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# Foreign Trade Regimes and Economic Development: THE PHILIPPINES

# Foreign Trade Regimes and Economic Development:

*A Special Conference Series on Foreign Trade Regimes and Economic Development*

VOLUME V

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# THE PHILIPPINES

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## *Relation of the Directors of the National Bureau to Publication of the Country Studies in the Series on Foreign Trade Regimes and Economic Development*

The individual country studies have not passed through the National Bureau's normal procedures for review and approval of research reports by the Board of Directors. In view of the way in which these studies were planned and reviewed at successive working parties of authors and Co-Directors, the National Bureau's Executive Committee has approved their publication in a manner analogous to conference proceedings, which are exempted from the rules governing submission of manuscripts to, and critical review by, the Board of Directors. *It should therefore be understood that the views expressed herein are those of the authors only and do not necessarily reflect those of the National Bureau or its Board of Directors.*

The synthesis volumes in the series, prepared by the Co-Directors of the project, are subject to the normal procedures for review and approval by the Directors of the National Bureau.

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# Co-Directors' Foreword

This volume is one of a series resulting from the research project on Exchange Control, Liberalization, and Economic Development sponsored by the National Bureau of Economic Research, the name of the project having been subsequently broadened to Foreign Trade Regimes and Economic Development. Underlying the project was the belief by all participants that the phenomena of exchange control and liberalization in less developed countries require careful and detailed analysis within a sound theoretical framework, and that the effects of individual policies and restrictions cannot be analyzed without consideration of both the nature of their administration and the economic environment within which they are adopted as determined by the domestic economic policy and structure of the particular country.

The research has thus had three aspects: (1) development of an analytical framework for handling exchange control and liberalization; (2) within that framework, research on individual countries, undertaken independently by senior scholars; and (3) analysis of the results of these independent efforts with a view to identifying those empirical generalizations that appear to emerge from the experience of the countries studied.

The analytical framework developed in the first stage was extensively commented upon by those responsible for the research on individual countries, and was then revised to the satisfaction of all participants. That framework, serving as the common basis upon which the country studies were undertaken, is further reflected in the syntheses reporting on the third aspect of the research.

The analytical framework pinpointed these three principal areas of research which all participants undertook to analyze for their own countries.

Subject to a common focus on these three areas, each participant enjoyed maximum latitude to develop the analysis of his country's experience in the way he deemed appropriate. Comparison of the country volumes will indicate that this freedom was indeed utilized, and we believe that it has paid handsome dividends. The three areas singled out for in-depth analysis in the country studies are:

1. *The anatomy of exchange control:* The economic efficiency and distributional implications of alternative methods of exchange control in each country were to be examined and analyzed. Every method of exchange control differs analytically in its effects from every other. In each country study care has been taken to bring out the implications of the particular methods of control used. We consider it to be one of the major results of the project that these effects have been brought out systematically and clearly in analysis of the individual countries' experience.

2. *The liberalization episode:* Another major area for research was to be a detailed analysis of attempts to liberalize the payments regime. In the analytical framework, devaluation and liberalization were carefully distinguished, and concepts for quantifying the extent of devaluation and of liberalization were developed. It was hoped that careful analysis of individual devaluation and liberalization attempts, both successful and unsuccessful, would permit identification of the political and economic ingredients of an effective effort in that direction.

3. *Growth relationships:* Finally, the relationship of the exchange control regime to growth via static-efficiency and other factors was to be investigated. In this regard, the possible effects on savings, investment allocation, research and development, and entrepreneurship were to be highlighted.

In addition to identifying the three principal areas to be investigated, the analytical framework provided a common set of concepts to be used in the studies and distinguished various phases regarded as useful in tracing the experience of the individual countries and in assuring comparability of the analyses. The concepts are defined and the phases delineated in Appendix C.

The country studies undertaken within this project and their authors are as follows:

| | |
|---|---|
| Brazil | Albert Fishlow, University of California, Berkeley |
| Chile | Jere R. Behrman, University of Pennsylvania |
| Colombia | Carlos F. Diaz-Alejandro, Yale University |
| Egypt | Bent Hansen, University of California, Berkeley, and Karim Nashashibi, International Monetary Fund |
| Ghana | J. Clark Leith, University of Western Ontario |

| | |
|---|---|
| India | Jagdish N. Bhagwati, Massachusetts Institute of Technology, and T. N. Srinivasan, Indian Statistical Institute |
| Israel | Michael Michaely, The Hebrew University of Jerusalem |
| Philippines | Robert E. Baldwin, University of Wisconsin |
| South Korea | Charles R. Frank, Jr., Princeton University and The Brookings Institution; Kwang Suk Kim, Korea Development Institute, Republic of Korea; and Larry E. Westphal, Northwestern University |
| Turkey | Anne O. Krueger, University of Minnesota |

The principal results of the different country studies are brought together in our overall syntheses. Each of the country studies, however, has been made self-contained, so that readers interested in only certain of these studies will not be handicapped.

In undertaking this project and bringing it to successful completion, the authors of the individual country studies have contributed substantially to the progress of the whole endeavor, over and above their individual research. Each has commented upon the research findings of other participants, and has made numerous suggestions which have improved the overall design and execution of the project. The country authors who have collaborated with us constitute an exceptionally able group of development economists, and we wish to thank all of them for their cooperation and participation in the project.

We must also thank the National Bureau of Economic Research for its sponsorship of the project and its assistance with many of the arrangements necessary in an undertaking of this magnitude. Hal B. Lary, Vice President-Research, has most energetically and efficiently provided both intellectual and administrative input into the project over a three-year period. We would also like to express our gratitude to the Agency for International Development for having financed the National Bureau in undertaking this project. Michael Roemer and Constantine Michalopoulos particularly deserve our sincere thanks.

JAGDISH N. BHAGWATI
Massachusetts Institute of Technology

ANNE O. KRUEGER
University of Minnesota

# Preface

The objectives of this book are twofold: to present an analysis of trade and payments policies in the Philippines that, it is hoped, can contribute to the formulation of better future policies for that country; and, as one of a series of country studies in a larger project, to provide background material within a common framework that can be utilized to understand better the reasons for the relative success or failure of various exchange-rate and trade policies in a wide range of economic circumstances and environments.[1]

The pursuit of the two goals simultaneously has, I believe, contributed positively toward the achievement of each. In having as a sole objective the evaluation of past policies in a specific country for the purpose of recommending policies that apply to that country, one is likely not only to adopt a parochial approach but to present conclusions based on material that is not always explicitly set forth in the study. The reader who is not an expert in the subject can do little else but agree with the author, since the data that are presented are highly selective and closely interwoven with the author's conclusions. However, given the second objective as well, it is necessary to recount in some detail the nature of the trade and payments policies adopted by the Philippines in such a way that the author's opinions do not always intrude, and so that the reader will be able to draw his own conclusions about the lessons to be learned from various economic events. The acquisition of economic knowledge is hampered because many studies present too few facts about what went on, and too many conclusions that are not carefully substantiated. Those interested in improving policymaking thus frequently find they must cover ground already studied by others to satisfy themselves that the conclusions reached by other writers are pertinent to the particular problems in which they are interested.

On the other hand, if the only purpose of a monograph is to provide inputs into a broader integrating study, one is likely to describe and analyze a country's experience with different foreign trade regimes in an overly stylized manner that fails to capture the unique economic, political, and social conditions existing in the country. Without an understanding of these latter features, any policy recommendations directed at the particular country may well be unrealistic or not meaningful.

In consequence of the two goals I have made a deliberate effort to present a somewhat detailed description of Philippine trade and payment policies without drawing economic conclusions at every step of the way. Chapters 2, 3, and 4 are largely of this nature, although Chapter 3 does have a section in which I evaluate the exchange-decontrol efforts of the early 1960s. The detail given in these chapters is excessive for readers interested in a general survey of the foreign trade regimes followed by the Philippines, and they are advised to focus on the tables given in these chapters, summarizing major policy actions. Those readers interested in an in-depth understanding of the country's international economic policies (and this is the audience to which the study is primarily directed) will, it is hoped, not find the enumeration of these policies too overwhelming. Its purpose is to permit the reader himself to make an informed judgment about the merits or drawbacks of the various policies adopted.

In Chapter 5 I try to help in the formation of this judgment by presenting a quantitative assessment of the different aspects of foreign trade regimes in which such concepts as effective rates of exchange, implicit levels of protection, and effective rates of protection are utilized. Finally in Chapter 6 an evaluation is made of the country's international economic policies in terms of economic efficiency, growth rates, and consequences on the distribution of income. This is done not only by drawing on the preceding historical and quantitative analyses, but by attempting to integrate previous studies of trade and payments policies in the Philippines.

I have become indebted to many people in the course of the study. First, I am grateful to the Agency for International Development (AID) for providing financial support for undertaking the study and to the National Bureau of Economic Research for administering the grant and providing funds to publish the monograph. Jagdish Bhagwati and Anne Krueger, the entrepreneurs of the general project, are to be thanked not only for securing the financial support but together with Hal Lary, Charles Frank, and Carlos Díaz-Alejandro for reading the manuscript and providing many valuable suggestions. I am also greatly indebted to the members of the Economics Department at the University of the Philippines, especially Amado Castro, José Encarna-

ción, and Leon Mears. Without the advice of these individuals and their cooperation in providing the physical facilities for carrying out the study as well as introductions to government and business officials, the study could not have been done. But more than this, the economists at the University of the Philippines are a highly motivated, research-oriented group who have written extensively about the Philippine economy. I have profited enormously from reading their books and papers and discussing my project with them.

Two able research assistants, Rosalinda Marquez in Manila and Juliet Mak in Madison, have been extremely helpful in searching out data on the Philippine economy and in undertaking statistical analyses of this data. Typing assistance has been provided by Roberta Wood, Mary Boudreau, Margaret Burns, Jeanine Gleason, and Jo Ann Giese. The chart was drawn by H. Irving Forman, and the manuscript was edited by Ester Moskowitz.

1. This broader study is being carried out by Jagdish N. Bhagwati and Anne O. Krueger.

# Principal Dates and Historical Events in the Philippines

1946 The Philippines achieve independence.
Enactment of the Bell Trade Act providing for an eight-year period of free trade between the United States and the Philippines and then a gradual increase in the share of regular duties that each country would pay.
Passage of an act granting special internal tax privileges to "new and necessary" industries.

1949 Emergence of a foreign-exchange crisis and the introduction of exchange controls.

1951 Imposition of a 17 per cent excise tax on the peso value of foreign exchange sold by the banking system.

1953 Enactment of a new tax exemption law for "new and necessary" industries, covering import taxes as well as internal taxes.

1955 Signing of the Laurel-Langley Agreement between the United States and the Philippines, providing for an acceleration of the rate at which imports from the United States would be subject to the full amounts of Philippine tariffs.
Replacement of the 17 per cent excise tax on foreign exchange by a gradually declining tax on imports.

1957 Passage of an act raising Philippine tariffs.

1959 Introduction of a 25 per cent margin fee levied by the Central Bank on sales of foreign exchange.

1960 Beginning of the decontrol period with the establishment of a multiple exchange-rate system.

1961 Passage of another tax-exemption law favoring many domestic manufacturing industries.

1962 Removal of exchange controls and move to a uniform exchange rate for all transactions except exports.

1965 Elimination of penalty exchange rate for exporters.

1967 Introduction of some controls over foreign-exchange transactions. Passage of the Investment Incentive Act granting special tax privileges to key domestic industries.

1970 Floating of the peso after the emergence of a foreign-exchange crisis. Passage of the Export Incentives Act designed to stimulate new export industries.

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