A Framework for Export Policy and Administration

Lessons from the East Asian Experience

Yung Whee Rhee
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Lessons from the East Asian Experience
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Abstract

In recent years the remarkable export successes of several East Asian developing countries have been recognized as "models" to be emulated by other developing countries seeking to promote exports. This paper explores the framework of export policy and administration in the successful countries in order to draw practical lessons for those countries still at early stages of export development.

Because export policy and administration in developing countries are best analyzed within the context of an overall development strategy, the discussion presented in this paper centers around two key concepts: "neutral status" and "extended neutral status." Neutral status enables exporters to compete with foreign competitors in world markets on an equal footing in regard to undistorted markets and policies. Extended neutral status enables equal incentives between export and import substitution firms. Conventional export policy instruments and administrative arrangements that are designed to achieve neutral or extended neutral status discussed in the paper include:

(a) those for maintaining a realistic exchange rate;
(b) those for achieving a free trade regime for exporters;
(c) those for assuring automatic access to export financing;
(d) those for keeping primary input prices competitive.

Even though first-best policy instruments are emphasized, circumstances under which the need arises to adopt second-best policy instruments during transition periods are carefully examined.

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

(a) implementing efficient conventional export policies;
(b) developing the ability and desire of producers and traders to respond aggressively to opportunities in the world market.
Ces dernières années, les succès remarquables enregistrés à l'exportation par plusieurs pays d'Asie de l'Est sont devenus des "modèles" pour les autres pays en développement désireux de promouvoir leurs exportations. Cette étude examine le cadre dans lequel s'inscrivent la politique d'exportation et son administration, dans les pays qui connaissent de tels succès, afin d'en tirer des leçons pratiques pour les pays qui en sont encore aux premiers stades du développement de leurs exportations.

Comme la politique d'exportation et son administration dans les pays en développement s'analysent mieux dans le cadre d'une stratégie d'ensemble du développement, l'analyse présentée dans cette étude est centrée sur deux concepts : la "neutralité" et la "neutralité élargie". La neutralité permet aux exportateurs de se mesurer sur un pied d'égalité avec les concurrents étrangers, sur les marchés mondiaux, grâce à l'absence de distorsions dans les marchés et les politiques. La neutralité élargie accorde les mêmes avantages aux sociétés d'exportation qu'aux sociétés de substitution aux importations. Parmi les instruments de politique d'exportation et les arrangements administratifs utilisés couramment pour conférer la neutralité ou la neutralité élargie qu'analyse cette étude, on peut citer :

a) ceux qui permettent de maintenir un taux de change réaliste;

b) ceux qui permettent d'assurer un régime de libre échange aux exportateurs;

c) ceux qui assurent un accès automatique au financement des exportations;

d) ceux qui permettent de maintenir compétitifs les prix des intrants;

Tout en préconisant l'emploi des meilleurs instruments de politique, cette étude examine soigneusement les circonstances où il devient nécessaire d'adopter des instruments de deuxième choix pendant les périodes de transition.

Elle analyse également les instruments de politique non conventionnels employés pour développer les exportations et souligne l'importante contribution au succès de leurs exportations des mécanismes institutionnels efficaces dont disposent les pays d'Asie de l'Est — mécanismes qui ont servi de catalyseurs pour :

a) la mise en œuvre de politiques d'exportation conventionnelles efficaces;

b) le développement de la capacité et de la volonté des producteurs et des commerçants de répondre avec dynamisme aux possibilités offertes par le marché mondial.
Los notables éxitos en materia de exportación alcanzados por varios países en desarrollo de Asia Oriental en los últimos años han sido reconocidos como un "modelo" a emular por otros países en desarrollo interesados en promover sus exportaciones. En este trabajo se analiza el marco administrativo y de política en lo que atañe a las exportaciones en los países que han logrado tales éxitos, a fin de derivar enseñanzas de valor práctico para aquellos otros que todavía se encuentran en las etapas iniciales de crecimiento del sector.

Dado que la mejor manera de analizar la política y la administración de las exportaciones en los países menos desarrollados es hacerlo dentro del marco de una estrategia general de desarrollo, el análisis presentado en este trabajo gira en torno a dos conceptos fundamentales: el "estado neutral" y el "estado neutral ampliado". El estado neutral permite que los exportadores compitan en los mercados mundiales con los de otros países en un pie de igualdad en lo que respecta a mercados y políticas no distorsionadas. El estado neutral ampliado ofrece los mismos incentivos a las empresas de exportación y a las de sustitución de importaciones. Entre los instrumentos de política y los mecanismos administrativos convencionales orientados a lograr un estado neutral o un estado neutral ampliado que se examinan en el presente estudio se incluyen los que tienen por meta:

a) mantener un tipo de cambio realista;

b) lograr un régimen de libre comercio para los exportadores;

c) asegurar un acceso automático al crédito de exportación, y

d) mantener competitivos los precios de los insumos primarios.

Aunque se hace hincapié en el uso de instrumentos de política óptimos, se examinan cuidadosamente las circunstancias en que, durante los periodos de transición, surge la necesidad de adoptar los que les siguen en eficacia.

En el documento también se examinan los instrumentos de política no convencionales en esta esfera del fomento de la exportación y se subraya la contribución crucial de los mecanismos institucionales eficaces al éxito de las exportaciones en los países de Asia Oriental, mecanismos que han actuado como elementos catalizadores de:

a) la puesta en práctica de políticas de exportación convencionales eficaces, y

b) el fortalecimiento de la capacidad y el deseo de los productores y exportadores para responder con energía a las oportunidades del mercado mundial.
Acknowledgments

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INTRODUCTION

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

A search for lessons from the East Asian experience must begin with recognition of two critical considerations. First, export promotion has recently been undertaken by many developing countries largely to satisfy urgent needs for earning foreign exchange. But the export success in East Asian countries has resulted from successful trade and industrial strategies that stress specialization based on comparative advantages, rather than from a simple desire to earn foreign exchange. Second, while much has been written about the success stories of the East Asian countries, the broad generalities describing these successes are of little practical use unless supplemented with explanation of specific policies and institutions that provided the foundation for export growth at early stages of export development. Therefore, in articulating the lessons of the East Asian experience in export policy and administration, this paper stresses
these considerations: (a) export policy within the context of a rational development strategy and (b) specific policy tools and public and private institutions. These are discussed further below.

Because the primary objective of this undertaking was to discover and relate specific means by which the successful East Asian countries accomplished their export development and growth, the resulting paper--entitled "Instruments for Export Policy and Administration: Lessons From the East Asian Experience"--is inevitably quite lengthy and detailed. The current paper is presented, therefore, not as a summary of specific material, which would hardly be meaningful, but as an introduction to the significant points of the full report. (The current paper also omits all references; these are included in the full report.)

The countries examined in drawing lessons from the East Asian success stories are Hong Kong, Singapore and Korea. To illustrate some of the practical issues that developing economies face as they attempt to rationalize their policies and build export capabilities, some of the ongoing developments in Indonesia, the Philippines, and Malaysia are sketched. This paper is not a comparative analysis of these six East Asian countries. Rather, it attempts to build an analytic framework, to the extent possible, based on the East Asian experience. The basic approach taken, however, is descriptive rather than prescriptive.
Information on Korea has been based largely on materials collected through the author's involvement in the World Bank research project, Export Incentives in Developing Countries. Information on Singapore and Hong Kong was collected through the author's brief visits to these countries during May 22-30, 1983. Information on Indonesia and the Philippines has been based on materials collected through the author's participation in several operational missions to these countries during 1982-83. Information on Malaysia is mainly based on materials collected during the author's participation in a manufacturing sector mission in 1980.

**Export and Development Strategy**

A rational development strategy of a developing country strives for production specialization in both domestic and export markets (i.e., import substitution and exports) where the country has comparative advantages, while imports are not discouraged where the country has comparative disadvantages. Our discussion of export policy and administration focuses on the export side within the context of such a rational development strategy. As such, import substitution and imports are dealt with only implicitly, not because they are not important in a rational development strategy, but because the focus of this undertaking is on the specifics of export policy and administration. As our discussion of the export side unfolds, the equal regard for the importance of import substitution and imports will be apparent.
As used in this paper, "exports" include processing, manufacturing, and sales activities for all commodities that generate export value added. This definition therefore encompasses the activities of indirect as well as direct exporters. Excluded from the term "exports" are activities involved in the production of primary goods that are exported.

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

Specific Policy Tools and Institutions

To dig beneath broad generalities and provide practical guidance for developing countries at the early stage of export development, several factors that are implicit in export development efforts must be recognized. First, the market fragmentation, externalities, uncertainties, and
lack of institutional development that are characteristic of most developing countries dictate the use of transitional policies when first-best policies are not feasible. Second, the lessons from successful developing countries would be of little use if we failed to consider the institutional requirements needed to implement policies. Finally, because we are concerned with the behavior of the business firm, any consideration of export incentives that is not based on disaggregation at the firm level will be misleading. Therefore, our discussion of the lessons of the successful East Asian countries in export policy and administration emphasizes (i) institutional development, (ii) specific transitional policy tools, and (iii) incentives at the firm level.

Structure of the Paper

Chapter I defines neutral status and extended neutral status, discusses the above three key elements in achieving neutral status, and introduces principles of administrative arrangements for neutral status. Chapters 2 through 6 deal with the specific policies and administrative arrangements necessary to achieve neutral status for export activities: maintaining a realistic exchange rate, achieving a free trade regime for exporters, assuring automatic access to export financing, keeping primary input prices competitive, and implementing compensatory export incentives to establish neutral status. Chapter 7 discusses issues related to extended neutral status. Chapter 8 focuses on how public and private institutional mechanisms can be designed to achieve a synergistic partner-
ship between government and business in implementing effective export policies and competing successfully in world markets. Chapter 9 summarizes the major findings and discusses their implications for other developing countries.
CHAPTER I

NEUTRAL STATUS - ITS MEANING AND KEY ELEMENTS

Because export policy and administration in developing countries are best analyzed within the context of an overall development strategy, the discussion presented in this paper centers around two key concepts: "neutral status" and "extended neutral status". This chapter defines these concepts and, based on the experiences of the successful East Asian countries, discusses the key elements and principles of administrative arrangements for achieving neutral status.

Definitions of Neutral Status and Extended Neutral Status

A country cannot exploit its comparative advantages in the world market through specialization if it is not able to compete with other countries on an equal footing in regard to undistorted markets and policies. For example, if a tariff on an input required for the production of a potential export results in higher production costs for a domestic producer than for a similar foreign producer who operates under free trade, the domestic producer is not on an equal footing. In this case, the exporter can achieve equal footing with his foreign competitors if imports used for export production are tariff-free.
We therefore will define neutral status as the set of arrangements that will enable exporters to compete with foreign competitors in world markets on an equal footing in regard to undistorted markets and policies. The major competitors operate under a flexible and realistic exchange rate, free trade in inputs and outputs, competitive financial and money markets, competitive primary input markets, and nondiscriminatory domestic taxes. Neutral status for export activities in a developing country can be achieved by providing a combination of these five elements or equivalent compensating incentives in all activities that generate export value added.

If a country provides positive protection for import substitution activities, achieving neutral status for export activities puts potential exporters on an equal footing with world market competitors, but does not provide incentives equivalent to those for import substitution activities. With high effective protection for import substitution, anti-export bias in the domestic economy is reduced, but not eliminated, by putting exporters on an equal footing with foreign competitors. In the example above, neutral status achieved by duty-free import of inputs for export production that results in a zero effective protection rate provides an incentive level lower than that for an import substituting firm whose effective protection rate is, say, 50 percent. Anti-export bias can be eliminated by "extending" neutral status for export activities such that export is not discouraged relative to import substitution. We will define extended neutral status as a situation in which the level of export incentives is as high as the level of incentives for import substitution activities. If—
addition to neutral status provided by duty-free imports used for export production--the exporter in the example above is granted tax incentives worth 50 percent of world market value added, then the exporter would enjoy extended neutrality with respect to the import substitution firm that enjoys an effective protection rate of 50 percent. These firms, then, would have equal incentives for import substitution and for export.

Key Elements in Achieving Neutral Status

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

Incentives at the Firm Level. It has been suggested that incentive neutrality is the key factor explaining why the economies of developing countries with outward-looking strategies have registered better export performance and better overall economic growth than economies with inward-looking strategies. This hypothesis is based on empirical evidence indicating that in developing countries with outward-looking strategies, aggregate (i.e., economy-wide or average) effective incentives for exports have come close to matching aggregate effective incentives for import substitution (see Chapter VII). But despite this aggregate empirical evidence
there has been insufficient emphasis of the critical importance of the internal structure of such extended neutrality and the detailed administrative apparatus needed to achieve extended neutral status as well as neutral status at the firm or product level.

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

Transitional Policies. Adoption of several second-best policies--with respect to all activities that generate export value added--has been critical to the achievement of neutrality for some successful East Asian developing countries during transitional periods, when they were not yet
ready for first-best policies. These second-best policies are: (i) guaranteeing a realistic exchange rate for exporters, even if the official exchange rate is overvalued; (ii) providing free trade status for export production, even if imports for domestic sales are subject to restrictions and tariffs; (iii) guaranteeing automatic access to working capital at uniform interest rates that are not higher than the neutral rate for all export production and sales activities, even if other sectors of the economy are subject to credit rationing; (iv) guaranteeing that the actual prices of primary inputs for export activities are equal to shadow prices; and (v) using differential compensatory incentives to achieve the preceding four policies.

Institutional Development. Adoption of second-best transitional policies in the developing East Asian economies has required innovation and diligence by government. Experience shows that it is far from simple to achieve neutral status, and that it is therefore critical to create efficient administrative arrangements that are designed to guarantee neutral status.

Principles of Administrative Arrangements

The typical export incentive system of the successful East Asian developing countries includes a formal structure of laws and regulations administered by government and private agencies. But we are concerned here with the key principles of export incentive systems. These principles are:
(i) **Automaticity.** To free would-be exporters from administrative uncertainty and allow would-be entrepreneurs to respond to incentives granted by the government, automatic granting of neutral status has permitted the quick response that is critical in international trade.

(ii) **Equal Treatment of All Activities That Generate Export Value Added.** This has required equal treatment of exports sold through different methods of payment; of direct and indirect exports; of imported and domestically produced inputs; of all manufacturing, processing, and sales activities associated with foreign-exchange earning activities, including foreign exchange earned through construction or service contracts.

(iii) **Prevention of Abuse.** Rules have been applied strictly to minimize abuses of the incentive system.

(iv) **Administrative Convenience.** Administrative costs and feasibility are important factors in determining the most suitable administrative arrangements. To reduce the costs and increase the efficiency of administration, many administrative tasks have been delegated—for example, to commercial banks or export associations.
CHAPTER II
MAINTAINING A REALISTIC EXCHANGE RATE

The most important and central variable affecting the return exporters realize in local currency for the foreign exchange they earn through export value added is the exchange rate. Several methods are employed by developing and developed countries to set exchange rates: pegging domestic currency to the currency of a major trading and financial partner, pegging to various composites of currencies such as the SDR, adjusting the exchange rate on the basis of a set of indicators, maintaining the value of the domestic currency in relation to the values of the currencies of other countries participating in a joint arrangement, and maintaining systems of managed or independently floating currencies. Several of the Western industrialized countries practice the latter.

Current account convertibility as defined in Article VIII of the IMF's articles of agreement is maintained by Hong Kong, Singapore, and Malaysia. Korea, Indonesia, and the Philippines abide by Article XIV, which permits a country to maintain restrictions on current payments and transfers until it is satisfied that its balance of payments is strong enough to remove such restrictions. A majority of the developing countries
belong to this latter group. The discussion presented in this chapter considers the East Asian countries under headings describing the general policies and procedures that govern operation of their foreign exchange markets.

A Market-Based Foreign Exchange Regime

Institutions and Markets. A free market foreign exchange regime is feasible for countries with mature financial markets that are integrated with international financial markets. It is important to understand that free foreign exchange markets developed in Hong Kong, Singapore, and Malaysia directly as a result of their early British connections and early exposure to international trade-related activities, which provided ample opportunities to develop mature financial and trade-related institutions.

A foreign exchange market has several functions. It offers a mechanism for clearing payments related to international trade or investment on a multinational basis, provides credit in different currencies, includes facilities for hedging foreign exchange, and determines exchange rates between convertible currencies. The market determines not only the spot exchange rate but also forward exchange rates, a means by which both exporters and importers can be protected against unexpected fluctuations in exchange rates.
Singapore's foreign exchange market became much more active after the Singapore dollar began to float in 1973. Deliberate efforts by the government—which offered exemptions from its withholding tax to dollar depositors much earlier than Hong Kong did—were instrumental in establishing the Asian Dollar Market in Singapore. The Asian Dollar Market is an international money and capital market similar to the Euro-Dollar Market. Government policies have been instrumental in making Singapore an active foreign exchange market while at the same time maintaining the stability of the Singapore dollar through market intervention. Hong Kong's foreign exchange market became active after Hong Kong's exclusion from the Sterling Area in 1972. The residual source of liquidity for the banking system as a whole is the foreign exchange market and the ability of each individual bank to acquire Hong Kong dollars against the sale of US dollars, an ability assured through the activities of the government's Exchange Fund. Malaysia also operates a foreign exchange market, although it is not as big as the exchange markets of Singapore and Hong Kong.

**Free-Floating versus Managed Floating Exchange Rate.** Two factors distinguish a free (clean or independent) floating exchange rate from a managed (or dirty) floating exchange rate: whether the monetary authorities intervene in the foreign exchange market and whether they adjust the domestic money supply to smooth exchange rate fluctuations.
Even though the exchange rate of its dollar is determined by the free market, the government of Hong Kong is active in foreign exchange markets through its commercial bankers to the extent that portfolio management considerations of the Exchange Fund require, and the timing of transactions can be varied with a view to their impact on the exchange rate of the Hong Kong dollar. Another policy instrument is the imposition of withholding taxes on interest earned from foreign currency deposits. The Hong Kong dollar depreciated about 24 percent between 1974 and 1982 and the government's managed floating foreign exchange regime helped to maintain Hong Kong's competitive position as a major manufactured goods exporter as well as a major international financial center.

Singapore's exchange rate management system is operated on the basis of the Singapore dollar's relationship to a trade-weighted basket of currencies representing Singapore's major trading partners. The exchange rate of the Singapore dollar in terms of the US dollar, the intervention currency, is determined in the foreign exchange market. The centerpiece of Singapore's domestic monetary policy has been the stabilization of its exchange rate with respect to the US dollar. The monetary base has thus been largely endogenized by the desire to maintain an orderly foreign exchange market. Instead of setting firm internal rules for rates of monetary growth, Singapore has allowed the monetary base to reflect foreign exchange interventions. This policy has achieved the objective of maintaining stability in exchange rates, even though the money supply has fluctuated widely in the short run. Singapore's successful policy has resulted from that country's determination to separate the domain of foreign cur-
rency transactions from the domain of local currency. After the elimination of exchange controls in 1978, this separation was accomplished through (i) differential tax treatment of interest income from foreign currency deposits between nonresidents and non-bank residents and (ii) differential tax treatment of interest income from foreign currency deposits versus that from domestic currency deposits. This separation has prevented currency substitution and allowed the market-based exchange rate regime to achieve a stable exchange rate. Consequently, Singapore's exchange rate policy has achieved competitiveness for exporters as well as domestic price stability.

Malaysia's exchange rate system is similar to that of Singapore. It has been based on the relationship between the Malaysian ringgit and an undisclosed weighted basket of currencies of Malaysia's major trading partners. The exchange rate of the ringgit in terms of the US dollar, the intervention currency, is determined in the foreign exchange market, and Bank Negara Malaysia intervenes with an objective of maintaining stability in its exchange rates. Malaysia's exchange rate policy has maintained exporters' competitive positions at reasonable levels.

Managed Foreign Exchange Regime

Institutions and Management. Financial immaturity in developing economies is characterized by fragmented financial markets. In most cases, this fragmentation merely reflects stages of underdevelopment in general,
but financial repression associated with misguided government policies aggravates such fragmentation. While efforts to build financial maturity are pursued in developing economies, their transitional status in foreign exchange management may have to be accepted. Financial immaturity and repression are also closely related to choice of trade regime which, in turn, influences the type of foreign exchange regime.

During transitional periods a foreign exchange management system operated by the government must perform the functions which a market-based foreign exchange system carries out in an advanced industrial economy. A managed system should be carefully designed to achieve, with minimum administrative costs, the objectives of realistic exchange rates and efficient allocation of foreign exchange. In setting priorities in such a system, nothing appears more important than guaranteeing unrestricted access to the foreign exchange needed for importing inputs for export production. As the recent external debt crises of some developing countries attest, efficient foreign exchange management is currently one of the most important issues in economic management, particularly for an economy with a large external debt.

As mentioned above, Korea belongs to the nonconvertible currency group. During the 1960s and 1970s, its managed foreign exchange regime was an integral part of its managed financial system. During that period, an annual program for foreign exchange supply and demand was one of the key components of the annual economic management plan of the government. Korea's experience demonstrates that efficient management of foreign
exchange during the transitional period is a most important immediate practical issue for developing economies while efforts to build financial maturity are being pursued. As efforts to liberalize the financial system progress, conditions in Korea will become conducive to a gradual transformation to a free market-based foreign exchange regime.

Real Exchange Rate Policy. Under a managed foreign exchange regime, the central bank must establish an official foreign exchange market by setting official exchange rates and managing foreign exchange transactions on a day-to-day basis. Since exchange rates are not governed by a free market, we must examine criteria the government relies on to determine official exchange rates and the issues associated with nominal vs. real exchange rates and the pegging of one currency to another.

Nominal versus Real Exchange Rate. The export incentive value of the official exchange rate is reflected in the underlying purchasing power of the local currency unit that is being obtained in exchange for one unit of the foreign currency. Therefore, particularly in an economy where the purchasing power of the local currency is relatively unstable due to a higher inflation rate than that of its trading partners, the objective of exchange rate policy should be to maintain stability in the real exchange rate. A real exchange rate is defined as a purchasing power parity (PPP) adjusted official exchange rate, where PPP is the relationship of the domestic price index to the foreign price index. To maintain a constant
real exchange rate when PPP changes, the official exchange rate must be adjusted so as to devalue (or appreciate) the local currency as much as the excess (or deficit) of the domestic inflation rate over the foreign inflation rate.

Adjustable Peg versus Crawling Peg. In an adjustable peg system, the exchange rate is kept rigid for several months or years until a possibly large devaluation must be made. In a crawling peg system, the government devalues in very small steps by an amount equal to the amount domestic inflation in the preceding week or month exceeded that abroad. The crawling peg eliminates the distortions inherent in delayed and massive devaluations stemming from an adjustable peg and also checks the dangers associated with excessive speculation that may occur under the adjustable peg by increasing the frequency of changes in the exchange rate and making the changes quite small. On the other hand, those who fear that frequent exchange rate movements may directly accentuate domestic inflation in addition to destabilizing the demand for money claim that the adjustable peg is preferable because of the need to stabilize price-level expectations and to inspire confidence in the government's financial future. Such skepticism about the crawling peg appears largely unwarranted, however, particularly when the disadvantages of large discrete adjustments are considered.

Single Peg versus Composite Peg. In a world of floating rates, pegging to any one of the major currencies implies floating vis-a-vis all others. Thus, to avoid large fluctuations in their exchange rates, an increasing number of developing countries have adopted composite pegs—
pegging the local currency to a weighted average of the currencies of trading partners. A single intervention currency such as the US dollar is usually selected. This automatically sets the exchange rates of the local currency in terms of the other major convertible foreign currencies, because the international market determines the exchange rates of the intervention currency in terms of the major convertible foreign currencies.

In a floating, multiple-currency world "the exchange rate" of a country has been defined by a trade-weighted index of the local currency price of various foreign currencies. The appropriate set of weights for the basket of foreign currencies can be estimated, depending on a specific government target. Once the optimum set of weights is chosen based on the target (such as balance of trade), the object of exchange rate policy under the composite peg is merely to determine the optimum official exchange rate of the local currency in terms of the dollar that satisfies specific formulas yielding the desired real devaluation (or appreciation) of the local currency in terms of the dollar. The exchange rates of the local currency in terms of the other foreign currencies are then established mechanically.

Korea's exchange rate policy since its adoption of an outward-looking development strategy has been a mixture of adjustable and crawling peg policies. Since early 1980, however, the crawling peg has been firmly rooted. Korea has attempted to provide realistic exchange rates for exporters through a mixture of major devaluations and flexible adjustments. Although a constant real exchange rate has not been achieved, the Korean government has generally succeeded in compensating for periodic
domestic currency overvaluation by means of financial and tax incentives for exporters. In the Philippines and Indonesia, exporters did not receive the benefits of stable real exchange rates (including compensation for currency overvaluation) throughout the 1960s and 1970s. Recently, there have been more concerted efforts to bring about stable real exchange rates in these economies.

Conclusions

The experience of the successful East Asian countries in exchange rate policy and management provides several lessons. First, maintaining a realistic exchange rate for exporters—regardless of the trade and foreign exchange regime employed—is the first requirement for export development. A crawling peg system is preferable, but, if an adjustable peg is employed, compensatory fiscal and financial export incentives could compensate for periodic currency overvaluation. Second, the maturity of financial institutions and markets and the level of financial repression appear to be the most important factors determining whether a market-based or a managed foreign exchange regime is suitable for determining a realistic exchange rate and achieving efficient allocation of foreign exchange. Third, in a floating rate, multiple-currency world, adoption of composite pegs rather than a single peg is preferred for setting exchange rates.
CHAPTER III

ACHIEVING A FREE TRADE REGIME

An important tool for eliminating the disadvantages that exporters in developing countries may face in competing in the world market is a guarantee of free access to the imported raw materials and intermediate inputs used in industrial activities that generate export value added. "Free access" means that such imports are free of import and foreign exchange restrictions as well as free from tariffs and indirect taxes.

Because free trade status for export activities is a step toward an economy-wide, first-best situation of free trade, and because it is designed to reduce anti-export bias by seeking true neutrality vis-a-vis competing or importing economies, neither GATT nor any importing developed economy or competing developing economy objects to it. A free trade status for export activities can also be a step to completely liberalizing imports for the domestic market.

Free Trade

A free trade status is assured if a free trade policy is adopted for the entire economy of a country or through permitting exporters to
operate in free trade zones (see below). Given their small domestic markets, extensive involvement in entrepot trade, and specialization in the final stages of production, Hong Kong and Singapore rely on free trade in virtually all commodities in providing free access to imported inputs that are used to produce exports. Until 1967, however, Singapore had a policy of temporary protection of imports sold domestically.

Free Trade Zones

A free trade zone (FTZ) is a special industrial area located physically or administratively outside a country's customs barrier and is devoted to the production of exports. Transactions in FTZs are not subject to tariffs, and therefore escape the delays and administrative costs often associated with the duty exemption or drawback systems applied to firms located outside FTZs. FTZs in Singapore, Hong Kong, and Korea have apparently been effective in the early stages of an export drive as a means of attracting foreign investors and giving demonstrations of export potential. Where outward-looking development strategies have been continued and reinforced, however, the relative importance of FTZ exports has tended to decline as free trade status has been gradually provided to exporters throughout the entire economy. Malaysia has been quite successful in inducing direct foreign investments in its export development by means of FTZs, while the role of FTZs in the Philippines is currently being expanded.
Free Trade Status and Its Components

Achieving free trade by eliminating restrictions and duties on all imports may be desirable and rational objective for many developing economies. However, such an objective, while certainly a worthwhile long-term goal, often cannot be achieved if it is not pursued on a gradual basis. This owes to a number of factors, including political and institutional rigidities. If adopted immediately, free trade would allow imports to displace much domestic production, including production by infant industries that could become competitive in the near future. If not fully "compensated" by exchange rate adjustments, immediate liberalization would also increase balance of payments deficits, worsening already heavy external debt burdens. Often the political and social reaction to very rapid or ill-considered liberalization attempts results in a movement backward toward import and foreign exchange controls. Rather than opening their borders immediately to free trade, many developing economies attempt to establish free trade regimes for exporting while maintaining protected trade regimes for production for the domestic market at least during transition periods. Below, the major "building blocks" for establishing free trade status for export industries in an economy that continues protection of domestic market oriented activity are described and evaluated, based on the experiences of the successful East Asian countries and, in particular, the Korean experience.

Automatic Import License. Import licenses for raw materials and intermediate inputs (and capital equipment) are given automatically to producers of goods that generate export value added.
Import Administration for Export Production. When trade is free for export production and protected for production for the domestic market, a potential exporter can increase net earnings by selling products on the domestic market rather than competing on the world market. An exporter can also increase net earnings by selling intermediate inputs on the domestic market rather than using them for export production. Schemes that can prevent these events and maintain the integrity of the export system usually provide that: (i) each purchase of intermediate inputs be limited to the amount required to produce export goods that have been ordered or for which orders are expected and (ii) a determination will be made of whether the goods, after having been produced, have actually been exported.

Automatic Access to Foreign Exchange. Policies are adopted that eliminate constraints on using foreign exchange to pay for imported raw materials, intermediate inputs, or capital equipment for activities generating export value added.

The Bonded Manufacturing Warehouse System. In order to allow companies outside FTZs to bypass certain customs procedures when they import inputs needed to manufacture products for the export market, a bonded manufacturing warehouse (BMW) system provides valuable encouragement for exporters. BMWs are typically required to deal exclusively with manufactured commodities for export, to have separate warehouses for the storage of imported inputs and finished commodities, and to have customs officers stationed on-site.
**Duty Exemption and Drawback Systems.** A duty exemption system frees exporters outside FTZs and BMW systems from paying duties and indirect taxes on imports used in export production. These exemptions are granted at the time of importation. A duty drawback system permits exporters located outside FTZs or BMW systems to obtain refunds of the duties (and indirect taxes) they have paid on imported inputs. Such refunds are determined on a case-by-case basis under individual drawback systems, but are made according to preset schedules under fixed drawback systems. While a system of fixed drawbacks does not require case-by-case tracing of linkages between imported inputs and exported outputs, it does require the preparation of fixed drawback schedules.

Korea's prior exemption/drawback system has been characterized by continuing efforts to streamline administrative arrangements while minimizing anti-export bias on exporters. Under a new drawback schedule implemented by the government in 1981, exporters rely on individual drawbacks for major imported input items for each export product, based on input-output coefficients listed in a drawback schedule published every six months. Fixed drawbacks are applied only to miscellaneous imported items. Korea has also made continuing efforts to streamline its Input Coefficient Administration.

Singapore currently administers duty exemptions and drawbacks for the few items on which it imposes tariffs, including sugar imports. One innovative aspect of its administrative arrangements is a firm-level accounting book method used to compute the duties to be paid at the end of
a period. Another important administrative instrument is a banker's guarantee that is used as security to cover the average amount of duties an exporter owes to the government.

Malaysia has both individual drawback and exemption arrangements. It does not appear that automaticity has been guaranteed for all activities generating export value added that are located outside FTZs or BMWs, but import substitution industries have enjoyed substantial duty exemptions on top of import protection. It also appears that the principles of automaticity and equal treatment of all activities generating export value added have not been perfectly adopted in the Philippines, due to the multiplicity of agencies involved and the existence of administrative arrangements that do not appear to be consistent with the objective of granting free trade status for export activities. Indonesia administers both a fixed drawback system and a prior exemption system. The fixed drawback system has been extensively used by exporters, but could be improved by increasing the product coverage and assuring free trade status. In turn, extensive use of the prior exemption system would need to be encouraged.

The important lessons that can be learned from the administration of duty exemption and drawback systems in the successful East Asian developing economies are, then, that: (i) automatic import licensing for both direct and indirect exporters (i.e., absolute free choice between imported and domestic inputs) is a critical precondition for an efficient
duty exemption and drawback system; (ii) regular publication of input-output coefficients leads to more reliable and higher-quality figures; (iii) individual drawbacks or exemptions offered along with fixed drawbacks allow exporters to choose between completely free trade and administrative cost savings; (iv) the business community and the government improve technical and procedural aspects by working together; and (v) the government should continuously review its tariff schedule and reduce administrative burdens by aiming for elimination of redundant tariffs, as a first step toward lowering or removing tariffs.

Conclusions

One of the most important lessons from the experiences of the successful East Asian countries is the importance of guaranteeing a free trade regime for all activities (including participation by small and indirect exporters) that generate export value added through free trade, free trade zones, bonded manufacturing warehouses, or duty exemption/drawback systems. The East Asian experiences also suggest that establishing a free trade status for export activities can be a first step to liberalizing imports for the domestic market. It is the single most important element in reducing anti-export bias and establishing neutral status without risking retaliation from importing countries, which is a precondition for realizing greatest potential gains from international trade.
Guaranteeing automatic import licensing and free access to foreign exchanges (i.e., unrestricted choice between imported and domestically produced inputs) for both direct and indirect exporters is imperative for successful implementation of the duty exemption/drawback system. There appears to be no simple solution in implementing an efficient duty exemption/drawback system other than improving the system continuously, based on updated information on input-output coefficients and imported input prices. On the one hand, a careful balance must be maintained between providing status close to free trade and structuring an administratively feasible design and implementation of the duty exemption/drawback system. On the other hand, the administrative burden of the duty exemption/drawback can be reduced if all redundant tariffs are eliminated and tariffs are gradually lowered and eliminated.
CHAPTER IV
ASSURING AUTOMATIC ACCESS TO EXPORT FINANCING

In most developing economies, money and financial markets are not well developed and are highly segmented. Large firms are favored over small ones and demand for physical collateral often cannot be met by small exporters. In such a financial environment, the full potential of export capabilities can hardly be exploited.

Guaranteeing automatic access to financing at uniform interest rates for all activities (including participation by small and indirect exporters) that generate export value added is therefore critical because it provides neutral status for export activities until the time arrives when deeper and more competitive money and financial markets have been developed. A preshipment export financing system can assure neutral status as a temporary measure. Since automatic availability of export financing at a uniform interest rate and equal treatment of all activities generating export value added are of primary importance, the specific level of the interest rate appears to be of secondary importance. In the early stages of export development the highest priority is given to preshipment working capital loans. These loans are a critical factor, because without them a net foreign exchange earning is difficult, even when the potential exporter has a confirmed order.
Korea's preshipment export financing system, introduced in the mid-1960s, has made an enormous contribution to assuring neutral status for its export industries, particularly in light of its underdeveloped money and financial markets and the predominance of credit rationing. Hong Kong, possibly the only major developing economy without a government-supported export financing system, relies on a well-developed network of inter-firm credit to supplement a well-developed financial market in meeting exporters' financing needs. Even though Singapore is an international commercial financing center, the government introduced a preshipment export financing system in 1975. Malaysia introduced preshipment export financing in 1979. In Indonesia export loans outstanding for traditional and nontraditional exports amounted to about 5 percent of total exports (excluding oil and LNG) in 1980. Total export loans for Philippine nontraditional exports were about 8 percent of nontraditional export value in 1982. While the export loans granted per dollar of total industrial exports in these latter economies appear to be somewhat lower than in the other East Asian countries, the major differences between them exist in the structure of financing and the degree of modernization of export financing system designed to provide automatic and equal access for all exporters.

Acceptance Financing versus Bank Loans

In the developing economies, which lack an active market for banker's acceptances, acceptance financing can play no role in export and import financing. The alternatives to acceptance financing are working capital loans or short-term advances. But because of the noncompetitive
nature of financial markets in most developing countries, financing by means of working capital loans often cannot be managed efficiently without strong government involvement. A majority of the exports from developing economies are based on the export L/C, which in effect is a purchase order with payment guaranteed by a bank (if the goods are shipped). Commercial banks and others are then ready to provide financing if there is an automatic rediscouniting mechanism and if the risk that the exporter will default is negligible.

Automaticity and Equal Treatment

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

**Preshipment Export Finance Guarantee**

Pooling the risks that come from a lack of technical and managerial capabilities among small and new exporters by creating a preshipment export finance guarantee scheme is an important responsibility of the government of a developing economy. This has been little different from the role of government in export credit insurance schemes in developed and developing countries, i.e., offering risk-pooling schemes in order to deal with uncertainty stemming from imperfect information on importers and importing countries. Such a guarantee scheme permits realization of the strong contribution that the endogenous entrepreneurial and labor resources of developing countries can make in export development.

In Korea, although the Korea Credit Guarantee Fund and the Export-Import Bank of Korea provide preshipment export finance guarantees, automatic and equal access to export financing has been achieved because commercial banks took the risk of exporter defaults head-on by granting export loans without requiring any collateral other than documentary evidence of actual or expected export orders. One of the goals of Indonesia's 1982 Export Policy is to guarantee automaticity and equal treatment of all activities generating export value added by providing a mandatory guarantee of preshipment export financing. Small exporters
(actual or potential) in Malaysia and the Philippines do not appear to be assured yet for automatic and equal access to export financing.

Modernization of a Preshipment Export Financing System

A key to modernizing preshipment export financing system in the successful East Asian countries has been employment of well-established international trade financing mechanisms by integrating them with the government's export financing system to achieve the goals of automaticity, equal treatment, prevention of abuse, and administrative convenience.

A typical system of modernized export financing classifies export loans as those which (i) generate value added (VAL), (ii) purchase domestically produced intermediate inputs (DIL), (iii) purchase imported intermediate inputs (FIL), and (iv) purchase domestically produced finished goods (DOL). VAL, DIL, and FIL are employed in production financing, while DOL is employed for sales (or inventory) financing.

The separation of DIL from FIL and DOL from production financing makes it possible to implement a domestic L/C system for domestic purchase (see below) and an import L/C system for imported inputs. The separation of FIL, DIL, and DOL from VAL makes it possible to create quasi-physical
collateral, with inputs or outputs financed by export loans through the
automatic loan disbursement mechanisms. Under such a scheme, the actual
payment of FIL, DIL or DOL is not made to the purchaser, but instead takes
the form of the handling bank's making payment directly to the supplier,
thus clearing a bill on behalf of the purchaser. The commercial bank con­
firms that the purchaser is in possession of the deliverable merchandise;
at that time FIL, DIL, or DOL is granted. In turn, a foreign currency loan
scheme applied to FIL can be very important in managing scarce foreign
exchange.

By dealing with foreign exchange constraints through foreign
currency loans and pursuing efforts to maximize backward linkages to local
industries and develop trading companies based on export financing for
indirect exporters, a modernized export financing system has made an
enormous contribution to Korea's export development. While the export
financing systems of Malaysia, Indonesia, and the Philippines have not yet
been modernized, initial steps for modernization are being taken in the
latter two countries in order to deal with increasing foreign exchange
scarcities and the importance of backward linkages and trading companies
for export development.

The Domestic Letter of Credit System

The single most important innovation in export incentive
administration is the domestic letter of credit, which has assured
automatic availability of short-term export loans and free trade status to all indirect exporters (firms that generate export value added but do not export directly). There are two types of indirect exporters: (1) input-supplying indirect exporters—which supply intermediate inputs to final stage (or next stage) export manufacturers—and (2) output-supplying indirect exporters—which supply finished export products to trading companies that export directly (or sell to other trading companies).

Indirect exporters most commonly are manufacturers, but they can also be pure traders. Input-supplying indirect exporters are critical for achieving backward linkages from exports; output-supplying indirect exporters are critical for developing trading companies that specialize in overseas marketing. In many developing countries attempts to encourage final exporters to pass the benefits of export incentives through to indirect exporters have not been successful, because the systems constructed have apparently not dealt adequately with the different needs of indirect and direct exporters in a well-coordinated manner. The successful East Asian countries, on the other hand, have granted equal export incentives to indirect exporters themselves, not through intermediaries. The domestic L/C system has been the most effective administrative tool for this direct granting of export incentives.

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

The domestic L/C system is the most effective instrument for meeting the two basic requirements in structuring administrative arrangements that provide critical incentives for indirect exporters. These requirements are: (i) that a means exist for independently and automatically verifying that the supply of intermediate inputs or completed export commodities provided by the indirect exporter were in fact purchased by and delivered to the final exporter and (ii) that both the indirect exporter and the final exporter are strongly encouraged to use available instruments in order to gain access to export incentives. Because the domestic L/C is handled by commercial banks, it also offers the advantage of delegating much of the authority for export incentive administration to the commercial banks, which generally offer greater administrative efficiency than governments can provide.
A domestic L/C is a document created by a bank that declares to the indirect exporter that the bank will pay, on behalf of the final exporter, a draft drawn on it when the indirect exporter submits, together with the draft and a receipt that commodities have been delivered to the final exporter. Therefore, the domestic L/C is the most reliable and automatic instrument for verifying the transaction between the final exporter and the indirect exporter. The mutual encouragement to use available instruments is provided under the domestic L/C because the final exporter gains access to export loans for purchasing domestic inputs (DIL) or finished export commodities (DOL) based on the domestic L/C he issues, while the indirect exporter must be the beneficiary of the domestic L/C in order to gain approval for his production loans (DIL, FIL, and VAL). For this mechanism to operate, it is essential that the export financing system be modernized along the lines indicated above.

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

Backward Linkages. By extending free trade status and automatic availability of short-term export loans to every production process contributing to the generation of export value added, the true comparative advantage of each production process has been exploited. Recent figures showed that for every dollar of export from Korea some fifty cents worth of domestic inputs were purchased from input-supplying indirect exporters.

Development of Trading Companies. The development of Korea's trading companies has contributed to the participation of small and medium-scale firms in the country's export drive. Recent figures showed that for every dollar of export from Korea about 24 cents worth of finished export products were purchased by trading companies from other manufacturers.

Development of Small and Medium-Scale Export Industries. The total value of direct and indirect exports by Korea's small and medium-scale manufacturing firms amounts to some 42 percent of the aggregate exports of Korea's manufacturing industries. By guaranteeing small and medium-scale industries absolute equality in obtaining export incentives, many potential small and medium-scale export producers were brought into export production activities.
Export Credit Insurance

After neutral status for the production of export commodities is achieved, export sales can be expanded by promoting exports through payment methods other than the sight L/C, by establishing a system of postshipment financing and export credit insurance (i.e., insurance against nonpayment by importers). Protection of exporters and export financing institutions against the risks stemming from nonpayment by importers is provided by export credit insurance agencies in Hong Kong, Singapore, and Korea. Recently, Malaysia and Indonesia have also established export credit insurance organizations. However, apart from important gains in institution-building, which occur over relatively long periods, the short run impact of the insurance plans will not be dramatic due to the relatively limited volume of exports that need export credit insurance coverage at early stages of export development.

Postshipment Financing

Postshipment financing covers financing needs for export sales on credit from the time of shipment of commodities to the time of payment. Short-term credit at the postshipment stage is generally made available through the negotiation of bills or advances against bills tendered for collection abroad, backed by the rediscounting facilities available from central banks.
Conclusions

In reviewing export financing, the experiences of the successful East Asian countries illustrate the critical importance of assuring automatic and equal access to export financing for all firms that generate export value added (including small and indirect exporters)—either through competitive financial markets or through the modernized export financing systems—rather than granting financial subsidies. Such an assurance has not only prevented the loss of potential foreign exchange earnings based on confirmed export orders, but has brought large number of potential exporters into the export drives.

The governments of the successful East Asian countries have assured automatic and equal access by providing the supply of funds and risk-pooling schemes to commercial banks handling preshipment export financing, until the time when competitive financial markets were developed and export industries matured. Assuring uninterrupted supply of funds for preshipment export financing at a uniform interest rate has effectively created a situation close to competitive financial and money markets for exporters. Risk-pooling schemes have permitted potential exporters to deal with uncertainties stemming from infant exporters' lack of information on technology, marketing, and management.

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

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

KEEPING PRIMARY INPUT PRICES COMPETITIVE

If primary input markets are not competitive, exporters will be at a disadvantage, because they will pay more than true economic prices for inputs used in export production. The first-best policy for assuring true market or shadow prices for export activities is to keep primary input markets competitive. If the first-best policy is not possible, the government can use export incentives to compensate exporters for the difference between noncompetitive market prices and the shadow prices of primary inputs.

Keeping Primary Input Markets Competitive

Many argue that the export success of Hong Kong, Singapore, and Korea is due to their competitive labor markets and noncombative labor unions, as well as the existence of private sectors that have exercised initiative and creativity in export activities. In general, the wages of unskilled and semi-skilled labor in these economies have been determined by free markets and have been close to their shadow wages, even though these countries appear to depend on both government incentives and markets to attract highly skilled engineers and technicians and to encourage investment in skill information. In short, policies of the successful East
Asian countries have been directed at keeping primary input markets competitive.

It is important to recognize that the competitive primary input market mechanisms, together with the outward-looking development strategies, in the successful East Asian economies have resulted during the 1960s and 1970s in: (i) full employment despite increasing populations and rising labor force participation; (ii) impressive rates of real wage increases in most of the successful East Asian countries that were generally consistent with growth rates for real GNP; and (iii) improved income distribution.

Compensating for Non-Competitive Input Prices

The Philippines' value-added based income tax incentives for export industries may be partly designed to compensate for any discrepancy between actual and shadow wages. In Malaysia, labor utilization relief investment tax incentives can be considered to be compensation for excess wage costs. In turn, tax compensation for skill formation and upgrading has been stressed for the improvement of its segmented labor market. Indonesia's minimum wage regulations and requirements that private firms obtain government approval before dismissing more than 10 workers and pay indemnities for doing so are apparently applied selectively, even though they are not effectively enforced. There are no income tax incentives for exporters in Indonesia.
Conclusions

The simple and straightforward lesson concerning primary input markets in the successful East Asian developing countries is that policies directed at keeping primary input markets competitive would be more effective than those directed at compensating for noncompetitive primary input prices stemming from noncompetitive primary input markets encouraged, created, or ignored by the government. The former policy, together with the successful outward-looking development strategy, has resulted in full employment, increasing real wages, and improved income distribution. If moving from noncompetitive primary input markets to perfectly competitive markets takes considerable time due to political and social constraints, however, exporters need to be compensated for excess input costs through tax or financial export incentives.
CHAPTER VI
COMPENSATORY EXPORT INCENTIVES TO ESTABLISH NEUTRAL STATUS

The definition of neutral status presented in Chapter I indicated that neutral status can be achieved by providing a combination of five elements (a flexible and realistic exchange rate, free trade in inputs and outputs, competitive financial and money markets, competitive primary input markets, and nondiscriminatory domestic taxes) or equivalent compensatory incentives for all activities that generate export value added. This chapter presents a discussion of the compensatory incentives.

As previously emphasized, the major concern of an export financing system is the assurance of speedy and automatic access to short-term working capital at a uniform interest rate, rather than interest rates that may contain preferential margins (even through, as indicated below, the export loan interest rate is frequently used as a compensatory export incentive tool). In turn, because it takes considerable time and effort to prepare a reasonably well-designed and well-managed duty exemption/drawback system, compensatory export incentives are frequently used as temporary measures until exporters are guaranteed complete free trade status. Additional export incentives may be needed to guarantee neutral status by compensating for exchange rate overvaluation and differences between the market and shadow prices of primary inputs. The following discussion groups compensatory export incentives in three categories: (a) financial incentives, (b) tax incentives, and (c) other
incentives. The incentive tools discussed here are designed to achieve neutral status by compensating for less-than-free-trade status or for an overvalued exchange rate. These tools could also be used to achieve extended neutral status, a process that will be discussed in Chapter VII.

Financial Incentives

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

As Primary Instrument for Automatic Access at Neutral Rate. A means of guaranteeing that exports will have neutral status vis-a-vis foreign competitors is to assure automatic access to short-term working capital export loans at an interest rate that is close to the short-term international market interest rate. A means for achieving the parallel objective of guaranteeing neutral status vis-a-vis domestic competitors, including the beneficiaries of preferential credit rationing, is to assure automatic access to short-term working capital export loans at an interest rate that is close to the average interest rate of domestic bank loans, including various preferential loans. As domestic money and financial markets become competitive and a single prime market interest rate prevails, the uniform neutral interest rate charged for short-term working capital export loans might best approximate the prime rate.

As a Subsidiary Compensatory Instrument. Although the use of short-term working capital loans as a compensatory instrument to achieve
neutral status for exports (i.e., to compensate for other policy failures such as overvalued exchange rates) is less important than assuring automatic access to short-term financing at neutral rates, such loans have frequently been utilized as a compensatory instrument in many developing countries at the early stages of their export development.

For Korea, one may infer that (i) a neutral interest rate has been assured for export loans and (ii) interest rates have been used at times as a supplementary instrument to compensate for exchange rate overvaluation. The gap between the prime rate and the interest rate on export loans declined monotonically over 20 years before it was eliminated in 1982, as exchange rate overvaluation has gradually been reduced due to a more flexible exchange rate. Singapore's gap between the prime rate and the export financing rate has never exceeded 1 to 1 1/2 percent. While there has been no need for government-supported export loans in Hong Kong because of easy access to local financial institutions and a free flow of international financial resources (the results of efficient financial institution development), the market interest rate is not uninfluenced by government policies. At least two instruments are being used to influence effective interest rates on deposits: maximum interest rates (set by Hong Kong Association of Banks' Interest Agreement) and tax rates. The interest gaps between the export loans and the preferential loans for non-export industries in the Philippines, Indonesia, and Malaysia do not appear to be very large.

We reemphasize here the importance of having a proper perspective on the relative administrative difficulties involved in achieving the
primary objective of automatic access to export financing and the secondary objective of compensating for non-neutral elements, as well as the relative importance of these loans. To achieve the primary objective of assuring automatic access to working capital loans at a neutral interest rate for all activities generating export value added demands painstaking institution-building efforts that may take anywhere from a few to a great many years, depending on conditions that vary from country to country. But the consequences of failing to achieve this objective are far more serious than the impact of interest rate changes.

Medium- and Long-Term Loans for Exports on Deferred Payment Basis. The use of preferential interest rates on medium- and long-term loans on a deferred payment basis are merely designed to compensate exporters in developing economies for any disadvantages they may suffer in the world market when developed economies use similar practices. The Export-Import Bank of Korea provides medium and long-term loans for Korean exports on a deferred payment basis. The Export Credit Insurance Corporation of Singapore Ltd., introduced a Fixed Rate Export Finance Scheme in 1979 that provides exporters with medium and long-term financing at fixed preferential rates of interest for capital good exports sold on credit for two years or more. (The scheme was suspended in February 1981, reintroduced in July 1981, and then suspended again). There is no medium or long-term export financing scheme in Malaysia, Indonesia, or the Philippines.
Investment Capital Assistance. Korea has made three types of investment capital loans available for export industries: (i) foreign currency loans to finance imports of capital goods for export industries, (ii) investment loans for export industries, and (iii) loans for small and medium-scale export industries. Even though these three types together did not exceed 15-20 percent of total export loans during 1975-79, the government's attempts to establish neutrality were reflected by these arrangements as well. Investment capital loans were critical in bringing new small exporters into export activities at the same time that the domestic L/C system provided them with preshipment working capital financing. Singapore provides no special capital assistance for export industries. However, in view of the small size of Singapore's domestic market and the country's heavy reliance on exports for GNP and employment, it may be reasonable to assume that most preferential investment capital schemes are related to exports, directly or indirectly.

Tax Incentives

Income tax reductions of one form or another are the major tax incentives for exporters. Depending on the basis for tax reductions or deductions, we classify tax incentive schemes as: (i) profit-based, (ii)
sales-based; (iii) value added-based, (iv) specific expense (noncapital) based, and (v) investment-based.

**Profit-Based Incentives.** The simplest and most straightforward tax incentive is the income tax reduction for export profits, a scheme currently being implemented in Singapore. In addition to a 90 percent reduction offered to export enterprises, Singapore provides a 50 percent income tax reduction for certain foreign exchange earning operations. Hong Kong's tax incentives, in contrast, rely on a low uniform rate. In Korea, income tax reduction incentives (of half the regular rate) were used very effectively during a period from the mid-1960s to the mid-1970s, which was a critical stage in export development there.

**Sales-Based Incentives.** Malaysia's income tax deduction for export allowances is a sales-based tax incentive. The allowance consisted of 2 percent of a company's total export sales during the basis year, and 10 percent of any increase in export sales in the basis year over export sales in the previous year until 1982. Since 1983 the allowance is 5 percent of total export value.

**Value Added-Based Incentives.** The Philippines' system of granting income tax credit on the net local content of exports is a value-added based incentive scheme. The value added-based tax incentive is
the most ideal form of tax incentive for exports, but highly efficient administrative arrangements are needed to implement this type of scheme.

Specific Noncapital Expense-Based Incentives. Singapore's system of double income tax deductions for overseas marketing expenses, Malaysia's similar scheme for certain export promotion expenditures, and Korea's income tax allowance for various "reserve accounts," including overseas marketing expenses, are specific noncapital expense-based tax incentives.

Investment-Based Incentives. Singapore's investment tax credit scheme and Korea's accelerated depreciation allowances are investment-based tax incentives. The former is an alternative to using pioneer status incentives or tax reductions for export profits. Pioneer status tax incentives (providing tax holidays during an initial 5 to 10 or 2 to 12 years' production), which are being implemented in Singapore and Malaysia, are the most important investment-based tax incentive schemes not directly related to export activities. Malaysia's investment incentives not directly related to exports, other than its pioneer status incentive, are the investment tax credit, the increased capital allowance, the accelerated depreciation allowance, and the reinvestment allowance.

Other Compensatory Export Incentives

Other types of compensatory export incentives can be grouped as: (i) import protection-related incentives, (ii) infrastructure support, and (iii) technical or marketing assistance.
Import Protection-Related Incentives. Through a wastage allowance scheme, which allows additional wastages on top of the normally required input-output coefficients in administering duty-free imports of intermediate inputs for export production, efficient firms can benefit by selling the residual inputs imported duty-free that have been saved in the process of producing export commodities in the protected local market. An import-export link system permits import of prohibited or restricted items that can be sold domestically at protected prices in exchange of exporting certain goods. The success of these incentives requires modernized and well-managed administrative arrangements. Korea used these compensatory tools on a highly selective basis in early stages of export development.

Infrastructure Support. Industrial parks and infrastructure facilities for export industries can be important compensatory incentives.

Technical Assistance. Government assistance on such matters as product engineering, quality control, skill upgrading, marketing, accounting, and management is very important to manufacturers and traders, especially in the early stages of export development. However, the fact that Singapore, Hong Kong, and Korea still provide such assistance implies that its importance extends beyond the early stages.
Conclusions

A review of compensatory export incentives in the successful East Asian countries shows that guaranteeing automatic and equal access to preshipment short-term working capital export loans to all firms generating export value added is much more important and difficult than adjusting interest rates of these loans as a compensatory incentive instrument. Another lesson is that, while various tax incentives have been quite effective at certain stages of export development in establishing neutral status, the importance of other compensatory export incentives such as import protection-related incentives, infrastructure support, and technical assistance should not be overlooked.
CHAPTER VII
EXTENDED NEUTRAL STATUS

Extended neutral status was defined in Chapter I as a situation in which the level of export incentives is as high as the level of incentives for import substitution activities. The various compensatory export incentive tools discussed in Chapter VI as instruments for achieving neutral status can also be employed to achieve extended neutral status.

The theoretical justification for implementing extended neutral status for export industries is that unless the effective incentives for export activities are close to the corresponding effective incentives for import substitution activities, private producers will prefer to sell their products in the domestic market. The major empirical studies on trade regimes and the industrial development performance of developing countries have concluded that economies that have maintained extended neutral status for industrial export industries have performed far better in terms of exports and economic growth than the economies that have failed to do so, as discussed in Chapter I. These studies have generally defined extended neutral status at an aggregate level.

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

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

**Empirical Evidence**

We can examine the empirical evidence on the critical importance of the internal structure of extended neutral status for export activities by comparing Korea with another developing country at a similar stage of industrial maturity, Brazil. Although one can conclude that these countries have more or less achieved extended neutral status at the aggregate level for their export industries, there has been a marked difference between the two countries at the micro level.
Korea's extended neutral status has been built on neutral status as defined at the firm or product level, while Brazil's did not do so until 1982. Korea has succeeded in achieving neutral status for all activities generating export value added at the product and firm level, even though it has not assured extended neutral status across the board at that level. Korean exporters--direct and indirect--have enjoyed a free trade status and automatic access to export financing without exception, either with or without compensatory tax and financial incentives designed to achieve extended neutral status. Therefore, at least the minimum level of neutral status was assured for every exporter, resulting in little variation in effective incentives among exporters.

Brazil's export incentive system, on the other hand, used financial and tax incentives to achieve an aggregate extended neutrality without neutral status at the firm and product level. Many exporters could enjoy neither duty-free and restriction-free imports (until 1982) nor automatic access to export financing, while large discretionary tax and financial incentives were provided for selected exporters. At the aggregate level, negative and positive incentives cancelled each other, yielding extended neutral status. The result, however, was extreme variation in incentives among exporters and potential exporters, discouraging participation in the country's export drive by those firms subject to negative incentives of less than free trade status. The comparison suggests that guaranteeing neutral status for all activities
generating export value added at the product and firm level is much more important than providing an extended neutral status for export industries at the aggregate level.

Singapore has been similar to Korea in guaranteeing neutral status for export activities by (i) providing free access to intermediate inputs and export financing, (ii) paying competitive market wages to workers, and (iii) compensating for exchange rate overvaluation by means of compensatory export incentives before development of the exchange rate market. Hong Kong is a classic case in which an extended neutral status for export activities collapsed to neutral status for all activities, with impressive export and economic development based on the neutrality of incentives maintained by free international trade and competitive markets for money, finance, capital, labor, and foreign exchange. Malaysia, the Philippines, and Indonesia are all attempting to move toward neutral or extended neutral status as part of their efforts to rationalize trade and industrial policies.

Threats of Retaliation and Policy Options

In light of threats of retaliation, the incompleteness of the analytic framework employed by many developed countries in defining export subsidies (in particular, inability or reluctance to accept the role of compensatory export incentives for achieving neutral status), and the conventional wisdom based on classical welfare economics, developing
countries are well advised to do their best to achieve neutral status for export industries at the micro level, with minimum utilization of compensatory tax and financial incentive tools. Compensatory export incentives judged absolutely essential to achieving neutral status should be used as temporary measures.

The danger of retaliation is even greater if a developing country relies heavily on compensatory fiscal and tax incentive instruments in achieving extended neutral status under a very high import protection wall. The burden of narrowing the gap in effective incentives between exports and import substitution should be accomplished largely by lowering import protection levels. In sum, while focusing on neutral status, developing countries might well put more resources into export incentives that are not controversial, such as infrastructures, technical assistance, and institution-building for efficient administrative arrangements that include domestic L/C, preshipment guarantee, modernization of the export financing system, export credit insurance, and duty drawback systems.

Conclusions

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

If a country wishes to achieve extended neutral status, a first step is maintaining neutral status at the product and firm level. Second, the major burden of achieving extended neutral status would most wisely be placed on lowering import protection. Third, if additional export incentives beyond neutral status are sought, noncontroversial incentives such as institutional support, overhead structure, and technical assistance are least risky.
The conventional export incentives and administrative arrangements will be useless unless they are effectively implemented through sound institutional mechanisms. They will make little difference in export development (even if well-implemented) if producers, investors, and traders in a developing economy do not respond aggressively to rational incentive policies. If potential exporters lack the ability to respond to incentives, as well as price and quantity signals in the internal and external markets, it is also a responsibility of the government to become a catalyst in creating that ability. In this chapter, therefore, we are interested in the lessons to be learned from the experiences of the successful East Asian countries regarding key institutional mechanisms that can result in effective government action and vitality of the private sector.

**Commitment to an Outward-Oriented Strategy**

A strong political commitment to an outward-oriented development strategy is essential for the implementation of effective institutional mechanisms. An outward-oriented strategy supports neither inefficient
import substitution nor inefficient export, but supports both efficient export and efficient import substitution.

A critical factor in the exporting successes of Hong Kong, Singapore, and Korea has been stable-and efficient governments committed to an outward-looking strategy. Malaysia's "Look East" policy appears to reflect its commitment for an outward-oriented strategy, while Indonesia's January 1982 Export Policy reflects that government's intention to promote export. The Philippines' recent reforms of duties and BOI incentives reflect the government's policy to move toward an outward orientation.

**Externality of Export Activity**

Externality is found in the tremendous efficacy of export activity as a means of acquiring industrial competence because of easy access to overseas information and technical knowledge, and because of the competitive attitude generated by going into the world market. The externality hypothesis, adopted in explaining the superiority of an outward-looking strategy, may be based on the empirical evidence associated with the impressive performance of the East Asian economies during the 1960s and 1970s. The vitality in the economies of Hong Kong, Singapore, and Korea appears to be the outcome of competing in the world market and the gains in productive efficiency stemming from exporting.
Although one could argue that a developing economy must have effective institutional mechanisms before it adopts an outward-oriented strategy, it is precisely in those economies that have not had any effective institutional mechanisms that an outward-looking strategy could make the greatest contribution to the development of such mechanisms. In such economies, experience in the world market would be an eye-opener; going into export markets could become an agent for change.

Implementation of Export Policy

Instrumental to implementing and maintaining export incentives is development of institutional mechanisms that gather and disseminate the information needed to implement incentives and the administrative arrangements for those incentives. Two such institutional mechanisms critical in the Korean export drive are a system of setting export targets and the practice of holding monthly trade promotion meetings. Government ministries, in concert with firms, have sought to identify problems and opportunities and to determine appropriate actions. These actions have been characterized by pragmatism, speed, and flexibility. Specifically, the government has been willing to try any methods that might achieve a desired end, it has preferred immediate implementation of policies to protracted study, and it has been willing to modify policies and programs and retreat from mistakes without jeopardizing the public's perception on
the permanence of the government's commitment to an outward-looking strategy.

Korea's export target system and monthly trade promotion meetings have also made possible the use of unconventional export incentives, such as public exhortations by political leaders about the importance of exporting, public awards given to exporters who set export records, and encouraging firms to export in the early stages of production of goods for sale on the domestic market. Singapore's institutional mechanism for incentive administration is also characterized by flexibility, both in initiating required changes and in responding to new problems, and the process of decision-making is distinguished by efficiency, pragmatism, and a "top-to-bottom" approach.

**Partnership between Business and Government**

In the early stages of export development, it is essential to have a strong partnership between the government and business. The synergistic partnership between business and the government in Hong Kong, Singapore, and Korea, which are in mature stages of their export development, is evidence of the critical importance of such a collective approach.
Export Promotion Institution

The efforts of Hong Kong, Singapore, and Korea to mobilize both the government and private firms are reflected in the organizational structures and revenue sources of the Singapore Trade Development Board, the Hong Kong Trade Development Council, and the combination of the Korea Traders Association and the Korea Trade Promotion Corporation. These trade promotion agencies are financed partly or entirely by the net proceeds of an ad valorem levy on exports and imports. The most vital function of an export promotion agency is to play the role of catalyst in carrying out an outward-oriented strategy, in addition to the commonly perceived role of promoting overseas marketing. The experience of the developing countries that have succeeded in export development indicates that they had initially relied more on foreign buyers rather than investing large sums to set up their own elaborate marketing networks, delaying such networks until they learned marketing techniques and export industries matured.

Organizing the Private Sector

It is difficult to imagine how the private sectors of Hong Kong, Singapore, and Korea could have competed in the world market if they had not organized themselves, as they have done so impressively. In Hong Kong, for example, more than two hundred industrial and commercial associations and chambers of commerce covering more than seven thousand member firms are integral to the much-talked-about market-oriented economy, which is by no
means a laissez-faire economy. In the case of Korea, besides the Korea Traders Association, there are more than thirty specialized exporter associations. These associations are private organizations, but they were established under the government's trade promotion law. Singapore's major private sector associations reflect the diverse ethnic composition of the private sector as well as differences in firm size.

Inducing Foreign Factors

Foreign factors are particularly important to a developing country at the early stage of export development. Therefore, adopting a very progressive approach to bringing foreign factors into the country is critical. A review of the relative importance of domestic and foreign factors for manufactured export good production or sales activities in the six East Asian economies shows that Singapore has relied extensively on direct foreign investments for its export development, while Korea and Hong Kong have more or less utilized unpackaged foreign factors. Similarly, Malaysia and the Philippines have relied more on direct foreign investments for their export development than Indonesia has.

Developing countries at an early stage of export development have a lot to learn from Singapore's pragmatic approach to direct foreign investments. Hong Kong's multinational chemistry, characterized by its unique status as a free port and international financial center, in combination with its free market mechanisms, has contributed greatly to
inducing foreign factors for development. The most important element appears to be an enlightened administration that gives full play to individual entrepreneurship within a stable and secure environment. Korea has relied rather heavily on inflows of investment resources in the form of debt rather than equity. Except for industries established during the colonial period, technology has been acquired from abroad largely through means other than direct foreign investments. Turkey plant import has been of great consequence in the transfer of technology, and a tremendous amount of know-how has entered with Koreans returning from study or work abroad.

Malaysia’s successful inducement of foreign direct investments into its export industries has been achieved through its policy of promoting FTZs. However, measures beyond the FTZs may be needed to ensure efficient backward linkages with local resources. Although a 1972 study showed that in the Philippines large-sized firms with foreign management tended to have a higher degree of export orientation, some argue whether exports based on foreign direct investment have made a maximum contribution to employment by generating backward linkages and utilizing local primary factors. In Indonesia, there appears to be a growing feeling that a more concerted effort to induce foreign involvement in manufacturing would maximize the contribution of foreign factors to export development.

Conclusions

The experience of the successful East Asian countries are unique in providing important unconventional lessons. First, effective
implementation of export policy might have been difficult without strong political commitments to outward-looking strategies and efficient institutions (public and private) and without development of well-managed administrative arrangements. Second, specific institutional mechanisms have been critical in creating a synergistic partnership between government and business that has stimulated vitality in the export community and exploited the externality of exporting. Third, the private sectors have been organized effectively and foreign factors absent in domestic economies have been induced with marked success.
The important lessons from the experiences of the successful East Asian countries can be summarized under three general headings: (a) neutral status as the centerpiece of export policy and administration, (b) export as a first step for rationalization and efficiency, and (c) institutional mechanisms as a catalyst for implementing export policy and administration.

Neutral Status as the Centerpiece

Guaranteeing neutral status at the individual product and firm level for all activities that generate export value added has been the cornerstone of the development strategies of the successful East Asian countries and has anchored their export development. Neutral status has been achieved by a combination of the following or equivalent compensating incentives: (i) flexible and realistic exchange rates, (ii) free trade in inputs and outputs, (iii) competitive money and financial markets, (iv) competitive primary input markets, and (v) non-discriminatory domestic taxes.
Flexible and realistic exchange rates for export activities have been maintained either through a free market-based foreign exchange regime (for countries with mature financial markets and institutions) or through a managed foreign exchange regime employing a crawling peg, supported by various compensatory export incentives when an adjustable peg resulted in exchange rate overvaluation. Free trade status for all activities (including participation of small and indirect exporters) that generate export value added has been provided by free trade, free trade zones, and/or a well-managed duty exemption/drawback system. Automatic and equal access to bank loans at a neutral interest rate for all activities that generate export value added has been provided by either competitive financial markets or a modernized export financing system. Competitive primary input prices have been assured through government policies that have attempted to keep primary input markets competitive. Neutral domestic taxes have been achieved either through uniform tax rate systems or compensatory tax incentives designed to achieve neutral status.

What is most impressive about export incentive administration in the successful East Asian countries is the innovative schemes employed, such as the domestic L/C systems and the modernized export financing systems, which have contributed so much to the establishment of neutral status when competitive markets have not yet been developed.

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

**Export as a First Step**

The most productive sequence of policy reforms that have transmitted efficiency throughout the economies of the successful East Asian countries appears to be dealing with export first—to provide neutral status and encourage production efficiency by competing in the world market—and then gradually or over short periods imposing neutral status and transmitting efficiency to the entire economy (including import substitution industries). Several factors appear to be responsible for the success of this strategy: (i) successful exploitation of the tremendous externality associated with exporting, (ii) a relatively low or negligible level of domestic protection or a commitment to maintain protection only as a temporary measure for the sake of infant export industries, and (iii) introduction of efficient institutional mechanisms—both public and private—that have led firms to view the domestic and export markets as equally essential to their success rather, than as distinct entities that offer the choice of competing in either one market or the other.

**Institutional Mechanisms as a Catalyst**

An important unconventional lesson to be learned from the experiences of the successful East Asian countries is that effective
institutional mechanisms—both public and private—have been critical, acting as catalysts for (i) implementing export policy and administration and (ii) developing the ability and desire of producers and traders to respond to opportunities in the world market. A strong political commitment to an outward-looking development strategy has in turn been critical in developing such institutional mechanisms. A synergistic partnership between business and government has also been a key factor.

Implications for Other Developing Countries

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

The critical role of public and private institutions and of efficient administrative arrangements in successfully implementing rational policies must also be recognized and understood. The fact that institutional and administrative capabilities of the developing countries vary tremendously actually strengthens the argument for the importance of
institution-building, because the alternative—when faced with a lack of institutional capability—would be to abandon development efforts altogether.
A Brief Review of the World Lube Oils Industry
A. Ceyhan, H. Kohli, L. Wijetilleke, and B.R. Choudhury
This report assesses the structure, background, and outlook for the world lube oils industry. Presents the historical and projected lube oils demand and trends in manufacturing and provides an indicative assessment of the economics of lube oil production with detailed market and economic data.

Capital Utilization in Manufacturing: Colombia, Israel, Malaysia, and the Philippines
Romeo M. Bautista, Helen Hughes, David Lim, David Morawetz, and Francisco E. Thoumi
The authors surveyed 1,200 manufacturing firms in four developing countries to establish actual levels of capital utilization. The information collected was the first and remains the only data base available for the study of capital utilization. It was found that capital utilization is not as low as had been supposed. The study is concerned with factors that cause differences in levels of capital utilization and the policies that might be used to increase it.
Oxford University Press, 1982. 288 pages (including bibliography, index).

The Construction Industry: Issues and Strategies in Developing Countries
Ernesto E. Henriod, coordinating author
Presents a profile of the construction industry. Points out that construction work represents 3 to 8 percent of the gross domestic product of developing countries. Fostering a domestic capability in construction, therefore, is important. Discusses problems and constraints of the industry and formulates strategies for future actions. Draws heavily from the experience of the World Bank in supporting construction industries over the past ten years. Useful to contractors, engineers, and administrators in construction industry.

Cost-Benefit Evaluation of LDC Industrial Sectors Which Have Foreign Ownership
Garry G. Pursell

Development Finance Companies
Examines the role of development finance companies as major mechanisms for assisting medium-scale productive industries, assesses their potential for aiding small enterprises in meeting socioeconomic objectives of developing countries, and discusses the evolution of World Bank assistance to them.
Stock Nos. BK 9040 (English), BK 9058 (French), BK 9041 (Spanish). $5.

Empirical Justification for Infant Industry Protection
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Employment and Development of Small Enterprises
David L. Gordon, coordinating author
Examines the potential role of the World Bank in encouraging developing countries to assist small enterprises and suggests that efficient substitution of labor for capital is possible in a broad spectrum of small-scale manufacturing and other activities that are able to absorb a rapidly growing labor force.
Stock Nos. BK 9060 (English), BK 9061 (French), BK 9062 (Spanish). $5.

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Anne O. Krueger and Baran Tuncer
Staff Working Paper No. 422. 1980. 64 pages (including references, appendix). Stock No. WP 0422. $3.

Financing Small-Scale Industry and Agriculture in Developing Countries: The Merits and Limitations of “Commercial” Policies
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Mary M. Shirley
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Manufacture of Heavy Electrical Equipment in Developing Countries
Ayhan Çilingiroğlu
Analyzes growth and competitiveness, comparing prices and costs with those in the international market.
Spanish: Fabricación de equipo eléctrico pesado en los países en desarrollo. Editorial Tecnos, 1971. $5.50 paperback.

The Mining Industry and the Developing Countries
Rex Bosson and Bension Varon
An overview of the world's nonfuel mining industry, its structure and operation, and the major factors bearing on them.
Occupational Structures of Industries
Manuel Zymelman

Eighty-four tables profile the occupational composition of industries in each of twenty-six countries. Data show the structure of employment by sectors and industries for each country; cross-classify 120 occupations with fifty-eight industries; and provide information about productivity (value added per person engaged), energy consumption per person engaged, and employment.


Policies for Industrial Progress in Developing Countries
John Cody, Helen Hughes, and David Wall, editors

Analysis of the principal policy issues that influence the course and pace of industrialization in the developing countries. The text, organized along lines of governmental administrative responsibility for various industrial policies, includes chapters on trade, finance, labor-technology relations, taxation, licensing and other direct production controls, public enterprises, infrastructure and location, industry-agriculture linkage, and the international environment.


Pollution Control in Sao Paulo, Brazil: Costs, Benefits, and Effects on Industrial Location
Vinod Thomas

Stock No. WP 0501. $5.

The Process of Industrial Development and Alternative Development Strategies
Bela Balassa

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