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INDUSTRIAL DEVELOPMENT

By

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The industrial sector, according to the World Bank Report, will have to bear the burden of alleviating the employment and foreign exchange problems of the Philippines in the coming decade. To quote from Chapter 2, "An Overview of Development Prospects":

> An investment strategy is required that will produce at least 75,000 new jobs a year in industry by the mid-1980s. Also necessary are larger investments to expand the capacity of traditional and nontraditional exports. These are minimum goals, and any shortfall could have dangerous repercussions, such as a rise in open unemployment or more underemployment in both urban and rural areas, with attendant social unrest. (p. 22)

This quotation is reflective of the investment orientation of the *Report* and is in line with its declared emphasis on the financial aspects of Philippine development in the decade 1975-1985. The two chapters on industry (Chapters 8 and 9) describe a "recommended growth program" which, it is asserted, stands little chance of implementation "without major changes in the policy framework to restructure protection, resource allocation, and, most importantly, the relative position of manufactured exports" (p. 215). Accordingly, some sections are devoted to an examination of the effects of prevailing policies on the economic performance of Philippine manufacturing over the 1956-73 period and a discussion of suggested changes in the policy environment. In particular, the biases in the incentive system against manufactured exports and small-scale industries need to be removed, the Report also advocating regional balance of future industrial development.

The World Bank Report adds nothing new to the existing analysis of the protection issue in the Philippines. Indeed the policy analysis and recommendations are in essence a restatement of those made by

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the I.L.O. Employment Mission in a report published two years earlier.[1] The latter source still provides the most cogently argued case for the need to reform industrial incentives, to liberalize imports and, generally, to make the effective protection rates more uniform across industries.[2] There are of course some differences between the World Bank and I.L.O. Reports in specific policy suggestions. Thus, while each would favor the restructuring of the protection system and the eventual reduction of the average tariff level, the World Bank Report disagrees with the recommendation of the I.L.O. Mission to set a uniform (nominal) tariff level of 20 or 30 per cent after eight or ten years since "this would raise the cost of many imported inputs that now have only a 10 per cent duty ... and even after eight or ten years the country may temporarily need protection for certain new industries" (p. 218n). It advocates a "general 10 per cent duty on all imports with the possibility of an additional 10 to 90 per cent for some commodities" (p. 218). Unless these percentages are meant to represent effective protection rates, such statement is unmindful of the distortionary effects that tariff rates of certain products different from the 10 per cent standard duty would have on the using industries.

The substantive contribution of the industry chapters of the World Bank Report has to be the quantification of the sectoral growth prospects of Philippine manufacturing during 1975-85 and its description of the investment program necessary to realize the growth projections. In a sense, therefore, there is complementarity with the I.L.O. Report, which does not present in quantitative form its "vision of the status which ... the Philippine economy is capable of achieving" (I.L.O. Report, p. 35) under the improved policy framework.

Assuming an annual GDP growth rate of 7 per cent, domestic demand for manufactured goods is estimated for 1980 based on a set

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[1] International Labor Office, *Sharing in Development: A Program of Employment, Equity and Growth for the Philippines* (Geneva 1974); from hereon, the I.L.O. Report. There has to be some significance however for Philippine policy-making that attaches to the virtual endorsement by the World Bank of the recommendations for policy changes made in the I.L.O. Report.

[2] For one thing, it derives estimates of social rates of return among industries of differing levels of protection, which the World Bank Report has not attempted. Merely stating that effective protection rates differ substantially is not as illuminating as showing how they affect the social profitability of industrial investments.

of World Bank estimates of income coefficients of demand (ranging from .83 for food, beverages and tobacco to 1.5 for basic metal industries). No account is taken of possible price effects on the future demand pattern.[3] Sectoral production (gross output) and exports are derived "on the basis of BOI-sponsored plans, other major projects under consideration, and various programs or estimates in such industries as sugar and coconut, basic metals, engineering, mining, wood processing, and other export-oriented sectors" (p. 202); however, interindustry transactions are not considered, which is surprising given the existence of Philippine input-output tables for three years (1961, 1965 and 1969). Import requirements are obtained residually. One major finding is that the incremental domestic demand during 1974-80 will be met almost entirely by domestic production in each industrial group except engineering, in which the ratio of imports to domestic demand will remain unchanged at 47 per cent. The import dependency ratio would be about halved for chemicals and oil products (from .52 to 25 per cent) and for basic metals (from 26 to 14 per cent), and reduced substantially for light consumer goods, food and beverages.

Sectoral value added projections are computed in two ways: (1) for metals, pulp and paper, chemicals and wood processing, in which the magnitude of planned investment is known or approximated, capital-value added ratios are used; and (2) for the rest of the sectors, growth rates are assumed on the basis of demand projections and in some cases NEDA's development plan targets for 1974-78. With the gross output for 1980 having been estimated, a very simple procedure would have been to use constant sectoral value added-gross output ratio. There is probably as much (if not less) ground for assuming constant capital-output ratios as for assuming constant value added-gross output ratio. It speaks well of the value added projections in the Report that it does not diverge significantly from those obtained using the latter procedure (except for the basic metals group, which has value added-gross output ratios computed at .30 for 1974 and .36 for 1980).

To estimate investment requirements, assumed sectoral capital-output ratios are again used, with allowance for time lags between investment and output considered only for basic metals and petrochemicals. Total investment over the period 1975-80 amounts to

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[3] This is perhaps due to the uncertainty about future price movements as expressed in an earlier chapter (p. 38).

about P44 billion at 1974 prices, three industrial groups (basic
metals, chemicals and food) contributing more than 60 per cent of
the total. The employment projections are to be taken on faith, little
information having been provided beyond the stated use of project
information, historical labor coefficients and assumed capital-labor
ratios. The average annual rate of employment increase from 1974 to
1980 is computed at 6.7 per cent;[4] the corresponding growth rate of
value added is 9.1 per cent. Average investment per worker is
P176,000 at 1974 prices, which seems very high.

One table lists some major industrial projects already approved or
under consideration, including three large, highly capital-intensive
projects (an integrated steel plant, a petrochemical complex, and an
aluminum project) accounting for two-thirds (P20 billion) of the
total program. These projects are expected to generate 65,000 new
jobs, implying a direct capital cost of P462 thousand on the average.
While these are not all part of the BOI's investment and expor
priorities plans (the eight IPP and sixth EPP, respectively), the expan
sion program of the BOI for 1976-79 shows an even stronger bia
toward highly capital-intensive projects; "the capital-labor ratio o
P500,000 (US$71,000) per worker for the program as a whole is on
rarely found in countries at a similar stage of development" (p. 197

Despite such expression of subtle criticism (and in Chapter 1
direct suggestions for a "thorough overhaul" of the BOI incentiv
system), the *Report* does not question the social profitability
BOI approved investment projects involving huge capital outlay
Indeed the increase in capital intensity of the BOI expansion pr
gram for 1976-79 is explained away in the Report by the observ
drastic shift in the distribution of industries toward mining an
chemicals at the expense of such labor-intensive industries as agr
processing and engineering.[5] The entire set of BOI priority projec
are fully considered in the derivation of output, investment an

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[4] This does not square with the annual manufacturing employment grow rates of 1.9 and 3.0 earlier estimated for 1965-75 and 1975-80, respectively, presented in Table 2.3 of Chapter 2 (p. 29). On closer reading, it would app that the 6.7 per cent employment increase applies only to the *organized* ma facturing sector.

[5] In an earlier chapter, however, the government is advised "to rethink investment program at the margin if industrial production does not prov sufficient jobs. In this case, reductions or delays ... in some of the large capi intensive industrial investments might have to be considered" (p. 28).

employment projections through 1980. (How the projections for 1985 were obtained is not made clear.) It is emphasized that the projections represent "what is *likely* on the basis of existing development programs but also World Bank estimates of what *could* be achieved through intensified efforts under an improved policy framework" (p. 203; italics supplied). This may be taken as a strong endorsement by the World Bank of current industrial investment plans, reflecting also a rather optimistic view of the policy directions to be taken.

The *Report* predicts that

> "There will still be a serious employment problem in the 1980s. According to the above projects, about 600,000 new jobs will be created in manufacturing during 1975-85, and the sector will be able to absorb nearly 80,000 new workers a year by the end of this period. This would represent 13 to 14 per cent of the incremental labor force in 1985, a fairly low labor-absorptive capacity in view of the amount of financial resources expected to be drawn into this sector over the period." (p. 214)

This is no doubt a very pessimistic prognosis of the medium-term employment prospects for the Philippines in relation to that given in the I.L.O. Report.[6] The reason is not a low priority being attached to the solution of the country's employment problem in the recommended growth program. On the contrary, the World Bank Report is emphatic that "labor-intensive activities should be promoted as much as possible to generate employment" (p. 213), and that, "in view of the importance of employment creation at this stage of Philippine development, labor-intensive exports deserve the highest priority in the industrialization program" (p. 225). Despite such recommendations, however, the *Report* is quite explicit about the low employment generating capacity of the developing industrial sector. This would seem to be attributed partly to the other side of the two-pronged strategy being suggested, which is that capital-intensive intermediate goods industries should be expanded "in order to reduce import dependency and utilize external market opportunities ... they will have to grow rapidly if industry is to develop faster than the economy as a whole" (pp. 213-214).

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[6] The Introduction states, among other things, that "acceptance of our policies can turn the present labor-surplus situation into one of labor shortage and sustained dependable improvements in the distribution of income within a decade." I.L.O. Report, (p. xxvii).

Since resources are not unlimited, the need to invest heavily in the intermediate goods sector necessarily reduces what could be made available for the development of labor-intensive manufactures. The importance of such tradeoff, however, would probably be denied by the authors of the *Report*, judging from the procedure they have used in evaluating the prospects of Philippine industrial development. Estimates of prospective demand (domestic and export) for the different manufactured commodity groups provide an upper limit to the level of production in each of the industrial subsectors. Depending on their technological capability (and, one might add, profitability expected by producers), domestic industries would be able to supply varying fractions of the total demand, with the residual amount in each commodity group being assumed to be imported. In recommending also that "capital-intensive and intermediate goods industries should under no circumstances expand at the expense of labor-intensive activities" (p. 214), there is implicit assertion that investment in labor-intensive manufactures beyond the recommended amount would have a zero payoff.

Perhaps reflecting the fact that it was written before the 1974-75 world recession, the I.L.O. Report neglects entirely demand considerations, appearing to have assumed an infinitely elastic demand for Philippine manufactured exports. Since the comparative advantage lies in labor-intensive goods, the level of output that could be produced and the amount of employment generated would be limited only by supply factors. Accordingly, the suggested policy changes affecting manufacturing industries are directed at providing incentives to producers removing supply bottlenecks. Under the recommended policy environment, the performance of the industrial sector and the rest of the economy is expected to be such that the Philippine problem will be gone within a decade, according to the I.L.O. Report.

On the other hand the World Bank Report, estimating that labor-intensive manufactured exports will at best increase by 26 per cent annually during 1975-80, contends that the amount of industrial employment creation would not be sufficient to reduce significantly the extent of labor force underutilization in the 1980s. Unfortunately, the assumptions underlying the estimates of the export growth rate and the labor absorptive capacity of the export sector are not indicated, which one could have examined to form his own judgment. But it is very distressing that the Report is convinced of the perpetuation of a serious employment problem through the 1980s.

Even more disconcerting is the possibility of "dangerous repercussions" (cf. earlier quotation) from any shortfall in investment requirements due to, say, non-implementation of recommended policy changes.

The student of Philippine industrial development who invests time and effort to read carefully the I.L.O. and World Bank Reports will be amply rewarded. While it is not likely that he would be fully convinced of the alternative scenarios being presented, his own assessment of the prospective growth of the industrial sector and its contribution to the country's development almost certainly will be influenced.