# NATIONAL ECONOMIC STRATEGY IN A SLUGGISH WORLD SETTING

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The challenge and opportunity in the present difficult period of the 1980's is how to last long enough and to reorient basic policies so that the economy can move well once the upturn in the world economy occurs. This is a challenge which many countries face, but some will find the adjustments tougher and more unique if they make rapid growth a goal.

In fact, the general difficulties faced by the Philippines today may be commonplace in the sense that many countries face basically the same problems. In some cases, the situation is more serious and hopeless, while that of the Philippines remains viable and still promising.

Within ASEAN, however, the Philippine situation is the most difficult for some while to come. In the company of the higher growth countries of ASEAN, the Philippine economy appears to be in the most challenging but precarious position today. It was not always so and it need not be so in the future if the corrections in strategy and policies continue.

ASEAN has demonstrated that it is an area of growth during the difficult decade that just passed. The Philippines performed well during that period. In the 1980's, the difficulties have caught up with ASEAN, largely because of the prolonged nature of the economic slowdown. But in this subsequent period, the Philippines appears to come out in the most difficult shape in the region.

Malaysia and Indonesia have energy resources of petroleum and natural gas to rely on for their development in the 1980's. Their energy and foreign exchange requirements for development are therefore more or less assured. So, these two countries can afford a higher level of development spending, even if their other exports — basically also primary export goods from the agricultural and mineral sectors — face largely bleak medium-term prospects like the traditional exports of the Philippines. In fact, they have accumulated reserves of

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Chairman, Philippine National Bank. Presented before the 19th Annual Meeting of the Philippine Economic Society, December 11, 1982 at the Manila Hotel.

foreign exchange during the recent heydey of the oil price increases, and it takes only a downward adjustment of their already ambitious development plans to proceed in their activities.

Thailand is the country that was most similar to the Philippine case. But recently, a more active growth of agricultural exports and manufacturing exports has overtaken Philippine performance on both counts. And recent discoveries of natural gas off the Gulf of Thailand and petroleum in central Thailand (although they appear less dramatic than originally expected) will reduce their energy dependence significantly. Therefore, a higher level of economic resources for public development projects can still be undertaken by Thailand.

The Philippines and Singapore emerge as the only countries that face the burden of a large energy bill. Singapore's strategy of integrating largely with the world economy – both in the sense of world trade and finance – and her high gear development of the 1970's has put her in the class of newly industrializing countries (NICs).

In the Philippines, the oil discoveries of the mid-1970's have turned out to be marginal, and prospects for future ones are likely to be of the same magnitude as these limited commercial finds. While the Philippines, unlike Singapore, is a much more varied country, the pressures of population and the high energy bill of development pose a joint problem for the longer term.

In fact, the present and future development strategy in the Philippines must recognize the following elements:

1. That it is an open economy, and therefore, it must find ways of earning from international trade;

2. That the most important resource of the economy, in view of the fairly large population of 50 million, growing at about 2.5 percent per year, rests on providing a high level of employment. Therefore, exports from labor-intensive activities, notably in manufacturing and new commercial crops, should be the basic source of trade specialization, in addition to the traditional exports;

3. That in view of the energy deficit, which will eat up a large proportion of export earnings, the assumption of national planning now must be that of a resource-poor country, more or less like Japan, South Korea and Taiwan. This is in spite of the presence of other natural resources that may substitute for part of the energy deficit. This assumption has major consequences in the long-term economic strategy;

4. That, for domestic economic priorities, continued modernization of the rural sector is essential. Agriculture is still a major base of economic development. An improvement in agriculture is especially essential for sustaining the economy during difficult times.

## Immediate Term Prospects and Causes of Recessionary Conditions

When will the upturn in the world economy occur? Recently, Walter Wriston of the Citibank was reported to have made an optimistic forecast about a strong upturn for the U.S. economy, when it comes. However, others have been much more cautious. Even in Japan, there is caution about the possibility of an upturn. In the meantime, record unemployment levels are being experienced in the U.S., Germany, UK and other industrial countries.

The threatening gloom of protectionism after the recently concluded GATT ministerial meeting in Geneva had become much more real, since essentially that meeting was a failure. If anything, the meeting fueled the possibilities of a trade warfare between the U.S. and Europe on agricultural issues, but it would seem that broader trade conflicts among the industrial countries will likely surface, for instance, between Japan and the EEC, and the U.S. If this happens, the prospects for world markets becoming more fragmented are likely. Then, for developing countries, there arises a greater difficulty for export-oriented manufacturing. And it is likely that the low prices for basic commodities in world trade, including Philippine primary exports, will continue for some time.

During the last decade, greater interdependence became much more obvious within the world economic system. The major actors – which means the U.S., EEC and Japan – can no longer act without clearly affecting each other's position. However, the growth of interdependence has not been accompanied by a full understanding among the main actors. Up to now, they have behaved rather like quarreling cousins instead of one family interested in its own unique welfare.

The result of this has been observed in the last decade: an unstable mixture of national fiscal and monetary policies that failed to support one another. Complicated by the oil shock, this failure to act cooperatively as interdependent nations has led to world recession, growing protectionism and unstable exchange rates. And this has become a much deeper and persistent problem since the last five years or more.

## Impact on Developing Nations

While all the main actors themselves have suffered through domestic recession, unemployment, inflation and unstable exchange rates, the developing countries have felt these instabilities all the more.

The largest casualty has been international development assistance. The shrinkage of ODA levels and the hardening of terms of what remained has been accompanied by terms of trade losses of the commodity-dependent developing countries. The oil-producing and exporting developing countries enjoyed enormous prosperity, but the rest had to experience reduced growth or stagnation, uncertain export market opportunities, and serious terms of trade losses. Hence, the aggravation of the conditions of developing countries is marked.

In true fashion, because the industrial world began feeling the chill, the developing world caught pneumonia.

## Philippine Development Strategy Worked for a While

The Philippines enjoyed a much better position during the 1970's. Through internal development efforts and because of a basically more diverse economy, it was able to weather the problems of that decade. In addition, it managed a good growth record, as stated at the beginning. Through a management of its economy, the flow of development resources – through ODA loan terms and through the access to capital sources in the commercial market – have in fact increased, not decreased. The primary exports, which are a mix of agricultural and mineral products, did not necessarily register the same price trends. In fact, they were acting like any good, balanced portfolio until the onset of the second oil shock of 1979, when they became like a single item suffering a depressed market.

The fortunate component of recent Philippine experience was that definitive steps towards an improved development strategy took place throughout most of the 1970's. The economic reforms of martial law carried forward a momentum that provided government with a unified stance. The volume and relative magnitude of development spending increased the role of government. This was facilitated initially by the tax reforms which gave high revenue yields and the initial harvest from the export tax and premium duties during a short-lived commodity boom in the 1970's.

As a result of this, government fiscal policy was not only able to perform actively as a development instrument; it was also able to provide a basis for countercyclical fiscal policy. This was achieved by, first, generating a new base for revenues which enlarged the capacity of the government to provide peso counterpart financing to development projects obtained from loans which increased in magnitudes. This meant a high relative public investment budget as a percentage of the GNP, from 2 percent in the 1960's to 8 percent recently. The increase of resources also redistributed purchasing power over a wider range of sectors in the economy. The policy of budget deficits had always been in connection with the development budget in mind and the countercyclical element of fiscal policy during the hard period of continuing global recession. In fact, there was a rise in the budget deficit in 1981 to the present 4 percent of GNP, compared to less than 2 percent in earlier years to undertake countercyclical finance.

The development spending and the extent of import demand within the whole economy have a balance of payments impact. The level of that deficit is conditioned by the following: access to official development assistance in the form of long-term loans, and the foreign debt service levels. However, the prolonged period of the recession, the continuous terms of trade losses for the country's major exports, and the sluggish upturn for the new industrial exports because of protectionism in the industrial countries and competition among the hard hit exporting developing countries in their exports of manufactures — all these developments have combined to produce a difficult balance of payments position.

To retrench domestic demand is to reduce the potential impact on the trade balance of payments deficit. The retrenchment is a reduction from originally planned public spending as an adjustment to prospective falls in revenues as projected. While absolute levels of spending are up, the real volume has fallen. This is the setup in which we find ourselves in 1982.

## Worst Case Scenario

The worst case scenario one can think of is that poor international demand will extend for two more years before things improve. The implications of this on the course of government policy will be as follows:

The economic managers will have to coordinate the major macroeconomic policy tools so as to keep the critical variables — domestic prices, foreign exchange rate, foreign debt ceiling – within manageable levels, all three of which are highly interrelated. To do this requires continued fiscal retrenchment or standstill in government budget and in the domestic credit. In short, fiscal and monetary policy can only be tight.

The standard countercyclical policy of promoting an expansionary fiscal and monetary policy during a fairly sluggish economic period has reached limitations at the present time because of the following reasons:

The government cannot raise the domestic budget deficit without endangering the balance of payments position. A foreign exchange gap is to be filled by planned flows of project assistance (ODA) at the international level and by sufficient balance of payments borrowings, through additional credits from the IMF and access to the international banks for revolving credits. This will maintain the current development projects now under construction.

The reduction in *real* government tax revenues is a consequence of the domestic recessionary conditions. The failure of exports to grow sufficiently is the handiwork of the world economic recession and partly the result of inherited flaws in the economic incentives pattern which prevented a much larger long-term export growth in the past decades. Hence, the government spending limits have to be consistent with the planned balance of payment deficit. This, in turn, should be consistent with objectives about domestic price stability. On the other hand, the foreign loan program has to be consistent with the ceiling on the debt burden set at 20 percent of the previous year's foreign exchange earnings.

This chain of constraints is significant. Breaking it couia mean unstable domestic prices, higher import graps, and higher foreign debt. Who knows what all these would mean to the foreign exchange rate? For all these are linked together via the exchange rate for the peso.

This is why the strategy of retrenchment on the fiscal and monetary side of the government, so long as the present recession works, is the only option available at this time if the desire is to maintain economic stability at the expense of growth. In any case, growth cannot be pushed with the constraints being reached already.

But look at it from another viewpoint. The last few years have led to a coordination of fiscal and monetary policies, to a point where there is a larger scale of total development activity and a greater level of diversification of the economy. There is less uncertainty on the level of spendings, on the balance of payments, and on capital inflows in the economy. Economic management has gone a long way from the problems that the economy faced in the mid-1960's and the economic crisis of the 1970's. The foreign debt is under a large degree of control mainly because the government kept a tight watch on the maturities and on the schedules of repayment throughout all these years that it allowed a buildup. Hence, the additional degrees of fiscal discipline are much more finely tuned with the control of domestic and international economic stability.

### Linking Long-Term Goals with Short-Term Strategies and Policies

Now we go to the more important component of this discussion, which is to relate the present immediate term strategies to the long-term strategy.

As indicated at the beginning, there are several factors that must be taken into account in determining the long-term strategy. These are already incorporated in the current planning for the economy, but a new element that is not widely appreciated has to be emphasized: that basically, the Philippines is, in today's bill for development, as resource-poor as Japan is in many respects. This means that the Philippine economy must import a large component of energy, raw materials and other goods in order to achieve a degree of domestic viability, if it is to grow at all.

The sooner this is appreciated by everyone, the easier it is possible to acknowledge the need for the economic reforms began in the 1970's, which are critical to the attainment of new directions in economic development.

While the immediate term program of fiscal-monetary retrenchment is essential to sustain economic stability, the varying components of economic policy should work themselves to foster the longer-run objectives. As the circumstances allow, an effort to supplement domestic saving through foreign loans should continue at a high level. But this has to be planned only in conjunction with a high domestic effort to mobilize saving and raise domestic resources for development.

These long-run objectives center on promoting a dynamic open-economy, partly dependent on international specialization, and aiming to continuously raise the levels of modern agriculture and industry so that activities with high employment impact are chosen over those that simply consume the country's scarce resources.

In conjunction with this, the economy should be managed with a far greater reliance on the market mechanism and the promotion of competition. Tariff restructuring is an essential component of the economic restructuring. The financial institutions have to continue undergoing institutional change promoted by recent financial reforms. The government strategy of raising the domestic effort in saving mobilization is essential so that continued access to foreign saving, through development loans, and through the attraction of foreign direct investment, would proceed. Greater technical efficiency should be derived from new investments so as to achieve a higher output growth per investment activity.

An elaboration of these points is essential.

**Dynamic Open-Economy Strategy**

If there is a closed economy alternative for the Philippines which would insulate the economy from external influences, that option exists only as an inferior and therefore less preferred alternative today.

The Philippine economy for many years has been an open one. If the programs of development proceed, it is inevitable that imports of machinery and raw materials, as well as other goods, will come about, hence necessitating that exports be earned.

The export industries must continue to explore product groups in which comparative advantage can be developed. The indiscriminate import substitution policies (which were nurtured by import and exchange controls) of two decades ago cannot even be called a closed or autarkic development model, because they heavily depended on the export sector to generate its requirement of foreign exchange. That import substitution model is an extreme aberration of the open economy model of development. It merely encouraged high-cost, noncompetitive industries to absorb and allocate scarcely earned foreign exchange by the main export sectors so that they could sell poor quality products at high domestic profits. This built-in system has impeded the growth of an export-minded entrepreneurial class. In fact, it is the system of policies which not only became a stumbling block to serious tariff reforms until recently but which continues to foster a strongly protectionist mentality in the economic outlook.

What should be promoted is an economy that depends on comparative advantage as a principle in decisions involving every possible undertaking. This will promote exports not only in industry but also in agriculture. The industrial sector should, at every turn, earn its foreign exchange resources rather than consume that which is earned by other sectors. The basis of this is inevitably labor-intensive manufactures, in view of the supply situation for labor which guarantees for a long while the availability of inexpensive labor.

How is a country to survive in an open economy if the world economy is not cooperating in view of recession, protection, and market fragmentations?

**The Importance of Being Insignificant**

The role of the insignificant, price-taking firm in pure competition is something that has lessons for national economic management. Countries that are insignificant in the export markets – as the Philippines is in virtually all new lines of export manufacturing – have the advantage of entry and quick performance without being noticed at first. The example of the so-called "gang of four" NICs in Asia dramatizes the principle of the insignificant competitor in trade. They consciously promoted exports for a long time and enjoyed success in doing so. But they noticed that their market penetration rate had become insignificant in the market they had chosen. In today's world, however, they are no longer insignificant competitors.

Some would argue that in the growing protectionist world, this is not likely to be a rewarding strategy. But we need only remind ourselves that the labor-intensive products that are entering the surveillance mechanism of many industrial countries are relatively few. There are still many product opportunities that exist – aside from the limited quota provisions now obtaining for garments, textiles, and other products. In short, if the appropriate search is made by private enterprise, guided only by helpful price incentives by national policy, it is likely that many new lines of manufactures and agricultural processing are still open. This is the reason why the incentives should attract private enterprise including foreign investment, rather than depend on grand government product indentification schemes.

The appropriate climate for growth should be available from the world economy sometime soon. But even in a sluggish world economy, it is possible for the insignificantly small producer to make market penetrations if the entrepreneurial skills are present. During this adjustment period, some economies will grow faint in the prospects and leave the opportunities to those aggressive enough countries which recognize and provide the appropriate opportunities.

### Attracting New Entrepreneurial Skills

Notice the emphasis being placed on entrepreneurial skills. These are resources that unfortunately do not exist in sufficient quantity in the Philippines. And here is where major concession to factual evidence of the last few years should be made. There are many entrepreneurial skills in the country, but the protectionist policies of the decades after independence have concentrated them in many industries with dead-end or low-growth opportunities. Their interests are now in maintaining continued governmental patronage and protection. There is clearly a need for a new breed of entrepreneurs, and since these are probably the most scarce human resources in the economy, they have to be attracted from abroad.

It therefore makes sense, for instance, to attract the Hongkong Chinese entrepreneurs to come to the Philippines. But to do this in high employment industries, the needed market incentives should be available and should markedly be competitive with other areas in the region. If all these market incentives are in their correct perspectives, it is not only the uncertain Hongkong entrepreneurs that will be attracted but also the business enterprises in the high labor-cost countries of the region and of industrial countries.

### The Role of the Market Mechanism

A sustained reliance on the market mechanism is the guarantee against unwarranted distortions that arise out of manipulating many policies. This reliance on the market mechanism is a trend toward which current economic policies are already focused. A continuous effort at maintaining market-oriented policies relieves government not only of the tedious task involved in rationing resources. It also reduces the possibility of making the wrong allocation decision.

It is in this sense that the pesos should continue to float in the exchange markets. This is a critical price variable that helps in the decisions on the cost of imports and the rewards of exporters. It provides an appropriate gauge at the micro level decision-making for pricing imported capital goods and other raw materials.

The removal of ceilings on interest rates finally came after gradual moves towards flexible interest rates. The arguments in favor of floating interest rates for a saving-scarce country may have been fully appreciated but it was not until the recent experience in double-digit interest rates in the world that it became possible to convince others of the need to act in this case. Then, it became suddenly recognizable that Philippine interest rate policy needed revisions, because rates seemed low in relation to those in the developed countries.

It is not a secret that I have been impatient in correcting many of the flaws of economic policy which deflected from the use of the market mechanism. Hence, it would have made for a better state of affairs if all the bold moves undertaken on the floating of interest rates and on the restructuring of the tariff had come much earlier in the decade, especially at the time when the peso was allowed to float, and in the case of the tariff reforms, if the full structure had been at a generally lower average level which would have allowed a much faster speed of adjustment. This would have attained the shock effect of all those adjustment measures and aligned market incentives more quickly. Perhaps, these would have avoided the problems of highly capital-intensive ventures established in recent years because they would have been naturally discouraged at the initial decision stages.

But it is good that, finally, the full orchestration of these basic pricing policies is now possible, even though delayed a little. These are important policy weapons essential to maintaining a dynamic, open economy. If there is no retreat from them, a great deal of decision-making will rest in the private sector and the government will be less involved in industrial planning.

### Correcting Communications and Other Deficient Infrastructure

It is significant to mention a sectoral issue which is of critical importance to attaining some of the development goals related to promoting greater domestic economic efficiency and to attracting more foreign investments.

This is the need to correct the deficiency of communications which not only tends to isolate the country internationally but also regions within the country quite unnecessarily. The communications infrastructure in the country — measured by telephone and postal efficiency — is in poor shape. It seems that there are structural defects in institutional policy or there is a need for greater active attention in this area.

Manila cannot hope to become a financial and commercial center if efficient communications are prohibitive. Couple this with the power problem of the metropolis and the costs of operating any enterprise in the country are compounded. These costs easily offset some of the advantages naturally available to the country because of inexpensive and relatively skillful labor.

Essentially, the improvement of communications, power, and transportation are long-term problems in infrastructure construction. The need to give these sectors more attention is essential and this should not relent during times of retrenchment even in fiscal spending.

**The Large Industrial Projects**

Finally, how do all the industrial projects fit into the above? Appropriate pricing policies and other criteria for decisions such as potential comparative advantage should be the basic guide in setting them up. Some of these projects are needed to create internal linkages in the economy between end-using industries and basic raw material industries. Precisely because of this, it is essential to see to it that the additional cost penalty to end-using industries, if any, is not substantial, lest their competitive position in the world setting is reduced.

In the immediate future, however, the retrenchment in government spending programs poses the possibility of these large-scale projects being in direct conflict with some of the government priorities in infrastructure. The development projects in infrastructure have already been reduced or postponed, in view of budgetary restraints.

The large-scale industrial projects have been justified mainly on the basis of a minimal governmental participation. Since the private sector proponents are required to meet much of the foreign equity requirements, the present conditions of many foreign companies that had indicated initial interest in these projects have been adversely affected by weak economic conditions. Hence, there is a natural bent in the case of project proponents to delay their participation in these projects. On the other hand, the government had been trying to accelerate the schedules of these industrial projects.

It is likely that the trade-offs for the use of scarce government resources between direct industrial projects and the development of basic infrastructure such as the need for upgraded communications facilities and power investments will require a reevaluation of some of the schedules of the industrial projects.