cause an erosion of the corporate income tax base, there should be a limit on these deductions which are proportional to total manufacturing wage expenditures. I suggest that 10 to 15 per cent of total wages paid to production related workers should be the allowable limit on these deductions. I think this incentive should apply to any manufacturing enterprise whether it exports or not. It should be used to replace any one of the incentives used to encourage capital investments.

There are many expenditures of these type, which can be cited. Let me enumerate those that occur for the moment: programs for apprenticeships, donations or scholarships to vocational schools, either publicly or privately run, which help to increase the supply of technicians, and even the costs of within-firm productivity training sessions. All these expenses must be those that benefit only laborers at the foremen and/or lower levels of labor.

This incentive, in addition, will provide a source of financing for the much needed vocational schools in the country. These very important schools have found inadequate financing sources because they compete with the resources made available essentially by the government for elementary education. Since the donors will probably have a strong say on the nature of the training to be supplied, we automatically induce an adjustment of the supply of skills to their demand.

As a rule, some firms which may make grants to vocational schools may want to tie their donations to the employment or re-employment of laborers undertaking training in specific skills. This is one way of having a firm appropriate part of the productivity gains made by newly trained laborers. But whether these donations are tied or untied, the laborer appropriates part of the new gains in productivity (and, as a result will improve his wages and his income potentials over his lifetime). In addition, the economic and social benefits that the nation achieves would be obviously substantial and predictable, on the basis of the experience of other countries.[10]

Factor-Neutral Incentives Related Directly to Export Performance: Progressive Exemption of Exports from Corporate Income Taxes

Again, the export ratio of the enterprise is a crucial determinant of the incentive which is proposed to be tied to corporate income taxation. √*The definition of the export ratio must be identical to the one used in the incentive on labor employment.* In this incentive, the *marginal* export ratio,[11] in contrast to the simple export ratio is crucial.

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[10]See, for instance, Becker, *op. cit.*, and E.F. Denison, *Why Economic Growth Differs*, The Brookings Institution, 1967.

[11]This is simply defined as the additional export ratio of the firm, from the first x per cent to the next x+1 per cent.

The corporate income tax can be used to stimulate export performance, by utilizing the principle of progressive exemptions, depending on the marginal export ratio of the enterprise. Unlike the other export incentive measures proposed in the Philippines, which are biased towards capital-intensive activities, this alternative incentive scheme is neutral in its effects on capital-labor use. Supplemented by the wage deduction which we have proposed in the previous section, this incentive can encourage relatively more labor-using export industries. Taken by itself, it will help to encourage exports even among industries which have been induced by policy to be relatively less labor-using. Moreover, this incentive is all the more called for in view of the recent upward revision in the rates of the corporate income tax.[12]

The nature of the corporation tax incentive is already argued positively in another paper in this volume.[13] Below, we shall answer two potential criticisms of this proposal and then we shall give an example.

(1) *It will not affect collections from the corporate income tax seriously.* The exemptions are only *for the*

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[12]Just passed into law by Congress in its 1968 session.

[13]"A Design for Export-Oriented Industrial Development" (Discussion Paper 67-5, June 20, 1967, Institute of Economic Development and Research, University of the Philippines.)

export component of output. If the incentive works to expand total domestic output, the domestic tax base of the economy will widen. Corporations whose output and domestic sales increase because of the expansion of domestic incomes will be covered by the corporate income tax. Thus, since export expansion assures domestic economic growth, the collection of taxes based on activities serving the domestic economy will increase, not fall.

It can be reasonably argued that this incentive will make the government earn more potential revenues than the one incorporating all types of deductions of capital costs. Being tied up directly to export achievement, their export growth potentials are higher and with the probability of success for all "subsidized" export operations certain, there will be no danger of giving incentives to unworthy enterprises. In other words, the incentive program does not simply degenerate into a subsidy operation.

(2) *The administrative mechanism involved in the enforcement of the corporate tax incentives, and all the other incentives proposed in this paper, can be relatively simple.* To demonstrate this later, a numerical example will be presented. The Social Security System and the Bureau of Internal Revenue are the only agencies that need be affected by these incentives. All export sales should be supported by

certified copies of export documents. These data are crucial for the determination of the export ratio. These can be summarized simply, with certification by a proper branch of any export paper processing agency (e.g., the Bureau of Customs, the National Export Coordinating Center). Certification by the Social Security System of actual total *production related workers* engaged by the firm for a specific tax period should also be required. Apart from these two additional requirements, which can be threshed out on an interagency basis, little else need be done in terms of administrative paper work. At most, the Bureau of Internal Revenue may simply device an additional form that may be filled out for the use of firms taking advantage of these incentives. Thus the old forms for the corporate income tax may not even be changed. Some clues to the nature of this tax form can be derived from the illustrations in the next page.

III. ILLUSTRATION OF THE FISCAL INCENTIVES

The alternative economic incentives for export and employment expansion are illustrated with the use of specific examples. Take two situations, A and B, in which B involves a higher export ratio. This situation may be thought of as a change of export orientation of a particular firm as it moves from situation A to B, or as one involving two corporations A and B.

Table 1 illustrates the assumptions clearly. We assume that standard accounting procedures will be followed so that all ordinary legally deductible expenses not involving any incentives are separated. After all *standard* tax accounting work is finished, deductions which the firm takes advantage of as incentives appear for the *first* time. This accounting procedure should be adopted by the internal revenue authorities if these proposals are adopted, so that the tax forms as already used need not be further complicated. In situation B, the gross sales are twice that of A. The export ratio of the firm in situation A is 20 per cent and in B, 60 per cent. All the other assumptions state that labor cost, direct production workers, and income subject to tax *prior* to all deductions of labor-related expenses are a constant percentage of gross sales. It is up to the reader to follow through these assumptions.

Table 1. ILLUSTRATIVE ASSUMPTIONS FOR A AND B SITUATIONS

A S S U M P T I O N S	Situation A	Situatior
1. Total gross sales	₱ 10,000,000	₱ 20,000,(
2. Of which domestic sales are	8,000,000	8,000,(
3. Therefore, export sales are	2,000,000	12,000,(
(3a. Or export ratio is:	20%)	60%)
4. Cost of labor 15% of gross sales	1,500,000	3,000,(
5. Direct production workers as certified from reports to SSS in previous years. Assume to be 60% of total workers	900,000	1,800,
6. Assume that income subject to tax, prior to additional deductions of labor-related expenses, is 15% of gross sales	1,500,000	3,000,

Table 2 is an example of labor-related deductions from corporate taxable income. Row 1 is the standard net corporate income subject to tax in the corporate income tax statement. This table shows the value of production-related employment which can be attributed to export manufacturing. We note that in situation B the labor used for export manufacture is so much

Table 2. LABOR-RELATED DEDUCTIONS FROM CORPORATE TAXABLE INCOME

Description of Deduction	A		B	
1. NET INCOME SUBJECT TO TAX, PRIOR TO EXTRA LABOR-RELATED DEDUCTIONS	₱1,500,000		₱3,000,000	
2. Additional deduction of production-related labor used (Total)	315,000		1,350,000	
(a) Labor used for export manufacture: (export ratio times wage bill for production workers)		180,000		1,080,000
(b) Maximum allowable for productivity-related expenses (15% assumed)		135,000		270,000
3. FINAL NET INCOME SUBJECT TO TAX = TOTAL TAX LIABILITY PRIOR TO DIRECT CORPORATE TAX INCENTIVES	1,185,000		1,650,000	

more labor compared to that of situation A. As we have already said earlier, *in practice* it will be difficult to determine manufacturing for export because of economies or diseconomies of scale. For administrative ease of implementation of this provision, the use of the export ratio in segregating manufacturing for export from manufacturing for domestic sales therefore has a major advantage.

We note that our recommendation for double deduction of productivity-related expenses towards labor training would apply whether or not the firm has any export orientation.

The final net income subject to the corporate income tax (total corporate income tax liability of the firm, in our terminology) in situation B is no longer much larger than that in situation A. This can easily be seen by a comparison of the effects of the labor-related deductions on the original difference, which is shown in row 1.

After the deduction of labor-related expenses, we arrive at the *corporate income tax liability* of the firm. It is now desirable to compute the *income tax liability due to exports*.

Before we get the actual tax exemptions due to export, it is first necessary to derive the total tax liability of the corporation in both situations. Using the 1959 rates of the corporate income tax,[14] we find that the total income taxes that should be shared in both situations are as follows:

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[14] 22 per cent tax rate for the first ₱100,000 of corporate income subject to tax and 30 per cent for incomes over ₱100,000. See *National Internal Revenue Code*. The rates of the corporate income tax have been raised in 1968, and therefore the incentive to export may become stronger if these proposals are adopted.

A - ₱ 347,000

B - ₱ 487,000.

The export ratio plays an important role in the computation of the exemption from the corporate income tax. We can now define the coporate income tax liability due to exports by multiplying the export ratio with the total corporate income tax liability. From this, we discover that the total tax liability due to exports in both situations are:

A - ₱ 69,400

B - ₱ 292,200.

Table 3 now illustrates the progressive exemption from export tax due to the ability to export. This illustration is similar to the one used in the previous paper.[15] In accordance with the principle of progressive exemptions, the greater the export ratio, the larger the total amount of exemption from the corporate income tax. And therefore the firm in situation B gets more exemption due to its better ability to export.

A summarization of the total corporate taxes due to exports is given in Table 4. In this table, we take taxes as

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[15]"A Design for Export-Oriented Industrial Development," this volume. The numerical figures used in this paper are different.

Table 3. EXEMPTIONS OF THE CORPORATE INCOME TAX LIABILITY DUE TO EXPORTS

			Situation A		Situation B	
Average Export Ratio	Marginal Export Ratio	Marginal Tax Exemption	Actual Tax Liability Due to Exports	Amount of Taxes Exempted	Actual Tax Liability Due to Exports	Amount of Taxes Exempted
1 - 10%	10%	10%	₱ 34,700	₱ 3,470	₱ 48,700	₱ 4,8
11 - 30%	20%	30%	34,700	10,410	97,400	29,2
31 - 50%	20%	40%	-	-	97,400	38,9
51 - Over %		60%	-	-	48,700	29,2
			₱ 69,400	₱13,880	₱292,200	₱102,2

Table 4. TOTAL CORPORATE TAXES DUE TO EXPORTS AS PER CENT OF CORPORATE TAX LIABILITY

	Situation A	Situation B
Total Taxes Exempted		
a) As ratio to total tax liability due to exports	20%	35%
b) As ratio to total net income subject to tax	4%	21%

shown in Table 3 as a percentage (a) of total tax liability due to export and (b) of the total tax liability of the firm. The amount of corporate tax exemption in situation B is so much higher compared to A.

The implied distribution of all the incentives which are awarded are given in Table 5. It is easily seen that the incentives which are directly related to the employment of labor occupy a greater portion of the incentives. In situation A the incentives due to labor use in manufacturing is 54.7 per cent while in situation B this becomes 74.3 per cent. The incentives for labor productivity growth are relatively higher with respect to the total in situation A than in situation B. Exemptions on the corporate tax are relatively smaller with respect to this amount of subsidy in situation A (4.2 per cent) compared to 7.0 per cent in situation B.

It will be interesting to examine the direct marginal gains made by the economy as a firm attains situation B, that is, as it moves from A to B. If we simply assume that the annual wage per man of production-related workers is ₱3,000 and of non-production related workers is ₱6,000[16] then an additional 800 manyears of gainful employment will be created. On the basis of the current social security law, each one of the pro-

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[16]Since these assumptions are on the high side, we get conservative estimates of the marginal employment gains.

Table 5. IMPLIED DISTRIBUTION OF INCENTIVES

	Value of "Subsidies" or Incentives (Pesos)		Per Cent Distribution of Incentives	
	A	B	A	B
1) Labor New Labor due to Manufacturing	180,000	1,080,000	54.7	74.3
2) Labor Productivity Growth Incentive	135,000	270,000	41.0	18.6
3) Corporate Tax Exemptions	13,880	102,270	4.2	7.0
	₱328,880	₱1,452,270	100.0	100.0

duction related workers would generate ₱18 per month, or a total of about ₱129,000 for export-related production labor. Since this particular incentive is tied with the social security law, we generate new money into the system which would not otherwise find its way there.[17] We do not make any computation of the contribution of non-production workers because some of these employees may not be compulsorily covered

[17] We can assume 100% compliance of the firm with the Social Security Law since no export deductions are possible except for those firms which comply with the social security law.

Table 6. MARGINAL *DIRECT* GAINS IMPLIED BY $2.56 MILLION (₱10 MILLION) OF NEW EXPORT SALES, ALL OTHER THINGS REMAINING THE SAME*

A. New employment (manyears)	800
1) Production-related	600
2) Non-production related	200
B. New contributions to SSS system due alone to production-related workers (as amended by RA 2658)	₱129,000
C. New tax collections	175,350
1) New taxes based on new employment	₱120,000
2) New corporate taxes	55,350

*All these numbers are based on the difference in magnitudes of situation B from A. It should be emphasized that these are all *direct* economic effects. The indirect effects are somewhat larger, as any economist well-versed in the theory of the multiplier will easily conclude.

by the Social Security System. However, when we add the contribution of non-production workers to the System, more new contributions are generated. The mobilization of these collections provide one source of investment finance in the country. Moreover, if we simply assume that the tax system of the country, whether through the personal income tax or through all types of excise taxes, captures at least **(conservatively)** 8 per cent of every new peso income stream, then the new tax collections that will be generated by the new wage income is ₱120,000. Add to this the additional corporate taxes paid by the corporation in situation B, the total tax collections are more. So, as I pointed out earlier, we do not actually erode the tax base of the economy! The incentives also strengthen the social security system of the country.

The above are the marginal direct gains which are derived with the use of very simple assumptions. An implicit assumption in these computations is that it is possible to generate new employment from the unemployed labor force. This will be a tenable assumption while there is a large percentage of unemployed and underemployed persons in the labor force. For many years to come, even if we have higher rates of employment absorption into industry, this feature of labor surplus will likely continue.

IV. CONCLUSION

that

At the beginning it is advanced that economic policies in the field of industrial promotion have been largely biased against the employment of labor. This bias has not encouraged the sufficient absorption of relatively more labor in the Philippine industrial sector during the 1950's. A summarization of the economic reasons against over-encouraging capital related expenses in industrial activities is presented in Part I.

In Part II we suggest two major sets of policies related to export promotion. The first are incentive policies which are biased in favor of labor use and of employing **labor** productivity. This is in the form of double deduction of wage costs of production workers in industry which can be associated to manufacturing for export and deduction of production-related workers incentives for the training of labor. It is suggested that the last incentive will provide the most desirable means of balancing the demands of industry and the development of supply of new skills through the vocational and educational school system. The second incentive proposed, which is tied to exemptions from the rates of the corporate income tax, is neutral with respect to the employment of labor and capital. It is simply related to the export performance of the firm. The exemption rates are progressive, i.e., the higher the export ratio, the higher is the rate of exemption.

In Part III we illustrate the application of the alternative package of incentives suggested. As we stressed at the very beginning, social justice can be attained through the expansion of employment opportunities. So long as the labor force finds it very difficult to attain gainful employment, there will be undesirable social consequences which will be borne by society and individuals jointly and severally.

Going through the reasonings of this paper, it may be helpful to summarize the effects of the proposals which have the biggest merits: (1) the expansion of employment opportunities and thus a more speedy absorption of the growing labor force; (2) the strengthening of the Social Security System; (3) the widening of the economy's tax base; (4) the assurance of faster growth of labor productivity; (5) the linking of industry demand with the supply of vocational skills through the incentives for labor productivity related expenses; and (6) direct *reward* for ability to export for export-oriented enterprises. The most important contribution of the policies suggested here, I believe, is the recognition of the need to expand employment directly and the tying up of the most important incentives to employment and to specific performance. In this sense, the proposals depart drastically from Philippine policies of the past and present. They are also more directly linked to the Constitutional goal of social justice for the Filipino.

Only for those concerned. I wish to end this paper by explicitly directing my statements to special sets of individuals.

To labor leaders and all traditional champions of the poor. To consider laws which will push up the (legal) price of labor is helpful only to employed labor, but not to those seeking work. Thus, these laws have a tinge of class legislation, which is not desirable. The gains of labor can be realized only from an expansion of demand for employment opportunities and the increase of skills, which can be attained by an expansion of the economy and the encouragement of productivity increasing activities. The proposals suggested here, if adopted, will be of immense benefit to *all* laborers and *all* citizens. Support of laws which expand job opportunities should be the proper role of all champions of the poor.

To all nationalists. Foreign companies should be given opportunities to invest in the Philippines so that we can expand domestic income and employment by giving them the incentives outlined in this paper. Also, if we direct foreign investments to move into export activities such as we suggest here, we can assure ourselves that the area of conflict of interests between Filipinos in their own land and foreigners will diminish if not disappear.[18]

To policy makers. If it is the objective of the export expansion policy to diversify the export product composition, then the incentives as suggested here can exclude the *traditional exports*. All my suggestions about how to define "new industrial exports"[19] may be used in tying up this objective of export diversification with the policy suggestions made in this paper.

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[18]On this point, see "Economic Incentives and Foreign Investments," this volume, where much of this point is developed. {Discussion Paper 68-15, April 22, 1968, Institute of Economic Development and Research, University of the Philippines}.

[19]See "Two Proposals for Expanding Industrial Exports, Without Legislation," this volume. {Discussion Paper 68-4, February 5, 1968, Institute of Economic Development & Research, University of the Philippines}.