Volume Title: Foreign Trade Regimes and Economic Development: Philippines

Volume Author/Editor: Robert E. Baldwin

Volume Publisher: NBER

Volume ISBN: 0-87014-505-3

Volume URL: http://www.nber.org/books/bald75-1

Publication Date: 1975

Chapter Title: Decontrol and Devaluation, 1960-65

Chapter Author: Robert E. Baldwin

Chapter URL: http://www.nber.org/chapters/c4100

Chapter pages in book: (p. 50 - 64)

Chapter 3

Decontrol and Devaluation, 1960–65

Continuing pressure from export producers, dissatisfaction with the way in which exchange controls were being administered, and a general disillusionment with the system because of its failure to maintain the high growth rates of the early 1950s finally led to a gradual easing of exchange controls and depreciation of the peso. The first section of this chapter contains a description of the various decontrol steps taken from 1960 through 1965; the economic effects of the liberalization effort are analyzed in the second section.

DECONTROL MEASURES

The major steps taken in the first two years of the liberalization period, i.e., Phase III in the Bhagwati-Krueger schema of exchange-control stages, are summarized in Table 3-1.

The Introduction of Multiple Exchange Rates.

Formal decontrol and liberalization began in April 1960 when the Central Bank introduced multiple exchange rates under Circular 105. Two rates were set: an official rate (later called the "preferred" rate), which equaled the existing rate of P2 per dollar, and a "free-market" rate which was initially set at P3.2 per dollar. "Free market" was a misnomer, since this rate was rigidly maintained by the Central Bank, to which all foreign exchange still had to be surrendered. The actual exchange rate that applied to sales of foreign

TABLE 3-1

Major Trade, Payments, and Related Economic Policies, 1960–61

April 1960	Establishment of multiple-rate system in which exchange rate on dollar, including margin fee, ranged between P2.5 for imports of essential goods to P4 for nonessential imports. Exchange rate for exports set at P2.3 per dollar.
Sept. 1960	Modification of "free-market" rate so that the most depreciated rate (i.e., that for nonessential imports) including margin fee was reduced to P3.75 per dollar. Export rate unchanged.
Nov. 1960	Increase in proportion of transactions taking place at "free-market" rate plus reduction of margin fee from 25 per cent to 20 per cent. Exchange rate on dollar including margin fee ranged from P2.4 for imports of highly essential goods and P2.5 for exports to P3.6 for imports of nonessential commodities.
June, Sept., and Nov. 1960	Reduction of rediscount rate in three stages from 6½ per cent to 5 per cent. Reserve requirement also decreased.
March 1961	Further increases in share of transactions taking place at P3 to the dollar. Margin fee reduced to 15 per cent. Thus, rate on dollar, including margin, ranged from P2.75 for exports and P2.87 for imports of highly essential goods to P3.45 for most transactions.
May 1961	Additional easing of credit conditions by decreasing rediscount rate to 3 per cent and further reductions in required reserve ratio.
June 1961	Passage of new tax exemption law permitting many major domestic manufacturing industries to waive import taxes on imports of machinery and equipment.

exchange to the Central Bank depended upon the proportions at which this exchange could be converted at the official and "free-market" rates. The initial proportions for purchases of exchange by the Central Bank are shown in Table 3-2.

Foreign exchange from the Central Bank for imports of items classified as essential consumer goods, semiessential consumer goods, essential producer goods, semiessential producer goods, and decontrolled items could still be purchased at the old rate of P2 to the dollar plus the 25 per cent margin fee on the sale of foreign exchange, i.e., an actual rate of P2.5 to the dollar.[1] All other import transactions took place at the rate of P3.2 per dollar plus the 25 per cent margin requirement.[2] The effective rate on these import transactions, taking account of the 25 per cent margin levy, was thus P4 pesos per dollar.

TABLE 3-2

Conversion Proportions of Foreign-Exchange Receipts by the Central Bank at Official and Free-Market Rates, April 1960

	Percentage to Be Surrendered at		Actual Pesos per Dollar
	Official Rate	Free-Market Rate	
Export receipts	75	25	2.3
Gold proceeds		100	3.2
Tourist receipts		100	3.2
Receipts from other invisibles	75	25	2.3
Receipts from U.S. government	75	25	2.3

SOURCE: Central Bank of the Philippines, *Annual Report*, 1960, p. 267.

It was also stated in Circular 105 that the proportion of transactions at the so-called free-market rate would be gradually increased and the 100 per cent level would be reached not later than 1964. About 25 per cent of all foreign-exchange transactions took place at the "free-market" rate in the first stage of decontrol.

In September 1960, the bank retreated somewhat in the extent to which it allowed the peso to depreciate by fixing the so-called free-market rate at P3 per dollar, exclusive of the margin fee. This reduced the most depreciated import rate from P4.00 to P3.75 per dollar inclusive of the 25 per cent margin. At the same time, however, the actual buying rate by the Central Bank for foreign-exchange receipts from exports, invisibles, and U.S. government transactions was maintained by increasing the proportion of exchange convertible at the free-market rate from 25 per cent to 30 per cent. The margin-deposit requirements introduced in 1957 with Circular 79 and which had been reduced in May were also revoked in September 1960.

The second stage of decontrol by the Central Bank began in November 1960 when changes were made in the proportions at which exchange was allotted at the two rates so as to lesson the gap between buying and selling rates for most classes of transactions. Half of all foreign-exchange receipts from exports, U.S. government expenditures, and invisibles other than those specifically mentioned could be converted into pesos at the preferred (official) rate and half at the free-market rate. The latter rate applied entirely with respect to foreign investments in the country, gold proceeds, foreign tourists' expenditures, and inward remittances of veterans and Filipino citizens as well as the personal expenses of diplomatic personnel. The preferred rate of P2 per dollar still held for imports of decontrolled items, but only 50 per cent of essential producer and essential consumer goods and 40 per cent of semiessential producer goods could be purchased at this rate. About one-half of all transactions took place at the "free-market" rate of P3 to the dollar. An accompanying measure to these changes was the lowering of the margin fee on the sales of foreign exchange by the Central Bank from 25 to 20 per cent.

Various rules were promulgated during the year, permitting foreign exchange to be purchased at the "free-market" rate without prior Central Bank approval. For example, quota-holding producers could purchase exchange at this rate in excess of their quotas, provided the exchange was for imports to be used for the maintenance or expansion of their existing lines of business.

Besides easing exchange controls, the Central Bank pursued a liberal credit policy during 1960 as part of its efforts to stimulate free-market forces and ease the adjustment of producers to the currency depreciation. The rediscount rate was reduced in June from 6½ to 6 per cent, with preferential rates remaining at 4½ and 5 per cent. In September the basic rate dropped to 5¾ per cent and then to 5 per cent in November.[3] The legal reserve requirement against peso demand deposits was also lowered: from 21 to 19 per cent in September, then to 18 per cent in November, and to 17 per cent in December.

As is indicated in Table 5-1, the impact of the various steps taken in 1960 was to increase the effective exchange rate—i.e., the number of pesos actually paid or received per dollar on international transactions of a particular type—by 38 per cent for imports of nonessential consumer goods and by 11 per cent for traditional exports.

Further Depreciation and Additional Adjustment Policies.

The Central Bank began the third phase of its decontrol program, in March 1961, by a currency depreciation for both selling and buying transactions. Seventy-five per cent of export proceeds, exchange from U.S. government transactions, and, subject to certain exceptions, invisibles could be surrendered at the "free-market" rate of P3 per dollar. The conversion ratio at this rate for foreign investment, gold proceeds, etc., remained at 100 per cent. Importers of decontrolled items were permitted to pay the lower preferred rate on 50 per cent (rather than, as before, 100 per cent) of the Central Bank exchange allocations to this category. Twenty-five per cent of the import requirements of dollar-earning industries could also be purchased at the favored P2-per-dollar rate. Except for government expenditures up to June 30, 1961, and forward exchange contracts approved by the Central Bank, sales by the Central Bank for all other purposes took place at the P3-per-dollar rate. This included purchases in excess of licenses granted by the Central Bank. The bank reported that 75 per cent of all foreign-exchange transactions took place at this depreciated rate. Still another liberalizing measure, adopted in March 1961, was a further reduction of the margin fee on foreign-exchange sales from 20 per cent to 15 per cent. At this stage the actual level for the "free-market" rate was thus P3.45 per dollar.

In early 1961, profits and dividends earned on foreign investments approved after January 1, 1960, were permitted to be remitted entirely at the "free-market" rate. The nonremittable part of nonresidents' profits or earlier investments could be used to purchase gold from local producers at a specified subsidy price, i.e., above $35 an ounce, and then exchanged at the Central Bank for foreign exchange at the official rate of $35 per ounce of gold. Foreign technicians and executives employed by firms doing business in the Philippines were allowed to remit abroad up to 50 per cent of their salaries at the "free-market" rate.

A policy of monetary ease continued to be pursued during 1961 despite a reduction in international reserves. The reserve requirement on peso demand deposits was cut from 17 to 16 per cent in January and then to 15 per cent in May. In the same month the rediscount rate for all types of transactions was cut to 3 per cent, and portfolio ceilings on real estate loans were eased. The money supply rose 16 per cent during the year. Because 1961 was a presidential election year, there was also a sharp increase in the government's cash deficit and in borrowing from the Central Bank.

As previously noted, unclassified items (UI) could be imported only when specifically authorized by the Central Bank and in effect were banned. Consequently, one way that the pressures of exchange liberalization were eased for certain industries was by transferring import-competing goods into the UI category. During 1960 and 1961 some twenty-eight commodity lines were transferred to this classification.[4] As of mid-1960, about one-third of all import items (in terms of their classification numbers) were already unclassified.

Local firms engaged in producing refrigerators, air-conditioners, beverage coolers, and other refrigerating units were also helped by a change in the sales tax (or its equivalent for direct users of imports, the compensating tax). The tax on local firms was reduced from 30 per cent to either 15 or 7 per cent, depending upon whether the firm processed a relatively high or low share of raw materials into intermediate inputs. Imported equipment of this type still was taxed at a rate equivalent to 45 per cent.

In addition to being assisted in their adjustment by easy credit, an expansionary fiscal policy, and import-classification changes, most of the key import-substitution industries were helped by the enactment of a new tax-exemption law in 1961—the so-called Basic Industries Act (R.A. 3127). This permitted the special import tax, the compensating sales tax, the margin fee on foreign exchange, and import duties on imports of machinery, spare parts, and equipment to be waived for many major lines of domestic manufacturing as well as several nonmanufacturing activities.[5] However, implementation of the act was delayed by lack of operating funds, and no grant was extended until February 1963. Amendments were made to the act, in both 1964 and 1965, which changed the industry coverage somewhat as well as the schedule of exemptions. As of 1965, a 100 per cent tax exemption was granted through 1967; 75 per cent for 1968 and 1969; and 50 per cent for 1970 and 1971. Thereafter, the full amount of the taxes was to be paid. After 1965 both the margin fee on foreign exchange and the special import tax were lifted, so that the tax exemption applied only to import duties on machinery and spare parts, and to the sales tax. Between 1963 and 1967 exemptions totaling P121 million were granted—a sum that amounted to only 80 per cent of the exemptions granted in the last year (1961) of the old act. The plywood and veneer industry received 25 per cent of the exemptions; the food industry, 24 per cent; and the textile industry, 22 per cent.[6]

During the second year of exchange decontrol (1961) the effective exchange rate for imports of nonessential consumer goods increased less than 1 per cent while the rate for traditional exports increased by 21 per cent. The rates for imports of essential consumer goods and producer goods for "new and necessary" industries rose 40 per cent from 1960 to 1961.

Complete Exchange Decontrol.

With the inauguration of President Diosdado Macapagal, the liberalization timetable of the previous administration was scrapped. Full exchange decontrol was decreed on January 21, 1962, under Circular 133 of the Central Bank. This continued liberalization marks the beginning of Phase IV in the Bhagwati-Krueger schema. The major policy changes that occurred in this period are indicated in Table 3-3. Under the decontrol order licenses were no longer required for any imports, exports, or invisibles. However, the order stipulated that imports (except "no-dollar" imports) must be covered by letters of credit and that a special time deposit must accompany letters of credit. The time-deposit requirement varied with the essentiality classification of imports in the following manner: unclassified items and nonessential consumer goods, 150 per cent; nonessential producer goods and semiessential consumer goods, 100 per cent; semiessential producer goods, 50 per cent; essential consumer goods, essential producer goods, and decontrolled items, 25 per cent. Importers were required to maintain the time deposits in their banks for at least 120 days, and the banks were required to hold reserves on the deposits equivalent to 100 per cent of their value. The margin levy on foreign exchange was suspended.

TABLE 3-3

Major Trade, Payments, and Related Economic Policies, 1962–65

Jan. 1962	Removal of most exchange controls and elimination of margin fee. Peso floated in free market. However, special time-deposit requirements imposed on imports; exporters required to surrender 20 per cent of their foreign-exchange receipts at old rate of P2 per dollar. Import duties on many items raised at same time that exchange controls were lifted.
June 1962	Free-market rate stabilized at P3.90 per dollar. With 20 per cent surrender requirement, rate for exporters became P3.52 per dollar.
Jan. 1962	Both rediscount rate and reserve requirement raised (former to 6 per cent).
1962–64	Some easing of special time-deposit requirement.
Nov. 1965	Elimination of penalty rate for exporters and formal move to unified exchange rate of P3.90 per dollar.

In addition to eliminating virtually all controls, the Central Bank floated the peso in the free market. However, the Central Bank intervened in the market through the Philippine National Bank to prevent excessive short-run fluctuations. All import transactions took place at the free-market rate, but 20 per cent of the receipts from exports and invisibles had to be surrendered to the Central Bank at the official rate of P2 per dollar.[7] Thus, in effect, the bank continued to impose a tax on exporters. The free-market rate rose slowly until May 1962 when it reached a temporary plateau of P3.54 per dollar. However, in June, the rate rose again to around P3.90 per dollar, and the Central Bank supported this rate. The rate remained stable at this level, and in November 1965 the peso was formally devalued from P2 per dollar to P3.90 per dollar.

The unfavorable export rate and the special time deposits were directed primarily at curtailing inflationary forces that could nullify the move toward a more realistic exchange rate. Other anti-inflationary steps were also taken. In January 1962, the rediscount rate for commercial banks was raised from 3 to 6 per cent, and the reserve requirement was increased from 15 to 19 per cent. Later in the year, however, there was some easing of credit controls. In March, the special time deposit was abolished for decontrolled items, essential consumer goods, and essential producer goods. At that time the Central Bank also stipulated that the time-deposit requirement, where applicable, could be made in government securities as well as cash. These changes were followed, in May, by a cut in the time-deposit requirement for unclassified items and nonessential consumer goods from 150 to 100 per cent; for nonessential producer goods and semiessential consumer goods from 100 to 75 per cent; and for semiessential producer goods from 50 to 25 per cent.[8]

The easing of the time-deposit requirement continued into 1963 when imports of machinery, spare parts, and equipment by firms coming under the new tax exemption law of 1961 (R.A. 3127) were exempted from the requirement.[9] A slight concession to exporters was also made in September 1963 by excluding the cost of freight from the export proceeds required to be surrendered to the Central Bank at the official rate. In December 1964 the 20 per cent surrender requirement was further modified to exempt exports with a 1962–63 average annual value of $2 million or less. This represented an attempt to stimulate exports of manufactured goods. Finally, on November 6, 1965, the 20 per cent requirement was completely eliminated, and a unified exchange rate of P3.90 per dollar was officially established.

Besides exempting imports of equipment and raw materials by many new manufacturing industries from the special time-deposit requirement, the government granted special credit arrangements to these industries and increased the tariffs protecting them. In 1962, for example, the 3 per cent preferential rediscount rate of the Central Bank was extended to food processing; textiles; drug-making; veneer, plywood, and prefabricated products; farming and livestock; fisheries; cassava and coconut flour; the marketing and distribution of the foregoing products; and home construction approved by the government. Moreover, at the time that most controls were eliminated, in January 1962, tariffs on nearly 700 articles were raised in order to protect local industries from the greater import competition associated with the decontrol program.[10] Other increases in import duties occurred in later years of the decontrol period. Additional protection against imports from the United States was also provided in 1962 by the scheduled increase from 50 per cent to 75 per cent in the share of Philippine duties applicable to these imports. As provided by the Revised Trade Agreement of 1955, this ratio was then raised to 90 per cent in 1965.[11]

ECONOMIC EFFECTS OF EXCHANGE-CONTROL LIBERALIZATION

In undertaking the decontrol efforts between 1960 and 1965 the main objectives of the government were to satisfy the persistent demands of exporters for a more favorable exchange rate and, by relying more on free-market forces, to meet charges of favoritism and poor administration in allocating foreign exchange. There was no intent to bring about a significant contraction in the industrial sector, where development had been fostered by exchange controls. It is for this reason that decontrol measures were coupled with such actions as tariff increases, the extension of especially favorable credit terms to certain industries, and the granting of tax exemptions to so-called basic industries. The discriminatory sales taxes and the highly protectionist tariff system, which became effective as quantitative controls were eliminated, also did much to continue the sheltering of domestic industry from foreign competition. In short, exchange controls were removed, but liberalization in the sense of a significant easing of all controls over imports did not occur.

Import Prices and Quantities.

From 1959 to 1962, when the exchange rate per dollar including the margin fee rose from P2.50 to P3.90, or by 56 per cent, the wholesale price index of imported products increased only 22 per cent. If the rise in the dollar price of imports is taken into account, the net rise in import prices associated with the increase in the price of foreign exchange was only 15 per cent. In view of the very high windfall profits that had existed on most imported goods, this much smaller rise in the peso prices of imported goods compared with the peso price of a dollar is not surprising. Permitting unlimited imports of most items at the same time that the currency was depreciated meant that these windfall gains absorbed most of the price-increasing effects of the depreciation.[12]

Further information on price behavior can be obtained by grouping the imported goods included in the wholesale price index according to exchange control classes. Classifying on this basis indicates the following price rises from 1959 to 1962: essential consumer goods, 46 per cent; essential producer goods, 20 per cent; semiessential producer goods, 11 per cent; and nonessential consumer goods, 9 per cent.[13] The higher price rise for more essential goods conforms to what would be expected, since these were already being imported quite liberally in 1959, and importers did not, therefore, reap large windfall gains. Thus, a larger share of the increased peso cost of foreign goods had to be passed on to wholesalers.[14]

This larger price rise in essential goods also meant, of course, that the decontrol efforts were successful in narrowing somewhat the differences in the degree of protection among nonessential consumer goods, essential producer goods, and essential consumer goods. In 1959 the price indices (1949 = 100) for nonessential consumer goods and essential producer goods were 2.25 and 1.25 times higher, respectively, than the price index for essential consumer goods. In 1962 these ratios were only 1.69 and 1.03. However, decontrol was only a partial effort toward equalizing incentives among manufacturing sectors. Removing the windfall gains associated with exchange controls still left the highly protective system that resulted from the 1957 Tariff Code and the discriminatory system of sales taxes. Furthermore, as noted earlier, tariff rates for many import-substitution industries were sharply raised at the time of the 1962 exchange-rate depreciation. The explicit tariff rate for a sample of nonessential consumer goods analyzed by Valdepeñas increased from 51 per cent in 1957 to 83 per cent in the 1962–67 period.[15] Import duties on essential consumer goods rose from 18 to 38 per cent in the same period; producer goods, from 25 to 47 per cent.

Some information on the behavior of import quantities during the decontrol episode can be obtained by grouping imports according to exchange-control categories and then constructing quantity indices for these categories. However, because of the well-known serious deficiencies with unit values even at the most detailed level at which import statistics are reported, the results of this exercise must be regarded with some skepticism. They show the following percentage changes in import quantities between 1959 and 1962: essential consumer goods, −13.0; essential producer goods, −3.0; semiessential producer goods, −18.0; and nonessential consumer goods, +19.0.[16] The rise in imports of nonessential consumer goods relative to essential consumer and producer goods is what one would expect from the decontrol program unless there were offsetting tariff changes. Although tariffs on nonessential consumer goods were raised, apparently these increases were not enough to counter entirely the effect of easing the previously severe restrictions on importing nonessential consumer goods. Presumably the significant decline in imports of semiessential producer goods is related to the rise in imports of nonessential consumer goods, since the former set of goods are used in part to produce the latter goods domestically.

Manufacturing and Export Activities.

Many import-competing manufacturing activities were, of course, adversely affected by the liberalization because manufacturers who had directly imported raw materials and capital goods at the exchange rate of P2 to the dollar and thus had reaped the windfall gain themselves now were faced with higher input costs. Import prices of competitive final outputs also increased but by less than the price increase for imported producer goods. The average annual rate of growth in the manufacturing sector declined from 7.7 per cent between 1957 and 1959 (a rate already considerably less than that during the early 1950s) to 3.8 per cent from 1960 to 1962 and 3.7 per cent for the entire 1960–65 period. The unfavorable impact of decontrol on non-export-oriented manufacturing is confirmed by Castro's study of profit rates before and during the liberalization period.[17] His figures show that the ratio of net profits (after taxes) to total assets for manufacturing firms (excluding sugar mills, lumber and plywood, and cordage) fell from 11.8 per cent for 1957–59 to 6.4 per cent for 1960–62.

The main test of the success of a liberalization effort is whether or not resources are pulled into export activities. Export values did indeed rise significantly during the decontrol period (see Table 1-2 and Chart 1-1). From a level of about $550 million between 1959 and 1962, exports rose after the 1962 depreciation to around $750 million between 1963 and 1965. With the removal in 1965 of the penalty rate against exporters, the value again jumped in the next year to about $850 million. (In volume terms, the increase was 24 per cent between 1962 and 1963 and 6 per cent between 1965 and 1966.) As is pointed out in Chapter 5, Hicks has shown that there was considerable understatement of the value of exports between 1960 and 1962, whereas exports were slightly overvalued in 1963.[18] After 1965, declared export values again were too low. Thus, the export rise associated with the devaluation actually consisted more of a fairly steady increase between 1959 and 1966 than spectacular increases in a few years. After adjusting the declared value by Hicks's corrective factors, the increase in export values between these two years still turns out to be an impressive 57 per cent. Even deducting the $20 million increase in the value of sugar exports between 1959 and 1966, which was due to the U.S. quota increase, still gives a 53 per cent increase in the value of exports between these years.

The increase in the growth rate of exports covered manufactured as well as nonmanufactured commodities. Between 1956–61 and 1962–66 the average yearly growth rate of manufactured exports increased from 6.0 per cent to 7.9 per cent.[19] If traditional manufactured exports, namely, coconut oil and sugar, are excluded from these exports, the export growth rates for these two periods are 8.5 per cent and 14.6 per cent, respectively. Although these are impressive increases in growth rates, the rise between these periods in the growth rate for exports of nonmanufactured commodities was even larger.[20]

Not only was the shift in resources toward export activities reflected directly in the value of exports, but also in profit rates, savings, and levels of productive activity in the export sector. Castro found, for example, that in contrast to the decline for his sample of manufacturing firms, profit rates for mining corporations rose from 11.2 per cent for 1956–59 to 16.2 per cent for 1960–62. The corresponding rise for agricultural corporations was from 4.7 to 4.9 per cent.[21] Another manifestation of this shift in income is seen in the findings of Paauw and Tryon that, after a decade of dissaving, agricultural savings turned positive in 1961 and grew rapidly through 1964 (the last year for which they have data on savings).[22] The most significant shift in production in the agricultural sector occurred in the area devoted to commercial export crops and to food crops produced for domestic consumption. As Treadgold and Hooley point out in their excellent analysis of the redistributive effects of the decontrol effort, the proportions in which the supply of cultivatable land is divided between these two types of productive activities are quite responsive (with a time lag) to the relative prices of agricultural export products and agricultural products for home consumption.[23] Thus, when export prices (in pesos) rose relative to the prices of locally consumed foods during the early phases of the liberalization period, there was a sizable shift toward the production of export crops. Specifically, the harvested area of commercial crops, which had risen only about 3 per cent between 1955 and 1960, increased over 40 per cent from 1960 to 1965, whereas the harvested area of food crops increased nearly 30 per cent in the first period but remained unchanged in the second. Similarly, the output of commercial crops increased at an annual average rate of 1.9 per cent from 1955 to 1960 and 6.1 per cent annually from 1960 to 1965, in contrast to an annual rate for food output of 4.4 per cent in the 1955–60 period and 3.1 per cent in 1960–65.

Not only did the shift away from cultivating food crops in favor of export crops tend to cause a supply-induced rise in food prices, but the redistribution of income toward the rural sector tended to reinforce this rise from the demand side, since the expenditure elasticity in the Philippines for food products has been found to be 0.76 for rural families compared to only 0.41 for urban families.[24] The net effect of these forces was that the food component of the consumer price index rose 58 per cent between 1959 and 1965, most of the rise occurring in the second half of that period. The other components of the cost of living index increased by the following percentages between these years: clothing, 27; rent and repairs, 7; fuel, light, and water, 18; and miscellaneous items, 15. The rise in the composite index was 33 per cent.[25]

The rise in the absolute price level during the early 1960s was related to the easy credit policies pursued by the monetary authorities. As previously noted, the rediscount rate was cut from 6.5 per cent in 1959 to 3 per cent by 1961, and the reserve requirement for commercial banks was reduced from 21 per cent in 1959 to 15 per cent by 1961. The result was that the money supply increased at an annual average rate of nearly 16 per cent between 1960 and 1963 as compared to an annual average rate of only 6.5 per cent between 1953 and 1960.

The burden of the rise in food prices fell to a considerable extent upon industrial workers, since their money wage rates rose only modestly in response to increasing prices. From 1959 to 1964, money wage rates for skilled and unskilled workers rose 6 per cent, and for unskilled workers, 12 per cent, while the consumer price index increased 28 per cent. However, in 1965 an increase of 2 pesos per day in the minimum wage rate helped to restore part of the real wage loss for unskilled workers. Consequently, as of 1965 real wage rates for these workers were 8 per cent below the 1959 level.[26] Of course, the increase in money wages placed still further pressures, in addition to those resulting from the increased costs of imported inputs, on profit rates in the industrial sector.

Conclusions.

As mentioned at the outset of this section, the government dismantled exchange controls mainly because of the corruption and maladministration connected with them and the pressures of exporters for a more favorable exchange rate. President Macapagal took special care in his 1962 address on the state of the nation to inform the business community that the government, in removing controls, wished merely to substitute tariff protection for the protection provided by the control system.[27] Protection of domestic industry was in itself regarded as a legitimate and desirable goal. Consequently, the fact that the decontrol effort did not significantly reduce the size of the import-substitution sector built up during the period of quantitative controls is not surprising. Actually, what must have surprised government officials was the extent of the economic difficulties that the import-substitution sector did face. They did not seem to appreciate that, by providing the export sector with more favorable trading terms and increasing the import costs of raw materials and capital goods, resources would be pulled out of the new industrial sector even if the level of protection on final consumption goods was maintained. In a sense, the decontrol episode was partly successful in changing the production incentives built into the economy during the 1950s despite the intentions of the government. But the resulting situation was not very satisfactory from an economic standpoint, since a significant liberalization effort that could have established the basis for a new type of export-oriented growth was not achieved and the import-substituting manufacturing sector was left in a relatively stagnant state.

NOTES

1. This selling rate also applied to Philippine government purchases, reinsurance premiums, and existing contractual obligations previously approved by the Central Bank.

2. As before, unclassified items could not be purchased without specific authorization of the Central Bank. The extent of the depreciation was increased by transferring 29 items previously classified as essential producer goods as well as 67 items previously classified as semiessential producer goods to the category of nonessential producer goods.

3. At that time the preferential rates for loans secured by agricultural or industrial

paper declined from 4½ to 4 per cent, and for loans secured by export bills, from 5 to 4 per cent.

4. These included a wide array of textile items, certain sizes of corrugated roofing sheets and plain galvanized sheets, unsweetened chocolate, chewing gum, book cloth, certain types of raw or green coffee, Portland cement, and certain parts of radios and radio-phonograph combinations.

5. Some of the industries enumerated in the act as "basic industries" were basic iron, nickel, aluminum, and steel; basic chemicals; copper and aluminum smelting and refining; pulping and the integrated manufacture of paper products; refining of gold, silver, and other precious materials; mining and exploration of base metals and crude oil or petroleum; production of agricultural crops; logging and the manufacture of veneer and plywoods; vegetable oil manufacturing, processing, and refining; manufacture of irrigation equipment and farm machinery; production and manufacture of textiles, cotton, ramie, synthetic fibers, and coconut coir; and the manufacture of food products.

6. Vicente B. Valdepeñas, Jr., *The Protection and Development of Philippine Manufacturing* (Manila: Ateneo University Press, 1970), pp. 47–50.

7. Certain foreign-exchange obligations of the Central Bank also were amortized at the official rate.

8. The May circular also excluded raw materials imports by local industries from the special time-deposit requirement and permitted the financing of those goods not requiring time deposits by means of documents against payment and documents against acceptances not exceeding 90 days.

9. The financing of imports not covered by the time-deposit requirement was also extended from 90 to 120 days for producing importers (but not merchant importers), and open-account financing of raw materials by local industries was permitted for 120 days.

10. President Diosdado Macapagal, "Five-Year Integrated Socio-Economic Program for the Philippines," in *A Stone for the Edifice: Memoirs of a President* (Quezon City: Mac, 1968).

11. In 1964 local manufacturers of phonographs, combination radio and phonograph sets, television sets, and combination radio and television sets were also granted the same type of tax preference given local manufacturers of refrigerating equipment in 1961. Specifically, the sales or compensating tax for domestically manufactured items in this group was reduced to 7 per cent, while the tax on imports was still held at 45 per cent.

12. It is theoretically possible for import prices either to rise or fall when a currency is depreciated and exchange controls are abandoned.

13. Table 5-6 contains price information for these groups of commodities from 1951 to 1970.

14. The tariff increases on imported nonessential consumer goods also acted to absorb part of the windfall gains earned on luxury imports and therefore had the effect of requiring part of the increased peso costs of importing to be passed on in the form of higher prices. However, these tariff increases were not sufficient to raise wholesale prices for imported nonessential consumer goods as much as for imported essential items.

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

16. The number of items included in the indices are 9 for essential consumer goods, 42 for essential producer goods, 14 for semiessential producer goods, and 26 for nonessential consumer goods. Unit values for 1962 were used as weights for the various quantities.

17. Amado A. Castro, "Philippine Export Performance," in T. Morgan and

N. Spoelstra, eds., *Economic Interdependence in Southeast Asia* (Madison: University of Wisconsin Press, 1969), pp. 189–192.

18. George L. Hicks, "Philippine Foreign Trade, 1950–1965: Basic Data and Major Characteristics" and "Supplementary Data and Interpretations, 1954–1966" (Washington, D.C.: National Planning Association, Center for Development Planning, 1967; mimeo.).

19. Gerardo P. Sicat, *Economic Policy and Philippine Development* (Quezon City: University of Philippines Press, 1972), p. 69.

20. Ibid., p. 71.

21. Castro, "Philippine Export Performance," p. 190.

22. Douglas S. Paauw and Joseph L. Tryon, "Agriculture-Industry Interrelationships in an Open Dualistic Economy: The Philippines, 1949-1964," in "Growth of Output in the Philippines" (Papers presented at a conference of the International Rice Research Institute, Los Baños, Laguna, December 9–10, 1966; mimeo.), pp. 7-34 and Table X.

23. M. Treadgold and R. W. Hooley, "Decontrol and the Reduction of Income Flows: A Second Look," *Philippine Economic Journal,* Second Semester 1967, pp. 109–128.

24. From an unpublished study by J. Williamson and A. Kelley.

25. For a more detailed analysis of the manner in which various items on the index behaved as well as for a general discussion of the food inflation, see A. C. Ross, "Understanding the Philippine Inflation," *Philippine Economic Journal,* Second Semester 1966, pp. 228–259.

26. The increase in the minimum wage also probably increased unemployment among unskilled workers.

27. Macapagal, *Five-Year Program,* p. 21.