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A NOTE ON INDUSTRIAL POLICIES AND INCENTIVE STRUCTURES IN THE PHILIPPINES: 1949-1980

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The import and foreign exchange controls were introduced into the Philippine economy in late 1949 in response to the balance-of-payments difficulty aggravated by sharp declines in both export prices and net foreign capital inflows as well as election-related liberal policies. As such measures gradually intensified in the 1950s, they became increasingly used to adopt an industrialization strategy of import substitution at finishing stages of processing and assembly. Protection was afforded to import-competing industries by restricting imports of nonessential consumption goods and by allowing the relatively easier importation of inputs required for the production of their substitutes.[1] The incentive structure established by the exchange controls was thus in favor of the domestic production of the very items classified as nonessential consumer finished products at the expense of manufactures of intermediate and capital goods. Furthermore, it resulted in a strong bias against export-oriented industries in view of the prevailing overvalued exchange rate.[2]

Exchange-control liberalization efforts started in April 1960 with the establishment of a multiple exchange-rate system that permitted a stage-by-stage devaluation of the domestic currency. Subsequently, most exchange controls were eliminated and the peso was formally devalued from P2 to P3.9 per dollar in 1965. The period of complete liberalization had then lasted until 1967 when time-deposit requirements for imports and other controls were reintroduced by the Central Bank.

These liberalization attempts in the 1960s, however, did not substantially change the inward-looking trade strategies adopted during the pre-decontrol period. Exchange decontrol efforts accompanied

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[1] Most import-substituting activities have consequently relied on imported materials and capital goods.

[2] One measure taken in the 1950s to partially offset the discrimination against traditional exporters was the enactment of the "no-dollar import law" allowing a limited amount of exports to be bartered for imports outside of the exchange control system. However, the measure neither had an extensive coverage, nor developed the base for potential new exports. For details, see Baldwin (1975), pp. 44-45, Staelin, C.P. and Jurado, G.M. (1976), pp. 29-30.

by devaluation were simply counterbalanced by a highly protective tariff system and discriminatory sales taxes against imported goods. The incentive structure in favor of import-substituting industries was consequently maintained throughout the decade. Under such a system of protection, disincentives were continuously given to backward integration in the manufacturing sector. While facing the difficulties brought about by higher input prices, exporters had been further penalized until November 1965 due to the requirement that 20 per cent of their foreign exchange receipts be surrendered at the old exchange rate. The bias against all exportation effectively discouraged the development of nontraditional manufactured exports that could have been based on the country's comparative advantage.

Since 1970 several measures have been taken to stimulate the growth of the sluggish manufacturing sector and to cope with the worsening balance-of-payments problem. Such industrial policies have been geared to the expansion of exports, especially of nontraditional industrial products. The government's decision to float the peso in exchange markets in February 1970 provided a major stimulus to previously ill-treated export industries but to a lesser extent to traditional exporters because of the imposition of a stabilization tax on their exports. Moreover, exporters of new manufactured goods were explicitly offered numerous incentives in the form of tax exemptions, deductions from taxable income, tax credits and other benefits when the enactment of the Export Incentives Act in 1970 widened the scope of incentives initiated by the previous legislation, namely R.A. 5186 in efforts to promote industrial exports.[3] In 1972 an industrial free trade zone was established to provide infrastructure along with fiscal incentives to export-oriented firms. It has been witnessed throughout the 1970s that nontraditional manufactured exports have grown so dynamically that the total value reached more than two billion US dollars in 1980, indicating an increase of about 20 times over the 1970 level.

The effective exchange rates by the exchange-control groups are calculated over time to quantitatively analyze the pattern of incentives provided by various industrial measures discussed above. These rates used here consider not only the differential impacts of official exchange rates on the corresponding transactions but also of "tariffs, discriminatory sales or compensating taxes, special foreign-exchange taxes, exemptions from various domestic taxes, subsidized borrowing rates,

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[3] Although some measures have been adopted to correct the persistent bias against the use of labor and locally-available materials, the incentive structure based on these acts has generally produced capital-cheapening effects. See Gregorio, (1979), pp. 173-237.

and margin-deposit requirements on imports" (Baldwin, 1975, pp. 84-85).[4]

Table 1 shows average effective exchange rates of exchange-control groups of commodities, calculated for each sub-period. The

Table 1—Average Effective Exchange Rates, 1949-80
(Pesos Per U.S. Dollar)

Category[a]	1949	1950-59	1960-69	1970-75	1976-80
NEC	2.05	3.65	10.56	21.19	25.49
		(78.05)	(189.32)	(100.66)	(20.29)
SEC	2.05	2.46	5.27	9.16	10.17
		(20.00)	(114.23)	(73.81)	(11.03)
EC	2.00	2.06	3.91	7.56	8.82
		(3.00)	(89.81)	(93.35)	(16.67)
NEP	2.05	2.43	6.91	12.46	13.46
		(18.54)	(184.36)	(80.32)	(8.03)
SEP	2.00	2.44	4.22	8.08	9.34
		(22.00)	(72.95)	(91.47)	(15.59)
EP	2.00	2.44	4.61	8.24	9.40
		(22.00)	(88.93)	(78.74)	(14.08)
TX	2.00	2.00	3.46	6.17	7.12
		(0.00)	(73.00)	(78.32)	(15.40)
NX	2.24	2.29	3.70	7.66	8.44
		(0.02)	(61.57)	(107.03)	(10.18)

Sources: Table 5.1 in Baldwin (1975) for 1949-71 and Appendix 2 for 1972-80.

Note: Rate of change (in per cent) between a sub-period and its previous one is given in parenthesis.

[a] The exchange-control category is specified as follows:

Imports	Exports
Nonessential consumer goods (NEC)	Traditional exports (TX)
Semi-essential consumer goods (SEC)	New exports (NX)
Essential consumer goods (EC)	
Nonessential producer goods (NEP)	
Semi-essential producer goods (SEP)	
Essential producer goods (EP)	

[4] Baldwin's study gives the estimates of effective exchange rates between 1949 and 1971, while his method is employed to calculate the 1972-80 rates based on the data discussed in Appendix 1. The limitations of the measure are briefly discussed in his study (p. 85).

introduction and intensification of import and exchange controls clearly gave a relative bias favoring domestic producers of nonessential consumption commodities, as shown by a high rate of change, about 78 per cent, in the exchange rate between the "1949" and "1950-59," while import-substituting industries of essential consumer goods were slightly protected from the import competition. On the other hand, local producers for exportation were hardly encouraged to expand their activities.

The incentive structure against producers of essential goods and exports during the 1960s in spite of eliminated exchange controls and devaluation is exhibited in the table wherein the rates of both NEC and NEP, ₱10.56 and ₱6.91 per dollar, respectively, increased almost two times over the pre-decontrol period of the 1950s. This was due in part to the increasing proportion of the import duty applied against U.S. goods. Although the staged devaluation during the first half of the 1960s undoubtedly contributed to higher rate of change in effective exchange rates for exports, much higher rates were registered for imports in general.

The comparison between "1960-69" and "1970-75" periods indicates a change in the pattern of protection. While the decelerated growth rates were realized for the import groups previously subject to high protection, the high rate of change was marked by the new export group. Although the exchange rate for NEC almost increased as high as that for NX due to the continuously protective tariffs, the presence of a series of export incentives during the early 1970s cannot be disregarded for the promotion of nontraditional exports.[5]

[5] Towards the end of the 1970s, no additional measures have been taken to accelerate the expansion of new industrial exports. The group consequently exhibits one of the lowest rates of change in the 1976-80 period. An exchange rate adjusted for price changes also shows the unfavorable impact on this group in the late 1970s. See Bautista, R.M. and Associates (1979).

Appendix A
Data Used in Calculating Effective Exchange Rates, 1972-80

Exchange Rates (in terms of the average interbank guiding rates for peso-dollar exchange[1])

1972, 6.67; 1973, 6.76; 1974, 6.79; 1975, 7.25; 1976, 7.44; 1977, 7.40; 1978, 7.37; 1979, 7.38; 1980, 7.51.

Tariffs	1972	1973-80
NEC	83%	96%
SEC	40	30
EC	9	15
NEP	100	70
SEP	29	20
EP	25	22

For 1972, the nominal tariff rates were taken from Baldwin's study (1975), p. 114. For the 1973-80 period, they are recalculated in accordance with Presidential Decree No. 34 in the following manner:

a) NEC-goods rate is represented by an unweighted average for 7 goods, among the Valdepeñas' sample of 32 goods, which have remained in the NEC group in the 1976 CB Statistical Classification of Commodities;

b) SEC by thermos bottles;

c) EC by an unweighted average for canned milk and antibiotics;

d) NEP by loudspeakers;

e) SEP by some items under other inorganic bases and metallic oxides, hydroxides and peroxides, such as oxides, hydroxides and peroxides, barium or magnesium, tin oxides, titanium hydroxide (these items replace the Baldwin's sample, aqua ammonia, now classified as EP); and

f) EP by an unweighted average for 20 goods, among the Valdepeñas' sample of 53 goods, which have remained in the EP group in the 1976 CB Statistical Classification of Commodities.

Sales Tax Rates

NEC: 1972-80, 50 per cent

All other groups[2]: 1972-77, 7 per cent; 1978-80, 10 per cent

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[1] Data provided by Department of Economic Research, Central Bank of the Philippines.

[2] Although Presidential Decree No. 1358 has generally reduced the rates of exchange-category items above, the rates of "ordinary articles," which consist of most goods, are used for these groups as they were used for the 1951-71 period. Incidentally, these rates had been increased to 10 per cent.

Size of Valuation Base[3]

NEC: 1972-80, 2

All other groups: 1972-80, 1.25

Protective Effect of Margin-Deposit Requirement[4]

NEC, SEC, NEP, SEP : 1972-80, 1.5

EC, EP : 1972-80, zero

Subsidy on New Exports

In addition to a 4 per cent subsidy effect of borrowing at a lower rate, the subsidy effect of the various tax exemptions has been estimated as follows:

1972, 6.4 per cent[a/];
1973, 5.8 per cent[b/];
1974, 21.6 per cent[c/];
1975, 18.3 per cent[c/];
1976, 3.1, per cent[c/];
1977, 8.5 per cent[c/];
1978, 13.6 per cent[b/];
1979-80, 11.8 per cent[d/];

Tax on Traditional Exports[5]

1972-73, 6 per cent
1974-80, 4 per cent

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[3] In accordance with P.D. 1358, the sales tax is computed on the basis of the home consumption value (HCV), or price plus 10% of such HCV (that is defined as "the value or price declared in the consular, commercial, trade or sales invoice, certified to as correct under penalties of perjury by the Philippine Consul at the port of origin, if there is any"). Although the additional 10% of HCV has been imposed, no corresponding change was made since the provisions exclude freight and insurance from the importation expenses in order to attain the valuation base. The 25 per cent markup is used for all other groups in order to be consistent with Baldwin's estimates.

[4] No revised guidelines on margin deposits have been made until 1982.

[5] R.A. 6125 and P.D. 230 are responsible for change in tax imposed on traditional manufactured exports, such as crude coconut oil (including cake and meal), centrifugal and refined sugar, dessicated coconut, logs and lumber, and veneer and plywood.

[a/] Average of the 1971 and 1973 figures.

[b/] Total value of incentives, that is, the sum of deductions from taxable income, tax exemptions, tax credits, received by export producers registered under R.A. 6135 as a proportion of exports. (Source: Data derived from various tables in BOI, Statistical Appendix to the Twelfth Investment Priorities Plan and the Tenth Export Priorities Plan, 1979).

[c/] Source: Appendix Table 4A in Gregorio's study, p. 231.

[d/] Average of the 1973-78 figures.

Appendix B
Effective Exchange Rates, 1972-80
(pesos per U.S. dollar)

	1972	1973	1974	1975	1976	1977	1978	1979	1980
NEC	20.07	21.92	23.32	24.90	25.56	25.42	25.32	25.35	25.80
SEC	9.50	8.96	9.23	9.85	10.11	10.05	10.15	10.17	10.35
EC	7.37	7.87	8.02	8.56	8.78	8.74	8.80	8.81	8.97
NEP	13.42	11.61	12.18	13.00	13.35	13.27	13.47	13.49	13.72
SEP	8.78	8.30	8.49	9.06	9.30	9.25	9.32	9.34	9.50
EP	8.42	8.33	8.53	9.11	9.35	9.30	9.38	9.39	9.56
TX	6.27	6.35	6.52	6.96	7.14	7.10	7.08	7.08	7.21
NX	7.36	7.42	8.53	8.87	7.97	8.33	8.67	8.55	8.70

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