

THE EFFECTS OF TRADE AND FOREIGN INVESTMENT LIBERALIZATION POLICY ON PRODUCTIVITY IN THE PHILIPPINES

HIROKAZU KAJIWARA

INTRODUCTION

DURING the decade of the 1980s, which was characterized by high levels of economic growth in the Asian NIEs, People's Republic of China, and many countries of ASEAN, the Philippines, in contrast, found itself in economic difficulty and was forced to implement structural adjustment policies aiming at the correction of balance-of-payments deficits in accordance with conditionalities placed on the country by the IMF and the World Bank. The move to reduce its fiscal deficit by decreasing government investment did bring about an investment-savings balance at a relatively low level; but the move also led to a large drop in the economic growth rate and setbacks in the living standards of the Philippine people.

Implementation of structural adjustment policy got under way in earnest during 1986 with the establishment of the Corazon Aquino regime, whose major policy goal was economic liberalization. The Aquino government was greeted favorably by the developed countries of the world and international financial organizations in the form of relaxation of foreign aid conditionalities, an influx of concessional loans, and debt rescheduling, all of which led to the gradual improvement of economic conditions as shown by an upturn in growth rate figures from negative to positive. The favorable recovery shown by improved economic indicators enabled the Aquino government to go forward in an attempt to better the nation's impoverished lifestyles by means of a policy transformation from mere crisis control to positive economic growth promotion. However, a rising growth rate led to increases in imports, inflation, rising interest rates, and a fiscal deficit, a set of conditions clearly demonstrating that an economic structure capable of sustaining such growth-oriented policies had not yet been formed. With the addition of recurring natural disasters, the economy again began losing ground toward the end of the decade, as the projected 1987-91 growth rate of 6.8 per cent fell below expectations to the actual figure of 4.5 per cent.

It was in the midst of such poor economic performance that Fidel Ramos succeeded Corazon Aquino as president of the Philippines. A new economic development plan was planned to go into effect in 1993; however, as of July 1994 it still has not been accepted by the Congress. The target growth rate of 2.3 per cent for 1993, despite being a very modest goal in comparison to other countries in the region, was not realized.

The above scenario of low economic growth in the midst of the prosperity experienced by other countries of Southeast Asia will be investigated in the present paper from the aspects of the background, content, and effects of trade and investment policies implemented in the Philippines during the 1980s for the express purpose of escaping the throes of economic stagnation. Our goal in this study is to inquire whether or not liberalization is a key to economic recovery in the Philippines.

I. THE BACKGROUND TO TRADE AND FOREIGN INVESTMENT POLICY DURING THE 1980s

Domestic markets in the Philippines designed for the promotion of industrialization based on import substitution were protected during the 1950s by direct import restrictions, and then beginning in the 1960s through import protection policies. Under the Tariff Law of 1957 the average tariff levied on manufactured imports was 46.2 per cent, and incoming consumer goods earmarked for import substitution were taxed at an average tariff rate of 64.1 per cent. (Imports of capital goods and intermediate goods were taxed at 16.2 per cent and 24.6 per cent respectively.) These tariff rates were raised due to pressure from opposition forces dissatisfied with the worsening economic effects of liberalization measures during the 1960s. By 1965 tariff rates had increased on manufactures and consumer goods to 50.8 per cent and 70.1 per cent respectively. (Capital and intermediate goods remained stable at 16.2 per cent and 27.4 per cent.)¹ The sales tax system also contributed to Philippine protectionism. As in the tariff system, the further goods proceeded toward the final goods stage, the higher their sales tax rates became. Among domestic goods only intermediate ones were taxed, while imported goods prices (c.i.f.) were marked up at rates between 25 and 100 per cent. In addition, since export promotion measures were not adopted, makers tended to choose production directed at domestic rather than international markets.

This type of protectionist policy based on the tariff and sales tax systems persisted until the early 1980s and was effective in creating profitable businesses manufacturing for domestic markets; but due to the small scale of those markets, the resulting economic growth was proportionately modest. Moreover, the manufacturing sector's ability to gain an edge in the accumulation of foreign currency was not at all improved, while at the same time the necessity to import capital and intermediate goods was not matched by increasing export of primary goods. The result was an economy easily susceptible to a worsening of its balance of payments. One more result of such a prolonged protectionist policy was the formation of an inefficient production structure of the manufacturing sector. During the 1960s the average incremental capital-output ratio (ICOR) was 4.2, almost 60 per cent higher than the 2.7 figure for the Republic of Korea during the same period.

¹ Unless otherwise indicated, all statistics for the Philippines have been taken from [4] [15] [16].

The development plan of the Ferdinand Marcos government, which was set up in 1965, was geared toward industrialization and also stressed the positive role of the government in promoting it. Policy decisions resulted in the passage of such legislation as the Investment Incentives Act of 1967 (Republic Act 5186), the Export Processing Zone Act of 1969 (RA 5490), and the Export Incentives Act of 1970 (RA 6135), as well as currency devaluation from 3.9 to 6.4 pesos to the U.S. dollar. The new plan was directed at promoting exports and increasing both domestic and foreign investment.²

The positive economic management stance taken by the Marcos government was further reinforced after the declaration and implementation of martial law in 1972. The National Economic and Development Authority (NEDA) was set up to coordinate economic planning and policy implementation, the introduction of foreign capital was guaranteed by the central bank and other government-run financial institutions, and the promotion of import substitution of intermediate and capital goods was carried out. This type of industrialization through governmental leadership helped increase economic growth rates during the 1970s to levels above those of the late 1960s, and growth in the manufacturing sector, which was unable to realize the figure for the economy as a whole during the 1960s, consistently achieved levels above the national averages. Concerning GNP figures, the share of gross domestic capital formation significantly rose, approaching 30 per cent during the last half of the decade.

Economic growth in the Philippines during the 1970s can be compared to a chain reaction of sort starting with increases in investment leading to growth in the manufacturing sector, which in turn bring about overall growth in the economy. At the same time, however, this chain reaction widened both the trade and investment-savings gaps. Thus, the government-led high-growth policy was financed by foreign capital. Dependence on foreign capital for economic development has been observed not only in such NIEs as Taiwan and Korea, but also in such developed countries as Japan, at differing amounts and differing stages in their histories; the problem is whether or not the debt incurred can be paid back as the result of development. One important factor in repayment is a strengthening of export competitiveness as the result of development in the country's manufacturing sector.

In the case of the Philippines, growth in manufactured exports was realized during the 1970s to the extent that in 1980 such exports occupied 45.8 per cent of the total, an increase of 600 per cent over a ten-year period. However, while Philippine export manufactures do include clothing, electrical appliances, and electronic components, they are consignment manufacturing goods included in SITC 9, which have sharply increased from 4.2 per cent of total manufactured exports in 1970 to 40.3 per cent in 1980 [21, p. 99]. Consignment manufacturing is an activity that has expanded in developing countries with bonded warehouse systems and export processing zones. It is one of the means by which the NIEs have been able to accumulate foreign currency. However, in the NIEs the per-

² For information on political and economic trends and policy in the Philippines, see [3] [6] [8] [13] [21].

centage these goods occupy within total manufacturing sector exports has tended to decrease with the further development of this sector, and the role played by export processing zones has declined in importance. This is not the case in the Philippines, where consignment manufacturing forms the core of the manufacturing sector.

Consignment manufacturing is definitely one means in the process of industrialization. For example, in Taiwan the government attempted to guide consignment manufacturing into higher end products and promoted the construction of industrial parks adjacent to export processing zones, in order to expand input-output relationships between the two areas, all for the purpose of gradually integrating those zones, which had originated as special enclaves, into the national economy. In contrast, export processing zones in the Philippines have remained as enclaves with almost no relationship to the domestic economy. Furthermore, the domestic manufacturing sector continues to be marked by inefficiency and a low level of international competitiveness, while the establishment of export processing zones and export priority policy encourages exporting without the use of domestic inputs. This situation is the cause of the exceptional increase in consignment manufacturing goods among Philippine exports.

Export competitiveness in the Philippine manufacturing sector outside of consignment manufacturing remains weak. Protectionism through the tariff and sales tax systems was not only applied to consumer goods, but also to intermediate and capital goods that grew during the 1970s. The central bank imposed import restrictions through the rationing of foreign currency. In addition, when domestic manufacture of new groups of intermediate goods was begun, rigid restrictions were placed on the import of these goods to protect the infant industry. What resulted was a rise in the average effective rate of protection (ERP) for the manufacturing sector from 51 per cent in 1965 to 125 per cent in 1974, while at the same time the ERP for consumer goods increased from 86 per cent to 247 per cent.³ In addition, domestic resource cost (DRC) in the six textile-related industries worsened between 1969 and 1974 [1]. In other words, the conditions underlying the kind of textile export expansion that exerted a tremendous pull effect on NIEs exporting activities did not take shape in the Philippines.

The expansion of areas of the manufacturing sector subject to protectionist policy merely increased the sector's inefficiency as a whole, as the ICOR during the 1970s rose to as high as 5.8. Although the export of consignment manufacturing goods did increase under such conditions, the Philippines' export growth rate did not exceed its import growth rate, meaning that industrialization dependent on foreign capital did not satisfy conditions for making full payback possible in the future.⁴

³ The 1965 figures are from [18], while the 1974 figures have been taken from [20].

⁴ When depending on foreign capital to fill a trade gap, the condition for paying back the debt incurred is an export growth rate that exceeds the import growth rate, regardless of the length of the payback period. The higher the export growth rate the shorter the period of time for paying back foreign debt. If we calculate export and import growth rates for the Philippines in five-year averages, we find no period in which the former exceeded the latter.

Any manufacturing industry that is not expanding its export profitability capacity by leaps and bounds, while at the same time attempting to promote import substitution in the heavy and chemical industry sector with a great deal of reliance on foreign capital, is sooner or later going to hit a dead end. In 1980 the unpaid foreign debt incurred by the Philippines reached U.S.\$20 billion. Then, with the occurrence of the second oil crisis resulting in increased imports and recession in developed countries causing stagnating primary goods exports, a heavier debt burden was caused by high interest rates throughout the world. Add to this the various domestic problems that occurred and we can understand why changes had to be made in the Philippine industrialization plan.

Despite declining growth rates, stagnating exports, increasing foreign debt, expanding fiscal deficit, and rising inflation at the end of the 1970s, the Philippine government announced in 1979 the implementation of eleven major industrial projects (MIPs) as part of its plan to go ahead in promoting the development of heavy and chemical industries. However, due to high interest rates in the midst of an international economic downturn, obtaining long-term foreign financing became very difficult, short-term debt increased, and the implementation of the MIPs became near to impossible. At the same time, the government finally recognized the need for structural reform in the country's existing inefficient, uncompetitive industries, and in 1980 adopted a policy in line with industrial reform recommended by the World Bank.

This policy contained such measures as a reduction of import tariffs over a five-year period, the removal of import restrictions, and the restructuring and modernization of the textile and cement industries. These steps aimed at eliminating overprotectionism and increasing productivity, capital efficiency, and competitiveness, as the Philippines received a U.S.\$200 million structural adjustment loan (SAL) from the World Bank in 1981 and another U.S.\$300 million SAL in 1983. Also during 1980-81, an extended fund facility (EFF) of U.S.\$410 million in special drawing rights (SDR) was received from the IMF for tackling the problem of its balance-of-payments deficit, and ODA from various countries were increased from U.S.\$1 billion to U.S.\$1.2 billion.

Just as the country began struggling to overcome its economic difficulties with the help of such international aid, the Dewey Dee scandal broke in 1981, causing a financial crisis. As short-term capital markets were closed, investment companies and financial institutions continued to fall into insolvency. This gave rise to general business decline and even bankruptcy in the corporate sector. The growth rate dropped to the 3 per cent level in 1982, and government revenue declined in the midst of recession, while at the same time exports stagnated and foreign loans increased. Nevertheless, as of 1981 international debt outstanding came to 63 per cent of the gross national product and represented an amount three times the country's exports figure. Moreover, since 46 per cent of these debt existed in the form of short-term debt, serious limitations were in sight concerning additional foreign loans. For this reason, in 1982 the Philippines received U.S.\$345 million in stand-by credit and a U.S.\$205 million export-income guarantee loan from the IMF, which then imposed some very strict conditions. However, the

economy failed to improve. For example, the total balance-of-payments deficit, projected at U.S.\$600 million for 1983, had already reached U.S.\$560 million by June of that year. This forced the government to abandon five of its eleven MIPs and depreciate the exchange rate by 7.8 per cent.

In the midst of such economic misery, Benigno Aquino, Jr. was assassinated in August of 1983, and a group of foreign private banks refused to renew short-term debt, while transforming all long-term into short-term debt and canceling any further short-term lending. In addition to the resulting capital outflow, the current account in November showed a deficit of U.S.\$2 billion, and foreign exchange reserves fell drastically from U.S.\$2.3 billion to U.S.\$430 million. The Philippine government then announced a moratorium, and, unable to put together any new financing due to strict conditions imposed by international organizations, foreign governments, and overseas banks, the government decided in December on a U.S.\$13 billion settlement that included rescheduling.

The harshest condition imposed from the standpoint of the government was the economic adjustment plan (memorandum) which was forced to come up with in conjunction with the IMF. According to this plan, during its eighteen-month period implementation would be reviewed once every three months from the first review in March 1985. During that time the Philippines would be placed under IMF and World Bank conditionalities and lose its prerogative in policy matters. The plan was then so implemented, and in 1986 with the election of the Aquino government liberalization in the areas of foreign trade and investment was begun, marking a transition from industrialization through protectionism to industrialization via open, free trade policy.

II. THE PROCESS OF FOREIGN TRADE AND INVESTMENT LIBERALIZATION

Under IMF and World Bank conditionalities the Philippine government initiated trade liberalization with the Tariff Reform Program (TRP) of 1981 and a program to liberalize import licensing. Through TRP the tariff range was cut in half from 0-100 per cent to 0-50 per cent.⁵ With respect to import liberalization, 263 items were removed from the prohibition listing in 1981, followed by 610 more in 1982 and another 48 in 1983. In spite of this move, 1983 was marked by stronger restrictions on foreign investment due to the international payments crisis, and the liberalization plan was put aside until the next administration.

After the establishment of the Aquino regime, quantitative restrictions on imports were reduced across the board. Between 1986 and April 1988 such restrictions were lifted on some 1,229 items. In 1992 only 150 restricted items remained, and today restrictions are imposed either for national defense and health reasons, on specific agricultural products, or on manufactures earmarked for the Board of Investment's progressive manufacturing programs. In addition, quantitative restrictions have been replaced by tariff imposition. Together with the reductions in tariff rates, the taxation base, which was the subject of inter-

⁵ The Philippine structural adjustment policy is covered in detail in [12].

TABLE I
EFFECTIVE RATE OF PROTECTION, 1985

	ERP (%)	Exports (US\$ Million)	Imports (US\$ Million)
Agriculture, fisheries, and forestry	85.5	6.6	5.0
Mining and quarrying	21.2	4.3	26.9
Food processing	75.1	14.2	6.3
Textile	137.5	1.9	5.7
Apparel, footwear, and leather	154.9	8.0	4.1
Wood, cork, and furniture	102.4	3.2	0.1
Paper and printing	74.3	0.5	2.1
Chemicals	53.3	3.3	16.9
Nonferrous metal	91.1	0.4	0.4
Basic metal	32.5	10.7	3.7
Metal products	78.7	0.1	1.4
General machinery	23.6	0.3	5.9
Electric machinery	90.2	16.8	18.5
Transport machinery	48.5	0.3	2.6
Other manufactures	80.5	2.4	2.0
Manufactures	74.2	62.7	70.0
Light manufactures	84.8	28.1	18.3
Intermediate goods	52.2	14.5	21.1
Machinery	74.2	17.5	27.0

Source: [9].

Note: The ERPs of 426 sectors estimated on the basis of [9] were converted by the weighted average method using each value added.

national complaints and the main reason for rising import prices, was transformed from a domestic consumer price system to the internationally employed cost, insurance, and freight (c.i.f.) system.

Tariffs were indeed reduced, but different imposition systems based on the degree of processing has brought about differences in the effective protection rate for each kind of product, leading to the bias toward exports that existed before. Table I presents ERPs estimated from input-output tables [9]. The average ERP for manufacturing industries as a whole has decreased significantly since 1974, but rates for light manufactures, which are considered to have export competitive advantages, are high in comparison to mining or chemical products, which are imported in large amounts. Despite a high ERP, electrical machinery exports a large amount; but, as previously mentioned, this figure reflects the fact that consignment manufacturing is on the increase in this industry, while the electrical home appliances manufactured by domestic makers are being protected. In order to lower such protection, tariff rates have been reduced since 1985, but even as late as 1990 items with a nominal tariff rate of 50 per cent account for 23 per cent of the total and show an average ERP of 22 per cent (exportables -3 per cent; importables 44 per cent) [17].

In order to rectify this situation the Philippine government laid out a plan in 1990 to reduce tariffs, but the weight of the reductions was lightened by Executive

TABLE II
REAL EFFECTIVE EXCHANGE RATES

												(1985=100)	
1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	
97.27	102.38	105.66	109.68	92.26	91.39	100	78.03	71.80	69.84	74.94	72.90	71.99	

Source: [10].

Order 470 for the sake of ensuring the desirable level of tax revenue. According to estimates made by the Tariff Commission, the average ERP for all items will decrease from 25 to 19 per cent as of June 1995—agricultural, marine, and forestry products declining from 4 to 2 per cent and manufactures dropping from 35 to 28 per cent [17]. However, opposition is strong in the business community toward foreign trade liberalization, and the liberalization program itself is being stalled by such problems as the country's fiscal deficit.

Since the 1970s the Philippines has operated under a floating exchange rate system. Its exchange rate pattern has been characterized by depreciating exchange rates due to balance-of-payments deficits and appreciating rates when the deficit is corrected by an influx of foreign investment and loans. Table II summarizes movements in the real effective exchange rate between 1979 and 1991. From 1970 until the early 1980s, despite a constant balance-of-payments deficit, the real effective exchange rate of the peso remained relatively high due to foreign loans. During 1983–84 the exchange rate was devalued in order to lower the high level of the real effective rate. The real effective rate again rose in 1989, but since 1990 the occurrence of national disasters and threats of coup d'état have brought about deficiencies in foreign currency, thus depreciating the real effective rate.

The floating exchange rate system in the Philippines, however, does not rely on the market system. The central bank has come to intervene in the market, but the timing of policy implementation tends to be too late. For this reason, free currency exchange transaction was declared in December 1991 and put into effect in August 1992. Direct remittance of foreign currency has been recognized for the purpose of investment from abroad and non-trade transactions, allowing full retention of all foreign currency obtained from exports. The trading hours of the Philippine foreign exchange market have also been lengthened. Exchange markets have thus been formed to reflect the realities of the economy in general. Nevertheless, before the depreciation of foreign exchange rates brought about by such liberalization could help increase exports, they would cause domestic inflation and increases in foreign debt. Whether the economy can hold up under such a strain is one of the important problems facing the Philippines today.

Turning to investment, the Investment Incentives Act (RA 5186), Export Incentives Act (RA 6135), and the Foreign Business Regulations Act (RA 5455) are the main pieces of legislation that guide Philippine policy in this area. Due to the widely varied definitions and interpretations caused by these acts, the legislation was made uniform in 1981 with the passage of the Comprehensive Investment Law, or so-called Omnibus Investment Code. This legislation was

revised in 1987 with the recognition of income tax exemptions as investment incentives and additional deductions for direct cost of employing labor in labor-intensive industries. These changes are both in line with tax breaks introduced in other ASEAN countries. More revisions were made in June 1991 with the establishment of clearly defined areas in which foreign investment is restricted combined with the liberalization of foreign investment in all other areas. These restricted areas were to be reduced in number to a minimum by the target date of October 1994.

The 1991 revisions of the 1987 investment legislation left in effect the tax breaks outlined in the original law and added provisions concerning the advance of enterprises into export processing zones. In addition to the export processing zones of Bataan, Baguio, Cavite, and Mactan, a portion of other industrial parks were designated as such, and a system was instituted for these areas to be regulated under the Export Processing Zone Authority. Therefore, enterprises operating within the latter areas became subject to the same favorable treatment enjoyed by enterprises in the four export processing zones proper. This was thought to be a measure promoting the influx of more foreign capital for export production, because of the relatively inconvenient geographical location of the original four zones.

III. THE EFFECTS OF TRADE AND FOREIGN INVESTMENT LIBERALIZATION

Due to the government's protectionist policies, the Philippine economy became structurally inefficient, resulting in the smallest export figures among the countries of ASEAN. Hooley has measured total factor productivity (TFP) in the Philippines in five-year increments between 1956 and 1983 [7]. According to these estimates for a total of six periods, plus TFP figures were registered only during 1956-60 and 1966-70. All of the periods recorded minuses after adjusting the data by work hours and labor quality, with figures worsening as time went on. In addition, Sanchez's TFP estimates [19] comparing the Philippines with Korea between 1960 and 1973 show the Philippines operating at a level of only 27 per cent that of Korea. The inefficiency in the Philippine economy indicated by such poor TFP figures was improved through the liberalization measures of the 1980s. In this section we will look at whether these measures were related to increases in exports.

Table III presents estimates of absolute figures and growth rates of labor productivity in the Philippines. Productivity growth rates rose significantly during the last half of the 1970s in all industries but mining, then declined during the early 1980s to minus growth figures due to a sharp decline in the production. The last half of the 1980s was again a period of rising growth rates (except in the mining industry), but the absolute figures failed to achieve the maximum figures realized in previous years of positive growth.

Table IV shows industry-by-industry TFP growth rates in two periods: 1974 to 1979, a period of time from the first oil crisis up to the year before the second;

TABLE III
LABOR PRODUCTIVITY

	Growth Rate (%)				Absolute Value (Pesos)			
	1971-75	1976-80	1981-85	1986-91	1970	1980	1985	1991
Primary industry	-1.94	3.58	-3.07	1.18	15.9	17.0	14.5	15.5
Secondary industry	5.36	4.38	-5.49	-0.80	61.7	96.7	71.3	67.2
Manufacture	2.97	3.79	-3.99	0.30	68.6	92.8	74.8	75.5
Tertiary industry	-0.40	1.97	-4.43	0.98	38.7	40.4	31.7	33.6

Source: [16].

Note: Labor productivity = GDP (1985 price) / the number of laborers.

and 1984 to 1988, a period in which trade liberalization was promoted. The manufacturing sector as a whole during the first period experienced negative growth, with only six industries in that sector growing at a positive rate. Growth in total exports during that period came to 5.29 per cent, with primary industrial products growing by 1.01 per cent and manufacturing sector exports by a rather high 14.5 per cent.⁶ Both consignment manufacturing exports from the electrical machinery (consumer electronics, etc.) and the apparel and footwear industries were especially high from the beginning of the 1970s and were the leading industries in the Philippine export production sector. The share of the former industry in total exports increased from 1 per cent in 1974 to 9 per cent in 1979, and the latter industry increased from 3.5 per cent to 8.8 per cent of the total during that same time. Both industries also achieved positive TFP rates during the 1970s, indicating that improvements in productivity enabled them to increase exports.

These improvements were the result of technological assistance from foreign enterprises and the use of imported raw materials, two characteristic features of consignment production. For example, during 1974-79 import growth rates for the manufacturing sector as a whole rose by 1.8 per cent, while at the same time the electrical machinery, textile, and apparel and footwear industries grew by 18.1 per cent, 3.4 per cent, and 6.1 per cent respectively.⁷ In other words, these industries were able to improve productivity and increase export amounts because they had no relation to inefficient domestic manufacturing industries.

The other industries experiencing positive TFP growth rates outside of the manufacturing sector all recorded minus export growth rates. On the other hand,

⁶ Real export growth rates were calculated by correcting nominal dollar-base exports with a GDP deflator for exports.

⁷ Real import growth rates were calculated by correcting nominal dollar-base imports with a GDP deflator for imports.

TABLE IV
GROWTH RATES OF TFP, VALUE ADDED, AND EXPORTS

	1974-79			1984-88		
	TFP	Value Added	Exports	TFP	Value Added	Exports
Manufacturing total	-3.50	4.27	14.52	-2.78	6.95	1.04
Food	-6.77	-4.56	10.86	-6.26	6.47	0.00
Beverages	-3.22	4.92	11.83	-6.47	4.63	-5.00
Tobacco	2.01	6.09	-2.59	18.73	27.64	-31.25
Textile	-1.83	9.77	10.94	-6.01	-0.75	4.92
Apparel and footwear	1.74	6.91	17.98	5.47	22.50	7.85
Wood and wood products	-0.41	13.09	-1.78	-0.93	3.03	14.47
Furniture and fixtures	-1.91	24.88	17.27	-3.60	19.25	1.10
Paper and paper products	-0.11	12.18		-2.88	6.55	
Printing and publishing	-1.71	8.53		-4.15	8.65	
Leather and leather products	1.50	18.87	-5.00	-0.23	11.08	-2.24
Rubber products	-1.94	5.10		-0.50	13.70	
Chemicals	-2.80	8.96	16.69	-4.15	11.73	7.08
Petroleum and coal products	-11.12	-21.89	10.51	3.59	-0.14	-20.00
Nonmetallic mineral products	1.77	10.96	-9.74	-4.89	7.18	9.68
Basic metal products	-5.82	-4.55	19.78	-7.07	0.10	2.83
Fabricated metal products	-4.45	2.21	15.91	-3.56	-5.26	0.00
Machinery	-5.37	3.10	16.81	-4.82	-1.01	1.72
Electrical machinery	0.43	11.50	18.37	-2.52	0.95	-8.72
Transport equipment	-2.59	15.55	16.81	5.15	15.02	1.72
Other manufactures	1.03	4.45	13.11	0.29	12.36	3.13

Sources: [15] [16].

industries with minus TFP growth rates like chemicals, basic metal products, and machinery recorded high export growth rates.

Equation 1 in Table V is the result of a regression analysis of export and TFP growth rates during the period 1974-79. The sign of TFP growth, our independent variable, is minus, leading us to the conclusion that growth in TFP is not related to increases in exports, and that the statistical significance level is low.

TFP growth rates during the liberalization policy promotion period of 1984-88 continued to be negative. The industrial sectors registering positive TFP growth rates numbered only five, a smaller group than in the previous period examined. The total export growth rate was negative at -3.54 per cent with primary materials at -10.8 per cent and manufactures at 1.04 per cent. The export composition for 1988 showed that the share enjoyed by the electrical machinery and apparel and footwear industries had increased to 21 per cent and 18.6 per cent respectively. This tendency has continued into the 1990s with electrical machinery reaching 26 per cent and apparel and footwear 21 per cent of total exports during 1991.

Regression 2 of Table V results in the independent variable TFP growth with a minus sign, a result that would not be generally predicted. However, as a

TABLE V
REGRESSION ANALYSIS

Dependent Variable	Independent Variables				R ²	No. of Sample
	Constant	TFP Growth (1974-79)	TFP Growth (1984-88)	ERP (1985)		
1. Export growth (1974-79)	8.187 (3.430)***	-1.087 (-1.891)*			0.427	18
2. Export growth (1984-88)	-1.842 (-0.898)		-1.071 (-3.239)***		0.629	18
3. Degree of dependence on exports (1985) ^a	23.291 (0.434)			0.508 (0.256)	0.256	15
4. Degree of dependence on imports (1985) ^b	92.913 (2.598)**			-0.725 (-2.313)*	0.829	15
5. TFP growth (1984-88)	-5.236 (-2.048)*			0.034 (1.168)	0.320	14
6. TFP improvement ^c	5.720 (3.645)***			-0.067 (-3.738)***	0.733	14

Sources: [15] [16].

Notes: 1. TFP figures (GT) were calculated by the formula, $GT = \alpha(GY - GK) + \beta(GY - GL)$, where GY is the growth of value added, GK is capital growth, GL is growth in the labor force, α is capital share, and β is labor share. GY was calculated by deflating the value added of each manufacturing sector with a GDP deflator for the manufacturing sector as a whole. GK was calculated by deflating book value of fixed capital at the end of each year by a GDP deflator for gross capital formation. L is the number of paid employees. β is the ratio between total wages paid in all industries and total value added. α is the value $\beta - 1$.

2. The figures for 1974-79 include only enterprises with five or more employees. The figures for 1984-88 include only enterprises with ten or more employees. For this reason, it is impossible to calculate TFP for the whole period 1970-89.

3. t -values are in parentheses.

^a Exports / total production.

^b Imports / (total production - exports + imports).

^c TFP growth rate in 1984-88 - TFP growth rate in 1974-79.

* Significant at the 10 per cent level.

** Significant at the 5 per cent level.

*** Significant at the 1 per cent level.

result of calculating the ratio of domestic resource costs to shadow exchange rates for enterprises in three different industries for the period 1980–84, the rate of the flour mill in the study dropped on the average from 1.26 to 0.74, the textile firm from 1.23 to 0.95, and the consumer electronics maker from 2.94 to 0.78 [17]. This shows that at least according to corporate base data during the early 1980s, industrial efficiency was improving and competitiveness growing stronger.

In regression 3 of Table V using degree of dependence on exports as the dependent variable, we find ERP to be insignificant as an independent variable; however, in regression 4 using degree of dependence on imports as the dependent variable we find significance at the 10 per cent level. The ERP coefficient is negative, showing that imports are negatively proportional to the ERP. Regression 5 with the ERP as the independent variable and TFP growth rate during the 1980s as the dependent variable produces an insignificant statistic. In regression 6 the TFP improvement rate was used as the dependent variable and the ERP as the independent variable, producing significance at the 1 per cent level and showing a negative relationship between TFP improvement and ERP. In other words, we can read from this analysis that the higher the ERP becomes, the poorer the improvement in TFP will be.

Therefore, even though TFP rates in the manufacturing sector during the 1970s and 1980s were negative, there was improvement, which was caused by a market competition effect brought about by trade liberalization, represented by a lowering of ERPs over time. However, the regression analysis of the TFP growth rates and export growth rates during the 1980s shows that improving productivity still does not tend to cause increases in exports. Therefore, while trade liberalization measures made domestic markets more competitive and improved the structural efficiency of the manufacturing sector, the core of the export industry remains dominated by consignment manufacturing, a production activity with little relation to domestic industry, leading us to conclude that domestic industry is not being directed toward expanding exports.

Improvements in productivity in the Philippines during the 1980s were caused by means of both trade liberalization and privatization policies that weeded out the inefficient manufacturers that were nurtured during the 1970s and brought about a reduction in unemployed plant and equipment. For this reason, unstable economic conditions have continued, with low growth rates and increasing under- and unemployment. Since expanding production scale is not necessarily accompanied by improvement in productivity, enterprises have little surplus enabling them to concentrate on exporting.

Unfortunately, sector by sector data for manufacturing industries is available only up through 1988, making analysis impossible from that time on. Trade and investment liberalization policy was implemented past 1988 and brought about lower ERPs and real effective exchange rates. The average growth in GDP during 1988–91 was 3.43 per cent, exports grew by 7.83 per cent, and imports rose by 10.43 per cent. On the average the export growth rate exceeded the growth of production in general, but large fluctuations occurred each year. Moreover, these export growth rates are quite a bit lower than the figures recorded in the NIEs

during the 1960s and 1970s, and judging from recent figures, which are also low, export growth does not seem to be a factor in raising growth in production. Therefore, it is probably necessary to turn to promotion policies specially designating export industries, like what was done in both Korea and Taiwan, in order to start the virtuous circle of increased exports → increases in production → improved productivity → increased exports → increases in production. If something like that is not done, it will take time for improvements in economic efficiency to bring about increases in production and exports, and there is the very real possibility that any economic durability existing in the Philippines may not last until such an effect can be realized through that route.

The effect of investment liberalization policy was an increase in both domestic and foreign capital spending. Domestic investment first reached a peak in 1982, then stagnated until 1986, when it again began to increase. Foreign investment reached a peak in 1984, declined, and then began to rise again in 1986. Despite the fact that the level of investment both from domestic and foreign sources dipped somewhat in 1991 due to various causes including natural disasters, the trend has been toward gradual increase when compared to the situation in the early 1980s.

The characteristic feature of foreign investment since 1986 has been an increase in Asian capital. For example, at the time foreign investment peaked in 1984, Asia accounted for 33.5 per cent (compared to 44.2 per cent originating from the United States). In 1990 the countries of Asia were providing 75.8 per cent of the Philippines' foreign capital (compared to 10.8 per cent from the United States).

The percentage of domestic and foreign investment combined occupied by the manufacturing industries has exceeded 50 per cent except for 1990. There is no doubt that the manufacturing industries are overall the most attractive outlets for foreign investors. It should be mentioned, however, that during the second half of the 1980s there were many years in which foreign capital failed to provide more than half the total amount invested.

Let us compare increased foreign investment in the Philippines with what has happened in a country like Thailand: during 1986–90 the amount of foreign capital that flowed into the Philippines totaled U.S.\$2.46 billion on a license basis, while Thailand received U.S.\$30.89 billion worth [11]. The reason for such a large discrepancy is that all of the countries of ASEAN, not just the Philippines, made reforms in their laws concerning foreign investment that were designed to encourage capital flowing in from Japan and the NIEs. And while the legislation passed in the Philippines is equivalent to legal measures taken in neighboring countries, we can see that legal preparations alone are not sufficient to attract foreign investment. From the mid-1980s, a wave of foreign investment inundated Asia under the slogans "historical Japanese opportunity" and "historical NIEs opportunity," but the Philippines was not able to take advantage of such chances to the same extent as Thailand and other ASEAN countries. Though it is true that direct investment did increase in the Philippines, it did not increase on the same scale as in the other ASEAN countries, reflecting the negative effect that

political and economic instability has on expectations concerning a developing country's investment environment.

Furthermore, it has been said that foreign capital plays the dominant role in the Philippine economy. However, it is impossible to prove this due to changes in a statistical base that defies comparison of past and present.⁸ Of the top 2,000 corporations in gross sales during 1991, 382 were financed with foreign capital and accounted for 25.3 per cent of the larger group's total income and 33.3 per cent of its net income. Top 50 companies among the top 200 exporters accounted for 75.1 per cent of total export sales, and of this group of 50, 21 were foreign capital ventures claiming 54.5 per cent of the group's total export sales.⁹

CONCLUDING REMARKS

The above discussion shows that trade and investment liberalization policy in the Philippines has progressed systematically enough, but has not yet brought about any epoch-making economic results. The elimination of government intervention and restrictions has characterized all policy stances since the Aquino regime, yet liberalization alone is not sufficient to produce significant, conspicuous economic achievements. Government also must play an important role in capitalizing infrastructural projects, in order to lay the foundations for a healthy investment environment. In the Philippines, for example, the Aquino government was not able to build any new power plants, resulting in present-day electricity shortages, a condition that has worked to worsen the country's investment environment.

The present Ramos regime is expected to implement soon its 1993–98 Medium-Term Philippines Development Plan [14]. The strategy for achieving the plan's goals concentrates on regional development centering around core cities in each region. Here the government will designate industries to be emphasized in each region, carry out infrastructural projects for preparing investment environments, and provide policy support in the hope of expanding local government autonomy. The industries that will apparently be stressed are agro-industry and labor-intensive manufacturing industries. Both are areas in which the Philippines are thought to enjoy a comparative advantage. The goal here is to develop regional economies, while at the same time strengthening regional industrial linkage to unify the agricultural, manufacturing, and service sectors.

This development strategy differs from previous plans that aimed at dispersing funds for the purpose of regional development, in the sense that emphasis is being put on the development of specially designated geographical areas and industries on a regional basis. The idea here is that by developing core areas in each region the peripheries of these areas will gradually feel the economic benefits

⁸ According to Business Day [2], out of the 1,000 top corporations in sales for 1986, 227 of them were capitalized with foreign funds and accounted for 29.4 per cent of all the corporations' total sales. However, recent statistics are based on different calculating methods as can be seen in [5].

⁹ Calculated based on data contained in [5].

which they generate. The present economic geography of the Philippines is characterized by an over-developed Manila metropolitan area and underdeveloped rural areas. Since the Philippines is an island country, economic relationships between the capital region and the provinces do not work very effectively. The present strategy is aimed at developing regional economies by forming new geographical centers that will form close economic relationships with their immediate peripheries.

Centering around a number of cities in each province, fields of endeavor earmarked for development will range from traditional primary industrial products to textiles, apparel and footwear, miscellaneous goods, electrical machinery, and small-scale shipbuilding, each chosen on the basis of comparative advantage, potential marketability both domestically and internationally, employment creation capability, and environmental considerations. The government is also hammering out a plan that will create not only regional and interregional economic relationships within the Philippines, but also relationships with neighboring countries: for example, the formation of economic relationships among adjacent islands that exist partly in the Philippines and partly in Malaysia or Indonesia.

Previous regimes avoided such a plan thinking that the promotion of specially designated areas and industries would widen the regional gaps that already existed throughout the Philippines. However, because mere institutional liberalization will not bring about the kind of rapid improvement in economic conditions that the Philippines is in need of, specific industry promotion policy is crucial to the achievement of long-term growth, even if regional gaps are the consequence over the short term. This new strategy is important to the Philippine economy, in order to allow institutional liberalization to perform its intended function.

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