THE "TURBULENT WORLD ECONOMY" AND INDUSTRIAL DEVELOPMENT STRATEGY IN THE PHILIPPINES

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The "turbulent world economy," to use the terminology of the theme for this meeting, has in recent years presented difficult problems to nearly every sector of the Philippine economy. In terms of the likely impact on the country's long-term economic development, the problem occasioned by the recent and prospective decline in the growth rate of Philippine exports may prove to be the most serious, since it now threatens to undermine domestic policy efforts, initiated in the early 1970's, to promote labor-intensive, export-led industrial development.

The strategy of outward-oriented industrialization and the encouragement of labor-intensive industries find theoretical justification in classical comparative advantage and development theory. Given the relative abundance of unskilled, low-wage labor in most developing countries like the Philippines, comparative advantage lies in the production and export of labor-intensive products, and this could contribute to efficient resource allocation and rapid economic growth. Since the world market is virtually limitless for a small country, export producers would be able to exploit significant economies of scale, adding to the improvement in industrial productivity. Also, to the extent that unemployment and underemployment exist, the concomitant expansion of job opportunities in labor-intensive industries should help raise the standard of living of the poorest segments of the population. With the mopping up of surplus labor over time, a "commercialization point" will be eventually reached, after which further increases in labor demand relative to supply will force a rising trend in real wages, shifting the developing country's comparative advantage toward more skill- and capital-intensive products.

The development performance in the 1960's of the super-exporters of labor-intensive manufactured products — the so-called Asian NICs, especially Taiwan and South Korea (which, in contrast

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to the city states of Hong Kong and Singapore, are intermediate-sized economies) — appears to provide empirical support to the above model of trade and development. "Per capita real incomes in these countries have increased very rapidly and mass poverty has largely disappeared; there has been massive absorption of labor into the industrial sector and full employment has largely been achieved" (Lee 1981, p. 21). Most remarkable of all, these were accomplished within a period of less than a decade.

By the early 1970's, the Asian NICs have begun to shift resources toward the production and export of more skill- and capital-intensive products. Beginning at about that time also, labor-intensive outward-looking industrial development became increasingly emphasized in some developing countries, inspired by the earlier achievements of the Asian NICs. In the Philippines, relative incentives to export-oriented industries improved significantly with the 1970 de facto devaluation of the peso, accompanied by discriminatory "stabilization" measures favoring nontraditional (manufactured) exports,[1] and the enactment of the Export Incentives Act in the same year. Apart from the fiscal incentives made available to export-oriented enterprises which were additional to those already being given to BOI-registered firms under the Investment Incentives Act of 1967, the Export Incentives Act served to officially elevate export production to the highest priority, which meant favorable treatment in access to institutional credit and in import licensing, to mention only two major benefits accorded industrial export producers. Several measures were also subsequently adopted in line with export infrastructure development favoring export producers of nontraditional manufactured products.

The point of the above discussion is that, in contrast with the industrial and trade policies in the preceding two decades which effectively promoted inward-looking industrial development, the

1. The floating of the peso in February 1970 resulted in an exchange rate change from 3.9 to 6.4 pesos per U.S. dollar within the year. Exporters of traditional export products, however, were required to convert 80 percent of their foreign exchange earnings at the old rate. This dual exchange rate arrangement was later replaced by taxes on traditional exports of rates ranging from 4 to 10 percent *ad valorem.* These export taxes were made a part of the customs and tariff code in 1973. In February 1974, an additional tax was introduced, based on the premium derived from export price increases beginning 1973. Thus, the windfall gains from the devaluation and the commodity boom in the early part of the seventies were partially siphoned off from producers of traditional export products.

early 1970's witnessed a considerable improvement in the incentive structure for exporting, especially of new industrial products – which quantitative estimates of various relative incentive measures bear out.[2]

It is not surprising, therefore, that Philippine exports grew much more rapidly in the 1970's than in the 1960's (7.0 percent vs. 2.2 percent annually in volume terms, based on World Bank data). More important, there was a dramatic increase in the share of nontraditional export products, especially labor-intensive manufactures. Manufactured products as a percentage of total exports increased from 8.3 percent in 1970 to 36.4 percent in 1980. The average annual growth of manufacturing value added in real terms also increased – from 6.7 percent in the 1960's to 7.2 percent in the 1970's. In terms of overall growth, real GNP rose at an average annual rate of 6.2 percent during 1970-79, which is significantly higher than the corresponding figure of 5.1 percent for 1960-70. While these comparative statistics do not establish the superiority of outward-looking to inward-oriented industrial development, they are consistent with the well-established empirical association between "superior export performance" and "superior economic performance" among developing countries (at least in terms of the growth rate of real national income).[3] It is also to be noted that improvements in export and output performance occurred at a time of increased instability in the world economy (relative to the 1950's and 1960's) and rising protectionism in developed country markets.

In the last few years, however, growth of both total exports and gross national product sharply decelerated. In 1981 export earnings even fell slightly (by 1.2 percent) while the growth rate of real GNP declined to 3.8 percent (compared to the corresponding figures of 6.7 percent in 1979 and 4.4 percent in 1981). Nevertheless, nontraditional manufactured exports continued to increase rapidly, although also at declining rates: 41.3 percent in 1979, 38.7 percent in 1980 and 23.8 percent in 1981 at current dollar prices. Indications are that for 1982 the country's exports and real GNP will perform no

2. For example, Baldwin's (1975) estimates for 1970-71 were higher by 40 percent for traditional exports and 65 percent for new exports relative to the corresponding average estimates during 1967-69.

3. See, for example, the very competent survey of related empirical literature by Bhagwati and Srinivasan (1978).

better. The sluggish growth of industrial economies since 1980, the intensification of protectionism in developed country markets, and the steep decline in world prices of traditional export products have been commonly cited as the underlying reasons.

Recent economic policy has tried to move the economy towards greater competitiveness and efficiency. One area of major policy reform is in tariffs. Scheduled changes in tariff rates during 1981-85 are comprehensive and significant which, if fully implemented, will lead to a relatively substantial tariff liberalization by 1985, in terms of both the overall reduction in effective protection and the narrowing of the disparities in sectoral rates (Bautista 1982). Import licensing is also being liberalized, and a realignment of indirect taxes is being considered that will remove the protective effect resulting from the different taxation of domestically-produced and imported goods. Finally, a "revitalization program" is being adopted to assist existing industries to produce at lower cost based on "positive" (e.g. technical assistance and financing) rather than "negative" (protective) measures.

The government has apparently decided to follow in earnest the development track of the now more advanced developing countries, particularly the Asian NICs, characterized by a liberal foreign trade regime and outward-looking policies. (The important point that should not be missed by Philippine policymakers, it seems to me, is that the Asian NICs accorded export producers a virtual free trade regime, in some instances even overcompensating them for any apparent bias of relative incentives against exporting, which served to place them on at least equal footing with competitors in foreign markets.) This can be viewed as a logical sequel to the export promotion drive of the last decade which, despite its unsystematic character, contributed to the improved performance of the export sector and the national economy. It is perhaps not farfetched to hypothesize that, had this kind of policy reform been implemented in the early 1960's (which was also the time when most of the Asian NICs were initiating policy shifts from import substitution to export promotion), the country might have registered much higher economic growth rates in the last two decades. But this is of course now an academic question.

What would be useful to examine here is how future prospects of the Philippine economy might be influenced by the on-going structural adjustment program. In a high growth scenario for the industrial economies, which are the principal destination markets of Philippine exports, there is little question that the long-term payoff to the current policy reforms is substantial and positive in terms of improved allocative efficiency and growth of the national economy. It is also likely, I think, that the employment and equity repercussions would be favorable, as the experience of the Asian NICs since the early 1960's has demonstrated. But, of course, there are other more efficient means, in the arsenal of government policy instruments, of influencing income and wealth distribution than a change in trade policy.

The question arises, however, of whether increased openness is a desirable objective for the Philippines if the industrialized countries continue to suffer from low growth rates and the international economy grows more unstable. Indeed, not a few growth economists subscribe to the view that many of the forces underlying the recent slowdown in the industrialized countries are long term in character, deeply embedded already in the structure and institutions of the West (Oshima 1980). Already, we can discern strong voices from domestic manufacturers arguing for a delay in the implementation of the industrial restructuring program, particularly the tariff reform and import licensing components, on ground of financial distress under current recessionary conditions. There are also voices that call for an outright reversal of export-oriented industrialization into an inward-oriented development strategy.

My own view is that we cannot afford to postpone rationalizing the country's industrial structure, especially since financial and technical assistance seems available to industries with long-term viability. Domestic resources need to be utilized more efficiently regardless of what may happen in the external sector. This can only contribute to making the economy more responsive and adaptive to changing parameters in the international economic environment. That the Northeast Asian countries, which are poorly endowed in natural resources per capita, had been able to sustain more than satisfactory economic performance despite the adversities that confronted them during the last decade owes much to the discipline and cost consciousness that the spur of international competition has required of domestic producers, which in turn helped develop their ability to react to change, whether originating abroad or at home, adapting to new situations in an economic fashion. Unless the Philippine economy acquires such "capacity to transform," it is unreasonable to expect that a high growth performance can be sustained in a world of rapidly changing economic parameters.

The possibility of lower economic growth rates in the industrialized countries does not imply that the efficiency with which domestic resources are being used no longer matters. The need to import a large component of producer goods used by domestic industries gives added urgency to earn and save foreign exchange efficiently, which would hardly be facilitated by a return to protectionist policies. To the problem of increasing trade restrictions in the industrialized countries, the solution is not to turn inward and protect heavily the domestic market, which past Philippine experience has shown to be very costly. The better means is to expand export markets elsewhere. Some possible directions present themselves which I think should be pursued actively at this time of increasing uncertainty concerning future access to developed country markets. The main point is that the slowing down of the industrial economies does not necessarily imply stagnation in foreign trade and economic activity for developing countries like the Philippines in the future.

First, efforts could be made to promote greater complementarity in production and expanded trade among the ASEAN countries. This would require a substantial reduction of tariff and nontariff barriers to trade within the region. The present preferential trading arrangement (PTA) needs to be overhauled to allow for automatic, across-the-board and meaningful tariff cuts, perhaps eventually leading to the establishment of a free trade area, and for the elimination of nontariff restrictions in intra-ASEAN trade. Also, ASEAN country governments need to effectively coordinate national plans, especially concerning heavy industries where scale economies have to be exploited to achieve international competitiveness, so that regional demand could at least be assured. Harmonization of national industrial projects would require, it seems to me, a greater degree of political goodwill among the ASEAN countries than has been displayed thus far by their governments.

A broader area of inter-developing country cooperation in production and trade would be necessary, I think, to effectively offset the increasingly restrictive access to developed country markets. The most logical source of inter-LDC trade expansion at this time would be between the ASEAN countries and the Asian NICs, which have two of the world's highest regional income growth rates in the last decade. Liberalization of trade among these countries would provide the needed stimulant for rapid and sustained growth in this part of the world, in much the same way that the opening up of the industrialized countries for two decades after the Second World War led to unprecedented growth not only of those countries but also of the NIC economies in that period.

As a final point, one aspect of current industrial policy that I find incompatible with the larger thrust toward achieving gains in allocative efficiency relates to the vigorous promotion of several large-scale, capital-intensive industrial projects. This is due to a desire for "balanced industrial development," perhaps as a reaction to the recently observed deceleration in the export growth of light industry products. Obviously, these projects would not employ much of the country's underutilized labor force and, if they are not coordinated with similar projects of other ASEAN countries, very few (perhaps only those based on domestic raw materials and not subject to rapid technological change) stand a chance of becoming commercially viable without heavy protection from foreign competition. A highly protected heavy industries sector, inevitably producing higher-priced and lower quality intermediate industrial products (compared to what can be imported), will be a drag in the growth of-downstream industries which are typically more labor-intensive and less energy-using and have a greater potential for exports. Such effective penalty on the latter industries will make it unlikely that their products could compete successfully with foreign-made goods in both domestic and export markets. Lastly, if there is any lesson to be learned from related experiences of South Korea and Taiwan in the second half of the 1970's, it is that moving hastily and indiscriminately into heavy industries can lead to expansionary demand management and high inflation rates. This is hardly a prospect that should confront the Philippine economy at a time when it is most vulnerable to economic instabilities — whether externally or internally generated.

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