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*Chapter 2*

# Exchange Controls and Related Development Policies, 1946–59

## 1946–49: THE RECONSTRUCTION PERIOD

The main economic goals of the Philippine government in the immediate postwar years were to restore prewar production levels, initiate an industrialization effort, and ensure adequate supplies of essential consumption and capital goods. Table 2-1 contains a summary of the main trade, fiscal, and monetary measures directed at these objectives.

### Reducing Imports of Consumption Goods.

World War II resulted in severe devastation of the Philippine economy. As Paul McNutt (the last high commissioner from the United States) reported, at the end of the war only a bare remnant of the major industrial equipment was intact; not a single sugar mill was operating; the fishing fleets has been taken away or destroyed; rolling stock had been carried away to Japan; and mile after mile of concrete highway had been destroyed.[1] In 1946, the first year of the reconstruction period, total output was only 35 per cent of its 1940 level. The mining and manufacturing sectors were especially hard hit by the war, and 1946 production levels in those sectors were only 1 and 18 per cent, respectively, of their 1940 levels.[2]

Fortunately, large disbursements by the U.S. government in the form of war damage payments, relief expenditures, veterans' pensions, and military expenditures, as well as a remarkably rapid expansion of export proceeds permitted the country to ease the shortage of domestically produced goods

TABLE 2-1

**Major Trade, Payments, and Related Economic Policies, 1946–49**

| | |
|---|---|
| July 1946 | United States–Philippines Trade Agreement providing for eight-year free-trade period between the countries and restricting Philippines' ability to change its exchange rate or impose exchange controls |
| Sept. 1946 | Exemptions from domestic taxes for "new and necessary" industries |
| Oct. 1946 | Establishment of Rehabilitation Finance Corporation to provide low-cost loans for reconstruction and development |
| June 1948 | Increase in the sales tax on luxury and semiluxury items (most of which were imported) from 20 to 30 per cent and from 10 to 15 per cent, respectively |
| July 1948 | Enactment of Import Control Act, leading to imposition of import quotas on nonessential and luxury imports |
| Nov. 1949 | Imposition by Central Bank of 80 per cent margin requirement on all letters of credit covering imports of luxury and nonessential goods |
| Dec. 1949 | Institution of foreign-exchange controls by Central Bank |
| | Increase by Central Bank in annual rediscount rate from 1.5 per cent to 3 per cent |

with substantial imports. For the two years 1945 and 1946, for example, total U.S. government expenditures of $393 million more than covered combined imports of $364 million.[3] Thereafter, the rapid rise in exports, from $64 million in 1946 to $327 million in 1948, coupled with continued high levels of U.S. government expenditures and foreign aid resulted in a rise of imports to an average of $613 million between 1947 and 1949—an average level that was then one-third larger than the prewar value and was not again reached until the early 1960s. The outstanding export performance was due in large part to a rapid increase in export prices. The index of these prices (1937 = 100) rose from 156 in 1946 to 291 in 1948. The volume of exports in 1948 was still only 74 per cent of the 1937 level.

Policymakers were, however, concerned at the time by the high consumption component of imports. In 1947, consumption goods made up 68 per cent of all imports (one-quarter of these were textiles), and capital goods averaged about 10 per cent of imports. Although the share of capital goods was not too different from the 14 per cent figure of 1937–40, top government officials believed that this level was insufficient to meet the country's reconstruction and development requirements. Most Philippine leaders believed that the country needed both additional export-oriented and import-replacing production in order to meet the adjustment problem associated with the gradual phasing out of reciprocal preferential relations with the United States.[4] Achieving these increases in production in turn required additional imports of capital equipment. The concern of government authorities was further heightened by the steady depletion of the international reserves which had been built up in 1945 from large U.S. government expenditures.

The policy options available to the Philippine government to achieve its import-substitution goals and meet the growing deficit problem were severely constrained by the provisions of the Philippine Trade Act of 1946 (the Bell Trade Act). This act, passed by the U.S. Congress shortly before the scheduled independence date for the Philippines (July 4, 1946), and accepted by the Philippines as of that date as an Executive Trade Agreement between the United States and the Philippines, provided for an eight-year period (until July 1954) of free trade between the two countries. For the rest of 1954 each country was to tax imports at 5 per cent of its full rate. Beginning in 1955, the tariff on imports was to be at 10 per cent of the full rate. Thereafter, this level was to be raised by five percentage points per year until full duties would apply as of January 1973.[5] The act also stipulated that until 1973 the Philippine government could not change the established exchange rate of 2 pesos per U.S. dollar, impose exchange inconvertibility, or restrict capital transfers without explicit agreement from the President of the United States.[6] Since the United States supplied 80 per cent of Philippine imports in this period, the effect of the free-trade agreement between the countries was to rule out tariff increases as a means of reducing imports. Likewise it was evident that permission to devalue the currency or impose exchange control was likely to be given by the United States only if a severe exchange crisis developed. Two other features of the act that infringed upon Philippine sovereignty were the commitment not to levy export taxes and the agreement to accord Americans equal rights with Filipinos in the exploitation and development of natural resources and public utilities in the Philippines. As Golay remarks, the act was accepted by the Filipinos because it was accompanied by another piece of legislation providing for U.S. compensation for war damages suffered in the country.[7]

Despite the constraints imposed by the Bell Act, it was not long before the government found means other than tariffs to restrain imports. One method, adopted in June of 1948, was to raise the sales tax on luxury and semiluxury items—most of which were imported—from 20 to 30 per cent and from 10 to 15 per cent, respectively. The measure also stipulated that the sales tax be paid in advance on imported articles, i.e., prior to their release by customs officials. More important as a means of limiting imports, however, was enactment of the Import Control Act (Republic Act [R.A.] No. 330) in July of the same year. Under this law, which was not considered to be inconsistent with the Bell Trade Act, but was not implemented until January 1949 because of the opposition of foreign importers, President Elpidio Quirino was authorized to establish a system of import control by regulating imports of nonessential and luxury articles and to create an Import Control Board to devise the necessary rules and regulations. The intent of the act was not so much to encourage the domestic production of nonessential items, but, by restricting imports of luxury goods, to permit the importation of a sufficient volume of essential consumer goods for lower-income groups and of essential capital goods for basic reconstruction and development needs.[8]

The mechanics of import restriction under the Import Control Act involved placing various imports on a list of so-called luxury or nonessential items and then requiring import licensing for these goods by the three-man board set up under the act.[9] To begin operation of the controls, the value of imports from July 1, 1947, to July 30, 1948 was established as the base period; and then (as of January 1949) current imports were permitted equal in value terms to between 5 and 80 per cent of these base-period imports. Imports of commodities that were produced locally were given the greatest percentage cuts. A definite share of imports was reserved for new importers, first, without any nationality requirement, but then later only for Filipinos. Another feature of the control system aimed at curtailing primarily luxury goods was that import quotas for some categories of goods applied only if the c.i.f. unit values of the items were high enough to make them among the most expensive types of a particular class of goods.

**Introduction of Exchange Controls.**

Despite increases both in the range of items brought under control and in the percentage cutbacks during the second half of the year, the volume of imports actually was slightly larger in 1949 than in 1948. Only imports of tobacco products declined significantly. There was also no significant change in the commodity distribution of imports.[10]

One reason for this failure was a shifting from high-priced to low-priced imports of a particular commodity. Import controls applied, for example, only to automobiles costing more than $3,500. By purchasing mainly inexpensive cars, importers were able to increase the value of imported cars from $7 million to $8 million in the first half of 1949. Permitting importers to transfer quotas among articles also operated to frustrate any pattern of differential cutbacks. More fundamentally, however, the poor performance in cutting imports was due to an unwillingness of the government to impose the harsh monetary and fiscal measures needed. The year 1949 was a presidential election year, and one can observe at this early date the pattern of deficit spending, increases in the money supply, and a tendency to ease controls that characterizes election years up to the present time.[11] For example, the government deficit from July 1, 1949, to June 30, 1950 (elections are in November), was $212 million compared to levels in the $50 million–$70 million range before and after the election. Obviously, this deficit spending added to the pressure for large imports. The governor of the Central Bank warned President Quirino in early 1949 that, due to rapidly increasing imports, exchange control would have to be imposed by the end of the year unless appropriate alternative measures were taken. However, according to the governor, no action was taken because it was an election year.[12] Apparently, political pressures were effective in thwarting the implementation of the Import Control Act in that year.[13]

The failure to reduce imports in 1949 probably would not have resulted in the full-scale exchange crisis which developed near the end of the year had it not been accompanied by a sharp drop in both exports and U.S. government expenditures. The value of exports dropped from $327 million in 1948 to $261 million in 1949, even though the volume rose somewhat. The reason for the decline in value was a sharp drop in the prices of coconut products, the product group that made up 68 per cent of the country's exports in the 1947–49 period. Still another factor precipitating the crisis was a capital flight near the end of 1949 based on the fear that the Philippines would fall in line with the devaluation pattern followed by a number of countries in September of that year.[14]

The drop in international reserves from $420 million in 1948 to $260 million in 1949 led the Central Bank, which had only opened for business on January 3, 1949, to intervene in the exchange market immediately after the election. First, on November 17, the bank issued Circular 19, under which an 80 per cent margin requirement was imposed on all letters of credit covering various luxury and nonessential items. The list of items was substantially the same as the one that formed the basis for the initial implementation of the Import Control Act. Commercial banks were also prohibited from granting credit facilities either directly or indirectly for the purpose of providing the margin requirements. Next, on December 9, 1949, the Central Bank instituted foreign-exchange controls by issuing Circular 20 under the authority vested in the bank by the act (R.A. 265) that had established it. Before doing so, however, the consent of the President of the United States was obtained, as required by the Philippine Trade Act of 1946. The circular stipulated that all transactions in gold and foreign exchange must be licensed by the Central Bank and all receipts of foreign exchange must be sold to the Bank. On December 29, the Central Bank also raised its rediscount rate from the very low rate of 1.5 per cent to 3.0 per cent.[15]

Thus, the immediate reason for the imposition of exchange controls was an exchange crisis touched off by liberal spending and credit policies related to the 1949 election. However, more basic reasons for the underlying weakness in the country's balance-of-payments conditions were pent-up demand for both consumption and capital goods coupled with an unrealistically low price for foreign exchange.

**Tax Exemption and Special Financing Facilities.**

Although the promotion of domestic industrial development does not appear to have been the main purpose of the early import controls, the government, soon after gaining its independence, did utilize special tax and financing privileges for the specific purpose of fostering "new and necessary" industries. The enabling act (R.A. 35, September 1946) exempted new industries from all internal (but not import) taxes for a period of four years from the time the industry was organized. While "new and necessary" industries were not defined in the act, the Secretary of Finance in an implementing order specified these industries to be ones that "had not been commercially exploited in the Philippines before the war" and that "contribute to industrial and economic development." The latter phrase was regarded by the Finance Secretary as being general enough to cover a very wide variety of manufacturing activities. However, despite this broad interpretation and even though aliens as well as Filipinos could enjoy the tax benefits, only one new manufacturing corporation availed itself of the tax exemption as of March 1948.[16] It was not until import controls were introduced, in 1949, that the number of firms applying for the privilege became significant. This poor response to tax incentives seems to have been due to the absence of tariffs on imports of manufactures from the United States coupled with an abundance of U.S. aid and the profitability of reconstructing previously established industries.[17]

Another governmental measure that should be mentioned as contributing to the import-substitution efforts initiated in the reconstruction period was the 1946 act establishing the Rehabilitation Finance Corporation (RFC). This organization, with an initial authorized capital of P300 million and lending rates below those in the free market, became the major source of industrial credit in the economy. In the 1947–49 period the RFC approved loans averaging about $45 million annually. Real estate construction and repair absorbed 51 per cent of this sum (a share that rapidly decreased as war-damaged buildings were repaired or replaced); the industrial sector, 28 per cent; and agricultural activities and the government, the remaining 21 per cent.

## 1950–52: THE EARLY YEARS OF EXCHANGE CONTROL

The exchange-control experience of the first few years of the 1950s is noteworthy for two main reasons. First, after exchange controls were introduced by the Central Bank, in December 1949, government controls rapidly spread to all types of international transactions and became increasingly complex. Second, prices of imported goods increased sharply, in part because of the Korean War, but mainly because of the restrictive import controls. The government responded to the price increases by adopting tax measures designed to capture the windfall gains associated with exchange controls and also by liberalizing import controls over the more essential consumer goods and raw materials. As is shown in the statistical analysis of Chapter 5, it was during this period that the pattern—so typical in many developing nations—was firmly established of protecting commodities generally classified as luxury items compared to capital goods, essential raw materials, and basic consumption goods. Table 2-2 summarizes the main policy changes in the 1950–52 period.

**The Nature of Import and Exchange Controls.**

Republic Act 426, passed in May 1950, illustrates the growing complexity of import controls. This law stipulated that import licenses issued by the Import Control Board be required for all articles imported into the country. These imports were divided into four groups, depending upon their degree of essentiality; and maximum and minimum percentage cuts from 1946–48 trade levels were established for each group. The first category, prime imports, consisted of items regarded as being of prime necessity and as not being in sufficient supply locally.[18] Quotas established for these goods were to reduce the value of imports in the base period by no more than 40 per cent. The second group, essential imports, consisted of articles that were regarded as necessary (but not of prime necessity) for the health and well-being of the people. Imports of these items were to be cut back so as to encourage their domestic production.[19] The legislated reduction on these imports was to be no less than 40 per cent nor more than 60 per cent. Nonessential imports, the third category, were defined as items "not necessary for the health and material well-being of the people, but whose consumption is concomitant with the rise of their standard of living." [20] These were to be cut between 60 and 80 per cent to encourage their domestic production in sufficient quantities to meet local demand. Luxury imports, the last group, were categorized as articles primarily "for ostentation or pleasure" and were to be reduced between 80 and 90 per cent.[21] The main items specifically not subject to import quota allocation under the law were raw materials used in the manufacture of goods on the list of so-called prime imports, supplies and equipment for the Philippine government, and books and supplies for schools and charitable organizations. Moreover, agricultural equipment and "other machinery, materials, and equipment for dollar-producing, and dollar-saving industries" were excluded from

TABLE 2-2

**Major Trade, Payments, and Related Economic Policies, 1950–52**

| | |
|---|---|
| May 1950 | New Import Control Act requiring import licenses for all imports, stressing the import-substitution objective, and giving preference to Filipino citizens |
| June 1950 | Price controls instituted, covering essential consumer goods, raw materials, and machinery |
| Sept. 1950 | Increases in sales taxes, with greatest rise occurring in luxury consumer items |
| Dec. 1950 | Issuance of Executive Order permitting certain highly essential consumer goods and raw materials to be imported without quota limitations in order to hold prices down |
| Feb. 1951 | Increases in base on which sales tax calculation is made for imported goods; again, greatest increase occurred for luxury consumer goods |
| Mar. 1951 | Imposition of 17 per cent excise tax on peso value of foreign exchange sold by banking system |
| May 1951 | Adoption of still another Import Control Act completely decontrolling a number of essential consumer items but also extending import-substitution goal by stating as an objective that nonessential commodity imports be reduced or banned; re-export of certain essential goods also banned |
| June 1951 | Further easing through an Executive Order of the importation of additional essential commodities in order to stem increase in domestic prices |
| Aug. 1951 | Retrenchment of liberalization policy by reducing number of decontrolled items and establishing list of banned items |
| May 1952 | Introduction of measures designed to make it more difficult to undervalue exports |
| Aug. 1952 | Reduction of rediscount rate from 3 per cent to 2 per cent |

the provision that items not enumerated in the control lists (about 55 per cent of 1949 imports) would not be granted import licenses that resulted in imports exceeding their 1948 levels.

The import-substituting objective was stated much more clearly in the 1950 act than in the Import Control Act of 1948. If the domestic production of a commodity was deemed sufficient to meet local demand by the secretaries of Agriculture and Commerce, the Import Control Board was required to impose the maximum percentage cut stipulated for the appropriate category to which the item belonged. In addition to that, an uncontrolled item could be moved into the list of controlled goods and a controlled item could be moved to a more restrictive category.

We can see quite clearly at this early stage how the Philippines embarked upon an industrialization policy directed not only at import-substitution activities rather than export-promoting ones but also at the production of many nonessential consumption commodities. Instead of attempting to remove exchange controls once the 1949 crisis had passed, policymakers decided to continue to employ these controls to carry out their export-promoting and import-replacing goals. With a simplistic view of economic interrelationships, these leaders reasoned that the capital goods needed for an expansion of export-oriented and basic import-replacing production would be more or less automatically imported once imports of consumption goods were forcibly curtailed. They also concluded that the most plausible criterion for restricting these consumption imports was their degree of essentiality in terms of basic nutritional and health needs. Thus, imports of so-called luxury items were sharply curtailed. They had overlooked the tendency of capital to flow into the most profitable industries and that the act of restricting imports of nonessential consumption goods would raise the domestic prices of these goods sharply and thereby make their production the most profitable opportunity available. Imports of luxury goods were restricted so severely that the production incentives brought about by this act dominated all the other policies aimed at encouraging the manufacturing sector.

Another important feature of the 1950 Import Control Act was the marked preference it gave to Filipino citizens. The Import Control Board was instructed to reserve 30 per cent of the total import quota for any article in the fiscal year 1950–51, 40 per cent in 1951–52, and 50 per cent in 1952–53 to new Filipino importers. At least 60 per cent of a company's stock had to be owned by Filipinos for a firm to qualify under this provision of the law. Existing import businesses, which had long been dominated by Westerners and Chinese, received the remaining quota allocations.[22]

The granting of an import license by the Import Control Board automatically entitled an importer to a foreign-exchange license. However, the Monetary Board, which supervised exchange control, informed the Control Board from time to time (apparently every six months) of the amount of foreign exchange available for any specified period for imports. Import licenses were not to be issued in amounts that would exceed the available foreign-exchange supply.

Besides cutting down on commodity imports, the Central Bank modestly curtailed the amount of foreign exchange available for service transactions.[23]

Controls were also imposed on the remittance of earnings of foreign companies. Initially, the amount of income transferable could represent 10 per cent of the foreign participation in the current net profits or capital stock as of December 31, 1949, whichever was higher. In order to attract foreign capital, this provision was relaxed, in May 1950, to permit the additional remittance of earnings representing 30 per cent of the foreign participation in either the fixed assets or capital stock of the company, whichever was higher.

The efforts of the Central Bank and Import Control Board to conserve foreign exchange proved very successful, and imports declined 20 per cent between 1949 and 1950. Furthermore, in line with the import-substitution policy that began in earnest in 1950, the composition of imports shifted significantly from consumption goods to raw materials and capital goods. Consumption goods constituted 64 per cent of total imports in 1949 but only 50 per cent in 1950. As the analysis in Chapter 5 indicates, implicit protective rates of 200 per cent or more for nonessential consumer goods were not unusual in this period. The share of raw materials imports increased from 26 to 38 per cent, and that of capital goods, from 10 to 12 per cent between the two years. The success of the policy in actually stimulating domestic production is indicated by the sharp rise in the net capital of firms granted tax exemptions —from P2.7 million in 1949 to P8.6 million in 1950.[24] The shift was also aided by the moral suasion exerted on commercial banks by the Central Bank to limit real estate and consumption loans and direct more of their credit operations to production.

Not only did imports drop in 1950, but starting in August exports rose sharply due to increases in demand related to the Korean War. During the year export prices rose 12 per cent, and the value of exports, 30 per cent. Consequently, the current account balance shifted from a $68 million deficit in 1949 to a $189 million surplus in 1950, while reserves rose by $96 million.

### Controlling Price Increases and Windfall Gains.

A significant consequence of the tight import controls instituted in 1950 was upward pressure on the domestic prices of imported goods. These prices rose 21 per cent from 1949 to 1950. To offset this pressure a price control bill (R.A. 509) was passed, in June 1950, which was intended "to prevent, locally or generally, scarcity, monopolization, and profiteering, from affecting the supply . . . of both imported and locally manufactured" goods for which price control was deemed in the public interest. The group of commodities covered reflected the government's concern for maintaining low prices for basic consumer goods, machinery, and certain raw materials. Specifically, the categories covered by price controls were stipulated to be manufactured foodstuffs, textiles, clothing, paper, school supplies, building materials, agricultural and industrial machinery, and fuel and lubricants.

In still another attempt to hold prices down, President Quirino issued Executive Order 388, in late December 1950, stipulating that certain "prime commodities and raw materials in short supply in the Philippines" be imported without quota allocation during the first quarter of 1951. In a new import act, in May of 1951 (R.A. 650), these efforts were supplemented by the establishment of a class of "completely decontrolled items" which included the items mentioned in previous executive orders and to which were added a few more consumption articles. A second specified category, "essential items of import," consisted mainly of a long list of manufactured intermediate commodities and capital goods. In budgeting for essential imports the administering authorities were instructed to give priority to imports of machinery and raw materials for essential industries and to the needs of government agencies engaged in stockpiling essential goods and in stabilizing prices. Second priority was to be granted to the equipment and raw materials requirements of bona fide producers of nonessentials to the extent that these requirements could not be adequately met from local supplies. The balance of foreign exchange available after meeting the first two priorities was distributed to businesses and bona fide importers in proportion to their 1949 import levels, including a reasonable allocation for new Filipino importers. No specific list of nonessentials was appended to the act, but it was stated that an objective should be to reduce or ban the importation of these latter types of commodities.

Two other anti-inflationary measures taken by the government in May 1951 were: (1) a lifting of the 80 per cent margin requirement introduced in 1949 for certain textile imports that had become important raw materials for the industry, and (2) the banning of re-exports of such goods as machines, medicines, foodstuffs, oils and gasoline, and scrap metals (R.A. 613). On the other hand, one conspicuously absent anti-inflationary policy was a tight monetary policy.[25] The money supply had expanded 19 per cent between 1949 and 1950, and in early 1951 credit still remained easy.[26]

These efforts to restrain the upward movement of prices were not very successful until the latter part of 1951, as the retail price indices for selected commodities shown in Table 2-3 indicate.[27] With regard to the late 1950 and 1951 period, it is noted in the Central Bank *Annual Report* that "the expanded purchasing power due to inflated export earnings, heavy final war damage payments, and deficit financing was being penned in by the stringent import and exchange controls in force and was pushing prices up." [28] A rough notion of the profitability in producing import-competing goods domestically is indicated by the fact that, although the c.i.f. unit value of imported goods in 1951 actually was less than in 1949, wholesale prices of imported goods in 1951 were 53 per cent above their 1949 level. Wholesale prices of locally produced goods for home consumption rose less than 1 per cent between 1949 and 1951. This protective effect of import controls is analyzed in detail in Chapter 5.

TABLE 2-3

**Retail Prices of Selected Commodities, 1950–51**
(January 1950 = 100)

| | July 1950 | Jan. 1951 | July 1951 | Dec. 1951 |
|---|---|---|---|---|
| All items | 102.7 | 113.0 | 122.2 | 117.2 |
| Foodstuff | 99.7 | 113.3 | 111.6 | 110.3 |
| Wearing apparel | 99.4 | 120.3 | 135.6 | 112.5 |
| Construction materials | 101.0 | 105.3 | 126.6 | 117.7 |
| Fuel | 106.5 | 103.8 | 110.6 | 110.6 |
| Drugs and medicine | 100.3 | 122.3 | 124.7 | 115.8 |
| School supplies | 117.0 | 102.6 | 155.4 | 142.1 |
| Cigarettes and cigars | 129.1 | 127.8 | 140.2 | 116.5 |
| Liquor | 108.8 | 119.7 | 151.2 | 121.4 |
| Kitchen utensils | 108.7 | 150.6 | 182.0 | 178.6 |
| Starch and oils | 124.5 | 148.7 | 141.0 | 143.0 |
| Soap | 92.3 | 113.1 | 97.7 | 92.3 |
| Electrical supplies | 103.2 | 99.2 | 167.5 | 215.8 |

SOURCE: Central Bank of the Philippines, *Annual Report*, 1951, pp. 181–182.

The government was, however, successful in capturing some of the windfall gains going to many importers. First, in September 1950, the sales tax on both imported and domestically produced goods was raised. For jewelry, medium-priced automobiles, and toilet preparations, the rate was raised from 30 per cent to 50 per cent (to 75 per cent in the case of high-priced automobiles); for lower-priced automobiles, sporting goods, refrigerators, radios, phonographs, washing machines, firearms, etc., from 15 to 30 per cent; and for all other articles, from 5 to 7 per cent. Next, in February 1951, the base for calculating the sales tax on imported goods was increased to 200 per cent of the c.i.f. value for the first group of items, 150 per cent for the second, and 125 per cent for all other imports. As the analysis in Chapter 5 indicates, in the absence of these measures windfall gains of 100 percent or more would have been obtained in 1951 from selling many imported nonessential goods. A noteworthy point about this discriminatory customs valuation measure is that, when exchange controls and such measures as special trade taxes and margin requirements were finally lifted, in the 1960s, this measure remained in effect and, together with the tariff structure, still provided a high degree of protection to domestic industries producing nonessential consumer goods.

Besides raising the sales tax, the government in the fall of 1950 increased the rate of taxation on personal and corporate income. The rate on corporate income, for example, was increased from 12 per cent to 16 per cent. In 1951 the corporate rate was again raised so that the tax level on incomes below P100,000 became 20 per cent. Direct taxes, however, still remained a relatively unimportant source of government tax revenue. Their 1950 share of total tax revenue was only about 17 per cent.

These actions were followed, in late March 1951, by the imposition of a 17 per cent excise tax on the peso value of foreign exchange sold by the Central Bank or commercial banks (R.A. 601). This measure had been recommended, mainly for the purpose of raising revenue and reducing imports, by the Bell Mission, an economic survey group sent from the United States, at President Quirino's request.[29] However, because domestic prices were already considerably above c.i.f. prices for tightly controlled items, the tax had the apparent initial effect of capturing windfall gains rather than cutting imports.[30] Upward price pressure on essential items subject to a liberal control policy was prevented by forgoing or refunding the tax on such items.[31] Furthermore, the tax was not levied at all on foreign exchange used to purchase machines and raw materials by the "new and necessary" industries covered by R.A. 35.[32]

In June 1951 the President further expanded the list of items exempted from quota allocation in order "to arrest the rising trend of prices and discourage speculation." Under Executive Order 446 the Price Stabilization Corporation was authorized to import some 150 specifically mentioned items "in such quantities as may be found necessary." The list included not only basic consumer goods but the main raw materials and capital goods used by the industrial and agricultural sectors.

The policy of attempting to hold down prices by liberalizing the country's import policy began to conflict with the objective of stimulating import-substituting production through protection. It was claimed, for example, that the easing of controls led to excessive stockpiling and a glut of certain imported goods to the detriment of local production.[33] Consequently, in August 1951, the President instituted a retrenchment in his liberalization policy (Executive Order 471). As already noted, the import legislation passed in May had directed the control authorities to "reduce or ban" both nonessentials and commodities produced "economically and in sufficient quantities" domestically, but Executive Order 471 went a step further in actually setting out a schedule for banning such imports. Almost 150 items were to be banned immediately and another 20 by July 1952. The number of completely decontrolled items was also reduced from 19 to 6. Nevertheless, the government did succeed in halting the rise in the retail prices of imported goods. As is indicated in Table 2-3, the index of retail prices fell from a high of 122 in July 1951 (January 1950 = 100) to 117 in December 1951. The money supply actually declined 5 per cent during the year as the government fought the inflation by liberalizing imports. However, the balance-of-trade deficit rose from $5 million in 1950 to $76 million in 1951.

No significant changes in economic policy occurred in 1952. Although some steps were taken to make it more difficult to undervalue exports, imports continued to be closely regulated by means of import and exchange controls, while such measures as the 80 per cent margin requirement on letters of credit for the importation of specified luxury and nonessential items and the 17 per cent tax on foreign exchange further discouraged imports. However, the Central Bank did lower the rediscount rate from 3 per cent to 2 per cent in August 1952. Retail prices continued the decline begun in mid-1951, and the trade account deficit remained at about its 1951 level.

## 1953–59: FURTHER EFFORTS TO PROMOTE IMPORT SUBSTITUTION

The year 1953 is an important one in any survey of Philippine experience with trade controls because the Congress, in response to continued charges of favoritism and excessive delays on the part of the authorities administering import controls,[34] failed to extend the Import Control Act when it expired in June of that year. The Executive branch responded by placing the entire control mechanism in the hands of the Central Bank. This shift reduced the number of charges of favoritism and excess delays in the allocation of foreign exchange but did not change the general goal of import substitution. This objective was vigorously pursued by the Central Bank and other agencies throughout the rest of the 1950s. By 1959 protective rates of 400 per cent or more were not uncommon in the category of nonessential consumer goods. Besides holding to the belief that exchange controls were helpful in fostering industrialization and to the policy of providing low-priced essential consumer goods for lower-income groups, Central Bank authorities found exchange controls desirable from the viewpoint of their responsibilities "to maintain monetary stability" and "to preserve the international value of the peso." Fear of inflation and a resulting exchange crisis and depreciation should controls be removed was frequently expressed by these authorities during the 1950s. However, there were growing pressures from exporters to be permitted to trade at a more favorable exchange rate. They pointed out that the overvaluation of the peso acted to discourage production for export purposes. Finally, in 1955 a "no-dollar import law" was passed that enabled certain exports to be bartered for imports outside of the exchange system.[35] Largely because of this law, the second phase of the Bhagwati-Krueger schema, namely, the adoption of ad hoc measures to offset some of the unfavorable aspects of exchange control, is dated as beginning in 1955.

In this section, trade and related policies during the entire 1953–59 period are described in five broad areas of special interest: operation of exchange controls by the Central Bank; monetary and fiscal measures; changes in tariffs; tax exemptions for new firms; and finally, measures designed to increase exports. Table 2-4 contains summaries of the major trade-related measures adopted during the period.

### Operation of Exchange Controls by the Central Bank.

Major policy actions of the Central Bank were decided by a seven-member Monetary Board. The Secretary of Finance was the presiding officer, while the other ex-officio members were the governor of the Central Bank, the president of the government-owned Philippine National Bank, and the chairman of the Development Bank of the Philippines. In addition, three members were selected for six-year terms from the general public.[36]

Circular 44, issued on June 12, 1953, set forth the guiding principles to be followed by the Central Bank in the licensing of foreign exchange for the payment of imports. For each six-month period the Central Bank specified not only the total amount of foreign exchange available to each commercial bank, but also the sums available by commodity category and by importers. The year 1952 was established as the base for allocating foreign exchange among importers, but a contingency reserve was also set up to meet the expansion needs of existing producers, the requirements of new producers for machinery and raw materials, the adjustments of quotas for existing importers, and the foreign-exchange requests of new importers. Only Filipino merchants could qualify as new importers. The commodity breakdown, covering 1,865 items, consisted of:

1. Highly essential commodities (30 items), composed chiefly of medical and pharmaceutical products and dairy products.
2. Essential producer goods (560 items), including particularly most machinery, some transport equipment and professional and scientific instruments, most chemical elements and compounds, fertilizers, minerals and base metals, fuels and lubricants, and selected yarns and fabrics.
3. Nonessential producer goods (162 items), comprising hides and

TABLE 2-4

**Major Trade, Payments, and Related Economic Policies, 1953–59**

| | |
|---|---|
| June 1953 | Expiration of 1951 Import Control Act and placing of entire import-control mechanism under control of Central Bank |
| | Enactment of new tax exemption law for "new and necessary" industries, covering import taxes as well as internal taxes |
| Oct. 1953 | Repeal of 80 per cent cash-deposit requirement for specified luxury and nonessential items |
| Jan. 1954 | Reduction of rediscount rate from 2 per cent to 1½ per cent |
| Sept. 1955 | Revision of United States–Philippines Trade Agreement which included accelerating rate at which Philippine duties would be levied on imports from the United States and eliminating statutory U.S. influence over management of foreign-exchange matters |
| | Replacement of 17 per cent excise tax on foreign exchange by gradually declining (1.7 percentage points per annum) tax on imports |
| | Enactment of "no-dollar import law" permitting certain exports to be bartered for imports outside of exchange system |
| 1957 | Tightening of monetary policies by means of two-step (March and September) rise in rediscount rate to 4½ per cent, establishment of ceilings on various categories of loans, and reintroduction in September and December of differential cash-deposit requirements on letters of credit for importation of various types of goods |
| June 1957 | Introduction of new tariff schedule providing for low rates on essential consumer and producer goods and high rates on items classified as nonessential |
| Feb. 1958 | Easing of cash-deposit requirements on letters of credit |
| Feb. 1959 | Further tightening of monetary controls by increasing rediscount rate to 6½ per cent (but establishing lower preferential rates for crop loans and export bills) and raising reserve requirement against demand deposits |
| July 1959 | Imposition of 25 per cent margin fee levied by Central Bank on sales of foreign exchange |

skins, essential oils and perfume materials, and selected animal and vegetable oils, chemicals and yarns, fabrics and other materials.

4. Essential consumer goods (125 items), including certain medical preparations, some foods, and selected items of machinery and transport, heating and lighting equipment.

5. Nonessential consumer goods (460 items), including most fruits and vegetables, most beverages and tobacco products, toilet preparations, most leather goods, and many other consumer manufactures.

6. Unclassified goods (528 items), embracing numerous raw materials and a wide variety of manufactures (e.g., clothing, furniture, wood and cork manufactures) deemed to be produced locally in sufficient quantity and of acceptable quality to meet home demand and offered at competitive prices. The importation of items placed in this category was virtually banned, since specific authorization of the Central Bank was required to bring them into the country.

This essentiality classification remained until 1957 when in accordance with a resolution of the National Economic Council two new groups, semiessential producer goods and semiessential consumer goods, were added, and the highly essential class was replaced by a list of decontrolled items. At this time, the three consumer classes were defined as follows: (1) essential consumer goods—basic necessities of food, clothing, shelter, health, and education for low-income families defined as not earning more than $60 per month; (2) semiessential consumer goods—consisting of nonbasic goods for families with earnings of $60–$150 per month; and (3) nonessential consumer goods—luxury items for families earning over $150 per month. On the producer side the specification of the items to be included was: (1) essential producer goods—requirements of industries producing essential consumer goods, export goods, essential and semiessential producer goods and services including raw materials, and essential utility services; (2) semiessential producer goods—requirements of industries producing semiessential consumer goods, certain exports, and semiessential and nonessential producer goods; and (3) nonessential producer goods—requirements of industries producing nonessential consumer goods. In the allocation of foreign exchange an "adequate" supply was to be made available for imports of essential consumer and producer goods; a "limited" supply for semiessential producer goods; a "more limited" supply for semiessential consumer and nonessential producer goods, which was to be made available only after the requests for semiessential producer items were satisfied; and a "very limited" supply for nonessential consumer items. The 1957 resolution also reaffirmed a policy already in effect in 1954,[37] namely, that notwithstanding these priorities, "foreign exchange shall be made available only to the extent that the commodity proposed to be imported or any suitable substitute is not produced locally."

The main effect of placing all import control operations within the Central Bank was to improve the administrative efficiency of these activities rather than bring about any fundamental change in policy direction. In particular, import-substituting activities were vigorously and consistently pursued throughout the rest of the 1950s. As is noted in the 1954 *Annual Report* of the Central Bank, this was done by the "virtual decontrol of raw materials and machinery and the curtailment of foreign exchange allocations for commodities produced locally in sufficient quantities." At the same time controls on highly essential foods and medicines were eased, with the result that by 1957 all of these items were decontrolled and thus could be imported in unlimited quantities.[38]

TABLE 2-5

**Number of Items Shifted from One Import Classification to Another Between 1953 and 1958**

| | From | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| To | DC | HE | EP | EC | NEP | NEC | UI | Total |
| DC | | 11 | | 13 | | 1 | | 25 |
| HE | | | | | | | | |
| EP | | 1 | | 16 | 5 | 3 | | 25 |
| EC | | 1 | | | | | | 1 |
| SEP | | | 107 | 33 | 51 | 5 | 5 | 201 |
| SEC | | | | 5 | 1 | 9 | | 15 |
| NEP | | | 12 | 1 | | 40 | 4 | 57 |
| NEC | | | 4 | 12 | | | 2 | 18 |
| UI | | | 9 | 14 | 6 | 38 | | 67 |
| Total | | 13 | 132 | 94 | 63 | 96 | 11 | 409 |

DC = decontrolled items.
HE = highly essential items.
EP = essential producer goods.
EC = essential consumer goods.
SEP = semiessential producer goods.
SEC = semiessential consumer goods.
NEP = nonessential producer goods.
NEC = nonessential consumer goods.
UI = unclassified items.

NOTE: Categories are arranged from left to right and from top to bottom in roughly descending order of priority for allocation of foreign exchange for imports.

SOURCE: Central Bank of the Philippines.

These points are brought out in Table 2-5, in which are shown the changes made in the classification of goods between 1953 and December 1958. In the consumer goods classes, for example, 52 of the 190 shifts moved items into the unclassified list and thus resulted in the virtual banning of these imports. Articles so affected included writing ink, typewriter ribbons, sausages, roasted coffee, smoking tobacco, waxes and polishes, knitted fabrics, blankets, carpets, incandescent lamps, automobiles, cotton gloves, and lead pencils. At the same time such basic items as canned milk, canned fish, wheat flour, corned beef, and antibiotics (in bulk) were completely decontrolled. It also appears from the table that the exchange authorities must have sought to encourage the domestic production of many simply processed intermediate producer goods, since a large number of items were transferred to the semi-essential producer category. The growing emphasis on reducing imports of both consumption goods and nonessential producer goods in favor of essential producer goods is further brought out in Table 2-6, which contains the percentage distribution of import values on the basis of the 1957 exchange-control classification system. Between 1954 and 1959 imports of essential producer goods rose from 40 to 61 per cent of all imports.

As the above descriptions of the 1953 and 1957 exchange-control classes indicate, the criteria for allocating foreign exchange among commodity categories remained essentially unchanged throughout the 1950s. Consumption commodities regarded as necessary to maintain adequate nutritional and health levels for the population were imported very freely, whereas commodities considered to be nonessential luxury items were admitted very sparingly. The key change in the 1957 classification system was that it determined the difficult question of just how one should grade consumption goods by degree of essentiality on the basis of observed consumption patterns by level of income. In the 1957 system also, the goal was to direct a larger share of producer goods imports into the production of the more essential consumer and producer goods categories and of exports. However, in the 1953 and 1957 classifications, the practice was continued of virtually banning imports of an item that exchange-control authorities thought could be produced competitively within the country. The fundamental point to be made about the exchange-control system, however, is that its continued effect was to encourage the domestic production of the very items regarded as nonessential by the authorities.

Another feature of the operation of exchange controls during this period was the increasing Filipinization of the import trade. Between 1948 and 1958, the value of imports traded by Filipinos rose from 23 per cent to 54 per cent. The import share of American importers only declined from 28 per cent to 24 per cent between these years, but the share attributable to Chinese traders fell from 39 per cent to 14 per cent.[39] However, part of the trade classified as being undertaken by Filipino importers was in fact carried out by regular, non-Filipino importers. New Filipino importers sold their import licenses to these regular importers for substantial gains.[40]

TABLE 2-6

**Imports Classified by Official Category, 1954–63**
(percentage of total imports)

| Year | Essential Producer | Semiessential Producer | Nonessential Producer | Essential Consumer | Semiessential Consumer | Nonessential Consumer | Unclassified | Decontrolled |
|---|---|---|---|---|---|---|---|---|
| 1954 | 40.2 | 16.5 | 7.9 | 2.1 | 1.1 | 6.8 | 12.6 | 12.7 |
| 1955 | 46.5 | 11.6 | 8.4 | 3.9 | 0.7 | 5.3 | 9.5 | 14.0 |
| 1956 | 54.8 | 12.1 | 6.8 | 2.5 | 0.5 | 3.2 | 5.6 | 14.4 |
| 1957 | 52.0 | 12.2 | 6.9 | 3.4 | 0.7 | 3.5 | 8.0 | 13.2 |
| 1958 | 50.4 | 12.4 | 4.9 | 4.9 | 0.5 | 0.8 | 7.1 | 18.9 |
| 1959 | 61.3 | 11.9 | 3.7 | 1.1 | 0.6 | 1.1 | 7.1 | 13.1 |
| 1960 | 59.4 | 10.2 | 4.8 | 2.0 | 0.4 | 1.1 | 6.7 | 15.3 |
| 1961 | 60.2 | 9.4 | 6.2 | 1.6 | 0.5 | 1.6 | 6.8 | 13.7 |
| 1962 | 64.0 | 11.9 | 6.9 | 1.3 | 0.5 | 1.8 | 5.4 | 8.2 |
| 1963 | 59.7 | 11.3 | 7.5 | 1.4 | 0.6 | 2.7 | 8.3 | 8.5 |

SOURCE: Central Bank of the Philippines, *Statistical Bulletin*, March 1964, as cited by Gerardo P. Sicat, "Industrial Policy and the Development of Manufacturing in the Philippines" (University of the Philippines, School of Economics, Institute of Economic Development and Research, Discussion Paper 65-1, January 6, 1965).

**Monetary and Fiscal Policies.**

The same year (1953) in which the Central Bank assumed full authority for quantitatively controlling imports was also an election year. The Central Bank responded to the consequent pressures for easy exchange-control and credit policies by repealing the 80 per cent cash-deposit requirement for imports of specified luxury and nonessential items and by reducing the required ratio of net foreign-exchange holdings, cash in bank vaults, excess reserves, etc., to letters of credit from 70 to 50 per cent. Furthermore, government spending was significantly increased, and the internal government debt rose 45 per cent.

These expansionary policies were continued after the election of President Ramon Magsaysay, who immediately recommended that a truly integrated development program be planned and put into effect by the National Economic Council.[41] In order to finance the governmental portion of the resulting plan, the Congress authorized the President to borrow up to P1 billion. As part of the general expansionary program, the rediscount rate was lowered in January 1954 from 2 per cent to 1½ per cent per year. Since the capacity of the private sector to absorb government bonds was slight, most of the newly issued government debt ended up in the hands of the Central Bank. For example, in 1954–55 the expenditures of the government for development purposes totaled P331 million, of which P250 million was borrowed from the banking system. In 1955–56 and 1956–57 development expenditures[42] were P467 million and P488 million, with borrowings of P152 million and P129 million, respectively.[43] The money supply increased at an average annual rate of 9.2 per cent from 1954 to 1957. However, real GNP rose at an average annual rate of 6.7 per cent between these years, and the wholesale price index increased at an average yearly rate of only 1.6 per cent.

Central Bank authorities were, however, concerned about the potential inflationary effect of the monetary and expenditure expansion and did succeed in obtaining a credit tightening in 1957. The rediscount rate was raised from 1½ to 2 per cent in March and to 4½ per cent in September. The rate of interest paid on savings deposits was also raised from 2 per cent to 3 per cent in September. Furthermore, in April 1957 the Central Bank adopted a system of priorities on credits to commercial banks and imposed ceilings on the various categories established.[44] But it was not until after the presidential election, in November, that the pressures on the trade balance could be eased by significantly tightening import controls. The deficit on the trade account reached $182 million, the highest since 1949.

The main restraining measure adopted was the reintroduction of margin requirements on letters of credit, in September of 1957. A cash deposit of 100 per cent was required for imports of goods classified as nonessential. In December, imports of decontrolled items, essential consumer and producer goods, and semiessential producer goods were also made subject to the 100 per cent margin requirement, and imports of semiessential consumer and nonessential producer goods, to a 200 per cent margin requirement. Also at that time the opening of letters of credit for nonessential consumer goods, including those purchased through barter, was prohibited.[45]

As the balance of payments quickly improved, most of these measures were relaxed. In February 1958, margin requirements were lifted for imports of decontrolled items and for imports by essential and semiessential producers. In October the margin requirement was reduced from 200 per cent to 100 per cent for semiessential consumer goods and nonessential producer goods. In early 1959, imports of nonessential consumer goods were permitted, first only on a barter basis and then on a normal payment basis. However, a 100 per cent margin requirement was established for such imports.

At the same time that the Central Bank moved to ease its very stringent import controls, it also took various actions to curtail excess demand and reduce windfalls. The rediscount rate was raised in February 1959 from 4½ per cent to 6½ per cent with preferential rates of 4½ per cent given to agricultural crop loans and 5 per cent on export bills. In addition, the reserve requirement against demand deposits was raised in stages from 18 per cent to 21 per cent. Most important, however, was the imposition in July 1959, under R.A. 2609, of a 25 per cent "margin fee" levied by the Central Bank on sales of foreign exchange. The fee was not a tax in that it accrued to the Central Bank rather than the government. The level of this fee was reduced to 20 per cent in November 1960, 15 per cent in March 1961, and finally abolished in January 1962, though, as we shall see in the next chapter, its place was taken by other measures of depreciation.

The 25 per cent levy on foreign exchange was designed not merely to curtail the excess demand problem of the period but also to serve as a significant but uniform cushioning measure for the exchange decontrol that the government had finally decided to undertake.[46] Toward this end, by the act establishing the margin fee, the Central Bank was permitted to set the rate as high as 40 per cent, with the stipulation that application of the rate must be uniform. There were a number of exemptions from the fee, e.g., drugs and medicines, medical and hospital supplies, canned milk, and fertilizers, but significantly they did not include "new and necessary" industries. This move away from preferential treatment for these industries as well as other long-favored groups was further extended by two other laws, approved in June 1959 (R.A. 2351 and R.A. 2352), that eliminated the exemptions of "new and necessary" industries from the special import tax in force since 1955 as well as from the income tax.

As the preceding description indicates, during the 1950s (and also the

1960s) the government did not hesitate to employ deficit spending and easy credit policies either to improve the re-election probabilities of the party in power or to implement a particular development program. Consequently, the Central Bank alternately pursued liberal and restrictive monetary policies. At the outset of a new administration, for example, it would be required to provide credit on a liberal basis in order to stimulate economic growth. However, when this overly liberal monetary policy resulted in strong inflationary pressures as well as serious balance-of-payments problems, the Central Bank would attempt to solve these problems by quickly applying such restrictive monetary policies as higher rediscount rates and cash-deposit requirements for letters of credit.

**Increases in Tariff Levels.**

As the expiration date (1954) for the period of mutual free trade under the U.S.-Philippine Trade Agreement of 1946 approached, the Philippine government requested a re-examination and adjustment of various provisions of the agreement. The agreement was widely criticized in the Philippines on the grounds that it prevented the Philippines from exercising control over its own exchange rate, resulted in a sizable loss of potential tariff revenue, and granted the country a considerably smaller margin of preference in U.S. markets than initially because of subsequent U.S. tariff cuts. The result of the ensuing negotiations—and after the free trade period had been extended to the end of 1955—was the Revised Trade Agreement, better known as the Laurel-Langley Agreement. This new agreement accelerated the rate at which imports from the United States would be subject to the full amount of Philippine tariffs, while slowing down the initial rise in the application of U.S. tariffs to imports from the Philippines. Specifically, the percentage of each country's tariff rates applicable to imports from the other was set as follows (in place of the annual increases of five percentage points under the 1946 agreement):

| *Period* | *Philippine Imports from the United States* | *U.S. Imports from the Philippines* |
|---|---|---|
| 1956–58 | 25% | 5% |
| 1959–61 | 50 | 10 |
| 1962–64 | 75 | 20 |
| 1965–67 | | 40 |
| 1968–70 | 90 | 60 |
| 1971–73 | | 80 |
| After 1973 | 100 | 100 |

Besides these tariff changes, the absolute quota imposed by the United

States on rice was dropped, and those on cigars and scrap tobacco, coconut oil, and pearl buttons were turned into tariff quotas. The sugar and cordage quotas were retained, but the United States agreed that additional sugar quotas, when these became necessary, would be extended to the Philippines.[47] In return for these various concessions, the Philippines agreed to replace the 17 per cent excise tax on foreign-exchange sales with a 17 per cent tax on imports that was reduced 10 per cent i.e., 1.7 percentage points, each year from 1957 on. This change represented an important concession to American investors as well as shipping and insurance companies.

In addition to accelerating the rate at which the full height of Philippine tariffs would be attained against U.S. imports, the government also took steps to raise the level of these duties. The tariff schedule that went into effect after the war was essentially that which had prevailed since 1909. This schedule had been constructed mainly with revenue considerations in mind and was aimed at an ad valorem tariff level of about 23 per cent on dutiable imports from countries other than the United States. Since it was felt that this tariff schedule did not encourage the kind of industrialization sought by the government, a Tariff Commission was created, in 1953 (R.A. 911), and charged with making a thorough study of the duty structure. The Laurel-Langley Agreement went into effect before the Philippine Congress could agree on a new set of tariffs; so the President raised duties by executive order as of January 1, 1956.[48] However, a new tariff code finally was agreed upon and went into effect in June 1957. Under the new law not only were duty rates changed, but the President was given the authority to raise tariffs up to 400 per cent of their new levels or lower them by 50 per cent after an investigation by the Tariff Commission.

Under the 1957 act, duties were lowered on essential consumer goods (e.g., canned milk) and on essential raw materials and producer goods (e.g., tractor fuels and machinery) that were not likely to be produced in adequate supply domestically in the foreseeable future. On the other hand, they were raised on nonessentials and goods for which import-substitution possibilities were regarded as favorable (e.g., textile products and paper and paperboard manufactures). Valdepeñas calculated the following 1957 nominal tariff averages for a sample of 111 commodities classified by the essentiality categories of the Central Bank: highly essential goods, 15 per cent; essential consumer goods, 18 per cent; nonessential consumer goods, 51 per cent; essential producer goods, 25 per cent; nonessential producer goods, 30 per cent.[49] The distribution of dutiable items by tariff levels is shown in Table 2-7 for the 1949 and 1957 tariff schedules as well as for the rates prevailing in 1970. As this table shows, a number of duties were lowered in 1957, but so, too, were a number raised. On balance the simple average of duties rose from 23 per cent in 1949 to 36 per cent in 1957. A consideration of tariff changes by major

TABLE 2-7

**Distribution of Ad Valorem Duties, 1949, 1957, 1970**

| Percentage Range of Ad Valorem Rates | Percentage of Dutiable Items[a] | | |
|---|---|---|---|
| | 1949 | 1957 | 1970 |
| 0–5.0 | 1.0 | 1.8 | 1.8 |
| 5.1–10.0 | 12.5 | 29.9 | 26.8 |
| 10.1–15.0 | 18.1 | 9.8 | 9.3 |
| 15.1–20.0 | 13.8 | 8.2 | 8.0 |
| 20.1–25.0 | 21.0 | 8.7 | 7.6 |
| 25.1–30.0 | 11.2 | 3.1 | 4.0 |
| 30.1–40.0 | 13.5 | 7.1 | 7.3 |
| 40.1–50.0 | 5.6 | 6.8 | 7.5 |
| 50.1–60.0 | 2.0 | 4.3 | 5.7 |
| 60.1–90.0 | 1.0 | 8.0 | 9.5 |
| 90.1–100.0 | 0.3 | 9.0 | 8.8 |
| 100.1–250.0 | 0 | 3.4 | 3.6 |
| | 100.0 | 100.0 | 100.0 |
| Mean rate | 22.8 | 36.2 | 37.7 |

SOURCE: Philippine Tariff Commission.
a. In 1949, the ad valorem schedule included only about 300 items; by 1957 and 1970, the number had risen to about 1,200.

commodity categories from 1949 to 1957 brings out that for such simple manufactures as textiles and prepared foodstuffs tariffs were sharply increased, whereas for raw materials groups, such as chemicals, or capital goods categories, such as mechanical and electrical equipment, they were reduced on many items. The following description of the tariff structure, taken from a document prepared by the Tariff Commission, aptly describes not only the pattern of tariff protection, but also the protection pattern afforded by the exchange-control system of the 1950s.

> The height of duties, however, for different classes of products varies according to several factors, namely, essentiality of the articles, availability of the articles locally and comparability quality-wise of domestically produced articles with the imported. Essential articles may be either consumer or producer goods. Non-essentials include luxuries and articles normally consumed by the high-income consumers. On the basis of these factors, the structure of the Philippine tariff may be broadly described as follows:

1. Low rates are provided for essential consumer goods and essential producer goods which are not produced locally in sufficient quantity and of the desired quality.
   a) The essential consumer goods in this category consist of products which are consumed by the general mass of the people and necessary for their health and well-being.
   b) Essential producer goods include raw materials and intermediate goods used in the manufacture of locally made articles. Machineries, equipment and supplies used in domestic production also belong to the category of essential producer goods.
2. On the other hand, high rates of duty are imposed on luxuries and non-essential articles.
3. Protective duties are levied on articles produced locally in substantial quantity and acceptable quality. The level of the duty is considered according to the nature of the protected article, the production capacity of the local industry to meet the domestic demand, cost equalization, labor, raw materials, capitalization and other economic factors.[50]

When the 1957 Tariff Act was put into effect its main impact was to capture for the government a greater share of the windfall gains associated with the quantitative limitation of many imports through exchange controls. However, as is brought out in Chapter 5, when exchange controls were dismantled, in the early 1960s, and tariffs became effective constraints on import prices, the pattern of low duties on basic consumer goods, raw materials, and capital goods and high rates on luxuries and other nonessential goods continued to provide the same general structure of protection as existed under exchange controls.

**Tax and Financial Assistance to Industry.**

The policy of import substitution was further strengthened in the early 1950s by the enactment in 1953 of a new tax exemption law (R.A. 901) for "new and necessary" industries. The new law covered not only internal taxes but, unlike the 1946 law, it also covered external taxes (i.e., import duties, the sales tax, and the 17 per cent excise tax on foreign exchange). The extent of the tax exemption was 100 per cent through 1958, 90 per cent in 1959, 75 per cent in 1960, 50 per cent in 1961, and 10 per cent in 1962, after which the privilege expired. Not only did firms covered by the old act automatically receive the new benefits, but also firms whose exemption period had expired could apply anew for the privileges. The qualifications for "new" and "necessary" industries were similar to those of the previous law. A "new" industry was one not in existence on a commercial basis before January 1, 1945, and a "necessary" industry was one that would: (1) "contribute to the attainment of a stable and balanced national economy,"[51] (2) "operate in comformity with up-to-date practices" and give promise of "a reasonable degree of permanency," and (3) use imported raw materials that "do not exceed 60 percent of manufacturing cost plus reasonable selling and administrative expenses." Under the previous law a 50 per cent import-component ceiling had been imposed for raw materials.[52] During the six years (1953–58) when the exemption rate was 100 per cent, the tax exemption law of 1953 resulted in tax savings equivalent to 12.1 per cent of the annual sales of the firms involved.[53] This figure gradually decreased thereafter, e.g., to 9.1 per cent in 1960, until firms were liable to the full tax rate in 1963.

As already noted, the early response to the 1946 tax exemption law was disappointing; and it was not until tight import controls began, in 1950, that any significant number of entrepreneurs took advantage of the law. In 1950, 13 firms were granted tax exemptions, and by 1952, the number had risen to 48. After the revisions in 1953, the number rose to 321 in 1955 and 900 in 1958. The output of these 900 firms was P650 million, or 21 per cent of the gross output of all manufacturing firms in 1958.[54] The commodity distribution of the tax-exempt firms as of 1957 is shown in Table 2-8. It can be seen that the assistance provided under the tax-exemption program up to that date especially favored producers of nonessential consumer goods.

TABLE 2-8

**Tax-exempt Industries in the Philippines Classified by the Essentiality of Their Products, 1957**

| Product Category | Number of Enterprises | Per Cent |
|---|---|---|
| Nonessential producers | 49 | 6.3 |
| Semiessential producers | 118 | 16.1 |
| Essential producers | 228 | 29.5 |
| Nonessential consumers | 268 | 34.7 |
| Semiessential consumers | 29 | 3.1 |
| Essential consumers | 78 | 10.1 |
| Decontrolled | 2 | 0.2 |
| Total | 772 | 100.0 |

SOURCE: Jack Heller and Kenneth M. Kauffman, *Tax Incentives for Industry in Less Developed Countries* (Cambridge: Harvard Law School, 1963), Table VI, p. 121, as reported in G. P. Sicat, "Industrial Policy and the Development of Manufacturing in the Philippines" (University of the Philippines, School of Economics, Institute of Economic Development and Research, Discussion Paper 65-1, January 5, 1965), p. 32.

Still another impetus to economic development during this period stemmed from the easy long-term credit policies of various Philippine and international financing organizations. The Rehabilitation Finance Corporation (RFC),[55] for example, made loans totaling $788 million (P1,576 million) between 1947 and 1957, of which 55 per cent went to agriculture, 19 per cent to industry, 23 per cent for real estate construction and repair, 2 per cent for self-liquidating government projects, and 1 per cent for miscellaneous purposes.[56] The lending rate of the RFC was about 2 per cent below that prevailing in private markets.

Economic assistance from the United States and Japan also furthered the development and import-substitution goals of the Philippines. During the 1946–52 period American aid amounted to $777 million—$670 million in grants and $107 million in loans.[57] This early aid was used mainly for rebuilding and to meet urgent needs for consumption goods. Between 1953 and 1965 the aid figure came to $333 million, of which $260 million represented grants and $73 million, loans.[58] In allocating aid in this period, greater emphasis was placed on the industrialization goals of the country.[59] One-quarter of the aid went for industrial purposes. Other uses of this assistance were: food relief, 16 per cent; communications, 10 per cent; health and education, 12 per cent; community development, public administration, and miscellaneous purposes, 10 per cent. The government of Japan agreed in 1956 to make reparations to the Philippines equivalent to $550 million in capital goods, services, and cash over a twenty-year period. By April 1965 the sum received was $144 million. The main recipients were the shipping industry, the railroads, the Public Works Department, and the cement, textile, and paper and pulp industries.[60]

**Encouraging Exports.**

Few specific measures were taken in the 1950s to stimulate exports, and it was the pressure of traditional exporters that played a large role in finally bringing about the devaluations of the early 1960s. As is shown in Chapter 5, during the 1950s exporters suffered a significant decline in domestic purchasing power. The main policy taken to offset in part the penalty on exporters of an overvalued exchange rate was the enactment of the so-called No-Dollar Import Law of 1955 (R.A. 1410). Under this law, certain exports could be bartered for imports outside the exchange control system. The first set of rules limited barter transactions to "minor" exports, to any excess over the U.S. quotas for goods covered by the trade agreement between the two countries, and to any excess over the preceding five-year export average for all other goods. Presumably, the effective exchange rate for these barter transactions was at about the black-market exchange rate of P3 per dollar. Permitted imports were mainly restricted to producer goods and essential raw materials. In 1957 barter exports amounted to 10 per cent of total exports. After considerable oscillation in the rules covering allowable transactions and because of the strong opposition both of protected importers and the Central Bank, the law was repealed in 1959. However, a new law (R.A. 2261), An Act to Promote Economic Development by Giving Incentives to Marginal and Submarginal Industries, was passed in its place and specified a list of items as eligible for barter trade (subject to the conditions that they could not be sold profitably for dollars and were in adequate supply to meet local requirements).[61] In addition, the National Economic Council was directed to recommend annually to the Congress any additional industries that should be covered by the act.

Gold producers, who had accounted for about one-quarter of Philippine exports in the prewar period, were another group accorded preferential treatment under the exchange-control system. The details of the country's gold policy varied during the period, but its main features were a direct subsidy and permission to sell a portion of production in the higher-priced free market for gold rather than to the Central Bank. As Golay points out, in the years 1949–57, over 80 per cent of the country's production was sold on the free market.[62] Its average price was about $55 per ounce of gold rather than the official price of $35 an ounce.

Undervaluation of exports was a persistent problem throughout the period of tight exchange control as Philippine citizens used exports as a means of attempting to transfer funds abroad in expectation of a devaluation, to circumvent the limitation on funds available for foreign travel, or to diversify their foreign investment portfolios. Consequently, the export licensing system established as part of the exchange-control system was gradually tightened and made more elaborate. Exporters were eventually required to submit detailed evidence as to the quantity and kind or grade of the commodity exported, which was then authenticated at the port of discharge. Officials in the Export Department also undertook a thorough analysis of the proposed export prices before granting an export license. Despite these efforts, it was estimated by the Central Bank itself that at least 10 per cent of the dollar receipts from exports remained abroad rather than being turned over to the Central Bank.

## NOTES

1. Paul V. McNutt, *United States High Commissioner to [the] Philippine Islands——Final Report,* U.S. Congress, *House Document,* vol. IX (389), 80th Cong., 1st sess., 1947, pp. 20–21.
2. Central Bank of the Philippines, *Second Annual Report,* 1950, p. 15.

3. In 1945 the country's exports amounted to less than $1 million and its imports to $29 million. See R. Garcia, "Exchange Rate Policy in the Philippines," *Central Bank News Letter,* July 26, 1966.

4. See Philippine Economic Survey Mission *Revised Philippine Economic Development Program* (1950; dittoed).

5. The agreement also stipulated that Philippine exports of sugar, cordage, rice, cigars, scrap tobacco, coconut oil, and buttons of pearl shell were to be subject to absolute quotas in the U.S. market throughout the entire period of the agreement.

6. Agreement between the United States of America and the Republic of the Philippines, Article V, U.S. Department of State, *Treaties and Other International Acts,* Series 1588 (not dated).

7. Frank H. Golay, *The Philippines: Public Policy and National Economic Development* (Ithaca: Cornell University Press, 1961), p. 64. This U.S. legislation provided the Philippines with $620 million for war damages.

8. Still another attempt to increase the supplies of essential goods available for domestic purchasers was the imposition of export controls through Executive Order 192 in December 1948. This restricted the exportation of vital foodstuffs, important industrial goods, and a few construction materials. However, the Supreme Court of the Philippines declared the order null and void because it violated the Philippine Trade Act of 1946.

9. Examples of items included on this list were beer, wines, whiskey, automobiles, perfumes and other toilet preparations, toys, wool, silk and synthetic woven fabrics and ready-made wearing apparel, radios, boots and shoes, cigarettes, and fresh fruit.

10. Vicente B. Valdepeñas, Jr., *The Protection and Development of Philippine Manufacturing* (Manila: Ateneo University Press, 1970), Table 4.2, p. 56.

11. This relationship is analyzed in more detail in Chapter 6.

12. Miguel Cuaderno, Sr., *Problems of Economic Development* (*The Philippines—A Case Study*) (Manila: privately published, 1961), p. 20.

13. Valdepeñas, *Philippine Manufacturing,* p. 57.

14. An increase in the magnitude of the errors and omission item in the balance of payments from a debit level of $48 million in 1948 to $93 million in 1949 supports this view.

15. The reserve requirement for demand deposits remained unchanged at 18 per cent from 1949 to 1959. Little use has been made of open-market operations in the Philippines because of the absence of a significant bond market.

16. Valdepeñas, *Philippine Manufacturing,* p. 29.

17. Loc. cit.

18. Such consumption commodities as corned beef, fresh and frozen meat, spices, medicines, rubber boots and shoes, and jute bags were on this short list.

19. Butter, cheese, raw coffee, tea, hams, inexpensive cotton, silk and rayon textiles, cotton and rayon yarns, fresh oranges, apples, grapes and lemons, electrical batteries, nails, inexpensive radios, refrigerators, paints, and commercial explosives illustrate the type of commodities on this list.

20. Examples of such goods were bakery products, breakfast foods, fresh and canned fish, canned and dried fruits, canned and dried meat, tobacco products, electric stoves, musical instruments, lamps, writing paper, phonograph records, table and kitchen utensils, and inexpensive watches.

21. Leather manufactures, air-conditioning equipment, automobiles, small cameras, furs, whiskey and wines, phonographs, perfumes, sporting goods, toys, fresh and canned vegetables, and wood manufactures were among the items included in this list.

22. Golay, *The Philippines,* p. 28.

23. For example, the bank permitted students studying abroad to use a maximum of $2,400 per year for all living expenses exclusive of tuition and other expenses payable to the educational institution. Funds for the latter purpose were made available, but it was required that they be paid directly to the institution. For persons other than students situated abroad, a maximum of $200 per month was permitted for the necessary living expenses of each authorized beneficiary or dependent residing in North, Central, or South America, $50 per month for each such person in Asia, and $150 for each one residing in other countries. Payments of life insurance premiums on nonpeso policies were permitted if in force before December 9, 1949, but new or extended policies required the approval of the Central Bank.

24. Valdepeñas, *Philippine Manufacturing,* Table 3.1, p. 30.

25. See Golay, *The Philippines,* pp. 222–226; and Amado Castro, "Central Bank of the Philippines" (1970; mimeo.), p. 4.

26. Central Bank of the Philippines, *Annual Report,* 1951, p. 15.

27. Even the prices of controlled items rose above their established ceilings. The Central Bank found, for example, that in March of 1951, for a selected sample of 60 commodities, actual retail prices exceeded their ceiling levels by an average of 10.3 per cent.

28. Central Bank of the Philippines, *Annual Report,* 1951, p. 9.

29. Economic Survey Mission to the Philippines, *Report to the President of the United States* (Washington, D.C., October 5, 1950).

30. Central Bank of the Philippines, *Annual Report,* 1951, pp. 14–15.

31. Specifically, tax refunds were made on such foodstuffs as rice, flour, canned meat and fish, cattle and beef, and on textbooks and a long list of medicines and medical supplies.

32. As is further explained in the section on tariff changes, this 17 per cent excise tax on foreign exchange was replaced in 1957 by a 17 per cent special import tax on commodities. Furthermore, beginning in 1957, this tax decreased by 1.7 percentage points each year until it was finally eliminated in 1966.

33. Virginia Yapinchay, "General Theories and Mechanics of Trade Restrictions with Emphasis on Philippine Experience," *Central Bank News Digest,* June 14, 1955; Valdepeñas, *Philippine Manufacturing,* p. 60.

34. For an elaboration of these charges, see Caridad Carreon Semana, "Some Political Aspects of Philippine Economic Development" (Ph.D. diss., Harvard University, June 1965). Apparently payments to government officials amounted in some cases to as much as 50 per cent of the value of foreign exchange licenses. See A. V. H. Hartendorp, *History of Industry and Trade of the Philippines; the Magsaysay Administration* (Manila: Philippine Education Press, 1961), pp. 300–301.

35. Imports under "no-dollar remittance" referred to commodities for which no foreign-exchange allocation was made by the Central Bank.

36. In November 1972 the chairman of the Central Bank was made chairman of the Monetary Board. In addition, the president of the Philippine National Bank and the chairman of the Development Bank were replaced by the director-general of the National Economic Development Authority and the chairman of the Board of Investments.

37. Speech by A. Jison, reported in *Central Bank News Digest,* November 16, 1954.

38. Speech by I. M. Cuaderno, reported in *Central Bank News Digest,* March 26, 1957.

39. Golay, *The Philippines,* p. 318.

40. A. V. H. Hartendorp, *History of Industry and Trade of the Philippines* (Manila: American Chamber of Commerce of the Philippines, 1958), p. 678.

41. The function of the National Economic Council was to coordinate government economic policies.

42. Development expenditures by the government were concentrated on the construction of schools, hospitals, hydroelectric projects, communication facilities, and irrigation systems.

43. Cuaderno, *Problems of Economic Development,* p. 121.

44. In order of priority the categories were: Priority I, industrial loans; Priority II, public utility loans; Priority III, real estate loans; and Priority IV, consumption loans.

45. Imports of essential producer raw materials for industrial plants approved by the Central Bank and National Economic Council plus essential industries established before December 9, 1949, required only a 50 per cent margin requirement, and capital goods imports under deferred payment arrangements only a 25 per cent requirement. Another important feature of this restraining measure was the clause stating that imports "by the Philippine Government, its subdivisions, instrumentalities, government owned and controlled corporations and all other government agencies and importations under U.S. Public Law 480 and all ICA imports shall be given the same treatment as ordinary imports."

46. President Garcia stated in a speech on July 2, 1959, that over a three- or four-year period there would be a substantial relaxation of controls. Reported in *Central Bank News Digest,* July 14, 1959, pp. 4–5.

47. Valdepeñas, *Philippine Manufacturing,* p. 78.

48. His authority for doing so was based upon a 1954 law permitting him to raise tariffs by 100 per cent or reduce them by 60 per cent.

49. Valdepeñas, *Philippine Manufacturing,* p. 81.

50. Philippine Tariff Commission, "General View of the Present Philippine Tariff Structure" (July 31, 1970; mimeo.).

51. Industries listed in the appendix attached to the act as being conducive to its objective of attaining "a stable and balanced" economy were iron and steel products, processed local fuels, chemicals, copper and copper alloy products, refractors, processed foods, textile and fiber manufactures from local raw materials, fertilizers, agricultural equipment, refrigeration and air-conditioning equipment, raw plastic materials, porcelain products, paper and paper products, medical and pharmaceutical products, rubber manufacturers, electric motors, office and school equipment and supplies, household and kitchen utensils, and industrial abrasives.

52. John H. Power and Gerardo P. Sicat, *The Philippines: Industrialization and Trade Policies* (London: Oxford University Press, 1971), p. 80.

53. Philippine Chamber of Industries, *Official Proceedings,* Fifth National Convention of Manufacturers and Producers, Volume VIII, 1958.

54. Calculated from Philippine Chamber of Industries, *Official Proceedings;* and Philippine Bureau of the Census and Statistics, *Preliminary Report on BCS Annual Survey of Manufactures,* 1958, Tables 1 and 2.

55. In 1958, the name of this organization was changed to the Development Bank of the Philippines and its lending resources were increased.

56. Rehabilitation Finance Corporation, *Ten Years of the RFC* (Manila, 1957).

57. U.S. AID Mission to the Philippines, *A Survey of Foreign Economic Assistance Programs in the Philippines,* October 1964, p. 50.

58. Loc. cit.

59. Golay, *The Philippines,* pp. 299–300.

60. U.S. AID Mission, *Survey of Assistance*, p. 37.

61. The following items were specified: ore and concentrates of copper, iron, chrome, manganese, quicksilver, coal, muscovado sugar, embroidery, pearl buttons, low-grade hemp, saw logs, low-grade veneers and lumber, railway ties, industrial salt, cassava and products made thereof, snake and crocodile skulls, and peanuts.

62. Golay, *The Philippines*, p. 160.