

Problems of Philippine Foreign Trade

AMADO A. CASTRO*

The problems of Philippine foreign trade include those of the nation's trade as a whole as well as those specific to its different exports. These problems have been the result not only of natural endowment but also of economic history, especially in the first half of this century. A brief sketch of this history might, therefore, be useful.

SECTION I: HISTORICAL BACKGROUND

By the Treaty of Paris, signed December 10, 1898, the control of the Philippines passed from Spain to the United States; thus begins the modern economic history of the country. In the period of its incumbency, the United States was not a colonial power in the usual model, for almost from the start it promised the Filipinos eventual self-government and carried out a political programme pointed towards that goal. But while separation was the aim in the political sphere, in the economic field American policy actually led to the opposite. The Philippine economy was gradually linked with that of the political suzerain. In 1903 a gold exchange standard, the first such currency system to be set up on a formal basis, was established. In 1902, a 25-per-cent tariff preference was accorded to Philippine products entering the United States; in 1909, substantial free trade was decreed between the two countries with limitations on only a few Philippine products, such as sugar, tobacco and rice; and in 1913, trade was made completely free.

Under the impact of such measures, Philippine foreign trade expanded, especially with the United States, and new products were developed—sugar, gold, and so on. To be sure, material living standards rose till (using M. K. Bennett's rankings) consumption levels in 1934-1938 were the highest in Asia excluding Japan.¹ But the economic integration meant dependence: Philippine foreign trade was highly vulnerable to movements or legislation in the United States, as became increasingly clear in the depression of the thirties. The trade was also colonial in character, that is, the exchange of raw materials for finished goods. As in other colonial economies, though perhaps less than in Indonesia, the Philippines was becoming but an exten-

*Dr. Castro is Director, Institute of Economic Development and Research, University of Philippines, Manila.

¹ M. K. Bennett, "International Disparities in Consumption Levels," *American Economic Review*, September 1951, pp. 632-649.

sion of the market of the home country. This economic dependence was felt to be a bar to the attainment of complete Philippine political independence, even after the inauguration of the self-governing commonwealth in 1935.

The Second World War brought isolation during the Japanese occupation and death and devastation in the liberation campaign: the Philippine economy was a shambles when independence was achieved on July 4, 1946. Production was speedily restored along pre-War lines—which brought back the pre-War problem of dependence. But with the wartime destruction there was structural change too; and as regards foreign trade, the altered situation manifested itself in problems of balance of payments, especially in the decade of the fifties when hitherto sizable invisible earnings from the United States dwindled.

Thus, the main foreign-trade problems with which the country has grappled in the last decade have been : *first*, economic dependence; *secondly*, the need to change the colonial character of the trade; *thirdly*, problems of balance of payments; and *fourthly*, and related to the third, the task of expanding exports not only of the traditional commodities but also of new lines. Each of these problems will now be taken up in turn, along with the measures that are being taken to solve them.

SECTION II : ECONOMIC DEPENDENCE

Economic dependence is a relationship which cannot be measured quantitatively, but at least it can be indicated. Among such indicators are the proportion which foreign trade bears to total trade (or national product) and the degree of concentration of products and markets. Other items in the balance of payments might be considered such as the net annual foreign debt obligations, the net annual capital imports, and other invisible earnings, such as the disbursements of foreign governments. For the Philippines, only the last of these other factors, insofar as it relates to United States government disbursements in the Philippines, is important.

Foreign trade has not been as great in relation to Philippine national product as in other underdeveloped countries of the same size: exports came to 23 per cent of national income in 1938 (the only pre-War year for which national income has been calculated—although it is probably understated by 50 per cent). In the post-War years, exports amounted to about 9 per cent of gross national product in 1950 and also in other years since. This is not as much as in other Asian countries; it compares with 40 per cent of gross national product in Ceylon in 1950, 25 per cent in Burma, 7 per cent in Japan and 15 per cent of national income in Thailand.

For a typical primary-producing economy, the concentration in products again is not as great as in some other countries. In 1950, the three

largest exports accounted for 84 per cent of total exports (coconut 56.7 per cent, sugar 15 per cent, abaca 12.3 per cent). In the same year, rice made up 88 per cent of total Burmese exports; in Ceylon, three large products comprised 95 per cent of all exports (tea 50.3 per cent, rubber 27.1 per cent, coconut products 18.4 per cent); in Malaya, rubber was 66 per cent of total exports and tin 9.6 per cent. In 1960, five commodities accounted for 76 per cent of total Philippine exports.

However, the concentration in markets was more marked. In 1950, 74 per cent of total trade was with the United States: 72.8 per cent of all exports went there and 74.5 per cent of all imports came from there. As for invisibles, in 1949 the United States government disbursements in the Philippines aggregated \$367 million and served to fill the gap made by the adverse trade balance which was \$391 million in that year. In 1950, the trade deficit was \$217.6 million, while the United States government disbursements dropped to \$259.9 million. In 1960, these disbursements totalled only \$101.6 million.

Finally, from an examination of the behaviour of trade, it would seem that there was an immediate effect on volume of exports whenever the United States suffered a depression or even a recession. But then under the gold exchange standard, the adjustment in imports lagged by one year.

The approaches to solution of such problems of dependence have been mainly two. One was a drive for selfsufficiency and economic development which has involved trade controls, measures of discrimination, and so on; this will be discussed in a later section. The other has been a series of laws and executive agreements designed to cut down preferences for American and the Philippine goods in each others' markets.

These pieces of legislation started with the Tydings-McDuffie Independence Act of 1934 and continued through the Tydings-Kocialkowski Readjustment Act of 1938. The Japanese occupation intervened; but after the War, the Philippine Trade Act of 1946 (popularly known as the Bell Act) set the stage for an executive agreement between the presidents of the two countries (the Philippines became independent in July 1946—two months after passage of the Act). This was amended by the Laurel-Langley Agreement of December 15, 1954 (accepted as Republic Act No. 1355).

The revised executive agreement, signed by the Presidents of the United States and the Philippines and based on Republic Act No. 1355, decreed a period of free trade between the two countries from 1946 to 1955, the purpose being to facilitate the rehabilitation of the Philippine economy. From then on, American and Philippine goods were to pay increasing portions of the regular duties of the respective countries, according to the schedule in **Table 1**.

Naturally, a developing Philippines wanted to be able to protect its domestic products as early as possible. While easing the adjustment for its exports, the schedules might appear to be biased in favour of the Philippines and so vitiate the principles of reciprocity, but the Philippine negotiators pointed out that only under terms like these could both countries be giving up the same amounts of revenue.

TABLE 1

**PERCENTAGES OF REGULAR DUTIES IMPOSED ON UNITED STATES
AND PHILIPPINE PRODUCTS**

(Under the Philippine Trade Act of 1946, As Amended)

Year	United States products*	Philippine products†
1946-1955	0	0
1956-1958	25	5
1959-1961	50	10
1962-1964	75	20
1965-1967	90	40
1968-1970		60
1971-1973		80
1974	100	100

*Percentage of regular Philippine customs duties.

†Percentage of regular United States customs duties.

In addition to the provisions regarding tariffs, there were tariff quotas on the Philippine coconut oil, cigars, scrap tobacco, and pearl or shell buttons; and, an absolute quota on sugar. The tariff quotas were to decline until in 1974 all exports to the United States of these Philippine products were to be subject to full duties.

It was, therefore, the idea to attain economic dependence by separation and a cutting-off of preferences, so that the Philippine and American goods would no longer enjoy advantages in each other's markets. The country turned its back on anything savouring of a customs union. But there are

two ways to attain non-discrimination: instead of erecting tariff walls, the Philippines could have demolished them not only for American goods but also for the products of all nations. Classical trade theory says that economic efficiency would have been served better in this manner. As a matter of fact, this proposal was made various times by a number of Filipinos and Americans. The suggestion never carried much support: it was somehow felt to be contrary to full sovereignty and complete economic independence. Furthermore, tariffs were desired for the revenue and the protective effects they could bring.

Another issue that arises now with the projected loss of trade preferences is whether Philippine export products can bear the added burden of tariffs; for if these goods are subject to duties, the market situation is such that the tariff will be borne not by the American importers but by the Philippine exporters in the form of lower prices. One answer to this problem is for the Philippine industries, long sheltered in the American market under the protective umbrella of preferences, to rationalize and increase efficiency. Another solution is devaluation which will increase peso receipts even if dollar earnings decline; this point will be discussed below. It might be remarked that both approaches are being tried at the present time.

What have been the results of the endeavour to break away? The data on distribution of trade furnish an answer. The absolute value of United States-Philippine trade has of course risen: in 1948 (when conditions in the Philippines may be said to have returned to pre-War normality), exports to the United States were \$209.1 million; they were \$284.1 million in 1960. Imports from the United States were \$468.6 million in the former year, \$255.3 million in the latter year. Again, in 1948 trade with the United States was 76 per cent of total Philippine trade: 83 per cent of total imports and 66 per cent of all exports. In 1960, this share had been cut to almost half: 46 per cent of total trade, 43 per cent of imports and 50 per cent of exports.

Hirschman's index of concentration of a country's trade may also be brought in. It will be recalled that an index of 100 represents a situation when all of a country's trade is with one other country alone and an index of zero means an infinite number of equal trading partners. Hirschman has suggested a threshold of 40 as the dividing line between undue concentration and proper diversification. The record shows the progress in the attempt to diversify Philippine foreign trade as regards the export side from an index of 78.0 in 1938, to 73.3 in 1950, to 56.8 in 1960; on the import side, from 69.4 in 1938 to 74.9 in 1950 and 50.6 in 1960.

Such movement towards economic independence is not all due to the Bell Act, even though the Act was a dramatic expression of an attempt to attain the national objective of economic independence. The shortage

TABLE 2

PHILIPPINES' INDICES OF CONCENTRATION OF TRADE

Year	Import index	Export index
1913	52.5	43.0
1925	59.7	73.9
1929	64.6	76.3
1932	66.0	87.1
1937	60.6	82.2
1938	69.4	78.0
1945	87.6	74.2
1946	87.1	61.2
1947	86.2	58.4
1948	80.5	65.9
1949	80.2	72.1
1950	74.9	73.3
1951	72.1	66.0
1952	73.3	68.4
1953	77.2	69.6
1954	68.3	62.5
1955	65.9	61.6
1956	60.8	57.3
1957	56.9	56.3
1958	54.6	59.8
1959	49.9	60.0
1960	50.6	56.8

Sources: A. O. Hirschman, *National Power and the Structure of Foreign Trade*, (California: University of California Press, 1945), p. 105; B. Legarda, Jr., "The Concentration of Philippine Foreign Trade, 1945-1954," *Central Bank of the Philippines News Digest*, July 17, 1956, p. 8; and, the Central Bank of the Philippines.

of foreign exchange, the imposition of import and exchange controls, and pressure to economize on uses of foreign exchange have broken the comfortable habit of buying only from the United States without any effort to shop around. Conscious efforts have been directed not only towards searching for new sources of imports, whether of consumer goods or machinery, but also for markets for the various Philippine commodities, from copra which is now sent in larger quantities than before to Europe, to logs and base metals which are sold mainly to Japan. Industrialization and the emergence of consumer-goods production at home has cut down the im-

ports of finished consumer items from the United States, even if often the products turned out are American brands. As for Philippine exports to the United States, imposition of tariffs has not led to a decline in trade.

All in all, in the search for economic independence more success has been achieved than was anticipated. There had been much misgiving about the twenty-year adjustment period in the Bell Act; many feared that this was too short a span of time. Now, however, it can be suggested that a ten-year period would have been adequate.

As a final word on dependence, what of the future? It would seem that irrespective of the closeness or looseness of the political relationship between the two countries, the United States is bound to be an important market for the Philippines for a long time to come. The world's richest economy, the largest importer of tropical raw materials which traditionally has bought more than it sold to the tropical countries, will remain an important outlet for the products which the Philippines exports, as it was even when the Spaniards ruled the country.

SECTION III : CHANGING THE CHARACTER OF THE ECONOMY

The colonial character of the Philippine economy is seen in the exchange which used to take place between raw-material exports and imports of finished consumer goods. In economic theory, this is not deplorable *per se* as it may be part of international specialization, although it must be remembered that the world is not static and situations of comparative advantage change. What makes underdeveloped countries, such as the Philippines, seek to alter this state of affairs is the fact that exporters of primary products suffer from extreme instability in their export earnings. The balance-of-payments pressures and the desire to minimize fluctuations in income caused by instability in foreign trade may dictate attempts at insulation and greater selfsufficiency, especially through industrialization. Industrialization in the Philippines is also part of a greater objective, that is, economic development so as to create new jobs and raise incomes, as there seems no other avenue open for absorbing the rapidly growing labour force. Thus, import-substitution has been one important area of Philippine economic development in the last decade.

To attain this objective of a change in pattern of imports, a constellation of policies has been utilized of which import and exchange controls, monetary policy, tax exemptions, easy financing, and government encouragement have been most prominent. In the foreign-trade sphere however, the import and exchange controls have been the chief instruments of change; it may be said too that they have been the most effective of all the various weapons in stimulating import-substitution and economic development generally.

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Import controls were first imposed in 1949. Far from being effective, they actually led to a spurt in imports as merchants started building up stock, so that imports in 1949 hit a peak reached only once after that, in 1957. The sterling devaluation of September 1949 triggered speculation about devaluation of the peso. Problems of internal dissension caused by the Hukbalahap movement engendered doubts about political viability. As a result, there was a flight of capital which reached alarming proportions in the last quarter of 1949. The fall in foreign-exchange reserves forced the imposition of exchange controls on December 9, 1949. When import control lapsed in mid-1953, exchange control was turned by the Central Bank of the Philippines to use for the regulation of imports as well.

The original reason for the imposition of controls was, therefore, to cope with balance-of-payments problems; this was reinforced by a decision made to back up a slight overvaluation of the peso in hopes that eventually the internal price level could be brought down. Then from 1954 on, the exchange controls became conscious instruments of national policy, that is, they were employed not only to deal with a short-run situation of disequilibrium, but also to attain in the long run a diversification of the production pattern, industrialization, and nationalization (Filipinization) of economic activity.

Controls have become progressively more refined. Eight categories of imports are now set up, with varying priorities for each in their access to foreign exchange: EC (essential consumer), SEC (semi-essential consumer), and NEC (non-essential consumer); EP (essential producer), SEP (semi-essential producer), and NEP (non-essential producer); DC (decontrolled commodities), and finally UI (unclassified items, that is, products the importation of which is banned). "Essentiality" depends on a combination of the distinction between luxuries versus necessities, and also on the criterion whether the good is, or can be, produced at home. Finished goods imports have been relatively tightly restricted while allocations for foreign exchange for raw materials and machinery, at least up to 1958, were liberal.

The controls bred monopoly or near-monopoly positions for those fortunate to possess exchange licences. At the same time, large domestic demand for goods existed. Raw materials and machinery were cheap while the finished goods turned out from them were expensive. The monopolies, internal inflation, and overvaluation of the peso meant windfalls and subsidies for a native entrepreneurial class that emerged to seize the opportunities for profits.

The result of such policies has been a shift in the import-pattern. Using ECAFE classifications, in 1952 consumption goods comprised 48.9 per cent of the Philippine imports, materials for consumption goods were 19.9 per cent, capital goods were 22.4 per cent, and materials for capital goods 8.8 per cent. In 1960, the proportions were 27.0 per cent for con-

sumption goods, 19.2 per cent for materials for consumption, 46.1 per cent for capital goods, and 7.7 per cent for materials for capital goods. In addition, economic growth was stimulated. Industrialization was especially rapid, and even in agriculture new products were introduced or cultivation of old ones expanded—rubber, coffee, cocoa, ramie, and so on. The structure of production shifted; in 1950, 42.3 per cent of national income originated in agriculture and 8.5 per cent in manufacturing; in 1960, agriculture was down to 33.7 per cent while manufacturing constituted 17.7 per cent of national income. Someone has suggested that a case can be made for overvaluation and controls as a spur to economic development, using the Philippine experience as illustration. To be sure, there were other favourable factors that fostered economic growth in the Philippines, such as a large reservoir of entrepreneurship and technically trained manpower built up during the preindependence period. But the argument for overvaluation can be made not entirely with tongue in cheek.

How is success in import-substitution measured in a situation where balance in international payments has been achieved only with the use of controls? Perhaps, it is to be gauged from an estimate of the pressure that exists on those controls. For a variety of reasons, definite judgment about such pressure on controls in the Philippines cannot be made. So much depends on other factors, not least of which is the exchange rate that happens to rule at different time periods. One would be tempted to say however that the Philippines is now closer to attaining balance in trade, although in recent months the complications brought on by a "decontrol" (really devaluation) process, which has gotten out of hand, have clouded the picture.

Unfortunately, there has been less success with expansion of exports; this will be discussed more fully below.

SECTION IV : BALANCE-OF-PAYMENTS PROBLEMS

In the early post-War period up to 1950, the Philippine balance of payments was generally close to balance, which is not to say that the position was necessarily sound: imports far exceeded exports, but large invisible earnings—United States military and civil expenditures, veterans benefits, payments for War damage (advanced by the United States in anticipation of reparations from Japan)—more than made up the gap. From 1950 on, invisible earnings declined.

Since then the trade gap has steadily narrowed, so that exports almost equalled imports in 1959 and 1960. Total foreign exchange available to the country has been consistently high for an Asian country, although it has increased only gradually over the years: from \$ 581 million in 1950 to \$ 688 million in 1960.

In a situation of balance-of-payments difficulties, two main cures are usually suggested: *first*, devaluation; and *second*, capital inflow. Each of these may now be examined.

The case for devaluation of the peso has been put forward repeatedly in the last decade by Filipino commentators as well as by foreigners. For example, most recently it was given scholarly treatment by Professor Frank Golay who felt that, as a balance-of-payments corrective, the Philippines should have devalued in 1952.² To quote from Professor Golay:³

“The basic argument for devaluation is that it will stimulate export production and thereby increase foreign exchange earnings. The Philippines has not shared proportionately in the worldwide expansion in trade which characterized the post-War period. Not only have the export industries remained relatively depressed, but the limited foreign exchange earnings have required the Philippines to exist on lower levels of imports than would have been necessary if export potentials had been more fully developed.”

I too would say that purely from a balance-of-payments viewpoint devaluation would have been useful. Without conceding that the prices received by Philippine exporters have been depressed, it could be seen that devaluation was going to be a spur to exports, not immediately after action was taken but in perhaps three years when some adjustment had taken place. Demand elasticity considerations had no relevance in the early post-War years when the problem was supply of the traditional exports. Then from 1958 on, new exports were ripe for the market and the elasticity pessimism expressed by some Philippine writers seemed unrealistic. The significant expansion in Philippine exports, it appeared, could be looked to not in the traditional products but in the agricultural and manufactured commodities which were beginning to come up—garments, processed coffee, tires, pharmaceuticals, cosmetics, rum, and so on.

As to the short run, the really helpful balance-of-payments effect was as usual on the import side—higher costs of exchange would have cut down demand for imports and eased pressure on controls. Devaluation would have meant higher costs not only of consumer goods but also of capital goods. And so to make a judgment on desirability of devaluation, one had to balance an impetus to domestic production of import-substitutes against a disincentive on account of higher costs of capital goods.

All in all, perhaps a \$100-million improvement in the balance of payments, on both the export and the import sides, could have been expected within a reasonably early period.

² F. N. Golay, *The Philippines: Public Policy and National Economic Development*, (Ithaca: Cornell University Press, 1961). The specific date is not given in the book, but in private conversation he has mentioned 1952.

³ *Ibid.*, p. 139.

But the problem had more than balance-of-payments aspects. Domestically, devaluation did not have to lead to an automatic rise in price level. After all, on the cost side, export commodities partly consumed at home are not many, imports come to only about 10-12 per cent of gross national product, and the import-component of domestic commodities is not equal to unity.

More crucial was the demand side. Monetary and fiscal policies had to be considered and also the reactions of the public. In other words, did the requisite discipline to make devaluation stick exist in the Philippines—in the monetary authorities, the government and the Congress, and the public? One would have encountered all ranges of opinion on this query, from the pessimistic, to the guardedly hopeful, to the completely optimistic among those who could not grasp the ramifications of the problem.

Finally, there are the broadly social and political questions, especially the effects on distribution of income and of political power. The unfavourable effect of price rises on exploited agricultural and industrial workers is familiar. But the more uniquely Philippine worry was that devaluation would have meant that the traditional exporting sectors, which after all were not doing badly in terms of absolute income, would have gotten undeserved windfalls. A devalued rate would have provided a cushion for perpetration of old methods of production and of conducting business, instead of forcing efforts to rationalize. Politically, the conservative group would have been given a new lease of life in a struggle for position which they had been losing to new and more progressive elements. The ascendancy of the rising business groups would have been delayed and a potent countervailing force in the political process would have been less speedily developed.

Much of the above line of reasoning is mentioned by Professor Golay. He feels that "the case for post-War Philippine exchange rate policy is not economic but political", yet he concludes that the Philippines should have devalued anyway.⁴ Even if politics was the sole justification, it might be ventured that this was a weighty enough reason to override any economic benefits and so postpone devaluation for at least a period of years.

To my mind, the legitimate dispute about devaluation was one of timing. It appeared to me that the proper time to devalue was sometime in the period between 1960 and 1962, with perhaps 1962 as the ideal moment. Balance-of-payments considerations were relatively neutral as regards this issue; the overvalued peso was no overwhelming burden to exports in 1952 or 1960, Philippine exports had increased steadily in step with the *growth in* world trade in primary products generally. There was not much reason to accelerate devaluation until other Philippine products could come up to

⁴ *Ibid*, p. 419; see also, p. 135.

benefit from a more favourable exchange rate. Measures to protect local industries through tariffs were of little effectiveness until 1962, when under the trade agreement, tariffs on American goods were to rise to 75 per cent of the regular levels. The exchange control machinery could still keep a balance in payments. Controls were not yet penalizing initiative too greatly; up to then the stimulus to Filipino entrepreneurship was more favourable than the negative effects of controls. This meant that the economy and the new entrepreneurs were progressively gaining strength.

On the ticklish question of internal discipline, there were more grounds for confidence as the years went by. One could discern among the national leaders, the press which moulds public opinion, the business community, and the public generally, an increasing sophistication in economics, a greater readiness to reject the mouthings of cranks, a deepening will to accept the discipline necessary to make a devaluation successful. Socially and politically too, a more ideal situation could be expected; social responsibility was increasing, new groups were gaining power, younger and more enlightened leaders were emerging. An election was coming up in 1961 which was bound to see fresh faces in the Congress and the executive branch, plus a renewed dedication to public welfare, whoever happened to be elected the President of the Philippines. These factors were all coming to a favourable conjunction in 1962.

SECTION V: GRADUAL DEVALUATION

Since April 25, 1960 in fact the Philippines has had a "decontrol" programme, which is more realistically described as a gradual or controlled devaluation process. It is essentially a multiple exchange rate system which has so far gone through at least three distinct phases, each getting closer to ultimate devaluation with a unified exchange rate.

The stage had been set for a multiple rate in July 1959 when a "foreign exchange margin" (in reality a foreign exchange tax) covering most foreign exchange transactions was authorized by the Congress. It was fixed at 25 per cent, so that there were two effective buying rates (but not selling rates) for foreign exchange, P2.00 for \$1.00 and P2.50 for \$1.00. By the "decontrol" plan of April 25, 1960, a "preferred" buying rate for the dollar and a "free market" rate were decreed, at P2.00 to \$1.00 and P3.20 to \$1.00 respectively. The "foreign exchange margin" of 25 per cent was retained. On the export side, exporters were allowed to realize 25 per cent of their receipts at "free market" and the other 75 per cent at the official or "preferred" rate; thus, the composite rate for their exchange earnings was P2.30 to \$1.00. Tourists and gold exporters were allowed the full free-market rate of P3.20. In the first phase of the decontrol programme, therefore, there were five rates; on the import side, P2.00, P2.50 (preferred plus foreign exchange margin), P3.20, and P4.00 to \$1.00 (free market plus exchange margin) on the export side, P2.30 to \$1.00 (not counting the tourist rate of P3.20).

ERRATA

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[The following final paragraphs of Professor Hiroshi Kitamura's article, "Economic Theory and Regional Economic Integration in Asia", were inadvertently omitted from the article which appeared in the Winter 1962 issue of the Pakistan Development Review, Vol II, No. 4—"Special Issue on Asian Trade", pages 485—505. These paragraphs should be inserted immediately after page 505 in continuation of the last sentence on that page. Ed.]

in particular lines. Although OEEC itself did not coordinate investment programmes, the mutual scrutiny of programmes improved the basis on which investment decisions were taken and helped to stimulate a rational allocation of resources.

The success of harmonization of economic policies in Western Europe can be seen in the rapid progress that has since been made in the direction of liberalization of trade and payments and other integration moves, such as the Benelux Union, the European Coal and Steel Community and the European Economic Community. Policy coordination has paved the way to freeing trade and payments within the regional framework. But in somewhat different circumstances, if the start is to be made with an attempt at regional trade liberalization, the movement to a higher form of integration will make inevitable the introduction of some measure of policy coordination and harmonization. From the general point of view of economic integration, it does not make much difference where the beginning is made. The experience in Western Europe indicates, however, that under the conditions of disequilibria measures of policy coordination have to claim precedence over those of trade liberalization. In present-day Asia this is all the more so, as the existing structure of production and trade does not permit a considerable trade expansion to take place simply as a result of removals of trade hindrances; and the main task of policy is rather to create new lines of trade deliberately.

One of the essential elements of the formulation of optimum economic policies on a regional basis is to make use of the most

advanced techniques of economic analysis and economic theory. In order to estimate the future export possibilities to the region, for instance, we need to estimate the prospective development of national income of a number of countries within the region, together with the prospective movement of demand for particular products. This operation is a simple application of economic projection models. Such a long-term projection may serve as a basis for regional policy recommendations, assisting the national economic policy-makers in bringing their programmes and policies into line with those of neighbouring countries. Should we call the totality of such regional economic projections a regional plan, as Professor Jan Tinbergen proposes?¹¹ We are here concerned not so much with the terminology as the substance. Even in Western Europe of today, much of forward-looking economic policy is formulated in terms of perspective planning and projections. In Asia, too, regional economic integration is in essence a matter of regional planning.

¹¹. See J. Tinbergen, "A Note on Planning in the ECAFE Region," a paper submitted to the first session of the Conference of Asian Economic Planners, New Delhi, September-October 1961.

The multiple exchange rate system was operated in conjunction with the exchange control structure; for example, the types of imports allowed at the preferred rate were the EC, DC, EP, and SEP categories. At the present time (October 1961) there are eight distinct exchange rates, as shown in Table 3.

A gradual devaluation rather than a once-for-all effort was decided apparently for a number of reasons. It was felt that businessmen were not prepared to have to face suddenly a higher price for imported raw materials; a period of adjustment was needed. With a multiple exchange rate, it was possible to discriminate, for example, between essential and non-essential or luxury goods or goods which could be produced at home. The revenue aspect, that is, the possibilities of exchange profits for the Central Bank of the Philippines from discrimination, was not a consideration. It would also appear that the Central Bank did not have a clear idea of what was an equilibrium exchange rate for the peso and so wanted to feel its way towards this. Moreover, the Bank wanted to make sure that certain requisites for the success of a devaluation, such as a foreign investments law and repeal of certain other laws, were enacted. Lastly, the elements of hesitation and vacillation—for the Central Bank had no experience in managing a devaluation—cannot be discounted.

Similar situations of multiple exchange rate systems have been analysed in the literature, and often the experience with this system has been good. Unfortunately, the multiple exchange rate system in the Philippines in 1960-61 cannot be cited as a success. The supposed advantages have not been realized and the programme may be blowing up in the faces of those who planned it. Perhaps a quick and sudden devaluation soon after the "decontrol" programme was instituted, that is anytime in the months from May up to December 1960, would have been more beneficial.

In the first place, the adjustment period has proved inappropriate: from one point of view, it has been too short; from another, it has been unnecessarily long. In Thailand, for example, devaluation was accomplished over a span of time long enough (1946-1955) to ensure some stability in business policy and discourage speculation. Another approach would have been to make the devaluation process short and quick, again to minimize harmful speculation and instability. The first method was probably unacceptable to Philippine business and other pressure groups, as well as unsuited to a country which seeks to industrialize rapidly. Perhaps the error has been to announce a programme of devaluation and to make so many changes over a short period, all of which create an atmosphere of irresolution and yet to drag out the process over a longer time than necessary. The supposed benefits of a gradual transition have been swamped by businessmen's reluctance to make any moves to start up new ventures; growth in the economy has slowed down in the last year and a half.

Furthermore, the discrimination among categories of goods in a multiple rate system has meant a perpetuation of the arbitrariness of control and the distortion of allocation of resources. The opportunities for graft have not been removed. The controls have continued practically as tight as ever; no real decontrol has taken place.

The dilemma about what is an equilibrium exchange rate for the peso has not been resolved. Technically, this problem could have been cleared up by setting up a fluctuating exchange rate system, at least for the first few months of the devaluation, but this was not done. I would make a guess that in 1960, P2.75 to \$1.00 would have been a proper exchange rate. But since then the devaluation programme has been sabotaged by excessive money creation—money supply was constant through most of 1960, while it has risen almost 15 per cent in the last year, imports have continued unabated in spite of higher peso prices for them, exports are not expanding in 1961, the balance of payments has deteriorated, and the foreign exchange reserves have fallen. As for what were said to be the legislative and political prerequisites, such as enactment of a foreign investments law, the Congress has been unable to act, so that the Central Bank now has no more in the way of legislation than it had in April 1960. The fiscal discipline required has also gone out of the window in this election year of 1961.

One final issue regarding exchange rate policy is the role to be assigned to black markets, of which that in Hong Kong has been most conspicuous so far as the peso is concerned. In the first stage of devaluation in April 1960, the "free market" rate of P3.20 to \$1.00 was chosen because it was the price then ruling in the Hong Kong market. But even at that time this appeared to be an incorrect technical decision. Black market rates are hardly the proper indicators of a true equilibrium rate for the Philippine peso. They are fringe rates, growing out of restrictions on purchases of exchange. The bulk of foreign exchange sales from official sources today is still at less than P3.00 to \$1.00. It is those who do not have access to official sources or have demands in excess of their exchange allocations who are forced to go to the black market. Controls inevitably lead to a premium on foreign exchange, as there are always people willing to pay more for their extra-legal purchases.

The Hong Kong rate, which is the most conspicuous black market quotation for the peso, is particularly unsuited as a guide to the setting of an equilibrium price. It results from a shallow market, greatly affected by such circumstances as measures of economic nationalism which force capital flight by the Chinese, or by the efforts of tax evaders to conceal earnings, or even by the influx of tourists during school vacation periods.

The recent flurry in the Hong Kong market in which the cross rate between the peso and the dollar has risen to P4.00 and even to P4.50 to \$1.00

is somewhat difficult to account for on a rational basis. The two most plausible explanations for the deterioration in the value of the peso seem to be capital flight and hedging against a devaluation. The Philippines has, for a long time, been known as the biggest source of overseas Chinese capital for Hong Kong. In the last year, nationalistic pressure against the Chinese in the Philippines has continued to mount; for example the rice and corn trade is being Filipinized and new restrictions on the employment of foreigners have been promulgated. But it seems that it is not the Chinese alone who are sending out their capital; it is said that a number of Filipinos too have lost confidence in the economy and are moving out. Again, it is widely known that devaluation is forthcoming, especially since the 1961 elections are over. The best hedge against one currency is another currency, which is one reason why the peso has been losing ground *vis-a-vis* the dollar. Finally, a short-run seasonal factor is the approach of the Christmas season; Hong Kong is a convenient shopping centre for Filipinos.

TABLE 3
EXCHANGE RATES AS OF SEPTEMBER 30, 1961

<i>(pesos per United States dollar)</i>	
Buying*	Selling *
2.00 (Preferred rate)	2.00 (Preferred rate). 50% of some decontrolled items which are exempted from the exchange margin.
	2.30 (Preferred rate plus 15% margin) 50% of some decontrolled items which are subject to the exchange margin; 25% of the import requirements of dollar-earning industries; forward exchange contracts with Monetary Board approval; deferred payments transactions and other foreign loan obligations (without forward exchange contracts or peso promissory notes) covering imports of capital goods, for payments due up to December 31, 1961, subject to certain conditions.

(contd.)

(Contd.)

- 2.75 (25% preferred rate plus 75% free-market rate)
All exports other than gold; U. S. government expenditures; all invisibles not negotiable at 100% free-market rate.
- 2.50 Importations under the information Media Guarantee programme, subject to certain conditions.
- 2.88 (50% preferred rate plus 50% free-market rate plus 15% margin)
Remittances in respect to peso collections on account of foreign press and news features services furnished local publications (up to December 31, 1961 only).
- 3.00 (Free-market rate)
Approved foreign capital; inward dollar remittances of:
1) veterans; 2) Filipino citizens; 3) U. S. government and agencies to resident Filipino citizens; 4) foreign insurance companies abroad to their branch offices in the Philippines in settlement of specific loss claims on peso risks insured before November 1960; personal expenses of diplomats; tourists receipts; certain charitable contributions; proceeds from sales of gold.
- 3.00 (Free-market rate)
Imports in excess of Central Bank quotas exempted from the exchange margin; imports equal to 90% of the exchange earnings of contractors supplying U. S. bases; cargo freights; sales of forward U. S. dollar exchange to authorized agent banks.
- 3.27 (Free-market rate plus 9% surcharge)
Airline and shipping passenger fares†
- 3.45 (Free-market rate plus 15% margin)
All other imports which are subject to the exchange margin all invisibles not paid at the preferred rate and subject to exchange margin; imports against gold export proceeds.

Source: Central Bank of the Philippines.

*Excluding the normal spread between buying and selling rates and Central Bank service charges.

†This refers only to airline and shipping passenger fares. Foreign exchange for travel is sold at the free-market rate plus the 15-per-cent margin.

So much for exchange rate policy as a cure to balance-of-payments problems. A second method, besides expansion of foreign exchange earnings through exports, is an addition to exchange resources through an influx of capital. In the past, exchange controls and nationalistic sentiments have held up a freer inflow of foreign capital. Now, however, a more rational attitude towards foreign investment has been evolving, as exchange controls have been scheduled for removal and as Filipinos have gained more confidence in themselves. It can be predicted with some confidence that a reasonable foreign investment law will be enacted soon. True and full decontrol and the taking-up once again after the elections of the vital concerns of the nation, especially economic development, will open the way for more foreign capital, both from official and private sources.

SECTION VI: PROBLEMS OF EXPORT EXPANSION

With gradual devaluation, the exchange rate no longer can be pointed to as a barrier holding back Philippine exports. Since April 1960, exporters have enjoyed a more favourable conversion rate for their earnings; at the present time, they get P2.75 for every dollar instead of the official rate of P2.00. The domestic prices of their exports have increased correspondingly: in March 1960, the price of a picul (139.4 pounds) of export sugar averaged P15.00, now it is P21.00. For copra, the price per hundred kilos was P42.00; the dollar price has fallen about 20 per cent, but the domestic price has gone up nonetheless to P58.00 per hundred kilos.

It might be expected that devaluation would have a beneficial effect on exports, and as a matter of fact, Philippine exports in 1960 (\$560 million) were the highest ever. Unfortunately, devaluation cannot be claimed to have been the only or even the main instrument of such expansion; exports rose, but only along the trends that had already been established, especially in 1957 and 1959. Moreover, one large cause of increase was additional sugar quota allocations on the United States market amounting to 171,000 tons which brought in earnings of about \$20 million. In 1961, exports have been running below 1960 level in spite of devaluation, an even larger sugar quota, and continued economic recovery in the United States.

Attention may now be turned to the particular Philippine export products and their prospects. The Philippines, as a typical primary exporter, has suffered from export instability both in prices and quantities, though its exports are subject to less violent fluctuations than those of its Asian neighbours. With regard to the Philippine exports, there is no general rule as to whether these oscillations are engendered by supply or by demand factors. As shown by the 1957 ECAFE survey, for sugar in the protected United States market it is demand factors which have determined the fluctuations.⁵

⁵. United Nations, Economic Commission for Asia and the Far East, *Economic Survey of Asia and the Far East, 1957*, (Bangkok: Economic Commission for Asia and the Far East, 1957), chap. 5.

For abaca, on the other hand, it is the supply difficulties rather than lagging demand or unattractive prices. Copra is an inbetween case where both the demand and supply forces operate to set prices.

Besides cyclical variations, there is the problem of secular growth. In the past, the rise in both volume and value of Philippine exports has been steady. But it seems fair to say that prospects of enlarged exports of the traditional products—copra, sugar, logs, abaca, pineapples, and so on—are not overly sanguine, or at any rate it is unwise to depend only on expansion here to solve Philippine balance-of-payments problems.

Nevertheless, there are other possibilities, even though at present nothing spectacular can be expected. The direction of growth of Philippine export trade would seem to derive from the changing character of Philippine production. By this is meant that new export commodities, largely made-up articles, are appearing. However, there are a few obstacles to trade, and these the more developed countries in particular can materially reduce. To the usual old saw about how the industrial countries should attempt to restrain domestic instability and also take other measures to mitigate export instability in primary products should be added a plea for freer world trade, especially through lowered tariff barriers. There is a peculiar twist to this matter which affects the Philippines, for it constricts the growth of exports of semimanufactured or manufactured goods. The point has been developed by Dr. Heinz Bachman in his doctoral dissertation submitted to the University of Vienna in 1960, and it may be briefly sketched.

Dr. Bachman points out that tariff policy in developed countries operates to perpetuate the colonial pattern of trade whereby underdeveloped countries are exporters of raw materials. Typically in developed countries, raw materials are on the free list while semiprocessed or processed commodities derived from these raw materials are subject to a tariff which might appear to be moderate but which in real effect is quite high. This is because the value added in conversion of the raw material might be modest relative to the raw material cost. Thus, a slight tariff on the finished product is equivalent to a high tariff on the value added.

This might be illustrated by a hypothetical example. Suppose that the raw material cost comes to 90 per cent of the value of the finished product, so that the value added from processing is 10 per cent of the final price. Then, a tariff of 10 per cent on the value of the finished product is equivalent to an impost of 100 per cent on the value added. The duty may be sufficient to dictate location of the processing plant at the market rather than the source. This is only an illustration of how commercial policy can determine the location of a foot-loose industry.

Yet, it would seem that a case can be made for encouraging the processing of their raw materials by underdeveloped countries. Even if the underdeveloped countries have a disadvantage in the production of all commodities, comparative advantage would still hold that it would pay all parties if the underdeveloped countries specialized where they are less inefficient. Presumably, this is the situation with the transformation of many of the raw materials of underdeveloped countries. Examples from the Philippines are coconut oil from copra and marine rope from abaca fiber.

It is not enough, however, that the developed countries act to alleviate the problems of the primary producers. The underdeveloped countries too must help themselves. In the case of the Philippines, export promotion has been mainly a promise waiting to be fulfilled. The time is now come for the challenge to be taken up and for vigorous export promotion campaign to be launched.

Postscript : This paper was presented early in *January* 1962. Since then, "final decontrol" was instituted on January 21, 1962, whereby controls on most foreign-exchange transactions were removed. There is now a free market for foreign exchange—that is to say free purchase of foreign exchange for imports, and also free convertibility of export proceeds, except that 20 per cent of export proceeds is to be converted at a fixed parity of P 2.00: \$1.00 and the remaining 80 per cent is to be sold at free-market rates. No formal devaluation has taken place, but while the official parity is still P2.00: \$1.00, the free-market rate has been steady over the last few months at approximately P3.90: \$1.00. Foreign-exchange receipts have exceeded payments; and, the balance-of-payments situation has improved significantly.