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**TRADE LIBERALIZATION EXPERIENCE
IN THE PHILIPPINES, 1960-84**

By

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The views expressed in this paper are those of the authors and not necessarily those of PIDS.

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Part I

THE ECONOMIC BACKGROUND

A. The Economy's Attributes

1. Introduction

This description of the Philippine economy's attributes is not meant to be an exhaustive specification of economic characteristics but an overview of some factors which may be relevant to the process of implementing a trade liberalization policy. To the extent possible, we aim in this description to cover the period from the fifties to 1983.

The Philippines comprises 7,107 islands with a land area of 115,739 square miles. It lies on the western edge of the Pacific Ocean and the country stretches more than a thousand miles from north to south and about 700 miles from east to west. More than half of the country's population live on the two largest islands, Luzon and Mindanao. This tells of the wide disparities of the island sizes such that less than a tenth of them are actually inhabited.

Both the country's size and population of 52.8 million (1983) are comparable to such Asian countries as Thailand in terms of size and population, Pakistan and Burma in terms of size. In the 1971 the Philippines population was comparable with South Korea¹.

2. Population and Labor Force

The Philippines continues to be one of the developing countries with high population growth rates.² Its yearly growth rate has been 2.9 percent between 1950 and 1983. The pattern of this average growth rate however has been an acceleration until the decade of the seventies before leveling off to 2.7 percent per year in 1980-1983. As a result population density has been increasing. Table I.1 presents basic population indicators.

Table I.1
Population Indicators
1950-1983

Year	Number (millions)	Density (persons/sq. km.)	Annual Population Growth Rate (percent)
1950	20.3	67.6	-
1960	27.1	90.3	2.9
1970	36.7	122.3	3.0
1980	48.3	100.3	2.7
1983	52.8	172.8	2.7
1984 ^a	53.4	177.4	2.7

a/ advance estimate

Source: NCSO

This persistent high population growth rate over a long time period has been associated with uneven internal migration into urban areas, more progressive regions, and broad areas or industrial growth. This seems to have worsened over time between 1948 and 1975. For example, of the migration flows from the Visayas in 1948-1960, 28.4 percent moved to Luzon. The proportion increased to 37.2 percent in 1960-1970 and 48.4 percent in 1970-1975. Movements into Luzon have been continuous from the rest of the country with only a slight outflow from Luzon itself to the Visayas.

At the regional level, 8 out of 12 regions (excluding the National Capital Region) have been regions of net outmigration during the decade of the seventies – heavy in Bicol, Western Visayas, Central and Eastern Visayas, declining in the Cagayan Valley and Western Mindanao. The National Capital Region (NCR) has seen an influx in 1975-1980 that was 2.63 times the flow in 1970-1975. Table I.2 and I.3 portray the extent of internal migration over the 1948-1975 period by three major geographic regions and by five regional breakdowns. Notice the decline in migration from the Visayas to Mindanao after 1970 in contrast to the strong policy encouragement of migration earlier (during the fifties and the sixties). The strength of this policy push during that period is also evident for migration from Luzon and for people remaining in Mindanao.

Table I.2
Internal Migration by Broad Region of Origin and
Broad Region of Destination: 1948-1975

Broad Origin of Destination/Period	Broad Region of Origin		
	Luzon	Visayas	Mindanao
<u>1948-1960^{a/}</u>			
All Regions	100.0	100.0	100.0
Luzon	88.1	28.4	13.4
Visayas	3.6	16.8	13.2
Mindanao	8.2	54.8	73.4
<u>1960-1970^{b/}</u>			
All Regions	100.0	100.0	100.0
Luzon	85.7	37.2	18.0
Visayas	6.9	8.9	22.4
Mindanao	7.4	53.9	59.6
<u>1970-1975^{c/}</u>			
All Regions	100.0	100.0	100.0
Luzon	82.9	48.4	16.4
Visayas	12.2	13.3	25.9
Mindanao	4.9	38.3	57.7

a/ Figures include only migrants approximately 11 years old and over and are based on a 0.5 percent sample of the 1960 census.

b/ Figures refer to persons 10 years old and over.

c/ Figures refer to persons 5 years old and over and are based on a 0.5 percent sample of the 1975 census.

Source:

Aurora Perez, "Trends and Patterns in Spatial Mobility," in M. Concepcion (ed.), Population of the Philippines: Current Perspectives and Future Prospects, NEDA, 1983.

Table I.3
In and Out-Migrants by Region
1970-1975 and 1975-1980
('000)

Region	1970-1975			1975-1980		
	In-Migrants	Out-Migrants	Not Migrants	Out-Migrants	In-Migrants	Out-Migrants
ALL REGIONS	887.9	887.9	-	1136.9	1136.9	-
NCR	263.0	195.9	67.1	378.9	202.2	(176.7)
I. Ilocos	29.7	70.7	(41.8)	35.6	85.3	(49.7)
II Cagayan Valley	24.1	28.2	(4.1)	33.3	36.0	(2.7)
III Central Luzon	99.2	72.3	25.9	90.5	92.3	(1.0)
IV Southern Tagalog	94.1	73.7	20.4	183.1	113.1	70.0
V Bicol	35.5	67.1	(31.6)	36.9	98.4	(61.5)
VI Western Visayas	39.9	55.8	(15.9)	33.5	104.8	(71.3)
VII Central Visayas	51.1	89.8	(38.7)	51.8	114.2	(62.4)
VIII Eastern Visayas	44.7	49.7	(5.0)	27.6	96.9	(69.3)
IX Western Mindanao	18.0	40.9	(22.9)	20.1	36.9	(8.0)
X Northern Mindanao	81.9	45.9	36.0	92.3	56.5	35.8
XI Southern Mindanao	77.4	49.9	27.5	89.0	61.0	27.2
XII Central Mindanao	29.3	48.8	(10.7)	56.3	38.5	17.8

Source: NCSO Special Tabulations, 1970, 1975 and 1980 census.
(Concepcion, M. "The Philippine Population: Trends, Prospects, Problem," 6th
National Population Welfare Congress, November 1983).

The Philippine labor force has been growing in tandem with overall population growth. The working age population has been growing even faster – about 5.5 percent per year between 1967 and 1975 and 3.4 percent per year between 1975 and 1982. The labor force participation rate has been about 60 percent while the number employed in the labor force continued to remain high. Table 1.4 presents a set of brief labor force data.

Table I.4
Labor and Employment
(1967-1982)

Year	Working Age Population (million)	Labor Force (million)	Labor Force Participation Rate (percent)	Employment (million)
1967	18.3	11.9	65.0	11.0
1970	20.0	11.6	57.7	10.7
1975	23.7	14.3	60.3	13.6
1980	28.0	17.6	62.7	16.7
1982	30.9	19.2	62.3	18.3
1983	31.7	20.5	64.6	19.5

Source: NCSO

Copied: NEDA

In general and over a long time period, both labor force and employment have been growing at a faster rate than aggregate population. This overall structure has therefore remained stable with some yearly fluctuations.

The distribution of labor force employment by industry and occupation has not changed dramatically in close to three decades of economic growth. Table I.5 shows the labor force by major industries. While agriculture's share seems to be showing a structural (but slow) decline, manufacture's share has fluctuated and it is government services and commerce which have borne the absorption. Neither is there a dramatic change in the occupation structure of labor for the same period as can be seen from Table I.6. There is a continuous increase among the professional, technical and related workers in the same manner as there is a continuous decline among farmers, fishermen and related

Table I.5
Distribution of Employment by Industry
(In Percent)

	1956 ^{a/}	1961 ^{a/}	1965 ^{a/}	1970 ^{b/}	1975 ^{b/}	1980 ^{c/}	1983 ^{c/}
Agriculture, Fishery and Forestry	59.0	60.6	56.7	53.8	53.5	51.4	52.2
Mining and Quarrying	0.4	0.3	0.2	0.4	0.4	0.6	0.6
Construction	2.5	2.5	2.9	3.9	3.1	3.6	3.4
Manufacturing	12.5	11.3	10.9	11.9	11.4	11.0	9.6
Electricity, gas and water	0.3	0.2	0.2	0.3	0.3	3.5	0.5
Commerce	10.4	9.6	11.0	7.3	11.2	10.1	11.2
Transportation, storage and communication	3.0	3.0	3.3	4.3	3.4	4.4	4.2
Government	5.1	5.9	7.0	9.8	9.2		
Domestic Services	4.3	4.0	4.9		5.4	16.4 ^{1/}	16.5 ^{1/}
Personal	1.7	2.8	2.2	6.5	1.9	2.0 ^{1/}	1.8 ^{1/}
Net Reported	0.6	0.4	0.5	1.6	0.3	0.0	0.0
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0

^{a/} October Surveys

^{b/} Census

^{3/} 3rd quarter, preliminary figures

^{1/} Community, social and personal services

^{2/} Financing, insurance, real estate, and business services

Source: NCSO

Table I.6
Distribution of Employment by Occupation
(In Percent)

	1956 ^{a/}	1961 ^{a/}	1965 ^{a/}	1970 ^{b/}	1975 ^{b/}	1980 ^{d/}	1983 ^{d/}
Professional and technical workers	2.0	3.4	3.7	5.7	5.5	6.4	6.1
Proprietors, Managers and Administration	4.6	3.7	4.3	1.2	1.0	0.8	1.0
Clerical Workers	2.0	3.0	3.5	3.2	3.8	4.5	4.1
Sales Workers	5.9	5.9	6.7	6.8	9.7	10.2	11.0
Farmers, farm laborers, fishermen, loggers, and related workers	58.7	60.5	56.2	53.1	53.1	51.0	50.9
Workers in mines	0.4	0.2	0.1	0.3	0.2	} 19.2	} 18.2
Transport workers	1.9	2.0	2.7	4.3	3.4		
Craftsmen and production process workers	13.9	12.1	12.6	14.4	12.1		
Manual workers	2.2	1.0	1.5	2.2	2.2		
Service and related workers	7.0	7.0	8.3	7.6	8.6	3.6	8.1
Net Report	0.5	0.3	0.4	1.1	0.2	0.3	4.6
T o t a l	100.0	100.0	100.0	100.0	100.0	100.0	100.0

^{a, b, d/} See table I.5

^{c/} August

Source: NCSO

agricultural workers. On the other hand, there is no clear increase among craftsmen and production process workers.

There are naturally wage differentials among the employed by industries as well as by occupational structure of the labor force. The differences in average earnings by major occupation group are more transparent than the average wage differentials by industry groupings. For example, using production and related workers as our base (100), average earnings range from a lower rate (85) for service workers and highest for administrative, executive and managerial workers (631). Contrast this with less marked disparities by industry wherein, with reference to manufacturing as base (100), the range is from employees in construction (96) to financing, insurance, real estate, and business services (220).

Employment benefits are satisfied by two institutions servicing the private (the Social Security System) and the public (Government Service Insurance System) sectors.

Benefits provided however are those related to retirement, health, death, and medical services and none of unemployment insurance. Beginning 1975 some additional benefits have been given such as rehabilitation services and disability.

1. Income and Income Accounts

Between 1950 and 1983 the country's overall gross domestic product (at 1972 prices) has been growing at an annual average rate of 5.78 percent. In absolute values real GDP stood at P14,830 million in 1950 and P100, 125 million in 1983. Growth in per capita terms however has been slower during the same period (at 2.59 percent per year) owing to the high population growth rate.

In terms of broad sectors (agriculture, fishing and forestry, industrial, and service), agriculture's real GDP has been growing at annual averages of 4.40 percent along with services at 5.77 percent. The industrial sector however has been growing at 7.33 percent per year during this long period.

Table I.7 presents period growth rates for the broad income aggregates while Table I.8 shows the sectoral distribution of domestic product. The annual growth rates for 1946-50 represent a reconstruction phase from World War II such that it is really the period 1950-1983 that one considers a long term pattern. It is to be noted that the growth of manufacturing has exceeded that of agriculture within each 5-year interval (with the slight exception of 1960-1965). These broad sectoral rates of growth are sometimes made the basis for assessing the context of policy regimes.

It is in Table I.8 that long-term changes in economic structure are perhaps more discernable. From a share to 39 percent of GDP in 1950, agriculture, fishery and forestry fell to one-fourth in 1983. Conversely the industrial sector's share increased from 22 percent (1950) to over 36 percent in 1983. Within industry we find the manufacturing sector to have consistently increased its share from about 12 percent to 24 percent while construction has fluctuated throughout the period. There is no clear pattern for the services sector.

The structural change depicted in the tables is not a typical of the experience of economic development in general although it simply reflects movements of gross domestic products or value added and no specific structural characteristics.

Table I.7
Average Annual Growth Rates
GNP and Net Domestic Product of Selected Sectors
1946-1983
(In Percent at Constant 1972 Prices)

	1946-50 ^{a/}	1950-55	1955-60	1960-65	1965-70	1970-75	1975-80 ^{b/}	1980-83 ^{b/}
Agriculture	12.4	7.0	2.9	4.8	3.5	3.8	5.4	1.5
Manufacturing	5.5	12.1	7.7	4.5	6.1	6.0	7.0	2.5
Services	16.9	9.0	5.0	4.5	4.8	4.8	5.3	3.4
GNP	19.9	7.7	4.9	5.6	4.8	6.5	6.2	2.6

^{a/} Rates at 1955 prices

^{b/} Gross value added except GNP

Source: Baldwin (1975, 3) for 1946-50
 1984 Philippine Statistical Yearbook (NEDA).

Table I.8
INDUSTRY DISTRIBUTION OF DOMESTIC PRODUCT, CY 1950-83
(IN PERCENT, CONSTANT PRICES)

Industry	1950	1955	1960	1965	1970	1975	1980	1983
1. Agriculture, Fishery and Forestry	38.8	37.3	24.4	34.3	32.9	30.8	25.9	24.8
2. Industrial Sector	21.9	21.5	23.4	24.2	24.8	27.6	34.5	35.9
a. Mining and quarrying	1.0	1.2	1.3	1.2	1.9	1.9	2.4	2.0
b. Manufacturing	12.5	15.1	17.5	17.2	18.7	19.4	24.6	25.1
c. Construction	7.7	4.6	4.0	5.3	3.6	5.6	7.5	7.7
d. Electricity, gas and water	0.7	0.6	0.6	0.5	0.6	0.7	1.0	1.2
3. Service Sector	39.3	41.3	42.2	41.5	42.3	41.6	38.0	39.2
a. Transportation, communication & storage	3.0	3.4	3.5	3.5	3.7	3.9	5.2	5.3
b. Commerce	23.5	24.0	24.3	23.6	23.7	22.4	20.6	21.6
c. Services	12.8	13.9	14.4	14.5	15.0	15.3	12.2	12.3
NET DOMESTIC PRODUCT	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: See Table I.7

1950-1975 data are for net domestic product.

1980-1983 data are for gross domestic product.

2. Industry Characteristics

From Table I.7 it is seen that the manufacturing sector's growth rate appears to have been dynamic over time. An examination of some industrial characteristics would reveal that changes have been less dramatic. First, the distribution of value added by industry in the sector has basically remained the same. While it has been shown that some

marginal structural change occurred, it is not evident from aggregate tables.³ There has been fluctuations in the path of industry value added. Table I.9 shows the industry distribution from 1948 to 1983.⁴ Second there is a wide spread of factor proportions used among sectors, which spread has increased between 1960 and 1980. For instance the difference between minimum and maximum, capital-labor ratio was 47 times in 1960 rising to over 112 times in 1980. While higher capital labor ratios are associated with higher value added per employee, the latter has grown much less than the former. Out of 24 industries only in 6 cases is it that labor productivity has grown faster than capital-labor ratios. Finally, Hooley's calculations of total factor productivity growth reveal a predominantly negative pattern between 1956 and 1980.⁵ Table I.10 reports general characteristics of manufacturing industries in 1960 and 1980.

Part of the lack of structural dynamism in Philippine manufacturing is associated with adjustments within industries, especially between small and large firms. To the extent that large firms are substituting labor for capital in response to shocks (e.g. oil price increase) some average productivity declines may be experienced.⁶ This may have been taking place in the seventies. In general however the persisting import-substituting nature of industry has probably prevented a stronger dynamism in manufacturing. Table I.11 shows the ratio of imports to total supplies between 1969 and 1979 reported by Intal. It shows that there are as many industries for which the ratios have fallen as there are industries for which the reverse is true.

4. Investment and Capital

Expenditures for gross domestic capital formation and its changes roughly depict a picture of the country's capital structure and real investment. In the long period 1950-1983 real gross domestic capital formation (GDCF) has been growing at around 11 percent per annum. The major components of this aggregate are fixed capital formation (construction by government and the private sector for residential and non-residential purposes, durable equipment purchases for machinery other than electric, electric machinery/apparatus, and transport equipment) and increases in stocks.

Table I.9
DISTRIBUTION OF VALUE ADDED BY MANUFACTURING
1940-1983
(IN PERCENT)

Industry	1940	1955	1960	1965	1970	1975	1980	1983
Food, Beverage and Tobacco	60.6	43.3	41.2	40.1	41.8	40.0	43.9	40.0
Textile	2.6	3.7	4.6	4.7	5.9	5.6	4.5	6.1
Footwear and Wearing Apparel	6.6	5.1	3.0	7.0	3.8	3.6	4.4	6.1
Wood and Cork Products	9.7	5.0	4.0	4.6	4.2	2.8	2.9	3.6
Furniture and Fixtures	1.0	1.3	0.9	1.4	0.7	0.4	0.6	0.5
Paper and Paper Products	0.0	1.7	2.3	2.1	2.9	2.9	0.8	1.2
Publishing and Printing	3.7	3.1	3.2	4.1	2.2	2.7	1.4	1.0
Leather and Leather Products	0.0	0.2	0.3	0.3	0.2	0.2	0.3	0.2
Rubber Products	0.6	0.9	3.2	2.9	1.4	1.6	1.3	1.2
Chemical and Chemical Products	2.9	9.9	10.0	9.1	7.9	13.1	16.1	7.6
Non-metallic Mineral Products	2.1	4.7	3.7	4.4	4.2	3.6	2.5	2.6
Basic Metal and Metal Products	1.9	4.7	0.0	0.5	7.4	6.0	0.2	6.2
Machinery	0.5	2.1	4.2	4.8	4.5	3.8	8.1	6.8
Transport	1.0	2.2	2.2	2.0	4.2	5.1	3.8	1.8
Miscellaneous Manufactures	5.7	11.2	8.2	5.2	8.7	8.7	1.1	1.5
T O T A L	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Bautista, Power and Associates (1979) for 1948-1965.
1983 Philippine Statistical Yearbook (1983).

Table I.12 reports a summary of gross domestic capital formation and aggregate real saving (persons, corporations, and government) over time, net lending to or borrowing from abroad and a ratio of the change in real GDCF (lagged one period) to the change in real GDP.

Several things are apparent here. One is the higher annual growth rate of GDCF of 10 percent and 11.9 percent for the period 1960-1965 and 1970-1975, respectively. This is in contrast to the 5.4 percent to 7.7 percent at other periods. Another is the decline in saving as source of GDCF from about 65 percent before 1970 to slightly over 50 percent after. Of course increased borrowing from abroad took up the slack (the other source being capital consumption allowance). Finally the incremental capital output ratio is seen to have perceptibly increased in 1975 from P0.171 per peso output (1960) to P0.458.

TABLE I. 10
MANUFACTURING INDUSTRY CHARACTERISTICS

Code	Industry Group	1960		1980		TFP 1956-00
		FA/L	VA/L	FA/L	VA/L	
311/312	Food	6.52	9.00	76.91	51.85	0.011
313	Beverage	5.41	15.20	86.23	102.41	0.009
314	Tobacco	2.70	6.53	21.06	132.03	0.009
321	Textiles	6.99	4.17	61.62	29.22	-0.007
322	Wearing apparel except footwear	1.33	2.44	8.84 <u>a/</u>	14.23 <u>a/</u>	0.014
323	Leather and leather products	4.01	4.78	21.90	10.74	-0.024
324	Footwear	1.40	2.55	12.43	11.01	0.000
331	Wood Products	4.77	4.01	35.81	97.90	0.006
332	Furniture and Fixtures	1.75	2.72	10.53	12.70	-0.025
341	Paper and Products	14.12	10.11	125.16	77.68	-0.007
342	Printing/Publishing	3.61	5.29	39.14	32.20	0.008
351	Industrial Chemicals	17.56	7.02	164.30	210.60	-0.004
352	Other Chemicals	6.29	16.72	45.24	100.77	0.000
353	Petroleum Refineries	62.62 <u>b/</u>	132.18 <u>b/</u>	402.12	1449.11	-0.082
355	Rubber Products	9.35	11.27	36.70	56.77	-0.003
356	Plastic Products	4.72	6.04	34.20	33.09	0.001
362	Glass Products	8.54	9.77	62.74	40.54	-0.032
364	Other Non-Metallic	12.97	8.76	114.07	61.74	-0.010
371	Iron and Steel Basic	9.34	7.84	102.68	247.45	0.002
372	Non-Ferous Metal	6.77	6.77	38.04	63.09	-0.046
381	Fabricated Metals	0.06	7.56	23.45	20.70	-0.006
382	Machinery	4.95	9.07	37.99	31.14	0.039
383	Electrical Machinery	4.17	8.40	22.79	42.12	0.012
384	Transport Equipment	4.95	9.07	56.37	63.60	

a/ Estimated by Hooley (1984).

b/ 1962.

FA/L -- value of fixed assets per total employees in thousand current pesos.

VA/L -- census value added per total employees in thousand current pesos.

Source of Basic Data: Hooley (1984).

*Hooley, 1984.

TABLE I.11
RATIO IMPORT TO TOTAL SUPPLIES
(IN PERCENT)

Industry	1969	1979
Beverages	2.41	2.29
Tobacco products	7.98	0.22
Textile manufactures	40.25	18.04
Wearing apparel	2.62	0.43
Lumber	0.06	0.10
Other wood and cork products	1.98	0.99
Furniture and paper products	24.35	22.99
Publishing and printing	13.78	12.65
Leather and leather products	4.43	46.55
Rubber products	12.86	11.77
Coconut and other oils and fats	12.68	0.34
Basic industrial chemicals	25.04	30.00
Petroleum refineries, etc.	6.41	11.38
Cement	1.67	1.06
Non-metallic mineral products	19.82	15.24
Basic metal	52.14	37.23
Metal products	23.71	18.97
Machinery except electrical	3.55	69.58
Electrical machinery	27.90	55.26
Transport equipment	20.06	51.77
Miscellaneous manufactures and scrap	9.04	35.71
Electricity, gas and water services	0.47	0.00
Construction	0.18	0.30

Source: Intal (1985).

TABLE I.12
GROSS DOMESTIC CAPITAL FORMATION INDICATORS
(1972 PRICES)
1950-1983

	GDCF (million pesos)	Savings (million pesos)	Lending/(borrowing) Abroad (million pesos)	GDCF GDP (million pesos)
1950	2,632	2,727	875	-
1955	3,838	2,282	(460)	-
1960	5,173	3,532	120	0.171
1965	8,336	5,751	379	0.223
1970	10,835	6,105	(764)	0.193
1975	18,984	9,745	(3,103)	0.458
1980	26,609	14,098	(4,460)	0.338
1983	25,029	9,310	(6,237)	1.018
1984	15,462	4,054	(2,835)	

^{a/} advance estimate

Source of Basic Data: NEDA, Philippine Statistical Yearbook (various years).

The capital formation in manufacturing is shown in Table I.13. What is striking about these figures is clearly the high ratio of the increase in fixed assets to the increase in gross value added of the sector, even more so for the increment in 1970-1975. When the real decline in manufacturing gross value added between 1975 and 1980 is taken into account it is quite obvious that factor productivity must have been declining, and in general the overall productivity growth of the sector since 1960. While long term gross domestic investment was increasing, we find that commensurate output was not forthcoming efficiently.

6. Trade and Balance of Payments

Philippine trade is characterized by a long-term pattern of persistent trade deficit. In the period 1950-1983, only in 3 years has the trade balance shown a surplus (1959,

1963 and 1973). Although the current account balance has also been in deficit over the long term, it has had more years of surplus (7 years between 1950-1983) than the trade account.

TABLE I.13
VALUE OF FIXED ASSETS AND GROSS VALUE ADDED
PHILIPPINE MANUFACTURING: 1956-1980
(1972 PRICES)

	Fixed Assets (million pesos)	Gross Value Added (million pesos)	FA-1 GVA (pesos)
1956	1,910.8	1,885.2	-
1960	3,139.1	3,030.4	-
1965	6,141.6	3,896.8	1.42
1970	10,438.8	6,180.0	1.31
1975	14,396.9	7,563.0	3.11
1980	21,120.5	7,542.5	-

Source of Basic Data: Hooley (1984).

Exports have always been concentrated and ten products, mostly unprocessed or raw, accounted for more than 80 percent of total exports since the beginning of Philippine Trade. The products are copra, sugar, bananas, logs, lumber, desiccated coconut, coconut oil, abaca, copper concentrate and gold.

The strength of these ten principal exports in the total has been fairly stable and it is only in the mid-seventies that their share fell below 70 percent of exports. What has emerged in this last decade is an increasing share of non-traditional manufactured exports, composed mostly of labor-intensive tradeables.

The change in the structure of exports is not only between principal and non-traditional manufactures but even within the principal ones as more processing has taken place. For instance within coconut product exports one finds an increased share of coconut oil from copra, desiccated coconut or copra meal. One finds a better balance

among logs, lumber and plywood among forest products exports. On the other hand, concentration can also be detected among exports of non-traditional manufactures in 2 or 3 products (electrical and electronic equipment and components, garments, and handicrafts).

Table I.14 presents the pattern of the exports of ten principal product groups between 1950 and 1983. The share began dramatically to fall from 1974 when 70.6 percent of exports were still concentrated on ten principal products.

**TABLE I.14
EXPORT AND IMPORT STRUCTURE
1950-1983**

	Export Structure		Import Structure		
	Share (percent of 10 Principal Exports)		Share (percent of)		
	Exports	Others	Consumer Goods	Intermediate Goods	Capital Goods
1950	85.3	14.6	90.9 ^a		
1955	80.4	19.6	21.1	58.1	20.8
1960	89.1	10.9	16.0	45.0	39.0
1965	79.5	20.5	22.1	40.9	37.0
1970	76.0	24.0	10.8	47.6	41.6
1975	70.5	29.5	15.9	52.5	31.6
1980	45.5	54.5	18.4	55.9	25.7
1983	34.6	65.44	22.5	54.0	23.5

a/ 1952.

Source: NEDA, Philippine Statistical Yearbook (1984).

The historical growth (1950-1980) of exports has been at the real rate of about 10 percent per year. There are variations in this growth pattern within this long stretch with slow rates in the fifties and dynamic surges in the seventies. Table I.15 shows a summary of major balance of payments components including trade balance and overall current account transactions.

Imports have historically grown at 10.7 percent per year in real terms and were initially concentrated on consumer goods imports. Import controls in the fifties curtailed

the inflow of “non-essential” goods such that by 1955 the share of consumer goods imports to total imports fell to 21.1 percent. Since then this share has remained at about a fifth of all imports. The rest are divided between capital goods and intermediate goods imports. Between 1950 and 1983 however the latter has had higher shares to the total.

TABLE I.15
PHILIPPINE BALANCE OF PAYMENTS
(US DOLLARS)
1950-1983

	Exports (M \$)	Imports (M \$)	Trade Balance (M \$)	Services and Transfer (M \$)	Current Account Balance (M \$)	Basic Balance (M \$)
1950	333	356	(23)			
1955	419	536	(117)	(12)	(129)	
1960	535	624	(89)	85	(4)	
1965	796	835	(39)	162	123	
1970	1,142	1,159	(17)	(31)	(49)	54
1975	2,294	3,459	(1,165)	261	(904)	(421)
1980	5,788	7,727	(1,939)	(107)	(2,046)	(947)
1983	5,005	7,487	(2,482)	(225)	(2,707)	(1,276)

Source: Central Bank of the Philippines, Statistical Bulletin (various years).

Returning now to Tables I.14 and I.15 we can see that a continuing deficit in the trade balance has been a “normal” experience for the country although it is really in the early seventies (1970-1975) that the deficits accelerated, which is from US\$17 million to US\$1.2 billion. The gradual increase in the services and transfer accounts hides an important dimension to the balance of payments. This is the role of remittances from the export of Philippine labor in the seventies. On the imports side this has come from interest payments for accumulated debts, repatriation and related outflows. In the 1970 earnings from exports of services accounted for 15.6 percent of merchandise exports whereas in 1983 this formed almost 60 percent of physical exports. For imports the importance of services did not accelerate that much. All these are evident from Table I.16.

TABLE I.16
EXPORTS (FOB) AND IMPORTS (FOB) OF GOODS AND SERVICES
(MILLION US DOLLARS)
1970-1983

	Exports		Imports	
	Goods	Services	Goods	Services
1970	1,142	178	1,159	331
1971	1,189	212	1,186	352
1972	1,168	285	1,260	193
1973	1,837	688	1,597	638
1974	2,725	834	3,143	868
1975	2,294	907	3,459	952
1976	2,574	871	3,633	1,131
1977	3,151	1,085	3,915	1,333
1978	3,424	1,414	4,732	1,591
1979	4,601	1,576	6,142	1,966
1980	5,788	2,222	7,727	2,621
1981	5,722	2,896	7,946	3,205
1982	5,020	2,984	7,667	3,944
1983	5,005	2,990	7,487	3,614

Source: IMF, International Financial Statistics (various years),
Central Bank of the Philippines

In summary the acceleration of trade deficits has been partly cushioned by the strength of services exports and thus contributing to a more moderate current account balance deficit, at least until the middle of the seventies.⁷

B. Description of A Long-Term Policy Pattern

1. Introduction

This description of a long-term policy pattern uses several commercial and financial indicators to discern the degree or restriction or liberalization followed by the country. At this level or generalization we will not detail the explicit process (if any)

pursued in increasing or decreasing protection accorded the economy. Our purpose is rather to highlight particular waves of liberalization which are to be the basis for further elaboration and study.

There is an abundance of studies on trade and development in the Philippines. In particular, Power and Sicut (1971), Baldwin (1975) and Bautista, Power and Associates (1979) provide comprehensive accounts of trade regimes, protective effects, resource allocation consequences and industrial incentives. In addition there are other studies on tariff reforms and liberalization.⁸

It is perhaps accepted by Philippine trade scholars that (a) the decontrol program in 1962 while liberalizing commercial exchange, effectively activated a protective tariff code (enacted in 1957 during a period of exchange controls) which somehow retained the same bias as the control era, (b) the effective protection structure in 1965 remained basically the same as 1974,⁹ (c) the 1973 tariff code (Presidential Decree / PD 34) retained the same protection structure as 1957, except for classification realignment with Central Bank procedure, and simplified the number of tariff rates as well as narrowed the boundaries, (d) the 1970 Export Incentives Act (Republic Act 6135) added a trade promoting element to an earlier investment incentives program (Republic Act 5186), and (e) the tariff reform of 1980 was fundamental program towards lower effective protection rates (EPR) and uniform tariff across industries.

Our interest however is in understanding a long-term pattern of protection and liberalization and their processes of sequencing and timing. Thus while intermittent measures of them are useful, it is the use of consistency measures that we want to track. Ideally a long series of EPR estimates can yield indications of the degree of liberalization over time. For example, Baldwin estimated yearly EPR's for different categories of goods from 1950 to 1971. We have extended his series until 1980 and present them as Figure I.1 according to three categories of goods (import substituting manufactures, new exports and traditional exports). However since our primary interest in this part is an overall measure of protection, we are using more aggregative indices. But the pattern of the yearly EPR's has been taken into account in the next section. Alternatively to the extent that we can, following through specific policy tools that dictate commercial trade

behavior (e.g. tariff and non-tariff measures, border taxes, quantitative restrictions etc.) can indicate a pattern of protection and liberalization.

Short of these, one can examine a set of price structures that would tend to influence trade behavior. Indeed in some cases prices become the more effective determinants, as illustrated for example when tariffs are inoperative in the presence of quantitative restrictions. Here tariff-based EPR estimates will not likely capture the protective element from the discretionary policy of licensing or quantitative restrictions.

2. Some Liberalization Indicators

Point estimates of EPR are available for 1985, 1974 and 1979 (preliminary), since these are the years for which transactions matrices were gathered. Adjusted input-output data are available for other years (1969, 1978) but since there have been no major changes in tariff rates, the EPR estimates for the 3 years can indicate direction of effective protection.

Because of varying coverage, levels of aggregation and sectoral classification, EPR estimates are not directly comparable across these three time periods. Nevertheless attempts were made to (a) arrive at common items and their unweighted and weighted average EPR's derived, (b) consider a narrower set of products for comparisons between 1965 and 1974 as well as between 1974 and 1979, and (c) discern the spread of EPR's. Table I.17 presents EPR's by end-use. Notice the decline in consumption goods EPR's between 1974 and 1979, larger than the decline in intermediate goods. On the other hand adjustments made to allow greater comparability between 1965 and 1974 and between 1974 and 1979 reveal that there have only been slight movements in protection (excluding capital goods and inputs into construction). The sharp reduction in unweighted average EPR for consumption goods in 1979 is compensated in part by a rise in unweighted average EPR's for intermediate goods, inputs into construction and capital goods such that the overall change in protection may have only been marginal (as revealed in Figure I.1).

The EPR's of the various input-output sectors were weighted by the 1974 share of sectoral value added to the manufacturing total to arrive at weighted means. The movements of the weighted EPR's follow the same general pattern for the simple means,

noted earlier. However when adjustments were made to allow comparability of sectors for different years, there are noticeable differences in the weighted EPRs.

Between 1965 and 1974 the weighted mean EPR for consumption goods almost doubled in comparison with the slight movement of the simple EPR. Between the same periods, the weighted mean EPR for intermediate goods fell by a half. These two comparative measures suggest there may have only been a slight overall change in the protection to the economy between 1965 and 1974.

There is also a noticeable narrowing of EPR variabilities between 1965 and 1979 especially for consumer goods and intermediate products. Thus while changes occurred in the levels of protection especially between 1974 and 1979 the direction seems to have been some narrowing of the differentials according to end-use and thus on the pattern of import substitution.¹⁰

Exchange rate policies affect the official exchange rates by which commercial transactions take place. There are at least two ways by which this will indicate the relative degree of liberalization: (a) by either narrowing or widening the gap between official rates and parallel black market rates and (b) by the frequency with which exchange rates move relative to the movement of the trading partner's exchange rates. The former can be measured by the ratio of black market to official rates while the latter can either be computed as a nominal effective exchange rate (NEER) or real effective exchange rate (REER), as shown as

$$\begin{aligned}
 \text{NER}_i &= \frac{\sum_{j \neq i} (m_{ij} / m_i) r_j}{r_i} \\
 \text{REER}_i &= \frac{\sum_{j \neq i} (m_{ij} / m_i) r_j / P_j}{r_i P_i}
 \end{aligned}$$

where i and j are country indices, r is the number of units of domestic currency per U.S. dollar, m_{ij} is imports from j by i and P is the wholesale price index.

Figure 1.1 EFFECTIVE PROTECTION FROM TAXES, TARIFFS AND SUBSIDIES

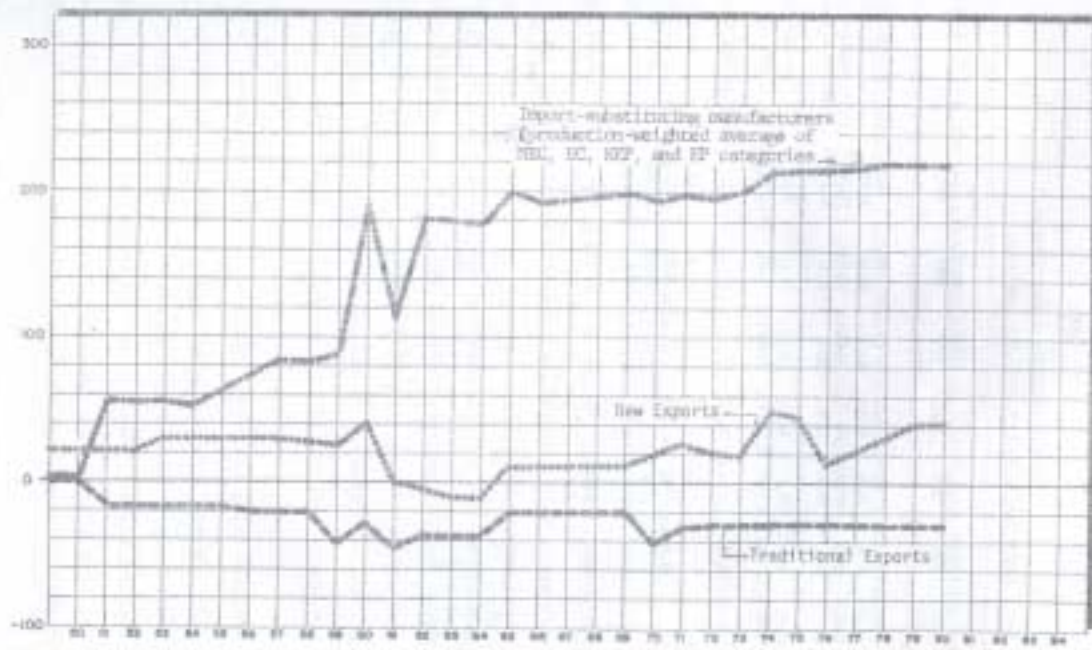


TABLE I.17
EFFETIVE RATES OF PROTECTION BY END-USE

	Consumption Bonds				Intermediate Bonds			
	1965	1974	1979	1985	1965	1974	1979	1985
Number of Items	43	56	69	31	23	35	42	14
Simple Mean (%)	57.08	180.02	88.00	43.10	45.48	35.71	46.60	12.63
Standard Deviation	236.97	507.77	123.54	40.20	103.22	67.00	42.07	14.31
Coefficient of Variation	4.16	2.70	1.39	1.12	2.27	1.30	0.90	1.13
Weighted Mean (%)	29.28	163.44	65.58	62.69	7.22	19.94	24.87	7.58
Number of Items	24	32	44	30	11	17	10	14
<u>Adjusted for 1955 and 1974</u>								
Number of Items	20	20			14	10		
Simple Mean (%)	73	89.8			51.56	32.39		
Standard Deviation	203.06	139.44			130.14	77.17		
Coefficient of Variation	2.79	1.57			2.52	2.38		
Weighted Mean (%)	7.05	14			10.03	5.65		
Number of Items	11	11			10	10		
<u>Adjusted for 1974 and 1979</u>								
Number of Items		49	49			35	35	
Simple Mean (%)		191.3	165			35.71	43.97	
Standard Deviation		539.8	140.9			67.83	41.67	
Coefficient of Variation		2.02	1.34			1.96	0.95	
Weighted Mean (%)		48	60.69			18.69	31.64	
Number of Items		27	27			15	15	
<u>Inputs into Construction</u>								
	1965	1974	1979	1985	<u>Capital Goods</u>			
	1965	1974	1979	1985	1965	1974	1979	1985
Number of Items	16	21	22	14	4	7	7	7
Simple Mean (%)	80.44	20	61.36	24.74	22	19.06	67.56	19.61
Standard Deviation	102.38	64.82	62.97	26.45	25.73	11.3	83.43	8.5
Coefficient of Variation	1.27	1.35	1.03	1.07	1.17	0.57	1.23	0.43
Weighted Mean (%)	-15.05	14.51	6.07	19.92	5	17.17	37.61	21.96
Number of Items	8	15	15	14	1	7	7	7
<u>Adjustment Discarding Logging</u>								
Weighted Mean (%)	18.46	44.36	43.26	19.92				
Number of Items	7	14	14	14				

Source: 1965: Power, John H. "The Structure of Protection in the Philippines" in The Structure of Protection in Developing Countries, ed. By Dela Balanca & Associates, 1971.
1974: Bautista R., Power J., & Associates. Industrial Promotion Policies in the Philippines, PIDS, 1979.
1979: Tariff Commission Estimation.
1980: Bautista Romeo M. "The 1981-85 Tariff Changes and Effective Protection of Manufacturing Industries," Journal of Philippine Development VIII (1981).

Two aggregate measures of the degrees of liberalization are (a) an “implicit import premium” which includes the effects of quota and tariffs, and (b) a ratio of the prices of tradeables to non-tradeables. We have simply derived the former as the ratio of the wholesale price index of imported goods to the import unit price index (both in peso terms). Power and Sicat has used this as a “good indicator or trends in the implicit degree of protection provided by the control system.”¹¹

The latter on the other hand has been proxied by the ratio of the wholesale price index (WPI) to the consumer price index (CPI). The basket of goods in CPI tends to emphasize the menu consumed by low income groups which are generally non-tradeable goods. In the WPI are tradables (i.e. importable). Thus trends in the ratio would show the domestic prices of tradables relative to non-tradables (even though the latter goods prices may be subject to price controls).¹²

There may be ad hoc restrictions that may be applied temporarily that would be product specific or across all trade transactions. In the Philippine context what would induce these measures to be taken are balance of payments problems. Deterioration in the current account balance obviously triggers immediate restrictions to imports or surcharges to exchange transactions that would have a direct bearing on the ability to carry on trade. Perhaps the more relevant information is the current account balance or the previous period’s deficit before quantitative measures are taken.

In recent years (from about 1975) it is our impression that non-tariff barriers have increased dramatically at the same time that exemptions from duties mushroomed for either favored industries or firms. The former had led to greater restrictions while the latter, though distortionary, is less restrictive.

3. An Index of Trade Liberalization

The complete decontrol of the Philippine economy in 1962 (and the unification of the exchange rate in 1965) is probably the most important single act to free international trade transactions from the discretion of the control era. Thus in spite of the protective nature of the ensuing tariff structure that became operational, decontrol by itself was a form of liberalization. Put differently, the substitution of a price-dominated protection

system over a maze of controls was less restrictive. Baldwin has adequately documented the regime of complete liberalization as occurring from 1965 to 1967, after which controls were gradually reimposed following balance of payments deterioration.

In February, 1970, the exchange rate was allowed to float and simultaneously some of the earlier restrictions lifted. The commercial policy however remained basically the same except that on the one hand controls on less “essential” consumer goods imports were retained and, on the other hand, export promotion was actively pursued. In one sense the latter was another form of liberalization in as much as the trade policy regime had an export bias. The commodity boom in 1973-74 allowed a further degree of liberalization.

A major revision to the 1957 tariff code was made in 1973. The revisions however were marginal rather than structural, e.g. simplification by setting a maximum rate of 100 percent ad valorem and a minimum of 10 percent and providing for six levels of rates (10, 20, 30, 50, 70 and 100), special duties to protect Philippine industries against dumping or subsidy, and institutionalization of the export tax. The Tariff and Customs Code of 1978 had likewise marginal modifications. Thus between 1957 and 1978 there was very minimal structural changes in the tariff.

The operating mechanism for the degree of liberalization between 1970 and 1979 was embodied in various circulars, administrative orders, and decrees which imposed either restrictions or exemptions. The continuing trend of deficits in the current account balance necessitated fragmented and non-transparent restriction.

A major tariff reform program was designed in 1980 and implemented in 1981. Along with this was an import liberalization effort to free from restrictions items classified as non-essentials, banned and unclassified. The 1963 economic crisis, however, effectively aborted these fundamental changes in tariff structure and commercial policy in the country.

This abbreviated description of a long-term liberalization policy pattern is represented graphically in Figure I.2. Although the index is numerical it should more or less be seen as an ordinal specification of the degree of liberalization in the period 1960-1983, 0 representing a least liberal and 20 representing a most liberal policy. The

numerical magnitudes are judgmental, based as far as possible on the objective indicators explained in the previous section and shown in Table I.18.

Notice the steep acceleration of liberalization between 1960 and 1962 after which the freeing of commercial trade at the fringes until 1965 leveled the degree of liberalization. The ad hoc measures in 1968 and 1969 increased protection until the floating of the rate in 1970. The fundamental tariff reform in 1981 is evident as a rise in the index, while the reimposition of import and foreign exchange controls in 1982 and 1983 induces a downturn in the index.

The current account balance column in Table I.18 has been lagged by one year. It shows positive balances from 1964-1967 after which it deteriorates. Improvements are then seen from 1971-1974. This follows our rough index of quantitative restrictions.

On the other hand the ratio of the black market to official exchange rates shows a pattern not too dissimilar from Figures I.1 (see Figure I.3). The real effective exchange rate and the quota premium on imports series are shown in Figures I.4 and I.5 respectively. The index for REER is based on May 1970, 3 months after the floating of the Philippine peso.

The general picture that emerges from this is three episodes of liberalization: (a) the first resulting from the 1962 decontrol, (b) the floating of the exchange rate in 1970 and export promotion, and (c) the tariff reform and import liberalization in 1981. Although these many not all reflect changes in commercial policy or even deliberate policy designs, the environment over this long period suggests the degrees of liberalization we outlined.

These episodes constitute the bases for our detailed study of their timing and sequencing.

FIGURE 1.2 INDEX OF TRADE LIBERALIZATION*

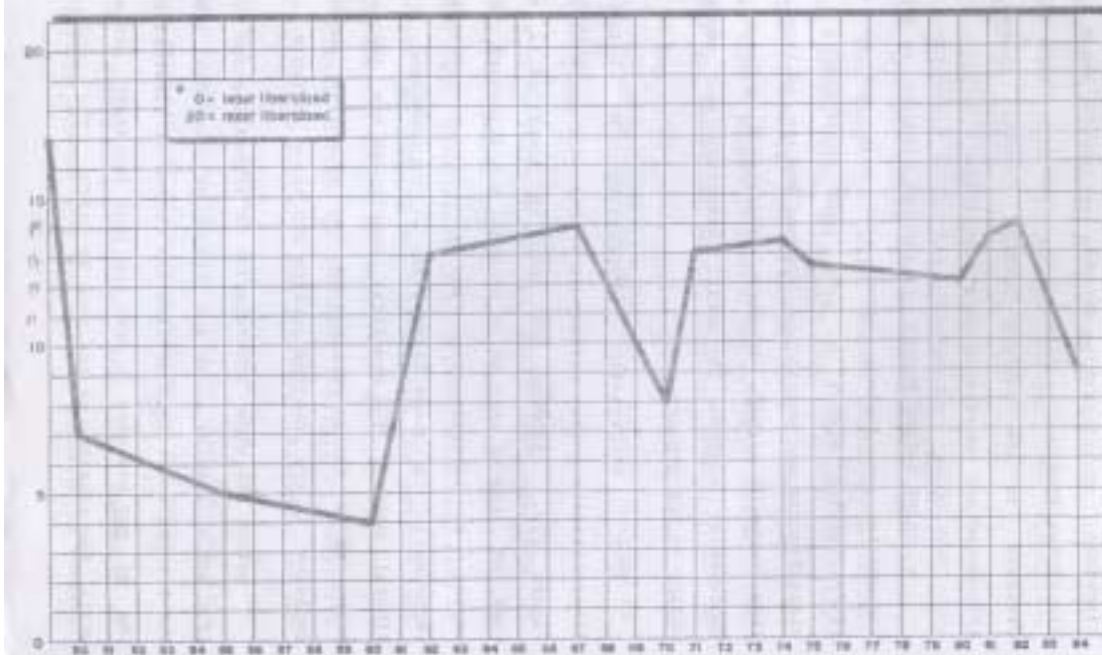


TABLE I.18
SELECTED LIBERALIZATION INDICATORS
1960-1983

Year	NER ^{a/} (1970=100)	RER ^{b/} (1970=100)	"Implicit Import Premium" (1970=100)	CAB ^{d/} (million US\$)	IR ^{e/} (million US\$)	BR ^{f/} OR	WPI ^{g/} CPI (1970=100)
1960	305.5	210.8	232.0	56	90.0	1.29	101.8
1961	305.0	218.3	240.4	-4	120.0	1.18	101.8
1962	166.3	121.0	135.1	-66	44.1	1.05	104.1
1963	157.8	127.8	133.2	-30	75.0	1.01	105.5
1964	157.9	132.4	132.8	182	109.5	1.00	101.6
1965	157.9	133.4	131.1	85	123.3	1.03	100.5
1966	158.3	136.1	129.4	123	188.5	1.02	100.0
1967	157.5	136.5	126.3	147	166.1	1.05	97.3
1968	157.9	137.7	126.3	-42	179.8	1.59	97.8
1969	157.5	134.5	127.0	-266	161.4	1.27	97.7
1970	103.4	103.7	110.1	-253	120.7	1.12	105.2
1971	93.8	107.1	103.4	-48	251.0	1.09	105.8
1972	84.9	103.8	100.0	-2	375.5	1.05	100.0
1973	79.0	108.1	89.5	4	548.8	1.06	106.4
1974	80.7	142.7	83.3	473	1037.0	1.05	116.9
1975	75.9	129.4	89.8	-207	1502.5	1.09	115.3
1976	75.3	129.4	94.7	-904	1360.6	1.06	114.0
1977	72.8	130.2	88.3	-1105	1641.7	1.05	112.7
1978	66.2	124.6	90.9	-820	1525.1	1.07	109.9
1979	66.5	134.6	95.3	-1162	1882.7	1.08	111.3
1980	66.5	135.5	80.1	-1562	2422.9	1.07	111.3
1981	68.6	137.4		-2046	3155.4	1.05	111.3
1982	73.1	142.5		-2327	2707.0	1.06	111.5
1983	73.1	127.3		-3360	2542.7	1.27	124.0

a/ $NER_t = \frac{\sum_{j=1} (m_{ij} / m_i) r_j}{r_i}$, see text for definition

b/ $RER_t = \frac{\sum_{j=1} (m_{ij} / m_i) r_j / P_j}{r_i P_i}$, see text for definition

c/ Define as the ratio of wholesale price index for imported goods (in peso prices) to the units price index for imports (in pesos prices).

d/ Current Account Balance the previous year.

e/ International Reserves the previous year.

f/ Black market rate divided by official rate of exchange.

g/ Ratio of wholesale price index to consumer price index.

Sources:

- a, b - computed by P. Rana (Asian Development Bank)
- c - Central Bank of the Philippines
- d - Central Bank of the Philippines
- e - IMF, International Financial Statistics
- f - Dick's Currency Yearbook (various issues)
- Central Bank of the Philippines
- g - Central Bank of the Philippines and NEDA, Yearbook of Philippine Statistics (various years).

Figure 1.3 RATIO OF BLACK-MARKET TO OFFICIAL EXCHANGE RATE

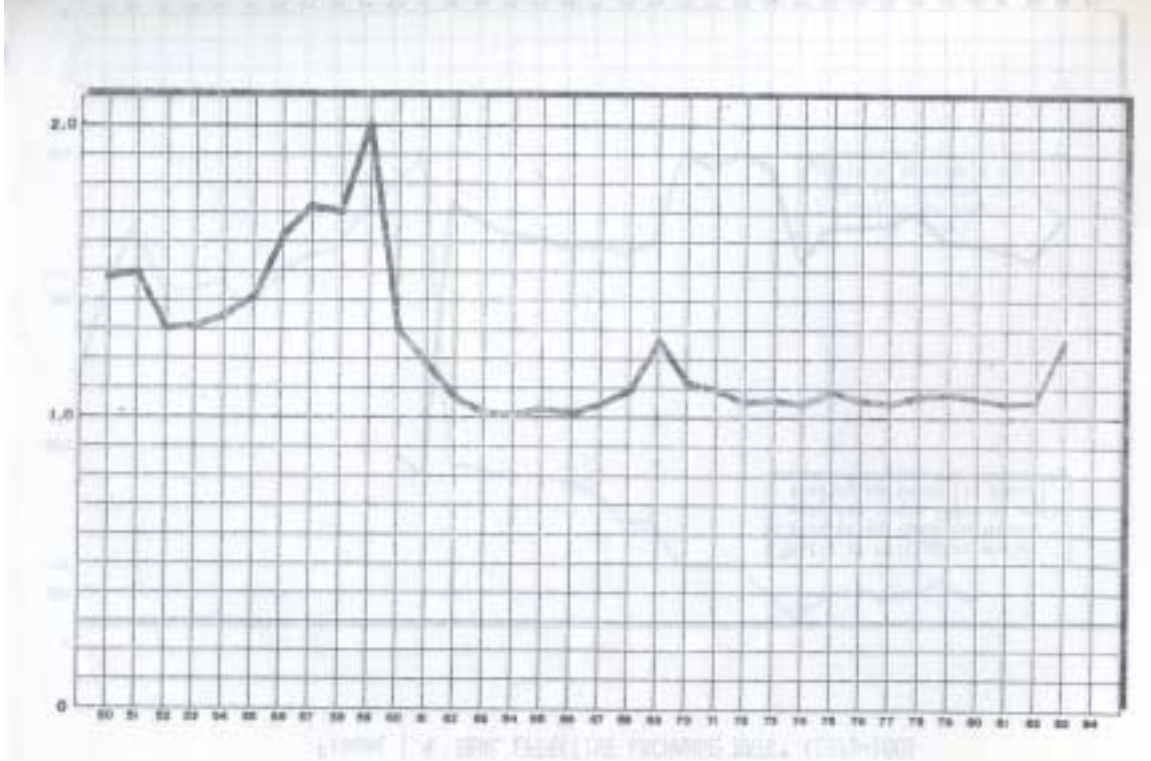


Figure 1.4 REAL EFFECTIVE EXCHANGE RATE* (1972=100)

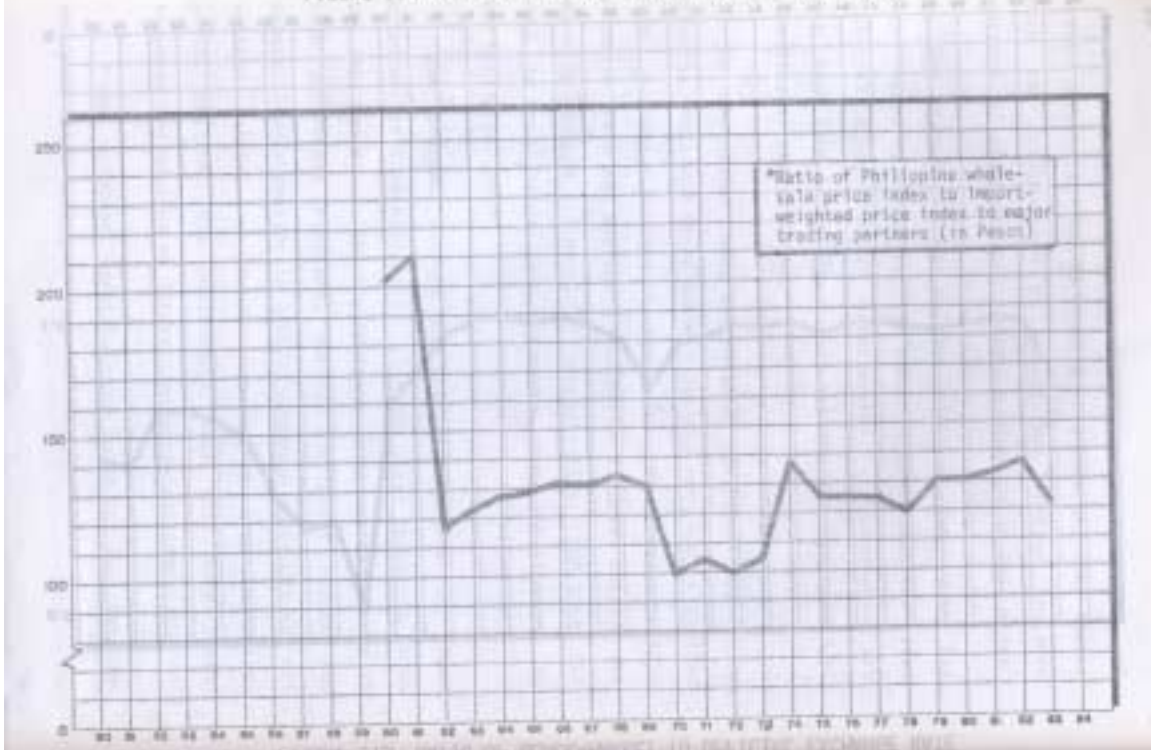
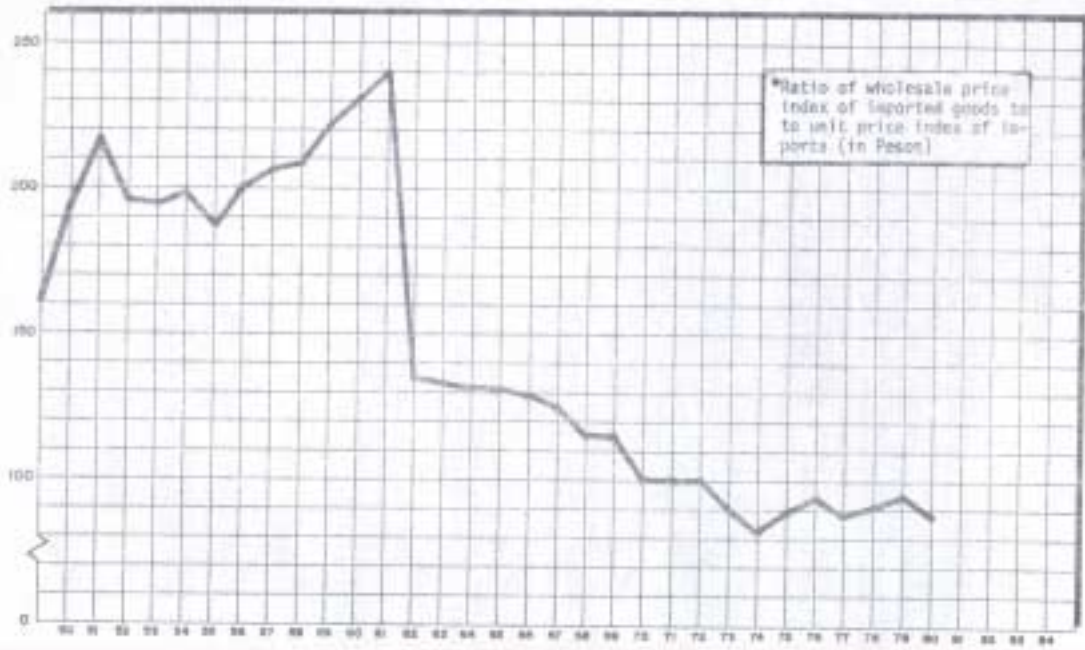


FIGURE 1.5 INDEX OF IMPLICIT IMPORT PREMIUM* (1972=100)



FOOTNOTES

¹ In Baldwin (1975), a comparison is made between the Philippines and Korea in terms of population (p. 2) in 1971. Yet what was not covered in his comparisons is the fact that in 1970 the manufacturing sector's share to GDP was roughly comparable – 23.1 percent for the Philippines and 18 percent for Korea. In 1980 the ratios were reversed – 23 percent for the Philippines and 33.2 percent for Korea.

²The World Bank continues to classify the country among those with high population growth rate such that the premature leveling of the annual rate at 2.75 percent is considered to pose a drag to growth.

³ Although calculations of an index of structural change are sensitive to periods chosen, one estimate indicates a sharp increase from the period 1987-70 to 1975 – 80. See Albuero (1984).

⁴The industries included in the calculation combines a number of important industries (e.g. food, beverage and tobacco) and excludes others (e.g. petroleum)

⁵ The measure of total factor productivity growth is the usual residual that comes with differentiation of aggregate production function with respect to time. See Hooley (1985).

⁶ Albuero (1984).

⁷ In precise terms this has only been true because services exports had a low base to begin with. What is apparent from Table I.16 is that only in 1972 and 1973 did the country experience a services account surplus.

⁸ For instance, Bautista (1985).

⁹Tan (1970).

¹⁰ This observation which is not striking in Bautista's estimates of EPR's based on the 1974 I-O tables, confirms an earlier observation by Albuero about narrowing of EPR's with different $\{a\}$'s due to the external disturbances leading to differential factor price movements. See Bautista (1982) and Albuero (1982).

¹¹Power and Sicat (1971), p. 35.

¹²Relative prices are considered effective signals for resource flows. Since the price-controlled items are for food and basic necessities, these have been effectively institutionalized since the period of controls and therefore do not confer wild fluctuations to the series.

PART II

NOTES ON THE FIRST EPISODE: FOREIGN EXCHANGE DECONTROL 1960-65¹

1. Introduction of the Policy

Foreign exchange controls had been introduced as a balance-of-payments measure in 1949 (at a time when post-independence treaty obligations with the US prevented the Philippines from unilaterally changing the exchange rate of P2 = \$1). Their unintended effect was to encourage a rush of import-substituting investment in the early 1950s. The foreign exchange control system was based from 1953 onwards in the Central Bank which allocated foreign exchange according to a classification of goods by use ('producer' or 'consumer') and degree of essentiality, the less "essential" consumer goods having the lowest import priority and thus providing the greatest incentives for import – substitution investment. With changes of classification of products this same list has continued to serve as a bible to the Central Bank, except in the period of full decontrol, 1962-69, and, to an extent, after the liberalization of 1981-83.

It is hardly surprising that the system of protection should make the Peso progressively more overvalued in the 1950s, discouraging exports (in the face of the industrial sector's appetite for foreign exchange). Moreover, it is not surprising that the import allocation system should have led to substantial corruption. One indicator of the overvaluation is the black-market premium (ratio of black-market to official exchange rate) which moved from 1.30-1.50 in the first half of the 1950s to 2.01 by 1959 (the going rate for the purchase of import licenses is said to have moved, as one might expect, by similar magnitudes).

By 1959 reserves were severely depleted and there was simply no more room for maneuver in cutting imports. The political fight for decontrol had been waged in earnest since around 1957. Its major proponents were the export sector, particularly the powerful sugar lobby, which was well represented in Congress. Resisting the move was the Garcia Administration (Nacionalista Party) which placed great emphasis on the role of controls in industrialization. The sugar lobby was not very popular – its power and

evident self interest were resented--), hence economic issues were clouded with political equity issues in the debate. In the event, it was this Administration which undertook the first phase of decontrol. This it did rather reluctantly and cautiously.

This consisted in a planned effective devaluation through the means of a multiple exchange rate to start in April, 1960, and to culminate in a unified devalued exchange rate not later than 1964. The first three stages of this plan saw a gradual increase in the amount of transactions taking place at the so-called "free" rate (a rate actually fixed by the Central Bank). In the first phase, from April to November, 1960, about one-quarter of all foreign exchange transactions occurred at the free-rate of P3.00. In the second phase, from November, 1960, to March, 1961, about half of these transactions occurred at the free rate; from March, 1961, to January, 1962, in the third phase, about three-quarters of such transactions took place at P3.00. While the steps taken under the three stages represented a partial devaluation, the import liberalization was less: the Central Bank still effectively controlled import allocation.

For the November, 1961, presidential election, Diosdado Macapagal, the Liberal Party candidate, made an acceleration of decontrol one of his important planks (but, interestingly, the appeal was perhaps more to the elimination of graft than the promotion of efficient resource allocation). His stance on decontrol may have won him the support of the US government in the election. One of his first steps on assuming office in January, 1962, was to completely decontrol of imports, letting the Peso float, while exports were to face a temporary retention of 20% of foreign exchange earnings at the P2.00 rate. By mid 1962 the exchange rate had settled at P3.9, where it was held until 1970. The January decontrol was also accompanied by the realignment of some tariffs in a conscious move to protect manufactures from some of the effects of decontrol (already in 1957 a reform of tariffs had made them considerably more protective), not so much perhaps in preparation for decontrol as to capture a larger share of the import quota premium for the government. The intended removal of the 20% retention on exports finally occurred in November, 1965, thus reconstituting a unified exchange rate.

2. Economic Performance following Decontrol

The complete dismantling of foreign exchange controls was achieved over a 21-month period (April, 1960, to January, 1962). In spite of the tariff rises of 1957 and 1962 to cushion the impact on industry of decontrol, the (imperfect) evidence suggests a very large fall in the protective premium on imports, concentrated in 1961 and 1962, the virtually complete elimination of the black-market premium, and a large fall in the implicit degree of nominal protection to industry (see table below).

	<u>Price Indices (1959 = 100)</u>			Ratio of Black-market to Official Rate
	Unit Price of Imports (In Pesos)	Wholesale Price of Imports	Price of Domestic Manufactures	
1959	100	100	100	2.01
1960	107 ^a	106	103	1.29
1961	151 ^a	111	110	1.18
1962	202	122	115	1.05
1963	217	129	120	1.01
1964	220	130	126	1.00

^aConverted at estimated weighted import (multiple) exchange rate of 2.09 in 1960, 2.92 in 1961.

It is difficult to infer the effect on effective protection, for nominal protection to both outputs and inputs must have been slashed by the removal of quota premia. However, the poor performance of manufacturing in the post-decontrol period (see below) does imply a loss of effective protection.

Especially by the standards of the 1970 devaluation episode, post-decontrol price rises, though high by historical standard, were modest (a 22% rise in the CPI from 1959 to 1963). But this was enough to reduce real wages by about 10% in 1959-63 and lead to significant labor unrest in 1963, and a rise in minimum wages in 1966 that restored part of the real loss. The modesty of deflation and the extent of real devaluation combined to achieve a substantial improvement in real effective exchange rates for imports and

exports, as measured by the ratio of the CPI to unit prices of imports and exports in Pesos (see the following table, 1959=100):

	CPI	Real Wage	REER Imports	REER Exports
1959	100	100	100	100
1960	105	101	103	107
1961	110	97	106	121
1962	113	95	56	72
1963	122	89	56	68
1964	133	86	61	71
1965	137	88	61	72
1966	144	92	63	75
1967	152	93	65	78
1968	155	91	61	75
1969	157	94	60	76

a/ The use of the official exchange rate (rather than the weighted multiple exchange rate) leads to an overstatement of the height of the REER.

Three important effects of decontrol on the economy are worth stressing. First, as far as the external position went, there was a large increase in export quantities from 1962 (when there was a considerable improvement in the export exchange rate) to 1966 (NB taking into account exports outside official channels, it appears that the real growth began in 1959). Export expansion concentrated on a small number of product groups, sugar, coconut, logs and mining. There was also some growth, though at a lower rate until after 1966, of manufactured export. The restrained growth of imports from 1959 to 1963 contributed to the restoration of a positive balance-of-payments current account in 1963-66. After 1963 there was a rapid increase in import volume which, together with a steady (if unspectacular) decline in the terms of trade, led to high balance-of-payments deficits by 1968 and 1969.

Second, the success of export agriculture led to a shift in land use from food to export crops, particularly sugar, in the early-to-mid 1960s (according to Treadgold and Hooley, 1967). This led to higher food prices (especially rice up to 1966), fed into the

consumer price index, and helped in the real wage decline. (Rice was one of the few products in the post-decontrol period not to be freely traded). This aspect of the post-decontrol experience may have helped convince the incoming Marcos Administration in 1960 of the need for a rural development program.

Third, while the decontrol had a salutary effect on the external position of the economy in 1962-66, the positive effect on growth was less obvious. In particular the jolt to manufacturing, was serious. Manufacturing GDP growth averaged 7.7% in 1957-59; this figure fell to 3.7% in 1960-65 (there is also some corresponding evidence of falling profit rates). It does not seem that this much pressure on manufacturing had been intended; perhaps the control system had masked the true extent of protection to manufacturing. Some have said that the competitive atmosphere created after 1962 for a few years proved very salutary, though it is difficult to find any statistical evidence – such as structural change or productivity growth – to reflect this. Indeed, the latter 1960s saw several measures taken by the Marcos Administration to reduce the pressure. First the Development Bank of the Philippines introduced an important program to aid distressed industries in 1966. Second, the Investment Incentives Act of 1967 provided important fiscal incentives, as well as an important step towards industrial planning. Third, the foreign-exchange crisis saw the re-introduction of Central Bank controls on imports of certain “non-essential” consumer goods (which were to remain in place throughout the 1970s). Fourth, the government introduced controls on entry to 30 “overcrowded” industries in 1970 (many of them, such as textiles, the “victims” of decontrol), likewise controls that were to stay throughout the 1970s. Thus part of the post-decontrol experience helped feed forces for protection in the 1970s.

FOOTNOTE

¹ This section is largely based on Power and Sicat (1971) and Baldwin (1975).

PART III

THE SECOND EPISODE: DEVALUATION AND THE GROWTH OF NON-TRADITIONAL EXPORTS, 1970-80

1. Introduction

This episode is characterizable in two distinct periods. In 1970 to about 1974 there is a devaluation-induced stabilization episode with many of the characteristics of the post-decontrol period. The devaluation in itself represents a liberalization of the trade regime, but in addition, a series of export promotion measures is undertaken, most of them in 1970 and 1973. In the second period, beginning in 1974, we do not perceive a net trend to trade liberalization in terms of conventional commercial policy measures of exchange-rate policy; indeed, the reverse may be true. Yet this is also the period, rather than 1970-74, where a fundamental restructuring of exports takes place, the result of rapid growth in non-traditional manufactured exports (i.e., broadly speaking, manufactured exports outside of traditional processed products – refined sugar, plywood, coconut oil, canned pineapple) and the stagnation of traditional (agriculture-based and mining) exports.

We shall suggest that, while policy affecting the real exchange rate (i.e., decontrol in the 1960s and the 1970 devaluation) laid the basis of manufactured export growth, the normal export promotion measures of the early 1970s had a more marginal effect, while the sustained growth of these exports (till 1981 in fact) has to be understood in the context of falling real wage costs for manufacturing from 1969 to 1974.

In all, this is perhaps a curious liberalization episode, in the context of our attempts to better understand how episodes are planned and implemented. This episode is largely unplanned; the outcome of growing manufactured exports may have been intended, but, in our view, the apparent instruments of the specific export promotion policy at best contributed only a modest amount to the actual outcome.

The abnormal characteristics of the “liberalization” episode make it advisable to depart somewhat from the reporting format for the other episodes. First, since

commercial policy measures are not the dominant element in this episode, we have grouped together, in section 2, discussion of major relevant policy development before we discuss the political and economic circumstances at the beginning of the episode (section 3). Second, there is little to say about implementation beyond what can be said about the policies themselves. Third, we give separate treatment to post-liberalization economic performance for the sub-periods 1970-74 (section 4) and 1978-80 (section 5). The first period, 1970-74, is treated at somewhat greater length in terms of both policy and performance, since this appears to be the period when trade liberalization was explicitly intended.

2. The Major Policies Impinging on Trade Liberalization: Their Nature, Targets and Implementation

2.1 Tariff and Non-Tariff Barriers

Between 1962 and 1969 imports were largely governed by tariffs alone, albeit high ones. In response to the growing balance-of-payments crisis of 1967-70, foreign-exchange controls began to be reintroduced from March, 1968.¹ In June, 1969, the import of various categories classified as “semi-essential” and “non-essential” – by and large the very goods that domestic manufacturers tended to produce – were subjected (for the first time since 1962) to Central Bank approval. After the devaluation of February, 1970 (see section 2.3), these controls (with some other controls on invisible imports) were largely retained. This contrasts with the complete dismantling of such controls in 1962 in the decontrol episode. After 1970 and until 1981 this Central Bank import control remained in place, though individual products were reclassified between controlled and uncontrolled categories. We believe that these reclassifications had little systematic liberalizing or deliberalizing effect. More important, we believe, was the ad hoc response of the Central Bank to deterioration in the balance of payments: there was a discernable fall in the share of consumer goods (where these Central Bank controls are concentrated) in the period 1974-80, when these substantial current-account deficits developed, compared to 1972 and 1973, the only current-account-surplus years in the 1970s. (But

the fall in consumer-good share could also reflect other factors, for instance a growing level of investment).

Ever since the introduction in congress of a draft omnibus tariff reform bill in 1964 tariff reform had been stalled by the conflict of individual pressure groups represented in Congress. Under the circumstances, reform of individual rates was undertaken within the Presidential prerogative (under various Executive Orders). One of the first economic acts of the government after Martial Law was declared (September, 1972) was a thorough revision of the tariff code under Presidential Decree (PD) 34, on January, 1973. It was largely a rationalization of the tariff structure, reducing many columns to only 6 rates ranging from 10% to 100% ad val., and intended to reduce the scope for technical smuggling. It could be, and was, presented as a modest step towards tariff reform, inasmuch as the highest rates (above 100%) were removed, a minimum 10% tariff was introduced (thus, for instance, removing some of the bias towards capital-intensity by taxing imported capital goods), and all previous duty exemptions enjoyed by public institutions were removed.² On the other hand, and less publicized, there was conscious realignment of tariff rates with the Central Bank commodity classification used to control imports, in an attempt to make protective instruments more consistent.³ While the reforms promised added consistency in protection, it is less clear whether average protection levels increased or not: the results of tariff-based effective protection studies for 1965 and 1974 (with different product coverage, different approaches to the problem of tariff redundancy, but otherwise broadly similar Methodologies) suggest that high effective protection levels for consumer goods were not much touched, but that considerably lower effective protection for intermediate and capital goods was further reduced.

Soon after the 1973 reform the new-found consistency in protection started to be undermined. On the one hand, between 1974 and 1970 many of the ad hoc tariff exemptions (i.e., those broadly outside of general fiscal incentive legislation) were reintroduced: the ratio of estimated duty exemptions to actual duties paid on all imports rose from 9% in 1973 and 1974 to a level of at least 22% from 1976 to the end of the decade.⁴ The growth in ad hoc exemptions benefitted both the government and private firms and institutions. On the other hand, there is evidence of the growth of ad hoc

legislated non-tariff barriers outside the Central Bank commodity-classifications-and-control system, dating from the mid 1970s, though how important this is has yet to be ascertained. The growth of both tariff exemptions and NTBs various benefited the government, individual producing firms, producing sectors, and consuming firms and institutions. Exemptions from industrial inputs might improve a given firm's level of effective protection vis-à-vis competing producers, while exemptions given to users for imports of goods competing with local production might reduce the level of effective protection to local production. Whatever the net effect of exemptions on effective rates of protection, some of them must have introduced additional distortions in domestic competition, while the growing use of ad hoc exemptions must surely have increased uncertainty.

2.2 Specific Measure to Promote Non-Traditional Exports

The Investment Incentives Act of 1967 (Republic Act - RA 5286) was a piece of landmark legislation in terms of the promotion of effective instruments of industrial planning (see section 2.6 below) through fiscal incentives. The Act in addition legislated fiscal incentives for exports of non-traditional goods for the very first time. Apart from enabling exporters to acquire imported inputs at world prices (through a tax credit on import taxes), these incentives provided for some modest subsidy to the use of local raw materials (via tax credits) and to export-related marketing and shipping expenses (through tax deductions).

In 1970 these provisions were augmented by the Export Incentives Act (RA 6135) which legislated incentives for non-traditional exports of goods and services (extending some of the incentives to export traders) for the firms exporting in excess of 50% of their output. A direct subsidy to value added was given under a formula for tax deductions based on the amount of use of direct labor and local raw materials.

In November, 1972 (after some initial Congressional legislation of 1969 that was never implemented), provisions to create the first-export-processing zone at Mariveles, Bataan, and to subsidize its construction were decreed (PD 66).

In January, 1973, PD 92 (amending Ras 5186 and 6135) added to some previous incentives. The main feature for exports was to remove the tax deductions for export-related marketing and shipping expenses under RA 5186, but to provide a stronger tax-deduction incentive to local direct labor and raw material use than that of the RA 6135. In 1973, in addition, the establishment of bonded warehouses was permitted under certain conditions (for larger firms exporting at least 70% of their output).

After 1973 there was no further major change in export incentives until the wholesale overhaul of fiscal incentives under parliamentary law BP 391 of 1983. While the new export incentives systems of the 1970s did provide effective means for firms to price their imported inputs at or near world prices, the incentive to the use of local raw materials or to the firm's value added was more modest. In any case the level of incentives as a proportion of sales to value added depended on firm's ability to make profits (so that tax deductions could be made). A very rough guide to the evolution of incentives to domestic value added can be given by calculating their value with respect to a standard cost structure: stylized rates of nominal and effective protection (NP and EP) are as follows:⁵

	<u>NP</u>	<u>EP</u>
RA 5186, 1967	2	5
RA 6135, 1970	4 ½	10
PD 92, 1973	6	14
BP 391, 1983	8	19

These rates and those in the likely range of estimated values appear to provide modest protection if we compare them to the average rate of effective protection to manufacturing in 1974 (44%) or the estimated overvaluation of the Peso in that year (34%).

While the trend to an increasing value of export incentives over time is clear, as well as an attempt to move their bias towards local labor and raw material use, it appears that the amendments were largely an ad hoc form of “fine tuning” coming from the technical and economic analyses of the Board of Investments (BOI), the planning body

created with the Investment Incentives Act of 1967 and empowered to implement both this and the Export Incentives Act.

2.3 Exchange Rate Policy

The exchange rate crisis of 1967-70 was originally brought on by the expansionary macro-economic policy adopted by the incoming Marcos Administration in 1966, and fuelled by the very large increase in money supply that preceded the November, 1969, presidential election. Foreign exchange controls were progressively applied and external borrowing led to a debt problem. In February 1970, the Peso was floated; it immediately went from P3.9 to P5.5 against the Dollar and had reached P6.4 by December 1970, when it was agreed to be fixed at that rate. The downward float, accompanied by conservative macroeconomic policy, was in fact a stabilization episode. It had happened at the instigation of the IMF, the price of getting a third tranche and obtaining the agreement of foreign banks to the rescheduling of external debt.

While the import controls were relaxed following the introduction of the package, controls were retained on certain consumer good imports and some invisibles. These retentions appear to have been a deliberate reaction to the “excessive” decontrol of 1962. The February, 1970, measures also imposed the condition that 80% of foreign exchange receipts from leading exports be converted at the old rate. Ostensibly intended to encourage further processing of export goods and to minimize the problems of excess domestic liquidity from increased exports, the real intention of this positive retention appears to have been to spur Congress to legislate proper export taxes, which it did in May (see section 2.4).

The Central Bank began to intervene actively to stabilize the exchange rate after 1972.⁶ De facto exchange rate policy in the 1970s has been that of a “crawling peg” based on the US dollar. There was a moderate piece-meal devaluation from the end of 1974 to the third quarter of 1975, and a steeper gradual devaluation from the end of 1979. Until the early 1980s the effective devaluation was greater than the devaluation against the Dollar, given the effective devaluation of the latter. Yet the falling value of the Peso was insufficient to prevent a growing trade deficit after 1974 (see 5.2 below on real

effective exchange rates). Instead, the deficit was covered at first by drawing down foreign exchange reserves, then by increased foreign borrowing. This policy may have had some initial justification because of low international interest rates in the 1970s, but the external debt problem was to build up to a crisis by the early 1980s.

2.4 Export Taxes

In May, 1979, Congress legislated export (or “stabilization”) taxes under RA 6125 at 8% or 10% on leading export products. These taxes were intended to last only until the end of 1973, but soon after Martial Law they were made permanent as part of the new tariff code. Subsequently some new products were added. In February, 1974, an additional premium duty, taxing 20% of the excess international price above the level at this date, was introduced for 15 products. Both the basic export tax and the premium duty have been varied over time for different products following international price trends and domestic conditions in the industry.

Export taxes have been applied generally to stabilize prices, generate government revenue, encourage further processing, and safeguard domestic supply. They have not been justified as means of influencing the country’s terms of trade: for the Philippines’ leading exports its only dominant share in world trade is in coconut products, but substitutability of these with other vegetable oil products is high. While it is true that the export tax has been used countercyclically since 1974, it is nonetheless the case that the export tax became a permanent feature of commercial policy in a decade when terms-of-trade movements became extremely adverse. In general terms, therefore, export tax and export promotion policies have combined to create a distinct bias against traditional exports (mostly agricultural and mining) in favor of non-traditional exports (mostly manufactured).

2.5 Policies to Agriculture⁷

Since the 1930s the government has intervened in the sugar market to administer the US sugar quota. Until the end of US Sugar Agreement in 1973, the US was virtually the only

export market for Philippine sugar and exporters enjoyed prices well above world levels. Even so, failures to fulfill quotas were the norm. The ending of the Agreement thus removed a powerful price support to the Industry.

Apart from sugar the only case of government price intervention in agriculture before the 1970s, apart from tariffs and taxes, occurred with its monopoly on international trade in rice and corn since the 1950s (i.e., the government imported as necessary to stabilize supply and prices). In 1972 this monopoly was broadened to cover all grains (most importantly, the government controlled wheat imports). In 1981 the monopoly was extended to all food crops (and the government, in addition to controlling prices, also went into food marketing, in direct competition with the private sector).

From 1973 to 1982 copra farmers were levied (at the equivalent of a 20% export tax) for the Coconut Consumers' Stabilization Fund (CCSF). The proceeds were in theory meant to go back into the industry, but replanting programs under the Fund have apparently been modest, while much of the money had clearly not directly benefited farmers. Some of it was used to buy up three-quarters of oil-milling capacity under one institution (UNICOM). As a result, it appears that prices to farmers relative to world prices farmers have been driven down.

Since 1975, there has been an increasingly stringent ban on log exports, for conservation reasons (though one wonders how effective such a ban can be if it is not applied to downstream products as well).

In export agriculture, it seems therefore that policy measures including the export tax, have generally created disincentives for exports. For cereal production the trend is less obvious. There was considerable emphasis on public expenditure on rural development, particularly in aid of food production, in the first Marcos Administration (1966-70), and again in the first flush of Martial Law from 1973. This push for food self-sufficiency at times constituted an important subsidy to agriculture even offsetting in some cases – most notably irrigated rice – the disincentive of high-cost inputs.

Nevertheless, according to David (1983), agriculture has generally faced falling rates of nominal protection over time, and its level of effective protection in the later 1970s was in many cases negative, and well below that for manufacturing. It is reasonable to infer a falling rate of effective protection over time, although this is not so clear in the

case of rice: the advent of high-yielding varieties (HYVs) in 1968 clearly increased productivity, while the spread of subsidized irrigation has helped offset other disincentives.

2.6 Other Policies

Macro-Economic Policy. In 1970-72 a tight fiscal and monetary policy was pursued, though the signs of expansion-growth in the money supply and of the budget deficit – were clear for 1972. Inflation became endemic in 1973 and 1974: while this was largely imported, these were also the years in which a more expansionary domestic policy was pursued.

Restriction on Capital Movements. The Philippines has tended to follow a reasonably liberal policy on capital movements (except at times of balance-of-payments crisis). However, it has continued to restrict direct foreign investment to minority participation, except in the case of activities defined as “pioneer” under incentives legislation and in the case of certain wholly export-oriented operations (in Export Processing Zones, for instance).

Domestic Controls. The incentives legislation of 1967 and 1970 and the creation of the BOI in 1967 laid the basis for stronger government controls in industrial (and agro-industrial) investment. In addition, in 1970 the government nominated some 30 industries as “overcrowded”, including those industries such as textiles that had suffered more obviously under decontrol. Until the partial abandonment of this system in the early 1980s the government had (through the control on imports of capital goods) a powerful weapon to control new entry (and to protect existing inefficient productive assets). In addition, price control legislation was introduced in 1970 and the government continued to exercise influence over wage levels through setting wage minima.

3. Economic and Political Circumstances

3.1 Economic Circumstances during the Stabilization/Devaluation

The balance of payments crisis of 1967-1970 was caused by rapidly growing imports, stagnant exports and mounting foreign debt – (but part of this reflected the redirection of exports, of logs and copra particularly, to unofficial channels). Potentially the breakthrough in HVY rice in 1968 provided favorable conditions for devaluation, but in the event inclement weather (typhoon and floods) and disease affecting the new varieties created considerable problems for food agriculture in 1970-72.

3.2 The Political Background up to 1972

The first Marcos Administration was strongly committed to economic achievement, especially in the area of rural development. The political motivation for this may have been to secure a rural electoral base, but, in addition, one of the economic motives was a sense in the government that the incapacity of food agriculture to respond more quickly to decontrol forces helped fuel inflation in the early 1960s.

Commercial policy reform was not central to government policies. It is true there was something of a debate on the relative merits of a less-protected, more marketed-oriented economy and those of a more protected and more planned economy. This was part of continuing debate between economic liberals and economic nationalists. Indeed, the decontrol experience had engendered a strong feeling of the waste of economic resources (seen principally in the growth of excess capacity) and the need for planning, a feeling to an extent shared on both sides of the debate. The legislation of investment incentives and the creation of the BOI in 1967, as well as the provisions to control entry to overcrowded industries from 1970, were outcomes of this.

By contrast, the constituency for any immediate thoroughgoing reform of import protection appears to have been a small one (its nucleus having been formed by some among a number of US-trained “technocrats” that Marcos began to appoint to key economic positions), much less powerful than the business interests favoring continued

protection which had been consolidating themselves in Congress. The protectionist position was given vital support by the common perception of the costliness of decontrol in the industrial sector: Tariff reform of the protection-reducing variety was hardly on the agenda.

On the other hand, the promotion of non-traditional manufactured exports was an objective that everyone – economic nationalists and economic liberals alike – could agree on: it could be seen as a liberalizing move without however disturbing the objectives – and vested interests – of import-substitution protection. Indeed, the legislated incentives of 1967 and 1970 can be seen as the expression of this one area of compromise. For many, the export success of Korea and Taiwan, countries that were in the process of overtaking the Philippines, provided a powerful example to follow.

Congress continued to provide a major vehicle for the representation of a diversity of special interests, with the results that the legislative process was drawn out. We have already cited the example of tariff reform, but the BOI-drafted Exported Incentives Act also took a couple of years to get through Congress. It may be hypothesized that the passage of time from the late 1950s to the late 1960s had seen the relative eclipse in Congress of the sugar lobby by that of import-substituting industrialists. The legislation of the two incentive acts, including the creation of BOI, represented the important step of partially removing planning from the political process. One of the main congressional influences on incentives legislation appears to have been to make the conditions under which foreigners could invest more restrictive than the Administration wanted.

The major external role in the area of trade-related policy during this period appears to have been played by the IMF whose argument for floating (or devaluing in all but name) the Peso in early 1970 appears to have been the decisive factor in a broader debate on the relative merits of devaluation vs. multiple exchange-rate vs. austerity measures. However, it is also important to note that this period saw the beginning of a closer relationship between the Philippine and international aid donors – led by the World Bank – who were impressed by the Administration's development policies (the consultative Group for the Philippines was formed in 1970).

3.3 The Political Background from 1972

Martial Law was declared in September 1972. It found its political justification in the increasing civil unrest of 1970-72, some of which was sparked off by the 1969 presidential election, the costliest, and many say the most corrupt to date. The government also forwarded an economic justification for Martial Law, a doctrine of what one might call “progressive economic authoritarianism”. Indeed, there was a spate of reforming moves in the early days of Martial Law, including government reorganization, a new rural development push, and – though less important – industrial incentives and tariff reform.⁸ In labor relations one of the first acts of Martial Law (General Order No. 5) was to ban strikes in “vital industries,” broadly defined to include exporting among others. Labor legislation in 1972-76 sought to revamp the collective bargaining system along corporatist lines (anti-strike legislation in “vital” industries, reform of collective bargaining, etc.).

This mixture of reformism and authoritarianism seems to have begun to give way around the mid-1970s to growing problems of coherence in economic policies and decision-making. We have already mentioned the growth of ad hoc trade protection and given some examples of the growth of monopolies, both public (in food, for instance) and private (in coconut milling, for instance). It is in the second half of the 1970s that “crony capitalism” – the development of certain favored businesses through the extension of fiscal advantages, credit or other monopoly privileges - becomes increasingly remarked on. In addition, it seems that public economic decisions became less subject to broad government review and cabinet discussion, more subject to the ability of different government factions - even individual ministries – to further their particular projects.⁹ Much public investment seems to have been undertaken outside of normal budget provisions.

4. Economic Performance, 1970-74: External Stabilization of the Economy

4.1 The External Sector

In the four years following the 1970 devaluation (i.e. through 1973), there was a substantial growth in the volume of exports. Some of this growth represented the gestation of large investments made in the later 1960s – particularly in copper mining, banana plantations and sugar milling – and could not be ascribed to the 1970 devaluation (though it could be ascribed to the devaluation of the early 1960s).

Exports grew by 14% in volume for 1969-70 (Table III.1). Some of this was more apparent than real as some pre-devaluation export reverted to official channels. Nonetheless, since export volume grew by 6-7% in the following two years while the terms of trade declined from 1969 to 1972, there is obvious evidence of a real devaluation effect. But in 1973 exports were only able to expand by 8% in volume in spite of a 57% rise in their prices in the first year of the 1973-74 world commodity boom. The country's export price index further expanded by 48% in 1974, yet export volume fell by 11% , largely as a result of an enormous decline in copra exports. As Table III.2 shows, there was little systematic change in the structure of exports from 1970 to 1974. The big four product groups – sugar, coconut, wood, and copper concentrates – more or less maintained their share (around three-quarters of the total) while that of non-traditional manufactures grew from 12% to 16%.

The drop in import quantity in 1970 to 6% below the 1969 level probably reflects anticipatory stock building as the Peso became progressively overvalued in the period before the devaluation. But in fact import volumes were generally stagnant until 1974, when there was a very large growth in volume and Dollar prices (Dollar inflation having seriously set in the year before). The period saw no significant change in the producer-good-dominated structure of imports.

TABLE III.1

QUANTUM, PRICE VALUE INDICES (IN US MILLIONS), NET TERMS
OF TRADE AND PURCHASING POWER OF EXPORTS, 1950 - 1984
(1972 = 100)

Calendar Year	Country Index		Price Index ^{1/}		Value Index		Net Term of Trade	Purchasing Power of Exports
	Imports	Exports	Imports	Exports	Imports	Exports		
1950	43.6	20.7	61.0	106.1	86.6	30.5	173.9	49.9
1951	54.6	32.5	60.0	113.2	37.6	35.8	164.5	52.5
1952	49.6	35.7	67.0	88.2	33.6	31.8	131.6	47.0
1953	54.7	33.5	64.7	100.9	35.4	36.5	160.3	56.4
1954	60.4	37.3	61.9	96.6	37.4	36.0	156.1	58.2
1955	60.5	40.5	61.9	80.6	42.4	35.9	143.1	58
1956	63.2	45.3	62.7	89.9	39.6	40.7	143.4	65
1957	74.7	42.5	64.8	91.1	44.4	30.7	140.6	59.8
1958	66.2	46.9	66.2	94.8	43.8	44.5	143.2	67.2
1959	59.8	46.5	67.6	102.7	40.4	47.8	151.9	70.6
1960	66.0	50.6	60.1	101.2	45.6	50.6	146.4	73.2
1961	67.8	48.3	70.1	93.1	47.5	45.0	132.8	64.1
1962	64.1	53.0	71.4	94.1	45.8	49.9	131.0	69.8
1963	63.1	65.0	75.2	99.1	40.1	63.2	130.0	85.5
1964	70.0	67.4	76.8	98.3	58.9	66.3	128.0	86.3
1965	80.3	60.2	70.1	100.0	62.7	69.2	120.0	80.6
1966	85.4	73.5	75.4	100.9	67.8	74.2	127.1	93.4
1967	101.7	70.9	81.2	102.7	82.6	72.6	126.5	89.7
1968	101.2	75.4	80.6	100.1	88.7	82.3	123.1	92.8
1969	99.1	76.9	90.2	109.5	89.4	24.2	121.4	93.4
1970	92.6	80.0	93.5	111.1	86.6	97.8	110.0	104.5
1971	99.1	96.4	95.5	105.6	94.6	101.8	110.6	106.6
1972	100.0	108.0	100.0	100.0	100.0	100.0	100.0	100
1973	93.6	107.7	128.0	145.9	120.5	157.2	113.3	122
1974	110.3	96.2	211.6	242.3	233.5	233.2	114.5	110.1
1975	115.8	101.9	219.6	192.8	254.2	196.4	87.8	89.5
1976	122.6	130.5	217.2	168.8	266.2	220.3	77.7	101.4
1977	119.2	157.4	241.1	171.3	207.5	269.7	71.0	111.8
1978	140.9	152.6	245.0	193.7	346.3	293.1	70.0	120.2
1979	153.4	165.4	270.1	236.2	442.3	390.8	87.4	144.6
1980	155.8	201.3	350.6	216.0	558.5	495.4	60.6	133.1
1981	143.2	203.5	398.6	240.6	570.0	409.7	60.4	122.9
1982	163.4	215.0	340.5	199.9	556.3	429.7	50.7	126.2
1983	156.9	204.2	342.4	209.8	537.1	420.4	61.3	125.2
1984 1st quarter	97.3	175.1	431.3	240.2	419.8	434.4	57.5	100.7

^{1/} Unit values of imports are based on C.I.F. value while those for exports are based on F.O.B. value.

1950 - 1975 - Period from quarterly trade indices, (1965 = 100).

1960 - 1971 - Period from quarterly trade indices, (1972 = 100) for the same period as given by NSCO.

Source National Census and Statistics Office.

TABLE III.2
THE STRUCTURE OF EXPORTS, 1970-84
(percent)

	1970	1974	1980	1982
Coconut Products	18.6	22.3	14.0	11.8
Sugar	17.2	28.1	11.4	8.9
Forestry	26.4	12.4	8.1	6.1
Copper Concentrates	16.2	14.4	9.4	6.2
Sub-total	<u>78.4</u>	<u>77.2</u>	<u>42.9</u>	<u>33.0</u>
Fishery	0.2		2.4	2.2
Bananas	0.5	1.7	2.0	2.9
Other Mining	2.3	4.6	8.4	4.1
Manufactures	12.4	16.1	39.0	47
Other	6.2		5.3	10.8
Sub-total	<u>21.6</u>	<u>22.8</u>	<u>57.1</u>	<u>67.0</u>
Total	100.0	100.0	100.0	100.0
Total \$ m.	1,142	2,725	5,787	5,021

Source: Foreign Trade Statistics of the Philippines.

The backdrop to devaluation of a rapidly deteriorating terms of trade (an 18% fall in 1969-72) saw a partial but temporary, reversal with the commodity boom of 1973-74.

The growth of exports and restraint on imports (plus a relatively favorable position on invisibles) achieved a clear four year (1970 through 1973) improvement in the current account of the balance-of-payments. Indeed, the 1973 surplus, equivalent to 5% of GDP (Table III.3), was unprecedented. In 1974, the position reverted to severe deficit as a result of the poor growth of exports. The improved trade performance allowed a reconstitution of foreign exchange reserves after their severe depletion in the last balance- of-payments crisis. There was also a notable improvement in the overhang of foreign debt from the crisis (and external debt as a proportion of GDP was reduced from 29% in 1970 to 19% in 1974 – Table III.4), as well as an improvement in its structure (i.e., a reduction of the share of the short-term component).

TABLE III.3
BALANCE OF PAYMENTS AND FOREIGN EXCHANGE
RESERVES AS PERCENTAGE OF GDP
(Current Prices)

	Balance of Payments				
	Goods and Non-factor		Balance on Current Account	Basic Balance	Reserves
	Services				
	Exports	Imports			
1950					
1951					
1952					
1953					
1954					
1955					
1956					
1957					
1958					
1959					
1960					
1961					
1962					
1963					
1964					
1965					
1966					
1967					
1968					
1969					
1970	18.1	(20.4)	(0.7)	(0.2)	3.4
1971	18.0	(19.7)	(0.03)	(0.3)	4.8
1972	17.3	(19.5)	(0.08)	0.8	6.5
1973	23.7	(21.0)	5.0	6.2	9.7
1974	24.2	(27.3)	(1.2)	0.7	10.2
1975	20.3	(28.0)	(5.6)	(3.3)	8.6
1976	19.1	(26.4)	(5.8)	(0.8)	9.1
1977	20.1	(24.9)	(3.5)	0.7	7.2
1978	19.9	(26.0)	(4.8)	(0.3)	7.7
1979	20.6	(27.1)	(5.2)	(2.1)	8.0
1980	22.6	(29.2)	(5.3)	(1.5)	8.8
1981	22.3	(28.8)	(5.3)	(2.3)	7.0
1982	19.9	(28.9)	(7.7)	(4.6)	6.3
1983	23.3	(32.3)	(7.8)	(6.4)	2.6

Source: Calculations based on Central Bank data.

Table III.4

**EXTERNAL DEBT AND DEBT-SERVICE RATIO
AS PERCENTAGE OF GDP
(Current Prices)**

	Total	Short-term + Revolving Credits	External Debt Medium Term	Long Term	Debt-& Service Ratio
1970	29.3	4.9	8.3	16.0	N.A.
1971	26.8	4.3	6.4	16.0	4.2
1972	26.4	3.8	5.6	16.9	4.1
1973	21.7	2.6	3.7	15.3	4.3
1974	18.5	2.2	2.4	13.8	2.8
1975	21.5	2.7	2.5	16.2	2.5
1976	28.3	3.9	2.5	21.8	2.7
1977	31.2	2.8	2.2	24.1	2.8
1978	33.8	5.5	1.6	26.5	5.2
1979	32.5	6.0	1.4	25.0	4.9
1980	34.4	7.1	2.0	25.1	2.8
1981	38.6	9.4	2.2	26.8	4.0
1982	42.4	9.9	2.1	30.3	5.1
1983	55.4	11.6	43.8	N.A.	N.A.

SOURCE: Calculations based on Central Bank data.

4.2 Prices, Real Effective Exchange Rates and Real Wages

The domestic price level, after low rates of inflation (even in the late 1960s), moves up to grow at an average of 16% p.a. in 1969-73 (Consumer Price Index, Table III.5) then jumped by 35% in 1974. To an extent this inflation was pushed by the effects of national disasters and disease on food production in 1970-72. However, the inflation rate was considerably lower than the Peso price rise of imports and exports.

To capture a net measure of domestic and foreign price movements and of exchange rate movements we have calculated real effective exchange rates that, in essence, compare an index of domestic prices (in Pesos) with an index of world prices (in Pesos). We have taken the Consumer Price Index, which is heavily weighted to the

domestic-product-intensive consumption of low income households (and which moves very closely with the GDP deflator) as a proxy for the Peso price of non-tradables. Given the extreme divergence of world prices for different product groups, we think it unwise to rely on any single REER after the early 1970s, but instead we compare REERs for different representative product groups. (There is also a problem, arising from the choice between different price indices; in this case, it becomes, as a result, extremely difficult to interpret exactly how early and how severely after the period of effective devaluation, 1970-74, domestic and world prices got out of line). Thus the REERS as we have defined them crudely reflect changes (assuming no change in nominal protection on inputs and outputs or shifts in the supply curve) in the incentive to produce non-tradables or (specific) tradables. Thus a falling REER for a specific tradable represents an increasing incentive to produce it (relative to producing non-tradables). Table III.6 provides REERS: for imports and exports (columns 1 and 2, using the unit price index from trade statistics); for rice (col. 3); for manufactures (col. 4, using a unit price index for manufactured exports) col. 5 a “general” REER using as a world price the producer price index of major industrialized countries (weighted by the Philippines’ imports from them).

For each product group (except rice which is further discussed below) there is a sharp fall in the REER, following devaluation in 1970, of around 24-28%. The improved REER is generally maintained for these groups until 1973 or 1974 (with the exception of exports in 1972), sometimes much longer. In other words, the 1970 devaluation is, in the 1970-74 period, dissipated neither by domestic inflation nor by the adverse movement of the terms of trade. After 1973/1975 the trend to falling REERS (if at times ambiguous) is over.

Whether deflated by the wholesale or consumer price index the real wage shows a clear decline in the year of devaluation (Table III.7) and the declining trend is only halted in 1975. The fact that wage inflation was less than domestic inflation overall has implications both for income distribution and the pattern of comparative advantage the Philippines enjoys. The latter aspect is explored in connection with the growth of manufactured exports after 1974.

TABLE III.5
PRICE AND WAGE INDICES
(1972 = 100)

	GDP Implicit Deflator	Consumer Price Index in the Philippines	Index of Manufacturing Wages (ASE)	Index of Average Monthly Earnings of Wage Earners	General Wholesale Price Index for Metro Manila
1949		40.1			41.2
1950		41.3			40.0
1951		44.7			44.5
1952		41.9		43.3	41.0
1953		40.4		44.3	40.6
1954		39.8		46.6	38.5
1955		39.4		47.9	37.5
1956		40.5	43.3	48.6	38.7
1957		41.2	44.3	50.3	40.4
1958		42.2	46.7	50.7	41.7
1959		41.3	49.6	52.9	42.3
1960		43.3	50.4	56.0	44.1
1961		45.4	n.a.	56.2	46.2
1962		46.7	52.7	57.0	48.6
1963		50.5	55.4	57.6	53.3
1964		54.9	58.5	60.2	55.8
1966		59.5	68.6	70.4	59.5
1967		62.7	n.a.	74.4	61.0
1968		64.1	72.6	74.8	62.7
1969		65.0	76.2	77.9	63.5
1970	83.2	74.6	85.4	83.8	78.5
1971	93.6	85.8	98.1	90.6	90.8
1972	100.0	100.0	100.0	100.0	100.0
1973	117.8	116.2	102.7	101.9	123.7
1974	155.3	156.3	119.4	111.9	182.7
1975	167.6	167.0	144.2	125.3	192.6
1976	183.6	183.2	148.7	143.8	210.3
1977	199.6	200.4	171.0	144.8	225.9
1978	215.7	215.5	183.2	164.4	236.8
1979	249.6	253.2	212.0	204.6	281.8
1980	286.9	299.4	262.0	247.0	333.4
1981	317.3	338.6			377.0
1982	343.5	373.3			423.9
1983	380.4	410.6			492.8

Source: NEDA National Accounts Staff: Central Bank, Statistical Bulletin; NSCO, Annual Survey of Establishments.

Table III.6

**REAL EFFECTIVE EXCHANGE RATES FOR SELECTED SECTORS
(RATIO OF CONSUMER PRICE INDEX TO WORLD PRICE INDEX)**

	Import REER	Export REER	Rice REER	IS Manufacturing REER	"General" REER
1949					
1950	223.2	130.3			
1951	214.9	132.2			
1952	204.4	157.5			
1953	206.1	124.3			
1954	212.8	137.7			
1955	210.7	148.7			
1956	213.2	150.6			
1957	210.2	151.5			
1958	211.0	149.1			
1959	201.5	134.5			
1960	207.2	143.4	153.5	189.1	199.0
1961	214.2	163.3	161.0	197.4	206.0
1962	113.1	96.7	82.9	106.6	112.0
1963	113.5	92.0	83.3	114.0	116.0
1964	122.0	95.8	88.5	120.9	125.0
1965	123.8	97.3	89.4	124.1	127.0
1966	127.1	101.2	79.8	122.4	131.0
1967	130.6	104.7	80.1	126.9	135.0
1968	122.1	100.6	79.8	139.0	136.0
1969	121.7	101.6	83.9	140.4	133.0
1970	91.4	78.3	81.5	98.8	95.0
1971	92.9	86.1	110.7	95.0	97.0
1972	100.0	100.0	100.0	100.0	100.0
1973	88.2	78.8	47.1	92.2	90.0
1974	72.0	63.5	32.9	99.5	117.0
1975	69.5	80.0	53.9	87.4	108.0
1976	74.6	98.2	75.6	91.4	109.0
1977	73.8	106.4	85.2	92.8	111.0
1978	78.3	101.7	65.1	84.9	109.0
1979	83.7	97.8	82.1	89.8	117.0
1980	73.5	109.1	73.0	96.4	117.0
1981	71.4	120.0		109.9	119.0
1982	85.3	147.4		114.9	121.0
1983	72.1	117.5			

Source: Calculations based on Central Bank, Balisacan and Unnevehr (1982),
World Bank, Commodity Price Trends, ADB.

TABLE III.7
INDICES OF REAL WAGES
(1972 = 100)

	Wage Deflated by CPI		Wage Deflated by Wholesale Price Index	
	Manufacturing	Wage Earners	Manufacturing	Wage Earners
1949				
1950				
1951				
1952		103.3		105.6
1953		109.7		109.1
1954		117.1		121.0
1955		121.6		127.7
1956	106.9	120.0	111.9	125.6
1957	107.5	122.1	109.6	124.5
1958	110.7	120.1	112.0	121.6
1959	120.1	128.1	117.3	125.1
1960	116.3	129.3	114.2	127.0
1961	n.a.	123.8	n.a.	121.6
1962	112.8	122.1	108.4	117.3
1963	109.7	114.1	103.9	108.1
1964	106.6	109.7	104.8	107.9
1965	110.6	112.3	110.0	111.8
1966	115.3	118.3	115.3	118.3
1967	n.a.	118.7	n.a.	122.0
1968	113.3	116.7	115.8	119.3
1969	117.2	119.8	120.0	122.7
1970	114.4	112.3	108.0	106.8
1971	114.3	105.6	108.0	99.8
1972	100.0	100.0	100.0	100.0
1973	88.3	87.7	83.0	82.4
1974	76.4	71.6	65.4	61.2
1975	86.3	75.0	74.9	65.1
1976	81.2	78.5	70.7	68.4
1977	85.3	72.3	75.7	64.1
1978	85.0	76.3	77.4	69.4
1979	83.7	80.8	75.2	72.6
1980	87.5	82.5	78.6	74.1

Source: Table III.5

4.3 Production

The successful external stabilization of the economy had no obvious counterpart in the growth of the economy. Overall GDP growth rates in 1969-72 picked up a little from those of the late 1960s. In agriculture growth in 1970 and 1971 was indeed higher than in 1968 and 1969, but it was still generally low in spite of strong export growth and because of natural disasters and crop disease. Manufacturing saw neither expansion nor contraction in its growth. 1973 was a high-growth year across all sectors. It was led by the commodity boom and the demand thus generated by the export sectors for industrial goods and for services. There was in the 1970-74 period little discernible change in the structure of the economy.

4.4 Labor and Unemployment

At first view, the labor and unemployment statistics show little change in levels of activity in 1970-74 that can obviously be associated with the devaluation episode. (According to the statistics there is a marked drop in open unemployment, from 6.7% in 1969 to 3.2% in 1974, but these statistics are open to doubt).

4.5 Capital

The most notable feature of the period 1970-73 is the fall in the level of investment: in the last three years of the previous decade investment averaged 21% of GNP, but in 1970-73 it averaged 16-17%. This may be associated particularly with changes in the level of government investment consequent on the conservative macro-economic policies pursued in this period.

4.6 Income Distribution

The direct evidence on income distribution trends is not always clear, though there are signs of an increasing inequality of income in the 1970s. The declining real wage

mentioned above (which may however not have a very firm statistical foundation) has clear implications of a falling incomes share to wage labor, to the benefit of capital/land and/or government consumption.

4.7 1970-74: A Summing-up

The 1970-74 devaluation episode saw a stabilization of the external sector – balance-of-payments, reserves and foreign debt. While export performance was aided by 1960s investment coming on stream, it was not helped by the terms of trade. Macroeconomic restraint helped make devaluation effective until 1973. Its gradual loss of effectiveness from this period can be ascribed to more expansionary macroeconomic policy, but above all the terms of trade shock after 1974 which was insufficiently offset by exchange rate adjustment. The failure of the economy to grow faster reflects not only the cost of external stabilization, but also the external disasters in food in 1970-72.

The direct effect of devaluation was clearly greatest on the existing export sectors (including the “new” sectors, such as bananas, resulting from investment in the 1960s). There seems to have been notably little direct impact on manufacturing: instead of the improved REER for manufacturing stimulating import substitution, it is reasonable to suppose that the increased peso Price of world manufactures merely increased the level of tariff redundancy for a sector that had already exploited most import-substitution possibilities (including backward linkages). Nonetheless, manufacture exports became more attractive relative to import substitution and, even if they had less obvious impact in 1970-74 than later, they nonetheless grew in this period.

5 Economic Performance, 1974-80: The Leading Role of Non-Traditional Exports

5.1 The External Sector

In quantity terms export grew impressively from 1974, and faster than in the preceding years (at 8% p.a. in 1975-82). It is not clear how much of this was due to the

growth of non-traditional manufactures, but coconut oil, pineapple, bananas and lumber also showed sustained growth in the second half of the 1970s. However, prices were very unstable and continued to fall in real terms. Between 1974 and 1980 there was a fundamental change in the structure of exports: the share of the top four export groups (coconut, sugar, wood, and copper concentrates) fell from 77% to 43%, while the share of manufactured exports rose from 16% to 39% (Table III.2).

Volume growth of imports was substantial (5% p.a. in 1975 –82), but less than for exports. However, import price rises were far higher. Part of this import growth was directly related to export growth in the form of imported inputs.

After a 34% decline in the terms of trade in 1975, these continued to decline with scarcely a rally (at 6% p.a. on average in 1975-82) (Table III.1).

Invisible exports and imports grew relative to merchandise trade in 1970s. Part of the growth of invisible exports was from the remittances of contract workers (which, from negligible levels in 1970, had come to account for one-quarter of such exports by 1982). But invisibles accounted for one-third of the large current deficit of the balance of payments by 1982. The item principally accounting for this deficit was the steady rise in interest payments on foreign loans (see below).

In the period 1973-75 the current account of the balance of payments went from unprecedentedly large surplus (+5% of GDP in 1973) to unprecedentedly large deficit (-6% of GDP in 1975). This level of deficit (in terms of GDP) was maintained for the rest of the 1970s (Table III.3). At the onset (in 1975), the current deficit was partly financed by drawing down international reserves, but from then on (until 1983) reserves were maintained at a higher level and the current-account deficit was financed by increased external borrowing (Table III.4). In 1974, external debt was equivalent to 19% of GDP, while by 1983 the figure had risen to 55% (in the same time short-term and revolving debt alone rose from 2% to 11% of GDP). From 1977 there was a marked growth in the ratio of debt-service payments to GDP.

In all, the post 1974 policy of accommodating a semi-permanent current account deficit with foreign borrowing that accumulated external debt represents a remarkable turn-around from the policies of external balance pursued in 1970-74. For several years,

it may have been possible to justify this fundamental change in external policy by the low, even negative, level of real international interest rates.

In spite of the generally depressed nature of international markets after the turbulence of 1973-74, the growth record of the Philippine economy after 1974 appeared to be better than in the period preceding it, as the following average real annual growth rates indicate:

	<u>GDP</u>	<u>Agriculture</u>	<u>Manufacturing</u>
1969-74	5.7	3.9	8.0
1974-80	6.6	4.4	6.4

The improvement in agricultural growth may partly have reflected the impact of the government food program from 1973. In particular, it was only after the natural disasters of the early 1970s that rice could realize the full potential of the green revolution. The apparent fall in manufacturing output may in part reflect the effects of foreign exchange shortages after 1974: the two best years of growth, 1976 and 1977, were the years when the current account deficit was smallest. Manufacturing growth would also have been smaller, of course, without the growth of non-traditional exports (with an estimated reduction of around one-half a percentage point of manufacturing GDP p.a.).

From 1975 rates of GDP growth in construction were high. This reflected a clear quickening in the pace of investment which rose from 22% of GDP in 1973 to 31% in 1975 and stayed at this for higher level for the rest of the 1970s. (As several sources have pointed out, this also led to higher ICORS, and the implication of this, as well as of the casual evidence about investment projects, is that there was considerable inefficiency and wasted investment for the mid 1970s). This increase in investment seems to have been largely directed at infrastructure, both in the private sector (for instance an epidemic of hotel building) and in the public sector. Indeed public investment and public guarantees of private investment (through the Development Bank of the Philippines for instance) were an important factor in the accumulation of external debt.

The increase in investment may also have been a deliberate counter-cyclical measure. In general macroeconomic policy in the second half of the 1970s was more expansionary than in the first half.

5.2 Real Effective Exchange Rates

While there was an undeniable deterioration in the balance of payments after 1974, the evidence on the re-alignment of REERS – which one might expect to accompany such a deterioration – is difficult to interpret. One conventional form of REER compares the movement of domestic and foreign price levels (in a common currency, the foreign price levels being weighted by domestic imports or exports). Such measures for the Philippines clearly indicate that, after a period of historically low REERS in 1970-73, there was a clear deterioration in 1974 that was maintained thereafter (see row 6 of the text table below). Several commentators have used this kind of measure to indicate an apparent fall in Philippine competitiveness and link it to overvaluation of the exchange rate (see col. 2 of Table I.18 above, for such an index).¹⁰

Yet the REERS we used earlier in this chapter – comparing the Philippine CPI to world price indicators for specific tradeable commodity groups (Table III.6) do not tell quite the same story: earlier there is no obvious deterioration in REERS after 1974 or the deterioration is not as severe as for the REER discussed in the preceding paragraph. This can be seen in the following figures (rows 1 to 5) comparing the average REER for 1974-80 with that for 1970-73 (1970-73 = 100):

A. CPI-numerator REERS:

1.	CPI/Unit price of imports	81
2.	CPI/Unit price of exports	109
3.	CPI/World price of rice	79
4.	CPI/World price of manufactures	95
5.	CPI/Import-weighted world producer price	115

B. Producer-Price-numerator REER:

6.	WPI/Import-weighted world producer price	125
----	--	-----

The CPI-based figures show a deteriorating REER for exports (reflecting poor export prices), but an improved REER for manufactures, imports and rice.

Why the difference among the different forms of REER? First, there was an important divergence in 1972-74 between the CPI (and the GDP deflator which acts in a very similar manner) and the Wholesale Price Index (WPI). Over this two year period the WPI rose by 83%, the CPI by 56%. The divergence has since been maintained more or less. The reason for this is not entirely clear, but since the CPI is a reasonable proxy for non-tradable prices, while the WPI is entirely composed of domestic and imported tradable goods, one can argue that the process of rapid world inflation in 1972-74 permanently affected the ratio of non-tradable to tradable prices. (In this sense rapid external inflation unmatched by internal inflation is exactly the same as a domestic devaluation). (This argument at the very least needs further refinement: both the 1960-62 decontrol and the 1970 devaluation increased the WPI faster than the CPI, but the relative cheapening of non-tradables did not last for more than two years in either episode).

The second source of divergence in REERs relates of course to the “world price” series. In this respect, it appears that the (weighted) producer prices of the Philippines’ major trading partners (i.e. the OECD countries) behaved differently from their export prices, inflation being greater in the mid-1970s in their export prices than their producer prices.

In summary, even though the period 1975-80 is characterized by large trade deficits, there is no unambiguous evidence of deteriorating (i.e. rising) REERS to explain this. Instead it is plausible to explain much, if not all, of the deficit as the result of the import requirements of the higher investment ratio. In order for the tradables-producing sector to accommodate this rising import requirement without a current-account deficit, the Peso would have needed to devalue further and the REER also to have fallen.

5.3 Non-traditional Exports

More needs to be said about the growth of non-traditional manufactured exports. The basis for such exports was laid by decontrol, the 1970 devaluation, certain aspects of

export incentives, and the apparent maintenance (i.e. non-deterioration) in the 1970s of the REER for manufactures (in other words the CPI did not grew faster than the world Peso price of manufactures). In addition, there is evidence of large fall in real industrial wages between 1969 and 1974-75 and the maintenance of this new lower level, more or less, from then until the end of the 1970s. Real wages fell in terms both of workers' consumption (i.e. deflated by the CPI) and of their costs to employers (i.e. deflated by the WPI). Since the WPI rose faster in the period 1972-1974, the fall in real wage GSIS is larger than in workers' real consumption. The movement in real wage costs must have laid a very strong basis for the expansion of non-traditional exports after 1974.

TABLE III.8
EVOLUTION OF NON-TRADITIONAL EXPORTS, 1970-83

	Total Exports	Non-Traditional Exports	Consignment Imports	Share of Non-Traditional in Total Exports		Share of Non-Traditional in Total Exports in Manufacturing Output
				Gross	Net of Consignments Imports	
1970	1,142.2	94.5	4.1	8.3	7.9	5.4
1971	1,189.3	107.5	4.6	9.0	8.7	5.4
1972	1,168.4	116.0	8.3	9.9	9.3	6.1
1973	1,837.2	226.8	60.1	12.3	9.4	8.7
1974	2,725.0	327.4	128.9	12.0	7.6	6.4
1975	2,294.5	374.3	183.6	16.3	9.0	7.5
1976	2,573.7	573.4	286.7	22.3	12.5	9.5
1977	3,150.9	769.3	279.0	24.4	17.1	8.7
1978	3,424.9	1,076.2	442.6	31.4	21.2	10.0
1979	4,601.2	1,519.5	612.4	33.0	22.7	12.9
1980	5,787.8	2,106.9	858.0	36.4	25.3	12.7
1981	5,722.2	2,571.6	1,006.7	44.9	33.2	
1982	5,020.6	2,460.7	993.0	49.0	36.4	
1983	5,005.3	2,537.2	1,007.0	50.7	38.3	

Source: Foreign Trade Statistics of the Philippines.

These exports grew from 10% to 39% of total exports in 1974-80, or 9% to 25% if we make a rough calculation to exclude most of the imported input of these exports (Table III.8). The major features of this new export activity are:

- The dominance of labor- and import-intensive garment and electronics “assembly,” most of this taking place in exclaves (bonded warehouses largely, but also export-processing zones) with little linkage to, impact on, other sectors;
- The development, nonetheless, of a broad variety of other export activities (particularly food products, handicrafts, furniture, and footwear) with greater linkages;
- a mixture of local (often themselves “non-traditional”) and foreign entrepreneurs.

5.4 1974-80: A summing Up

A reasonable growth of the economy was sustained in this period while the current account of the balance-of-payments experienced a “permanent” (until the crisis of the 1980s at least) deficit. Initially this deficit can be understood as a failure to adjust the exchange rate sufficiently quickly to a rapid decline in the terms of trade, but for the period as a whole it can also be understood as a failure to adjust the exchange rate to the import requirements of an increased investment rate. Instead of exchange-rate adjustment, the external sector used external borrowing to accommodate the deficit. In view of the declining terms of trade for non-traditional exports, export performance overall in 1974-80 was rather successful, in terms not only of volume growth, but also of the shift out of primary commodities. In our view the successful growth of non-traditional manufactured exports has several (no doubt interrelated) explanations which we tentatively place in very rough order of descending importance as follows:

- a series of favorable moves in the real effective exchange rate for manufacturing that starts with decontrol in the 1960s and continues with the 1970 devaluation.
- a fall in real wage costs, cementing these REER developments, from 1969 to 1974, and stagnation in real wage costs thereafter;

- the legislation of various export incentives in 1970 and 1973, the most important of which we believe to be those allowing exporters to acquire imported inputs at world prices (subsidies to domestic value added being less important);
- a surge of foreign investment in 1973 and 1974 that can probably be associated with the stable investment climate that early Martial Law provided in the eyes of foreign investors;
- reasonably favorable international demand trends in the 1970s.

It could be said that the early 1970s marked a watershed period after which the balance shifted from Philippine exports of resource-based (agricultural) products to exports of labor (in the form either of valued added in “footloose” industrial activities or of contract labor). In this respect, the role of declining/stagnant real wage costs is interesting to pursue. There may be several possible components:

- the effect of the 1970 devaluation
- the effects on the labor market of Martial Law (the strike ban for “vital” industries in 1972, etc.) ; most of the fall in real wage had occurred prior to Martial Law, but it is possible that the new labor market conditions may have helped prevent a return to the levels associated with the 1960s
- It is also reasonable to argue that real wage costs could be maintained at a low level by the relatively lower rate of inflation in consumer prices (especially for lower income levels) than in prices for tradable (as reflected in the WPI)

After 1974 domestic rice price declined in real terms as a consequence of the HYV breakthrough in the late 1960s and a broad program of government support to the industry from 1973. This development, which must have had a considerable influence in stabilizing the CPI, stands in the contrast to the effect of rising rice-price on the CPI in the 1960s. In turn, it may be the case that poor terms of trade for export agriculture in the second half of the 1970s helped remove the pressure on and which affected food crops and which has been argued to be a feature of the rising price of rice in the early 1960s.

Thus the surge of non-traditional exports appears to have more to do with the exchange rate, price and wage movements (and behind some of these political and agricultural developments) than with commercial policy per se.

Notes to Part III

¹ Baldwin (1975); pp. 69-72.

² Sicat (1974), p. 56.

³ Tariff Commission (1976).

⁴ Calculated from various annual Tariff Commission Reports.

⁵ These figures represent a rough median between an “import-intensive” and “local-raw-materials-incentive” cost structure, as well as between an “average-profit” (10% margin on sales), and “high-profit” (25% margin on sales) cost structure.

⁶ See Pante (1982).

⁷ See David (1983).

⁸ See Chapter 3 of Sicat (1974).

⁹ See for instance Sicat (1984).

¹¹¹⁰ See Pante (1982) and Bautista and Power (1979), p. 29

PART IV
THE TARIFF REFORM PROGRAM: 1981-1985

A. The Introduction of A Liberalization Policy

In terms of long term policy pattern the liberalization starting in 1981 did not happen following a trade crisis (as in 1969 and 1970) or a clamor for giving better terms to exporting (as in 1960).¹ Yet this appears to have been a potentially more fundamental form of liberalization than 1960 or 1970 and was probably the first important structural change to the protective nature of the Philippine tariff since 1957.

Several interrelated factors contributed to this deliberate program to liberalize. One was the country's membership in GATT in 1980 which carried a commitment to reduce tariff and non-tariff barriers to trade. Indeed for a few months after the country's official membership in January a number of import duties was reduced, and commodities removed from restricted imports.² Another was the availability of new financing sources, mainly from the World Bank, to support basic structural adjustments. Indeed the country was one of the first ones to have used structural adjustment loans (SAL) in pursuing trade liberalization and industrial restructuring. Another was the increasing acceptance within the larger economic policy circles of tariff reform and trade liberalization as important ingredients to efficiency and rational industrial development.³ Indeed there had been expressed, especially by Sicat,⁴ the weaknesses of policy in promoting open trading systems. And then, there was the convenience of promulgating a liberalization program in a political atmosphere of unorganized if not ineffective dissent coupled with a strong and monolithic regime. Indeed one notices the thinness of debate and discussion of reforms with far reaching consequences compared with the protracted and heated arguments surrounding decontrol, the new tariff code of 1973 and the floating of the exchange rate in 1970.

A.1 Nature and Targets of Policy

The 1981 trade liberalization has two major components⁵ (1) the loosening of quantitative restrictions (QR), or a more general import liberalization and (2) the reduction of protection

by tariffs, or a more general tariff reform. In terms of the latter the broad targets include the reduction in the degree of tariff escalation i.e. the cascading nature of tariffs, and the lowering of the average rate of nominal protection from 45 percent to 28 percent by 1985. For the former the broad target was to eliminate the need for licensing or approval for import of 1,304 items.

The achievement of the broad targets in the tariff reform was planned to be pursued in 4 stages covering 14 major industries and 10 residual sectors over the course of a 5-year period 1981-1985.

Although the tariff program *per se* had no explicit thrust with regard to export encouragement, it was clear that the narrowing of effective protection rates (EPR) across sectors implied raising the EPR for some exports from negative values to a positive level or to reducing the penalty to these sectors. Where export encouragement played a role was in the associated changes in policy that affected the incentive system.⁶

The four phases of the tariff reform program are shown in Table IV.I together with the nature of the tariff changes to be made and the number of tariff lines covered by the sectors. It is evident that the larger fraction of the tariff modifications is for rate reductions. The rate increases would mostly cover commodities or industries where nominal rates are below 10 percent.

Quantifying the general target, this means reducing the range of nominal tariffs from 0 to 100 percent to 10 to 50 percent. In turn this means targeting an EPR range of 10-80 percent compared to a situation before 1981 of a range from negative EPR's to over 200 percent for some consumer goods. The revised tariff schedules were incorporated in the new Tariff and Customs Code of 1982.⁷

On the import liberalization program, the general target of policy was to phase out the need for seeking clearance or prior approval from the Central Bank (CB) for the importation of non-essential consumer (NEC) and Unclassified Consumer (UC) items. Until the liberalization program in 1981, some 1,304 items belonged to the NEC/UC category. The multi-stage phasing of the relaxation of import restrictions was aimed at completely liberalizing all these items in 1985.

In addition some 26 groups of “regulated” commodities which importation was controlled by the Central Bank were to be liberalized in 1982. These commodities were categorized according to reasons for regulation – the safeguard of public health and safety, national security, local industry protection, complement to on-going content programs and others.

A.2 Intended Sequences of Liberalization

Table IV.1 lays out the phasing of the tariff reform program, explicitly indicating the sectors to be affected and within each the items and products subject to modification. The stages however were not tightly sequenced in the sense that there were some overlaps. The phasing over a 5-year period was to allow sufficient time for industries affected to adjust to new rates and thus competitive rules.

For instance, phase I was intended to be pushed over a 2-year period, 1981 and 1982, such that the peak rates were not to be eliminated overnight but in 2 stages. In 1981 the ceiling rates were to be reduced to 70 percent ad valorem and further reduced to 50 percent in 1982. The process in the first phase implied a deceleration from peak rates to 70 percent and a slower reduction to the new ceilings of 50 percent.

The three other phases were to become effective over not more than one year, i.e. phases 2 and 3 effected in January 1981 while phase 4 became operative in August, 1981.⁸

For the import liberalization part of the policy the sequencing is clearly more numerically defined. In particular the number of items to be liberalized accelerated before settling down to a limited number with a remaining set that were to continue to be restricted for reasons of health, defense or safety. The latter numbered 145 items. Again the sequencing was in yearly phases – 1981, 1982, 1983 and 1984. Thus 263 items to be liberalized in January 1981. Another 610 were to be taken off the list in January 1982, 87 in 1983 and the residual by 1984.

TABLE IV.1
TARIFF REFORM PROGRAM
1981-1985

	PHASES			
	I	II	III	IV
Item/Sectors Covered		food processing textiles and garments leather and footwear pulp and paper	cement iron and steel automotive wood & wood product cycles glass and ceramics furniture domestic appliance machineries and capital equipment electrical goods	agriculture and forestry products basic chemical and petroleum basic non-ferrous
Number of tariff lines covered:	177	272	396	480
For modifications:	all	184	229	149
a. For reduction		167	129	128
b. For increase		14	16	13
c. Others		3	15	8

Source: Tariff Commission (1982).

The 960 items that were scheduled to be liberalized over a 3-year period, 1981-83, belong to the food, chemical, cosmetic, pharmaceutical, wood, leather, rubber and plastic product, textiles and garments, furniture and travel goods, footwear and headgear, and electrical and electronic appliances industries. For the regulated commodities specific dates were given for their liberalization: viz caustic soda, basic iron and steel products, tires (except used tires), gasoline and kerosene engines (by January 1982); fabrics and textiles, vinyl-asbestos tiles and sheets and newsprint, Portland cement, sheet glass (by January 1985).⁹

Despite therefore the numerical precision of the numbers to be liberalized the future sequencing of policy was vague with the exception of 12 items that had specific dates or the broad industries which formed the NEC/UC items.

A.3 Economic Circumstances

In the immediate 3 years preceding the 1981 trade liberalization, exports had been growing at 17 percent per year and imports at 10 percent per year. In real terms however exports had been growing substantially faster than imports at 9.0 percent per annum compared to 3.4 percent per year for imports. The balance on current account of the balance of payments further deteriorated from a deficit of US \$1.2 billion in 1978 to US \$1.9 billion in 1980.

Table IV.2 presents the balance of payments for the period 1978-1983 for the various accounts. It can be seen that in 1978 the current account balance deteriorated by more than 50 percent and in subsequent years the deficit further widened. Because of substantial inflow of long-term loans however the basic balance did not appear to suffer as much (in comparison to a 1975 peak deficit).

The official reserves transactions balance (which ultimately determines the claim on financing and settlement) implied an increase in reserves in 1977 and a slight reduction in 1978. From 1979 onwards however there has been a continuous depletion of exchange reserves.

Thus external accounts in the 2 or 3 years before liberalization depicted an adverse balance of payments position occasioned by large deficits in the balance on goods and services. While the long-term capital account (principally through long-term and not investment) may have cushioned the severity of the basic balance, it may have only masked the required adjustments that were reflected in the current account and trade balances.

Overall Philippine GNP was growing at real annual rates of 3.4 percent (1978-80), low in comparison to the immediate 5-year period at 6.2 percent per year but certainly higher than 2.8 percent growth of real GNP in the industrialized countries.¹⁰ Both the US and Japan, the country's major trading partners, had real growth rates below this average. In fact the real declines were experienced by these two countries. Indeed the world was suffering from the second oil shock and the recession that followed.

TABLE IV.2
BALANCE OF PAYMENTS, 1970-1983
(IN MILLION US DOLLARS)

	1978	1979	1980	1981	1982	1983
1 . Exports of Goods and Services	4,838	6,177	8,018	8,618	8,004	7,995
2 . Imports of Goods and Services	(6,323)	(8,108)	(10,340)	(11,151)	(11,611)	(11,101)
3 . Balance of Goods and Services	<u>(1,485)</u>	<u>(1,931)</u>	<u>(2,330)</u>	<u>(2,533)</u>	<u>(3,607)</u>	<u>(3,102)</u>
4 . Private Remittances	312	355	434	472	486	399
5 . Balance on Current Account	<u>(1,173)</u>	<u>(1,576)</u>	<u>(1,984)</u>	<u>(2,061)</u>	<u>(3,121)</u>	<u>(2,707)</u>
6 . Long-term Capital	<u>1,062</u>	<u>1,250</u>	<u>930</u>	<u>(1,507)</u>	<u>(1,365)</u>	<u>1,431</u>
Direct Investment	171	99	(102)	175	17	4
Long Term Loans	891	1,151	1,032	1,332	1,540	1,427
7 . Basic Balance	<u>(111)</u>	<u>(326)</u>	<u>(974)</u>	<u>(544)</u>	<u>(1,556)</u>	<u>(1,276)</u>
8 . Private STC and Errors and Omission	<u>25</u>	<u>(313)</u>	<u>436</u>	<u>(433)</u>	<u>(308)</u>	<u>(925)</u>
Short-term Capital	168	(48)	310	(219)	(56)	(925)
Errors and Omissions	(143)	(264)	126	(214)	(252)	0
9 . Official Reserves Transactions Balance	(86)	(639)	(538)	(897)	(1,864)	(2,201)
10 . Gold Movement, SDR, Monetization of Gold	32	69	157	427	277	183
11 Total Change in Reserves	<u>54</u>	<u>570</u>	<u>301</u>	<u>(560)</u>	<u>1,587</u>	<u>2,018</u>

Source: Central Bank of the Philippines.

The overall nature of trade and exchange rate in the aggregate economy in the 3 years before the 1981 trade liberalization seems to have been slightly restrictive. For instance the ratio of black market to official exchange rate slightly increased in 1978-80. Similarly “implicit import premium” increased in 1979 before easing up again in 1980.¹¹ Our estimates of the EPR for 1979 are only joint estimates and therefore are unable to describe protection in the period preceding liberalization except to compare them with 1974.¹²

More aggregative price indicators also tend to show the apparent restrictiveness in the 2 or 3 years prior to the 1981 trade liberalization. Table IV.3 shows several of these. Although the indices of prices for all imports and import-substituting manufacturing have moved in similar fashion, the ratio of domestic to world price for imports increased. Alternatively the effective exchange rate for four goods classified according to essentiality favored large margins for non-essential consumer goods over exports whether traditional or new (TX and NX) implying some premium of domestic import substitution.

The inflation rate in the country, measured by CPI increased by 7.6 percent in 1978, 18.8 percent in 1979, and 17.8 percent in 1980. Measured by WPI the rates were 6.8 percent in 1978, 19.0 percent in 1979 and 18.3 percent in 1980.

A.4 Political Circumstances

There was a generally stable political environment when the 1981 trade liberalization policy was implemented. The growing dissent, the more activist media, and a stronger political opposition came only after the Aquino assassination and subsequent economic crisis of 1983. Thus it can be inferred that political circumstances even before liberalization were equally stable.

The regime that sponsored the policy has been in power since 1966 and one may therefore ask why did such a fundamental reform come at a time later than desirable? In fact the same political regime was in power in the floating of the exchange rate in 1970. Of course the big difference was the centralization of power as a result of the 1972 declaration of Martial Law, the abolition of the legislature, and the use of presidential decrees in its stead.

TABLE IV. 3
SELECTED AGGREGATE PRICE INDICES
(1972 = 100 EXCEPT EER)

	1978	1979	1980
Wholesale Price Index (Imports)	250.0	288.3	358.9
Import-Substituting Manufacturing	252.2	306.4	378.7
All Exports	271.5	335.4	343.2
Ratio of Domestic to World Price for Imports	88.3	90.9	95.3
Ratio of Domestic to World Price for Exports	128.1	129.5	125.1
Effective Exchange Rate (EER), pesos per US dollar: ^{a/}			
NEC	25.32	25.35	25.80
EC	8.80	8.81	8.97
TX	7.08	7.08	7.21
NX	8.67	8.55	8.70
Guiding Rate (pesos per US Dollar)	7.37	7.38	7.51

a/

NEC - Non-essential Consumer goods

EC - Essential consumer goods

TX - Traditional Exports

NX - New Exports

Sources: Appendix Tables
 Senga(1983)
 Central Bank of the Philippines

The subsequent changes in tariff rates were merely marginal such as the 1973 revisions to the Tariff Code (Presidential Decree No. 34) the 1978 Tariff and Customs Code (P.D. No. 1464) and other executive order. These did not change the basic bias and distortion of the protective nature of Philippine tariffs (which had remained similar to 1965). Moreover the increasing use of decrees to grant tariff exemptions to industries or individual firms effectively created further distortions to the structure towards uncertain directions, especially after 1974.¹³ For example, out of about 102 decrees or instructions relating to the manufacturing sector since 1972, 69 were instituted after 1975. Instead of harnessing a favorable political climate towards a more rational incentive structure for trade and industry, the machinery turned out fragmented decrees that probably stifled growth.

The increasing realization of this and the conviction among a larger set of policy makers about the need for a more open trading system facilitated the 1981 trade liberalization. Conversely the thinness of its consistency in policy circles may partly explain the drag in the policy formulation. By the late seventies the intellectual ferment from both academe and government contributed to the jelling of a need for basic policy reforms to industrial and trade incentives.¹⁴

At the same time the accession of the country to GATT membership and the emergence at the World Bank of more flexible support for structural adjustments combined to create a political need for trade liberalization.

It is difficult to judge the strength of the influence of an international organization such as the World Bank in the 1981 trade liberalization versus the indigenous “technology” and political will. Negotiations for structural lending to the country began as early as 1979.¹⁵ It is known that an explicit plan was necessary for support with a SAL. Although in the final analysis the mechanics and sectoral incidence of liberalization were probably drawn up independently it seems clear that the political circumstances surrounding it were unidirectional.

B. Accompanying Policies

The various policies that will be described here are those that may have been pursued to accompany the 1981 trade liberalization or those that matter (in the complementary sense) to the degree of impact of such a liberalization drive.

B.1 Exchange Rate Policy

When the liberalization program got underway in 1981 the exchange rate policy was one of a floating rate with margins established by “guiding rates” on dollar trading floors established by the Bankers Association of the Philippines (BAP). Except for some marginal exchange regulations (e.g. increased foreign exchange allowance for travel,¹⁶ export prohibitions of foreign exchange without CB approval¹⁷ etc.), there were no new forms of exchange controls in that year. The prevailing average rate in 1981 was P8.200 per US dollar.

In the early 1982 exchange controls were further relaxed such as forgoing certain documentation requirements for imports by “no-dollar importation”,¹⁸ reduction in reserve requirements for import letters of credit from 100 percent to 50 percent by July 1982. By the second half of the year however controls started to increase. For instance by October the net foreign exchange position of commercial banks could not exceed 20 percent of outstanding letters of credit and all excess exchange holdings were to be sold to the Central Bank.¹⁹ By December an import surcharge of 3 percent for all import transactions was imposed.²⁰

In 1983 the severity of exchange controls accelerated culminating in the suspension of exchange transactions in November of that year. In January restrictions were placed for imports under documents against acceptance (D/A) and open accounts (O/A).²¹ Duties were made payable at the time of opening of letters of credit. Required reserves were raised to 100 percent against marginal deposits for importers’ letters of credit for imports of liberalized items. The approvals for import applications for fresh fruit, electronic products and liquors were suspended. Finally in November the Central Bank required all banks to sell 100 percent of their foreign exchange receipts, a priority system for their use established and an additional import duty of 5 percent imposed.

There were two exchange rate devaluations in 1983. The first in June, raised the rate to P11 to a US dollar. By October of the same year the second devaluation took place and the guiding rate was P14 to a US dollar. The guiding rates for 1982 and 1983 were P9.171 and P14.002 per US dollar, respectively. In terms of real effective exchange rates however the index appreciated slightly by 1.4 percent in 1981 increasing by 3.7 percent in 1982 before depreciating in 1983 arising from the exchange rate adjustment of June and October.

The real effective exchange rate (REER) defined as

$$\text{REER} = \frac{\sum_{i=j} (m_{ij}/m_i) r_j / P_j}{r_i / P_i}$$

(where m_j / m_i is the share of imports from country j to i 's total imports, r_k ($k = i$ or j) is the price of US dollar in terms of index of k 's currency and P_k ($k = i$ or j) is the wholesale price index in k 's currency with (May 1970 as base year) depreciated during the first 3 months after the official beginning of the 1981 trade liberalization (January). In the next 3 months however a real appreciation took place and the index of REER in June was 141.9 compared to the January index of 138.1. At the end of 1981 the index showed a real depreciation of 3.7 index points relative to January.

B.2. Export Promotion Policy

The deliberate export promotion policy in the country was started in earnest in 1970 as a complement to the broader investment incentives package drawn up in 1967. These two policies were considered part of a change in trade orientation in 1970. The liberalization attendant to this has been discussed elsewhere. Our purpose here is simply to highlight changes which may have been instituted in concert with the tariff reform program or which may have occurred within its implementation span.

Prior to 1983, the operating incentives were incorporated in the 1967 and 1970 acts as well as subsequent revisions such as Presidential Decree (PD) 92, 485 and 1789. In general

the incentives given to exporters (whether as producer, trader or service exporter) consisted of provision for tax breaks related to the purchase of equipment and raw materials (whether imported or locally produced), deduction from taxable income of reinvestments, direct labor costs (not to exceed 25 percent of export revenues) and net operating losses.

A new Investment Incentives Policy Act of 1983 was implemented in that year intended to correct the biases of the previous promotions incentives. The features of this Act include an emphasis on performance, streamlining of bureaucracy and limitation of previously generous provisions. For example a number of incentives with capital cheapening bias were discontinued (accelerated depreciation, allowance for reinvestments, deduction for preoperating expenses). And then two new incentives were introduced. One provided for a tax credit on net value earned which is 5 percent for non-pioneer and 10 percent for pioneer projects for 5 years. The other provided for a tax credit on net local content for exporters also for 5 years (with a further 5 years on an incremental basis). In this new incentive scheme therefore the value of incentives is determined by performance rather than value of investment.

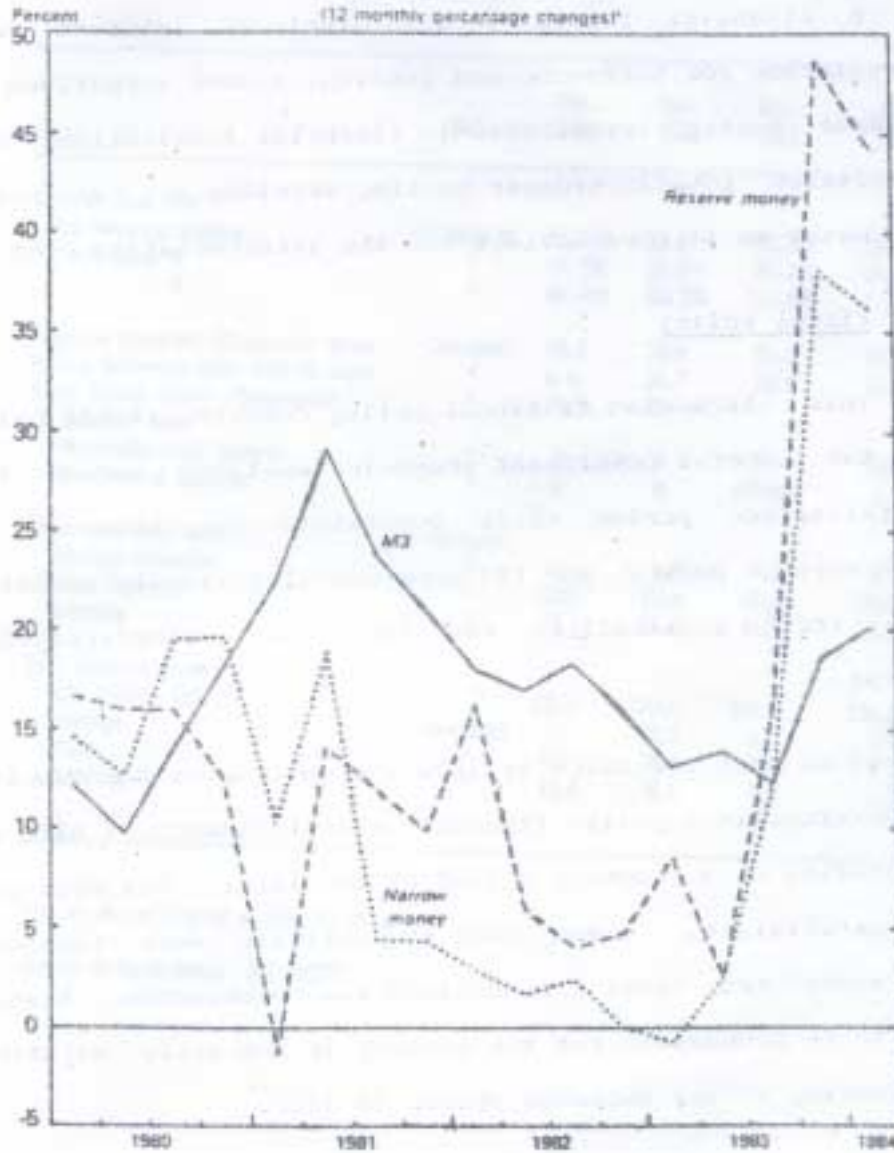
B.3. Monetary Policy

Monetary policy at the start of liberalization in 1981 was moderately tight to counteract the growing deficits in the external accounts. A financial crisis in early 1981 however reversed this towards moderate expansion for the rest of the year as the Central Bank bailed out financial institutions to restore confidence.

Monetary policy was likewise moderately expansionary in 1982 to accommodate expected recovery (and stimulate the economy) from the 1979 recession. Reserve requirements were reduced during the year. Growth in Central Bank new domestic assets was rapid at 63 percent between December 1981 and December 1982. A 62 percent rise in net credit to the public sector was mainly responsible for this reflecting expansion of the budget.

FIGURE IV.1

DEVELOPMENTS IN MAJOR MONETARY AGGREGATES,
1980-1984



¹ End of period

Source: IMF 1984

By 1983 policy became less expansionary to reduce balance of payments deficit. Growth in CB net credit to the public sector declined as the budget deficit was cut especially between end December 1982 and March and June 1983. But towards the latter part of the year reserve money expanded again to provide large overdrafts and emergency lending to financial institutions experiencing substantial withdrawals.

In all the pattern of monetary policy during the 1981 liberalization can be characterized by some tightening in early 1981 which was frustrated in the middle of that year due to a domestic financial crisis. In the next year and a half some relaxation took place after which another tightening happened in early 1983. Again the financial crisis of that year resulted in a rapid expansion of credit that needed mopping up in 1984. Figure IV.1 shows the growth changes in basic monetary aggregates while Table IV.4 presents some aggregate monetary data.

A financial reform in 1980 included interest rate deregulation for borrowing and lending, fiscal incentives to increase equity investments in financial institutions and legislation towards broader banking services all of which were meant to improve savings and the intermediation process.

B.4 Fiscal Policy

This discussion of fiscal policy concerns itself with (a) the general government economic functions during the liberalization period which constitute one form of an accompanying policy and (b) some specific fiscal policies with direct implications for the trade liberalization episode.

Since the recession of 1979 the government had adopted a countercyclical policy (through deficit financing) with an expectation of a recovery a year or two later. Yet this did not materialize. Given that the deficits were financed ultimately from foreign borrowings the consequences turned out to be precarious for the economy in the early eighties culminating in the exchange crisis in 1983.

TABLE IV. 4

MONETARY POLICY INDICATORS

	Unit	Dec. 1981	Dec. 1982	Dec. 1983	March 1984
Central Bank (CB) Accounts					
Net Domestic Amounts	(Bill P)	20.598	33.617	52.731	59.331
Reserve Money M	"	17.798	18.644	27.723	24.843
M	"	82.100	95.300	113.000	
Required Reserves (Commercial Bank)	(Percent)	19.9	18.0	23.0	24.0
Manila Reference Rate (MRR-90 days)	"	n.a.	16.7	16.9	16.1
Money Market Rates (Interbank)	"	14.9	16.0		
CB Interest Rate					
Non-traditional Exports	(Percent)	3	3	7	MRR90-9
Traditional Exports	"	5	8	MRR90-6	6
Commercial Bank Rate					
Savings Deposits	(Percent)	(1)	9.8	9.7	9.7
Time Deposits	"	(1)	17.4	22.5	15.5
Lending	"	18	14.4	16.2	21.5
Real Interest Rate					
CPI (1978 = 100)	(Percent)	157.1	177.6	223.9	238.2
Savings	"	(1)	5.5	4.3	4.1
Time	"	(1)	9.8	10	6.5
Lending	"	11.4	8.1	7.2	9

(1) = No ceiling as of July 1, 1981.

Source of Basic Data: IMF (1984).

The rapid deterioration of the government accounts is reflected in the increasing ratio of aggregate deficits to GNP from 0.2 percent in 1979 to 4.3 percent in 1982. This sharply fell in 1983 to 1.6 percent of GNP. The domestic-based deficit did not deteriorate as rapidly since expenditures exclude repayments-less-lending.

The ratio of government consumption expenditures to total government expenditures declined from 1979 to 1982 or 1983 indicating an increase in investment expenditures. When the deficits had to scaled down however capital shares had to suffer thus raising again the share of government consumption to all government expenditures. Table IV. 5 reports some fiscal policy indicators.

In general, indirect taxes constitute about 60-70 percent of the tax revenue sources of the government. This share has been quite stable even before the liberalization drive. Within indirect taxes, international trade transactions taxes are half, mostly in the form of import duties. It is not much the reliance however on indirect taxes for revenue that is important in trade liberalization as in their use as protective instruments and thus influencing resource allocation. For instance, advance sales and excise taxes varied differently according to the degree of essentiality of imports. Moreover higher nominal rates were imposed in imports than equivalent domestically produced goods. Finally the tax base for the calculation of these taxes was generally marked-up in varying percentages depending on landed costs. In other words the fiscal system had accorded considerable protection to the manufacturing sector through the system of indirect taxes.

The rationalization of this indirect taxes structure that distorts the protective system is the more direct accompanying piece to the 1981 trade liberalization.²² The program involved the removal or differential taxes for imported and locally produced goods simultaneously simplifying tax administration.

Most of the fiscal realignments took place in 1983, such as the imposition of a uniform 25 percent advance sales tax on imports (March 1983), the reduction in the number of tax brackets for cigarettes from 10 to 6, the reduction in tax differentials on imported and domestically produced spirits, wines, and cinematographic films.²³

TABLE IV.5
GOVERNMENT REVENUE AND EXPENDITURES
1979-1983

	1979	1980	1981	1982	1983
1 Total Revenue ^{a/} (billion pesos)	29.3	34.4	35.7	30.0	45.3
2 Domestic Revenue (billion pesos)	39.1	34.1	33.5	37.7	45.0
3 Total Expenditure (billion pesos)	29.7	37.7	47.9	52.4	51.5
4 Domestic Expenditure ^{b/} (billion pesos)	25.4	32.6	30.9	40.8	43.4
5 Surplus/Deficit, (1)-(3) (billion pesos)	(0.4)	(0.7)	(12.2)	(14.4)	(6.2)
6 Current GNP (billion pesos)	221.0	265.1	383.6	336.1	377.4
7 Current National Income (billion pesos)	200.4	240.5	273.0	301.4	338.2
8 (5) / (6) (percent)	(0.2)	(0.3)	(4.0)	(4.3)	(1.6)
9 (5) / (7) (percent)	(0.2)	(0.3)	(4.5)	(4.8)	(1.6)
10 Government Consumption Expenditure (billion pesos)	10.3	21.2	24.8	29.2	31.4
11 (10) / (3) (percent)	61.6	36.2	51.8	55.7	61.0

^{a/} Includes grants received.

^{b/} Includes lending minus repayments.

Sources: IMF, International Financial Statistics (various issues).
NEDA, *Philippine Statistical Yearbook* (various years).

B.5 Restrictions of International Capital Movements

The manner of regulating capital movements is partly coured through foreign exchange transactions in the banking system. In this context as early as 1972, inward and outward capital movements with the exception of certain transactions related to the financing of international trade required prior and specific approval of the CB.²⁴ The flexibility given to agent banks in balancing foreign exchange holdings also dictate partly the degree of restriction or relaxation to acquisition of invisible instruments. This has ranged from requiring banks to have full foreign exchange cover for their foreign currency liabilities to requiring a certain fraction of net foreign exchange position that banks can hold (e.g. 20 percent of outstanding letter of credit).

As a general rule however restrictions are placed on outflows of capital than inflows wherein the latter is even encouraged. There have been minor changes of the policies in this field during the 1981 trade liberalization except in the 1983 foreign exchange crisis.

B.6 Domestic Controls

Price and wage controls are instituted for certain commodities and some categories principally to protect consumers from excessive price fluctuations and to guarantee reasonable earnings consistent with living costs. These domestic controls have now been in force for at least a decade. There is no explicit indication that domestic controls have been made an integral part of the liberalization policy.

Only basic commodities that constitute the consumption basket of low income classes are generally controlled including petroleum products, electricity, transport fares and rental for dwellings (below certain levels). A Price Stabilization Council (PSC) determines the list and decides on ceiling changes. The list includes food items (rice, corn, eggs, pork, chicken, sugar, canned fish, milk) and school supplies. Successive adjustments to these prices have been undertaken especially after the 1983 exchange crisis and the subsequent inflation.

Since minimum wage legislation began in the fifties (which set floor wages for agriculture and non-agriculture workers) more than twenty changes have been instituted through legislative acts, decrees or wage orders. After Martial Law in 1972, wage setting included the provision of additional allowances and 13th month pay. Inspite of the fact however that control

of wages were meant to allow them to keep pace with cost-of-living changes, wage setting does not have an explicit specification that relates how it should adjust. Consequently real wages have been falling for workers since the 1981 trade liberalization. Table IV.6 below shows the trend of legislated real wages for the National Capital Region (NCR), and outside for non-agricultural labor, and agricultural wages (both plantation and non-plantation).

TABLE IV.6
LEGISLATED DAILY REAL WAGES
1981 - 1984
(PESOS)

	1981	1982	1983 ^{a/}	1984 ^{b/}
Non-agriculture: NCR	20.28	18.07	17.63	16.72
Non-agriculture: Non-NCR	20.01	17.81	17.79	16.80
Agriculture: Plantation	16.04	15.17	14.86	14.03
Agriculture: Non-Plantation	12.79	11.38	11.11	10.58

a/

Average for June-December

b/

Average for January-November

Source: National Wages Council, Ministry of Labor and Employment.

C. Implementation of the Liberalization Policy

From Table IV.1 above the various phases of the tariff reform program part of the 1981 trade liberalization were implemented according to schedule. There were of course several serious departures from the announced scheme which can be traced as due more from exogenous circumstances than from the implementation of it (or its earlier phases).

In late 1982 and early 1983 import surcharges were imposed across-the-board for all import transactions largely due to the deterioration in the balance of payments. This did not affect however the continued pursuit of the reform program in the sense that the surcharges were considered temporary and had a neutral marginal effect on the relative tariffs targeted to be affected.

On the part of import liberalization the scheduled relaxation of 87 items in 1983 was reduced to 48 in response to hearings conducted by the Ministry of Trade and Industry.²⁵

The major setback to the trade liberalization was the exchange crisis in October 1983. Firstly this resulted in the redundancy of the tariff system as all exchange transactions were effectively controlled. Yet the tariff changes were still implemented according to schedule. Secondly new quantitative restrictions were imposed and in fact consolidated by October 1984 under CB Circular 1029.²⁶ Finally priorities were established for the use of foreign exchange upon partial resumption of trading transactions.

Political stability was shaken in the latter part of the third year of implementation but it had nothing to do with the liberalization drive. It probably delayed it in terms of effects. In fact objections to the liberalization program have been fragmented and the government maintained that series objections to the reforms should be considered in an integrated manner and in view of the entire changes in resource allocation.²⁷

During the implementation of the tariff reform the distribution and values of nominal tariffs gradually changed and by the end of 1983 the average nominal tariff fell to 29 percent from 43 percent in 1980. Similarly in accordance with Phase I peak rates were cut from 100 percent. At the end of 1982 there were no tariff lines with rates of 100 percent.

Table IV. 7 shows the tariff rates and the number of lines with those rates, the total number of tariff lines, and the average nominal tariff rates by year. It can be seen that in 1981 peak rates were reduced to a ceiling of 70 percent.

D. Economic Performance Following Liberalization

By reason of the fact that the 1981 trade liberalization is yet to be fully completed by 1985, that it has been held in abeyance during the period of the 1983-1985 crisis, that the conditions under which it was to be implemented have changed and that any after effects

(whether positive or negative) have differential time paths, economic performance at this stage would simply provide a monitoring function although constituting a critical component of its eventual impact.

TABLE IV.7
TARIFF REFORM PROGRAM
1980-1985

Tariff Rates (percent)	Number of Tariff Lines			
	1980 ^{a/}	1981	1982	1983
10	322	671	660	650
20	197	420	429	452
30	211	284	341	344
50	186	252	525	366
70	128	182	83	134
100	327	2	-	-
Total Number*	1283	2300	2300	2300
Average Nominal (percent)	43	34	30	29

a/ Based on PD 1464

* Does not sum to column items because of other tariff rates.

Source: Tariff Commission (1983).

D.1. Major Prices

The consumer price index (CPI) for the year 1980 had been growing at a rate of about 3 percent over the previous quarter. At the start of 1981 CPI increased by a percent less than the previous quarter's increase, fluctuating and reaching by 1982 (4th quarter) an increase of 10

percent over the third quarter. On the other hand increases in the Wholesale Price Index (WPI) had fallen off beginning the first quarter of 1981 and continued to increase slowly until the last 2 quarters of 1983.

Real exchange rates varied throughout 1980-1983 and had shown some real depreciation towards the end of 1980. However in 1981 the exchange rate (towards the end of that year) appreciated slightly. For 1982 there was initially a real appreciation before leveling off at rates marginally lower than 1981. Sharp real depreciation came in 1983.

The nominal effective rate showed an appreciation throughout the 1981-1983 II period and the fall in the real effective exchange rate was therefore due more to increases in WPI (relative to the country's trading partners) than of adjustments to the nominal exchange rates.

Table IV.4 shows the movements of various interest rates. What is most noticeable from the table is the sticky real interest rate movement in spite of the deregulation of it beginning with the 1980 financial reforms.

The real (daily) wages of non-agricultural workers in Metro Manila show an index that sharply declined until 1982 before recovering the 1980 levels in 1983. The structural decline in real wages especially in the seventies is quite marked and is not captured in this limited indicator after 1980.

Table IV.8 reports the movements in major prices over the period 1980-1983. The quarterly changes in the unit value of exports and imports indicate very drastic fall in the former compared to the latter or higher increases in the latter compared to the former all implying a deterioration in the terms of trade. After the June 1983 devaluation however the movements started to favor better unit values for exports.

D.2. The External Transactions

Table IV.9 shows the pattern of quarterly external transactions for 1981-1983 including percent change in them, some balance of payments measures and external debt. It is difficult to discern any pattern to the movement of aggregate imports even on a quarterly basis since the liberalization was staggered across different sectors, the emergence of restrictions towards end-1982 and 1983 and of adverse exchange rate movements (in 1983). A separate estimate for

imports under NEC and UC reveal that these accounted for 1.2 percent of total imports in 1981 compared to 0.9 percent in 1980 reflecting a 33 percent increase.

The pattern for exports is also not discernible. There has been a decline in exports in the last 3 quarters of 1981. What is important to notice is the decline in the share of the 19 principal exports and the continuing increase in manufactured exports. Trade balances have remained negative worsening after the first quarter of 1981.

TABLE IV.8
MAJOR PRICES: 1980 - 1983

	1980				1981				1982				1983			
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
CPI (percent change)		3.2	3.6	3.1	2.1	1.7	5.1	4.1	3.4	0.7	3.4	10.0	1.7	1.5	5.3	12.3
WPI (percent change)		(1.3)	2.2	4.6	3.4	3.2	2.3	2.1	2.8	2.7	3.1	1.4	0.4	1.8	6.2	19.0
Nominal Exchange Rate (P/\$)	7.42	7.49	7.55	7.58	7.68	7.96	8.1	8.29	8.29	8.41	8.66	8.9	9.45	10.1	11.0	13.9
NER (end of quarter, May 1978=100)	69.44	65.44	65.1	64.85	66.46	69.6	70.51	68.81	72.4	73.78	75.53	72.07	73.44	73.63		
RER (end of quarter, May 1970=100)	143.6	131.6	132	136	134.22	141.87	138.17	134.38	142	144.9	149	133.4	129.57	118.21		
Real Wages (1980=100)		100				94.35				84.94						
Unit Value of Exports (percent change)		(3.3)	2.3	5.7	4.6	(5.4)	(5.2)	(1.3)	(5.2)	1.7	(2.8)	3.0	6.5	14.7	6.0	53.8
Unit Value of Imports (percent change)		2.9	2.7	8.6	(3.1)	13.4	8-8.2	0.0	(7.4)	3.1	(7.9)	9.3	26.7	(3.7)	(4.0)	52.9

Source of Basic Data: IMF, *International Financial Statistics* (various issues).

TABLE IV.9
EXTERNAL TRANSACTIONS ACCOUNTS: 1981 I - 1983 III

	1 9 8 1				1 9 8 2				1 9 8 2				1 9 8 2			
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
	(Million US Dollars)				(Percent Change)				(Million US Dollars)				(Percent Change)			
Imports (fob)	1,897	2,034	2,902	1,922	-1.40	7.22	2.85	-8.11	2,101	2,159	2,044	1,952	9.31	2.76	-5.33	-4.50
SITC 0 - 4	767	902	885	803	-8.03	17.60	-1.88	-9.26	793	910	735	800	-1.24	14.75	-19.23	8.84
SITC 5 - 9	1,130	1,131	1,207	1,119	3.67	0.00	6.72	7.29	1,307	1,249	1,310	1,154	16.00	-4.44	4.80	-11.91
Exports (fob)	1,593	1,451	1,346	1,333	4.46	-8.91	-7.24	-0.96	1,289	1,345	1,184	1,214	-4.00	6.00	-11.97	2.53
SITC 0 - 4	969	788	645	646	8.63	-18.68	-18.15	-0.15	623	701	532	627	-3.56	12.52	-24.11	17.86
SITC 5 - 9	622	659	698	685	-1.43	5.95	5.92	-1.88	646	644	652	587	-5.69	-0.31	1.24	-9.97
10 Principal	934	712	648	656	78.24	-23.77	-9.00	1.23	635	687	584	620	-3.20	8.19	-14.99	6.16
Trade Balance	-305	-503	-746	-589	-23.56	91.15	27.96	-21.04	-832	-814	-860	-730	41.26	-2.16	5.65	-14.19
Current Account Balance	-291	-616	-885	-649	-35.76	111.68	43.67	-26.67	-829	-851	-931	-746	27.73	2.65	9.40	-19.87
Foreign Debt	26.45	27.59	3088.00	3303.00	7.38	4.31	11.92	6.96	34.88	37.10	39.61	-	5.60	6.36	6.79	-
Export + Imports/GDP	-	0.44	-	-	-	-	-	-	-	0.41	-	0.38	-	-	-	-
Exchange Rate (Pesos/US \$)	7.68	7.86	7.96	8.10	-	2.30	1.30	1.70	8.29	8.41	8.55	8.90	2.3	1.4	1.7	4.1

TABLE IV.9 (continued).....

	1 9 8 3 ^a					
	I	II	III	I	II	III
	(Million US Dollars)			(Percent Change)		
Imports (cif)	1,962	2,002	2,000	0.51	2.04	-0.10
SITC 0 - 4	821	784	719	2.62	-4.51	-8.29
SITC 5 - 9	1,131	1,219	1,282	-1.99	7.78	5.17
Exports (fob)	1,166	1,247	1,222	-3.95	6.95	-2.00
SITC 0 - 4	595	590	533	-5.10	-0.84	-6.27
SITC 5 - 9	570	636	669	-2.90	11.58	5.19
10 Principal	607	617	-	-2.10	1.65	-
Trade Balance	-786	-755	-778	6.50	-3.94	3.05
Current Account Balance	-778	-684	-739	4.29	-12.00	8.04
Foreign Debt						
Export + Imports/GDP	-	0.42	-	-	-	-
Exchange Rate (Pesos/US \$)	9.45	10.09	11.00	6.2	6.8	9.0

a/ all imports at c.i.f. prices.

Sources: 1981: CB, Philippine Financial Statistics, March 1982.

1982 & 1983: ADB, Key Indicators of Developing Member Countries of ADB, APRIL 1984.

Except 10 Principal Exports and Foreign Public Debt, from CB, PPS.

Notice that the ratio of exports and imports to GDP has been declining from 1980 to 1981 – from 46 percent to 38.4 percent in the first semester of 1983.

There is very little from these external transactions accounts that indicate sharp departures from previous trade. For example, the declining share of 10 principal exports has been a noticeable pattern since the early seventies and not really unique to the period after trade liberalization. Similarly the import structure remains the same in terms of seasonality of value, distribution by primary (SITC 0-4) and manufactured (SITC 5-9) goods category, and absolute levels. The trade balance as well as current account balance has however shown a significant

deterioration on a quarterly basis especially between the first and the third quarters of 1981. The degree of openness of the economy likewise did not see any noticeable change in value as measured by the ratio of export and import value to gross domestic product. While it fell in 1982, this recovered in 1983.

There is also only small changes in the nominal exchange rates, deteriorating by around 16 percent between the beginning of 1981 and the last quarter of 1982. Given the movements of the consumer price indices during the same period, the real exchange rates appreciated lending support to the notion why the trade balance did not vary in terms of exports and imports flows.

D.3 Income and Product

At the aggregative level, it was shown (see Part I) that GNP's growth rate in 1980-1983 was at 2.6 percent per year, brought down in part by the 1983 economic crisis. This means that on a per capita basis real GNP declined Agriculture, fishing and forestry suffered most while services the least. Industry's growth decelerated in contrast to the historical rates it was previously experiencing. Table IV.10 shows the industrial origin of GDP for 1980-1983.

It can be seen from the table that manufacturing progressively deteriorated in growth between 1980 and 1983 – from a growth rate of 3.4 percent in 1981 to 2.1 percent and 2.4 percent growth in 1982 and 1983, respectively. Within manufacturing several industries showed real deceleration. These include leather and leather products, chemical and chemical products, transport equipment and products of petroleum and coal. Others such as textile manufactures and paper and paper products suffered as well but it appears these have been their condition even before 1980. Table IV.11 presents the gross value added for manufacturing by industry from 1972 to 1983 in order to highlight the longer term movements rather than just the structure between 1980 and 1983.

TABLE IV.10
INDUSTRIAL ORIGIN OF GROSS DOMESTIC PRODUCT
(Billion 1972 Pesos)

	1980	1981	1982 ^r	1983 ^p
Agriculture, fishery and forestry	23.7	24.6	25.4	24.8
Industry	33.5	35.0	35.7	36.0
Mining and Quarrying	2.2	2.2	2.0	2.0
Manufacturing	23.2	24.0	24.5	25.1
Construction	7.1	7.8	8.1	7.7
Electricity, gas, and water	0.9	1.0	1.1	1.2
Services	35.4	36.6	37.9	39.3
Transport, communication and storage	4.8	5.0	5.2	5.3
Trade	12.2	12.7	13.1	13.9
Finance and Housing	7.1	7.0	7.3	7.8
Other Services	11.3	11.9	12.4	12.3
GDP	92.6	96.2	99.0	100.1

r/ - revised

p/ - preliminary

Source: NEDA National Account Staff

TABLE IV.11

**GROSS VALUE ADDED IN MANUFACTURING BY INDUSTRY GROUP
AT CONSTANT 1972 PRICES
(IN MILLION OF PESOS)**

Industry Group	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
Food manufactures	3623	3871	4129	4245	4558	7189	7498	7865	8419	8803	9099	9246
Beverage industries	724	758	787	808	859	661	585	707	732	730	747	765
Tobacco manufactures	950	1291	1457	1542	1556	979	990	1858	1039	1100	1114	1117
Textile manufactures	798	852	899	923	1097	940	1022	1071	1049	1095	1053	1050
Footwear wearing apparel	431	533	544	591	628	785	857	932	1019	1109	1224	1247
Wood and cork products	582	627	638	471	558	629	660	686	665	707	704	716
Furniture and fixtures	86	90	88	74	79	104	107	114	132	139	140	142
Paper and paper products	345	420	480	486	558	186	193	282	191	188	172	196
Publishing and printing	265	339	430	447	455	252	283	301	324	344	359	360
Leather and leather products	22	25	26	30	31	43	45	49	68	70	71	66
Rubber products	220	238	257	263	232	274	293	312	302	311	324	316
Chemical & chemical products	1012	1994	2075	2165	2462	2038	2165	2321	2365	2317	2273	2315
Products of petroleum & coal	1048	1358	1219	1230	1134	1294	1325	1398	1373	1287	1313	1351
Non-metallic mineral products	445	597	541	597	613	478	520	535	574	540	569	587
Basic metal industries	409	526	505	587	631	756	819	865	853	791	856	947
Metal industries	401	414	424	398	309	807	952	1040	1041	977	1052	1091
Machinery except electrical	184	206	193	190	195	540	618	678	226	764	787	797
Electrical machinery	355	376	400	443	394	591	814	1005	1153	1401	1475	1717
Transport equipment	516	561	688	842	854	760	875	898	885	918	883	742
Miscellaneous manufactures	172	176	193	205	218	168	198	230	265	296	320	334
GROSS VALUE ADDED IN MANUFACTURING	12588	15252	15973	16537	17421	19492	20917	22239	23175	23959	24535	25108

Source: NEDA.

To see what has been the pattern of the imports to total supply for the manufacturing sector Table IV.12 presents the shares of imports to total supply for selected manufacturing industries from 1980 to 1983. Chemical and chemical products industries show an increase in import share to supply along with paper and paper products, textile manufactures, and metal products. Transport equipment industries however show a marked decline in imports over the period.

D.4. Employment and Unemployment

Employment series in the Philippines come (since 1980) from two surveys conducted at the end of the third and fourth quarters of the year. Prior to 1979 employment breakdown by major sectors of the national income accounts were available. After that breakdowns have been categorized only as either agricultural or non-agricultural employment. Table IV.13 presents a brief account of aggregate labor force, employment, unemployment rate and labor force participation rate.

The cyclical nature of the labor force participation rate is apparent from the figures between the third and fourth quarters of each year. The same is true for the unemployment rate – higher during the third quarter of each year.

The employment figures outlined above have probably less meaning in the context of understanding the employment implications of liberalization. What is more relevant is information concerning factory shutdowns, workers terminated, reasons for shutdowns and other related conditions. The Ministry of labor and Employment records establishments reporting shutdown and employment status. It is difficult to put a lot of weight to the information in this regard since they are simply based on those establishments which report and the coverage therefore varies. But their movements over time may reveal the industrial incidence of lay-offs or shutdowns. For instance the share of workers in manufacturing to the total number of workers terminated had not really increased substantially in 1983 and 1984 contrary to expectations surrounding the economic crisis during these periods. Whereas in 1981 81.1 percent of all workers terminated as reported by firms came from the manufacturing sector, the ratio fell to 69.5 percent in 1982, 73.7 percent in 1983 and 62.4 percent in 1984. There has also been

increases in the coverage of establishments although no breakdown by industry of these firms reporting is available. Table IV.14 summarizes the distribution of terminated workers according to industry.

TABLE IV.12
SHARES OF TOTAL DOMESTIC SUPPLY *
MANUFACTURING: 1980 - 1983
(IN PERCENT)

Industry Group	1980	1981	1982	1983
Food manufactures	15.6	15.8	16.8	16.0
Beverage and tobacco	6.5	6.9	8.5	10.3
Petroleum & coal products	63.9	64.2	60.9	62.6
Chemical & chemical products	48.4	50.1	50.8	54.8
Rubber products	30.8	25.7	30.0	25.6
Paper and paper products	35.2	32.4	38.3	37.6
Textile manufactures	19.0	19.3	19.4	26.6
Non-metallic mineral products	24.8	15.6	14.5	12.6
Basic metal	57.1	53.6	57.9	54.6
Metal Products	47.6	48.2	50.6	50.5
Machinery except electrical	84.0	81.3	81.2	82.0
Electrical machinery	57.6	55.2	52.3	52.3
Transport equipment	72.3	61.0	57.7	65.6
Miscellaneous manufactures	63.7	59.7	55.6	57.3

*Imports are derived in peso cif values from the NCSO Foreign Trade Statistics (1980 to 1983) and the values are divided by the sum of imports and domestic value added.

Source of Basic Data: NCSO, Foreign Trade Statistics
 NEDA, Philippine Statistical Yearbook (1984).

TABLE IV.13

EMPLOYMENT

	1980		1981		1982		1983	
	III	IV	III	IV	III	IV	III	IV
Working Age (000) ^a	28,835	29,072	29,701	30,023	30,747	30,978	31,676	31,907
Labor Force (000)	17,705	18,638	18,421	19,005	18,488	19,900	20,465	20,521
Participation Rate (percent)	61.4	64.2	61.7	62.6	60.1	63.6	64.6	64.3
Unemployment Rate (percent)	5.4	4.3	5.3	5.4	6.0	5.5	4.6	4.1
Underemployment Rate (percent)							30.1	31.8

^{a/} Population 15 years and older

^{b/} Available beginning first quarter 1983.

Source: NCSO

The major part of terminated workers belong to the manufacturing sector which is also the more sensitive sector to be affected by any liberalization drive. The rest of the sectors are either service-oriented or are non-tradable. Thus the movements reflected in Table IV.14 suggest that the proportionate share of manufacturing workers terminated had been declining since 1981. This point however needs to be adjusted for the possible bias in the incremental coverage of reporting establishments for the subsequent years. Unless the industry distribution of reporting firms for the four years has remained the same it is difficult to associate the decline as an economic consequence of trade liberalization.

TABLE IV.14

DISTRIBUTION OF TERMINATED WORKERS BY INDUSTRY
1981-1984

	1981	1982	1983	1984
Agriculture, Fishery and Forestry	3,399	1,347	7,218	3,888
Mining and Quarrying	3,420	6,175	1,685	6,574
Manufacturing	63,648	34,436	55,613	58,283
Electricity, Gas and Water	0	0	0	0
Construction	1,055	1,373	2,814	6,621
Wholesale and Retail Trade	2,351	1,629	3,545	6,412
Transport, Storage and Communication	1,743	2,638	1,745	4,140
Others	2,850	1,914	2,792	7,318
Total Workers Terminated	78,466	49,512	75,428	93,386
Number of Reporting Establishments	n.a.	638	1,267	2,212

Source: Labor Statistics Division, Ministry of Labor and Employment.

n.a. - not available.

FOOTNOTES

¹It is partly for this reason that there is no sharp dip in the curve of the liberalization index.

²In Memorandum to Authorized Agent Banks (MAAB) No. 2 (January 28) 66 tariff headings were removed from the restricted import category and made fully importable. In February (MAAB No. 587) 13 tariff were reduced. In May another 29 lines from restricted categories were lifted (MAAB No. 10).

A country's accession to GATT does not of course obligate a unilateral tariff reduction. But in the case of the Philippines it appears that the country went through the motions of reducing protection and promoting liberalization, evident in a number of unilateral tariff reductions or removal of import restrictions as noted.

³Bautista (1985).

⁴See for example Sicat (1975).

⁵See Tariff Commission Annual Report for 1982.

⁶This is discussed in the section on fiscal policy.

⁷This code already specifies the applicable tariff rates for every year of the tariff reform program and their eventual levels.

⁸Executive Order (EO) 609 AND 632-A embody the former while EO 706 the latter.

⁹See World Bank (1984).

¹⁰World Bank (1982).

¹¹Refer to Table I.18 in Part I of the report.

¹²The overall protection to the economy must be reckoned by the relative changes in the EPR's of different Commodities. While consumer goods EPR's declined between 1974 and 1979 the protection to the other industries (intermediate goods, inputs into construction, capital goods) increased.

¹³The effect of this on EPR really depends on where the exemptions fall, whether into inputs to production or final goods. An increase in the former increases EPR while an increase in the latter decreases protection.

¹⁴One major study on the incentive system on trade and industry is Bautista, Power and Associates (1979).

¹⁵World Bank (1984).

¹⁶MAAB No. 7 (1981).

¹⁷See IMF, Annual Report on Exchange Arrangement and Exchange Restrictions (1981).

¹⁸CB Circular No. 849.

¹⁹MAAB No. 39.

²⁰World bank (1984).

²¹MAAB No. 1.

²²See IMF, Annual Report on Exchange Arrangement and Exchange Restrictions (1984).

²³The distortion here comes from the fact that not only are sales tax different for an imported product but even the calculation for the cost base of the imported good varies.

²⁴ World Bank (1984).

²⁵See IMF, Twenty-Third Annual Report on Exchange Restrictions (1982), p. 354.

PART V

SOME CONCLUDING REMARKS

The Commitment to Trade Liberalization

Has there been any long-term commitment to trade liberalization in the Philippines? The answer to this question is yes and no.

- Yes, at least in an ex post sense, because we (appear to) observe a perhaps “classic” sequence of:
 - replacing QR’s by tariff (stage A)
 - promoting Manufactured exports (stage B)
 - liberalizing the manufacturing import-substitution sector (stage C)

- No, in terms of coordinated and sustained intention i.e. ex ante. Stage A was formed by events (as in many countries). Stage B did not present nearly as fundamental a commitment to new exports as we see in the successful Southeast Asian NICs; if new exports were achieved (i.e. ex post), this was largely so for reasons other than specific export promotion measures. In fact Stage B, ex ante, was perhaps a weak compromise in the late 1960s/early 1970s between stronger forces wanting to increase intervention, planning and protection and weaker forces wanting a more open economy. As for stage C, it is difficult to see any systematic build-up of pressure within government for such a thorough-going reform; indeed the decision in favor of the Tariff Reform Program (TRP) may be better seen as a “palace coup” brought about by a technocratic minority, with World Bank help. It is difficult, in reality, to see any convinced and sustained commitment to trade liberalization in the government as a whole. Perhaps in fact, we are witnessing, in political economy terms, a basically conservative society in which rent-creating controls suit business and government, while liberalization attempts are imposed every decade, either to correct the development of external disequilibrium or to bow in the direction of the liberal solutions that the Western international community tends to prescribe.

But, in addition to this general suggested explanation for the absence of a long-term commitment to trade liberalization, we also think, specifically, the consequences of the first (decontrol) episode – particularly in terms of the loss of profitability in manufacturing – came to be viewed very negatively, i.e. decontrol was not viewed as an entire success. We believe this perception strengthened the hand of interventionist forces and put off the timetable for trade liberalization. The motivation for this negative view of liberalization no doubt partly reflected a genuine sense of apparently wasted resources (e.g. in the development of overcapacity), but it also reflected what must have been the very large loss of rents in the manufacturing sector in the years following the 1962 decontrol.

The Episodes: Success and Failure

At the very least the 1960s decontrol and the 1970 devaluation packages succeeded in the medium-term as instruments of external stabilization, but in both cases were overtaken by the reintroduction of expansionary macroeconomic policies while external conditions – i.e. the deteriorating terms of trade – did not help much.

As we have already stressed the interpretation of the apparent success of the second episode in restructuring exports is not straight-forward. The role of formal export promotion measures was a necessary one, in the sense that manufactured exports would not have taken off without effective provisions for exporters to acquire imported inputs at world prices, but a limited one in the sense that the subsidies they provided to offset the anti-export bias of other trade policies were modest. Instead the restructuring of exports has to be understood in terms of the more realistic exchange rate achieved with the decontrol (and cemented by devaluation in 1970), the collapse of the traditional export sector in the 1970 (largely as a result of world price developments, but also helped on its way by a growing commercial policy bias against these exports), and a quite remarkable fall in the real wage in the period 1969-74 (a phenomenon not unconnected with movements in the real exchange rate and the terms of trade). One is entitled to ask whether this was a real liberalization episodes.

The third episode is noteworthy for its failure and two specific points are worth making. First, compared to the other two episodes – and by any standard – the timing was wrong, though we should emphasize that a lot of this may be considered bad luck rather than bad judgement. The wrong external conditions were constituted on the one hand by the more rapidly deteriorating terms of trade at the beginning of the 1980s than in the early 1960s or early 1970s, on the other hand by the severe recession in the OECD countries. The wrong internal condition where bad judgement may be more evident, was the growing precariousness of the external debt situation after 6 to 7 years of uninterrupted and large current-account balance-of-payments deficits. (It may be the case that liberalization contributed to the economic crisis of 1963, though this must have been quite marginal).

Second, it appears that this potentially major reform was carried out with some disregard for its macroeconomic consequences, specifically the need for devaluation to accommodate the short-term effects of liberalizing the domestic market for manufactures. Perhaps this may partly reflect what we have suggested to be the “palace coup” routine of the reform – a reform that was not put through the proper machinery of economic policy-making.

Will the TRP survive the present crisis given the fact that the tariff reductions are continuing in accordance with plans? It appears that for a number of import-substitution industries the liberalization philosophy behind TRP reinforced by the 1983 foreign exchange crisis may have indeed induced autonomous reforms that respond to international competitiveness. Without import privileges of the availability of exchange resources at an overvalued exchange rate efficiency may have become a guiding light for industry. On the other hand the reintroduction of non-tariff measures soon after the beginning of the TRP may have induced the survival of rent-seekers nurtured by an unchanged political economy of the country. While the crisis may have induced an important trait of reform its success depends on how much “water in the tariff” will eventually exist.

Export Promotion in the “Classical” Liberalization Sequence

From an economic of view, it is difficult to see how the non-traditional export promotion experience of the 1970s – Philippine style – has a role to play in any sequencing of trade liberalization. We have suggested that such exports largely took place as an enclave activity, representing the export of unskilled labor. There have been no obvious effect at all on the import-substitution manufacturing sector. Yet from a political point of view, the export-promotion stage may eventually turn out to have an impact. If nothing else, the 1970s have seen the beginning of the building up of a political constituency of industrialists favoring a more open trade regime.

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