

The important issues raised by import substitution can be summed up by an assessment of ⁽⁴⁾ which imports to substitute. Today, project evaluation or the literature on industrial criteria can be used as a guide for the resolution of this problem. However, it may be pointed out that from the beginning of the period of industrial development in 1950,²⁴ the literature on industrial criteria was not developed well enough to provide much help to policy makers. The seminal theoretical papers on industrial criteria came out in the early 1950's, but their applications to actual policy questions have not been perfected during that decade. The broad outlines suggested by theory and their adaptations to Philippine conditions²⁵ became clear only as the end of the decade neared. But the lack of explicit working theoretical framework regarding industries to establish could not have been a serious obstacle to the long run policy question as regards manufacturing. There is strong preference to develop a manufacturing sector in the country, and the question was how such sector should develop.²⁶ Import substitution was used as the means of policy.

²⁴Elsewhere I have offered to date 1950 as the year marking the beginning of postwar economic development (in contrast to pure reconstruction).

²⁵As exemplified by the industrial criteria formula adopted by the National Economic Council.

²⁶G.P. Sicat "Philippine Economy," op. cit., p. 12.

Much of the material already discussed has stressed the multiple pyramiding of protective policies in the development of manufacturing. In addition to these policies, import substitution was in truth characterized by the replacement of "final" imported goods with those assembled in the Philippines. The "semi-final" goods were put together into final goods for distribution in the Philippines. Much processing really took the character of packaging imported parts. *The direct value-added to national income of the industry was the labor input in the packaging process, plus the return to the owners of capital. There are exceptions to this, and reference to this shall be made later on. } The crucial thing is that overconcentration of policy on the promotion of domestic manufacturing overshadowed the more important aspects of increasing the supply of the commodity upon which the industrial program depended -- foreign exchange. In particular, the import substitution policy led to the neglect of an important segment of any successful industrial development policy -- the encouragement of exports especially from the manufacturing sector. / I have discussed elsewhere how the Philippines failed to take advantage of the differential tariffs in the manufacturing sector through the trade agreement with the United States.²⁷ The argument that it was not

²⁷"Philippine Manufacturing and the Trade Agreement with the United States," Laurel-Langley Committee Paper prepared by G.P. Sicat.

possible to develop manufacturing exports because at the beginning the industries had to be established first appears to me to be a weak argument. A more basic reason is that the development of exports from the manufacturing sector have not been given much encouragement²⁸ or if such encouragement appeared in print, the policies were excessively in favor of import-replacement and at the expense of export-creation. Naturally, with industrial policy mainly concentrated with subsidizing many import-substituting industries, lines of comparative advantage in some manufacturing exports was not achieved as fast as it should have and at the end of the 1950's no significant export prospects have appeared. It is true that in most of the legislation and accompanying administrative orders during the period, any industry that helped the country to gain foreign exchange was covered by the multiple subsidies given to the manufacturing sector. But since resources were not unlimited, once committed to any directly import substituting industry (whether it was a "good" or a "bad" choice when tested against certain standards) they could not/^{be}used for other undertakings. [Thus, the highly protective film thrown around industry for the domestic market made it more attractive to allocate resources to these merely import-replacing industries than to those with a promise of export expansion.]

²⁸ Aside from the usual talk about looking for new export products and export markets, which are heard here and there, and token references in official papers, e.g., the NEC Planning 1959.

New and Necessary Industries Revisited

The above remarks lead us back to the "new and necessary" industries. Perhaps an assessment of these industries should be along several questions. To what extent did they contribute to the growth of manufacturing in the Philippines in the 1950's? Had tax exemption and other preferential treatment for these industries been helpful in allocating the country's scarce resources during that period of economic development? What were the dynamic implications of such industries on the economy, especially as regards import-substitution -- the central object of industrial policy?

These are important questions to which I shall give only some tentative answers for the time being. In terms of the growth of manufacturing in the Philippines, new and necessary industries contributed substantially to the initial growth of manufacturing. The list of establishments granted tax exemption grew in numbers through the years in the 1950's. But in large part, such growth was the result of the broadness of the definitions applied to the words "new and necessary". Some discussion of these definitions have been made elsewhere above.²⁹ Whether or not the industries established were very desirable from the viewpoint of economic criteria either on a long run or shorter run viewpoint is

²⁹ See p. 6.

still another thing. Employing the test of essentiality used by the Central Bank in classifying import commodities, it has been shown that many of the so-called industries were of the "non-essential" varieties.

Table 4

Number of New and Necessary Industries in the Philippines,
According to the Essentiality of Their Products, Central
Bank Commodity Classification (December 31, 1957)

Product Category	Number of Enterprises	Per Cent
Non-essential producers	49	6.3
Semi-essential producers	118	16.1
Essential producers	228	29.5
Non-essential consumers	268	34.7
Semi-essential consumers	29	3.1
Essential consumers	78	10.1
Decontrolled	2	0.2
Total	772	100.0

SOURCE: Heller and Kauffman, Tax Incentives for Industry in Less Developed Countries, Harvard Law School, Cambridge, 1963, Table VI, p. 121.

Central Bank definitions notwithstanding, the only other economic test is to determine whether the industries established were capable of adapting to more competitive conditions. From a development standpoint, this is a more operationally meaningful test. On this, I cannot yet offer concrete proofs either one way or the other, although it may be offered at this time that the multiple subsidies above may not have encouraged the establishment of more competitive position.

If the above conjecture is correct, [heavy dependence of most of these industries on foreign exchange allocations were not helping the balance of payments position of the country. Incidentally, such a set-up also distorted capital costs in the economy.³⁰ Whether this thing has contributed to a misallocation of the country's scarce foreign exchange resources will depend on the extent of success in import substitution.

[By success in import substitution is meant that the import replacing industry established when exposed to minimal protection is able to stand on its own feet in competition.] Or better yet, the industry does not only substitute imports in the domestic market but is able to export in the world market. Moreover, such industries should have been able to spread their influence on other sectors

³⁰"The Structure of Philippine Manufacturing," G.P. Sicat (ed.), The Philippine Economy in the 1960's.

through linkages. In the case of industries of the type established in the country -- replacing final goods imports by processing semi-final inputs and intermediate goods -- the most important linkage is the backward linkage, the development of industries supplying the inputs to the industry so as to reduce the import dependence. The empirical evidence supporting backward linkage cannot be fully established here, but it may be pointed out that nothing is intended to suggest complete development via backward linkage in order to achieve autarky.³¹ But an industry ought to be able to integrate production processes either horizontally or vertically in order to effect a larger contribution to national income.

There is successful import substitution in some areas of manufacturing. While this is not the place to review this in its entirety,³² a number of significant industries have really shown good import substitution possibilities -- shoes, drugs, in some chemicals, petroleum products, food and beverages -- may be termed successful. The performance of a number of industries -- including

³¹A recent study on Industrial Priorities at the Program Implementation Agency has shown that the import leakage of industrial growth has been high. This is further supported by different evidence to be presented in my "Import Dependence of Import Substitution," op. cit.

³²The World Bank Resident Mission in the Philippines has made some partial assessment of this. The 1963 ECAFE Survey has also done this.

textiles -- are still in doubt. Were these results due to the law on new and necessary industries principally? It may be that the generous tax-exemption grants were probably not the crucial factor, considering the strong supplementary subsidies already discussed above.

Philippine Industrial Growth in Perspective: Concluding Remarks

Reviewing industrial development in the 1950's, we find enormous growth in a variety of industrial undertakings. Many of these industries established under tax-exemption and protected by the aegis of the controls were highly dependent on imports so that when opened to market forces as a result of decontrol, some of them were left floundering.³³ The hardships reported in the manufacturing sector in the early 1960's are due to lack of success in integrating to a good degree these production processes domestically. So when foreign material costs went up due to decontrol, the difficulties of the industries began. Those industries which really lived in foreign inputs were hard hit.

Let us turn more fully to the effects of import dependence of import-substituting industries. When an industry becomes dependent highly on the foreign inputs and is unable to integrate some stages of processing in the domestic sector, its fortunes

³³To be supported with evidence later on. Discussions of this has been present in Langrebe's Report on Textiles, in Benito Legarda, Jr., "Back to the Sugar Republic," Far Eastern Economic Review, and elsewhere.

can be at the whims of the balance of payments position. In case of foreign exchange scarcity, plant capacities may not be utilized fully. The resource allocation implications of this situation are obvious. With capacity underutilized in a period when demand is not insufficient, unnecessarily high prices of the goods result. During the period of controls, as balance of payments crises upon crises came about, the industries using sizable foreign inputs were also subjected to these difficulties.³⁴

Aside from the restrictive policies characteristic of the period of exchange and import controls, one other policy may be worth pointing out here. This policy is particularly relevant to the export potentials of the economy and could very well be a characteristic result of most import substitution policies. Market restrictions may be imposed on the once imported final product, when the import substitute is developed in the local market. This is most true of import substitution by producing a foreign brand in the country. The usual arrangements of foreign brand manufactures in the Philippines was between a foreign firm licensing a domestic firm to produce a commodity only for the Philippine market. While initially such arrangements were very useful, once the firm gains experience and maturity and once the

³⁴Cite here A.V.H. Hartendrop's survey of excess capacity utilization, History of Trade and Industry in the Philippines, vol. II. Cite also B. Legarda's old article ... Landgrebe reports.

demand for the product is "saturated", expansion of the industry is limited. For an industry which is complemented by a relatively large market, such market agreements are sufficient to generate growth in the industry. However, it may be pointed out that a great many of the import substituting industries set up in the Philippines had these barriers to market expansion.³⁵

This makes Philippine industrial growth uniquely different from the phenomenal growth of manufacturing in Hongkong. The development of manufacturing in that colony is based mostly on domestic processing of foreign inputs, but manufacturing is export-oriented. This case, therefore, represents a strikingly different growth-orientation in the industrial sector. The unique position of Hongkong as a new exporter of industrial goods has brought up problems upon that island colony, but they are problems different in nature from the Philippines. While the Hongkong manufacturer is constantly faced with the competitive task of breaking tariff barriers and establishing market positions in the world, the Philippine manufacturing sector was developing at the whims of balance of payments difficulties. Probably one serious effect of such policies on the country's entrepreneurial talent is to develop what, to paraphrase psychologists, would be protection-centeredness. The

³⁵See Manila Times, October 8, 1964 for a news report entitled "Foreign Firms Tie-Up: Re-examine All Contracts - NEC." p. 17-A.

Filipino industrial entrepreneurs having been shielded by protectionist policies favoring manufacturing have developed a propensity to depend more on government protection for their domestic market positions. This is not unexpected since from the very beginning they were made to bargain for foreign exchange allocations from the foreign exchange allocation authorities. Because of such dependence on government protection, it can be pointed out that their propensity or talent to think in terms of world competitive markets was not developed. Instead, they had a protected market to begin with which they supplied with "final" goods import substitutes. Since there was not much encouragement of production for export, it was natural for them to seek only the necessary protection for the domestic market.

What is being pointed out is that the Philippines and the Hongkong cases are unique examples of two types of industrial development. While in the case of the Philippines, the benefits of a foreign trade entrepot which are related to the suitable natural harbor of Hongkong are not present, some measures could have been encouraged to make manufacturing more export-oriented even at the start of attempts to establish industries. But this only brings us back to the earlier point stressed in this paper, that the over-emphasis of policies towards import substitution really led to the neglect of the export creating sectors in manufacturing. It would have been possible, in my view, for the

Philippines to have adopted a policy incorporating the best of two worlds if only industrial policy from the very beginning took cognizance of industries that could have led to industrial exports. After all, ~~the~~ initial market base for manufacturing is larger than in Hongkong, and therefore, much industrial growth could have been achieved using a policy of import substitution, with immediate export-creation in some industries in mind. What happened really is that the primary export sector has financed most of the industrial development of the country. While this is not bad at all -- in fact this is the essence of industrial growth in an open economy -- it would have been possible to supplement the sources of finance from the manufacturing sector itself.

A recent criticism leveled against import substitution is that it has a tendency to encourage high costs and therefore delays the achievement of growth based on competitive efficiency in world production.³⁶ It may well be that reviewing the industrial policy of the 1950's in this paper, this criticism is partly valid for the Philippine case (although some import substituting industries were worth the effort). The over-encouragement of import substitution without taking care of the real financing side of the industrial development effort (e.g., exports) may have been costly, especially

³⁶Wilfred Malenbaum, "Comparative Costs and Economic Development: The Experience of India," American Economic Review, May 1964.

if after exposure to minimal foreign competition, such as is found in decontrol, the industries established are unable to make competitive adjustments. In this case, the burden of the multiple subsidies given to manufacturing development in certain lines of economic activities may not have paid off handsomely. However, a further encouragement of the shield that protects some inefficient manufacturing industries from foreign competition may be an extension of these high costs of industrial development. On the other hand, the more some successful import-replacing industries are now able to look at wider markets and help to take care of the export diversification aspect of economic development. On balance, there were net gains to the process of import substitution as induced by domestic industrialization policy. The argument advanced here is that greater gains could have been accomplished in allocating the country's scarce resources by a somewhat different form of import substitution.