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EXTERNAL TRADE AND FINANCE

By

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As in many of the developing countries, foreign trade and its associated activities in the Philippines play a relatively major if not critical role in the attainment of the country's development goals. What their prospects are in a given planning period can therefore indicate feasible objectives and constraints that confront the country.

Any assessment of the external sector needs to take account not only of the country itself and its domestic economic pressures but of what particular circumstances trading partners are in. While it may take a fairly elaborate exercise to undertake this in reference to trading among various countries or for that matter in context with the domestic sector, it is quite possible to make broad benchmarks from where a departure for country prospects becomes visible.

My purpose in this review paper is to provide a synopsis of the external trade and finance sector of the World Bank document. I shall first describe the analysis undertaken by the authors and then spell out some salient points which I think need to be considered in reviewing the chapter.

This chapter focuses on the external trade and financial implications for the Philippine economy in the decade from 1976 to 1985. The approach is basically simple in nature. The two sides of trade transactions are closely examined in quantitative and prospective terms. Their net impact on resource requirements is then evaluated as to feasibility, source, and what steps to take in assuring external stability consistent with the overall country economic growth path.

The structure of Philippine imports has not changed much over the years. While import substitution did take place, it did not weaken import dependency. The striking change is of course the quantum

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jump in the importance of petroleum imports from around 9.4 per-cent to 22.4 percent of total import payments in 1970 and 1975, respectively. Import growth is seen to be 15 per cent per year with 7 to 8 percent reflecting price movements. The chapter observes a reduction in consumer and cereal and food imports as the country attains sufficiency in agriculture in 1985. The same trend is seen for raw materials and intermediate goods though not as significant. Capital goods imports will continue on a high plane as expansion of industrial and public infrastructure investment requires increased capital equipment. All told, total import payments (at current prices) are expected to rise to $6,871 million in 1980 and $13,364 million in 1985. This means almost four times the 1975 payments of $3,350 million.

The prospect for exports or the capacity to import is extensively treated as each of principal exchange earners are assessed for their contributions to import potential. Exports are viewed to grow at 19 per cent per year in the decade with around 10 per cent yearly increase in unit values. While the importance of agroindustrial products, i.e., the traditional export products such as copra, coconut oil, sugar, etc. fluctuate around 43 to 85 per cent of total exports, these have mainly depended on price movements. The further processing of primary products, industrial incentives (discussed in chapter 9 and 13), and active export promotion assure better performance of these goods. Although there are increases both in absolute and relative values, the major burden of export earnings for 1980 and 1985 rests with manufactured goods. Nontraditional manufactured exports must expand 11 times, as compared with an average expansion of other commodities at 5.17. This expansion is only topped by copper concentrate and copper, seen to increase 12.3 times. The export growth of 19 per cent suggests projected export receipts in 1985 of $12,875 million (at current prices).

Trade balances are expected to be continually negative but declining throughout the whole period (Table 16.4). On the other parts of the current account balance, net services will increase as more dividend payments are transferred. The chapter projects that cumulative deficits will hover around $5,000 million in 1976-80 and $6,000 million in the subsequent five-year period (p. 464), or more than $1,000 million a year between 1976 and 1985.

Country requirements for foreign financial resources are then identified, taking into account trade deficits, increases in reserves

(rule of thumb being equivalent or 2 1/2 to 3 months of imports), and balance in services and transfers. The sources of the requirements are categorized according to loans (medium- and long-term), direct investment and short-term trade finance. Conventionally speaking, yearly average requirement for long-term capital stands at $2,114 million while short-term capital needed amounts to a yearly average of $434 million.

Long-term capital needs (loans and direct investments) take into account amortization payments so that net inflows required would be around $1,065 million ($910 million for loans and $155 million for direct investment) on the average over the decade cited. The difference between the gross inflow of $2,114 million and the net inflow would go into amortization and interest payments. The assumption therefore is that of the long-term capital needed, the main bulk to come from medium- and long-term loans and development assistance (93 percent).

The implication of the foreign exchange resource requirements is a heavy reliance on loans (public and private) and official development assistance (Table 16.7). The reliance on loans is supported by possible increased commitments from the World Bank Consultative Group, the tract record of the increasing flow of commercial loans, and the improved level of official assistance into the country. Based on the growth of export receipts discussed earlier, the debt-service ratio of the projected capital inflow is not expected to rise beyond a manageable 17 per cent.

The analysis presented in Chapter 16 of the book is straightforward and need no further elaboration. It is appropriate however to give several observations concerning the broader scope of external trade and finance, and the kinds of caveats that one needs to be aware of.

As a first point, one can argue about the assumptions surrounding the quantitative projections, the patterns and distributions of trade and resource requirements, and the behavior of Philippine trading partners which would obviously affect the relationships asserted in the chapter.

The capacity to import hinges on the growth of trading partners and their absorptive demand for Philippine goods. This is aptly recognized in the analysis (p. 450) but it is not clear what kind of recovery

is sufficient in order to realize the projections. It seems to me this is an important point. Firstly, there is a suggestion for broadening trade patterns (pp. 461-464) from traditional U.S. and Japan nexus which in itself suggests an indication of prospects elsewhere. Of course while existing experience may not generate enough bases for deriving necessary magnitudes, there is certainly room for surmising elasticities for example[1], that would make a difference between "... rates of economic growth comparable to those of the 1960s..." and other (say accelerated) rates. [Secondly, this assertion is also made to be relied upon for the country's external resource requirements.] Even more so, as evidenced by the latter part of the chapter which sees the same host of countries as both markets for products and sources of external finance. In short, this point is doubly important both as access and source. Thirdly, there is the notion of export price movement (p. 460 and Table 16.3) tending to fall before gaining a marginal recovery into 1985. There would be implications of this issue to export volume in the face of broadened markets and perhaps diversified products. Clearly some ranges of values are important here rather than a specific assumption of 19 per cent vis-a-vis the statement that "... recovery in terms of trade can be put forth only tentatively. The balance of payments is obviously quite sensitive to fluctuations in export prices that cannot be predicted..."

There is also a particular emphasis on expansion of mineral and agricultural exports (wood) but this time processed as a result of industrial policies for these activities. Three items (wood products, copper concentrate and copper, and other mineral products) would increase their share from 24 per cent of the total export value in 1975 to 34 per cent in 1985. Although part of expansion would come from price increases (only other mineral products price index is seen to increase by more than the overall export price index), one can wonder about the reasonableness of the prospect in the face of natural resource depletion and the concern for ecology and conservation now gaining ground, even presuming the products to be processed from raw components.

A similar question can be posed with respect to the import side of the trade matrix. In particular the volatility of petroleum prices can

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[1] As what Bautista and Encarnacion did in Romeo M. Bautista and Jose Encarnacion, Jr., "A Foreign Trade Submodel of the Philippine Economy, 1950-1969," *Philippine Economic Journal*, XI (Second Semester 1972), although their concentration was more on price elasticities of exports and imports. But their work is illustrative of the kinds of magnitudes that can be derived.

have a wide range of implications for overall imports. For example, simply as a result of cartel price increases, the share of crude petroleum increased from 9.4 per cent in 1970 to 22.4 per cent in 1975. Yet it is assumed (p. 454) that crude petroleum prices would rise in the decade by about 7 to 8 per cent a year in line with international prices generally. One can argue that if recent experience is to be a basis for judgment, hardly have petroleum prices been tied to international prices generally. Thus even a slight deviation would alter the import structure assuming the same requirements of petroleum as before (p. 454). This is clearly illustrated in the text (p. 453).

As a second point, one needs to recognize both the timing and the dynamic nature of some of the variables being considered in the analysis. The concern about adverse effects of short-run cutbacks on growth and employment merits second thoughts about the employment generation of large-scale projects requiring massive external financing (p. 455) and on what the forgone alternatives are with respect to output. The book spends Chapters 9 and 13 to reflect on labor intensive activities both under the industrial and export incentives plan.

One wonders about the various lags that affect resource flows in the balance of payments. For example, the association between trade balances and short-term capital would suggest a lag. The proportion of trade balance financed while high (over 35 per cent compared to 25 to 30 per cent in late 60s and early 70s) appears reasonable. The important point is that exchange flows may indeed be different from what is projected depending on the various lags that can reasonably be seen as a trade behavior. Hence resource requirements may alter. The same reservation can be said for direct investment.

There is also an apparent timing question regarding the flows of development assistance and overall medium- and long-term loans. The optimism about foreign aid inflows rests with the formulation of the Consultative Group for the Philippines, and the reduction of the proportion of grants from 60 per cent of the total (1952-69) to 18 per cent (1970-74). In effect, the switch reflects both concessions and a clear bearing on project considerations. But the projected commitments are still quite large ($780 million and $760 million in 1980 and 1985, respectively). Of the commitments in 1971 and 1975 ($140 million and $510 million) only 36 per cent and 55 per cent became actual disbursements. The bank seems to view this experience as reversing itself to 76 per cent and 102 per cent in 1980 and 1985.

As a third point, the issue of the foreign exchange rate is hardly treated at all in the chapter or for that matter elsewhere in the book. It is possible that the rate could be stable throughout the period being considered. But certainly one can appropriately ask what the basis for a stable trend is. For one, varying exchange rates would impart repercussions on merchandise trade transactions. For another, and much more important, they would significantly impinge on resource flows in the form of direct investments, long-term private capital, and short-term capital through different lags and coefficients and thus total inflows. For example, I find that a rate that is actively supported and surrounded by varying controls can reduce financial flows, and the reduced flows themselves being delayed.[2] Conversely other capital (Table 16.4) such as captured in errors and omissions could show high negative values occasioned by different foreign exchange rates. This category is seen to be positive over the period. Compare this with the negative 1970 value (presumably prior to devaluation).

In summary, the analysis of the external trade and finance is an important departure point for considering these issues and qualifying the medium-term prospects for Philippine trade and finance. I suspect that if some of these points are spelled out as to how they bear upon the analysis, the variety of prognosis can be made stronger and policy directions more operational.

Short of formulating an elaborate model incorporating these concerns, among others, and then grafting it into a structural model of the economy, it is unfeasible (or tedious) to work out the same variables (but being more behavioral). For example, the financial requirements for trade can take into account possible lags and delays, yet keeping the same tabular presentation of projections over the decade cited. A complementary avenue can be a consideration of export prospects under alternative scenarios for the behavior of world trade in general and trading partners in particular. All these can still retain the simplicity of the exposition (exemplified in the chapter) yet capture the structural substance and realism of the sector.

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[2] Florian A. Alburo and Fred R. Glahe, "Exchange Rate Policies and Financial Capital Flows", *Philippine Economic Journal* (to appear).