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EDUCATION AND INVESTMENT

By

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I want to review these topics as they relate to each other in the World Bank Report. Chapter 12 deals with investment in education. Chapter 13 discusses the level and allocation of investment while Chapters 14 and 15 describe respectively the problems of financial management to meet the requirements of a higher level and desired allocation of investment, and the role of the public sector.

The Level and Allocation of Investment

Investment is expected to grow at the rate of 12 per cent per year during this decade 1976-85. The increase in investment is to come partly from increased share of the public sector in capital formation, and continued increase in foreign investments. The report recommends or endorses the NEDA plans for investment in infrastructure, particularly in irrigation systems, transport facilities, and power generators. There is to be a very substantial increase in the share of the public sector in power generation, from 12 per cent in the previous decade to 50 per cent in the coming decade. There is also to be a more equal distribution among the regions of government investments, with more funds going to Mindanao and other more remote areas.

The World Bank Report mainly endorses the priorities of the government in public investment. It says that there is an inter-agency team consisting of the NEDA, DAP, PROD and the Presidential Economic Staff assisted by the USAID staff working on the improvement of a method of allocation of public investment. The chosen areas of investment, viz., transport, irrigation and power generators follow earlier priorities of the government. The report however does not touch on the other projects considered by the team and how they failed to be included in the priority list. There is also no mention of capital outlay for social services, areas which are currently being given attention. Should not capital outlay for health services

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and low cost housing have been included as priority items? The chapter talks of distributing investment more equally among regions yet it ignores the concentration of investment in Metro Manila in the past two years.

The *Report* includes, however, a chapter on the educational system. Its recommendations are mainly concerned with organiza tional reforms.

In the section on incentives, it gives very interesting informatio on estimated value of subsidy to industry by form of incentives import duties, compensating tax, tax credits, accelerated depreci tion, double-deduction of shipping cost, reinvestment allowances, ta credit for tax on foreign loan interest. The table is reproduced Table 1 below for emphasis. The estimated incentive to capit (compared to other factors) amounts to about 80 per cent of to subsidy during the period examined (1970-72).

Table 1

Estimate of Incentives Availed of by Projects Registered with the Board of Investments, 1970-72 (In Millions of Pesos)

Category	1970	1971	1972	Tot
Capital-related incentives				
Transport duties on machinery	11.1	37.0	32.7	80.
Compensating tax on imported machinery	7.3	23.2	10.8	41.
Tax credit for locally produced machinery	1.0	0.3	—	1.
Accelerated depreciation	1.4	11.5	3.7	16
Double deduction of shipping cost	3.8	6.2	4.0	14
Reinvestment allowance	38.3	29.8	6.6	74
Tax credit for tax on foreign loans interest	0.1	0.0	0.1	0
Total	63.0	108.0	57.9	228
Other incentives				
Preoperating expenses	3.0	0.5	0.1	3
Double deduction of promotional expenses	0.2	0.2	0.2	0
Net loss carry-over	2.6	2.4	0.2	5
Compensating tax on imported raw materials	1.6	13.1	7.6	22
Sales tax	12.3	2.1	4.5	18
Tax credit for exported finished products	0.9	4.1	0.1	5
Total	20.6	22.4	12.7	55
Total value of tax relief	83.6	130.4	70.6	284
Capital-related incentives as percent of total	75	83	82	80

Source: BOI, statistical appendices to the fourth, fifth, and sixth Investment Priorities Plan. The number of reporting firms was 75 in 1970, 105 in 1971, and 70 in 1972. Table 13.9, p. 335, World Bank Report.

The *Report* brings a very important feature of the incentives system in the Philippines — its general applicability to practically all industries. The *Report* finds that all industrial activities not included in the list of over-crowded industries are potentially preferred. They can be included in the Industrial Priorities Plan (IPP) or Export Priorities Plan (EPP). The *Report* further observes that since only about 25 per cent of industries can be classified in the over-crowded category, 75 per cent are potential recipients of the IPP or the EPP. As time passes, many industries get out of the overcrowded category so that potential candidates for BOI registration increases proportionately.

The incentive system has very significant implications on the allocation of resources. Incentives lower the cost of factors used by the firm obtaining the incentives. Table 1 shows that about 75 per cent of the value of incentives relates to capital input and 25 per cent to raw materials and labor inputs. These statistics give support to criticisms of the incentive system quite frequently made in early writings of Secretary Sicat and the ILO report. A less obvious implication of the incentive system is the distortion of prices making large-scale industrial firms in urban centers more favored than the small-scale traditional consumer-oriented industries, including those catering to the agricultural areas. The reason for this distortion is mainly administrative. The cost in terms of time, transport cost, and know-how in applying for BOI registration is relatively fixed or does not vary with the size of the investment or the firm. Small scale, remotely located firms therefore bear relatively higher registration cost per output than larger ones in Metro Manila. Furthermore the BOI was really set up to cater to the larger firms. This would explain to some extent why small-scale firms decreased in relative importance or at best stagnated since 1960. (Chapter 9 of the report).

Another implication here is the distortion in the allocation of resources at the aggregate level between savings and consumption, and the flow of funds from rural to urban centers.

When incentives for investments are given indiscriminately as is happening in the Philippines, it lowers the cost of the favored factor. Assuming that demand for capital is cost elastic, the lowered cost increases the demand for capital. To meet this increased demand, we either have to increase the supply of funds or ration them to favored applicants. I think that we have been doing both — increasing the supply to some extent through inflationary financing of DBP and PNB, and foreign borrowing, and rationing the available funds. Infla-

tionary finance is indirect taxation of households whose income has been reduced by price increase. The question arises as to whether it is equitable to tax the average household to subsidize large corporations.

The *Report* concludes that incentives should be given for "very specific goals" but here it identifies these to be labor intensive and export-promoting activities. Moreover, it recommends the reduction of tax holidays. Why not abolish all incentives? The *Report* does not discuss what would be the new basis for having incentives or for the choice of the form of incentives. The more basic question confronting the government is whether or not any incentive should be given. If this question is not asked, vested interest is not likely to permit the World Bank suggestion for the selected removal of incentives. Past experience shows that business lobby was very strong in resisting the ILO recommendations for dismantling incentives. It is very likely that graduated changes will merely amount to token changes. It is also likely that dismantling the whole incentive system is easier done that dismantling selectively.

Resource Management

As in the preceding chapter which discusses allocation of resources, in particular the incentive system, the chapter on resource management also concludes with recommendations for partial reforms. The chapter is very informative in describing with statistics the structure of the financial system as to types of institutions, distribution of financial assets by maturity and by form of assets. The paper rightly points to the weaknesses of the system, namely (a) the instability of the market as symptomized by a small securities market, (b) the tendency of institutions to over-extend their liquidity comments, and (c) the concentration in extremely short money market instruments and other features.

The *Report* does not discuss the possible causes of the instability. At the heart of the problem is the administered structure of the rate of interest. The system pegs deposit rate, government institution loan rates, and government bond rate to unreasonably low levels. At the same time it requires very high minimum placements for special time deposit. Given these regulations, we would expect competing instruments with freely determined rates to expand at relatively faster rates. As the tables presented in the *Report* indicate, deposit substitutes grow faster than ordinary deposits. The *Report* also shows that

more inter-firm borrowing (at uncontrolled rates) occur, an expected consequence of the pegged rates on loans by banks. The availability of "cheap" credit from DPT, PNB, GSIS, etc. works against the growth of long-term markets since borrowers flock to these government institutions. We could also expect that the current interest and issue policies on government bonds would obstruct their marketing and thus reduce their contribution to the variety and size of the securities market.

The *Report* seems to be satisfied with the partial reforms being done such as the raising of ceiling rates and the stricter regulations of the financial institutions. If we are to develop the financial system as an effective supportive agent for mobilizing savings, more than partial reforms are necessary. The institutionalization of savings, especially of households, majority of which are fairly small savers, require the reform of the interest rate structure, the removal of minimum placements, the offering of less risky securities such as government securities (not marketed to small holders now), and encouragement of open corporation (as the *Report* suggests).

The *Report* also shows that the agricultural sector obtains a shockingly small (6.5 per cent in 1973) proportion of credit granted. Deduct from this proportion the bulk that goes to sugar industry and we are left with inconsequent proportion of loans for rice, fishing, corn, coconut and other agricultural activities. The *Report* fails to state why this happens. An earlier paper by this reviewer speculates why this happens. Financial intermediary tends to get concentrated in urban centers where the small market for short-term papers with unrestricted interest earning assets can be transacted. In rural areas, banks, instead of the more advanced types of institution, concentrate. Interest on bank deposits and loans are regulated at below market levels. Thus funds tend to flow to urban centers for speculation in high earning short notes.

The reforms which have been instituted are in the right direction but they are not likely to remove the major defects or weaknesses of the system. In brief the reviewer questions the reason, if any valid one exists, for the interest policy covering deposits, loans, and government securities; for imposing a minimum amount on placements; and for continued subsidy of rural banks. I agree that we should encourage open corporations. I do not think that the life of the securities market would depend on taxing family corporations. It would depend more on changing the cost of equity issue relative to loans from DBP or PNB, on the available securities in the market

especially government securities, and the over-all development of the financial market through a more reasonable interest rate policy.

On the whole the *Report* provides newly collated information particularly on value of incentives and the structure of the financial market. It gives good criticisms of some of our policies and institutions. But it takes a rather timid tone in its recommendations. At this time we have imposed so many restrictions and incentives, one on top of another, that a total revamp, rather than partial changes, may be the needed approach.

The Educational System

This chapter points to the major features and weaknesses of the Philippine educational system as has been done by the Presidential Commission to Survey Philippine Education (PCSPE) and the 1972 ILO Mission to the Philippines. The World Bank Report endorses all the major recommendations of the ILO Report as to the need for improvement of the quality of instruction at all levels through curriculum reform, expanded accreditation and increased supply of textbooks; "rationalization" of the system so that there would be better matching of supply and demand for specific training; and reorganization of administration. The *Report* endorses the steps being undertaken, including the increase in supply of textbooks to elementary schools, the reorganization towards more decentralized administration, and the establishment of a more effective planning office. The major contribution of the *Report*, it seems, is in identifying which recommendations of the PCSPE and ILO are being implemented and which are not. In higher education, it points to the lack of effort at expanding accredition and in establishing programs of support of needy students through loans and/or scholarship. It also describes the causes for the ineffectiveness of educational planning as arising from inadequate staffing and unreliable system of data collection.

On the whole, however, the *Report* lacks a thrust or a focus. It is a very polite and acquiescent chapter which relegates to one or two sentences critical features of the system. For example, it discusses problems of organization in the same tone as the problem of poverty and inequality. Both are serious problems but poverty and inequality represent much more crucial considerations in formulating policies. There have been studies and reports of the inequality of educational opportunities here. The Fund for Assistance to Private Education (FAPE) has published a series of reports on the National College

Entrance Examination (NCEE) which show clearly strong relations between NCEE outcomes and family background. The results obtained from the analysis of the outcome of the NCEE and the University of the Philippines entrance examinations reinforce the reports of FAPE. The study on the distribution of public services which the World Bank Report cites in Chapter 15 also shows that there is a very regressive access to public higher education. More empirical works have been completed since the publication of the World Bank Report. Most of the problems writers addressed themselves to in the chapter — be it finance of education, drop-out, poor quality of instruction — have their roots in poverty and income inequality, and the mismatching of demand and supply. To the reviewer, the solution to the problems of Philippine education should be found in understanding the implications of poverty on educational opportunities.

The *Report* seems to assume that the 10 regional centers for sub-professional manpower training are adequate to meet the requirements. The capacity of these centers probably reaches 50,000 or less. The population of those who leave elementary schools and high schools amount to several millions. It is not feasible and probably not efficient to increase training center capacities since doing so would require very substantial amounts of education resources which up to now have been concentrated in providing elementary education. After all, most sub-professional training takes place outside the institutional set-up, i.e., at home, on the job, and in informal apprenticeship. Informal media through learning by doing, assisting parents and others similar could be strengthened through non-formal ways also — radio, pamphlets, newspapers. These alternatives are not mentioned in the *Report*.