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Policy Choices in the Newly Industrializing Countries

Bela Balassa

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The Far Eastern newly industrializing countries (Hong Kong, Korea, Singapore, and Taiwan) achieved much larger increases in per capita incomes than their Latin American counterparts (Argentina, Brazil, Chile, and Mexico) in the 1963-88 period. Differences in economic growth rates find their origin in differences in savings ratios and investment efficiency.

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While savings rates differed little between the two groups of countries between 1963 and 1973, these ratios increased substantially in the Far Eastern NICs in subsequent years as they employed measures encouraging savings. Similar increases did not occur in Latin America where the policies applied were not favorable to savings.

Investment efficiency was higher in the Far Eastern NICs than in the Latin American NICs throughout the period. The Far Eastern NICs achieved high levels of investment efficiency in the framework of an open economy, with high and rising ratios of exports to the gross domestic

product. Export expansion involved an increasing shift toward manufactured goods.

Exports in the Far Eastern newly industrializing countries were promoted by the system of incentives that entailed no discrimination, or little discrimination, against exports. These countries also relied to a considerable extent on export promotion in response to external shocks and did not engage in excessive foreign borrowing.

The experience of the Far Eastern and Latin American newly industrializing countries provides important lessons to other developing countries. It indicates the superiority of outward-oriented policies that provide similar incentives to exports and to import substitution. It also shows that the continuation of outward-oriented policies permits overcoming the effects of external shocks while reliance on external borrowing reinforces the adverse effects of these shocks.

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POLICY CHOICES IN NEWLY INDUSTRIALIZING COUNTRIES

Bela Balassa *

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* The author is Professor of Political Economy at the Johns Hopkins University and Consultant to the World Bank. He prepared this paper for the Conference "Attempts at Liberalization: Hungarian Economic Policy and International Experience," held in Budapest, Hungary on November 16-18, 1989. The author is indebted to Vinod Thomas for helpful comments and to Shigeru Akiyama for research assistance.

POLICY CHOICES IN THE NEWLY INDUSTRIALIZING COUNTRIES

Bela Balassa

I. Introduction

This paper will compare the policies and economic performance of newly-industrializing countries (NICs) in the Far East and Latin America in the 1963-88 period. The two groups of countries include Hong Kong, Korea, Singapore, and Taiwan and Argentina, Brazil, Chile, and Mexico.

Information will be provided on indicators of economic growth as well as on domestic savings ratios, the efficiency of investment, and export performance. Next, the results will be explained in terms of the policies applied.

II. Growth Performance

The Far Eastern newly industrializing countries had relatively low income levels in 1963. Even Hong Kong and Singapore were behind Argentina, Chile, and Mexico in terms of income per head (Table 1).

The situation changed dramatically in the following two-and-a-half decades. By 1988, all four of the Far Eastern NICs surpassed the per capita incomes of every Latin American newly industrializing country. These changes occurred as the per capita income of the four Far Eastern NICs increased four-and-a-half to six times during the 1963-87 period. Among Latin American NICs per capita incomes increased two-and-a-half times in Brazil, one-and-a-half times in Mexico and by less than one-quarter in Argentina and Chile.

Further interest attaches to intercountry differences in increases in per capita incomes over time. Table 1 provides data for the benchmark years of the 1963-73 period of world economic boom, the 1973-81 period of two oil shocks, and the 1981-87 period of the debt crisis.

Table 1

Gross Domestic Product per Capita
(U.S. dollars)

	At Purchasing Power Parities in 1980 prices					At Exchange Rates
	1963	1973	1981	1988	1988/1963	1988
Hong Kong	2247	4552	7751	11952	5.32	9600
Korea	747	1553	2457	4094	5.48	4082
Singapore	1777	3838	6308	11693	6.58	9009
Taiwan	980	1976	3029	4607	4.70	5862
Argentina	2949	4157	3935	3474	1.18	2806
Brazil	1400	2338	3252	3424	2.45	2454
Chile	3231	3502	4443	3933	1.22	1732
Mexico	2312	3403	4576	3649	1.58	2114

Sources: 1963-81 figures from Summers, R. and A. Heston, "A New Set of International Comparisons of Real Product and Price Levels Estimates for 130 countries," Review of Income and Wealth, March 1988.
1988 estimates updated from 1985 figures by utilizing national data on economic growth rates.

It appears that the Far Eastern NICs started gaining on the Latin American NICs already in the 1963-73 period; per capita incomes doubled in the Far Eastern NICs, much surpassing the performance of any of the Latin American countries. The Far Eastern NICs increased their lead during the period of the oil crises, notwithstanding their reliance on imported petroleum, while Argentina suffered declines in per capita incomes.

Differences in economic performance increased further in the period of the debt crisis. The Far Eastern NICs experienced increases in per capita incomes by one-half to four-fifths. In turn, apart from small gains in Brazil, incomes per head fell in the Latin American NICs. In this connection, reference may be made to differences in the foreign debt situation. There is a contrast between the high degree of foreign indebtedness of Latin American countries and the low external debt of the Far Eastern NICs (see further below).

III. Domestic Savings and the Efficiency of Investment

Various factors may be introduced to explain differences in growth performance between the Far Eastern and the Latin American newly-industrializing countries. They include differences in domestic saving ratios and investment efficiency, as well as the changing relative importance of exports. Increases in domestic savings ratios and in investment efficiency add to GDP directly while exports have indirect effects.

A comparison of the Far Eastern and Latin American NICs does not show overall differences in domestic saving ratios in the 1963-73 period while there were considerable differences within each group. The superior growth performance of the Far Eastern NICs during this period is thus explained by their higher investment efficiency which is measured, however imperfectly, by

incremental capital-output ratios (ICOR). ^{1/} Among Latin American NICs, Brazil and Mexico had low incremental capital-output ratios (Table 2).

The situation changed in the 1973-81 period. All Far Eastern NICs increased their domestic saving ratios to a substantial extent while the increases were smaller, or domestic saving ratios declined, in the Latin American NICs. At the same time, the Far Eastern NICs maintained higher levels of investment efficiency than their Latin American counterparts. An apparent exception is Mexico where newly-found oil raised GDP growth rates, thereby reducing incremental capital-output ratios.

In the 1981-87 period, negative GDP growth rates in Argentina and Mexico do not permit deriving meaningful estimates of incremental capital-output ratios. Growth rates in Brazil and Chile continued to fall behind those of the Far Eastern NICs.

IV. The Role of Exports

The Far Eastern NICs attained high rates of economic growth in an open economy as shown by their high export-GDP ratios (Table 3). Nor can these differences be explained by disparities in country size. Thus, while Brazil and Mexico have large economies, Korea's population and GDP are greater than Argentina's and Taiwan's population and GDP are greater than Chile's.

In Korea and Taiwan, the export-GDP ratio increased greatly between 1963 and 1988, indicating the leading role of exports in the growth process. This was the case, to a lesser extent, in Hong Kong and Singapore that already had high export-GDP ratios at the beginning of the period. At any rate, the

^{1/} ICORs fail to allow for the effects of factors other than capital on economic growth and are subject to considerable measurement error. They are derived from national accounts statistics.

Table 2
GDP Growth Rates, Domestic Savings Ratios,
and Incremental Capital-Output Ratios

Country	1963-73			1973-81			1981-88		
	GDP Growth Rate	Domestic Saving Ratio	ICOR	GDP Growth Rate	Domestic Saving Ratio	ICOR	GDP Growth Rate	Domestic Saving Ratio	ICOR
HONG KONG	8.9	24.3	3.6	9.1	29.0	3.4	7.3	29.3	3.9
KOREA	9.3	13.0	2.0	7.7	23.7	4.0	10.1	31.0	2.8
SINGAPORE	10.3	16.5	3.1	7.8	32.8	5.0	6.1	41.8	7.0
TAIWAN	11.1	24.4	1.9	8.0	32.8	3.7	7.9	33.8	2.8
ARGENTINA	5.0	20.5	4.2	1.1	24.2	20.2	-0.0	16.3	-925.9
BRAZIL	8.2	26.3	2.2	5.3	21.2	4.9	3.0	21.8	5.9
CHILE	2.8	14.3	7.5	3.7	14.2	4.5	1.6	15.9	9.2
MEXICO	7.4	19.2	2.7	6.7	22.1	3.4	-0.0	26.2	-905.6

Source: World Bank data base.

Note: ICOR = Incremental capital-output ratio.

Table 3
Export and Import Shares
(per cent)

	Export/GDP Ratio				Import/GDP Ratio			
	1963	1973	1981	1988	1963	1973	1981	1988
HONG KONG	39.0	49.8	48.5	51.1	75.4	74.1	83.6	117.2
KOREA	2.3	23.7	30.4	35.4	14.6	31.3	37.3	30.2
SINGAPORE	124.5	86.5	151.0	164.2	153.4	121.5	198.5	183.3
TAIWAN	15.3	41.2	47.7	51.8	16.7	35.7	44.7	38.2
ARGENTINA	10.0	4.6	7.4	10.2	7.2	3.1	7.6	5.9
BRAZIL	6.0	7.8	8.8	9.5	6.3	8.8	9.1	4.5
CHILE	11.6	12.1	11.5	31.9	13.6	10.7	19.2	21.9
MEXICO	5.1	4.4	8.0	11.9	7.4	6.9	9.9	11.2

Sources: United Nations and World Bank. Data relate to merchandise trade.

figures for these countries are much affected by entrepôt trade. The results are further affected by the importation of inputs for processing to export that raised the ratio for Singapore above 100 percent. ^{1/}

Export-GDP ratios increased much less in the Latin American NICs than in Korea and Taiwan. In Mexico's case, the oil finds raised the export-GDP ratio; in Chile, an even larger increase occurred as economic policy shifted in an outward-oriented direction after 1973.

Export expansion in the Far Eastern NICs involved an increasing shift towards manufactured goods. In Korea, the share of manufactured goods in total exports rose from 45 percent in 1963 to 93 percent in 1988; in Taiwan, the corresponding figures were 38 and 92 percent (Table 4). Smaller changes occurred in Hong Kong that already had a 92 percent manufactured export share in 1963 and in Singapore where entrepôt trade in primary products is of importance.

The share of manufactured exports increased also in the Latin American NICs, but it remained lower than in the Far Eastern NICs. The relevant shares for 1963 and 1988 are: Argentina, 6 and 32 percent; Brazil, 3 and 48 percent; Chile, 4 and 15 percent; and Mexico, 17 and 56 percent.

Data on manufactured export share are affected by the availability of natural resources, in particular copper in Chile. At the same time, interest attaches to per capita manufactured exports that provide an indication of a country's success in these export products.

^{1/} In any case, export values and value added (GDP) are not strictly comparable.

Table 4
Commodity Composition of Exports
(per cent)

1963	Fuels	Non-fuel Primary Goods	Manufac- tured Goods	Other	Total
HONG KONG	0.0	7.8	91.7	0.5	100.0
KOREA	3.0	51.8	45.1	0.2	100.0
SINGAPORE	16.7	52.3	27.8	3.3	100.0
TAIWAN	0.9	61.0	38.0	0.0	100.0
ARGENTINA	0.8	93.4	5.7	0.0	100.0
BRAZIL	0.7	96.1	3.0	0.2	100.0
CHILE	0.0	96.0	3.9	0.2	100.0
MEXICO	4.5	78.4	17.0	0.1	100.0
1973	Fuels	Non-fuel Primary Goods	Manufac- tured Goods	Other	Total
HONG KONG	.	3.3	96.5	0.2	100.0
KOREA	1.1	14.7	84.0	0.2	100.0
SINGAPORE	19.8	33.8	44.3	2.1	100.0
TAIWAN	0.3	16.0	83.6	0.1	100.0
ARGENTINA	0.2	77.4	22.4	0.1	100.0
BRAZIL	1.3	77.1	19.6	1.9	100.0
CHILE	0.2	96.1	3.7	0.0	100.0
MEXICO	0.9	57.1	41.9	0.0	100.0
1981	Fuels	Non-fuel Primary Goods	Manufac- tured Goods	Other	Total
HONG KONG	0.1	3.0	96.5	0.4	100.0
KOREA	0.7	8.7	90.0	0.5	100.0
SINGAPORE	27.3	16.8	48.2	7.7	100.0
TAIWAN	1.9	9.2	88.7	0.1	100.0
ARGENTINA	6.8	73.6	19.6	0.0	100.0
BRAZIL	5.1	54.3	39.1	1.5	100.0
CHILE	1.8	90.2	7.7	0.3	100.0
MEXICO	72.1	17.8	10.1	0.0	100.0
1988	Fuels	Non-fuel Primary Goods	Manufac- tured Goods	Other	Total
HONG KONG	0.2	3.2	95.4	1.2	100.0
KOREA	1.0	5.7	93.3	.	100.0
SINGAPORE	12.5	13.2	70.3	4.0	100.0
TAIWAN	0.6	7.4	91.8	0.2	100.0
ARGENTINA	1.5	66.8	31.6	0.0	100.0
BRAZIL	4.1	48.1	47.8	.	100.0
CHILE	0.9	84.1	15.0	.	100.0
MEXICO	30.7	13.6	55.8	.	100.0

Table 5 shows the rapid expansion of manufactured exports in the Far Eastern NICs. These exports were negligible in Korea and Taiwan in 1963 but reached \$1349 per head in the first case and \$2786 per head in the second in 1988. The rate of expansion was slower in Hong Kong and Singapore that started with a higher base (nearly \$180 per head in both cases in 1963). But the absolute figures are much higher (\$4683 in Hong Kong and \$10398 in Singapore in 1988), although a portion of the total represents re-exports.

The per capita manufactured exports of the Latin American NICs are dwarfed by those of the East Asian NICs. In 1988, these exports were only \$140 per head in Mexico, \$112 per head in Brazil, \$90 per head in Argentina, and \$83 per head in Chile.

V. The Policies Applied

The data show that, for the 1963-88 period as a whole, superior growth performance in the Far Eastern newly industrializing countries was associated with high domestic saving ratios and high levels of investment efficiency. At the same time, exports played an important role in the growth process, contributing to the efficient use of investment funds.

Apart from Hong Kong, all developing countries passed through the first stage of import substitution, involving the replacement by domestic production of the imports of nondurable consumer goods and their inputs. The manufacture of these products, including clothing and textiles, shoes and leather, and furniture and wood, conform to the production possibilities of the developing countries. They utilize in large part unskilled labor, involve the use of simple production processes, are not subject to important scale economies, and do not require the existence of a sophisticated industrial structure.

Table 5
Per Capita Exports of Manufactured Goods
(US \$)

	1963	1973	1981	1988
HONG KONG	179.7	866.9	2664.7	4682.5
KOREA	1.5	79.2	492.8	1349.3
SINGAPORE	175.0	730.0	4139.0	10398.0
TAIWAN	10.8	237.7	1110.8	2785.8
ARGENTINA	3.7	29.4	62.6	90.4
BRAZIL	0.5	12.	73.4	111.8
CHILE	2.6	4.7	25.5	83.0
MEXICO	3.7	19.6	28.5	139.9

Sources: United Nations and World Bank.

Once the first stage of import substitution has been completed, however, the rate of growth of industrial production cannot continue to exceed that of consumption. Now, countries face two choices: embarking on the exportation of nondurable consumer goods and their inputs or moving to the second stage of import substitution through the replacement by domestic production of the imports of producer and consumer durables and intermediate products.

Among present-day newly-industrializing countries, the choice was made for the first alternative in Korea, Singapore, and Taiwan in the early 1960s. These countries also carried out financial reforms that permitted raising domestic saving ratios.

Negative real interest rates (nominal interest rates exceeded by the rate of inflation) led to financial repression in the Latin American NICs that was not conducive to increasing domestic saving and to the efficient allocation of the amount saved. And, these countries shifted to the second stage of import substitution that proved costly as the commodities in question did not conform to the production possibilities of the countries concerned.

Thus, the manufacture of producer and consumer durables requires the existence of a sophisticated industrial structure to provide parts, components, and accessories made to precision. Also, such vertical specialization, as well as a horizontal or product specialization, need a large domestic market for manufactured goods.

Large domestic markets are also necessary for the production of intermediate goods, where traditional economies of scale obtain. Furthermore, the manufacture of producer and consumer durables relies to a considerable extent on skilled and technical labor while intermediate products are highly

capital intensive. At the same time, the margin of transformation for intermediate products is often small and can be squandered through the poor organization of production.

The resulting high domestic costs reduced the efficiency of investment in countries pursuing a strategy of continued import substitution. In order to compensate for the higher costs, these countries also increased import protection, thereby discriminating against exports.

As the costs of continued import substitution became apparent, leading to declines in export expansion and economic growth, the three large Latin American NICs undertook reforms aimed to provide improved incentives to exports in the mid-1960s. The most far-reaching reforms were carried out in Brazil while its favorable balance-of-payments position, due to workers' remittances, tourism, and border industries, hampered the reform effort in Mexico and the opposition of urban interests obstructed the course of economic reforms in Argentina.

The reforms undertaken in the mid-1960s permitted reducing the bias of the incentive system against exports in Brazil, to a lesser extent in Mexico, and even less in Argentina. But, not even Brazil provided equal incentives to exports and import substitution as was the case in the Far Eastern NICs. Finally, after initial efforts, reforms were jettisoned by the Allende government in Chile in the early 1970s.

Policies changed again following the oil crisis of 1973-74. The quadrupling of oil prices, together with the ensuing world recession, imposed a considerable cost on the economies of the nearly-industrializing

Table 6

External Shocks and Policy Responses to External Shocks

		External Shocks (% of GDP)	Additional Net External Financing	Export Promotion (% of External Shocks)	Import Substitution	Deflationary Policies
1974-78	Hong Kong	na	na	na	na	na
	Korea	10.5	-88	90	128	-30
	Singapore	20.9	42	11	-24	70
	Taiwan	7.2	-92	14	96	82
	Argentina	0.5	-168	-13	146	136
	Brazil	3.3	30	15	66	-11
	Chile	6.0	-48	71	18	60
	Mexico	1.2	123	-70	33	14
1979-81	Hong Kong	na	na	na	na	na
	Korea	9.4	-18	-7	8	116
	Singapore	30.4	39	89	-59	31
	Taiwan	13.1	-40	27	91	22
	Argentina	1.2	423	-109	-281	67
	Brazil	2.5	-33	38	49	47
	Chile	3.9	257	50	-133	-74
	Mexico	-0.5	309	412	-756	-64

Source: World Bank

For explanation, see text.

countries. This cost, shown in Table 6, was the largest in the East Asian NICs that were most exposed to foreign trade. ^{1/}

Table 6 further shows the balance-of-payments effects of the policies applied in response to external shocks, including additional net external financing, export promotion, import substitution, and deflationary policies. Additional net external financing has been derived as the difference between actual financing and that estimated on assumption that past trends in exports and imports continued. The effects of export promotion have been calculated in terms of changes in export market shares. Import substitution has been defined as savings in imports associated with a decrease in the income elasticity of import demand compared with the preceding period. Finally, the effects on imports of changes in GNP growth rates in response to the macroeconomic policies followed have been estimated on the assumption of unchanged income elasticities of import demand.

The Far Eastern newly-industrializing countries accepted an initial decline in the growth rate of GNP in order to limit reliance on external financing. Economic growth accelerated subsequently, however, as the countries in question maintained their outward oriented policies. At the same time, adopting realistic exchange rates helped not only exports but also import substitution.

Among the Latin American newly-industrializing countries, Chile shifted to outward oriented policies in response to the external shocks it suffered. These policies led to considerable gains in export market shares

^{1/} The cost of external shocks is measured as the balance-of-payments effects of the deterioration of the terms of trade and of the export shortfall, resulting from the slowdown of the world economy.

while reliance on external financing was reduced. In turn, Brazil and Mexico relied to a considerable extent on external borrowing in order to finance the adverse balance-of-payments effects of external shocks while, self-sufficient in petroleum, Argentina experienced practically no external shocks.

The three large Latin American NICs also increased the extent of inward orientation of their incentive system, thereby promoting the replacement of imports by domestic production. Only Brazil, which continued with the export subsidies introduced in the preceding period, made some modest gains in exports; Argentina and Mexico lost export market shares.

The effects of the policies followed in regard to foreign borrowing are apparent in Table 7 that shows considerable increases in the external indebtedness of Brazil and Mexico between 1973 and 1978. By contrast, Korea and Singapore experienced a decline and Taiwan's external debt remained very small.

Having found oil that led to rapid export expansion, the ratio of external debt to exports declined in Mexico after 1978. Also, Brazil reduced reliance on external borrowing and adopted a mixture of policies aimed at increasing exports, import substitution, and slowing the economy. In turn, Argentina and Chile experienced a considerable capital inflow as a result of the overvaluation of the exchange rate aimed to reduce inflation.

The Far Eastern NICs again accepted a slowdown in economic growth after 1978 in order to limit reliance on foreign borrowing while maintaining their outward oriented policies that led to the subsequent acceleration of economic growth. Only Korea engaged in foreign borrowing but its debt-export ratio hardly changed.

Table 7
External Debt Ratios
(per cent)

	External Debt/Exports				Debt Service/Exports			
	1973	1978	1981	1988	1973	1978	1981	1988
HONG KONG	.	.	.	.	.	.	.	.
KOREA	95.2	100.8	121.0	52.4	16.8	12.8	21.7	13.5
SINGAPORE	12.5	10.0	7.7	10.1	1.8	4.1	1.4	1.9
TAIWAN	.	.	.	.	.	.	.	.
ARGENTINA	171.6	169.4	302.0	512.0	36.7	42.3	45.7	43.6
BRAZIL	183.9	371.0	299.5	314.3	27.0	57.5	66.0	50.2
CHILE	223.1	247.1	279.0	232.5	16.1	53.6	64.8	25.3
MEXICO	185.9	313.2	283.0	319.1	38.6	65.1	51.9	48.9

Source: World Bank data base.

Note: Exports of non-factor and factor services are included in the figures.

The results of alternative policies are apparent in the debt situation of the NICs on the eve of the debt crisis. While in Korea the debt-export ratio was 1.1 in 1981, this ratio reached 3.3 in Chile, 2.8 in Brazil, 2.7 in Mexico, and 2.5 in Argentina. Also, debt-service ratios ranged between 90 percent (Chile) and 56 percent (Mexico) in the Latin American NICs, compared with 24 percent in Korea. These high ratios necessitated corrective action on the part of the Latin American NICs, leading to a decline in their per capita incomes after 1981. By contrast, growth continued in the Far Eastern NICs, where Singapore and Taiwan accumulated a net asset position abroad.

VI. Conclusion

This paper has reviewed economic developments in the Far Eastern and Latin American newly industrializing countries. The results show that the Far Eastern NICs attained much larger increases in per capita incomes than their Latin American counterparts in the 1963-88 period.

Differences in economic growth rates find their origin in differences in savings ratios and investment efficiency. While savings ratios differed little between the two groups of countries between 1963 and 1973, these ratios increased substantially in the Far Eastern NICs in subsequent years as they employed measures encouraging savings.

Investment efficiency was higher in the Far Eastern NICs than in the Latin American NICs throughout the period. The Far Eastern NICs achieved high levels of investment efficiency in the framework of an open economy, with high and rising ratios of exports to the gross domestic product. Export expansion involved an increasing shift towards manufactured goods.

Exports in the Far Eastern newly industrializing countries were promoted by the system of incentives that entailed no discrimination, or limited discrimination, against exports. These countries also relied to a considerable extent on export promotion in response to external shocks and did not engage in excessive foreign borrowing.

The favorable external-debt situation of the Far Eastern NICs also augurs well for their future economic growth. Korea's external debt ratio declined to 0.5 in 1988 as it had a large trade surplus in 1988 when Taiwan and Singapore also increased their surpluses. In turn, the external debt ratio reached 5.1 in Argentina, 3.2 in Mexico, 3.1 in Brazil, and 2.3 in Chile in 1988.

The experience of the Far Eastern and Latin American newly industrializing countries provides important lessons to other developing countries. It indicates the superiority of outward-oriented policies that provide similar incentives to exports and import substitution. It also shows that the continuation of outward-oriented policies permits overcoming the effects of external shocks while reliance on external borrowing reinforces the adverse effects of these shocks.

Countries that have accumulated external debt, then, should adopt outward oriented policies that provide impetus to economic growth through increased exports while improving the balance of payments. Such policies involve the simultaneous promotion of exports and liberalization of imports.

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