or a composite of such currencies. We

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14/ There are two types of swaps: interbank swaps and swap deposits taken from the public.

consider pegging under a market-based foreign exchange regime to be one form of managed floating.

Free-Floating: McKinnon (1983a) summarizes in the following words his analysis of the unstable aspects of a free-floating exchange rate regime:

> Under the conditions prevailing in the commodity and asset markets of the major industrial economies, I show that a floating rate is an inefficient mechanism for balancing international payments. The comparative political or economic riskiness of holding financial assets in different countries changes continually. But domestic money supplies and national interest rates cannot vary to provide the necessary offsetting risk premia demanded by investors. The result is inherently high exchange-rate volatility--overshooting--that distorts the flow of international commodity trade and causes cycles of unanticipated inflation and deflation in any open economy.

Some suggest that the argument over a managed versus a free float is dead for all practical purposes, since almost all countries manage their float by more or less heavily intervening in the foreign exchange market (Haberler 1982). A critic might well argue that if the governments of industrial countries agreed not to intervene at all in foreign exchange and followed fixed domestic monetary growth rules, more stability would be achieved. McKinnon, however, criticizes the noninterventionist solution on

the ground that it implicitly presumes that the demand for national money is stable, ignoring the possibility of cumulative currency substitution in favor of or against the national currency.[15] Recent empirical evidence--in particular, the current overvaluation of the dollar--confirms that there is extensive currency substitution (McKinnon 1982a, 1983c). In any event, many have expressed concern regarding the harmful effects of floating exchange rates on the international trading system and have stressed policy interdependence among industrial economies (Witteveen 1983, IMF 1983b).

Managed Floating: The argument for managed floating is based on a belief that the costs imposed by volatility and the misalignments associated with free floating exceed the benefits of treating the exchange rate as a residual in policy determination. If exchange rate stability is accepted as a key policy objective, two major questions arise. First, what is the norm for determining the stability or instability of the exchange rate? Second, what policy instruments are available to manage a floating rate?

The usual approach to determining a norm exchange rate[16] involves finding a period during which exchange rates appear to have been

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15/ International currency substitution includes indirect as well as direct substitution. Direct currency substitution means that two (or more) currencies compete as a means of payment within the same commodity domain. Indirect currency substitution refers to investors switching between nonmonetary financial assets--say bonds--denominated in different currencies in a way that indirectly influences the domestic demand for transaction balances (McKinnon 1983b).

16/ Williamson (1983) calls it a Fundamental Equilibrium Rate.

at appropriate levels and then making a "purchasing power parity" (PPP) comparison to identify the nominal exchange rate that would produce the real exchange rate of the base period, given intervening inflation (see below for the concept of PPP and real exchange rate).[17]/ The norm exchange rate may need to be adjusted to reflect desired change in capital flows; a "zone" or "band" approach will be preferable in comparing the norm rate with the actual rate.

There appears to be a consensus that monetary policy provides the main instrument for influencing the exchange rate, even though there may be some disagreement on (i) the relative importance of various objectives of monetary policy, and (ii) the relative effectiveness of other policy tools for influencing the exchange rate. McKinnon stresses the consistency in monetary cum exchange rate policy. He contends (1983b) that in a small open economy (not using an inflation tax) in a position of monetary and exchange rate equilibrium, the rule for maintaining equilibrium is to be aware that the national money supply should expand above its norm when the currency becomes unexpectedly strong on foreign exchanges, and contract when it is weak. McKinnon suggests that further monetary coordination may be necessary among larger countries to maintain stable growth in their aggregate money supply.

17/ See Williamson (1983). Mckinnon's discussion (1983c) of dollar overvaluation was based on a similar estimate.

Other policy instruments that can complement monetary policy in maintaining exchange rate stability are, (i) sterilized intervention,[18] (ii) capital controls; and (iii) fiscal policy. It has been argued that sterilized intervention is impotent to remedy persistent misalignments, even though it is a useful tool for smoothing out short-run volatility. The effectiveness of capital controls varies, depending on the degree to which a country is integrated into the world capital market. For example, while the effectiveness of capital controls in Japan has been noted, the opposite was the case in the US in the 1960s. While it is very important that fiscal policy be consistent with exchange rate policy,[19] it has been argued that fiscal policy is not well suited to be a major instrument of exchange rate policy (Williamson 1983).

Table 6 of Annex I summarizes the history of Hong Kong's foreign exchange regime. Although Hong Kong was a part of the Sterling Area until 1972, the relationship between the Hong Kong dollar and sterling was at no time a statutory one but was established and maintained by the operations of the Exchange Fund in conjunction with note-issuing banks. The relationship weakened after the devaluation of the pound in 1967, and ended

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18/ Intervention in the exchange market is said to be "sterilized" when it is not allowed to affect the domestic money supply. This requires that the potential reduction in the monetary base as a result of the central bank selling foreign currency in exchange for domestic currency is prevented by a central bank purchase of domestic nonmonetary assets (Williamson 1983).

19/ It has been widely accepted that a major cause of the very high value of the dollar has been the large US budget deficits. See 1984 annual report of the President's Council of Economic Advisers (U.S. Government 1984).

after the pound was allowed to float in June 1972. The government then announced the pegging of the Hong Kong dollar to the US dollar (with provision for fluctuations of up to 2.5 percent). This link was broken in 1974. Since that time the Hong Kong dollar has floated according to market conditions.

Even though the exchange rate of its dollar is determined by the free market, the government of Hong Kong is active in foreign exchange markets through its commercial bankers to the extent that portfolio management considerations of the Exchange Fund require, and the timing of transactions can be varied with a view to their impact on the exchange rate of the Hong Kong dollar. The government may on occasion intervene more positively, but such intervention generally seeks only to smooth out erratic movements in the rate. The main purpose of the Exchange Fund has been to regulate the exchange value of Hong Kong's currency by selling or purchasing foreign currency in the foreign exchange market. Another policy instrument is the imposition of withholding taxes on interest earned from foreign currency deposits. In 1982 the government abolished the interest tax on foreign currency deposits held in Hong Kong, while it reduced the corresponding tax rate for Hong Kong dollar deposits from 15 percent to 10 percent. This stimulated local financial institutions to compete with other international centers for funds by means of interbank swaps. At the same time, it resulted in a very extensive switch of local funds into foreign currencies. This switch prompted some criticism about the wisdom of different tax treatment of local and foreign currency deposits. There is neither a central bank nor marketable government debt in Hong Kong.

However, it is interesting to note that, in hopes of slowing a drastic weakening in the value of Hong Kong's dollar, the Hong Kong Association of Bankers raised the prime lending rate two percentage points to 13.5 in the middle of 1983 (Asia Week, June 10, 1983). Between 1974 and 1982 the trade-weighted exchange rate index, which is calculated against the currencies of Hong Kong's 15 principal trading partners, showed that the Hong Kong dollar depreciated about 24 percent (see Table 6, Annex I). A managed floating foreign exchange regime helped Hong Kong to maintain its competitive position as a major manufactured good exporter as well as a major international financial center.

The exchange rate of Singapore's dollar was tied to sterling until June 1972, when the pound was allowed to float. The Singapore dollar did not follow sterling downward because Singapore then tied its currency to the US dollar. But when the U.S. dollar declined in June 1973, Singapore allowed its dollar to float. Singapore's exchange rate management system is operated on the basis of the Singapore dollar's relationship to a trade-weighted basket of currencies representing Singapore's major trading partners. The exchange rate of the Singapore dollar in terms of the US dollar, the intervention currency, is determined in the foreign exchange market. Rates for other currencies are established on the basis of the daily rate of the US dollar and their cross rates in international markets.

Singapore's exchange rate policy represents, more or less, a successful example of the aforementioned integrated strategy of monetary

and exchange rate policies for a small open economy advocated by McKinnon. The centerpiece of Singapore's domestic monetary policy has been the stabilization of its exchange rate with respect to the US dollar. Singapore's monetary base has thus been largely endogenized by the desire to maintain an orderly foreign exchange market. Instead of setting firm internal rules for rates of monetary growth, Singapore has allowed the monetary base to reflect foreign exchange interventions. This policy has achieved the objective of maintaining stability in exchange rates, even though the money supply has fluctuated widely in the short run.20/ Singapore's successful policy has resulted from that country's determination to separate the domain of foreign currency transactions from the domain of local currency (McKinnon 1982c). Until June 1978, this separation was achieved by exchange controls; Singapore residents were restricted from borrowing or depositing in foreign currencies, particularly in ACUs, which are specifically authorized to deal only in foreign currencies. After exchange controls were eliminated in June 1978, the separation was due to: (i) differential tax treatment of interest income from foreign currency deposits between nonresidents and non-bank residents; and (ii) differential tax treatment of interest income from foreign currency deposits and those from domestic currency deposits. There is no withholding tax on interest income from ACUs for nonresidents, but there is a 40 percent withholding tax on interest income for domestic nonbank residents who own foreign currency deposits in ACU and on Singapore dollar deposits. Thus, foreigners are given a strong incentive to transact

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20/ Such short-run fluctuations in money supply do not endanger price stability in an open economy whose domestic prices are completely dominated by a flow of imports and exports.

business in foreign currency only with ACUs, whereas local residents are not given artificial incentives to move out of Singapore dollars. In the absence of exchange depreciation, Singapore residents have had no incentive to switch to foreign currencies inside or outside the country. As shown in Table 7 of Annex I, the Singapore dollar has appreciated relative to the US dollar over the last 10 years or so. In 1951, 3.1 Singapore dollars exchanged for one US dollar, and this rate stayed constant until 1970, when it began to decline. By 1982, one US dollar was equivalent to only 2.1 Singapore dollars. After adjustment for inflation, which in the case of Singapore has been less than that of its trading partners, the nominal appreciation of its dollar implies fairly stable real exchange rates. In sum, Singapore's exchange rate policy has achieved competitiveness for exporters as well as domestic price stability.

Malaysia's exchange rate system is similar to that of Singapore. It has been based on the relationship between the Malaysian ringgit and an undisclosed weighted basket of currencies of Malaysia's major trading partners. The exchange rate of the ringgit in terms of the US dollar, the intervention currency, is determined in the foreign exchange market, and Bank Negara Malaysia intervenes in order to maintain stability in its exchange rates. Table 8 of Annex I shows nominal and real exchange rate indices during 1970-79 (measured in terms of the official composite of foreign currencies per ringgit). During 1970-79 the nominal exchange rate appreciated. Due to the stability of domestic prices as compared to the prices of export and import commodities, however, real exchange rates for exports and imports depreciated between 1970 and 1974. During 1975-79,

however, the real exchange rate for imports appreciated while that for exports depreciated, resulting in a somewhat improved position for export industries compared to import substitution industries (Rhee 1980).

(c) Managed Foreign Exchange Regime

Institutional Background

Underdeveloped financial markets and financial institutions in developing countries may be one of the major reasons why these countries have continued to maintain managed foreign exchange regimes rather than relying on a free foreign exchange market. McKinnon (1981a) states:

> Financial immaturity, or more active domestic financial repression, is clearly linked with maintaining tight controls over foreign exchange transactions. If, as in most LDCs, domestic financial assets are illiquid and bear a low real rate of return for that degree of liquidity, then domestic nationals will prefer to hold liquid assets abroad unless prevented by official restrictions. These exchange controls are usually tightened in a situation of on-going price inflation, an important aspect of which is to collect a tax from the domestic banking system. Because the tax is levied on domestic currency and deposits, the purchase of foreign bonds or working balances of foreign exchange erodes the tax base. These resources not only elude the government's inflation tax but in doing so cause a

further socially unwarranted capital outflow from the domestic economy. Given the initial distortion of a repressed domestic financial system, therefore, a detailed web of exchange controls is a perfectly rational--indeed necessary--policy response.

Financial immaturity in developing economies is characterized by fragmented financial markets. In most cases, this fragmentation merely reflects stages of underdevelopment in general (Goldsmith 1969). Of course, financial repression associated with misguided government policies (McKinnon 1973) aggravates such fragmentation. In turn, financial repression may stem partly from financial immaturity. While every effort to relieve financial repression by means of rational fiscal and monetary policies should be encouraged, a mature financial market cannot be achieved without a painstaking process of institution-building and learning by doing. Thus, while efforts to build financial maturity are pursued in developing economies, their transitional status in foreign exchange management may have to be accepted.

Financial immaturity and repression are closely related to choice of trade regime. For example, McKinnon (1971, 1979a) stresses capital constraints stemming from financial market fragmentation in explaining the persistent use of import restrictions to protect infant industries. The NBER study (Krueger 1978), which analyzed the five phases in trade regimes and exchange control, considered the most advanced phase (Phase V) as the phase of full currency convertibility on the current account. This phase

could be associated with detailed controls on the capital account, implicitly requiring a pegged exchange rate, even though it is free from quantitative restrictions. Except for Israel, however, none of the other eight countries in the study (including Korea and Brazil) was able to reach Phase V by 1972.

Foreign Exchange Management

During transitional periods a foreign exchange management system operated by the government must perform the functions that a market-based foreign exchange system carries out in an advanced industrial economy. Under a managed system, the monetary authority views foreign exchange management as an integral part of its work. Under such a system, capital flows and the convertibility of local currency into foreign currency are partially or fully restricted. Of course, such a managed system must be carefully designed to achieve, with minimum administrative costs, the objectives of realistic exchange rates and efficient allocation of foreign exchange. Prevention of capital flight takes high priority in a managed system.21/ Selectivity is applied to capital inflows in order to minimize

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21/ Keynes realized the problems caused by capital flight. He argued that a free flow of capital among many countries would make successful domestic planning for full employment in any one country impossible (Crotty 1983).

any harmful impact on domestic stabilization policies and borrowing status[22/] without jeopardizing inflows of the physical capital essential for domestic capital formation and technology transfer. A foreign exchange supply and demand plan is an important administrative tool in achieving efficient resource allocation. In setting priorities in such a system, nothing appears more important than guaranteeing unrestricted access to the foreign exchange needed for importing inputs for export production. In an economy that has an underdeveloped financial market and shortages of foreign exchange, a foreign currency loan scheme can be an effective tool for achieving efficient foreign exchange management.

As the recent external debt crises of some developing countries attest, efficient foreign exchange management is currently one of the most important issues in economic management, particularly for a developing economy with a large external debt. Some developing economies, however, did not appear to know the extent of their own short-term debt until they reached a point of crisis. (Short-term debt in many developing countries generally exceeds 30 percent of the total medium and long-term debt outstanding.) Thus, 1983-84 World Debt Tables (World Bank 1984) concludes: "...the events of the past two years have emphasized the need for borrowing countries, banks, and international agencies to monitor more closely trends in short-term flows (of external debt)."

22/ Diaz Alejandro (1983) argues that the case for some limitations on free capital account movements rests partly on macro-economic considerations, partly on the need to correct micro-economic imperfections in domestic and international financial markets characterized by "moral hazard" and "expectations of bail-outs."

As indicated above, Korea belongs to the nonconvertible currency group (i.e., countries with Article XIV status). The major reason for reliance on a managed foreign exchange regime in these economies appears to be a lack of well-developed financial markets and institutions integrated with international capital markets. Unlike Singapore and Hong Kong, Korea did not have an early opportunity to develop financial institutions specializing in trade financing and foreign exchange transactions. During the Japanese colonial period (1910-1945), the financial system in Korea was owned and controlled by the Japanese and was used to channel savings into Japanese industrial expansion and then into the Japanese war effort. Even in Japan the financial markets have been characterized as noncompetitive and segmented, unlike those in the Western industrial economies at a similar stage of development (Wallich and Wallich 1976). Cole and Park (1983) evaluated Korea's financial system during 1945-1978 in these words:

> As in the case of Japan during the post-war period, and also in many other developing countries, the regulated part of the Korean financial system may be characterized as a 'disequilibrium system' in which institutional controls have taken away from interest rates much of the function of allocating resources... the government has been actively involved in managing the system, using it to mobilize financial resources from abroad and at home, and to allocate those resources in ways that supported its high-growth policies....To judge from the remarkable performance of the economy over the past decade and a half, the total mix

of policies has been effective in transforming Korea from a poor agricultural to a newly industrialized middle-income country.

Korea's managed foreign exchange regime has been an integral part of its managed financial system. An annual program for foreign exchange supply and demand has been one of the key components of the annual economic management plan of the Korean government. Judging from the success of an outward-looking development strategy that involved heavy external borrowing, Korea's managed foreign exchange system has been very effective in: (i) preventing capital flight, (ii) allowing selectivity in capital inflows, (iii) utilizing a foreign currency loan scheme for the use of exchange reserves, and (iv) maintaining stability in the real exchange rate or the effective real exchange rate. Korea's experience indicates that efficient management of foreign exchange during the transitional period is the most important immediate practical issue for developing economies while efforts to build financial maturity are being pursued. As Korea's efforts to rationalize its financial system progress, conditions in Korea will become conducive to a gradual transformation to a free market-based foreign exchange regime.

Real Exchange Rate Policy

Under a managed foreign exchange regime, commercial banks and nonbank customers are in no position to create a unified market for foreign exchange, either spot or forward, as they might do under a free market-based regime. Instead, the central bank establishes an official foreign

exchange market by setting official exchange rates and managing foreign exchange transactions on a day-to-day basis. Many foreign exchange transactions are delegated to commercial banks, which handle such transactions on the basis of official rules, regulations, and exchange rates. Since exchange rates are not governed by a free market, what criteria does the government rely on to determine official exchange rates? Since we have already discussed the infeasibility of floating, we turn now to the issues associated with nominal vs. real exchange rates and the pegging of one currency to another.

Nominal vs. Real Exchange Rate: Under a managed foreign exchange regime, a central bank does not have much choice but to adopt some version of a pegged exchange rate. Pegging the nominal value of the local currency to that of a leading foreign currency does not mean, however, that the objective of pegging is to maintain the stability of the nominal exchange rate. The export incentive value of the official exchange rate is reflected in the underlying purchasing power of the local currency unit that is being obtained in exchange for one unit of the foreign currency (and the associated purchasing power in the foreign country). Stabilization policy aims at direct stabilization of the international purchasing power of the local currency by stabilizing the exchange rate, which is considered the first line of defense in stabilizing domestic purchasing power (McKinnon 1982a). Therefore, particularly in an economy where the purchasing power of the local currency is relatively unstable due to a higher inflation rate than that of its trading partners, the objective of exchange rate policy should be to maintain stability in the real exchange rate.

A real exchange rate is defined as a purchasing power parity (PPP) adjusted official exchange rate:

$$[\text{Real Exchange Rate}] = \left[\begin{array}{l}\text{Official Exchange Rate}\\ \text{(number of units of the}\\ \text{local currency per unit}\\ \text{of the foreign currency)}\end{array}\right] - [\text{PPP}], \quad (1)$$

where

$$[\text{PPP}] = [\text{Domestic Price Index}] - [\text{Foreign Price Index}] \quad (2)$$

In order to maintain a constant real exchange rate (i.e., a base level real exchange rate) when PPP changes, the official exchange rate must be adjusted so as to devalue (or appreciate) the local currency as much as the excess (or deficit) of the domestic inflation rate over the foreign inflation rate (all rates being relative to the base period):

$$\left[\begin{array}{l}\text{Desired Official Devalua-}\\ \text{tion Rate (rate of increase}\\ \text{in the number of units of}\\ \text{the local currency per unit}\\ \text{of the foreign currency)}\end{array}\right] = \left[\begin{array}{l}\text{Domestic}\\ \text{Inflation}\\ \text{Rate}\end{array}\right] - \left[\begin{array}{l}\text{Foreign}\\ \text{Inflation}\\ \text{Rate}\end{array}\right] \quad (3)$$

For the purpose of maintaining stable export incentives (i.e., the competitiveness of exporters in the home country with those of the competing country), the most appropriate price index for computing inflation rates with Formula (3) would be the manufacturing cost indices of both countries. For example, Balassa (1983) uses labor cost indices for computing real exchange rates. Given the objective of maintaining the stability of the real exchange rate, two additional questions arise. First, what is the appropriate base level real exchange rate that would

enable an economy to maintain stability? Second, how often should the official exchange rate be adjusted in order to maintain the real exchange rate at a constant level?

We indicated previously that the usual approach to estimating a norm for exchange rate stability in a managed floating regime involves finding a period during which exchange rates appear to have been at appropriate levels. A similar approach may be most practical under a managed foreign exchange regime in a developing economy that has maintained realistic exchange rates at least for a while after previous devaluations. But if a developing economy has maintained an overvalued exchange rate throughout its whole development process, a new equilibrium exchange rate must be sought as the base rate on which the crawling peg can adjust the official exchange rate. Such an equilibrium exchange rate can be estimated by using a method of "compensated devaluation" that involves reductions in import protection (Balassa 1977). In turn, an equilibrium exchange rate estimate must also take into account the optimum level of foreign capital inflows. While there appears to be no generally accepted method for estimating with precision the equilibrium exchange rate under alternative circumstances (Krueger 1983a), policy-makers in a developing economy may be able to come up with some reasonable "band" or "zone" for such an equilibrium rate, based on sensible judgements on how to improve the competitive position of exports. Many recent contributions to the literature dealing with the shadow prices of foreign exchange[23/], as well

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23/ The literature on shadow price of foreign exchange concerns mainly correct exchange rates for a micro-project appraisal. See Blitzer, Dasgupta, and Stigliz (1981).

as information on black market exchange rates, would be useful in making such judgments.

Adjustable Peg vs. Crawling Peg: In an adjustable peg system, the exchange rate is kept rigid for several months or years until a possibly large devaluation must be made. In a crawling peg system, on the other hand, the government devalues in very small steps by an amount equal to the amount domestic inflation in the preceding week or month exceeded that abroad. Haberler (1982) states that the crawling peg is best regarded as a species of the managed float, since it is much closer to a system of floating exchange rates than to a system of par values. However, McKinnon (1981a) calls such a typical crawling peg a "passively downward crawling peg," since the policy is simply to adjust passively in order to maintain stability in the real exchange rate. Since the distortions inherent in delayed and massive devaluations stemming from an adjustable peg have become so well-known, many advocate the advantages of the crawling peg over the adjustable peg. Also, the crawling peg can check the dangers associated with excessive speculation that may occur under the adjustable peg by increasing the frequency of changes in the exchange rate and making the changes quite small. However, experience in many developing countries indicates that the crawling peg often faces resistance from those who fear that frequent exchange rate movements directly accentuate domestic inflation in addition to destabilizing the demand for money. They claim that the adjustable peg is preferable because of the need to stabilize price-level expectations and to inspire confidence in the government's financial future. While skepticism about the effectiveness of the crawling

peg appears largely unwarranted, however, particularly when the disadvantages of large discrete adjustments are considered.

Single Peg vs. Composite Peg: So far, we have only discussed pegging the local currency to a single major currency. Countries with trade that is highly concentrated in one major currency area peg only to that major currency. However, countries whose trade is so diversified that a single currency peg is not appropriate are left with the choice of a currency basket for the peg. Under the old fixed exchange rate system, and in the absence of major currency readjustments, pegging to any one of the major currencies was equivalent to maintaining a fixed parity with all others. In a world of floating rates, however, pegging to any one of the major currencies implies floating vis-a-vis all others. Thus, to avoid large fluctuations in their exchange rates, an increasing number of developing countries have abandoned single-peg policies and adopted composite pegs. A composite peg amounts to pegging the local currency to a weighted average of the currencies of trading partners. Even under a composite peg system, a single intervention currency such as the US dollar is usually selected, because once an official exchange rate of the local currency in terms of the intervention currency is determined, the exchange rates of the local currency in terms of other major convertible foreign currencies are automatically set in light of the international market exchange rates of the intervention currency in terms of the major convertible foreign currencies.[24/]

24/ The exchange rate of the local currency in terms of a major convertible currency = [the official exchange rate of the local currency in terms of the intervention currency] x [The exchange rate of the intervention currency in terms of a major convertible currency].

What is meant by "the exchange rate" of a country in a floating, multiple-currency world? A trade-weighted index of the local currency price of various foreign currencies has been used to approximate "the exchange rate" of a country. The IMF now publishes such weighted average exchange rates for 18 industrial countries[25]. This is an index combining the exchange rate of each currency in question weighted against 17 other major currencies, using the IMF's multiple currency exchange rate model (Artus and Rhomberg 1973). We present below a convenient formula for pegging to a currency basket to maintain the constant real weighted average exchange rate (Branson and Katseli 1981). A country can maintain a constant real weighted average exchange rate by pegging the local currency to the optimum level of the intervention currency, based on this formula. The country sets an appropriate official exchange rate for the local currency in terms of the intervention currency after choosing an appropriate set of weights for the intervention currency's exchange rates with respect to the various foreign currencies so as to equate the real devaluation (or appreciation) rate of the local currency in terms of the intervention currency with the weighted average real appreciation (or devaluation) rate of the intervention currency in terms of the various foreign currencies (including the intervention currency):

25/ IMF calls such weighted average exchange rates "effective exchange rates." We, however, use the term effective exchange rates differently (see below).

$$\left[\begin{array}{l}\text{Desired } \underline{\text{Real}} \text{ Devaluation (or Appreciation) of the local currency in terms of the dollar}\end{array}\right] = \left[\begin{array}{l}\text{Weighted Average } \underline{\text{Real}} \text{ Appreciation (or } \underline{\text{Devaluation}}\text{) Rate of the dollar in terms of the various foreign currencies}\end{array}\right], \quad (4)$$

where

$$\left[\begin{array}{l}\text{Desired Real Devaluation (or Appreciation) Rate of the local currency in terms of the dollar}\end{array}\right] = \left[\begin{array}{l}\text{Desired Official}^{a/} \text{ Devaluation Rate of the local currency in terms of the dollar}\end{array}\right] - \left[\begin{array}{l}\text{Domestic Inflation Rate} - \text{Dollar Inflation Rate}\end{array}\right] \quad (5)$$

$$\left[\begin{array}{l}\text{Weighted Average Real Appreciation (or Devaluation) Rate of the dollar in terms of the various foreign currencies}\end{array}\right] = \sum_{i=1}^{N} \left[\text{Weight}_i\right] \left[\begin{array}{l}\text{Dollar Inflation Rate} - \text{Inflation Rate in country } i - \text{Nominal Devaluation Rate of the dollar in terms of foreign currency } i\end{array}\right] \quad (6)$$

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a/ Official nominal devaluation (or appreciation) rate of currency A in terms of currency B = Rate of increase (or decrease) in the number of units of currency A per unit of currency B.

The appropriate set of weights for the above basket of N currencies can be estimated, depending on three different targets of the government: (i) the balance of trade, (ii) terms of trade, and (iii) stabilization of the relative price of traded vs. nontraded goods (see Annex II-A for the specific formulas for the weights). Note in formulas (4) to (6) that all the data are exogenously given except for the basket weight for N foreign currencies and the official exchange rate of the local currency in terms of the dollar. Therefore, once the optimum set of weights is chosen based on one of the above targets, the object of exchange rate policy under the composite peg is merely to determine the optimum official exchange rate of the local currency in terms of the dollar that satisfies formulas (4) to (6). The exchange rates of the local currency in terms of the other foreign currencies are mechanically established on the basis of (i) the newly set official exchange rate of the local currency in terms of the dollar and (ii) the daily exchange rate of the dollar in terms of the foreign currencies in international markets (see Footnote 26 on page 50).

An intuitive interpretation of the above rule for the basket peg can be made in relation to the recent real appreciation of the dollar against such currencies as the Japanese yen and the German mark. Countries such as Korea, which export to Japan and Germany as well as the U.S., must devalue their own currencies in terms of the intervention currency (the dollar) much more than they would in the absence of the overvaluation of the dollar in terms of the yen and mark in order to maintain stability in their real weighted average exchange rate.

Korea's exchange rate policy since its adoption of an outward-looking development strategy in the early 1960s has been a mixture of adjustable and crawling peg policies. The four major devaluations that occurred prior to 1980 suggest that the crawling peg policy was not perfectly implemented, since it was forced to yield to an adjustable peg policy several times. Since early 1980, however, the crawling peg policy has been firmly rooted (see Tables 9 and 10 of Annex I). The exchange rate reform of May 1964 (which marked the transition to an export-oriented policy) resulted in a fluctuating unitary exchange rate policy and a large devaluation from 130 won to 256 won to the dollar (a 96.9 percent devaluation). In March 1965 the government announced the implementation of a fluctuating unitary exchange rate system, but from August 1965 through December 1967 the exchange rate was pegged at around 272 won to the dollar. Beginning in 1968, the won was allowed to devalue gradually at a rate believed to be sufficient to maintain purchasing power parity. The rate reached 326 won to the dollar by June 1971, when a devaluation brought the rate to 370 won to the dollar (a 13.5 percent devaluation). After further gradual devaluation, the won was pegged at about 400 won to the dollar in June 1972. When the dollar was devalued in February 1973, Korea decided to maintain the won-dollar rate, resulting in sizable devaluation of the won relative to the Japanese yen. The 400-won per dollar rate

remained until December 1974, when it increased to 484 won per dollar (a 21 percent devaluation). The 484 won per dollar rate prevailed until January 1980, when there was an increase to 580 won per dollar (a 16.7 percent devaluation). As shown in Table 10, the won per dollar exchange rate has been increasing about one percent or so every month since the crawling peg was adopted after the January 1980 devaluation. In February of that year, a basket-peg system replaced Korea's single-peg system (Bank of Korea 1981).

In sum, Korea has attempted to provide realistic exchange rates for exporters (even though at times with some time lag) through a mixture of major devaluations and flexible adjustments. Although the policy adopted in Korea has not resulted in a perfectly constant real exchange rate, particularly in the periods between major devaluations, the Korean government has succeeded in compensating for periodic domestic currency overvaluation by means of financial and tax incentives for exporters, except for several years in the latter half of 1970s (Westphal and Kim 1982; Balassa 1983). In the Philippines and Indonesia, exporters did not receive the benefits of stable real exchange rates (including compensation for currency overvaluation) throughout the 1960s and 1970s (Baldwin 1975, Bautista and Power 1979, Pitt 1981). Recently, there have been more concerted efforts to bring about stable real exchange rates in these economies.

From Managed to Market-Based System

It is difficult, if not impossible, for a country to maintain a freely floating exchange rate unless current account convertibility and free capital flows are allowed and the country has a well-developed and mature financial market that is integrated with world financial markets. What is the correct order of steps in moving from a managed foreign exchange system to a free market-based system? The following answer is based on some recent contributions to the subject (Mckinnon 1982b, Edwards 1983). First, controlling any fiscal deficit is a precondition for taking initiatives to reduce financial repression. Second, eliminating financial repression and developing a competitive and mature domestic financial market are necessary for eliminating trade restrictions and allowing free capital flows. Third, liberalization of current accounts normally precedes liberalization of capital accounts. Fourth, after a free and mature domestic financial market is developed and foreign trade is liberalized, exchange rate policy can be converted from a passive to an active crawling peg. Abandoning its goal of maintaining a constant real exchange rate by means of a passive crawling peg, the government can, in the presence of freed commodity arbitrage with the outside world, manage the nominal exchange rate to make the domestic inflation rate converge toward the international rate. (Fiscal surpluses and wage restraints are also needed.) Fifth, after a change in exchange rate policy from passive to active downward crawling, the restrictions that have inhibited inflows and outflows of financial capital can be relaxed. The differential between foreign and domestic nominal rates of interest should lessen gradually as

the rate of devaluation slows, and international arbitrage between foreign and domestic financial markets becomes more mature. Finally, with convergence toward a fixed exchange rate and liberalization of capital controls, a free market-based foreign exchange regime can emerge.

The reason for fine-tuning flows of foreign financial capital during the transitional stages are twofold. While the opening of a capital account usually generates a real currency appreciation, a successful liberalization of the trade account can require a real devaluation of domestic currency. Thus, Dornbusch (1983) states: "The worst thing to do is to liberalize the capital account....before the required real depreciation has been achieved." In dealing with the negative impact of opening a capital account first, one should be aware of the fact that financial markets adjust much faster than goods markets (Frenkel 1982). Another important issue in opening a capital account is how to determine the optimum level of foreign borrowing. As the recent experience of some Latin American countries has shown, the private sector tends to overborrow due to moral-hazard imperfections and expectations of bail-outs. Therefore, Diaz Alejandro (1983) states: "Moral-hazard considerations...or expectations of bail-outs reinforce the case for home-country supervision of international financial flows."

(d) Conclusions

Several lessons can be drawn from the experiences of the successful East Asian countries in exchange rate policy establishment and

management: (i) The initial requirement for export development is to maintain a realistic exchange rate for exporters--regardless of the trade and foreign exchange regime employed. Although a crawling peg system is preferable, if an adjustable peg is employed, compensatory fiscal and financial export incentives could compensate for currency overvaluation. (ii) The most important factors determining whether a market-based or a managed foreign exchange regime is suitable for determining a realistic exchange rate and achieving efficient allocation of foreign exchange appear to be the maturity of financial institutions and markets and the level of financial regression. (iii) Adoption of composite pegs rather than a single peg is preferred for setting exchange rates in a floating rate, multiple-currency world.

CHAPTER III

ACHIEVING A FREE TRADE REGIME

An important tool for eliminating the disadvantages that exporters in developing countries may face in competing on the world market is to guarantee free access to the imported raw materials and intermediate inputs used in industrial activities that generate export value added. "Free access" means that such imports are free of import and foreign exchange restrictions as well as free from tariffs and indirect taxes.[26] Since free trade status for export activities is a step toward the first-best situation of economy-wide free trade, and since it is designed to reduce anti-export bias by seeking true neutrality vis-a-vis competing or importing economies, neither GATT nor any importing developed economy or competing developing economy objects to it. A free trade status for export activities could also be a step to completely liberalizing imports for the domestic market.

(a) Free Trade

A free trade status for exporters is assured if a free trade policy is adopted for the entire economy of a country or for exporters operating in free trade zones. Due to the small size of their domestic markets, extensive involvement in entrepot trade, and specialization in the

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26/ Indirect tax exemptions for exports merely achieve a neutral status vis-a-vis indirect taxes for domestic sales under the destination principle as well as vis-a-vis a free trade status.

final stages of production, Hong Kong and Singapore rely on free trade in virtually all commodities by providing free access to imported inputs that are used to produce exports. Until 1967, however, Singapore had a policy of temporary protection of imports (i.e., tariff and import restrictions) sold domestically. Furthermore, it appears that Singapore built its internationally competitive industries through an outward orientation strategy before it dismantled protective measures against domestic sale of imports, in view of the prevalence of the tariff redundancy observed in 1967 (Tan and Hock, 1982).

The free trade policies of Hong Kong and Singapore do not mean that these economies are free from minimally required import and export procedures, but continuing efforts have been made to streamline these procedures. The Hong Kong Trade Facilitation Council was established in 1981, and the Trade Facilitation Committee of the Singapore Trade Development Board was created in January 1983. Ironically, increasing protectionism among the developed countries has resulted in the imposition of additional administrative burdens on the developing countries. Hong Kong's export and import licensing systems for textile products, for example, are the consequence of the textile quotas imposed by the developed countries.

(b) Free Trade Zone

A free trade zone (FTZ) is a special industrial area located physically or administratively outside a country's customs barrier and is devoted to the production of exports. Transactions in FTZs are not subject

to tariffs, and therefore escape the delays and administrative costs often associated with the duty exemption or drawback systems applied to firms located outside FTZs.

FTZs usually offer prepared and fully serviced land with easy access to port facilities and, in many cases, industrial plants. Considerable public costs are incurred to pay for the infrastructure and facilities of FTZs, which developing economies use as showcases to induce foreign investments in their export industries. Additional incentives, such as income tax holidays and unrestricted transfer of profits, are usually offered as well. There are now at least 65 separate FTZs available in 33 developing countries, and more are being developed (Currie 1983).

Commercial FTZs have been in existence in Singapore since 1819 and Hong Kong since 1842. When Singapore and Hong Kong adopted export-oriented manufacturing development policies in the 1960s, their commercial FTZs expanded to country-wide industrial FTZs. Korea's first FTZ was created in Masan in 1971, followed by a second one in Iri in 1975. FTZs have apparently been effective in the early stages of an export drive as a means of attracting foreign investors and giving demonstrations of country's export potential. Where outward-looking development strategies have been continued and reinforced, however, the relative importance of FTZs's exports has tended to decline as the exports of other domestic industries have expanded (de Vries and Goderez 1978). FTZ exports in Korea have never exceeded 10 percent of Korea's total exports, since all export

production and sales activities (whether inside or outside FTZs) have enjoyed free trade status. Free trade zones have been important in inducing investments in countries that rely heavily on foreign direct investments for export development. Korea's development, however, has relied more on foreign loans than on foreign equity investments (Westphal, Rhee, and Pursell 1981).

Malaysia has been quite successful in inducing direct foreign investments in its export development by means of FTZs. More than 40 percent of its 1978 exports (excluding palm oil and other oil products) came from its FTZs (Rhee, 1980). The Bataan FTZ of the Philippines, developed in the early 1970s, produced $76 million in exports (accounting for 6 percent of the country's manufactured exports) in 1978. The development of four new zones (Mactan, Baguio, Batangas, and Isabel Leyte) suggests an expanding role for FTZs in the Philippines. The Indonesian government recently began a study on establishing FTZs with World Bank assistance. While the initial contribution of FTZs could be substantial, ultimate success in the development of exports will depend on extending neutral status to the whole economy, maximizing backward linkages with local industries, and mastering foreign technologies.

(c) Free Trade Status

Achieving free trade by eliminating restrictions and duties on all imports may be a desirable and rational objective for many developing economies. However, such an objective, while certainly a worthwhile long-term goal, often cannot be achieved if it is not pursued on a gradual

basis. This owes to a number of factors, including political and institutional rigidities. If adapted immediately, free trade would allow imports to displace much domestic production, including production by infant industries that could become competitive in the near future. If not fully "compensated" by exchange rate adjustments, immediate liberalization would also increase balance of payments deficits, worsening already heavy external debt burdens. Often the political and social reaction to very rapid or ill-considered liberalization attempts results in movement backward toward import and foreign exchange controls. Rather than opening their borders immediately to free trade, many developing economies attempt to establish free trade regimes for exporting activities while maintaining protected trade regimes for production for the domestic market--say, by allowing unrestricted, tariff-free imports of raw materials and intermediate inputs that will be used to produce exports--at least during transition periods. Below, the major "building blocks" establishing free trade status for export industries in an economy that continues protection of domestic market oriented activity are described and evaluated, based on the experiences of the successful East Asian countries and, in particular, the Korean experience.

Automatic Import License

In the successful East Asian countries, import licenses for raw materials and intermediate inputs (and capital equipment) are given automatically to producers of goods that generate export value added. Many other developing countries do not do this, however, especially for inputs that compete with domestically produced counterparts. The reason is that

they want to promote local input-producing industries and increase the export value added generated locally. As a result of such a policy, neither export nor domestic input-producing industries have been developed efficiently. A solution is the creation of a policy environment in which efficient backward linkages based on a country's comparative advantage can be exploited. To do this, industrial producers creating export value added should be able to choose freely between imported and domestic inputs (at world market prices), irrespective of whether their production occurs at the final stage or some preceding stage. Empirical evidence suggests that under a free trade regime for inputs toward all activities that generate export value added, the export value added generated through efficient backward linkages is much higher than that under a regime of protection for domestic inputs.

Import Administration for Export Production

To understand the basic administrative requirements for establishing a free trade regime for export production alongside a protected regime for domestic production, it helps to compare the components of net foreign exchange earnings (measured in domestic currency) under a free trade regime with the corresponding components under a protected regime.

Under a free trade regime for export activities, the net amount of foreign exchange earned is the difference between the gross foreign exchange earned, based on the world market (fob) price of a product and the foreign exchange cost of producing the product based on world market (cif) prices of intermediate inputs. Under a protected trade regime for domestic

goods, the gross earning is adjusted by the nominal protection rate for the product. The corresponding intermediate input cost is equal to the foreign exchange cost of producing the input adjusted by the nominal protection rate for inputs. Therefore, if trade is free for export production and protected for domestic production, an exporter can increase his net earnings by selling his products on the domestic market rather than exporting them. An exporter can also increase net earnings by selling intermediate inputs on the domestic market rather than using them for export production. Schemes that can maintain the integrity of the export system might provide that:

(i) Each purchase of intermediate inputs be limited to the amount required to produce export goods that have been ordered or for which orders are expected.

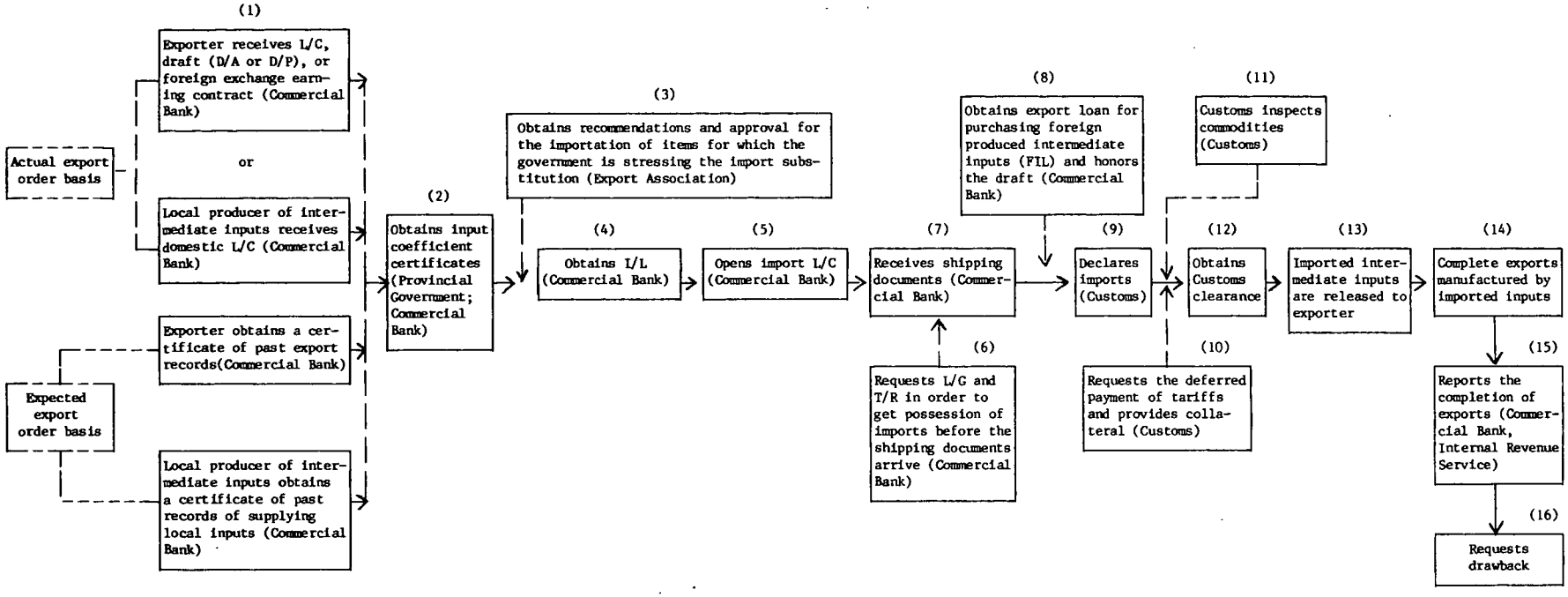
(ii) A determination will be made of whether the goods, after having been produced, have actually been exported.

These rules can establish the underlying bases for the administrative arrangements needed to guarantee free trade status for all activities generating export value added alongside a protected regime for domestic sales. A discussion of the procedures for administering free trade status for export production follows. Figure 1 is a chart showing these procedures in schematic form.

Documentary Evidence of Exports: At stage 1, the importation of intermediate inputs on the basis of expected export orders is treated the same as importing on the basis of actual export orders. In turn, a local supplier of intermediate inputs for export is treated the same as an exporter in importing intermediate inputs. When documentary evidence of an actual export order is accepted, types of payment are treated the same. Sight drafts (D/P), time drafts (D/A), construction service contracts earning foreign exchange, and so on are treated the same as an export L/C or a domestic L/C (the domestic L/C is explained below). An expected export order is not a potential export order. An expected export order means a projected export order received by an established exporter, the projection being based on past export records. Documentary evidence of eligibility to import intermediate inputs under this category is the record, verified by a commercial bank, of the export or local supply performance of a company during the preceding year.

Documentary Evidence of Input Requirements and Import Ceiling: At stage 2, an exporter or export supplier obtains input coefficient certificates from a commercial bank (for coefficients listed in an input coefficient book) or from a provincial government (for coefficients not so listed). Input requirements for an actual or expected export order are estimated by multiplying the amount of the export order by the input coefficients.

Figure 1: AN OVERVIEW OF THE ADMINISTRATIVE AND BANKING PROCEDURES FOR IMPORTING INTERMEDIATE INPUTS FOR EXPORTS



L/G = Letter of Guarantee
T/R = Trust Receipt
I/L = Import Licence

The amount of imported intermediate inputs needed for expected export orders (or for local supply, in the case of indirect exporters) is determined according to the following formula:

[Amount of imported intermediate inputs for an expected export (or local supply) order] ≤ [Input coefficients] x kx [Company's export (or local supply) records during preceding q months.a/] (7)

The amount of imported intermediate inputs needed for export production is determined by this formula:

[Total amount of imported intermediate inputs allowed for export production] ≤ Max [Amount of imported intermediate inputs allowed on expected export order basis ; Amount of imported intermediate inputs allowed on actual order basis.] (8)

where

[Amount of imported intermediate inputs allowed on actual order basis] ≤ [Input coefficient] X [Value of L/C, D/P, D/A, contract earning foreign exchange, or domestic L/C.] (9)

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a/ k is normally 1/4
q is normally 12.

A firm usually maintains just enough intermediate inputs to produce an export volume equivalent to an average [k x q] month's order, based on formula (7). As soon as some exports produced with this stock of intermediate inputs have been completed (that is, after an L/C is negotiated), the same amount of inputs can be imported for reaccumulation. According to formula (8), unless actual export orders at one time exceed

the average [k x q] month's export, the company cannot maintain more imported intermediate inputs than formula (7) permits. Note, however, that formula (8) has a built-in allowance for export growth.

Import License: Restricted import items (designated by periodic announcements) require licenses or some other form of approval from the relevant ministry. But import licensing for intermediate inputs for export production (stage 4) is made automatic as long as the documentary evidence in stages 1 and 2 is presented. (For certain items designated as special promotion items for local production, an exporter or local supplier of intermediate inputs needs a letter of recommendation in order to obtain an import license from the appropriate export association. This is also automatic (stage 3)).

Import L/C and Export Loan: The commercial bank that is the notifying or advising bank for the export (or master) L/C or domestic L/C opens an L/C for the importation of intermediate inputs for export production within 10 days of obtaining an import license (stage 5). Because the commercial bank is guaranteeing payment to the seller (provided the goods are shipped) by opening the L/C and providing an export loan for importing intermediate inputs to the buyer, and accepting the export L/C (or D/P, D/A, and so on) as collateral, it is extremely careful to verify the authenticity of the documentary evidence obtained in stages 1 and 2 when granting the import license in stage 4.

Export or Local Supply Completion Report: An import license in stage 4 or an export loan in stage 8 is granted subject to the condition that the exporter completes the export. The administrative procedures for importing intermediate inputs for export production are unfinished so long as the final report of export (or local supply) completion is not submitted (in stage 15). The importer of intermediate inputs completes the corresponding export within 18 months (or the corresponding domestic product within a year) from the date of the import license and submit an export completion report to the commercial bank. Duty drawbacks can only be claimed after export has been completed (stage 16).

Input Coefficient Administration: An Input Coefficient Administration is necessary for guaranteeing a free trade regime for export-related activities in the midst of protected activities related to domestic sales and for guaranteeing the automatic availability of short-term export loans even if credit rationing exists. The authority to issue input coefficient certificates is given to commercial banks or provincial governments, but the responsibility of estimating, compiling, and publishing the input coefficients rests with the Input Coefficient Administration.

Automatic Access to Foreign Exchange

Policies that eliminate constraints on using foreign exchange to pay for imported raw materials, intermediate inputs, or capital equipment for activities generating export value added have proven invaluable. If the initial foreign exchange holdings of a country are substantial, it will

be enough to establish correct priorities. This means that nothing in the allocation of foreign exchange receives greater priority than the inputs needed to earn additional foreign exchange. (This point was stressed in previous discussions on efficient management of foreign exchange.) If initial foreign exchange holdings are scarce, external financial assistance can be used to create a foreign exchange revolving fund earmarked for imports of inputs for activities that generate export value added. (The administrative arrangements necessary to maintaining the revolving nature of such a fund are explained later.)

The Bonded Manufacturing Warehouse System

In order to allow companies outside free trade zones to bypass certain customs procedures when they import inputs needed to manufacture products for the export market, a bonded manufacturing warehouse (BMW) system is available in most of the successful East Asian countries. The usual requirements for licensing BMWs are:

(i) a firm's factories must be exclusively engaged in manufacturing commodities for export;

(ii) a firm's factories must have separate warehouses approved by customs through inspection as appropriate for the storage of imported inputs and finished commodities;

(iii) customs officers must be stationed in BMWs to inspect imported inputs and finished outputs.

There were 218 BMWs in Korea in 1981, contributing about 12 percent of the country's total exports and accounting for about 6 percent of Korea's total imports. In Malaysia there were 22 BMWs in 1979, accounting for no more than 5 percent of its total exports (Rhee, 1980). In 1984, however, the number of BMWs in Malaysia increased to about 80.

A BMW system is quite advantageous for well-established large-scale firms that only produce exports. But it is impractical for small-scale producers and indirect exporters, as well as for producers selling on both export and domestic markets. As in the case of FTZs, there is no adequate substitute for a policy of guaranteeing free trade status for all activities generating export value added.

Duty Exemption and Drawback Systems

A duty exemption system exempts exporters outside FTZs and a BMW system from paying duties or indirect taxes on imports used in export production. These exemptions are granted on a case-by-case basis at the time of importation. In a duty drawback system, on the other hand,

exporters located outside FTZs or a BMW system obtain refunds of the duties (and indirect taxes) they have paid on imported inputs. It is important to realize that the GATT provisions and the framework of the Tokyo Round of Multilateral Trade Negotiations do not consider duty and indirect tax exemptions or drawbacks for inputs used for export production at the final stages of fabrication and at the earlier stages as "export subsidies" (Balassa 1982, p. 72). There are two ways of making such refunds. Individual drawback systems refund the duties (and indirect taxes) paid by firms, as determined on a case-by-case basis, and thus operate much like a system of exemptions. Fixed drawback systems refund the estimated duties (and indirect taxes) that enter the cost of production of export commodities according to a preset schedule.

Under both systems, the value of the import duty exempted or refunded for each unit of export commodity depends on four elements:

(i) The physical amounts of the various inputs needed for each unit of given output, that is, an input-output coefficient.

(ii) The import prices, converted into local currency, of intermediate inputs.

(iii) The rates of import duties (and indirect taxes) on inputs (as fractions of import values).

Because these three elements depend on the specifications or quality of a product, the fourth element is:

(iv) The specifications or quality of a product, the quality frequently being reflected by its price.

A formula to determine the duty value for one unit of an export commodity is given in Annex II-B.

Under full exemption or individual drawback systems, the prices of tradable inputs purchased domestically for export production cannot be higher than the tariff-free import prices of those inputs, as long as exporters have a free choice between imported and domestically produced inputs. This is because the exemption or refund is granted only for imported inputs. Even in a fixed drawback system, the refund is normally allowed only for imported inputs directly used for export production by the final exporter. Under these circumstances the effective tariff rate for locally purchased inputs would be zero for exporters, and no duty refund is needed. Indirect exporters are allowed to access to duty free imported inputs for their export value added, while their prices for inputs to be used by final exporters are world market prices rather than protected domestic prices. This is achieved through one of two ways. One is to allow a prior exemption or individual drawback to indirect exporters for duties to be paid or paid for imported inputs used for export value added. The other is to add the duty refund to indirect exporters' selling prices while final exporters receive individual drawbacks based on documents supplied by indirect exporters.

In administering prior exemption systems, the completion of the export of a commodity which uses a specified amount of imported inputs that were exempted from duties is traced on a case-by-case basis. In

individual drawback systems the duty on imported inputs is also traced and refunded on a case-by-case basis.

Unlike the two foregoing systems, where the linkages between imports of inputs and exports of outputs must be traced case-by-case, a system of fixed drawbacks does not require a tracing of these linkages and thus reduces the administrative burden. But it does require the preparation of fixed drawback schedules. To prepare these schedules, administrative authorities collect the same information needed under the other two systems, or at least a sample of that information.

A fixed drawback schedule is a list of the fixed money values of duties to be refunded for one unit of an export commodity. For a commodity of given specifications and quality, the value of duties to be refunded for one unit of export commodity equals the sum of the import price of inputs times the input coefficients times the duty rate. (See the formula in Annex II-B.) To prevent the problem of under-invoicing, the government conducts spot checks of prices for imported inputs in addition to relying on invoice prices. Note that if import prices, input coefficients, and duty rates remain constant, the duties to be refunded are fixed. A drawback is a fixed value per unit of export, and the price of the export has nothing to do with the amount to be refunded. Drawback schedules must be updated periodically, however, because import prices change. Countries using such schedules usually revise them every three to six months.

The administrative cost saving offered by a fixed drawback system comes not in preparing the schedule but in implementing it. Import-export linkages do not have to be traced case by case, and additional savings are possible by aggregating products and inputs in the schedule (so long as such aggregation does not undermine the free trade status of export industries). To protect exporters from the possible negative effects of aggregation, many countries that use fixed drawback schedules also offer exporters the alternative of individual drawbacks.

Because of the administrative burdens of other arrangements, there appears to be much temptation to adopt schemes where rebates (say, as a percentage of export value) are applied uniformly across all products. But it is impossible to seek a magic number that can be used to achieve tariff-free trade status, given the existing structure of trade protection in most developing economies. There are extremely wide variations in the input-output coefficients for different export products and in the import prices, duties, and indirect taxes for different inputs used for export production. Even under a hypothetical uniform tariff rate structure, tariff rebate rates (as a percentage of export value) might vary widely across sectors because of wide variations in input-output coefficients.

Basically, duty exemption and drawback systems are designed to provide a tariff-free and indirect tax-free status only for <u>tradable</u> inputs. Usually, such systems do not include tradable input components already embodied in nontradable inputs. Complete free-trade status would

mean duty exemption or drawback systems for these components as well. Usually, exemptions for duties on nontradable inputs are treated separately from those for tradable inputs. For example, Korea provided exemptions for nontradable inputs by offering reduced rates for electricity and rail transport for export activities until the early 1970s.

Korea's prior exemption/drawback system has been characterized by continuing efforts to streamline administrative arrangements while minimizing anti-export bias on exporters. The success of Korea's system has depended on two major factors: (i) the government's uncompromising objective of outward-oriented development and (ii) a pragmatic, speedy, flexible policy-making and administrative approach that is not so much a deliberate one of careful long-range planning but more one of diving in, getting started, observing results, adjusting policy and administrative arrangements, and repeating the process until the appropriate mix is found. When balance-of-payments problems worsened after the first oil crisis, the government hastily replaced its duty exemption system with a drawback system, with an intention of instituting a fixed drawback system in the middle of 1975. That was a threat to free trade status in the name of administrative convenience, and when exporters expressed concern, the government introduced measures to guarantee tariff-free status. Importers of intermediate inputs used in exports have in most cases been allowed to defer paying tariffs for considerable periods. In turn, the fixed drawback system was modified by combining it with an individual drawback system (Rhee 1980). As shown in Table 3, only about 20 percent of Korea's exports had been subject to the fixed drawback system by 1980.

Table 3

Composite of Fixed and Individual Drawbacks in Korea, 1975-1979

	Fixed Drawback		Individual Drawback		Total	
	Amount (bil.won)	(Share) %	Amount (bil.won)	(Share) %	Amount (bil.won)	(Share) %
1975 (Jul-Dec)	7.1	20	28.60	80	35.7	100
1976	72.9	28	185.1	72	258.0	100
1977	80.4	26	228.2	74	308.6	100
1978	67.4	19	288.4	81	355.8	100
1979 (Jan-May)	30.4	19	126..9	81	157.3	100
Total	258.2	(23%)	857.2	(77%)	1,115.4	(100%)

Source: Rhee (1980b), p.27.

On the basis of a complete review of its drawback system during 1975-80, the Korean government implemented a new drawback schedule in 1981. Exporters rely on individual drawbacks for major imported input items for each export product, based on input-output coefficients listed in a drawback schedule published every six months. Fixed drawbacks are applied only to miscellaneous imported items. This new system appears to have a good balance: providing a tariff-free status is given the highest priority when major imported items are involved, while administrative simplicity is given the highest priority in the case of miscellaneous imported items.

Korea has also made continuing efforts to streamline its Input Coefficient Administration. This Administration--embracing banks, provincial governments, and the Office of Industrial Promotion in the Ministry of Commerce and Industry--estimates, updates, publishes, and

administers input coefficients for most export commodities. A revised aggregation scheme implemented in 1979 reduced export commodity classifications from roughly 6,000 to 3,000 items and reduced imported input classifications from roughly 17,000 to 11,000 items. At the end of 1982 the Input Coefficient Administration published six volumesconsolidating all the technical input-output information that had been officially announced so far. Other developing countries in the early stages of export development can apparently learn much from the rich experience of Korea's input-coefficient administration.

Singapore currently administers duty exemptions and drawbacks for the few items on which it places tariffs, including sugar imports. One innovative aspect of its administrative arrangements is a firm-level accounting book method used to compute the duties to be paid at the end of a period, based on the balance of imported inputs for an export item and the completed export value of that item during that period. Another important administrative instrument is a bankers' guarantee that is used as security to cover the average amount of duties an exporter owes to the government. As in the case of Korea, very detailed input-output coefficients are provided by the government for estimating the value of duty exemptions and drawbacks for export items that use sugar as their major imported input, such as candies, biscuits, and soft drinks.

Malaysia has both individual drawback and exemption arrangements. Automaticity has not been guaranteed for all activities generating

export value added that are located outside FTZs or BMWs, but import substitution industries have enjoyed substantial duty exemptions on top of import protection (Rhee 1980a). The requirements that the goods must be listed in the government's schedule and must be manufactured with the prior approval of customs appear to be the main reasons for failure to utilize the individual drawback system for export activities before 1981. Such requirements were eliminated since 1981, and the drawback procedures have been rationalized. The major reasons why duty exemptions are not granted automatically for all activities generating export value added are:

(i) Exemption applications must be submitted to the government for case-by-case review.

(ii) Only firms directly manufacturing finished commodities exclusively for the export market can apply for tariff exemptions.

(iii) The intermediate goods to be imported with tariff exemptions are not manufactured locally, or where they are manufactured locally, are not of acceptable quality or price.

Nor does it appear that the principles of automaticity and equal treatment of all activities generating export value added have been perfectly adopted in the Philippines, due to the multiplicity of agencies involved. Two different individual drawback schemes are administered by the Bureau of Customs and the Board of Investments. Some of the administrative arrangements that do not appear to be consistent with the

objective of granting free trade status for export activities are (i) the requirement that an import license can only be issued when no local competitive materials are available, (ii) the procedures for administering indirect exporters' drawbacks are too cumbersome to be practical, and (iii) the input output coefficient administration is not modernized (Cox 1980). Parallel application of the country's duty exemption system is mainly confined to some fifty firms operating under the Embroidery and Apparel Control and Inspection Board, due to the complicated procedures to be followed. The Board of Investment (BOI) incentive act of 1983 proposes the preparation of a fixed drawback schedule.

Indonesia administers both a fixed drawback system (Export Certificate system) and a prior exemption system. While the fixed drawback system has been extensively utilized by exporters, it must extend its coverage to a wider array of products and contribute more toward achieving free trade status. The prior exemption system has not been used at all because of its time-consuming procedures. Indonesia'a fixed drawback schedule includes data on (i) the fixed drawback rate (as a fraction of export price) and (ii) check price of product, in addition to (iii) specification of export item, and (iv) fixed money value of the duty to be refunded (per unit of export item). Information on (i) and (ii) is simply designed to meet legal requirements, with (i) obtained by dividing the separately estimated (iv) with (ii), as one might expect, rather than (iv) being estimated by an exogenously given (i). The key issue is determining the level of aggregation that is most appropriate for each product and input in estimating (iv), based on input-output coefficients, import prices of inputs, and duty and tax rates. What is "most appropriate" is

the level of aggregation that helps meet two objectives: guaranteeing free trade status for all export products (maximizing the coverage of products listed in the fixed drawback schedule) and saving administrative costs. There are two separate administrative issues. One relates to administrative efficiency in collecting and processing information for a fixed drawback schedule, the other to administrative efficiency in implementing a schedule of actual rebates. The issues of parallel implementation of an individual drawback system (or some change that would cause the existing prior exemption system to be utilized) have yet to be resolved.

The following are some of the important lessons to be learned from the administration of duty exemption and drawback systems in the successful developing economies:

(a) Guaranteeing absolute free choice between imported and domestic inputs (i.e., automatic import licensing) for both direct and indirect exporters is the chief precondition for an efficient duty exemption and drawback system.

(b) Since duty exemptions/drawbacks at not only final stages but also earlier stages of export production are <u>not</u> treated as "export subsidies" by GATT and developed countries, it is very important to have an efficient system of duty exemptions/drawbacks for both direct and indirect exporters.

(c) Input-output coefficients must be published regularly, so that exporters can review their reliability and provide information to government officials that can help to improve the quality of the coefficients.

(d) Individual drawbacks should be put into place along with fixed drawbacks in order to let exporters choose between completely free trade and administrative cost savings.

(e) The business community and the government must work together on a continuing basis to improve the technical and procedural aspects of a duty exemption and drawback administration. There is no magic solution to this particular administrative problem.

(f) Since the administrative burden of an exemption and drawback administration would be reduced if all redundant tariffs were eliminated as a first step toward lowering or removing all tariffs, the government should continuously review its tariff schedule.

(d) Conclusions

The experiences of the successful East Asian countries provide clear avidence of the critical importance of assuring a free trade regime for all activities (including participation by small and indirect exporters) that generate export value added through free trade, free trade zones, bonded manufacturing warehouses, or duty exemption/drawback systems. The East Asian success stories also suggest that establishment of free trade status for export activities can lay initial groundwork for completely liberalizing imports for the domestic market. It is the single most important element in reducing anti-export bias and establishing neutral status without risking retaliation from importing countries, which is a precondition for realizing greatest potential gains from international trade.

The duty exemption/drawback system can be implemented successfully only by guaranteeing automatic import licensing and free access to foreign exchange (i.e., unrestricted choice between imported and domestically produced inputs) for both direct and indirect exporters. It appears that the only means for implementing an efficient duty exemption/drawback system is simply to improve the system continuously, based on updated information on input-output coefficients and imported input prices. On the one hand, it is necessary to maintain a careful balance between providing status close to free trade and structuring an administratively feasible design and implementation of the duty exemption/drawback system. On the other hand, there can be reductions in the administrative burden of the duty exemption/drawback if all redundant tariffs are eliminated and tariffs are gradually lowered and eliminated.

CHAPTER IV

ASSURING AUTOMATIC ACCESS TO EXPORT FINANCING

In developed economies, where both money markets and overall financial markets are well-developed, exporters have few problems obtaining bank loans at uniform market interest rates. Preshipment export financing is handled through normal commercial loans, like any other production financing. In these economies, in other words, all exporters enjoy neutral status without a special export financing system.

In most developing economies, on the other hand, money and financial markets are not well developed and are highly segmented. Thus, exporters cannot be assured neutral status in competitive money and financial markets. Even where money and financial markets are developing, they typically favor large firms over small ones and demand physical collateral that often cannot be provided by exporters. These difficulties can put the exporters in developing economies at a great disadvantage vis-a-vis both foreign competitors and local beneficiaries of credit rationing. As a consequence, a developing economy's export capability can hardly be exploited. Guaranteeing automatic access to financing at uniform interest rates for all activities that generate export value added is therefore critical--providing neutral status for export activities until the time arrives when competitive money and financial markets have been developed. Therefore, a preshipment export financing system can assure

neutral status as a temporary measure. Furthermore, guaranteeing automatic access to preshipment working capital at uniform interest rates for all activities generating export value added could be a first step toward uniform interest rates for the whole economy. Since automatic availability of capital at a uniform interest rate and equal treatment of all activities generating export value added are of primary importance, the specific level of the interest rate is of secondary importance as long as the rate is neutral vis-a-vis beneficiaries of domestic credit rationing and foreign competitors.

Because the first requirement of exporting is to produce export commodities at internationally competitive costs, and because there is relatively little need for postshipment export financing in many developing countries in early stages of export development, the highest priority is given to preshipment working capital loans. These loans are designed to meet financing needs for production or sales activities from the time an export order is received to the time the order is shipped. (As will become clear below, in fact, the need for preshipment export financing arises long after an export order is received.) Basically, therefore, there is no need for preshipment financing until an exporter has a confirmed export order. And once the export commodity is shipped, the need for preshipment financing ceases. Normally, the loan period is not more than 60 days, during which time the preshipment export loan becomes the critical factor without which a net foreign exchange earning based on the confirmed order becomes difficult. In other words, receiving an export order has not much to do with preshipment financing. However, failure to provide preshipment export

loans means nothing less than a loss of export earnings, due to failure to meet the order. It is important to understand this fundamental difference between preshipment working capital financing and other working capital financing.

For two reasons, the justification for providing unlimited access to investment capital for export production may be less than the justification for providing working capital. The first is the longer maturity of investment loans; the second is the possibility that such loans may encourage decisions to invest in capital-intensive technology. But if most exporters (including potential exporters) are excluded from borrowing investment capital, and constraints on production capacity are the chief barrier to export expansion, priority should be given to channeling investment loans to export industries.

Korea's preshipment export financing system was introduced in the mid-1960's. In light of its underdeveloped money and financial markets and the predominance of credit rationing, Korea's export financing system has made an enormous contribution to assuring neutral status for its export industries. Short-term export loans accounted for 58 to 71 percent of total export loans in Korea during 1970-79 (Table 11 of Annex I). This predominance of short-term loans stemmed from (i) the greater importance of operating capital (compared to investment capital), and (ii) the greater importance of preshipment financing of exports over postshipment financing of exports. Short-term export loans as a share of total domestic credit ranged between 7 and 12 percent during 1970-79; short-term export loans

outstanding ranged from 12 to 22 percent of annual exports during the same period. Between 70 and 98 percent of short-term export promotion loans were given to manufacturing industries during 1970-79. Short-term export loans ranged from 10 to 14 percent of the total annual exports of Korea's manufacturing industries during 1974-79 (Table 12 of Annex I).

Hong Kong may be the only major developing economy that does not have a government-supported export financing system. There, where the major commercial bank carries out the functions that would otherwise be performed by a central bank, a well-developed network of inter-firm credit supplements Hong Kong's well-developed financial market in meeting exporters' financing needs. But it is important to remember that more than a century was needed to develop Hong Kong's current financial institutions. A major Hong Kong bank recently established a special "line of credit to small manufacturers" that eschews physical collateral in order to make funds available to firms that cannot obtain financing through normal channels.

It is interesting to note that even though Singapore is an international commercial financing center, the government of Singapore introduced a preshipment export financing system in 1975. Currently, short-term preshipment working capital loans amount to approximately half of Singapore's total export loans, while export loans outstanding are approximately 10-15 percent of annual exports. Malaysia introduced preshipment export financing in 1979. Malaysia's total export loan volume granted in

1982 and 1983 was about ten percent of total manufactures good exports in the corresponding years. Malaysia's preshipment financing granted, however, was only one-quarter of the total export financing in 1982 and 1983. In Indonesia, export loans outstanding for traditional and non-traditional exports amounted to about five percent of total exports (excluding oil and LNG) in 1980. Total export loans (mostly preshipment working capital loans) for Philippine nontraditional exports were about 8 percent of nontraditional export value in 1982. While the export loans granted per dollar of total industrial exports in these latter three economies appear to be lower than in the other East Asian countries, the major differences between them exist in the structure of financing and the degree of modernization of export financing systems designed to provide automatic and equal access for all exporters.

(a) Acceptance Financing versus Bank Loans

The predominance of bank loans, as compared with equity financing, in most developing economies stems from underdeveloped capital markets. A major reason for the relative importance of short-term bank loans, in turn, is underdevelopment of money markets. In the developed economies, where money markets are well-established,[27] the role of acceptance financing in export and import financing is very important. A banker's acceptance is created when a bank agrees to pay, at a specified

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27/ In the United States the term "money markets" generally refers to the markets for short-term credit instruments, such as treasury bills, commercial paper, bankers' acceptances, negotiable certificates of deposits, loans to or repurchase agreements with securities dealers, and federal funds (Monhollon and Picou 1974).

future date, a draft drawn on it. A draft bearing such a commitment by a prime bank becomes a marketable instrument which, when offered for sale at an appropriate discount from its face amount, is an attractive short-term investment for a corporation, an individual, or other holder of excess funds. As long as there is an active market for banker's acceptances, a bank is generally willing to discount its own acceptances at prevailing market rates.

The beneficiary of a letter of credit has an irrevocable commitment from the issuing bank to accept drafts drawn and negotiated in accordance with the terms of the L/C. Therefore, shipments made under an L/C create banker's acceptances. Since time drafts drawn under an L/C create a prime banker's acceptance, the exporter can usually find a financial institution willing to discount the draft prior to maturity and thus provide him with immediate cash. Therefore, the major type of postshipment financing is acceptance financing. An exporter selling abroad on draft terms can obtain funds before collecting on his export drafts by drawing on his bank and using the export drafts as collateral, having his own draft on the bank accepted by that institution, and selling the acceptance to the bank or some other investor.

An exporter who imports inputs can also use acceptance financing to pay for the inputs while he is processing them for export. If an exporter importing inputs has been able to obtain a time draft for his imports, the interval between the arrival of the goods and the maturity of the draft may help him through this interim period. But if he has been

asked to pay by sight draft for his imports (or if the time draft has not given him enough time), he can draw a time draft on his bank. The latter will accept the time draft, buy its own acceptance from the exporter at a discount, and use the proceeds to pay the exporter's sight draft.[28/] In the absence of an active market for banker's acceptances, however, acceptance financing can play no role in export and import financing. In most developing economies, acceptance financing is not important except to provide postshipment financing backed by the export financing system. The alternatives to acceptance financing are working capital loans or short-term advances. But because of the noncompetitive nature of financial markets in most developing countries, financing by means of working capital loans cannot be managed efficiently without strong government involvement.

As mentioned above, a majority of the exports from developing economies are based on the export L/C. Since an irrevocable L/C in favor of the exporter is, in reality, a purchase order with payment guaranteed by a bank (if the goods are shipped), commercial banks and others are ready to provide financing if there is an automatic rediscounting mechanism and the risk that the exporter will default is negligible. In other words, a letter of credit can become collateral for loans to finance intermediate inputs and to pay for manufacturing as well as actual shipment. Therefore, the normal basis for a system of short-term export loans is the irrevocable

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28/ At maturity of the acceptance, the importer's account is debted for the amount due. If he received the proceeds of the sale before maturity of the acceptance, he is generally expected to prepay the acceptance.

letter of credit received by exporters and the automatic rediscounting of export loans by the central bank, provided that the risk of a default by the exporter is negligible or taken care of. Of course exports on a draft basis need to be treated the same as exports on an L/C basis in obtaining export loans, by providing export credit insurance. Commercial banks can then accept export drafts or other documents as collateral.

(b) Automaticity and Equal Treatment

In the successful East Asian countries, several major administrative instruments have been critical in establishing systems designed to implement the principles of automatic access to financing and equal treatment of all activities that generate export value added: (i) The governments have provided strong commitments to automatic and speedy rediscounting of preshipment financing by the central bank. (ii) The preshipment export finance guarantee or liberal commercial bank policies have been instrumental in assuring equal treatment of large and small, old and new exporters. The domestic L/C and preshipment finance guarantee systems have been two of the most important policy tools that have encouraged potential exporters to engage in export activities. (iii) Modernization of the preshipment export financing system has been essential for providing administrative convenience and preventing abuse. (iv) A domestic L/C system has been the most effective administrative instrument for assuring equal treatment of direct and indirect exporters. (v) The export credit insurance and postshipment export financing systems have been designed to

achieve equal treatment of all export sales activities, whether based on sight or nonsight L/Cs. Table 4 lists these instruments and their major objectives.

Table 4

MAJOR ADMINISTRATIVE INSTRUMENTS OF EFFICIENT EXPORT FINANCING SYSTEM

Instruments	Objectives and Principles			
	(1) Automaticity and speed	(2) Equal Treatment of		
		(a) All export value added activities (direct and indirect)	(b) All export producers (small and large)	(c) All export sales activities (sight L/C and nonsight L/C basis)
A. Automatic rediscounting by Central Bank	x			
B. Preshipment export finance guarantee			x	
C. Modernization of preshipment export financing system	x	x		
D. Domestic L/C system		x		
E. Export credit insurance				x
F. Postshipment export financing system				x

(c) Preshipment Export Finance Guarantee

Physical collateral is demanded in order to cover risks that may arise from exporters' negligence, default, or failure to comply with the terms and conditions of export contracts. Strict demands for physical collateral, even where an export financing system offers a very generous spread to commercial banks by means of a low rediscount rate, appear to be the most important reason why exporters do not receive equal treatment in obtaining export financing. Small firms that cannot easily meet physical collateral requirements have a particularly difficult time. Thus, alternative forms of collateral must be developed to reduce the fears of commercial banks about lending to small or new exporters. Clearly, pooling the risks that come from a lack of technical and managerial capabilities among small and new exporters by creating a preshipment export finance guarantee scheme is an important responsibility of the government of a developing economy. This is little different from the role of government in export credit insurance schemes in developed and developing countries, i.e., offering risk-pooling schemes in order to deal with uncertainty stemming from imperfect information on importers and importing countries. Such a guarantee scheme permits realization of the strong contribution that the endogenous entrepreneurial and labor resources of developing countries can make in export development. For example, about 40 percent of Korea's exports are produced by small and medium-size firms. Hong Kong's exports come mainly from small but efficient firms.29/

29/ Average employment per industrial establishment in Hong Kong in 1982 was less than 20.

Even though the risk-pooling scheme of a preshipment export finance guarantee system could serve as an effective alternative to physical collateral, such a scheme will not be successful unless (i) banks have a strong commitment to the government's policy of promoting exports and (ii) the risk-pooling scheme is supplemented by "risk-reducing" activities of the government, large exporters, and commercial banks (such as technical assistance by the government and large firms and modernization of the export financing system). The very generous spreads allowed by rediscounting schemes in many developing economies are precisely to encourage commercial banks to take risks and to compensate them for such risk-taking. The Korea Credit Guarantee Fund and the Export-Import Bank of Korea provide preshipment export finance guarantees in Korea. For most exporters, however, the commercial banks took the risk of exporter defaults head-on by granting export loans without requiring any collateral other than documentary evidence of actual or expected export orders. This clearly evidenced the commitment of commercial banks to the government's policy and the confidence of commercial banks in the exporters and the integrity of the export financing system.30/

Because of Hong Kong's competitive loan market and network for inter-firm credit line, exporters there do not need a government-supported export financing system. To make funds available to firms that cannot obtain financing through normal channels, however, a major Hong Kong bank recently established a "line of credit to small manufacturers" that requires no physical collateral.

30/ The unpaid balance of Korea's matured short-term export loans at the end of 1978 was only 3 percent of the total short-term export loan outstanding.

In Singapore, a partial guarantee of preshipment financing can be obtained through an endorsement arrangement. In order to obtain central bank rediscounting of export loans based on pre-export bills of exchange, exporters must have the bills endorsed by two institutions, one being the negotiating bank, the other another bank or discount house.

One of the goals of Indonesia's January 1982 Export Policy is to guarantee automaticity and equal treatment of all activities generating export value added by providing a mandatory guarantee of preshipment export financing. This mandatory guarantee, which appears to be without precedent, reflects the strong determination of Indonesia's government to deal with conservative banking practices. Under the program, the government automatically guarantees 85 percent of each export loan against default. Any losses on the remaining 15 percent are shared equally between Bank Indonesia and the handling bank. Although P.T. Askrindo is administering this program, the government plans to establish a new organization to provide export credit insurance and preshipment finance guarantees. For the success of the guarantee scheme, more concerted effort is needed in small and new exporters' risk-reducing activities such as technical assistance and modernization of the export financing system.

Malaysia guarantees credit for small-scale enterprises through a Credit Guarantee Corporation created in 1972, but the corporation does not

provide preshipment export finance guarantees (Skully 1983). A similar failure to provide small exporters with equal access to export financing exists in the Philippines, where a three million peso export finance guarantee facility of the Philguarantee has been ineffective in dealing with the problem.

(d) Modernization of a Preshipment Export Financing System

In designing efficient administrative arrangements for a preshipment export financing system, an imaginative approach is needed. The key to such an approach is to utilize well-established international trade financing mechanisms by modifying and integrating them with the government's export financing system to achieve the goals of automaticity, equal treatment, prevention of abuse, and administrative convenience. The important elements in modernization are: (i) disaggregating export loans into four categories; (ii) introducing automatic export loan disbursing mechanisms (tied to negotiations of drafts drawn under import or domestic L/Cs) and automatic export loan pay-off mechanisms (tied to negotiations on bills for exports); (iii) creating quasi-physical collateral by using commodities financed by the export loans; (iv) introducing a domestic L/C system; (v) developing a plan to combine export loans based on actual export orders with loans based on expected export orders; and (vi) administering the rediscounting mechanism with speed and administrative convenience.

Disaggregating Export Loans

Preshipment financing is needed to cover all production costs (i.e., the costs of imported and domestically produced intermediate inputs and payments of wages, interest rates, and rents) or, in the case of pure traders, to cover the purchase costs of domestically produced finished goods to be exported. The initial step in modernizing an export financing system is to classify export loans into the following four categories:

(1) Export loans for generating value added (VAL).

(2) Export loans for purchasing domestically produced intermediate inputs (DIL).

(3) Export loans for purchasing imported intermediate inputs (FIL).

(4) Export loans for purchasing domestically produced finished goods (DOL).

VAL, DIL, and FIL are employed in production financing, while DOL is employed for sales (or inventory) financing.

The basis of these export loans is an actual export order (backed by an L/C, D/A, D/P, etc.) or an expected export order extrapolated from the past record of the company's exports or local supply. But the sum of the export production loans (VAL + DIL + FIL) cannot exceed the value of the associated export order. Likewise, a loan given to purchase domestic outputs (DOL) cannot exceed the value of the associated export order.

There is a particularly strong need to disaggregate a production loan into its component parts in economies with foreign exchange constraints, extensive backward linkages between export and local industries, conservative banking practices, and widespread abuse or misuse of the export financing system. Such disaggregation makes it possible to separate import financing (FIL) and domestic input financing (DIL) from pure production financing (VAL), to separate domestic currency loans (DIL, VAL, and DOL) from foreign currency loans (FIL), and to separate inventory or sales financing (DOL) from production financing (VAL, DIL, and FIL).

Foreign Currency Loan Scheme: In a developing economy in which the domestic financial market is segmented, the foreign exchange rate does not always reflect the true opportunity cost. Since external borrowing plays a large role in financing development projects, one way to assure efficient management of foreign exchange is to denominate all loans that are tied to the use of foreign exchange reserves in a foreign currency and charge an international interest rate. Export loans for purchasing imported inputs (FIL) must be included in this category. If the foreign exchange holdings of a country are substantial, it will be sufficient to establish the correct priorities in meeting the needs for import financing--that is, nothing should receive higher priority than importing the inputs needed to earn additional foreign exchange reasonably quickly (within 60-90 days). But if foreign exchange holdings are scarce, external assistance can be obtained to create a foreign exchange revolving fund devoted to financing imported inputs for activities that generate export value added. The revolving fund should be large enough to avoid rationing

of credit for import financing for export production, since rationing would contradict the basic principle of automaticity. If foreign exchange constraints exist, excess demand may make credit rationing inevitable for uses of foreign currency other than short-term preshipment working capital financing and public-supported investment financing. Given the unique nature of short-term preshipment working capital loans (which finance export production on the basis of confirmed export orders), the rationing of such loans would mean a reduction in the foreign exchange earnings expected from confirmed export orders. No government operating under foreign exchange shortages can afford such a reduction.

Using Domestic L/Cs: The separation of domestic input financing from financing for foreign-made inputs makes it possible to implement a domestic L/C system,which is critical in granting export loans to indirect exporters (see below). Such separation also makes it possible to manage scarce foreign exchange so that the need to finance imports for export production can be met without constraint.

Creating Quasi-Physical Collateral: The separation of import and domestic input financing from value added financing makes it possible to create quasi-physical collateral, with inputs or outputs financed by export loans (FIL and DIL, or DOL) through the automatic loan disbursement mechanisms (as shown in Annex II-E). Such quasi-physical collateral, created by export financing itself, would reduce the concerns of commercial bankers about possible defaults by exporters. This is accomplished because the actual payment of FIL, DIL, or DOL is not made to the purchaser, but

instead takes the form of the handling bank's making payment directly to the supplier, thus clearing a bill on behalf of the purchaser. The commercial bank confirms that the purchaser is in possession of the deliverable merchandise at that time FIL, DIL, or DOL is granted.

Preventing Abuse: The automatic loan disbursement mechanism prevents misuse or abuse of the system by eliminating the waste that would stem from granting a loan before an actual need for it arises. Disaggregation of export loans amounts to classifying them by type of expense and granting these loans at the time payment is made. While the export loan for value added (VAL) is granted only after the purchase of intermediate inputs has been confirmed, the three other types of loans (DIL, FIL, and DOL) are granted when a draft drawn under a domestic or import L/C is presented for payment or acceptance. At this point, physical collateral is being created from domestic inputs, finished export goods, or imported inputs (see Annex II-E).

It should also be emphasized that disaggregation does not necessarily create additional administrative burdens. Such disaggregation occurs in the international trade-related activities of commercial banks in every economy. Commercial banks open import L/Cs for exporters as part of their normal business. In turn, back-to-back L/Cs are the basis for domestic L/C systems. Indonesia's commercial banks, for example, have been using a domestic L/C system for inter-island trade.

Korea's outward-looking development strategy has relied on two key factors: foreign capital in the form of commercial loans, and endogenous entrepreneurial and labor resources. By meeting foreign

exchange constraints and pursuing efforts to maximize backward linkages to local industries, an export financing system based on disaggregated export loan schemes has made an enormous contribution to Korea's export development. Without such a well-designed and well-managed export financing system, Korea could not have achieved its export miracle. During the period 1975-79, 35 to 48 percent of Korea's short-term export loans to manufacturing industries were for generating value-added (VAL), 34 to 39 percent were for purchasing domestically produced intermediate inputs (DIL), and 19 to 28 percent were for purchasing foreign-produced intermediate inputs (FIL). (Table 12 of Annex I).

Foreign exchange constraints have not been a factor in Singapore because of its status as a leading international financial center. Furthermore, Singapore's exports have not depended as much as Korea's on backward linkages to local industries. Consequently, the need to disaggregate export loans has been much less than in the case of Korea. Modernization of Singapore's export financing system has therefore focused on increasing the speed of the rediscounting mechanism.

The export financing systems of Malysia, Indonesia, and the Philippines have been based on aggregate export loan schemes. Increasing foreign exchange scarcities and the critical importance of backward linkages for export development, however, call for serious consideration of disaggregation of export loans. Indonesia set the stage for such modernization when it adopted a new export policy in 1982, and Bank Indonesia has been working on detailed implementation of a modernization scheme. The Philippines is also planning to implement a modernized export financing scheme.

Administration of Export Loans

The timing, amount, and maximum maturity of the various kinds of export loans are summarized in Annex II-D. The maximum maturity of export loans is seven days after shipment (or delivery) of the export (or local supply), or the standard loan period (mostly 90 days), whichever is shorter. Annex II-E provides an overview of the typical procedures of export financing under a modernized system.

The amount of the different types of loans is obtained by multiplying the value of an export order (actual or expected) by the loan percentage (which is usually 70-90 percent) determined by the government. Formulas to compute the maximum allowable level of expected export (or local supply) orders for export loan purposes are given in Table 13 of Annex I. Note that these formulas are identical to the formula applied to imports used for export production. As indicated above, an expected export order is not a potential export order. An expected export order is a projected order, the projection being made with the above formula. The financing needs of potential exporters are normally covered by investment financing rather than preshipment short-term working capital financing. It should be stressed that while short-term working capital loans are granted essentially on the basis of confirmed export orders, loans based on expected export orders are allowed: (i) to simplify procedures for well-established large exporters; (ii) to allow production to build up inventories so that export orders can be filled speedily; and (iii) to make

it possible to check actual export orders against expected export orders on a regular basis. Therefore, the actual export order basis for loans is a case-by-case basis, while the expected export order basis can be considered an aggregate basis, aggregation being done for a period of time.

The documentary requirements for loans used to purchase domestically produced products (DIL and DOL) or loans used to purchase foreign intermediate inputs (FIL) are more or less similar to those needed for import licensing or domestic purchase of intermediate inputs through a domestic L/C system. In the case of export loans to generate value added (VAL), the additional requirement is an estimate of value added.

Rediscounting Administration

Without automatic rediscounting by the central bank of export loans granted by commercial banks, it is not possible to guarantee that all exporters will have automatic access to export financing. Speedy and efficient rediscounting mechanisms are essential to an effective export financing system.

The main role of the export financing system of Singapore may be to guarantee that exporters will be able to obtain funds quickly for export production; simple availability of funds may not be a problem in view of the well developed commercial loan market.[31/] Commercial banks in

31/ An alternative explanation for the Singapore's export financing system may be that, even though it is one of the international financial centers, the domestic working capital loan market is not perfectly competitive due to imperfect information on exporters. See Stiglitz and Weiss (1981) for a theoretical discussion of credit rationing even in commercial bank loans.

Singapore are able to process export loan applications and obtain central bank rediscounting within 24 hours on the basis of a single instrument called "pre-export and export bills of exchange" (a sample is shown in Annex II-C).

Korea's system for granting preshipment export loans uses exporters' promissory notes, backed by actual or expected export orders. In Indonesia, where a refinancing scheme that requires a separate loan agreement between a commercial bank and the central bank for each application has been used rather than a rediscounting scheme, speedy disbursement of export loans has not been possible.

(e) Domestic Letter of Credit System

The single most important innovation in export incentive administration is the domestic letter of credit. The domestic L/C is essential to assuring automatic availability of short-term export loans and free trade status to all firms that generate export value added but do not export directly, i.e., indirect exporters. There are two types of indirect exporters: (i) input-supplying indirect exporters--which supply intermediate inputs to final stage (or next stage) export manufacturers--and (ii) output-supplying indirect exporters--which supply finished export products to trading companies that export directly (or sell to other trading companies). Indirect exporters most commonly are manufacturers, but they can also be pure traders. Input-supplying indirect exporters, shown in the upper part of Figure 2, are critical for achieving backward linkages from

exports; output-supplying indirect exporters, shown in the lower part of Figure 2, are critical for developing trading companies that specialize in overseas marketing.

In many developing countries attempts to encourage final exporters to pass the benefits of export incentives through to indirect exporters have not been successful, because the systems constructed have apparently not dealt adequately with the different needs of indirect and direct exporters in a well-coordinated manner. The successful East Asian countries, on the other hand, have granted equal export incentives to indirect exporters themselves, not through intermediaries. The domestic L/C system has been the most effective administrative tool for this direct granting of export incentives.

Basic Principle of Domestic L/C

The principle of a domestic L/C system is the creation of "back-to-back credit," a vehicle through which the beneficiary of an export L/C (or other export order) can take advantage of the creditworthiness of the importer (and the availability of export incentives tied to an export order). When an exporter has an irrevocable L/C in his favor, the existence of the L/C induces his bank to open a second, similar credit account on behalf of the exporter, with the input-supplying indirect exporter or output-supplying indirect exporter as the beneficiary. Thus, the indirect exporter gains access to all export incentives based on the

receipt of the domestic L/C, just as the final exporter gains such access based on the receipt of an export L/C, (or other evidence of an export order).

If the supplier of inputs for export production is a foreign manufacturer, as shown in the upper part of Figure 2, the second credit is an import L/C; if the supplier is a domestic input-supplying indirect exporter, the second credit is a domestic L/C. The exporter, in fact, assigns the primary credit--the master export L/C--to the bank as collateral and applies for an import or domestic L/C. Generally, the bank opening the second credit establishes exactly the same documentary requirements as those under the primary credit. Note in the upper part of Figure 2 that a domestic L/C is parallel to an import L/C. There is no difference between them except for the fact that the beneficiary of the former is in the country, while the beneficiary of the latter is overseas. A domestic L/C is no different from an export L/C in that the beneficiary in either case is an exporter (an indirect exporter for the former, a direct exporter for the latter). Both provide a basis for opening another domestic or an import L/C.

As one can see from the upper part of Figure 2, under a free trade regime a garment exporter should be neutral in deciding whether to purchase fabrics from a domestic weaver (by opening a first-stage domestic L/C) or a foreign weaver (by opening an import L/C). Equally, a domestic textile weaver should be neutral in deciding whether to purchase yarns from a domestic spinner (by opening a second-stage domestic L/C) or from a foreign spinner (by opening an import L/C).

Let us suppose that the domestic textile weaver is a small-scale producer (located on a back street in a suburb of a big city) equipped with 20 looms. This weaver sells his textile fabric to a garment exporter through a first-stage domestic L/C and purchases yarns either through a second-stage domestic L/C or an import L/C. This weaver is purchasing the intermediate inputs and selling output under a free trade regime and receives the same treatment as large-scale firms when he applies for export loans. Through a domestic L/C system this small-scale weaver becomes an important actor in international trade, because a domestic L/C system extends free trade to domestic trade involving small-scale enterprises. The backward linkages from garment export to domestic production of textile fabrics, and from domestic production of fabrics to the domestic production of yarns, are achieved through first and second-stage domestic L/Cs. Because the backward linkages are achieved under a free trade regime, these domestic industries should be in accordance with the principle of international comparative advantage, as will be discussed below.

If the garment manufacturer (i.e., output-supplying indirect exporters) in the lower part of Figure 2 cannot receive the same export incentives as the final exporter (i.e., the trading company) that purchases the export commodities for export, then trading companies cannot be developed effectively, since the garment manufacturer would try to export directly rather than sell to the trading company. Furthermore, if the garment manufacturer is a small producer, the export potential would simply be lost, since such small firms cannot afford to have an export marketing

channel. Therefore, the domestic L/C system is critical in developing trading companies by providing equal export incentives to output-supplying indirect exporters.

The domestic L/C system is the most effective instrument for meeting the two basic requirements in structuring administrative arrangements that provide critical incentives for indirect exporters. These requirements are: (i) that a means exist for independently and automatically verifying that the supply of intermediate inputs or completed export commodities provided by the indirect exporter were in fact purchased by and delivered to the final exporter and (ii) that both the indirect exporter and the final exporter are strongly encouraged to use available instruments in order to gain access to export incentives. Because the domestic L/C is handled by commercial banks, it also offers the advantage of delegating much of the authority for export incentive administration to the commercial banks, which generally offer greater administrative efficiency than government can provide.

A domestic L/C is a document created by a bank that declares to the indirect exporter that the bank will pay, on behalf of the final exporter, a draft drawn on it when the indirect exporter submits, together with the draft, a receipt that commodities have been delivered to the final exporter. Therefore, the domestic L/C is the most reliable and automatic instrument for verifying the transaction between the final exporter and the indirect exporter. The mutual encouragement to use available instruments is provided under the domestic L/C because the final exporter gains access

to export loans for purchasing domestic inputs (DIL) or finished export commodities (DOL) based on the domestic L/C he issues, while the indirect exporter must be the beneficiary of the domestic L/C in order to gain approval for his production loans (DIL, FIL, and VAL). For this mechanism to operate, it is essential that the export financing system be modernized along the lines indicated above.

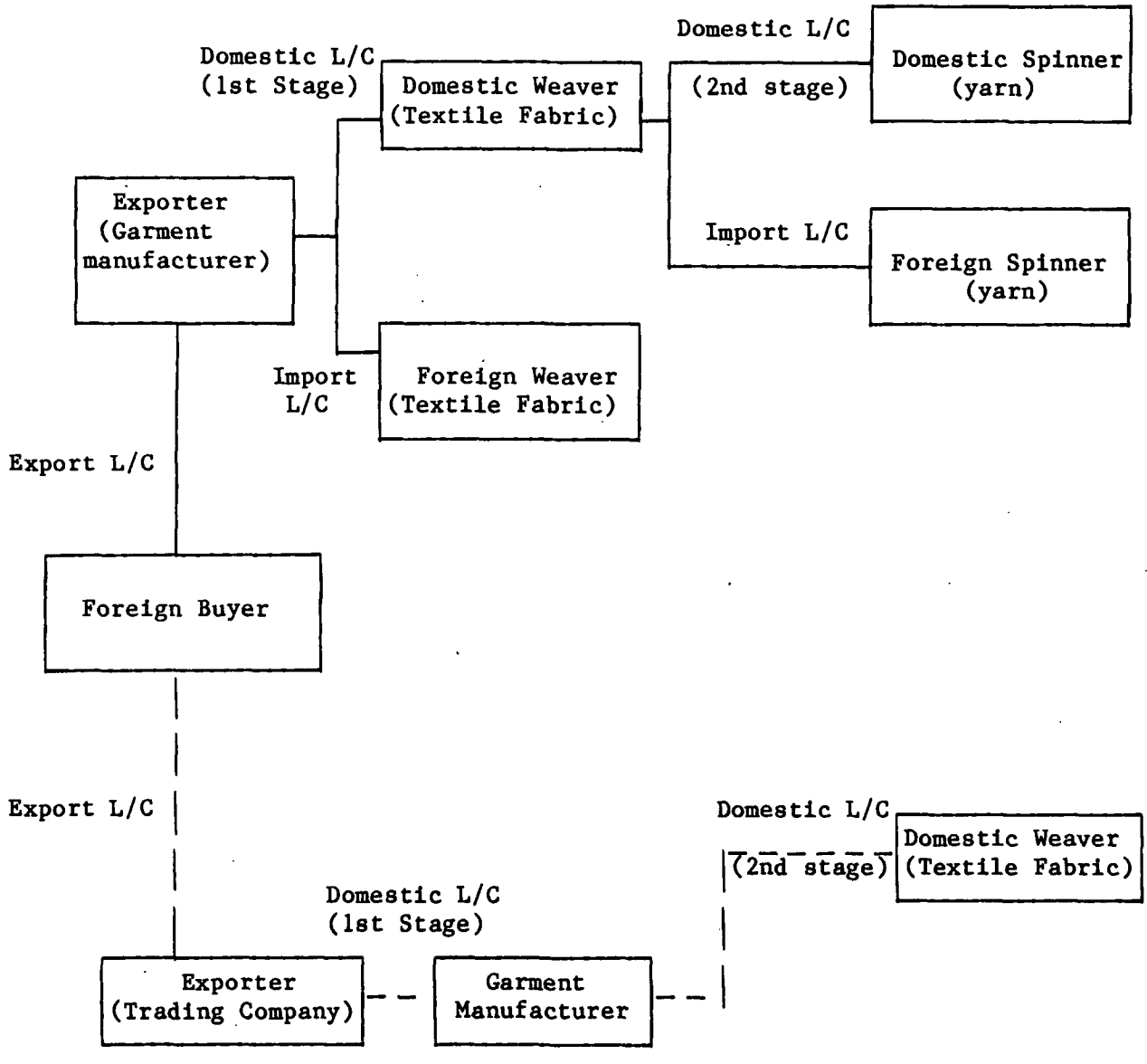
The following additional elements are designed to treat a domestic L/C just like an export L/C:

(a) Equal treatment of other payments methods. In other words, purchasers of domestically produced intermediate inputs for export production or finished export commodities must be able to ask a commercial bank to open a domestic L/C based on a D/P or D/A draft, a previous domestic L/C, or other foreign-exchange-earning contracts, as well as an export L/C.

(b) Equal treatment of expected and actual orders. A purchaser of domestically produced intermediate inputs for export production or finished export commodities must be able to ask a commercial bank to open a domestic L/C on the basis of an expected export order (a specific formula representing the average export performance of the company in the past is shown in Table 13 of Annex I).

Figure 2

DOMESTIC L/C: BACK-TO-BACK CREDIT



There are several administrative requirements for domestic L/Cs: (a) domestic L/Cs are irrevocable, opened in accordance with internationally adopted practices (see International Chamber of Commerce 1974); (b) the beneficiary of a domestic L/C is authorized to draw a sight draft on the opening bank; (c) once an export loan is granted on the basis of a domestic L/C, only the lending bank may purchase the draft drawn under the domestic L/C; (d) a bank negotiating a domestic L/C collects proceeds from the bank opening the domestic L/C through a domestic L/C clearinghouse.

Impact of Domestic L/C System

The domestic L/C system is critical for several reasons: it breaks the barrier that restricts free trade status and access to export financing to a free trade zone or a final exporter; it makes domestic trade the equivalent of free international trade as long as the domestic trade is tied to exports; and it helps to achieve efficient industrial development through (i) the accomplishment of more efficient backward linkages because of export expansion, (ii) development of trading companies specializing in overseas marketing, and (iii) the development of small and medium-scale industries by bringing them into export production activities.

A domestic L/C system has been extensively and successfully used by Korea. The most notable achievements of the system have been more efficient backward linkages, development of trading companies, and the successful development of small-scale export industries. These are discussed below.

Backward Linkages: By extending free trade status and automatic availability of short-term export loans to every production process contributing to the generation of export value added, the domestic L/C system of Korea has brought about backward linkages that accord with the true comparative advantage of each production process. According to Table 14 of Annex I, about 67 percent of the total value of domestic L/Cs issued in Korea during 1976-78 was for the purchase of domestically produced intermediate inputs, 31 percent was for the purchase of domestically produced finished products, and 2 percent was for the payment of subcontract fees. Note that for every dollar of manufactured exports, about 50 cents' worth of domestically produced intermediate inputs were purchased. In the textile industries the use of domestically produced intermediate inputs in exports was even more extensive. About 60 cents' worth of intermediate inputs were purchased from other domestic producers for every dollar of textile exports. These figures indicate the depth of the backward linkages associated with exports.

Development of Trading Companies: Without the domestic L/C system, Korea could not develop its trading companies as effectively as it did. According to Table 14 of Annex I, for every dollar of export about 24 cents worth of finished export products were purchased by trading companies from other manufacturers.

Development of Small-Medium Scale Export Industries: According to a 1979 survey of small and medium-scale manufacturing firms in Korea, the total value of direct and indirect exports by the firms amounted to

41.8 percent of the aggregate exports of Korea's manufacturing industries.[32] What major policy factor accounted for this impressive contribution by the smaller firms to export-led growth? The answer is clear. By guaranteeing small and medium-scale industries absolute equality in obtaining export incentives, the domestic L/C system brought many potential export producers into export production activities. As far as I know, no other developing country so successfully avoids discrimination against small and medium-scale enterprises engaged in export activities. The Korean experience suggests that the best policy toward such enterprises is neither the excessive subsidizing that comes from the "small is beautiful" notion nor the discrimination of the counter-reaction that "small is inferior."

(f) Export Credit Insurance

After neutral status for the production of export commodities is achieved, a developing economy should devote more resources to promoting overseas sales of export commodities by guaranteeing equal treatment of all export sales activities. To expand export sales through payment methods other than the sight L/C (such as the usance L/C, D/A, D/P, consignment sale, etc.), a system of postshipment financing and export credit insurance (i.e., insurance against nonpayment by importers) needs to be developed.

32/ The survey was conducted by the Small-Medium Enterprise Promotion Corporation at the end of 1979, covering 32,459 firms in the manufacturing and mining industries. (Hankook Daily, December 25, 1980). Small-medium scale firm is defined by the number of employees: less than 300, and more than 5. The total value of exports (direct and indirect) by the small-medium scale firms in the manufacturing industries in 1979 was $5,724 million; total manufacturers exports in the same year were $13,680 million.

An export credit insurance scheme that provides broad coverage against risk enables producers and exporters to venture into new markets and new lines of exports with greater confidence.

Even in developed economies, governments have taken an active part in instituting export credit insurance, as exemplified by the Export Credit Guarantee Department of the Board of Trade in the United Kingdom and the Ministry of International Trade and Industry of Japan. Thus, the view that the government in a developing economy should implement an export credit insurance system can hardly be disputed.

Protection of exporters and export financing institutions against the risks stemming from nonpayment by importing countries and importers is provided by export credit insurance agencies in Hong Kong, Singapore, and Korea. Recently, Malaysia and Indonesia have also established export credit insurance organizations. Among these agencies, the Hong Kong Export Credit Insurance Corporation (ECIC) has the longest history. The ECIC was established by the Hong Kong government in 1966 as Hong Kong's official export credit insurer. The corporation's paid-up capital of 20 million Hong Kong dollars was provided by the government, which also guarantees the liabilities created by the corporation's insurance and guarantee operations. The statutory limit of this guarantee is 3 billion Hong Kong dollars. Indemnity protection of 90 percent of insured value is available against "buyer" risks (such as insolvencies, bankruptcies, defaults, and repudiation of contracts) and against "country" risks (such as blockage or

delay of transfer of foreign exchange, war and civil disturbances, import bans, cancellation of import licences, and other causes of loss beyond the control of the exporter and his overseas customer).

The Export Credit Insurance Corporation of Singapore Ltd. (ECICS), established in 1976 as the first such institution in the ASEAN region, is half-owned by the government and half by some 80 or so local and foreign banks and insurance companies. Following the pattern of Singapore, the Malaysia Export Credit Insurance Berhad was established in 1977 as a joint venture of the Malaysian government, commercial banks, and insurance companies. It is presently 50 percent owned by the government, 40 percent by commercial banks, and 10 percent by the insurance industry.

Korea's export credit insurance organization is different from those of Hong Kong, Singapore, and Malaysia in two respects. First, Korea does not yet have an organization that handles only export credit insurance, even though a legal entity to handle export credit insurance schemes and the export credit insurance fund was established in 1969. Currently, the Export-Import Bank of Korea (whose main function is administering medium and long-term export loans designed to promote overseas sales through deferred payment methods) operates export credit insurance plans as part of its role. Second, Korea's export credit insurance includes preshipment export finance guarantees. Although Korea plans to create a separate organization to deal with export credit insurance activities, budgetary considerations have so far prevented it from doing so.

The January 1982 Export Policy of Indonesia provided the legal foundation for an export credit insurance plan, and work is in progress to create a separate organization for administering the plan. Realizing the critical importance of preshipment export credit guarantees, the Indonesian government has given the new organization the tasks of handling both export credit insurance policies and a preshipment export finance guarantee scheme. For some time to come, however, the preshipment export finance guarantee will be the most important function of the new organization. The Philippines has yet to implement a decree issued in 1981 to establish a new export credit insurance corporation.

Under the sponsorship of the UNCTAD, it has been proposed that an International Export Credit Guarantee Facility be established. This agency would guarantee export credit paper arising from exports on credit (the duration of credit being from over six months up to ten or more years) used by developing countries that are members of the Facility. This guarantee would permit these countries to rediscount their export paper on favorable terms in international capital markets. Intergovernmental experts have undertaken a detailed examination of the operational features of the proposed Facility (UNCTAD 1983). It has been proposed that an in-depth study be carried out under the sponsorship of the Economic and Social Commission for Asia and the Pacific, to examine the operational features of a proposed multinational regional export credit guarantee and direct refinancing facility 33/ with the objective of promoting exports of developing countries on deferred payment terms (ESCAP 1982).

33/ Unlike BLADEX (the regional export bank for Latin America), which refinances both preshipment and postshipment export financing, this refinancing facility appears to be limited to postshipment financing of exports on deferred payment terms.

While it is clearly the responsibility of the governments of developing countries are responsible for pooling the risks stemming from potential nonpayment by importing countries and importers of export commodities by developing export credit insurance plans, it is important to wait until the benefits of such schemes outweigh their costs and to have a broad perspective on how much such schemes can make a difference in export performance in the short run. Table 5 shows export values when the export credit insurance systems were first established in five east Asian economies and the shares of exports covered by these systems in 1981. It is important to understand that the basic objective of an export credit insurance system is to expand exports by creating additional export opportunities through non-L/C payment methods, rather than to substitute exports based on non-L/C methods of payment for exports based on L/Cs.

Hong Kong and Korea started their export credit insurance schemes when their exports were less than US$1 billion; Singapore, Malaysia, and Indonesia started their plans when their exports exceeded $4 to 6 billion. However, the composition of export commodities and payment methods is an important as aggregate export volumes in determining the proper time to establish export credit operations.

Export credit insurance plans covered no more than five percent of the export of Korea, Singapore, Hong Kong, Malaysia and Indonesia in 1981. Of course, as exports from these economies become more sophisticated

Table 5

COVERAGE BY EXPORT CREDIT INSURANCE SYSTEMS

Country	Establishment of Export Credit Insurance System	Shares of Exports covered by Export Credit Insurance Scheme in 1981		
	Year	Merchandise e/ Exports (million US dollars) (1)	Merchandise f/ Exports in 1981 (million US dollars) (2)	Insurance Coverage in 1981 (million US dollars)	[(2)/(1)] x 100
Hong Kong	1966	830	14,631	618 a/	4.2%
Singapore	1976	6,187	19,499	937 b/	4.8%
Korea	1969	703	20,881	746 c/	3.6%
Malaysia	1977	6,035	11,092	161 d/	1.5%
Philippines	-	-	5,722	-	-
Indonesia	1982	4,170 f/	5,587 f/	-	-

a/ Hong Kong Export Credit Insurance Corporation, 1981/82 Annual Report.

b/ Export Credit Insurance Corporation of Singapore Ltd., Annual Report and Accounts 1982.

c/ This figure represents commitments as of December 31, 1980.
The Export Import Bank of Korea, Annual Report, 1980.

d/ M. Skully, "The Malaysian Financial Sector: Development and Institutional Structure." The World Bank, 1983, processed, p. 67.

e/ Various issues of International Financial Statistics, except for Hong Kong and Indonesia.

f/ Merchandise exports, excluding oil and LMG. Manufactured good exports were estimated to be $668 million in 1981 and $758 million in 1982.

and methods of payment become more diversified, the shares of exports covered by insurance will increase. Apart from important gains in institution-building, however, we should recognize that in the short run the net impact of the insurance plans will be limited.

The most important kind of institution-building is to build the capability to collect information on overseas buyers and importing economies and the ability to evaluate the credit standing of potential importers. One advantage of joining the Berne Union (The International Union of Credit and Investment Insurers), a non-official association of export credit insurers, is gaining access to information filed with the Union. Currently, the Berne Union has 38 members from 30 countries, including the developing countries of Argentina, Hong Kong, India, Korea, Mexico, Singapore, South Africa, Jamaica and Zimbabwe. Sri Lanka and Malaysia are observers.

It is interesting to observe that in the early 1980s there were considerable differences among Hong Kong, Singapore, and Korea in the composition of insured exports. About 80 percent of Hong Kong's insured exports in 1982 were light manufactured goods, such as textiles and footwear (Table 15 of Annex I), while the corresponding figure for Singapore was less than half (Table 16 of Annex I). While less than 20 percent of Singapore's insured exports in 1982 were related to construction and overseas investment activities (Table 16 of Annex I), the corresponding figure for Korea in 1981 was more than 85 percent (Table 18 of Annex I).

Long-term postshipment insurance in Singapore (20 percent) was higher than in Korea (10 percent). The share of export credit insurance under secured terms in 1982 exceeded 10 percent in Singapore (Table 17 of Annex I); the corresponding figure in Korea in 1981 was negligible.

(g) Postshipment Financing

Postshipment financing covers financing needs for export sales on credit from the time of shipment of commodities to the time of payment. Short-term credit at the postshipment stage is generally made available through the negotiation of bills or advances against bills tendered for collection abroad, backed by the rediscounting facilities available from central banks. Discounting of bills other than those drawn on letters of credit depends in most cases on export credit insurance policies that provide protection against commercial and political risks. Usually, export credit insurance is a condition for securing credits for exports based on payment methods other than irrevocable sight L/Cs[34]/ from financial institutions, irrespective of whether the credits are granted to suppliers or to overseas buyers.

Until the end of 1976, Korea's export loans extended into postshipment periods for exports based on time L/Cs (usance L/Cs) or drafts (D/P or D/A), although preshipment financing accounted for the major part of short-term export loans. Currently, postshipment financing for

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34/ As one can see from Table 17 of Annex I, part of the irrevocable L/Cs are also insured to cover country (political) risks.

these types of exports is handled through the normal commercial banking practice of discounting acceptances, backed by automatic rediscounting (100 percent) by the Bank of Korea. Singapore, Malaysia, the Philippines, and Indonesia all include postshipment financing (ranging up to six months) in their export financing systems, offering terms similar to those for preshipment financing.

If the deferred payment period extends beyond six months, the transaction is not eligible for acceptance financing. (In this case, an L/C is usually used rather than a time draft.) To provide deferred payment credits, Korea established the Export-Import Bank of Korea in 1976. Such loans are counted with medium and long-term export loans (Annex I, Table 11). The average share of such loans was less than 15 percent of all export loans during 1977-79, but as the Korean export structure shifts toward technology-intensive commodities, the share of loans for deferred export payments will increase. Singapore introduced a medium and long-term financing facility for deferred payment exports in 1979 (see below for more on this facility). Malaysia, Indonesia, and the Philippines do not have any special arrangements for providing medium or long-term credit to finance exports.

Domestic Usance System. There are two kinds of short-term postshipment financing for imported materials or capital goods: the shipper's usance draft, and the buyer's usance draft. By means of a shipper's usance draft, a foreign exporter provides short-term postshipment credits to a domestic importer of intermediate and capital goods.

Alternatively, a buyer's usance can be drawn on and accepted by the bank that opens a usance L/C. In this case, the foreign exporter receives his proceeds when the bank accepts and discounts the usance bill of exchange. Short-term postshipment export credits are granted to the importer of intermediate or capital goods by the domestic accepting bank. The domestic usance system in Korea provides automatic rediscounting (by the central bank) of a usance draft discounted by a commercial bank.

(h) Conclusions

An examination of the export financing experiences of the successful East Asian countries illustrates the key role played by assurance of automatic and equal access to export financing for all firms that generate export value added (including small and indirect exporters)--either through competitive financial markets or through the modernized export financing system--rather than the granting of financial subsidies. Automatic and equal access has not only avoided the loss of potential foreign exchange earnings based on confirmed export orders, but has brought large numbers of potential exporters into the export drives.

Automatic and equal access has been assured by the governments of the successful East Asian countries by providing the supply of funds and risk-pooling schemes to commercial banks handling preshipment export financing, until the time when competitive financial markets were developed and export industries matured. Assuring a continuing supply of funds for preshipment export financing at a uniform interest rate has effectively

created a situation close to competitive financial and money markets for exporters. Risk-pooling schemes supplemented by risk-reducing activities have permitted potential exporters to deal with uncertainties stemming from infant exporters' lack of information on technology, marketing, and management.

Export financing modernization has been critical in assuring automatic and equal access to export financing for all firms generating export value added by (i) eliminating wastes and abuses through automatic mechanisms (this has been essential in light of macro monetary constraints) and (ii) assuring automatic access to small producers and indirect exporters. Innovative administrative tools such as the domestic L/C system have been essential in achieving invaluable backward linkages through export financing to input-supplying indirect exporters as well as input-buying final exporters and in promoting development of trading companies through export financing to output-supplying indirect exporters as well as output-buying trading companies.

Because the first requirement of exporting is to produce export commodities at internationally competitive costs, the highest priority has been placed on preshipment export financing and preshipment finance guarantees rather than on postshipment financing and export credit insurance in early stages of export development in the successful East Asian developing countries.

CHAPTER V

KEEPING PRIMARY INPUT PRICES COMPETITIVE

If primary input markets are not competitive, exporters will be at a disadvantage, because they will pay more than true economic prices for inputs used in export production.

Assuring neutrality vis-a-vis competitive primary input prices is important in promoting exports in a developing economy in accordance with its comparative advantage. A recent NBER study (Krueger 1983c) concludes:

> Perhaps the most striking findings emerging from the trade strategies and employment project were that, on one hand, despite factor market conditions, developing countries' manufactured exports tend to exhibit the factor intensity consistent with their endowment, and that, on the other hand, the scope for further increasing their demand for labor through both trade policies and realignment of domestic factor market incentives is sizable.

The first-best policy for assuring true market or shadow prices for export activities is to keep primary input markets competitive. If such a first-best policy is not possible, the government can use export incentives to compensate exporters for the difference between noncompetitive market prices and the shadow prices of primary inputs.

(a) Keeping Primary Input Markets Competitive

Many argue that the export success of Hong Kong, Singapore, and Korea is due to their competitive labor markets and noncombative labor unions, as well as the existence of private sectors that have exercised initiative and creativity in export activities. In general, the wages of unskilled and semi-skilled labor in these economies have been determined by free markets rather than by institutional factors 35/ and therefore have been close to their shadow wages. In Hong Kong there is no statutory minimum wage rate, and the prevailing wage is essentially the result of interplay between supply and demand.

The policy of wage restraint adopted by the Singapore Government was supported by Singapore's trade unions in order to create a climate conducive to foreign investment and expanded employment, and this policy proved effective in the 1960s, when Singapore suffered from high unemployment and underemployment. In response to rapidly rising wages in the early 1970s, the government set up a National Wages Council (NWC) to recommend orderly wage changes. The NWC is a tripartite body consisting of representatives from the government, employers, and workers. The NWC's tasks are: (i) to formulate wage guidelines for the economy, (ii) to ensure orderly wage increases to promote economic and social development, and (iii) to assist in the development of incentive schemes to improve national productivity. The NWC recommended high wage increases for 1972-74, partly to

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35/ See Fields (1982) for the function of labor markets in Hong Kong, Korea, and Singapore, and their impact on industrialization and emloyment.

offset inflation and partly to encourage firms to use labor efficiently. Because of the recession in the mid-1970s, the NWC recommended modest wage increases during the period 1975-78. In 1979, as the Singapore government shifted its strategy toward exporting goods that require greater skills to produce and result in more value added, the NWC recommended high wages to facilitate a restructuring of the economy in that direction. This policy resulted in annual increases in wage rates of about 20 percent during 1980-82. In June 1982, the Singapore government announced changes in the NWC designed to reduce the influence of the government on wage determination. Under the new NWC, wage bargaining will largely be in the hands of employers and unions.

Western-style labor unions have not been allowed in Korea, and the government has not imposed any minimum wage or other regulations that have significantly affected the determination of wages. To be sure, real wages have risen dramatically, but this appears to have been the outcome of market forces. In order to attract highly skilled engineers and technicians (mostly foreign-trained) and to encourage investment in skill formation, however, Hong Kong, Singapore, and Korea appear to depend on government incentives rather than purely on markets. The rationale may be that markets tend to underinvest in skill formation, and the wages of highly skilled workers may not reflect their shadow prices, even in these economies.

It is important to recognize that the competitive primary input market mechanisms, together with the outward-looking development strategies, in the successful East Asian economies have resulted during the 1960s

and 1970s in: (i) full employment despite increasing populations and rising labor force participation; (ii) impressive rates of real wage increases in most of the successful East Asian countries that were generally consistent with growth rates for real GNP; and (iii) improved overall income distribution (Fields 1982).

(b) Compensating for Non-Competitive Primary Input Prices

According to a ILO report (ILO 1974), the Philippines has perhaps the most comprehensive minimum wage legislation in Asia. In the early 1970s the government modified the labor laws to prohibit strikes and picketing for the explicit purpose of promoting exports of labor-intensive manufactured goods (Datta-Chaudhuri 1981). The Philippines' value-added based income tax incentives for export industries (see below) may be partly designed to compensate for any discrepancy between actual and shadow wages.36/

Labor market segmentation in Malaysia has been reported as the major cause of the coexistence of labor shortages in one job category or region with labor surpluses in other job categories or regions. Labor utilization relief investment tax incentives (see below) can be considered to be compensation for excess wage costs. In turn, tax compensation for skill formation and upgrading has been stressed in Malaysia for the improvement of its segmented labor market (World Bank 1981b).

36/ Medalla (1979) estimates that Philippines' shadow wages were 77% or 86% of market wages during 1969-77.

Minimum wage regulations were enacted in Indonesia in 1975; a law enacted in 1964 required private firms to obtain government approval before dismissing more than ten workers and to pay indemnities. Pitt (1981) reports, however, that the number of industries and employees covered by these regulations was relatively small, and enforcement was of doubtful effectiveness. So far, no income tax incentives have been offered to export industries in Indonesia.

As the NBER (Krueger 1983c) study acknowledges, there is a general lack of knowledge about primary input markets:

> An equally striking finding was the extent to which our knowledge and understanding of factor markets in developing countries is imperfect. Analysis of the interaction between trade strategies and domestic factor markets was generally more constrained by a lack of data and analyses on domestic factor market conditions than by lack of data and analyses on trade strategies.

We need to know more about the nature and causes of market failures in many developing countries for the establishment of right policies designed to keep primary input markets competitive or to compensate for excessive primary input prices.

(c) Conclusions

The clear and uncomplicated lesson regarding primary input markets in the successful East Asian developing countries is that policies that strive to keep primary input markets competitive would be more effective than those that strive to compensate for noncompetitive primary input prices stemming from noncompetitive primary input markets encouraged, created, or ignored by the government. The former policy, together with the successful outward-looking development strategy, has resulted in full employment, increasing real wages, and improved income distribution. We need to know more about the nature and causes of primary input market failures in many developing countries for the establishment of right policies designed to keep primary input markets competitive or to compensate for excessive primary input prices.

CHAPTER VI

COMPENSATORY EXPORT INCENTIVES TO ESTABLISH NEUTRAL STATUS

So far, we have reviewed the basic foundations of export policy and administration. The goal of such a policy is to guarantee neutral status, which--as defined in Chapter I--can be achieved by a combination of the following: (i) a flexible exchange rate; (ii) free trade for intermediate inputs and outputs; (iii) competitive money and financial markets; (iv) competitive primary input markets; and (v) nondiscriminatory domestic taxes for all activities generating export value added. Neutral status can also be achieved through equivalent compensatory incentives for all activities that generate export value added if the five separate policies above cannot be perfectly implemented due to some constraints. This chapter presents a discussion of the compensatory incentives.

In view of the importance of institutional and administrative arrangements in achieving elements (ii) and (iii) above, we have reviewed in detail the basic principles and administrative structures necessary to provide free trade status and automatic access to export financing at a uniform interest rate for all export activities. The purpose is to assure automatic access to preshipment short-term working capital export loans to all exporters (direct and indirect). Otherwise, exporters may not be able to earn foreign exchange even when they have export orders. The major concern here is speedy and automatic availability of short-term working capital at a uniform interest rate that ensures neutrality, rather than interest rates that may contain preferential margins. Providing completely

free trade status for all export activities is as urgent as providing automatic access to export financing, but it takes considerable time and effort to prepare a reasonably well-designed and well-managed duty exemption/drawback system. To the extent that export activities must suffer negative protection rates due to the incompleteness of a duty exemption/drawback system, compensatory export incentives are frequently used as temporary measures until exporters are guaranteed complete free trade status. We also suggested that while maintaining a flexible exchange rate and competitive primary input markets is desirable, it may not be possible to do so because of various structural rigidities. If that is the case, additional export incentives are needed to guarantee neutral status by compensating for exchange rate overvaluation and differences between the market and shadow prices of primary inputs:

Compensatory export incentives needed to achieve neutral status	=	Loss of export earnings stemming from currency overvaluation	+	Excess of (current and capital) input costs over free trade prices	+	Excess of primary input cost over competitive market prices	(10)

Equation (10) refers to each export product or exporter.[37] Dividing equation (10) by the appropriate export value in dollars, one obtains (for a given exporter):

37/ This formula is based on the assumption that automatic and equal access to export loans at an interest rate which is not higher than the nondiscriminatory rate is guaranteed for all export activities, and that domestic taxes for exporters are nondiscriminatory except for being used as compensatory export incentive tools.

Compensatory export incentives per dollar of export needed to achieve neutral status	=	Currency over-valuation per dollar	+	Excess of input costs over free trade prices per dollar of export	+	Excess of primary input costs over competitive market prices per dollar of export	(11)

Note that the left-hand side of equation (11) differs for various export products and exporters if a duty exemption/drawback system is not efficiently managed or primary input markets are not competitive, since duty rates are generally different for various inputs for export production, and imported input-output coefficients and primary input-output coefficients are different for various export products and exporters. Therefore, unless free trade status and competitive primary input markets are guaranteed, it is not possible to achieve neutral status based on uniform compensatory export incentives per dollar of export.

Effective Exchange Rate: Let us relate the concept of compensatory export incentives needed to achieve neutral status for a given exporter (defined in (11)) to the concept of an "effective exchange rate" for exports, which is an economy-wide average concept and is related to observed compensatory export incentives. Aggregating the value of equation (10) for all exporters in a country, dividing by the country's aggregate export value, and replacing the desired value with the observed value of compensatory export incentives, one can define an "effective exchange rate":

$$\begin{bmatrix}\text{Effective exchange rate for export}\end{bmatrix} = \begin{bmatrix}\text{Official exchange rate}\end{bmatrix} + \begin{bmatrix}\text{Average observed compensatory export incentives per dollar of export}\end{bmatrix} \quad (12)$$

The concept of an effective exchange rate defined in equation (12) is consistent with that in the NBER study (Krueger 1978, Bhagwati and Srinavasan 1978).[38/] Comparing equation (11) with equation (12), one can see that as long as the national average differs from individual exporters' averages on compensatory export incentives and the observed average differs from the desired averages, the estimated effective exchange rate can hardly show a true picture on neutral status for export activities. The effective exchange rate will only show clearly whether neutral status has been achieved or not if:

(i) the second and third elements on the right-hand side of equation (11) are close to zero (i.e., free trade status for exporters is guaranteed, and primary input markets are competitive); and

(ii) nondiscriminatory tax and financial incentives are employed.

The level of compensatory export incentives, then, simply indicates whether currency overvaluation is fully compensated or not, and the resulting effective exchange rate is the sum of the official exchange rate and the compensation for currency overvaluation:

38/ The effective exchange rate for export is defined as the units of domestic currency that can be obtained for a dollar's worth of exports, taking into account compensatory tax, financial, and other export incentives.

$$\begin{bmatrix}\text{Effective exchange rate for export}\end{bmatrix} = \begin{bmatrix}\text{Official exchange rate}\end{bmatrix} + \begin{bmatrix}\text{Compensation for currency overvaluation per dollar of export}\end{bmatrix} \quad (13)$$

Korea's export incentives, more or less, have always met the conditions underlying equation (13), and its compensatory export incentives have been mainly designed to compensate for currency overvaluation. As indicated in the exchange rate section, the Korean government has maintained stability in real effective exchange rates (i.e., purchasing power parity-adjusted effective exchange rates) by means of periodic devaluations and by compensating for currency overvaluation through tax and financial export incentives (Westphal and Kim, 1982).

The following discussion groups compensatory export incentives in three categories: (a) final incentives, (b) tax incentives, and (c) other incentives.

(a) Financial Incentives

Short-Term Working Capital Export Loans (Pre- and Postshipment)

As Primary Instrument for Automatic Access at Neutral Rate. A means of guaranteeing that exports will have neutral status vis-a-vis foreign competitors is to assure automatic access to short-term working capital export loans should at an interest rate that is close to the short-term international market interest rate. Certainly, foreign exchange components of short-term working capital export loans should not carry a

higher interest rate than the international interest rate. LIBOR is usually considered a parameter representing the international rate. A means of achieving the parallel objective of guaranteeing neutral status vis-a-vis domestic competitors, including the beneficiaries of preferential credit rationing, is to assure automatic access to short-term working capital export loans at an interest rate that is close to the average interest rate of domestic bank loans, including various preferential loans. At the very least, the domestic currency components of these short-term loans should not carry higher interest rates than the average rate of domestic bank loans. This does not mean, however, that the existing interest rate structure for domestic credits in many developing economies is ideal. Our concern is neutrality for exports, given the existing structure.

As domestic money and financial markets become competitive and a single prime market interest rate prevails, the uniform neutral interest rate charged for short-term working capital export loans should be the prime rate. (The rationale for guaranteeing a neutral interest rate for exporters vis-a-vis other beneficiaries of credit rationing will become more evident in Chapter 7 of the paper.) Domestic beneficiaries of credit rationing in many developing economies--that is, import substitution industries-- receive favorable interest rates in addition to other protection. Therefore, a neutral interest rate offered to exporters is a first step in equalizing incentives between exports and import substitutes.

Table 6 shows the interest rates on short-term working capital export loans in five East Asian economies as of June 1983. In Korea and Singapore the interest rates for export loans were either equal to or very close to the corresponding prime rate. In Malaysia, Indonesia, and the Philippines the differences between interest rates on export loans and average interest rates on bank loans or various preferential loans did not appear to be large, even though the differences may be substantial if one compares these rates with free market rates. In the Philippines, the interest rates on export loans as of June 1983 were 12-14 percent, while the weighted average interest rate of commercial bank loans at the end of 1980 was 13.5 percent. Commercial bank loans with preferential interest rates ranging from 0 to 14 percent were about 60 percent of total commercial bank loans in 1980, while export loans with interest rates of 12-14 percent made up only 7 percent of total commercial bank loans. It therefore appears that the interest rates on the export loans were not higher than the median of the interest rates on different types of loans. In the case of Indonesia, the government announced a number of sweeping financial reforms on June 1, 1983. The main reforms were the removal of ceilings on interest rates on rupia time deposits and the removal of all quantitative ceilings on bank loans. However, the government retained a 12 percent interest rate ceiling for various preferential loans, compared to a 9 percent interest rate ceiling for export loans.

Table 6

INTEREST RATES FOR SHORT-TERM WORKING CAPITAL EXPORT LOANS IN 5 EAST ASIAN ECONOMIES (AS OF JUNE, 1983)

	Singapore	Korea	Malaysia [b]	Indonesia	Philippines [f]
Export Loan For Exporters					
(1) Annual interest rate	Rediscount rate + 1.5%	10%	4.5%	9%	12% (Nontraditional exports) 14% (Traditional exports)
(2) Export Loan as % of export order(f)[a]	100%	VAL:83%(f_1) DIL:90%(f_3) FIL:68%(f_4) DOL:75%(f_2)	50%	85%	80%
For Handling Banks of Export Loan					
(1) Rediscount rate	6.5%	5%	3%	3%	3% (Nontraditional exports) 8% (Traditional exports)
(2) Rediscount amount as percentage of export loan	100%	70%	100%	60%	80%
Commercial Bank Loans					
° Weighted Average Rate	9%	10%		12%[c]	13.5%[d]
° Prime Rate	9%	10%	7.5%	18%	17.5%[e]

a/ $f = f_1 = f_2 = f_3 = f_4$ in Annex II-D.
b/ As of June 1981. Currently, the annual interest rate for exporters is 5% and the rediscount rate is 3.5%.
c/ Interest rate of all preferential loans refinanced by Bank Indonesia other than export loans after June 1983.
d/ (Central Bank of the Philippines, Statistical Bulletin, 1981).
e/ As of June 1980.
f/ In November 1983 the export loan interest rates were changed as shown below:
Export Loan for Exporters: MRR (Manila Reference Rate) - 2% for nontraditional exports
MRR for traditional exports
Rediscount Rate: 7% for nontraditional exports
8% for traditional exports
(MRR was 16% in November 1983)

As a Subsidiary Compensatory Instrument: The use of short-term working capital loans as a compensatory instrument to achieve neutral status for exports is less important than guaranteeing automatic access to short-term financing at neutral rates. However, short-term working capital export loans have been utilized as a compensatory instrument in many developing countries at the early stages of their export development. The following are the major reasons for doing so:

(i) In an economy in which the export financing system is successful in achieving the task assigned to the aforementioned primary instrument, it is most convenient administratively to use the well-designed and well-managed export financing system as the subsidiary instrument, because all one has to do is to change the neutral interest rate to a lower rate.

(ii) A preferential interest rate for short-term working capital loans is neutral with respect to choice of techniques, unlike preferential investment capital loans, which are capital-biased.

(iii) Since commercial banks in developing economies generally have better human resources than, say, customs or internal revenue services, one can expect better administrative efficiency if a compensatory incentive tool is managed by commercial banks.

(iv) It has been assumed that preferential interest rates may be less controversial than alternative compensatory tools (such as reduced taxes or cash rebates) in dealing with potential retaliation from importing countries (except for the United States), since developed countries offer preferential interest rates on exports sold on credit.39/ (Balassa and Sharpston 1977).

From Table 19 of Annex I, one may infer that (i) a neutral interest rate has been assured for export loans in Korea, and (ii) interest rates have been used at times as a supplementary instrument to compensate for exchange rate overvaluation. The gap between the prime rate and the interest rate on export loans has declined monotonically during the last 12 years (and was completely eliminated in the middle of 1982); preferential loan interest rates have gradually become more uniform, and exchange rate overvaluation has gradually been reduced due to a more flexible exchange rate. In turn, Korea's interest rate for working capital export loans in foreign currencies (for importing intermediate inputs for export production) has been based on the LIBOR since the middle of 1970 in order to reflect the scarcity of foreign exchange (as shown in Table 20 of Annex I).

39/ For example, GATT has never effectively come to grips with the subject of export finance, even though it has been active in tariff and non-tariff trade barriers, maybe because export credit has usually been regarded as an OECD responsibility.

In the case of Singapore, the gap between the prime rate and the export financing rate has never exceeded one (or one-and-a-half) percent.[40] While there has been no need for government-supported export loans in Hong Kong because of easy access to local financial institutions and a free flow of international financial resources (the results of efficient financial institution development), the market interest rate is not uninfluenced by government policies. At least two instruments are being used to influence effective interest rates on deposits. One is the Hong Kong Association of Banks' Interest Agreement, which sets the maximum interest rates that can be paid by banks on various types of deposits. The other is manipulation of the tax rates on interest income. In 1982 the government abolished the tax on interest on foreign currency deposits held in Hong Kong. The tax had tended to impede local financial institutions in competing with other international centers for funds, particularly funds for large syndications. At the same time, the government reduced the withholding tax on Hong Kong dollar deposits from 15 percent to 10 percent. This policy stimulated deposits (estimated to be in the range of 15 billion Hong Kong dollars in early 1983). An administered interest structure for local deposits has been defended because of a lack of monetary alternatives in the form of more stringent liquidity requirements. Total abolition of the withholding tax on local deposits has been objected to on the ground that it would reduce government revenues.

40/ There may be two explanations for Singapore's export financing system and its interest preferences. One is the compensatory export incentives argument under externality associated with exporting. The other is the less-than-perfectly competitive money and financial market argument under the imperfect information (see Stiglutz and Weiss, 1981).

The interest preferences on export loans in the Philippines, Indonesia, and Malaysia do not appear to be very significant when compared with interest rates on local preferential loans in light of the various anti-export bias created in these economies through other policies. Since short-term working capital export loans are for periods of no more than two or three months, the average annual loan balance used to estimate the magnitude of the incentive stemming from preferential interest rates is only one-sixth to one-quarter the loan amount.

We reemphasize here the importance of having a proper perspective on the relative administrative difficulties involved in achieving the primary objective of automatic access to financing and the secondary objective of compensating for non-neutral elements, as well as the relative importance of these loans. Changing an export loan interest rate upward or downward can be done overnight: all that is required is a new central bank decree. But such action does not influence export performance significantly, since there are alternative instruments to compensate for anti-export bias. To achieve the primary objective of assuring automatic access to working capital loans at a neutral interest rate for all activities generating export value added demands painstaking institution-building efforts that may take anywhere from a few to a great many years, depending on conditions that vary from country to country. But the consequences of failing to achieve this objective are far more serious than the impact of interest rate changes.

Medium- and Long-Term Loans for Exports on Deferred Payment Basis

The use of preferential interest rates on medium and long-term loans on a deferred payment basis are merely designed to compensate exporters in developing economies for any disadvantages they may suffer in the world market when developed economies use similar practices. OECD's attempts to harmonize and regulate the terms of export credits among the developed economies have made clear the extent to which preferential loans are used by developed economies to promote their exports. In 1978, the OECD countries established voluntary guidelines setting up minimum interest rates and ceilings on maturities and stipulating minimum down payments and maximum local cost financing for officially supported export credits. Rapid changes in interest rates, inflation, and exchange rates have made it difficult to establish international norms for credit terms. This question has been the subject of extensive discussions and studies in the OECD; the Wallen report has drawn attention to the deficiency of arrangements stemming from lack of definition of such key concepts as "interest rates" and "official support" (Dunn and Knight 1982).

Additional problems have been raised by the creation of "mixed credits," a technique in which public funds are combined with private export credits to finance down payments and the local costs associated with large projects. Mixed credits have substantially reduced the effective borrowing costs of importers to levels well below those established in the OECD arrangements and are generally contrary to the practice of official

export credit agencies. Protracted negotiations led to the adoption of a new agreement that established three categories of importing countries: those in the first category represent relatively rich countries, those in the second category include some of the more rapidly industrializing countries, while the third category represents relatively poor countries. Each category has corresponding interest rates and maturities that apply to it. A comprehensive revision of these guidelines was made in October 1983. One key element of the revised new agreement was to introduce the automatic semi-annual interest rate adjustment mechanisms so as to reflect changing money market conditions for different currencies (Table 21 of Annex I). It should be kept in mind that most of the transactions covered by this agreement involve capital goods exported by OECD countries on a deferred payment basis.

Since exports made on a deferred payment basis are mostly capital goods, plant exports, or overseas construction projects, the amount of medium- and long-term loans from developing economies for such exports is not large compared to the amount of short-term working capital export loans (mostly preshipment). The relative shares of such loans made by advanced developing economies is increasing, however.

The Export-Import Bank of Korea provides medium and long-term loans for Korean exports on a deferred payment basis. The major export items covered are ships, plants, rolling stock, machinery, and technical services. The annual interest rate charged for local currency loans is generally nine percent, while interest on foreign currency loans is based on the LIBOR. The Export Credit Insurance Corporation of Singapore Ltd.

introduced a Fixed Rate Export Finance Scheme in 1979 that provides exporters with medium and long-term financing at fixed preferential rates of interest for capital good exports sold on credit for two years or more. Only exports that are guaranteed by the ECICS are eligible for this type of financing. The scheme was suspended in February 1981, reintroduced in July 1981, and then suspended again. Under the scheme, ECICS would underwrite bank loans up to 80 percent of the Singapore content of the contract value, subject to a maximum of $40 million for each contract at a fixed interest rate. The difference between the fixed interest rate and the market rate would be paid by the government. As indicated above, there is no medium or long-term export financing scheme in Malaysia, Indonesia, or the Philippines.

Investment Capital Assistance

As pointed out above, the justification for establishing unlimited access to investment capital financing for export industries may be less than the justification for working capital financing. But due to the underdevelopment of the capital market in most developing economies, neutrality vis-a-vis investment capital financing must be assured to exporters as well. This is especially true if most exporters are having difficulties obtaining investment capital and if constraints on production capacity are the chief obstacle to export expansion.

Korea has made three types of investment capital loans available for export industries: (i) foreign currency loans to finance imports of capital goods for export industries, (ii) investment loans for export industries, (iii) loans for small and medium-scale export industries. Even though these three types together did not exceed 15-20 percent of total export loans during 1975-79 (as shown in Table 11 of Annex I), suggesting that short-term working capital loans accounted for the major share, the government's attempts to establish neutrality were reflected by these arrangements. These loans provided the support that exporters (including potential exporters) needed to expand their operations, based on their export targets or plans. In particular, investment capital loans were critical in bringing new small exporters into export activities at the same time that the domestic L/C system provided them with preshipment working capital financing. Preferential interest rates for investment capital loans for export industries, as well as for all other types of loans, were abolished in 1982.

Singapore provides no special capital assistance for export industries. However, in view of the small size of Singapore's domestic market and the country's heavy reliance on exports for GNP and employment, it may be reasonable to assume that most preferential investment capital schemes are related to exports, directly or indirectly. Unlike Korea, Singapore's financial assistance to private firms, administered by an Economic Development Board (EDB) established in 1961, includes both loans and equities. (Virtually all exporting firms in Korea are privately owned

except for one integrated steel mill and one agricultural product processing corporation.) The Board's Capital Assistance Scheme, established in 1975, provides financial assistance in the form of term loans up to 10 years or equity participation of up to 50 percent to medium-scale, high-technology projects which may have difficulty in raising funds from commercial sources. The Small Industries Finance Scheme of the EDB is a loan scheme with low interest rates aimed at encouraging the further development and technical upgrading of the operations of small industries which serve a vital role in providing supporting services for larger companies. Thus, even in an international financial center like Singapore, it appears that equal availability of long-term financing and EDB's less stringent standards of creditworthiness have been important, due to the non-neutral status of small industries and the externality involved in technology development (Tan and Hock 1983).

Currently, there appear to be no special investment capital financing schemes for privately owned export firms in Malaysia, Indonesia, or the Philippines. In view of the underdeveloped status of capital markets for long-term financing and the predominance of credit rationing in working and investment capital financing granted to import substitution industries in these countries, it appears important to assure exporters of neutrality in obtaining both working and investment capital financing.

Other Financial Incentive Schemes

Financial assistance for overseas marketing, new product development, and R & D is given to export-related firms in certain countries. Korea gives general trading companies access to foreign currency loans to promote their overseas marketing and information-gathering activities. The Product Development Assistance Scheme of Singapore's EDB offers financial assistance to cover up to 50 percent of the direct costs of a product development or process improvement project. Singapore's Skills Development Fund, set up in 1979, offers three kinds of financial assistance, a "training grant scheme," an "interest grant for mechanization scheme," and a "development consultancy scheme." These schemes may be designed to compensate for externality of technology mastery or private risks that are higher than social risks. There appear to be no similar schemes available for private exporters in Malaysia, Indonesia, or the Philippines.

(b) Tax Incentives

Table 7 provides an overview of the various tax incentives being implemented as of June 1983 for export industries in the six East Asian economies discussed in this paper. Because indirect tax exemptions for export industries merely provide tax neutrality vis-a-vis import substitution industries paying indirect taxes where the destination principle [41]/

41/ The destination principle of indirect taxation entails levying indirect taxes on goods consumed locally, whether they are of domestic or of foreign origin, and rebating indirect taxes paid on exports and their inputs.

of indirect taxation is applied, they are not genuine tax incentives. Therefore, income tax reductions of one form or another are the major tax incentives for exporters. Depending on the basis for tax reductions or deductions, we classify tax incentive schemes as follows: (i) profit-based; (ii) sales-based; (iii) value added-based; (iv) specific expense (noncapital) based; and (v) investment-based.

At the outset of this paper we stressed domestic tax neutrality as one key element in maintaining neutral status for export activities. This can be achieved only if compensatory tax incentive measures result in tax neutrality, with differential tax treatment being used strictly to maintain neutrality in exchange rates, trade, financing, and primary input prices.

Table 7

TAX INCENTIVES FOR EXPORT INDUSTRIES IN SIX EAST ASIAN COUNTRIES
(AS OF JUNE 1983)

	Singapore	Korea	Hong Kong	Malaysia	Philippines	Indonesia
(a) Profit-Based						
(1) Low Uniform income tax rate.			x			
(2) Income Tax Reduction for Manufactured Exports	x					
(3) Income Tax Reduction for Special Foreign Exchange Earning Activities	x	x				
(b) Sales-Based						
(4) Income Tax Deduction for Export Allowance (Proportional to Sales Level)				x		
(c) Value Added-Based						
(5) Income Tax Credit on Net Local Content of Export.					x	
(d) Specific Expense-Based						
(6) Income Tax Reduction for Overseas Marketing or Promotional Expenses	x			x		
(7) Reserve Account for Marketing Expenses		x				
(e) Investment-Based						
(8) Accelerated Depreciation Allowance for Export Industries		x				
(9) Investment Tax Credit	x					

Profit-Based Incentives

The simplest and most straightforward tax incentive is the income tax reduction for export profits currently being implemented in Singapore. A Singapore manufacturing company designated as an export enterprise enjoys a concessionary tax rate of 4 percent instead of the normal tax rate of 40 percent, which is equivalent to a 90 percent reduction on profits earned for a period of five years. If the company is already qualified for completely tax free operations for five years under what is called pioneer status (see below), this concession may be granted for another three years. Tax relief periods of up to 15 years may also be granted to export enterprises which have incurred or intend to incur substantial fixed capital expenditures. This tax reduction scheme in Singapore is a marked contrast to Hong Kong's tax incentives, which rely on a low uniform rate rather than on differentiated rates for different activities. The tax rates on profits in Hong Kong are a uniform 15 percent on individuals and partnerships carrying on a business, and 17 percent on corporations. Singapore's income tax relief system for exporters started in 1967 under the Economic Expansion Incentives Act. In Korea, income tax reduction incentives (a uniform 50 percent reduction on all income tax liabilities on export activities) were used very effectively during a period of about 10 years from the mid-1960s to the mid-1970s, which was a critical stage in export development there.

In addition to the 90 percent reduction offered to export enterprises, Singapore provides a 50 percent income tax reduction for certain foreign exchange earning operations, such as trading companies, international consultancy services, and warehousing and servicing operations. For these operations, a concessionary tax of 20 percent on foreign exchange earning profits for five years is permitted to substitute for the standard rate of 40 percent. A similar tax incentive (a 50 percent income tax reduction for five years) is available in Korea for construction and plant export operations. These income tax reductions have two advantages when used as export incentives: (i) the scheme is administratively simple and easy to manage[42/] and (ii) it rewards greater efficiency because it is based on profit.

Sales-Based Incentives

Malaysia's income tax deduction for export allowances is a sales-based tax incentive. The allowance consisted of 2 percent of a company's total export sales (ex-factory value) during the basis year, and 10 percent of any increase in export sales in the basis year over export sales in the immediately preceding year until 1982. Since 1983 the allowance is 5 percent of total export value. This export allowance is given as a deduction from gross income. It can only be claimed by manufacturer-exporters of manufactured products. Companies that have been granted pioneer status, labor utilization relief (see below), or locational

42/ For a company selling on both the domestic and export markets, the sales share of exports is usually used to estimate export profits as a share of total profits in light of the administrative burden of using other sophisticated criteria.

incentives do not qualify. Logically, any method of compensating for anti-export bias to achieve neutral status must be based on value added or net foreign exchange earnings rather than gross sales. But questions can be raised as to why an increment in foreign exchange earnings should receive a greater incentive than other foreign exchange earnings. This scheme therefore appears less appealing conceptually than a value added-based incentive scheme, even though it is easier to administer.

Value Added-Based Incentives

The Philippines' system of granting income tax credit on the net local content of exports is a value-added based incentive scheme. According to the 1983 Investment Incentives Policy of the Philippines, for the first five years of commercial operation or registration, all new or expanding export producers are entitled to a tax credit equivalent to 10 percent of net local content.[43/] For another period of five years immediately following, the tax credit is computed on the basis of the increment in real terms over the average net local content for the immediately preceding three years. Registered indirect export producers are granted a tax credit of five percent of net value earned.[44/] The value added-based tax incentive is the most ideal form of tax incentive.

43/ Net local content means value of export sales less depreciation of capital equipment and the value of imported raw materials and supplies and indigenous commodities which the government may exclude if they are not available under clearly more favorable terms in the international market.

44/ Net value earned means value of sales less cost of raw materials and components, supplies and utilities, and depreciation of capital equipment.

However, highly efficient administrative arrangements are needed to implement this particular type of scheme. A modernized export financing system would provide an important basis for such administrative arrangements by linking export, import, and domestic L/C mechanisms to the value added-based tax incentive instrument.

Specific Noncapital Expense-Based Incentives

Singapore's system of double income tax deductions for overseas marketing expenses, Malaysia's similar scheme for certain export promotion expenses, and Korea's income tax allowance for various "reserve accounts," including overseas marketing expenses, are specific noncapital expense-based tax incentives. Singapore's double tax deduction scheme for R & D expenses is another specific expense-based incentive, even though it is not directly related to exports.

Investment-Based Incentives

Singapore's investment tax credit scheme and Korea's accelerated depreciation allowances are investment-based tax incentives. Singapore's investment tax credit is an alternative to using pioneer status incentives or tax reductions for export profits. Pioneer status tax incentives, which are being implemented in Singapore and Malaysia, are the most important investment-based tax incentive scheme not directly related to export activities. Singapore's pioneer status incentive provides for complete exemption from income tax (i.e., a tax holiday) for a period of 5 to 10 years from initial production by a manufacturing company. Since longer

pioneer periods are offered for projects involving higher fixed investment, the resulting incentive value is proportional to the size of the investment. Therefore, this type of incentive is biased toward capital-intensive projects.

Malaysia's investment incentives not directly related to exports, other than its pioneer status incentive (which allows 2 to 12 years tax holidays), are the investment tax credit, the increased capital allowance, the accelerated depreciation allowance, and the reinvestment allowance (Rhee 1980a). In addition, Malaysia's labor utilization relief plan can be considered a labor-based incentive scheme. In this scheme, the number of income tax holiday years is proportional to the number of jobs created. Since the scheme is based on the absolute size of employment (and not on the employment/capital ratio), its impact is capital-biased in the sense that it favors the large firm that is able to make large investments.

(c) Other Compensatory Export Incentives

Besides financial and tax incentives, other types of compensatory export incentives are also used to achieve neutral status for private firms engaged in export activities. These other types of compensatory export incentives may be grouped as (i) import protection-related incentives, (ii) infrastructure support and, (iii) technical or marketing assistance.

Import Protection-Related Incentives

A wastage allowance scheme allows additional wastages on top of the normally required input-output coefficients in administering duty-free imports of intermediate inputs for export production. Through this scheme, efficient firms can benefit by selling the residual inputs imported duty-free that have been saved in the process of producing export commodities in the protected local market. Input coefficients are set in such a way, however, that some inefficient firms would suffer from negative effective protection rates in the event that the coefficients were not sufficient to produce given export items due to extra wastages caused by inefficient operations. An Import-Export Link System permits the import of prohibited or restricted items that can be sold in the domestic market at protected prices in exchange for exporting specified goods. On a highly selective basis, Korea used these compensatory tools in the early stages of its export development. This incentive scheme is not easy to implement in a developing economy in which administrative arrangements for export incentives are not modernized and not well-managed.

Infrastructure Support

Industrial parks and infrastructure facilities for export industries can be important compensatory incentives. Singapore's Jurong Town Corporation, established in 1968, has provided industrial sites and facilities that can be purchased or rented at reasonable prices by exporting firms. Infrastructural support for the Singapore Science Park is one of

the most recent attempts by the Singapore government to redirect its industries toward high technology. Korea's export development has benefited much from its well-designed and managed port facilities, export processing zones, and other infrastructures. As of March 1983 there were two free trade zones, seven specialized manufacturing processing zones (mostly export-oriented), and 14 regional industrial estates in Korea. Even the Hong Kong government, which does not provide any special financial or tax incentives for exporters, has been involved in industrial parks and factory development for priority industries. Malaysia and the Philippines have been active in providing industrial park and infrastructure facilities, including FTZs for manufactured goods exporters. Currently, the Indonesian government is keen on developing export processing zones for manufactured exports.

Technical Assistance

Government assistance on such matters as product engineering, quality control, skill upgrading, marketing, accounting, and management is very important to manufacturers and traders, especially in the early stages of export development. However, the fact that Singapore, Hong Kong, and Korea still provide such assistance implies that its importance extends beyond the early stages. Singapore's Economic Development Board operates its own training centers and institutes of technology in collaboration with the private sector and other governments. The Hong Kong Productivity Center (which is the executive arm of the Hong Kong Productivity Council

financed by an annual government subvention and fees earned from its services) provides consultancy and technical services on subjects ranging from electronics data processing and production management to technology transfer. It also conducts a wide range of training programs in industrial technology, management techniques, and electronic data processing. Korea has public agencies (such as the Advanced Institute of Science and Technology) that are engaged in technical assistance and training for many manufacturing firms, most of whom are exporters. Korea also operates an efficient quality control inspection agency for exporters. In the area of public assistance for overseas marketing, the activities of the Korea Trade Promotion Corporation, the Korea Traders Association, the Singapore Trade Development Board, and the Hong Kong Trade Development Council (discussed below) are most notable. But it appears that there is much to be done in Malaysia, Indonesia, and the Philippines in these areas of technical assistance for export manufacturers and traders.

(d) Conclusions

An examination of the successful East Asian countries' compensatory export incentives shows that guaranteeing automatic and equal access to preshipment short-term working capital export loans to all firms generating export value added is much more important and difficult than adjusting interest rates of these loans as a compensatory incentive instrument. This examination also shows that, while various tax incentives have been quite effective at certain stages of export development in establishing neutral status, the importance of other compensatory export incentives

such as import protection-related incentives, infrastructure support, and technical assistance should not be overlooked.

CHAPTER VII

EXTENDED NEUTRAL STATUS

Extended neutral status was defined in Chapter I as a situation in which the level of export incentives is as high as the level of incentives for import substitution activities. The theoretical justification for implementing extended neutral status for export industries is that unless the effective incentives for export activities are close to the corresponding effective incentives for import substitution activities, private producers will prefer to sell their products in the domestic market. As for the empirical justification for extended neutral status for export industries, there are at least two hypotheses: the incentive neutrality hypothesis and the allocative and X-inefficiency hypothesis. As explained in Chapter I, the three major empirical studies on trade regimes and the industrial development performance of developing countries have reached the same conclusion: the economies that have maintained extended neutral status for industrial export industries have performed far better in terms of exports and economic growth than the economies that have failed to do so. The incentive neutrality hypothesis claims that these studies provide empirical support for the aforementioned theoretical reasoning. It argues that economies that have maintained extended neutral status for export industries will perform better because they have achieved optimum allocation of resources and maximization of economic efficiency by following the theory of incentive neutrality. On the other hand, the allocative and X-inefficiency hypothesis stresses the misallocation of resources and chronic inefficiencies found in economies that have failed to

achieve modified neutral status due to excessive protection for import substitution industries. Therefore, these two hypotheses do not conflict with each other, even though the emphasis in each hypothesis is somewhat different. These studies, however, have generally defined extended neutral status at an aggregate level.

But extended neutral status that is not built on neutral status at the micro level incorporates many elements that are inconsistent with an efficient incentive system, because such extended neutral status results in tremendous variation in effective incentives for different exporters. Under neutral status at the firm and product level, on the other hand, effective incentives are uniform across the board for all exporters.

Returning again to the example first presented in Chapter I, in a country in which exporters must pay duties that are the same as those paid by import substitution firms (meaning that neutral status at the product and firm level has not been achieved), economy-wide extended neutral status can be achieved by conferring huge cash grants on a few exporters. This results in an aggregate effective subsidy rate for export that is equal to that for import substitution. Under such extended neutral status, however, the maximum contribution of all exporters to export success can hardly be expected: those exporters with negative effective incentives are not on an equal footing in regard to undistorted markets and policies with both foreign competitors and domestic import substitution firms.

(a) Empirical Evidence

Before we review the empirical evidence on neutral status and extended neutral status for the export industries in the six East Asian economies, let us first examine the empirical evidence on the critical importance of the internal structure of modified neutral status for export activities.

We can do this by comparing Korea with another developing country at a similar stage of industrial maturity, Brazil. According to the NBER study, Korea and Brazil have both maintained Phase IV systematically since the latter half of the 1960s (Krueger 1978). Phase IV precedes the most liberal of the five phases outlined in that study. World Bank studies on Korea and Brazil indicate that the gap between effective incentives for import substitution and effective incentives for export in the two countries has been almost negligible at the aggregate level in recent years (Westphal and Kim 1982, World Bank 1983). Therefore, one can conclude that Brazil and Korea have more or less achieved extended neutral status (defined at the aggregate level) for their export industries. However, as far as extended neutral status at the micro level is concerned, there is a marked difference between the two countries. Whereas Korea's extended neutral status has been built on neutral status as defined at the firm or product level, Brazil's aggregate extended neutral status had no micro-level counterpart until 1982.

More specifically, Korea's administration of exports has been based on the basic principles of automaticity and equal treatment of all activities generating export value added. Thus, Korea has succeeded in achieving neutral status for all activities generating export value added at the product and firm level, even though it has not assured extended neutral status across the board at that level.

Brazil's export incentive system, on the other hand, has used financial and tax incentives to achieve an aggregate extended neutrality. Instead of automaticity and equal treatment of all export activities, such elements as the "law of similars" and "enterprise-specific" discretionary assistance have been built into Brazil's export incentive system. As a result, neutral status for export industries at the product and firm level has not been achieved. Many exporters could enjoy neither duty-free and restriction-free imports (until 1982) nor automatic access to export financing, while large discretionary tax and financial incentives were provided for selected exporters. At the aggregate level, negative and positive incentives cancelled each other, yielding extended neutral status. The result, however, was extreme variation in incentives among exporters and potential exporters, discouraging participation in the country's export drive by those firms subject to negative incentives of less than free trade status. This comparison between Korea and Brazil suggests that guaranteeing neutral status for all activities generating export value added at the product and firm level is much more important than providing a extended neutral status for export industries at the aggregate level.

Singapore has been similar to Korea in guaranteeing neutral status for export activities by (i) providing free access to intermediate inputs and export financing, (ii) paying competitive market wages to workers, and (iii) compensating for exchange rate overvaluation (before a competitive foreign exchange market was developed) by means of compensatory export incentives (Tan and Hock 1982). If there have been differences between Singapore and Korea, they may be that Singapore has placed relatively greater importance on tax and financial incentives, while Korea has placed relatively greater importance on selective import protection. Singapore still maintains substantial tax and financial incentives for export industries in a virtually free trade economy; Korea maintains selective import protection for domestic sales, but differential tax and financial incentives for exporters have almost been eliminated. What, one may ask, is the rationale for tax and financial incentives for export industries in Singapore, with its free trade? To answer this question, we have to rely on the externality hypothesis, which is discussed in Chapter VIII.

Hong Kong is a classic case in which an extended neutral status for export activities collapsed to neutral status for all activities. Hong Kong's impressive export and economic development has been based on the neutrality of incentives maintained by free international trade and competitive markets for money, finance, capital, labor, and foreign exchange (Geiger and Geiger 1975, Little 1981). Of course, one should not overlook the historical, cultural, locational, and other factors that have made such free market mechanisms possible. The Hong Kong government's contribution

to such areas as infrastructure and technical assistance cannot be ignored either. Furthermore, the institutional mechanisms (public and private) that have resulted in dynamism and vitality in private enterprise and induced foreign participation must be carefully examined (see Chapter VIII).

Malaysia, the Philippines, and Indonesia are all attempting to move toward neutral or extended neutral status as part of their effort to rationalize trade and industrial policies. However, in light of their legacies of inward-oriented policies, export strategies based heavily on free trade zones, and primary good export-oriented policies, it will take these countries quite some time to achieve aggregate extended neutral status (see Rhee 1980a, Bautista, Power and Associates 1979, World Bank 1981a). In light of the experiences of Brazil, Korea, Singapore, and Hong Kong, it clearly seems important to provide neutral status at the product and firm level in most developing economies.

(b) Threats for Retaliation and Policy Options

In principle, any compensatory export incentives designed to achieve neutral status in developing countries should not be subjects of dispute with importing countries on grounds that such incentives constitute unfair trade practices. If one takes one compensatory financial or tax incentive instrument (designed to achieve neutral status for exporters) separately and argues that it is an "export subsidy," then such argument appears to be partial since an export subsidy can be evaluated properly

only by comparing the parameter values of all compensatory export incentive instruments with currency overvaluation, the excess of current and capital input costs for export production over free trade prices, and the excess of primary input costs over competitive market prices. By definition, neutral status means zero export subsidies. In fact, the spirit of the Code on Subsidies and Countervailing Duties agreed upon at the Tokyo Round of trade and tariff negotiations recognizing the special position of developing countries appears to be compatible with our view on the temporary role of compensatory export incentive instruments designed to achieve neutrality. While the Code prohibits the use of "export subsidies," it recognizes "domestic subsidies" as legitimate policy instruments so long as their use does not lead to an adverse effect on other countries. Here, the term "export subsidies" appears to mean aggregate export incentives that exceed neutral status. The "domestic subsidies" appear to be equivalent to compensatory export incentives designed to achieve neutral status. Therefore, the code, in principle, appears to recognize the right of developing countries to use compensatory incentive tools to achieve neutral status. This right is subject to the qualifications that (i) compensatory incentives should not have an adverse effect on the production or trade of another signatory and (ii) the developing countries should endeavor to reduce or eliminate such compensatory incentives when they are "inconsistent with their competitive and development needs." These qualifications appear to suggest that so long as compensatory export incentives do no more than assure neutral status for exporters, they do not harm any importing or competing country producers and therefore are acceptable as temporary measures (Kemper 1980, Nayyar 1979).

In practice, however, agencies investigating charges of unfair trade practices often base their arguments on the reasoning which may be different from our reasoning on neutral status. If one argues that the existence of export subsidies is proved by isolated compensatory tax or financial incentive instruments, and neglecting the existence of currency overvaluation, excesses of current and capital input costs for export production over free trade prices, and excesses of primary input costs for export production over competitive market prices, such an argument appears to be tantamount to an unwillingness to recognize and accept the second-best policies that are sometimes used by the developing countries as interim measures before they can adopt first-best policies. The development process is always a transitional process moving from one equilibrium to another, and compensatory export incentives must be understood as the temporary measures needed in such a transitional process.

But, in light of threats of retaliation, various definitions of export subsidies which may be different from our definition of "aggregate export incentives that exceed neutral status", and the conventional wisdom based on classical welfare economics, developing countries are well advised to do their best to achieve neutral status for export industries at the micro level, with minimum utilization of compensatory tax and financial incentive tools. They can achieve this by: (i) making the exchange rate more flexible, (ii) modernizing their export financing system, including a

nondiscriminatory interest rate, (iii) assuring that the administration of export production and duty exemption/drawback systems is well-designed and well-managed, and (iv) making the labor market more competitive. If compensatory export incentives are absolutely essential to achieving neutral status, they are best employed as temporary measures. The danger of retaliation is greater if a developing country relies heavily on compensatory fiscal and tax incentive instruments to achieve extended neutral status for export industries under a very high import protection wall. In that case, highest priority on the export side should be given to assuring neutral status at the product and firm level.

The burden of narrowing the gap in effective incentives between exports and import substitution can be accomplished largely by lowering import protection levels. To the extent that protection for an infant industry is justified (Westphal 1981 and 1982), some of the burden of narrowing the gap in effective incentives between exports and import substitution can be shared by such indirect and temporary means as import protection-related compensatory export incentives. Such import-export related incentives are feasible if a producer sells in both the export and domestic markets.

Finally, developing countries are advised to put more resources into indirect export incentives that are not controversial, such as infrastructures, technical assistance, and institutional mechanisms for private and public collaboration in overseas marketing, foreign factor inducements, and private sector mobilization. Institution-building for

efficient administrative arrangements designed to provide free access to intermediate inputs and financing for all activities generating export value added should also be emphasized. Investments for domestic L/C, preshipment guarantee, modernized exort financing, export credit insurance, and duty drawback systems do not arouse controversy.

Since the possibility of retaliation depends on the product and the market for which exports are destined, it is an important function of the government of a developing country to collect and disseminate to its exporters timely information on potential retaliation. Also, it may be necessary to fine-tune compensatory tax and financial incentives by carefully evaluating the risks of retaliation for different products in different markets.

(c) Conclusions

The experiences of the successful East Asian countries show us that guaranteeing neutral status at the product and firm level for all activities that generate export value added is much more important than achieving extended neutral status at the aggregate level, and that focusing on the former rather than the latter offers the additional advantage that neutral status at the product and firm level, when achieved without relying on compensatory export incentives, does not invite any retaliation from importing countries, while extended neutral status at the aggregate level may bring about complex controversies and risks of retaliation.

A first step for a country that wishes to achieve extended neutral status is to maintain neutral status at the product and firm level. A second step is to place the major burden of achieving extended neutral status on lowering import protection. A third step, if additional export incentives beyond neutral status are sought, is to adopt noncontroversial and less risky incentives such as institutional support, overhead structure, and technical assistance.

CHAPTER VIII

INSTITUTIONAL MECHANISMS

The conventional export incentives and administrative arrangements discussed earlier are the necessary conditions for successful export development and rational industrial and trade policies. However, without two additional (and unconventional) elements, the conventional incentives can hardly assure success. First, the conventional export incentives and administrative arrangements will be useless unless they are effectively implemented through sound institutional mechanisms. Therefore, identification of the factors determining effective implementation of export policies and administration is as important as designing incentive instruments and systems for rational policies. Second, the conventional export incentives and administrative arrangements will make little difference in export development (even if well-implemented) if producers, investors, and traders in a developing economy do not respond aggressively to rational incentive policies. The key to export success is the ability of producers and traders to respond to incentives as well as price and quantity signals in the internal and external markets. If such ability does not exist in the business community, then it is also a responsibility of the government to become a catalyst in creating it.

Two things appear common to the success of Hong Kong, Singapore, and Korea: (i) a stable and efficient government that is committed to an outward-looking development strategy and (ii) a synergistic partnership between the government and the private sector in export development.

Although political leadership may be committed to an outward-oriented development strategy, what institutional mechanisms translate that commitment into actions by the bureaucracy and by business firms? The export incentives designed to achieve neutral status or extended neutral status may be satisfactory, but what institutional mechanisms make it possible to implement export policies effectively? Private firms may be full of vitality and dynamism, and the relationship between business and government may be very close, but what institutional mechanisms support the private sector's vitality and dynamism, and make the relationship between business and government possible?

These are the kinds of questions we attempt to deal with here. In many developing countries, many institutions deal with export incentives that fail to achieve neutral status for export activities, and there are also numerous export promotion agencies that neither function well nor contribute much to generating vitality and dynamism. We are not interested in simply listing such institutions or agencies, describing their legally defined tasks, or drawing their organization charts. We are interested in the key institutional mechanisms that can result in effective action. As Lewis (1984) states, "At issue is the working of institutions that influence decisions, and the changing of these institutions through time."

(a) Commitment to an Outward-Oriented Strategy

Without a strong political commitment to an outward-oriented development strategy, a developing economy can hardly expect to have the

efficient institutional mechanisms it needs to implement export policies designed to achieve neutral status or extended neutral status for export industries. The analytic and empirical basis of an outward-oriented strategy is either the incentive neutrality hypothesis or the allocative and X-inefficiency hypothesis. Therefore, an outward orientation is merely designed to prevent mistakes stemming from excessive protection for import substitution industries. Consequently, it is wrong to interpret outward orientation as a policy of "export at any cost." In fact, an outward-oriented strategy encourages efficient import substitution as much as it encourages efficient export. An outward-oriented strategy therefore never condones export development based on "subsidies" properly defined, since any export development that needs such subsidies must be inefficient. An inward-oriented strategy tends to support inefficient import substitution; an outward-oriented strategy supports neither inefficient import substitution nor inefficient export, while it supports both efficient export and efficient import substitution. Thus, an outward-oriented strategy means the optimum strategy that supports only efficient outward orientation and efficient inward orientation.

One cannot argue, therefore, that an outward-oriented strategy is not needed for a country with a huge domestic market. While an efficient inward orientation is necessary in such a country, an efficient outward orientation should not be discouraged. Malaysia's "Look East" policy, announced in late 1981, appears to reflect its commitment for an outward-oriented strategy (Asian Wall Street Journal, Nov. 11-12, 1983). Indonesia's January 1982 Export Policy (Government of Indonesia, 1982)

reflects that government's intention to promote export. The Philippines' recent reforms of duties and BOI incentives reflect the government's policy to move toward an outward orientation.

(b) Externality of Export Activity

One important aspect of an outward-oriented strategy is closely related to the externality hypothesis. According to the externality hypothesis, the overwhelming superiority of an outward-oriented strategy stems from the beneficial externality of export activity. Such externality is found in the tremendous efficacy of export activity as a means of acquiring industrial competence because of easy access to overseas information and technical knowledge, and because of the competitive attitude generated by going into the world market. Whereas the allocative and X-inefficiency hypothesis has largely been based on the empirical evidence of the poor development performance in the Latin American economies in the last decades, the externality hypothesis is based on the empirical evidence associated with the impressive performance of the east Asian economies during the 1960s and 1970s. Thus so far, the beneficial externality of export activity has largely gone unnoticed in the literature on trade and development. But the experiences of Korea, Singapore, and Hong Kong indicate that it is very real (Westphal, Rhee, and Pursell 1981, Westphal 1982). The empirical evidence that tariff and import restriction redundancies were widespread in Singapore and Korea suggests that efficient

production had been achieved through exporting before imports (for domestic sales) were fully liberalized.[45]

Among the various elements that contribute to the externality associated with export activities, the most important one appears to be the "vitality" or "dynamism" in institutional mechanisms that embraces private firms as well as government agencies. There are at least two reasons why this is so important. First, anyone who observes the activities in the private as well as the public sectors in Hong Kong, Singapore, and Korea is immediately impressed with the vitality that underlies them. The vitality in these economies appears to be the outcome of competing in the world market and the additional gains of exporting. Second, in a stagnant and depressed economy, neither rational incentives nor anything else will be sufficient to bring about immediate change unless the institutional mechanisms that generate vitality are in operation. Of course, one could argue that before a developing economy adopts an outward-oriented strategy, it must have effective institutional mechanisms to start with. However, it is precisely in those economies that have not had any effective institutional mechanism that an outward-oriented strategy could make the greatest contribution to the development of such mechanisms. In such economies, experience in the world market would be an eye-opener; going into export markets could become an agent for change. But for this to happen, a strong political commitment to an outward-looking strategy is mandatory. Without such commitments, Korea, Singapore, and Hong Kong would not have developed

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45/ See Tan and Hock (1982) for Singapore and the preliminary findings of the quantitative part of the Korea Study under the World Bank research project, Export Incentives in Developing Countries.

the effective institutional mechanisms that have played a catalytic role in carrying out such a strategy.

If a country is to exploit the externality of export activities, the neutral status and extended neutral status discussed earlier must be redefined by taking externality into consideration. In other words, compensatory export incentives must include an element designed to compensate for the externality. As indicated above, one might interpret the tax and financial incentives provided to Singapore exporters as incentives designed to compensate for the externality of export activities, in light of free trade and competitive markets in financing, exchange rates, and primary inputs. In turn, one might argue that the externality of export activities provides an empirical basis for protection of an infant export industry (Westphal 1981 and 1982).

In reality, however, it is hard to believe that a concept of neutrality that incorporates externality would be used by importing developed countries in determining whether compensatory tax and financial incentive parameter values granted to developing country exporters exceed neutral status (i.e., whether subsidies are given). Thus, to minimize any risk of retaliation, it would be better to give emphasis to putting public resources into the development of effective institutional mechanisms for the purpose of exploiting the externality of export activities.

(c) Implementation of Export Policy

The institutional mechanisms for implementing and maintaining export incentives are essential for getting those incentives right. Instrumental to this is developing institutional mechanisms that gather and disseminate the information needed to implement incentives and the administrative arrangements for those incentives. A developing economy must consciously develop institutional mechanisms that are compatible with the particular conditions of the country.

Two institutional mechanisms have been particularly important in the Korean export drive: a system of setting export targets and the practice of holding monthly trade promotion meetings[46]/. These two mechanisms have provided some of the most important information needed to administer the Korean export drive. Perhaps most important is the up-to-date information provided on export performance by firm, product, and market, and on the reasons for discrepancies between targets and performance (targets are set mostly by firms). Through these meetings the government has obtained much solid information about what has been going on in the world, and the firms have received much solid information about shifting priorities and new undertakings by the government. But the government has not only acquired this information, it has acted wisely on it. The ministries, in concert with the firms, have sought to identify

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46/ Chaired by the President of Korea, the monthly trade promotion meetings are select gatherings of ministers and top bureaucrats; the chief executives of export associations, the heads of export firms, and representatives of research and educational institutions.

problems and opportunities and to determine appropriate actions. These actions have been characterized by:

(i) Pragmatism. The government has been willing to try any method that might achieve a desired end.

(ii) Speed. The government has preferred the immediate implementation of policies that might work to the delayed implementation of policies whose effectiveness could only be determined by protracted study.

(iii) Flexibility. The government has been willing to modify its policies and programs and to retreat from mistakes, an essential trait when new policies are speedily implemented.

The export target system and the monthly trade promotion meetings have helped translate political resolve into bureaucratic resolve and provided the information needed for bureaucratic action. Without these two mechanisms, Korea's system of export promotion probably would not have been so effective, the various conventional export incentives would not have worked as well as they have, and Korea's export performance would not have been what it has been (Rhee and Others forthcoming).

Singapore's institutional mechanism for incentive administration is also characterized by flexibility, both in initiating required changes and in responding to new problems, and the process of decision-making is

distinguished by efficiency, pragmatism, and a "top-to-bottom" approach. The administrative style is to treat policy alternatives as "in-house" matters to be resolved by an elite. Generally speaking, the institutional mechanism in Singapore is very much project-oriented; that is, a project is initiated to deal with some well-defined task. Such projects may be initiated by a ministry, a department, or a statutory board. Statutory boards in particular play a crucial role in Singapore. In the process of implementing public policies, coordination is speedy and very close because statutory boards are composed of members of both the public and private sectors, and there are a relatively small number of people in policy-making positions (Chen 1983).

Even though the Hong Kong economy is a classic example of efficiently functioning competitive market mechanisms, the economic affairs of the city remain firmly in the hands of a small elite, highly ordered and predictable in important respects. Interlocking directorates are common among British-owned firms as well as those owned by Chinese (Hofheinz and Calder 1982). The interaction between business and government is very close (see below).

Korea's export target system and monthly trade promotion meetings have made possible the use of unconventional export incentives as well as conventional ones. Public exhortations by political leaders about the importance of exporting and public awards given to exporters who set export records are examples of the unconventional incentives that have imbued the export drive with a powerful team spirit and simultaneously unleashed the

natural competitiveness of heads of firms. Another unconventional incentive is encouraging firms to export in the early stages of production of goods for sale on the domestic market. Using this method very selectively, the government was able to spur some big firms into starting up new lines of export production that might otherwise have languished. By so doing, the government was able to prevent the inefficiency that so often plagues infant industries. To manage the informal system of encouraging exports in the early stages of production, the government needed some institutional mechanisms to link export sales to domestic production. The export targets and monthly meetings provided this link. This system has ensured that the ultimate criteria in deciding whether to provide an infant industry with protection is its international competitiveness.

(d) Partnership Between Business and Government

In the early stages of export development, it is essential to have a strong partnership between the government and business in the common goal of working toward producing internationally competitive products and competing in the world market. The fact that a synergistic partnership between business and the government exists, even in Hong Kong, Singapore, and Korea (which are in mature stages of their export development), is evidence of the critical importance of such a collective approach. The monthly trade promotion meetings and export target-setting of Korea have contributed to the collective efforts of the public and private sectors in export promotion. While production and trade are handled mostly by private enterprises in Hong Kong, export and investment promotion efforts are

considered the collective tasks of the government and private firms in these economies. Singapore established a new Trade Development Board in January 1983 with the objective of accelerating the collective efforts of the public and private sectors in export promotion. The Singapore Trade Development Board is similar to the Hong Kong Trade Development Council (or the combination of the Korea Trade Promotion Corporation and the Korea Traders Association) in conducting overseas trade promotion activities and playing the role of catalyst in carrying out export development strategies in the field. (See Annex III-A for more information on the Singapore Trade Development Board; Annex III-B for the Hong Kong Trade Development Council; Annex III-C for the Korea Traders Association; and Annex III-D for the Korea Trade Promotion Corporation.) The previously mentioned "Look East" policy of Malaysia may also be an attempt to learn the Japanese approach to a strong partnership between government and business as well as the Japanese management system.

(e) Export Promotion Institution

The efforts of Singapore, Hong Kong, and Korea to mobilize both the government and private firms are reflected in the organizational structures and revenue sources of the Singapore Trade Development Board, the Hong Kong Trade Development Council, and the combination of the Korea Traders Association and the Korea Trade Promotion Corporation. All of these trade promotion agencies are financed by the net proceeds of an ad valorem levy on exports and imports. The Singapore Trade Development Board and the Hong Kong Trade Development Council are composed of representatives

of major trade associations, leading businessmen, and senior government officials. The chairman of the Korea Traders Association is usually a former Deputy Prime Minister, while the Korea Trade Promotion Corporation is a quasi-governmental agency.

As one can see from Annex III-C, the activities of the Korea Traders Association (which has 3,500 member firms) are diverse, ranging from coordination between the government and business circles in general economic policy-making as well as export policy administration to trade missions. The Korea Trade Promotion Corporation played a key role in overseas marketing by Korean exporters in the early stages of export development, but the function of KOTRA has gradually been taken over by 10 general trading companies being promoted by the government through special incentives--except for such activities as overseas exhibition and information collection on import restrictions. Korea's policy of using general trading companies follows Japan's pattern and is an attempt to exploit economies of scale in overseas marketing and information-gathering.

The functions of the Singapore Trade Development Board and the Hong Kong Trade Development Council appear to be similar to the functions of KTA and KOTRA. It is apparent that Singapore established its trade promotion agency after learning lessons from the activities of the trade promotion agencies of Hong Kong and Korea[47]/. It is highly significant

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47/ Intraco Limited of Singapore is a government-owned trading company whose function is similar to the function of Korea's general trading companies.

that Singapore, despite its impressive export performance, established a new export promotion agency as recently as 1983. This suggests that institutional development is a continuing process. There is no question about the potential lessons to be learned by other developing economies (including the three Asian countries covered in this paper) from the experiences of the export promotion agencies of Korea, Singapore, and Hong Kong. Indonesia's National Agency for Export Development (NAFED), Malaysia's Export Trade Center, and the Philippine International Trading Corporation are government agencies engaged in export promotion and overseas marketing activities.

It is important to recognize that the most important function of an export promotion agency is to play the role of catalyst in carrying out an outward-oriented strategy. Therefore, its function as a marketing organization should not be stressed too much. In the early stages of export development, the marketing agencies of a developing country government can play a catalytic role in collecting overseas marketing information and disseminating it to exporters. As exporting firms mature and a country's export volume increases, the marketing function can gradually be taken over by private trading companies and exporters. But the experience of the developing countries that have succeeded in export development shows that marketing is not the first priority in export promotion. The is because foreign buyers will perform many, if not all, of the marketing tasks. The experience of these countries also shows what is needed to attract foreign buyers, mainly, the ability to produce internationally competitive products and the desire to do everything needed to satisfy

foreign buyers. Therefore, a selective approach to marketing is needed. A country should initially rely on foreign buyers rather than investing large sums to set up its own elaborate marketing network, and it should gradually have its private trading companies and exporters take over the marketing function as they learn marketing techniques by observing foreign buyers (Rhee and Others forthcoming). In this regard, some argue that Malaysia's decision to promote five general trading groups similar to Japan's general trading companies might have been somewhat early (Asian Business, Sept. 1983).

(f) Organizing the Private Sector

It is hard to believe that the economies and export trade of Hong Kong, Singapore, and Korea would have reached such impressive levels without the vitality and dynamism of their private sectors. By the same token, it is difficult to believe that the private sectors would have achieved such vitality if they had not chosen to compete in international markets. Furthermore, it is difficult to imagine how the private sectors of these economies could have competed in the world market if they had not organized themselves, as they have done so impressively.

Take the case of Hong Kong's private sector. One must be able to understand the intricate roles and inner workings of more than two hundred industrial and commercial associations and chambers of commerce covering more that seven thousand member firms if one wants to comprehend the much-talked-about market-oriented economy of Hong Kong, which is by no

means a laissez-faire economy. The Hong Kong General Chamber of Commerce, for example, is virtually a small government itself in terms of its diverse activities.

In the case of Korea, besides the Korea Traders Association, there are more than thirty specialized exporter associations, such as the Korean Knitted Goods Exporters Association, the Korea Electronic Products Exporters Association, and the Korea Footwear Exporters Association. These associations are private organizations, but they were established under the government's trade promotion law. Most of these associations, like KTA and KOTRA, are housed at the World Trade Center in Seoul. Their activities are similar to those of KTA, but they focus on their special fields.

As in Korea and Hong Kong, Singapore's private sector is well-organized. The major private sector associations--such as the Singapore Federation of Chambers of Commerce and Industry, the Singapore International Chamber of Commerce, the Chinese Chamber of Commerce and Industry, the Indian Chamber of Commerce, the Malay Chamber of Commerce, and the Singapore Manufacturer's Association--reflect the diverse ethnic composition of the private sector as well as differences in firm size. The Singapore International Chamber alone embraces 600 member firms and is engaged in very diverse activities, from maintaining a close dialogue with the government on policy matters to endorsing certificates of origin and other shipping documents for exporters.

The importance of organizing the private sector for export promotion was also recognized in the Philippines, where the Confederation of Philippine Exporters (CORE) was established in 1973. In order to assure a close link between the government and exporters, government representation on the board of CORE was authorized in 1975. Fourteen private sectors (such as agriculture-edible and cottage industries for handicraft products) are also represented on the CORE council. Indonesia and Malaysia also appear to realize the need to organize their exporting firms better. The key to the success of such efforts is how well the government and private organizations work together to develop the institutional mechanisms that generate vitality and dynamism in the private sector.

(d) Inducing Foreign Factors

Development experience in recent decades suggests that foreign sources of production factors and export sales can effectively supplement the initial endowment of domestic factors and capabilities, while the domestic capabilities can gradually be improved through deliberate effort. At the early stage of export development, in particular, the complementarity between domestic and foreign factors is very high, and therefore the government and the private sector of a developing country must adopt a very progressive approach to bringing foreign factors into the country.

Direct foreign investments are packages of such foreign factors as foreign capital, technology, management (entrepreneurship), and marketing. Thus, if a country needs all these factors, direct foreign

investments are the most ideal way to induce foreign factors for export development. In order to induce direct foreign investments, most host governments place their emphasis on very generous tax incentives. However, empirical studies show that, in general, foreign investors consider the most important inducements to be political stability; continuity of the announced development strategy; favorable terms for the transfer of profits and repatriation of capital; nondiscrimination against foreign ownership and control; freedom from detailed and burdensome regulations on organization, ownership, and management; protection of their share of a domestic or export market; and favorable wage rates, workers' efficiency, and infrastructures (Lim 1980). Therefore, the only justification for offering special tax incentives to foreign investors would be to compete with neighboring countries. Other things being equal, a country that does not grant such incentives would be at a disadvantage. In any event, the emphasis here is on effective institutional mechanisms that attract direct foreign investments, rather than on tax incentives.

Of course, developing countries must employ selectivity in trying to induce direct foreign investments. Regarding the importance of selectivity, Carlos Dias-Alezandro (1981) states: "Suitably directed by responsible host-country planning and channelled selectivity, Transnational Enterprises (TNEs) can contribute to achieving specific development targets by supplying clearly defined services and expertise .... LDC selectivity regarding TNEs should become as expected and acceptable in the international community as the selectivity industrial countries apply to immigrant labor." In turn, for an economy that needs only some of the above foreign

factors to supplement its local factors, unpackaged foreign factors are sought. In the case of capital, foreign loans are an alternative source. In the case of labor, expatriates not employed by a multinational company are an alternative source. In the case of technology, licensing agreements, capital good imports, or imported turn-key plants are an alternative source. Finally, in the case of marketing, foreign buyers or foreign trading companies are an alternative source.

Table 8 (mostly based on impressions rather than statistical analysis, except for Korea) shows the relative importance of domestic and foreign factors for manufactured export good production or sales activities in the six East Asian economies. Singapore has relied extensively on direct foreign investments for its export development, while Korea and Hong Kong have more or less utilized unpackaged foreign factors. Similarly, Malaysia and the Philippines have relied more on direct foreign investments for their export development than Indonesia has.

Singapore's high dependence on multinational companies for its export development is evidenced by the share of its manufactured exports accounted for by foreign firms; these are estimated to be around 70 percent, compared to 10 percent for Korea and 15 percent for Hong Kong (Lee 1981). Singapore's heavy reliance on direct foreign investments may have been dictated by its relative lack of local entrepreneurs compared to Korea and Hong Kong. Korea's industrial experience before the end of the Second World War led to the emergence of entrepreneurial and managerial factors that allowed it to carry out its development strategy without relying on

foreign entrepreneurs. In the case of Hong Kong, there was an influx of entrepreneurs from mainland China, although the political leadership was composed of foreigners. Singapore aggressively encouraged foreign investments through foreign offices of its Economic Development Board, offering such additional incentives as concessionary tax arrangements for non-residents, double taxation relief, no capital gains tax, property tax relief, and foreign investment guarantees on top of the various tax and financial incentives described earlier. However, the factors most responsible for the active and successful participation of multinational companies in Singapore's development have been political stability and institutional mechanisms, which are characterized by being efficient, pragmatic, reasonable, consistent, and predictable. In turn, it is no small achievement on the part of Singapore to have succeeded in letting the rest of the world see its future in alliance, not competition, with foreign multinationals.

Table 8

RELATIVE IMPORTANCE OF DOMESTIC AND FOREIGN FACTORS FOR MANUFACTURED EXPORT GOOD PRODUCTION OR SALES ACTIVITIES IN SIX EAST ASIAN ECONOMIES

Factor	Source	Hong Kong	Singapore	Korea	Malaysia	Philippines	Indonesia
(a) Capital	D	x					x
	F DFI		x		x	x	
	Loan			x			
(b) Labor	D	x	x	x	x		x
	F					x	
(c) Intermediate Input	D			x			x
	F	x	x		x	x	
(d) Technology	D						x
	F DFI		x		x	x	
	Licensing or Capital Good	x		x			
(e) Management and Entrepreneurship							
Gov.	D		x	x	x	x	x
	F	x					
Private	D	x		x			x
	F DFI		x		x	x	
(f) Marketing	D						
	F DFI		x		x	x	
	Buyer or Trading Co.	x		x			x

Note: D = domestic factor; F = foreign factor; DFI = direct foreign investment

Singapore tried to maintain leverage against foreign companies, especially banks, by financing the bulk of its domestic investments internally rather than borrowing abroad (unlike Korea, which borrowed heavily). Also, it sought to maintain its autonomy through the active use of public corporations and by encouraging joint ventures between foreign firms and the Singapore government in strategic sectors. In short, the institutional mechanisms of Singapore can truly be characterized as "Singapore, Inc." (Hofheinz and Calder 1982).

Developing countries at an early stage of export development have a lot to learn from Singapore's pragmatic approach to direct foreign investments, which was well expressed in a lecture ("Extrapolating From the Singapore Experience") given by Mr. Lee Kuan Yew in 1978: "This development would not have been possible if Singapore had not been able to plug into the world grid of industrial powerhouses in America, Europe, and Japan. Other developing countries should be encouraged and helped to plug into this grid. How soon and how effectively they can tap this world grid depends upon them, upon how realistic and pragmatic their governments are in their policies, so as to strike a bargain with those who have the capital, technology, and management, to help produce goods for their own people, and perhaps also for export in the competitive international markets" (Lee 1978).

Hong Kong's multinational chemistry, characterized by its unique status as a free port and international financial center, in combination with its free market mechanisms, has contributed greatly to inducing

foreign factors for development. For example, the Hong Kong and Shanghai Banking Corporation currently holds assets that are well over twice as large in amount as the economy's annual GNP. The government does involve itself in foreign investment promotion activities by providing preferences in infrastructure and training facilities for the technology intensive industries and establishing industrial investment promotion offices overseas, in addition to offering a low uniform income tax rate. However, the most important element in inducing foreign factors appears to be an enlightened administration that gives full play to individual entrepreneurship within a stable and secure environment.

Korea's export-led industrialization has been directed and controlled largely by nationals. However, foreign resources have made substantial contributions since the early 1960s. Korea has relied rather heavily on inflows of investment resources in the form of debt, not equity. Except for industries established during the colonial period, technology has been acquired from abroad largely through means other than direct foreign investments. The purchase of technology through licensing has been of modest importance. Turkey plant construction has been of much greater consequence in the transfer of technology, and a tremendous amount of know-how has entered with Koreans returning from study or work abroad. Overseas marketing has largely been performed by overseas firms, even though the acquisition of marketing savvy is well under way, mainly through Korea's general trading companies. In Korea, unlike in Singapore, an abundance of entrepreneurial resources in effect have removed a major advantage of direct foreign investments, the possibility of substituting

foreign for domestic entrepreneurship. Currently, the Korean government is promoting direct foreign investments in the area of high technology more actively than before because of the apparent difficulties in divorcing high technology from foreign management.

Malaysia's successful inducement of foreign direct investments into its export industries has been achieved through its policy of promoting FTZs. As we indicated above, the contribution of FTZs to export development at the early stage of export development may be very high. In Malaysia, however, measures may be needed to expand the contribution of multinational companies to export development beyond the FTZs in order to ensure efficient backward linkages with local resources. The majority of companies located in the export processing zones at Bataan are foreign-owned. The foreign share in total investment approved under the Export Incentive Act (from December 1970 to December 1974) exceeded 40 percent. A study based on a sample of Philippine manufacturing firms in 1972 showed that large-sized firms with foreign management tended to have a higher degree of export orientation. Some argue, however, whether Philippine exports based on foreign direct investment have made a maximum contribution to employment by generating backward linkages and utilizing local primary factors (Datta-Chaudhuri 1981). In the case of Indonesia, there appears to be a growing feeling that a more concerted effort to induce foreign involvement in manufacturing would maximize the contribution of foreign factors to export development.

(h) Conclusions

We learn several unconventional lessons in examining institutional mechanisms established in the successful East Asian countries. First, strong political commitments to outward-looking strategies and efficient institutions (public and private) and development of well-managed administrative arrangements were critical for effective implementation of export policy. Second, specific institutional mechanisms have been key factors in creation of a synergistic partnership between government and business that has stimulated vitality in the export community and exploited the externality of exporting. Third, the private sectors have been organized effectively and foreign factors absent in domestic economies have been induced with marked success.

CHAPTER IX

CONCLUSIONS

The important lessons from the experiences of the successful East Asian countries can be summarized under three general headings: (a) neutral status as the centerpiece of export policy and administration, (b) export as a first step for rationalization and efficiency, and (c) institutional mechanisms as a catalyst for implementing export policy and administration.

(a) Neutral Status as the Centerpiece

The cornerstone of the development strategies of the successful East Asian countries has been guaranteeing neutral status at the individual product and firm level for all activities that generate export value added. This objective has anchored their export development. Neutral status has been achieved by a combination of the following or equivalent compensating incentives: (i) flexible and realistic exchange rates, (ii) free trade in inputs and outputs, (iii) competitive money and financial markets, (iv) competitive primary input markets, and (v) non-discriminatory domestic taxes.

Flexible and realistic exchange rates for export activities have been maintained either through a free market-based foreign exchange regime (for countries with mature financial markets and institutions) or through a managed foreign exchange regime employing a crawling peg, supported by

various compensatory export incentives when an adjustable peg resulted in exchange rate overvaluation. Free trade status for all activities (including participation of small and indirect exporters) that generate export value added has been provided by free trade, free trade zones, and/or a well-managed duty exemption/drawback system.

Competitive money and financial markets can only be developed over time. Their absence in early stages of export development has been compensated for in the short term with automatic and equal access to bank loans at a neutral interest rate for all activities that generate export value added. This has been provided by modernized export financing systems, the major components of which have been undisrupted and speedy rediscounting by central banks, preshipment export finance guarantee systems, automatic loan disbursement and liquidation mechanisms tied to import and export bill negotiations, and domestic L/C systems. Competitive primary input prices have been assured through government policies that have attempted to keep primary input markets competitive. Uniform tax rate systems or compensatory tax incentives designed to achieve neutral status have been employed to achieve neutral domestic taxes.

A most impressive fact of export incentive administration in the successful East Asian countries is the innovative schemes employed, such as the domestic L/C systems. These were instituted as key components in providing modernized export financing systems. Such schemes have been invaluable in establishing neutral status in the absence of competitive markets.

During transitional periods (i.e., until the institutions and administrative arrangements needed to achieve neutral status are developed and managed efficiently), compensatory tax and financial export incentives have also been successfully employed, as temporary measures, to achieve neutral status. In light of threats of retaliation by the developed countries and the incompleteness of the analytic framework employed by the developed importing countries to define export subsidies, however, it may be advisable in the future for developing countries to put more resources into indirect export incentives that are not controversial, such as infrastructures, technical assistance, and institutional mechanisms.

Attempts to achieve extended neutral status selectively have been built on existing neutral status at the individual product and firm level. In turn, the task of narrowing the gap in effective incentives between exports and import substitutions has been gradually or within very short periods accomplished largely by lowering import protection levels and by implementing relatively uncontroversial export incentives.

(b) Export as a First Step

Policy reforms that have transmitted efficiency throughout the economies of the successful East Asian countries have been instituted in a sequence that has been quite productive. Export has been dealt with first--to provide neutral status and encourage production efficiency by competing in the world market. Then, gradually, neutral status has been imposed and efficiency has been transmitted to the entire economy

(including import substitution industries). Because international competitiveness is the name of the game for exports, there has not been much room for inefficient import substitution industries to survive. Therefore, export policy has led to overall policy reforms, and export development has led to restructuring throughout the economies.

It clearly appears, then, that entry into export markets has been a powerful agent for change in the successful East Asian countries. Several factors appear to be responsible for this successful strategy: (i) successful exploitation of the tremendous externality associated with exporting, (ii) a relatively low or negligible level of domestic protection or a commitment to maintain protection only as a temporary measure for the sake of infant export industries, and (iii) introduction of efficient institutional mechanisms--both public and private--that have led firms to view the domestic and export markets as equally essential to their success, rather than as distinct entities that offer the choice of competing in either one market or the other.

(c) Institutional Mechanisms as a Catalyst

An important unconventional lesson to be learned from the experiences of the successful East Asian countries is that effective institutional mechanisms--both public and private--have been critical, acting as catalysts for (i) implementing export policy and administration and (ii) developing the ability and desire of producers and traders to respond to opportunities in the world market.

A strong political commitment to an outward-looking development strategy has been critical in developing such institutional mechanisms. A synergistic partnership between business and government has also been a key factor. The chief function of the export promotion agencies of the successful East Asian countries has been to play the role of catalyst in carrying out an outward-looking strategy, rather than to specialize in overseas marketing promotion. In order to compete effectively in the world market, the developing East Asian countries have organized their private sectors well and maximized the contribution of foreign factors.

(d) Implications for Other Developing Countries

The institutional structures, resources, markets, and other conditions of other developing countries are different from those of the successful East Asian countries. Therefore, it may hardly be possible to attempt to duplicate exactly the specific East Asian performance or the policies and administrative arrangements. But in considering rational development strategy and policy, there appears to be no other alternative than to attempt to adopt similarly rational approaches. In pursuing such approaches, the lessons from the East Asian experience can be extremely valuable.

The critical role of public and private institutions and of efficient administrative arrangements in the successful implementation of rational policies must also be recognized and understood. While it is true that institutional and administrative capabilities of the developing countries vary tremendously, this fact actually strengthens the argument

for the importance of institution-building, because the alternative--when faced with a lack of institutional capability--would be to abandon development efforts altogether.

ANNEX I
Table 1

Table 1

Korean Exports by Type of Payments, 1968-1980
(unit: $ million)

	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
Total	464.9 (100.0)	604.9 (100.0)	815.9 (100.0)	1,036.8 (100.0)	1,580.0 (100.0)	3,097.5 (100.0)	4,341.4 (100.0)	4,917.7 (100.0)	7,635.2 (100.0)	10,119.2 (100.0)	12,281.9 (100.0)	14,806.0 (100.0)	17,248.6 (100.0)
(1) Sight L/C	389.2 (83.7)	543.0 (89.8)	718.3 (88.0)	877.8 (84.7)	1,318.6 (83.4)	2,784.0 (89.9)	3,963.4 (91.2)	4,266.5 (86.8)	6,465.0 (84.6)	7,892.0 (78.0)	9,483.1 (77.2)	11,953.6 (80.7)	14,162.5 (82.1)
(2) Usance L/C	14.6 (3.1)	31.2 (5.2)	43.5 (5.3)	64.0 (6.2)	111.9 (7.1)	122.7 (4.0)	143.5 (3.3)	272.4 (5.5)	402.2 (5.3)	512.1 (5.1)	701.7 (5.7)	962.5 (6.5)	1,186.1 (6.9)
(3) Red clause L/C	25.7 (5.5)	3.6 (0.6)	18.1 (2.2)	41.8 (4.0)	67.7 (4.3)	87.0 (2.8)	66.3 (1.5)	68.9 (1.4)	167.5 (2.2)	374.5 (3.7)	177.0 (1.4)	137.2 (0.9)	112.0 (0.6)
(4) D/P	0.4 (0.1)	0.9 (0.1)	0.2 (0.0)	0.5 (0.0)	7.6 (0.5)	14.9 (0.5)	15.6 (0.3)	22.9 (0.5)	59.5 (0.8)	410.4 (4.1)	393.7 (3.2)	181.1 (1.2)	218.5 (1.3)
(5) D/A	0.1 (0.0)	0.7 (0.1)	4.2 (0.5)	17.2 (1.7)	52.3 (3.3)	63.3 (2.0)	63.6 (1.4)	95.9 (2.0)	205.7 (2.7)	457.8 (4.5)	855.3 (7.0)	1,021.8 (6.9)	991.2 (5.7)
(6) Pre-payment	4.1 (0.9)	1.9 (0.3)	3.7 (0.5)	6.8 (0.7)	6.8 (0.4)	13.8 (2.8)	27.4 (0.6)	33.3 (0.7)	43.5 (0.6)	76.2 (0.8)	164.8 (1.3)	90.0 (0.6)	97.9 (0.6)
(7) Military Procurement	30.8 (6.6)	23.6 (3.9)	27.9 (3.4)	28.6 (2.8)	15.0 (0.9)	7.6 (0.2)	0.5 (0.0)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)
(8) Deferred payment (medium and long-term)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	4.2 (0.1)	61.2 (1.4)	157.8 (3.2)	291.8 (3.8)	396.1 (3.9)	506.3 (4.1)	459.9 (3.1)	477.8 (2.8)

Note: Export figures are based on the negotiation of drafts
Figures in parentheses are percentage shares.

Source: The Bank of Korea

ANNEX I
Table 2

TABLE 2: Percentage Shares of U.S. Exports by Different Type of Payments: Third Quarter, 1975

Commodity Group	Cash Basis (%)	Deferred Payment Basis: Total (%)	(Less than 1 year) (%)	(1 - 4 years) (%)	(5 - 9 years) (%)	(10 years or more) (%)	(Unknown) (%)
Total, all commodities	64	36	(49)[1/]	(6)[1/]	(6)[1/]	(3)[1/]	(37)[1/]
Food and live animals, beverages and tobacco	68	32	(54)	(4)	-	-	(4)
Crude materials, inedible, except fuels	54	46	(50)	(15)	-	-	(25)
Mineral fuels, lubricants & related products	71	29	(84)	-	-	(7)	(16)
Animals and vegetable oils and fats	37	63	(31)	(5)	-	-	(64)
Chemicals	58	42	(64)	(2)	-	-	11
Manufactured goods classified chiefly by material, except iron and steel and manufacturing of metals, n.e.c.	66	34	(74)	(6)	(3)	(6)	(23)
Iron & steel & manufacturers of metals, n.e.c.	61	39	(44)	-	(3)	(3)	(52)
Power generating machinery and switch gear equipment	63	37	(18)	(2)	(26)	(12)	(63)
Metal working machinery	44	56	(D)	-	(D)	(9)	(63)
Special industry machinery	59	41	(33)	(5)	(17)	-	(45)
Ocher nonelectrical machinery	59	41	(43)	(D)	(D)	(1)	(39)
Telecommunications apparatus	59	41	(43)	(D)	(14)	(D)	(37)
Other electrical machinery, apparatus and appliances except electric power generating machinery	60	40	(60)	(2)	(9)	(1)	(28)
Railway vehicles	43	57	(D)	-	(D)	(4)	(85)
Aircrafts	54	46	(9)	(D)	(D)	(33)	(40)
Other transport equipment	80	20	(50)	(D)	(6)	(D)	(32)
Miscellaneous manufactured articles, n.e.c. and special transactions, not classified by kind	71	29	(64)	(6)	(4)	-	(24)

1/ As percent of category total.

- Represents zero

D: Withheld to avoid disclosing information for individual respondents.

Source: Bureau of the Census, U.S. Department of Commerce: Characteristics of Financing U.S. Exports: Third Quarter 1975, U.S. Government Printing Office, 1978.

TABLE 3

PATTERN OF CHANGES IN PERCENTAGE SHARES OF EXPORT BASED ON DIFFERENT METHODS OF PAYMENTS: CASE OF KOREA, 1968-1980.

Dependent Variables	Dependent Variables: Constant	Per Capita Export a/	1 / Per Capita Export	% Share of Heavy Industry Export b/	Year c/	1 / Year	Adjusted R^2	F	Durbin-Watson	Dynamic Pattern
(1) $\log_e$ (% share of sight L/C)	4.492 (0.248)	-0.00000079 (0.00000033)					0.300 0.300	5.717 5.717	1.185 1.185	Exponential, decreasing
(2) $\log_e$ (% share of usance L/C)	4.419 (0.023)		741.128 (587.354)				0.051	1.592	0.854	Asymptotic, decreasing
(3) $\log_e$ (% share of D/P)	-3.111 (0.417)	0.00000033 (0.00000006)	..				0.761	36.104	2.174	Exponential, increasing
(4) $\log_e$ (% share of D/A)	2.035 (0.259)		-59715.482 (6575.492)				0.881	82.474	0.8555	Asymptotic, increasing
(5) $\log_e$ (% share of pre-payment)	-0.795 (0.187)	0.0000046 (0.0000025)					0.177	3.367	2.261	Exponential, increasing
(6) $\log_e$ (% share of deferred payment)	-18.75 (3.001)			0.610 (0.120)			0.694	25.999	1.678	Exponential, increasing
(7) % share of red clause L/C	1.635 (0.542)					3.159 (1.559)	0.206	4.108	1.512	Asymptotic, decreasing
(8) % share of military procurement	5.869 (1.622)				-1.756 (1.622)		0.859	73.807	0.809	Linear, decreasing

Note: Figures in the parentheses are standard errors of the estimates.

a/ In 1,000 won (1975 prices) equivalent to $2.07 (1975 prices)

b/ S.I.T.C.s of the heavy industries included are: 66, 67, 68, 69 7, and 86.

c/ 1968 = 1, 1969 = 2,....., 1980 = 13.

TABLE 4: KOREAN IMPORTS BY TYPES OF PAYMENTS AND USERS, 1968-1972

(Unit: $ million)

	1968		1969		1970		1971		1972	
A. For government use	44.6	(5.0)	72.5	(7.5)	40.9	(3.5)	54.8	(4.0)	56.4	(3.7)
1. Sight Draft	37.9	(4.2)	40.7	(4.2)	40.9	(3.5)	48.9	(3.5)	56.1	(3.7)
2. Time Draft	6.7	(0.7)	31.7	(3.3)	0.0	(0.0)	5.9	(0.4)	0.3	(0.0)
B. For Commercial Use (Domestic Market)	663.6	(74.0)	621.9	(64.3)	764.8	(66.3)	879.2	(63.7)	881.5	(58.3)
1. Sight Draft	333.9	(37.2)	390.4	(40.4)	405.3	(35.1)	459.6	(33.2)	431.0	(28.5)
2. Time Draft (excluding D/A)	195.2	(21.8)	114.3	(11.8)	158.9	(13.8)	245.6	(17.8)	318.9	(21.1)
(a) Grain	75.2	(8.4)	23.9	(2.5)	26.2	(2.3)	52.2	(3.8)	58.3	(3.9)
(b) Fuel	46.6	(5.2)	55.7	(5.8)	81.8	(7.1)	136.8	(9.9)	209.6	(13.9)
(c) Others	73.4	(8.2)	34.7	(3.6)	50.9	(4.4)	56.6	(4.1)	51.0	(3.4)
3. D/A	134.5	(15.0)	117.1	(12.1)	200.7	(17.4)	174.0	(12.6)	131.6	(8.7)
C. For Export Use	189.1	(21.1)	272.6	(28.2)	348.8	(30.2)	446.0	(32.3)	573.1	(37.9)
1. Sight Draft	173.6	(19.3)	259.4	(26.8)	318.3	(27.6)	395.0	(28.6)	498.9	(33.0)
2. Time Draft (excluding D/A)	9.8	(1.1)	10.1	(1.0)	25.6	(2.2)	42.1	(3.1)	47.2	(3.1)
3. D/A	5.6	(0.6)	3.4	(0.4)	5.0	(0.4)	3.9	(0.6)	26.8	(1.8)
TOTAL IMPORT	897.2	(100.0)	967.0	(100.0)	1154.6	(100.0)	1380.0	(100.0)	1510.9	(100.0)

Note: Figures in parentheses are percentage shares

Source: The Bank of Korea

TABLE 5: KOREAN IMPORTS BY TYPES OF PAYMENTS AND USERS, 1975-1980

(Unit: $ million)

	1975		1976		1977		1978		1979		1980	
TYPE OF PAYMENTS												
1. Sight Draft	3,027.7	(54.1)	3,308.4	(49.2)	4,853.0	(55.2)	8,797.6	(70.8)	9,975.8	(59.1)	9,053.6	(47.2)
(a) Sight L/C	2,884.3	(51.6)	3,044.9	(45.3)	4,611.7	(52.5)	8,458.3	(68.0)	9,683.7	(57.4)	7,567.4	(39.5)
(b) D/P	15.6	(0.3)	15.9	(0.2)	29.4	(0.3)	46.3	(0.4)	44.9	(0.3)	52.7	(0.3)
(c) Others	127.8	(2.3)	247.5	(3.7)	211.8	(2.4)	293.0	(2.4)	247.1	(1.5)	1,433.5	(7.5)
2. Time Draft	2,564.0	(45.9)	3,417.0	(50.8)	3,938.3	(44.8)	3,635.9	(29.2)	6,893.4	(40.9)	10,116.8	(52.8)
(a) Usance L/C (Including long-term deferred payment)	2,247.9	(40.2)	3,185.4	(47.4)	3,758.2	(42.7)	3,539.6	(28.5)	6,698.8	(39.7)	9,870.6	(51.5)
(b) D/A	316.1	(5.9)	231.7	(3.4)	180.1	(2.0)	96.2	(0.8)	194.6	(1.2)	246.1	(1.3)
TOTAL IMPORT	5,591.7	(100.0)	6,725.4	(100.0)	8,791.3	(100.0)	12,433.5	(100.0)	16,869.2	(100.0)	19,170.4	(100.0)
TYPE OF USER												
A. For Government Use	289.0	(5.2)	345.6	(5.1)	432.7	(4.9)	676.7	(5.4)	959.5	(5.7)	1,116.5	(5.8)
B. For Commercial Use (Domestic Market)	3,485.3	(62.3)	3,816.3	(56.8)	5,265.4	(59.9)	7,867.2	(63.3)	11,395.9	(67.6)	13,098.1	(68.3)
C. For Export Use	1,817.7	(32.5)	2,563.6	(38.1)	3,093.2	(35.2)	3,889.6	(31.3)	4,513.8	(26.7)	4,955.7	(25.9)

Note: Figures in parentheses are percentage shares.

Source: The Bank of Korea.

Table 6

HONG KONG'S EXCHANGE RATE REGIMES AND EXCHANGE RATES

Date	Exchange Rate Regime	Par value of the HK$ in grams of fine gold	HK$ per Pound	HK$ per US$	HK$ per SDR	Trade-weighted Index 1/ 18.12.71 = 100
A. Under Fixed Exchange Rate Regime						
Dec. 18, 1946	IMF parities established Hong Kong dollar is pegged to sterling	0.223834	16.00	3.970		
Sep. 18, 1949	Hong Kong dollar devalued pari passu with sterling by 30.5%	0.155517	16.00	5.714		
Nov. 20, 1967	Hong Kong dollar devalued pari passu with sterling by 14.3%	0.133300	16.00	6.667		
Nov. 23, 1967	Hong Kong dollar revalued by 10%, including against sterling, but continues pegged to sterling, at new rate	0.146631	14.55	6.061		
Dec. 18, 1971	As part of the general currency realignment, Hong Kong dollar and sterling appreciate by 8.57% against US dollar. As a result of USA terminating, in Aug. 71, the convertibility of US dollar into gold, gold par value no longer has a practical meaning. IMF begins to adopt the SDR as its accounting unit.		14.55	5.582	6.061	
Jul. 6, 1972	Hong Kong dollar pegged to US dollar following the floating of sterling			5.650	6.134	
Feb. 14, 1973	US dollar devalued: Hong Kong dollar remains pegged, at new rate			5.085	6.134	
Nov. 26, 1974	Hong Kong dollar allowed to float, i.e., the govt. no longer undertakes to maintain a particular rate against any other currency					
B. Under Floating Exchange Rate Regime						
1974 (end of period)			11.53	4.910	6.012	105.9
1980 (end of period)			12.27	5.130	6.543	88.2
1981 (end of period)			10.88	5.675	6.605	85.9
1982 (end of period)			10.58	6.495	7.165	80.1

1/ The trade-weighted exchange rate index is derived from a weighted average of nominal exchange rates of the Hong Kong dollar against the currencies of 15 principal trading partners.

Source: Kong Kong Government, Hong Kong 1983, p.280.

Table 7: SINGAPORE'S EXCHANGE RATE (1963-1980)

Year (As of End of Year)	Singapore Dollar per U.S. Dollar
1963	3.06
1964	3.07
1965	3.06
1966	3.08
1967	3.07
1968	3.08
1969	3.09
1970	3.08
1971	2.90
1972	2.82
1973	2.49
1974	2.31
1975	2.49
1976	2.46
1977	2.34
1978	2.16
1979	2.16
1980	2.09
1981	2.05
1982	2.11

Source: IMF, International Finance Statistics, various issues.

Table 8: MALAYSIA'S FOREIGN EXCHANGE RATE INDEX (1975 = 100)

OFFICIAL COMPOSITE OF FOREIGN CURRENCIES PER MALAYSIAN RINGGIT (1970-1979)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
(a) Nominal exchange rate index a/	93	93	95	102	105	100	103	102	99	103
(b) CPI b/	70	71	74	82	96	100	103	108	113	117
(c) Export price index c/	76	71	67	88	115	100	121	142	151	172 d/
(d) Import price index c/	51	55	57	67	94	100	102	104	107	112 d/
(e) Price-adjusted exchange rate index for export (= (a) ÷ $\left\lvert\frac{(c)}{(b)}\right\rvert$)	86	93	105	95	88	100	88	78	74	70
(f) Price-adjusted exchange rate index for import (= (a) ÷ $\left\lvert\frac{(d)}{(b)}\right\rvert$)	127	120	123	125	107	100	105	101	105	108

a/ Official composite of foreign currencies per Malaysian Ringgit; increase in index represents appreciation of Ringgit. Source: Bank of Negara Malaysia.
b/ IMF, International Financial Statistics, 1970-1980.
c/ Department of Statistics.
d/ Jan-August Average.

Source: Rhee (1980), pp. 3-15.

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Table 9

KOREA'S OFFICIAL EXCHANGE RATES, 1960-1983

Effective From	Official Exchange Rate (Won per U.S.Dollar)
January 20, 1960	50.0
February 23, 1960	65.0
January 1, 1961	100.0
February 2, 1961	130.0
May 3, 1964	256.02
December 31, 1964	256.02
December 31, 1965	272.06
December 31. 1966	271.46
November 25, 1967	271.50
December 31, 1968	281.50
November 3, 1969	304.35
December 31, 1969	304.45
December 31, 1970	316.65
June 28, 1971	370.80
December 31, 1971	373.30
December 31, 1972	398.90
December 31, 1973	397.50
December 7, 1974	484.00
December 31, 1974	484.00
December 31, 1975	484.00
December 31, 1976	484.00
December 31, 1977	484.00
December 31, 1978	484.00
December 31, 1979	484.00
January 12, 1980	580.00
December 31, 1981	700.50
December 31, 1982	748.80
December 31, 1983	795.50

Note: Rates for 1960 and 1961 are "official rates." Rates for 1964, 1965, and 1966 are "Bank of Korea's selling rate to foreign exchange banks." Rates since 1967 are "Bank of Korea's standard concentration rates."

Source: Bank of Korea, Economic Statistics Yearbook, 1983 and Bank of Korea, Monthly Statistical Bulletin, January 1984.

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Table 10

Table 10

KOREA'S OFFICIAL EXCHANGE RATES, JANUARY 1980-DECEMBER 1983

At the End Of	Official Exchange Rate (Won per U.S.Dollar)	At the End Of	Official Exchange Rate (Won per US Dollar)
January 1980	580.00	January 1982	708.30
February 1980	580.70	February 1982	712.00
March 1980	586.10	March 1982	718.30
APril 1980	590.50	April 1982	721.30
May 1980	596.20	May 1982	733.10
June 1980	603.00	June 1982	740.80
July 1980	612.70	July 1982	741.30
August 1980	616.30	August 1982	741.90
September 1980	625.00	September 1982	742.90
October 1980	651.60	October 1982	744.90
November 1980	658.80	November 1982	744.70
December 1980	659.90	December 1982	748.80
January 1981	665.20	January 1983	751.50
February 1981	670.50	February 1983	753.10
March 1981	672.80	March 1983	763.40
April 1981	678.90	April 1983	767.90
May 1981	683.80	May 1983	771.10
June 1981	685.10	June 1983	776.70
July 1981	686.90	July 1983	783.10
August 1981	685.50	August 1983	790.10
September 1981	685.50	September 1983	789.30
October 1981	687.20	October 1983	792.90
November 1981	689.90	November 1983	796.90
December 1981	700.50	December 1983	795.50

Note: Rates are "Bank of Korea's standard concentration rates."

Source: Bank of Korea, Monthly Statiscal Bulletin, various issues.

TABLE 11: OUTSTANDING BALANCES (AT THE END OF YEAR) OF KOREA'S EXPORT PROMOTION LOANS, 1970-1979

(Unit: Billion Won)

		1970	1971	1972	1973	1974	1975	1976	1977	1978	June 1979
I.	Short-Term Export Promotion Loans	57.4 (100%) (69.2%)	80.1 (100%) (58.4%)	106.8 (100%) (59.7)	222.2 (100%) (58.9%)	359.5 (100%) (59.3%)	462.9 (100%) (61.5%)	582.5 (100%) (66.0%)	568.3 (100%) (63.9%)	883.5 (100%) ((70.8%)	992.1 (100%) (64.3%)
	(a) Export loan (for manufacturing industries)	48.9 (85.2%)	68.5 (85.5%)	91.7 (85.9%)	204.5 (92.0%)	268.0 (74.5%)	324.6 (70.1%)	457.0 (78.5%)	507.2 (89.2%)	836.7 (94.7%)	966.9 (97.5%)
	(b) Loans for construction and service contracts	4.5 (7.8%)	6.9 (8.6%)	9.1 (8.5%)	10.2 (4.6%)	50.2 (14.0%)	97.0 (21.0%)	75.7 (13.0%)	14.7 (2.6%)	18.3 (2.1%)	21.8 (2.2%)
	(c) Loans for agriculture and fishery product exports	4.0 (7.0%)	4.8 (6.0%)	6.1 (5.7%)	7.6 (3.4%)	41.4 (11.5%)	41.4 (8.9%)	49.8 (8.5%)	46.4 (8.2%)	28.5 (3.2%)	3.4 (0.3%)
II.	Medium and Long-Term Export Promotion Loans	25.6	57.1 (41.6%)	72.2 (40.3%)	155.1 (41.1%)	247.0 (40.7%)	290.0 (38.5%)	300.0 (34.0%)	320.5 (36.1%)	364.4 (29.2%)	551.7 (35.7%)
	(a) Loans for deferred payment exports	-----	0.4	1.4	4.0	4.3	29.9	56.2	120.6	164.6	187.4
	(b) Foreign currency loans (for capital good imports	21.4	51.7	65.6	100.2	166.6	178.9	167.7	133.7	144.2	312.8
	(c) Investment loans for export industries	-----	-----	-----	44.2	66.3	72.3	67.0	56.3	39.6	34.0
	(d) Loans for small and medium-scale export industries	-----	-----	-----	6.6	9.8	8.9	9.1	9.9	16.0	17.5
III.	Total Export Promotion Loans	83.0 (100%)	137.2 (100%)	179.1 (100%)	377.3 (100%)	606.5 (100%)	753.0 (100%)	882.5 (100%)	888.8 (100%	1,247.9 (100%)	1,543.8 (100%)
IV.	Domestic Credit	866.6	1,134.5	1,479.2	1,940.4	2,983.5	3,934.4	4,836.8	5,978.6	8,721.9	9,835.0
V.	Share of Total Export Promotion Loans in Domestic Credit (III/IV)	9.6%	12.1%	12.1%	19.4%	20.3%	19.1%	18.2%	14.9%	14.3%	15.7%
VI.	Share of Short-Term Export Promotion Loans in Domestic Credit (I/IV)	6.6%	7.1%	7.2%	11.5%	12.1%	11.8%	12.0%	9.5%	10.1%	10.1%
VII.	Total Annual Commodity Export	264.5	425.9	647.8	1,281.9	2,158.8	2,459.2	3,734.1	4,862.5	6,152.0	7,286.8
VIII.	Export Promotion Loans as Percentage of Exports (III/VII)	31.4%	32.2%	27.6%	29.4%	28.1%	30.6%	23.6%	18.3%	20.3%	21.2%
IX.	Short-Term Export Promotion as Percentage of Exports (I/VII)	21.7%	18.8%	16.5%	17.3%	16.7%	18.8%	15.6%	11.7%	14.4%	13.6%

Source: The Bank of Korea.

TABLE 12 OUTSTANDING BALANCES (AT THE END OF THE YEAR) OF KOREA'S SHORT-TERM EXPORT LOANS FOR MANUFACTURING INDUSTRIES (UNIT: MILLION WON), 1974-1979

		1974	1975	1976	1977	1978	May 1979
a.	Loans for generating value-added (VAL)[1/]	76,683 (28.6%)	114,111 (35.2%)	187,356 (41.0%)	237,574 (46.8%)	340,988 (40.8%)	380,516 (39.1%)
b.	Loans for purchasing domestically produced intermediate inputs (DIL)	47,260 (17.6%)	118,762 (36.6%)	162,452 (35.5%)	172,608 (34.0%)	288,797 (34.5%)	333,193 (34.3%)
c.	Loans for purchasing foreign produced intermediate inputs on actual export order basis (FILA)	28,589 (10.7%)	14,886 (4.6%)	31,157 (6.8%)	26,913 (5.3%)	90,002 (10.8%)	104,897 (10.8%)
d.	Loans for purchasing foreign produced intermediate inputs on expected export order basis (FILE)	112,372 (42.0%)	76,812 (23.7%)	76,027 (16.6%)	70,106 (13.8%)	116,901 (14.0%)	153,468 (15.8%)
e.	Total short-term export loans for manufacturing industries	267,904 (100%)	324,571 (100%)	456,992 (100%)	507,201 (100%)	836,688 (100%)	972,074 (100%)
f.	Total annual commodity export[2/]	2,158,819	2,459.212	3,734,112	4,862,485	6,151.951	7,286.839
g.	Total short-term export loan outstanding as % of total annual export (= [(e)/(f)] x 100)	12.4%	13.2%	12.2%	10.4%	13.6%	13.3%

Source: The Bank of Korea

1/ Includes loan for purchasing domestically produced finished products (DOL).

2/ Total annual export of manufactured goods was 87.5% in 1977 and 89.8% in 1978 of total annual commodity export.

Table 13

FORMULAS TO COMPUTE THE MAXIMUM ALLOWABLE LEVEL OF EXPECTED EXPORT (OR LOCAL SUPPLY) ORDER (FOR THE EXPORT LOAN PURPOSE)

Basic formula for the maximum allowable level of expected export (or local supply) order [a/] = (k)x preceding (q) months' performance of company's exports (or local supply

Normal Values of k and q for :					
1. Export loan for purchasing intermediate inputs on an expected export (local supply) (DILE and FILE). [b/]		2. Export loan for generating value added on an expected export (local supply) order basis (VALE).		3. Export loan for domestically produced finished commodities on an expected export order basis (DOLE) [c/]	
k	q	k	q	k	q
1/4	12	1/6	12	1/4	12

Example:

a/ The formula is basically applied at the product-level. However, the use of the formula at the firm-level must be allowed for the firms exceeding certain level of exports in order to reduce the administrative costs.

b/ This formula is applied also for obtaining import license or opening local L/C for the purchase of intermediate inputs.

c/ This formula is applied also for opening local L/C for the purchase of domestically produced finished commodities on an expected export order basis. Past performance refers only the exports of finished commodities purchased from the other firms.

Table 14

Domestic L/C Issued During 1976-78: Korea

Purchases	Domestic L/C Issues: Export L/C Based Value (billion won)	Export L/C Based (Share) (%)	Non-Export L/C Based Value (billion won)	Non-Export L/C Based (Share) (%)	(i) Total Domestic L/C Value (billion won)	(i) Total Domestic L/C (Share) (%)	(i) Total Domestic L/C (Share) (%)	(ii) Corresponding manufactured good exports a/ (billion won)	(iii) Domestic L/C / Manufactured good exports [= (i) + (ii)]
(a) Domestically produced intermediate inputs in the textile industries	1,997.0	(65.4)	1,047.9	(34.6)	3,024.9	(100.0)	(31.3)	5,056.3	0.60
(b) Domestically produced intermediate inputs in the other manufacturing industries	1,787.7	(52.5)	1,594.7	(47.5)	3,402.4	(100.0)	(35.2)	7,866.2	0.43
(c) Domestically produced intermediate inputs in all manufacturing industries [= (a) + (b)]	3,764.7	(58.6)	2,662.6	(41.4)	6,427.3	(100.0)	(66.5)	12,922.6	0.50
(d) Domestically produced finished products	842.36	(15.9)	2,557.3	(84.1)	3,039.7	(100.0)	(31.5)	12,922.6	0.24
(e) Processing fee (sub-contract)	28.78	(15.0)	163.3	(85.0)	192.1	(100.0)	(2.0)	12,922.6	0.01
(f) Total [= (c) + (d) + & 1)]	4,275.86	(44.4)	5,383.2	(55.7)	9,659.1	(100.0)	(100.0)	12,922.6	0.75

a/ Payment basis.

Source: The Bank of Korea.

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TABLE 15: HONGKONG'S INSURED EXPORTS BY PRODUCTS IN 1982

	Products	Value of Insured Exports in 1982 (Million Hong Kong Dollar)	%
1.	Textiles	1,627	43
2.	Toys	427	11
3.	Plastic, Metalic and Leather Goods	280	7
4.	Cameras and Capital Goods	212	5
5.	Flashlights and Household Appliances	114	3
6.	Machinery and Transport Equipment	141	4
7.	Footwear	153	4
8.	Travel Goods	165	4
9.	Radios and Electronic Components	213	6
10.	Watches and Jewelry	107	3
11.	Miscellaneous	378	10
	TOTAL	3,817	100

TABLE 16: EXPORTS INSURED BY COMPOSITION OF GOODS IN 1982: SINGAPORE

(Unit: 1,000 Singapore Dollar)

	Types of Products	1982	%
1.	Textile, Clothing, Footwear and Leather Goods	112,669	6.5
2.	Plant, Machinery and Mechanical Appliances	410,644	20.8
3.	Paper Materials and Articles	74,756	3.8
4.	Timber and Wood Articles	79,439	4.0
5.	Chemicals, Paint and Plastic	244,987	12.4
6.	Building Materials	16,890	0.9
7.	Metal and Articles	96,024	4.9
8.	Foodstuff and Vegetable Products	26,746	1.3
9.	Mineral Products	7,486	0.4
10.	Services	4,863	0.2
11.	Oil Rigs and Allied Constructions	299,314	15.1
12.	Other Constructional Works	22,063	1.1
13.	Miscellaneous	566,087	28.6
	TOTAL	1,976,968	100.0

TABLE 17: EXPORTS INSURED BY TERMS OF PAYMENT IN 1982: SINGAPORE

(Unit: 1,000 Singapore Dollar)

TERMS OF PAYMENT		
Secured Terms		
Sight Term	175,819	
30 Days Term	2,542	
90 Days Term	25,847	
180 Days Term	36,154	
360 to 720 Days Term	814	
Sub-Total:	241,176	(12%)
Unsecured Terms		
CAD/Sight Term	99,478	
30 Days Term	105,083	
90 Days Term	279,253	
180 Days Term	798,095	
360 to 720 Days Term	68,668	
Sub-Total:	1,350,577	(68%)
Long-Term Credit		
2-10 Years	385,215	(20%)
Overdue Amounts	-	
TOTAL	1,976,968	(100%)

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TABLE 18

Commitments by Insurance Type: Korea's Export Credit Insurance

	Dec. 31, 1979		Dec. 31, 1980	
	Amount 1/ ($ mil.)	(Percent)	Amount ($ mil.)	(Percent)
Pre-Shipment Insurance	4.2	0.7	0.4	0.1
o General export insurance	1.8		-	
o Export finance insurance	2.4		0.4	
Short-Term Post-Shipment Insurance	34.2	6.4	25.9	3.5
(Export bill insurance)				
Long-Term Post-Shipment Insurance	60.5	11.3	77.1	10.3
o Medium & long-term credit insurance	60.5		77.1	
o Consignment sale export insurance	-		-	
Other Insurance	436.6	81.6	642.3	86.1
o Overseas construction insurance	423.4		124.6	
o Export bond insurance	-		506.1	
o Overseas investment insurance	13.2		11.6	
Totals	535.4	100.0	745.6	100.0

1/ Converted into U.S. dollar based on the official exchange rate.

Source: The Export Import Bank of Korea, Annual Report, 1980.

ANNEX I
Table 19

TABLE 19: INTEREST RATES OF KOREA'S SHORT-TERM EXPORT LOANS, GENERAL BANK LOANS, AND CENTRAL BANK REDISCOUNT RATE FOR EXPORT LOANS
(1970-1982)

Month/Date/Year	(A) Annual Interest Rate of the Short-Term Export Loans 1/ (%)	(B) Annual Interest Rate of the General Bank Loans 2/ (%)	(C) Annual Discount Rate for the Export Loans by the Bank of Korea 1/ (%)	(D) (A)/(B)	(E) (C)/(A)
06/18/70	6	24	3.5	0.25	0.58
06/28/71	"	22	"	0.27	"
01/17/72	"	19	"	0.32	"
08/03/72	"	15.5	"	0.39	"
05/14/73	7	"	"	0.45	0.50
01/24/74	9	"	"	0.58	0.39
04/17/75	7	"	"	0.45	0.50
08/02/76	8	17	"	0.47	0.44
09/01/77	"	16	"	0.50	"
10/04/77	"	15	"	0.53	"
06/13/78	9	18.5	4	0.49	"
01/12/80	15 3/	24.5	10	0.61	0.67
06/05/80	"	23.5	"	0.64	"
09/16/80	"	21.5	"	0.70	"
11/08/80	"	19.5	"	0.77	"
01/14/82	12	15.5	5	0.77	0.42
03/29/82	11	13.5	"	0.81	0.45
06/28/82	10	10.0	"	1.00	0.50

1/ The export loan for purchasing imported intermediate inputs (FIL) is not included here. The annual interest rate applied to the standard loan period.

2/ Commercial bank loan with less than one year maturity. From 08/02/76 refers to the prime rate.

3/ Temporary rate of 12% applied up to 12/31/80.

Source: The Bank of Korea.

ANNEX I
Table 20

TABLE 20 : TERMS OF KOREA'S SHORT-TERM EXPORT LOAN FOR IMPORTING INTERMEDIATE INPUTS, (FIL) 1972-1978

Month/ Date/ Year	Amount of Loan: Actual Export Order Basis (FILA)	Amount of Loan: Expected Export Order Basis (FILE)	Annual Loan Interest Rate 1/: Actual Export Order Basis (FILA) (B.O.K. Discount Rate)		Annual Loan Interest Rate 1/: Expected Export Order Basis (FILE) (B.O.K. Discount Rate)	
03/02/72	350 Won X $ value of import draft	0.9 X official exchange rate X $ value of import draft (≤ 350 Won)	6%	(3.5%)	9%	(6.5%)
01/24/74	[$ Value of import draft - $ import guarantee money] X current TTSR	(≤ 350 Won)	"	(")	"	(")
11/12/74	"	(≤ 380 Won)	9%	(")	"	(")
12/02/74	"	(≤ 420 Won)	12%	(")	12%	(")
01/16/75	[$ Value of import draft - $ import guarantee money] 2/		"	(6.5%)	"	(")
04/17/75	"		6 months LIBO rate + 2.5%	(6 months LIBO rate + 0.5%)		
07/22/76	0.85 X ["]		"	"		
01/04/77	" "		6 months LIBO rate + 2%	(6 months LIBO rate)		
04/20/77	" "		"	(6 months LIBO rate + 0.5%)		
05/12/77	" "		6 months LIBO rate + 1.5%	(" ")		
08/01/77	[$ value of import draft - $ import guarantee money] X current TTSR	(≤ 420 Won) 3/	8%	(3.5%)		
10/11/77	[" "]	(≤ 380 Won)	"	"		
01/04/78	[" "]	(≤ 400 Won)	"	"		

1/ Annual interest rate applied to the standard loan periods.
2/ The short-term export loan for importing intermediate inputs switched from a domestic currency loan to a foreign currency loan.
3/ FIL switched from a foreign currency loan to a domestic currency loan.
Source: The Bank of Korea.

Table 21

MINIMUM INTEREST RATES FOR THE REVISED NEW OECD AGREEMENT ON EXPORT CREDITS AND THEIR ADJUSTMENTS

Country classification	Maximum repayment terms (years)					
	2 - 5		5 - 8.5		Over 8.5	
	Oct. 83	July 84	Oct. 83	July 84	Oct. 83	July 84
I. Relative rich [a/]	12.15%	13.35%	12.40%	13.60%	Not applicable	
II. Intermediate [b/]	10.35%	11.55%	10.70%	11.90%	Not applicable	
III. Relatively poor [c/]	9.50%	10.70%	9.5%	10.70%	9.5%	10.70%

a/ Defined as countries with a 1979 GNP per capita of over $4,000 as shown in the World Bank Atlas for 1981.

b/ All countries not in the relatively rich or relatively poor category. Countries moving from Category III to II as from 6 July 1982 benefit from somewhat lower interest rates until 31 December 1982; maximum maturity of ten years will continue to be allowed for these countries.

c/ Countries eligible for IDA credits (i.e., the World Bank's concessional funds) and any others whose income levels would meet the IDA eligibility criterion.

Note: The interest rates were revised with effect from July 15, 1984, based on the following automatic adjustment guidelines agreed on in October 1983:

(i) The minimum interest rates would be adjusted semi-annually if the weighted average of the monthly average of interest rates of the SDR currencies differ by 50 basis points or more from the weighted average for the month of May 1983.

(ii) There would be complementary upward adjustments of 50 basis points in the interest rates applicable to Category III countries in respect of long-term export credits (i.e., over 5 year repayment periods) and of 65 basis points for Category II countries over the next 2 or 3 years.

(iii) Where commercial lending rates for a currency fall below the relevant minimum level, the member countries can provide official support to export credits in that currency at an interest rate below the minimum level provided that the interest so charged is 0.2% p.a. above the commercial interest reference rates.

Source: UNCTAD 1983 and I.B.R.D., World Bank Cofinancing with Export Credits, October 12, 1984, pp. 7-8.

(D-53h)

ANNEX II-A

WEIGHTS FOR BASKET CURRENCIES [1]/

Balance of Trade Weights

$$w_i = \frac{Xk(1+s_x)a_i - Mk'(1+d_m)b_i}{Xk(1+s_x) - Mk'(1+d_m)}$$

Terms-of-Trade Weights

$$w_i = \frac{ka_i - k'b_i}{k - k'} .$$

Weights Stabilizing the Relative Price of Traded Goods

$$w_i = \frac{z_x k a_i + z_m k' b_i}{z_x k + z_m k'} ,$$

where

w_i = weights for the currency of ith country (to be given when the home country's basket peg is considered) [2]/

X,M = export and import quantity of the home country

k = $d_x/(d_x - S_x)$, an inverse index of export market power of the home country

d_x, s_x = price elasticities of export demand and supply in the home country

a_i, b_i = Home country's export and import shares from/to country i

k' = $s_m/(s_m - d_m)$, an inverse index of import market power of the home country

d_m, s_m = price elasticities of import demand and supply of the home country

z_x, z_m = weights of exports and imports in total trade in value terms

---

1/ For the derivation these weights, see Branson and Katseli (1981).

2/ i = 1,.--,N, where Nth country is the numeraire.

ANNEX II-B

VALUE OF DUTY TO BE EXEMPTED OR REFUNDED FOR ONE UNIT OF THE EXPORT COMMODITY

$$\sum_i c_i \, x_{ij} \, t_i \, ,$$

where

c_i = import price (converted into local currency) of input i;

x_{ij} = input (i) - output (j) coefficient;

t_i = rate of import duty on input i (as fraction of import values).

Note that above value of duty to be exempted or refunded for one unit of the export commodity has nothing to do with the price of the product.

BILL TO BE DISCOUNTED UNDER
THE MONETARY AUTHORITY OF SINGAPORE REDISCOUNTING SCHEME

FRONT (12 cm x 21 cm)

Accepted on ..... (Date)
Payable at ..... (Name of Bank)
Accepted by ..... (Name of Exporter)
(Acceptor's authorised signature & stamp)

Bill No. _____ Singapore _____ (Date)

Exchange for S$ (Amount in figures)

On (Due Date) Pay to the order of _____

(Name of bank - pre-printed in Block Letters)

the sum of Singapore Dollars _____ (Amount in words)

value received in *(Export/Pre-Export) Finance

Goods to be exported _____ (Description of Goods)

Country of destination _____

To : (Exporter's name & address) For

(Industrial Classification)

(Drawer's authorised signature & stamp)

* To fill in with "Export" or "Pre-Export", whichever is applicable.

ANNEX II-D

TERMS OF PRE-SHIPMENT EXPORT LOANS

Type of Loan		Timing of Loan	Amount of Loan (in local currency)	Maximum Maturity (within 90 days)
1. Loans for generating value added (VAL)	(a) Actual export order basis (VALA)	Confirmation of necessary intermediate input purchases (i.e. opening of import L/C or domestic L/C)	f_1 x value added	7 days after shipment or delivery of goods.
	(b) Expected export order basis (VALE)	"	f_1 x k x value of certificate of past q months' export (or supply of local inputs) records x average value added ratio	Shipping date of the exports
2. Loans for purchasing domestically produced products	(a) Loans for purchasing domestically produced finished outputs (DOL)	Presentation of draft drawn under local L/C for payment or accep-		For (a) maximum maturity is 30 days
	(i) Actual export order basis (DOLA)		f_2 x value of draft drawn under domestic L/C	7 days after shipment of goods
	(ii) Expected export order basis (DOLE)		f_2 x value of draft drawn under domestic L/C	Shipping date of the exports
	(b) Loans for purchasing domestically produced intermediate inputs (DIL)			
	(i) Actual export order basis (DILA)		f_3 x value of draft drawn under domestic L/C	7 days after shipment of goods
	(ii) Expected export order basis (DILE)	(For new purchases it is necessary to confirm exports manufactured by the inputs previously purchased)	f_3 x value of draft drawn under domestic L/C	Shipping date of the exports
3. Loans for purchasing foreign produced intermediate inputs	(a) Actual export order basis (FILA)	Presentation of import bill for payment/acceptance or B/L	f_4 x value of import draft	7 days after shipment of goods
	(b) Expected export order basis (FILE)	" For new purchase, it is necessary to confirm export manufactured by the inputs previously purchased	f_4 x value of import draft	Shipping date of the exports

Note: f_1, f_2, f_3, and f_4 are the loan percentages which are usually 70-90%.

Procedures for Export Financing:

The following figure provides an overview of typical procedures for export under the modernized system. In the typical case of figure 2, there are three producers -- an exporter, a domestic producer of intermediate inputs, and a foreign producer of intermediate inputs -- and their banks. While the exporter purchases the domestically produced intermediate inputs for export production, the domestic producer of intermediate inputs imports the earlier-stage intermediate inputs for the domestic production of later-stage intermediate inputs. The flow chart shows the sequence of opening export, domestic, and import L/Cs as well as obtaining and paying off the export loans (VAL, DIL, and FIL). The following are brief explanations of the steps in figure 2.

(1) A foreign buyer orders goods, and an exporter agrees to fill orders.

(2) The foreign buyer arranges an L/C (master export L/C) with his bank.

(3) An exporter receives the master export L/C. Usually the issuing bank sends the L/C to a bank abroad for delivery to the beneficiary. In some cases the importer takes the L/C from the issuing bank and sends it directly to the exporter.

(4) The exporter orders domestically produced intermediate inputs, and a domestic producer agrees to fill orders.

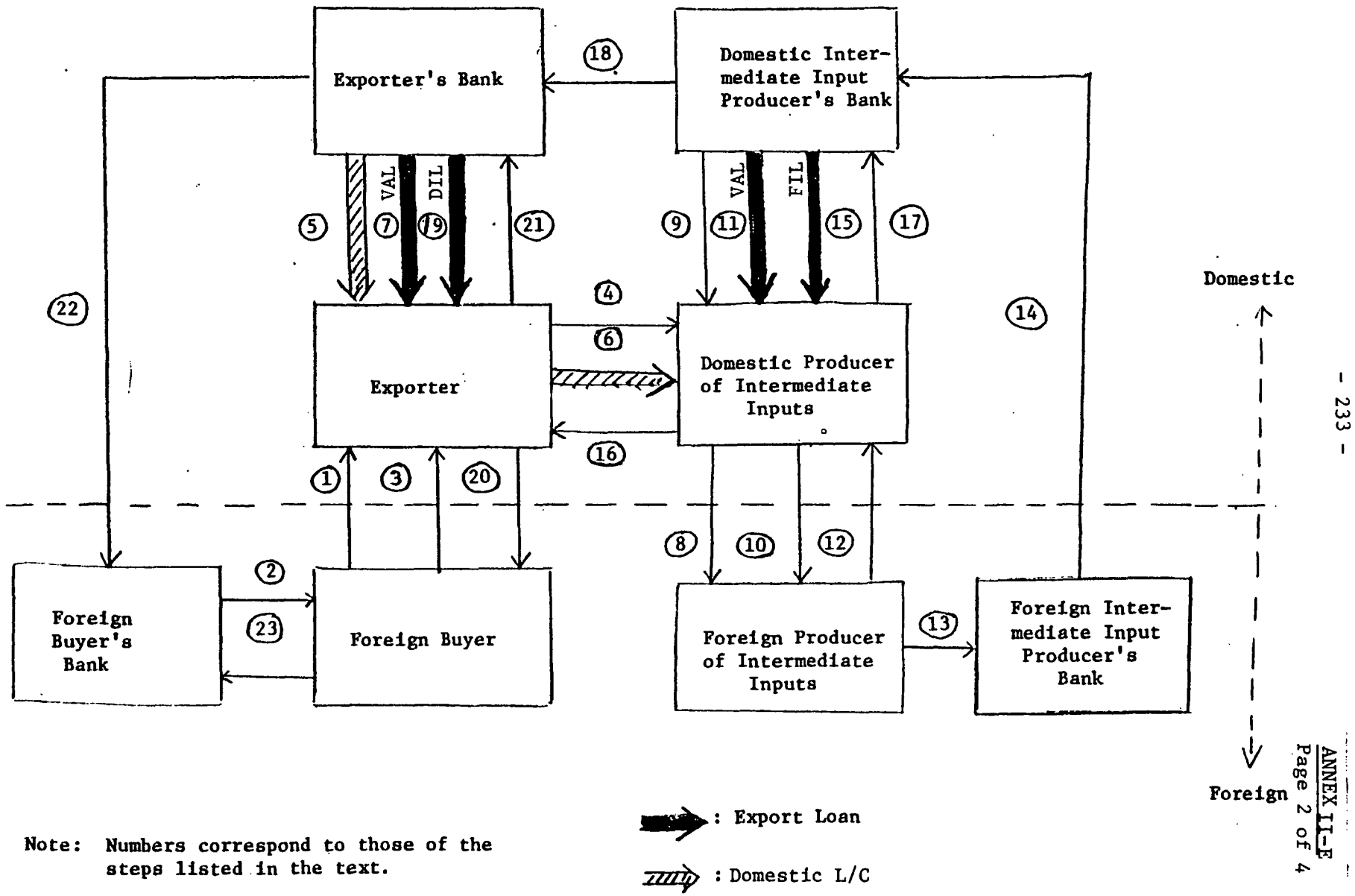
(5) The exporter arranges a domestic L/C with his bank for the purchase of domestically produced intermediate inputs.

(6) A domestic producer of intermediate inputs receives the domestic L/C.

(7) The exporter obtains an export loan for generating value added (VAL).

(8) The domestic producer of intermediate inputs orders foreign raw materials and intermediate inputs, and a foreign producer agrees to fill orders.

An Overview of the Procedures for Opening Domestic L/C and Financing Exports with the Short-Term Export Loans



Note: Numbers correspond to those of the steps listed in the text.

(9) The domestic producer of intermediate inputs arranges an L/C (import L/C) with his bank.

(10) The foreign producer of intermediate inputs recieves the import L/C.

(11) The domestic producer of intermediate inputs obtains an export loan for generating value added (VAL).

(12) The foreign producer of intermediate inputs ships the foreign-made intermediate inputs to the domestic producer of intermediate inputs.

(13) The foreign producer of intermediate inputs presents the draft drawn under the import L/C to his bank for payment or acceptance.

(14) The bank of the foreign intermediate-input producer forwards the draft drawn under the import L/C to the bank of the domestic producer of intermediate inputs for reimbursement.

(15) The domestic producer of intermediate inputs honors the draft drawn under the import L/C with an export loan for purchasing foreign-made intermediate inputs (FIL) obtained from his bank.

(16) The domestic producer of intermediate inputs delivers the domestically produced intermediate inputs to the exporter.

(17) The domestic producer of intermediate inputs presents the draft drawn under the domestic L/C to his bank and liquidates the export loans obtained in (11) and (15).

(18) The bank of the domestic producer of intermediate inputs forwards the draft under the domestic L/C to the exporter's bank for reimbursement.

(19) The exporter honors the draft drawn under the domestic L/C with an export loan for purchasing domestic intermediate inputs (DIL) obtained from his bank.

(20) The exporter ships the goods to the foreign buyer.

(21) The exporter presents the draft drawn under the master export L/C to his bank and liquidates te exporrt loans obtained in (7) and (19).

(22) The exporter's bank forwards the draft drawn under the master export L/C to the foreign buyer's bank for reimbursement.

(22) The exporter's bank forwards the draft drawn under the master export L/C to the foreign buyer's bank for reimbursement.

(23) The foreign buyer's bank presents the draft drawn under the master export L/C to the foreign buyer for reimbursement.

Note that although the loans for generating value added (VAL) are handed over directly to the exporter and to the domestic producer of intermediate inputs for their payments for wages and nontradable goods, those for intermediate inputs (FIL or DIL) are not. Such loans are used directly to honor the draft drawn under the import L/C by the domestic intermediate input producer's bank or the draft drawn under the domestic L/C by the exporter's bank. The FIL (or DIL) and VAL are paid off directly with the proceeds of sales (or exports) in the bank, when the domestic producer of intermediate inputs presents the draft under the domestic L/C to his bank (or the exporter presents the draft drawn under the master export L/C to his bank).

The sketch shows that as long as production capacity to produce exportable commodities is available and export orders are forthcoming, the producers (whether large or small, whether exporter or local suppliers), can export or supply local inputs based on the export loans.

ANNEX III - A

SINGAPORE TRADE DEVELOPMENT BOARD

Establishment

The Trade Development Board of Singapore came into existence on January 1, 1983, based on the Trade Development Board Act 1982 (No. 29 of 1982). The TDB has absorbed virtually all the functions carried out by the former Department of Trade, together with the functions of the former Timber Industry Board. The new TDB is oriented toward helping the private sector and looks for maximum private sector input.

Organization

The twelve TDB members appointed by the Minister for Trade and Industry are composed of private sector representatives, Members of Parliament, and current and former government officials, in order to achieve maximum public and private interface.

Under the new Board, there are six Committees:

(i) Administration and Finance Committee;
(ii) Trade Facilitation Advisory Committee, which embraces the functions of the former Free Trade Zone Committee;
(iii) Timber Advisory Committee, to provide expertise now that the Timber Industry Board is merged with the TDB;
(iv) Textile and Garment Advisory Committee;
(v) Electronics and Electrical Advisory Committee;
(vi) Printing and Publishing Advisory Committee.

The TDB office structure involves two divisions. They are:

The Trade Development Division, with three departments as follows:

(i) Market Development, responsible for establishing overseas trade offices, and all aspects of market development;
(ii) Information and Services, responsible for participation and arrangements for trade fairs, etc., commodities, rubber, coffee, timber and shipping; and
(iii) Trade Relations, responsible for bilateral trade relations, GSP, GATT, UNCTAD and ASEAN Regional Cooperation.

The second TDB Division is the Secretariat Division, responsible for finance, staff recruitment, training and documentation. The Import and Export Office inherited from the former Department of Trade also comes under this division.

Functions

Among the activities and services which the TDB aims to provide are:

(a) Activities

(i) Trade promotion
(ii) Trade exhibition
(iii) Trade missions
(iv) Negotiations and attending overseas conference relating to trade
(v) Assist in the development/improvement of distribution, transportation and warehousing
(vi) Overseas representation
(vii) Publications films and other forms of trade information media
(viii) Training - will liaise with SDF for grants

(b) Services

(i) Marketing and overseas liaison
(ii) Computerized information services (by end of 1982)
(iii) Marketing research
(iv) Market development
(v) Setting up more overseas trade offices - presently in service are offices in Bonn, Jeddah, Los Angeles, New York, Rotterdam, Tokyo and Beijing
(vi) Appointment of Honorary Trade Representatives
(vii) Library services - providing market and product research reports
(viii) Incentive schemes - trade missions are eligible to claim double tax deduction or International Home Incentive Scheme
(ix) Documentation services - procedures will be streamlined and applications can be processed in 2 to 2-1/2 hours time

(c) Group Promotion

(i) Task forces on fact-finding mission for on-the-spot market surveys to be accentuated towards non-traditional markets (Latin America, Socialist countries, and Asian countries)
(ii) Trade fair participation - will be on the increase in 1983 and 1984
(iii) Product display, including permanent display on rotation - this was strongly emphasized as experience showed that the West Asian market inclines to see first before buying
(iv) Selling missions
(v) In store promotion in foreign markets - enlisting help from department stores
(vi) Incoming buying missions - organizing this type of mission to come to Singapore. Requires the help of Chambers of Commerce and SMA.

Financial Provisions

Part V of the Act lays down that:

(1) The Board may, with the approval of the Minister, make an order published in the Gazette for the imposition of a levy on the export of such goods as may be specified in the order.

(2) Any order made under subsection (1) may provide:
(a) for different rates of levy in respect of the export of different goods;
(b) for the recovery of the levy by the Board in such manner and through such channels as may be specified in the order; and
(c) for the exemption of any person or class of persons from the payment of the levy.

(3) The levy collected under this section shall be paid to the Board.

(4) The Board shall, in every year, prepare and adopt annual estimates of income and expenditure of the Board for the ensuing financial year.

(5) Supplementary estimates of expenditure may be adopted by the Board.

(6) A copy of all annual and supplementary estimates shall, upon their adoption by the Board, be sent forthwith to the Minster who may approve or disallow any item or portion of any item shown in the estimates, and shall return the estimates as amended by him to the Board, and the Board shall be bound thereby.

(7) For the purpose of enabling the Board to carry out its functions under this Act, the Minister may from time to time make grants-in-aid to the Board of such sums of money as the Minister may determine out of moneys to be provided by Parliament.

(8) Without prejudice to the generality of subsection (1):
(a) all costs of works involving capital expenditure, including the costs of building and equipment; and
(b) such other costs and expenditure as the Minister considers necessary to improve the services rendered by the Board shall be defrayed out of moneys provided by Parliament.

(9) The Board may, from time to time, for the purposes of this Act raise loans from the Government or, with the consent of the Minister, from any other source.

The TDB is to be funded initially by a government grant in aid, and it is therefore not the immediate intention to invoke the power under Section 11 to impose a levy in respect of the export of goods. This reliance upon government funds is not intended as a permanent solution to funding the TDB, and the private sector could well find that the TDB imposes such a levy in due course, as is the practice with the similar organization in Hong Kong (The HK TDC).

ANNEX III - B

HONG KONG TRADE DEVELOPMENT COUNCIL

Establishment

The Trade Development Council was established in September 1966 under the Hong Kong Trade Development Council Ordinance (Cap. 1114 of the Laws of Hong Kong) for the purpose of coordinating the trade promotion activities previously undertaken by various government departments and trade associations. The statutory functions of the Council are:

(a) to promote, assist and develop Hong Kong overseas trade, with particular reference to exports; and

(b) to make such recommendations to the Government as it sees fit in relation to any measures which it considers would achieve an increase in Hong Kong's trade.

To fulfil these functions, a program of trade promotion projects is planned each year which provides a comprehensive mix of activities throughout the world. The program is designed to expand trade with traditional markets to consolidate market penetration in territories that hold promise of a profitable trading relationship, and to seek opportunities for developing new markets and new sources of supply for Hong Kong industries.

Organization

Council's chairman is appointed by the Governor, and the other 16 council members include representatives of major trade associations, leading businessmen and industrialists, and two senior government officials.

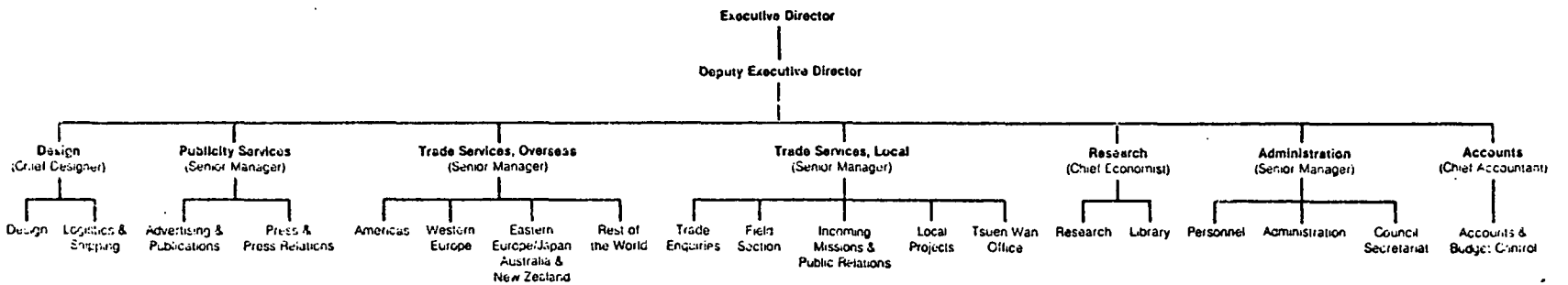
The Council usually meets once a month to decide on the strategy and policies of trade promotions on a worldwide scale and to oversee the operation of its executive. It is assisted by a Program Committee and a Staff and Finance Committee. The tasks of these Committees are sufficiently defined by their titles.

Trade Services Department: It is mainly responsible for preparing and executing the annual trade promotion program of the Council, with the assistance of the Council's overseas offices and consultants and the support of various Head Office departments. It also develops and advises the Council of new promotional opportunities in Hong Kong and overseas markets.

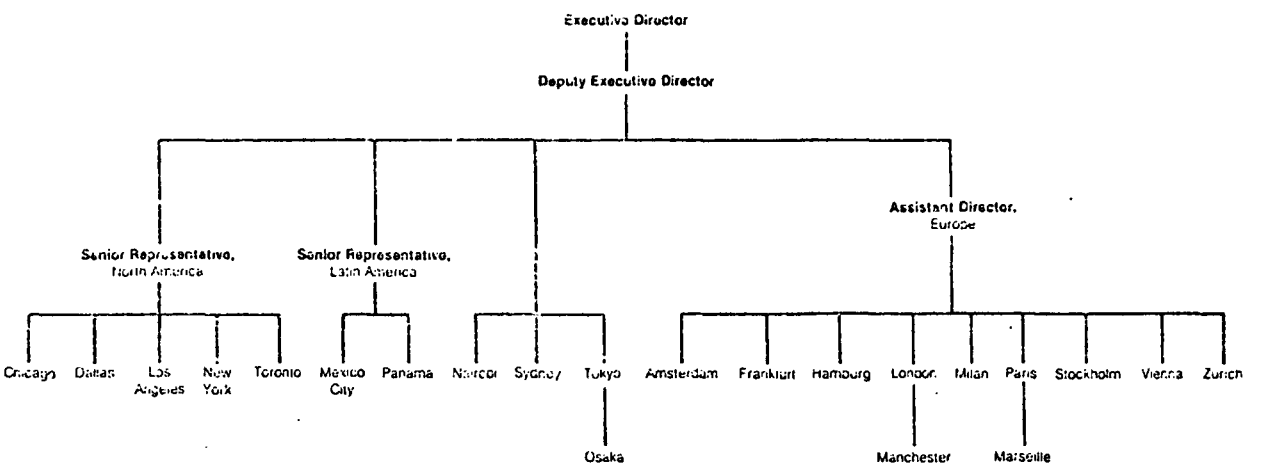
Overseas Section: In the year 1981/82 it organized over 60 promotional projects, approved by the Council.

Local Section: It has responsibility for the trade enquiry service, local projects, field activities, incoming missions, and the Tsuen Wan Office, New Territories.

HEAD OFFICE



OVERSEAS REPRESENTATIVE OFFICES



Publicity Services Department: It acts as the communications arm of the Council, and is responsible for a wide range of activities which include the Council's own trade publications and local and overseas publicity through its press offices located throughout the world. The department is also responsible for advertising relating to Council's promotions and services worldwide.

Research Department: It is responsible for meeting the information needs of the Council's Head Office and overseas offices, as well as providing trade-related information to the business and trading community at large.

Design Department: It is responsible for the corporate visual image of the Council both locally and overseas. Its aim is to create and sustain an international standard of design and visual presentation throughout the Council's promotion activities.

Overseas Representative Offices: The Council is represented in twenty-two overseas cities, viz., Amsterdam, Chicago, Dallas, Frankfurt, Hamburg, London, Los Angeles, Manchester, Marseilles, Mexico City, Milan, Nairobi, New York, Osaka, Panama, Paris, Stockholm, Sydney, Tokyo, Toronto, Vienna and Zurich. It also maintains consultants in Athens, Barcelona and Dubai.

Overseas offices supply trade information to businessmen, handle trade enquiries, publicize Hong Kong-made products, facilitate contacts between foreign traders and Hong Kong manufacturers and exporters, and provide logistical support for special overseas promotional projects. The offices also inform Hong Kong businessmen about trading conditions and export opportunities in their market areas. Close contact is maintained with Head Office. Staff posted overseas make periodic visits to Hong Kong to bring themselves up-to-date on commercial and industrial developments, while overseas recruited local staff are given familiarization training in Hong Kong.

Financing

The Council's three sources of revenue are: (a) a Government subvention of $1.275 million; (b) the net proceeds of an advalorem levy on exports and on imports other than foodstuffs; and (c) minor income from miscellaneous sources such as advertising fees and sales of publications. The net proceeds of the levy provided 89% of the Council's revenue for 1982.

Activities in 1982

The Council carried out an extensive trade promotion programme in 1982, organizing about 80 major international projects. These included an economic mission to Europe, covering Austria, Belgium, France and the Netherlands, and another to Australia and New Zealand. These missions were aimed at developing trade opportunities by strengthening high-level contacts with senior government officials and business and industrial leaders in the host countries.

In addition to activities in Hong Kong's major trading partner nations, the council also mounted a number of promotions in less-developed markets during the year, including a major exhibition of Hong Kong-made products in Jeddah, Saudi Arabia, with a view to helping manufacturers diversify their export markets. Reflecting the growing role of China in Hong Kong's external trade, members of an official mission of the Council to China held meetings in Beijing, Shanghai and Guangzhou in late October and early November to discuss the development of mutually beneficial trade between Hong Kong and China. Other promotional activities organized in 1982 included promotions of Hong Kong products, particularly garments, with chain stores in Japan, and participation in many international trade fairs around the world - notably the Nuremburg International Toy Fair, the American Toy Fair in New York, the Swiss Industries Fair in Basle, MACEF International Fair in Milan, Birmingham International Spring Fair, Frankfurt Spring Fair, Summer Consumer Electronics Show and National Hardware Show in Chicago, Winter Consumer Electronics Show in Las Vegas, Tokyo International Toy Fair, and Cairo International Fair.

In addition, the Trade Development Council organized business group visits to Europe, North and South America, the Middle East, Africa, Japan and Australia both to explore new markets and consolidate existing trade ties. Similar groups from overseas regularly visit Hong Kong, and in 1982 the Council received inward missions from Panama, Britain, France, Germany, China, Japan, Mexico, Austria, Sweden and the USA.

The Council organised the eighth Hong Kong Toy and Gift Fair and acted as advisor to the Hong Kong Electronics Fair and to the first Hong Kong Watch and Clock Exhibition. All three were held in Hong Kong in October.

The Trade Development Council produces four regular publications, mainly for circulation overseas. They are the monthly Hong Kong Enterprise, the half-yearly Hong Kong Apparel, the annual Hong Kong Toys and the two-monthly news magazine Hong Kong Trader. It also puts out several newsletters in various languages to keep overseas businessmen informed of the latest financial and industrial developments in Hong Kong.

In 1982, the Council expanded and upgraded its international network with the opening of a new office in Mexico City and a move to larger premises in Sydney. Besides its headquarters in Hong Kong, and a local branch in Tsuen Wan, the Council has staff in 22 cities, and consultants in three cities, throughout the world.

ANNEX III - C

KOREA TRADERS ASSOCIATION

History

The Korean Traders Association was established on July 31, 1946 as a nonprofit, private economic organization. Starting with little more than 100 members, KTA has kept pace with the growth of Korea's foreign trade, and now embraces over 3,500 member firms, comprising all licensed exporters and importers in Korea.

Functions

1. Trade Promotion and Membership Service

   (a) Recommendations to the Government: One of the important functions of KTA is to play the role of a bridge between business circles and the government. KTA, therefore, frequently organizes meetings of member companies to uncover their problems. It then makes appropriate recommendations to the government to help find a solution to their problems.

   (b) Trade Law File: KTA collects information on domestic and international trade-related laws and distributes information to member firms and companies. Latest changes in such laws and regulations are made public in appropriate KTA publications. It also maintains a file system on trade laws so that its members may have immediate access to the latest changes in trade laws and regulations.

   (c) Consultation: KTA operates a trade counseling office to help members solve their trade problems. Counseling services cover trade transactions, tariffs, foreign exchange, financing, and taxes. KTA also organizes group meetings on occasion to keep members informed of relevant changes in the corporate and market environments.

   (d) Government-delegated Functions: On behalf of the government, KTA is empowered to issue trade-related certificates, trade performance certificates, and recommends the use of VIP room at Kimpo Airport by influential persons from abroad and the customs clearance of foreign commodity samples.

   (e) KOSTPRO: The Korean Committee for Simplification of International Trade Procedures (KOSTPRO) was established and operated by KTA to help reduce manpower and incident expenses required by trading circles, through the simplification and standardization of export and import paper forms.

(f) Training and Education: In order to ensure the improvement of Korean merchandise, both in productivity and quality, KTA provides to its member firms and companies study tours and practical training programs both at home and abroad for guidance workers on productivity.

KTA also provides educational programs for practical trading business, business English, international marketing, and practical tax affairs. It also provides language training for staff of trading firms to be sent abroad under a contract with the Hankook University of Foreign Studies.

2. International Cooperation

(a) Trade Missions: KTA forms private-level trade missions comprising directors and staff of its member firms and companies; and it sends them abroad to explore new export markets and expand existing ones.

It also provides its assistance in business talks by visiting trade missions from abroad with its member firms and also in their courtesy calls at the government departments concerned. KTA also provides conveniences such as a guide to industrial facilities for them, contributing greatly to bilateral economic cooperation and to boosting trade.

(b) Bilateral Economic Councils: KTA promotes mutually beneficial trade relations between trade partners by sponsoring bilateral economic cooperation groups. KTA operates the following cooperative councils:

- o The Korea-Philippines Economic Cooperation Council.
- o The Korea-Venezuela Economic Cooperation Council.
- o The Committee for Balanced Expansion of Korea-Japan Trade.

In addition, KTA advises a number of other groups on bilateral economic cooperation activities.

In 1972, KTA joined the WTCA; and in 1976, it hosted the WTCA's General Assembly in Seoul.

(c) Korean Shippers Council: The Korean Shippers Council was formed by KTA in 1977 to protect the rights and interests of Korean shippers. The organization engages in tariff negotiations with international freight conferences and domestic carriers, makes recommendations to the government, assists members with shipping problems, and makes other activities related to cargo transportation.

(d) Overseas Publicity and Inquiry Service: KTA runs advertisements in leading mass media of the world in order to promote exports of Korean-made goods and expand Korea's overseas markets. KTA also distributes promotional publications such as "the Korea Export" and "the Korean Trade Directory" to buyers abroad.

KTA handles more than 10,000 trade inquiries from abroad annually, successfully leading to trade contacts and business arrangements.

(e) Diplomatic Activities at Private Level: KTA develops its diplomatic activities to promote economic cooperation at private levels. To this end, KTA invites Korean overseas mission chiefs, foreign diplomatic mission chiefs and economic officers in Korea to roundtable meetings, to provide opportunities for discussing ways and means to promote bilateral trade.

3. Research and Survey

(a) Research Reports: KTA prepares the following periodical research reports:
- o Export industry trends
- o Analysis of the latest economic trends
- o Trade indices and trends in trade conditions
- o Analysis of the beneficial effects of exports on Korean industry
- o Analysis of export and import structures
- o Major indicators of the Korean economy

(b) Seminars and Symposia: KTA frequently holds seminars and symposia for trade promotion, which are attended by civil leaders, journalists, and members of trade information networks. Prominent personalities are invited to participate in these seminars and symposiums. The results of these discussions are forwarded to appropriate government offices for consideration in the formulation of trade policies.

(c) Relations with Foreign Research Institutes: KTA has established cooperative arrangements with the prominent research institutes and been engaged in the exchange of necessary economic data.

(d) Trade Library: KTA maintains a trade library, the only one of its kind in Korea.

4. Publication

(a) Trade Newsletters: English and Korean trade newsletters are published by KTA for domestic distribution. The English version entitled the "Daily Korean Trade News," is published once a day, while the Korean version is published twice a day.

In order to supply trade information to branches of KTA member firms and companies in Europe and Southeast Asia, KTA publishes and distributes biweekly trade newsletters in Dusseldorf and Hong Kong.

For the publication of those trade newsletters, KTA has correspondents assigned to Tokyo, New York, Dusseldorf, and Hong Kong.

(b) Publications: KTA publishes the following periodicals for the speedy dissemination of economic information:
- o Monthly International Trade
- o Korean Trade Yearbook
- o Domestic and Foreign Economic Trends
- o Korean Trade Directory (in English)
- o Laws and Regulations Relating to Trade (in Korean and English)
- o Introduction to Export-Import Procedures
- o Monthly Trade Statistics
- o Trade Business Guide
- o Korea Export
- o Quarterly Shippers

(c) Data Processing by EDPS: KTA operates an EDPS to analyze and process various trade-related data and statistics. It supplies the processed information to the government and member firms for use in formulating trade policies and for their conduct of trade business.

(i) Principal statistical data
Export-import statistics

(ii) Research and analysis
- o Trade indices
- o Research and analysis of trends in export industries
- o Survey and analysis of the status of exporters and importers
- o Preparation of world trade matrix

(iii) On-line inquiry system
KTA "On-line Inquiry System" provides information on imports and exports, international economic trends, and imports and exports of OECD countries.

(iv) Export Administrative Management and On-Line Network
For efficiency in export-import related control service, such as the allotment of quotas, KTA has established its on-line

network with related export associations. Under this network, the computerization of export quota service and export-import administrative affairs is now under way.

(d) Telex Service: The KTA telex service is offered to member firms and companies in Seoul and in Pusan without their own telex facilities.

5. Branches

(a) Overseas Branches: Activities of the overseas branches in Tokyo, New York, Hong Kong and Dusseldorf are to explore international markets for Korean products and to collect information on local trading procedures and market trends.

Branches conduct researches and surveys of current international economic problems and also sponsor seminars and meetings in order to exchange ideas on problems arising from the rapidly changing economic environment.

They provide various facilities to support the overseas activities of member firms and companies. Not only that, the branches also provide their support in their commercial transaction activities through assistance in transactions.

KTA branches also provide various information on Korea and business in Korea, thereby serving as a dependable channel for foreign businessmen interested in commercial trade with Korea.

(b) Domestic Branches: Domestic branches are located in Pusan, Taegu, and Chonju. The functions and activities of the domestic branches are to encourage exports of local products, to acquire information concerning provincial export industry zones, and to do research on special industries of the provinces.

The branches sponsor other trade-related activities including meetings, seminars and the collection of trade information; and generally help the local business communities.

(c) Trade Centers: In March 1973, KTA completed construction of 22-story World Trade Center Korea building, the home base of all Korean traders. Similar-size office buildings were also purchased by KTA in New York in 1974 and in Hong Kong in 1970 to serve as bridgeheads for development of the all-important U.S. and Southeast Asian markets.

In January 1972, KTA became a member of the World Trade Centers Association (WTCA) and in 1976 hosted the WTCA general assembly in Seoul.

6. KTA-Related Organizations

(a) Korea Trading International, Inc.: KOTI is a general trading house which handles a great variety of commodities ranging from light industry products to heavy-chemical industry items.

(b) The Korea Exhibition Center: The largest facility of its kind in the Orient, KOEX was opened in 1978 to stimulate international trade by providing spacious, ultramodern facilities for international display, trade fairs, and exhibitions.

(c) Korean Commercial Arbitration Board: K-CAB helps settle international trade disputes involving Korean merchants.

(d) Korea-U.S. Economic Council: KUSEC was established as a non-government organization to promote trade and technological cooperation between Korea and the United States.

(e) The Korea Herald Inc.: One of the two English language daily newspapers in Korea, the Korea Herald presents Korea's political, economic, social, and cultural news to the international community. It boasts an extensive circulation overseas.

ANNEX III - D

THE KOREA TRADE PROMOTION CORPORATION

Establishment

The Korea Trade Promotion Corporation (KOTRA) was established in 1962 as the non-profit trade promotion organization of the Korean Government. Through its worldwide network of Korea Trade Centers, KOTRA offers, free of charge, a wide range of services to both overseas and Korean businessmen. With its 21-year experience in trade promotion, KOTRA assists foreigners to do business with Korea in such diverse fields as trade investment and international tender bidding as well as turnkey plant exports.

1. Trade Promotion Activities

The Trade Promotion Department, consisting of the General Marketing Division and the First, Second, Third and Fourth divisions, provides various services including:

- Conveying inquiries from abroad to Korean Businessmen
- Introducing reliable Korean exporters to foreign importers while on business tours in Korea

The various divisions and their areas of responsibility are as follows:

- General Marketing Division: General business information
- First Division: Steel, metal, agricultural products, footwear, sporting goods, furniture, musical instruments
- Second Division: Electric & electronic products, machinery, stationery, handicraft goods
- Third Division: Forestry & marine products, textiles, medical instruments, toys and dolls
- Fourth Division: Chemical & mineral products, personal accessories, optical equipment, wallpaper and other miscellaneous products

2. Overseas Project Development Activities

The Overseas Project Development Department, comprising five divisions - Market Development Division, Commodity Development Division, Overseas Cooperation Division, Counter Trade Division and Special Marketing Service Division - undertakes the following tasks:

- Promoting the export of Korean heavy and chemical industry products through establishing Korean Permanent Exhibition Centers abroad
- Compiling international tender and plants projects information for prospective Korean bidders

- Assisting the activities of trade missions from abroad and promoting joint ventures and technical ties between foreign and Korean firms
- Dealing with import and export transactions involving counter trade and answering inquiries about imports to Korea
- Promoting trade with those countries which have centrally planned economies through handling inquiries, participating in trade fairs and exhibitions, and arranging exchanges of visits by businessmen
- Providing guidance to improve the quality of export products and develop new products
- Holding exhibitions for purchasing parts in Korea in cooperation with major foreign companies to enable these companies to contact Korean suppliers

3. Overseas Exhibition Activities

The Exhibition Department consists of the Exhibition Planning Division, the Overseas Exhibition Division, the Domestic Exhibition Division, and the Special Exhibition Division - all dedicated to promoting Korea's trade with foreign countries by carrying out the following activities:

- Holding special international exhibition in Korea and making arrangements for foreign and domestic firms to participate in such exhibitions
- Sponsoring domestic exhibitions held by foreign organizations
- Holding domestic exhibitions in conjunction with foreign organizations
- Making arrangements for Korean firms to participate in international trade fairs overseas and organizing Korean product exhibitions abroad
- Holding the Seoul International Trade Fair
- Sponsoring Korean participation in world's fairs

4. Domestic Exhibition Activities

The Exhibition Center Management Department consists of four divisions: The First Division, the Second Division, Design Division and Maintenance Division. Its main tasks are the following:

- Maintaining a permanent display of representative products of Korea
- Organizing domestic and international exhibitions to promote trade
- Seeking mutual cooperation and information exchanges with foreign exhibition centers and international exhibition organizations
- Providing exhibition facilities to foreign and domestic exhibition participants

5. Overseas Market Research Activities

The Overseas Market Research Department, which consists of the International Economic Affairs Division, the Asia Division, the Africa & Middle East Division, the Europe Division, the Americas Division and the Commodity Research Division, handles the following tasks:

- Studying measures to promote trade with foreign countries
- Researching trade policies, trade-related laws and regulations of foreign governments and international economic organizations
- Reviewing of international economic and trade trends
- Collecting overseas market information for major Korean export items and providing it to domestic firms
- Analyzing and evaluating commodity information to assist domestic firms' export efforts

6. Trade Information Service

The EDPS & Information Department consists of the EDP Planning Division, the EDP Development Division, the EDP Operation Division, and the Trade Library. Its main services are:

- Developing and planning trade information control
- Setting up and implementing plans for computerization of trade information
- Analyzing and designing programs for development of the EDP system
- Operating the trade library.

7. Public Information Activities

The Public Information & Publications Department consists of the Public Relations Division, the Publications Division and the Photography Division with the following functions:

- Distributing press releases and placing advertisements in leading domestic and foreign publications
- Conducting briefings on Korean industry and KOTRA's activities for visitors
- Producing films, slides and video tapes related to trade promotion
- Publishing for overseas distribution the bi-monthly "Korea Trade" (a catalogue of Korean products), the monthly "Korea Trade and Business" and various additional publications in English and other languages
- Publishing in the Korean language: "The Daily Overseas Market News" and the quarterly "The Trade Promotion" to provide overseas market information to Korean exporters and importers

8. KOTRA's Domestic Network

KOTRA's domestic branches conduct surveys of their regional industries, supply information about overseas markets, deal with trade inquiries, and hold exhibitions displaying various articles obtained through the overseas network.

9. Korea Trade Centers

The 86 Korea Trade Centers in major cities around the world introduce interested Korean manufacturers and exporters to foreign importers, and provide the latest information about Korean industries. Information regarding the Korean market and Korean importers is also provided by KOTRA and its branch offices abroad.

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How did Korea manage to expand its exports from less than $100 million a year in the early 1960s to more than $20 billion a year in the early 1980s? To find out about the underpinnings of Korea's competitive edge, the authors asked more than 100 major Korean exporters what had been important for them in institutional support, in technological development, and in marketing overseas. The findings show that there is a strong interaction between exporting and the effectiveness of a country's economic institutions, both public and private. Without effective institutions, a country may not be able to implement effective policies for export promotion. Conversely, successful exporting appears to give economic institutions more vitality and effectiveness. The findings also show how Korea's selectivity—in the acquisition of technology and in the marketing of products overseas—has been an important part of Korea's success in the world marketplace.

The Johns Hopkins University Press. June 1984. About 204 pages.

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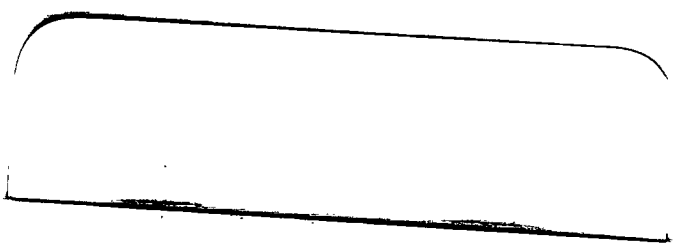

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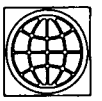

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