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1 AMONG LDCs:

EA AND TURKEY
FOR COUNTRIES IN TRANSITION

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EXECUTIVE SUMMARY

Korea and Turkey: The Transition from Import Substitution to Export Led Growth

Korea and Turkey have achieved remarkable and noteworthy successes with their export-led growth strategies. However, until the 1960s in Korea and until the 1980s in Turkey, both countries pursued import-substitution development which protected domestic industries producing nondurable consumer goods.

Both countries decided to switch their strategies from import-substitution to an outward-looking or export-oriented one in order to increase export earnings to finance necessary inputs. In the sixties, Korean industry began looking at external markets because its domestic market was small and its industrialization through import-substitution had reached saturation. In the early eighties, Turkish industry began to explore the export sector more seriously in response to poor domestic conditions and new market opportunities in the surrounding region.

The Problem of Export Pessimism

The outward-looking development strategy in both countries was firmly established by the won devaluation in 1964 and the lira devaluation in 1980. Yet even with the devaluations and subsequent price corrections, which would in theory remove the bias against exports, many businessmen did not enter production for export. The reservations and doubts about the potential for export growth voiced by businessmen and policymakers in Korea and Turkey are part of

a larger tradition of export pessimism. Faced with this pessimism, governments must ask themselves several basic questions:

- Why do firms respond to export incentives?
- When do they not?
- What did firms in Korea and Turkey perceive to be obstacles to export growth?
- Which justify government action?

Fears and Responses from Korea and Turkey

In the following analysis of the 1960-1969 period in Korea and the 1980-1984 period in Turkey, we examine entrepreneurs' reluctance to export by grouping these fears and constraints into three categories: export demand problems, export supply problems, and institutional problems. Specifically, we break them down as follows:

Export Demand Problems:

- Low income elasticity of demand for agricultural exports
- Insufficient growth in world demand for exports
- Protectionism
- Lack of ties to potential markets.

Export Supply Problems:

- Labor costs
- Costs of imported raw materials and capital goods
- Costs of capital
- Transportation and utilities infrastructure.

Institutional Constraints:

- Governmental/institutional support
- Export procedures
- Tax policies.

obstacles?

By examining the constraints and fears of entrepreneurs in Korea and Turkey, and the government's responses to those fears, we attempt to discern when and how it is appropriate for a government to intervene to counteract export pessimism. Some export growth constraints, principally those inhibiting world demand were not addressed by either government - perhaps because they were viewed as exogenous constraints or perhaps because they did not threaten export growth sufficiently. In general the governments chose to intervene when they could accomplish one of two things :

- the removal of procedural impediments or existing economic distortions which inhibited export sector growth
- the correction of some market failure.

Removing Procedural Impediments and Existing Distortions

In most instances of bureaucratic or procedural obstacles, the response was less government involvement. Methods of limiting government interference with export performance included:

- Streamlining and simplifying export licensing procedures
- Relaxing import and export controls.

Export growth was also hindered by existing economic distortions such as foreign subsidies of capital. In these cases the government may have adopted a

second-best policy - or counterbalancing subsidy - to improve the competitiveness of the export sector.

Correction of Market Failures

When market failures existed, the governments tended to respond actively to articulated concerns. Generally speaking, two types of market failure may have diminished export growth in Korea and Turkey, public goods and imperfect information.

Marketing information, establishment of diplomatic ties, infrastructure and worker training programs all exhibit characteristics of public goods. As such, they may not inspire sufficient investment by the private sector. Responses to the existence of public goods included:

- public provision of the good or service
- government coordination or encouragement of private sector initiatives.

Inaccurate information about the government's commitment to export growth and, therefore, the risk of investing in the tradeables sector may have dampened export growth. If entrepreneurs systematically overestimate the risks of political or policy instability, the government may have to provide additional incentives to exporters. Problems posed by imperfect information were ameliorated by:

- export subsidies
- policies which signaled a strong governmental commitment to export led growth.

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The Costs of Overcoming Export Pessimism.

While Korea and Turkey managed to overcome widespread export pessimism and maintain an outward oriented growth strategy after their initial devaluations, the policies adopted by each government incurred substantial costs. With heavy subsidies a government runs the risks of encouraging inefficient industrial development amassing large budget deficits, and provoking retaliatory responses from its trading partners.

The Korean and Turkish experiences will undoubtedly continue to spark much debate and review in other developing countries. While not recommending direct replication of the policies adopted in Korea and Turkey, we hope to provide developing countries embarking on similar export promotion paths with a framework that draws on these experiences yet remains relevant to their particular needs. This framework may prove useful for governments facing similar doubts and concerns in the private sector.

I. INTRODUCTION

A. Export-Led Growth as an Alternative to Import Substitution

. . [for] countries that are resource-poor and have relatively small domestic markets, the trade strategies based on primary exports or on import substitution provide scant hope for sustained development."

-- Gillis et al., 1987

This view of the dominance of export-led growth strategies over import-substitution strategies and primary export strategies has become the orthodoxy of the 1980s -- quite literally, as suggested by the above quote, the textbook strategy for development in the Third World. Export-led or outward-looking growth has emerged as this decade's alternative to the two more traditional development strategies: import substitution and primary resource-led growth. In the manner in which it is used in this paper, export promotion means altering the incentives of the private sector in a way that develops both traditional and non-traditional export industries in which the country has some degree of comparative advantage. In essence, the government eliminates or scales back policies that protect and draw factors into production for the domestic market, in order to allow export industries to emerge from among those that currently have unused export potential [Gillis et al., 1987]. These industries tend to be those that make good use of the country's most abundant resource, usually inexpensive labor, for export. Gustav Ranis has called this strategy "export substitution," in the sense that exports of labor-intensive manufactures replace exports of labor-intensive agricultural products.

The list of those who have rejected portions of the export-led growth strategy is a long one, however, and it includes both economic theorists and -- both

explicitly and implicitly -- many developing-country policymakers. The modern academic notion of "export pessimism" achieved prominence in the 1950s, when it had both individual and institutional foundations. In addition to numerous individual economists of note, the United Nations' Department of Economic Affairs and its Economic Commission on Latin America (ECLA) published numerous writings in the export-pessimism vein, lending credibility to this viewpoint [Meier, 1968]. The export pessimists expressed grave doubts about the ability of developing countries either to increase exports at a rapid pace or to translate export growth into strong economic performance overall. As a result of this conclusion, the export pessimists instead prescribed a model of inward-looking growth -- that is, import-substituting industrialization -- with production geared toward the domestic market and with considerations of domestic resource cost and world prices assuming only secondary importance.

Despite the theoretical shortcomings of the export pessimistic literature, which we will explain in more detail later, the policy implications were picked up in the 1950s by many developing countries. Through his role at ECLA, Raul Prebisch in particular had great influence on the economic development strategies of several Latin American countries, including his native Argentina. Most countries in that region had first explored the territory of import-substitution during the breakdown in world trade and disappearance of primary export markets in the 1930s, and then again as World War II interfered with transoceanic shipping. The writings of Prebisch and others encouraged these nations in the postwar years to further develop import-substitution regimes, which were based on heavy protection of domestic markets and investment in relatively capital-intensive industries. As new nations emerged from colonial status throughout Asia and Africa in the same period, they found a ready model in the Latin American economies. Many of these newly independent countries

chose to emulate these strategies in constructing their postindependence economies [Gillis et al., 1980]. While the buoyant growth in world trade in the 1960s seemed to belie many of the assumptions and conclusions of the export pessimism, the 1970s saw a revival of export pessimism, in response both to the sharp increases in oil prices and perceptions of increasing protection. This "neo-export pessimism" cautioned countries against too much "external dependence," in order to minimize the negative effects of these external shocks.

B. Examples of Successful Export-Led Growth: Korea and Turkey

The export pessimists have never achieved full acceptance in the developing world, however. Both for their own reasons and as a result of pressure from international holders of capital, many countries have at some point pursued strategies that depart from those suggested by the export pessimists. Two very different examples of successful export-led growth since the 1950s, South Korea and Turkey, suggest that the case for export pessimism, while perhaps valid in certain circumstances, is not universally applicable. Both countries have achieved impressive results in shifting their economies rather abruptly from inward to outward orientation and making exports the engine of growth.

After 1961, the Korean government decisively redirected the economy toward exports by implementing several massive devaluations, unifying exchange rates, liberalizing the trade and payments regime, and engaging in expansionary fiscal policies. The results were impressive by most standards: from 1960-80, export growth averaged 24% per year, and GNP growth averaged 6% per year, one of the highest rates in the world. Compared with most other developing countries, Korea was able to achieve this growth with an admirably equitable distribution of income. [Mason et al., 1980].

Turkey, by contrast, did not launch its export drive until 1980, when it faced a considerably less hospitable environment than the rapidly expanding world trade arena of the 1960s. To shift the orientation of the economy away from the import substitution of the 1970s, the Turkish government carried out a series of devaluations, abolished export barriers and price controls, and provided tax rebates as an incentive for exporters. Again, the resulting export growth was impressive: exports grew by an annual average of 21.6% between 1981 and 1986, compared with the developing country average of 5.0%.

The process of shifting from an entrenched strategy of import substitution to a strategy of export led growth was not easy in either country. While government policymakers were able to affect incentives by devaluing the currency and removing some of the barriers protecting home markets, many other factors were also at work in convincing the domestic business sector and policymakers themselves that rapid and sustained expansion of exports was possible -- i.e., that their export fears either were unwarranted or could be addressed through government or private initiative.

It seems clear from a review of both the Korean and the Turkish experiences that devaluation and subsequent maintenance of a realistic exchange rate was the single most important impetus to expanded exports. In both countries, for most of the periods under consideration, the initial adjustment in the exchange rate was followed by frequent devaluations that more than kept pace with ^{relative} inflation. Whatever the negative effects these devaluations may have had on price stability and income distribution -- both of particular concern in Turkey -- they certainly provided a strong incentive for exporters to redirect their efforts toward foreign markets by enabling them to compete effectively.

This paper, however, discusses devaluation and its effects only peripherally; the same is true for import liberalization, which may have played

some role in forcing domestic manufactures to produce more efficiently. More generally, this paper does not venture into the well-travelled territory encompassing the criticisms of the standard International Monetary Fund (IMF) stabilization/structural adjustment package and the rebuttals to these criticisms. Instead, it focuses on export fears that are likely to plague exporters after implementation of the standard package of devaluation, fiscal stabilization, and import liberalization. It attempts to answer the question of why the private sector might not respond to this package -- i.e., of what lingering "fears" or causes of export pessimism might deter potential exporters from shifting their efforts toward foreign markets.

The following section, Section II, discusses in slightly greater detail the basic arguments of the academic export pessimists and offers both theoretical and empirical rebuttals to those arguments. These arguments are nevertheless discussed rather briefly, as they generally seem to have been of less concern in the countries studied than were various specific fears discussed later in the paper. Section III outlines in broad terms the initiatives taken by the Korean and Turkish governments as they launched their export-led growth strategies and attempts to give some broad context for those initiatives, showing that rapid export growth was not universally seen as an attainable goal in either country in the years before the export drive. Section IV, the main body of the paper, divides major export fears into three categories: demand-related, supply-related, and institutional (or governmental) factors -- and, where applicable, attempts to gauge the validity of each "fear." In cases where the fear seemed warranted, it then discusses steps taken -- usually by the government -- to respond to the each concern, and finally tries to gauge the outcome of those efforts. Section V contains the paper's conclusion, which summarizes the information from the preceding

sections and suggests possible rationales for observed governmental responses to the concerns of export pessimists.

II. EXPORT PESSIMISM: A BRIEF DISCUSSION

A. The Academic Theorists

A number of major economists in the 1950s -- among them W. A. Lewis, Gunnar Myrdal, Ragnar Nurkse, Raul Prebisch, and Hans Singer, to name the most prominent -- argued that developing countries should not pursue export-oriented growth strategies. This group believed foreign trade, and particularly exporting to the developed world, to be an unsound foundation for economic growth. Taken as a group, they argued that both demand and supply constraints limited the potential for sustained economic growth through trade. On the demand side, Nurkse, Myrdal, and Prebisch argued that the growth in volume of demand would fall and that LDC terms of trade (the relative price of exports to imports) would deteriorate over time. W. A. Lewis added supply constraints, comparing the productivity of the labor pool in LDCs unfavorably with that of the developed countries.

The views of these economists largely conflicted with those held by many classical economists, who believed that diminishing returns in primary production would cause the prices of these products to rise relative to manufactures [Meier, 1968]. Keynes, for example, argued early in the 20th century that Britain had to sell more and more manufactured exports in order to obtain the same volume of food imports. He explained that the price elasticity of the world's demand for Britain's manufactured products was higher than that for food products, and that increasing the real prices of manufactures could only be done at the cost of reducing real wages [Keynes, 1924].

The assertions of these two schools of thought had strikingly different policy implications. The classical economists envisioned the dependence of the industrial countries on the less developed countries (LDCs) for primary products,

primarily foodstuffs, especially as population continued to rise, and predicted that an advantage would thus accrue to primary product producers. From this viewpoint, LDCs would benefit from basing their economic development on primary good production. Comparative advantage considerations reinforced this view, suggesting that LDCs should concentrate on industries using inputs that were relatively abundant in their economies. The export pessimists, in contrast, warned LDCs that the position of primary goods would always be weak relative to manufactures, and that if they focused on the production of primary goods, they would remain at a relative disadvantage to the industrialized nations. From this alternative viewpoint, the LDCs should shy away from foreign trade in primary goods and focus inward on the development of industries for domestic consumption. This way of thinking, with its radical implications, influenced the development policies of numerous developing countries.

B. A Summary of Their Theories

Initial arguments against export led growth centered on faltering demand growth and deteriorating net barter terms of trade for primary sector products. Nurkse identified six sources of slower demand for LDC exports: 1) the shift in developed countries towards heavy industries which use fewer raw materials; 2) the rising share of services in total developed country output; 3) the fact that demand for primary sector goods tends to be income-inelastic (an offshoot of Engel's Law); 4) agricultural protectionism in the developed world; 5) the growing use of conservation and recycling techniques in developed industries; and 6) the introduction of synthetic materials. As a result, Nurkse asserted, total revenues received by a developing country's export sector will tend to decline over time relative to a manufacturing country's. While Nurkse focused primarily on a relative reduction in the volume of LDC exports demanded by the industrial

world, Prebisch and Myrdal's arguments centered more on prices than on quantities. They claimed that increasingly monopolistic markets and the low income elasticity of demand for traditional LDC exports would force prices down. The resulting deterioration of the LDC's terms of trade would diminish LDC purchasing power and provide inadequate revenue for investment and economic expansion, particularly into manufactured or capital intensive industries.

C. A Brief Critique of the Theories

The arguments for export pessimism have been faulted on both theoretical and empirical grounds. The demand-side limitations described by the export pessimists can be summarized as (i) shrinking world demand (due to low income elasticities for primary goods) and (ii) deteriorating terms of trade. The main supply-side constraint is Lewis' idea of surplus labor. Closer examination of these arguments shows that although they are valid in some circumstances, they are neither universally applicable nor insurmountable.

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1. Theoretical counter-arguments. From a theoretical standpoint, the first problem mentioned -- that of shrinking world demand for primary products - can to some extent be overcome by diversifying the type and destination of exports. This rebuttal applies to perhaps all but the second and sixth of Nurkse's six causes of diminishing demand -- and maybe even to the second, if we consider that developing countries may export services, as the foreign construction industries of Korea and Turkey demonstrate. By diversifying, a developing country reduces its dependence on any one product or trade partner, and hence the risk of being adversely affected by shrinking world demand. Moreover, the export pessimists also assumed implicitly that LDCs could earn foreign exchange and increase capital flows only by exporting to industrial nations, but an alternative is for developing countries to engage in inter-LDC trade.

The second main warning of the export pessimist to LDCs was an inevitable decline in their terms of trade. They implied that a decrease in the relative price of exports to imports would mean diminished revenue, making the country worse off. One flaw in their argument is that declining commodity terms of trade do not necessarily cause a decline in welfare. This can be compensated for by increased productivity, as given by the factoral terms of trade, or by a rise in the prices and hence purchasing power of the country's exports.

Finally, Lewis' surplus labor proposition asserts unrealistically that the marginal productivity of labor in LDCs is negative or zero, and that labor supply in these economies is perfectly elastic. This assertion seems flawed: even in the most impoverished developing nations, marginal labor productivity cannot be less than or equal to zero in all sectors. Shortages of skilled and semi-skilled laborers afflict virtually all developing countries; moreover, even unskilled laborers probably have positive marginal products, due to their ability to earn money through pursuits other than regular employment in the formal sectors to which this theory applies.

2. **Empirical counter-arguments.** Economic data also support the view that the export pessimist theorists were not entirely correct in their assertions and predictions. One of their key assumptions was that of LDC specialization in agricultural commodities. Although this assumption applies well to some smaller economies, many developing countries engage in a mixture of substantial amounts of natural resource and industrial production. According to the 1988 World Bank's World Development Report, 1986 agricultural production for low-income developing countries averaged 32%, and industrial production 35% of GDP. Moreover, the trade among LDCs has remained constant at 32%, while LDC exports to industrial economies has gone from 47% in 1965 to 56% in 1986. It would seem that, as suggested earlier, it is possible for LDCs to diminish the

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impact of shrinking world demand growth by diversifying the type and destination of their exports

Secondly, it appears that even if overall growth in world demand falls, industrial country imports may not always follow suit. From 1960-73, for example, the share of imports of nonfuel raw materials and food in total industrialized-country imports fell from 42% to 30% [World Bank, World Tables]. Yet since imports grew so rapidly -- over 8% per year -- imports of these goods, valued in constant prices, appear to have grown about as fast as GDP in the developed world, at about 5% annually. As some theorists have cautioned, however, "[t]he lesson is not that demand for primary imports in the industrial world will grow sufficiently to support rapid development in the third world. It is rather that some commodities will face brisk demand growth and some countries will benefit substantially from producing such exports" [Gillis et al., 1980]. If an LDC can diversify its production to take advantage of such opportunities, it may be able to compensate for sluggish demand growth.

Third, it is not certain that developing countries will always face particularly great price instability in world markets. The previous section noted that the variability of export revenues depends on whether the price and quantity fluctuations result from demand or supply shifts. Two major studies [MacBean; Knudsen and Parnes] found that commodity concentration seems to be a significant cause of fluctuations in export earnings. By contrast, the studies showed little correlation between price instability of a country's exports and the fraction of those exports that consisted of primary commodities. They suggested more broadly that primary exports may be no more likely to cause earnings instability than are exports of manufactured goods [Gillis et al., 1980].

Empirical data do support the export pessimists' argument that the commodity terms of trade of LDCs will decline steadily over time. International

Monetary Fund statistics show a sharp decline for non-petroleum exporting developing countries, averaging 0.9% a year from 1955-83 [International Financial Statistics]. While this trend does apply to the average country in this group, it certainly does not hold for all LDCS. Korea, for example, actually enjoyed a rise in both net barter and particularly income terms of trade during the 1960s. Using 1965 as a base year, from 1963-70 the net barter terms of trade went from 97.1 to 116.8, and income terms of trade from 51.1 to 478.5 [Bank of Korea statistics]. Korea's primary commodity exports did fall -- as feared by the export pessimists -- after it began its outward-oriented growth, but this decline was more than compensated for by the increase in exports of other types of products. Turkey's terms of trade also showed steady increases during certain periods. From 1969 to 1973, for example, ^{①? which?} it rose from 99.1 to 106.4, only declining subsequently in response to the OPEC oil price shocks. The export pessimists also failed to take into account other factors such as falling transportation costs and changes in quality of and access to imports, which distorted the "true" value of the terms of trade used in their analysis.

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III. EXAMPLES OF RAPID EXPORT GROWTH: AN INTRODUCTION TO KOREA AND TURKEY

A. The Korean Experience

During the five years before 1961, South Korea's GNP growth averaged 4.6% per year. In 1961, after a period of post-war rebuilding and subsequent stagnation, the Park government came to power soon proved itself committed to the goal of economic development through export growth. Since then, the country has experienced a tremendous surge in economic activity and has become one of the world's fastest-growing economies. The years from 1962 to 1973 can be considered the most important stage in the country's modern economic development. This first decade saw a dramatic expansion of the industrial base, a new and more constructive planning role for government, and highly visible changes in the economic behavior of Korean entrepreneurs, as a result of major policy reforms and institutional changes. The country's First and Second Five Year Economic Plans covered the periods 1962-66 and 1967-71, respectively. Growth averaged 8.3% and 11.4% in these years, far exceeding the plan targets of 7.1% and 7.0%. As a result, GNP in 1971 was 2.5 times higher than it was in 1961; much of this growth can be attributed to the export sector. [Kim, Kwang Sum, p. 3]

In the late 1950s, Korea had begun an industrialization strategy based on a policy of import-substitution. By around 1960, the country was well into its phase of import substitution in nondurable consumer goods and their inputs. For example, by 1957 "textiles had achieved enough import substitution to induce the government to prohibit their import" [Amsden, 1987]. Recognizing certain economic conditions that seemed to prescribe export promotion -- namely, limited natural resources, a small domestic market, excess manufacturing capacity, and

~~the~~ the availability of US food aid that would allow Korea to bypass primary export specialization in agricultural products -- the Park government adopted an outward-looking development strategy based on the growth of exports. At the core of Korea's outward-looking strategy in the 1960s was the export of labor-intensive manufactures in which the country had a comparative advantage.

To implement this strategy, the government instituted extensive policy reforms and took an active role in shifting the national policy focus from inward to outward-oriented development. One of the most important areas of policy reform was a turnaround in the country's trade policy. In 1961 the government devalued the won against the dollar by 100%. Three years later, it devalued again by 96%, and in March of 1965, it adopted a unified exchange rate system, thus eliminating a bias against the export sector. Following the exchange rate reform, the government almost doubled the interest rates on bank deposits and loans in September 1965 in order to increase voluntary private savings. As a result, deposits doubled every year for the next three years. In addition, the government made a strong effort to make substantial short-term financing available. It also held interest rates for export activities well below other rates (6.5% for export trade vs. 26% for loans on other bills) and allowed tariff rebates for materials imported for export production. Throughout the 1960s, direct export subsidies and trade incentives were kept high, with incentives available to all export activities regardless of the industry. Targetting of specific industries, such as heavy machinery and chemicals, did not take place until the early seventies. The general export incentives included a variety of tax exemptions, reduced rates on public utilities and loans, tariff rebates on products imported for export production, simplified customs procedures, and accelerated depreciation allowances. The government also liberalized credit restrictions and eased financing regulations for new export companies through loans of foreign

exchange and import-export credits for overseas marketing activities. [Kim, Kwang Suk, p. 2]

The 1960s were also a period of considerable institutional change in Korea. The key institutional changes and government policy measures included: a revamping of the tax administration; the founding of an Export Promotion Council (KOTRA) to facilitate export efforts, marketing information, and communication between the government and private business sector; and the development and implementation of the Five-Year Plans by the Economic Planning Board, which was organized in 1962 as a more powerful transformation of the former Economic Development Council.

These policy changes helped the Korean economy achieve impressive results in the international trade sector. Korea's exports grew from \$55 million in 1962 to \$1.068 billion in 1971, increasing at a tremendous 40% average annual growth rate. In the fifties and early sixties, most Korean exports were primary products (mainly tungsten, iron ore, raw silk, rice, and coal). In subsequent years, however, the share of agricultural exports dropped from 23% in 1962 to 3% in 1970; manufactured exports, which had only been 27% of total exports in 1962, reached approximately 86% by 1971. By the latter year, the main export products were clothing, machinery, plywood, textiles, and wigs. Moreover, the number of Korean export commodities skyrocketed from 100 to 983 from 1961-71, and its number of trading partners more than quadrupled, from 25 to 108 during the same period. [Kim, Kwang Suk, p. 12]

B. The Turkish Experience

In 1980, faced with chronic problems in the external balance of payments, the Turkish government adopted a series of economic policies designed to promote export growth. Policymakers hoped that these measures would remedy the

widening trade deficit and depleted foreign exchange reserves resulted from the 1970s. The reforms included a liberalization of the pricing system, the provision of specific export incentives, and the simplification of bureaucratic processes for exporters. The results of the program exceeded most expectations, both expanding and diversifying Turkey's exports.

OPEC oil price shocks, widespread inflation, and a deceleration of the growth rate in the industrial countries during the 1970s left Turkey with a large current account deficit, low levels of foreign exchange reserves and high inflation. During this period the price of Turkey's imports -- particularly of petroleum and other manufacturing inputs -- had escalated rapidly. The added combination of stagflation in the industrial countries and an appreciating real exchange rate in Turkey heavily constrained export growth. The trade deficit in 1977 reached \$3.88 billion. Real GDP growth was negative from 1978-1980 and was particularly slow in the manufacturing and mining sectors.

Even prior to the turbulence encountered in the 1970s, Turkey had had only moderate success in exporting. Economic planning under the Menderes government of the 1950s placed little or no emphasis on the development of exports. The 1960s saw greater coordination and consistency in economic planning, with the creation of a State Planning Organization and the adoption of two Five Year Plans, the first running from 1963-1968 and the second from 1968-1972. Nevertheless, policies in this period focused on the development of import-substitution industries in the manufacturing sector. Turkey continued to lag behind other middle income LDCs in export performance. In 1960 the average ratio of exports to GDP for a sample of middle-income LDCs was 11.6; in Turkey, the ratio was only 4.2. Similarly, by 1977 the the middle-income average had grown to 18.5, while Turkey's remained at 5.6. Sporadic attempts were made throughout the 1970s to improve export performance through exchange rate and

other price adjustments, but no substantial improvement appeared until after the decade's end.

The policies adopted in 1980, by contrast, placed heavy emphasis on export growth and depressed domestic demand. A devaluation of the Turkish lira against the U.S. dollar by 33% and the gradual phasing out of multiple exchange rate practices were central to this effort. Price controls were abolished and attempts were made to increase the competitive forces affecting State Economic Enterprises and domestic industries. Further tax and credit incentives were granted to exporters; these included low-interest loans, tax rebates, and more generous foreign-exchange allowances for firms involved in export. The government also enacted institutional and procedural reforms to facilitate export planning and licensing.

In the years following the adoption of these measures, export growth was quite strong. Most notably, export value grew 184% from 1980 to 1985. The current account deficit narrowed considerably after the 1980 devaluation, although an increasing debt servicing burden has helped the deficit to remain high. GDP growth was steady -- if not spectacular -- throughout this period, averaging 4.6% annually. The composition of Turkish exports has also changed radically. While traditional agricultural exports like hazelnuts, cotton and tobacco remain active, manufactured goods, particularly electrical equipment, iron and steel, rubber and plastic and textiles have grown enormously. In 1980, manufactured goods made up only 36% of Turkey's total exports; they now account for roughly 75%. Turkey has also managed to diversify its markets. The surge of OPEC-generated income in the Middle East and the particular needs created by regional conflicts, such as the Iran-Iraq war, gave Turkey the opportunity to expand its exports to non-European and non-industrial areas. Turkish exports to industrialized countries dropped from 68% in 1977 to 54% in 1984. There was a corresponding

increase in trade with oil-exporting LDCs, from 9% of total exports in 1977 to 33% in 1984. As noted above, exports to Iran grew particularly rapidly, shooting up 78-fold over the six year period. [International Monetary Fund, Direction of Trade Statistics]

C. Export Pessimism in Korea and Turkey

In retrospect, it is clear that both countries were tremendously successful over the periods under study, at least in achieving their goal of rapid export growth. Nevertheless, in both countries, the government made its decision to shift toward export-led growth amid widespread doubt about the capability of their export sectors to grow significantly, doubts expressed by domestic policymakers, academicians, and business communities. Some of the "export fears" voiced were general statements about Korea's or Turkey's inability to grow at all; others were specific comments about particular economic factors that were felt likely to limit significantly the growth within the export sector.

Because documents dating from the 1950s were largely unavailable, this paper does not draw on significant primary resource material expressing export concerns. Several secondary sources, however, do describe export fears among policymakers and entrepreneurs. David Cole, a specialist on the Korean economy, describes Korean thinking during the 1950s as ambivalent and full of self-doubt.

[There was a] general sense of despair and pessimism about the factors for economic growth in the South (Korea), even among advocates of improved policies and practices. Such an attitude was, for example, reflected in much of the academic writing on economic matters, both in the late 1950s and beyond. [Cole and Lyman, p. 81-82]

He also notes that:

... even as late as 1965, when exports, agriculture, and overall GNP were showing considerable progress, a Korean professor, not atypically. . .

characterized the period of the First Five-Year Plan as one of worsening inflation, income distribution, and unemployment.

Furthermore, even outsiders -- for example, consultants from the United States, were not hopeful about the potential of Korea's export sectors:

The Nathan Plan emphasized the expansion of primary production -- agriculture, fisheries, and mining -- to satisfy domestic demand and to meet minimum necessary export levels. It also projected extensive import-substitution to meet consumption and investment demands and to bring the import level down to roughly 10% of GNP by the end of the plan period. This move toward a more closed economy was deemed necessary because of the apparently limited prospects for boosting the export ratio above 10%. [Cole and Lyman, 1971, p. 209]

Twenty years later, during the mid- to late 1970s, policymakers and entrepreneurs had similar concerns about ^{the potential of} Turkey's exports to tackle world markets. Before the major export-oriented reforms were instituted, there was serious worry about the ability of the Turkish economy to produce enough for domestic consumption, let alone to export:

... structural problems [import controls, quality, and price] within Turkish industry are causing particular concern at present. [Hindle, The Banker, June 1978]

Later on, after the export drive had already begun, there remained considerable doubt:

The most hotly-debated subject in Turkey today is exporting. Can the country export its way out of trouble? ... Industrial exports have done badly -- for the first six months of 1978 they were actually down on the same period in the previous year and only accounted for 30% of the value of agricultural exports. [Hindle, The Banker, February 1979]

Thus, some of the fears about the inability to achieve export growth were more general in nature. Others, as highlighted in the following section, expressed fears and doubts about particular factors that could inhibit the growth of exports.

IV. AN EVALUATION OF EXPORT FEARS IN KOREA AND TURKEY

As suggested by the above sections, potential objections to a strategy of export-led growth are myriad, stemming both from the different economic interests threatened by the transition to such a strategy and from the uncertainty that seems to pervade international trade. Many of these objections, however, can be classified under the rubric of export "fears" -- reasons why, despite the adoption of reasonably "correct" exchange rate and import-liberalization policies, some policymakers and -- more central to this paper -- private-sector decisionmakers, might fear that an effort to redirect production toward external markets would not be worth the costs. Section IV groups fears of potential constraints on an export-led growth strategy into three categories: factors limiting **demand** for the developing country's exports; factors constraining exporters' willingness or ability to **supply** exports at prices that will make them competitive in international markets; and **institutional** factors serving as incentives or disincentives for firms to divert their energies toward exports. Within each of these categories, we focus on several individual factors that appear to be of particular importance. Although it does not attempt to gauge with any precision each factor's contribution to the success of expanding exports, this section may suggest difficulties that economies in transition may encounter on the road to export growth.

Obstacles in the first category, the **demand**-related factors, include: low income elasticities of demand for agricultural exports; insufficient growth in demand for traditional LDC exports; protectionist barriers around industrial-country markets; and a lack of LDC market ties with and knowledge of foreign

markets. Factors influencing **supply** of exportable goods include: unit labor costs and, implicitly, education and productivity levels of the workforce in the exportables sector; cost and availability of necessary foreign exchange and imported inputs; costs of capital and availability of financing for exporters; and price of heavily infrastructure-dependent services, such as transportation and utilities. Finally, among the **institutional** factors considered are the following: disincentives provided by export licensing or other export-related procedures; incentives or disincentives provided by the fiscal system, including taxes and tax rebates; and the government role in facilitating shifts into new foreign markets.

A. **Demand-related Factors**

1. **Low Income Elasticities of Demand for Traditional Exports.**

To push exports of primary commodities in the face of an inelastic and more or less stationary demand would not be a promising line of long-run development

-- R. Nurkse, 1959

As previously discussed, a number of the arguments against excessive reliance on an export-based growth strategy emphasize the low developed-country income elasticities of demand for traditional goods. Income elasticity of demand is defined as the ratio of the proportional changes in the quantity demanded of a good for a given proportional change in income. If this ratio is low -- more precisely, when it is less than unity -- then as world growth accelerates, total demand for income inelastic goods increases less rapidly than income. By holding growth of world demand for agricultural exports to relatively low levels, these low elasticities diminish the potential for an export-led growth strategy to

raise rapidly the national income, assuming that such a strategy is based on exports of food and other agricultural commodities.

The impact of reduced growth of world demand for a developing country's exports depends to some degree on the size of that country's exports relative to the world market. For a small country the effect may be negligible, particularly in the short run. Furthermore, income elasticity of demand is not constant over varying levels of income. Demand for many essential goods may be more income-elastic in lower-income countries than it is in industrialized countries. The extent to which a developing country can expand its trade with other LDCs may further reduce the impediment to export led growth caused by low income elasticity products. These mitigations notwithstanding, the fear of relying on revenue from the export of goods that face diminishing markets was expressed often both by academic export pessimists and policymakers. In discussing the use of devaluation to improve an LDC's balance of payments, representatives from the Central Bank of Turkey argued that "devaluation can not solve their (the LDCs') problems for the export goods of these countries are primary goods with low price and income elasticities of demand." [Turkish Central Bank Report p.13] 1979? biblio., p.1

And, while it is not clear that fear of income inelasticity was widely held by the business community, or that it motivated a high degree of industrial targeting in either Turkey or Korea, both countries did divert resources into more income-elastic sectors.

Korea. Prior to the initial export drive, food and crude materials accounted for 72% of Korean exports; manufactured goods made up 9.8% of the total. The two largest food exports were dried fish and swine. Crude materials exports which represented 51.3% of the total, comprised mainly tungsten ore (1.1%), iron ore (10%), raw silk (7%), and coal (5.4%).

Table 1. Korea: Income Elasticities and Export Composition

	Income Elasticities of Demand	% Total 1979	% Total 1981
Tungsten ore	n.a.	0,11	0,03
Dried fish	0.84*	0,07	0,01
Raw silk	-1.16*	0,07	0,05
Swine	3.1*	0,06	**
Textiles	0.93	0,02	0,15
Clothing	1.49	0,02	0,19
Wigs	n.a.	**	0,07
Footwear	1.26	**	0,03
Machinery	1.85	0,02	0,04
% of Total Exports		0,35	0,57

* See Appendix I

Sources: All income elasticities estimates from UNIDO Handbook of Industrial Statistics, except where indicated; Korea data from UN Yearbook of Industrial Statistics.

As Table 1 shows, by 1967 Korea had greatly increased the share of manufactured goods in its total exports. The increase in manufactured goods tended to raise the average income elasticity of demand for Korean exports. Clothing and textiles, both with higher income elasticities than some of Korea's dominant exports in the late 1950s, showed the strongest growth. Clothing, which was not included in the 1961 UN trade statistics data for Korea, accounted for 18.5% of total exports in 1967. Textile fabrics, principally regenerated fiber, and synthetic fabrics, made up 15.3% of total exports, and textile yarns accounted for another 11.4%. Altogether the textiles and clothing category made up roughly 45% of total exports. Crude materials dropped as a share of total exports to 18%, of which raw silk and tungsten ore were still the largest.

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Turkey. Similar trends occurred in Turkish exports. During the early 1980's the composition of Turkish exports changed dramatically. The shift away from traditional agricultural exports to manufactured goods may have been motivated in part by the unpromising elasticity of demand for traditional goods.

Table 2. Turkey: Income Elasticities and Export Composition

	Income Elasticities of Demand	Portion % Total 1979	1984? % Total 1981
Hazelnuts	0.63*	0.16	0.04
Cotton	0.41*	0.10	0.02
Tobacco	0.61	0.08	0.03
Dried fruit	n.a.	0.07	0.02
Textiles	0.93	0.17	0.26
Clothing	1.49	0.17	0.26
Processed apricots	n.a.	0.07	0.11
Iron/steel	1.6	0.01	0.08
Total Exports		0.66	0.56

*See Appendix I

Sources: All income elasticities estimates from UNIDO Handbook of Industrial Statistics, except where indicated; Turkey data, OECD Surveys, Turkey 1979-86;

In 1979, 59.4% of Turkish exports were non-processed agricultural goods; within this category, the most important items were hazelnuts, cotton, tobacco, and dried fruit. By 1981, the share of each of these products in total exports had fallen dramatically. Hazelnuts, for example, had dropped to 4.3% of total exports. Cotton fell even further, to 2.4%, although some of the decline may have represented diversion into domestically produced cotton textiles and clothing over the same period.

As the share of total exports made up by traditional goods began to decline, exports of manufactured goods rose rapidly. In 1984, manufactured goods

double
since 42%
as shown
in
Table 2

accounted for 72% of all exports. As is clear from Table 2, the products which grew to dominate Turkey's exports tended to have higher income elasticities than those which had been important in the late 1970s. Thus, while Turkey did export primarily income-inelastic goods at the time of the initial large devaluation, this seems to have been neither a hindrance to export growth nor a difficult condition to alter. The Turkish government does not appear to have explicitly promoted income-elastic industries. To the extent, however, that manufactured goods tend to have higher income elasticities than agricultural goods, the government's encouragement of the industrial sector indirectly increased the average income elasticity of Turkey's exports. More generally, the shift was probably motivated more explicitly by a desire to move into industries with greater value added.

Policies designed specifically to promote income-elastic goods were not articulated in either Korea or Turkey at the time of its export drive. The growth of higher-elasticity products in both countries in spite of the lack of any clear policy diminishes the potency of the argument that elasticities pose a lasting threat to export-led growth. Nevertheless, for countries that are less likely to see a rapid expansion of their industrial sectors, income elasticities may prove to be more of a problem.

While low income elasticities of demand for primary export products may or may not have threatened the stability of export growth in Turkey and Korea, heavy dependence on a small number of commodities may make an economy vulnerable to external shocks. The expansion of the manufacturing sectors in both countries provided an important balance to agricultural specialization. Within this broad expansion, the substantial growth in the number of products exported by both countries further insulated their economies from unfavorable trends. Leaving aside textiles, the next six largest commodities made up only 39% of Turkey's total exports in 1984. In 1979, also discounting textiles, the top six

commodities accounted for 54% of total exports. Korea nearly doubled the number of specified export commodities between the years 1961 and 1967.

2. Insufficient Growth in World Demand for Exports.

The present world economic situation is characterized by a slow pace of economic advance in most countries, which is expected to weaken further in the coming months, particularly in developed market economies [T]he growth results of 1979 appear to confirm that the world economy is passing through a period of lower economic growth.

-- United Nations, 1979

Fears such as these are largely absent from the Korean literature, as the years immediately preceding Korea's export drive were considerably more bouyant ones for the world economy. But during the 1970s, the decade before Turkey's export expansion drive, oil shocks and the resulting stagflation slowed growth in the industrialized countries -- particularly the United States. Economic agents both inside and outside Turkey in 1980 expressed the fear that excessively slow industrial-country growth might prove a severe constraint on export growth. The extent of the concern over stagnation in the industrial economies is evident from remarks made by the Central Bank Board of Governors. In the 1979 Annual Report to its shareholders, the Central Bank summarized economic conditions as follows:

. . . when compared with the previous decade, considerable decreases in production, excessive unemployment, and high inflation rates constituted the most evident features of the economies of western industrialized countries in the 1970-1979 period.

They continue to articulate the perceived relationship between slow economic growth in the west and stagnation in the LDCs. Of particular interest is the statement that the channel for this effect is trade; the reliance on trade with

developed countries implicitly makes a developing economy vulnerable to economic downturns in those countries:

The basic reason why developing countries are being severely affected by the crisis in industrialized countries is that a larger portion of their international economic relations continue to be with these developed countries . . . [F]or instance in the total volume of international trade of developing countries, the share of industrial countries was 81% whereas volume of trade among developing countries accounted for only 14%. [Turkish Central Bank]

The view that economic recovery in the industrialized economies would be slow to come and that the success of an export-led growth strategy depended on the adequate growth of these economies was supported by international agencies. The United Nations projected continued economic stagnation in the United States throughout the early 1980s. In the 1979-80 Economic Survey the Organization for Economic Cooperation and Development (OECD) made the following assertions:

Prospects for economic growth in the world economy in the immediate years ahead are generally expected to be somewhat gloomy . . . [N]egative, zero or very low rates of growth in production are expected and retarded growth is a likely prospect for the developing market economies.

Both the United Nations and the OECD supported the connection between recovery in the industrialized countries and accelerated economic growth in the developing countries. One United Nations document, for example, reported that "the lower rate of economic expansion in the developed market economies has had dampening effects on the growth processes of other country groups via its impact on the expansion of world trade (1979 World Survey, p.13). OECD analysts stated more specifically that the export promotion policies adopted by Turkey in early 1980, while important corrective steps, might not succeed without an improved

growth rate in the west. They expressed the following doubts about Turkey's ability to expand exports:

[I]t is difficult to judge how quickly exports will respond. There are examples from other marginal exporters that exchange rate adjustment and restrictive demand management can lead to a marked and quick increase in exports. But weaker growth of world trade is an unfavourable factor ... developing an adequate export volume is not only a question of an appropriate exchange rate, which whilst providing an economic incentive, cannot by itself provide the new export markets that Turkey needs [OECD Economic Survey, Turkey, p.30].

Turkey differs from Korea in that it attempted an export drive during a period of greater economic uncertainty and of contraction in the industrialized countries. While the 1980s proved to be more expansionary than was projected, fears about both the level of growth likely to occur in the industrialized countries and the advisability of increasing Turkey's interaction and dependence on these economies may have motivated the substantial diversification of Turkey's trading partners. Turkish diversification may have been particularly beneficial, in that they expanded primarily into markets in the oil-exporting Middle East, a region whose growth in the 1970s and early 1980s seemed likely to be somewhat negatively correlated with that of Turkey's other trading partners.

3. Protectionism in the Industrial World.

Another negative factor for developing countries stemming from the weakening mechanism of the adjustment process, is the spreading tendency towards protectionism in industrialized countries.

-- Central Bank, Turkey, 1980

Some policymakers in Korea and Turkey also worried that, even if natural import growth should prove to be sufficiently rapid to allow export-led growth to succeed, success in exporting would sow the seeds of its own unravelling, as industrialized-country governments would respond by levying tariff barriers against exports from our two developing country case studies. Alternatively, protectionism could occur as a political response to the slowdown in economic growth envisioned in the statements above. The fear of protectionism applied both to traditional agricultural exports and to the exports of manufactured goods of which each country hoped to expand production. Again, the historical context dictated that this fear should be more prevalent in the case of Turkey, as policymakers in Istanbul made decisions concerning export-led growth in a period marked by a reversal of the previous trend toward liberalization of industrialized-country markets -- a trend from which Korea had already benefitted greatly.

Korea. Korea could afford to be relatively sanguine about the possibility of encountering severe protectionist constraints when it launched its export drive in the early 1960s. At that time, a series of GATT negotiations (the Dillon Round, 1960-62, and the Kennedy Round 1962-67) was underway, and the industrialized countries seemed committed to the idea of liberalizing trade among themselves and with the developing nations. The Kennedy Round of multilateral negotiations was particularly important, as it resulted in an across-the-board tariff cut of 35% on 60,000 products. The context was thus a relatively optimistic one: as Robert Gilpin describes it:

[t]he growing network of international trade began to enmesh national economies in a system of economic interdependence and (led) some observers to speculate that a tightly integrated world economy was inexorably emerging. [Gilpin, p. 192]

source?

According to GATT statistics, the average tariff levels in industrialized countries ~~was~~ ^{were} fairly low in 1973: 2% on raw materials, 8% on semi-finished manufactures, and 9.8% on finished manufactures [World Bank, World Development Report 1978]. In the early 1970s, the US and some of the other industrial nations had even adopted the Generalized System of Preferences (GSPs), which "lowered the duties on a number of LDC exports in manufactured products, and it was generally assumed that the less developed countries would benefit from measures that ensured a stable growth of world trade" [Gilpin 1987, pp. 196-97].

In the mid-1970s, however, the free-trade momentum of the postwar regime began to falter. Non-tariff barriers became increasingly prevalent, and the perpetual problem of tightly protected agricultural trade remained unsolved. Typical of this period was one writer's warning that:

between 1974 and 1975, 3-5% of world trade previously affected only by tariffs became subject to overt restrictions. The main categories were textiles and clothing, steel, ships, and certain light engineering sectors The risk of a general retreat into widespread protectionism, as occurred in the inter-war years, is probably small although not negligible The principal danger then is one of continued creeping protectionism rather than a major collapse of free trade. [Calverly, 1982]

Moreover, several of the developed nations now placed increasing pressure on the industrializing countries to open up their markets and remove protectionist barriers.

The Turkish economy made its shift from inward- to outward-oriented economic strategies during a particularly delicate period. Unlike Korea, it faced a world in which industrial-nation protectionism was probably growing. Many feared that its export-driven strategy would therefore make it highly vulnerable to external fluctuations, which at the time seemed a very valid fear. Why, then, did the Turkish government feel that the risk was worth taking, and how did they

overcome the constraint of world protectionism? One suggestion is that the government realized that, by diversifying both the type and destination of its exports, it could diminish its dependence on any one trade partner, and therefore its overall risk. An academic statement of this position follows:

The greater diversity of export items implies in development terms that the relative stagnation of world demand for some exports can be balanced, or outweighed, by the more dynamic demand for others. In other words, the wider the range of commodities in the export basket, the better the prospect of expanding export earnings, even in the face of unfavorable market conditions [Choi, p. 94].

Another explanation is that the Turkish government felt that:

[A]lthough this [outward-oriented growth] is vulnerable to external shocks, it has proved to be a better option than to look inward. It enables the country to exploit international economic opportunities, to overcome the limitations of the domestic market and to benefit from the stimulus associated with greater exposure to foreign competition. [Whitehill, p. 36].

Turkey both expanded the number of its export commodities and explored new product markets, particularly in the Middle East, taking advantage of the vacuum resulting from the Iranian Revolution in 1979 and the increased demand produced by the Iran-Iraq war. This strategy, which is discussed in greater detail in the following section, may have helped Turkey to avoid some of the strains and protectionist pressures that a program of rapid growth of sales to a single export market might have engendered.

4. Lack of Ties with Potential Markets

The other essential element of any serious export drive is an improvement in the quality control packaging and marketing of Turkish products. The absence of foreign influence and competition

here is particularly evident. Examples abound. The best of Turkish wines is very good but the percentage of poor-quality bottles is high. Turkish razor blades are extremely good - they cope with some of the toughest beards in Europe - but the packaging falls to bits too easily. And Turkey's presence in the arenas of international selling is all too rare.

-- The Banker, 1979

One obstacle to export-led growth raised by many critics concerns the necessity for a certain amount of marketing acumen in designing a strategy of export-led growth. Both critics and supporters of the export-promotion strategy recognized that its success would depend on prompt responses to shifts in preferences, prices, and products in the developed-country and other markets; such flexibility and market awareness would prove critical in the case of exports of manufactured goods, which demanded more of those qualities than did the export of traditional agricultural goods, such as hazelnuts.

Korea. The central export promotion agency in Korea during this period was the Ministry of Commerce and Industry, MCI, which collaborated in its work with other ministries -- including Foreign Affairs, Finance and Economic Planning -- and with the governmental export promotion institutions and organizations of private enterprise. Export promotion policy was framed through interactions among several groups, most notably MCI, the Korean Trade Promotion Corporation (KOTRA), and the Korean Traders' Association (KTA), all of which communicated often with one another. Thus, some of the leadership in export promotion was taken by governmental organizations, while private organizations played a supplementary role. The major task of KOTRA, formed in 1962 and a fully governmental institution until 1968, was to promote South Korean foreign trade through its head office in Seoul and several branch offices throughout the country. KOTRA's several dozen Trade Centers, scattered around the world, provided information about South Korean companies and products and

about commercial and investment opportunities for foreign companies in Korea. In addition, KOTRA worked to inform Korean exporters about foreign trade inquiries and overseas market conditions. The organization was assisted in its mission by diplomats: one of their primary goals became increasing Korean trade with the countries to which they were posted.

Two private groups also played a significant role in export promotion. The Korea Traders' Association, KTA, is a private organization founded in 1946 with offices throughout Korea and overseas offices in Tokyo, New York, Hong Kong, and Dusseldorf. KTA engaged in trade promotion activities of a more general nature, such as sending and receiving trade delegations, administering economic cooperative committees with certain countries, researching world market information concerning Korean industry and products, and contacting trade-promotion institutions and diplomats in other countries as a means of encouraging bilateral trade. The Korea Federation of Small Businesses (KFSB), founded in 1962, aimed to improve the competitive strength of small and medium-sized South Korean businesses both in the home market and internationally. To improve productivity and product quality, the KFSB promoted the modernization, and internationalization of its member companies.

It is widely thought that these private groups contributed substantially to the growth of Korean exports, by contributing to the progress in the diversification of its export commodities and trading foreign markets. According to Economic Planning Board data, Korea exported only some 100 different commodities in 1961, but by 1971, the number of types of items exported reached 983. With a wider range of export commodities, Korea had better prospects for expanding its export earnings, even in periods when world market conditions seemed unfavorable. Over the same period, 1961 to 1971, the number of countries trading with Korea rose from 25 countries to 108. [Choi, p.94] While the number of trading countries

did increase, however, most of Korea's exports went to the United States and Japan (approximately 60-75% of exports). The high percentage of exports to these two countries has been attributed to Korea's political and geographical ties with these countries and to the compatibility of its export commodities -- mainly sea products, minerals, textiles and clothing to Japan and mostly labor-intensive light manufactures such as textiles, clothing, wigs, plywood and shoes for the United States -- with the demands of those two customers.

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Table 3. Korea: Composition of Exports by Region and Major Country
of Destination (percent)

<i>Region and Country</i>	<u>1960</u>	<u>1965</u>	<u>1968</u>
Asia:	73	49	33.4
Japan	62	25	21.9
Hong Kong	8	6	3.2
Vietnam *	0	8	1.2
America:	11	37	55.1
United States	11	35	51.7
Europe:	13	12	8.0
Other:	3	2	3.5
TOTAL	100	100	100.0

* The exports to Vietnam do not include those financed with US economic and military assistance funds.

Source: Economic Planning Board, Major Economic Indicators, 1969.

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Turkey. During the 1960s and 1970s, the Turkish business community began to set up institutions and pressure groups, outside the framework of the mandatory Chambers of Commerce and Industry, in order to protect its interests at home and overseas. Such activity was in response to the strong role of the

government in Turkish society and the emergence of an outspoken trade union movement. The business associations that emerged included TISK, the Turkish Confederation of Employers' Associations, and TUSIAD, the Association of Turkish Businessmen and Industrialists, which is sponsored by a number of holding companies, other private companies, and banks, as well as various other financial and public relations organizations. TUSIAD's reports and studies served as a major source of information on the prospects and possibilities for the Turkish economy, particular sectors and local problems. Additionally, a group of firms, with foreign capital participation, set up YASED, the Foreign Capital Coordination Association. These organizations both encouraged government export initiatives and helped members to capitalize on the marketing opportunities offered them by policy changes. [Business International Research Report, 1983].

Turkey's overall expansion of exports was concurrent with a major change in the structure of exports, both in terms of its product composition and country destination. To a significant degree, the opening that led to these shifts was political. The Ozal government -- and earlier, the Demirel administration, with Ozal as deputy prime minister -- were quite solicitous of various Middle Eastern nations in the years immediately following the downfall of their neighbor, the Shah. The improved ties with these countries offered a window of opportunity to Turkish firms, as did the outbreak of the Iran-Iraq war. Marketing activities of the private-sector organizations helped exporters to take advantage of these openings, with particular successes coming in the fields of construction and heavy industry. There was a notable increase in the number of overseas contracts for construction, with Libya and Saudi Arabia among the principal clients. Industrial exports, which had made up 36% of total Turkish exports in 1980, had almost doubled by 1984, with an average annual growth of 50%. [The Banker,

August 1982] Over the same period, the total share of agricultural and livestock exports decreased from 57% to 25%. In terms of the composition of trading partners, exports to Middle Eastern countries increased by almost 54% each year on average, so that their share in Turkey's total exports grew from 17% in 1980 to approximately 40% over the 1981-1984 period. [The Middle East, 1985]

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**Table 4. Turkey: Composition of Exports by Region and Major Country
of Destination (percent)**
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	<u>1980</u>	<u>1983</u>	<u>1985</u>
Merchandise exports, f.o.b.	2,910	5,728	7,958
European Community	1,251	2,010	3,204
France	164	181	215
Germany, Fed. Rep. of	604	838	1,391
Italy	218	423	502
United Kingdom	105	247	539
Other countries	160	321	557
Middle East and North Africa	654	2,629	3,338
Iran, Islamic Rep. of	84	1,088	1,079
Iraq	135	320	961
Libya	60	184	59
Saudi Arabia	44	365	430
Other countries	430	672	809
United States	127	232	506
Japan	37	37	43
Switzerland	125	236	128
U.S.S.R.	169	89	100

Source: State Institute of Statistics.
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Table 5. Turkish Firms Active in Arab Countries

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<i>Country</i>	<u>1978</u>	<u>1980</u>	<u>1982</u>	<u>1984</u>
Libya	13	34	98	112
Saudi Arabia	4	13	79	129
Iraq	3	7	35	36
Jordan		2	11	12
United Arab Emirates	1	2	2	2
Kuwait			1	1
Egypt			1	1
Tunisia			1	1

A total of 223 Turkish firms were active abroad as of March 1985, 60 of them in more than one country.

Source: The Middle East, March 1985.

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B. Supply-related Factors

Much of the pessimism concerning the potentials of an export-led growth strategy focused quite correctly on relative costs: would the country be able to compete in export markets by providing export goods with the necessary combination of cost and quality? The answer to this question will virtually always be "yes," if the country is willing to accept a sufficiently great drop in its standard of living. Thus, a more correct phrasing would focus on the ability of the country's firms to sell to export markets as profitably as they do at home. In this section, we will examine the different components of the firm's costs, focusing on those that seemed to entail the most significant -- i.e., most widely held -- "export fears".

1. Labor Costs

[Referring to the industrial wage increases of 31% in 1977:] The increase reflects the strength of Turkish unions and constitutes one of the principal worries of industrialists. These fears that, coupled with low productivity, the high wages are eroding their main competitive advantage with their markets in the European Economic Community.

-- The Middle East, October 1977

Exporters in both countries felt acutely the need to restrain increases in labor costs, as such costs tend to be the major component of the cost of most export goods, and as their magnitude relative to that of competitor nations is taken as one of the primary indicators of an economy's ability to compete. Labor productivity is ultimately of greater importance than wage levels, of course, but because of data limitations, we will concentrate on labor costs, discussing only briefly the implications of these costs for productivity.

Korea. The level of wages at the start of Korea's export drive was very low relative to that of other economies, which was an asset from the point of view of the exporter, if not from that of the worker. In 1962, Korea's hourly wages in manufacturing industries averaged some \$0.115, as opposed to \$0.12 in Taiwan, \$0.34 in Japan, \$0.73 in West Germany, and an \$2.32 in the US [Choi, p. 92]. Furthermore, the workforce also tended to be very educated; an indicator of this is the 80% literacy level achieved by the early 1960s [Whitehill, p. 27]. Translated into productivity growth, the high level of education contributed to the ability of Korean exporters to produce at relatively low cost. Low wages alone, without reasonably high productivity, would have done little to spur export growth, but in Korea, "[t]he average annual increase in labor productivity from 1961-69 . . . was 12.8%, compared with 10.4% in Japan, 5.6% in Israel, and 3.5% in the US. An

index of labor productivity further illustrates the Korean manufacturing industry's comparative cost advantage. Unit labor cost decreased from a base index of 100 in 1960 to 53.5 in 1969. In Israel and the US the figures were 86.4 and 83.3, respectively" [Choi, p. 91]. The implication is that labor productivity was rising much faster than the wage level in Korea, and that this offset the large (91.3%) increase in nominal wages in Korea from 1962-70. This combination of low wages and growing labor productivity allowed exporters to produce profitably at low prices and thus gave Korea a considerable comparative advantage.

Rising productivity thus allowed both export growth and growth of wages in the export sector, a combination that belied the fears of the export pessimists. In the manufacturing sector, earnings per person-day, in won, rose steadily from 1957 to 1971, from 801 to 241 [Korean Statistical Yearbook] but remained low relative to wages in competitor economies. Continued growth in labor productivity was the key to keeping pace with rising wages. One element of this was long hours: average hours worked tended to be well above even the high figures reported in the Korea Statistical Yearbook. Another was probably training: the early 1960s saw a significant increase in the availability of semi-skilled manpower, made possible through short training courses [ITC/UN, p. 36].

Turkey. During the 1970s, Turkey too had the dubious advantage of wage levels that were low relative to those of its competitors, so that Turkey was often referred to as a "labor surplus" economy. As a foreign business publication noted midway through the initial export drive, "[o]ne international bank official working in Istanbul puts the cost of labor in Turkey at around one tenth of what it would be in Europe. By general agreement, labor costs are one area of considerable comparable advantage for Turkish industry." [Business International 1983, p. 69]

A major fear that the Turkish government did have to face, however, was the upward pressure of labor unions on wage levels. The strength of the unions had allowed them to achieve great gains in the past, so that Turkish workers had benefitted from minimum wage legislation since the 1930s. In the late 1970s, however, the effective take home pay was only 60% of the nominal wage, and real wages began to decline. In 1976, in response to falling real wages, the government and a confederation of unions vowed to keep the real purchasing power of urban industrial workers at the current level [World Bank 1980, pp. 140, 144]. Once it decided to orient its economy outward, in order to contain wage levels, the government suspended all union activity in the country, thereby defusing the pressure on wages. This method, while perhaps not exemplary, proved to be relatively effective in holding down wages over the period in question. Literacy levels in Turkey during the 1970s were low compared with Korea but strong relative to the non-NIC developing countries. About 55% of the population was literate in 1970, 64% in 1975, and 67% by 1980 [Turkey, State Institution of Statistics, 1980 and 1985]. Although nominal wage levels skyrocketed during the 1970s, from a base of 100 in 1970 to 594.9 in 1978, real wages remained fairly constant, reaching an index of only 105.9 by 1978 [Turkey, Social Insurance Institute Statistics].

2. Availability of Imported Inputs and Foreign Exchange

The size of industrial firms is small while such firms are too numerous. This form of industrial organization puts an upward pressure on the cost of industrial goods....the basic raw materials are overpriced according to world market prices. This too affects negatively the cost of production

-- TUSIAD, 1980

Most export industries depend to a significant degree on imported raw materials, capital goods, or intermediate inputs for production of export goods. Often, such goods and materials are either unavailable in sufficient quantities domestically -- as in the case of petroleum, for many countries -- or can be produced domestically only at relatively high prices. The latter case, of course, would not preclude an industry with sufficient protection from selling in the home market. If a government is committed to export promotion, however, it must be more concerned with the cost competitiveness of its export industries, which may depend largely both on the cost of imported inputs (see Section IV.C.2 for information on tariff rebates) and on the availability of foreign exchange to purchase those inputs. Because foreign exchange scarcity tends to be the immediate stimulus for a shift to an export-oriented development strategy, such availability will be an issue of great importance to exporters. Regular access to foreign exchange affects not only a firm's competitiveness, but also its ability to prove itself a stable supplier; if exports fall each time a foreign-exchange crisis precludes importing inputs, the exporter may find few buyers for its goods. This section thus describes the measures taken by the governments of Korea and Turkey to make adequate quantities of foreign exchange available to exporters. Readers will note a certain degree of overlap between this section and Section IV.C.2, which discusses the subsidy effects of tariff rebates to exporters. The distinction between the two, however, is that this section focuses on means of relaxing what are in effect foreign-exchange-imposed quotas on the importation of goods, while the later section is limited to tariff reductions or rebates.

Korea. Availability of imported raw materials has traditionally been an issue of particular importance in the Korean context, both in fact and in domestic perceptions. Government and business alike emphasize the relative meagerness of Korea's natural resource endowment, which consists of anthracite coal and

little else of consequence. In the early 1960s, keeping exporters supplied with imported inputs was thus essential for their success. A somewhat different problem demanded that exporters enjoy some access to cheap foreign intermediate inputs and capital goods. While these were often available from Korean manufacturers, their prices were seldom competitive with those prevailing in international markets. In late 1965, one Seoul National University study concluded, in examining a large sample of import-substituting industries, that median prices for intermediate and investment goods were 30 percent and 60 percent, respectively, above prices for comparable goods in world markets (cited in Brown, p. 170). Although the sample of firms on which the researchers based their conclusions may not have been very representative, it appears to yield at least some estimate of the degree to which tariffs and quantitative restrictions on inputs might have decreased the competitiveness of exports.

Measures to grant exporters access to imported inputs substantially predate the export drive of the early 1960s. As early as 1951, for example, the government implemented a system linking import approval to the amount a firm exported. Although this allowance was revoked in 1955, other policies linking exports and imports appeared over the next several years. From 1957 onwards, the government granted import licenses only to firms whose exports exceed a certain minimum level (Frank et al., p. 40). More relevant to this section is the September 1958 decision to allow exporters to keep all of their foreign exchange earnings, which they could then either use to purchase imported inputs or sell to other importing firms.

With the accession of the military regime, however, such incentives were expanded to become a key element of the export drive. President Park signalled his determination to gear imports toward production of exports in his first statement after the 1963 elections (Leudde-Neurath, p. 59), but his administration

had begun this shift even earlier. In early 1963, the government reinstated the system of retention of foreign exchange by exporters, which proved so well received initially that it was scaled back later in that year; the government subsequently allocated foreign exchange and granted import rights in proportion with each firm's net export earnings, rather than its gross earnings (Leudde-Neurath, p. 64). This incentive clearly provided an impetus for firms to export. In principle, this size of this impetus could be estimated as the differential between the price of foreign exchange thus allocated (the exchange rate of exporters) and the price of foreign exchange in the domestic market; in practice, researchers investigating Korean export incentives do not appear to have performed this calculation.

Other incentive schemes also stressed the linkage between exports and the right to import. In 1965, the government eased the guarantee requirements for imported inputs for export production, so that such imports now required prior bank guarantees equal only to 9.5% of the value of the goods, as opposed to the 100% requirement that applied to other importers. In 1966, the export-import link was extended to products that were not to be used as inputs, but sold directly to consumers. Exporters of chinaware, for example were granted the right to import porcelain for sale in the Korean domestic market. Although this scheme contained elements of a direct tax expenditure -- as eligible exporters paid no duty on the imports -- it was significant also as a means of using foreign-exchange allocations to promote exports.

Turkey. As with Korea, foreign-exchange incentives in Turkey met a need that stemmed from the deficit in the balance of payments and from the government attempts to allocate scarce foreign currency. Exporters frequently complained about the difficulties of purchasing vital inputs from abroad; an Istanbul Chamber of Commerce report from the mid-1970s, for example, argued

that "the difficulties confronted in fulfilling the raw material demands of export-oriented industries [had] caused a decrease in productivity and an increase in expenditures " (Journal of the ICC, p. 22). The problem of obtaining foreign exchange became acute in 1979, when severe balance-of-payments difficulties blocked the importation of many essential imported inputs, contributing to a slight decline in GNP for that year. [Milanovic, p. 1]

The Turkish government addressed this problem with part of its broader program of export incentives in 1980. Exporters holding "Export Incentive Certificates" from the Directorate of Incentives and Implementation (TUD, later TUB) were allowed to purchase foreign exchange from commercial banks, which would in turn receive reimbursement from the central bank. Initially -- until December 1983 -- exporters could claim foreign exchange in amounts up to 60% of the gross value of their exports; after that date, only 40%. Officially, requests for exchange in excess of the 60% limit required special authorization, and even then such firms would be allocated foreign currency commensurate with their net, rather than gross, earnings.

Again, calculating the value of this exchange to exporters requires venturing somewhat into the issue of tax policy. Section IV.C.2 discusses the subsidy value of rebates to exporters for import duties paid of inputs. This section deals with another type of relief from import duties: firms that obtained foreign exchange through the procedure described above could then use it to import duty-free inputs. The foreign-exchange subsidy thus had two components: the differential between the official exchange rate and the rate at which foreign exchange sold in the domestic market (the scarcity premium), and the value of the import duties that exporters did not have to pay. Milanovic does not attempt to calculate the former, as he notes that, because in 1982 it became illegal for firms to resell foreign exchange purchased through this method, assessing the value to

firms of this inexpensive foreign currency becomes more difficult after that year. Using the premium estimates that he provides, however, it is possible to obtain estimates for at least the potential subsidies available to exporters. We may do this by multiplying the foreign-exchange premium per dollar by the number of dollars of foreign exchange allotted per dollar earned (.60, for the period under consideration). This method yields the following estimates:

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Table 6. Foreign Exchange Allocation in Turkey: Subsidy Value

	<u>1980</u>	<u>1981</u>	<u>1982</u>
Estimated foreign-exchange premium (%)	12.0	7.0	4.5
Potential subsidy as proportion of export earnings (%)	7.2	4.2	2.7
Actual foreign exchange allocated as proportion of export earnings (%)	16.8	15.5	17.2
Subsidy value of premium as proportion of export earnings	2.0	1.1	0.8

Source: Calculated from Milanovic, pp. 42-45.

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Note that the second column refers only to the potential subsidy effect of the foreign-exchange allocation. Because these estimates do not use aggregate figures for the purchase of foreign currency, they do not properly gauge the extent to which firms took advantage of this opportunity. In fact, the actual subsidy amounts appear to have been somewhat lower than the potential suggested above. Aggregate foreign-exchange allocations as a proportion of exports held steady at around 15-17% through the 1980-82 period -- rather than at the 60% level assumed above -- before rising to 25% in 1983. The third and fourth columns above

incorporate these figures to yield more realistic estimates of the subsidy value of the foreign-exchange premium.

These calculations suggest that, in the aggregate, the foreign-exchange-premium subsidy probably was not a major component of the government's incentive package; compare, for example, the duty-exemption subsidy reported below. The subsidy may have been far more significant in individual export sectors, however; the metal products industry, in particular, received foreign-exchange allocations that exceeded total exports each year from 1981 to 1983 (Milanovic, p. 45).

Access to duty-free imports represented a more substantial subsidy. Had the duty rebates for imported inputs been assessed on the basis of actual tax paid by the firm, of course, this access would have been worth very little, as an increase in duty-free imports would simply have reduced the rebate for which the firm was eligible. (Strictly speaking, the value to the firm would have been positive, equalling the interest that would accrue on the the duty amount between the time of importation of the input and the time of receipt of the tax rebate, which would not take place until after the export of the final product.) But because firms were assigned ex ante to tax-rebate brackets, the duty-free option represented an additional subsidy. Using nominal rates of protection on inputs, Milanovic calculates the value of this subsidy at between 4.2% and 5.5 % of export earnings over the 1980-83 period (see Table below:). In 1984, the subsidy value was halved by the combined effects of the reduction in foreign exchange allocated and the 20% cut in tariff rates.

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Table 7. Duty-Free Import of Inputs in Korea: Subsidy Value

	<u>Subsidy Value</u> <u>% of Export</u> <u>Earnings</u>
1980	5.48%
1981	4.49%
1982	4.21%
1983	5.47%
1984	2.48%

Source: Milanovic, pp.42-45.

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3. Costs of Capital.

It is unrealistic to expect to be able to compete within the existing conditions, because even if the tariff barrier is removed, the Turkish economy will not be able to find the finances to buy goods.

-- TUSIAD, 1980

The cost of capital is clearly another major cost for potential exporters; in fact, these firms may face particularly acute needs for both short- and long-term loans. Reorientation and expansion of a firm or factory being prepared for export production will often require retooling or construction of entirely new facilities, and thus may require access to long-term capital. Export production may also increase the firm's need for short-term credits, as a result of increased production, marketing, transportation, and working capital requirements. In both Korea and Turkey, however, government intervention in the financial marketplace was extensive during the initial years of the export drive, with interest rates kept artificially low and credit thus made artificially scarce. The

fear of not being able to obtain sufficient capital through official channels -- or, alternatively, of being forced to borrow instead through expensive curb markets -- might have made potential exporters wary of risking an export push, in the absence of government assurances of relatively inexpensive access to credit.

Korea. In Korea, one of the key mechanisms for providing incentives to exporters was special access to credit, at subsidized rates of interest. Government planners justified the favorable treatment accorded to exporters by arguing that the subsidies countered potential cost advantages that would otherwise accrue to exporters from Hong Kong or Singapore, who benefitted from access to relatively free credit markets (Lim, p.31). In Korea, by contrast, government intervention in the credit market was widespread and distortionary. It exerted this control through three major means: (i) it was a major shareholder in domestic banks and could appoint managers, thus wielding effective control despite having transferred ownership to the private sector shortly before this period; (ii) it controlled the inflow of foreign credit, which was a very significant source of resources for the Korean private sector; and (iii) it set interest rates through the Ministry of Finance and the Bank of Korea (Brown, p. 160).

This interest-setting power provided a channel for subsidization of exporters. Over the early years of the export drive, the government increased subsidies to export firms both by lowering the relevant rate of interest and by expanding the amount of credit available to exporters. Through a series of reforms in 1962-63, the government lowered interest rates for exporters from 12.8% to 8%; over the same period, interest rates for other borrowers rose slightly, from 15.7% to 16%. Further reductions in 1965 and 1967 lowered the rate for exporters to 6% by the latter year. Concomitantly, the authorities expanded exporters' access to preferential loans. In mid-1964, exporters could obtain credits up to the value of 110 won per dollar of gross export earnings; in 1965, the

ratio rose to 200 won, although it was now granted per dollar of net export earnings; and in 1968, to 275 won. The total nominal subsidy level associated with preferential interest rates rose from some 290 million won in 1963 to over 6.8 billion won in 1968. Measured per dollar of export earnings, credit subsidies rose constantly over the mid-1960s, from 2.5 won in 1963 to 10.6 won five years later; in percentage terms, this translates into a rise from some 1.3% of export earnings (using the official exchange rate) to about 4.5% over the same period [Brown, p.134] Table 8 summarizes these effects:

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Table 8. Export Credit in Korea: Estimated Subsidy Levels

	<u>1963</u>	<u>1964</u>	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>
Nominal interest rate on export credits (% per year, avg.)	8.0	8.0	6.5	6.5	6.0	6.0
Credit subsidy per \$ of export earnings (won)	2.5	4.3	5.0	6.5	9.1	10.6
Credit subsidy as a proportion of total export earnings (%)	1.5	1.9	1.9	2.4	3.3	3.8
Real rate of interest, calculated using WPI (% per year, avg.)	-12.1	-28.1	-3.4	-2.5	-0.4	-2.9

Source: Calculated from Brown, pp. 134, 143; Lim, p. 32.

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Turkey. Turkish exporters have since 1968 benefitted from subsidized short-term credit to finance production, purchasing, and marketing needs. In 1980, the government expanded the export credit system to include medium- and long-term financing for investments in export industries (Yagci). As most of the

subsidized financing during the early years of the export drive was of the former type, however, this section will focus on the volume and subsidy content of short-term credits.

As with foreign exchange, the export incentive value of subsidized credits resides in the differential between the price of export credit -- i.e., the interest rate -- and the price of short-term credits elsewhere in the economy. The government contributed to this differential in four ways: (i) by providing credit at a lower basic rate of interest; (ii) by exempting exporters from the transaction tax, which for other borrowers was equivalent to 15% of the basic interest rate on non-subsidized credits; (iii) requiring a lower contribution to the Interest Rate Rebate Fund; and (iv) granting a subsidy to exporters through the IRRF, with the subsidy equal to 35% of the basic rate (Yagci). Table 9 below shows how this interest rate differential changed over the 1980-84 period. Initially at 23.3% in 1980, it rose to almost 30% in the following year, then declined gradually to 17% in 1984. A year later, the government eliminated subsidized export credits entirely.

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**Table 9. Export Credit in Turkey:
Interest Rates, Differentials, and Subsidy Element**

	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>
Effective nominal interest rate on export credits (% per year, avg.)	15.1	20.3	27.2	28.0	46.1
Effective nominal interest rate on other short-term credits (% per year, avg.)	38.1	50.2	47.5	46.9	63.1
Differential (subsidy element) (% per year, avg.)	23.3	29.9	20.3	18.9	17.0
Subsidy to manufacturing					

as % of value of manufactured exports	15.9	12.6	7.2	6.5	1.0
Effective real rate of interest on export credits (% per year, avg.)	-44.6	-12.8	+1.1	-1.8	-2.3

Source: Milanovic, pp. 29, 39.

Although the nominal value of export credits extended to exporters of manufactures increased rapidly between 1980 and 1983, it failed to grow as quickly as did exports themselves. This lagging trend, combined with the reduction in the interest rate differential, caused the subsidy value of export credits to decline each year from 1980 on. In that year, the subsidy embodied by export credits equalled nearly 16% of total exports, making it clearly the most important form of subsidy in that year. By 1984, however, the subsidy component of export credits had declined to about 1% of total export value. In that year, credits comprised quite a low percentage of total subsidies to exporters, who thus did not suffer severe withdrawal pains upon elimination of the credits in 1985.

As Table 9 above suggests, the differential between export and other credits was not the only subsidy component embodied in the export credits. To the extent that all short-term credit was available at below-market interest rates, exporters benefitted also from a second subsidy element in borrowing. In 1980, for example, while the interest-rate differential between export and other credits was 23.3 percentage points, exporters were actually paying a negative 44.6% effective interest rate on credits, and other borrowers were also paying a significantly negative rate. This general credit subsidy element declined rapidly, however, so that the effective interest rate had turned briefly positive by 1982. Moreover, as this form of subsidy affected all users of credit, it is not relevant as an incentive for firms to export rather than produce for the domestic market.

4. Transportation and Utilities Infrastructure.

On the subject of increasing the foreign competitive strength of the industry and its opening out, our committee adopted the opinion that the basic problem which is the consequence of developing an oligopolistic tendency turned to domestic demand, stems from inadequate transportation and communication...

-- Committee on Industry

Competitiveness of exports depends also on the level of infrastructure development within the developing country. Inadequate power or water utility networks may cause interruptions of service and delays in production, thus raising costs and threatening reliability of supply. Similarly, poor road, rail, and shipping infrastructure within the developing countries may make costs of transportation high, thereby diminishing the expected net return of export production for domestic firms. Although much data exists on Turkey's and Korea's infrastructure development during the relevant time periods (i.e., thousand kwh of power generated, train-km available, number of cargo ships on hand, etc.), little data was available on the costs of transportation and utilities. It would therefore be unwise to discuss each country's competitiveness in terms of the costs of infrastructure. Instead, this section will examine the infrastructure that was available at the time Turkey and Korea were beginning their export drives. Based on these analyses, we will attempt to evaluate whether or not the availability of these services was an actual constraint on the export sector, and hence whether or not it was a valid fear.

Korea. The division of Korea into North and South after World War II had highly significant implications for economic planners. Just as in the case of East and West Germany, the two Koreas were vastly different in terms of resources

and infrastructure. It was North Korea that had most of the natural resources, much of the plant and equipment left by the Japanese occupation, and control of several electrical power generation plants. Whereas before 1948, South Korea had received a third of its power from the North, all such transmission ceased by May 1948 [Korea Statistical Yearbook, 1961]; the vacuum left by northern sources of power would have been a problem for any manufacturers, whether or not they were exporters. The transportation network too had its underdeveloped, and "[a]t the beginning of this period (1961-72) . . . was one of the serious bottlenecks to growth in the Korean economy" [Hasan, 1976, p. 31]. The government raised growth targets to encompass heavy infrastructure expenditures in the Second Five-Year Plan; this move "was prompted in large part by experiencing the severe constraints of bottlenecks in key infrastructure areas, such as power and transportation." [Cole and Lyman, 1971, p. 207]

The government responded by investing heavily in electric power plants and coal mining, assuring sufficient domestic supplies of coal and electricity to meet the country's requirements for the first time in the postwar years [Cole and Lyman, 1971, p. 211] Railroads were also expanded, and the development of roads and coastal shipping was even more rapid, shifting freight traffic away from the railroads. [Hasan, 1976. p. 31] The costs of this expansion were very high, but

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Table 10. Korea: Expansion of Social Overhead Capital

	<u>Units</u>	<u>1961</u>	<u>1972</u>	<u>% increase</u>
Electric power generating facilities	000 kw	367	3,871	1,050
Freight cars	#	9,435	16,808	180
Highways	km	n.a.	655	n.a.
Port loading and loading facilities	000 metric tons	900	22,185	240
Railroads	km	4,630	5,507	120

Source: Hasan, p. 31.

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to some degree, they represented a roughly equivalent subsidy to all manufacturers. To give exporters an advantage relative to non-exporting manufacturers, the government provided export credits, reducing the costs of utilities and transportation. Beginning in 1958, discounts on railroad freight rates were given to exporting firms, and from 1965 on, such firms also received discounts on electricity rates [Lim, p. 20].

Turkey. In the Turkish economy, the inadequacy of transportation, communication, and utilities infrastructure was also a concern, but the problems had very different roots.

Energy. The adequate provision of energy has for years been a problem. Although Turkey's official energy policy has been to "meet the entire demand . . . by developing resources within Turkey, and to replace noncommercial energy

resources . . . ,” projections indicated that such a policy would be practically impossible to fulfill unless substantial additional resources were discovered. “Despite intensive efforts to develop indigenous resources, reliance on imported sources was expected to increase from 20% of total consumption in 1965 to over 60% by 1985 before the [then-] recent increases in oil prices. This policy will have to be reviewed now since Turkey will probably not be able to finance the cost of excessively large oil imports in the eighties.” [World Bank 1975, p. 235-36]

Furthermore, before it began its export drive, powercuts in Turkey were a daily bother, “sometimes lasting up to six hours [By 1983] only occasional and ‘accidental’ powercuts take place (A)ny firm wishing to set up in Turkey has to take note of the country’s serious deficit in energy.” [Business International, 1983, p. 68]

Communications. As of the late 1970s, “telephone and telex services (were) poor. During peak hours of the day, it (was) difficult to get a line. New telephone lines (were) in short supply, though it is possible to buy out an existing subscriber for between TL 50,000 and TL 250,000 Courier services (were) also undeveloped (Nevertheless, the) record of improvement over the past decade has been substantial” [Business International, 1983, p. 73-74].

Ports and Airports. “Turkish ports need improvements to meet efficiently the demands of growing traffic. There are shortcomings in equipment, availability of mechanical installations and speed of operation, harbor depths, length of wharves, and storage capacity. The airport infrastructure is (however), by and large, adequate. There is a program under way to equip Turkey’s major domestic and international airports with modern air control facilities. Only the important international airport, Yesilkoy in Istanbul, needs considerable extension and improvement to cope with future tourism and other international traffic” [World Bank 1975, pp. 265-66].

Roads and railroads. Turkey's large size and rugged terrain have rendered construction of the land/surface transport network difficult and costly During the past three decades, the transport system underwent basic

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Table 11. Turkey: Transportation Infrastructure

	1965	1967	1969	1971	1972
Railways					
- freight cars	19,980	20,249	20,744	20,496	21,392
Road network					
- Provincial roads	24,290	24,290	24,288	na	24,437
- Nat'l highways	11,530	11,808	14,532	na	18,879
Vessels					
- Cargo	na	34,463	390,963	430,863	645,012
- Oil tankers	na	169,516	250,516	301,516	336,644
Aircraft and carrying capacity					
- Freight	8	21	26		

Source: World Bank study, 1975, p. 451

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structural changes; and the emphasis on railway construction was replaced by a rapid expansion of the highway system" [World Bank 1985, p. 263].

"The Turkish State Railway (TCDD) network has remained substantially the same in the past twenty years at around 8,000 km except for a small extension in 1971 to connect Turkey with the Iranian railway system and the construction of a small line from Edirne to the Bulgarian border. ... The network also conforms poorly to the present pattern of main traffic flows. ... (t)rack maintenance has been largely neglected." [World Bank 1975, p. 263]

Government Response. To control the price of energy, the Turkish government administers the prices. Oil prices, for example, including local production, "are based on Persian Gulf posted prices plus transportation and taxes" [World Bank, 1975, p. 240] Also, wielding a strategy similar to that of used by Korea, the Turkish government allowed exporting companies to utilize export credits to cover transportation costs, "provided they guarantee to repatriate a certain amount of the proceeds of new operations" [TUSIAD, 1981, p. 204].

C. Institutional Factors

1. Governmental/Institutional Support

Reliance on economic planning up to micro levels and in administrative controls to realize planned targets and objectives need to be shed and replaced by greater reliance on market mechanisms and forces State intervention up to micro levels and needless administrative controls have all proved destructive rather than constructive. Price controls have now been waived and market forces have taken over.

-- TUSIAD, 1980

Institutional changes accompanying an announced shift to a strategy of export-led growth may contribute both to the credibility of the announcement and to the ease with which a firm can make its transition to production for the external market. Such institutional changes may be designed with several effects in mind: signalling, provision of public goods, and planning or direction of the economy. As a signal, far-reaching institutional change may demonstrate to potential exporters the seriousness of the government's intent to move to an outward-oriented strategy. In the provision of public goods, new organizations may often help address the lack of research and marketing acumen that impedes diversification into new products and markets. The government can often play an

important role here, primarily by encouraging and promoting research and exchange of information, improving trade ties with other countries and establishing marketing organizations to assist exporters. This role may have both practical and theoretical justifications: practically, state or joint state/business leadership in research, planning and marketing may provide a catalyst for exports and an indication of the government's seriousness in pursuing export growth; from a theoretical standpoint, the argument that information and marketing has certain public good characteristics provides a justification for a government role in establishing trade contacts abroad. As this section will discuss, the Korean and Turkish governments took a variety of steps to develop a more coordinated planning effort and a marketing presence in foreign countries. Finally, while the government's planning and direction role is less easy to characterize as a response to export fears, it almost certainly has some such effects other than those listed in the preceding sectors. In both cases, the new organizations shifted some of the loci of power toward groups or bureaucracies that supported a further expansion of export growth.

Korea. The outward-looking program on which Korea embarked in the 1960s prompted a central coordination of the industrialization and internationalization processes. Export promotion acquired a central role, as international demand was to be the engine of development and growth. In this context, therefore, boundaries between the government and the private sector needed to be flexible. While there was central planning and coordination, there was also a need for a certain degree of consensus with the private actors and their organizations.

The 1960s was a period of substantial institutional changes, among which active government involvement in economic planning was of primary importance. The key institutional changes and government policy measures

included a reform of the tax administration, the founding of the Export Promotion Council (KOTRA, discussed earlier), and very importantly, the creation of the Five-Year Plans implemented by the Economic Planning Board (EPB).

Planning Changes

A significant institutional policy development of this period was the rising influence of the EPB, which was founded in 1962. The EPB functioned as the main actor behind the government's heavy involvement in orchestrating the outward-oriented development strategies. Through the Five-Year Plans and the institutional organization of the Deputy Prime Minister (who also held the position of Minister of Economic Planning), the EPB acted as the main directional force of the Korean economy in the 1960s. The EPB not only created the long and short-range development plans, but was also involved in plan implementation, in resource allocation through its budget authority, and in regulation. Furthermore, the Deputy Prime Minister had direct coordinating influence on all ministries, due to the EPB's budget function, in addition to chairing the weekly meetings of the Economic Ministers' Council. Institutions such as the Korea Development Institute (KDI), a governmental economic research institute, and the Korean Advanced Institute of Science and Technology (KAIST), supplied basic information and policy proposals on which discussions and policy-making were based. Korean planners, therefore, sought information about changing demand conditions and sales opportunities abroad. With this information, they were able to calculate the resource needs for some industries on an annual (and sometimes monthly) basis.

An obvious question here is whether the planning had a beneficial effect on relations between government and the private sector, and whether it seems to have contributed to the growth of exports. Korea's early economic planning efforts (the Nathan Plan and the 1959 Three-Year Plan) did little to raise the

government's effectiveness. The Nathan Plan introduced the basic concept of overall planning to Korea, but the concept remained fairly abstract and irrelevant for government operations. Officials at the time (between 1953 and 1958) may have preferred to retain the flexibility of negotiating with aid donors and to avoid the constraints, commitments and possible rigidities of an economic plan. Korean planners involved in formulating the Three-Year Plan had no experience and little outside assistance with their work. Nevertheless, with the Nathan Plan and the Three Year Plan, at least a few government officials became exposed to the ideas, problems and purposes of planning and gained some experience. [Cole and Lyman]

Although the First Five-Year Plan did not present a well-defined set of economic policies, it at least set out a number of policy directions and provided the push for Korea's rapid growth. Unfortunately, however, despite the greater sophistication of the First Plan compared to the other plans and the greater potential for influencing government policies, the First Five-Year Plan was largely ignored (due to the poor performance of the economy during the first year of the Plan and the subsequent inflation) and the planning staff was not significantly involved in economic policy deliberations.

Thus, when work began on the Second Plan in 1964, planning was still not well-established or influential in the Korean government. In just over a year, however, planning and planners became an important part of the government's decision-making process.

What brought about this shift in attitudes? During the preparation of the Second Five-Year Plan, the quality of the statistical and analytical work in the models and projections had improved; many officials from all parts of the government actively participated in organizing the planning effort; foreign aid agencies supported and were involved with the plan formulation; and economic

actors began to realize that the plan was likely to have some longer-term influence on the budgetary and policy actions of the government. As a result, the business sector and various agencies in the government began to take the planning process more seriously.

Thus, the Second Plan did achieve an important influence on the Korean government by strengthening the political role of the government both at home and abroad. Where the Nathan Plan and the First Five-Year Plan were much criticized and resulted in much disagreement, the Second Plan generated more favorable reactions and greater recognition of and cooperation with the government. It helped gear the economy toward export production without setting targets that were beyond reach. If anything, the Plan confirmed the belief that more and better planning was necessary.

Other Institutional Changes

Another major institutional change for the 1960s, as noted earlier, was the founding of the Korean Trade Promotion Council (KOTRA). KOTRA was created to facilitate export strategies, marketing information, and business communications between the government and private sector interests. Beyond these tasks, the Council served two primary functions: to provide motivation and economic incentives for businessmen, workers, and the general public for promotion of the overall trade environment, and to provide a forum for discussion and debate of complaints and concerns of local businessmen about exports and customs procedures. As noted in an earlier section, KOTRA played a key role in expanding the number of Korea's export commodities and trading partners.

Another important institutional change in the government's drive to promote export growth and outward-looking development was an overhaul of the domestic tax administration. To minimize price distortions stemming from

inflation and to increase government savings, the government proceeded to eliminate budgetary deficits by reforming the tax administration. In 1966, a new National Tax Administration was created under the Ministry of Finance, with expanded responsibilities of tax scheduling, auditing, direct tax collection, and implementation of substantial penalties and fines for delinquent businesses. As a result of these significant powers of tax collection and penalties, the tax administration in Korea developed into an important system which helped the government finance the ambitious development programs which had been started in the 1960s.

Export promotion in Korea, therefore, involved extensive cooperation in economic analysis, research, and planning. The South Korean model of planning and export promotion is based on much information being available and regularly discussed at expert meetings attended by the representatives of important organizations described in earlier sections and at meetings between senior MCI officials and big trading houses.

Turkey. The principal objectives of the Turkish authorities at the time of the economic stabilization program of early 1980 were to reduce the number of direct government controls and to introduce instruments which would emphasize indirect demand management policies. Policies were to be more market-oriented, encouraging competition and greater development of private initiative; and foreign investment would now be permitted in areas that had been closed to it in the past. The implicit philosophy, therefore, was that "the government, rather than be interventionist, would lay down trade guidelines, look after the interests of all groups, and rely on the dynamism of the private businesses." [TUSIAD, 1980, p. 78]

As in Korea in the 1960s, this far-reaching Turkish program necessitated a number of organizational and institutional changes. To facilitate and coordinate

economic policymaking and implementation, two specific committees and two new departments in the Prime Minister's office were created. Among the specific changes were the following.

Administratively, all authority for the promotion of exports was under the "Directorate of Incentives and Implementation" (TUD, Tesvik ve Uygulama Dairesi) within the State Planning Organization. [World Bank] In particular, under the chairmanship of the Under-Secretary of the State Planning Organization, senior officials of the Ministries of Finance, Commerce, Industry and Technology, Energy, Foreign Affairs, and the Central Bank were members of the Coordination Committee. Their responsibilities were to coordinate policies related to development plans and annual programs, to prepare import and export regimes, and to coordinate economic relations with other countries and international organizations.

The Money and Credit Committee, chaired by the Under-Secretary of the Prime Ministry, was composed of the Under-Secretaries of the Ministries of Finance and Commerce, the Governor of the Central Bank, and senior officials of the State Planning Organization. The Committee's role was to coordinate money and credit policies, to ensure that credit allocations to users followed the general principles of monetary policy; and to undertake studies related to support price policies. As evidence of the government's determination to allow a freer role to the market, the Price Control Committee, which had been established in 1978, was abolished.

At the same time, a Department of Foreign Investment was created to smooth the foreign-investment application process. Previously, several governmental bodies (Ministries of Finance, Industry, Commerce and the State Planning Organization) had all been involved in this process.

Lastly, under the new 1980 economic program, all authorities on matters related to imports (such as issuing licenses, shifting items among different lists, changing tariffs, and granting the right to purchase foreign exchange), previously scattered among various ministries and the Central Bank, ~~were~~ were centralized into a newly formed Under-Secretariat under the Deputy Prime Minister. The main task of the new Investment and Export Promotion and Implementation Department, therefore, was to simplify government regulations concerning investment incentives and rules with respect to exports.

While it is difficult to measure with any precision the contribution of such institutional and organizational reforms to the growth of Turkey's economy, they did have an important influence on government and business activities. As with Korea's planning efforts, Turkey's institutional changes may have sent a signal about the government's firm and sincere commitment to this outward-oriented strategy not only to the private sector but to foreign markets as well.

2. Export procedures.

. . . . [I]t might have been expected that there would have been a further expansion of these sales [T]hat this has not happened seems to indicate that the lack of marketing know-how and institutional factors, such as extensive red tape in respect of administrative export procedures may still be substantial obstacles to Turkish industrial exports.

- OECD, 1975

Government was not seen by potential exporters in either country as solely an ally in their efforts to enter foreign markets profitably. Among the obstacles to export growth mentioned often by the business community was what they saw as the unnecessary complexity of export procedures. In both countries, entrepreneurs were hampered, before the shift in policy, by a web of

administrative requirements, clearances, and licensing arrangements that they had to endure if they wished to export. Similarly, the ability to streamline, implement, and successfully manage export requirements is often hampered by bureaucracy, and in this sense could be an "export fear" from the viewpoint of policymakers. Simplification of these procedures may be a necessary precondition for the dramatic export growth envisioned by an outward-oriented development strategy. This section discusses regulations affecting exporters, as well as the degree to which export-oriented reforms were able to simplify these procedures.

Although criticism of export procedures does not in itself constitute a "fear" -- as these procedures can theoretically be altered with ease by the government -- the policymakers' ability to streamline the process can sometimes be limited by managerial capability and bureaucratic inertia. In both Korea and Turkey, the simplification and consolidation of steps that potential exporters had to take to enter the market was instrumental to the success of its export drive. Before the changes took place, there was great uncertainty of property rights, some measure of corruption and bribery, complicated exporting procedures, and few incentives for potential exporters. In reforming procedures and adding incentives, the governments to an extent also took care of the first two problems.

Korea. In the pre-reform period, the Korean government "had nearly monopolized the distribution of financial credit and intervened often in the marketplace As a result many government economists were lobbying for freer markets and less government control, and the Chun administration had pledged to liberalize the economic system in the future Closely related to this issue was the problem of business accountability. Some citizens suspected the nation's businessmen of corruption and the accumulation of excess profits Thus if business was to receive a freer reign in the marketplace, the government

might find it necessary to reform and monitor private enterprise" [Bunge p. 110]. By the mid-1960s, exporters operated under a regime that closely approximated free-market conditions, in some characteristics. Thus, "[t]he reforms wiped out most of these modes [of rent-seeking activity] and brought the relative private profitability of different activities more nearly in line with their relative social profitability" [WRP, p. 12]. Throughout the 1960s export promotion institutions and arrangements of varying power were established. Among them were the Export-Import Bank, a system of general trading companies and exporters associations, and the Korea Trade Promotion Corporation (KOTRA).

Beginning in 1953, trade licensing had been based on export performance. In 1965, this practice of giving preference to exporters in the granting of import licenses was expanded and formalized. Exporters were given the automatic right to import raw materials duty free up to certain limits [Frank et al., p. 50]. Bank of Korea documents from the 1960s explicitly state the Korean government's goal to simplify export procedures. Some examples from the Bank's 1968 report include: "(I)n order to simplify export procedures, the following measures were newly adopted during the year: a) The Ministry of Commerce and Industry (MCI) ... adopted a system by which an item valued at 500 dollars or less could be exported by post without the requirement of an export license; b) . . . the MCI (enabled) the foreign exchange banks to approve exports [in certain circumstances]; c) . . . procedures to clear through the competent institutions were simplified . . . (and) approval of exceptional export and import transactions was delegated to the respective customs houses" [Bank of Korea, 1968, p. 124]. In the same vein, KOTRA literature from the same period notes that only a few documents were required to apply for export approval.

Many imported inputs were on an automatic approval list early in the export drive, which meant that, to import those items, the businessperson needed

only to apply for authorization to a foreign-exchange bank. Only if the item was import-restricted did he or she have to obtain a recommendation from the relevant agency before applying for approval through a bank [KOTRA 1985, p. 45-46]. Through the years, the automatic-approval list was gradually expanded, and during the late sixties the rule was reversed: only items that were on the exemption list had to be approved, thereby making it much easier on potential exporters. While this change may initially have been more cosmetic than substantive -- in that bureaucrats could easily list on the negative list all items that had not been on the positive list before -- in fact, the shift from a positive to a negative list system probably had both psychological and practical implications for the freedom of export firms to obtain need imported inputs.

Turkey. In Turkey, the "excessiveness and dispersement of administrative procedures" [Doganca] was often cited as a factor discouraging potential exporters. A foreign business group reported that even after the start of the export drive that "Turkish officials feel anything that is not specifically permitted by law is forbidden In times when less political unanimity prevails than at present, a government minister or high official can block what ought to be a routine approval. A streamlining of these procedures and more explicit legal guarantees than exist at present would prevent some of the difficulties that drove some firms out of Turkey in the 1970s" [Business International, 1983, p. 65].

As one of its reforms, the government moved to simplify export procedures; the reforms to the export credit system serve as a good example of this simplification: "1) One single set of formalities will be applied to export credits of all kinds, with no differentiation as between credits-on-export licenses 2) No certificate from any authority or agency will be required for these credits to be utilized. 3) For such credits, no export pledges will be required 7) No discount rate will be set in advance for the banks. It appears that Turkish

exporters are still operating under a "positive system" (automatic approval of items on the list) rather than a "negative system" (automatic approval of items not on the list) such as Korea's. "Exporters will submit an export project to the department [for promotion and implementation of the Prime Ministry]. If the project is approved it will receive an Export Promotion Certificate" [Demirgil, 1980, p. 43].

A 1983 report by Business International lists the following as the most important reforms for each year: 1980: 1) a Department of Investment and Export Promotion and Complementation was created; and 2) industrial goods could now be exported without a license to most countries, in order to allow exporters to respond quickly to prices; 1981: 1) most Turkish agricultural products were to be exempted from customs charges after 1985; 1982: 1) the number of items requiring an export license is reduced from 25 to two: tobacco and opium; and 2) the number of items subject to registration is reduced from 40 to 30. While these reforms do not represent the creation of a free-market regime in trade, they do suggest significant strides in the direction of simplification of export procedures.

3. Tax Policies. In both Korea and Turkey, the ability of government to use selective tax policies proved an important tool in altering the incentives of industrialists and redirecting their efforts toward world markets. Theoretically, government tax policies may either help or hinder an export drive. If the national tax base is so narrow that the government must raise much of its revenues from taxes on exports, then tax policies may lead industrialists to eschew exports in favor of production for the domestic market. Furthermore, in the absence of tax incentives for exporters, the bias in the government policy mix -- exchange-rate and fiscal policy, for example -- may tend to have the same inward-directing effect on production. Finally, tariff policy may restrain an export drive: exporters that

are forced to pay duties on imported inputs will usually compete at a cost disadvantage in international markets, as many exporters based in other countries benefit from tariff exemption or duty drawback schemes.

Korea. The more important Korean tax concessions date from 1965, when they were introduced as part of an eclectic package of export incentives marking the government's decision to enter the export promotion game in earnest. This is not to say that no such incentives had been available earlier: the government had in fact been offering exporters tariff exemptions on imports of raw materials and spare parts since 1959 -- even before the fall of the generally inward-oriented Rhee regime -- and other exemptions from direct and indirect taxes since 1961, when the military government acceded to power. Nevertheless, the flurry of tax incentives granted or broadened in 1965-66 dwarfed the earlier attempts to tax policy for export promotion. Among those incentives were the following [Brown, p. 140]:

- Wastage allowance subsidies -- In addition to allowing exporters to import quantities of raw materials and intermediate goods necessary for export production, the government in 1965 granted export firms liberal "wastage" or "material loss" allowances, thus permitting such firms access to additional duty-free imports. Exporters had the legal right to resell these imported goods on the domestic market, which provided an additional financial incentive. Because such imports were often covered not only by tariffs but also by quantitative restrictions, they tended to command a hefty premium over world prices; this premium thus added directly to the exporters' profits. Although estimating the exact value of this privilege to exporters is difficult, one attempt suggests that between 1965 and 1966, domestic sales of "waste materials" increased from an average of some 5.0 won per dollar of export earnings to 26.0 won per dollar (Brown, p. 142). By 1966, wastage allowances were thus the single most important non-credit element of the government subsidy package.

- Income tax exemptions -- Direct tax exemptions were expanded in 1965, as the government announced new exemptions from taxes on income earned on new or expanded exports.

- Export-import link -- The government in 1966 reinstated the export-import link system that had been in effect intermittently since the early 1950s. This system, as described earlier, allowed export firms or industries exclusive rights to the duty-free import of certain commodities. Unlike the wastage allowance or raw material provisions noted above, imports under this provision were not even ostensibly connected with the export production process. Instead, they were pure subsidy, in effect allowing export firms to usurp the government's power to collect tariffs.

- Accelerated depreciation -- From 1966 on, exporters were entitled to accelerated depreciation on investments on plant and equipment for export production, as well as on agricultural land improvements used for the same purpose.

- Tariff exemptions for capital equipment -- While raw materials and intermediate inputs had been exempt from customs duties for several years, only in 1966 was this exemption extended to capital equipment used in the production of exports.

Overall, suggests one estimate, the combined value of tax and waste subsidies may have increased from 8.2 won per dollar of export earnings in 1964 to 17.6 won in 1965 and 40.7 won in 1966. Adding customs exemptions to this total yields estimates for 1964-66 of 15.6 won, 29.6 won, and 56.3 won, respectively, per dollar of export earnings (Brown, 1973). Another estimate, which seems to exclude wastage allowances, sets the tax subsidy level at 31.6 won per export dollar in 1965 and 41.4 won in 1966 [Frank et al., p.66]. Although the Korean government devalued the currency significantly over this period, the growth in tax-related export incentives exceeded the pace of devaluation. Thus, while tax-related incentives represented only 5.5% of export earnings in 1964, the proportion climbed rapidly to 9.7% in 1965 and a highly significant 17.4% in the next year (calculated from Brown). Nor did this prove to be a temporary surge in government support for exporters: in 1970, tax incentives as a percentage of export earnings were considerably higher than they had been in 1966 (calculated from Frank et al.).

256 won = \$1

272 won = \$1 *271 won = \$1*

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**Table 12. Tax Rebates and Exemptions in Korea:
Amounts and Estimated Subsidy Values**

	<u>1963</u>	<u>1964</u>	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>
Subsidy per dollar of export earnings (won)	11.8	15.6	29.6	56.3	60.4	71.2
Tax rebates	1.9	3.2	12.6	14.7	16.2	18.8
Sale of waste material	5.0	5.0	5.0	26.0	27.0	27.0
Customs	4.9	7.4	12.0	15.6	17.2	25.4
Total tax subsidy as a proportion of export earnings (%)	6.9	6.7	11.2	20.8	22.3	25.7
Total tax relief not including wastage allowances (millions of won)	n.a.	n.a.	2,838	5,021	7,724	11,127

n.a. = not available

Source: Calculated from Brown, p. 134, 142; Frank et al, p. 66.

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Turkey. As in the Korean tax case, tax incentives played an important role in the Turkish government's drive to increase exports in 1980-85. Tax incentives in Turkey have primarily taken two forms: rebates of indirect taxes on inputs and exemptions from direct taxes. As the latter are allocated by province, no centralized data exists for them, and these exemptions were thus excluded from the World Bank study that provides most of the material for this section (Milanovic, p. 10). Extensive data is available for the indirect tax rebates, however, so that it may serve as the basis for this section's analysis.

Rebates for the indirect taxes paid on inputs for exported goods long predate Turkey's export drive of the early 1980s. The rationale behind this policy was simple: as in many other countries, government planners felt that such rebates were necessary to allow them to compete on an equal footing in international markets. Initially, in 1963, each firm was assigned an appropriate rebate level, but the system was later simplified, and from 1975 forward every export item was assigned to one of ten lists, with industrial sectors categorized according to their taxed-input content and a commensurate tax rebate level assigned to each list. Although they were scaled back briefly after the 1979 devaluation of the Turkish lira, rebate levels were raised again in May 1981. Sectors with the most "tax-intensive" inputs received rebates equal to 20% of export value, while sectors on the lowest list earned no rebates.

Analyses of the subsidy effects of these policies have generally suggested that, while precise firm-level data on tax content of output is not available, the 1980 rebate levels may be used as a proxy, on the assumption that -- as the government had recently been forced by fiscal stringency to reduce them -- these levels roughly approximated the rebates necessary to compensate exporters for indirect taxes (IBRD, Milanovic). If this assumption holds, then only subsequent increases in rebate levels reflect actual subsidies to exporters. This approach is considerably more conservative than the approach used by researchers cited in the Korea section above. It may also be a more accurate portrayal of the incentives that exporters face, however, although any analysis interested in the fiscal effects of incentives would have to include the full amount of the rebates. Moreover, to the extent that exporters would have been able to pass indirect taxes on to consumers domestically, even the "level-playing-field" 1980 rebate levels include some amount of subsidy -- that is, some incentive for exporters to forego the domestic market in favor of export markets [Milanovic].

In the years following 1980, the Turkish government was able to provide added incentives to exporters through the rebate system in either of two ways: by raising the actual rebate rates for eligible exports, or by expanding the list of exports eligible for rebates. Exporters of manufactured goods themselves could raise aggregate rebate levels by shifting into higher-rebate industries, as seems to have occurred throughout the early 1980s. As a result of the latter two effects, according to Milanovic, the share of eligible exports in total exports expanded from 60.7% in 1980 to 86.8% in 1984.

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Table 13. Tax Rebates and Exemptions in Turkey:
Coverage, Amount, and Subsidy Value

	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>
Tax rebate as proportion of value of eligible exports (%)	9.2	14.3	21.1	22.7	21.0
"Coverage": share of eligible exports in total exports (%)	60.7	66.0	78.7	80.4	86.8
Estimated subsidy component (% of export volume)	0.0	3.6	10.1	11.5	11.1

Source: Milanovic, pp. 18-20, 24.

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Over much of the same period, the government also raised the average tax rebate for eligible exports, at first raising it dramatically -- from 9% of export value in 1980 to 14% in 1981 and 21% in 1982 -- and then holding it roughly steady for the next two years. As a result, the "incentive value" or subsidy content of the tax rebates increased steadily, from 3.6% of Turkey's export value in 1981 to 11.1% in 1984. The final year shows an increase in incentive value despite the slight

decline in rebate rates, largely as a result of the expanded coverage and the shift toward high-rebate items, but also in part because the advance announcement of the rebate cuts encouraged exporters to ship their goods while the higher levels still applied (Milanovic, pp. 23-4).

These figures suggest that the indirect tax rebate program provided a significant and growing impetus to exports through the early 1980s. In fact, given the ability of exporters to pass on some of their indirect taxes domestically, the above estimates almost certainly understate the true magnitude of the stimulus. Furthermore, as the government was able to discriminate on a list-by-list basis, certain export sectors benefitted more from the rebates than is suggested by the averages. Merely examining the average tax rebate for eligible exports in a sector does not yield a valid measure of the incentive received by that industry, however, as it ignores both the "coverage" of the rebate within that sector and the size of the rebate's subsidy component. A more accurate procedure focuses not on nominal tax rebates, but on the differential between the actual average rebate rates for the sector's exports and the assumed tax content of the exported goods. Using this method, Milanovic finds that the subsidy level as a percentage of export earnings ranged from 4% for the food processing and transportation equipment sectors -- despite the latter's status as the sector with the highest average rebate rate -- to an astounding 42% for fabricated metal products.

Export Pessimism: Real or Perceived?

DEMAND-RELATED FACTORS

<u>Export Pessimist Fears</u>	<u>Policy Responses</u>	<u>Outcome</u>
1. Low income elasticities of demand for traditional export products	No specific governmental policy; fear not likely to constrain export growth	<ul style="list-style-type: none">• Change in product composition, with shift toward manufactures• Move toward export products with higher income elasticities
2. Insufficient growth in world demand	No specific governmental policy; fear not likely to be realized, over long run	<ul style="list-style-type: none">• 'Adequate' growth in industrial countries• Expansion of trade despite world recession• Increased trade with Middle East• Doubling of industrial exports as share of exports, from 36% to 75% between 1980 and 1985
3. Protectionism in the industrial world	No specific governmental policy; moves toward opening markets in Middle East may have been related	Same as above
4. Lack of ties to potential markets	<ul style="list-style-type: none">• Publicly and privately organized trade associations• Expanded trade contacts through diplomats, trade missions• Political openings to Middle East neighbors (Turkey), Japan (Korea)	<ul style="list-style-type: none">• Increase in number of trading partners – for Korea, from 25 in 1961 to 108 in 1971• Export surge in new markets – for Turkey, increase in share of exports to Middle East from 17% in 1980 to 40% in 1984, with 50% average annual increase in Middle East-bound exports

Export Pessimism: Real or Perceived?

SUPPLY-RELATED FACTORS

Export Pessimist Fears

Policy Responses

Outcome

1. High labor costs	<ul style="list-style-type: none">• Suppression of organized labor• High wage increases, but not excessive (Korea)• Worker training and educational infrastructure• Periodic devaluations to keep costs low, relative to those of competitors	<ul style="list-style-type: none">• Success in export of labor-intensive manufactures• Improvements in literacy, education• Productivity growth
2. Lack of access to foreign exchange and imported inputs (i.e., access only at artificially high prices)	<ul style="list-style-type: none">• Duty-free access to foreign exchange and imported inputs (i.e., access only at artificially high prices)	<ul style="list-style-type: none">• Greater attraction of export business to firms due to subsidization• Enhanced ability to compete profitably due to "levelling of playing field," (• Discrimination against domestically produced inputs)
3. Scarce capital or high capital costs	<ul style="list-style-type: none">• Special access to credit• Subsidized (often negative) interest rates	<ul style="list-style-type: none">• Inexpensive credit to exporters, largely for short-term needs• Smaller firms drawn into export production through domestic letter of credit (L/C) scheme• Rapid increase in volume of credit demanded: in Turkey, 300% increased from 1980-84
4. Lack of adequate transportation and utilities infrastructure	<ul style="list-style-type: none">• Heavy investment in electric power plants and coal mining• Expansion of railways• Discounts on railway freights and on electricity rates given to exporting firms to cover transportation costs• Government controlled oil prices in Turkey	<ul style="list-style-type: none">• Development of roads and coastal shipping• Modern air control facilities at Turkish airport• Reduced rates on transportation costs to improve export possibilities

Export Pessimism: Real or Perceived?

INSTITUTIONAL FACTORS

Export Pessimist Fears

Policy Responses

Outcome

1. Unnecessary complexity of export procedures	<ul style="list-style-type: none">• Establishment of Export-Import Bank in Korea and Department of Investment and Export Promotion and Complementation in Turkey• Automatic right to import raw materials duty-free• Decrease in number of steps necessary	<ul style="list-style-type: none">• Simplified, streamlined export procedures• Improved business accountability• Decreased wasteful rent-seeking activity• Decreased disincentives to export
2. Export-d discouraging tax policies	<ul style="list-style-type: none">• Rebates of indirect taxes, plus additional margin• Exemption from customs duties or inputs• Reductions in direct-tax liability• Wastage allowance	<ul style="list-style-type: none">• Reduced taxes for export businesses• Improved ability to compete with foreign export firms benefitting from similar reductions• Increased stimulus to export
3. Import-substitution industrialization (ISI) oriented governmental/institutional structure	<ul style="list-style-type: none">• Formation of Economic Planning Board, National Tax Administration, more export-directed bureaucracy (Korea)• Frequent export committee meetings with president (Korea)• Assignment of consolidated responsibilities to more export-oriented committees and departments (Turkey)• Creation of export marketing association (KOTRA - Korea)• Creation of information-gathering and research organizations	<ul style="list-style-type: none">• Five Year Plans, geared toward export economy (Korea)• Increased confidence in government commitment to export growth• Provision of public goods assisting exporters

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V. SUMMARY AND CONCLUSION: OVERCOMING EXPORT FEARS

Korea and Turkey began export promotion programs under different global economic conditions and with varying motivations. Each country undertook a large currency devaluation to increase exports. These currency adjustments -- along with other price corrections -- formed the cornerstone of both successful export drives. They diverted resources into the tradeables sector and, within that sector, to those industries in which Korea and Turkey had comparative advantages. In the absence of market distortions, exchange rate alignment and the lifting of price controls should correct an economy's import bias, making further government intervention unnecessary and often undesirable. The prevalence of export pessimism in both countries, however, may have prompted the government to consider taking a more active role in promoting exports. Two categories of concerns prodded Turkey and Korean into additional action: those regarding governmental procedures and policies which impeded export growth, and those regarding specific market failures. The governments generally did not respond to demand related constraints as these tended to be exogenous or of exaggerated significance.

Removal of Procedural Impediments

Often correction of administrative or procedural obstacles required a reduction of government intervention. Export licensing procedures, for instance, were streamlined. Bureaucracies were simplified or eliminated. But, government disengagement was not always an effective means of removing export hindrances. Occasionally a government must intervene to compensate for existing market distortions, distortions that will generally be of its own making. Attempts to maintain artificially low interest rates in the economy, for

example, may paradoxically result in scarcity of credit at reasonable prices and force the government to guarantee access to inexpensive credit, in the interests of helping its firms to compete in export markets. This second-best reasoning, while it does not explain the full extent of subsidization in any of the areas discussed, sheds some further light on the motivations between some forms of subsidy. In addition to credit, both tax rebates and guaranteed foreign-exchange access contain clear elements of second-best solutions to constrained maximization problems.

Market Failures

Where no clear impediment to export growth existed, government intervention was justifiable in Korea and Turkey by the existence of specific market failures. Both governments attempted to compensate for public goods and imperfect information.

Korean and Turkish export expansion required breaking into new markets and improving marketing techniques. Since the benefits of marketing Korean and Turkish products abroad accrue to all firms and since marketing research is non-rival in many respects, individual firms lacked the incentive to invest sufficient resources into marketing activities. Other kinds of export promotion could have similar public good characteristics like labor training or infrastructure. The existence of positive externalities for activities such as research expenditures might also motivate a government to provide subsidies or coordinating mechanisms for export industries. The Korean and Turkish governments set up coordinating bodies to provide marketing assistance and pool export industry resources for marketing activities. In Turkey, however, some industrial organizations formed independent cooperatives. The degree to which government involvement became necessary may depend on local characteristics

such as existing cooperatives and trade associations and local initiative.

Developing country governments may want to consider the costs of subsidizing or providing public goods in relation to the likelihood of organizations arising independently.

Varying kinds of uncertainty or poor information regarding investment risk provided a second rationale for increased governmental support of export industries. Such distortions are likely to arise after a history of import substitution policies and sporadic export promotion campaigns. Import substitution policies act as an additional cost for the export sector. If industrial entrepreneurs attach an exaggerated probability to the government reverting back to previous policies, they will invest less in the export sector than would be optimal. The expected cost of having to shift back into domestic production or pay the costs of unfavorable, inward-looking policies may inhibit the transfer of resources into the tradeables sector. Similarly, the degree of political instability in a country or region may increase the perceived risk of a reversion to import substituting policies.

The government can take a number of steps to overcome investor's hesitancy. Both Korea and Turkey subsidized export industries extensively. Such subsidies may be warranted in the initial stages of an export drive to compensate exporters for perceived investment risks. The fiscal costs and distortionary effects of such policies should be carefully considered, however. Because the precise degree of uncertainty may be difficult to gauge, the optimal subsidy may be elusive. A country should determine which side it can afford to err on - over or under subsidization - keeping in mind that it may be easier politically to initiate subsidies than to remove them. The type of subsidy must be determined as well as the amount. In most cases, direct unit subsidies of exports are the least distortionary. Exceptions exist if a government is correcting a specific distortion

or if such subsidies are likely to provoke retaliatory actions from trading partners. Finally the fiscal burden of subsidization must be measured along with the benefits. For Turkey, whose budget deficits have escalated recently, these costs may prove overwhelming.

Governments can further combat the perceived risk to export investment by choosing policies which signal commitment to export growth. These signals can take several forms. One important, if often unintentional, communication mechanism is the adoption of realistic growth targets and sustainable subsidy and expenditure policies. Failure to do this may curtail investment severely. Korea, by setting increasingly attainable growth goals and incorporating greater numbers of participants in the planning stages of the second five year plan, greatly increased confidence in the new economic program. By consolidating authority for export procedures and policies, both governments gave the export industry a political base and demonstrated a willingness to change government structures to accommodate export growth pressures. Subsidies may also send a signal. Aside from lowering present production costs, subsidies are less likely to be eroded by inflation than periodic exchange rate devaluations. Unlike the preservation of subsidies, maintaining a competitive exchange rate requires continual government action.

Income Elasticity Estimates

Equation: $\text{Log IMP} = a + b_1 \cdot \log P + b_2 \cdot \log \text{DOMP} + b_3 \cdot \text{GDP}$

IMP = Quantity of imports

P = Price

DOMP = Domestic production

Data from United States, Germany, and Japan.

	<u>b1</u>	<u>b2</u>	<u>b3</u>	<u>R2</u>
Cotton (t-statistics)	-1.36 (2.79)	0.49 (6.71)	0.41 (.73)	.80
Hazelnuts (t-statistics)	-0.18 (0.65)	-0.23 (23.0)	0.63 (2.57)	.99
Swine (t-statistics)	-1.64 (1.62)	n.a.	3.1 (2.33)	.41
Silk (t-statistics)	-1.16	n.a.	-1.16 (1.08)	.37
Dried fish (t-statistics)	-0.51 (1.21)	0.05 (0.16)	0.84 (1.07)	0.28

Sources: US Bureau of Census; FAO Agricultural Production Schedules; USDA Agricultural Production Profile; German Statistical Yearbook; Japanese Statistical Yearbook.

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