

TRADE AND PROMOTION POLICY IN PHILIPPINE INDUSTRIAL DEVELOPMENT

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I. INTRODUCTION

ONE of the most significant changes in development policy thinking among developing countries in the past decades was the shift from a purely import-substituting industrialization policy to a more outward-looking, export-oriented strategy. Owing primarily to the dissatisfaction with the former policy in achieving the multiple goals of development, a number of developing countries have opted for a change in terms of increased dependence on the export market to relieve the constraints to growth.

In this respect, the Philippines was no exception. Balance of payments difficulties brought on by the demands of postwar reconstruction led to import control measures which were later generalized to support an import-substituting industrialization strategy. The initial elan however was not sustained, given the limits of domestic demand and the inherent biases of the protective system adopted. The Philippines continued to suffer the ills of widespread unemployment and underemployment, owing partly to a manufacturing sector that had become increasingly capital-intensive, a regional concentration of investment and production, imbalances in the production structure, serious and growing disparities of income, and worsening balance of payments problems. Clearly a shift in the development strategy was called for, and the direction taken was towards a greater export orientation in industrialization. In the first part of this paper, we wish to review the trade and industrial policy environment in the period from the 1950s to the 1970s and the slow, sometimes hesitant, steps in the process of moving away from a purely import-substituting strategy. It will be shown that the observed structural shifts in export trade that have emerged at the end of the 1970s were a result of trade liberalization efforts coupled with positive industrial promotion policies enacted to break the institutional constraints to export expansion.

In spite of such changes it became evident at the end of the 1970s that the institutional reform did not go far enough in achieving the major objectives of development. Might not the underlying reason be found in the possibility of policies running at cross-purposes in terms of objectives? Or might some incentives geared towards specific objectives be in fact irrelevant to manufacturing sector decision-making activity?

In the second part of this paper, we will attempt to give partial answers to these questions by examining the consistency of the policies themselves with the

TABLE I
VALUE AND COMPOSITION OF PHILIPPINE EXPORTS, 1970-80

Year	Total Exports (F.o.b. Value in U.S.\$ Million)	Share of Ten Principal Traditional Exports* (%)	Share of Nontraditional Manufactured Exports† (%)	Others (%)
1970	1,142.19	75.97	8.28	15.75
1972	1,168.43	74.45	9.93	15.62
1974	2,724.99	78.69	12.01	9.30
1976	2,573.68	61.70	22.29	16.01
1978	3,424.88	51.11	31.42	17.47
1980	5,787.79	45.52	36.40	18.08

Sources: Central Bank of the Philippines data for 1970; National Census and Statistics Office data for 1972-80.

* Ten principal traditional exports: copra, sugar, bananas, logs and lumber, desiccated coconut, coconut oil, pineapples (canned), gold, abaca (unmanufactured), and copper concentrates.

† Nontraditional manufactured exports refer to manufactured exports whose value was less than \$5 million in 1968.

development objectives, as well as their relevance to private sector investment, production, and export activity. For this purpose, we will present the results of a survey conducted to appraise the relevance and direction of influence of specific policies on manufacturing sector activity. Then we will proceed to discuss the recent changes in trade and industrial policies that have been adopted as a direct result of policy reassessment conducted at academic and official levels at the end of the past decade. In the final section, we will draw some of the possible implications of such on-going policy reform on the prospects of achieving the development objectives of the Philippines.

II. GROWTH AND STRUCTURAL CHANGE IN THE 1970s

Typical of most small developing country trades, Philippine export trade has been characterized by a high degree of commodity and geographic concentration. As late as 1970, ten principal traditional export commodities comprised three-quarters of total export value (Table I). Indeed, the first three top-dollar earners (namely, sugar, logs and lumber, and copper concentrates) easily accounted for a little more than half of total export earnings.¹ These were mostly in unprocessed and semiprocessed forms of agricultural, forestry, and mining origin which found their way to the country's two principal trade partners, the United States and Japan. In terms of geographic concentration of export trade flows, North America and Japan accounted for about three-fourths of total sources of export earnings (Table II) in 1970. Forces of structural change, however, were at work before and all throughout the decade of the 1970s and by 1980, a remarkable change

¹ Little change in the commodity concentration was observed over the 1960s, so that the more than 50 per cent share of the first three export commodities in total export remained more or less constant over the decade.

TABLE II
DIRECTION OF PHILIPPINE EXPORT TRADE, 1970-80

Year	Total	North America	Japan	Northwestern Europe	Asia	Rest of World
1970	100.00	38.84	37.80	13.68	7.21	2.47
1972	100.00	38.87	31.94	19.52	6.39	3.28
1974	100.00	42.92	34.83	12.16	5.21	4.88
1976	100.00	37.04	24.15	18.25	9.40	10.46
1978	100.00	35.06	23.89	18.84	13.87	8.34
1980	100.00	28.64	26.49	16.63	16.90	11.34

Source: Same as Table I.

had emerged in the overall pattern of both commodity and geographic composition of exports: the share of the ten traditional exports had slid down to less than half of total export earnings (45.52 per cent), while the combined share of North America and Japan had come down to about 55 per cent of total dollars earned from merchandise trade (Table II).

In growth terms, total (dollar) export earnings grew at an average annual rate of 22.87 per cent over the decade and by 9.38 per cent in quantum terms. The decline in relative importance of the traditional exports cited earlier can be gleaned from their erratic and generally more sluggish average yearly growth of 13.23 per cent. In contrast the nontraditional manufactured exports registered a 34.81 per cent growth, or volume-wise, a 20 per cent average annual growth (Bautista [3]), bringing up with it the overall growth rate of exports. This phenomenon which showed a robust trend over the decade, shifted the position of the nontraditional manufactured exports from a less than 10 per cent share at the start of the decade to more than 35 per cent by 1980. Table III shows the composition of such nontraditional exports. While the ten traditional exports can be seen to have registered negative growth rates in at least four years during the decade, the nontraditional manufactured exports showed consistent increases, implying a relatively greater resiliency in containing the cyclical movements of external demand. As will be pointed out later in the section on the Philippines' new export strategy for the 1980s, this dynamic group of manufactured exports had already been earmarked for a concentrated effort at export promotion. The shifting pattern of the country's export structure is best exemplified by the export of semiconductor devices which in 1973 represented less than 1 per cent of total export value; by 1981 it was posting a 19 per cent share, having supplanted sugar from the top position among the leading exports of the year.

What about the growth performance of the manufacturing sector from which such exports originate? Admittedly the record is more modest. Gross value added in manufacturing between 1972 and 1982 grew at an average annual rate of 20.34 per cent. Inflationary forces accounted mostly for such increases, however, since in constant 1972 prices, only a moderate 6.31 per cent average yearly growth was evident. The first oil shock of 1973-74 drastically cut down the previously high growth rates posted early in the decade of the 1970s, i.e., about

TABLE III
PHILIPPINE EXPORTS OF NONTRADITIONAL MANUFACTURES, 1970-80
(F.o.b. value in U.S.\$ million)

Commodity Category	1970	1972	1974	1976	1978	1980
Total	94.52	115.98	327.36	573.67	1,076.16	2,106.90
Garments	36.21	38.80	94.03	184.66	326.34	500.04
Handicrafts	6.52	12.88	46.00	94.88	100.11	154.27
Electrical and electronic equipment and components	0	0.44	27.12	84.98	253.44	670.97
Nonmetallic mineral manu- factures (incl. cement)	3.02	9.95	36.40	28.07	42.20	58.92
Chemicals	5.42	6.28	15.92	27.01	59.89	94.94
Builders woodwork and other wood manufactures (excl. plywood, veneer, and lumber)	3.95	7.72	24.80	15.48	20.67	23.81
Food products and beverages	8.25	11.21	17.48	28.68	46.76	170.37
Machinery and transport equipment	1.06	2.12	5.48	16.11	36.87	46.54
Textile, yarn, fabrics, and other related products	2.81	3.54	7.16	15.15	23.61	49.32
Cordage, cable, ropes, and twines	1.93	3.14	9.71	10.35	12.48	18.52
Furniture and parts	0	0	0	9.76	26.64	77.16
Footwear	0	0	0	5.04	32.18	67.04
Others	25.35	19.90	43.26	53.50	94.97	175.00

Source: Board of Investments, Export and Import Division.

15 per cent real growth from 1970 to 1973. Although recovery took place in the mid-1970s (particularly in 1976-77), the second oil shock of 1978 exacerbated by the continued recession in the major industrial countries took its toll on the country's manufacturing industries in terms of steadily declining growth rates. Nevertheless some slight evidence of diversification is observed in the composition of manufacturing production during the decade. Except for food manufactures (including beverage and tobacco manufactures) and footwear and wearing apparel, which incidentally were among the fast-growing nontraditional exports, industries in the "light industry category" (i.e., textiles, wood and cork products, paper and paper products) showed declining shares (Table IV). On the other hand, the metal products and machinery groups showed increasing, though admittedly, still low shares in (real) manufacturing value-added composition over the decade.

To understand the forces at work behind such structural shifts, it is essential to step back and review the economic and policy environment that nurtured such trends. In the following sections, we shall take a retrospective and critical look at the historical evolution of trade and industrial policy of the preceding decades, and its role in promoting (or hindering) the growth of manufactured exports and of the manufacturing sector in general.

TABLE IV
INDUSTRY COMPOSITION OF THE MANUFACTURING SECTOR, 1972-82

Industry Group	(%)					
	1972	1974	1976	1978	1980	1982
Food, beverage, tobacco manufactures	39.11	39.88	39.89	46.17	43.97	44.67
Textile manufactures	6.01	5.63	6.28	5.74	4.53	4.30
Footwear, wearing apparel	3.24	3.40	3.59	1.63	4.40	4.99
Wood and cork products	4.38	3.99	3.19	2.45	2.87	2.91
Furniture and fixtures	0.65	0.55	0.45	0.74	0.57	0.57
Paper and paper products	2.60	3.00	3.08	0.92	0.82	0.70
Publishing and printing	1.99	2.69	2.60	1.34	1.40	0.46
Leather and leather products	0.17	0.16	0.18	0.12	0.29	0.29
Rubber products	1.66	1.61	1.33	1.38	1.30	1.32
Chemical and chemical products	13.64	12.98	14.08	10.24	10.21	9.09
Products of petroleum and coal	7.89	7.63	6.49	7.85	5.92	5.35
Nonmetallic mineral products	3.35	3.39	3.51	2.46	2.48	2.28
Basic metal industries	3.08	3.16	3.61	3.52	3.68	3.58
Metal products	3.02	2.65	2.23	4.42	4.49	4.37
Machinery (except electrical)	1.38	1.21	1.12	2.93	3.13	3.21
Electrical machinery	2.67	2.55	2.26	3.88	4.98	6.01
Transport equipment	3.88	4.31	4.89	3.67	3.82	3.60
Miscellaneous manufactures	1.29	1.21	1.25	0.52	1.14	1.30

Source: National Economic and Development Authority, National Accounts Staff, Statistical Coordination Office.

Note: Totals do not always add up to 100 per cent due to rounding.

III. TRADE AND INDUSTRIAL POLICY IN THE 1950s AND 1960s

As in most developing countries during the postwar rehabilitation period, ad hoc restrictive trade policies in the form of import quotas and foreign exchange controls were resorted to in the Philippines to stem the tide of imports which were straining the foreign exchange capacity of the country.² And as in most cases too, such import-restricting policies later evolved into a major tool for encouraging the growth of investment and production in manufacturing industries of an import-replacing nature. The Import Control Act of 1948 (Republic Act 330) was enacted to reduce the imports of luxury and nonessential consumer goods, so as to allow the importation of a sufficient supply of imported essential consumer goods for low-income groups and a supply of essential capital goods for economic rehabilitation and development objectives. The failure to reduce imports or to alter its composition, plus the shortfall in exports due to cutbacks in U.S. government expenditures in 1949, led directly to the imposition on

² The major reference for this section was the excellent study on Philippine foreign trade regimes by Robert E. Baldwin, *Foreign Trade Regimes and Economic Development: The Philippines* [1], a country study conducted under the auspices of the National Bureau of Economic Research and part of the Conference Series on Foreign Trade Regimes and Economic Development. Another important reference was that of John H. Power and Gerardo P. Sicat, *The Philippines: Industrialization and Trade Policies* [12].

TABLE V
COMPOSITION OF PHILIPPINE IMPORTS, 1949-68

Import Category	1949-68					
	1949	1951-53	1955-57	1959-61	1963-65	1967-69*
Producer goods:	62.7	76.8	81.7	86.1	83.9	87.9
Machinery and equipment	9.9	9.1	11.0	19.7	17.4	19.9
Unprocessed raw materials	1.0	1.6	4.2	10.4	15.4	13.1
Semiprocessed raw materials	41.6	48.0	51.3	45.8	45.9	50.2
Supplies	10.1	18.0	15.2	10.2	5.1	4.5
Consumer goods:	37.3	23.2	18.3	13.9	16.4	12.1
Durable goods	2.5	1.6	1.3	0.8	1.0	1.1
Nondurable goods	34.8	21.6	17.0	13.1	15.4	11.1

Source: [12, p. 39, Table 2.4].

* First half of 1969 only.

December 9, 1949 of foreign exchange controls covering all types of international transactions. The following year (in May 1950), an Import Control Act (RA 426) was passed with clear emphasis on inducing import-substituting production. The law involved import licensing according to "essentiality." Quotas were slapped on imported nonessential commodities, cutting them down to 60-80 per cent of their 1946-48 levels, while luxury goods were slashed by as much as 80-90 per cent. The result was a drastic change in the composition of imports as shown in Table V.

The import-substituting objective was evident from the stipulation that required the Import Control Board to impose the maximum percentage cut for the given category on any imported commodity whose domestic production was deemed by the Secretary of Agriculture and Commerce sufficient to meet local demand (Baldwin [1]). The potentially perverse effect which apparently was not perceived at the time consisted in the stimulation accorded to the flow of investment into the areas where the domestic price most exceeded their international prices, namely, in the most restricted sectors of luxury and nonessential commodity imports. Nevertheless, this trade-restrictive, import-substituting policy is considered by analysts as the single most potent instrument which spurred the country's industrialization at this period. Until the first half of the 1950s, the manufacturing sector was clearly the leading growth sector of the economy,³ posting average yearly growth rates (in terms of physical volume of production) of 13.55 per cent (Table VI).

The expiration of the Import Control Act in June 1953 and its failure to win congressional extension shifted the burden of the import controls on the Central Bank which was in charge of administering foreign exchange controls, but the objective of the import-substituting strategy remained essentially intact. The drastic change in the composition of imports that took place in 1949-50 in the

³ In fact Table VI shows a higher average annual growth rate for the same period for mining, but this 14.13 per cent average yearly growth hides the negative growth rates of 1952-53 and 1953-54, while that of manufacturing had been consistently positive and high, at least until 1956.

TABLE VI
AVERAGE ANNUAL GROWTH RATES OF PHYSICAL VOLUME OF PRODUCTION, 1949-70
(%)

Year	Agriculture	Mining	Manufacturing
1949-55	8.92	14.13	13.55
1955-60	3.87	5.05	8.59
1960-65	5.36	3.71	5.96
1965-70	4.99	12.43	4.93

Source: [8, 1970].

direction of producer goods imports did not guarantee a reduction in the total value of imports. In fact imports grew at an average annual rate of 10.06 per cent in contrast with a 4.12 per cent yearly growth for exports during the period 1950-57. Because of the generally import-dependent nature of the import-substituting industries fostered,⁴ and given the shortfall in export receipts in 1956-57, the trade account position worsened to an unheard-of degree since 1949. The ensuring monetary restraint and tighter foreign exchange controls (exemplified by the imposition of marginal reserve requirement on letters of credit of up to 100 per cent of value of nonessential imports) and the more fundamental problem of limited domestic demand expansion, put a sudden brake on the short-lived acceleration of manufacturing sector growth during the first half of the 1950s.

The fundamental disequilibrium in the balance of payments position of the country meant overvaluation of the peso, and hence a disincentive to export growth. Note the relatively low and erratic growth of export value and volume especially during the second half of the 1950s (Table VII). The traditional exports, not to mention any potential manufactured exports, were thus penalized. Major pressure on the government to correct the exchange rate in the ensuing devaluations of the 1960s thus came from the exporters of traditional products which at the time accounted for 90 per cent or more of total exports.

The tariff policy embodied in the Tariff Code of 1957⁵ reinforced the import-substituting effect of the foreign exchange control policy on domestic industries, including the possibly perverse effect on industry choice. This is because of the similar "essentiality" criterion employed in determining the height of tariffs as well as their increases. Duties were reduced on essential consumer and essential raw material and producer goods whose domestic supply was not considered forthcoming in the near future, while they were raised for nonessentials and other goods whose possibilities for substitution were considered promising. The simple average of duties thus climbed from 23 per cent in 1949 to 36 per cent in 1957, while differentials in average (nominal) tariff rates for different categories of products became pronounced, ranging from 15 per cent for highly essential goods to 30 per cent for nonessential producer and 30 per cent for nonessential

⁴ This seemingly paradoxical situation was observed in several other developing countries which had adopted a purely import-substituting industrialization strategy. See, for instance, Carlos E. Diaz-Alejandro [9].

⁵ For a fuller discussion, refer to Baldwin [1, pp. 40 ff.].

TABLE VII
TRADE INDICES, 1950-70

(%)

Year	Quantum		Price		Value	
	Imports	Exports	Imports	Exports	Imports	Exports
1950	54.5	41.4	78.1	106.1	42.5	44.0
1951	68.1	46.4	88.1	113.2	59.9	53.2
1952	61.7	51.7	87.8	89.2	53.6	45.9
1953	68.2	48.4	82.8	108.9	56.5	52.7
1954	75.4	53.7	79.2	96.6	59.6	52.0
1955	85.4	58.6	79.2	88.6	67.7	51.9
1956	78.6	65.4	80.3	89.9	63.2	58.8
1957	93.2	61.4	82.9	91.1	77.2	55.9
1958	82.3	67.7	84.8	94.8	69.8	64.3
1959	74.5	67.2	86.5	102.7	64.4	69.0
1960	82.4	72.2	88.4	101.2	77.8	73.0
1961	84.5	69.8	89.7	93.1	75.8	65.0
1962	80.0	76.5	91.4	94.0	73.1	72.1
1963	78.6	95.1	97.5	99.1	76.7	94.2
1964	97.3	97.4	98.3	98.8	95.6	95.8
1965	100.0	100.0	100.0	100.0	100.0	100.0
1966	106.4	106.0	101.6	100.9	108.1	107.2
1967	126.7	102.3	103.9	102.7	131.7	105.1
1968	138.8	103.8	103.3	107.9	142.9	112.0
1969	132.4	100.4	105.9	109.8	140.1	110.2
1970	118.1	114.8	115.2	120.5	135.6	137.8

Source: [8, 1970].

consumer goods (Baldwin [1]). Moreover fiscal incentives under the New Tax Exemption Law (passed in 1953) tended to strengthen the import-substituting character of the industrial strategy, again with potential built-in biases in favor of nonessential consumer good production.⁶

Up to this point in time therefore trade and industrial incentive policies of government had been essentially inward-looking, with its consequent bias towards domestic as against export market sales. Currency overvaluation retarded the growth of the traditional exports with little processed content, and manufactured exports were penalized vis-à-vis their foreign counterparts to the extent that tariff policy made their raw material inputs relatively more expensive, whether originating from foreign or from domestic sources.

Baldwin's estimates of implicit protection under the system of foreign exchange controls of the 1950s demonstrate higher rates, on the average, for nonessential consumer goods (297 per cent) and much lower rates (70 per cent) for essential consumer goods. His measures of effective protection rates for the period again show that the incentive system was biased in favor of import-substituting non-essential consumer goods, followed by nonessential producer goods, semiessential

⁶ The nonessential consumer goods producing enterprises topped the list of enterprises belonging to tax-exempt industries classified by essentiality of their products in 1957. See Baldwin [1, p. 43, Table 2-8].

consumer goods, and semiessential producer goods. Like essential consumer and producer goods, traditional exports were receiving negative protection during the period, although "new exports" did enjoy positive inducement, due presumably to the subsidies given to "new and necessary industries."

Foreign exchange liberalization started in earnest in April 1960 with the introduction of multiple exchange rates. A P2 per dollar rate, plus a 25 per cent margin fee for purchase of foreign exchange, was applied to essential and semiessential consumer and producer goods as well as decontrolled items (or an actual P2.5 per dollar rate) while all other import transactions were quoted at P3.2 per dollar rate plus a 25 per cent margin requirement (or effectively P4.00 per dollar). The second phase of the decontrol was started later during the year (November) when some changes were made in the proportion of foreign exchange that could be obtained at the given rates. Some penalty remained on exports, only one-half of whose proceeds could be exchanged at the "free market rate" and the other half at the official P2.00 per dollar rate. Further decontrol was effected in 1961 with currency depreciation for buying and selling transactions. The margin requirement was lowered from 20 per cent to 15 per cent so that the actual "free market rate" was about P3.45 per dollar. Up to 75 per cent of export proceeds could then be exchanged at P3.00 per dollar. Liberal monetary policy was pursued to ease the adjustment burden on producers as well as to encourage the free play of the market mechanism.

Finally on January 21, 1962, full exchange decontrol was enacted. It abolished decontrol order licenses but required letters of credit on imports accompanied by special time deposits, the amount of which was determined according to essentiality of the imports under question, ranging from 25 per cent for decontrolled, essential consumer and producer goods, and up to 150 per cent for unclassified items (UI) and nonessential consumer goods. The peso was floated in the free market and eventually stabilized at the P3.90 per dollar rate, at which rate the peso was finally devalued in November 1965. It was only with such unification of the exchange rate that the penalty to exporters originating from the currency overvaluation was eliminated. However, penalty originating from the tariff policy side remained.

To ease the possible adverse effects of the devaluation on domestic industries, tariff and industrial incentive policies were both revised: in January 1962 tariffs on about seven hundred commodities were raised for protection purposes, while other protective measures were imposed later. The Basic Industries Act (RA 9172) was enacted in 1961 granting fiscal incentives, notably in the form of exemptions from tax and import duties on machinery, spare parts, and equipment imports.

Nevertheless manufacturing growth further decelerated (Table VI). On the other hand, export growth in both value and quantum terms was rather impressive, demonstrating the responsiveness of exports to exchange rate changes. An average yearly growth rate of manufactured exports rose from 6 per cent to 7.9 per cent between 1956-61 and 1962-66, while nonmanufactured export growth rates were even higher.

IV. TRADE AND INDUSTRIAL POLICY IN THE 1970s

A definite shift to export promotion was observed in the decade of the 1970s. The official exchange rate stayed "put" at the P3.90 per dollar rate until the floating in February 1970. The float was adopted upon pressure from the IMF and the country's major creditors as a condition for a third credit tranche and a restructuring concession on maturing debts. By year-end the peso-dollar rate had moved to a P6.4 high, while fiscal and financial retrenchment policies were under way. In spite of the fact that only 80 per cent of export proceeds could be exchanged at the new rate (this dual rate was later replaced by a "stabilization tax" at an ad valorem rate of 8-10 per cent for traditional export products) export growth between 1969 and 1970 proved remarkable, with a 25 per cent growth of the export value index and a 14 per cent growth on the quantum index.

The boost to export growth was reinforced on the industrial policy side with the enactment of the Export Incentives Act of 1970 (RA 6135) granting fiscal incentives to export-oriented establishments. But more importantly the act gave an explicitly outward-looking dimension to a hitherto import-substituting industrial promotion strategy.

Between the first and second official devaluations (that is, between 1965 and 1969), the effective exchange rate (EER)⁷ for traditional exports was estimated by Baldwin to have been equal to the official exchange rate of P3.90 per dollar. The rate for new (i.e., nontraditional) exports was P4.13 in 1965, rising to P4.17 two years later (with the enactment of the Investment Incentives Act in 1967). It further moved up to P6.54 in 1970 and P7.26 in 1971, reflecting the combined impact of the devaluation, and the additional incentives under the Export Incentives Act of 1970. Thus the rates for nontraditional exports were 26.99 per cent and 26.04 per cent higher than those for traditional exports for 1970 and 1971 respectively. In terms of exchange rate adjusted for purchasing power parity⁸ (i.e., EER multiplied by the ratio of the U.S. to Philippine wholesale price indices) nontraditional exports enjoyed PPP-EERs in 1971 which were about 25 per cent higher than those for traditional ones. Since then the nominal exchange rate had "floated" from P6.4 in 1970 to P7.44 in 1976 and up to P7.62 in 1980. Given however the double-digit inflation rate of the 1970s it meant an erosion of the real exchange rate over the decade. The index of real exchange rate constructed by Bautista [3] for the period showed a decline of the 1970-based index from 100 per cent to 71.8 per cent in 1979, coming down

⁷ Effective exchange rate (EER) is defined in Baldwin [1] as the number of units of local currency actually paid or received for a one-dollar international transaction. Surcharges, tariffs, the implicit interest foregone on guarantee deposits, and any other charge against purchases of goods and services abroad are included, as are rebates, the value of import replenishment rights, and other incentives to earn foreign exchange for sales of goods and services abroad [1, p. 157].

⁸ Purchasing-power-parity-adjusted exchange rates (PPP-ER) are defined as the relevant (nominal or effective) exchange rates multiplied by the rates of the foreign price level to the domestic price level.

to a low of 61 per cent in 1977. Nevertheless the nominal increases in the exchange rate reinforced by the incentive system had served to quicken the pace of exports, particularly of the nontraditional manufactured type, effecting the structural shift discussed in an earlier section. The quantum index of exports for the decade rose yearly by an average of 9.39 per cent compared with the 5.56 per cent growth from 1962 to 1970.

In spite of the export orientation reflected in exchange rate and industrial promotion policies, the structure of protection accorded by tariff policy remained basically inward-looking. Power's estimates for 1965 show that after sugar, consumption goods industries were relatively the most protected, capital goods (machinery only) the least, while exports (excluding sugar) were not only not receiving any encouragement, but were also being penalized as attested to by the -19 per cent effective protection rate. Although the tariff policy was reformed on January 1, 1975, the reform apparently did not change substantially the observed 1965 structure of protection (Tan [15]). On the average, EPRs accorded to manufacturing were somewhat reduced; that for consumer goods increased, receiving therefore (as in 1965) substantially higher protection than the intermediate goods sector, inputs to construction, capital goods, and exports. Moreover the inclusion of subsidy rates accorded by the incentives available under the Investment Incentives and Export Incentives acts, while raising the EPR estimates somewhat (i.e., by a 3 percentage points rise), did not change, except for a few, the basic EPR ranking of industries.

The general picture that emerges from the above discussion is that while foreign exchange, trade, and industrial incentive policies in the seventies had taken an unmistakable shift toward export promotion, they had stopped short of completely eliminating the biases against export sales. Thus one may reasonably speculate that while nontraditional manufactured exports, which had benefitted from the different incentive schemes, managed to score substantial gains (and this in spite of the two oil crises and the doldrums in world demand), they might have achieved even more impressive growth had the incentive system been kept at least *neutral* between domestic and export sales.

In addition, the overall industrial strategy did not seem to have scored high in terms of other objectives. Full employment remained an elusive goal as the manufacturing sector growth did not adequately generate enough jobs to absorb the swelling labor force: its share of total employment remained more or less constant at 12 per cent [4]. Moreover the pattern of exports, at least until the 1970s, did not clearly reflect the labor-surplus character of the country's factor endowments. There was evidence that capital-intensive technological choices were favored as large-sized establishments grew faster than small and medium-scale ones. Industrial concentration in the cities, particularly in the Metro Manila area was hardly eased. After three decades of industrial growth, income disparities at the regional and personal income levels were left disappointingly wide.

To what extent was the failure to achieve the multiple objectives of development related to possible "built-in biases" (towards capital intensity, import de-

pendence, etc.) contained in the trade and industrial promotion packages themselves? Indeed, how relevant were these policies to the private business sector's investment, production, and export decisions? It is to these questions that we turn our attention in the following section.

V. PRIVATE SECTOR PERCEPTION OF AND RESPONSE TO TRADE AND INDUSTRIAL PROMOTION POLICY

One important albeit gray area in the study of economic policy is its evaluation from the vantage point of the sector it is designed to influence, namely, the private business sector. Oftentimes policy is almost single-handedly drawn up by bureaucrats who are more or less in touch with business and economic realities, with seemingly little attention given to its relevance as perceived by the business sector. Such oversight however can have important implications on the degree of effectiveness of policy in achieving its specific objectives. For in the final analysis the success of any policy package will depend upon the degree of importance or relevance attached to it by the affected parties, and hence their degree of availment of the incentives offered. As will be shown in the following section, the failure to achieve certain policy goals may have been the direct result of the limited relevance of certain provisions of the major incentive laws, as well as the limited scope of incentive availment due to the high transactions costs involved in availment.

In this section therefore we turn our attention to the possible extent and direction of influence of the country's trade and industrial incentive (or disincentive) system on private sector investment, production expansion, and export activity. For this purpose a survey of industrial establishments was conducted⁹ for the following industries: pulp and paper, capital goods, car and car parts manufacturing, leather and leather goods, and wood industry. The core section of the survey consisted of questions probing the respondent firms' reactions to specific and general policies which may have affected their decisions on investment, expansion, and exportation. A checklist of the major incentives available under the different incentive laws was provided, and so was a list of government policies or regulations which may have discouraged firm investment and other decisions. In the case of the incentives, the respondents were asked which of them have been availed of, when and how much, how significant they were to the firm, why certain incentives were not availed of. In a similar fashion, the disincentives list had to be ranked in order of significance with regard to deterring the firm's activity. Follow-up questions were asked as to the effect of the with-

⁹ Although the survey was conducted in April-June 1978 (for details, see G. R. Tecson, "Some Effects of Industrial Promotion Policies on Selected Manufacturing Establishments," University of the Philippines IPPP Working Paper No. 24 [1979]), we consider the results relevant as an example of a firm and industry-level evaluation of industrial policy prior to the policy reform of 1980. As will be noted in reading the section on policy reform, a number of the conclusions of the survey appear to tally with the problem areas addressed to by the reform.

drawal of such incentives or disincentives on the firm's business operations. To determine the firm's own perception of the industrial policies most responsive to actual needs, inquiry was made as to the revisions in government policy they deemed would effectively influence their decisions on different stages of their manufacturing activity. The pervasive influence of the Board of Investments (BOI) via the incentives offered under the two major incentive laws, the Investment Incentives Act (1967) and the Export Incentives Act (1970), warranted inquiry into the registered firms' perception of and response to such incentive packages. Embodying the multiple objectives of the incentives laws, the sixteen incentives presented to respondents for assessment related to the use of capital, labor, material inputs, the promotion of exports, and regional dispersal of industries.

A. *Significance of Incentives*

There is a striking convergence of opinion on the importance of tax exemption on capital equipment as the most important promotional policy, having been ranked first by the pulp and paper industry and the capital goods industry, and second by the wood and car and car parts manufacturing industries, ranked next to accelerated depreciation and export tax exemption respectively (Table VIII). Further evidence of its importance to BOI-registered firms, relative to other incentives, can be seen from the distribution of the amount of incentives availed of in 1970 and 1975 (Table IX). More than four-fifths of total exemptions availed of in that year is represented by exemptions from compensation tax and customs duties on imported capital equipment and the incentive's relative importance seemed to have increased, relative to its share in 1970.

A comprehensive investigation of the theoretical impact of incentive legislation in the Philippines was conducted by Gregorio [10]. Quantification (by simulation analysis) of the effect of tax exemption on imported capital equipment was shown to raise a firm's rate of return by 2 percentage points and to reduce its user cost of capital by 15 per cent. What is not immediately obvious is why this incentive is ranked before others that are theoretically more potent in their ability to raise profit rates or reduce cost. For instance, a tax credit on *domestic* capital equipment is also available and from a priori considerations tends to improve the firm's rate of return by 3 percentage points and reduce its user cost of capital by 18 per cent. Yet this incentive had been consistently classified as "insignificant" by respondent firms. Table IX further indicates its insignificance relative to total availments.

The explanation lies obviously in the fact that the net marginal benefit derived from availment of tax exemptions and/or deductions depends primarily on the existence of a tax liability related to the value of the factor input being promoted by the incentive and varies directly with the absolute amount of such liability. Thus the greater significance attached to the tax incentive on imported capital equipment implies the existence of a much greater tax liability relative to that on domestically-produced capital equipment. In turn this merely reflects the industries' substantially greater dependence on foreign sources of capital equip-

TABLE VIII
BOI INCENTIVES RANKED IN ORDER OF SIGNIFICANCE TO SELECTED
MANUFACTURING INDUSTRIES, 1977

Incentive	Pulp and Paper	Capital Goods	Car Manufacturing	Wood
Accelerated depreciation	5	2		1
Tax exemption on imported capital equipment	1	1	2	2
Tax credit equivalent to the compensating and sales tax and duties on imported inputs	4	3	5	
Tax credit equivalent to the sales tax and specific taxes on locally produced inputs	2			
Deduction for use of labor and cost of domestic materials	4			
Deduction for labor training expenses	5			
Net operating loss carry-forward	3		3	3
Tax deduction of organizational and pre-operating expenses			4	4
Deduction for expansion investment	4			4
Export tax exemptions			1	
Preference for obtaining private or government credit	4			
Tax credit for withholding tax on interest paid abroad				4
Employment of foreign nationals*				4
Tax credit on domestic capital equipment				
Income tax credit for a new brand name				
Tax credit for regional dispersal			6	
Tax deduction for regional dispersal			6	

Source: Industry Survey. For details of the survey see footnote 9 of text.

* Included in the wood industry survey only.

ment,¹⁰ given the underdevelopment of an indigenous capital goods sector. The latter in turn may have been perpetuated by the insufficient promotion accorded to the capital goods sector arising from the biases of the tariff policy earlier discussed as well as the continued incentives given to the imports of the so-called "essential producer goods."

Turning now to the incentive on labor utilization, one can infer the relative ineffectivity of incentives designed to encourage greater use of labor from the lower ranking given to the "deduction for labor training expenses" and to "deduction for use of labor cost and cost of raw materials in export production." Tax deduction for labor training expenses represented less than one-fifth of 1 per cent of total deductions availed of in 1975. The theoretical impact of such labor-related incentives has been found by Gregorio to bring about an estimated decline in the availing firm's wage bill of only 3.5 per cent, in stark contrast to the decline in user cost of capital for accelerated depreciation and for tax exemp-

¹⁰ Imports of capital goods represented about a third of the country's import bill during the decade of the 1970s.

TABLE IX
INCENTIVES AVAILABLE OF BY BOI-REGISTERED PROJECTS UNDER RA 5186
AND RA 6135, 1970 AND 1975

Incentives	1970		1975*	
	Amount	Percentage Distribution	Amount	Percentage Distribution
Tax exemptions:	31,906	100.00	335,229	100.00
Compensating tax and customs duties on imported capital equipment	18,410	57.70	285,698	85.22
Compensating tax on raw materials importation	1,154	3.62	29,598	8.83
Sales tax on pioneer enterprises	12,342	38.68	11,702	3.49
Export tax			8,231	2.46
Tax deductions (25% corporate tax):	35,294	99.99	117,596	100.00
Net operating loss carry-over	1,861	5.27	191	0.16
Expansion reinvestment	27,379	77.57	76,883	65.38
Additional deduction for labor training expenses			188	0.16
Reduced income tax			8,028	6.82
Accelerated portion of organization and pre-operating expenses	2,164	6.13	1,760	1.50
Accelerated portion of depreciation charges	1,007	2.85	30,546	25.98
Double deduction of promotional expenses	144	0.41		
Double deduction of shipping costs	2,739	7.76		
Tax credits:	2,019	100.00	n.a.	n.a.
Equivalent compensating tax and customs duties for purchase of domestically produced capital equipment	982	48.64	n.a.	n.a.
Interest withheld on foreign loans	124	6.14	n.a.	n.a.
Sales tax on raw materials supplies of exports	913	45.22	n.a.	n.a.

Sources: Board of Investments, *Statistical Appendix to the Fourth Investment Priorities Plan (1971)*; idem, *Statistical Appendix to the Ninth Investment Priorities Plan and the Seventh Export Priorities Plan (1976)*.

* Including those registered under RA 6135.

tion on imported capital equipment (both encouraging greater relative capital use) of 14 per cent and 15 per cent respectively. Moreover the labor-related incentive is available only in the year the incentive is claimed and at most up to five years, while the cost-reducing effects of the capital-related incentives are a "once-for-all" change effective for the whole life span of the capital equipment involved. The above indicates the strong capital-intensity bias of the incentive package which may have led to the choice of technologies inappropriate to the labor-surplus character of the country, ultimately working against the objective of

employment generation. Such a bias may have also spawned the growth of large-sized establishments at the expense of the generally more labor-using small and medium-sized ones.

One important objective of the industrial policy package is the deconcentration of industrial activity from Manila and the major cities for purposes of sharing the benefits of growth more widely. However the incentives addressed to the problem of industrial concentration, i.e., the tax credits or deductions for regional dispersal, elicited a "significant" vote from only one respondent firm. A similar finding is underscored in a study of Moran [11] on the impact of regional policies on the location choices of manufacturing firms. In the study, the author reports that government policies on regional dispersal did not come out as significantly as market and raw material factors as determinants of location choices of paper and textile manufacturers, in spite of the rather high degree of awareness of such incentives among the sampled firms. Moran argues that this might have been because in cases where the available tax deduction (which is equal to the sum of the local raw material cost and twice its direct labor cost) exceeds 25 per cent of the export revenue, the subsidy received will be, at most, minimal. With regard to the other incentive which is in the form of a tax credit equivalent to 100 per cent of the amount of infrastructure works undertaken by the firm, locating in an infrastructure-needy area may raise a firm's initial outlay unduly and may create liquidity problems for the firm, making the incentive unattractive to prospective investors who wish to locate in such areas. Thus incentives for regional dispersal seemed almost as unimportant to the sampled firms as tax credit on domestic capital equipment or the income tax credit for a new brand name.

The tannery, footwear, and leather goods industries merit a separate discussion on incentives because being small and medium in size, there is a predominance in the sampled establishments of registration under the National Cottage Industry Development Authority (NACIDA); only three firms in the sampled respondents were registered with the BOI. Given the NACIDA incentives, the three sub-industries (tanning, footwear, leather goods) considered the exemption from percentage tax on sales of their products as their most significant inducement to growth followed by the exemptions from fixed tax on business, and from the privilege tax on business. In contrast with the BOI-registered firms' most preferred incentive, exemption from customs duties on directly imported machinery was not considered significant by any of the NACIDA-registered firms, nor were the exemptions from the compensating and special import tax on directly-imported machinery. This may be reflective of the relatively lower capital intensity, and hence relatively lower dependence on imported capital equipment of this industry, composed as it is mainly of cottage and small-scale establishments.

With regard to the question of the possible effects of withdrawal of incentives, the response was that incentive withdrawal would be expected to result in an increase in costs for the firms, alternatively in a reduction in working capital, due in particular to the rise in tax liabilities. The anticipated effects are a decline in net profits and/or a loss in competitiveness with imported brands.

B. *Non-availment of Incentives*

A number of registered respondents, however, have opted not to avail of the given incentives: four out of six respondents from the pulp and paper industry, three out of the six capital goods manufacturers, two out of the six car manufacturing firms, and one out of four from the wood industry. Further inquiry led to the reason for non-availment. Too much time and expense allegedly went into the preparation of necessary documents, follow-up of papers in government agencies, etc., costs not considered commensurate to the benefits accruing from the incentives. The high incidence of non-availment of incentives by a larger sample of export firms in a survey conducted by Staelin [14] led the author to conclude that the role of financial incentives in the Philippine case is small. It had also been observed by P. Shome and S. K. Woo [13] that the legislation regarding tax incentives in the Philippines seemed to be the most complex compared to those of Thailand, Republic of Korea, and Malaysia, thus leading to high transactions costs. In an attempt to avoid the possibility of decisions resting in the hands of inexperienced bureaucrats, "an extreme measure of non-discretion, resulting in a highly cumbersome set of rules and regulations" had evolved. The problem, they noted, may be more deep-seated than what meets the eye for it might really be a reflection of a lack of a consistent overall plan, as is apparent from the wide fluctuation in incentives received by different industries over time.

C. *Disincentives due to Government Policy and Regulations*

While the incentive packages discussed in the previous section were designed to promote industrial growth, a number of existing policies and regulations might have effectively hampered the growth of the industrial sector or may at least have been perceived by firms as adversely affecting their investment, expansion, or export decisions. A list of such policies is given in Table X where they are ranked according to degree of (the firms' perceived) significance. The wide variation in the firm's ranking may be explained in part by the differences in their degree of vulnerability to these different policies. For instance, a relatively more import-dependent industry will be more vulnerable to tariffs on its intermediate inputs than one which is domestically resource-based or some policies are selective in nature and thus are not applicable to all industries, such as the export restrictions on logs, lumber, and plywood.

Among the more important policies perceived as disincentives to one or other type of firm activity are (not necessarily in order of importance): domestic taxes on outputs, tariff protection on inputs, government intervention on output pricing, minimum wage legislation, margin deposit requirements, import restrictions on inputs, and domestic taxes on inputs. Least disturbing to investment and expansion plans were those regulations related to exportation, namely, export tax, export payment terms, and the quantitative restrictions on exports either through government policy or through foreign collaboration agreements.

Needless to say, the withdrawal of disincentives was welcome to the majority of the firms interviewed, although the pattern and degree of effects would differ

TABLE X
DISINCENTIVES RANKED IN ORDER OF SIGNIFICANCE TO SELECTED
MANUFACTURING INDUSTRIES, 1977

Government Policy	Pulp and Paper	Car Mfg.	Capital Goods	Leather and Leather Goods	Wood
Minimum wage	7	2	4	4	6
Tariff protection on inputs	3	1	1	3	
Import restriction on inputs	5			5	
Domestic taxes on inputs	4		5	2	
Domestic taxes on output	2	2	3	1	8
Government intervention on output pricing	3		3		3
Margin deposit requirement	1		2	4	
Foreign exchange quota	4	3			
Export tax	6				5
Export payment terms	3				
Export restriction by government	6				4
Export restriction due to foreign tie-up					
Premium duty					7
Real property tax					1
Freight and shipping rates					2
Forestry charges and fees					5
Development tax					6

Source: Same as Table VIII.

across firms. The favorable effects were of course related to the easing of the financial burden caused by policy: the lowering of tariff rates on imported inputs will reduce their production cost (capital goods, wood industry), thus raising profit margins (capital goods, pulp and paper) and augment working capital (pulp and paper). This can also lead to a greater share of the market due to the downward adjustment in the selling price of final output (capital goods) and increase in working capital as funds would no longer be unnecessarily tied up in the 30-35 per cent marginal deposit on LCs at the time (pulp and paper).

To what extent did tariff and nontariff barriers act as incentives to the establishment and growth of certain industries? Vigorous opposition can be expected to a reduction in protection by the lowering of tariff barriers to respondent firms' competing imports, primarily from the capital goods and car and car parts manufacturers, many of whose establishment and subsequent expansion decisions were claimed to have been induced by the protection policy. In contrast, the footwear and leather goods manufacturers did not expect to be adversely affected by the possible dismantling of controls on competitive imports, unaware as many of them were even of the existence of such controls. On the other hand, the tanneries signified the important role played by such barriers in their establishment and expansion plans.

D. *Export Incentives*

On the role of export promotion policy in inducing exports, the respondents

were generally in agreement that there were no government policies that had discouraged them from exporting. However, some car and capital goods manufacturers pointed out the fact that the administrative requirements and documentation process involved in exporting were creating a hindrance to greater exportation on their part. The exporters among the car and capital goods firms would most probably not have exported in the absence of such export incentives and would generally tend to refrain from exporting once these incentives are withdrawn. In contrast, since the majority of the pulp and paper and leather and leather goods exporters claimed that they had exported even in the absence of export incentives, future decisions on exportation would generally not be affected adversely even with the withdrawal of such incentives.

Enlightening were the reasons cited by firms for *not* exporting. These are areas to which future export promotion policymakers may fruitfully address themselves. Aside from financial problems, firms that did not export felt that the style, quality, and design of their products could not meet export standards, or that they lacked the marketing expertise to sell in export markets, or simply that they had no foreign contacts and thus were waiting for an information drive that would provide such information. These suggest that problems related to quality upgrading as well as distribution and marketing techniques were considered by firms as real barriers to export expansion and that failure to export was not necessarily stemming from a lack of interest or the mere desire for a "quiet life" sometimes suggested by developing-country observers. Thus the incentives suggested by the respondent firms were directly related to what they considered as export barriers and may well be attended to by policymakers in the reform of the industrial promotion package. They were as follows: A pulp and paper manufacturer suggested that a government agency be set up to aid industries in improving the quality of products and in finding outlets for them. Footwear manufacturers expressed the desire for an intensive information drive on foreign markets to bring them into contact with buyers and to disseminate information on the process of exporting. Others suggested additional incentives, such as duty drawbacks on fuel used in the manufacture of exports products or more benefits on the use of local inputs for export production.

To summarize, judging from the foregoing survey results, there is indeed reason to believe that certain policy-determined barriers stood in the way of achieving some of the goals of development policy. The capital-intensive bias of the policy package was confirmed by firms' strong preference for the incentives which were of a capital-cheapening nature, namely, tariff exemption on imported capital equipment and accelerated depreciation. In contrast, the labor-related incentives were found to be too weak in terms of incentive impact vis-à-vis the capital-related ones, and were apparently perceived so by the surveyed firms who ranked the former consistently low in promotional significance. On both counts the incentives might have been running at cross-purposes with the objectives of employment generation and promotion of more labor-intensive technology choices appropriate to the country's presumed comparative advantage position. This in turn might have had important implications on the objective of a more equitable

sharing of the fruits of growth. The expected disincentive effect of tariffs on inputs was also pointed out by some respondents but so were the disincentive effects of disparate taxes on domestic inputs and final output, of price controls, and of minimum wage legislation. Moreover the incentives bearing on the objective of sharing the benefits of industrial development with the rural populace, namely, the incentives on industrial relocation away from the Manila area and the major Philippine cities, was widely considered insignificant, as were other minor incentives such as the income tax credit on a new brand name. Among the more disturbing findings however was that an important segment of the manufacturing firms might not in fact be availing of the incentives due to the high transaction costs of availment relative to benefits accruing from them.

In the light of the weaknesses of the industrial protection and promotion policy system outlined above, its reform became the major item on the agenda of industrial policymaking for the decade of the 1980s.

VI. POLICY REFORM IN THE 1980s

An intensive and extensive examination of existing policies was conducted at both academic (of which the above survey was a part) and government levels towards the end of the 1970s, leading to the formulation and adoption of a comprehensive structural adjustment program for the 1980s. In the following sections, we shall discuss the main features of the policy reform.

As was pointed out in previous sections, the protective policies built up during the two decades of import substitution phase had retained some of the institutional biases against increased manufacturing sector growth and manufactured export expansion. Thus the first target of policy was trade liberalization which consisted in the reform of tariff and internal (indirect) tax system.

A. *Liberalization and Industrial Restructuring*

A comprehensive program of restructuring of the tariff system (including nomenclature) had been set into motion, lowering peak nominal rates to 50 per cent and effective rates of protection in the manufacturing sector from 44 per cent to 29 per cent. In order to avoid excessive shocks to the affected industries, the tariff-dismantling activity is being conducted over a five-year period (that is, ending in 1985) and consists of four phases: phase I involves the lowering of peak rates; phase II, the tariff reform in the food processing, textile and garments, leather and leather products, and pulp and paper; phase III, tariff reform in ten other manufacturing sectors; and phase IV, tariff reform in the residual sectors. Annual decreases in average codal rates are targeted to go down by 28.03 per cent by 1985. Because of the historically higher rates of nominal as well as effective protection accorded to consumer goods production, tariff adjustment is envisioned to be relatively greater in this sector, with effective protective rates expected to decline to 43.2 per cent by 1985, compared to 115 per cent in 1980. On the other hand, presently lower nominal tariff rates are scheduled for across-the-board increases in order to effect greater uniformity in

the protective structure. For this a 10 per cent nominal rate will be used as a guideline rate for future tariff realignment. It goes without saying that some safeguards are available (such as import quotas) in cases of serious dislocation in industry due to the policy changes. The burden of proof however lies on the affected parties, and evidence to this effect will be closely examined by the Tariff Commission.

Next, because of the protective effect of some indirect taxes, the internal tax system is also being slated for reform for consistency with the tariff realignment program. The advance sales tax will be eliminated by January 1, 1985 and will be replaced by a second-stage tax, levied equally on domestically produced and imported products. Moreover differentials in excise tax rates are also scheduled to be equalized. The reform will, as in the case of tariffs, be implemented gradually and phased over a given period of time to allow domestic industries to adjust accordingly, presumably in the direction of cost rationalization and increased competitiveness.

Nontariff barriers, in the form of import licenses, will also be substantially lowered, as a complement to the tariff and indirect tax system reform. Thus existing import licensing procedures will be gradually liberalized over a period of three years starting 1981. In 1981, 264 items from an original list of 1,300 banned items had already been removed. At the time of this writing 873 items have already been liberalized, after the implementation of the first and second phases. A plan has also been adopted for the phasing-out of import restrictions on items that are not covered by import licensing procedures and is scheduled for implementation after the third phase of the import licensing liberalization.¹¹

It is recognized however that such reform of the protection system will not automatically lead to the sudden revitalization of certain industries and firms which have long been operating under protected market conditions. In fact the reform is expected to create adjustment problems for domestic producers, so that a positive and deliberate policy of revitalization and rationalization of affected industries and firms is called for. As an example of such "positive" adjustment measures, the textile industry was chosen among the first industries to be modernized under a \$450 million program (financed partly by the World Bank). Moreover, the cement industry is also being rationalized, and conversion to coal-fired machinery for seventeen designated firms is expected to be completed by this year. Studies are under way for other industries that are on the liberalization list to grant them support measures, especially in the form of needed financial assistance, enabling them to adopt the necessary rationalization measures to stand up to greater competition from imports.

B. *Major Industrial Projects*

It has been pointed out earlier that the protection and industrial promotion

¹¹ In order not to dislocate domestic industries, however, the government keeps close watch for any undue effects of the import liberalization program through a monitoring system and keeps the right to halt the flow of excessive imports that may be prejudicial to the interest of domestic firms and industries.

system apparently had worked against the adequate development of the intermediate and capital goods sector. Presumably to correct this structural weakness, eleven capital-intensive,¹² major industrial projects have been singled out for development within the decade of the eighties, intended to create internationally competitive industries for capital and intermediate goods production. They are envisioned by policymakers to induce the development of downstream labor-intensive industries as well as to upgrade the technological capabilities of the country. The designated projects are: copper smelter, phosphate fertilizer plant, diesel engine manufacturing, cement industry rationalization, coco-chemical plant, aluminum smelter, integrated pulp and paper, petrochemical complex, heavy engineering industries, integrated steel project, and alcogas distillery. At present the projects are in different phases of implementation.¹³

C. *Amendments to the Investment Incentives Code and Export Promotion Policy*

Complementary to import liberalization, reform of the investment incentive scheme as well as the export promotion policy is currently being undertaken to effect a transformation of the economy into a truly outward-looking one. Early in 1983 the National Assembly passed a New Investment Incentive Policy Act, modifying the present system of granting investment incentives to both local and foreign investors. An important feature is the emphasis given to export orientation of the availing units, in the form of new tax credits on direct exports and the reduction of refund obligation on tax credits by exports. Two new tax credits were also made available, one based on net local content and the other on net value added, presumably to link incentives to productivity measures. The use of net value added as a criterion for incentive availment was justified by government spokesmen as rendering the incentive system "neutral" as to factor use. In line with this neutrality objective, the past incentives on accelerated depreciation and the tax deduction on labor training expenses were withdrawn. Another important feature of the new act is the article relating to "criterion in investment priority determination" requiring that "the determination of preferred areas of investment to be listed in the Investment Priorities Plan shall be based on long-run comparative advantage taking into account the value of social objectives and

¹² It was recognized by policymakers that the major industrial projects were again supportive of the already existing trend towards large-scale firm promotion and capital intensity in production, both of which run counter to the avowed goals of increased labor absorption and the promotion of labor-intensive manufactured exports. Thus the promotion of small and medium-scale industries had been adopted as an important, albeit less publicized component, of the country's industrialization strategy for the 1980s. The policy consists (among other things) of financing, technical and market assistance, entrepreneurial development, appropriate product, and technology development for small and medium-scale firms.

¹³ The aluminum and petrochemical plants are presently considered of lowest priority due to their capital and energy intensity. Others such as the alcogas project have been scaled down, while site preparations for the integrated steel mill is already being undertaken. Moreover evaluation of projected bids for the iron and steel production facilities are under way, while the construction of the copper smelter plant is expected to be completed in the near future.

employing economic criteria along with market, technical, and financial analyses." This provision however depends crucially on the development of suitable measures or indicators of (long-run) comparative advantage for a proper evaluation of priority projects.

Much work remains to be done in the dismantling of bureaucratic red tape in the administration of incentives, which as the survey results suggest, could be a serious barrier to policy relevance. In the area of exports, however, a thorough review of export procedures and documentation requirements was undertaken, and for which an Export Procedures Commission was created to simplify, standardize, and improve present procedures to boost further export activity.

Aside from the greater export orientation being injected into the general thrust of the industrial policy scheme, the export promotion drive is further concretized in a new *integrated export development strategy* which has been drawn up through the cooperative effort of government policymakers and private business. It stresses the deliberate effort at developing specific priority exports of which seven had been initially selected: namely, garments, furniture, electronics, gifts and houseware (handicrafts), footwear and leather goods, fresh or processed food, and construction services. These sectors were singled out on the basis of their recent phenomenal growth, the increasing demand facing them, and their potentials in utilizing the country's comparative advantage in resource-based and labor-intensive production.¹⁴ One of the main features of the strategy is the deliberate policy of the products' sales promotion via trade fairs abroad and improvement in the market information network (for instance by soliciting the services of commercial attachés). This strategy is in line with the practical hurdles involved in export marketing that are faced by domestic firms, alluded to in the survey results, quite distinct from the market distortions that are being corrected by the overall industrial policy reform.

VII. IMPLICATIONS ON INDUSTRIAL GROWTH AND RELATED OBJECTIVES

This paper has reviewed the historical evolution of trade and industrial promotion policy in the Philippines during the postwar period with a view to understanding the institutional forces at work behind the structural shifts observed in the country's export sector, particularly during the decade of the 1970s. It has underlined

¹⁴ The plan which covers five years (1982-87) envisions \$10.81 billion worth of export earnings in 1987 or about double the total (f.o.b.) value of Philippine exports in 1980. Being not only product but also market specific, traditional export market potentials in the United States and Japan have been studied for each product category, but diversification is planned into the growing markets of the Middle East, European, and Socialist countries. Systematic studies on each priority export product have been completed, covering such detailed areas as the supply capabilities of domestic producers, the actual competitors in the field, the present relative position of Philippine products and projected potentials for greater market share, as well as the many actual problems of export expansion (trade restrictions such as quotas, technology and manpower upgrading, product design, raw material supply, financing, etc.).

the responsiveness of exports, especially of the nontraditional manufactured type, to policy and the changes therein. Moreover it has pointed out some of the main weaknesses of the trade and industrial promotion policy of the past, based on the results of analytical evaluation of policy instruments as well as on the findings of a survey of selected manufacturing establishments regarding their perception of the relevance and response to the government's industrial promotion policy package. In the last section the actual reform of the industrialization strategy currently under way has been discussed. While it is rather premature to evaluate the effects of the reforms on the economic variables to which they are addressed, it is possible to point out some of the merits and demerits of the reform and their possible implications on industrial growth and manufactured export expansion.

Probably the single most important policy change that has taken place consists in the commitment of government to promote a more outward-looking industrialization strategy, for which purpose it has embarked upon some drastic and possibly "painful" reforms demanded by such a commitment. Although an early-starter in industrialization vis-à-vis her Eastern and Southeast Asian neighbors, the Philippines appears to have been relatively slow in taking advantage of the existing world demand for manufactured products appropriate to her relative factor endowments. And among the major reasons for this was her failure to reduce early enough and to a sufficient degree the institutional constraints to export expansion. Nevertheless now that there is official endorsement of and active encouragement of a more export-oriented industrialization strategy, the Philippines may well benefit from learning from the mistakes of those who have gone ahead earlier, in particular on the potential pitfalls of excessive export-orientation. It has been recognized since that some NICs may have actually carried their export-promotion strategy too far, leading to some negative marginal benefits from exporting. An unusually high degree of openness and dependence on external markets may also bring about greater vulnerability to external shocks, while aggressive export promotion on the part of some countries has actually brought about trade friction leading to persistent threats and actual cases of increased protectionism. The role of policy for the Philippines therefore seems to be that of further eliminating the remaining policy and institutional constraints to export expansion bred by the purely import-substituting policy of the past. But once these are eliminated, policy has to see to it that a balance is achieved, such that the most efficient economic activities are promoted, whether they are import-substituting or export-oriented. For it must be pointed out that there remains a wide scope for efficient import-substitution in the Philippines, particularly in the intermediate and capital goods sector (Bautista and Tecson [7]). The long-run success of the processed export industries themselves may depend, to a large extent, on the success of a secondary import-substitution drive. Moreover as some studies have shown (Bautista and Tecson [6]) there are some consequences of export activity that may run counter to certain other objectives of development such as employment generation. Hence care must be taken not to "go overboard" so that in getting rid of some of the constraining aspects of

a purely import-substituting strategy, "the baby may not be thrown out with the bathwater." Apparently there are still at present no such visible tendencies towards excessive export promotion. In fact as will be pointed out below, there may remain some biases against exports even after the planned reform is over.

What can be said of the specific aspects of the policy reform of the 1980s? While the tariff reform under the trade liberalization program was an important and bold step in the right direction, it appears that it does not go far enough in reducing the disparities in effective protection across industry groups. As demonstrated by Bautista [2] in his estimates of EPRs under the final phase of the tariff realignment scheme in 1985, although drastic cuts will have been effected in average EPRs, and particularly in the most-protected consumption goods sector, consumption goods will still be receiving the highest protection after the reform, with average EPRs remaining 3.08, 2.20, and 1.75 times higher than those for intermediate goods, capital goods, and inputs into construction (in that order). Bautista also claims that even within the consumer goods sector itself, export industries will generally receive lower protection. This implies the need for further reform in the tariff structure itself, or for the institution of "positive" incentives directed to the intermediate and capital goods sectors as well as to the export sector in order to counteract the possible disincentive effect of the EPR differentials, assuming of course that upstream industry development, together with export industries, is indeed on the agenda of policy. It must be pointed out however that the latter remains a second-best approach.

The industry revitalization and rehabilitation program is intended to be "positive adjustment policy" to promote the creation of internationally viable industries. Care must be taken that such programs do not degenerate into projects that merely prolong the existence of certain industries or firms, when the economy might be better off without them or with less of them. This possibility is not remote, considering the experiences of certain industrial countries where rationalization programs involving government fiscal and financial incentive have been criticized for their failure to eliminate the least efficient and for prolonging the adjustment problems of the industries and firms being rationalized. Thus particular attention must be given to the choice of industries to be rationalized and constant monitoring and evaluation of results be undertaken based upon reasonable, quantifiable targets of policy. It is regrettable that the implementation of the trade liberalization and industry revitalization program has coincided with the world's most serious recession since the 1930s. Business morale is low and the drive for rationalization appears to be weak given the very uncertain future in terms of demand expansion. It is quite understandable therefore that although offered financial assistance (of up to \$150 billion by the World Bank) for the purchase of rationalization machinery and equipments, textile firms have started to reconsider original plans for renovation because of the heavy capital cost burden entailed at the time of still pessimistic demand projections.¹⁵ This should not detract attention from the objective merit of the drive for rationalization. Indeed

¹⁵ *Business Day* (Manila), Sixteenth Anniversary Special Report, March 4, 1983, p. 22.

some of the most successful rationalization schemes in Japan (e.g., in the steel industry) were undertaken during, and even because of, recessionary periods, thus gearing the industries adequately for competition during the ensuing upturn.

On the subject of the amendments to the industrial incentive packages under the Investment Incentives Act and the Export Incentives Act, it must be admitted that it is necessary to conduct an economic evaluation at some analytical depth of the weaknesses and strengths of the policy, particularly as related to the achievements of the objectives of national development. Some preliminary impressions, however, may be cited.

The Investment Incentive Policy Act of 1983 seems to utilize clearer measures of evaluating a firm's eligibility for incentive availment, namely, the firm's contribution to net value added and to the use of local inputs, or to exports, unlike the previous practice of granting the incentives to registered firms with little explicit reference to the economic objectives of the incentives. In the present case, registered firms will have to "earn" the incentives in terms of the above criteria. (For instance, waived taxes and duties on imported capital equipment will now have to be earned from net value earned and net local content or that obligation to refund is reduced by any exports.) This practice makes the objectives to which the incentives are linked more clearly seen, so that the social cost of the incentives availed of (namely, tax revenue foregone, etc.) can be more readily evaluated in terms of the social benefits from increased domestic output or exports. Moreover, some streamlining of incentives has been accomplished with the elimination of incentives generally considered "irrelevant" or hardly ever used by firms such as "additional tax deduction from use of a new brand name." Conspicuous also is the withdrawal of tax exemptions, both direct and indirect. An important capital-cheapening incentive, accelerated depreciation has been removed as well as the deduction for labor-training expenses, presumably in line with the objective of injecting greater "neutrality" in factor use, as seen from the use of the more neutral concept of "net value added" (that is, whether from capital or labor) as a criterion for incentive availment. However the capital-related incentive on tax-exemption/credit on machinery has remained without any "compensating" incentive encouraging labor use, so that it is not clear whether the "neutrality" objective is actually attained.

A more controversial point however is in the use of local content as an alternative criterion to incentive availment. From the viewpoint of economic efficiency, this may be difficult to defend in the light of results of empirical studies on the economic costs of domestic content legislation. A compensating provision to reduce the "penalty effect" on exporters is said to be offered precisely to compensate for this in the form of a "tax credit equal to 10 per cent of net local content on direct exports for five years from date of commercial operation" (extendible for another five years based on incremental exports). Nevertheless the inward-looking, nationalistic objective is difficult to miss.

The capital-intensive nature as well as the uncertain commercial viability of the eleven major industrial projects in the absence of heavy protection have drawn the criticism of a number of economists. It seems that the principal point at issue

is whether the Philippines at this point in time is ready for a shift into heavy industrialization, which the eleven projects appear to represent. And to this question, a clear-cut answer will admittedly be difficult to come by. The same question was raised and rather fiercely debated in Japan in the early 1950s. The private sector entrepreneurs, backed by the MITI, did not wait for the results of the debate but went ahead and resolved it themselves by building the heavy industrial complex that is presently in Japan. We are far from claiming that the Philippines is at a similar stage of development as Japan was in the early 1950s, for heavy industrialization in Japan had its roots in prewar years (albeit strongly linked to military demand). The point is that this question, though difficult to answer, must be carefully considered, especially in the light of other developing country experience (such as that of the NICs) whose recent heavy industrialization projects are encountering no mean problems at present. The problem of limited demand in the domestic market and the possibilities of world demand expansion must be clear-sightedly evaluated, and so must the real potentials of encouraging "downstream linkages" of a labor-intensive nature (as stressed by official pronouncements) in the face of inevitably lower quality and higher cost products at the initial stages of operation. This problem also calls for greater effort at coordination with other developing countries in the region such as the ASEAN (Bautista [3]) where similar heavy industrial projects are being planned or are already being pursued. Moreover the possibilities for complementary relationships and horizontal division of labor with industrial countries and the NICs, especially in the Asia-Pacific region, must be strengthened while at the same time soliciting their help. The fields of technological transfer and manpower upgrading particularly, can become the object of diplomacy as well as of firm-level cooperative action.

The new export strategy that is product-specific and country-market-specific is a concrete approach to export promotion, complementing the reform which is under way to make the overall environment more conducive to export expansion. One of its laudable features is that the industries chosen are labor-intensive, thus generally in line with the objective of increased labor absorption. The projections themselves may appear overly optimistic, although some credibility can be attached to the fact that the hypothetical growth estimates are drawn from the products' growth experience during a period of oil shocks and world recession. Thus the growing optimism about a future world recovery improves their credibility and augurs well for the economy as a whole. It seems important however that the policy strategists adopt a "dynamic" vision, particularly in the choice of products to be promoted, in order to keep pace with the changes in world demand and the structural shifts in the economy including the evolving pattern of its comparative advantage. Some economists have already raised the question of the long-run viability of such a strategy based on a few labor-intensive-manufactured products, considering the protectionist sentiments in the traditional industrial country markets, their technological capability of cancelling developing country comparative advantage in labor-intensive production through computerized production processes, as well as the strong competition among developing

countries for similar light-industry commodity exports. To inject a dynamic thrust into the strategy, the list of specific products must be constantly reviewed and modified if necessary, depending upon a long-run vision of supply and demand changes which reflect the shifting pattern of comparative advantage both at home and abroad. For this a running dialogue between government policy-makers and the business sector is essential since the latter is more closely in touch with the market. Thus the business-government liaison committees already set up in connection with the planning of the new export promotion strategy could be fruitfully used for the evaluation stage, and possibly widened to solicit the opinions of academicians, labor, marketing strategists, etc. With regard to the country-market-specific approach, one must warn against "torrential" exports that have recently provoked much resentment from importing countries' affected industries and have induced protectionism (e.g., trigger-price-mechanism for steel, VERs for autos) in world trade. The planned diversification away from traditional country markets is thus a step in the right direction. Moreover the simplification of export procedures should go a long way in further accelerating export growth.

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