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POLICY PROBLEMS OF A VIGOROUS INDUSTRIALIZATION

by

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## P R E F A C E

This paper is written in response to a request of the Philippine Chamber of Industries (PCI) to provide them a summary of my views on problems and policy solutions confronting Philippine industrialization. They need it in preparation for a "White Paper" to be submitted by them to the Philippine Government.

The contents of this paper reflect the results of my studies of Philippine industrialization. Therefore, I am solely responsible for these views, although I have relied on the work of colleagues at the University, notably that of Professor John H. Power. While I shall welcome the incorporation of these views in any position paper undertaken by the Philippine Chamber of Industries (or any one interested in these policy issues), it is necessary to make a basic distinction between this document and the PCI White Paper.

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Quezon City, January 8, 1970

## TABLE OF CONTENTS

### Page No.

I. INTRODUCTION .....	1
Order of Presentation .....	1
II. RECENT INDUSTRIAL PERFORMANCE .....	2
National Income Accounts .....	2
Index of Industrial Production .....	3
Energy Consumption .....	3
Poor Industrial Export Performance .....	4
Capacity Utilization .....	5
III. PRESENT ECONOMIC POLICIES AFFECTING THE INDUSTRIAL SECTOR .....	6
International Trade Barriers and their Relationships to International Distortions of Economic Policy .....	7
IV. CORRECTIVE MACROECONOMIC POLICIES .....	11
Exchange Rate Policy .....	11
Towards a Uniform Tariff Mixed with Domestic Taxes and Production Subsidies .....	13
The "uniform" or "near-uniform" revenue tariff .....	17
Progressive "excise" taxation .....	19
Production subsidies .....	20
Special uses of revenue tariff for industrialization measures ...	21
Tax Incentives for Industrialization .....	22
Monetary Policy .....	26
Defensive mechanism against import payments and restrictive monetary policy .....	27
Interest rate policy .....	27
Export Incentives .....	30
QUOTATION: MEMORANDUM TO SENATOR W. DIOKNO ON AN ALTERNATIVE EXPORT INCENTIVES LAW .....	32
"THE GENERAL EXPORT INCENTIVES AND EMPLOYMENT ACT OF 1970" - A Proposed Bill .....	35
V. MICROECONOMIC POLICIES	
The Role of the Board of Investment .....	41
Identification of industries with high social pay-off .....	43
Industries with external economies to all other sectors .....	44

The automotive manufacturing industry .....	45
Assuring "competition" in a "domestic" monopoly production situation .....	49
The steel industry complex .....	50
Role of foreign investments in steel-related industries .....	51 ✓
Shipbuilding .....	52
Maintaining a healthy climate of competition: vigilance over monopolies, cartels and market restriction contracts .....	55
Proposal for domestic surtax on "foreign brands" and outlawing market restriction contracts .....	57
Locational policies: industrial estates .....	59
Review of some selected industries .....	62
Resource-based industries .....	62
Processed food industries .....	62
Livestock-, Poultry-, and Fishery-Based industries .....	63
Forest- and Mineral-Based industries .....	65
The heavily protected industries: Electronics and Textiles ....	68
VI. THE NEED FOR SUPPORTING POLICIES FROM OTHER SECTORS .....	71
Support of agricultural development .....	72
Expansion of telecommunications and infrastructure network .....	73
Improvement of essential governmental services and other public utility services .....	73
The expansion of service industries: foreign tourism.....	74
VII. CONCLUSION .....	75
REFERENCES	



# POLICY PROBLEMS OF A VIGOROUS INDUSTRIALIZATION

by Gerardo P. Sicat

## I. INTRODUCTION

The objective of this paper is to summarize important policy problems confronting Philippine industrialization and suggest the policy changes needed to invigorate our industrial development. It is related to numerous studies which are now in the process of assimilation into a separate publication. To establish the link between this paper and the studies referred to, an extended reference is attached at the end. These references are cited in number, whenever the relevance of more extended discussion found in these works is felt necessary.

### Order of Presentation

The first section is devoted to an analysis of the major problems of the present industrial sector as we find them in 1969. To undertake this, an awareness of past policies and of past problems is required. The second section gives a capsule of the recent performance of the industrial sector. The third section summarizes the characteristics of present industrial policies. The fourth section scrutinizes and highlights the macroeconomic policies which are important to national policies affecting industry. The fifth section focuses on policies affecting the firm and the industry -- in short, microeconomic policies. Therefore, we have much to say about the role that the Board of Investment is expected to play in the context of

industrial promotion within the private sector. The sixth section summarizes some supporting policies related to other sectors which are required by a successful industrialization policy. A few general conclusions are recapitulated in the last section.

## II. RECENT INDUSTRIAL PERFORMANCE

The rate of industrial growth in the 1960's has been unimpressive. It has been close to the rate of growth of total gross national product, not generally far above it. If the country is to move vigorously towards industrialization, the rate of expansion of industry should at least be double the growth of GNP, in fact, triple if possible. It will be our task in this section to review the indicators of industrial performance in the Philippines.

National income accounts. The average growth of the industrial sector in the national income accounts shows that it is only 5 per cent per year in contrast to the growth of 6 per cent per year in agriculture. The percentage share of manufacturing to total GNP has not increased during the period 1960-1969.

The only saving grace to total economic performance of the last few years is the result of increasing agricultural productivity, the exploitation of our forest reserves, and the production boom in the mineral exporting sector. All these have helped to push the rate of growth of the economy. The signs of increasing agricultural productivity are a good omen, because this sector has been largely depressed for a long time. But

more fundamental to national development is the question of how to accomplish a much higher growth rate in industry which will outstrip the high growth rates of the agricultural sector.

It has been suggested by other quarters that the income accounts do not fully take into consideration the actual performance of the industrial sector. A brief review of other indicators of industrial performance is therefore needed.

Index of industrial production. The index of industrial production, which is the basis of income accounts, is based on a limited sample of firms. In view of this, the expansion of new firms outside the sample is not captured within the index. This may mean that the performance of the industrial index indicators is understated. However, in our view, taking into account a more realistic change in sample size would still not be enough to make the rate of growth of industrialization more than 2 per cent higher per year. The population of new industrial firms is not overwhelmingly and sufficiently large to change the total picture. Moreover, this view is supported by other evidence below.

Energy consumption. The rate of growth of energy use is over 10 per cent per year. It has been suggested that this evidence counters the rather poor industrial performance revealed by industrial statistics. This claim fails to recognize the fact that the expansion of mineral resource exploiting industries, logging, commerce, the modern service industries, and



consumption of consumer durables requires a high incremental demand for energy. These sectors, which have expanded even at rates higher than recorded industrial growth, are characterized by highly energy-intensive operations.

We may therefore discount the claim that growth in energy consumption is a good indicator of industrial performance if we know exactly the nature of incremental energy intensity of use in many sectors. However, this is intuitively greater than 1 (maybe in the vicinity of 2). Therefore, the message is clear that a one per cent growth in energy use is accompanied by less than one per cent expansion of industrial output.

✓ Poor industrial export performance. The industrial sector has been characterized by poor industrial export performance, as a result of the basic weakness of policy in this area. The industrial sector has not developed sizable new exports. Part of the new industrial export performance is highly related to the extraordinary demand situation arising from the Vietnam War, such as in the case of the rapid expansion of exports of the petroleum refining industries and even beer. If industrial exports are defined to exclude all processed traditional exports, like sugar, coconut oil, and canned pineapples, no substantial exports have resulted. As a matter of fact, after decontrol, the relative share of traditional and primary exports to total, compared to that of manufactured exports, has increased relatively. (See References {2}, {11}). None of the new industries

promoted in the first decade of industrialization, with a few exceptions, have succeeded in making exports a source of sustained income. On the other hand, they continue to be heavy users of foreign exchange.

Capacity utilization. On the average, although of course they vary from industry to industry and from firm to firm, the capacity utilization ratio of much of Philippine manufacturing would appear to be low. No known measures of capacity utilization have been made since early in the 1960's.<sup>1</sup> Based on the complaints of the private sector, it would seem that capacity use of existing physical facilities in manufacturing has not expanded. If at all, present capacity utilization may be lower than the earlier measures. An optimistic guess would be that, among large industrial enterprises in the country, the range of capacity use is in the range of 50 to 70 per cent of rated capacity. If we take the median of this optimistic range, 60 per cent, then we are but a short way from a conclusion that a large portion of capital is not efficiently being used. The reasons for this low capacity use are lack of demand within the domestic market, lack of raw material inputs due to balance-of-payments difficulties, and a "satisfactory" profit position at low capacity use enjoyed by some firms.

We have thus established that the industrial sector

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<sup>1</sup>For instance, see Bautista (1966).

has been growing at a rate which is far from satisfactory. It will be our task next to outline the present policy setup which has been responsible for this poor performance.

### III. PRESENT ECONOMIC POLICIES AFFECTING THE INDUSTRIAL SECTOR

It would be necessary to summarize the net effects of all economic policies applied to the industrial sector. It has been argued in other papers that these net effects represent some distortions which are briefly as follows:

(1) Resource price <sup>min wage law</sup> distortions which create a bias against the utilization of resources which are most abundant;

(2) Pricing policies (derived from monetary, tariff, and other policies) which prevent final goods import substituting industries from integrating backwards;

(3) Pricing policies which overfavor import substituting industries and fail to compensate for the weaknesses of price incentives for exports of manufactures.

All these distortions have been discussed in some papers that have gained relatively wide currency, so that there would be little need to elaborate on them further. (References {15}, {16}, and {19}). However, these distortions are central to the understanding of corrective policies towards a vigorous and efficient industrialization program. They therefore reenter the center of the stage as we move to the discussion of policy corrections.

An important aspect that should not be missed, however, relates to the problems of international trade barriers that has occupied a not insignificant part of policy discussion within our country. An elucidation of this and its implications for domestic policy should be a useful contribution towards our enlightenment, so that we can dismiss the problem at once. This will therefore occupy the rest of this section.

#### International Trade Barriers and their Relationships to Internal Distortions of Economic Policy

It is wellknown from studies of international trade that tariff and nontariff barriers to international trade are rigged against the expansion of exports of manufactures from the less developed countries. This was one of the original reasons for the industrial policies which earlier goaded less developed countries to adopt inward looking industrialization strategies.<sup>2</sup> The recent discussions of promoting world economic development, as envisioned by the catch-phrase "The Development Decade," which was applied to the decade of the 1960's and which culminated in the Conference on Trade and Development (UNCTAD), has awakened a dormant community of interests among less developed countries. In brief, UNCTAD has forged common interest among the less developed countries to help "unrig" barriers to international trade in their favor.

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<sup>2</sup>See Raul Prebisch (1950), whose writing was probably the most influential.

In the meantime, economists in the richer countries have long recognized the need to correct these barriers to international trade, because it is a more efficient allocation of their own resources and their citizens have all to gain in terms of increased economic welfare.<sup>3</sup> The Kennedy Round tariff cutting conferences represent an effort to reduce tariff barriers among the rich countries, and indirectly these tariff cuts will benefit the less developed countries because the tariff reductions are nondiscriminatory. The road is long, as shown by the rather limited accomplishments of the Kennedy Round discussions so far. However, there is now wide recognition of these problems. And the economics profession, of late, has come out with a tremendous outpouring of literature on the distortions of tariff protection on world trade and specialization, which have demonstrated that the system is inimical both to the rich countries and, more so, to the poor.<sup>4</sup>

In the meantime, at UNCTAD, the less developed countries have made a unilateral demand for preferences in trade in manufactures in their favor. Our country has joined vigorously in this demand.

While it is important that we are part of the movement to demand more concessions from the rich countries in terms of

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<sup>3</sup>See, for instance, H.G. Johnson (1967), H.B. Lary (1968).

<sup>4</sup>See, for instance, Bela Balassa (1965), G. Basevi (1966).

trade preferences, it **is** also ironic that we are part of it. We have come too late in realizing the need for preferences for manufactures. It is not even clear, based on the level of current discussions of our external trade relations, that we indeed appreciate a golden moment in our industrial history which has been missed because of our failure to recognize a market signal. We are referring to the most advantageous trade arrangement with the richest and most industrially developed country in the world -- the United States market -- as embodied in the Laurel-Langley Trade Agreement (and its predecessor).

[Since 1946, we have had a most advantageous bilateral preferential scheme with the United States. It is true this is bilateral and not "unilateral" in our favor. But the fact was that while the trade agreement was preferential in character with respect to tariffs, we had the tremendous advantage over all our neighbors in pushing forward an industrial export orientation as early as the first few years of independence. Our preferential access was largely potential. Had we recognized this early in our independence, we would have promoted healthier industries, because, firstly, they were dependent on international specialization and, secondly, they would have allowed us to utilize all our economic resources -- mostly our abundant labor resources and the fertility of our agricultural soil (processed foods and other tropical products). Thus, we would have pushed ourselves to a higher level of industrialization than we now have.] But our short-sightedness in favor

of a policy of inward-looking industrialization has given advantage to our neighbors (Hongkong, Taiwan, and now South Korea and Singapore) who have, without the benefit of tariff preferences, been able to cash in on industrialization strategies that have opened up rich opportunities in industrial export orientation.] Our neighbors have taken the existence of trade barriers as given. But they have pushed their energies in overcoming these barriers, so that finally they were able to penetrate the large market offered by the United States for industrial manufactures. How much simpler it would have been for us.

[All these are necessary lessons for the future, because past mistakes enable us to see where we are headed for. The point that we are leading to should now be clear. If there are international trade barriers, the fact that our neighbors, without the aid of tariff preferences and in the presence of larger barriers, have succeeded in pushing healthy industrial expansion based on exports should bring home the message that successful industrialization requires internal policies that overcome these trade barriers.] If trade preferences exist which give us any tariff differential in our favor with respect to other countries, then the work of correcting world trade barriers is much easier from the national standpoint. As we have put it elsewhere, "success depends on what we do, not on what we do in concert with other countries, although the latter can be made to serve national policy and further enhance success."<sup>5</sup>

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<sup>5</sup>See Reference {11}, p. 102. The reference to the UNCTAD "syndrome" is probably a good dramatization of the problem for internal policies.

To be able to overcome these barriers, however, we go back to the important question of correcting distortions of domestic policy.

#### IV. CORRECTIVE MACROECONOMIC POLICIES

Macroeconomic policies refer to monetary, fiscal, foreign exchange rate, and other related economic policies which are designed to affect the volume of aggregate economic activity. These policies, therefore, have wide ranging impact on all sectors rather than only on specific sectors, although they do affect the latter, too, in significant ways. They are very important in determining the course of the growth of the economy, the direction into which productive economic resources are utilized among sectors, and, finally, the way in which aggregate income is disposed of by households and institutions.

##### (1) Exchange rate policy.

[The foreign exchange rate has powerful effects on internal prices -- the relative prices among all domestically available resources, and among domestically produced goods and resources with those obtained abroad.] Because of its effects on relative prices, the exchange rate serves as an important signalling device for the flow and use of resources. It determines which enterprises become relatively more profitable (or less profitable) and which resources are cheaper (or more expensive) to use.

As an example, given all the distortions summarized in



the previous section, what happens to relative prices when the exchange rate is altered (for instance, through devaluation)? The policy change partially corrects simultaneously for all three of them. It makes more expensive imported inputs to the industrial process and relatively cheaper those which have domestic origin. Thus, a high wage rate economy prior to devaluation becomes a low wage rate economy if the devaluation is substantial enough and no non-market adjustments are imposed on the wage rate. [A cheap pricing of investment goods becomes a realistic pricing policy: the domestic prices of these goods, especially if they are imported, are adjusted upwards. Moreover, it discourages imports and therefore corrects for some part of balance-of-payments on the import side. It also encourages exports as it makes exporters earn more peso income on the same dollar of foreign exchange earnings.]

Therefore, it is obvious from this that the foreign exchange rate is a source of immense incentives (as well as disincentives). It also follows that any attempt to pursue an unrealistic exchange rate policy accentuates the distortions within the economy. The last statement is a corollary of the first. Moving from a distorted (unrealistic) foreign exchange rate to a more realistic one, many distortions in policy are corrected. Conversely, moving from a realistic to a less realistic exchange rate, however, substantiates many problems inherent in original distortions of policies.

A survey of the foreign exchange policy alternatives open to the Philippines have already been made (Reference {14}). and there would be no need therefore to elaborate on this point. However, it must be pointed out that the economic profession is substantially agreed on the principle that a realistic exchange rate is conducive to a better allocation of economic resources than an unrealistic one.

This brings to mind the Philippine experience after decontrol and the failure of the Philippine economy to get a sufficient enough export response, after the devaluation and the decontrol, from the manufacturing sector (Reference {2}). In essence, this was due to complications originating in fiscal and monetary policy, to the reversals of the gains made by devaluation by virtue of the return of basic incentives through the tariff system, and to wage policy which raised the institutional wage rate. (For an elaboration, see Reference {13}).

(2) Towards a uniform tariff mixed with domestic taxes and production subsidies.

Tariffs are widely accepted as protective instruments for domestic industries in our country, as elsewhere. Invariably, the argument used is to protect infant industries, yet, once they are established, they are continually justified as protective measures. Thus, they graduate as protective measures for old industries as well.

Tariff rates are different for different commodities. The difference in rates are due to the criteria of essential-

ity and of protective measures for new industries. High tariffs on nonessentials are based on the assumption that, if goods are not so essential, high tariffs would discourage their use and importation. Yet, the high tariff encourages incentives to produce the good which is by definition "nonessential". On the other hand, "essentials" are given very low tariffs, if at all; therefore, their importations become generous. Because of the high profits potentially available to the highly protected (nonessential) industry and the relatively low protection for the "essential" import, domestic investment resources are diverted to the nonessential and away from the essential; yet, by the implications of social rankings, the "essential" commodities are more important.<sup>6</sup>

Of course, there are exceptions to the concept of "essentiality". Some goods (e.g., capital goods) which do not have the potentials of being producible within the country by virtue of lumpiness of the initial investments and the extensive technological requirements will always remain "essential" from an importation criterion. Yet the "essentiality" criterion has been used in the past to encompass the importation of raw materials, unfinished goods, consumer goods, and the like. These essential imports have also been imported at unrealistically cheap exchange rates, so that they had practically swamped the potential profitabilities of domestic import

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<sup>6</sup>See John H. Power (1966), (1967).

substitutes of these commodities.

The tariff rates on many commodities are very different, and our imports are so extensive. No single individual can ever hope to master the tariff code because of its voluminous content, the wide variety of goods that are imported, and the wide ranging differences in rates of duty for the same import which is often a mixture of specific (based on unit physical measure) and ad valorem rates. The most extensive study of the structure of tariff protection in the Philippines was recently finished by John H. Power.<sup>7</sup> This study shows measurements of effective rates of protection on value added for scores of detailed (4-digit ISIC) industry groups. The effective rates of protection yield a consistent pattern which accounts for the distortions of incentives within the industrial sector. There are high protection rates for import substituting industries. These protection rates do not encourage industrial efficiency and in fact discourage expansion towards export markets. In addition, there is substantially less protection for intermediate manufactures and for exports.

The Philippine Chamber of Industries has been wellknown for its strong advocacy of efficiency in customs administration. Efficiency implies a reduction in the cost of administration, the weeding out of graft and corruption, the speedy movement of

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<sup>7</sup>See his (1969).

goods out of customs, and the reduction of technical and outright smuggling. Yet the ills which confront customs administration are intimately tied with the monetary incentives which are available to corruptors and corrupted, because of the intricacies of the tariff code and the prohibitive rates of protection. For instance, we have argued elsewhere that the reduction of tariff rates immediately provides a check on the relative profitability of smuggling. (See Reference {17}).

In order to improve customs administration and restore basic official morality at all levels of tariff administration, the first step is to simplify tariff rates by unifying as many of them and by reducing exorbitantly high tariffs. This requires a search for a superior protective mechanism than tariffs to promote new domestic industries. Such an alternative industrial promotion strategy should not only expose domestic industries to foreign competition but should also effectively enable them to thrive under a more healthy economic environment. Since faith in official morality has been often used as an argument in favor of good government, nothing could be more effective an instrument of policy for weeding out corruption as the removal of the source of **corrupting incentives**.

This, therefore, allows us to recommend to the PCI the following set of bold measures; they all form a package. Following one without the other will sorely weaken the effects of the policy proposals. (It must also be added that this is a



very bold set of policy recommendations, and we feel that they have a lot of **arguing** in their favor (overcome traditional arguments).

- (a) Reform the tariff code by converting the tariff into a purely revenue tariff and removing its "protective" characteristic.
- (b) Substitute "progressive" domestic <sup>excise</sup> taxation and production subsidies in place of <sup>tariff</sup> ~~tariff~~ <sup>subsidies</sup> ~~subsidies~~ are justified on "protective" and "national industrial" arguments. <sup>investments to</sup>
- (c) Utilize a portion of tax collection <sup>quick</sup>, short-term revenue tariff to strengthen the financial <sup>institutions</sup> available to the long term financing institutions for domestic industries.

The above proposals require some explanation. This is now done.

(a) The "uniform" or "near-uniform" revenue tariff.

[The tariff has become a serious battleground for favor among the different sectors of the economy and especially within the Philippine Chamber of Industries.] This is why this proposal is bound to elicit considerable debate. Yet, the advantages for long run industrial development are quite visible. In addition to the removal of incentives for official corruption and the reduction of the cost of administration, this will reduce smuggling considerably, if not totally erase it. Its

effects, therefore, on moralizing government administration, in the sense of reducing corruption, would be immense. It will facilitate a return to the respectability of faith in government which is so critical to the maintenance of democracy and which, as many commentators have decried, has already been largely eroded.

Moreover, the removal of the protective character tempta- of the tariff will restore a natural balance in industrial incentives. It will enable current and potential industrial entrepreneurs to gear the directions of their investments to activities that have long run capabilities. It will be a natural incentive to prevent investments based on quick, short-run gains which are likely to be economically unviable in a world of trade and, therefore, wasteful from the standpoint of our resource allocation.

The uniform tariff, i.e., a tariff which has only one ad valorem rate, say, 15 per cent of gross value of imports, f.o.b., completely does away with the voluminous tariff code. It reduces the need for a large staff in the Bureau of Customs and it will enable us to shift technical resources now committed to the study of tariffs for protection into other areas of economic planning.

As a transition from the present setup, it might be useful to operate along near uniform tariffs with provisions for the eventual unification of all tariff rates to a straight ad



valorem rate within a period of, say, ten years. A minimum of five separate rates would be sufficient to begin with.

But it must be added that this proposal is tied to the assumption that the government will maintain realistic foreign exchange rates as a matter of policy, or else the tariff would work against the national advantage arising from the delicate balance of internal against external prices. Another temptation which must be resisted is the demand for tariff exemptions of any kind, except for the uses of imported raw materials needed by export industries in the industrial sector. Capital goods must be subjected to the revenue tariffs.

(b) Regressive "excise" taxation.

The domestic taxation of goods should be able to differentiate between goods which are considered by the criterion of essentiality (nonessentiality). This is where a slightly more sophisticated internal revenue code might be necessary so that the differential effects of the tariff can be made to apply without the necessary distortion to production incentives that emanate from an unequal tariff protection for different goods. Imported goods which are considered nonessential (or luxuries) may be subjected to higher rates of domestic excise taxation. Goods which are considered essentials may be subjected to lower excise taxation. Since, eventually, nonessential imports are likely to be those which are considered to be the consumption items of the rich, there is an element of pro-

gressivity in the tax burden of the alternative domestic excise taxation. It is true that, at present, some element of progressivity already exists, but the current tariff rate mechanism and the system of compensating taxes is subject to more manipulations between importers and the customs.

Since the alternative setup is likely to shift the administrative controls between established business and the bureau of internal revenue, the area of improvements in tax administration can now be more fully shifted to internal revenue collections, where, in the long run, the benefits of improvements in tax administration can have lasting effects on economic development. The setup, as proposed, will create an opposition of forces which will be conducive to an efficiency in internal revenue administration. With the removal of overly protective tariff rates, the arena of conflict of interest between domestic producers and importers shifts, largely to internal revenue administration. Since both producers and importers will be subjected to the same excise taxes (the burden of which is not necessarily on these economic groups), with the exception of the proposal to be made in the next subsection, there will be greater pressures for the conflict to be resolved in terms of a higher collection rate of the internal taxes by the government.

(c) Production subsidies.

The provisions of the investment incentives act will operate to give indirect subsidies to enterprises that are

initially getting started through tax exemptions of various forms. Moreover, one basis for differentiating imports from domestically produced commodities (while we assume that a freer inflow of competitive imports is able to check the rise of unviable and uneconomic industries) is by giving a tentative differential tax subsidy on the domestic excise tax. For instance, if the domestic tax on refrigerators is 75 per cent ad valorem, the domestic producer may be given a 50 per cent tax deduction for the production of the refrigerator for a period of, say, 10 years. In the meantime, some other forces must go into operation so that this industry will not become purely import substituting. This will be the area of export promotion.

(d) Special uses of revenue tariff for industrialization measures.

The revenue tariff is bound to yield greater customs revenues than the protective tariff. For example, a 15 per cent ad valorem tariff on US\$1 billion of imports yields a revenue at the current exchange rate of about P600 million. These are more substantial than the current revenues from protective tariffs which have, firstly, encouraged smuggling and thereby removed from the tax base a sizable segment of imports (considering the impression that this smuggling is sizable) and, secondly, prevented some imports that would otherwise have come in without excessive protection.

Now, the area of allotting tax revenues for specific

funds is generally unwise as a fiscal rule. But it will prove attractive, especially in, say, the 10 year transition from a complex tariff structure to the uniform tariff to allot a proportion of the proceeds from the revenue tariff, perhaps 25 per cent, to a common fund that might be used to generate a supplementary long term capital fund for direct lending at realistic interest rates to private industry.

The new fund can be divided into separate funds or unified under one special long term fund. Opting for division into several, but not more than three, funds, a logical solution will be to divert a portion to the Development Bank of the Philippines, another fund for a new bank for medium and small scale industries, and a third for an export bank which should be able to finance loans for export-oriented industrial enterprises. For a period of ten years, considering a trend towards increasing imports over time, the potential long-term industrial fund should be able to generate a substantial source of long-term finance for industry that will capitalize a new bank (banks) or augment the capital of existing government banks.

### (3) Tax incentives for industrialization.

Part of tax policy has already been suggested in connection with tariff reform. This is in reference to more progressive excise taxation which taxes more severely items of luxurious consumption. Another related piece of taxation

which can have wide impact on the allocation of savings is related to land taxes. A higher rate of property taxation (due to more realistic assessment rates) should be able to help restrain, but obviously not curtail, investments in real estate. Another would be a percentage transaction turnover tax based on value. These measures will help to mobilize proceeds from consumption taxes for national development because the government is able to siphon away from consumption some income which can now be used for maintaining government and for pursuing economic development projects.

We have referred in other works to the substantial distortions of tax incentives in favor of capital-use and against labor-use. Most of the policies have been directly to subsidize capital. At the same time, we overprice labor through policies designed ostensibly to promote social justice. Given this pattern of policies, ~~tax~~ incentives must be able to correct the distortions by policies which restore the balance in favor of labor-use and employment.

If we must stick by our social goals of preferring employment creation and not business preference for a limited labor force, which has often been voiced in technical as well as business circles, tax incentives must be corrective, not reenforcive, of the distortion.

A possible correction is in the form of double deduction of wage costs from the corporate income tax. If this is not acceptable because of the fear that there will be an ero-

sion of the tax base of all industrial firms (which is probably the case in the short-run but not necessarily in the long-run), double deduction can be done at least for the portion of labor costs which go into exports.

It is very surprising that, given our huge labor surplus as evidenced by our high unemployment rates, this proposal has met with resistance even from those concerned with economic policy. However, we might be more convincing if we cite Australia whose factor proportions, compared to the Philippines, are certainly very different. A recent visit to Australia has given us the discovery that this country down south has devised incentives which enable exporting firms to get a rebate on the payroll (social security) tax attributable to exports. If anything, what Australia needs is an incentives policy which is related towards cheapening capital acquisition very much along the lines of United States economic policy to promote investments. But at least Australia is consistent with her objectives, for it is probably the only country in the world today, save one or two other exceptions, which encourages a high rate of population growth as a major national objective.

We have been aping, however, United States policy (not Australian), probably because many of those who have been recommending tax policy have been trained in American business schools and have, as a consequence, been greatly enamored by the importance, say, of accelerated depreciation. Australia

can learn from United States policy, but we can learn more from Australian policy. And given the enormity of our labor supply relative to gainful jobs we can generate, we must opt for bolder labor employment tax incentives than Australia has been giving.

Two points that have been raised concerning the desirability of incentives to capital acquisition have to be answered. The first is the need for technology which is modern in industry.<sup>8</sup> The second is that labor costs tend to be more variable than capital costs; once the capital is acquired capital rentals can be predicted over time.<sup>9</sup>

The first point raises the question that if the equipment is really superior to any technology available, then it must be superior even if the relative prices of capital and labor are at their market ratios. Therefore, it must come out as superior even if the enormous incentives to capital acquisition were not present. Under these conditions, there would be little danger of the substitution of capital for labor. But the negative impact of a capital-cheapening incentive is precisely when the opportunities are open for capital-labor substitution within techniques of production and within industries. In these situations, labor displacement is prematurely encouraged because of the distortions in capital-labor prices.

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<sup>8</sup>This viewpoint is often heard in government circles, where business preference for capital technology is often taken as given and desirable for economic policy.

<sup>9</sup>This second point has been raised in oral and written discussion with Mr. David Sycip, whose point we greatly admire.

The second point is further strengthened by the following possibility. If capital prices are rising, the acquisition of capital is not only an assurance of a predictability of input prices, but it allows the investing company to accumulate capital gains. From this standpoint, it becomes "rational" business behavior to prefer capital inputs to labor inputs, where no capital gains are likely (except in cases of "labor exploitation", in the classical sense that labor gets less than its marginal product).

However, the above should not be enough cause for government to distort relative prices in favor of capital. It is important enough to recognize that the desirability of capital equipment for its own sake is not a rational business motive, although economic reasons may motivate businessmen to prefer a relatively more capital-intensive technique to a less intensive. Moreover, it should be added that the proposed alternative incentives scheme is able to compensate for the effects of rising wage costs because it is total wage costs which get more than usual treatment as deductible items from the income tax.

#### (4) Monetary policy.

Monetary policy has its many sides. There is the policy with respect to the exchange rate, to which we have already made reference. There is also reference to the traditional powers available to the Central Bank concerning the expansion



of the money supply and the indirect means of controlling trade payments.

We shall deal briefly with two aspects of policy:

(a) Defensive mechanism against import payments and restrictive monetary policy. The Central Bank has been largely conservative in its treatment of international trade policy, whether during the period of controls or now. More recently, during the period of decontrol, its defense of the peso has been largely in the use of devices which reduced the level of imports. Many of the restrictive monetary policy circulars have been devised to stave off the level of imports. The experience concerning export expansion has been inadequate. It is in this sense that the Central Bank, as revealed by the actions of the Monetary Board, has apparently learned only one side of the question attacking monetary questions with respect to the balance of payments. (Reference {5}).

(b) Interest rate policy. Central Bank policy on interest rates has been ultraconservative. For instance, the rediscount rate of the Central Bank was once (sometime in the 1950's) as low as 1 1/2 per cent. It is only in response to rising world bank rates that the Central Bank changed its (effective) rediscount rates to as high as 10 per cent recently.

In a country where savings resources are very scarce

and where labor is generally very abundant, the appropriate policy to attract savings to move into investment instruments would be to monetize these savings through the banking system. The trick to this lies very much on how the Central Bank can invite a response among savers to put their savings within the instruments available to the banking system. On this score, Central Bank policy is in error. The error lies in the belief that low interest rates invite enormous investments or that savings are unresponsive to interest rates. Of course, the Anti-Usury Law (which was passed in 1916 and which provides that interest should not be more than 12 per cent on secured loans and 14 per cent on unsecured loans) has a lot to do in constraining the proper range of interest rate policy. However, it is also wellknown that the effective rates of interest among financing companies, especially in the area of consumption and real estate loans, is not lower than the range of 25 to 30 per cent. This is only for the organized lending market. These rates of interest are indeed very high.

The interest rate cuts both ways. { The level of interest rates attracts savers away from consumption or other unproductive instruments of saving } (e.g., real estate or stock exchange speculation). To the extent that it prevents the use of savings for speculative ventures, the interest rate level is able to give stability to the economy. For instance, a 10

per cent rate of interest on savings deposits is likely to generate more savers than a 6 per cent rate of interest. Second, a higher rate of interest on time deposits, say 12 per cent, is likely to attract long term savers away from shorter term savings instruments. The experience of Korea and Taiwan (see Reference {13}) shows that the response of savers to high interest rate policy has been effectively positive. Given this evidence, it would seem rather unlikely, as often claimed in the Philippines, that savings are unresponsive to interest rate levels (i.e., interest inelastic).

As an allocator of investment funds, the interest rate plays an important role. At very low rates of interest, just a lot more activities might be invited to seek loans. Activities economically feasible under low rates of interest may not be under higher interest rates. In any case, the policy must be balanced with realism in interest rate policy that is required to goad savings into the banking system.

The discussion above is put in terms probably unpopular to the industrialist. The successful industrialist is always in need of capital funds. This need is also matched by the natural desire to have the cost of capital as low as possible. Yet, it is common knowledge among industrialists that the interest rate terms at which long term finance institutions and commercial banks lend are commonly too low, so that they encourage an excessive demand for loans. This excess demand

creates pressures to increase the use of patronage, political contacts and even shady deals (which all increase the cost of borrowing). Moreover, all these side effects are very inimical to the sense of open and fair play for which most legitimate businesses would openly opt if only it were possible.

One way to make this possible is to accept that an increase of interest rates -- by even as much as 2 per cent per year -- is going to help not only increase the level of savings forthcoming into the banking system (which will feed enterprises of new externally generated financial funds) but also reduce the unrecorded transactions that come along with low interest rate policies.

(5) Export incentives.

General incentives are superior to specific incentives. Specific incentives are drawn on the assumption that these must be given on a commodity-by-commodity or firm-to-firm basis. This is more or less administratively more cumbersome and is based on the fallacious assumption that administrators (or economic technicians) know best what exports or firms to favor. Very often the experience of administrators or technicians is much more limited compared to the available possibilities. Therefore, it is best for the government to limit its controls over specific incentives.

In this light, the Philippine Chamber of Industries should favor general incentives for exports. What are general

incentives? They are incentives which, like macroeconomic policies, cut across-the-board rather than favor specific industries, commodities, or firms.

There is room for a slight modification of general incentives policy for exports, given the special circumstances of present Philippine export trade structure, because corrective policies are not present elsewhere. First is the sugar premium (the difference between US price and world sugar price), which sugar exporters derive because they sell to a protected U.S. market. Second are natural-resource-based export industries which do not undergo internal processing prior to exports. Under the second are included exports of logs and raw minerals.

Certainly, there should be no special reasons why these two sets of exports should benefit from any general export incentives since sugar has derived enormous profit incentives from the sugar premium, and, secondly, it is wise national policy to encourage the processing of mineral-resource-based industries. The minimum incentives required for these export industries is a measure of realism in the exchange rate policy. Other than that, and for other reasons, it is important that they be excluded.

One way of excluding some exports, without the necessity of specifying which exports to exclude, is to define a minimum export volume (in physical or in value terms) over a period of the last 5 years. Then all exports which exceed that minimum

are to be excluded from the export incentive. (See Reference {5}). An alternative procedure would be to exclude the first 20 exports appearing in our inventory of more than 700 exports. (See Reference {11}). A supplementary method is to define manufacturing origin by reference to the standard classification of industrial activities (ISIC), subject of course to either of the two classifications. (See Reference {5}).

Our recommendations on export incentives, aside from those emanating from a realistic exchange rate policy for exports, are best reported in a communication to Senator Jose W. Diokno, in response to a request by the latter for comment on the export incentives bill drafted by the Board of Investment. This is reprinted in full below:

QUOTATION:

MEMORANDUM TO SENATOR JOSE W. DIOKNO ON AN ALTERNATIVE  
EXPORT INCENTIVES LAW

For reasons already well elaborated in my writings on export promotion policy and on industrialization incentives policy, I can forego with elaborate arguments as to why the BOI export incentives draft is not necessarily the best export incentives bill our country can adopt. However, the following brief reasons are forwarded:

1. The provisions<sup>1</sup> of the bill intensify rather than

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<sup>1</sup>The provisions incorporated as incentives to registered enterprises in RA 5186 (the Investment Incentives Act) are repeated to be given to all export enterprises.

neutralize the bias of already existing incentives against employment.

2. The incentives assume largely that export industries are still inoperative. It can be argued that some manufacturing industries beset with low capacity use can become potential exporters on the basis of existing capacity in the industrial sector, if these are given sufficient inducements to export and if the exchange rate for exports were sufficiently attractive.
3. The incentives offered are peripheral to the act of exporting. If our objective is to promote exports, we must gear the incentives instrument directly to export achievement, not to side activities that are indirectly related to exports. Almost all of the provisions in Section 5 are of this type. We must search for a simpler incentive scheme which directly rewards the act of exporting.
4. The provision that all exporters getting incentives must be registered with the BOI, thereby making the BOI as the sole source of incentives, will be contrary to the rules of efficient administration of the export incentives scheme. It redirects the BOI from its more fundamental function of guiding and

studying the directions of all industrial investments desirable from the viewpoint of a sound industrialization and economic development as embodied in the Investment Incentives Act.

Accordingly, I wish to offer three distinct criteria which will enable us to device a useful export incentives scheme, which directly supplement the following goals of national policy:

- (a) industrial export growth and commodity and market diversification
- (b) expansion of employment
- (c) encouragement of productivity growth and technical change.

The criteria are:

- (1) The export incentives policy must reward directly the act of exporting;
- (2) The export incentives must correct for the existing distortions of incentives policy, which are essentially against employment, in the choice of techniques and of industries;
- (3) The incentives policy must be conducive to innovations which are related to labor-using productivity growth, not labor-saving, or at least not to encourage the latter explicitly by distorting policies in its favor;



- (4) The incentives must be general to all exporting firms (with a few minor exclusions) and automatic, rather than specific and on a firm-to-firm basis.

With the above goals and policy criteria, I am attaching an alternative export incentives bill. The provisions of this bill have been extensively discussed and defended in my papers "Towards Industrial and Employment Expansion: Alternative Proposals for Economic Incentives Legislation Applied to Export and Industrial Promotion," School of Economics Discussion Paper 68-22 (July 5, 1968) and "A Design for Export-Oriented Industrial Development," School of Economics Discussion Paper 67-5 (June 20, 1967).

What follows is a concrete legislation proposal which will be self-explanatory as it is read.

## "THE GENERAL EXPORT INCENTIVES AND EMPLOYMENT ACT OF 1970"

Section 1. Title. This act shall be known as the "General Export Incentives and Employment Act of 1970."

Section 2. Declaration of Policy. It is the policy of the government to promote (1) industrial export growth; (2) diversification of commodity and geographic market composition of exports; (3) rapid employment expansion; (4) rapid growth of productivity related to labor-using innovations; and (5) growth of industrial corporations in manufacturing.

Section 3. Definition of terms. For purposes of this act,

- (a) "Manufacturing enterprises entitled to export incentives" shall mean any corporation, organized and existing under Philippine laws, engaged in the manufacture, processing and production of export products classified under the revised International Standard Industrial Classification (ISIC) as falling under classifications with digits beginning with 3;<sup>1</sup>

provided that the manufacturing enterprises do not fall under the category of ten principal exports of the Philippines as recorded in Central Bank export statistics;<sup>2</sup>

provided further that the exports excluded from this definition which have domestic processing (manufacturing) content of at least 50 per cent of total final export value ("export receipts", as defined below) may be entitled to specific incentives by the Board of Investment, under authority granted to it in Republic Act 5186, the Investment Incentives Act; and

provided further that in the last case, the product concerned is not sold in a market at a premium price in excess of 10 per cent of the world market price for the same product.

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<sup>1</sup>This defines manufacturing activities at their most detailed levels. The basis for this is the revised version of ISIC (1968) as recently put out by the United Nations. To accommodate an increase in industrial activities classified, the United Nations changed the data codes of all manufacturing industries. Whereas before the codes referring to manufacturing begin with 2 and 3, now they are all assigned a code beginning with 3. Using this code, or any subsequent coding, such as the Philippine Standard Industrial Classification (PSIC) put out by the NEC, will give the administrators of the export incentives law an objective reference book for classifying exports of manufactures. They will be free from the somewhat arbitrary task of determining the desirable definition of "manufacturing" by domestic content. See United Nations, International Standard Industrial Classification of all Economic Activities, Statistical Papers series M, No. 4, Rev. 2 (New York, 1968).

<sup>2</sup>An alternative basis for exclusion, which is more specific, is by reference to the first 20 of 766 exports of the Philippines reported in G.P. Sicat, "An Inventory of Philippine Exports, 1961-1967," School of Economics Discussion Paper No. 69-5 (February 14, 1969).

- (b) "An export trading enterprise" shall be a corporation, organized and existing under Philippine laws, engaged in the sale of exports produced by manufacturing enterprises as defined above.
- (c) "Export receipts" shall mean f.o.b. Philippine export value, which have been certified by an appropriate bank and corresponding commercial documents; in the case of manufacturing enterprises whose products are distributed by an export trading enterprise, "export receipts" shall mean 95 per cent of the f.o.b. port value of "export receipts" certified as having been distributed by the export trading enterprise.<sup>3</sup> In all cases, the conversion of export receipts into pesos shall be at the buying rate for foreign exchange proceeds of the Central Bank.
- (d) "Export ratio" shall mean the historical three-year moving average of the ratio of "export receipts" to total sales of the enterprise" for firms enjoying incentives for at least three years; for firms enjoying their second year of benefits, the "export ratio" shall be the ratio of export receipts to total sales receipts in the last two years; and for enterprises in their first year of seeking benefits, the "export ratio" shall be the ratio of export receipts to total sales in that year.
- (e) "Total wage bill" shall mean the total wage payments to all production workers of the enterprise during the year, minus all salaries paid to executives, as certified by the Social Security System;<sup>4</sup>
- (f) "Wage bill used for export manufacture" shall mean the "export ratio" multiplied by the "total wage bill";
- (g) "Labor-productivity related expenses" shall mean all expenses made out by a manufacturing enterprises to upgrade labor skills. This includes expenses for apprenticeship programs and in-service training, donations of scholarships to vocational schools, either publicly or privately run, but in no case will expenses for training or donations abroad be included

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<sup>3</sup>This provision is needed to take account of the value added attributable to the export trader.

<sup>4</sup>This is necessary to remove executive payrolls from incentives.

in this definition.<sup>5</sup>

- (h) "Total net taxable income attributed to exports" shall mean the "total net taxable income from the corporate income tax multiplied by the export ratio". The "total net taxable income attributed to a given per cent range of exports" shall be computed as follows:

If a manufacturing enterprise with, say, 35 per cent export ratio has a "total net taxable income attributed to exports" of P35,000,<sup>6</sup> then,

the total net taxable income attributable to the first 10 per cent of exports is P10,000;

from 11 to 20 per cent of exports P10,000;

from 21 to 30 per cent of exports P10,000;

and from 31 to 40 per cent of exports P 5,000.

Section 4. Incentives to manufacturing enterprises. To carry out the policy declared in Section 2 of this act, the following tax deductions are to be given to manufacturing enterprises:

- (a) Double-deduction of (1) wage costs related to manufacturing; (2) labor-productivity related expenses of manufacturing enterprises up to 10 per cent of the total wage bill from the net taxable income of corporations;
- (b) Progressive exemptions from the computed net taxable income of manufacturing enterprises,<sup>7</sup> as follows:
- (1) For the first 10 per cent of export ratio, a 10 per cent exemption of total net taxable income attributed to the first 10 per cent of exports;

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<sup>5</sup>This provision is essential so that manufacturing firms are able to internalize within the Philippines their productivity training programs, thereby upgrading the quality of all schools.

<sup>6</sup>This procedure is fairly simple from an administrative viewpoint. It is akin to the application of the progressive income tax mechanism.

<sup>7</sup>Progressivity of tax-exemptions will encourage directly the attainment of greater export-orientation by all manufacturing enterprises.

- (2) For the 11th to 30th per cent of export ratio, 30 per cent of total net taxable income attributed to this range of exports;
- (3) For the 31st to 50th per cent of export ratio, 50 per cent of total net taxable income attributed to this range of exports;
- (4) For the 51st and up to 100 per cent of export ratio, 70 per cent of total net taxable income attributed to this range of exports.

Section 5. Incentives to export trading enterprises. For purposes of this act, all export trading enterprises will be entitled to the incentives specified in section 4(b).

Section 6. Application of labor-productivity incentives to non-export-oriented firms. All manufacturing corporations are entitled to avail of incentives under Section 4(a)(2).

Section 7. Exclusions from the coverage of the incentives. All manufacturing enterprises and export trading enterprises availing of the export incentives granted by the Board of Investment shall be disqualified from the incentives granted by this Act. However, a manufacturing enterprise whose benefits from the Board of Investment are effectively terminated may seek the incentives provided under this act.<sup>8</sup>

Section 8. Administrative machinery. The Bureau of Internal Revenue, the Bureau of Customs, and the Department of Commerce and Industry, and the Social Security System are to work out an administrative arrangement so that all the provisions of this act can be implemented efficiently in order to make the incentives apply almost automatically. These agencies are also expected to expedite all provisions in the Custom Code and the Internal Revenue Code pertaining to export enterprises so that they can get their tariff drawbacks on imported raw materials and their tax rebates, within a period of 2 months of their payments.

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<sup>8</sup>This is a very important provision. It clearly gives to all enterprises the option of using labor-cheapening incentives as against the capital-cheapening incentives under the Investment Incentives Act. As a consequence, this will provide the clearcut test as to whether, as many technicians in government today conclude, capital-cheapening incentives are superior to labor-cheapening incentives, especially in export promotion.

Section 9. Creation of an Export Bank.<sup>9</sup> In order to provide a fund for the establishment of an export financing institution, an Export Bank is hereby created. This bank will be established to finance short- and medium-term production loans to enterprises that receive incentives under this Act. Its capital assets will be financed from

- (a) all the frozen assets of the Central Bank related to the collection of margin fees on imports, in accordance with Republic Act 2609,<sup>10</sup> and all the proceeds from the 20 per cent export retention scheme during the period 1962-1965. The Central Bank is required to turn over one-half of these assets to the Export Bank within two months of the formal establishment of the Bank and the other half before the second year of operation of the Bank.
- (b) 20 per cent of the annual collections from the "Tobacco Fund" created under Republic Act 4155 and being administered by the Philippine Tobacco Administration for a period of 15 years beginning from the date of effectivity of this Act. The Commissioner of Internal Revenue and the Commissioner of Customs are hereby directed to turn over and deliver monthly within the first ten days of the succeeding month such part of the collections for the "Tobacco Fund" to the Export Bank for the duration of the period.

Section 10. Penalty provisions. (The Congress should devise the penalty provisions appropriate for infringements of this act.)

END OF QUOTATION

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<sup>9</sup>An enabling act for the separate creation of the Export Bank will be necessary to give it an organizational charter for operation.

<sup>10</sup>The "margin fee" or exchange premium law.

## V. MICROECONOMIC POLICIES

Microeconomic policies are those affecting individual firms, industries or regions. If we are to promote industrialization, we must have specific policies relating to the way we expect individual firms or industries to behave. Therefore, microeconomic policies must touch upon questions on (1) foreign investments, (2) locational policies, (3) wage and manpower policies, (4) promotion of individual industries, and (5) correcting major distortions due to policy or market phenomena that can be handled at the level of the firm or industry.

Rather than approach each one of these questions singly and because we have already mentioned some of them in passing), it will be most rewarding to examine the role of the newly created Board of Investment in the context of these microeconomic policies. This enables us to suggest approaches to some problems, while at the same time focusing on the important role that BOI can play in the whole setup.

### The role of the Board of Investments.

As soon as the Board of Investments was created in 1967 (by RA 5186), we at once mentioned that it was a milestone in Philippine legislation concerning laws affecting Philippine industrialization. The Board of Investment has the task of trying to guide investments into areas of high social as well as economic pay-off; therefore, it will play a very important and

continuing task in the whole scheme of Philippine industrialization. The BOI has practically much to say on all the aspects of microeconomic policies mentioned earlier.

We would like therefore to re-state in our way, given all the observations made here and elsewhere, the way we visualize the BOI to be more significant than might just seem on surface, i.e., from the standpoint of the powers given it by law. Working within its powers, it is the task of the BOI to correct existing industrial patterns when they are wrong or inadequate, promote new import-substituting industries where they are missing, connect specific economic sectors by linking new suppliers to buyers and new buyers to suppliers where these are still inadequate, oversee the nature and prime direction of foreign investments newly coming in or expanding their capacities in accordance with the investment incentives act or Republic Act 5455 (passed in 1968), which gave it broader supervisory powers over all foreign investments. Thus, the BOI should be able to exert a great measure of influence on the forthcoming industrial picture in the Philippines, especially in the 1970's.

But we must first re-state a note of warning, which we have said elsewhere. (Reference [16]). The magnitude of its tasks is already so great that the BOI should divorce itself from thinking that all forms of industrial incentives, including all those related to exports, should originate from it.



This will certainly distract it from its more important tasks, because it will broaden its tasks and therefore push its thinking in areas other than those for which it was best established. However, to generalize the scope of the powers given to the BOI is also not going to be a healthy direction because its importance in the whole scheme of Philippine industrialization is that it has specialized incentives that are helpful in differentiating between different sets of alternative investments. However, an enterprise which is not preferred from BOI's own criteria does not make it necessarily less desirable. The status of "preferredness" is related only to the specific missing links in the country's industrialization process, not to all types of industries. Therefore, it is obvious why many industries at the moment, including those that have been originally promoted by the import-substituting industries of the last decade or two, are outside the scope of the BOI. This is only to be expected. Of course, this note of warning is not necessary were it not for the recent overenthusiasm to build more powers which is transforming the BOI into the sole source of export incentives. (At this point, the suggestions for alternative export incentives should be recalled.)

We now deal with the more specific nature of the functions that we hope the BOI should undertake.

- ✓ (1) Identification of industries with high social pay-off.

The BOI recently came out with a rough formula (Industrial Priority Formula or IPP) on how to determine the specific

ranking of industries seeking promotion under its administration. This formula takes into account many factors, some of which are labor, location, and foreign exchange saving or earnings. In view of the relative thinness of the current applications for incentives, it has not been possible for the BOI to exert much more than just academic interest in this formula. As more applications are processed, the use of the IPP to discriminate among alternative proposals would become feasible. In any case, the IPP has enabled the BOI to point out industrial opportunities for prospective investors. Therefore, it makes the search for industrial projects among prospective investors without any prior commitments more easy to begin with.

✓(2) Industries with external economies to all other sectors.

The BOI is endowed with powers to determine on a year to year basis the capacity requirements of preferred industries, taking into account domestic and export capacity requirements. This provision may prevent healthy competition from taking place, as will be made clear in the next subsection, if we do not watch out carefully.

But in industries where enormous economies of scale exist, it is necessary to keep in mind the limited market of the Philippines to enable it to rationalize the nature of industrial capacities to be made. Some industries that fall under this category will be discussed. They are industries that re-

quire enormous investments. Many of these industries are necessary to give greater industrial linkage among domestic industrial activities, some of which are already in existence, for which enormous resources, foreign exchange as well as capital resources, have already been sunk by virtue of previous decisions.

X(a) The automotive manufacturing industry.

At present the automobile industry is composed of so many small assemblers of completely knocked down parts into finished cars. This industry is severely import dependent, and it is completely subsistent only on the high tariffs on finished cars compared to unassembled cars. But the market size of the economy has also continually grown, as shown by the steady growth of the motor vehicle population. Clearly, as more industrialization proceeds, and given the current state of transportation policy, which is favorable to car ownership as well as motorized public conveyances, the setting for a truly integrated car manufacturing industry becomes possible.

This is where the role of the BOI should be most important. In order to rationalize a rather inefficient industrial structure in car manufacturing, it is necessary to build the market for the domestic producer. Since motor vehicle manufacturing is a highly capital-intensive undertaking, a large production volume is required to sustain an economically efficient firm. One effective way of meeting this is through the grant of

an outright production monopoly to one producer of cars over a number of years so as to attain at least in this area a very rational production picture. At the same time, all assembly operations must cease. In the United States, for instance, the range of output of the largest manufacturing industries has ranged from 3.1 to 5.7 million units per year of output. In other countries, the range has been between a million units per year to a quarter of million units in some other countries. The following statistics taken from a study of Jack Baranson on automotive industries in developing countries should be revealing.

To have a car manufacturing industry gain the potential economies of scale, a firm must be able to tap the maximum market size that is consistent with the rules of competitive enterprise, where the competition is derived from foreign producers and not local ones. Italy has her Fiat, France her Citroen, Germany her Volkswagen, and Australia, Holden, and each one of these industries compete with car imports.

The BOI can request all potential integrated car manufacturers, mostly foreign car manufacturers to submit a proposal that will enable them to operate in conjunction with Philippine capital or independently to manufacture reasonably fully domestically integrated automobiles within the Philippines over a period of 10 years. Obviously, this activity will fall under a "pioneer" industry listing. The **invitation** to bid must be

# AUTOMOBILE MANUFACTURERS BY VOLUME OF OUTPUT

<u>Number of Firms, 1965</u>	<u>Volume Range per Firm p.a., (Units)</u>	<u>Average Volume per Firm p.a.</u>
2	3,100,000-5,700,000	4,400,000
9	500,000-1,600,000	856,000
14	200,000- 400,000	257,000
293	below 200,000	14,000
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318	-	76,000

Source: J. Baranson, Automotive Industries in Developing Countries, International Bank of Reconstruction and Development (The Johns Hopkins Press: Baltimore, Maryland, 1969), p. 10.

## COMPARATIVE PRODUCTION AND EXPORT FIGURES OF COUNTRIES WITH CAR MANUFACTURING INDUSTRIES

<u>Country</u>	<u>All Vehicles</u>		<u>Exports as Percent of Production</u>
	<u>Production</u>	<u>Exports</u>	
Sweden	204,000	108,100	53.0
West Germany	3,055,700	1,527,300	50.0
France	1,581,600	613,000	38.8
United Kingdom	2,134,900	793,800	37.2
Italy	1,158,200	326,700	28.8
Canada	849,000	96,200	11.3
Japan	1,870,500	194,200	10.4
Australia	352,900	12,383	3.5
USA	11,112,000	167,700	1.5

Source: J. Baranson, Automotive Industries in Developing Countries, International Bank for Reconstruction and Development (The Johns Hopkins Press: Baltimore, Maryland, 1969), p. 11.

made to all foreign companies. The invitation may be fairly similar to the way the Surigao nickel deposits were **subcontracted** for exploitation recently. The car manufacturing venture can be a joint venture.

Local companies may try to join with foreign companies in submitting bids that will allow them to manufacture cars. Let us assume that this is undertaken at 20-80 equity with 20 per cent belonging to Filipinos and 80 per cent belonging to foreigners. We assume that the enormity of the required capital investments will not allow the country to feed much more than 20 per cent equity, without starving other equally important sectors of the economy from funds. The local company that is trying to raise the capital may raise something like 10 per cent of local capital, while the other 10 per cent should be sold to all potential interested parties, who may be part of the present car assembly industry after the award had been made. This will enable erstwhile assemblers to recover part of their capital already sunk into the automobile assembly business.

The production monopoly grant is to be for a terminal period of 20 to 25 years. The firm must be required to integrate at least 80 per cent of all parts within a period of 10 years. It must be able to manufacture parts or components of automobiles for exports so that it is able to feed some of its foreign exchange requirements or supply more foreign ex-

change earnings for the country. After the termination of the monopoly grant, the field will be open to at least another firm.

Assuring "competiton" in a "domestic monopoly production situation".

To assure us that the local monopoly grantee for car manufacturing does not charge excessive prices for its products, it is essential that an interplay between the tariff, domestic excise taxation, and production subsidy policy should be undertaken. A uniform tariff policy, already discussed earlier matched by high domestic taxation of cars, with a differential tax exemption for the locally produced car can be combined together to assure that cars of foreign make are able to give competitive pressure to the domestic car manufacturer.

Assuming that the Philippines is not yet ready to accept the wisdom of a uniform tariff policy, the production subsidy might no longer be necessary, except in terms of the monopoly grant and the benefits that might be enjoyed through the BOI. One possible source of subsidies might be through a surtax on the sale of oil products, but this is inferior to the one suggested earlier {tax exemption on portion of excise taxes on sale of newly produced cars}, because the incidence of this subsidy is on the general public rather than on the buyer of the domestically produced car.

In any case, a car monopoly is justified in order to create a truly viable and efficient car manufacturing industry

consistent with the market size. Relatively low tariffs will allow competition from foreign manufacturers and thereby safeguard the public from "inferior" motor cars, but the production subsidies enable the local manufacturer to overcome earlier cost problems inherent in being a newcomer tapping a smaller market size.

(b) The steel industry complex.

The steel industry already has large investments being sunk in by the government and private sector. So the question before us is no longer whether we should go into steel manufactures at this time against competing alternatives. The question now is how we can make the steel industry achieve a maximum degree of influence on the course of present industrialization so that it supplements rather than drains away precious (capital and foreign exchange) resources.

Recent decisions have already been made which will eventually integrate steel manufacture. In addition to the steel plant in Iligan, a new steel plant will be erected in Luzon by 3 companies whose future growth projections show more demand for steel products. In other words, there is already a huge commitment of resources anticipated or already committed in the future.

Thus, the problem of policy related to the steel industry is how to stimulate new import-substituting industries that are heavily dependent on the output of steel. Recent



reports have at least indicated that one of the steel plants has exported to other countries and is busily campaigning to gain new market contacts. This is a hopeful sign. However, the volume of these exports is still marginal; but this is what might be expected earlier while market contacts are developed. Although we can imagine these steel industries to be highly export-oriented in the future, it is necessary to build domestic industries highly linked to the steel industry not only because steel is, as widely known, an important industrial intermediate good but also because, if expanded in the future, these newly established steel industries must continue to rise from a larger industrial base. The expansion of an integrated car manufacturing industry should complement the presence of steel industries. But for sustained industrialization, a good beginning is never always sufficient. There are many lines of steel-using industries that can be encouraged. Industrial feasibility studies should therefore do the major scouting work. In this area, BOI plays a useful role. Creating an internal demand for steel manufactures is a big task to be studied. Many industries that are to be induced by the creation of steel capacity would be the tool-making industry, the machinery building industry, as well as heavy equipments industry.

Role of foreign investments in steel-related industries. Many of the industries just mentioned are capital goods industries. Since capital goods industries and other

types of heavily dependent industries still require much expertise, it is essential that firms with high technological potentials be attracted. Foreign investments with local equity participation, either in the form of pioneering industries or preferred industries, should be able to appropriate lines of activities located in the area of buying inputs from the newly created integrated steel mills.

c) Shipbuilding.

Shipbuilding must be one industry which should be encouraged directly not only because of the insular character of the Philippines but also because in spite of technological progress in the air transport industry, it would still seem that ocean transport will be an important vehicle of world commerce for a long time to come.

Little effort has been undertaken to promote shipbuilding, although the development of our shipping industry has received quite a lot of government attention. Government pioneering in the shipbuilding industry through the National Shipyards and Shipbuilding Company (NASSCO) has been largely a "struggling" affair. The structure of decision-making in government corporations and poor management, two well-known factors that have transformed many government corporations into monumental white elephants, has rendered useless much "pioneering" effort by government in industry.

To promote the shipbuilding industry vigorously and quickly, the policy steps will have to be along the lines suggested for integrating the automobile industry. Foreign investments should be made to bid for a monopoly grant in the shipbuilding industry. There are many shipbuilders that might welcome a shift in their geographical locale, given relatively more favorable labor cost conditions. The great industrial shipbuilders -- the British, Japanese, Dutch, Norwegians, and Americans -- may be interested in a long run proposition.

The monopoly grant can be for a terminal period of 20 or 25 years. A special law might be needed to spell out the tax concessions which may be given to the shipbuilding industry or the benefits might be accorded by the BOI. In view of the large capitalization required by this industry and many other industrial activities that are pressing from the standpoint of investment priorities, this monopoly grant may be largely to a foreign investment company. Some safeguards can be instituted so that the ships built need not be exorbitantly priced. In any case, generous tax concessions might be given so that this firm can undertake shipbuilding activity which is designed to compete with other world shipbuilders. To build a truly integrated shipbuilding industry requires technological experience of a sophisticated type, and it can be provided for most easily by those which are already in the business. It may be added that the labor force for this industry is partly available already in the country. In preparation for the long run,

we must provide alternative employment opportunities to our laborers who have been working in the drydock facilities of Subic Bay Naval Base, because of the termination of war in Vietnam and the anticipated withdrawal of American bases in the country.

It may be necessary to anticipate one argument which might be raised in the future concerning this industry, which as everyone would easily say, is strategic to national security. Why should this industry be turned over to foreigners since it is vital to defense? The answer is simply that if this industry were not encouraged fast enough, with resources that do not use up our own, it will take a much longer time before we can even get into some shipbuilding activity of modest size. In other words, there would be no sense talking about an industry being vital to national security if to begin with the industry is nonexistent. Moreover, it would be so much better to have an industry vital to national security in existence rather than nonexistent. While it may be granted that a foreign-owned industry is liable to foreign sabotage, in this world of high technological progress in military weapons, anything is subject to easy destruction by the enemy in time of war. In other words, we have to put our investment decisions on the assumption (whether foolish or realistic) that, peaceful conditions will obtain.

✓(3) Maintaining a healthy climate of competition: vigilance over monopolies, cartels and market restriction contracts

The monopoly grants suggested in the previous pages are not inconsistent with promoting a healthy climate of competition. In fact, as we have stressed, the monopoly grantees must be subjected to a fair degree of international competition so that they do not become instruments of monopoly exploitation over Philippine consumers.

In the area of industries in which large economies of scale on the production and market side are not dominant, the role of the BOI in maintaining competition among domestic enterprises is critical. This is the important basis for the objection we have raised on the "capacity-setting" provision in the investment incentives act. (Reference {3}). Of course, capacity-setting can be a yearly ritual and therefore it is as flexible as can be to give the BOI an instrument of policy that can foster healthier competition.

We ought to be able to avoid situations in which one group of industries is able to reap oligopoly profits from a situation fostered directly by government policy. There are numerous examples that may be cited, but one would be sufficient. The ✓cement industry in the past has been able to cartelize its position over the domestic market by preventing capacity expansions of the existing industry. There have been, of course, new expansions, but these had been geared largely towards the import substituting character of their orientation.

It is fortunate that now the industry has looked elsewhere to export expansion, but more economically rational decisions designed to foster greater competition in the past would have made the Philippines a large cement exporter as early as five years ago, despite the expansion of governmental infrastructural activities. (True enough, it may be added, there is competition among the firms within the cement industry. But the competition is "competition among a few" -- clearly the mark of an oligopolistic setting -- when the firms could have been more. Policies designed to restrict entry of new firms into the industry and to protect the industry with a domestic market have proved <sup>as in this case</sup> inimical to a climate of healthier competition.)

It must be added that the recent discussions of export incentives is likely to have a liberalizing effect on the competitive spirit among Philippine enterprises. And this is in the right direction. But the residual undertaking, which is the major responsibility of the BOI, is still a large responsibility that the agency should be expected to undertake.

For instance, ✓ the BOI must take an active role in neutralizing the operations of international cartels or of multinational companies when it is clear that the arrangements desired can have disadvantageous effects on attaining larger gains from international trade for the Philippines. Thus, in the area of patent rights use and technological assistance

contracts, the BOI will have to be wary of market restriction arrangements. It must foster situations which give Philippine companies seeking privileges under BOI more leeway on the marketing horizons of the products they are going to manufacture.

Of course, the nature of technological assistance contracts being fostered depends very much on the more fundamental factor -- the net structure of economic incentives. And it would seem that in the area of fostering greater competition in relation to the use of proprietary rights (patents) connected with "brands" and technological assistance contracts of an international nature, the BOI needs the assistance of a corrective legislation which shifts incentives in favor of developing domestically manufactured brands which are unencumbered by restrictive market arrangements.

(4) Proposal for domestic surtax on "foreign brands" and outlawing market restriction contracts.

Many of the import-substituting industries promoted in the country over the last twenty years have been in the order of substitution of imported commodities for the domestically manufactured "brand" counterpart. This is true in many lines of industries from food products, drugs, textiles, pencils, and beverages to consumer durables like refrigerators, air-conditioners, cars, and electronics products. Most of these products are purely limited to domestic sales. The arrangement for brand use have been largely of the market restriction variety. Of course, it will exhaust an avid researcher com-

pletely without finding any incriminating legal evidence on market restrictions, because these are generally secret agreements, oral or written, or made on the basis of threat to withdraw brand use in case of infringements. This is one of the reasons for the highly import-dependent import substitution character of Philippine industrialization so far. (Reference {9}).

To discourage these types of contracts, it would seem that a surtax on foreign brands, under certain circumstances, and a statement of policy outlawing market restriction contracts will give leverage to domestic firms in negotiating for more liberal contracts with respect to technological assistance and use of proprietary rights.

The surtax can be an additional excise tax, for instance, 2 per cent of gross wholesale value on the foreign brand sold within the Philippines, which must be collected at the wholesaler's level. This tax will create an additional incentive for domestic and foreign companies to introduce brands which are different from those currently in existence abroad. This arrangement will help to shift interest among local companies away from "brand use" type of technological assistance into process-use type of technological assistance, an arrangement which is fairly common in Japan, Taiwan, and South Korea.



With the creation of local brands, and combined with a climate of industrial export-oriented policies that we hope will be generated in the Philippines in the 1970's, we may realize the growth of inner pride among Filipinos of industrial brands manufactured by local companies as they gain not only domestic but also international acceptance.

But this surtax must have an exemption, so as to encourage, not stifle, the growth of export-oriented foreign direct investments in the Philippines. All companies that are able to market at least 80 per cent of their products manufactured in the Philippines, which use a foreign brand, should be exempted from the surtax.

The outlawing of market restriction contracts might give a strong psychological leverage in favor of liberalized contracts between local companies and international companies. Since outlawing of such arrangements implies that the Philippine government does not allow Philippine companies to enter into such restrictive contracts, companies under pain of original market restriction contracts are now freed to violate "illegal" contracts to begin with. Thus, this gives the Philippine company more freedom of action with respect to foreign parties.

(4) Locational policies: industrial estates.

The government can consciously shift the geographic location of the new industries that are anticipated to be

set up through effective locational incentives policy. These policies, of course, are directly intertwined with resource pricing industries. When prices of resources are distorted against, for instance, the sources of supplies, industries might be set up in locations which are not optimal from the industry's longer run economic position.

One area of policy in which the government can certainly accomplish a great deal is related to industrial estates, a topic that has been much discussed previously.<sup>11</sup> Industrial estates can accommodate purely export-oriented firms, like the Kaohsiung Export Processing Zone in Taiwan. The creation by law recently of the Mariveles free port in Bataan province is a very sound idea. It is, however, more than 10 years overdue. Now that the law is a reality, efforts must be made by the government to put the necessary infrastructure at the soonest possible time, in the same spirit and confidence that the road-building project was pursued in the last few years.

But the industrial estate project should not stop there. There must be a search for feasible locations for more industrial estates within the country. The industrial estate concept must be spread to the areas of the Visayas and Mindanao.

Industrial estate projects must be pursued with careful

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<sup>11</sup>See, for instance, Roxas (1964).

planning. Handling facilities for shipping must be carefully laid out; the same is true for public utilities like water and electricity and for some housing policy with respect to the labor force to be employed. One of the major errors of industrial estate projects undertaken in some countries is that the provision for housing has not been adequately attended to. In the case of the Jurong estate in Singapore, for example, enterprises were established but labor was not induced to move easily into the new industrial ports. While this special problem may in fact be peculiar to Singapore and may be absent in the Philippines, it would be best to be forewarned about the implications of this for overall industrial estate planning.

In the field of conscious locational policy, the BOI can play again an immense role. After all, many of the firms seeking grants from the BOI have to be set up in some geographic location. ✓ Here is where the BOI can possibly play around with some of incentives necessary to induce firms to move in locations where the social effects of regional dispersal can have relatively beneficial effects.

Also, governmental interest rate policy may be put to good use in this area. (Reference {1}). Cheaper interest rates may be given to enterprises that borrow from governmental institutions which are located away from existing industrial centers (to be defined for the 1970's as the metropolitan industrial area). Another promising area of regional de-

velopment is to grant tax saving to corporations investing in preferred locations. (See Hirschman (1968)).

We must, however, be cautioned against being overenthusiastic. The success of industrial estates depend on the general climate for industrial policy and economic growth. Moreover, the success of the export processing zone in Taiwan, although certainly phenomenal, is really modest when viewed in terms of the larger success of Taiwan's economy in export expansion. (Reference {3}).

(5) Review of some selected industries.

(a) Resource-based industries.

These industries include those that are highly linked to agriculture in the sense that they supply major inputs, like fertilizers and other chemical compounds necessary for modern agriculture. Agricultural policy will determine to a large extent the nature of expansion of internal demand for the products of the fertilizer industry.

A second set of industries are those which use agricultural products as the primary inputs to further processing. There are three major types:

(1) Processed food industries.

Large export potentials may be gained from processing tropical products. The experience of Taiwan in this regard should be an interesting model. Mushrooms, asparagus, and other agriculturally processed products have become major

sources of export revenues. This is an area of investments that might be laid open to foreign as well as domestic investments. The pineapple canneries have been very good examples of the useful role that foreign investments can undertake. These investments have provided new employment in regions which are far away from centers of urban population pull, thereby also providing new centers of economic development within the region. It is also hoped that more Philippine capital will be encouraged in food processing industries which would tap foreign markets for the same reasons.

(2) Livestock-, Poultry-, and Fishery-Based industries.

Much import substitution (and perhaps potential export production) may be realized by paying attention to the development of the livestock-, poultry-, and fishery-based industries. The years after decontrol have given relatively more attention to these industries, further adding to regional economic development. (Reference {4}). Poultry and livestock have shown remarkable expansion. Yet, because in the case of livestock the industry has to begin from a fairly low level of the stock-producing breeders (capital goods), it will take some lag before the enormous possibilities in this area can be realized.

The food processing industries based on these two agricultural products certainly point to a bright future. These industries can be expanded more quickly with more liberal inducements for foreign and domestic capital to move into these

areas of agricultural investments. The savings in foreign exchange and the potential export earnings should not be discounted, because products of these industries are precisely those that could replace the enormous drain in foreign exchange due to imports of "necessities" like milk products, corned beef, meat loaf, and canned fish products and those that might give our country comparative advantage in world trade. (Recently, for instance, Indonesia has begun exporting corned beef.)

The failure of this industry to expand sufficiently in our favor when climatic conditions as well as the gift of soil and marine resources are both in our favor is essentially an error of government policy. It demonstrates critically the effects of distortions on investment patterns inherent in our system of protection and investment priorities. With tariff protection given largely to "luxuries" and low tariff protection or negative (i.e., tax-free importations) given to "necessities," it was obvious that these food industries could not become favored by the system of protection. In fact, the industries could not thrive effectively. Coupled with their favored importations at cheap rates of foreign exchange, they were also subjected to minimal taxes (if at all) and, during NAMARCO's time, the imports were sold at below acquisition costs.<sup>12</sup> Thus, although at the earlier stage of industrial-

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<sup>12</sup>For an analysis of NAMARCO imports, see Reference {9}, Chapter 5.

zation, the food processing industries would be very important sources of self-sustaining growth, lack of attention to them have almost stifled incentives for investments in the field.

The above setup further demonstrates how much more advantageous was a set of policies characterized by "uniform tariff" mixed with production subsidies under a realistic exchange rate policy. The distortions of market incentives from the tariff policy would have been absent under a uniform tariff. Production subsidies would have made these food related industries relatively more attractive investment opportunities. An equilibrium exchange rate policy would have favored the use of domestic resources in these industries and therefore would have further supplemented the investment climate in these food industries.

### (3) Forest- and Mineral-Based industries.

Our forests and mines have essentially financed about one-fifth of our foreign exchange requirements since the mid fifties. This constitutes an enormous contribution to our national effort. Yet, so much more of our national development could have been better enhanced if we had processed these products in increasing proportions through the years. We would have, firstly, created more employment for our citizenry and, secondly, fostered conditions for a slower rate of depletion of mother nature's endowments to our country. We have, for instance, made some rough computations of the gains foregone by not processing our log exports within the country; the re-

sults tend to show we had foregone from 1 to 2 per cent of Philippine gross national product. (Reference {6}).

Many reasons have been advanced in popular discussions about our failure to process logs in substantial quantities:

- (1) lack of incentives to wood-processing industries (counter-argument: the tariff preferences available to us through the Laurel-Langley Agreement represented an enormous source of incentives which was not available to major competitors and certainly the post 1962 exchange rate reform was a great incentive);
- (2) low labor costs in other competing producers, especially Taiwan and South Korea (counter-answer: shifts incentives to proposals on cheapening wage costs through tax subsidies);
- (3) the shipping cartel and shipping routes, favoring competitors;
- (4) mistaken disposition of forest policy by government which had encouraged indiscriminate logging;
- (5) poor organization and management of the industry, including economic inefficiency;
- (6) the relative ease of exporting logs compared to finished wood products;
- (7) monopoly power of Japanese buyers (although this becomes much weaker when viewed in the light of the increased purchases of South Korea, Taiwan, and Hongkong of our raw logs).

In our view, although the above reasons play some role in the relative discouragement of wood processing, the major reasons for our failure to process wood products is rooted in the nature of incentives policy. Tax policy has failed to



penalize log exporting and favor wood processing. Moreover, given the overall setup of industrial protection, entrepreneurial and capital resources had been attracted to other sectors, not to wood processing. The resource gap could have been provided by foreign investments, but given the restrictive approach to foreign investment policies that we have had, these resources would not have come in sufficiently enough.

The major tax policy correction could come from an export tax on logs and other mineral exports. Barring the feasibility of an export tax, perhaps an internal surtax, to be known, a national resources tax of, say, 10 per cent ad valorem gross output, might be enacted. Domestic export processors may be exempted from such a tax. This is one area of taxation that should receive the attention of those in charge of tax reform and of altering tax incentives in favor of processed export industries.

In the discussion of the three broad groups of industries just cited, the role of BOI can be crucial. But we must add that the BOI renders only what the law allows it, no more. The powers of BOI have been liberal at one end and restrictive at another. It is liberal in the giving of mostly capital-cheapening incentives and other incentives indirectly related to the aim -- e.g. -- to exporting. It is severely restricted in the dictating terms to foreign investments. It practically has no incentives that would lead to cheapening labor inputs,

when our laws keep on raising its legal price.

(4) The heavily protected industries: Electronics and Textiles.

There are many heavily protected industries, but two industries that have been listed as "distressed" in the mid 60's and which appear to be just as distressed, if not more so, in the early 1970's are the electronics and textiles industry. These industries have received, at the pre-operating beginnings, the tax incentives available to them either under special laws or the more general tax incentives laws for "new and necessary" and "basic" industries.

The textiles and electronics industries have, firstly, been heavily hit by technical smuggling. The incentives to smuggling are the result of heavy protection. The demand for reform in this area has been to tighten the administrative noose against smugglers while retaining a high level of protection. As long as the incentive is there, the corrupting influence will be there. The demand for protection is also heavily dependent on the inward-looking attitudes of these industries. This attitude reflects in part their relative failure in the area of exports.

These industries have also been exposed to the decontrol policy and the attendant vacillation of monetary policy to give consistent support to industrial enterprises in feeding them with their raw material needs. Thus, again, the problems

of these industries merge at some point with macroeconomic policy problems.

The problems afflicting these industries can be again put in terms of relative incentives. The present discussion may represent a stark contradiction of the commonly attributed causes for the distressed conditions of these industries as discussed in public.

There are three factors which have essentially caused these industries to fail to move. First,<sup>①</sup> there is the climate of overprotection which encouraged entrepreneurial efforts towards looking inward to the domestic market. The argument that these industries need protection to survive does not hold much water, because the appropriate medicine for those with investments in these industries to generate more competitive spirit within its entrepreneurial class is competition, not protection. Moreover, the example of Hongkong should be a sufficient example of how without protection, the textiles and electronics industry have become leading industries. This should be sufficient bans to dismiss the importance of "heavy protection" as a necessary measure for industrialization.

Second,<sup>②</sup> labor welfare legislation has hurt these industries because these are labor-intensive industries, although this is ~~not~~ <sup>not</sup> openly claimed even by those in charge of the firms. Fairly advanced labor legislation in our country has placed these industries in relative comparative disadvan-

tage compared to our neighbors in producing their commodities for export. So long as these industries are inward-looking and are heavily protected (despite encroachments of smuggling), labor costs would not appear to hurt them on surface.

Third,<sup>8</sup> monetary policy related to defending the exchange rate of the peso has imposed restraints on the expansion of these industries. It may have decisively increased the costs of securing their raw inputs (due to the tendency for the peso to be overvalued). At the same time, the overvalued exchange rate has become the major instrument for making exports of these products unattractive as business propositions.

Fourth,<sup>9</sup> there was the total absence of export incentives (until 1967 with the enactment of the Investment Incentives Act). Thus, it made these industries look more inward to the local market.

Finally, it may be advanced that perhaps these industries had paid too dearly a price for foreign technical assistance, although we wish to state that this is difficult to ascertain, as we have already said earlier. Some questions that might be posed for future study a propos this point are as follows: were the franchises to manufacture the products under these industries too costly in per unit terms compared to similar franchise in our neighboring countries? Were they restrictive in terms of market orientation? Was the presence of foreign technical advice insufficient? Would it have been a superior pol-

icy to allow freer entry of foreign direct capital in this area?

It has been suggested in some quarters that the quality of Philippine entrepreneurship has been lacking, and therefore this explains why such industries are in terrible economic shape, when their counterparts in other countries -- notably Taiwan, South Korea, Hongkong, and Singapore -- are thriving rather well. We may dismiss this as too simplistic an argument. (References {18}, {7}, {19}, and {20} give evidence about the correct response of entrepreneurs to policy.) The more important reason is that these industries have been victims of an overprotective policy, of our advanced law laws, and a short-sighted and rather defensive monetary policy, especially in the area of export incentives. Given more favorable conditions, the answers to the questions posed in the previous paragraph could be made negative even if to begin with the answers to them were all in the affirmative. In other words, the policy climate is the more important one, not the "quality" of entrepreneurs.

#### VI. THE NEED FOR SUPPORTING POLICIES FROM OTHER SECTORS

We have discussed in the above many problems related to Philippine industrialization. Since industrialization is just one part of a whole picture of total economic activities, it is necessary to review here very briefly some other sectoral policies that are needed for the expansion of industrial

activities. In fact, some of these policies are crucial so that no bottlenecks occur which stop the rate of progress from moving faster.

(1) Support of agricultural development.

Agricultural development is necessary to expand Philippine industrialization. There is no competition between a high rate of agricultural development and a high rate of industrial development. In fact, if agricultural productivity were to expand at 10 times per year, it can be expected that with appropriate policies, the industrial sector will be able to expand even at 20 per cent per year. A higher agricultural productivity raises new demand for inputs of industrial products into agriculture and as a means of generating greater final demand for consumer products. Moreover, the growth of agricultural productivity is the surest way of releasing the agriculturally dependent labor force into industry. With new income opportunities being made open to farmers, many agriculturally dependent workers become releaseable into industry to earn subsidiary income in other sectors. For example, the farmer, who is able to send his children to school, is an effective supplier of potentially well prepared labor to the non-agricultural sector.

Thus, we should rule out any thought that investments needed in supporting agriculture, such as investments in irrigation, water control, extension work, credit for farmers, and even land reform, should be neglected, simply because what we

want is industrialization. Incidentally, this thinking was probably the biggest Philippine folly of the 1950's.

(2) Expansion of telecommunications and infrastructure network.

Internal trade within the Philippines can grow fast only with efficient communications network.

(3) Improvement of essential governmental services and other public utility services.

We may cite many areas of governmental services which have deteriorated over the last few years. The postal service has become a great mess, to the extent that service industries providing postal services independently of the Philippine postal system have flourished. The cost of safe and fast carriage of mails is something that should be studied. This is also very true of police protection. These essential governmental services should be improved.

The internal transport network in industrial locations as well as urban centers should now concern planners. The need for a mass transportation system within Metropolitan Manila has now become more than just a dream. People must be made to move at the quickest possible time, with schedules fairly well set. The present system of transportation in Manila has to pave way to one which is faster and more efficient.

Public utility services, especially telephone services, should be made more efficient. It is unfortunate that the

telephone services within Metropolitan areas have deteriorated, and the much advertised expansion of services have largely been advertised. Interisland communications still leave a lot to be desired.

Public utility companies should be goaded by policy to expand their capital outlays. A study of the applicability of special tax incentives for capital facility expansion to public utility companies might be needed.

(4) The expansion of service industries: foreign tourism.

Service industries naturally follow the developments along other fronts. But some segments of the service industries can become the object of more intensive changes in policy. We have reference to foreign tourism. There is now much common talk about the expansion of tourism. But we shall not be able to gain much from this tourist industry so long as we try to be overprotective in our tariff policies concerning, for instance, major tourist commodities like cameras, electronic equipment, textiles, etc.; so long as the country maintains a supernationalistic stand in defending the Philippine Air Lines in its policy of restricting passage into the country of other airlines thus preventing a greater inflow of tourists within the country; so long as little investments are put in the expansion of Philippine tourism propaganda abroad; so long as we allow the foreign exchange rate to become overvalued. But as we have pointed out elsewhere (Re-



ference {14}), that is one great area where enormous support can lead to a secondary effect on the expansion of industrial activities within the Philippines.

## VII. CONCLUSION

We have enumerated the problems of Philippine industrialization, analyzed the nature of the policy problems, and pointed out the clear distinction between those policies that ought to be undertaken on a macroeconomic level meaning policies related to fiscal, monetary, as well as foreign trade policy, and those that are related to plain microeconomic policies, which are within the venue of the activities of the Board of Investment. We have also continually pointed out that these policy problems at two levels often merge into one.

Our only object in undertaking this is to put to bear the results of research of the academic profession concerning Philippine industrialization to which we have been a major participant. We hope that we have shown the problems of policy so that they can be attended to in the interest of further industrialization and, consequently, a greater rate of economic progress for our citizens.

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