

Final Report Upon Completion of Research Project

EXCHANGE CONTROL, LIBERALIZATION AND ECONOMIC DEVELOPMENT

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## Introductory Note

This report is intended to comply with the provisions of the contract calling on the National Bureau to submit a final report which "summarizes the accomplishments of the assignment, methods of work used and recommendations regarding unfinished work and/or program continuation."

It will be useful to begin with a brief statement of the objectives of the project and then to review the methods of research employed before reporting on the accomplishments of the assignment and on work remaining to be done.

This report will be relatively succinct, particularly with respect to the research results emerging from the project, inasmuch as these results are being presented in the synthesis prepared by Professor Anne Krueger, Co-Director of the project together with Professor Jagdish Bhagwati. Professor Krueger's synthesis, already submitted to AID and approved for publication, is now in process of publication by the National Bureau under the title "Foreign Trade Regimes and Economic Development -- Liberalization Attempts and Consequences." Her report will be supplemented by a companion volume by Professor Bhagwati, now being completed, which focuses more particularly on distilling the research findings with respect to the "Anatomy and Consequences of Exchange Control Regimes."

As a separate introductory point it should be noted that the original name of the project, as given in the contract and therefore used in the title of this report, was broadened in the course of the work to that indicated above in the title to Professor Krueger's synthesis; namely, "Foreign Trade Regimes and Economic Development."

## I. Objectives of the Project

The purpose of the project has been to develop empirical evidence illuminating the uncertainties and controversies which have arisen on the relationship between foreign trade controls and economic growth of less developed countries.

At one time or another since World War II many, and probably most, less developed countries have imposed direct quantitative controls of varying severity and complexity over their foreign trade and payments. Usually such restrictive measures have been invoked to restrict imports and combat balance of payments deficits. The latter may have originated either in unfavorable development in the country's export markets or in its own domestic inflation not offset by devaluation.

Whatever the origin, import controls have necessarily become related, via the stimulus to import substitution, to the country's industrialization aims and programs. Almost inevitably also controls as originally imposed have tended to become more complex in form and administration in the effort to meet different import priorities, however defined or imposed, and to offset in some measure the adverse effects of over-valued currencies on exports and, hence, on the ability to import.

Fairly typically, however, countries have tried at some point, or periodically, to escape from these difficulties by liberalizing their payments regimes in greater or lesser measure in combination with a devaluation of the currencies. These efforts have met with varied results. Some countries have experienced genuine liberalization, at least for a time. Others have been thwarted in their efforts, and stringent controls

have quickly reappeared.

As implied in the foregoing brief recital, policy makers as well as economists are aware that restrictionist trade and payments regimes present major problems and may contain serious disadvantages. Such regimes are sometimes defended, however, on the ground that the stimulus they provide to import-substituting industrialization outweighs the costs, although the latter may be inadequately known. Here, then, lies one major area on which fresh empirically oriented research was deemed essential -- i.e., the anatomy and effects of restrictionist trade and payments regimes. This topic was further spelled out in a number of pertinent questions: What sorts of economic and political factors lead to the adoption of restrictionist measures? Once restrictionist measures are adopted, what kinds of economic and political pressures operate to increase the restrictions, and what factors resist greater controls? Do the types of measures employed in a restrictionist regime significantly affect the operation of the control system over a period of time? What are the effects on resource allocation, income distribution, and economic growth of such regimes? How can one measure and compare the restrictiveness of different systems of controls? Is there some tolerable degree of restriction which can be maintained without significant retardation of growth rates?

A second major area on which new, systematic research was considered essential concerned the conditions for and consequences of liberalization of restrictionist regimes. A widely held, if inadequately documented, view among students of trade and development problems was that successful

liberalization could result in increased efficiency and accelerated growth rates. Yet it was not readily apparent without further investigation why some attempts at liberalization had apparently met with success, while others failed to achieve any significant, lasting relaxation of the trade regime. What, then, are the conditions and components of a liberalization program likely to result in a successful transition? Are some types of restrictionist regimes more amenable to liberalization than others? And, as a particularly difficult challenge to empirical research, what is the impact of liberalization on growth rates?

The project was therefore undertaken in the hope that systematic investigation of these and related questions would move analyses of trade and payments policies away from the realm of casual empiricism, implicit theorizing and institutional investigations toward a more scientific framework wherein the lessons drawn from the experiences of some countries could be meaningfully applied to new situations as they arise.

## II. Research Methods Employed

Given the inadequate state of existing knowledge on the foregoing questions, it was deemed imperative from the inception of the project to seek new, systematic evidence by a series of carefully coordinated country studies. Approximately 12 such studies were foreseen in the research contract. These studies, along with special research on particular topics and other pertinent data, would then provide the basis for cross-country comparisons and possible generalization in the final over-all study to be prepared by the Co-Directors (each of whom was,

incidentally, also responsible for a particular country study).

The authors of the country studies were selected for their recognized competence in the particular countries concerned in each case. Subject to providing the data and analysis needed for the common purposes of the project, each author enjoyed maximum latitude to develop the analysis of his country's experience in the way he deemed appropriate. It was hoped thereby to gain the benefit of individual perceptions and expertise along with the inputs required for the overall analysis.

In addition to regular contact between Co-Directors and authors, coordination of the country studies to serve the needs of the project was sought through two means, an Analytic Framework prepared by the Co-Directors and a series of working parties of all project participants. These two devices were combined insofar as the initial working party, in May 1970, was devoted in considerable part to a critical review of the Analytic Framework, after which it was revised by the Co-Directors.

The Analytic Framework was in itself something of a research landmark, spelling out as it did the major issues to which any study of the subject would need to be addressed and examining the research techniques that could be employed. It devoted separate chapters to each of the two main areas identified above; i.e., the efficiency and growth effects of exchange control regimes and the liberalization problems and experience of such regimes. In the document the Co-Directors not only took pains to elaborate a common set of definitions and concepts to be observed by authors but also elaborated a set of five phases to aid in tracing

the experience of individual countries with exchange controls and liberalization over the period since World War II. Within the general framework the author of each country study was asked (1) to single out for in-depth analysis a particular period for which the detailed working of the exchange control regime would be analyzed and (2) to select one liberalization episode for intensive study with respect to its economic effects and the conditions determining its success or failure.

With respect to the working parties as an instrument of coordination of the country studies, it should be understood that their purpose was not to impose a common set of views or conclusions but only to make sure that the key questions were being addressed and the essential data provided and that results were exposed to critical examination. The second working party in June 1971 and the third in February 1972 were devoted to this purpose. Still a fourth working party was held in September 1974, this one being devoted, however, to an examination of the preliminary and still partial overall reports by the Co-Directors and to plans for the regional seminars, about which more will be said in the following section.

Before leaving the topic of research methodology and procedures we should note that, in a group undertaking of this nature, the pace of the project as a whole tends to be tied to that of its slowest members. Delays in completing some of the underlying country studies have inevitably increased the task and slowed the performance of the Co-Directors in their cross-country analyses. In addition, the size of the fact-finding and analytical responsibilities assumed by country authors and Co-Directors proved to be much greater than had been anticipated at the outset and, incidentally, much greater than had been provided for in the budget.

### III. Accomplishments of the Project

#### A. Publications and Papers

Chiefly for the reason just stated, the output of the project in terms of published or unpublished works has been larger by far than had been foreseen when the undertaking was launched. Each of the country studies carried through to completion has become a full-scale volume in contrast to the briefer papers originally contemplated. The number of studies undertaken was, however, one short of the "approximately 12" country studies mentioned in the contract (efforts to line up a qualified author for Sri Lanka having failed). The 11 studies commissioned and their authors were as follows:

|             |  |
|-------------|--|
| Brazil      | Albert Fishlow, University of California, Berkeley   |
| Chile       | Jere R. Behrman, University of Pennsylvania  |
| Colombia    | Carlos F. Diaz-Alejandro. Yale University  |
| Egypt       | Bent Hansen, University of California, Berkeley, and Karim Nashashibi, International Monetary Fund   |
| Thana       | J. Clark Leith, University of Western Ontario  |
| India       | Jagdish N. Bhagwati, Massachusetts Institute of Technology, and T.N. Srinivasan, Indian Statistical Institute  |
| Israel      | Michael Michaely, The Hebrew University of Jerusalem   |
| Pakistan    | Nurul Islam, Pakistan Institute of Development Economics   |
| Philippines | Robert E. Baldwin, University of Wisconsin   |
| South Korea | Charles R. Frank, Jr., Princeton University and The Brookings Institution; Kwang Suk Kim, Korea Development Institute, Republic of Korea; and Larry E. Westphal, Northwestern University |
| Turkey      | Anne O. Krueger, University of Minnesota   |

Nine of these country studies have been or are now being published.

The other two -- Brazil and Pakistan -- have not yielded sufficiently complete and definitive manuscripts to be published.\* The work done on them has nevertheless provided valuable inputs into the two syntheses by the Co-Directors, which will complete the National Bureau's publications in this series.

In addition to the studies already mentioned, two papers emerging from the project are of special interest. One is a joint paper by Bhagwati and Krueger on this project (and carrying the same title) delivered at the American Economic Association in December 1972 and printed in the American Economic Review for May 1973. Though preliminary as a digest of the project results, the paper has the advantage of presenting the issues and some tentative findings in very concise and clear form. The other paper is a more recent one by Bhagwati, prepared for the UNCTAD meeting in Nairobi in June 1976 and entitled "Protection, Industrialization, Export Performance and Economic Development."\*\* This is a parti-

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\*Islam produced in 1971 during the Pakistan civil war a massive (800-page draft, but was called back to Bangladesh to serve as head of the Planning Commission before he could add his final chapter and revise and compress the whole draft to meet criticisms. Later, at the Manila seminar in December 1974, he expressed keen interest in completing the work for publication by the National Bureau. He was encouraged to do so (even if too later to include in the present series) but did not follow through.

Fishlow's output on Brazil was slow and irregular from the outset (attributable in part to the demands on his time as head of the Economics Department at Berkeley), but he did produce a "summary" paper of more than 100 pages that was essential to the success of the Bogota seminar. At that point his work, too, was interrupted by official duties upon being appointed Deputy Assistant Secretary of State for Inter-American Affairs. He has subsequently affirmed his intention of completing the study for publication, but up to the time of this report he has not submitted a manuscript for review.

\*\*UNCTAD/MD/80 GE.76-63285 dated March 19, 1976. The paper also draws, to a lesser extent, on an earlier OECD project.

cularly timely, and well presented, summary of the project's scope and results to a group of officials and advisers most directly concerned.

#### B. Regional Seminars

Even before the UNCTAD meeting the results of the project began to be disseminated to policy officials and economists in less developed countries through the medium of two regional seminars financed by AID. The first was a three-day meeting in Manila in December 1974 sponsored jointly by the Asian Development Bank and the National Bureau with the former serving as host. The second was a three-day meeting in Bogota in April 1975 sponsored jointly by the Banco de la Republica (i.e., the central bank of Colombia), the U.N. Economic Commission for Latin America, and the National Bureau with Banco de la Republica serving as host.

Both seminars succeeded in obtaining the participation of high-ranking civil servants as well as leading economists from the countries of the region. The agenda at each seminar included a critical evaluation of the studies of individual countries in the region -- the Philippines, South Korea and India (also Egypt) at the Manila seminar, and Brazil, Chile and Colombia at the Bogota seminar. Particular attention and sometimes controversy attached, however, to the presentation and discussion of the overall results found by the Co-Directors in their syntheses. Since the latter were still in preliminary and incomplete draft, some beneficial feed-back was gained from this discussion.

These regional seminars have undoubtedly strengthened the likelihood that future policy decisions as well as economic analyses in the countries of Asia and Latin America will take account of the issues, analytical methods and findings stemming from the National Bureau's project. Dissemi-

nation of the project results is further promoted by a proceedings volume on the Manila seminar for distribution to member countries and others which is now being brought out by the Asian Development Bank.

C. Some Conclusions

It would go far beyond the physical limits or purpose of this report to try to present here, with appropriate qualifications and explanations, the substantive findings of the project bearing on the questions briefly identified in Section I above. For that purpose the overall reports of the Co-Directors should be consulted. Attention will here be focused instead on two related main points, one from each of the Co-Directors, out of many that might be selected.

In the final chapter of her synthesis Professor Krueger takes a close look at South Korea and Brazil, countries dissimilar in many ways but alike in that their "truly remarkable growth performances have come about ... when they switched from import substitution to export promotion" (i.e., after 1964 in the first and 1968 in the second). "It would appear," says Professor Krueger, "that the dictates of an export promotion strategy are such as to result in a variety of phenomena which enable more rapid growth and simultaneously constrain policy to reduced variance in incentives and increased rationality of the regime."

In the concluding remarks of his UNCTAD paper mentioned above Professor Bhagwati looks at the same course of action from a different angle. "Furthermore," he says, "one cannot help reiterating the fact that the wisdom of developing countries as a whole moving to an export-promoting

strategy depends critically on the willingness of developed countries to permit developing countries to have substantial access to their markets." He adds that protection instituted by developed countries against market disruption "is clearly pertinent especially as the export-promoting strategy does relate to more rapid promotion of manufactured exports."

#### IV. Completion or Continuation of Research

In the expectation that the full draft of Professor Bhagwati's synthesis will soon be ready for distribution and final review, there is nothing to add with respect to completion of work undertaken in the project reported on here.

With regard to continuation of research in this area, a very useful extension is provided by the AID-financed project more recently undertaken by the National Bureau, with Professor Krueger as Director, on "Trade Strategies and Employment Growth." This project focuses more sharply than the earlier one, or than previous research done elsewhere, on a question of growing concern to less developed countries. That is the impact of alternative trade regimes -- or, more specifically, export promotion versus import substitution -- on job creation.