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PART II

Anatomy of Exchange Control Regimes: Patterns and Sequences

Chapter 2

Anatomy of Exchange Control Regimes

In this chapter, we propose to delineate the alternative forms that direct controls can, and often do, take under exchange control regimes.[1] These possibilities are illustrated extensively from the country studies. They are also taxonomically organized in a functional fashion: thus many so-called administrative details, which are often considered to be economically uninteresting, are shown to be of economic importance, having distinct effects on economic efficiency and on income distribution. The chapter concludes with a brief delineation of the *price* measures that often co-exist with the direct controls under the exchange control regimes.

I. CONVENTIONAL THEORY

The analysis of quantitative restrictions in the trade-theoretic literature has generally relied on the so-called equivalence proposition. This Marshallian proposition asserts that tariffs and quotas are basically equivalent in their real effects, the only difference being in their revenue (and, to that extent, in their income-distributional) effects, as noted in Figure 2-1 and the legend thereto. Thus, if a quota were to be replaced by a tariff set at a rate that *equals* the ratio of the import premium to the c.i.f. import price, the "real" effects on domestic and international equilibrium values of production, consumption, and prices would be identical. The only difference would be that the government would now pick up the import premium as tariff revenue.

Related to this basic equivalence proposition, of course, is the standard Marshallian depiction of the QR regime in terms of the supply and demand

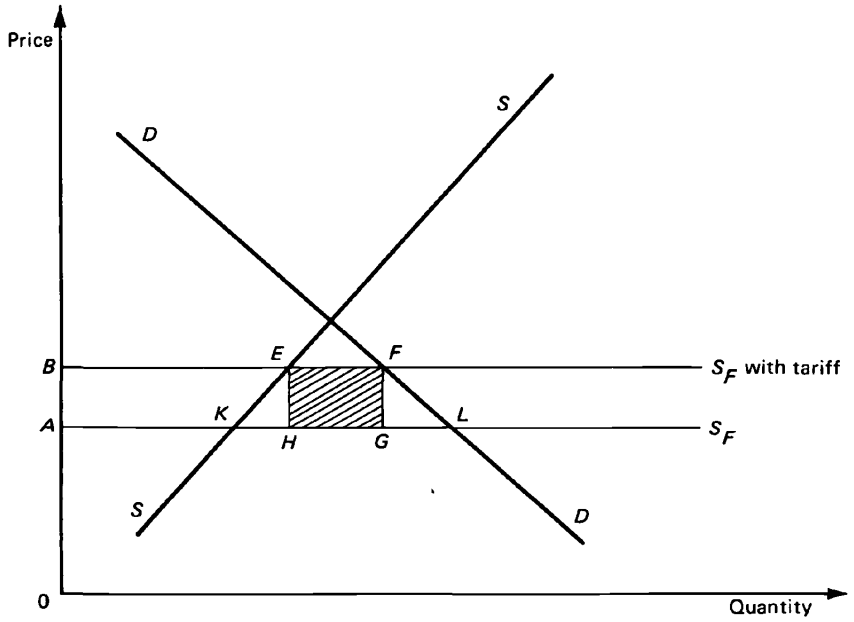

Figure 2-1. The Equivalence of Tariffs and Quotas Under Perfect Competition.

(*DD* and *SS* are the domestic demand and supply curves for a product. S_F is the foreign supply curve. A tariff at rate *BA/0A* shifts S_F upward and reduces imports from *KL* to *EF*. *EFGH* is then the import tax revenue. Alternatively, an "equivalent" import quota of *EF* units could be imposed, leading to the same equilibrium except that *AB/0A* would now be the import premium rate on c.i.f. import price and the revenue *EFGH* would now accrue to the holders of the import licenses.)

schedules of foreign exchange. The QR-equilibrium price of foreign exchange would then be lower than the "true" equilibrium price, the lower quantities would be cleared at an import-premium-inclusive price, and it would generally be argued that the same QR equilibrium could be equally achieved by an equivalent tariff on imports (which would make the effective exchange rate on imports equivalently higher than the effective exchange rate for exports), as noted in Figure 2-2 and the legend thereto.

Such "equivalence" notions have typically provided the underlying conceptual basis for many quantitative and descriptive studies of the trade and payments policies of LDCs. An excellent example is the World Bank study of the structure of LDC protection, which does not extend to discussion of many of the caveats that must surround the resort to the equivalence assumption.[2] At the same time, however, it has increasingly been appreciated in the theoretical

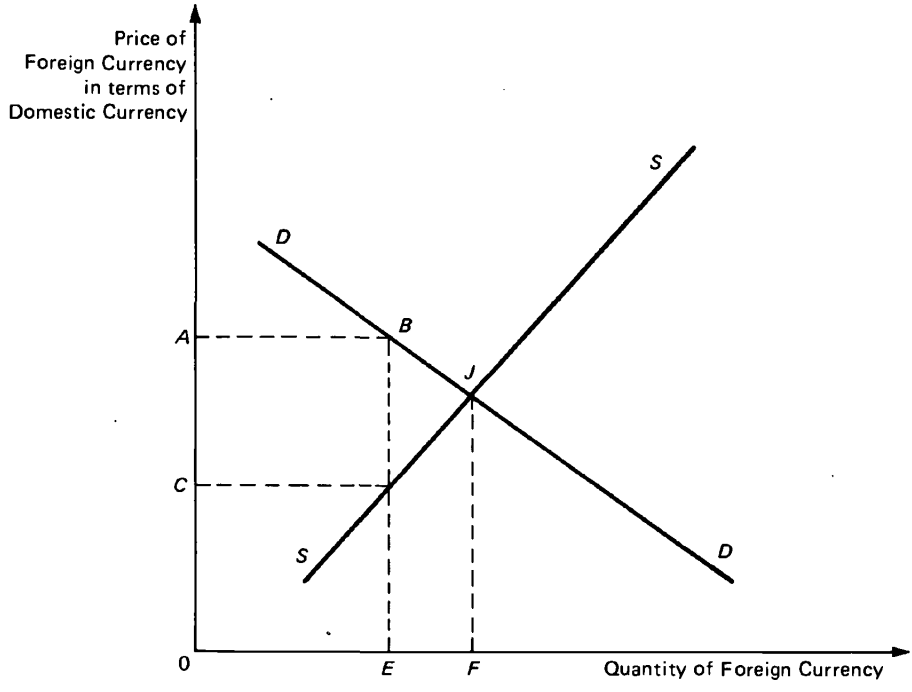

Figure 2-2. The Foreign Exchange Market and Overvaluation.

(*DD* and *SS* are the supply and demand curves for foreign exchange. The equilibrium price should be *JF*. However, *QR*s peg the exchange rate at *0C*, resulting in quantity *0E* of foreign currency being supplied. This amount clears the market at *domestic* price *0A*, the difference *AC* then representing the premium on foreign exchange and the premium rate being *AC/0C*.)

literature that the Marshallian equivalence assumption will hold only under singular circumstances. Yet, as will be evident below, even this theoretical literature is concerned only with a narrow set of non-equivalence circumstances and leaves out many aspects of exchange control allocation mechanisms in practice that, as the country studies in the Project illustrate, have definite efficiency and distributional effects that are asymmetrical to those that would obtain if the same quotas were replaced by *ad valorem* tariffs (levied at rates identical to the observed ratio of import premium to c.i.f. import prices under the quota regime).

Thus, the conventional equivalence proposition has been shown in the theoretical literature to depend on special restrictions. Within the Marshallian framework, Bhagwati has shown that equivalence can break down when the assumption of perfect competition is replaced by, say, monopoly in domestic

production, export supply, or quota holding, that is, institutional assumptions that are not exactly foreign to the economic scene of many LDCs.[3] Moreover, within the same partial-equilibrium framework, Fishelson and Flatters, as well as Pelcovits, have discussed the relative merits of quotas and tariffs under conditions of uncertain supply and/or demand using a two-period analytical approach to rank, with respect to welfare, the two instruments for optimal restriction of trade and to achieve target level of domestic production respectively.[4] Their analysis implies that, if the policy instrument cannot be flexibly adjusted to the situation materializing when uncertainty is resolved, the equivalence of tariffs and quotas, as defined, will not hold. Next, McCulloch and Johnson have shown that proportionally distributed quotas (i.e., as when import licenses are assigned *pro rata* to importable production, as with U.S. oil imports) will produce differential welfare levels from tariffs (or "normal" quotas), while achieving the same "non-economic" objectives such as targeted levels of imports or import-to-production ratios.[5] Although they do not consider the equivalence question in the sense defined here (i.e., if the observed premium under the quota equilibrium is replaced by a tariff set at the rate defined by the premium-to-landed-price-of-import, the equilibrium values of prices, production, and consumption, domestically and abroad, will not change), it is readily shown that, if the premium observed under a proportionally distributed quota regime is turned instead into an explicit tariff, the resulting equilibrium will *not* be equivalent.

Finally, using general equilibrium analysis, Rodriguez and Tower have recently demonstrated that, in a retaliation analysis of the Cournot-Johnson variety, the retaliation process, using optimum tariffs, may lead to welfare improvement of either country and to tariff cycles, whereas the same process, using instead optimum quotas, would lead inexorably to an erosion of world trade.[6]

A little reflection will show that what is essentially at the bottom of these demonstrations of non-equivalence is the breakdown of the implicit Marshallian assumption that the supply and demand schedules are given. If they can change *exogenously* (to the use of quotas or tariffs), then non-equivalence will arise purely because the policy instruments being compared are not flexible and cannot be adjusted parametrically to suit the new supply and/or demand schedules. This is clearly the case in the analysis of uncertainty by Fishelson-Flatters and Pelcovits. If the supply and/or demand schedules will change *endogenously* (to the use of the trade policy instrument), then the equivalence will generally break down regardless of flexibility in the use of the tariffs/quotas. This latter is clearly the case in Bhagwati's demonstration where the introduction of monopoly in his analysis of quota holding and of domestic production involves differential, policy-related shifts in the supply and demand schedules; in the McCulloch-Johnson case where proportionally

distributed quotas affect supply incentives; and in the Rodriguez-Tower analysis where the duopolistic responses of the retaliating countries generate quite different offer curves during the retaliation process so that optimal policy response is also correspondingly different at each step.[7]

While therefore these recent theoretical developments have underlined the strictly limited, almost negligible, scope of the equivalence proposition, the sources of non-equivalence that they formalize are themselves only a small subset of the many different possibilities that are to be encountered in reality and, in fact, are to be found in the countries studied under the present Project. Thus, take only three examples. (1) Under some exchange control regimes, quotas of imported raw materials are assigned to approved industrial users *pro rata* to their capacity (somehow defined). As argued later, this obviously creates (*ceteris paribus*) an incentive to add to capacity in the presence of excess capacity since capacity attracts premium-carrying import allocations. (2) Alternatively, consider the case of inefficiency following rather from the specification of strict non-transferability of imported raw materials. In the absence of illegal markets, or coincidental balancing of demands and supplies in specific markets, serious bottlenecks could arise with magnified income losses. (3) Or, consider the case where all capital goods imports are controlled to restrict domestic entry; all raw material imports are allocated, *pro rata* to installed capacity, to the existing producers; and competing imports are also strictly regulated in the interest of domestic producers. In this case, there is virtually no real competition with possible efficiency consequences on cost-minimization, and so on.[8]

Clearly, therefore, efficiency, and related distributional, consequences will follow from the methods of allocating quotas (as is, in fact, evident also from the existing theoretical analysis of the proportionally distributed quotas already alluded to). We proceed therefore to a taxonomy of the various ways in which imports are, in fact, regulated under exchange control regimes developing our classification in, we hope, a manner that should lend itself to systematic analysis of the consequences of different types of exchange control regimes. We also take the opportunity to illustrate our taxonomic possibilities by reference to the country studies. In fact, it is these studies that have suggested the different possibilities. We shall also account, insofar as is possible, for the "reasons" that may explain the presence of these different features in our countries' exchange control systems at different times.

II. REGULATING IMPORTS

We begin first by distinguishing among alternative characteristics of import control systems. We can analyze import control regimes by their features on

five different dimensions (each of which has implications for economic efficiency and income distribution):

1. The regulation of imports by source
2. The regulation of imports by commodity composition
3. The regulation of imports by end use (in the broadest sense)
4. The regulation of imports by payments conditions
5. The regulation of imports by the degree and kind of restrictions on the disposal of the licenses (or the imports thereunder) once one or more of the preceding forms of regulation have been attempted[9]

While we focus initially on methods of regulating imports, we proceed then to discuss briefly alternative forms of regulating exports. The methods of operating exchange restrictions on capital account also can vary but less so and are well understood; hence we forego discussing them here. Besides, few countries are characterized by or aim at achieving restriction-free capital accounts. The debate among the proponents and opponents of exchange control regimes thus is focused on the control of current account, as distinct from capital account, transactions.

A. Regulation of Imports by Source

A number of our country studies show that the exchange control regime was characterized by restrictions on imports by source. But the reasons for such a phenomenon were diverse. Three were particularly relevant during the 1960s.[10]

1. Aid-tying.

One of the reasons for specification of source on import licenses was aid-tying. Through the 1960s, aid came to be increasingly tied by source (and by commodity specification). The donor countries, when in deficit, thought it necessary to avoid any leakage of their funds into purchases from the surplus countries. And the surplus countries followed suit by giving in to their exporting interests. The Germans found it difficult to counter their exporters who complained that their American rivals could compete for German-aid-financed contracts whereas they could not tender for the U.S.-aid-financed purchases.[11] Thus, the bulk of aid flows came to be tied by source by the second half of the 1960s.[12]

The source specification of import licenses from the United States, the United Kingdom, Japan, and other aid donors was thus evident in Colombia, Pakistan, Israel, India, Phillippines, South Korea, Ghana, and Turkey, among our countries.[13] One example should illustrate. Thus, in Colombia, Carlos Díaz-Alejandro has shown that the use of import controls to enforce

aid-tying to U.S. sources was definitely prevalent and his amused comment thereon is worth quoting:[14]

> INCOMEX and related institutions took strong measures to divert purchases toward U.S. products. . . . Those were the days of bitter wrangling over "positive" and "negative" lists, "additionality." U.S. officials were in the awkward position of simultaneously urging Colombians to liberalize import controls, to use controls to enforce tying, and to stop using controls to divert imports toward bilateral partners, such as Spain and the socialist countries.

2. BILATERAL TRADE AGREEMENTS.

An equally important cause of source-tying of imports, for several of the countries in the Project, was the bilateral trade agreements. These agreements were often signed by LDCs with one another and were of special importance in their trade with the Soviet-bloc countries. In what is probably the most important instance of the latter relation, the share of Egypt's trade with Eastern Europe rose fivefold from 1950 to 33.5 percent of imports and 60.7 percent of exports in 1970.[15]

The standard practice in such agreements was to stipulate that the rubles, or any non-convertible currency, so earned must be spent on imports from the country whose currency had been earned from exports under that bilateral agreement. A typical consequence was, of course, that such source-tied import licenses were often sold in the (legal or illegal) market at significantly lower premiums than import licenses without such source restriction, as in India.

The relatively short-lived geographical restriction of Israeli import licensing was clearly due to bilateral agreements. As Michaely notes:[16]

> Paradoxically, significant geographic discrimination started only in 1953, when the general restrictiveness of the system was already rapidly diminishing. This discrimination clearly originated on the export side. In those years, as some capacity for industrial exports developed, it was assumed that such exports would flow provided there was access to protected foreign markets, the instrument for protection being bilateral trade and payments agreements. Consequently, Israel entered into a number of such agreements, in which the partner country was to purchase from Israel mainly industrial products while Israel would buy in exchange mainly foodstuffs and raw materials. The most important partner country to such an agreement was Turkey, with Yugoslavia coming next. Stated in terms of convertible currencies, Israel's imports from these countries were clearly more expensive than similar goods in the free world market. Obviously, each of the partners to such an agreement, tried to sell to the other its most expensive goods and to exclude exports which could compete freely in convertible-currency markets. Although Israel used a specific price mechanism designed to compensate importers for these price differences . . . , this mechanism in itself was quite often inadequate; so that the government resorted to the QR system as a means of directing Israel's import trade toward bilateral agreement countries.

For Ghana as well, Clark Leith has noted the determining influence of bilateral trade pacts on the sourcewise specification of import licenses during the Nkrumah regime in the 1960s:[17]

> The licensing system during 1962 and part of 1963 was not well designed to induce importers to purchase from bilateral-pact countries. Licenses were valid for importation of the specified items from any country. While official entities were redirecting their purchases, for private importers the only apparent advantage that might be achieved by purchasing from trade-pact countries revolved around payment in local currency to the bilateral account in the Bank of Ghana and the consequent reduction in problems associated with arranging payment to suppliers. This was seldom enough to offset the traditional ties with West European and U.S. suppliers. The result of this situation was a substantial undersubscribing of the bilateral accounts in 1962, yielding a positive net balance in bilateral clearing accounts of nearly NC6 million. This phenomenon and its meaning were not unnoticed, and in 1963 specific licenses distinguished between trade-pact sources and other areas. In addition imports of certain goods (8 commodities) could be obtained only from those countries, and 20 percent of other specified imports (28 commodities) were to come from trade-pact countries. For 1964 the redirection of licenses to bilateral trade-pact countries was strengthened. A special exchange allocation was provided, and a list of 35 commodities developed which permitted purchases only in bilateral-pact countries. Further, in order to discriminate among the various bilateral partners, the system of simply distinguishing between bilateral partners as a group and all others was abandoned in favor of specifying the bilateral country from which the licensed commodity had to be imported.

3. Preferential Trade Arrangements.

A related reason for source-tying of import licenses, noted by Carlos Díaz-Alejandro for Colombia, is the existence of preferential trading arrangements (e.g., the Andean Common Market), which, in practice, imply not merely preferential tariffs but also occasionally source-tied import licenses.

Likewise, Chile also had some source-tying of import licenses because of preferential trade arrangements. Thus, in the 1960s, Chile signed two such agreements: the Treaty of Montevideo, which initiated LAFTA, and the Bogota Agreement, which initiated the Andean subregional group.[18]

4. Non-convertibility of Currencies.

A fourth reason for source specification of import licenses was the general non-convertibility of currencies in Western Europe. The source specification of licenses merely reflected then the fact that the foreign currencies earned, or

"released" (in case of sterling balances accumulated during World War II by countries such as Egypt and India), were not convertible and had therefore to be spent, if at all, in the countries that issued them or accepted them (as with sterling in the sterling area). This reason for source specification of import licenses, of course, became inoperative as the Western European currencies became convertible in the 1950s.[19]

B. Regulation of Imports by Commodity Composition

Specification of the items authorized for importation was, of course, an almost standard feature of the licenses issued under the exchange control regimes of the countries studied in the Project. Occasionally it was combined with source specification—as in the case of India—so that there was a double restriction with rather serious consequences that we shall consider presently. The reasons for itemwise or compositional specification of import licenses were diverse.

1. Aid-Tying.

Aid-tying was again a reason for such itemwise specification. The source-tying of aid, by itself, was soon discovered to be subject to substitution possibilities, especially when non-project aid was given. To make source-tying more effective, commodity specification in the import licenses was increasingly sought by donor countries. Thus, typically Japanese yen credits (aid) were available for specific commodities, U.S. aid funds for importing U.S. steel, and so on.[20]

The donor countries often argued (with much truth) that they tried to foresee what the recipient-country importers would buy and only then to agree on the list of permissible imports. Insofar as this was a correct description of the process, the cost of such tying would be less than when the tying looked rather to the donor-country's export interests.[21] We must also note here aid-in-kind, for example, PL480 surplus disposal of wheat, cotton, and other commodities, chiefly from the United States, into countries such as India, Pakistan, Israel, and Chile.

2. Protection.

Quite aside from aid-tying by commodity specification, our countries showed quite endogenous reasons for administering import licenses subject to such specification. The most obvious and persistent reason was, of course, the protective one. An important aspect of the QR regimes in all the countries studied was the eventual utilization of the QRs to confer varying degrees of "automatic" protection to domestic activity. "Saving foreign exchange" often

became an adequate excuse for protecting domestic industry against import competition. "Prohibited" lists of importable items were also typically used at times to ensure such protection.

The extreme examples of such protective use of the QR regime are the Indian rule of indigenous availability and the (early) Brazilian law of similars, which virtually ruled out imports when local substitutes were available. In the Indian case, the authorities maintained (inadequate) lists of locally producing firms in different products and the burden of proof was on the import-license applicants to show that they could not physically (as distinct from economically) utilize their output.[22] The situation was so odd that, like the East European jokes, it found its way into humor as in the story of the minister inaugurating a hospital. Having been taken to witness a surgery prior to cutting the ribbon, the minister announced in his speech that it was a matter of pride for the country that the hospital was using indigenously manufactured equipment and that, at the surgery he had seen, the anesthetic used had also been "local"!

The less extreme versions of the protective nature of itemwise specification of import licenses (as also of prohibited lists) are well illustrated by the Colombian case. Carlos Díaz-Alejandro brings this out gently but firmly:[23]

> If the application is satisfactory in form, the INCOMEX staff next examines whether products similar to those requested are produced locally. Extensive files on domestic production have been built up during the last few years. There is at this point a frank and clear protectionist bias; in case of doubt, the presumption is that local goods are indeed fully satisfactory candidates for import replacement, at least in their physical attributes. Prospective importers whose requests have been turned down on these grounds bear the burden of demonstrating to INCOMEX that the local product is in fact different from the proposed imports because of quality, product specification, or other reasons. Price differences, unless extreme, are not considered valid grounds for importing. INCOMEX occasionally brings together the potential importer and the local import-competing producer, to iron out serious disagreements regarding prices, quality, and specifications. INCOMEX officials occasionally visit plants of import-competing firms to verify their capacity, output quality, and other characteristics, a time-consuming, subjective, and ad-hoc practice.

The INCOMEX's arguments about occasionally verifying or raising quality issues with indigenous suppliers are, of course, paralleled by the Indian DGTD's arguments to the same effect; they surely carry little weight, given the protective thrust of the regime.[24]

For Israel, Michaely has documented an equally firm use of the quotas to confer domestic protection, although the regime was to be adapted fairly early in the game to restrict the degree of protection that could be so obtained. Thus, in Israel, there existed a general directive to prohibit any imports of goods that were produced domestically. A declaration by a manufacturer to

the Ministry of Commerce and Industry that the manufacturer was producing a given good was usually sufficient for the prohibition of imports of the good. During the 1950s a public commission "for the protection of local industries," associated with the ministry, operated with the announced purpose of deciding on requests for protection. However, as Michaely notes, with protection by total import prohibition afforded almost automatically, the commission handled applications of importers who argued that, in their case, imports should be allowed despite the fact that they competed with existing local production. The working of the commission was subject to rules regarding such things as how much excess cost would be permitted to domestic production. In practice, however, Michaely notes that decisions were made *ad hoc* and "occasions on which imports were allowed because local prices were found to be excessive were rare indeed."[25]

The use of "prohibited" import lists to protect domestic production is also noted by Clark Leith for Ghana. Thus, in the instance of the import liberalization beginning with the July 1967 devaluation, Ghana simultaneously expanded the list of restricted or prohibited imports amounting to some eighty or more items primarily as a response to pressure by domestic manufacturers already engaged in production.[26]

Anne Krueger has also noted for Turkey the definite tendency to shift importable items, once they became domestically produced, from the "liberalized" (*L*) list to the "quota" (*Q*) and the "prohibited" (*P*) lists.[27] In an interesting time-series examination of three 100-commodity samples of items on the import lists, she mapped out the transition matrices for these items, tracing their classification under the three (*L*, *Q*, and *P*) categories in successive programs spread from August 1959 to January 1971. These transition matrices are reproduced here in Table 2-1. They show rather vividly the greater fluctuations in the import-classification treatment of commodities in the early days of planning (during the period from the 3rd to the 16th Import List)—as reflected in the increased importance of the diagonal elements (in the latter period from the 16th to the 24th Import List).[28]

3. PRIORITY NOTIONS.

Leaving aside the protective rationale for regulating the imports of specific goods, some of the countries studied also aimed to regulate the other (non-competitive) imports on "priority" notions of one kind or another. The most extreme example was India where the AU (actual user) licenses issued to producers for imports of intermediates were item specified in considerable detail to ensure that only the (priority) approved production would be made feasible. This also required that value and/or quantity limits were specified for the listed importables, in addition to the list of permissible imports, on each license.

Perhaps the main reason why itemwise specification of import licenses

Table 2-1. Transition Matrices, 100-Commodity Samples: Turkey

1. *3rd to 16th Import List*

	Sample 1				*Sample 2*				*Sample 3*			
From:	*L*	*Q*	*P*	*T*	*L*	*Q*	*P*	*T*	*L*	*Q*	*P*	*T*
To: *L*	16	12	0	28	14	13	7	34	15	7	12	34
Q	4	46	0	50	4	32	15	51	3	24	9	36
P	2	20	0	22	1	5	9	15	0	6	24	30
T	22	78	0	100	19	50	31	100	18	37	45	100

2. *16th to 24th Import List*

	Sample 1				*Sample 2*				*Sample 3*			
From:	*L*	*Q*	*P*	*T*	*L*	*Q*	*P*	*T*	*L*	*Q*	*P*	*T*
To: *L*	22	7	1	30	28	5	1	34	30	0	8	38
Q	4	39	3	46	3	36	4	43	4	34	12	50
P	2	4	18	24	3	10	10	23	0	2	10	12
T	28	50	22	100	34	51	15	100	34	36	30	100

Notes:
L = Liberalized List
Q = Quota List
P = Prohibited List
T = Total

Source: Krueger, *Turkey*, op. cit., Chapter VI, page 32, Table VI-4.

frequently arose was the desire to ensure the domestic availability of "essential," imported goods. Thus, in the Philippines, quotas were determined generously for priority items and restrictively for "non-essentials," the different items of interest having been initially classified into four groups.[29] Moreover, the list of import classes was later increased in the 1950s from four to nine groups, and as in India and Turkey in particular, a definite tendency existed to shift consumer goods not regarded as highly essential into very restrictive import groups. For example, 52 out of the 190 consumer items shifted in the Philippines between 1953 and 1959 were placed in the unclassified group, a move resulting in the virtual banning of imports of these items.[30]

The degree and nature of specification by items therefore varied among the countries and within countries over time, depending on the balance of payments position and prospects, the degree and nature of aid dependence and aid-tying, the pressure of protective interests, and the susceptibility of the governments to notions of "priority" in resource-allocation decisions.

Note also the general point that the *de jure* specification of itemwise, source, and other restrictions is, to some extent, an inverse function of the degree to which such purposes can be *de facto* achieved by *indirect* in-

ducements cum penalties on deviant behavior. Thus, on source discrimination, it is occasionally the case that importers can be and are nudged into importing from specific areas even when area restrictions are not explicitly specified. The penalty for not abiding by the implicit restrictions is usually the elimination of access to future licenses and, given the profits from the premiums thereon, that indeed can be a deterrent. In fact, according to some aid-recipient officials, aid-tying by source has at times been "enforced" in this way—*via* the prospect of aid reduction if "additionality" criteria were not met in importing from the donor source.[31] Nonetheless, having made the point that the restrictions on import licenses may be *de facto*, rather than *de jure*, we must note that none of our countries has shown much hesitation in specifying the bulk of its intended restrictions on a *de jure* basis.

4. Goods vs. Bads.

Next, while there is no new wrinkle here, we should also list the prohibition of "bads" that all trade regimes are addressed to: for example, the prohibition of heroin imports except for prescribed uses.

5. Probability of Illegal Capital Flows.

Finally, we may note the resort to regulation, including occasional prohibition, of imports of goods likely to be instruments for effecting illegal capital transfers. As discussed at greater length in Chapter 4 on *Illegal Transactions and Exchange Control*, this was the case with used-goods imports in Turkey and Colombia. It also led to closer scrutiny and regulation of imports of capital goods under direct foreign investment in India.

In conclusion, we should also note in regard to itemwise control of imports that the different countries in the Project used a variety of administrative means to implement such control. Moreover, the labels used for similar methods were quite diverse; for example, "automatic approval" items in South Korea were essentially the same as "open general license" items in Pakistan and India. However, one general substantive distinction between alternative means used is perhaps worth stressing and comes from the South Korean reform of 1967. Korea then shifted from a "positive list" to a "negative list" system of import control. Under the positive list system, only those items listed in the trade program could be imported or exported, as specified in that program. Under the negative list regime, however, the trade program listed only items whose imports (or exports) were prohibited or restricted.[32] Thus, all other (unlisted) items were routinely importable under the automatic approval (AA) umbrella. This shift clearly increased flexibility considerably; but this, in turn, basically reflected a desire to have fewer imports tied by specification. In the absence of such an objective, the relative weight of the negative list to the AA imports would surely have increased, nullifying the flexibility attributed to the negative-list regime.

C. Regulation of Imports by End Use

Quite aside from the specification of importable items and permissible source in import licenses, all QR regimes can be characterized by what end uses they seek to allow. Essentially, these regimes have to settle the question: "How much should be given to whom for what use?" The corresponding regulations thus have two component aspects: (1) Allocation by functional end use (e.g., production vs. consumption, production for export vs. domestic sales, investment vs. consumption) and (2) allocation among rival claimants once the functional end use was determined (e.g., division of licenses among different regions, between large and small applicants, among different industries, among different firms within an industry, between the private and the public sectors)

1. Functional End Use.

The division of available foreign exchange among alternative functional end uses was common to all our countries though the extent and pattern differed. The most recurrent patterns here related to (1) imports of capital goods, consumer goods, and intermediates, (2) imports of intermediates for domestic as against export production, (3) import licenses given to reward exporters, and (4) import licenses given to attract remittances, capital inflows, and so on. We will consider each in turn.

a. Capital Goods, Consumer Goods, and Intermediates. The desire to control the amount of foreign exchange going to the importation of *consumer* goods has been evident in a number of LDCs, and not just the countries in this Project, since the last world war. The impulse toward this policy in many LDCs has been clearly the view that the imports of "inessential" consumer goods should be considered a "non-priority" utilization of scarce foreign exchange, a theme that recurs throughout the studies in our Project as well. This philosophy, which may be aptly described as "priority illusion in foreign exchange utilization" because it rarely prevented the countries in question from the allocation of resources for producing the same consumer goods, is to be contrasted with the economic philosophy under which countries, such as India and Ghana, professed actual plans and targets for import substituting in these consumer goods industries and utilized the import-control system to provide the necessary, automatic protection. In this latter case, the targets were buttressed by industrial licensing (in India and Pakistan) and corresponding control over the expansion of capacity in these, as in other, industries. The targets were progressively worked out by reference to overall macro-planning techniques such as consistency models of different types ranging from crude material balances to optimizing, intertemporal, and multisectoral models (as in India's case).

Note further that the preceding analysis applies to "inessential" consumer goods and that "essential" consumer goods such as food have remained relatively large proportions of total imports in many LDCs. Furthermore, as in Chile, whenever foreign exchange "shortage" became more acute, governments have often tended to postpone the importation of capital goods rather than of essential consumer goods for obvious reasons.[33]

At the empirical level, the data in a recent analysis by Bhagwati and Wibulswasdi of the shift in import structure of twenty-eight LDCs during 1954-1956 to 1965-1967 may be cited here for they broadly confirm the relative decline in the imports of consumer goods as a group and of "inessential" consumer goods in particular.[34] Moreover, on comparing with the shift in import structure of twelve DCs (developed countries), these authors find that the major contrast is in the category of non-food consumer goods, where the DCs actually experienced an *increase* in the relative share of this category in overall imports whereas, as seen from Table 2-2, the LDCs experienced a decline. While the Bhagwati-Wibulswasdi LDCs overlap with only about half of the countries in the present Project, it is clear that the generally low and declining share of non-food consumer goods category in overall imports has characterized many of the countries in the Project, especially India, Israel, Philippines, Turkey, and Egypt.[35] In particular, the import structure for most of the countries in the Project has shifted heavily in favor of intermediates and capital goods.

In keeping with this shift, it is interesting that the distinction between producers/users/industrialists on the one hand, and traders/sellers/importers on the other, had become administratively built into the import-licensing procedures, with economic consequences that will be spelled out later. Thus, in India, the major categories of licenses were AU (actual user) and CG (capital

Table 2-2. Comparison of the Shifts in the Import Structures in LDCs and DCs

	Total of 28 LDCs Percentage Shares in Total Imports			*Total of 12 DCs Percentage Shares in Total Imports*		
	1954-1956	*1965-1967*	*Changes*	*1954-1956*	*1965-1967*	*Changes*
I. Food and Beverage	16.6	14.6	−2.0	26.6	19.0	−7.6
II. Non-Food Consumer Goods:	10.6	9.4	−1.2	4.9	10.1	+5.2
Durables	4.5	4.5	No change	2.3	5.0	+2.7
Nondurables	6.1	4.9	−1.2	2.7	5.1	+2.4
III. Total Consumer Goods	27.2	24.0	−3.2	31.6	29.1	−2.5

Source: Bhagwati and Wibulswasdi, op. cit., Table 5, p. 235.

goods), which were given *directly* to the producers and investors (who, in consequence, enjoyed the benefit of the import premium themselves) and permitted the imports of raw materials and capital equipment for use in production, whereas an increasingly small category was the EI (established importer) import licenses, assigned to traders, and predominantly consisting of consumer goods. The same division of licenses, and with the same tendency to give intermediate and capital goods licenses directly to producers rather than traders, was to be found in Colombia and Turkey.

In the Turkish case, in particular, these producer allocations were affected not directly from the licensing authorities to the producers but *via* the chambers of commerce and of industry, which examined individual import claims by their members and negotiated presumably for the resulting total import bills with one another at the union of chambers and, in turn, with the official authorities dispensing imports. In consequence of the competing claims by traders and producers, as elsewhere, the Turkish situation was also marked by a bifurcation of the traditional chamber of commerce and industry into two chambers. As Anne Krueger remarks:[36]

> The importers are of course interested in increasing the flow of resaleable goods into the country, in receiving foreign-exchange allocations themselves and in keeping finished goods on the list of eligible imports. Industrialists are by contrast interested in their own quotas of intermediate goods and raw materials and in reducing the importers' quotas to limit competition with their products.

Furthermore, as elsewhere, the (value) proportion of import licenses going to importers steadily went down in Turkey, from 48 percent in 1962 to 23 percent in 1970.[37]

We may now turn to the division of foreign exchange among capital goods and intermediates, materials, and so on, for current production. Nearly all the regimes studied in the Project divided up the "available" foreign exchange into allocations of raw materials and intermediates and of capital goods. No criteria for this division can be discerned in the countries in the Project except that, in countries that sought to maintain overall plans (as in India, Pakistan, and Turkey), there was some attempt at providing for sufficient capital goods imports to support the planned industrial investment.[38] In practice, however, even in this regard, the fluctuating availability of foreign private and official capital made for inevitable *ad hocery*, and few of the stated targets in regard to provision of targeted capital goods imports were achieved in the countries that practiced such targeting.[39]

b. Export-Import Links: Intermediates. The QR regimes in many of the countries in the Project were also to be distinguished at some stage of their

evolution by schemes for linking the allocation of a fraction of their raw materials and intermediates licenses to exporting producers. This phenomenon occurred generally when the effects of the overvaluation on export performance were becoming visible and attempts had to be mounted *within* the QR framework to increase the export incentive.[40]

These links were either *de jure* or *de facto*. Thus, the *de jure* links typically took the form of some kind of import entitlement such as the early Indian import entitlement schemes and the later import replenishment schemes. Under these schemes, the producer-exporter was given allocations of licenses to import *raw materials* in quantities that either replenished those used up in the exportation or were provided in greater quantitites as an added incentive. The *de facto* links consisted, on the other hand, in stressing to the producers that, unless their export performance improved or was sustained, the "normal" allocations of AU (actual user) licenses to import raw materials could get cut or that a better export performance would make the import authorities look more kindly on future applications for spares, expansion, and so on.[41]

Similar links were found in other countries as well: South Korea, Colombia, the Philippines, and Chile, in particular. Thus, in the Colombian case, Carlos Díaz-Alejandro argues that:[42]

> [The import licensing] mechanism has been increasingly used to ensure that new projects, particularly those granted tax or other advantages, commit part of their expected output for exports; for several projects specific export targets have been laid down at the time of their approval by INCOMEX in the form of formal contracts. It is not in the INCOMEX style to insist rigidly on exact compliance with such targets, but the companies know that systematic departures from these promises can lead to a displeased and colder INCOMEX in the future.

A sample survey of Colombia's 1970 registered imports and statistical analysis did indicate that, for the industrial importers, there was a very weak, negative relationship between 1970 "minor exports" per 1970 imports and the chances of getting import applications approved.[43] But this has to be put against both the INCOMEX claims that industrial exporters were treated better in the award of import licenses and another analysis based on the same sample survey that shows, for example, that for industrial importers, the average characteristics of firms with rejected applications showed a substantially lower level of minor exports during 1970 than the firms with approved applications.[44]

For the Philippines, Baldwin notes the No-Dollar Import Law of 1955 as having been designed to encourage exports by permitting exporters to barter a certain amount of their exports for imports, with the permitted imports mainly restricted to producer goods and essential raw materials.[45]

In Chile, *de facto* links existed for large-scale mining and for other exports.[46]

c. Export-Import Links: Unrelated Goods. The export-import links occasionally went *beyond* rewarding the producer-exporter with the intermediates used in production. The import entitlements were made expendable on imports of "unrelated" goods as a pure incentive. Thus, the Pakistan bonus voucher scheme deliberately permitted the import of a number of high-premium consumer goods items against the import entitlements earned by exporters eligible for the scheme.[47] Similarly, the Indian authorities had an unpublicized scheme for importing, on an *ad hoc* basis, scarce dry fruit by exporters who needed the "extra" incentive to complete export deals remuneratively.[48] Frank and others have also noted such a scheme for Korea where, in the latter part of 1966, an export-import link system was reintroduced. Export performance was linked with the import rights for popular consumer items and not merely to imports of inputs for exported commodities. Thus, the exporters of radios and electronic products were given import rights to television accessories, exporters of domestically assembled watches and exporters to Switzerland the import rights to Swiss watches, and so on.[49]

d. Links to Remittances et al. Finally, note that the functional end use of import licenses, defined broadly to include their use to promote a specific economic function (e.g., encouraging exports or investment), was not restricted merely to export-import links. It turned up in the form of links designed to promote remittances, for example. Thus the national defense remittance scheme, introduced in India in mid-1966, entitled the (inward-) remitter to import licenses that fetched a sizeable premium in the market.[50] In Israel, they had the so-called "imports-without-payment" market with supply fed from three sources: foreign capital transfers, immigrants' capital, and gifts from abroad. Michaely notes that, by the end of 1948, the government allowed foreign investors to transfer their capital in the form of goods from a specified list on condition that foreign exchange amounting to 30 percent of the import license be sold to the treasury at the official rate. Import licenses thus issued were more or less marketable, although not in a sanctioned market.[51]

2. Allocations Among Claimants Within Category of End Use.

The functional end use having been decided, the most recurrent problems for the authorities in our countries related to the allocation of the quotas within each end-use category among competing claimants.

a. Large vs. Small Applicants. It appears as if the majority of the QR-regime authorities like to think of themselves as biasing access to imports in favor of the smaller applicants. Indeed, in countries such as India and Pakistan, this was considered to be one of the benefits of the import control system vis-à-vis the market allocations.

In point of fact, little of the evidence produced in our country studies would seem to support such a thesis: *ex post* outcomes appear to have been disturbingly concentrated on the large-scale applicants, though one cannot meaningfully assert that such concentration would have been higher or lower under a non-QR market system.

Thus, in the Indian case, Bhagwati and Srinivasan argue that, while the import control authorities claimed that the small-scale sector would benefit from the control regime,

> it is extremely difficult to take this . . . seriously. In point of fact, there is reason to conclude that the control system discriminated against the small-scale sector: as when import cuts in face of sudden accentuation of the foreign exchange shortage fell relatively more acutely on the small-scale sector and much less on the (well-connected) larger firms.[52]

Similarly for South Korea, Frank and others note that under the Trade Transaction Law of 1957 there were minimum export volumes, steadily rising, before an exporter-importer could be registered by the authorities.[53]

For Ghana, however, Clark Leith indicates a deliberate bias in favor of the larger importers:[54]

> [For traders' imports] a system involving grades for importers was introduced, with grades ranging from A (large trading firms) through D, based on historical shares of turnover, taxes paid, and employment . . . [In the post-Nkrumah period] the system of grading commercial importers established in the early days of import licensing was retained. . . Grades were assigned according to past volume. Importers with N¢ 2 million annual volume over the period 1961 to 1965 were assigned the top grade. . . Within each grade [alone] commercial importers were assigned approximately equal foreign-exchange allocations. The objective in this approach was to "obtain goods on competitive terms and at reasonable prices to the consumers," hence the reliance on larger firms with proven trade and financial contacts and facilities to ensure that the country had adequate supplies of essential commodities.

The advantage of the larger claimants in the QR regime thus stemmed from the desire of the authorities to have "reliable" firms with "proven experience," in the Ghanaian case. It was paralleled by the Colombian case where the INCOMEX appears to have been happy with the simplicity and "ease of administration" that dealing primarily with the larger claimants

seemed to confer on the authorities. Thus, during 1970, Carlos Diaz-Alejandro has estimated that only 119 companies and public institutions accounted for nearly 48 percent of the total import bill. Moreover, some 500 private companies were not only major actors in the import field but also acted as major exporters and tax collectors (i.e., generators) for the government. He also found, on examining the reimbursable imports category, that the largest industrial companies had the highest percentages of approved requests for imports, and that the advantage of the very largest companies in percentage of approvals went up when both the reimbursable and non-reimbursable requests were considered together.[55] His further comments on this issue are worth quoting:[56]

> Given the burden of work, and the speed with which applications must be handled, there is an inevitable tendency to accept without much analysis most "reasonable" requests from established, well-known (i.e., large) companies, and to examine more closely and reject, in case of doubt or stringency, those of less well-known, smaller newcomers, many of which may not even bother to apply. . . [The junta] argues that at times of exchange stringency, proportional cuts in import requests are larger for bigger than for smaller firms, and that it tends more readily to overlook faulty request forms from small than from large importers.
>
> But, on balance, the larger and better-known importers find it easier than others to communicate with the junta. Given the Colombian milieu, potential small importers may actually exaggerate in their own minds the complications of dealing with INCOMEX. . . Some junta officials candidly admit that this may be so, but . . . argue that there are no other practical ways of handling the enormous mass of actual and potential applications. What is wrong, they ask, with tilting in favor of applications from long-established corporations, with honorable records, and of being skeptical of new and unknown applicants, who may turn out to be no better than phony industrialists, disguised smugglers, and black-market operators?

Aside from the ease of administration and the readier access to INCOMEX by the "well-connected" larger companies, Carlos Díaz-Alejandro's analysis also points to additional factors that helped to bias the concentration of imports toward the largest firms. These included the fact that the larger industrial companies could get more non-reimbursable licenses against foreign credits and investment (to which they had greater access because of their size in the first place).

The bias of the import-licensing mechanism against the small-scale sector was noticeable in Pakistan as well. Nurul Islam observes that this bias arose principally from the fact that the firms in large-scale industry had access to their own allocations of (premium-exclusive) raw materials, whereas the small-scale entrepreneurs were expected to rely on commercial importers whose

allocations in any case were steadily diminished (as in India). This situation continued right up to 1968, until which time the small-scale and cottage industries had to rely on commercial importers for the supply of both imported raw materials and capital goods because the system of industrial licensing for the distribution of import licenses based on the recommendation of the provincial departments of industry was restricted to large-scale industry. The survey conducted by the provincial governments for the assessment of the raw material requirements covered only the registered firms in the large-scale industry. Thus, the units in large-scale industry had access to (at least a fraction of their) raw material and capital goods imports at premium-exclusive, landed prices. On the other hand, the units in the small-scale industries had no such access and were also faced with possibly lower (*pro rata* to capacity) allocations of imports via commercial-importer licenses than their counterparts in the large-scale industries.

In addition to this subtle implication of the licensing mechanism against small-scale firms, the Pakistani import licensing system had the typical bias against smaller firms that arose from making *pro rata* to capacity allocations to producers or making historic-share allocations to commercial importers. Thus, Nurul Islam has noted that, under the system of commercial licensing, the controller in Pakistan distributed import licenses to traders or importers who imported to resell in the market. The selection of "eligible importers" from a large number of potential importers was made by the adoption of "a rule of thumb," which defined eligible importers as those who had an import performance to their credit during the period July 1950 to November 1952, when there was essentially free importing under the open general license (OGL) system. Each importer of the OGL period was then given a monetary "category" for each type of good that the particular importer imported. The monetary value of each category was determined by the average imports during the five OGL shipping periods between July 1950 and December 1952. A category was not a definite commitment by the government to issue to the importer a license of equivalent value, but rather the actual value of each license was expressed as a certain percentage of the monetary value of each category. The variation in this percentage was the main instrument by which the controller enforced a liberal or stringent import policy.[57] A similar phenomenon obtained in the allocation of industrial imports directly to producers. We will, however, return to this theme later when we discuss the criteria for allocation among firms within the same industry.

Altogether therefore the import allocations in many of the countries in our Project would seem to have been biased in varying degrees in favor of the larger applicants. The reasons included: (1) ease of administration in dealing with smaller numbers of successful applicants; (2) a feeling that larger firms were more "reliable"; (3) a sense that larger firms would get better c.i.f. terms

from foreign suppliers;[58] (4) the greater access (and contacts) of the larger firms to the bureaucracy and politicians, in general, and to the licensing authorities, in particular; and (5) the important edge obtained by the larger firms, whether traders or producers, quite simply because nearly all the licensing authorities tended to allocate quotas *pro rata* to "past shares" or "capacity installed" or such size-related variables. The operative "fair-shares" rules of thumb were therefore loaded in favor of larger quotas for the larger firms. The reward of the rich was, much as in the market system, here and now, but that of the poor was often in a later millenium!

b. Regional Allocations. The import control authorities have often had to grapple with the problem of allocations among claimants from different regions within the country. This is a distributional issue, much like the problem of large *versus* small applicants, but more explosive since interregional politics are often important and, as Pakistan's experience demonstrates, can be even critical.

The import control regime can be found to be justified on the ground that it permits a "fair" or "balanced" regional distribution of import licenses. It is argued that the market will not work in this way. But control regimes have not often worked better either.

Thus, while INCOMEX in Colombia claimed, as do most licensing authorities elsewhere, that regional considerations were important, they resolutely refused to comply with persistent requests to open up regional offices, citing possible corruption at regional level, and the complaints of inattention and neglect continued from firms outside the Bogota and Medellin region. Carlos Díaz-Alejandro's sample survey also seems to confirm the possible validity of these complaints. The industrial companies in the Bogota/Medellin region did better than those in the rest of the country in terms of percentage of total import requests approved; and even if attention were confined to the reimbursable requests, the percentage of approvals was higher for Bogota and Medellin for both industrial and commercial categories.[59]

For Pakistan, the neglect of the East Pakistan region by the licensing authorities would appear to have been even more drastic. Yet, given the economically less developed nature of the region compared to West Pakistan and the lack of entrepreneurial activity and tradition on the same scale, it would appear that the neglect was probably as much a consequence of the fact that large importers were favored (for reasons discussed in the preceding subsection) as it was politically motivated.

In India, the regional allocations of import licenses for investment and for materials and intermediates were generally perceived to be satisfactorily resolved. The state administrations were actively involved in the ultimate

allocations of most scarce items, including foreign exchange, and few regional grievances in this regard were allowed to simmer on without some form of conciliatory response. In short, thanks to the conciliatory and responsive nature of the political regime, the precise regional allocations of import (as other) licenses rarely became a matter of public debate and concern. The apparent absence of this issue from divisive debate was a reflection, in fact, of the importance attached to it *prior* to the allocational decisions.

Special attention to regional distribution of import licenses has been noted also in Chile by Jere Behrman. In fact, the "special regimes" according discriminatory treatment generally by region accounted for 30 percent of total imports in 1961 and for as much as 74 percent of imports in 1970. The objective was to subsidize the integration of remote areas into the national economy.[60] However, it should be noted that the overwhelming bulk of the discriminatory benefits for these remote areas took the form of *price* measures (e.g., higher protective tariffs for industry) rather than biased, beneficial allocations of imports through the *control* mechanism.

c. Public Sector vs. Private Sector Allocations. Yet another basic problem of allocation in many of our countries related to the division of available foreign exchange between the public and the private sectors. This was a decision that was rarely settled by letting public sector concerns get their "fair share" (in any functional category) in the same fashion as the private sector concerns.

For one thing, many public sector concerns, including those undertaking industrial activities, are in monopolistic positions in some of the countries in our Project. This is true of Egypt and, in some instances, of Chile, Ghana, and India as well. The allocations to these concerns then raise issues identical to those underlying interindustrial allocations, as distinct from interfirm, intraindustrial allocations.

Next, the public sector monopolies have sprung largely from ideological reservations of certain industries (as in India) or overall sectors (as in Egypt) on the ground that they are "key" or "basic" activities, represent " commanding heights of the economy," and so on. A "priority" allocation of scarce imports to these public sector enterprises has thus frequently been a consequence of these notions that led these activities into the public sector domain in the first place.

Finally, when it comes to the allocation of materials and capital-goods licenses to concerns in the public and private sectors belonging to the same industry (e.g., steel in India), the import authorities often seemed keen to claim that no favors were shown to the public sector while the private sector asserted the opposite. This was the case in India; and, for Colombia, a bias in favor of official import needs was reported by Alejandro Díaz.[61] For the Philippines, as well, Baldwin reports that supplies and equipment for the government were

not subject to import quotas, implying a general view about the priority of all governmental demands for imports. Similarly, in Chile, Behrman notes several ways in which governmental importers managed to have better access to scarce imports.[62] Finally, we may note also that items such as weapons purchases are always treated separately and that "embodied" aid such as PL480 surplus food has always been channeled through public agencies. Hence the relative division of these imports between the private and the public sectors is only an academic question.

d. Interindustrial Allocations. The allocation of imported capital goods, and of raw materials and intermediates, among alternative industries/activities was naturally a primary function of all the control regimes in our Project.

i. Capital Goods. In regard to capital goods, the interindustrial allocations tended to be aligned with the planned, targeted expansion of capacity in the different industries in the countries where the method of targeting and often concommitant industrial licensing was practiced. Thus, the criteria for allocation of capital goods imports have to be sought, in turn, in the more fundamental criteria that determined the basic choice of relative expansions of different industries during a planning period. In turn, these targets tended to reflect varying degrees of planning sophistication at a macro level, as stated earlier. On the other hand, in countries such as Colombia and the Philippines where no such targeting and industrial licensing were in vogue, the allocation of foreign exchange among rival claimants in different industries appears to have been more market-oriented. There was little attempt at regulating the interindustrial allocation of capital goods (except insofar as the applying industry could use indigenously produced capital goods, in which case the protective rules could take over and the import applications denied). In such "non-planned" regimes presumably the allocations of capital goods were made to applicants on a first-come first-served basis until the foreign exchange provided for this purpose ran out. A few exceptions were made for industries producing "essential" items, the chief exception in most countries being defense.[63]

A natural question, of some interest, is whether the import-licensing authorities under either type of regime, with or without industrial capacity targets and industrial licensing, attempted to refuse the allocation of capital goods to industries that already had some excess capacity (thus implicitly trying to use some type of "productivity" criterion to allocate imports). It appears that the different import-licensing authorities reached their decision on this issue in light of three considerations: if there was excess capacity, the creation of additional capacity was wasteful; if additional capacity was not licensed, the degree of competition in the industry would be reduced; and if aid or

foreign private capital were available specifically for expanding capacity in an industry, despite excess capacity therein, this opportunity should not be allowed to lapse. Thus Leith notes for Ghana under the National Liberation Council (NLC) that the import license system came to be used as an industrial licensing system as well. The Ghanaian Ministry of Industries saw a conflict between the need for competition among domestic producers and the wasteful expenditure involved in duplicating underutilized domestic facilities. But during the NLC period this was generally resolved in favor of "rationalization" of industries and against new entrants.[64]

For the Philippines as well, Baldwin argues that since 1970 the Central Bank attempted to prevent foreign borrowing to expand investment in industries listed as "overcrowded."

In India, on the other hand, the balance of forces seems to have gone more toward capacity creation in face of excess capacity. The targeting of capacities under the plans implied that the corresponding allocations of foreign exchange for supporting imports of capital goods would be more or less sanctified. Moreover the import control authorities predominantly seem to have confined themselves then to allocating the "available" foreign exchange for intermediates among all the capacity holders according to "fair shares" (as we shall presently note).

The main thrust in all the "planned" regimes appears to have been toward capacity creation in light of explicit or implicit targets of industrial expansion. As Bhagwati and Srinivasan have noted, however, the working of the import control regime seems to have also provided the private sector with incentives to add to capacity in the face of excess capacity. Unless this were so, it would be difficult to see why entrepreneurs would choose to add to capacity just because the import authorities were willing to give capital goods licenses for such capacity creation. Thus, in India, the allocation of raw materials *pro rata* to capacity installed implied that the installation of new capacity would enable access to imported materials and hence to associated profits. We quote Bhagwati and Srinivasan on the subtleties of the interaction between the licensing rules and the creation of incentives to add to underutilized capacity in India:[65]

> The tendency to relate equity in allocations of AU licenses to installed capacity led to an incentive to create capacity by linking the availability of premia-fetching imports with creation of more capacity. Thus, as Bhagwati and Desai have argued, an entrepreneur, with a given capacity that was underutilized for lack of imported inputs, could not (under the Indian QR-regime) expand output through additional utilization of capacity. The only way he could increase production was by getting capacity installed and having some import quota allotted to him on basis of it. But even if the entrepreneur were allowed access to more imports at market prices[66] so that he could expand utilization of existing

capacity, he would have to purchase inputs at import-premia-inclusive market prices, whereas expansion of capacity would enable him to expand output by access to premia-exclusive import allocations. This would then certainly bias, *ceteris paribus*, his choice between these two courses of action toward creating more capacity. . . .

Even more important in practice . . . is the fact that (for most industries, until 1966 at least) licensing constrained the creation of capacity and QR policy guaranteed domestic sales at high enough prices to let licensed firms make large profits even at low levels of capacity utilization. Thus, even when there was excess capacity, it would pay a new firm to enter the industry, provided it could get the license to do so, then get its pro-rata-to-capacity share of scarce AU imports, and still earn a large profit. On the other hand, with free entry and competition for imported materials in the market, such a venture would have been untenable.

ii. Intermediates and Raw Materials. Few criteria can be distinguished among the countries studied in the Project as far as the allocations of foreign exchange among different industries for their requirements of raw materials and intermediates are concerned. "Essential" industries were favored, no doubt, but the definition of essentials varied from capital goods industries to consumer goods industries. Besides, in the regimes that claimed to plan their growing industrialization, there was a real problem raised by the fact that nearly all activities had been implicitly sanctioned or explicitly licensed, so that nearly everything was "essential" or "priority." Undoubtedly, the end result for the bureaucratic decision-making turned out in nearly all cases to be the allocation of foreign exchange according to (1) some historic shares among industries, (2) targeted shares in total production during the planning period,[67] (3) *ad hoc* bargaining and reflection of pressure groups, (4) "priority" notions of varying operational importance[68] and/or (5) outright corruption (as in Ghana during part of President Nkrumah's regime, involving two of his ministers).[69]

It is of some interest to note, however, that consumer durables industries appear to have been regarded as generally "luxury" or "inessential." Thus, in India and Pakistan there is some evidence that the cut in allocation of their actual user (AU) licenses during acute foreign exchange crises was disproportionately higher than for the other industries.[70] In Egypt as well, Hansen and Nashashibi note that in 1965, when the foreign exchange crisis became acute, automobile assembly imports were slashed. Since these industries were usually set up at a very low scale, again in view of their "luxury" nature and the consequent desire to contain the availability of such goods, the investment in their capacity appears to have been doubly wasteful. Low scale meant that average costs of production were excessive, and the deprivation of raw materials and intermediates resulted in underutilization of even that low capacity. Both factors made it highly probable that an alternative strategy of merely importing relatively cheaply the small number of such luxury items (e.g., air condi-

tioners, cars, refrigerators) and shutting off their imports whenever foreign exchange availability got worse would have been more economical.

e. Interfirm Allocations. We need again to distinguish between the allocations of capital goods and of raw materials and intermediates.

i. Capital Goods. For capital goods, to add to capacity or to invest afresh in an industry, the firms that had access to the bureaucracy and to foreign technology and credits appear invariably to have been favored with successful applications to invest in nearly all the regions we have examined. This, in turn, often meant, as we noted for Colombia earlier, that the larger firms were relatively better off than the smaller firms under the import control mechanism. In India, this happened again to be the case. The authorities were to become conscious of the phenomenon after a decade of operation and tried to bend the system in the direction of favoring smaller scale applicants by setting up new guidelines for import and investment licensing, with possibly harmful impact on the overall amount of investment in the economy.[71]

ii. Intermediates and Raw Materials. In regard to intermediates and raw materials for current production there appears to have been a common tendency to adopt "fair shares" as a working rule for interfirm allocations. The precise rules, however, varied from *pro rata* to installed capacity to *pro rata* to production in base year allocations. It is interesting that no import control authority among the countries studied ever attempted to lay down explicitly the rules in this regard, and varying elements of executive discretion always remained, defying the analyst's ability to decipher what exactly were the criteria utilized in the end.

For Ghana, Leith has noted how the Ministry of Industry utilized various categories such as "essential consumer goods," "exporting industries," and "import-substituting industries," and made initial allocations among them. Then, for the interfirm allocations, Leith records a rather complex decision process (as perceived by the authorities):[72]

> . . . The Ministry of Industries . . . attempted to make *pro rata* allocations among firms within a category based approximately on previous market shares but taking into account their assessment of the firms' "performance" in such things as employment, taxes paid, and what was called general efficiency of operation.

The method of allocations used by the import control authorities in Pakistan illustrates rather better the "fair-shares" doctrine and the *modus operandi* of its execution. A "quota system" was designed there to routinize the issue of licenses to industrial importers for the import of raw

materials and spare parts. Each eligible industrial importer, called a "quota-holder," was assigned a quota, specifying the importer's "requirements" for industrial raw materials and spare parts for one shipping period. This enabled the provincial directorates to determine simultaneously the commodities (i.e., spare parts and raw materials) that should be imported and the industrial importers who were eligible to import them in each shipping period. These quotas were revised every three years. The provincial directorates then determined the *percentage of the quota* that each quota-holder would be allowed in each shipping period, the percentage allowance reflecting the foreign exchange availability relative to total quota needs.

Two points finally need to be noted here. First, the tendency to go by "fair-shares" rules was probably motivated as much by notions of fairness as by the bureaucrat's desire to *appear* impartial and just. Any attempt at biasing allocations in relation to "efficiency" or "performance," evaluated subjectively by the bureaucrats, would have landed them into situations where charges of corruption could have been freely laid at their doorstep. Second, the effect of such "fair-shares" rules was to create economic incentives for inefficiency. Thus, for India, we have already noted in the preceding subsection that the result was to encourage the expansion of capacity despite excess capacity when the allocations tended to reflect shares in installed capacity in the industry. Yet another effect was that the more efficient firms could not readily drive out the inefficient ones by competing freely for more scarce raw materials and intermediates. The effect of competition was thus blunted by the import control regime that gave these imports at artificially low rates to both the efficient and the inefficient firms in the first round.

f. Domestic vs. Foreign Applicants. Finally, although instances of this practice are infrequent, there is some evidence that the import allocations were used to "indigenize" trade. The most striking example is furnished by the Philippines where, under the 1950 Import Control Act, marked preference was given to Filipino citizens and the Import Control Board was instructed to reserve 30 percent of the total import quota for any article in the fiscal year 1950-1951, 40 percent in 1951-1952, and 50 percent in 1952-1953 to new Filipino importers. Furthermore, at least 60 percent of a company's stock had to be owned by Filipinos for a firm to qualify under this provision of the law. Existing import businesses, which had long been dominated by Westerners and Chinese, received only nominal quota allocations. As a probable result of this policy, Baldwin notes an increased Filipinization of the import trade. Thus, between 1948 and 1958, the value of imports by Filipinos rose from 23 percent to 54 percent, and the share of Chinese traders fell from 39 percent to 14 percent.[73] A similar "Ghanaization" of business, using the import-licensing system, has also been noted by Leith.[74]

D. Regulation of Imports by Payments Conditions

We could also classify the regulation of imports, as is evident from the analysis and examples in the foregoing discussion, by the payments conditions associated with the financing of the imports. Four types of such regulation may be distinguished:

1. REMITTANCE-TYING.

As illustrated by the Israeli, Indian, and Pakistani cases noted above, imports from remittances were regulated with more laxity than imports financed from other foreign exchange funds.

2. BARTER.

Similar laxity was evident in imports financed from accumulated foreign balances under barter and/or bilateral trade agreements in countries such as Egypt, Ghana, and India.

3. FOREIGN CREDITS.

Again, capital goods imports in general were often easier in most countries when accompanied by foreign credits. This practice was, in fact, a motivating factor in getting the Japanese foreign-aid program, with its primary emphasis on yen credits for imports of Japanese machinery, off the ground in the late 1960s.

E. Degree and Types of Restrictions on Transferability

The final dimension on which the import control regimes need to be distinguished from one another is the degree and nature of restrictions on the transferability of either the import licenses or the imports brought into the country under these licenses once the other dimensions, which we have already distinguished above, were defined.

While it may be thought that these restrictions would be fairly similar across countries, our studies threw up remarkable contrasts. Thus, for example, the Indian regime was characterized by extremely stringent restrictions on the transferability of licenses and imports thereunder. The Colombian system permitted the transfer of imports rather freely while frowning on those producers who earned import allocations only to transfer them to other producers. The Turkish regime seemed to have no stigma of any kind attached to transferring licenses or imports thereunder even though this was illegal. Finally the Pakistani system had elements of both rigidity and transferability.

The restrictions on transferability were of different kinds. They related to (1) whether the license could be sold to other parties, (2) whether the imports, once effected, could themselves be resold to other parties, and (3) whether these other parties had to meet certain eligibility criteria.[75] Depending on how many of these restrictions were in effect, the degree of non-transferability could be the cause of great or little inflexibility in the system.

In India, the actual user (AU) import licenses for direct imports by producers were generally non-transferable by individual firms, even for use by other plants in the same firm. Combined with the equally rigid pattern of permissible imports—specified in itemized detail on the AU licenses in most cases—it was inevitable that the result would be inflexibility leading to economic inefficiency. Bhagwati and Srinivasan have speculated on the motivations underlying this remarkably rigid regime and argued that the theoretical premise that AU allocations were being made on the basis of well-defined priorities at the detailed-industry level led the authorities to rule out legal transferability of the licenses among the different industries. Bureaucratic logic took the inevitable next step and eliminated transferability even among units within the same industry, thus making AU licenses (legally) *altogether* non-transferable by the licensee units.[76]

In Colombia, the situation was *de facto* more flexible. Carlos Díaz-Alejandro argues that:[77]

> It is INCOMEX's expectation that goods imported in the industrial category will be used only by the company to which the license has been issued. When INCOMEX was questioned about the legality of resales of merchandise imported for industrial companies, its answers were surprisingly fuzzy. The license itself is clearly non-negotiable, as it is issued only to a specific company or person. The reselling of the imported items by industrial users is apparently not strictly illegal, but it is frowned upon by INCOMEX. . . . Companies shown to be systematically selling part of their imported industrial inputs to others are punished by INCOMEX with total or partial rejections of future requests. Similar punishment is dealt to individuals or companies discovered trying to import under several social or private names. . . . INCOMEX, however, does not punish temporary swapping or lending of imported items among industrial firms. Indeed, it finds such practice quite reasonable, particularly if done during periods of stringency and in a "non-speculative" manner. Apparently, during 1971 very little reselling or swapping of non-commercial imports took place, although some INCOMEX officials indicated that that practice was widespread during difficult years, e.g., 1967.

It is interesting and important to note that the import control regimes, even when characterized by the extreme rigidities of the kind just described, had three different types of "safety valves" that helped ease the resulting bottlenecks and waste.

First, the establishment of links between imports and exports *via* import entitlement schemes (South Korea, India), "bonus voucher" schemes (Pakistan), "special unnumbered license" category (Ghana),[78] and the like often created a new channel for imports of scarce materials. These schemes worked by making the import premiums the inducement for exports. Hence the worst bottlenecks, leading to the highest premiums, tended to be relieved through the presence of such schemes.

Second, there were always the illegal transfers of non-transferable licenses and imports.

Third, in nearly all countries, the presence of some commercial (or trader, established importer) licensing, as also the occasional shift of items to open general licensing or the introduction of "automatic" licensing (Pakistan) and "repeat" licensing (India) for producers who had used up their allocations of imports, managed to blunt somewhat, and from time to time, the worst effects that a rigid set of non-transferability rules would have created for those who otherwise would not have had access to the imported items that created the bottleneck.

III. REGULATING EXPORTS

The anatomy of direct exchange controls, when we turn to exports, is drastically simplified for the reason that, asymmetrically with import controls, the basic control relates mainly to the surrender of receipts to the exchange authorities within a specified period.[79] However, in several of the countries in the Project, there were occasional instances of regulation of exports (1) by destination, and (2) by (itemwise) composition though, naturally, there was no counterpart to the regulation of imports by end use or by the degree of restrictions on transferability of licenses.

The regulation of exports *via* licensing, by destination, and by items can occur simultaneously when exports of specific items need to be "diverted" under bilateral trade agreements to fulfill prior official commitments to deliver. On the other hand, there were few explicit instances of this nature to be found in the countries in the Project since this task was undertaken *via* the use of state trading agencies with attendant monopolization of export trade in such items. This resulted in *implicit* licensing of the exports of such items by destination (as in Egypt).

More frequent, though still uncommon, instances of (only) itemwise regulation of exports were to be found, however, in the countries studied. These arose from the simple need to maintain adequate domestic availabilities of specific "sensitive" items. This was the case with vegetable (cooking) oils in India. Similarly, in the Philippines, in 1948 the government restricted the

export of vital foodstuffs and industrial goods (but this action was held in violation of the Philippine Trade Act of 1946). Again in 1951, as an anti-inflation measure, the reexport of "vital materials" was banned. At the same time, restriction of exports to make the domestic price to producer-users cheaper also was not uncommon. Thus, in Israel, the cotton Marketing Board is not permitted, in the interest of domestic spinning establishments, to export as much cotton as it wishes or finds profitable to sell abroad.

Itemwise regulation of exports in the interest of *quality control*, aimed at maintaining long-term competitiveness for the country's exports, was also evident in some cases. Thus, in the case of Israel, the producers of citrus and groundnuts have been obligated to sell their yield to the corresponding marketing board, which then exports the high-quality produce and sells the low-quality produce domestically. The marketing-board arrangement therefore acts in lieu of export licensing, to restrict and regulate the export of the items in question.

Perhaps the more noteworthy practice relating to the itemwise regulation of exports, however, was *via* the fixing of export targets, much as the import quotas were fixed for specific items. We may quote Frank and others on this:[80]

> Another facet of the military government's export strategy was the institution of full-scale export *targets* in 1962. Before the beginning of each year, the Ministry of Commerce and Industry was to set the new year's targets on the basis of past export performance and new export forecasts for separate commodities. Annual export targets were usually classified by commodity, region, and country of destination. Commodity targets were assigned to industrial associations and firms, and the regional and country targets to South Korean trade and diplomatic missions abroad. The Ministry maintained an "export situation room" to check actual performance during the year against the annual targets. In addition, an Expanded Export Conference, which was chaired by the President and attended by ministers, government officials, bankers, and exporters, usually met several times during the year to deliberate on the annual targets.

Targeting of exports to the same degree as in South Korea does not appear to have been present in the other countries in the Project. However, the practice of tying in export obligations before new capacity was licensed seems to have been common during the late 1960s in India and Pakistan. Carlos Díaz-Alejandro describes the activities of the INCOMEX in Colombia in similar terms.[81]

In short, the countries in the Project *either* had sporadic export regulations of a quantitative nature to handle critical shortages in small sectors of the economy, *or* in a few instances (e.g., Egypt, Ghana, and India) were having to divert exports geographically to fulfill barter-trade agreements, *or* in yet fewer instances (e.g., South Korea) were using effective export targeting as an

export-augmenting device on a broad front. In none of these cases, however, did the scope of export regulation (by quantitative, control methods) match the scope of the control mechanism regulating imports.

IV. REGULATING SERVICES

The direct regulation of services is symmetric with the control mechanism for imports and can be so analyzed, as we noted earlier, in terms of identical dimensions. Thus, obvious parallel examples can be cited. For example, aid-tying can lead, and has led, to (partial) tying of imports of shipping services to U.S. shipping for PL480 exports in a number of countries in the Project that were the beneficiaries of such aid. Similarly, expenditure on travel abroad has been controlled in nearly all countries, and this control mechanism has distinguished among classes of users, functional end use (e.g., for business, for students, for pleasure, for visiting relatives, for medical treatment, and so on) in much the way that imports of goods have been regulated in these regimes,[82] while they have also been subject (in Chile and India, e.g.) to severe cuts at times of exceptional foreign exchange shortage.

V. REGULATING CAPITAL FLOWS

As with the regulation of services, no particularly significant, differential aspect of the regulation of capital flows in the countries in the Project can be distinguished for spelling out here. However, one significant interaction effect between capital account controls and controls on trade on current account does need to be highlighted as it is not always appreciated. In many of the countries in the Project there is some evidence that the need to enforce capital account controls more effectively led to specific controls on current account. Thus, as we note in Chapter 6 on illegal transactions under exchange control regimes, used machinery imports were occasionally ruled out because they facilitated capital outflows through overinvoicing. Similarly, in Turkey the purchase of airline tickets with domestic currency had to be controlled as it became a loophole through which Turkish liras could be converted into foreign exchange (*via* resale abroad of these tickets). In Ghana refunds on air tickets abroad were prohibited. It is indeed a moot question whether foreign exchange controls can be made reasonably effective on capital account in the absence of general controls on current account. This is an issue that has not been tested for the countries in the Project as practically none of them has managed to reach this degree of liberalization.[83]

VI. OVERALL SETTING

We may next note that the *control* mechanisms and methods described and analyzed above were combined with varying degrees of resort to a variety of *price* measures in each of the countries in the Project. Thus, on the import side, there were "prior deposit" requirements, tariffs, multiple exchange rates, and exchange auctions, to take the most important examples. On the export side, there was resort to duties, cash subsidies, export-import links yielding access to lucrative imports, preferential access to profitable investments, tax rebates on imported inputs, and so on.

The exchange control regimes varied, not merely in respect to the control mechanisms discussed so far but also in regard to their varying and variegated resort to price measures in regulating imports and exports. In the next chapter, we will define phases in the evolution of exchange control regimes in the countries in the Project, drawing on the blend between control and price instruments in the trade and payments regime as a distinguishing feature. Immediately, however, we proceed to describe some of these price instruments in depth and illustrate them from the countries in the Project.

VII. PRICE INSTRUMENTS: IMPORTS

The use of the price mechanism to influence imports was widespread among the countries in the Project. But it took diverse forms and had varying objectives. Thus, the forms extended to tariffs, "prior" or advance deposits, sales taxes on commodities primarily imported, multiple exchange rates, exchange auctions, and forthright parity changes. And the objectives varied from the imposition of tariffs to mop up the premiums on the import licenses to their use as protective devices and their deployment as an instrument to improve the balance of payments deficit.

Since the most complex interaction of intended objectives, requiring careful attention and analysis, arises in the case of tariffs, and since the other price instruments raise few new issues, we focus here exclusively on the use of tariffs, drawing on the country studies again to illustrate the alternative objectives to which they were addressed. In regard to the other price instruments, note merely two things: (1) the use of exchange auctions, while proposed in other countries at the time,[84] has been attempted in a significant manner only for Brazil for a brief period; and (2) interestingly, the use of "prior" or advance deposits as an instrument for taxing imports has been used predominantly in Latin American countries, to varying extent in Turkey and Ghana, but almost never in India and Pakistan.

Turning then to the use of tariffs, we should note their major distinguish-

ing characteristic, namely, that they are used not merely for (direct) balance of payments objectives, as are instruments such as prior deposits, but also traditionally for revenue collection and for protection.

1. QRs vs. Tariffs.

What is interesting, however, is that, in terms of their *protective* effects, tariffs were typically "swamped" by QRs in many of the countries in the Project for quite substantial periods. This was the case in Pakistan, Turkey, and India for the bulk of the period studied; it was so for the Philippines and Israel for long periods except when liberalization really took root; and it has been the case for Chile, Colombia, and Brazil occasionally, except when multiple exchange rates, exchange auctions, or sliding parities served to dampen the premium on imports. For South Korea, the only year for which evidence was collected is 1968 when QRs were unimportant, as indeed they continued to be later. One has indirect evidence however that, during the pre-1960 period, QRs swamped tariffs.[85]

Thus, for Turkey, Anne Krueger was able to report on Ahmet Aker's data on c.i.f. landed (inclusive of tariffs) and wholesale (inclusive of import premium) prices for 1968, for seventy-four commodities covering 8.6 percent of Turkey's imports.[86] It turned out that, for thirty-one commodities in this sample, the premium exceeded the landed cost, with twenty-seven of these showing a difference in excess of 100 percent of the landed cost. The importance of the premiums is also evident from the following analysis:[87]

> . . .the 1967 value of imports of each commodity in the sample was obtained. The value of the premia as given by Aker was then computed under several assumptions as to what mark-up would yield a normal rate of return. Three mark-up rates were used: 20, 50 and 100 per cent. The results of the computations were:

	(millions of TL)
Value of imports in the sample, c.i.f.	547
Landed cost of imports	1,443
Wholesale value of imports	3,568
Premia:	
20 per cent markup	1,836
50 per cent markup	1,404
100 per cent markup	682

> The average EER for the sample, thus, was TL 23.76 = $1 contrasted with the official rate of TL 9 = $1. This EER is slightly above the rate calculated in Appendix A. The premium however, equalled TL 30.21, TL 23.1, or TL 11.22, depending upon the assumption made about the normal mark-up. That would

vary from one product to another, but in this author's judgment, a 50 per cent mark-up is probably the best estimate. On that basis, a dollar's worth of imports cost the importer TL 23.76, and his return from it was TL 58.75, giving him an average windfall gain, or premium, of TL 23.11 per TL 9 of licenses received.

Thus by 1968 the premium on import licenses was considerably in excess of the duties and surcharges imposed upon imports. Industrialists receiving import licenses for intermediate goods imports were, in effect, subsidized by the amount of the premium they received, and protected by the amount of the EER plus the premium on imports competing with their own production. The premia associated with final outputs were at least as high as those on intermediate goods . . . therefore, the protection afforded through quantitative restrictions considerably exceeded that through tariffs and surcharges. Quantitative restrictions were thus of much greater importance than price interventions in providing incentives for import-substituting production.

Anne Krueger also notes that the structure of import premiums bore no relationship to the structure of landed costs. The premiums on import licenses varied considerably from commodity to commodity, and the tariffs and surcharges absorbed different proportions of the final prices on these commodities.[88]

For the Philippines, Baldwin records for the period before 1962 a similar situation. He utilizes three alternative methods to demonstrate the importance of implicit tariffs.[89] First, he estimates the implicit tariffs from surveys of prices during 1950 and 1951, indicating that the range of implicit protection was very large, going from nearly 400 percent to almost 700 percent on such luxury items as oranges, cigarettes, and salt to quite moderate levels on evaporated and condensed milk. On the other hand, the protection afforded a given bundle of non-essential consumer goods by explicit fiscal and monetary measures (i.e., tariffs, prior deposits, etc.) in 1951 was only 69 percent. The comparable figure for essential consumer goods was 21 percent. Assuming that the sample was representative, implicit rates of 200 percent or more in 1951 were not unusual for non-essential consumer goods. Since prices of this group of items rose about 80 percent between 1951 and 1959, levels of implicit protection of 400 percent or more at this time apparently existed for some items. Since the protection from explicit fiscal measures on this category of goods was 149 percent, this implied that windfall gains of over 200 percent were being made on these commodities. Second, Baldwin argues backward from the behavior of import prices and domestic wholesale prices for the same category of goods between 1959 and 1962 when import controls were completely dismantled. He shows that their peso cost, inclusive of tariffs, and so on, rose by 90 percent during the period whereas the wholesale price index for this group of non-essential consumer goods rose by only 10 percent, indicating large premiums before the dismantling of the import controls. Third, Baldwin

utilizes comparisons between U.S. and Philippines prices of comparable goods for selected items, estimating what the Philippines prices should be (based on U.S. prices plus transportation, tariff, and other charges) and what they actually were. Baldwin concludes from these statistical analyses that:[90]

> It is clear from these three estimates that exchange controls added greatly to the degree of protection provided by explicit fiscal and monetary measures. In 1959, for example, implicit protective rates of 400 percent were not uncommon for nonessential consumer goods, whereas the average explicit degree of protection in 1959 for this category was around 150 percent. For the essential-consumer-goods group, average implicit and explicit protective rates in the same years were roughly 30 and 5 percent, respectively.

Clark Leith records for Ghana in 1968 a situation where QRs were important for a fair number of industries. While he could not obtain premium data for twenty out of the forty-seven industries for which he estimated protection, thirteen out of the remaining twenty-seven had implicit tariffs in excess of the explicit tariffs.[91] By 1970, with the imposition of an import surcharge on several items and the shift of these items to open general licensing, the role of import premiums had declined but still persisted in a few industries.[92]

For India, the evidence of the importance of implicit tariffs is quite overwhelming. Indeed, except for a period of three years after the June 1966 devaluation, the dominance of implicit over explicit tariffs seems to have been quite general. Thus, as with Leith in Ghana, the analysis of protection in India would have been totally misleading if Bhagwati and Srinivasan had not analyzed it on the basis of implicit protection.[93]

For Israel also, Michaely notes that, as of 1956, moderate to strong restrictions affected over half of the total value of imported goods, with only raw materials bearing a small brunt of this regime (Table 2-3). Indeed, until the liberalization of the 1960s, the protection of industries producing final consumer goods by import prohibition was "comprehensive and almost total."[94]

Table 2-3. Effectiveness of Import Restrictions in Israel, 1956

(proportions of imports in each class, by value of imports, in percent)

Import Category	*Formal or Effective Liberalization (1)*	*Moderate Restrictions (2)*	*Strong Restrictions (3)*	*Total (4)*
Foodstuffs and fodder	40	4	56	100
Raw materials	60	32	8	100
Finished goods	35	33	32	100
Total import of goods	45	31	24	100

Source: *Israel*, op. cit., Chapter 2, Table 2-3.

In none of the countries in the Project, however, were explicit tariffs altogether dominated by implicit tariffs. Nearly all countries had open general licensing or, as with South Korea since the mid-1960s, items not on any import lists were available for free importation.[95] Nor did any countries in the Project forego the use of explicit tariffs for any length of time for, as already stated, the use of explicit tariffs could be addressed to several objectives, including that of reducing the magnitude of the implicit tariff by cutting into the import premium resulting from QRs. Indeed, we turn now to a discussion of the tariffs as addressed, *ex ante*, to these diverse objectives, treating tariffs to mop up premiums and tariffs to provide protection, in turn.

2. Tariffs to Mop up Premiums.

Tariffs with the explicit objective of depriving import licenses of their windfall premiums were adopted in some of the countries in the Project. Such tariffs naturally bear close affinity to tariffs customarily adopted for revenue purposes insofar as the premiums are turned thereby into governmental revenue.

The Ghanaian surcharges of August 1970 and the Indian tariffs of 1964 and 1965 clearly fall into this category. However, the most striking example comes from South Korea where Frank and others note:[96]

> With the adoption of a unitary fixed exchange rate in June 1961, the differential between the import price and the domestic price became greater for some items restricted by import quota. Thus in July 1961, a Temporary Special Customs Law was enacted to capture the windfall profits that would otherwise accrue to importers receiving import licenses for restricted items. Under the law, about 700 items subject to import quotas were classified into four categories, I to IV, in order based on the ratio between the domestic price and the c.i.f. import price and the estimated degree of nonessentiality. A temporary special tariff was imposed on these classified import items in addition to regular tariffs. The special rates were 100 percent of import value on category I, 50 percent on category II, 30 percent on category III, and 10 percent on category IV. Adjustments were made periodically in the classification of items. . . .
>
> Also after the May 1964 devaluation, a new Temporary Special Tariff Law was enacted to soak up margins between c.i.f. import prices and domestic prices of restricted import items. About 2,200 import commodities, for which the "foreign exchange ratio" exceeded 30 percent, were classified in categories I and II. The special tariff was imposed on the difference between the domestic wholesale price of an imported good and the landed price of that import plus regular tariff, commodity tax, incidental expenses, and normal profit. A tariff rate of 90 percent was applied to category I and 70 percent to category II.
>
> To administer the special tariff, the Bank of Korea and the Ministry of Finance made a monthly survey of domestic wholesale prices of import commodi-

ties. On the basis of this price survey, the list of items for the special tariff was expanded from about 2,200 in 1964 to about 2,700 after 1965. Those items to which a regular tariff did not apply were, however, exempted from the special tariff. [Foreign exchange ratio = (domestic wholesale price of imported goods) minus (regular tariff + commodity tax + normal expenses) divided by (normal foreign exchange price of the import on c.i.f. basis). This formula was basically an estimate of the premium which could be obtained by an importer licensed to import a restricted item.]

3. PROTECTIVE TARIFFS.

We next consider the relative importance of protective tariffs, as recommended by regulatory agencies such as tariff commissions and boards, as distinct from tariffs levied during the budgetary process explicitly for purposes other than the protection of domestic import-competing industries.[97] It is interesting to note, here, that even the *ex ante* role of tariffs as protective devices had shrunk in many of the countries in the Project. Thus, in India and Pakistan, detailed analysis shows that the tariff commissions had often been reduced to a relatively minor role, with few industries appearing before them for the purpose of claiming tariff protection.[98] Clearly, most industries were sufficiently protected by the QR system and did not therefore feel it necessary to argue the traditional protective case before a regulatory body!

A question of some interest is then why a few industries did ask for tariff protection. Here, the answer seems to lie in the possible desire of these industries to provide for a rock-bottom rate of protection just in case the QR regime was changed and the protective incidence of quotas was eroded. After all, payments positions could ease, criteria of allocation of imports could shift, and there was therefore not the same level of assurance perhaps about the continuity of QR protection.

VIII. PRICE INSTRUMENTS: EXPORTS

In conclusion of our taxonomy, we now may address briefly the range of price instruments utilized to affect exports. Aside from parity changes, these price instruments divide into direct (cash) subsidies and taxes and indirect subsidy and tax schemes. The latter, in turn, take numerous forms as is evident from the country studies in the Project, and quite clearly have differential economic effects.

Examples of direct taxes and subsidies can be found in South Korea, Pakistan, India, and other countries. Typically, because of the "large-country" (i.e., monopoly power in trade) problem associated with exports of primary products in markets where the country may have an imperfectly competitive

position, some of the countries in the Project used export *taxes* while using export subsidies on manufactured exports instead mainly to counter the export-reducing effects of overvaluation of the exchange rate.

The role of direct cash subsidies, however, appears to have been minimal, with substantial emphasis being placed in most countries on the *indirect* schemes. Leaving aside the routine schemes offering rebates and drawbacks, and also marketing and credit advantages, the major indirect instruments for export subsidization were essentially those that exploited the exchange controls on imports to channel the premiums associated with the restricted imports to those who successfully exported. Examples of these "link" schemes can be found in South Korea, Pakistan, and India where they were formally instituted (as already noted in our taxonomy of the direct controls of imports), whereas they were informally used in other countries such as Colombia (where, as Carlos Díaz-Alejandro has noted, the INCOMEX gently but effectively also managed to prod the import licensees into export performance by implicit threats of not so favorable treatment of import requests if the exports did not materialize).[99] In turn, these links set up numerous efficiency implications. These have been systematically analyzed in the India study in the Project, which the reader may wish to consult,[100] and are addressed more generally here in the concluding Chapter 8 on the optimal foreign trade strategy suggested by the results of the Project.

NOTES

1. The detailed comments of Bent Hansen, Ana Martinera-Mantel, Barry McCormick, Clark Leith, Gideon Fishelson, Larry Westphal, Padma Desai, Rodney Falvey, Jere Behrman, and Anne Krueger on an earlier draft of this chapter have been very helpful.

2. Cf. Bela Balassa et al., *The Structure of Protection in Developing Countries* (Baltimore: Johns Hopkins University Press, 1971).

3. J. Bhagwati, "On the Equivalence of Tariffs and Quotas," in R.E. Baldwin et al., *Trade, Growth and the Balance of Payments: Essays in Honor of G. Haberler* (Chicago: Rand McNally, 1965). Later contributions, including a further discussion of the different dimensions of equivalence (i.e., domestic price, production, consumption, foreign price, and imports), include: J. Bhagwati, "More on Equivalence of Tariffs and Quotas," *American Economic Review* 58 (1968):142-146; H. Shibata, "A Note on the Equivalence of Tariffs and Quotas," *American Economic Review* 58 (1968):134-142; G. Yadav, "A Note on the Equivalence of Tariffs and Quotas," *Canadian Journal of Economics* 1 (1968):105-110; and Tsvi Ophir, "The Interaction of Tariffs and Quotas," *American Economic Review* 59 (1969), drawing upon 1956 dissertation at Hebrew University.

4. Cf. G. Fishelson and F. Flatters, "The (Non-) Equivalence of Optimal Tariffs and Quotas under Uncertainty," *Journal of International Economics* 5 (1975):385-393; and M. Pelcovits, "Quotas *versus* Tariffs," *Journal of International Economics* 6 (1976):363-370.

5. Cf. R. McCulloch and H.G. Johnson, "A Note on Proportionally Distributed Quotas," *American Economic Review* 63 (1973):726-732.

6. Cf. C. Rodriguez, "The Non-equivalence of Tariffs and Quotas under Retaliation," *Journal of International Economics* 4 (1974):295-298; and E. Tower, "The Optimum Quota and Retaliation," *Review of Economic Studies* 52 (1975):623-630. Two points may be noted: (1) the Metzler paradox requires that the tariff *increase* imports: this implies that an import quota (which can only restrict, *not* expand, imports) cannot be equivalent to the Metzler tariff (cf. R.Falvey, "A Note on the Distinction Between Tariffs and Quotas," *Economica* 35 (1975): 319-326); and (2) furthermore, as noted by both Rodriguez and Tower, for similar reasons, an optimum quota response may not be feasible with an import quota but, as in the Metzler case, would require the use of an export quota.

7. In fact, once endogenous changes in supply and demand schedules are seen to invalidate equivalence, it is easy to imagine numerous such applications. Thus, for example, the Bhagwati-Hansen theorems on the welfare effects of smuggling ("A Theoretical Analysis of Smuggling," *Quarterly Journal of Economics* 87 (1973):172-187; reprinted in J. Bhagwati, ed., *Illegal Transactions in International Trade*, Series in International Economics, vol. 1 (Amsterdam: North-Holland, 1974), are based on assuming tariff-induced smuggling; if the tariff is replaced by a quota, R. Falvey, "A Note on Preferential and Illegal Trade Under Quantitative Restrictions," *Quarterly Journal of Economics* 92 (February 1978):175-178, has shown that the results are not identical.

8. Evidently, in all these cases, analyzing these exchange controls merely by turning the observed import premiums into *ad valorem*, "equivalent" tariffs would be, at best deficient and misleading, and at worst quite seriously wrong.

9. Where we use the word "imports" here the reader should infer that we also include the utilization of foreign exchange for purposes other than the import of goods alone.

10. The reader should *not* infer anything about the relative importance of these reasons from either the order in which they are discussed or the relative space devoted to them.

11. For details, see J. Bhagwati, "On the Tying of Aid," UNCTAD Secretariat, 1968; printed in UNCTAD II Papers and Proceedings; reprinted in J. Bhagwati and R. Eckaus, eds., *Foreign Aid* (Harmondsworth: Penguin Books, 1970).

12. Since the 1960s, however, the policies and practices of most aid donors have shifted significantly away from tied procurement. There now exist agreements among the major aid donors (1) with respect to untying of contribution to multilateral development institutions and (2) with respect to the untying of their bilateral assistance programs for procurement within the developing countries. In addition, many donors have as a result of a shift in the nature and emphasis of their programs increased the level of their local cost financing activities and reduced the level of their direct commodity procurement, all of which has reduced both the incidence of tying arrangements and the possible influence of tying arrangements on LDCs' exchange control regimes.

13. An interesting example of a country that reportedly refused, on exchange control considerations, to benefit from aid-financed contracts is Thailand. The United States, under PD31, permitted a small set of LDCs to tender for U.S.-aid-financed contracts *provided* that, in turn, they spent the dollars so earned on U.S. exports. This would have required opening "restricted" accounts. Thailand did not wish to do this and opted out of the PD31 benefit.

14. Carlos Díaz-Alejandro, op.cit., Chapter 5, pp. 147-148. INCOMEX is the import licensing authority. On the other hand, USAID has argued that "one reason for the U.S. practice [was that] Colombia was using its licensing procedures to give preference to its European bilateral trading agreement partners at the expense of traditional U.S. suppliers" (private communication dated September 13, 1974).

15. Cf. *Egypt*, op.cit., Table 1-6, p. 22. For Chile, *before* the period of our study, Behrman notes that there were bilateral trade agreements with DCs as well and that the share of bilateral to total trade was as high as 60 percent for imports and 25 percent for exports in 1936. Cf. *Chile*, op.cit., pp. 99-100.

16. Michaely, *Israel*, op.cit., Chapter 2, pp. 53-54.

17. Leith, *Ghana*, op.cit., pp. 26-27.

18. *Chile*, op.cit., pp. 102-103.

19. Finally, although there do not appear to be any significant examples of this in the country studies in the Project, Bent Hansen has suggested that an additional factor leading to source specification in licenses may be included, to complete the set of possibilities. Thus there may be politically motivated discrimination (as in the case of trade embargoes imposed, for example, on Cuba by Brazil, Chile, and Colombia or Ghana's prohibition on use of licenses to purchase imports from South Africa, Rhodesia, and Portuguese territories).

20. An additional reason for such commodity-tying, at least with U.S. aid, was concern over the types of items that may be procured with the aid funds: the familiar champagne glasses and pink bidets issue.

21. Although source-tying would have been made most effective only by specification of commodities in which the donor was *least* competitive, and such an idea was discussed in certain donor-country aid agencies, there is no evidence that it was systematically applied. Cf. Bhagwati, ibid. In fact, after June 1969, USAID claims to have relaxed commodity specification on U.S.-aid-financed imports substantially, allowing a "very long list of 'development-type' goods" (private communication, September 13, 1974).

22. See Bhagwati and Srinivasan, *India*, op.cit., Chapter 2.

23. Ibid., Chapter 5, pp. 135-136.

24. DGTD stands for the Directorate General of Technical Development; see Bhagwati and Srinivasan, ibid., Chapter 2, for further discussion.

25. *Israel*, op.cit., Chapter 2, pp. 51-52.

26. *Ghana*, op.cit., Chapter 2.

27. *Turkey*, op.cit., Chapter VI. Refer to this for details on the transition matrices reported in the text above.

28. Krueger also notes that: "The transition matrices fail fully to reflect the extent of the increasing use of the 'Prohibited List': (1) since all three samples were drawn from import lists, any item continuously prohibited could not be drawn. . .; and (2) for many of the items which continued on the lists, only a subcategory of the original classification was eligible for importation in later Programs" (Chapter VI, p. 162).

29. *Philippines*, op.cit., pp. 31-33.

30. See *Philippines*, ibid., Table 2-5, p. 34.

31. For further discussion, see Bhagwati, "The Tying of Aid," op.cit. This prospect was apparently pointed out at times by sympathetic aid agencies to recipient countries as arising from the possibility of effective slashing of aid programs on balance of payments grounds by the foes of these programs.

32. *South Korea*, op.cit., Chapter 5.

33. See, for example, *Chile*, op.cit., Chapter 5 and Chapter 6, especially pp. 157-161.

34. This is demonstrated in J. Bhagwati and C. Wibulswasdi, "A Statistical Analysis of Shifts in the Import Structure in LDC's" *Bulletin of Oxford University Institute of Statistics* 34, 2 (1974):229-239. For further analysis, especially of the distinction between essential and non-essential consumer goods, refer to this paper.

35. Cf. *Israel*, op.cit., Table 2-10, p. 49; *Egypt*, op.cit., Table 1-5, p. 21; *Turkey*, op.cit., p. 127; and *Philippines*, op.cit., Table 2-6, p. 36.

36. *Turkey*, op.cit., Chapter VI, p. 151.

37. Ibid., Table VI-1, p. 151.

38. For Egypt, Hansen and Nashashibi suggest that raw material imports were generally considered more important than capital goods imports.

39. This can be inferred by comparing the planned "requirements" of capital goods imports in the official documents with the actuals year by year over the plan periods. This type of comparison for India and Pakistan supports the statement in the text.

40. Such a situation is characterized as Phase II in the evolution of exchange control regimes in Chapter 3.

41. For details, see Bhagwati and Srinivasan, op.cit., Chapter 7.

42. *Colombia*, op.cit., Chapter 5, p. 144.

43. Ibid., Chapter 6, pp. 160-168, especially Table 6-7.

44. Ibid., Table 6-6, p. 163.

45. *Philippines*, op.cit., Chapter 2.

46. *Chile*, op.cit., Chapter 4, pp. 103-114.

47. Cf. the work of H. Bruton and S.R. Bose, Pakistan Institute of Development Economics, Karachi; cited by Nurul Islam, *Pakistan*, op.cit.

48. Cf. J. Bhagwati and Padma Desai, *India: Planning for Industrialization*, (Oxford University Press, 1970), Chapter 18.

49. *South Korea*, op.cit., Chapter 4, p. 51.

50. *India*, op.cit., Chapter 4.

51. See *Israel*, op.cit., Chapter 2, pp. 36-39, for further details.

52. *India*, op.cit., pp. 39-40. Additional evidence on this bias against the small-scale sector is presented in Bhagwati and Desai, op.cit., Chapter 5.

53. Thus, they note that:

> . . . all exporters and importers were required to register at the Ministry of Commerce and Industry. A prerequisite for registration was a minimum export of $3,000 for exporters and a minimum export of $10,000 for importers in 1958. This form of trading system is unusual in that the importer's registration was granted according to his export performance. Minimum exports for registration were raised in 1959 to $5,000 for exporters and $20,000 for importers. To *maintain* the status of exporters and importers, traders had to sustain an annual export performance exceeding a certain standard. Minimum exports were $10,000 for export business and $50,000 for import business in 1958. A year later minimum requirements for registration were raised by 100 percent. Cf. *South Korea*, op.cit., pp. 39-41.

54. *Ghana*, op.cit., pp. 24, 31-32.

55. "Reimbursable imports" are those requiring payment in foreign exchange supplied by the central bank, while non-reimbursable imports (typically capital goods) are those financed by external sources. Cf. *Colombia*, pp. 126-127.

56. *Colombia*, op.cit., Chapter 5, p. 139.

57. Ibid., Part III, Chapter 1, p. 8-9; unpublished manuscript for the NBER Project.

58. In fact, for Ghana, points (1) to (3) together are cited by Leith as resulting in the "assured" supplies of essential consumer goods at "reasonable prices."

59. *Colombia*, op.cit., Chapter 5, pp. 168-172.

60. *Chile*, op.cit., Chapter 4, pp. 95-98.

61. Op.cit., Chapter 5, p. 143. "On balance, however, there is a presumption that official requests should be given priority, and they are said to fare better than private requests, particularly at times of exchange stringency."

62. *Chile*, op.cit., pp. 4-28 and 4-30.

63. Cf. Hansen and Nashashibi, *Egypt*, op.cit., Chapter 2. They emphasize that construction of new plants financed through special arrangements with foreign donors and purchases of weapons fell outside the foreign exchange allocation system described by them.

64. *Ghana*, op.cit., p. 32.

65. *India*, op.cit., Chapter 13, pp. 188-190.

66. This could happen through illegal purchases in the black market. It also became possible when the import entitlements under the export promotion schemes were made legally transferable since 1965.

67. Cf. Bhagwati and Desai, op.cit., p. 291; and *Pakistan*, op.cit., Part II, Chapter 1.

68. See, for example, the statement of "essentials" and "non-essentials" in *Philippines*, op.cit., Chapter 2, pp. 33-34.

69. Cf. *Ghana*, op.cit., pp. 25-26.

70. Cf. Bhagwati and Desai, op.cit., p. 291.

71. Cf. *India*, op.cit., Chapter 8.

72. *Ghana*, op.cit., p. 32.

73. *Philippines*, op.cit., p. 35.

74. *Ghana*, op.cit., pp. 35-36.

75. The distinction between transferring licenses and imports is substantive because the former may imply greater flexibility since licenses may not be too rigidly defined itemwise, for example. Again, there may also be greater flexibility to choose the time of purchase in the former case.

76. *India*, op.cit., Chapter 2.

77. *Colombia*, op.cit., Chapter 5, p. 146.

78. Cf. *Ghana*, op.cit., p. 21, footnote 37.

79. The anatomy of exchange control regimes as applied to exports becomes much more complex, moreover, when price-related instruments are considered, as in Section VIII.

80. *South Korea*, op.cit., Chapter 4, pp. 46-47; italics inserted.

81. *Colombia*, op.cit., Chapter 5, p. 144.

82. For details in one instance, see for example Jere Behrman, *Chile*, op.cit., Chapter 4, pp. 49-54.

83. Later, in Chapter 3, we describe this stage as Phase V.

84. Cf. J. Bhagwati, "Indian Balance of Payments Policy and Exchange Auctions," *Oxford Economic Papers*, 14 N.S. (February 1962).

85. Cf. *South Korea*, op.cit., page 194; and private communication from L. Westphal.

86. *Turkey*, op.cit., Chapter VI, Table VI-11.

87. Ibid., Chapter VI, pp. 177-178. Krueger also notes that, after the devaluation in 1958 until 1962, the resale market for import licenses was sluggish and premiums had become negligible, whereas in 1955-1958, the premiums had run as high as eight times the parity rate.

88. Ibid., Chapter VI.

89. *Philippines*, op.cit., pp. 98-103.

90. Ibid., p. 101.

91. *Ghana*, op.cit., Chapter III. Note that Leith estimated the explicit tariffs from average duty collections in view of several exemptions, and that the import premium data were based on unit value comparisons.

92. Ibid., Chapter III. Note that such a use of tariffs to reduce the pressure on QRs often precedes or accompanies what are described in Chapter 3 as Phase III attempts at liberalizing the QR regime. A use of tariff surcharges before the June 1966 devaluation in India is another instance of this phenomenon.

93. However, note that (as discussed in depth in Chapter 5 below) the measurement and analysis of protection becomes extremely complex in the presence of QR regimes and the mere use of implicit tariffs, based on premium data, can be seriously misleading in understanding the nature and degree of protection and its effects.

94. *Israel*, op.cit., Chapter 2, pp. 32-36.

95. Indeed, for South Korea, the role of implicit tariffs had declined to negligible proportions by late 1960s; cf. *South Korea*, op.cit., Chapter 10.

96. *South Korea*, op.cit., Chapter 4, pp. 44 and 49. One footnote in the quote has been eliminated.

97. Note again that this distinction applies only *ex ante*.

98. This is evident from Nurul Islam, *Pakistan*, op.cit., as also from Padma Desai, *Tariff Protection and Industrialization: A Study of the Indian Tariff Commission at Work* (Delhi: Hindustan Publishing Corporation, 1970).

99. In fact, such moral suasion, with the stick held firmly in hand, was evident in the Indian regime as well, whereas the INCOMEX used formal links of imports to exports in certain cases as well. Thus, a blend of both formal and informal links appears to have been used, rather than total reliance on one or the other method.

100. *India*, op.cit., Chapter 3, pp. 59-74; this analysis, in turn, borrows heavily from Bhagwati and Desai, op.cit., Chapter 19.