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PROPOSALS FOR EXPANDING INDUSTRIAL EXPORTS  
THROUGH CENTRAL BANK ACTION, WITHOUT LEGISLATION

by

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## TWO PROPOSALS FOR EXPANDING INDUSTRIAL EXPORTS THROUGH CENTRAL BANK ACTION, WITHOUT LEGISLATION

by Gerardo P. Sicut<sup>\*</sup>

### A New Balance of Payments Problem

The stagnation of total export receipts and the corresponding rise of the import bill in 1967 have brought to focus a new balance of payments problem for the Philippines. Except for 1962, the standard solution to a balance of payments problem in the Philippines has been the combination of restricting the import bill, maintaining the exchange rate for the peso, and promoting industries actively engaged in replacing imports. In 1962, decontrol allowed a major adjustment of the exchange rate which automatically induced export earnings to expand and the import bill to be reasonably checked. This measure appeared for a time sufficient to maintain a healthy balance of payments picture. But when the first signs of trouble occurred, the measures adopted were along the line suggested by our general observation. In November 1965, the results of the decontrol policy which changed the exchange rate of the peso became formalized into an actual devaluation.✓

Since its creation in 1949, the Central Bank has always played a key role in coping with Philippine balance of payments

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crises. It is empowered with the key instruments of monetary policies that have far-reaching effects on the operations of the banking system. Such effects have domestic as well as international repercussions.

The expansion of export earnings constitutes an important part in the solution of any balance of payments problem. The efforts directed towards encouraging the development of viable new industries with export potentials have not been adequate in this country. Such efforts were characterized by the promotion of the interests of traditional exports and of those exports which directly exploit Philippine mineral and forest resources. If there had been any promotion of potential export-oriented activities, they were negated easily by the strong incentives given to import-replacing industries and to the traditional exports. ✓ Most manufacturing industries established in the 1950's were based on the size and expected growth of domestic demand. Except perhaps for the pineapple canneries, none were ever seriously planned on the basis of export potentials. ✓ Yet, it can even be argued persuasively that given better export incentives, the pineapple canneries and their related agricultural processing industries will be able to expand their exports. ✓

Even after decontrol had been adopted as a policy in 1962, a further indication of the state of thinking about Philippine balance of payments problems is that certain policies had the effect of discouraging faster export growth. The 20% retention scheme (1962 to November, 1965) was designed as a temporary measure to check inflationary pressures and to prevent an undue redistribution of incomes in favor of traditional exporters as a result of the exchange depreciation arising from decontrol. But the scheme worked directly against the whole export sector, both traditional and potential. It had the consequence of "taxing" foreign exchange earnings by 7 per cent of actual earnings of *all* exports including *new*.<sup>1</sup> While on normative grounds, it was perhaps valid to argue that the traditional export sector should have been "taxed" because of their high windfall gains from decontrol, it was not rational to impose this on all exports, especially on the new and potential ones that could have emerged from the fledgling manufacturing sector.

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<sup>1</sup>Suppose the exchange rate parity was 3.90 pesos to 1 US dollar. For every dollar of export proceed, 80 cents was convertible at 3.90 pesos to 1 dollar and 20 cents at the "official parity" of 2 pesos to 1 dollar. Thus, the exporter received only a net receipt of 3.62 pesos. In effect, there was a 7 per cent "tax" on the earnings; that is,  $([3.90 - 3.62] \times 100 / 3.90)$ . The proceeds from this retention scheme were not legally usable by the government in any way, so they only represented withdrawals of purchasing power from the export sector.

Recent fresh thinking concerning problems of economic development in the Philippines has directed attention to the need for promoting exports from the manufacturing sector. This has been long overdue. The industrial policy package since independence has highly favored new industries engaged in import replacement. The foreign exchange controls of the 1950's and the tariff structure after decontrol have created a bias against the development of industrial and other exports. In 1967 talks about export promotion had been heard in policy circles. But despite some provisions covering export promotion, the Investment Incentives Act, the major economic legislation of 1967, still gives more overwhelming incentives to import substituting industries.

#### The Two Roles of Exports

The importance of exports to Philippine economic development arises from two major roles: (1) as a means of paying for the import bill of the country and (2) as a means of furthering domestic economic growth. However, until recently, exports have been thought of largely as fulfilling the first role, that of providing the foreign exchange needed by the economy to buy its machinery and other capital equipment and also to finance part of the country's consumption. This thinking was so prevalent in the past that it tended to swamp the other important role of

exports, providing a mechanism for a healthy economic growth and efficient use of the country's economic resources. The economic successes of countries that are export-oriented -- the most recent examples of which are Taiwan, Hongkong and Korea -- have demonstrated that the promotion of industrial exports can be a very successful strategy of promoting a high rate of economic growth. All these export successes have been accomplished in spite of the tariff barriers to trade in manufactures which have supposedly triggered the domestic import replacement policies of the less developed countries.

I have described in other work some schemes for promoting exports from the manufacturing sector.<sup>2</sup> All of these proposals require either or both of corrective legislation and administrative reform. While such reforms are needed in order to promote exports in the long run, the Central Bank has sufficient authority to change the incentive patterns for exporting and, therefore, help to shorten the time needed to accomplish the desired reforms.

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<sup>2</sup>"A Design for Export-Oriented Industrial Development," Discussion Paper 67-5, June 20, 1967, School of Economics, University of the Philippines. Part of the volume in which this essay is included.

PROPOSAL I. A DIRECT EXPORT BONUS

(Pakistan?)

I would like to make it clear that there is a legislative alternative to export incentives, and this is in the form of exemption from the corporate income tax of some percentage of export sales. However, in view of the current lack of incentives to industrial exports, direct attention to exports within the powers of the Central Bank may be made. Thus, we have the following proposal:

*The Central Bank of the Philippines, by virtue of its powers under its enabling Act, should give "new industrial exports" a 10 per cent bonus<sup>3</sup> on their earnings based on the current exchange rate. This means that for every \$1 of export revenue the exchange rate will be ₱4.29 with a 10% bonus, using ₱3.90 to \$1 as the exchange rate base.*

Section 70 of the Central Bank Act describes the actions that may be taken by the Central Bank to preserve the international stability of the peso. The Central Bank of the Philippines has always used this section to defend the balance of payments position by making the costs of buying foreign exchange more expensive. In the days of controls the Central

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<sup>3</sup>There is a reason why this bonus cannot be, say, 5 per cent, if 10 per cent is deemed to be excessive.

Bank requires "fees" on the sale of foreign exchange. From 1965 there was the 20% retention scheme, which has already been mentioned. At present, some instruments of monetary controls are being used to reduce import demand. These were exemplified by the Central Bank circulars in June of 1967, later superseded by somewhat relaxed circulars passed in October of the same year, to which we shall pay more detailed attention below. The actions of the Central Bank with respect to this section have been essentially "defensive." *Symmetry in the use of these foreign exchange instruments means that if a margin fee can be imposed on sales of foreign exchange, a margin bonus can be given to earners of foreign exchange.* The proposal focuses attention on attacking the balance of payments problem from the export side, without resorting to formal devaluation. A requisite of this action is that the Central Bank defend the current exchange rate with the use of monetary instruments like the ones presently in force. But in the meantime, by stimulating exports through the bonus scheme proposed, the Central Bank is able to adopt a powerful measure that directly pays attention to new exports. This should also enable the government to exert a major influence in correcting the system of economic incentives in the structure of industry. On this last point, we shall do a little more elaboration later.



"New industrial exports." The foreign exchange bonus for exports should apply only to *new industrial* exports. The most operational definition of new exports may be made with reference to the volume of past export proceeds in dollar value on a historical basis. The attached table shows the average yearly values of 10 principal exports for the period 1962-1966 and 1949 to 1953. As a historical and quantitative criterion, we may define as "new" an export which had an average value of less than \$20 million in 1962 to 1966. The term "industrial" can be defined as any manufacturing activity that falls within the 3-digit International Standard Industrial Classification (ISIC) of the United Nations.<sup>4</sup> Among the ten principal exports thus recorded, only the following may have industrial origin in accordance with our ISIC definition: centrifugal sugar (sugar refining), coconut oil (vegetable oil refining), canned pineapples (fruit canning), and plywood. If we use the definition of "new" as suggested above, only plywood and canned pineapples will qualify as "new" among these industrial products. The

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<sup>4</sup>Alternatively, the United Nations International Trade Classification (SITC) may be used to define "new exports." However, this is not as good as a basis for encouraging industrial exports unless specific categories of traded goods in the classifications from "0" to "9", which are clearly non-manufactures, are excluded. By stressing that the goods must originate from the manufacturing sector, that is from ISIC "20" to "39", the classifications reserved for manufacturing industries, exports which are agricultural and mineral in character are automatically excluded. Processed agricultural will fall under manufacturing,

**TABLE 1. AVERAGE YEARLY VALUE OF TEN PRINCIPAL  
EXPORTS, 1962-1966 AND 1949-1953  
(f.o.b. Value in Million U.S. Dollars)**

	<u>Industrial Origin</u>	<u>Commodity Classification</u>	<u>Average Yearly Value</u>	
	<u>ISIC</u>	<u>SITC</u>	<u>1962-1966</u>	<u>1949-1953</u>
Copra	011	221	155.4	117.7
Sugar (Centrifugal)	207	061	133.0	68.2
Abaca (Unmanufactured)	011	265	25.9	44.0
Logs and Lumber	022	242	155.8	15.6
Dessicated Coconut	209*	053	18.2	16.1
Coconut Oil	312*	413	56.3	17.1
Copra Meal or Cake	011	221	12.2	4.1
Canned Pineapples	203*	053	8.8	9.1
Plywood	251*	243	17.1	0.1
Copper Concentrates	122	682	46.8	2.1

\* "industrial" in accordance with definition offered.

World Bank *Statistical Bulletin*, Table 70, Vol. XVIII,  
December 1966.

bonus... incentive for indus-  
try... four exceptions. In addition  
of... of other exports which will be  
dis... the import replacing industries that  
have... which can benefit from the export in-  
centive... attractive to become exporters. Our defi-  
nition of industrial exports leads only to the exclusion  
of three major industrial exports. These exports are  
... the ones that have enjoyed a protected market in  
the United States, by virtue of the trade agreement with that  
country. New exports are directly encouraged because of the  
need to diversify our export product composition.

It is interesting to see how this definition of "new in-  
dustrial" exports helps to discriminate between different exports.  
Exports derived directly from mining and logging are excluded  
from the export bonus scheme by the definition of "industrial."  
However, those exports which are processed forms of these  
mining and forest products are included in the metallic smelt-  
ing industries (for processed output of mining) and in the

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... or "manufactured food." In the case of agricultural  
products we may cite some examples: "canned" mushrooms, pine-  
apples & vegetables will be under ISIC 203 (canned and  
processed fruits and vegetables), but "fresh" mushrooms,  
pineapples, fruits, and vegetables will be clearly  
agricultural and therefore not subject to the benefits of the  
bonus. What will this classification do? It will help to in-  
crease the incentives to processing the agricultural product  
prior to exporting.

wood products industries (for processed wood products). Thus, if adopted, this proposal will create more incentives for the wood processing industry relative to log exporting and smelting industries relative to mineral ore exports. Even if some mining and logging exporters would continue to export in raw form, the relative profitability of other export products as a result of the incentives for this export bonus may shift some resources to those activities that have higher value added contribution for every unit of economic resource exploited. This direction in the allocation of resources will attract export industries that presumably have high labor content, so that the potential employment gain is higher compared to the capital-intensive mining and logging industries. *The economy makes marginal gains by the shift in the use of economic resources.*

It is possible that the traditional export sector will welcome this proposal because this sector has been enjoying a privileged position in respect to their sales in the U.S. market anyway. They also apparently have a strong voice in the current discussions of future Philippine-American relations. Some segments of the sugar industry sometime in 1967 had even shown their willingness to be taxed provided that the proceeds were used to help in the increase of domestic rice production.

Even members of the traditional export sector will be the first to agree that there is a great need for the Philippines to diversify its exports so that the economy becomes more resilient and less subject to changes in foreign demand which have serious repercussions on specific Philippine exports. Moreover, even the recent export promotion proposals of the government, which shall not be discussed here, seem to recognize the need for "differential incentives" to non-traditional exports.

Safeguards against simple foreign exchange arbitrage through exports. What will prevent an enterprise from importing at the official exchange rate and re-exporting these goods at the bonus rate? This weakness can be easily corrected through some additional administrative supervision. But this is one reason why a unified foreign exchange rate policy is superior to a dual policy. The former erases the possibility of foreign exchange windfalls of this nature.<sup>5</sup> The simplest solution to this is to tie in the foreign exchange bonus only to "new industrial exports" which meet a specific minimum domestic value added composition. Such a minimum value added ratio may be set at 40 per cent of the sales value of the ex-

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<sup>5</sup>This operation is the exact opposite of the activities during the period of exchange controls of some supposedly manufacturing enterprises. They got foreign exchange allocations for raw materials and used the foreign exchange to purchase finished commodities of the type they were supposed to manufacture for direct sale to the market.

ports, ex-factory. Proofs to this effect can be supplied by the presentation of supporting documents concerning direct wage payments and other domestic purchases of the enterprise in the manufacture of the commodity exported. This can be simply taken as the total value of direct wages and domestic input purchases taken as a ratio of the total value of the good. This definition of the domestic value added is not one based on the value added of the firm but on the value of domestic value component of the commodity exported, including therefore intermediate purchases of domestic raw materials.

PROPOSAL II. A SUGGESTED RULE OF THUMB, OR SUPPLEMENTARY MEASURES FOR EXPORT EXPANSION

Proposal II is a rule of thumb for Central Bankers in dealing with monetary situations derived from balance of payments problems.

*If it is the desire of the government to promote exports, monetary policy at all times should be easy for the export sector, or at least to those branches of the export sector which are deemed to have the highest contribution to the country's economic development objectives. Thus, in times of credit squeezes enforced by the Central Bank in order to solve essentially a balance of payments crisis, the presence of easy credit to the export sector will insure that at least*

*export earnings will not have to fall unnecessarily.* The principal reason for this is that while a tight credit policy can prevent imports from expanding to worsening levels, monetary policy should at the same time be able to encourage exports to grow in order to hasten the improvement of the balance of payments situation from the export side.

Although this may be after the fact, it is instructive to examine the recent record of the Central Bank in terms of the proposal made. The point of reference begins in June 1966,<sup>6</sup> when the Central Bank revised all its previous priorities and instituted new ceilings on commercial bank borrowings. Priorities were set on two levels -- a long list of goods receiving "Priority I" under which there were three sublevels of priorities, as indicated by the maximum percentage loan value of the credit instrument (80, 65, and 50 per cent); all other activities not otherwise listed were considered "Priority II." A general statement about exports is listed in Priority I (b): "marketing of export products, primarily those goods that contain the maximum possible domestic processing and labor content." There were no entries about specific exports in the list of activities under

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<sup>6</sup> Circular No. 223, dated June 25, 1966.

Priority I.<sup>7</sup> Thus, credit instruments originating from exports may have different priority sublevels, depending on the industry's location in Priority I. Table 2, derived from the appendix of Circular No. 223, gives an idea of the classification of the major exports of the Philippines in accordance with the Central Bank priority scheme.

X The priorities are designed to give selective credit guidelines for banks in their credit awards. For each specific activity, no differential incentives are given to those firms with export businesses; that is, if two enterprises are engaged in, say, the manufacture of the same commodity, they will have each the same credit priority ratings regardless of whether one firm has an export sales ratio of, say, 50 per cent and the other sells only to the home market. In the case of a *uniform* tight credit squeeze due to a balance of payments problem, both enterprises would be adversely affected. However if exporters' credits are not made to suffer due to a monetary policy incentive, then even the home-market-oriented enterprise might even be induced to seek export markets to be able to hedge against

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<sup>7</sup> Except to say, for all the priority sublevels under commercial activities, "Export products (except financing of log exports which shall not be acceptable as security for Central Bank loans)" with the footnote stating, "To follow rating of economic activities included in this list."



Table 2. MAJOR EXPORT INDUSTRIES IN CENTRAL BANK  
CIRCULAR 223, LISTED AS PRIORITY I

A. Eligible for credits up to 80 per cent loan value of the  
credit instrument

Coconut oil  
Copra meal and cake  
Cordage, rope, twines  
Veneer, plywood, and prefabricated

B.  $\sqrt{65}$  per cent loan value of the credit instrument

Metal mining  
gold, chromite, copper, manganese, nickel,  
silver,  
iron,  
lead, zinc, quicksilver & mercury.

Dessicated coconut  
Sawn & planed lumber

C. 50 per cent loan value of the credit instrument

Sugar (a month later, reclassified to Priority IA.)  
Pineapple  
Tobacco  
Copra

Note: Financial instruments for log exports are not accept-  
able as security for Central Bank loans.

extreme tight credit situations. Thus, more export-oriented enterprises are encouraged to flourish. X

In terms of the objective of encouraging exports with more value-added and employment content, the priority list as defined in 1966 can be immensely sharpened to draw the distinction between export and non-export activities. The preferences revealed by the listing in terms of the export industries being promoted show that export industries which are traditional or with heavy agricultural origin are to have less credit priorities compared to those that originate from manufacturing. But inconsistencies are apparent. For instance, the metallic mineral industries have higher credit priorities than, say, pineapples when evidently the pineapple canneries are more labor intensive per peso unit of output than the mining industry. Moreover, coconut oil and sugar [presumably sugar refining] which have roughly the same domestic value added ratios per peso unit of output at first belonged to two different levels of maximum allowable loans per credit instrument, despite the fact that it may be argued that they are both traditional industries. (Sugar was moved to the same priority level one month after the list was approved. [Circular 226, July 25, 1966.] )

In view of the proposed rule of thumb, I suggest that all export activities satisfying our definition of "new indus-

trial" exports be elevated to a high priority. Export industries not satisfying the definition of "new industrial" may be relegated to lower priorities, although not necessarily out of Priority I as defined in the Central Bank list.

We continue discussing the monetary devices utilized by the Central Bank in funneling credit to the economy. Aside from credit priorities, which we have already discussed, commercial bank borrowings were regulated by rediscount ceilings with respect to a specific base and to differential rediscount rates. In this regard, Central Bank Circular No. 223 has the following provisions:

"The rediscount ceilings of commercial banks shall be equivalent to 135 per cent of their net worth as of March 31, 1966, ... as follows:

- 1) An amount equivalent to 110 per cent of their net worth ... at the basic discount rate of  $4 \frac{3}{4}$  per cent.
- 2) An additional amount equivalent to 25 per cent of their net worth for financing the production and distribution of domestically produced rice and corn at the preferential rediscount rate of 3 per cent, provided

that ... advances to all banking institutions for these purposes shall not exceed ₦200 million.

It is quite obvious from the examples above that the monetary authorities can manipulate as policy variables any one of the following items in determining lendings to the commercial banking system: (a) the rediscount rate, including any preferential rates for activities favored by economic policy, (b) the rediscount ceiling percentage, (c) the base of the rediscount ceiling, (d) the ceiling rates for any preferred economic activity. There are other instruments, of course, not the least of which are the manipulation of the legal reserve requirement and selective credit controls.

Judged from the nature of all the instruments used by the Central Bank, 1966 to mid 1967 was a period of easy credit.<sup>8</sup> We have pointed out that when the balance of payments position showed some signs of worsening, restrictive monetary measures were applied. These measures<sup>9</sup> consisted of the following:

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<sup>8</sup>The legal reserve requirement at the time on demand deposits was 10 per cent. Circular 215, dated January 24, 1966.

<sup>9</sup>Circulars 241, 242, 243, 244, all dated June 23, 1967.

1) A change in the base of the rediscount ceilings for loans, thus constricting the potential loans of the banking system; exports were entitled to an additional loan ceiling of 15 per cent, but rice and corn financing were *not* subject to any ceiling;

2) An increase of the rediscount rate to 6 per cent, with a preferential rate for exports at 4.3/4 per cent and rice and corn financing at the rate of 3 per cent (same as before);

3) An increase of the required reserve ratio for demand deposits of up to 16 per cent, but slowly rising from 11 per cent on a month to month basis. The monetary contraction from an increase in the reserve requirements ratio is quite strong; it has a negative multiplier sequence with a powerful across-the-board impact on the private economy.

✓ In addition, all import transactions involving more than \$100 were to be covered by letters of credit. This was evidently a measure to help check imports.

Taken all together, the above measures had powerful effects on the economy through the contraction of the money supply. In view of the fact that at the time these measures were adopted (and even as of this writing), there were no

specific incentives to exports, the measures had a contractionary effect on the credits made available to the export sector, in spite of the preferential rediscount rate for exports, at a time when perhaps export encouragement was a major problem. The increase in the reserve requirement would have wiped out existing excess reserves, in addition to reducing the lending capacity of the whole commercial banking system. Because of the specified ceiling for export lending and the change in the ceiling base for rediscounting, the preferential rediscount rate for exports could not have made credit much easier. Rice and corn financing had a better treatment, and this was due largely to the heavy priority given by the present administration to the rice and corn production program. But considering the monetary problems engendered by the bad turn in the balance of payments position, *exports should have received equal, if not the highest, priority.*

Thus, viewed in terms of the last statement, the measures<sup>10</sup> instituted by the Central Bank in October of the same year, which were supposed to relax the monetary situation, although more liberal to the export sector (at least 50 per cent of the new rediscount ceiling was to be used for export

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<sup>10</sup>Circulars No. 250, 251, 252, 253, all dated October 26, 1967.

financing), did not help to make credit for exports as liberal as the situation would have required because of the change in the rediscount ceiling base, which in effect reduced the total lending capacity of banks whose net worth had fallen by virtue of the tight credit situation in force<sup>11</sup> and the change in requirements concerning demand deposit reserves from 25 per cent to 50 per cent of the required reserves that should be deposited with the Central Bank.<sup>12</sup>

It may be concluded that the later actions (October, 1967) of the Central Bank were more inclined to favor the export sector. But in terms of the proposed rule of thumb about easy credit for the export sector at all times, especially during balance of payments crises, these actions could not have helped to expand exports in the substance and volume needed by the country.

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<sup>11</sup>The base was shifted from the net worth minus paid-up capital as of March 31, 1967 (easy credit period) to June 30, 1967 (one week after the tight credit circulars of June 26.) The other base reference was paid-up capital per bank, but this tends to be a more stable capital item for most banks and therefore could not have changed during the period.

<sup>12</sup>I do not touch on the changes in the required reserves against saving and time deposits because these items do not have the forceful effects on money supply that the changes in legal reserves against demand deposits have.

The above discussion may suggest the specific instruments of easy credit that may be utilized to help expand Philippine exports, specifically those originating from the "new industrial" sector. To my mind, they consist of the following:

1. A revisions of the selective credit priorities by putting all "new industrial exports" at the highest credit priority.
2. A greater utilization of rediscount ceilings and of preferential rediscounting treatment for exports, either through differential rates of rediscounts or through sheer liberalness in ceilings in respect to exports.
3. Less reliance on changes in reserve requirements on demand deposits.

A brief elaboration on suggestions (2) and (3) should be made. Changes in reserve requirements on demand deposits have across-the-board effects on the monetary system and can lead to indiscriminate harmful effects, when some need to discriminate in favor of the export sector is in fact imperative to save the balance of payments position. For this reason, they should only be resorted to only as extraordinary weapons



of monetary policy. Because rediscounting facilities enable the Central Bank to apply more selective credit controls and give more leeway for affecting the interest rate directly, they are superior instruments of monetary control insofar as promoting a more favorable balance of payments position through export promotion is concerned. The base for rediscount ceilings can be adjusted in the direction desired by a particular monetary situation, but to assure easy credit for exports, or for "new industrial exports", the ceilings should be so defined so that exports gain preferential credit attention.

Whether exports should get lower rediscount rates or not would really depend on the state of economic incentives for export-oriented industry. In view of their inadequacy at the present time, a preferential rate of rediscount in like manner to rice and corn financing would be desirable for export-oriented industries. However, if the bonus scheme proposed in this paper, or any other incentive yielding the same encouragements to exports, were in fact being used, a preferential rediscount rate need not be that essential. The important thing is ease of short-term financing needs for the export sector so that the country's export earnings are not prejudiced by monetary policy changes.

In view of what has been said, what alternative monetary policies giving easy credit to the export sector could have been adopted in lieu of the June 1967 circulars and given the absence of strong incentives to export promotion at the time? Firstly, the June balance of payments crisis would have called for a less drastic increase in the reserve requirements, if at all needed; secondly, the adoption of the most preferential rediscounting to export-oriented industries; and thirdly, a revision of the credit priorities by giving all "new industrial export-oriented enterprises" with the highest credit priorities.

The solution suggested above brings to focus the meaning of an "export-oriented enterprise." Since the implementing arm of credit policy as adopted by the Central Bank is the commercial banking system, it is important that the "new industrial export enterprises" be defined. Briefly, an enterprise should be producing a commodity that falls under the definition of "new industrial." Secondly, to determine its export-orientation some knowledge about the firm's past export sales or current year's export orders is necessary. Beyond this, "export-orientation" on the basis of historical performance may be defined somewhat arbitrarily. For instance, an export-oriented enterprise may be one in which the proportion of its past year's export sales

converted at the *official* exchange rate to total sales of that year is at least 20%. In addition, easy production credits should be given to firms with conclusive proof of current export orders. All unencumbered export bills such as *time* export letters of credit are automatically proofs of having exported and they should be treated easily as exports.

The above discussion dramatizes the need for promoting easy export financing. While the rule of thumb of easy credit to the export sector is in the context of the role of the Central Bank in influencing the commercial banking system, it also brings to focus the need for specializing export financing through the creation of a special bank. There are two possible alternative directions that may be undertaken in this regard. Without elaborating on them here, these may be as follows:

- (1) the creation of an Export Bank, financed by the government, designed largely for export financing; at this stage of the country's development, concentration on export financing is preferable to an Export-Import Bank.
- (2) an Export Bank financed by a consortium of private commercial banks, with perhaps some government participation.

Indeed, the long run direction that monetary and trade policy has to look to is in the promotion of banking institutions that will promote exports.

#### Correcting Bias in Industrial Development

The current structure of industry is characterized by a strong bias of incentives towards import substitution. Because these industries are protected by tariffs and other measures, many of the domestic industries have remained high-cost relative to the same industries in other countries.<sup>13</sup> In the absence of any incentives to promote the development of more intermediate industries, the manufacturing industries which find it profitable to produce are those at the finishing end. The foreign exchange bonus is just a corrective measure which, in my belief, is powerful enough to shift emphasis to export promotion, especially in the new industrial sector.

A major problem of the Philippine economy is how to sustain a high rate of economic growth and give new sources of employment for an expanding population. From the standpoint of the balance of payments, the solution is how to stimulate export growth more directly. A high export growth can enable

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<sup>13</sup>I have dealt on this point in several other papers.

the country to pay for the costs of a high import bill. An increase of the import bill should be met by an increase of export earnings.

The consequences of a Central Bank Monetary Board action along the lines suggested here will not only expand export earnings but will also generate more output, more value added, and more employment, thus making the economy more exposed to the self-propelling forces of economic growth.

#### Experience with Export Incentive Schemes

Since the easy credit policy for industrial exports has obvious implications, we discuss here the known experience about export bonus schemes. Pakistan has adopted since 1959 an export bonus scheme which made export industries earn more in terms of domestic currency yielded from their export proceeds. But Pakistan has been using the bonus scheme in a setting where strict foreign exchange controls are being enforced. In the Philippines foreign exchange controls have not been in use since 1962. The measures adopted by the Central Bank in 1967 to curtail import demand by the private sector are mild forms of monetary controls compared to those of the previous decade or to the ones currently adopted in

Pakistan. The results of the export bonus scheme in Pakistan have been very impressive. New exports in Pakistan have appeared; estimates about the growth rate of exports since the bonus scheme have been in the vicinity of about 25% per year.<sup>14</sup> It is important to note that the scheme, if adopted, will be able to correct the bias against exports which is the result of the current system of protection. Professor John H. Power's research on the structure of Philippine protection has shown that the current effective protection given by the tariff system is biased against integrating production processes within the economy and against export expansion. What this export bonus scheme will do, as pointed out already, is to change the pattern of incentives and, therefore, stimulate a drive towards exports and greater economic efficiency for Philippine industries.

In the Philippines, there is some similarity between this scheme and the Barter Law (No Dollar Import Law) which was in effect in the Philippines during the period of controls in 1955-1959. In implementing this law, 15 per cent of export proceeds were allowed to be used by exporters to purchase imported goods in specified broad categories. This gave the

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<sup>14</sup>Information supplied by Visiting Professor John H. Power at U.P., a close observer of the Pakistani development scene, quoting the claim of the Chief Economist of the Planning Commission in Pakistan.

exchange control authorities 85 per cent control over the foreign exchange earnings of the country. This incentive had a powerful effect on the growth of exports in the late 50's. This is one indication of positive response to profit incentives, and the experience of economic policy in the Philippines is replete with examples of positive price response to incentives. The identification of this law with the *traditional* export sector and the preoccupation with assuring that the foreign exchange controls helped the industrial development program of import substitution led to the discontinuation of this law. At present, there is more reason to identify the interests of the manufacturing sectors as a whole with the provision of an export incentive scheme, especially if it is designed to help in expanding the output of the industrial sector. Because the present rate of exchange for the peso is not too far from its equilibrium value, there is no reason to believe that the traditional export sector is being deprived of any major earnings.

#### 1968 Tax Proposal and the Effects on Import Bill and on Exports

The Marcos administration recently bared new proposals for tax legislation. Confronted with the enormity of the development effort, the administration is inevitably faced with the need for increasing resources for financing government

expenditures, including vital capital projects. The impressive electoral mandate given to the administration in 1967 has emboldened it to propose these tax measures.

The Philippines can still stand increases in its rate of taxation. Total taxes are about 9 to 10 per cent of the gross national product. The country can increase this by 1 to 2 per cent without creating adverse effects on economic incentives, especially if the expenditures are for projects which improve the economic environment.

If these taxes or some of them are adopted by Congress, the private income stream will be captured in part by the government. Whether this transfer of purchasing power to the government decreases the import bill, as some have claimed, will depend on the kind of taxes passed, on whom the final burden of the tax falls, and on the nature of the governmental spending resulting from these new revenues. Since none of the taxes proposed are on the sale of foreign exchange, we cannot immediately conclude that a reduction of the import bill be made because the cost of buying foreign exchange will not change.

If it is argued that for every peso of spending, the government will cause the generation of less imports than the private sector, then the import bill will be reduced by new



taxes. But about this little is known. However, if with the increase in revenues, the government cuts down its expected deficit financing, then the import bill can be reduced, and some corrective measures on the balance of payments exerted. The strongest argument for the new taxes is that the government needs the sources of revenue in order to advance the country's development effort.

Let us briefly review some of these tax proposals. Among these, the proposed taxes on gasoline (higher rates), on idle lands and log exports are taxes which will be productive of revenue or conducive to a better utilization of Philippine resources. Log exports have long been favored by many economists, including this writer, because it will help to check rapid forest denudation and create additional incentives for the wood processors to utilize Philippine logs for export. Two taxes that pose potential disincentives to industrial export growth are the development surtax on 9 existing taxes and the proposal to increase the corporate income tax rates. If these two taxes are passed in a form which applies to all industries, they may put sufficient additional burden on potential new export firms erstwhile serving the domestic market so that they are unable to exploit their export potentialities. Ideally, these last two taxes should give concessions to new

export-oriented industrial firms. Without these concessions, the proposal on a direct export bonus acquires greater usefulness as a measure of correcting the disincentives and new burdens imposed on potential exporting industries. In the presence of incentives which are overwhelming for all types of home-destined import substituting industries, this proposal can serve as the vehicle which will tilt the balance for certain industries to exploit much sooner the opportunity for larger scale of production provided by export markets.

#### A Note on Alternative Policy Measures to Proposal I

The arguments for the two proposals made in this paper are based on the major objective of expanding the exports of the manufacturing sector of the Philippines and of putting the balance of payments position in a relatively stable position. That these objectives are desirable for the country is no longer questioned. To achieve the same objectives, there are many alternative solutions. I will mention only two general ones. The first is devaluation. This is the simplest measure because it requires no administrative bureaucracy to enforce it. Philippine experience with the exchange depreciation of 1962 has shown that a balance of payments problem can be met reasonably well by exchange rate adjustments. South Korea has essentially utilized devaluations as a measure for correcting its

exchange rate and internal price problems, and has it succeeded to improve its export position immensely in recent years.

The second alternative solution has basic similarity with devaluation. It combines the direct export bonus proposed in this paper with attempts to check directly the import bill. Suppose the Central Bank requires a 10 per cent "margin fee" (or better yet, a tax of 10 per cent passed by Congress) on the sale of foreign exchange and declares a 10 per cent export bonus for all exports. In addition, suppose that all "new industrial exports" as defined already are given an additional 10 per cent bonus in the exchange of their foreign exchange earnings into pesos, so that in total, they get a 20 per cent export bonus. This measure is equivalent to 10 per cent devaluation (but is not officially so-called) with a 10 per cent bonus for new industrial exports. The disadvantage of this measure is that it "taxes" non-merchandise donations (or invisibles receipts, such as money gifts from abroad) because they are convertible only at the official exchange rate. Besides, the net effect of this on the encouragement of new exports will be almost the same as the one proposed in this paper.

Legislative and administrative reforms concerning exports should be viewed as complements of, or superior long run substitutes for, the direct export bonus proposal in

this paper. Any changes in administrative practices which reduce red tape in processing export papers will help export expansion. So the recent creation in January 1968 of an Export Processing Center by President Marcos is a big step in reducing administrative red tape connected with the processing of export papers. It is also important that Congress recognize the need for an export expansion law. Unfortunately, when legislative proposals are made before Congress, the full pressure of interest groups -- especially those with strong vested interests to protect -- often leads to a watering down or a spreading out of incentive benefits not only to new exports but also to other sectors of the economy. Thus, incentive benefits lose their discriminating force. But Congress should face up to the task of providing a sound mechanism for increasing new exports not only as a measure for improving the balance of payments position but also as a long run source for stimulating growth.

The current proposal pending in Congress, which gives export-oriented firms special incentives that are roughly similar to those given to registered enterprises in the Investment Incentives Act, however, are objectionable from the standpoint of the nature of the incentives. The incentives listed -- accelerated depreciation, deductability of promotional expenses from the corporate income tax base, and others -- are not related

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directly to actual export performance. These incentives -- insofar as promoting exports is concerned -- are inferior to schemes which directly reward export performance.

A tax incentive, which I consider as a superior substitute to the first proposal in this paper and definitely to the current export incentives bill before Congress, is a law providing for tax exemption of a portion of incomes earned by corporations through exports, the exemption progressively getting reduced the higher the export sales ratio of the corporate enterprise. This is described in another paper.<sup>15</sup>

As far as the second proposal in this paper is concerned, I believe that there is no alternative policy to it if the Central Bank is to help directly in promoting exports.

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<sup>15</sup>See G.P. Sicat, *op. cit.*