

# POLICY DISTORTIONS, RESERVE ACCUMULATION, AND THE WELFARE LOSS

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IN certain developing countries, the ambition of rapid growth has prompted governments to adopt many export-biased policy measures such as export subsidies, tax rebates, low interest loans, low tariffs on materials used in export goods, and in some cases the prohibition of domestic consumption of exportables.<sup>1</sup> More often than not, the export-biased policies are coupled with severe tariffs on import goods. Another strange policy adopted by certain countries is the rapid accumulation of international reserves beyond a "reasonable"<sup>2</sup> sum. In this note, the potential welfare losses from such policy measures are analyzed by a simple diagram.<sup>3</sup>

A production possibility curve of a nation is plotted as AB in Figure I. We assume conventional properties of production function such as the diminishing marginal productivities, smoothness, etc.

<sup>1</sup> Nationalist China and Korea have taken such a measure for the sake of foreign exchange earnings.

<sup>2</sup> Of course, there is no definitive answer to the question of the optimal international reserve holdings. See Heller [3]. However, an abnormally high rate of accumulation of international reserves by some Middle Eastern countries and Nationalist China really provided the motivation for this note. See Table 1.

Table 1: INTERNATIONAL RESERVES AND IMPORT VELOCITY OF RESERVES

	<i>Reserves in \$ million</i>		1970/1960 <i>in %</i>	<i>Import Reserves</i>
	1960	1970		
Cyprus	27	184	681	1.09 (1969)
Jordan	46	253	550	.75 (1969)
Saudi Arabia	185	718	388	.28 (1968)
Nationalist China	117	531	454	2.28 (1969)
Korea	157	602	383	3.03 (1969)
India	670	1,006	150	2.21 (1969)
Industrial Europe	20,094	30,296	150	3.21 (1969)
Japan	1,949	4,084	210	4.11 (1969)
United Kingdom	3,719	2,791	75	7.90 (1969)

SOURCES: IMF Statistics, October 1970.

<sup>3</sup> This note is intended as an elementary analysis of the problem. The actual policy decisions involve many other factors which are omitted here.